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Enabling poor rural people
to overcome poverty

Annual Report on Enterprise Risk Management Activities in IFAD

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Annual Report on Enterprise Risk Management Activities in IFAD

I. Introduction

1. In line with IFAD's Enterprise Risk Management Policy (EB 2008/94/R.4, reviewed by the Audit Committee and Executive Board in September 2008), the purpose of this report is to provide IFAD's governing bodies with an annual overview of enterprise risk management (ERM) activities carried out by IFAD, and an update on the corporate risks IFAD faces. This is the fourth such report, and it covers progress in the 12-month period since the last report was issued in early 2011.

II. Background

2. Implementation of ERM aims to ensure that risks that may impede IFAD's ability to carry out its mission and achieve its objectives are managed better and mitigated earlier to the extent practicable. It also brings IFAD's management and fiduciary processes into line with good practice.
3. During the Consultation on the Seventh Replenishment of IFAD's Resources, Management committed to implementing ERM gradually and in a structured manner within IFAD's decision-making processes without creating new and separate organizational units and positions. The need to deepen the ERM agenda was subsequently reaffirmed during the Eighth Replenishment Consultation.
4. Many key elements of risk management and internal control – such as results-based and risk-informed strategic planning, and investment management (focusing on market, currency and credit risks) – were put in place during the Seventh Replenishment period 2007–2009. In 2008, an ERM Committee (ERMC), chaired by the Vice-President, was established to catalyse the mainstreaming of ERM in IFAD, introduce a more formal and systematic approach to ERM, and regularly review ERM processes and outputs. IFAD's policy on ERM was formalized and reviewed by the Audit Committee and Executive Board in September 2008. In 2009, an ERM framework based on risk and control standards set by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) was released.

III. Update on ERM activities

5. Last year's edition of this report emphasized Management's heightened appreciation of risks in the financial area. Drawing in large part on recommendations of an external review of IFAD's financial structure in 2010, the principal focus of ERM activities over the last year has been on improving the overall quality and scope of financial management in IFAD. As such, this year's report dedicates particular attention to these efforts, but also covers other relevant ERM initiatives, such as the reassessment of IFAD's corporate risk profile.

Reassessment of IFAD's corporate risk profile

6. The corporate risk profile is IFAD's apex risk management instrument. It aims to ensure key risks to the achievement of IFAD's high-level and medium-term objectives are effectively and efficiently managed. A full reassessment of IFAD's corporate risk profile was initiated in January 2012 to take account of changes in the Fund's operating environment and new targets and priorities agreed in the Consultation on the Ninth Replenishment of IFAD's Resources (IFAD9 Consultation). So far, corporate risks have been defined and assessed,¹ root causes of each risk and main existing controls are being documented, and an analysis of potential new

¹ Risks were assessed taking existing controls into account in order to measure the level of residual risk. Both impact and probability were assessed using a 1–6 scale (1=lowest; 6=highest). Respective impact and probability ratings were in turn multiplied to yield an overall score ranging from 1–36 to determine the relative importance/priority of each risk.

and improved mitigation measures is under way (an overview of this work-in-progress as at the time of finalizing this report at the end of February 2012 for the Audit Committee and Executive Board is annexed herewith).

7. The overall score of the highest rated risk is 18 (at the midpoint of the overall score scale), and more than half of the risks have an overall score lower than 14, suggesting an adequate degree of control effectiveness for several of the risks identified. This, however, does not imply that IFAD can be complacent. On the contrary, the corporate risk profile points to challenges in achieving the targets established for the IFAD9 period (significantly greater and more demonstrable impact combined with increased value-for-money) and the challenging context within which they must be pursued (global economic slowdown and heavily constrained public finances). Indeed, it underlines that status quo with respect to IFAD's business model, resource mobilization strategy and mechanisms, allocation and usage of human and financial resources, and staff engagement will not serve achievement of IFAD9 targets well. On the other hand, the relatively moderate ratings and hence perceived moderate exposure to these risks reflect confidence that they are already being, or will be adequately addressed in the context of the ongoing change and reform agenda and/or the implementation of undertakings contained in the agreed IFAD9 commitment matrix. Efforts in this direction will be underpinned by linking the corporate risk profile exercise to IFAD's medium-term planning process, and by reassessing the same risks in a year's time to review progress made in mitigating them.
8. The residual risk of three out of four risks in the financial management area is low (a good sign for an international financial institution), reflecting the positive effect of reforms undertaken over the last year or so. Unsurprisingly, fraud and corruption rank highest among risks in the financial management area, as this is a risk inherent to the development finance field. Nonetheless, it is a risk that IFAD proactively strives to mitigate, including through its investigation unit.

Establishment of a new Financial Operations Department

9. At the end of 2010, a new Financial Operations Department was created, headed by a Chief Financial Officer, who assumed office in April 2011. This organizational change has been key to the implementation of various initiatives – detailed below – to improve the effectiveness and efficiency of the Fund's financial services and management.
10. The Controller and Financial Services Division has been reorganized, under the leadership of a new Controller who took office in May 2011, largely in anticipation of the introduction of a revised IFAD loan and grant management model and interdepartmental cooperation framework. One of the main changes under the revised model is that the Controller and Financial Services Division has taken on full responsibility and accountability for financial management of IFAD-financed projects and programmes, including the processing of withdrawal applications previously effected partially by the Programme Management Department. In so doing, the revised model aims to strengthen efficiencies and put in place risk-based financial management procedures and safeguards. The new model ensures that reporting lines are clear and distinct and consistent with inherent divisional/departmental responsibilities. Mindful of the need for a robust internal control system, the new model also aims to be responsive to the needs of IFAD-financed projects and programmes, including capacity-building requirements in the areas of financial management and procurement. Other initiatives have been rolled out or are under way to streamline processes in the accounting and the payments units and for loans and grants. This includes development of new tools and resources for internal and external stakeholders, work on which will continue in 2012.
11. The Treasury Services Division has been strengthened with the appointment of a new assistant treasurer and new team leader for asset and liability management.

Furthermore, in response to IFAD's evolving business model and the volatile financial environment in which it operates, a Financial Planning and Risk Analysis Unit has been created, with effect from January 2012, to strengthen financial planning and budgetary execution and establish a dedicated arms-length financial risk analysis capability, independent from the treasury function. The unit will have the following specific functions: financial planning and analysis, asset and liability management, budget planning, and creation and monitoring of financial management procedures and processes.

Revised Guidelines and Operational Procedures for Project Audits

12. Revised guidelines and operational procedures for project audits were developed in 2011 to better support IFAD's business model (particularly with respect to direct supervision), take into account reconfiguration of financial management responsibilities within IFAD, and integrate current audit best practices. Subsequent to the approval of the revised guidelines by the Executive Board in December 2011, the operational procedures were approved by IFAD's President at the end of December 2011 with immediate effect.
13. Salient features embodied in the revised guidelines and operational procedures include: simplified definitions and clarity of language; clarity on internal IFAD roles for the management of the project audit cycle; encouragement of the use and strengthening of country financial and audit systems, including national audit offices or supreme audit institutions; harmonization of IFAD approaches with those of other international financial institutions; and conformity with internationally accepted auditing and accounting standards. The procedures also introduce a new software package – the Audit Reports Tracking System – to support the management of project audits. This will be rolled out also to external stakeholders during 2012.

Sustainable cash flow approach to financial modelling

14. In the context of the IFAD9 Consultation, the approach taken by IFAD to financial modelling that underlies projections of future commitment capacity was reviewed, leading to agreement to move to a "sustainable cash flow approach" in line with the approach used by other international financial institutions. By explicitly assessing both inflows and outflows, a sustainable cash flow modelling system gives a clearer picture of future resource availability and potential risks associated with different assumptions of key variables (such as size of current and future replenishments, size of current and future programmes of IFAD loans and grants, and the rate of disbursement). As such, the revised approach maximizes the funds available for commitment in line with the Fund's Liquidity Policy, and provides clear early signals for corrective action as assumptions and circumstances change over time. Deployment of the enhanced financial model by January 2013 will be a critical priority during 2012.

Internal control framework for IFAD investments

15. IFAD reviewed and elaborated its framework of internal controls for investment in response to issues raised by the Audit Committee and Executive Board in the course of discussions on IFAD's Investment Policy Statement and Investment Guidelines. The review's outcome was presented in a paper detailing enhanced internal control mechanisms, a proposed risk management framework and a governance structure for oversight and decision-making with respect to IFAD's investments, which was endorsed by the Audit Committee and Executive Board in December 2011.

Management assertion and external audit attestation of internal controls over financial reporting and rotation of external auditor

16. The introduction of Management assertion and external audit attestation of internal controls over financial reporting for financial years 2011 and 2012, respectively, progressed according to plan in 2011. All recommendations contained in the 2010

external assessment of IFAD's readiness to obtain Management assertion and external audit attestation of internal controls over financial reporting were successfully implemented, and subsequently key controls were tested by the Office of Audit and Oversight. As a result, in 2012, IFAD will for the first time present its audited financial statements (for the year 2011) to governing bodies together with a Management assertion sign-off.

17. The first independent attestation report by the external auditor will be issued with the 2012 financial statements. The terms of engagement of the new firm of external auditors to undertake the external audit of IFAD covering financial years 2012 to 2016 have been broadened to include review of internal controls over financial reporting and issuing of attestation reports.
18. In line with best practice and IFAD guidelines, a full procurement process was conducted by IFAD Management on behalf of the Audit Committee to identify IFAD's second-ever external auditor. The new firm has a mandate approved by the Executive Board to conduct audit services, including attestation of internal controls over financial reporting, for the financial years 2012 to 2016.

Ethics Office

19. In February 2011, IFAD established an Ethics Office to promote and uphold the highest standards of the organization, its Code of Conduct and Core Values. During the year, the Ethics Office has proactively championed the ethics and compliance function. It also developed and is managing a comprehensive ethics and anti-harassment programme, which is contributing to the improvement of human resources management at IFAD. As part of this, a total of 34 training courses were held to raise staff awareness of ethical issues in the workplace, including anti-harassment and IFAD's Code of Conduct.
20. The Ethics Office also manages the annual financial disclosure programme. As previously reported, an expanded reporting requirement will soon be implemented for all staff at grades D-1 and above and other selected staff based on their duties and responsibilities. These staff members will be required to complete, on a confidential basis, a more detailed annual financial disclosure form, requesting information on financial assets and liabilities, including on selected financial transactions that occurred during the year. The first reporting period for this new programme will be the calendar year ending 31 December 2011. All staff remain obliged to complete an annual certification of compliance with IFAD's Code of Conduct, which also requires disclosing all sources of non-IFAD income, goods, services or assets.

Business continuity

21. IFAD is progressing with its implementation of a Business Continuity Management System through a project to undertake an initial iteration of the business continuity management life cycle as defined in the British standard (BS) 25999,² and the Business Continuity Institute's Good Practice Guidelines. This project is scheduled to be completed by the end of 2012. Two training workshops for the business continuity focal points have now taken place. A review of IFAD's existing continuity and recovery capabilities is being documented and a strategic business impact analysis is under way.

Review of ERM processes

22. As part of efforts to embed and ensure effectiveness of risk management within corporate processes, a review of risk management within IFAD's divisional-level planning and performance management process was carried out. While the identification, assessment and monitoring of risks to the achievement of divisional-level results was found to be widely practiced, the review pointed out the need to ensure that risk management is performed in a more meaningful and efficient way.

² Set by the British Standards Institution.

To this end, the guidelines for divisional management plans will be revised in early 2012.

23. Towards further improvement of IFAD's ERM practice, in 2012 the Office of Audit and Oversight will conduct an audit of ERM at IFAD. The aim will be to provide Management with the assurance that ERM is fully mainstreamed into its operations, and that the process is efficient and adequately serves Management's needs.

IV. ERM workplan for 2012

24. Key ERM priorities and deliverables for 2012 include:
 - Actively monitor and implement IFAD's corporate risk profile;
 - Obtain external audit attestation of internal controls over financial reporting for financial year 2012;
 - Deploy enhanced financial model;
 - Implement the Business Continuity Management System; and
 - Undertake ERM capacity-building activities.

IFAD's corporate risk profile: work-in-progress as at February 2012

<i>Risk (In descending order of importance/priority)</i>	<i>Root causes or drivers</i>	<i>Main existing controls</i>	<i>Potential improved/new mitigating measures</i>
Shortage and/or ineffective allocation of human and financial resources to achieve ambitious IFAD9 agenda	Members States' fiscal constraints Insufficiency of resources to operations Limited scope to achieve economies of scale in support areas due to IFAD's small size Inadequate focus and prioritization	Performance management tools Budget controls (including by cluster) IOE efficiency evaluation Job audit	Proactive use and revision of performance management tools to improve staff motivation and address poor performance Streamline internal procedures to make existing staff more effective Prioritize and focus resource use on high priority and value-adding activities Rebalance resources (both within and outside the Programme Management Division) through real zero-budgeting to project design, supervision and fiduciary management
Low staff morale	HR reforms threaten the present status of existing General Service staff Decentralization will lead to reduced positions in headquarters Job audit will add uncertainty	Consultation and communication with Staff Association and staff in general	Very difficult to mitigate. Requires trust building through fair measures and processes, along with quick execution to promptly identify positions at risk and put rest of staff at ease allowing them to focus on their job
Failure to adapt IFAD's development operations and business model to achieve more ambitious impact targets without growth in regular financial resources	Collective analysis and decision-making is weak or lacking Complacency about need to accelerate and expand impact, and insufficient political will to drive review/adapt business model, including in light of realities in middle-income countries (MIC) Inadequate capacity for policy dialogue and advocacy for engagement with private sector	High importance given to target of lifting people out of poverty and issues such as scaling up, engagement with MICs, private sector, and innovative financing in the IFAD9 commitment matrix EMC, OMC, OSC, QA, IOE, as well as other internal performance review processes	Collective engagement and focus of Senior Management on results and resources management/mobilization Action plan to strengthen scaling up performance Elaboration of a MICs strategy capitalizing on the MICs policy but going beyond to an operational strategy with targets and monitored implementation
Delayed/reduced pledges and payments to IFAD9 and previous replenishments	Global economic crisis	Follow-up with Member States	Do more of the same, more extensively and compellingly
Failure to mobilize significant additional resources through new financing mechanisms	Heavy dependence on replenishment Weak capacity for developing and exploiting strategic partnerships Legal and bureaucratic hurdles Resistance among IFAD Member States	Strengthened mandate of the Resource Mobilization and Partnership Office Establishment of and experience with new financing mechanisms such as the Spanish Food Security Cofinancing Facility Trust Fund Development of Partnership Strategy	Develop proposals for streamlining, rationalizing, and standardizing supplementary and trust funds Constructively engage governing bodies on expanding our partnerships and financing mechanisms

Notes: Executive Management Committee (EMC), Operations Management Committee (OMC), quality assurance (QA), Independent Office of Evaluation of IFAD (IOE).

<i>Risk (In descending order of importance/priority)</i>	<i>Root causes or drivers</i>	<i>Main existing controls</i>	<i>Potential improved/new mitigating measures</i>
Fraud and corruption in IFAD-financed projects	Control deficiencies Pervasive culture or environment	Investigation unit, and regular reporting of its activities Improving prevention (e.g. whistle blower hotline) and investigation effectiveness Review of external audit reports Frequent supervision missions Improving fiduciary controls	Mandatory rotation of supervision mission staff with fiduciary responsibilities Ensure minimum of two supervision missions per year Strengthen prevention awareness measures
Prolonged delay in filling vacant senior management and director-level positions	Significant turnover in the upper echelons of an organization creates uncertainty	Recruitments and induction programme	Increase/strengthen recruitment via headhunting firms Great effort to induct new senior managers and directors
Failure to devise and implement sufficiently credible methodology to measure IFAD's impact on poverty	Weak IFAD institutional capacity for impact assessment Weak country commitment and capacity for impact assessment	Ongoing efforts to strengthen IFAD's data analysis capacity Ongoing efforts to strengthen the data management capacity of development partners Identification of partnership opportunities with leading institutions on impact evaluation	Identify and partner with organizations that have capacity building in this area as a very high priority
Major unforeseen events or crises, e.g. natural disaster, technological crisis, terrorist attack, occurring at IFAD headquarters or in one or more IFAD country offices	Natural disasters Technological crisis Terrorist attack	Security, health and safety management Business continuity planning	Implementation of IFAD's Business Continuity Management System
Significant losses on IFAD's investment portfolio	High levels of instability in the financial markets	Strong set of investment management policies including: statement of investment policies, individual portfolio investment guidelines, and investment control framework	Continually proactively monitor investments and review all guidelines
Breakdown in IFAD's system of loan and grant disbursement	Large number of small payments to countries with high corruption index	Lengthy and time-consuming manual verification before disbursement	Examine risk-based checking Stronger controls over supervision and project audit
Significant misstatement of financial data	Complex accounting regulations Relatively small finance department	Training of staff External audit	Implementation of attestation process