

Document: EB 2011/102/R.35
Agenda: 20(a)
Date: 11 May 2011
Distribution: Public
Original: English

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Report of the Chairperson on the 118th meeting of the Audit Committee

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Executive Board — 102nd Session
Rome, 10-12 May 2011

For: **Review**

Report of the 118th meeting of the Audit Committee

1. The Audit Committee wishes to bring to the attention of the Executive Board the matters examined at the 118th meeting of the Committee held on 3 May 2011. The representative from Austria chaired the meeting in the absence of the chairperson.

Adoption of the agenda

2. The agenda was revised to substitute the original agenda item 8 "Changes to IFAD's investment policy" with a different document "Tactical changes to the IFAD investment portfolio". An item concerning the appointment of the Director, Office of Audit and Oversight was included for discussion under item 5, Office of Audit and Oversight. Two additional items were included under Other Business; these were "Advance commitment authority implications for future replenishments" and a possible amendment to the date of the November Audit Committee meeting. With those amendments, the agenda was adopted.

Minutes of the 117th meeting of the Audit Committee

3. The draft minutes of the 117th meeting as well as the confidential addendum covering the closed session of the same meeting were approved without amendments.

Review of the consolidated financial statements of IFAD as at 31 December 2010

4. The Chairperson invited the Committee to review the consolidated financial statements of IFAD, which had been audited by PricewaterhouseCoopers. The external auditors were in attendance and members were reminded that they could request a closed session. This was not deemed necessary. Management was invited to present the financial statements.
5. Management outlined the main factors that affected the financial transactions during 2010 and situation of IFAD at year-end. These factors were categorized into internal operations, external financial markets, financing activities and other significant developments in the year.
6. In terms of internal operations, the Committee was informed of the impact on IFAD's financial situation of the increase in operational activities, including the higher level of loan and grant approvals (19 per cent increase over the prior year) and the increase in the overall number of projects under implementation and under direct supervision. With regard to the external financial market, the Committee was informed of the significant impact of interest and exchange rate fluctuations. At the end of 2010 there was an inflow of US\$383 million in borrowings from Spain.
7. Other developments reported included the changes in accounting policy on the treatment of Debt Sustainability Framework (DSF) financing and the complete exit from securities lending. A Management commentary was included for the first time in the financial statements document, to provide explanations.
8. The external auditors informed the Committee that there were no significant issues and that they would be issuing an unqualified audit opinion on the financial statements. A report by the external auditors was tabled at the beginning of the meeting.
9. In response to queries from members, Management explained that the financial markets situation in 2010 had dictated the level of income that IFAD could obtain. Given the current investment approach, no safe investment option existed that could have achieved higher returns while also safeguarding the assets of the portfolio and maintaining certain liquidity. On the issue of lending interest rates, the Committee was informed that interest rates for intermediate lending terms were currently lower than those applicable to highly concessional terms due to the

methodology for determining interest rates adopted by the governing bodies. It was noted, however, that the rates for highly concessional loans are fixed for 40 years while intermediate and ordinary terms vary depending on the market interest rates to which they are linked. In 2010, this resulted in a lower rate than that applicable to highly concessional terms. While this situation is obviously an anomaly, it is consistent with the underlying policy (see the legal opinion given by the General Counsel "Question concerning the ranking of the lending terms applied to IFAD financing", EB 2011/102/INF.10). The increase in the cost of consultancy services is attributable to the direct supervision activities and the significantly increased volume of loans and grants approved. With the decrease in staff costs, the growth in activity had to be handled almost entirely through an increase in the use of consultancy services. The increase in fixed asset balances was attributable to computer hardware purchases and to the costs incurred for the Loans and Grants System replacement project. The balance in cash and investments increased as a result of the Spanish Food Security Cofinancing Facility Trust Fund loan, which was consolidated together with IFAD's and other supplementary funds.

10. The Chairperson underlined that the retained earnings decreased from 2009 and thanked Management for the explanations provided. There being no further comments, the consolidated financial statements of IFAD for the year ended 31 December 2010 were considered reviewed and ready for presentation to the next session of the Executive Board for endorsement before submission to the thirty-fifth session of the Governing Council for approval.

Office of Audit and Oversight

11. The Office of Audit and Oversight presented two reports, an annual report outlining its activities for the year 2010, and the 2010 Annual Report on Investigations and Anticorruption Activities. These reports assist the Committee in assessing the adequacy of IFAD's internal control and audit systems, including the efficiency and effectiveness of the internal audit and investigation functions. The first mentioned report set out progress made during 2010 and the year-end status of Management actions to implement audit recommendations; this was intended to allow the Committee to assess the extent to which Management is addressing issues raised. The second report provided information as to the activities carried out, including the number of reports issued and other activities such as capacity-building. Statistics on cases of allegations were presented; these are on the rise, but Management expressed confidence that this is due to both increased transparency and the type of environments in which IFAD is operating. The Committee was also informed of joint collaboration initiatives with other Rome-based agencies.
12. In response to questions and comments from members, Management noted that IFAD's expanded programme of work meant a greater workload in the investigations area. Consequently, new staff have been recruited to fill vacancies and external specialists are brought in as required. The Committee was informed that a whistle-blower policy is in place to protect individuals. The General Counsel informed the Committee that the delegation of authority framework from the President to IFAD staff is currently in final draft. It will be reviewed by the Operational Management Committee and then will go to the Executive Management Committee for final approval. The Committee was informed that the delegation of authority does not include governing bodies.
13. The Chairperson stated that the Committee had reviewed the papers and noted the information contained therein.
14. The Chairperson brought to the attention of the Audit Committee the consultation that had taken place between the President and the Chairperson of the Audit Committee on the appointment of the Director, Audit and Oversight. He invited comments from members on the correspondence that the Chairperson had

circulated to members in confidence, informing them of the consultation undertaken.

15. There being no comments, the Chairperson stated that the Committee had taken note of the consultation on the appointment process for the Director, Audit and Oversight.

Annual Report on Enterprise Risk Management Activities in IFAD

16. The Annual Report on Enterprise Risk Management Activities was presented to the Committee prior to submission to the Executive Board. The report provides an overview of the Enterprise Risk Management (ERM) activities carried out by IFAD in 2010, including the status of corporate risks.
17. Management outlined the purpose of this third annual report, which covered progress made in 2010 and the first quarter of 2011. The Committee was informed that greater emphasis had been placed on building on a maturing framework. As such, the corporate risk profile had been the principal instrument, which entails regular assessment of emergent risks by Management. The report also covers the risk mitigating measures in place. ERM initiatives include the non-IFAD income declaration now in place for staff and introduction of the Management assertion and external attestation on the effectiveness of internal controls over financial reporting. The Committee was assured that the ERM system has matured well and is yielding the desired results.
18. The Committee wished to know the top identified risks faced by IFAD. Management explained the general categories of risk and how they are applicable to IFAD.
19. The document was considered reviewed by the Committee. It will be presented to the 102nd Executive Board session for information.

Planning on the selection of the Fund's external auditor

20. The Committee was reminded of its role in the appointment of the external auditors: that of nominating an external auditor for the approval of the Executive Board following a procurement process – facilitated by Management – entailing a review of the costs and contractual terms of the appointment. Management had drawn up a plan to assist the Committee with the nomination. This included a waiver of the current policy barring the external auditor from performing additional professional services, which would be limited to the issuance of an attestation report on the internal controls assertion statement issued by Management.
21. Management made a presentation of the objectives of the selection process, outlining the proposed approach, the steps to be followed and timetable. The Committee was reminded that the mandate of the current auditors – PricewaterhouseCoopers – expires after their audit of the 2011 accounts and that they would not be eligible to tender for the 2012-2016 mandate under the current rotation policy. A detailed timeline for the tendering process was presented with a final date of December 2011 by which time the Audit Committee would present its nomination to the Executive Board for approval. The terms of reference for the mandate were also summarized and included annual audits and internal control attestation services. The proposed eligibility criteria were also discussed briefly.
22. Members requested further information on the reference to the waiver for non-audit services; involvement of Member States in the selection process; the balance between cost and benefit and consultation with the Audit Committee during the process.
23. Management explained that the purpose of the waiver for non-audit services was specifically to allow the firm to perform internal control attestation services. It was agreed that this should be specified to ensure that only attestation services could be performed as non-audit services. Furthermore, the Committee was welcome to join the evaluation panel at any stage of the selection process, as Management

would be performing this task on the Committee's behalf. Management assured the Committee that by way of consultation, the request for proposals would be shared with them before being sent out. This document would include more detailed selection criteria.

24. In response to a comment on the potential conflict of interest position of an audit firm that had provided services to IFAD in 2010, Management undertook to assess the matter and report back to the Committee during the next steps in the process.
25. The Committee noted and endorsed Management's plan to expedite the selection process as proposed.

Tactical changes to the IFAD investment portfolio

26. The Chairperson informed the Committee that Management had decided to present a final investment policy and statement to the September session of the Executive Board instead of the May session. Proposed changes will be discussed by the Audit Committee and the Executive Board at their September sessions.
27. Management explained the background to this postponement, referring to the informal seminar held in March. The Committee was reminded of the lack of a comprehensive review of IFAD's investment policy since 2001. Management had decided to present a holistic review of the IFAD Investment Policy and then present proposed changes within that framework.
28. Comments from members included expressing support for the proposal to overhaul the policy and implications of the tactical changes, which are in line with the existing policy and within the President's authority.
29. Management explained that the tactical changes are meant to address a specific issue raised in a report prepared by consultants regarding the expected return and risk relationship (yield to risk ratio). Changes to the portfolio will be aimed at improving the yield to risk ratio.
30. The Chairperson noted that the shift is likely to result in a less conservative investment policy. There being no further comments, the Committee took note of the document.

Standard financial reports presented to the Executive Board

31. The Chairperson informed the Committee that, in accordance with its terms of reference and rules of procedure, standard financial reports are presented to the Audit Committee for review prior to submission to the Executive Board. The Audit Committee had decided to consider these specific documents at its 117th meeting. It would revisit its selection in future.
32. Management informed the Committee that there were five papers to be reviewed:
 - Report on the status of contributions to the Eighth Replenishment of IFAD's resources: Presented at each Board session for information, to provide an update on the status of contributions.
 - Resources available for commitment: Used to obtain the approval of the Board to commit resources for the approval of loans and grants.
 - Investment portfolio for the year 2010: Reports the rate of return, investment income and general performance for the year.
 - Investment portfolio for the first quarter of 2011: Reports on investment performance for the first quarter.
 - Estimate of the principal and net service charge payments forgone as a result of the implementation of the Debt Sustainability Framework.
33. The Chairperson congratulated IFAD for a good rate of return in investments and enquired about IFAD's performance in investments as compared with other

international financial institutions (IFIs). Management assured the Committee that IFAD's performance is above average. The Chairperson noted the cost of the DSF, while noting that this had already been evident when its implementation was approved. The documents were deemed reviewed.

Other business

34. The Chairperson introduced the first item under other business: Advance commitment authority; implications for future replenishments. In the interests of transparency, this document provided the Committee with information on an issue expected to arise during the Consultation on the Ninth Replenishment of IFAD's Resources (IFAD9). Comparisons were made across other replenishment periods and their contributions ratios. The paper points out – at the start of the replenishment process – that IFAD8 is not repeatable. The practice of setting donor contributions at a relatively low percentage of the total financial mobilization cannot be sustained. Management clarified the effect of the advance commitment authority vis-à-vis the Fund's long-term cash position and expressed its intention to move to other methods, in line with other IFIs.
35. Members commented on the contribution portion expected for the the Ninth Replenishment relative to the Eighth. Management confirmed that the Member contribution ratio is expected to be higher than that for IFAD8. The Committee took note of the paper.
36. The second "other business" item dealt with the progress of the Loans and Grants System (LGS) replacement project. The related Management presentation elaborated on the expected benefits of the LGS project; the project phases; the capital budget and related costs; next steps; and the contract negotiation process. The Committee was informed that implementation is expected to kick off in the third quarter of 2011.
37. Members enquired about the recurrent costs of maintaining the system once under way. Management responded that costs are envisaged to be in the region of US\$1.5 million, including hardware hosting, software maintenance and staff costs. The progress report was noted.
38. The third "other business" item was an update on the introduction of an attestation for internal controls over financial reporting. Management presented a paper outlining the goals and anticipated benefits of the initiative. The Committee was informed of a key milestone accomplished: the hiring of an external services firm to conduct an assessment of IFAD's readiness. The firm's consultants had concluded that the control environment was generally robust. Some recommendations were provided in the final report. The next steps to be performed were also outlined.
39. A member questioned whether the firm undertaking the external assessment should be allowed to bid for audit services given the possibility of undue advantage over other bidders. Management took note of the comment and stated that they would assess this risk. Management further clarified that other options would be explored to ensure transparency and a level playing field for all bidders to the extent possible. The update was noted.
40. The final "other business" item related to the date of the November Audit Committee meeting. The Committee was informed that IFAD had received indications from the Food and Agriculture Organization of the United Nations (FAO) of a possible change to the dates of its 143rd Council session. Therefore the date for the Audit Committee's 121st meeting, currently set for 18 November, may need to be changed to avoid possible scheduling conflicts. Management assured the Committee that members would be informed once confirmation was received from FAO.
41. The Audit Committee meeting was declared closed at 4.40 pm.