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to overcome poverty

Report of the Chairperson on the 128th meeting of the Audit Committee

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Executive Board — 109th Meeting
Rome, September 2013

For: Review

Report of the Chairperson on the 128th meeting of the Audit Committee

1. The Audit Committee wishes to bring to the attention of the Executive Board the matters examined at the 128th meeting of the Committee held on 6 September 2013.

Adoption of the agenda

2. The agenda was adopted with the addition of an oral update on the status of the Global Mechanism under any other business.

Minutes of the 127th meeting of the Audit Committee

3. The minutes were approved subject to an addition requested by Management to include a statement reported under the oral update on the After-Service Medical Coverage Scheme (ASMCS). The statement related to the transfer of funds from IFAD's regular resources to the ASMCS Trust Fund. The change has already been reflected in the related report of the Chairperson on the 127th meeting of the Audit Committee to the Executive Board.

High-level preview of IFAD's 2014 results-based programme of work and regular and capital budgets, and the Independent Office of Evaluation of IFAD's results-based work programme and budget for 2014 and indicative plan for 2015-2016

4. Management presented the budget preview document, drawing the Committee's attention to the fact that the document was a high-level preview and that the final document presented in December would be based on detailed budget requests received from all IFAD departments.
5. Management highlighted that the original intention had been to present a 2014 budget with a minimal increase. However, implementing the action plan responding to the corporate-level evaluation of IFAD's institutional efficiency and efficiency of IFAD-funded projects (CLEE) had subsequently taken precedence. As a result, a large part of the proposed increase in the 2014 budget related to the additional cost of implementing CLEE recommendations as set out in the IFAD Consolidated Action Plan to Enhance Operational and Institutional Efficiency.
6. The Committee's attention was then drawn to the following key points in the high-level preview document:
 - (i) The planned programme of loans and grants for 2014 was set at US\$1.1 billion, compared to the 2013 forecast of US\$800million. The lending shortfall in 2013 would be covered by higher lending in 2014 and 2015 to reach the target of US\$3 billion set for the Consultation on the Ninth Replenishment of IFAD's Resources (IFAD9).
 - (ii) The 2014 strategic workforce planning exercise had made a clearer distinction between core staffing requirements and short-term or consultancy arrangements. The ongoing regularization of staff performing core functions into the regular budget was expected to increase in the regular budget.
 - (iii) An update was provided on the progress of the methodology to capture gender-based data from the loan portfolio and regular budget.
7. The Committee was informed of baseline cost drivers namely, an overall price increase of 2.1 per cent due to inflation and an anticipated 2.5 per cent potential increase in compensation for Professional staff, which would be absorbed. The other cost drivers, including the new rewards and recognition framework for staff, were highlighted.

8. The implementation of the CLEE recommendations would lead to information and communications technology (ICT) capital costs of US\$3.6 million, one-time adjustment costs of US\$3 million, and an increase in 2014 recurrent costs of US\$5.25 million.
9. The Committee was reminded that there had been either no or only minimal increase in the regular budget for several years. To take account of the CLEE action plan and other cost drivers noted above, the 2014 budget was set at US\$150.39 million, compared to a total of US\$144.14 million for 2013. The increase of 4.3 per cent or US\$6.25 million is broken down as follows:
 - (i) US\$3 million for incremental recurrent costs for the Loans and Grants System (inclusive of depreciation);
 - (ii) US\$2.25 million for other CLEE-related actions; and
 - (iii) US\$1 million for other non-CLEE cost drivers.
10. The capital budget for 2014 was proposed at an initial level of US\$5 million (US\$3.6 million relating to CLEE).
11. The Independent Office of Evaluation of IFAD (IOE) presented its section and confirmed that it reflected the first major change in the format and structure of its budget in 10 years, which were now aligned with those followed in the IFAD budget. This request for alignment was made by the Audit Committee.
12. The IOE budget provided details of actual expenditure for prior years and current utilization for 2013. The Evaluation Committee had reviewed a previous version of the preview document at its June session and expressed support for the programme of work and required resources. The Audit Committee was informed that inputs from the Evaluation Committee had been incorporated into the document under consideration, and that inputs from the Audit Committee and the Executive Board in September would be taken into account in the final submission to be made in October to the Evaluation Committee. IOE informed the Audit Committee that it had established a new selectivity framework to facilitate the formulation of the work programme. Among the activities foreseen under the work programme were: seven country programme evaluations, eight project performance assessments and one impact evaluation.
13. IOE had undertaken a strategic workforce plan, reviewing staffing numbers and grades, and concluded that there should be no changes to the current staff number.
14. IOE proposed a budget of US\$6 million for 2014, equivalent to a zero nominal increase with respect to the prior year.
15. IOE welcomed the IFAD Consolidated Action Plan to Enhance Operational and Institutional Efficiency. The CLEE had found IFAD's overall performance to be moderately satisfactory, noting that an improvement in performance to satisfactory or better was crucial. Clarification was also provided by IOE as to some apparent inconsistencies between the figures in Management's Action Plan and those appearing in IOE's comments.
16. The Chairperson of the Evaluation Committee highlighted the importance of increased dialogue between the Audit Committee and the Evaluation Committee. The Audit Committee was informed that the Evaluation Committee appreciated the document covering the IOE work programme and budget and the criticality of needs. The Evaluation Committee supported zero growth in budget, appreciated cost-cutting arising from efficiency gains, and supported the use of a 3 per cent carry-forward from 2013 for unforeseen activities. The Chairperson of the Evaluation Committee had also welcomed the consolidated action plan.

17. The Committee appreciated the presence of the Chair of the Evaluation Committee.
18. Comments from members included requests for more detailed justification for the increase in IFAD's budget and the benefits arising from the CLEE response. Members expressed appreciation for the inclusion of gender-sensitive budget data in the 2014 document and asked for further work in this regard. They also welcomed the improved format of the IOE budget.
19. Other comments included acknowledgement that a degree of budgetary increase would be necessary to implement the CLEE but additional information was sought on CLEE costs and on possible efficiency gains and savings as a result of Action Plan implementation. There was also a request for clarification as to the actual impact of potential salary increases in nominal terms and whether recommendations of the International Civil Service Commission (ICSC) were mandatory or discretionary. Clarification was requested on the reference to the "limited number" of staff to be rewarded under the new rewards and recognition framework, and on the quality and cost of consultants hired by IOE.
20. In particular, the Committee requested a detailed breakdown of staff costs and a document containing all the measures and actions undertaken over the last two years such as upgrades, staff regularization, etc. and indicating their financial impact on the 2014 budget.
21. With regard to the work programme, it was noted that insufficient information had been provided as to how IFAD plans to reach its cofinancing objective for 2014.
22. Management took on board all the comments made. On the issue of salary increases, in the unlikely event that the ICSC recommended a salary increase for Professional staff, funds set aside two years ago would cover such an increase. Management further stated that ICSC recommendations were generally followed.
23. On the rewards framework, Management clarified that this would apply to top-performing employees, which accounted for 15 per cent of staff.
24. The Chair wrapped up the item, noting the appreciation of Committee members. The additional information requested would be contained in future iterations of the document. The Chair referred to the need to work together with the Evaluation Committee on the consolidated action plan.

Establishment of the special expenditure budget for activities related to the replenishment of IFAD's resources

25. Management reminded the Committee that in February 2011 a special expenditure budget of US\$2 million had been approved by the Governing Council to fund the IFAD9 exercise. Of the approved amount, a total of US\$848,833 had been spent. After including an additional US\$100,000 to fund the mid-term review of IFAD9, the total cost would be US\$948,833, leaving a balance of US\$1.05 million. The savings were due to tight cost control and the fact that the costly external sessions originally planned did not take place.
26. Management proposed applying these funds to the IFAD10 exercise instead of requesting a separate appropriation for IFAD10. Management estimated that the unutilized balance would be sufficient to cover the cost of the IFAD10 exercise.
27. In the interests of streamlining the process, Management requested a delegation of authority from the Governing Council to the Executive Board to review and approve future appropriations of special expenditure budgets for IFAD replenishment exercises.
28. Members enquired whether this amount was included in the administrative budget, whether the savings had come from sessions not being held, and what

would be the implication if the balance was not sufficient to cover the IFAD10 exercise. Additional information on costs was requested.

29. Management clarified that the main source of the savings was the fact that all sessions had been held in Rome, meaning that no costs for external sessions were incurred.
30. The Committee agreed with the proposal.

Progress report on the workplan for IFAD's Office of Audit and Oversight for 2013

31. The Director, Office of Audit and Oversight (AUO) provided a report to assist the Committee in assessing the sufficiency and effectiveness of its function. The report provided information on the implementation of the workplan for 2013, status of audit recommendations and ageing of pending recommendations.
32. In response to the Audit Committee's request, additional information was provided on the system of rating used for audit opinions and the prioritization of audit recommendations. The status of audit assignments was reported; most of these were either completed or in progress.
33. As a result of its reduced staffing levels, AUO proposed an adjustment to its original plan, including postponement of an assignment due later in the year.
34. The following key performance statistics were highlighted:
 - 23 recommendations had been implemented during the first six months of 2013; and
 - 30 recommendations were overdue, of which only three were high priority.
35. The aging profile of recommendations remained stable compared to the prior year; overall, the number of outstanding recommendations had fallen significantly.
36. In the area of investigations, the Committee was informed that several cases had been concluded. The caseload of active cases was about 20. The need for additional resources was identified and Management had allotted funds accordingly in the midyear review of the budget.
37. Members requested clarification as to which assignments had been completed and whether AUO's request for an increased budget was part of the 2014 budget proposal.
38. The Director, AUO clarified that under the plan endorsed by the Executive Board, three assignments were still to be determined to allow sufficient flexibility to respond to emerging risks. The two performed to date involved audits of shipping services and payroll. The Director confirmed that the increase was included in the AUO budget submission for 2014.
39. With no further comments, the report was deemed reviewed.

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

40. At the 127th meeting of the Audit Committee, Management had been requested to enhance the document presented on the DSF and financial implications of grants.
41. In response, Management presented a paper encompassing the following:
 - additional information on the options for consideration with regard to practices adopted by other international financial institutions;
 - specific implications in terms of voting rights;
 - possible volume discounts for advanced payments;

- criteria as to which categories of donors were expected to contribute towards DSF compensation; and
 - a proposal for a minimum threshold of contributions for administrative efficiency purposes.
42. The remainder of the document focused on the review of the alternatives and recommendations for an approach to meeting the obligations to compensate IFAD for the shortfall on a pay-as-you-go basis. The impact of not covering the shortfall on IFAD's future operations and financial sustainability was highlighted.
 43. The Committee was informed that the contribution modality proposed from IFAD10 onwards would allow donors to either make single contributions from which their assessed DSF compensation would be deducted or they pledge separate amounts for DSF contributions and regular contributions.
 44. Finally, the document highlighted a range of conclusions and recommendations for the consideration of the Audit Committee and the Executive Board.
 45. Comments from members included recognition of Management's relentless hard work on the subject and the amount of progress made with respect to the previous versions; additional information on the forward-looking analysis; clarification on the meaning of the percentages cited to represent DSF compensation as a percentage of reflows compared to the percentages mentioned in the document presented to the Board in 2007; clarification on how long the organization could continue with the approximate level of 21 per cent of DSF grants relative to the programme of work and still break even; clarification on whether Member States should be considered donors and the overall impact of the "do nothing" option. Other comments included recognition that Member States would have to compensate IFAD for the principal repayments. Management was requested to streamline the document and eliminate repetition.
 46. Management clarified the trend in the proportion of DSF compensation to reflows and its steady growth over time related to the growing programme of loans and grants. On the "do nothing" option, Management clarified that Members were expected to honour their obligations towards IFAD as per the intention at the time of setting up the DSF. Management stated that the contribution modality mentioned did not change the overall contribution obligation of a donor, i.e. whether their contribution was made as a single contribution or as two separate contributions was irrelevant.
 47. Management was requested to revise the document to take into account the Committee's comments and present a fine-tuned version at the November meeting of the Audit Committee, which would subsequently be presented to the Executive Board in December 2013.

Update on progress in the development of the Loans and Grants System

48. Management presented the update, focusing on the history and current status of the Loans and Grants System (LGS) project.
49. The Committee was reminded of the original rationale behind replacing the current system, namely, its age (more than 15 years old), inability to support the current and future business needs of IFAD and the associated difficulties in making the required enhancements.
50. In 2011 the business requirements and the project scope were finalized. At the end of 2011, IFAD decided to run the project in two stages; the first stage covering the replacement of the current LGS and functionality for disbursement and debt service and data warehouse, and stage two covering the borrower portal and electronic withdrawal applications.
51. The Committee was informed of the following project timeline:

- (i) 2009: Market scan and revision of the business requirements.
 - (ii) 2010: Scope definition and finalization of the contract negotiations with Oracle
 - (iii) April 2012: Commencement of actual implementation.
 - (iv) End-September 2013: Provisional go-live date, subject to successful completion of the current user testing and approval of all stakeholders.
 - (v) November 2013: Go-live for the data warehouse.
 - (vi) 2014: Commencement of the implementation of the borrower portal and the withdrawal application
52. The project is financed by an approved multiyear capital budget of about US\$15.8 million. Current costs (as of 19 August 2013), including the pre-implementation phase, total US\$ 5 million, while the committed project cost amounted to US\$6 million. Post-implementation annual costs are envisaged to be around US\$1.68 million, in line with original estimates as presented to the Audit Committee and Executive Board.
53. Members requested confirmation of whether Oracle had agreed to swap two module licences for other licences and whether Management was in a position to make this swap.
54. Management stated that there was a good possibility that the swap would materialize. Management further stated that the probability of meeting the current target go-live date was 50 per cent. In the event of slippage of the 30 September provisional date, Management would postpone by one month.
55. The Committee took note and looked forward to another update at the next meeting.

Standard financial reports presented to the Executive Board

56. This item covered the Report on the status of the Ninth Replenishment of IFAD's resources, the Report on IFAD's investment portfolio for the first and second quarters of 2013 and the Status report on arrears in principal, interest and service charge payments. Management was invited to present an update to the status of contributions to the Ninth Replenishment and investment portfolio including proposed actions to mitigate adverse investment market conditions.
57. The Committee was presented with an oral update of contributions received since the date of the report.
58. The movements were as follows:
- (i) Additional pledges were received from Moldova, Uruguay and Peru. Pledges for the Ninth Replenishment amounted to US\$1.39 billion, or 93 per cent of the overall target.
 - (ii) Further instruments of contribution had been submitted from the United States. Instruments of contribution corresponded to 84 per cent of pledges.
 - (iii) Further payments had been received from Ghana, China, Mexico, South Africa, Belgium, Uruguay and the United States. Payments received as at 4 September 2013 totalled US\$ 700 million, representing about 50 per cent of pledges.
59. The Committee was informed that investments had been undertaken within the risk measures used for risk budgeting as set out in the Investment Policy Statement. At 30 June 2013 the conditional value at risk stood at 2.85 per cent, well within the risk budget level of 6 per cent.

60. The value of IFAD's investment portfolio in United States dollar terms decreased to US\$2.0 billion as at 30 June 2013, from US\$ 2.3 billion as at 31 December 2012.
61. This decrease was due to:
 - net outflows (as a result of increased disbursements);
 - negative investment income (unrealized market losses); and
 - foreign exchange movements.
62. Regarding the investment portfolio, the Committee was informed that as at 30 June 2013, the year-to-date net rate of return was minus 1.51 per cent, translating into a negative investment income amount of US\$35.8 million. This was due to difficulties in fixed income securities during the first six months of 2013.
63. Management provided an overview of the global government bond portfolio for the month of August with an estimated minus 1.6 per cent equivalent to a negative US\$32 million over the year and highlighted that the emerging market debt portfolio continued to perform poorly.
64. The Committee was reminded of the assessment of market trends undertaken by the Treasury Division at the end of 2012, which led to a query as to whether IFAD's investment portfolio had the most appropriate composition going forward. An asset class study was therefore instituted through a procurement action with a major investment house, Black Rock. The study highlighted the performance expectations of IFAD's type of portfolio (government bonds) under various economic conditions, stating that it performed better in periods of crisis and not so well in periods of economic recovery, which was the case in the current situation. Management stated that the losses were unrealized book losses as the bonds had not been sold.
65. The Committee was provided with background as to the composition of the IFAD investment portfolio and the historical gains made during the years of financial crisis and the conclusions reached after the investment strategy review in the first half of 2013. This also included a review of immediate-to-medium term liquidity needs that were taken into consideration in the proposed change to the investment composition. This included the near cash component to meet operational liquidity needs and longer-term durations such as bonds for other needs. This approach allowed IFAD to benefit from a better return on cash while committing to longer durations for funds not immediately needed. Management stated that this was within the existing Investment Policy Statement and did not need separate approval. Nonetheless the information was presented to assure the Committee that Management was not passive in the wake of the current negative return on the investment portfolio.
66. Comments from members included a request for a presentation of the investment results and plan to the Executive Board. Members also sought Management's opinion on the views expressed by consultants in the investment strategy review.
67. Management assured the Committee that the consultants were competitively selected through a tender process including a rigorous technical evaluation. While Management confirmed that the views expressed by consultants were valid and consonant with their independence and experience, there were no guarantees about their perception of the future.
68. The Committee noted that the report on the investment portfolio for the first two quarters would be presented to the Executive Board along with an additional document for information outlining Management's proposed plan of action.

Other business

69. Management presented an update on the Global Mechanism.
70. The Committee was informed of the plan currently in place for the handover of the financial services that IFAD had been providing to the Global Mechanism of the United Nations Convention to Combat Desertification (UNCCD). The plan was expected to be completed by 30 September 2013. Steps were already being taken to prepare the financial information for handover, including revising systems access.
71. The Committee was informed that some funds would be held in an escrow account pending the outcome of litigation cases. Other funds would be transferred to UNCCD to cover immediate needs and for business continuity.
72. The Committee noted the update.