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Enabling poor rural people
to overcome poverty

Applicability of performance audits to IFAD

Note to Executive Board representatives

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

For: **Information**

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Note to Audit Committee members

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Audit Committee — 127th Meeting
 Rome, 10 June 2013

For: **Review**

Applicability of performance audits to IFAD

Background

1. In response to the request of the Executive Board, at its 126th meeting, the Audit Committee requested Management to prepare a document on performance audits and their applicability to IFAD. The request was made in connection with queries raised by some Member States on the issue of IFAD engaging its external auditor to undertake such audits in addition to the statutory audit of IFAD's financial statements, and the potential costs and benefits of IFAD commissioning such audits. This document provides a technical explanation of performance audits and their application in United Nations system organizations and international financial institutions (IFIs).

Definitions

2. A performance audit examines the programmes, functions, operations, management systems or procedures of a governmental or non-profit entity to assess whether the entity is using available resources with economy, efficiency and effectiveness to achieve its objectives. The examination is objective and systematic and uses structured and profession methodologies.
3. The International Organization of Supreme Audit Institutions Auditing Standards 1.0.38 and 1.0.40 state the following:

The full scope of government auditing includes regularity and performance audit and performance auditing is concerned with the audit of economy, efficiency and effectiveness and embraces:

- (a) audit of the economy of administrative activities in accordance with sound administrative principles and practices, and management policies;
- (b) audit of the efficiency of utilization of human, financial and other resources, including examination of information systems, performance measures and monitoring arrangements, and procedures followed by audited entities for remedying identified deficiencies; and
- (c) audit of the effectiveness of performance in relation to achievement of the objectiveness of the audited entity, and audit of the actual impact of activities compared with the intended impact.

Financial audits versus performance audits

4. In defining financial and performance audits, the Development Assistance Committee of the Organisation for Economic Co-operation and Development (OECD/DAC) makes a distinction "between regularity (financial) auditing, which focuses on compliance with applicable statutes and regulations; and performance auditing, which is concerned with relevance, economy, efficiency and effectiveness."¹ Financial audits seek to express an independent opinion on the truth and fairness of an organization's financial statements. They check compliance with relevant and applicable accounting standards. Performance audits do not examine an organization's financial statements, they instead seek to express an opinion on how economically, efficiently or effectively an organization undertakes its programmes and/or functions and adds value by improving the programmatic performance of an organization.

Current experience of other IFIs

5. Currently, external auditors of IFIs perform only financial statement audits and assurance work regarding internal controls over financial reporting. Recently, consideration has been given to introducing performance audits as part of the external auditor's terms of reference in IFIs (see annex). It should be noted that in

¹ From Glossary of Key Terms in Evaluation and Result Based Management by OECD (2002).

most IFIs the statutory financial rules and procedures specifically preclude the provision by the external auditor of services other than financial statement audits and related work, such as reviews of internal controls over financial reporting.

6. The additional costs to be incurred as a result of such expansion in the scope of the work of the external auditor or recruitment of an external firm to carry out performance audits appear to be considerable in all cases reviewed. Therefore the cost implications are a significant factor in considering the introduction of a separate performance audit.

Performance audits in the United Nations system

7. In 1946 the United Nations General Assembly established the United Nations Board of Auditors (UNBOA) to audit the accounts of the United Nations organizations and its funds and programmes and to report its findings and recommendations to the Assembly through the Advisory Committee on Administrative and Budgetary Questions. The UNBOA derives its mandate to conduct performance audits from the financial regulations and rules of individual organizations, meaning that only organizations that include performance audits as part of their financial rules and regulations have performance audits conducted. The Board of Auditors may make observations with respect to the efficiency of the financial procedures, accounting system, internal financial controls and, in general, the administration and management of the organization as a result of the performance audit.
8. For example as part of the 2012-2013 workplan, the external auditors of the World Food Programme plan to undertake two performance audits: one on cooperating partners and another on the use of the cash and vouchers system.

IFAD's performance audit perspective

9. As an IFI, IFAD has adopted the same robust external audit and financial practices and standards as other IFIs and has similar audit and evaluation arrangements to the main IFIs and multilateral development banks. Operational and process performance at IFAD, as with the other IFIs, is independently assessed, mainly through the internal audit and independent evaluation functions, whereas the annual audit of the financial statements is conducted by an independent firm, hired on contracts renewable every year for up to five years. This mandate comes with terms of reference that currently exclude provision of services other than the audit of financial statements and review of internal controls over financial reporting on the grounds of independence, unless specifically requested by the Executive Board. The Executive Board may, if and when needed, sanction additional reviews on the relevance, economy, efficiency and effectiveness of the Fund where it is deemed that added assurance is needed over and above that provided by the work of the Independent Office of Evaluation of IFAD (IOE).
10. As per its charter, which was approved by the Executive Board, the IFAD Office of Audit and Oversight is mandated to carry out audits of the economy of administrative activities in accordance with sound administrative principles and practices and management policies, and the efficiency of the use of human, financial and other resources. These audits entail examination of information systems, performance measures, monitoring arrangements and procedures followed by audited entities in order to remedy identified deficiencies.
11. IOE is fully mandated to carry out performance audits, by assessing the relevance, economy, efficiency and effectiveness of projects and country programmes as well as corporate policies, strategies and business processes. IOE performance audits go one step further, as they also include an assessment of impact, sustainability, gender equality and women's empowerment, innovation and scaling up, and the performance of the lending agency (IFAD) and borrower. IOE's mandate is centred on the evaluation of IFAD-funded projects and programmes to assess their relevance and effectiveness. It is also entrusted with assessing IFAD's institutional and programme efficiency. In 2011, IOE hired the Emerging Markets Forum to

conduct the corporate-level evaluation on IFAD's efficiency. The purpose of the evaluation was to assess key determinants of IFAD's institutional efficiency as well as analyse the efficiency of IFAD-funded operations. This wide-ranging evaluation was completed in 2012 and the final evaluation report was considered by the 108th Executive Board session in April 2013.

12. IOE's evaluation approach is based on a coherent set of evaluation methodologies and tackles all areas cited in of the aforementioned OECD/DAC definition of performance audits. In addition, IOE submits an Annual Report on Results and Impact of IFAD Operations (ARRI), which constitutes in essence an annual performance audit of IFAD operations in all regions. IFAD is one of the few multilateral and bilateral organizations that produces such a report on aggregate-level performance each year. There is thus no need for an external agency to undertake an exercise that is potentially better performed by IOE. In Management's opinion, the independent evaluation function in IFAD effectively fulfils the function of performance audit.²
13. IFAD's Results Management Framework contains five levels of result indicators and level-five indicators that focus on IFAD's institutional efficiency in such areas as managing financial resources, human resources and risks, for example the ratio of actual administrative expenditures to the IFAD-funded annual programme of loans and grants. In addition, IFAD uses divisional/business process indicators, primarily as internal management tools for departments and divisions. These are developed and reported in quarterly performance reports and overall progress on these indicators is reported in the annual Report on IFAD's Development Effectiveness (RIDE). The Programme Management Department also carries out an annual project portfolio review of performance, which includes the aspects of effectiveness and efficiency. Similarly, all project completion reports (PCRs) examine the efficiency and effectiveness of the use of IFAD loan and grant funds. Conclusions are reported to the Executive Board through the RIDE document each year. Taken together, these indicators provide a comprehensive picture of IFAD's progress in meeting performance and efficiency targets.
14. In addition, the IFAD Evaluation Policy (2011) requires IOE to review and prepare written comments for the Board on each edition of the RIDE as well as validate all PCRs. This responsibility entrusted to IOE is intended to further strengthen the quality of the RIDE and PCRs, as well as bring to the attention of the Board areas that might require additional work to ensure better performance in the future.

Conclusion

15. IFAD is both an IFI and a United Nations specialized agency: its essential character is that of an IFI operating under the United Nations umbrella. It should be noted, however, that although IFAD operates under the United Nations umbrella, this does not mean that all United Nations rules apply in all cases.
16. In terms of governance structure, including financial accounting standards and reporting, IFAD has adopted an IFI approach rather than the approach followed by the United Nations. Similarly, IFAD follows the practices of IFIs regarding performance audits, which are covered by the independent evaluation function and internal audit unit rather than by external auditors, as is the case in the United Nations system; in particular, the ARRI report produced annually by IOE provides the findings of the basic annual independent performance audit conducted by IFAD.
17. Furthermore, introducing additional performance audits could raise governance issues as to who would be responsible for the exercise and how it should be

² For example, IOE conducts project performance assessments, which are de facto project performance audits. The independent evaluation offices in other multilateral development banks (e.g. the Asian Development Bank and the African Development Bank) conduct such assessments using broadly the same evaluation criteria used by IOE, although the names of such reports vary, for example project performance evaluations, project performance audits and project performance assessments.

conducted. It would also have cost implications that might be difficult to justify, especially taking into account existing systems and processes in place within IFAD.

18. In adopting International Public Sector Accounting Standards (IPSAS) – which require annual auditing of financial statements rather than biannual as per past practice – United Nations agencies have themselves recognized that the current practice of conducting performance audits may change. Among the expected effects of the United Nations implementing the IPSAS are recurring costs such as (i) incremental annual audit costs, though the increase in the frequency of financial statement audits might result in a reduction in the number of performance audits undertaken by the external auditor annually; (ii) the annual costs of commissioning external expertise (including for evaluations); (iii) ongoing staff training, including on IPSAS updates; and (iv) the biennial contribution to the jointly financed activities of the United Nations IPSAS Task Force.
19. On the basis of the above, IFAD Management considers that the current governance and operating frameworks in place are adequate and fulfil the same function of an independent performance audit. The recent corporate-level evaluation of efficiency complemented IOE's ongoing work and IFAD's internal guidelines and procedures and effectively covered the scope of a standard performance audit. It is therefore felt that there would be no value added to justify the potentially significant additional costs of undertaking separate performance audits.

Performance audit practices at other IFIs

1. At the African Development Bank and within the World Bank Group, audit work is covered by different areas of the organization such as internal audit, the budget unit (ensuring efficient use of resources) and more importantly, on the operations side, the financial management and post-evaluation departments. Both institutions consider that these functions cover most of what could be realized from a performance audit. External auditors are not allowed to carry out any non-audit work, except such work as is determined to be in the interest of the organization with clear evidence that such work can only be carried out by them; such cases must be specifically approved by the Board of Directors.
2. At the European Investment Bank (EIB), performance audits are considered outside the remit of the external auditor for many reasons; among these, the view that a standard audit team would lack the necessary skills set. Internal audit also reviews performance as part of their normal assignments. Significantly, the Operations Evaluation Department carries out ex post evaluations, and it ensures transparency by carrying out thematic, sector, regional and country evaluations of projects for the EIB's governing bodies and for interested outside parties.
3. The International Monetary Fund's external auditors do not conduct performance audits and do not have the capacity to do so. Neither are the external auditors permitted to perform any non-audit-related work; audit-related consulting services are subject to the prior approval of the Executive Board.