

Document: EB 2014/113/R.22
Agenda: 11(a)
Date: 11 December 2014
Distribution: Public
Original: English

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Investing in rural people

Report of the Chairperson on the 134th meeting of the Audit Committee

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Executive Board — 113th Meeting
Rome, 15-16 December 2014

For: Review

Report of the Chairperson on the 134th meeting of the Audit Committee

1. The Audit Committee wishes to bring to the attention of the Executive Board the matters examined at the 134th meeting of the Committee held on 24 November 2014.

Adoption of the agenda

2. The agenda was adopted with the addition of a short information note on the effect of the strengthening of the United States dollar on the 2014 financial accounts under the item other business.

Minutes of the 133rd meeting of the Audit Committee

3. The minutes were approved without comments.

IFAD's 2015 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 2015 and indicative plan for 2016-2017

4. The Committee's discussion of this item is covered in a separate report (EB 2014/113/R.3).

Workplan for IFAD's Office of Audit and Oversight for 2015

5. The Director, Office of Audit and Oversight (AUO) presented the proposed AUO workplan for 2014, stating that the selection of audits for 2015/2016 was based upon an assessment of corporate risks and priorities. Emphasis would be placed on developing a remote audit approach for IFAD country offices (ICOs) to allow the expansion of audit coverage within the resource envelope available to AUO. The proposed plan was designed to support Management in meeting institutional goals and to contribute to a more efficient and effective organization.
6. The Committee was informed that in the investigations area efforts would focus on the upgrading of the investigation and sanctions mechanism, based on the results of the recently concluded external review, and that AUO's anticorruption awareness-raising activities would be intensified.
7. The Director, AUO, further explained that the proposed AUO budget allocation for 2015 was at the same level for staff costs as 2014, with an increase in non-staff costs. This provided flexibility to use external resources in the area of both audit and investigations.
8. The Committee was assured that a progress report would be submitted in September 2015 to inform the Committee of any necessary changes introduced to the plan.
9. Members agreed to the workplan and requested clarification on: the extent to which the results of the audits of the different ICOs were compared in order to identify systemic issues; and the possible role of AUO with respect to the review of the General Framework for Borrowing including any risk assessment undertaken of the capacity of the Financial Operations Department (FOD) or assessment of IFAD's risk management capacity to manage the borrowing.
10. The Director, AUO clarified that comparisons were made between the results of audits of the different types of country offices and that common themes were addressed in the audit review. He also explained that AUO conducted an overall risk assessment when determining its workplan and that the additional processes associated with the General Framework for Borrowing would be included in this risk assessment. The Committee was informed that an AUO audit report issued in early 2014 on the internal management of investments had deemed the controls in this area to be satisfactory.

11. Management described the improvements that had been undertaken in the area of risk management of the investment portfolio as follows: creation of a separate unit for Financial Planning and Risk Analysis in 2013 and ongoing work to develop a risk management framework and more complex cashflow models.
12. The AUO workplan was deemed reviewed and would be submitted for confirmation to the Executive Board at its 113th session in December 2014. The Chairperson highlighted the possibility of adjustment of the AUO workplan to address additional risk deriving from the implementation of the General Framework for Borrowing during 2015 or 2016.

Annual review of IFAD's Investment Policy Statement

13. Management presented the background and rationale for the Investment Policy Statement. The 2014 revision aimed to further consolidate policy provisions by introducing a single credit quality limitation at investment grade for all asset classes.
14. Other changes were as follows:
 - (a) The limitation of the eligibility of asset classes to certain portfolios had been eliminated;
 - (b) The operational cash asset class had been renamed as working capital.
15. The Committee requested clarification on how the Fund managed its currency exposure.
16. Management explained that potential currency exposures of the Fund lay in two areas: the matching of assets and liabilities, and the management of currency cash flows. The former was mitigated by balancing the investment portfolio back to special drawing rights (SDR) to match the undisbursed liabilities related to loans, which were all currently denominated in SDR. In the case of the latter, currently all loans were denominated in SDR and hence the currency of disbursement and repayment did not create foreign exchange exposure. Should IFAD offer single currency loans then such an exposure would be created. Therefore, the Fund had commissioned a World Bank study to provide an assessment of the currency hedging of IFAD and to share the experience of the single currency lending pilot project at IDA.
17. The Chairperson invited Management to present an introductory paper to the Audit Committee on the limitations of the current Investment Policy, possibly including a comparison with experiences and investment policies of other IFIs. The Investment Policy Statement document was considered reviewed for presentation to the 113th session of the Executive Board.

Investment policy statement for the After-Service Medical Coverage Scheme (ASMCS)

18. Management explained that the paper had been changed in order to maintain the governance structure approved by the Governing Council by adoption of resolution 132/XXVI, subsequently modified in part by the Executive Board at its eighty-second session in September 2004, whereby the authority to transfer funds from the ASMCS Trust Fund back to IFAD would be with the Executive Board and authority to transfer funds from IFAD's resources to the Trust Fund would rest with the President. It was also explained that the overfunding of the ASMCS of 11 per cent could be considered minimal.
19. The Investment Policy Statement for the ASMCS Trust Fund was considered reviewed by the Committee for presentation to the 113th session of the Executive Board for consideration and submission to the Governing Council in February.

Progress report on preparation of a General Framework for Borrowing by IFAD

20. The Associate Vice-President, Financial Operations Department presented the update on the development of the General Framework for Borrowing. It was clarified that the Framework had been divided into two parts:
- (a) Part I -addressing borrowing from sovereign states and state-supported institutions; and
 - (b) Part 2 - addressing market-based borrowing.
- The second part would be developed by Management, who would periodically inform the Audit Committee on progress made and request guidance where necessary.
21. Management summarized other matters that had been discussed during the course of the five informal meetings of the Audit Committee and addressed within the Framework as follows:
- (a) clarification of the fundamental reasons as to why IFAD was looking into borrowing;
 - (b) a clear proposal for a borrowing limit both for IFAD10 and as a long-term debt/equity ratio;
 - (c) the possibility to present proposals to the Executive Board where, in Management's view, the advantages to supporting borrowing through IFAD's resources outweighed the risks;
 - (d) recognition that market borrowing was a long-term option and that such an option would be considered after thorough analysis by Management and consulting the Audit Committee and Executive Board as needed;
 - (e) the reasons why potential parties would be interested in lending to IFAD;
 - (f) clarification that all analysis of financial sustainability would be carried out, including any grant support that IFAD may receive from other sources;
 - (g) proposals for reporting to the Executive Board and for risk management strategies.
22. Management explained that although a draft of Part 1 had been submitted to the sixth informal meeting, some items still remained under discussion. Management expressed the hope that these matters would be resolved at the next meeting of the Committee.
23. Management recommended that the draft Part 1 be presented at the Audit Committee in March 2015 with subsequent submission to the Executive Board in April 2015 for approval. It was confirmed that there was currently no timetable for the development of Part 2 as this was a longer-term option.
24. Committee members requested clarification on the next steps in the process for the approval of the General Framework for Borrowing and on the legal opinion and drew Management's attention to the importance of developing Part 2 as well as ensuring that FOD had sufficient capacity to manage external borrowing.
25. Management expressed the willingness to conclude the discussions on the Framework at the next informal meeting and concurred that if agreement was reached, the draft Framework could be presented at the informal seminar of the Executive Board on 11 December 2014. The Committee was informed that an external consultant had been hired to assist the Fund in drafting Part 2 of the Framework and that an update on this would be presented to the Committee in September 2015.

26. The Chairperson concluded by requesting that the Framework for Borrowing provide a definition of equity for the purpose of computing the proposed debt/equity ratio. It was also clarified that discussions on the pending issues would continue at the next informal meeting of the Audit Committee. Both Management and the Committee members were in favour of being able to present the draft Framework to the informal seminar of the Executive Board in early December 2014.

Audit Committee work programme for 2015

27. The Chairperson introduced the work programme and opened the discussion by proposing certain changes to the workplan. These were discussed together with proposals from other members.
28. In conclusion, the Audit Committee adopted the work programme with the following amendments:
- (a) Inclusion of the review of the methodology used to set both the rate of inflation and the exchange rate in IFAD's administrative budget in 2015, in the July meeting;
 - (b) Inclusion of the review of an introductory paper on IFAD's Investment Policy, tentatively scheduled for the July meeting;
 - (c) Inclusion of the review of the implementation of the General Framework for Borrowing - Part 1 in November 2015;
 - (d) Inclusion of the update on the progress of implementation of the General Framework for Borrowing when such an update is available.

Project audit reports for financial year 2013

29. Management gave an overview and update on the situation of project audit reports and the related activities performed by IFAD in 2013. The proportion of qualified and unqualified audit opinions continued to remain stable at around 80 percent unqualified and 20 per cent qualified.
30. There had been an increase in the timely submission of audit reports from 45 per cent in 2012 to 58 per cent in 2013. Where significant control risks had been identified, the project had been requested to prepare a time-bound action plan.
31. Management informed the Committee of the improvements planned and/or implemented between 2013 and 2014 as follows:
- (a) As an extension of risk-based disbursements, in the fourth quarter of 2014 the Fund was rolling out a pilot exercise for electronic submission of withdrawal applications;
 - (b) Forums on financial management for projects and other stakeholders were organized for four regions between 2012 and 2014 and the forum for Latin America would take place in early 2015;
 - (c) Strengthening of financial management procedures for European Union funds to provide greater assurance, in particular in relation to project documentation. Management recalled that donor demands were more complex and demanding than in the past, and the European Commission auditors were now regularly requiring IFAD to provide additional evidence of the checks and controls.
32. The Committee acknowledged the progress made in this area and noted the status report.

Update on the development of the Loans and Grants System

33. Management presented an update on the progress made in the Loans and Grants System replacement project in the last two months with an urgent Flexcube customization being implemented to remove system-caused delays in processing

multiple withdrawal applications. Furthermore, work had commenced on certain customizations and reports which were put on hold pending launching of the system. Following internal approvals it was expected that the latter would be developed in a subphase implementation phase 1.5 the estimated cost of which would be contained within a ceiling of US\$1 million.

34. The total approved budget of the project was US\$15.76 million. The overall cost of the project to date, including implementation phase 1.5 was estimated at US\$8.4million. This would leave approximately US\$ 7.3 million for phase 2 of the project for which a preliminary scoping exercise had started.
35. The Committee noted the update.

Standard financial reports presented to the Executive Board

36. Management presented two reports for the Audit Committee's review:
 - (a) Resources available for commitment
 - (b) Report on IFAD's investment portfolio for the third quarter of 2013
37. Management confirmed that resources available for commitment for IFAD's programme of loans and grants were now defined under a sustainable cash flow approach. It was assumed that the ordinary loans presented to the Executive Board for approval in 2015 would be funded by the loan that IFAD negotiated with KfW Development Bank and that IFAD would only enter into further individual loan agreements with KfW provided that each such individual loan was financially sustainable, i.e. it would not require support from IFAD's own resources.
38. Management presented an update on the investment portfolio performance, reporting an almost flat performance during the third quarter of 2014, while the year-to-date performance for 2014 was 2.28 per cent.
39. The Committee requested clarifications on: the ability of the Fund to generate sufficient income from the investment of the funds received from KfW to cover the costs associated with the loan; the reason for having cash holdings of 7 per cent of assets; the criteria used for the outsourcing of investment portfolios to external managers and the reason for the investment in inflation-linked bonds. Management addressed the questions and provided explanations.
40. The reports were reviewed with no further comments.

Other business

41. Under this item, Management informed the Audit Committee of the appreciation of the United States dollar against other currencies and the effect that this was projected to have on IFAD's financial statements. The Committee was informed that the Fund had incurred a foreign exchange translation loss on the translation of the SDR loan assets of approximately US\$400 million which would be recorded in the income statement. Management also clarified that the translation loss was an accounting entry only and would have no effect on the overall cash situation nor on the Fund's business.