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Enabling poor rural people  
to overcome poverty

## Report of the Chairperson on the 125<sup>th</sup> meeting of the Audit Committee

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For: **Review**

## Report of the Chairperson on the 125<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 125<sup>th</sup> meeting of the Committee held on 19 November 2012.

### **Adoption of the agenda**

2. The agenda was adopted with the addition of an item under "other business" regarding new developments in Global Mechanism financial implications and related future expectations.

### **Minutes of the 124<sup>th</sup> meeting of the Audit Committee**

3. The Committee approved the minutes of its 124<sup>th</sup> meeting without comments.

### **IFAD's 2013 results-based programme of work and administrative and capital budgets, and the Independent Office of Evaluation of IFAD's results-based work programme and budget for 2013 and indicative plan for 2014-2015**

4. The Committee's discussion of this item is covered in a separate report (EB 2012/107/R.3).

### **Project audit reports for fiscal year 2011**

5. Management presented statistics on project audit reports for 2011. The year recorded a stable proportion between qualified and unqualified opinions (76 per cent unqualified and 24 per cent qualified in 2010 – 80 per cent unqualified and 20 per cent qualified in 2011). Management explained that having a qualified opinion was not always a sign of fiduciary weakness, but may sometimes be the result of technical issues and that an unqualified opinion may still hide serious fiduciary issues. Management letters and the review of project audits provided Management with additional fiduciary assurance.
6. Other statistics presented included the timeliness of audit report submission, which saw 2011 record an increase in timely submission compared with the prior year. In general, private audit firms are more efficient in this respect than supreme audit institutions.
7. The Committee was informed of the Fund's commitment to taking prompt action at the project level to resolve any control issues identified, including setting time-bound action plans. Implementation of action plans was monitored during supervision missions and in the review of subsequent audit reports.
8. Other financial management efficiencies and improvements implemented included:
  - Centralization of project financial management responsibilities in one division (Controller's and Financial Services Division) as of 1 January 2012 had allowed a more coherent and consistent approach to fiduciary issues.
  - Revised project audit guidelines were approved by the Executive Board in December 2011.
  - An updated financial administration manual had been issued in June 2012.
  - The arrears clearance process had been streamlined.
  - A corporate financial management resource pack had been developed and released.
  - A forum on financial management for projects and internal stakeholders was organized for sub-Saharan Africa (West and Central Africa Division [WCA] and East and Southern Africa Division [ESA]) in August 2012. This would be followed by a francophone forum in January 2013.

- Work had begun on an e-learning tool in English for external and internal stakeholders on basic financial management principles and practices.
9. Committee members sought clarification on: how Management intended to deal with the difference in quality and timeliness of audit reports between supreme audit institutions (SAI) and private-sector audit firms; whether it would be possible to present regional statistics for qualified or unqualified reports by SAIs and private firms; and the kinds of audit reports for projects directly supervised by IFAD or by cooperating institutions.
  10. Further clarification was sought on: the kinds of audits conducted by SAIs and private firms and who the SAIs were; whether Management anticipated specific targeted action at the country level and whether systematic capacity-building was envisaged; and the table of comparative ratings from prior years.
  11. Management responded that SAIs were government offices of auditor-generals. These were mostly used in the East and Southern Africa and Asia and the Pacific regions. The Committee was also informed of the requirement of three different opinions for one audit engagement covering different aspects of project financial management. On the issue of reliance on cooperating institutions, Management clarified that it requested input and insights from them and was seeking areas of cooperation and collaboration. Management was initiating capacity-building for SAIs to assist them in understanding IFAD requirements, including at the targeted country level. The other requested information was taken note of for inclusion in next year's report on the status of project audit reports.
  12. The Chairperson wrapped up the item and noted the improvements achieved in timeliness and the decreasing number of qualified opinions. Moreover, she encouraged Management to continue working with external stakeholders in this area – in particular, to enhance targeted capacity-building initiatives in regions having the weakest capacity. The report was noted.

#### **Annual review of IFAD's Investment Policy Statement**

13. The Committee was informed of three main topics regarding revision of the Investment Policy Statement (IPS):
  - (a) Proposed changes to the wording of the IPS, as outlined in addendum 1 to the document presented;
  - (b) A proposal to reduce the overall allowable conditional value-at-risk (CVaR), as outlined in addendum 2 to the document presented; and
  - (c) An update on overall implementation of the IPS since its approval in 2011.
14. Wording changes included reference to the revision of the financial regulations approved by the Governing Council; and removal of individual references to divisions and units, as responsibilities and functions were detailed in the internal control framework, which would accompany the IPS.
15. The Committee was informed that IFAD used CVaR to measure its risk budget. This was a measure of the potential average expected loss to a portfolio under some extreme conditions. The maximum allowable CVaR for the overall portfolio was approved in the IPS at the level of 10 per cent at the 104<sup>th</sup> session of the Executive Board. Stress tests subsequently performed showed CVaR not exceeding 5.6 per cent, and thus it was recommended that the overall portfolio maximum allowable CVaR budget be revised down to 6 per cent. After approval by the Executive Board in 2011, the IPS was fully implemented as of the third quarter of 2012. Portfolios were managed within the risk budgeting framework, and some newly eligible assets had been acquired, such as emerging markets debt securities. Investment guidelines were revised according to the new IPS, and external investment managers re-tendered. The Treasury Manual was being amended to reflect the changes made to date, and operational risk was being reviewed.

16. Members sought clarification on: the main changes in the proposal regarding the relationship with the Board and Management; whether the reduced risk budget would change the management approach for the portfolios; whether Management was able to organize the changes in clear groupings; whether the stress tests performed and the revision of CVaR implied a more conservative approach. Confirmation was also requested that the IPS would be accompanied by the internal control framework when presented to the Executive Board, with clarification on the roles and responsibilities of investment management.
17. Management confirmed that, in removing reference to specific units, the intention was not to change the IPS, but rather to avoid the need for continuous amendments in line with possible changes in internal reporting lines. The objective of the internal control framework was to embody how Management monitors and reacts to changing circumstances affecting the investment policy. In response to some concerns raised, and to reassure Board members that the IPS approved by the Board is supported by an appropriate framework in terms of governance, it was agreed that when revisions to the IPS are presented to the Board for approval, the Board will also be presented with the internal control framework, should revisions have been made thereto, or a statement confirming that the internal control framework remains unchanged. The internal control framework would not be for approval by the Board, however should Board members raise questions, possible changes thereto could be considered by Management. Management also confirmed that the reduction in CVaR was not a shift to a more conservative investment approach, but rather was intended to reduce the unused risk budget capacity and that it should not, in principle, affect decisions to invest in emerging markets at risk investments of appropriate quality. The Committee was further informed that the operational rules and procedures had been implemented in accordance with the internal control framework, and that reporting on compliance was being handled by the Asset and Liability Management team based on data received from the custodian bank.
18. It was agreed that Management would present a paper outlining amendments to the internal control framework, if any, whenever the IPS went to the Board. The item was concluded.

#### **Consultancy management procedures**

19. Management informed the Committee of the rationale for IFAD's use of consultants and confirmed that the system used for their management worked effectively and was in line with those of other international financial institutions (IFIs) and United Nations organizations.
20. The paper presented by Management covered consultants hired in an individual capacity only and not the hiring of consultant firms under IFAD's competitive procurement processes, or the hiring of project consultants by the recipients of IFAD loans and grants.
21. The consultant hiring process is similar to the process used to employ short-term staff. Hiring divisions identify potential consultants using a variety of means, including the use by some divisions of a targeted roster system, which was recently developed using IFAD's external recruitment website to identify consultants with specialized skills. Hiring divisions prepare terms of reference, propose fee arrangements, manage consultants, review their invoices, approve payments, and assess the quality and effectiveness of their services. This assessment is then added to the consultant database. The Human Resources Division (HRD) supports the hiring managers throughout this process.
22. Fees paid to consultants are based on the established International Civil Service Commission (ICSC) net salary structure, in line with practices at other United Nations organizations. IFIs generally tend to have higher fee rates.

23. Management clarified the difference between the amount for consultant expenditures in 2011, reported at the June 2012 meeting of the Committee, and the authorization reflected in the 2011 budget, including the use of vacant staff position funds pending the recruitment of full-time staff members. The Committee was informed that a review had been undertaken regarding the appropriate balance of staff and consultants as part of the wider Strategic Workforce Plan (SWP), especially in the Programme Management Department. Overall, the use of consultants was expected to decrease. In addition, position and budget controls had been introduced to limit vacant position expenditures and to ensure that managers recruited staff members to fill vacant positions within one year.
24. The Committee appreciated the explanation of the difference between the reported consultancy costs in the June session and the budgeted amount. Members requested clarification on: plans for further development of the consultant roster; expenditures on consultants by department; the level of diversification in the consultants being hired; the identification of methods to involve countries in the selection process; Management's views on the practice of hiring consultants for extended periods (over 260 days in one year); and the appropriateness of the use of vacant position funds to hire consultants.
25. Management informed the Committee that, while the consultant recruitment process was seen to be broadly effective in terms of attracting a wide diversity of consultants who were best qualified to address IFAD's evolving business requirements, an exploratory approach was being taken with respect to further improvements, with a view to finding the most suitable approach for IFAD's unique circumstances and needs. The current targeted roster process seemed effective, but would continue to be evaluated. In addition, hiring divisions undertook evaluations of the quality of work performed by consultants, and consultants who had not been evaluated were not eligible for further hiring. Other steps to further improve the process included introduction of a consultant portal to provide consultants with a better understanding of IFAD's opportunities and procedures. The Committee was reminded that countries were normally not involved in the selection process, as the consultants being referred to were not project consultants at the country level. Consultants working more than 260 days in a year accounted for only a small percentage of the total number of consultants hired – usually about 5 per cent. While such arrangements were not the norm, this practice was permitted if there was sufficient business justification and after review by HRD. The use of staff position funds for consultants was permitted under IFAD's staff rules and procedures, and was considered appropriate during the limited period when a recruitment was under way.
26. The Chair noted that there were a number of ongoing initiatives in the area of consultancy management and that the Committee may wish to revisit the subject in a year's time to review major developments and remain fully apprised. The report was noted.

#### **Report on the special expenditure for reform actualization**

27. Management informed the Committee that a conservative approach had been followed regarding the use of these funds in the first year to ensure that adequate resources were available in the subsequent year to support the initiatives envisaged in EB 2011/104/R.53 and EB 2012/107/R.42. These included the continued retraining of staff and the facilitating of separation arrangements where appropriate, both to support the outcomes of the Strategic Workforce Planning exercise and to cover other one-time costs related to implementation of human resource initiatives under the Change and Reform Agenda.
28. Members sought clarification on whether Management expected to stay within the approved expenditure envelope and if it would revert to the Committee or the Board on the planned use of funds before proceeding further.

29. Management confirmed that it intended to remain within the envelope. Under the terms of the Governing Council's approval of reform actualization expenditures, information reports on the actual use of the funds would be provided to the Executive Board (as was being done this year) and in a final report to the Governing Council in February 2014.
30. The Committee noted the report and requested that an audit be conducted by the office of Audit and Oversight of the actual expenditures.

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

- (a) **Report on the status of contributions to the Eighth Replenishment of IFAD's Resources**
  - (b) **Report on the status of contributions to the Ninth Replenishment of IFAD's Resources**
  - (c) **Resources available for commitment**
31. Management presented reports on the status of IFAD8 and IFAD9 contributions, highlighting changes in pledges and instruments deposited since the last report submitted to the September Audit Committee meeting. The amount of pledges to IFAD8 had remained the same, but the amount of instruments deposited had increased by US\$65 million and payments had increased by US\$30 million up to the date of the report of 30 September. Moreover, from the end of September to the date of the meeting, an additional US\$28 million had been deposited as instruments of contribution, and payments received had increased by US\$36 million. An update was provided on countries that had paid more than US\$1 million, which included Angola, China and Italy and an instrument of contribution from the United States of America.
  32. The Committee was also informed of movements in the status of IFAD9 as of the September meeting and further movements since September to date. Pledges corresponded to 94 per cent of the target, instruments deposited had increased by US\$58 million and payments received had increased by US\$23 million. Since September to date, pledges had increased by US\$8.4 million and instruments deposited by US\$80.9 million. Significant instruments of contribution received since September were from Austria, Germany, Japan and Sri Lanka. As of the meeting date, 36 per cent of instruments of contribution had been received, compared with the target 50 per cent needed for effectiveness. Member States were encouraged to deposit instruments early, preferably no later than the end of the year.
  33. The Committee also received an update on the status of complementary contributions to the Adaptation for Smallholders Agricultural Programme, to which four Member States had pledged and one, Canada, had made full payment on its pledge of US\$20.3 million. Other pledges included Belgium US\$8.5 million, the Netherlands US\$85.8 million and the United Kingdom US\$243 million.
  34. Comments from members included requests for: a table showing movements from the previous reported status; an oral update on any developments since the report submission date; and an indication of the direction of the new replenishment and whether it was on course.
  35. The reports were noted.
  - (d) **Status report on arrears in principal, interest and service charge payments**
  36. Management highlighted important developments in the arrears status since the last update at the September meeting of the Audit Committee. Following approval by the Board of the debt resettlement plans at its September session, Cuba and the Sudan had signed their respective agreements; Cuba had emerged from provision status and Management had begun disbursing to the Sudan projects.

37. Mali had fully paid its arrears and was continuing to service its debts.
38. The Committee noted the developments and requested an up-front update of changes with respect to the previous meeting.

(e) **Report on the IFAD investment portfolio for the third quarter of 2012**

39. Management reminded the Committee that the IPS adopted by the Executive Board in 2011 was under active implementation. This included funding of the emerging markets debt and global diversified fixed-income portfolios, and the mandating of external investment managers to manage them. All portfolios were managed within IFAD's risk budget. As at 16 November, net year-to-date investment return on total assets stood at about 2.8 per cent.
40. Members sought clarification on: the investment management approach; whether Management had reconsidered its perception of countries in which positions had been liquidated, following recent developments at the European Central Bank; movement in net outflows and change in the level of operational cash between the second and the third quarters; how Management was striking a balance between investments and projected loans and grants in order to achieve the objective of helping 80 million people move out of poverty.
41. Management confirmed that the perception had not changed; it was still based on the credit rating of countries. The objective was to follow the IPS and to adhere to the overriding principle of the Fund to minimize the probability of loss of capital as a priority before maximizing return. On the movement in net outflows, the Committee was informed that this was not within Treasury's control, as it depended on the stage of project disbursements. Management explained the linkage between investment and the overall IFAD mandate and emphasized that investments were not managed with the objective of poverty reduction efforts. Management instead followed the principles of prioritizing capital preservation and adequate liquidity before pursuing return generation. The high level of operational cash was explained as a temporal position following liquidation of some portfolios in readiness for investments in the revised portfolios.
42. The remaining papers were noted without further comment.

**Workplan for the IFAD Office of Audit and Oversight for 2013**

43. The Director, Office of Audit and Oversight (AUO), informed the Committee that the workplan took into consideration risks and resource issues. Due to the focus of audit planning for 2013 on the economical and proper use of resources (economy and efficiency), AUO emphasized the audit areas of budget process, internal investment management and project procurement.
44. AUO presented lists of planned audits and their rationale, with some flexibility for areas to be determined to leave room for responding to emerging risks in 2013. The staffing situation of the unit was presented: indications were that additional resources may be needed to support the workload in the investigations area and expiring contracts for associate audit officers would need to be extended. AUO intended to come back to the September meeting of the Committee to present a progress report and any changes introduced to the plan.
45. The Committee was also informed that the external quality assurance process was under way, following the selection of the Institute of Internal Auditors to undertake the exercise.
46. Members requested clarification on the relationship between risk and the areas selected for audit and on how country-specific audits were chosen.
47. The Director, AUO, clarified that the process of risk ranking and selection of audits involved the gathering of information from various sources, including financial data, the institutional risk register and interviews with managers and relevant officers.

The identification of potential areas to audit was also based on factors such as spread across the organization (to avoid attention overload in specific areas), recent audit coverage and ongoing institutional initiatives. The long list of potential audits was identified, prioritized and submitted to the President for approval and then presented to the Audit Committee. On the issue of country-specific audits, these were picked during the year based on levels of procurement activities and any known risk indicators.

48. The Committee noted the responses and proposed two areas for consideration in 2013 under the items to be determined: management of grants and institutional performance measurement. Additionally, a question was asked as to whether country offices would be considered as a potential area.
49. The Director, AUO, confirmed that this area had undergone an audit in 2012 and the outcome of the exercise would be presented to the April meeting of the Audit Committee as part of the 2012 results.
50. The Committee acknowledged the President's prior approval of the workplan and expressed general support for the plan.

#### **Audit Committee work programme 2013**

51. Under this item, the Committee considered the tentative work programme for 2013. It accepted the Chairperson's proposal to continue consideration of standard financial reports presented to the Executive Board. The Committee reviewed and approved the work programme, but noted its tentative nature.

#### **Joint Inspection Unit (JIU): Accountability framework in the United Nations System**

52. Management reminded the Committee that the report under discussion represented an elaboration on the explanation provided on this item at the last meeting. The Committee was also reminded that IFAD was not a party to the JIU.
53. Members requested that, in the next report, Management address the issue of communication with Member States and staff and the process of arriving at a "culture of accountability". Appreciation was expressed for the inventory of current provisions listed in the report.
54. The item was closed on the understanding that at the Committee's next meeting in March 2013, Management would present a document addressing the issues raised.

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

55. Management presented an oral update on the initiative of obtaining an independent attestation of internal controls over financial reporting, alongside a Management assertion report. The Committee was reminded of the tremendous benefits associated with this initiative, such as enhanced credibility of the Fund's financial statements, reduced misstatement risk, commitment to risk management and good governance, and alignment with other IFIs.
56. The Committee was reminded of the Management assertion report issued with the financial statements as of 31 December 2011. The next key milestone was the independent external auditor's attestation, which would be published with the external auditor's opinion on the financial statements for the 2012 financial year.
57. Members were informed that a series of testing on controls was currently being undertaken by an independent firm of accountants hired by AUO. Further testing would be carried out by the external auditors. The results of the current interim testing phase indicated overall operational effectiveness of controls, with a few minor deficiencies which were being addressed.



58. The Committee thanked Management for the presentation, acknowledged that the initiative was on the right track and took note of the positive developments. The update was noted.

**Other business**

59. Under other business, Management was requested to update the Committee on any developments involving financial implications related to the Global Mechanism (GM).
60. The Committee specifically requested Management to confirm whether the United Nations Convention to Combat Desertification (UNCCD) had been able to make payments towards funding the budget of the GM for the shortfall reported at the last meeting of US\$700,000, and also requested information on the possible financial implications of potential cases before the Administrative Tribunal of the International Labour Organization (ILOAT).
61. Management confirmed that funding had been consistently received on a monthly basis, including in November when additional payroll costs had to be met for the backdated pay increase for General Service staff.
62. The General Counsel confirmed that three cases had been filed with the ILO tribunal and that Management had filed a reply. In addition, seven requests for intervention had also been filed. The proceedings were still in the written stage. It was not anticipated that judgments would be rendered before 31 March 2013 or during 2013. On the financial implications, the Committee was informed that the scenarios had not changed. The Committee was further informed that UNCCD would post new vacancies for all GM staff.
63. The Committee appreciated the update and asked if there was any timeline with regard to the vacancy announcements. It was clarified that the aim was to address the expiry of the current six-month contracts in place, i.e. by 31 March 2013.
64. The update was noted and the meeting closed.