Document: EB 2013/109/R.26
Agenda: 10(a)(i)
Date: 29 August 2013
Distribution: Public
Original: English

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Enabling poor rural people
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Report of the Chairperson on the 127th meeting of the Audit Committee

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Executive Board — 109th Session
Rome, 17-19 September 2013

For: **Review**

Report of the Chairperson on the 127th meeting of the Audit Committee

1. The Audit Committee wishes to bring to the attention of the Executive Board the matters examined at the 127th meeting of the Committee held on 10 June 2013.

Adoption of the agenda

2. The agenda was adopted with clarification that item 11, which had been scheduled as an oral update, would instead be presented as a written document.

Minutes of the 126th meeting of the Audit Committee

3. The minutes were approved subject to an addition requested by one member in relation to the section on the Debt Sustainability Framework (DSF) document. The request was made to provide clarification on the different contribution modalities and their impact on developed and developing Member States.

External auditor's report on internal control and accounting procedures

4. The external audit engagement partner reminded the Committee that the audit of the 2012 financial statements had been successfully completed and unqualified audit opinions had been issued on IFAD's consolidated financial statements and on internal controls over financial reporting. The Committee was informed that three control weaknesses had been identified in the course of the audit and these were highlighted in the management letter, including recommendations for improvements. These issues were all considered of medium priority and had been discussed with Management, whose comments were incorporated in the report. The three areas of improvements identified were:

   (a) Lack of integration between the Loans and Grants System (LGS) and the PeopleSoft system and lack of cut-off in the LGS.

   (b) Investment pricing, Management's view of having different sources of information for valuation of the investment portfolio, and the process of dealing with possible differences in information from these different sources.

   (c) Information technology (IT) security and systems access including the process of enabling and disabling users in the system and segregation of duties in the change management process.

5. The Chairperson invited Management to comment on the weaknesses highlighted in the external auditor's report. Management acknowledged the current LGS weakness and informed the Committee that solutions to address it have been fed into the business requirements for the new LGS, which is due to be implemented by the end of 2013.

6. Management further agreed with the recommendation on the investments pricing information issue and assured the Committee that more efficient procedures for investment valuations are being put into place in 2013.

7. On the IT security issue the Committee was assured that the change control processes would be instituted to ensure appropriate segregation and that the access rights issue is being addressed in the current review of workflow.

8. Comments from members included: concern about the implementation time the LGS has required and whether it will indeed be in place this year; and clarification of the accounting policy applied for DSF grants.

9. Management assured the Committee that the LGS project is on track, notwithstanding some recent minor unexpected slippage. The external auditor confirmed that the current accounting treatment adopted for DSF grants is in line with International Financial Reporting Standards (IFRS).

10. Members sought clarification regarding the time frame within which Management intended to implement the recommendations. The Committee was assured that except for an element of the IT security issue, which is likely to be fully implemented in 2014, the other recommendations are targeted to be implemented in 2013. The external auditors indicated that they would be following up on implementation of their recommendations towards the end of 2013.

11. The item was closed.

External auditor's audit strategy memorandum for the year ending 31 December 2013

12. The external audit engagement partner informed the Committee that the audit strategy is consistent with that of the previous year, with the following differences:

    (a) Implementation aspects of the new LGS FLEXCUBE imply that significant data migration will be part of the process and specific tests will have to be performed.

    (b) Implementation of the 2012 Fair Value tool, which was tested as satisfactory in 2012, will not have to be redone in a similar manner.

    (c) A number of new accounting standards adopted in 2012 were subject to tests of both impact on figures reported and compliance with disclosure requirements.

13. The partner stated that the objective is to obtain sufficient evidence to be able to express an opinion on the consolidated financial statements of IFAD, and their compliance with IFRS, and to issue an opinion on the management assertion report on the effectiveness of internal controls over financial reporting. This will also include audit opinions on the financial statements of hosted entities such as the Global Environment Facility (GEF), International Land Coalition (ILC) and High-Level Task Force (on the Global Food Security Crisis). With regard to the Global Mechanism (GM), consideration must be given to the fact that the mandate will have to be confirmed by the United Nations Convention to Combat Desertification (UNCCD) and must include accounting data generated in two separate geographical locations.

14. Key areas of risk in the 2013 financial year were considered to be:

    (a) Fair value calculation at inception (initial recognition) to ensure that Management's estimates and key assumptions are consistent with IFRS.

    (b) The valuation approach adopted by Management for financial assets, especially in the light of possible impairment considerations and the effect of sovereign debt crisis.

    (c) Implementation of the new LGS and data migration into FLEXCUBE. The auditors will assess Management's control and reconciliation of the data transferred to ensure its accuracy and completeness.

    (d) Other issues that are not IFAD-specific, but are nonetheless required in order to comply with International Standards on Auditing, were identified as revenue recognition and possible management override of controls.

15. Members requested clarification on how the audit strategy will be affected should the LGS not go live in 2013 as anticipated, and the effect of the possible change in responsibility regarding audit of the GM's financial statements. Members also wished to know why Deloitte was auditing and issuing opinions on entities that are not IFAD, such as the ILC and GEF.

16. The engagement partner explained that if the LGS does not go live as planned, the audit approach will not be different from the 2012 one in this area.

17. Regarding the audit of the GM, it was clarified that the current memorandum of understanding (MoU) included the provision that accounting services be handed over to the UNCCD, and that the Convention had already taken over accountability for financial management of and reporting on the GM. Therefore, as it was no longer authorized to undertake any actions with respect to the financial management of the GM except on behalf of the UNCCD, IFAD would wait for authorization from the UNCCD before proceeding with a request for the external auditors to audit GM financial statements. Noting that this was a period of transition, the Committee observed the importance of ensuring the audit of GM accounts in the interests of good governance. Management further clarified that other hosted entities (i.e. the ILC) received accounting services from IFAD, but their respective managements signed off on the financial statements. The audited financial statements of GEF activities under IFAD, as a GEF implementing agency, were both included in IFAD's consolidated financial statements and provided separately to the GEF.

18. The item was closed and the strategy was noted.

Performance audits

19. Management presented the document on the applicability of performance audits at IFAD at the request of the Executive Board and in response to the Audit Committee's specific request at its 126th meeting in March 2013.

20. The main objective of performance audits was stated to be an assessment of an organization's economic, efficient and effective use of resources, whereas financial statement audits focus on the truth and fairness of financial statements. The Committee was informed of practices at both international financial institutions (IFIs) and United Nations organizations as far as performance audits are concerned.

21. The main difference highlighted was that United Nations organizations have performance audits performed by their external auditors, while IFIs have their independent offices of evaluation undertake such audits.

22. It was noted that the IFAD Executive Board can request for a performance audit to be performed. The Committee was further informed of the roles of the Office of Audit and Oversight, which assesses the efficiency and effectiveness of activities, and the approach and mandate of the Independent Office of Evaluation of IFAD (IOE), which captures all areas of focus covered by performance audits.

23. Management informed the Committee that IFAD's practice is aligned with that of other IFIs, and that Management believed that the current governance and evaluation structures in place are adequate and cost-effective in fulfilling the objective of performance audits.

24. Audit Committee members sought confirmation of whether IFAD requires a performance audit; expressed confidence in the current structure as covering the objective of performance audits; requested clarification on practices at the World Bank and Asian Development Bank (ADB); and confirmation of the capacity, skills and resources of IOE and the Office of Audit and Oversight (AUO) to undertake performance audits.

25. Management clarified that IFIs had been contacted about their practices and their responses had been incorporated into the document. The capacity of IOE is confirmed at the time it presents its budget. The AUO presented its annual workplan with an assessment of resources to Management and the Audit Committee and also provided updates as and when necessary.

26. The Audit Committee confirmed agreement with Management's statement on the adequacy of the existing structures for performance audits, that there is no need to duplicate efforts, and concluded that the Committee's recommendation would be in

line with Management's suggestion. The document would be presented to the Executive Board for information.

Review of the status of the Debt Sustainability Framework and financial implications of grants

27. Management presented the document in response to a request by the 126th Audit Committee meeting for further information.

28. The Committee was reminded that the total foregone principal reflows for DSF grants committed from the Seventh to the Ninth Replenishments of IFAD's Resources (IFAD7 to IFAD9) amount to US$1.445 billion; this will fall due between 2018 and 2055.

29. The document reviewed alternatives for determining compensation shares, with a view to recommending an approach to meeting the obligation to compensate IFAD for the shortfall resulting from DSF implementation. It was noted that, if not covered, this shortfall would have a significant impact on IFAD's future operations due to the reduction in the resource base.

30. The revised document presented practices at the International Development Association of the World Bank, the African Development Bank (AfDB) and the Asian Development Bank.

31. Management recommended adoption of AfDB's approach to calculating compensation shares for its contributing member states, as it was considered suitable, simpler and readily adoptable under IFAD's circumstances.

32. A simulation of the AfDB approach was presented as it would apply to the DSF principal repayments foregone falling due during the IFAD10 and IFAD11 periods.

33. Management further outlined the proposed contribution modality as follows: donors may make single contributions from which their assessed DSF compensation share may be taken or they may pledge two separate amounts for DSF and regular contributions. In cases of single contributions, DSF-assessed obligations should take precedence.

34. Audit Committee members requested information on voting rights, which were not mentioned in the document; clarification on whether developing countries benefiting from the DSF would also be expected to contribute towards compensation for the foregone principle reflows; clarification on the wording of who is included in the list of donors for the DSF in other IFIs; additional information as to why other IFI approaches are not applicable to IFAD; whether front-loading payments would result in encashment credits; and whether IFAD offered a 20 per cent volume discount on PBAS allocation to countries receiving DSF funds.

35. Management indicated readiness to carry out further work on the document in order to incorporate information on the queries raised. Management acknowledged that the number of donors in other IFIs would be rechecked and confirmed, and that consideration would be given to removing DSF countries from the list of donors from whom compensation is expected, although this would be a choice for the governing bodies to make, not Management. The Committee was further informed that Management would reconsider expanding the argument for the selected option. It was also explained that IFAD offered a 5 per cent volume discount. Clarification was also provided on the recalculation of a proposed contribution threshold of US$10,000 (which would be presented in a revised document as a decision for the Board) and that the aggregate amount for items below the threshold was redistributed among other donors so as to avoid a financing gap.

36. While it was agreed that this issue might require consideration during the IFAD10 Consultation, the proposal to continue technical consideration of the subject during Audit Committee sessions, with a view to presenting final proposals to the

Executive Board in December 2013, was accepted. The Committee requested that Management enhance the following issues in the paper:

- Further details of the options used by other IFIs;
- Clarification of whether countries receiving DSF funds should be asked to contribute towards compensation of principal repayments foregone;
- Implications on voting rights arising from making DSF contributions;
- Projection of the estimated compensation over time based on certain assumptions, which should be disclosed;
- As a reference, specification of the Board's decision as to how the burden should be decided at the time of introducing the DSF;
- The rationale for any minimum monetary threshold suggested by Management;
- If some countries are proposed to be excluded, reasons for exclusion and contributions with and without the excluded countries;
- Presentation of more options, including the implications of the "do nothing" option; and
- Consideration of early encashment credits for frontloading DSF countries.

37. The item was closed with the conclusion that Management would work on enhancing the paper along the lines suggested and would present a revised document to the September 2013 meeting of the Audit Committee. Management indicated that they would endeavour to meet this deadline, but noted that this would be challenging and that further information may need to be presented to the November meeting of the Audit Committee.

Update on IFAD's accountability framework

38. The Committee was reminded that the paper was being presented at the request of the Board in December, following discussion by the Audit Committee in November 2012. An initial request for development of an accountability framework had been considered by the Committee in November 2012. The document presented is a more comprehensive outline that builds on the components and pillars referred to in the report of the United Nations Joint Inspection Unit (JIU).

39. Management stated that the paper was built around the three components in the JIU report as applicable to IFAD. These are political commitment to Member States, an internal control component, and complaint and response mechanisms. The paper also presented a comparison with similar frameworks of other institutions. Management requested that the Committee provide feedback, on the basis of which the paper would be finalized and uploaded to IFAD's website.

40. Comments from members included: requests for clarification on why the document referred only to other United Nations agencies and not IFIs; clarification on the role of the Executive Board in the monitoring and achievement of strategic objectives; inclusion of reference to reporting on staffing levels and distribution to member countries; and provision of information on contracts awarded.

41. The General Counsel clarified that the document had been built on elements contained in the JIU report and presented a description of all accountability processes and delegation of authority. It was not intended to replace the normative framework already in place. He also clarified that the Executive Board's accountability derives from authority delegated by the Governing Council.

42. The Chairperson advised that a sample of the United Nations Development Programme's accountability framework document had been circulated to the

Committee and noted that the Committee needed to review and provide clear indications to Management as to what they wished included in this document.

43. The item was closed with the understanding that the document had been noted, but the Committee and Management would review frameworks of other institutions and agree on the best way forward.

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

44. Management informed the Committee of progress made since the last update provided to the Committee in March 2013. A number of key FLEXCUBE implementation activities have been completed and the FLEXCUBE system is expected to go live in the third quarter of 2013. The go-live for the data warehouse is targeted for the fourth quarter of 2013.

45. The Committee was informed that "user acceptance testing" was under way. Additional critical customizations had been identified, with an additional cost of approximately US$57,000, which was still within the contingency budget. Successful training had been conducted for end-users (Nairobi country office and some IFAD headquarters staff).

46. IFAD had raised the issue of the two modules contracted and paid for, but not required, with Oracle senior management. Oracle management stated that a refund was not possible – neither as a credit note nor a discount. An option was offered of swapping the two licences for other FLEXCUBE licences that IFAD may purchase.

47. The Committee was further updated on the data warehouse and data migration activities related to historical data store and reporting, which have resumed and are near completion. Risks that could affect the system go-live dates were identified as follows:

(a) Data migration errors that require data cleaning;

(b) Delivered customization not meeting IFAD's requirements and potential need for additional customization;

(c) The tight integration timeline for FLEXCUBE and data warehouse.

48. The expected next steps were data migration and data warehouse activities. IFAD will negotiate the level and amount of post-go-live technical and functional support required from Oracle. Post-go-live costs are expected to remain within the overall level estimated at the inception of the project of US$1.7 million per annum.

49. The Committee was informed that IFAD Management had launched the next and final stage of the project, which relates to e-disbursements and the borrower's portal. Implementation is expected to start in 2014.

50. Comments from members included: a request for a written update to be circulated in advance in future updates; clarification on Management's level of confidence in successfully going live in the third quarter of 2013; intended next steps with Oracle management regarding the issue of a discount for licences not required and critical considerations for the go-live; and a request that the next update be shorter and less technical.

51. Management responded that there was a 60 per cent chance of the project successfully going live in the third quarter of 2013. Regarding a refund for licenses not needed, it intended to pursue the matter with more senior management at Oracle.

52. The update was noted with a request to have a written paper dispatched in advance next time and that it be less technical, focusing on key critical issues.

Oral update on the IFAD After-Service Medical Coverage Scheme (ASMCS)

53. The Committee was informed that IFAD participates in a multi-employer ASMCS for staff receiving a United Nations pension and for eligible former staff on a shared-cost basis. The scheme is currently fully funded. Assets for the ASMCS are held in a separate legal entity in the form of a trust fund. The IFAD Trust Fund for the ASMCS was established pursuant to resolution 132/XXVI of the Governing Council, which stated that the resources of the ASMCS shall be invested in accordance with the same rules applied to the investment of IFAD's regular resources.

54. The Committee was informed that the investment considerations for IFAD's regular resources differ significantly from those of the portfolio for the ASMCS, which should normally be a liabilities-driven strategy, with a long time horizon. As a post-retirement benefit, the ASMCS takes into account aspects of planned participants such as age, inflation-linked future medical expenses, years of retirement, etc. These liabilities are driven by underlying actuarial assumptions. IFAD's investment policy for its regular resources prioritizes liquidity and safety to long-term returns.

55. The President of IFAD annually reports to the Executive Board on the Trust Fund's operations and resources. This is done through the annual audited financial statements, which are presented to the Executive Board with a note on the ASMCS Trust Fund status. At its September session in 2004, the Board decided that IFAD would make transfers of internal resources to the Trust Fund when required, and that the Audit Committee and the Executive Board would be informed of any such transfers (EB 2004/82/R.27).

56. Management suggested considering whether a more appropriate investment policy for the ASMCS should be developed.

57. Given the long-term nature of IFAD's ASMCS investments, it was recommended that a review should be performed to devise an investment policy giving due consideration to expected net flows, currency balance, inflation as well as investment simulations. It was recommended that such a review be undertaken with external assistance.

58. Comments from members included: clarification on whether IFAD sought the cooperation of the Food and Agriculture Organization of the United Nations (FAO); what exactly were the suggestions being proposed on the issue and what kind of paper would Management envisage developing.

59. Management clarified that the long-term nature of the liabilities associated with the ASMCS provides flexibility to invest over a longer term in more volatile instruments, as the funds are not immediately required. Potentially, this could mean higher returns on the plan's assets and less need for IFAD to transfer funds to meet funding shortfalls. It was further clarified that the document would not address medical costs, but would focus on investment policy for ASMCS plan assets. In response to the question of whether IFAD sought the cooperation of FAO, the Committee was informed that active information-sharing had been taking place with FAO and other United Nations agencies.

60. The Committee requested information on: how these funds are managed by similar organizations; what IFAD had done to date on this issue; and what Management would like to propose as changes, including the cost implications of the proposals. Management stated that this would be in the form of a document addressing the current status and implications of the suggested approach and would be presented for the Committee's review, together with the results of the study recommended by Management and now endorsed by the Committee.

61. The item was closed.

Oral update on developments with respect to the financial implications of housing the Global Mechanism of the United Nations Convention to Combat Desertification (UNCCD)

62. Management presented a paper, already circulated, which highlighted the current financial status and expectations for the future and made three main points:

- In accordance with the revised MoU, movement of staff to the UNCCD had taken place and all staff had received contracts as of 1 April 2013 with the United Nations office in Geneva.
- A transition plan is in place for the movement of accounts and handover of services.
- There had been no movement on the legal cases because, although GM staff had moved to UNCCD contracts, legal proceedings were still under way and had not been withdrawn.

63. Comments from the Committee included: requests for clarification on whether the figures presented in the paper had been revised from those presented a year earlier; whether there was a clause in contracts for the discontinuance of tribunal action; or whether the fact that contracts had been signed should mean closure of pending cases.

64. Management confirmed that the figures presented in the paper had been revised to take into account the actual number of cases, as the original figures had been estimates based on staffing levels. However, the figures remain consistent with the provisions made in the 2012 financial statements. The General Counsel declined to comment on the issue of litigation cases and the implication of the contracts being awarded.

65. The Chairperson took note of the status and stated that the Committee would appreciate being informed of any developments, especially new information on the legal cases, without having to make a specific request for such information. Management agreed to this request.

66. The meeting was closed.