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Enabling poor rural people  
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## Report of the Chairperson on the 120<sup>th</sup> meeting of the Audit Committee

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Executive Board — 103<sup>rd</sup> Session  
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For: **Review**

## Report of the 120<sup>th</sup> Meeting of the Audit Committee

1. The Audit Committee wishes to bring to the attention of the Executive Board the matters examined at the 120<sup>th</sup> meeting of the Committee held on 8<sup>th</sup> September 2011.

### **Adoption of the agenda**

2. The Committee welcomed Ms Stefania Bazzoni, the new Executive Board representative for Italy, as its Chairperson and proceeded to the adoption of the meeting's agenda. In preparing the agenda, the Committee's work programme for 2011 (AC 2010/117/R.11) had been amended to include the following changes:
  - Removal of the item "Oral update on progress towards a Management Assertion and an independent attestation of internal controls over financial reporting", to be given in the November session.
  - Removal of the item on Project Audit Guidelines, to be tabled in the November session for presentation to the 104<sup>th</sup> Executive Board session in December 2011.
  - A new item was added under 'Other Business' on the Cost of the review of the assumptions and projections contained in the papers "Financing requirements and modalities for IFAD 9" and "ACA implications for future replenishments" with regard to advance commitment authority(ACA).
3. There being no comments from members, the agenda was approved and adopted as presented.

### **Minutes of the 119<sup>th</sup> meeting of the Audit Committee**

4. The draft minutes of the 119<sup>th</sup> Audit Committee meeting were approved without any amendments.

### **High-level preview of IFAD's 2012 results-based programme of work and administrative and capital budgets, and the preview of the Independent Office of Evaluation of IFAD's results-based work programme and budget for 2012 and indicative plan for 2013-2014**

5. Management delivered a presentation of IFAD's 2012 result's based programme of work and administrative budget. The Committee was informed that IFAD had forecasted a programme of work of US\$ 1.2 billion for 2012. The total Administrative Budget was set at US\$ 144.1 million, registering a 2.4% nominal or zero percent real growth over the 2011 Budget. The area of country programme development and implementation (Programme implementation), categorized as cluster 1, represented 62.4% of the budget, an increase from 61.4% in 2011. The other clusters (2 to 3) had reduced, leading to a net zero percent real growth across all clusters. The efficiency ratio was therefore showing an improvement from 14% in 2011 to 12% in 2012, beating the original target of 13.5%.
6. The programme of Loans and Grants would increase by about 50% from US\$ 800 million in 2010 to US\$ 1.2 billion in 2012. The Committee was informed of Management's recognition of the financial constraints of member states in the current economic climate. A comparison of the Budget with the Medium term plan was also done.
7. The Committee was informed that Management decided to change the usual approach of preparing a budget with a large increase which is then negotiated down with the Board. Instead, Management had prepared an initial budget with a realistic target, with the intention of arriving at the end result in one go without protracted negotiations.

8. The Director of the Independent Office of Evaluation presented the Office's results based work programme and budget for 2012 and indicative plan for 2013-2014. The Committee was informed that the document presented had been reviewed in July by the Evaluation Committee, which expressed support for the proposed work programme and required level of resources. The Audit Committee was informed that their comments would be taken into account and incorporated into the next submission to the Evaluation Committee in October 2011. The Independent Office of Evaluation followed a results based approach. In the 2011 budget, the efforts to reduce costs had resulted in a real decrease of 6.3% from the 2010 budget. The proposed budget for 2012 is US\$6million which reflects a zero real growth from the 2011 budget. The proposed budget of the Independent Office of Evaluation for 2012 is expected to be at 0.5% of IFAD's programme of work, well within the cap of maximum 0.9% established by the Executive Board in December 2008.
9. Comments from members included requests for clarification on the format and level of presentation of the budget; budget categories and differences between corporate and administrative budget; impact of the administrative budget on the efficiency ratio. Further clarifications sought included the provisional US\$1.5 million set aside for possible change and reform costs following the job audit exercise and why this had not been reflected as part of the 2012 administrative budget; impact of the co-financing mechanisms caused by the decrease in cluster 2 resources; differences in the traditional budget break down with the cluster approach; justification for zero growth when the programme of work is increasing and whether that will impact negatively on the Fund's ability to deliver due to resource constraints.
10. Management responded and assured the Committee that it accepted the complexity of the high-level preview document and was willing to streamline future versions of it. The Committee was informed that its discussion of the item on the changes to Financial Regulations would clarify the differences between the Administrative budget and Corporate budget. Management also informed the Committee that a more detailed paper on efficiency was being prepared and would be submitted to the third session of the Consultation on the 9th Replenishment of IFAD's Resources, scheduled for October 2011. It was also further clarified that clusters cut across Departments and Divisions; the current structure of the budget showed an overall envelope for resources for the organization pooled. The amount of US\$ 1.5 million was described to be a provision for on-going work on the change and reform process which was currently at the stage of a job audit. Management emphasised that the outcome of this audit was as of yet unknown and the amount shown should be regarded as a place-marker only; more concrete figures and action points should be known for the final budget document in December, at which point the updated figure would be included outside of the administrative budget, as the nature of this items was not considered part of the day to day operations.
11. Management also clarified the breakdown of the total budget, including the impact of consultants on the overall budget, who were a category of resource requirements which did not form part of IFAD's regular staff. Members welcomed the explanations given by Management. The Committee expressed the view that since the discussion and the possible HR reform implications are still on-going and we do not know exactly what it implies, it is premature to include a figure in the budget that we do not know exactly what it will be used for. There were some Committee members in favour of having the administrative budget without this element with an indication that if and when we will have more details on that, this matter will be

reconsidered together with its possible budgetary implications... Overall, the zero real growth for the 2012 administrative budget was welcomed by most committee members.

12. Management raised an issue of possible contingency amount in the budget due to one member's query as to the robustness of resources available to cluster 1 in the light of the heavy increase in programme of work; the Committee's general feeling was that it was not necessary to include this contingency amount as internal consultation on resource requirements was assumed to have taken place before arriving at the budget as presented. This was confirmed by Management.
13. There were no comments raised on the presentation of the Independent Office of Evaluation of IFAD.
14. The Chair summarised the item and confirmed the Committee's support of the proposed 2012 budget as presented with the zero real growth.

#### **Revisions to the Financial Regulations of IFAD**

15. The Chairperson introduced the item and informed the Committee that they were expected to approve the submission of the Executive Board of the proposed revisions to the financial regulations, which were to be presented to and approved by the Executive Board and subsequently the Governing Council.
16. Management presented the item and outlined the nature of the proposed revisions. The Committee was informed that the current Financial Regulations had been in place since 1978 and had not been revised despite various structural changes and developments in the financial framework of the Fund. The key revisions were the following:
  - Carry forward principle: Originally IFAD had only one budget covering organizational running costs, the Corporate budget. Over time, various other forms of budgets had developed, namely the budget of the Independent Office of Evaluation of IFAD, which requires an independent budget and a capital budget for long term investments. Since 2002, practice had been to cancel all appropriations at the end of a financial year and allowing the President to authorise carry forward of 3% of unallocated funds. In the current budget structure, it was not clear where the 3% was applicable. Cancellation of unappropriated costs did not apply to Capital Budget which has a multi-year element;
  - Amendment to article 6: This article was to be amended to define the composition of the administrative budget; which is not to include the Capital Budget and the budget of the Independent office of evaluation. In the same article, text will be introduced to clarify that carry forward will only apply to organizational running costs;
  - One section explains that the President can only re-allocate within Corporate budget, other forms of re-allocation need the approval of the Executive Board;
  - Other amendments include the need to include the Executive Board in decisions regarding the Investments of IFAD's resources; and,
  - The codification of practices that are not in the current financial regulations - such as the appointment of external auditors by the Executive Board instead of the Governing Council - and the resolution to include the General Reserve into the Financial Regulations.
17. Comments from members included requests for clarification on the concept of corporate Budget and other categories of budgets; reallocation

procedures of funds between categories; on the reporting requirements resulting from strengthening the role of the Executive Board in the investment policy; consistency in terminology use; what budget types were allowed to be carried forward and; whether the capital budget could be carried forward.

18. Management responded and clarified that naming the overall budget “administrative budget” was the terminology of the Agreement Establishing IFAD. At the time there were only staff costs and non-staff costs. A capital budget was introduced when investments of a multi-year nature had to be made. With the introduction of the Independent Office of Evaluation of IFAD, which the Governing Council wanted to be independent, a separate budget was introduced. Management clarified that clear definitions would be introduced in the Financial Regulations to clarify the differences. It was also clarified that the use of a carry forward only applied to the running costs of IFAD, it did not include the Independent Office of Evaluation of IFAD’s budget or the capital budget. On the issue of the President’s re-allocation, it was clarified that the President had the authority to undertake reallocations within categories in IFAD’s annual administrative budget; reallocations between different budgets (capital budget, IFAD’s administrative budget and Independent Office of Evaluation of IFAD’s budget) required the approval of the Executive Board. It was agreed to revisit the text on the role of the Board with regard to investments and clarify the text on the frequency of the associated investment review.
19. The Chair wrapped up the discussions and clarified that the proposed amendments to the Financial Regulations would be revised to reflect the Committee’s discussion and a revised document would be presented to the November session for the Committee. As the changes would follow from the extensive discussions had, the Chair expressed her confidence that the discussions in November would be kept to a minimum. The proposed amendments to the Financial Regulations would therefore be presented to the 104<sup>th</sup> Executive Board session in December 2011 for approval.

#### **IFAD’s Investment Policy**

20. Management provided background to the rationale of preparing the new investment policy. In March 2011, an Executive Board informal seminar had been held, following a study by a consultancy firm Ortec. This report by Ortec had been circulated to Executive Board members. The paper stated that IFAD’s Investment policy was sub-optimal and was embedding higher risks. At the informal seminar in March 2011 therefore, Management presented proposed amendments to the Investment Policy to the Executive Board. The Committee was reminded that the current policy had been in place since 2001. IFAD’s new proposed policy was benchmarked against the Institute of Chartered Financial Analysts, which provided over-arching principles.
21. The proposed new investment policy allowed broadening of scope of investments, investment in emerging markets, reduced rating floor on corporate bonds and adopted a risk budget approach in monitoring of investment Managers’ performance. To implement such a risk monitoring mechanism, Management was in the process of reviewing risk monitoring software for possible licensing. There was no change in the implementation timeline, with Q2 2012 remaining the target timeline.
22. Comments from members welcomed the update of the Investment Policy and the preparation of the Investment Policy Statement. Some committee members fully supported the proposed Policy, whereas others had some concerns on the amount of risk being exposed to. In this context, Members

requested clarification on the table of eligible assets and whether there was a significant departure from the current policy and the appropriateness of the risk monitoring software for IFAD as an IFI and not a bank and whether investment guidelines will be presented at the Executive Board for approval. Another query raised was the Internal Controls in place surrounding the policy.

23. Management informed the Committee that they had been undertaking benchmarking by correspondence and visits to International Financial Institutions. Management clarified that the Board would approve the Investment Policy, whereas the guidelines to implement such Policy would be approved by the President and would be presented to the Executive Board for information. The issue of internal control was a more long term question and would require more time to be put in place.
24. A governance concern was raised relating to the annual review of the Investment Policy by the President, with the Committee finding that the review should be the subject of a report to the Executive Board. The General Counsel clarified that what had been intended was for the appropriateness of the investment policy to be reviewed annually by the Executive Board on the basis of a report from the President. The proposed Investment Policy Statement would be amended accordingly.
25. It was agreed that Management would provide more details before the Executive Board on the benchmarking and comparison to other IFIs, in particular, with regard to eligible assets. Clarification of the internal controls would take more time. The item was closed.

#### **Selection of the external auditor of IFAD for the period 2012-2016**

26. Management provided an overview of the current status of the selection process, milestones achieved and planned next steps.
27. The Committee was reminded of the previous update on the results of the requests for expression of interest and the requests for proposals. The Committee was informed that technical and commercial bids had been evaluated and one firm had come first in both stages of evaluation.
28. The Committee was informed of the next steps in the process, namely the endorsement by the Contracts and Review Committee (CRC). Members of the Audit Committee were invited to attend the CRC and to participate in the selection process.
29. The CRC will recommend a firm to the November session of the Audit Committee for nomination to the December Executive Board for its approval.
30. There being no comments, the update was noted.

#### **Standard financial reports presented to the Executive Board**

31. The Chairperson introduced the item and suggested that, given the standard nature of these reports and the constraints on the Committee's time, individual presentations of the reports be dispensed with. The Committee was in agreement and the meeting moved straight into the question and answer session.
32. Comments included a question on the state of arrears on contributions and Management's approach towards encouraging member states to be up to date with their contribution payments and a request for clarification on what would change on the risk matrix after the new investment policy was implemented.
33. Management assured the Committee that regular correspondence was entered into with members in arrears, noting that some members had a

staggered payments approach. On the risk matrix, Management confirmed that they would continue to use the current one.

34. The item was concluded with no specific concerns raised by the members on any of the reports to be presented to the 103<sup>rd</sup> Executive Board session.

**Review of the adequacy of Internal Oversight mechanisms**

35. The item was discussed in closed in accordance with what was previously decided by the Committee. The Committee discussed the purpose of such close sessions and the process followed in assessing the adequacy of the oversight mechanisms. It decided that as from 2012 this item will be scheduled for discussion in closed session at the April/May meeting of the Committee, in conjunction with and following the discussion of the annual reports of AUO on internal audit and investigations.

**Oral update on progress in the development of the Loans and Grants System**

36. Management presented an update on the status of the Loans and Grants System replacement project. The Committee was informed of activities since the last update in May 2011 and the planned next steps.. The Committee was reminded of the objectives of the project and its expected benefits.
37. Management reminded the Committee of the work to date and that the negotiation phase was currently underway. The negotiations had currently stalled due to unexpected contractual issues which the Legal and Procurement Divisions were working on.
38. Comments from members centred around concerns on the progress of the project and the fact that it was running late, questions as to whether Management had a backup plan in place and clarifications on the contractual complications that had held up the negotiations.
39. Management clarified that the delay in implementation had been due to unforeseen complications in the negotiations. Management advised that there was no immediate fall-back position should negotiations not be concluded with the preferred vendor, so Management would need to decide on future steps.
40. The Committee noted the update and requested Management to advise it of the negotiation outcome. The item was closed.

**Other Business "Cost of the review of the assumptions and projections contained in the papers "Financing requirements and modalities for IFAD 9" and "ACA implications for the future replenishments" with regard to Advance commitment authority (ACA).**

41. Management provided the Committee with background on the matter and reminded the Committee of the two papers presented to the Audit Committee\Executive Board in May and to the Replenishment Consultation in July 2011 respectively. The Committee was reminded of the Replenishment Consultation's request for the external auditor to review the IFAD's financial model and related assumptions and for the Audit Committee to endorse the request for the Executive Board to approve the mandate of the external auditor to do this work.
42. The Committee was informed of the basis behind the original estimate of the fees at Euro 40,000 and PwC's subsequent quote of Euro 70,000. This change was due to the use of the firm's specialist consultants, increased time and resources required, as well as an accelerated timetable.

43. Comments from members included concern that lack of competition was not good for pricing; requests for further clarification on the timeframe for the completion of the review and the associated expected reporting timeframe.
44. Management clarified how the process had been undertaken and the circumstances which had hindered undertaking a competitive bidding process; the Committee was informed that the report was expected for the following week.
45. Before closing, the Committee was informed that the date for the 121<sup>st</sup> Audit Committee meeting had been shifted tentatively from 18<sup>th</sup> November to 21<sup>st</sup> November 2011 to avoid conflicts with FAO meetings. One member requested the Secretary check the timing with FAO and revert back should any conflicts be noted.
46. There being no further business, the meeting closed at 6.35pm.