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Report of the Chairperson of the 132nd meeting of the Audit Committee

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Executive Board — 112th Meeting
Rome, 17-18 September 2014

For: Review

Report of the Chairperson on the 132nd meeting of the Audit Committee

1. The Audit Committee wishes to bring to the attention of the Executive Board the matters examined at the 132nd meeting of the Committee held on 3 July 2014.

Adoption of the agenda

2. The agenda was adopted with the following changes:
 - Removal of the item on oral update with respect to the financial implications of hosting the Global Mechanism;
 - Removal of the item on the Update on progress in preparing a General Framework for Borrowing by IFAD, which would be dealt with at the informal meeting of the Audit Committee; and
 - Addition of an item on the Audit of Global Mechanism accounts for 2013 under other business.
3. Members wished to know why some documents were provided only in English. It was clarified that documents from external auditors were not translated.

Minutes of meetings of the Audit Committee

4. The Chairperson invited comments from members on the minutes of the 130th and 131st meetings of the Audit Committee held on 24 and 28 March 2014 respectively.
5. With regard to paragraph 14 of the minutes of the 130th meeting, the Committee agreed to reword the sentence regarding credit rating to state that "The Committee was also informed that the proposal to have IFAD credit-rated would need to be examined, also in the light of cost implications."
6. In response to a request, Management agreed to revise the 131st meeting minutes to reflect the clarification provided by Management regarding the cash outflow amount under the item "receipts from investments."
7. The Committee discussed a member's request to be given access to the Audit Committee verbatim records for the current and previous years, in order to facilitate preparation for meeting discussions. The Secretary of IFAD informed the Committee that the minutes were the only official record of Committee meetings and that the verbatim transcripts served as a tool for the Secretariat and members in finalizing minutes. At the discretion of the Committee some of the verbatim records might be made available; however, the Secretary recalled the sensitive nature of such transcripts and the need to ensure that these were not publicly disseminated in order to protect the integrity and openness of proceedings. The Committee concurred with this view and agreed to grant access to the verbatim transcripts as requested.

External auditor's report on internal controls and accounting procedures and External Auditor's audit strategy memorandum for the year ending 31 December 2014.

8. The external auditors, Deloitte, presented the internal control and accounting procedures report stating that the recommendations included had arisen during the course of the audit for the year ended 31 December 2013. None of the recommendations had given rise to a qualification of either their audit opinion on the consolidated financial statements or Management's assertion over the effectiveness of internal control over financial reporting.
9. Arising from the 2013 audit, one issue of medium priority had been identified relating to manual operations surrounding the payroll and financial reporting preparation processes, with a recommendation for process automation to minimize manual activities and mitigate the related risk. Recommendations from the prior

year relating to integration of PeopleSoft and the Loans and Grants System, Treasury control activities and IT access rights for employees had been fully implemented. Two recommendations pertaining to change management and IT security had been partially implemented.

10. In presenting the strategy memorandum, the audit partner informed the Committee that the plan and scope of work were largely the same as the previous year except for some external factors that affected IFAD, and these had been taken into account.
11. The key risks identified were similar to those of the previous year, including fair value calculation on loans, valuation of financial assets, Debt Sustainability Framework (DSF) accounting, revenue recognition and, as a matter of standard procedure, Management override with a specific focus on Management judgement or estimation.
12. Management confirmed the recommendations stating that enhancement measures to address the recommendation had been planned and implementation was under way. With regard to the 2012 recommendations that had been brought forward and partially implemented, Management confirmed that the issue of change management would be implemented by the end of September 2014, while the matter of IT Security required additional resources and would be completed by 2015.
13. Members wished to know why some of the recommendations (such as for process automation in order to minimize manual activities) were issued by external auditors instead of internal auditors. Members requested details of timing and expected completion dates for the process automation projects.
14. The external auditors clarified that the issues they encountered in the course of their work were reported to Management with a view to adding value. The Director, Office of Audit and Oversight (AUO) assured the Committee that their audit exercises resulted in similar observations and that these observations were included in internal audit reports.
15. Management informed the Committee that the payroll automation projects were expected to be completed in early 2015. With regard to the financial statements preparation process, implementation of some measures would begin this year but solutions were still being explored. Completion dates would depend on the solution chosen.
16. **The Committee noted the contents of the reports.**

Standard financial reports

17. Management presented the report on IFAD's investment portfolio for the first quarter of the year, highlighting that the investment portfolio had increased in value by US\$53.1 million between end of 2013 and 31 March 2014. The key reasons were positive net flows, investment income, and foreign exchange movements. During the period, the investment portfolio had generated positive net investment income of US\$19.8 million which corresponded to a positive net rate of return of 0.99 per cent. All four externally managed asset classes performed positively and all the risk parameters remained below the budget levels as stated in IFAD's Investment Policy Statement.
18. Management went on to comment on performance since the first quarter, highlighting the continued positive trend witnessed in April and May. The Committee was informed that Management had started the yearly revision of the Investment Policy Statement. This would be submitted to the Committee in November and to the Executive Board in December 2014.

19. The Committee was informed that at the end of the first quarter the investment portfolio had returned about 1 per cent and at the end of the second quarter it had returned about 2 per cent. However it was not possible to extrapolate as market conditions could change either way.
20. Members requested clarification on: whether a 1 per cent return in the first quarter could be annualized to equate to 4 per cent for the full year; how unrealized income became realized; what percentage of overall investment income pertained to emerging market bonds; and whether the portfolio duration was just slightly higher than the benchmark as matter of policy or was this an anomaly.
21. Management clarified that achieving an investment return of 1 per cent in the first quarter could not be extrapolated to imply a likely full-year return of 4 per cent. Markets were uncertain and did not follow a constant path. Unrealized gains related to paper losses or gains that arose from valuations carried out at the end of an accounting period. Once the underlying investments were actually sold, unrealized gains or losses become realized. Management further clarified that 42 per cent of the total investment income related to emerging market bonds. In terms of the other asset classes, global diversified fixed income brought in 23.6 per cent of the total return, and inflation-linked bonds around 22.4 per cent, together accounting for 46 per cent. Management further clarified that managers could decide in their active management of IFAD resources to opt for a longer or shorter period than the benchmark. This decision reflected the views of the managers; they could move outside of the benchmark within a buffer which was specified in the guidelines. The guidelines were monitored on an active basis.
22. **The Committee noted the contents of the report.**

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

23. The Committee was informed of the implementation status of the Loans and Grants System and reminded of the fact that the new system had gone live in mid-November 2013. The last eight months had been spent embedding the system within the organization and ensuring business process alignment. Some enhancements had been identified and these would be introduced into the system. A total of US\$15.76 million had been allocated to the replacement project, US\$7.3 million had been spent to date, and going forward there would be more expenditure on enhancements; cost estimates were in the process of being developed.
24. **The Committee noted the update without further comments.**

Other business

Audit of the handed-over balances of the Global Mechanism by Deloitte

25. Management presented a request to the Committee to consider granting clearance for the United Nations Convention to Combat Desertification (UNCCD) to engage Deloitte in the audit of the Global Mechanism's accounting records and balances, which were handed over to UNCCD at the end of September 2013. Management explained that a contractual clause precluded Deloitte from offering any services other than the audit of financial statements for IFAD and hosted entities.
26. The Committee granted clearance for UNCCD to engage Deloitte for this exercise with the scope to be agreed. No further clearance was needed from the Committee in this regard.