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Report of the Chairperson on the 121st meeting of the Audit Committee

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Executive Board — 104th Session
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For: **Review**

Report of the Chairperson on the 121st meeting of the Audit Committee

1. The Audit Committee wishes to bring to the attention of the Executive Board the matters examined at the 121st meeting of the Committee held on 21 November 2011 and reconvened on 5 December 2011.

Adoption of the agenda

2. The agenda was amended to include the following changes:
 - Postponement of consideration of the item on the "Annual programme of work and administrative and capital budgets of IFAD and the Independent Office of Evaluation of IFAD's work programme and budget for 2012 and indicative plan for 2013-2014."
 - Postponement of consideration of the item on the "Revisions to the Financial Regulations of IFAD."
3. Due to the short time available for Committee members to consider these two documents, it was agreed that their discussion would be postponed. It was further decided to reconvene the Audit Committee on 5 December 2011.
4. The agenda was amended accordingly and approved.

Minutes of the 120th meeting of the Audit Committee

5. The minutes were approved without any comments from the members.

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

6. Management presented the Audit Committee with the results of the selection process, which had been conducted through a tender exercise as per IFAD procurement guidelines. The Committee was reminded of the various stages of the selection process and associated outcomes, as communicated in previous meetings. Management emphasized that their role had been to facilitate the process on behalf of the Committee. The Committee was informed that the competing firms had undergone technical and commercial evaluation and that one firm, Deloitte and Touche, had performed best in both the technical and the commercial assessment. Accordingly, this firm was recommended for nomination to the Executive Board at its the 104th session for approval of the appointment.
7. Members expressed satisfaction with the selection process. Clarification was sought on whether the fee charged for the first year would apply for subsequent engagements. Management explained that this would be the case assuming the scope of work remained the same, noting that inflation increases were normally applicable on an annual basis.
8. The Committee accepted the recommendation for the nomination of Deloitte and Touche to the Executive Board for approval of the appointment.

Standard financial reports presented to the Executive Board

9. The Chairperson introduced the item and invited comments from members on any of the papers to be presented to the December session of the Executive Board. Management was then invited to provide an update on the status of contributions to the Eighth Replenishment.
10. Management confirmed that the contributions situation as reported in the document under review reflected the status as at 30 September 2011. Since that time, IFAD had received US\$44.825 million in additional contributions as follows: Ghana US\$0.2 million; Belgium US\$9.4 million; Viet Nam US\$0.2 million; Iceland US\$0.025 million; and Italy US\$35.0 million.

11. Members requested clarification on the arrears in loans receivable, some of which were long outstanding and the follow-up mechanisms IFAD had in place, such as a trigger point at which to take action.
12. Management explained that there were internal mechanisms, including quarterly reviews and reports that prompt the Programme Management Department to follow up with the countries concerned. These mechanisms were currently being reviewed and would be enhanced with e-communication.

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

13. Management informed the Committee that the legal issue that arose as a result of Oracle's unexpected request to change the contract signing entity, which had been reported to the previous Committee meeting, had been resolved.
14. The Committee was further informed of Management's decision to cancel the Request for Proposals process and start direct negotiations with Oracle Italia to allow for more flexible interaction with Oracle. This approach is in the course of being approved internally.. Despite the shift to direct selection, the project cost would not increase.
15. Progress on the project management front had been made while negotiations were on hold, including alignment with best practice at other international financial institutions (IFIs) and streamlining of business processes.
16. In November, IFAD Management met with Oracle's management to identify a way forward that would allow for the awarding of the contract by early 2012. The meeting had a very positive outcome, including agreement on a plan, project implementation approach and contract structure.
17. Members requested a briefing from Management once the contract was finalized, including details of the actual contract cost.
18. Management confirmed that the Committee would continue receiving updates at every stage of the process and details of actual costs upon contract finalization.
19. The oral update was noted.

Oral update on progress towards an independent attestation of internal controls over financial reporting

20. Management presented an oral update on progress made on the initiative of introducing a Management assertion and an external attestation of internal control over financial reporting. The last update had been provided to the 119th Committee meeting in June 2011.
21. Since then, three key milestones had been reached:
 - (a) Implementation of recommendations from the report of the independent external assessment by Deloitte.
 - (b) Engagement of an independent expert to review and assess documentation and controls. This was done in the form of a desk review conducted by Deloitte, to confirm that recommendations had been fully implemented.
 - (c) Engagement of an independent consultancy firm by the Office of Audit and Oversight (AUO) to test key internal controls over financial reporting for functional and design effectiveness.
22. The preliminary report emerging from the independent consultancy firm's review indicated a possible need for revision of some key controls; however, this was under review for verification and to determine the root cause and appropriate remedial action. After revision or correction the controls would be retested to verify effectiveness.

23. The final report with recommendations was scheduled for December 2011. Once the recommendations had been implemented, AUO would retest the controls to ensure readiness for the Management assertion.
24. The first independent attestation report by the external auditor would be issued with the 2012 financial statements.
25. Members enquired what was the next output on this issue; it was clarified that the Management assertion report would be published with the 2011 financial statements.
26. The oral update was noted.

Annual programme of work and administrative and capital budgets of IFAD and the Independent Office of Evaluation of IFAD's work programme and budget for 2012 and indicative plan for 2013-2014

27. This item was considered at the Committee's reconvened meeting on 5 December 2011 and is covered in a separate report (EB 2011/104/R.2).

Project audit reports for the fiscal year 2010

28. Management informed the Committee that the report on project audits for financial year 2010 gave an overview of audit activities performed by IFAD in that period.
29. The Committee was provided with the main statistics for 2010, which included a 20 per cent increase in audit reports as a direct consequence of the increased programme of work and direct supervision business model.
30. Management reported that where major control issues are identified, the Fund takes prompt action at project level to ensure their resolution, requesting projects to prepare a time-bound action plan to address the main weaknesses. The implementation of action plans is monitored during supervision missions.
31. The Committee was informed that IFAD conducted audit reviews to examine the quality of both the financial statements and the audit reports to assess overall inherent risk. Management highlighted the main improvements that had been made, which included:
 - Creation of a Financial Operations Department at the end of 2010 and hiring of a Chief Financial Officer and new Controller in 2011;
 - Finalization of a corporate software package to manage project audits called ARTS (Audit Report Tracking System);
 - Revision of the Audit Guidelines for Borrower's use and the Internal Procedures; and
 - Distribution of a financial management resource pack to the projects of an IFAD regional division and plans to develop this for corporate-wide use.
32. Members wished to know why statistics showed that most of the audits undertaken in the West and Central Africa region were carried out by private firms and why most of the unfavourable audit opinions expressed in audits were found in projects in sub-Saharan Africa; the Chair sought clarification on the increased number of audit reports outstanding and whether there were mechanisms for appropriate follow-up action.
33. Management described the procedures in place for enforcing submission of satisfactory and timely audit reports, including the suspension of disbursements when required. Management also provided information about audit methods, the basis of appointment of auditors and their terms of reference, and capacity-building initiatives.
34. The Chair requested Management to include more details in next year's report to help interpret certain trends in regional statistics.

Revisions to the IFAD Guidelines on Project Audits

35. The Chair introduced the item and informed the Committee that the revisions to the audit guidelines had been necessitated by the change in the IFAD business model and project cycle.
36. Management presented an overview of the main areas of change and the rationale for these changes. The Committee was informed that the key reasons were:
 - Alignment of the 2003 guidelines to current legal text;
 - Alignment of the guidelines to the current project cycle and terminology to ensure consistency;
 - Achievement of flexibility with supervision arrangements and language simplification; and
 - Standardization, harmonization and introduction of best practice.
37. The presentation included a comparative analysis with other IFIs.
38. Members queried whether there was some contradiction in the text on the role of IFAD in the appointment of auditors and whether IFAD's involvement in the review of projects amounted to redoing the audits.
39. Management clarified that the review work done was intended to provide assurance on the fiduciary aspects of project management and involved the review of audit reports, financial statements and Management letters but did not result in redoing the audit.
40. An issue with regard to the French version of the document was raised and Management undertook to revise the translation to ensure consistency before the item was presented to the Board for approval.

Revisions to the Financial Regulations of IFAD

41. The Committee was reminded of the objectives of the revision of the Financial Regulations, which were:
 - (a) To permit carry-forward with respect to several categories of budget that had developed;
 - (b) To strengthen the role of the Executive Board with regard to the investment policy; and
 - (c) To consolidate financial regulations that had evolved and include them in the basic regulations.

The document had been revised to reflect the discussions of the last Audit Committee meeting.

42. Management informed the Committee that following the comments received at the 120th Audit Committee meeting in September, the following revisions were being suggested for inclusion in the document:
 - Regulation II (Definitions). The definition of the administrative budget had been clarified to include all expenditure of IFAD as required by the Agreement Establishing IFAD. Therefore, the administrative budget was composed of regular budget, capital budget and the budget of the Independent Office of Evaluation of IFAD (IOE). It was proposed that the term "regular budget" be used to refer to the budget voted for by the Executive Board for the administration of the Fund excluding IOE, rather than "corporate budget" as originally proposed. The definition of capital budget and IOE budget were also agreed upon. These were now being moved to the definitions section and would no longer be part of the substantive provisions.

- Regulation VI. In response to comments from members, Management had moved the definition of “capital budget” to the definitions section and provided a clarification of what it meant and how it would apply in the future. Management further proposed replacing the term “corporate budget” with “regular budget”. It was clarified that the IOE budget applied carry-forward, contrary to what was initially stated. Management had removed reference to the explicit power of the President to reallocate resources within categories since this was inherent in his authority. Clarification was only needed regarding the categories of budgets to which the President could make allocations.
 - Regulation VIII. The phrase “from time to time” had been removed.
43. The General Counsel informed the Committee that the above actions meant that all concerns raised at the 120th session of the Audit Committee had been addressed.
 44. Members then requested clarification on reallocation within the same budget type and across budget types; whether IFAD was departing from its mission and mandate by making reference to the “highest possible return in a non-speculative manner”. Further clarification was sought on possible contradictory statements within regulation VI on the reallocation of funds across budgets by the President with the approval of the Executive Board, while the statement on the capital budget expressly stated that it was to be used only to finance long-term outlays.
 45. The General Counsel explained that the statement on reallocation was meant to emphasize that the President needed Executive Board approval to reallocate between categories of budgets. The reference to highest possible return was in the context of investment of excess funds not needed for operations and did not relate to operational allocation of funds. All investment decisions pertaining to investment of excess funds were made in accordance with the Investment Policy Statement approved by the Executive Board. The General Counsel promised to review the two potential conflicting statements on reallocation and revisit the text if need be.
 46. The Chair summed up the item and concluded that members had no objections to the proposed revisions to the Financial Regulations, subject to clarification by the general Counsel on reallocations.. The General Counsel would revert with clarification on the consistency of the reallocations in proposed regulation VI. The other two regulations were agreed to in full. The Chairperson stated that the paper was therefore considered reviewed by the Audit Committee and would be submitted to the Board for approval. The revised Financial Regulations, once approved by the Executive Board, would be submitted to the thirty-fifth session of the Governing Council.

IFAD investment policy

47. The Chair introduced the item and informed the Committee that the Investment Policy Statement had previously been reviewed. As per the Committee’s request for further information at the last meeting, two other documents were now submitted. These were the Investment Guidelines and the Internal Control Framework for IFAD Investments.
48. Management summarized the feedback received on the Investment Policy Statement when it was last reviewed by the Committee and the Executive Board. Issues that had not been addressed directly in the Investment Policy Statement had been identified and these were dealt with in the two additional submissions.
49. Management explained the role of the investment guidelines, noting that they were intended to guide IFAD’s external investment managers and specify IFAD’s expectations of them. The new investment guidelines are changing to a risk-based budgeting system of measuring performance of the managers.

50. On the Internal Control Framework for IFAD Investments, two important issues were highlighted:
- The description of how IFAD intends to manage risk on an ongoing basis; and
 - The formal process within IFAD applying to investment activities and the related parties, which could be IFAD Management or IFAD divisions.
51. On the issue of implementation, Management noted that the staff of the Financial Operations Department would play a key role in the move to risk-based budgeting. Another critical element was risk management software. This was in the process of being procured, with the Request for Proposals process and the technical and commercial evaluations completed. Procurement staff were in the final stages of negotiation with the supplier.
52. Members requested information on the nature of the changes made to the Investment Policy Statement since last presented to the Audit Committee; frequency of review of the investment policy; the mechanism for the President to deal with unexpected situations; segregation of duties among finance divisions; whether the policy adopted a more risky approach to investments; the role of the external managers in risk analysis; and the size of the various mandates for managers.
53. Management stated that the main change related to the responsibility of the President with regard to investment decisions. It was noted that given the current volatile financial climate, Management may come back to the Audit Committee in less than the foreseen one-year period with proposals for changes to the policy. Segregation of duties would be implemented as established within the Internal Control Framework. The Asset Liability Management team would be transferred to a unit outside of the Treasury Services Division. Management also clarified that the policy approach is not aimed at investing in riskier assets to enhance portfolio performance, but rather at enhancing diversity because the individual assets in the portfolio are correlated.
54. In closing the item, the Chairperson stated that the Investment Policy Statement would be submitted to the Executive Board for approval and that the other documents for information had been noted.

Workplan of the Office of Audit and Oversight for 2012

55. The Committee was informed that the workplan was based on an assessment of risks and on the staffing and resources of the Office of Audit and Oversight.
56. The Committee was presented with a list of audits, with explanations for their selection. The main areas selected for 2012 were IFAD country presence, project design and recruitment.
57. The Director, AUO explained that the main challenge faced was ensuring a prompt response to allegations of irregularities given the reduced investigative capacity.
58. The Committee was informed of the internal audit capacity-building initiative. This had proved useful and was expected to continue in 2012, with a target of six secondments from IFAD counterpart internal audit functions.
59. Other developments included the restructuring undertaken in 2011 which was expected to result in increased capacity in 2012.
60. Finally the Committee was informed that due to the volatility of IFAD's risk environment, AUO may need to make adjustments to the 2012 workplan during the year to ensure that the planned activities remained relevant. A progress report would be presented to the Audit Committee meeting in September 2012.

61. Members commented on the increased number of reported allegations, wondering whether this was a worrying trend, and requested clarification on the changes in the internal audit staffing levels.
62. The Director, AVO explained that the increase in allegations was because of a backlog resulting from reduced staffing of the AVO Investigation Unit in late 2010 and in 2011. He noted that the trend of increasing allegations was not of concern as this was a natural consequence of the growing volume of IFAD activities and greater direct contact by IFAD staff with project activities. Finally, the Director explained that the changes in the numbers of auditors arose from internal transfers.

Audit Committee work programme for 2012

63. The Audit Committee was invited to review its own work programme for next year.
64. A number of amendments were made:
 - (a) For the 122nd meeting in March 2012, the item "Review of the consolidated financial statements of IFAD" was amended to include a Management assertion report on internal controls over financial reporting, as referred to during the related oral update. The other two items listed for the 122st meeting would be removed, as these would be discussed under the expanded item;
 - (b) As a result of the scheduling of the Committee meeting in March, it would not be possible to provide a report on the Investment Portfolio for the entire first quarter. Therefore, as had been done in the past, Management would present a report covering the first two months of 2012, and would subsequently provide the complete first quarter report along with the report on the second quarter for information to the Executive Board;
 - (c) Turning to the 123rd meeting in June 2012, the Committee was informed of the addition of an item on the "Review of the adequacy of the General Reserve" in light of the workload for the 122st meeting. Such a review had been envisaged at the Executive Board's last endorsement of the General Reserve (EB 2010/101/R.40); and
 - (d) For the 124th meeting in September, the Committee was informed that an item would be added on the "Progress report on the Workplan of the IFAD Office of Audit and Oversight for 2012."
65. The Chairperson drew the Committee's attention to the item on the "Review of the implementation of the cash flow sustainable approach". This item had been added at her request and was dependent on the outcome of the Consultation on the Ninth Replenishment of IFAD's Resources. The Chairperson noted that this item had been provisionally added to each Committee meeting, although she foresaw it being discussed only when developments warranted it.
66. The Chairperson also called for the Committee's understanding with regard to two documents slated for discussion at the meeting in March – "Report on IFAD's investment portfolio for the first two months of 2012" and "Consolidated financial statements of IFAD as at 31 December 2011", including a Management assertion report on internal controls over financial reporting – explaining that these would be submitted late to the Committee due to the meeting's proximity to the financial reporting dates that these documents relied upon.
67. On the issue of standard financial reports for presentation to the Executive Board, the Committee agreed that while all documents submitted to the Board would be available to the Committee, these would be considered in bulk, without specific introductions and with only specific questions from the Committee being addressed.

68. Finally, the Committee was requested to bear in mind the possibility that the 123rd meeting would have to be held on 8 June instead of 22 June, because of possible rescheduling of the World Food Programme Executive Board meeting in June 2012. Final information would be available at the 122nd meeting in March.

69. The programme was adopted as amended, and would be revised accordingly.

Other business

70. A member raised the point of confidentiality of matters discussed in closed sessions. Having been approached on matters discussed in a closed session, he enquired as to the mechanisms in place to ensure the confidentiality of such discussions.

71. Management confirmed both the confidentiality of such discussions and the existence of appropriate mechanisms to safeguard this confidentiality. Management further undertook to remind staff of these mechanisms and the member was assured that the incident raised by him would be followed up.