NATIONAL AUDIT OFFICE OF FINLAND
VALTIONTALOUDEN TARKASTUSVIRASTO

Compliance audit report

# Financial liabilities of the Government in international organisations

3/2018


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TRANSLATION OF COMPLIANCE AUDIT REPORT 3/2018

INFOGRAPHICS

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# Compliance audit report of the National Audit Office

Registry no. 112/52/2017

As part of its audit plan, the National Audit Office has conducted an audit on financial liabilities of the Government in international organisations. The audit has been carried out in accordance with the compliance audit guidelines issued by the National Audit Office.

On the basis of the audit, the National Audit Office has issued an audit report, which will be submitted to the Ministry of Finance, the State Treasury and the Ministry for Foreign Affairs. Copies of the report will also be submitted to the Parliamentary Audit Committee and the Government financial controller's function for their information.

Before the issuing of the audit report, the Ministry of Finance, the State Treasury and the Ministry for Foreign Affairs were provided with an opportunity to ensure that there are no factual errors in the report and give their views of the opinions of the National Audit Office contained in the report.

In the audit follow-up, the National Audit Office will determine which measures have been taken on the basis of the opinions presented in the audit report. The follow-up will take place in 2019.

Helsinki, 1 February 2018

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# Conclusions and recommendations of the National Audit Office

Finland is a member of several international organisations. When joining an organisation, a member state must enforce treaties regarding the organisation. With such treaties, the member states commit to being responsible for already existing commitments and liabilities. These include, among others, non-current employee benefits, such as pensions and after service health insurance.

The compliance audit on liabilities of the government in international organisations investigated what is Finland's portion of the contingent liabilities caused by non-current employee benefits. Another investigated issue was whether the current reporting practice of central government finances takes into account contingent liabilities and commitments that arise from Finland being active in international organisations.

Pension benefits are a major part of the liabilities that arise from non-current employee benefits. Pension systems are divided into defined benefit plans and defined contribution plans. A defined benefit plan is partially based on actuarial assumptions and values. There are significant uncertainties involved in the assessment of these values. In a defined benefit plan, the community carries more responsibility for the benefits to be paid than in a defined contribution plan.

Based on the audit, the conclusion is that according to the 2016 financial statements, the non-current employee benefits of the international organisations that were part of the audit were EUR 109 billion, of which approximately 90 per cent were not funded. A valuation was made in the audit that Finland's share of the employee benefits liabilities that are not funded is approximately EUR 1,4 billion.

Based on the audit, it is recommended that the sums to be paid to international organisations should be verified annually. Attention should be paid to any discrepancies between the government accounts and the payments declared by the organisations. Furthermore, it is recommended based on the audit that in the future, information on memberships in international organisations and the related financing contributions and liabilities should be collected in a centralised manner, and the information should be kept up to date.

The conclusion of the audit is that organisations are poorly prepared for the payment of their non-current employee benefits. Some organisations have assets in foundations or funds to cover the liabilities, but others plan to pay the liabilities directly from their budgets on a "pay-as-you-go" basis. This could have an impact on the organisations' operating conditions if, in the future, a large share of their budget is tied down to funding past operations.

International organisations have determined liabilities on member states in different ways in their treaties. Some organisations are permanent by nature while others have determined beforehand the effects of a potential resignation of a member state. Indicating the contingent liabilities of Finland that arise from the non-current employee benefits of international organisations is challenging, but not impossible.

Based on the audit results we find that the contingent liability that lies in international organisations forms a significant item in terms of true and fair information on the financial position of the central government. According to section 17 a of the State Budget Act (423/1988), the annual final central government accounts should include the notes to the accounts needed to provide the true and fair information referred to in section 18 of the State Budget Act. Under section 18 of the State Budget Act (423/1988), the annual final central government accounts and information on central government finances and the state's financial management and operative performance included in the report on the final central government accounts must provide true and fair information on compliance with the budget, state revenues and expenditure, the state's financial position, and performance (a true and fair view).

Parliament should have at its disposal, based on the financial statements of the state, the necessary information about the status of central government finances to secure its budgetary power. Reporting the contingent liabilities is already possible by virtue of the current legislation.

On the basis of the audit, the National Audit Office issues the following recommendations:

- Financing to international organisations should be verified annually. Attention should be paid to any discrepancies between the government accounts and the payments declared by the organisations.
- Information on memberships in international organisations and the related financing shares should be collected in a centralised manner, and the information should be kept up to date.
- The Ministry of Finance and the State Treasury should ensure with their guidelines that financial statements of the state and the financial statements of all government institutions and offices offer a true and fair view of the contingent liabilities arising from memberships in international organisations.
- When joining an international organisation, special attention should be paid to the financial effects of the commitment, including contingent liabilities. Furthermore, it should be taken into consideration before joining an international organisation how the liabilities are spread between the member states in case a member resigns from the organisation.

# Contents

# 1 Scope of the audit

In addition to examining compliance with the law and other provisions, the purpose of a compliance audit is to determine whether the activities are in accordance with the state budget, principles of good governance, operating policies, and financing and contractual terms and conditions. The aim is to provide decision-makers with information on whether the laws, other provisions and principles of good governance have been complied with, and whether the regulation has produced the desired results.

## 1.1 What was audited and why

The audit covered financial liabilities of the Government in international organisations. The purpose of the audit was to provide:

1. An opinion based on reasonable assurance on how much contingent liabilities to Finland will arise from employee benefit obligations of international organisations
2. An opinion based on the audit findings on whether the final central government accounts should indicate the financial liabilities of the Government in international organisations and how these liabilities should be taken into account when making decisions on joining international organisations

The audit investigated the scope of the liabilities and whether they should be reported

Firstly, the aim was to determine what contingent liabilities and employee benefits mean at the general level. This was achieved by studying the classification system based on pension plans and comparing the different accounting practices of the defined benefit plans and defined contribution plans and the risks these systems entail. Secondly, Finland's contingent liabilities based on its membership in these organisations was determined. Thirdly, it was determined whether the liabilities and the related risks should be taken into account in a more comprehensive manner in the reporting practices for central government finances to ensure that the final central government accounts provide sufficient information on the issues to be decided, the different options and the risks.

Reporting the government liabilities in international organisations is already possible by virtue of the current legislation. According to section 17 a of the State Budget Act (423/1988), the annual final central government accounts should include the notes to the accounts needed to provide the true and fair information referred to in section 18 of the State Budget Act. Under section 18 of the State Budget Act (423/1988), the annual final central government accounts and information on central government finances and the state's financial management and operative performance included in the report on the final central government accounts must provide true and fair information on compliance with the budget, state revenues and expenditure, the state's financial position, and performance (a true and fair view). Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States determines that all the government bodies and funds that are not regularly studied as part of the budget must be published in

connection with the budget process. Furthermore, information on all contingent liabilities (guarantees, non-performing loans, liabilities) with potentially large impacts on public budgets must be published.

Non-standardised reporting is a risk to the national economy

In its previous audits, the National Audit Office has highlighted the fact that reporting on the central government finances is not standardised and deemed this a risk to the entire national economy. The non-standardised reporting practices impair the management of the central government finances as a whole.[1] Even though the liabilities of the Government are reported in more detail nowadays, hidden risks contained in guarantees and contingent liabilities should be reported in a more transparent manner in the Government's annual report.[2]

The Parliament Audit Committee has also drawn attention to the fact that Parliament's budgetary powers are continuously being reduced. According to the Audit Committee, decision-makers need to obtain a true and fair view and an overall picture of the Government's financial liabilities. Furthermore, the Audit Committee considers it important that Parliament obtain an overall picture of the risks related to the liabilities and the measures taken to prepare for the risks. The Audit Committee has proposed that merely presenting the nominal values of the liabilities does not suffice; instead, the Audit Committee calls for management and better anticipation of risks, as well as reporting on the preparations made for the potential realisation of the risks.[3]

Governments commit to financial liabilities through membership

When joining an international organisation, a state must enforce treaties regarding the organisation.[4] At that time, the state also undertakes to carry its share of the organisation's liabilities. These include, among others, employee benefits, such as pensions and health insurance.

Changes in the international political situation, a prolonged period of slow global economic growth and the financial scale of the contingent liabilities influence the risk level of the liabilities. The number of citizens of the retirement age is increasing in Europe, which means that the pension plans will face a true challenge. In 2015, the old age dependency ratio between the employed population and pensioners was 29%, and it is expected to increase to more than 50% by the year 2050.[5] More pension must be paid for a larger number of people for longer periods of time. International organisations have implemented some pension reforms, but the reforms will enter into force in stages and the costs will increase at the transition stage.

The risk level is also dependent on changes of the international political climate. International organisations are strongly dependent on state funding. If a member state resigns from the organisation or the organisation's funding base is insufficient, both the legal and financial aspects of the organisation's liabilities must be determined.

Some organisations have made preparations for liabilities, but most have not

Another material risk factor is the preparation of the organisations for the payment of employee benefits. Some of the organisations have not made any preparations. Instead, their employee benefits are paid in accordance with the distribution scheme directly from the current year's budget. On the other hand, some organisations have made preparations for the liabilities by establishing funds and trusts. It is likely, however, that the assets in the funds or trusts are not sufficient to cover all of the organisations' employee benefits. One can assume that the liabilities will burden the finances of the international organisations in the form of contributions paid directly from the budget. This can have an impact on their performance if they are forced to use a larger share of their budget to fund past operations.

# 2 What are employee benefits obligations?

It is possible to investigate the value of international organisations' employee benefits obligations based on their final accounts, provided that the organisations prepare their final accounts in accordance with the International Accounting Standards (IAS), the International Public Service Accounting Standards (IPSAS) or the International Financial Reporting Standards (IFRS). Most international organisations use practices compliant with the IPSAS.

Employee benefits are calculated according to the standards

In the calculation and reporting of employee benefits, the organisations follow IAS 19 or IPSAS 25, while pension funds and trusts follow IAS 26 in their final accounts. The item "Employee benefits expenses" indicates compensation paid by the organisation to its personnel and management for work performed. The starting point is that this expense item includes compensation paid for work performed in different forms.

IAS 19 determines four employee benefit types: short-term benefits, post-employment benefits, other long-term benefits and termination benefits. An essential definition in terms of the issue at hand are the post-employment benefits, which include:

a. Pension benefits (pensions and one-time payments paid in connection with retirement)
b. Other post-employment benefits, such as post-employment life assurance and after service health insurance

The audit covered non-current benefit obligations that often involve other post-emplyment benefits, such as compensation for long-term paid absences (a holiday based on long-term employment or a sabbatical), jubilee benefits, long-term disability benefits and termination benefits (geographical mobility payments). The post-employment benefits are the financially most significant items, however.

## 2.1 Classification of post-employment benefit plans

Pension plans are divided into defined benefit plans and defined contribution plans

According to IAS 19, pension plans are divided into defined benefit plans and defined contribution plans. The most important difference between the defined benefit and contribution plans is the organisation's liability. In the case of a defined contribution plan, a unit separate from the international organisation carries the responsibility for the payment of the employee benefits. In the case of a defined contribution plan, the organisation does not have any legal or actual obligation to make any additional payments even if the unit does not have the funds needed to pay the employee benefits. Defined benefit plans can be non-funded pay-as-you-go type solutions paid directly from the budget or arrangements handled through pension funds or trusts, whose level of funding may vary. The organisation's liability is not limited to the payment for the period in a defined benefit plan, i.e., the or-

ganisation's liability to pay the pension benefit is broader than in the case of a a defined contribution plan.

Another important difference between these pension plans is the difference in the pensioner's income level. Traditional defined benefit plans guarantee a specific level of earnings when retired: according to the agreement, the pension corresponds to a predetermined percentage of the earned income before retirement. The pensioner's income level may fluctuate in the case of a defined contribution plan, because in the case of these plans, the individual's responsibility for the selected service is higher.

All pension plans are determined in accordance with IAS 19 as either defined benefit plans or defined contribution plans. In other words, any arrangements that do not meet the criteria for a defined contribution plan are classified as defined benefit plans – even if they include some features from both schemes.

Multi-employer plans are an exception to the classification of the benefits according to the standard

Even though pension plans must always be classified as either defined benefit plans or defined contribution plans, the standard allows one exception to this classification rule. If specific prerequisites are met, a defined benefit plan can be entered in an organisation's final accounts in the same manner as a defined contribution plan. Multi-employer plans must be classified as defined contribution plans or defined benefit plans in the final accounts, in compliance with the terms of the plan. This has been done in the case of the final accounts of organisations included in the United Nations Joint Staff Pension Fund (UNJSPF), for example.

The special arrangement allowed by the standard may be used in the case of a multi-employer defined benefit plan which does not allow the presentation of the share of a single organisation from the plan's total liabilities with sufficient accuracy, for example. In such cases, the organisation must present in its final accounts the reasons why this arrangement is used, as well as the pension plan's deficit or surplus (if any) which may influence the organisation's future financing contributions. If the plan shows a deficit or surplus, as specific information as possible and the calculation method used to arrive at this conclusion must be presented in the final accounts. Such multi-employer plans may influence the contingent liabilities of an organisation. The liability for pensions will not disappear even if one or several of the organisations are wound up or removed from the multi-employer plan.

## 2.2 Accounting practices for defined benefit plans and defined contribution plans are different

Defined benefit plans and defined contribution plans are different from each other

The processing of defined contribution plans when preparing the final accounts is easy, because the share of the reporting organisation's liabilities for each period is determined based on the payments made during the period. Therefore, no actuarial assumptions are necessary when determining the liabilities or expenses, nor are any actuarial gains or losses possible (IAS 19). In the case of a defined contribution plan, the organisation pays a fixed contribution to a separate unit that carries the responsibility for the payment of the employee benefits.

In the case of a defined benefit plan, pension liabilities are determined according to the projected unit credit method. The expenses to be entered into the final accounts and the debt or asset are calculated based on actuarial assumptions.

In many cases, the pension expenses will not be realised until decades later, which means that in order to determine the final expenses arising from the pension plans, the actuarial assumptions must be free from bias and mutually compatible as laid down in IAS 19. Actuarial assumptions are divided into two groups: demographic and financial assumptions. Actuarial assumptions are the organisation's best estimates of all the variables that will determine the final expenses arising from the pension plans.

Actuarial assumptions are used in the calculation of a defined benefit plan

The financial assumptions must be based on the prevailing expectations of the market on the reporting date regarding the period of time during which the pensions are to be paid. The most important financial assumption that is used to determine the benefit is the discount rate. The discount rate reflects the time value of money on the estimated future payment date. In practice, one discount rate that reflects the estimated time and amount of the benefit payments as well as the currency used in the benefit plan is usually used. Even minor changes in the discount rate may have a significant impact on the amount of the pension liability. IAS 19 or IPSAS 25 do not determine in detail what the term "high quality corporate bonds" used in the determination of the discount rate means. The discount rate has been interpreted as corresponding to the AA rating by Standard & Poor's or the AA2 rating by Moody's, but some international organisations determine the rate used in their calculation in their rules.

IAS 19. The discount rate is determined by reference to market yields at the end of the reporting period on high quality corporate bonds. In countries where there is no functional market for the high quality corporate bonds as required by the standard, the discount rate can be determined based on the market yield of high quality corporate bonds in another country, provided that the countries use the same currency. IAS 19 also allows the use of government bonds if there is no market for high quality corporate bonds at the time the discount rate is being determined.

Discount rate is the most important financial assumption in the determination of benefits

The defined benefit plan process can be described with a chart. The final amount of defined benefit plan pensions to be included in the final accounts is partially based on actuarial assumptions and values. The calculation method is not simple, which is why verifying the data produced by defined benefit plans is not unambiguous.

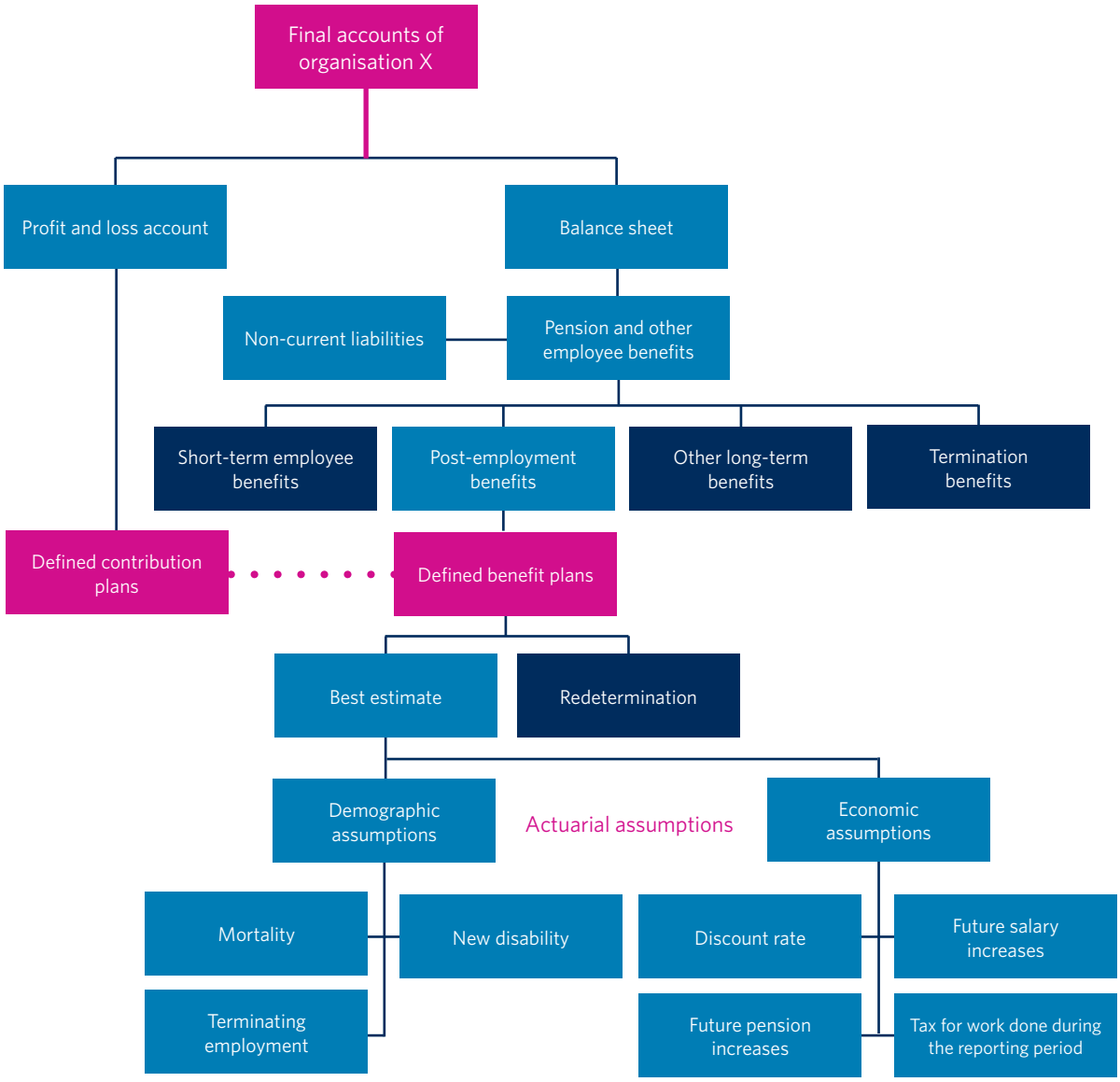


Figure 1: Process chart for a defined benefit plan

Pension plans involve risks that must be assessed when establishing the plan. The better predictability and clarity of defined contribution plans reduce their unanticipated risks. The calculation method used for defined benefit plans involves significant uncertainties.

## 2.3 Risks involved in pension plans

Popularity of pension plans vary

According to studies of the World Economic Forum (WEF), defined contribution plans have become more popular, and up to 50% of the total pension capital has been invested in defined contribution plans.[6] According to a report by the WEF, the increased popularity of defined contribution plans may be due to the willingness of employers to outsource their employment benefit obligations. Also according to the Bank for International Settlements

(BIS), employers' willingness to offer defined benefit plans to their employees has decreased. The reasons are varied. Many defined benefit plans were insufficiently funded and financial reforms made their poor financial status more clearly visible. Furthermore, the moderate development of the economy in general and the resulting low discount rate have increased the calculated non-current employee benefit obligations of the organisations. A transfer to a defined contribution plan has facilitated the anticipation of the employee benefit obligations, as a defined contribution plan decreases the fluctuation of expenses. This means that a transfer to a defined contribution plan has offered the employer organisation an opportunity to clarify their final accounts – at least in the long term[7] – and to transfer their actual and legal liability for pensions to a unit separate from the organisation. In the case of a defined benefit plan, the organisation's liability for the payment of the pension benefits is extensive.

Structural problems with defined benefit plans

Employers' willingness to outsource their liability for employee benefits is a simplified explanation for the changes in the popularity of the pension plans. There have been structural problems with defined benefit plans that have created a need to come up with new, more mobile and more individual solutions. Transferring the assets to another system in connection with a change of employer has not sometimes been possible in a defined benefit plan. Instead, the accrued pension has remained with the unit in which it was accrued. This has clearly reduced the mobility of the workforce. Furthermore, the link between the employer and the pension plan has caused a dependence between the employer and employees that survives even the termination of the employment.

The employer may have been forced to suffer from already granted, overly favourable pension plans during a change in the economic cycle, and this may have been one reason why employers have frozen their defined benefit plans or prevented new members from joining them.[8] For example, the final accounts of the World Intellectual Property Organization (WIPO) indicate that WIPO is still obligated to pay expenses related to a pension plan that was abolished in 1975.[9] According to the final accounts of the OECD, the organisation still has a defined contribution plan to which new members have not been accepted since 1974. The reasons behind the freezing of the old systems have not been determined in the final accounts.

The selected pension plan is not directly relevant to the targeting of this audit. Already existing pensions must be paid, regardless of whether they are based on a defined contribution plan or a defined benefit plan. Generally speaking, the risks related to pension plans are risks at the individual level. An individual's liability for the pension income often increases in the case of a defined contribution plan. According to the OECD, the transfer from defined benefit plans towards defined contribution plans transfers some of the financial risk from employers to households.[10]

Liability risks are related to the capacity of the plan

The risks related to employee benefit obligations are first and foremost related to the capacity of the pension plan. Significant elements include demographic assumptions that influence the actuarial calculations and, in particular, the manner in which the organisations have prepared for the payment of the benefits. Major uncertainties are linked to the calculation of pension liabilities, because the assumptions used in the calculations must extend far into the future.

Raising the retirement age or reforming the entire pension plan are potential solutions in a situation where the plan is not sustainable. In addition to the real effect, all implemented changes influence the final accounts, as they affect first and foremost the actuarial assumptions. According to the final accounts, the international organisations are aware of the risks inherent to pensions and many of them have implemented the required reforms.

Many of the audited organisations had implemented a pension reform or made a decision on implementing such a reform. During the reforms, they increased their employees' pension contribution and raised the age required for retirement and early retirement. For example, the funding of the new pension plan of the European Space Agency (ESA) is divided 2/5 for employees and 3/5 for the employer, compared to 1/3 and 2/3 for employees whose employment started before 2010.[11]

In 2015, the General Assembly of the United Nations decided to raise the retirement age (UN General Assembly Resolution 70/244). The reform raised the retirement age of employees who started their employment on or after 1 January 2014 to 65 years of age. The retirement age of older employees was retained as it was (60 or 62 years). The UN pension reform entered into force as of the beginning of 2018, and it will influence the calculation of future employee benefits.

Level of funding is a key issue when assessing pension plan risks

In addition to the actuarial assumptions, the preparation for the funding of pensions must be studied when assessing the risks of a pension plan. Investigating the level of funding of the pension fund or trust is of utmost importance when assessing the risks of the different pension plan types. The level of funding indicates how large a share of the current and future pension expenses can be covered with the system's assets. The less non-funded pension liabilities there are within the pension plan, the better it will be able to perform in the future. As the member states are ultimately responsible for the employee benefit obligations of the international organisations, they must be aware of the related risks.

# 3 How much contingent liabilities to Finland will arise from the employee benefits of international organisations?

The first objective of the audit was to issue an opinion based on reasonable assurance on how much contingent liabilities to Finland will arise from the employee benefit obligations of international organisations.

Based on the audit, the conclusion is that according to the 2016 final accounts, the non-current employee benefits of the international organisations that were part of the audit were EUR 109 billion, of which approximately 90 per cent were not funded. According to a rough estimate made during the audit, Finland's share of the non-funded liabilities is around EUR 1.4 billion.

90% of the liabilities are non-funded

Based on the audit, it is recommended that the sums to be paid to international organisations should be verified annually. Attention should be paid to any discrepancies between the accounts and the payments declared by the organisations.

Furthermore, it is recommended based on the audit that in the future, information on memberships in international organisations and the related financing contributions and liabilities should be collected in a centralised manner, and the information should be kept up to date.

The National Audit Office presents the following grounds for its opinions and conclusions supplementing its opinions.

## 3.1 Financing contributions and membership fees to international organisations

Operating in international organisations is considered long-term political action that is part of modern advocacy work. Finland has joined several international organisations by enforcing the treaties regarding these organisations. By joining an international organisation, a member state commits to carrying its responsibility for the organisation's existing obligations and liabilities, as well as to paying an annual membership fee or financing contribution to the organisation.

Finland became a member of the UN in 1955. After that time, Finland has joined dozens of international organisations. In this audit, the term "international organisation" refers to an incorporated society as laid down in international law. An organisation that meets this criterion must consist of already existing entities in international law.[12] Separating from each other inter-governmental and private organisations is important.

The nature and operations of the audited international organisations vary, because many of the organisations are profiled based on their specific content. In many cases, however, they are expert organisations in which personnel expenses form a large share of the total expenditure. The employee benefit obligations of such organisations are also high – after all, the organisations have been in operation for decades.

Finland pays membership fees and financing contributions to numerous organisations. This audit aimed at identifying the organisations with the most financial impact by choosing to audit the organisations that receive the largest contributions. The information on the financing contributions paid by the Government were obtained from the consolidated accounting of the Government.

Memberships in the EU and UN are the most important ones

Limiting the audit to membership fees only was not possible, because the Ministry for Foreign Affairs of Finland, among others, does not produce separate statistics on them. One should also note that the determination of the amount of financing and its distribution was highly challenging in the case of the Ministry for Foreign Affairs. Furthermore, the information published by the Ministry for Foreign Affairs on organisations that receive financing from Finland is somewhat misleading – which was already pointed out by the National Audit Office in connection with a previous audit.[13] Therefore, the audit aimed at identifying the general level at which Finland supports the core functions of the organisations. The clear limitation was made in order to keep the data reliable.

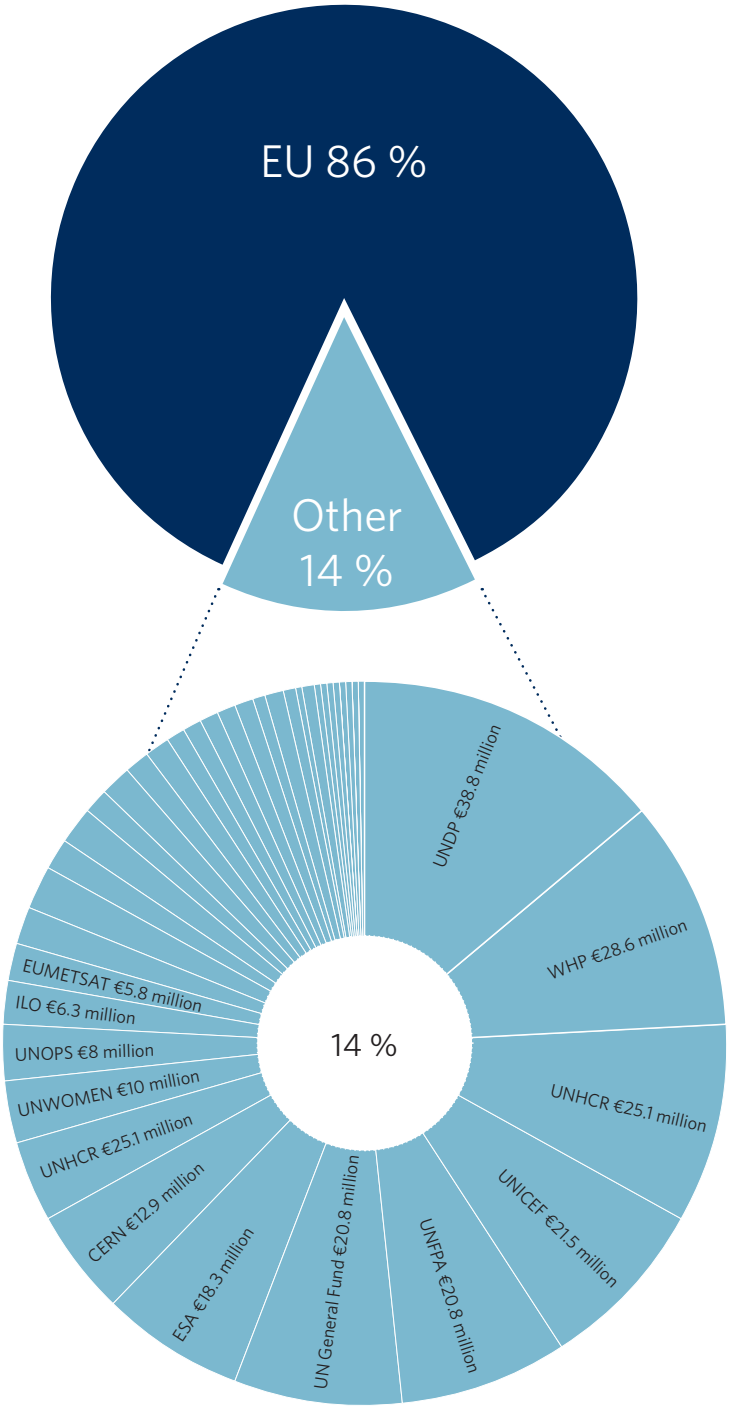


Figure 2: Financing from Finland to organisations in 2016

The financing contributions to the organisations selected for the audit varied from €300,000 to €1,717 million (the sum paid to the European Union). In 2016, Finland paid a total of €1,994 million to the organisations selected for the audit, of which 86% went to the EU. The rest of the sum, 14%, was divided among the other organisations. Most of this sum (of some €277 million) was paid to UN agencies.

Finland is a major financier of the UN and its specialised agencies. Determining the exact sum paid to the UN was challenging, because the data reported by the UN somewhat differed from the membership fee data obtained from the consolidated accounting of the Government. The discrepancy is partially due to the fact that the organisation received financing from outside the budget items selected for this audit.

Determining the financing contributions paid to the UN agencies was challenging

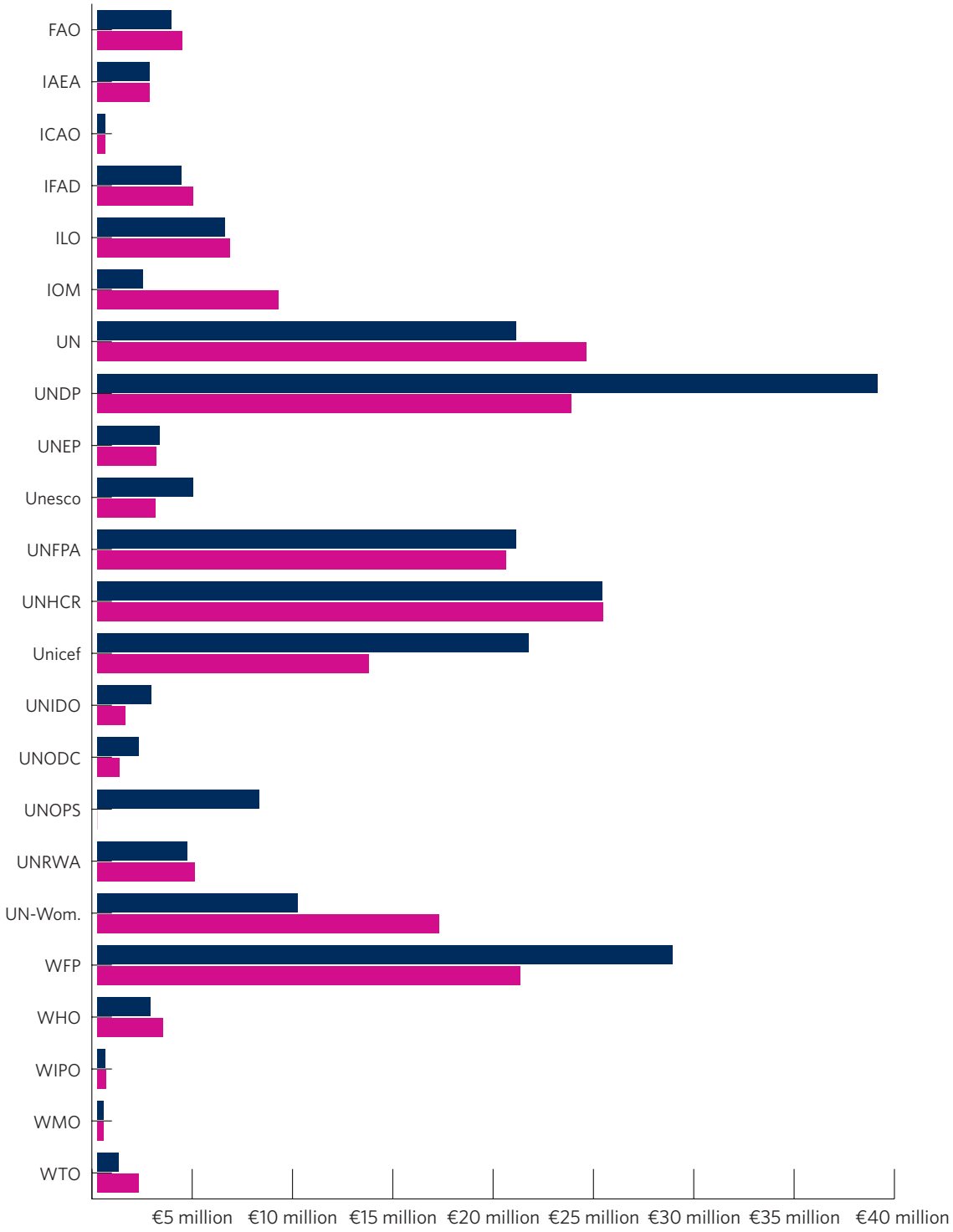


Figure 3: Financing to UN agencies in 2016. Source: Consolidated accounting of the Government (accounts 4540, 4541, 8270, 8280), data from the UN on financing www.unsceb.org. Currency conversions were made using the exchange rates of the European Central Bank on 30 December 2016.

There were major discrepancies in the financing data in the case of some of the organisations. For example, the actual sums paid to the UNDP and the WFP according to the consolidated accounting were clearly higher than the sums reported by the organisations. Furthermore, the financing contribution to UN-Women was not directly indicated in the consolidated accounting. Instead, the information was obtained from the Ministry for Foreign Affairs of Finland. The sum provided by the Ministry for Foreign Affairs was not the same as the sum reported by the UN. The comparison of the consolidated accounting of the Government and the public statistics of the UN clearly illustrated that the audit achieved good coverage of the general level of financing. The UN publishes very comprehensive information about the financing it receives.

Based on the audit, it is recommended that the data provided by the organisations and the sums paid by Finland be annually matched and attention be paid to any major discrepancies. In its opinion on the draft audit report, the Ministry of Finance agrees with the need to annually verify the financing contributions paid to international organisations. The State Treasury plans to include in its guidelines a note that the accounting office must compare the financing contributions to international organisations specified in its accounts with the amounts reported by the organisations and strive to investigate any discrepancies.

Financing to organisations is also provided through funds

Direct financing is not the only way of financing an organisation. Finland also finances some organisations through a variety of funds. The largest fund in which Finland is involved is the European Development Fund (EDF). The financing for EDF comes as direct contributions from the member states, outside the EU budget. Finland's share of the financing to the EDF is around €66 million per year or 1.51% of the total financing to the EDF (HE 92/2014). The European Investment Bank (EIB) manages projects of the EDF and grants venture capital credit directly to target states. (HE 92/2014)

International organisations receive direct financing from the EU through the EuropeAid programme. Some of the aid provided through EuropeAid is realised in cooperation with the UN agencies and projects of the World Bank Group. [14] The overlap between the organisations can also be seen in the data in other ways. Some of the audited organisations work in close cooperation and their financing contributions are parallel to some extent.

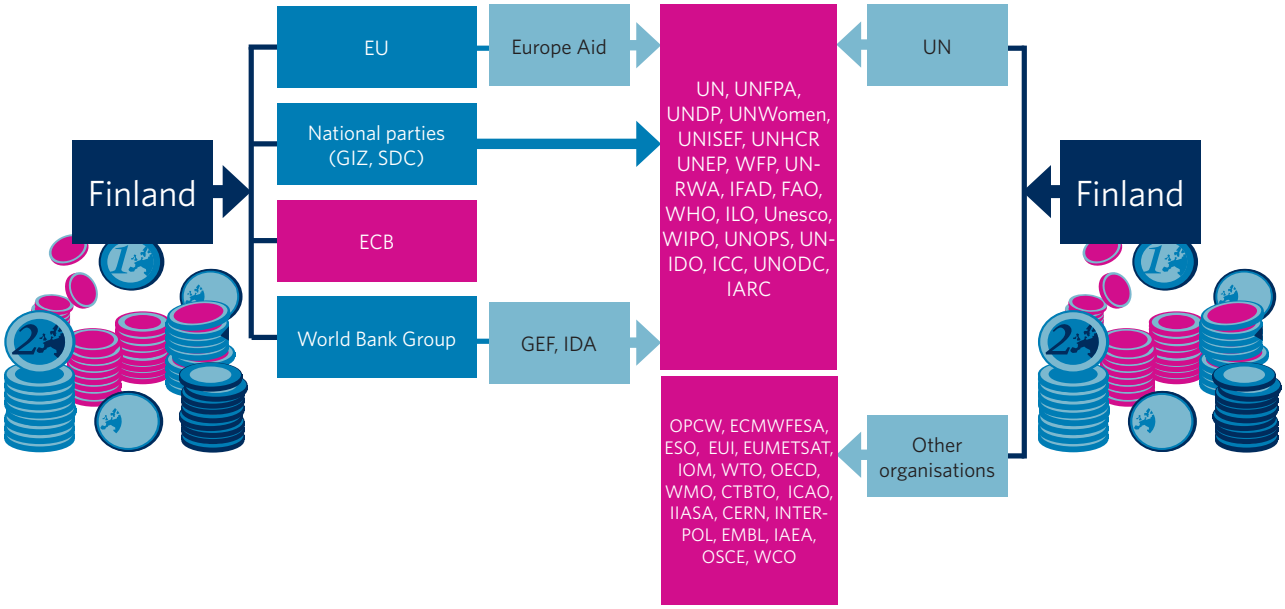


Figure 4: Financing process chart

The financing of Finland to international organisations is actually higher than the sum directly assessed based on the consolidated accounting of the Government. A single international organisation may be financed directly by the Government of Finland, the EU and funds to which Finland has paid contributions. A significant issue in terms of the final result is the manner in which the documentation of the receiving organisation determines the division of employee benefits obligations between the members of the organisation.

Organisations were investigated with the help of financing

During the audit, a broad investigation of the financing provided by Finland was necessary in order to identify the organisations whose member Finland is. Information on memberships of the Government or the financing contributions is not collected in a coordinated or systematic manner. It is recommended based on the audit that in the future, information on memberships in international organisations and the related financing contributions and liabilities should be collected in a centralised manner and made available. Reporting on the overall picture will be possible if the information is available in a centralised manner. In its opinion on the draft audit report, the Ministry of Finance states that collecting and maintaining information on memberships in international organisations and financing contributions is a good recommendation. According to the Ministry, finding an appropriate solution that is proportioned to the financial risk may prove challenging. Updating of the information should be included as part of the regular operating processes of the Government's shared systems.

According to the consolidated accounting, the Ministry of Finance is the largest financier due to the membership fees of the EU. A second significant financier is the Ministry for Foreign Affairs of Finland. Government agencies that handle the business of several organisations include the Academy of Finland and the Finnish Meteorological Institute, among others.

42 organisations selected for the second phase of the audit

A total of 42 organisations which Finland financed by more than €300,000 in 2016 were selected for the second phase of the audit. The second phase of the audit involved an analysis of the final accounts of all the 42 organisations.

## 3.2 International organisations' secondary employee benefits and obligations in the final accounts

Non-current employee benefit obligations of the international organisations consist of the following:

- Post-employment benefits
- Other non-current employee benefits
- Termination benefits

The non-current employee benefit obligations of the 42 organisations selected for the second phase of the audit emphasised pensions and after service health insurance (ASHI). These items comprised the largest share of the employee benefit obligations. According to the international accounting standards, an organisation must present its defined benefit service cost on its balance sheet. The fair value of the assets used for the plan (if any) is deducted from the present value of the defined benefit obligation. Assets used for the plan comprise assets managed by the fund established for non-current employee benefits and eligible collateral. The assets must be legally separate from the reported organisation, out of the reach of creditors (also in the case of a bankruptcy) and only available to pay or fund the employee benefits (IAS 19). In the audit, this was reflected in the fact that the organisations that had assets included in the plan presented the employee benefit obligations in compliance with the standards as service cost on their balance sheet. The audit took into account the present value of all of the organisations' defined benefit obligations, however, because this allowed presenting how well the organisations are actually prepared for their employee benefit obligations.

Standards determine calculation of liabilities

According to the 2016 final accounts, the combined non-current employee benefit obligations of the 42 organisations selected for the second phase of the audit amounted to some €109 billion. Most or around 90% of the non-current employee benefit obligations were not funded. The situation did not change much even when the assets reserved for the payment of employee benefits presented by the organisations in their final accounts – that did not comply with the standards – were taken into account (cash, separate accounts or arrangements that were deemed as assets earmarked for the employee


Figure 5: Combined non-current employee benefit obligations of all the organisations and the funded share of the whole.

The audit evidence was not uniform, and there were differences between the organisations. The first difference worth mentioning is the financially most significant deviation in the audit evidence. It consisted of the UN and its specialised agencies, the pension liabilities of which are covered by a multi-employer plan. The agencies included in the scope of the plan annually pay pension contributions to the United Nations Joint Staff Pension Fund (UNJSPF).

In accordance with this arrangement, which complies with the exceptions allowed by the standard, the organisations included in the UNJSPF treat their pension liabilities in their final accounts in the same manner as a defined contribution plan, even though the plan is actually a defined benefit plan. This should be taken into account when comparing the organisations' non-current employee benefit obligations, as the obligations of the UN and its agencies are actually higher than the audit findings suggest.

Pension liabilities of the UN have been comprehensively funded

On the other hand, even though the obligations of the UN agencies would seem higher if presented in another manner, they would also seem better funded. According to the 2016 final accounts of the UNJSPF, 91.2% of the pension liabilities are funded when taking into account future pensions as well. The UN agencies selected for the audit paid €1,235 million to the UNJSPF in 2016 (Table 1).

According to the final accounts, the UN agencies also plan to arrange the after service health insurance (ASHI) in the same way as their pension liabilities, with a multi-employer plan.[15] This procedure will make the annual costs more easily predictable, but it will not make the overall liability any more visible than a purely defined benefit plan in compliance with the standards.

Some organisations failed to comply with the IPSAS

Another deviation that influenced the final result of the audit was the selected auditing standard. Most organisations had selected to prepare their final accounts according to the IPSAS. However, some organisations had

prepared their final accounts according to national standards or generally approved accounting practices. Organisations that had elected to use an unusual standard included the European Synchrotron Radiation Facility (ESRF), the World Customs Organization (WCO), the European Molecular Biology Laboratory (EMBL) and the International Institute for Applied Systems Analysis (IIASA).

The national accounting practices are different from the international IAS, IPSAS and IFRS in many ways. According to the Belgian accounting practice, for example, a pension plan need not be classified as a defined contribution plan or a defined benefit plan. The legislation requires that pensions are funded through a separate pension fund or an insurance company, but there is no obligation to include any information on the related expenses in the final accounts. For this reason, ESRF and WCO had to be excluded from the audit review, because comparable information on non-current employee benefit obligations could not be found in their final accounts.

| Organisation | Payments in 2016 |
|---|---|
| FAO | EUR 49,806,750 |
| IAEA | EUR 61,574,000 |
| IARC | EUR 5,118,991 |
| ICAO | EUR 16,844,720 |
| ICC | EUR 20,512 |
| IFAD | EUR 10,289,937 |
| ILO | EUR 48,383,700 |
| IOM | EUR 29,599,440 |
| UN | EUR 258,425,880 |
| UNDP | EUR 149,894,600 |
| Unesco | EUR 32,635,280 |
| UNFPA | EUR 30,263,530 |
| UNHCR | EUR 97,241,750 |
| Unicef | EUR 142,010,903 |
| UNIDO | EUR 7,811,000 |
| UNODC | EUR 12,408,047 |
| UNOPS | EUR 15,653,550 |
| UNRWA | EUR 7,589,600 |
| UN-Women | EUR 13,376,670 |
| WFP | EUR 62,044,980 |
| WHO | EUR 153,974,010 |
| WIPO | EUR 24,583,680 |
| WMO | EUR 5,959,680 |
| Total | EUR 1,235,511,210 |

UNEP: The contributions of UNEP to the Pension Fund have been fully settled in 2016.

Table 1: Payments to the UNJSPF. The UNEP did not indicate the share of pension contributions in its final accounts. The latest information about pension contributions paid by the UNEP is from 2014, at which time the sum was $20.7 million.

The most essential issue in terms of the audit was how well the organisations were prepared for their employee benefit obligations. In this respect, the audit findings can be best interpreted by looking at Fig. 7, which indicates the funding level of the non-current employee benefit obligations of each organisation. The information in the table is based on the present value of the defined benefit obligation. Both information compliant with the standard and information given by the organisations in their final accounts on the amount of funding have been taken into account in the presentation of the funding status. As the figure shows, the level of preparation for the employee benefit obligations varies. The employee benefit obligations of some of the organisations are completely non-funded, while the funding level is good in the case of other organisations.

An issue that is as important as the preparation for the obligations is the total sum of the obligations. The employee benefit obligations of the audited organisations varied from a couple of million euros to dozens of billions euros. Such high differences between the organisations are mostly due to the fact that the organisations are very different in nature. The age, operations and specialisation areas of the organisations are different.

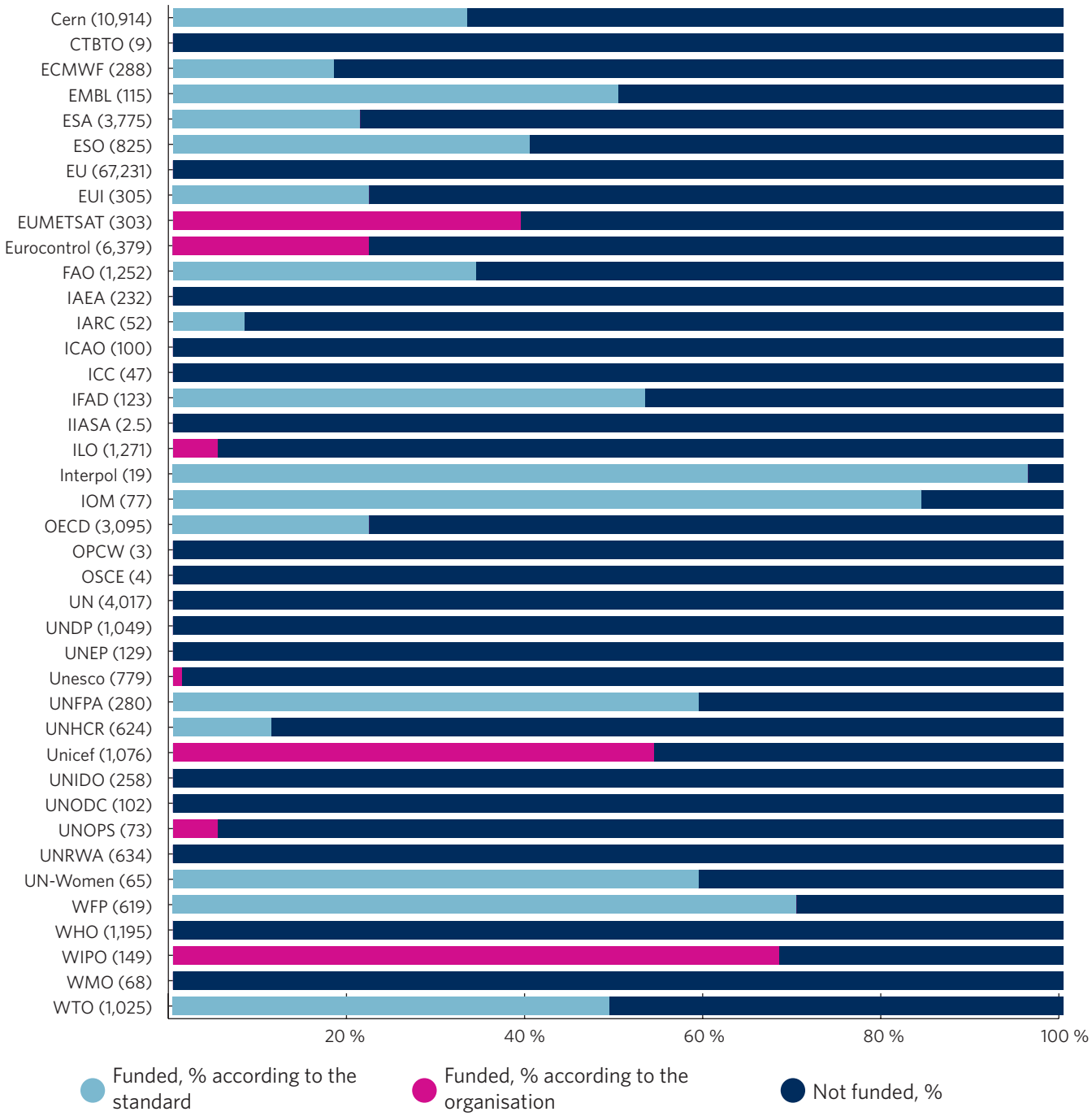


Figure 6: Non-current employee benefit obligations of the organisations.

The final result of the audit mostly complies with the assumption, i.e. the organisations are poorly prepared for the funding of their employee benefit obligations. Member states should be aware of the status of the organisations in which they are members. The employee benefit obligations will burden the organisations' finances in the years to come in the form of contributions paid directly from the budget. If an ever larger share of the budget is used to fund past operations, it will influence their performance.

## 3.3 Contingent liabilities are divided according to agreements

After having identified the employee benefits obligations as a whole, one must determine how the overall liabilities are divided among the member states. This information should be included in the internal guidance documentation of the international organisations or the original treaties. The audit revealed that the manner in which the organisations define the (financial) liabilities of the member states in their internal documentation varies.

Some of the organisations are permanent by nature, such as the EU or the UN. The charter or treaty of accession of these organisations does not mention resignation from the organisation or dissolution of the organisation. In the case of the EU, this changed with the Treaty of Lisbon. Article 50 of the Treaty determines the formalities related to resignation. There is no agreement on the substantive impact of a resignation, however. There is hardly any precedent or a ready-made procedure on what the organisation should do when one of the member states wants to resign. In many ways, Brexit will be the precedent.

EU's liabilities are paid as they are realised

The European Union is the financially most significant international organisation in which Finland is a member. In 2016, the combined membership fees paid by Finland to the EU totalled €1.717 billion. According to the 2016 final accounts, the non-current employee benefit obligations of the EU amounted to €67.23 billion. EU does not have a fund or any other buffer to cover the employee benefit obligations. Instead, they are paid from the budget as they are realised. In other words, the EU pays its non-current employee benefit obligations directly from its budget.

The Centre for European Reform (ECR) has discussed the liabilities arising from employee benefits in the publications on the expenses of Brexit that it has published. According to ECR report, the starting point for the calculation of the expenses of Brexit was that the United Kingdom is obligated to cover the liabilities it has accepted as a member state. Some of these liabilities are "civil servant pensions" (which is a general term referring to all employee benefit obligations). In the case of pensions, the Commission has determined that the United Kingdom is subject to all the EU pension commitments and dividing the commitments on the basis of the nationality of civil servants is not possible. According to the 2014 final accounts of the EU, the non-current employee benefit obligations of the EU amounted to €63.8 billion. On the basis of these figures, CER has estimated that the total liability of the UK for the pensions of the EU is €7–10 billion, if paid as one instalment.[16] So far, the share of the UK from the EU pension liabilities has been calculated in relation to its contribution to the EU budget. Using the same formula, Finland's share of the EU pension liabilities is around €1,096 million (according to the 2016 final accounts).

Another organisation from which significant liabilities could arise to Finland is the UN and its agencies. Determining how the employee benefit obligations of the UN agencies are divided among the member states is challenging due to the unique nature of the UN. When determining the liabilities of a single member state, the justification for the division of the liabilities can often be found in a charter or another internal document of the organisation. The liabilities of a single member state are usually specified

in the clauses on resignation from the organisation. For this reason, we also cover this speculative topic in this audit.

Division of liabilities in case of resignation is determined in treaties

The UN is an exception in this respect, as it is meant to be permanent in nature and its charter does not mention resignation. The establishment guidelines for the UN from the Dumbarton Oaks Conference do not mention resignation either. These decisions were based on the disappointment of the international community on the failure of the League of Nations. The plan was to avoid repeating the same mistakes when establishing the UN.[17] Therefore, the Charter of the United Nations does not mention the opportunity to resign from the organisation, nor has any state demanded adding such a clause in the treaty of accession or resigned from the UN.[18] Therefore, there is no certain legal interpretation of resignation.

On the other hand, the relevance of such a clause that identifies liabilities is minor, according to some interpretations.[19] According to the general regulations of international law, a civilised state cannot expect that any commitments it has approved as a member among other members would disappear when it resigns from the organisation. A state failing to meet its liabilities during its resignation from an organisation would be considered a violation of international law. Therefore, the lack of a clause that identifies the liabilities of a single state is not considered to exempt any state from its financial obligations towards the organisation. The permanent nature of the organisations supports the audit finding of the importance of identifying the liabilities. Together with the other member states, Finland has permanently committed itself to membership in an international organisation.

Apart from the two exceptions mentioned above (the EU and the UN), the organisations selected for the audit clearly indicate, often in the treaty of accession, what is to be done in case a member state wishes to resign from the organisation or if the organisation is dissolved. For example, Article 19, Denunciation of the Convention, in the Convention establishing the European Centre for Medium-Range Weather Forecasts (ECMWF) states that a member state "shall remain bound to contribute towards financing all commitments entered into by the Centre before such denunciation takes effect and to respect the obligations which it contracted itself as a Member State vis-à-vis the Centre before the denunciation takes effect."[20] In addition to clear conventions, some of the organisations indicate the financial liabilities of the member states in their final account documentation, such as the balance sheet.

Once the liabilities have been identified – and accepted – indicating the contribution of the member state from the total liabilities should be possible for the member state to be able to record the liabilities at the accounting office level. Usually, the liabilities of the member states have been divided in one of two ways, either in relation to the contribution of a single member state or as shared liability. If the division of the liabilities has not been separately determined, the liabilities should, according to the Institute of International Law (IIL), be divided in relation to the single member state's annual membership fee contribution or in relation to the member state's share of the budget.[21] This calculation method has been used as the starting point in the Brexit negotiations, for example. Calculated in this manner, i.e. in relation to the budget contribution, Finland's share of the employee benefit obligations would, in the case of the organisations selected for the audit, amount to some €1.4 billion.

Due to the fragmented nature of the issue and partially due to the hypothetical nature of the question, it is difficult but not impossible to indicate Finland's contingent liabilities from the organisations' employee benefit obligations. In the view of the National Audit Office on the basis of the audit, the workload divided into agencies would be fairly reasonable and the liabilities could be determined. The National Audit Office recommends that the liabilities in international organisations were presented at the agency and accounting office level so that they could be presented in the final central government accounts.

In its opinion on the draft audit report, the Ministry for Foreign Affairs of Finland states that the primary obligation of a single accounting office in charge of the membership and the membership fees is to take into account the expenses and liabilities arising from the membership fees and other direct financial commitments in its own information. According to the Ministry for Foreign Affairs, demanding the accounting offices to determine their own liabilities based on their own employment relations would be an unreasonable administrative burden on the accounting offices. The Ministry for Foreign Affairs states in the opinion that if the Ministry of Finance considers the employment liabilities a key financial liability that should be taken into account in the final accounts, this should be done in a centralised manner by the Ministry of Finance, the State Treasury or the special experts on final accounts in the Finnish Government Shared Services Centre for Finance and HR (Palkeet).

# 4 How should the liabilities be taken into account when making commitments and in the final central government accounts?

A second objective of the audit was to issue an opinion based on the audit findings on whether the final central government accounts should indicate the financial liabilities of the Government in international organisations and how these contingent liabilities should be taken into account when making decisions on joining international organisations

Based on the audit, the conclusion is that the Ministry of Finance and the State Treasury should ensure with their guidelines that the final central government accounts and the final accounts of all government institutions and offices offer a true and fair view of the contingent liabilities arising from memberships in international organisations.

Based on the audit, the conclusion is that when joining an international organisation, special attention should be paid to the financial effects of the commitment, including contingent liabilities. Furthermore, it should be taken into consideration before joining an international organisation how the liabilities are spread between the member states in case a member resigns from the organisation.

Contingent liabilities should be taken into account in preparations for accession

The National Audit Office presents the following grounds for its opinions and conclusions supplementing its opinions.

## 4.1 Identification of liabilities and reporting are important

Contingent liabilities have come under international scrutiny as a result of the financial crisis during the 2000s, because the amount of contingent liabilities has clearly increased. The increase in contingent liabilities can be due to one of their typical characteristics: they do not cause any direct expenses in the budget or increase the national debt or the general government debt, unless the related risks are realised. Therefore, more of such contingent liabilities than is justified from the perspective of the risk assessment may be granted.

Based on its research, the International Monetary Fund (IMF) has issued recommendations on how to identify contingent liabilities and property report them. According to the IMF, at its simplest a financial risk means a contradiction between expectations and the reality.[22] Financial shocks arising from this contradiction can start a chain reaction – financial interests will make it difficult to limit the crisis to a single sector. One of the most important factors increasing the indebtedness of member states in the past few years has been the materialisation of contingent liabilities due to such shocks.

Contingent liabilities increase financial risks in the future

The Audit Committee has expressed its concern about the increase of contingent liabilities and the constant reduction of the budgetary powers of Parliament. According to the Audit Committee, decision-makers having a true and fair view of the financial liabilities and risks of the Government is of utmost importance.

The definition of contingent liabilities varies, depending on whether the issue is being studied from the accounting or economics perspective. The simplest definition of contingent liabilities is probably the one from the accounting perspective, according to which contingent liabilities are financial liabilities not included on the balance sheet. Definition of the IMF is as simple: contingent liabilities are obligations contingent on the occurrence of a particular event that influences the matter. A high level of uncertainty is connected to contingent liabilities, as there is no way of knowing whether they will ever cause any expenses to the Government. It may be that the contingent liabilities are never realised and thus never cause any expenses to the organisation, but the opposite may as well be true. Furthermore, several contingent liabilities may be simultaneously realised.

Contingent liabilities are divided into explicit and implicit liabilities

Contingent liabilities are divided into explicit (transparent) liabilities where the obligation is based on legislation or a direct agreement (such as government guarantees) and implicit (hidden) liabilities that are based on moral or political obligations (such as the saving of banks). Explicit liabilities are the direct result of a binding law or agreement, while implicit liabilities are based on political pressure. Implicit liabilities involve expectations of the general public and a political pressure to act.

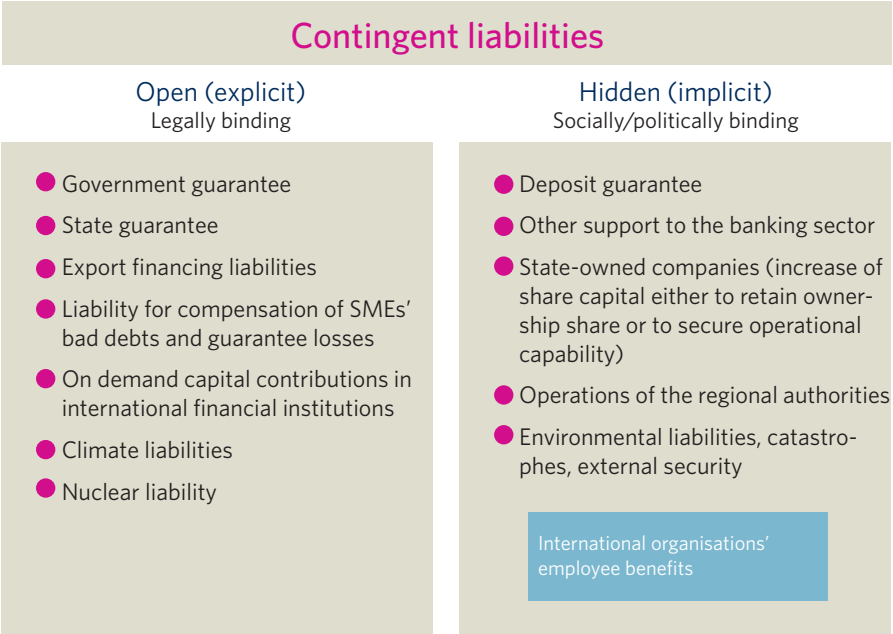


Figure 7: Classification of contingent liabilities. Source: NAOF according to classifications used by the Ministry of Finance and the IMF.

Liabilities in international organisations will be realised, but they are indirect and indirectly divided

There is no consensus on the classification of employee benefit obligations into explicit and implicit liabilities. According to some interpretations, employee benefit obligations are not contingent liabilities at all, but they should be classified as direct liabilities, because their realisation is certain in the long term (unless a pension plan reform takes place).[23] This interpretation debate regards an organisation's direct pension liabilities. Literature does not make any separation between financial liabilities of the Government and employee benefit liabilities of international organisations. In this

audit, liabilities of the Government to international organisations are considered implicit contingent liabilities. The liabilities exists and will be realised in the future, but as the liabilities are indirect, i.e. divided among several organisations and member states, and as their scope is dependent on several uncertainties, the general interest rate, life expectancy, the structure of the organisations and changes within the organisations, they are considered implicit contingent liabilities.

Recommendations on required measures in recent publications on contingent liabilities have been convergent.Reporting on contingent liabilities should be as comprehensive as possible and they should be identified, at least at the monitoring level. IMF has not issued any direct instructions on the reporting of contingent liabilities in final accounts. IMF's interpretation has been fairly lax and linked to the probability of the realisation of the contingent liabilities. The general trend has been a transfer towards transparency, however. Ambiguity as to what should not be included in the final accounts has been reduced, while awareness of the risks caused by contingent liabilities has increased.

Reporting on contingent liabilities should be as comprehensive as possible

Reporting on the risks may also be a signal, which means that the consequences of declarations should be carefully considered.[24] The risk of erroneous interpretations in terms of the issue at hand is minor, however. The identification of pension liabilities and related reporting may lead to more sustainable pension solutions and better identification of risks, and it may influence the finances of organisations by creating positive pressure.

## 4.2 According to the State Budget Act, liabilities must be reported in the final central government accounts

According to section 17 a of the State Budget Act (423/1988), the annual final central government accounts should include the notes to the accounts needed to provide the true and fair information referred to in section 18 of the State Budget Act. Under section 18 of the State Budget Act (423/1988), the annual final central government accounts and information on central government finances and the state's financial management and operative performance included in the report on the final central government accounts must provide true and fair information on compliance with the budget, state revenues and expenditure, the state's financial position, and performance (a true and fair view).

According to section 67 a of the State Budget Decree (1243/1992), an itemization of government guarantees and warranties and other contingent liabilities granted by the Government in effect at the end of the budget year must be appended to the final central government accounts. In addition, Council Directive 2011/85/EU on requirements for budgetary frameworks of the Member States determines that all the government bodies and funds that are not regularly studied as part of the budget must be published in connection with the budget process. Furthermore, information on all contingent liabilities (guarantees, non-performing loans, liabilities) with potentially large impacts on public budgets must be published.

Appendix 12 to the final central government accounts presents information on government guarantees, warranties and liabilities

To allow for reporting of the Government liabilities in international organisations in the manner specified by the Council Directive on requirements for budgetary frameworks, the State Budget Act and the State Budget Decree in the final central government accounts, the change must start at the accounting office level. According to section 66 h, point 12 of the State Budget Decree (1243/1992), an itemization of government guarantees and warranties and other government liabilities granted by an accounting office in effect at the end of the budget year must be appended to the final accounts of the accounting office. The itemisation must be prepared in the manner laid down in the regulation on final accounts in Appendix 14 of the accounting office guideline by the Ministry of Finance.

According to instructions provided by the State Treasury, accounting offices must include in their long-term liabilities any liabilities that are not based on mutual agreements of government agencies, that are not included as authorisations in the accounting office's budgetary outturn statement and whose value, starting from the reporting date, is at least €500,000. The itemisation must include any long-term agreements which cause appropriation needs of at least €500,000 (including VAT) after the reporting date.[25] Accounting offices do not report such liabilities at the moment, however, which is why the information is not included in the final central government accounts either. These instructions only apply to appropriation needs, i.e. they do not cover contingent liabilities. Based on the audit, the conclusion is that the Ministry of Finance and the State Treasury should further specify their instructions on the reporting of contingent liabilities.

In its opinion on the audit report, the State Treasury points out that it updates its guidelines based on instructions provided by the Ministry of Finance, while the Ministry of Finance states in its opinion that changing the regulation in Appendix 12 to cover an implicit liability, i.e. the employee benefit obligations of international organisations, is not recommended. The Ministry of Finance is of the opinion that changing of the final account reporting criteria would require a review of the general reporting principles and all implicit liabilities.

Furthermore, the Ministry of Finance states in its opinion that the development of the final central government accounts is linked to a project on the harmonisation of European Public Sector Accounting Standards (EPSAS) that is currently ongoing in the EU, which will most likely issue regulations on the information to be included in the notes to the final accounts. Furthermore, according to the Ministry of Finance, reporting the employee benefit obligations of international organisations in the Government's annual report should, and in some situations must, be possible. The Ministry of Finance also points out its risk survey and the opportunities to process the risks of central government finances in a discretionary and dynamic manner. The National Audit Office is of the opinion that this could be the right forum to introduce the risks observed in the audit.

Reporting the contingent liabilities is already possible by virtue of the current legislation

In Finland, more comprehensive reporting on the contingent liabilities is already possible by virtue of the current legislation. This has also been the goal of the legislators. When the State Budget Act was last amended, the Government proposal (HE56/2003) indicated the significance of the Government's annual report and the final central government accounts in a situation where authority has been delegated to the management of agencies. The final central government account procedures are of utmost importance

in a case where delegated authority is being monitored. With the Government's annual report and the final central government accounts, Parliament has a better opportunity to realise the authority it has based on the principle of democracy, i.e. its budgetary power. Detailed reports offer the decision-makers enough information to make decisions that will boost profitability and efficiency (HE 56/2003). The clearer the manner in which indirect financial liabilities are presented, the better they can be managed and the better the related risks can be assessed.

## 4.3 Liabilities must be determined before joining an organisation

Through global cooperation and involvement in organisations, Finland can participate in many issues and, as a small country, will benefit from the cooperation in a variety of ways. In the changing financial situation, particularly after a period of slow economic growth, the prioritisation of memberships in organisations should be considered, however. In many cases, the membership fees and general financing of organisations are connected to treaties that are valid until further notice. When new organisations are established in the future and Finland is given the opportunity to join them, all of the financial liabilities to which Finland is about to commit should be determined. An agreed sum is often paid in connection with the signing of the treaty of accession as a compensation for the old members for their initial investments. Furthermore, there may be other financial liabilities to the Government in addition to membership fees. In its opinion on the draft audit report, the Ministry for Foreign Affairs of Finland indicates that if the plan is to boost Finland's situational awareness, this must be done at the joining stage, in compliance with the conclusions given in the draft audit report, and in the form of other types of active participation in the preparation of the organisations' decisions or budgets and in internal decision-making.

Member states commit to already existing liabilities when joining an organisation

When joining an international organisation, new member states commit to carrying their responsibility for the organisation's financial liabilities. In the case of an organisation with a long history and a highly trained employee base consisting of experts, the employee benefit obligations can be very high, for example. The Ministry of Finance emphasises in its opinion on the draft audit report the fact that the decisions made when joining an international organisation are made primarily based on the content of the operations and the significance of the organisation, or on political basis. Indirect financial liabilities linked to the personnel must naturally be taken into account when assessing the financial impact of joining the organisation.

For Finland to be an active and profitable member of international organisations also in the future, the effects of the joining in relation to the total expenses should be considered. The National Audit Office recommends performing the necessary assessments when considering joining a new organisation to determine the organisation's financial indicators and the total expenses and financial liabilities arising from the joining. The preliminary assessment should also take into account any consequences of potential resignation to a member state.

# Appendix: Audit method

# Appendix

This appendix describes how the findings presented in the audit were produced and what are the limitations concerning the findings.

## Audit objective

The purpose of the audit was to offer an opinion based on reasonable assurance on how much contingent liabilities to Finland will arise from employee benefit obligations of international organisations. Furthermore, an opinion based on the audit findings on whether the final central government accounts should indicate the financial liabilities of the Government in international organisations and how these liabilities should be taken into account when making decisions on joining international organisations was to be offered.

The goal was to offer a general opinion on whether the final accounts of international organisations have been prepared in compliance with the international accounting standards and what kind of liabilities the member states have due to the organisations' secondary employee benefit obligations.

In addition to the main goals, the purpose was to introduce problems related to secondary employee benefit plans by discussing the justification and risks of the different plan types. In this respect, the audit report is a general presentation on the subject matter.

## Audited entity

Key partners in terms of the regulations on the preparation of the final central government accounts were the Ministry of Finance and the State Treasury.

Opinions on the draft audit report were requested from the Ministry of Finance, the Ministry for Foreign Affairs of Finland and the State Treasury. The feedback contained in the opinions was taken into account in the preparation of the final audit report. The opinions and the abstract based on them can be viewed on the website of the National Audit Office.

## Audit questions, criteria, material and methods

There were two main audit questions. Firstly, how much contingent liabilities to Finland will arise from employee benefit obligations of international organisations. Secondly, whether the final central government accounts should indicate the financial liabilities of the Government in international organisations and how these liabilities should be taken into account when making decisions on joining international organisations.

The final accounts of organisations used as the audit materials and initial data were selected based on the consolidated accounting of the Government. All organisations to which membership fees of €300,000 or more were paid in 2016 were selected from the accounts 4540 Membership fees in Finland, 4541 Membership fees abroad, 8270 Operating expenses to the EU and 8280 Other operating expenses. A total of 42 organisations were selected for the audit.

The main audit method was documentation analysis.

## Audit questions and subquestions

1. How much contingent liabilities to Finland will arise from the employee benefits of international organisations?

## Audit criteria, material and methods

Criteria:
- Have the final accounts of the international organisations been published on time and is the information openly available? (Final account documents of the international organisations)
- How high are the secondary employee benefit obligations presented by the international organisations in their final accounts? (IAS 19 or IPSAS 25)
- Do the international organisations use a defined contribution plan or a defined benefit plan? (IAS 19)
- How are the financial liabilities arising from the secondary employee benefit obligations divided among the members of the organisations?
- How large a share of the liabilities arising from the pension plans of the international organisations is non-funded?

Material: Final account documents of the international organisations, internal guidance documents of the international organisations, charters of the organisations, organisation-specific treaties

Analysis methods: Documentation analysis

2. Should the final central government accounts indicate the financial liabilities of the Government in international organisations and how should these liabilities be taken into account when making decisions on joining international organisations?

Criteria:
- Are Finland's liabilities on the secondary employee benefit obligations of international organisations presented in the final central government accounts or the final accounts of the accounting office, Appendix 12? (Sections 17 a and 18 of the State Budget Act 423/1988, sections 66 and 67 of the State Budget Decree 1243/1992, Article 14 of the Council Directive 2011/85/EU on requirements for budgetary frameworks)
- Should the liabilities of Finland to international organisations be presented in the final central government accounts?
- What information about the future financial liabilities of the Government should Parliament have at its disposal when considering joining an international organisation?

Material: TrVL 1/2016, publication 1/2016 of the Audit Committee, publication 15a-2016 of the Ministry of Finance)

Analysis methods: Documentation analysis

## Audit process

The audit was carried out between May and November 2017.

## Auditors

The audit was carried out by Audit Assistant Jonna Carlson and Planning Director Jenni Leppälahti, JHT. The audit was controlled and supervised by Director for Financial Audit Jaakko Eskola, JHT.

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