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Enabling poor rural people  
to overcome poverty

## Report of the Chairperson of the 129<sup>th</sup> meeting of the Audit Committee

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Executive Board — 110<sup>th</sup> Meeting  
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For: **Review**

## Report of the Chairperson on the 129<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 129<sup>th</sup> meeting of the Committee held on 21 November 2013.

### **Adoption of the agenda**

2. The agenda was adopted with the addition of a proposal to review the recommendations of the corporate-level evaluation on IFAD's institutional efficiency and efficiency of IFAD-funded operations (CLEE) related to the Audit Committee under the item other business.

### **Minutes of the 128<sup>th</sup> meeting of the Audit Committee**

3. The minutes were approved without comments.

### **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. The Committee's discussion of this item is covered in a separate report (EB 2013/110/R.3).

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

5. Management presented the background and rationale for the Investment Policy Statement. The first annual review conducted in 2012 resulted in a reduction in the risk budget from 10 per cent to 6 per cent. The current year's review generated no significant changes, however streamlining of some parts of the document was proposed, for example on the President's approval authority in the risk budget. More specifically, it was clarified that the overall risk budget (currently 6 per cent), which is a quantification of the stakeholders' risk tolerance and investment objectives, would be approved by the Executive Board, as per current practice. Within this overall limit, it was the President's responsibility to approve the risk budgets of individual investment portfolios.
6. Other changes were as follows:
  - (a) Changes to annex I and introduction of a new annex (annex II) to separate the overall risk budget from individual investment portfolios;
  - (b) Streamlined wording and definition of the investment objective "security" to align it to the risk budget approach;
  - (c) Updated definition of the asset classes and definition of IFAD's investment portfolios;
  - (d) Changes to annex III to reflect recent investment strategy implementation;
  - (e) Clarified time horizon of IFAD's investment portfolio; and
  - (f) Clarified responsibilities for operational cash management.
7. In answer to various requests for clarification from members, Management explained that:
  - The difference between asset class and portfolio is that asset class refers to a category of investments like bonds or their subsectors – such as those issued by governments and by corporates – whereas a portfolio is a group of asset classes.
  - The security and conservation of asset value is in nominal terms.

- The level of conditional value-at-risk (CVaR) of 95 per cent is industry standard, and 6 per cent CVaR at 95 per cent confidence level roughly means that there is a 95 per cent probability that the portfolio will not lose more than 6 per cent of its value within a one-year time horizon or, in turn, the likelihood that the portfolio will lose more than 6 per cent over a one year time horizon is 5 per cent.
  - The Investment Policy Statement is submitted for Board approval, while the Internal Control Framework is presented to complete the picture and is provided only for information.
  - The Executive Board is presented with an overall global picture of investments and individual portfolios while internal reports deal with individual asset classes and every type of investment.
8. The Committee requested that Management provide the Executive Board with an introduction summarizing changes and indicating the rationale for purposes of clarity. Further clarification was sought as to the source of the losses if IFAD's investments were in fixed income securities; why the wording of the frequency of reconciliations was changed from "daily" and what the new reconciliation frequency would be. Clarification was requested on the removal of the wording with respect to negative return not being tolerated and on Management's frequency of follow up with fund managers.
  9. The Committee was informed that the Fund's portfolio is divided into two distinct portfolios in terms of accounting treatment. The internally managed portion is mainly held to maturity. It is hard to incur losses on this part of the portfolio on a book basis. Held-to-maturity portfolios retain book value in the accounting book regardless of market price movement. The other part is managed by external fund managers with agreed mandates and guidelines within which they make investment decisions. The accounting treatment of externally managed IFAD portfolios is mark-to-market where the value of the portfolios reflects prevailing prices of the security holdings in the accounting record even when the securities are not sold at the price and hence with no loss being realized. Management further clarified that the focus of IFAD investment is on ensuring liquidity to meet disbursement obligations, while the highest possible return within the approved risk budget is also sought. Each portfolio and asset is monitored on a monthly basis.
  10. The Committee was assured that Management maintains close monitoring of external fund managers through daily contact by the Treasury Services Division as necessary, close risk control with quantitative risk measurement and qualitative guideline monitoring based on monthly reports produced by the Financial Planning and Risk Analysis Unit, and internally produced evaluation sheets and communication in writing on a quarterly basis.
  11. The frequency of reconciliations is generally monthly for investments and daily or as needed for cash management. It was agreed that the sentence referring to daily reconciliation would be divided into two to clarify the fact the two issues are being addressed.
  12. **The Chairperson concluded by asking that changes to the document be made to clarify the frequency of reconciliations and to ensure that the wording regarding the issue of negative return on the portfolio reflects Management's efforts to minimize the risk of negative returns. The Chairperson noted that the document had been reviewed by the Committee and would be presented to the Board in December for approval along with the Internal Control Framework for IFAD Investments, which would be provided for information.**

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

13. The Committee welcomed the document, noting that it reflected the requests for clarification made at the previous Audit Committee meeting and that it had been further streamlined. The Chair suggested that the US\$10,000 threshold for contributions be applied only to List C countries, as a matter of principle, as Lists A and B made contributions to regular replenishments. Members requested clarification on the nature of costs incurred in processing contributions of low value. With regard to section VI of the document (Proposed contribution modalities), members questioned options 2 and 3 as they were not consistent with the principle of "pay as you go" approved by the Board, and with the general thrust of the document. It was felt that the presentation of all three options would cause confusion. As a consequence, the Committee agreed unanimously to retain only the first option, which was also the one followed by the International Development Association, African Development Fund and Asian Development Fund, and requested that the other options be removed from the document.
14. The Committee noted that the threshold applicability appears to be a one-time scenario as the contribution amounts would increase from the Eleventh Replenishment of IFAD's Resources onwards. Members agreed with the proposal to apply the US\$10,000 threshold only to List C countries also considering that – as indicated by Management – the costs of dealing with small contributions were mainly administrative and were not envisaged to be prohibitive.
15. **The Chairperson summarized the Committee's recommendations as follows:**
  - **In section VI (Proposed contribution modalities), Management should present only one option to the Board for approval, namely option 1 in the current document; and**
  - **that the recommendation relative to the application of the US\$10,000 threshold should be revised to reflect that the threshold would be applied only to List C countries.**

**With the above recommendations, the Committee endorsed the document's presentation to the Executive Board.**

#### **Workplan for the IFAD Office of Audit and Oversight for 2014**

16. The Director, Office of Audit and Oversight (AUO) presented the proposed AUO workplan for 2014, stating that it was aimed at supporting Management in meeting institutional goals, contributing to a more efficient and effective organization and strengthening the ethical and anticorruption culture of the Fund.
17. The Committee was informed that the final budget proposal included an additional Professional staff resource for six months to work primarily on anticorruption efforts. The non-staff resource proposal increased to US\$200,000 in 2014. The proposed budget increase would mitigate the impact of the departure of the two associate professional officers, whose term ended in September this year. The unpredictable nature of investigations could necessitate requesting additional financial resources from Management during the year.
18. In answer to requests for clarification, the Director AUO advised that external expertise was utilized in specialized areas or where up-to-date skills were required and where it would be beneficial and in line with the professional standards of internal audit. On the selection of assignments, the Committee was informed that the process was based on a risk assessment exercise. The entity-level control environment and the delegation of authority assignment was found to be high priority in that addressed both efficiency and clarity of accountability in an environment undergoing decentralization. The other high-priority assignment identified was the administration of consultants. On the issue of synergies and

independence, the Committee was informed that AUO works with Management in identifying risks, planning audits, formulating recommendations and ensuring that they add value to the organization in a way that is valuable to Management, while maintaining the office's independence.

19. **The AUO workplan was deemed reviewed and would be submitted for confirmation to the Executive Board at its session in December 2013. Further to consideration of the final report on the special expenditure for reform actualization, the Committee requested that an audit of this expenditure be included in the AUO workplan for 2014. This proposal would be presented to the President for consideration accordingly.**

**Audit Committee work programme for 2014**

20. The Chairperson introduced the work programme, noting the item on the CLEE recommendations related to the Audit Committee that had been included on the agenda for the July meeting. The Chairperson indicated her wish to begin this discussion at the current meeting, under the other business agenda item. In answer to a query from one member, it was clarified that the Audit Committee does not play a role in the Replenishment Consultation.
21. **In conclusion, the Audit Committee adopted the work programme as presented. Further to discussions on the CLEE recommendations related to the Audit Committee, an additional item on the disclosure of Audit Committee documents should be submitted to 130<sup>th</sup> meeting of the Committee in March 2014. The Audit Committee work programme would be revised accordingly.**

**Project audit reports for fiscal year 2012**

22. Management informed the Audit Committee of the fifth financial management forum, organized by IFAD, which emphasized the importance of experience sharing and exchange of best practices among projects.
23. Management gave an overview and update on the situation of project audit reports and the related activities performed by IFAD in 2012. The proportion of qualified and unqualified audit opinions remained stable, at around 80 per cent unqualified and 20 per cent qualified. It was noted that a qualified audit opinion was not always a sign of fiduciary issues; sometimes it stemmed from technical issues. Moreover, an unqualified opinion could hide serious fiduciary issues, which rendered Management letters and project audit reviews essential instruments in discharging IFAD's fiduciary responsibilities.
24. The Committee was further informed that there had been a decrease in the timely submission of audit reports from 59 per cent in 2011 to 45 per cent in 2012. Generally, audits performed by private audit firms continued to be submitted more punctually than those prepared by supreme audit institutions. Some 30 per cent of IFAD's project audit reports were prepared by supreme audit institutions. For all significant control issues, time-bound implementation action plans were put in place and monitored during supervision missions or on an ad hoc basis as required.
25. Management informed the Committee of the accomplishments of 2012 as follows:
- (a) All project financial management had been centralized and consolidated within the Financial Operations Department;
  - (b) Risk-based disbursement had been introduced as an assurance framework governing financial management; and
  - (c) More than 50 per cent of projects showed high performance in terms of financial reporting preparation and audit report quality.

26. Five corporate forums on financial management for projects and other key stakeholders had been undertaken with the objective of enhancing financial management capacity and awareness of best practice.
27. In addition, following the Audit Committee's recommendations last year, Management reported that a grant had been designed in support of capacity-building of supreme audit institutions in the West and Central Africa region. Furthermore, IFAD had developed procedures, resources and guidance material, including the deployment of an e-learning tool dealing with basic financial management principles and practices.
28. Management indicated that significant progress had been made in the area of financial management, although challenges remained and progress in other areas would be of a medium- to long-term nature, also because of the limited resources available in the Controller's and Financial Services Division.
29. **The Committee acknowledged and appreciated the progress made in this area and urged Management to keep up its efforts to enhance the overall quality of project financial management.**

#### **Final report on the special expenditure for reform actualization**

30. In accordance with Governing Council resolution 169/XXXV, Management presented a report for approval by the Executive Board and eventual submission to the Governing Council session in February 2014.
31. The funds made available to implement the outcomes of human resource (HR) reform initiatives had been fully spent in four main areas:
  - (a) Funding the job audit exercise;
  - (b) Implementing improvements in certain core HR areas on the recommendation of the job audit consultants and completing related HR reform initiatives.
  - (c) Providing specialized training for IFAD staff, primarily related to improving internal mobility; and
  - (d) Funding an early separation programme.
32. It was recalled that, at its meeting in November 2012, the Committee had requested that an audit be conducted by AUO on this expenditure. In response, the Director, AUO explained that the audit had not been included in the AUO 2013 workplan confirmed by the Executive Board on account of two considerations: (i) the bulk of the expenditure had not yet been incurred at that time and was expected to be incurred in 2013, and (ii) the audit was of a financial nature and hence mainly the mandate of the external auditors and, as such, it was felt that this expenditure could be covered in coordination with the external auditors as part of the audit of IFAD's financial statements for 2013.
33. **The Committee noted the final report and requested that a specific audit on the special expenditure be conducted by AUO.**
34. **The Director, AUO, stated that in accordance with the terms of reference of the Audit Committee, the Committee may make proposals for amendments to the AUO workplan for the consideration of the President. Therefore, the Committee's request would be submitted to the President and the workplan would be brought to the Executive Board in December for confirmation.**

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

35. Management presented an update on the Loans and Grants System replacement project and informed the Committee of the successful completion of phase 1: the legacy LGS system had been replaced and both the Flexcube system and the data warehouse reporting solution were now live and operational. No major issues had

arisen to compromise the integrity of the system, IFAD operations or system data so far, although certain areas had experienced inefficiencies given the limited customization strategy adopted in rolling out the system.

36. The total approved budget of the project was US\$15.74 million. The overall cost of the project to date, including all committed costs until 31 December 2013 for the completion of phase 1, was estimated at US\$6.9 million. Approximately US\$8.8 million would be dedicated to phase 2 of the project.
37. The Committee was informed that phase 2 activities were expected to begin in 2014, after the phase 1 stabilization period.
38. Management would keep the Committee updated on the progress of key phase 2 activities.
39. **The Committee noted the update, congratulated Management for the successful completion of phase 1. The Committee welcomed Management's assurance that the resources included in the administrative budget for 2014, amounting to approximately US\$2.3 million, were sufficient to cover system maintenance costs.**

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

40. Management updated the Committee on the status of the housing arrangement with the Global Mechanism, highlighting key milestones that have been accomplished as per the plan communicated to UNCCD. These steps were as follows:
  - (a) Financial information and accounting records had been transferred and handed over to UNCCD in order to assist them in assuming the accounting and reporting functions. A statement of resources was available to show the financial position as at the date of handover on 30 September 2013.
  - (b) Residual balance of cash after setting aside funds to be transferred into an escrow account and cash to cover payment of travel and other advances amounting to US\$1.4 million had been transferred to UNCCD on behalf of the Global Mechanism in October 2013.
  - (c) An escrow bank account had been set up, into which an amount of US\$4.58 million had been transferred in November 2013 to cover potential costs of pending litigation cases for the staff of the Global Mechanism, invoices from FAO disputed by the Global Mechanism, and a provision for possible contingency.
  - (d) Finally, a transfer of US\$355,000 had been made to cover travel and other advances due to IFAD on behalf of Global Mechanism staff.
41. The Committee was informed of IFAD's intention to keep this measure as temporary as possible. The conditions under which the escrow account would be closed and funds handed back were provided as follows:
  - (a) Withdrawal of litigation cases and settlement of advances and other liabilities;
  - (b) Obtaining a guarantee from UNCCD to reimburse IFAD for any costs arising from these potential liabilities;
  - (c) Third party guarantee.
42. The Committee was assured that these measures had been taken to enable Management to exercise its responsibility to safeguard the assets of the Fund. The Committee was further informed that, as decided by the recent Conference of Parties, the Global Mechanism would transfer to Bonn by March 2014. A working

group had been set up between UNCCD and IFAD to work out an arrangement to address the legal liabilities and establish a joint approach for other issues.

43. An update was requested on the status of the investigation on the Global Mechanism being carried out by AUO. The Director, AUO, informed the Committee that he would bring this request to the President's attention as authority to disclose information in this respect rested with the President.
44. **The Committee noted the update provided and recommended that the President be informed that the Executive Board should be updated on the status of the investigation being carried out by AUO. The Committee requested regular updates on the progress of the UNCCD/IFAD working group in addressing legal issues and other issues related to the smooth transition of the Global Mechanism from IFAD to UNCCD.**

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

45. Management presented four reports for the Audit Committee's review:
- (a) **Report on the status of contributions to the Ninth Replenishment of IFAD's Resources**
  - (b) **Resources available for commitment**
  - (c) **Report on IFAD's investment portfolio for the third quarter of 2013**
  - (d) **Status report on arrears in principal, interest and service charge payments**
46. With regard to the status of the contributions to IFAD9, Management presented an update on contributions since the issuance of the report. An additional pledge had been received from Kazakhstan. IFAD9 pledges therefore amounted to US\$1.39 billion, equal to 93 per cent of the overall target for donor contributions.
47. Instruments of contribution corresponded to 90 per cent of pledges. Management reminded Member States whose instruments of contributions were now overdue to take the necessary measures.
48. Further payments of contributions had been received from Italy, Ireland, Madagascar, Mauritius, Republic of Moldova and Kazakhstan. Payments received as of 20 November 2013 totalled US\$768 million, representing 55 per cent of pledges.
49. A member commented on the relationship between the amount representing resources available for commitment and the programme of work.
50. Management clarified that resources available for commitment included only those resources that flow into projects from IFAD's regular Replenishment and did not include supplementary funds or other funds.
51. Management presented an update of the investment portfolio performance, reporting a slight improvement in the third quarter over the first half of the year such that, at the end of the second quarter, the net performance was approximately minus 1.7 per cent and at end of the third quarter, it stood at approximately minus 0.7-0.8 per cent.
52. **The reports were reviewed with no further comments.**

**Other business**

53. Under other business, the Committee initiated the discussion on the CLEE recommendations related to the Audit Committee. The three recommendations under consideration were as follows:
- i. Disclosure of documents submitted to the Audit Committee;
  - ii. Use of external expertise to support Audit Committee work; and
  - iii. Enhancement of the Audit Committee reports to the Executive Board.



54. Management informed the Committee that, in terms of disclosure to membership, Executive Board representatives were able to access Audit Committee documents through the Member States Interactive Platform by using their personal user identification and passwords, and that the Committee would review the recommendation for further public disclosure of Committee documents. Members noted the sensitivity of confidential issues and documents discussed by the Audit Committee and requested that a document reviewing practices at other international financial institutions in this regard be presented at the March 2014 meeting of the Audit Committee for consideration.
55. On the use of external expertise, the Committee indicated the need to avoid unnecessary costs. The Committee underscored its ability to access external expertise if needed, as contained in the Terms of Reference of the Audit Committee. Overall, the Committee felt that the current arrangement was acceptable and, if required, it would be prepared to access outside expertise on a case-by-case basis.
56. On the last recommendation, the Chairperson indicated that work was ongoing with the Secretariat to identify ways to improve Committee reporting and to ensure that reports were more focused.
57. **In conclusion, the Committee agreed:**
- **To further consider the issue of disclosure of Audit Committee documents at its meeting in March 2014, based on a document to be prepared by Management;**
  - **That the current arrangement whereby external expertise could be accessed by the Committee as required was sufficient; and**
  - **That every effort should be made to ensure that the Committee's reports were focused and major issues and recommendations were highlighted.**