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Investing in rural people

High-level review of IFAD's Financial Statements for 2015

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For: Information

High-level review of IFAD's Financial Statements for 2015

I. Introduction

1. This document provides additional information to assist readers in interpreting IFAD's Financial Statements. The main focus of the analysis is on the IFAD-only Financial Statements, which reflect the financial status and transactions of the Fund's core business.

2. The Consolidated Financial Statements of IFAD are prepared in accordance with International Financial Reporting Standards. They include the transactions and balances of IFAD and the Special Programme for sub-Saharan African Countries Affected by Drought and Desertification, consolidated with the following entities:

   - Other supplementary funds including associate professional officer funds and programmatic supplementary funds, and the Global Environment Facility;
   - Heavily Indebted Poor Countries (HIPC) Debt Initiative Trust Fund;
   - IFAD's After-Service Medical Coverage Scheme (ASMCS) Trust Fund;
   - Haiti Debt Relief Initiative;
   - IFAD Fund for Gaza and the West Bank;
   - Spanish Food Security Cofinancing Facility Trust Fund; and
   - Adaptation for Smallholder Agriculture Programme (ASAP) Trust Fund.

II. External financial environment

3. In 2015, volatility in the financial markets had an impact on the investment portfolio. Although the internally managed portfolio registered the strongest performance among all the asset classes, the overall IFAD investment portfolio had a negative net return of 0.06 per cent compared with a positive return of 2.58 per cent in 2014.

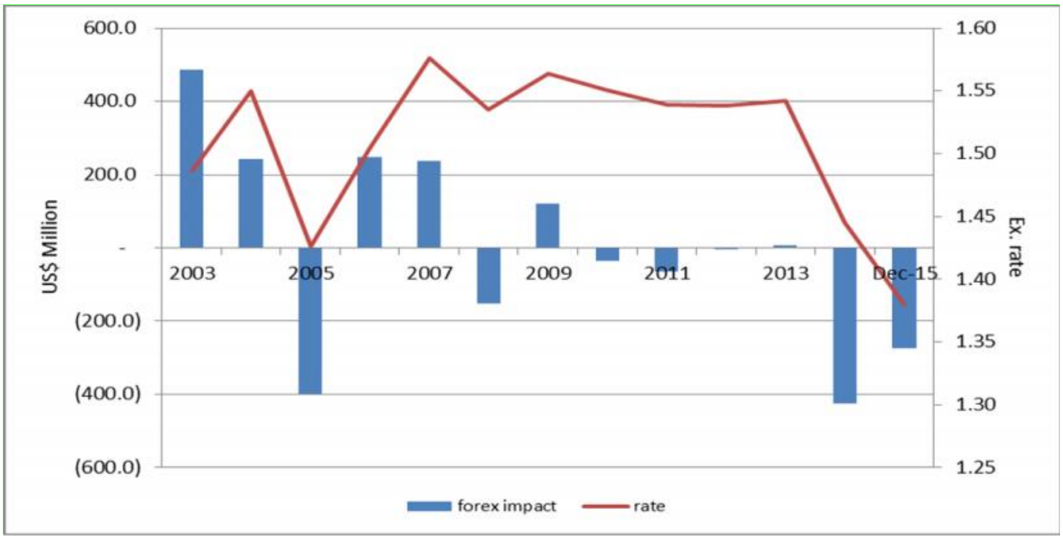
4. The year's overall results have been affected by the strengthening of the United States dollar against both special drawing rights (SDR) and the euro. The US$/SDR exchange rate moved from 1:1.445 at the end of December 2014 to 1:1.3837 at the end of December 2015 (a decrease of approximately 4.3 per cent), while the US$/EUR exchange rate moved from 1:1.21 to 1:1.086 during the same period (a decrease of 10.2 per cent).

5. Loans are mainly denominated in SDR, while the investment portfolio is kept in assets that replicate the SDR basket. The translation of such assets into United States dollars for reporting purposes sometimes generates unrealized losses. For the period, the strengthening of the dollar led to IFAD recording an unrealized consolidated exchange loss of US$290 million on the translation of monetary assets and liabilities. The effect was particularly evident in the balance of loans outstanding (US$209 million) and the investment portfolio (US$77 million). Operating expenses were also affected by the strong appreciation of the United States dollar against the euro. Salaries and administrative expenditures are strongly linked to the euro environment, therefore during 2015 all expense categories registered a decrease in value in United States dollar terms.

6. It should be noted that foreign exchange movements appear as unrealized gains/losses on IFAD's statement of comprehensive income; they do not have repercussions for IFAD's financial stability as IFAD ensures that there is enough liquidity to meet disbursement requirements. IFAD's currency risk is handled by ensuring that the commitments for undisbursed loans and grants (mainly

denominated in SDR) are covered by assets denominated in the same currency. Foreign exchange movements are always foreseen in institutions like IFAD that work in a multi-currency environment. Any material fluctuations in the US$/SDR exchange rate create volatility in IFAD's accounts. However, the exchange rate fluctuations have historically netted out as illustrated in the figure below.

Figure 1
Foreign exchange movements on IFAD's accounts since 2003



III. IFAD's operational activities

7. Fiscal year 2015 was the final year of the Ninth Replenishment of IFAD's Resources (IFAD9) period. In that year, IFAD approved loans and grants totalling US$1,340.3 million (2014: US$740.1 million), a historical record. Table 1 below shows the volume of operational activities, which is based on figures extracted from the Financial Statements.

Table 1
Loan and grant flows and balances
(Millions of United States dollars – nominal values)

	2015	*2014*
Loans approved*	1 005.7	593.1
Debt Sustainability Framework (DSF) approved	224.4	94.9
Grants approved	74.3	52.1
Total approval	1 304.4	740.1
Loans outstanding	6 270.4	6 269.8
Undisbursed DSF	780.4	715.9
Undisbursed grants	68.1	74.9
Loan disbursements	486.7	485.5
DSF disbursements	125.6	157.4
Grant disbursements	48.2	56.2
Total disbursements	660.5	699.1
Loan repayments	274.4	271.3

*Inclusive of loans approved under the debt financing facility.

8. During 2015, the overall volume of loan repayments and disbursements was higher than the previous year in denomination currency though it showed a decreased value in United States dollar terms. In the period, repayments of loan interest income were higher than in 2014, reflecting IFAD's reference interest rates for 2015

and encashment from debt settlement plans. Table 2 below presents the interest earned/service charge against prevailing interest rates.

Table 2
Lending terms

	2015				2014			
	Highly concessional	*Blend terms*	*Intermediate*	*Ordinary*	*Highly concessional*	*Blend terms*	*Intermediate*	*Ordinary*
Interest rate first semester	0.75%	2%	0.56%	1.12%	0.75%	2%	0.43%	0.85%
Interest rate second semester	0.75%	2%	0.58%	1.16%	0.75%	2%	0.56%	1.12%
Interest income repaid				US$57 million				US$52 million

9. Country office administration is managed through service agreements, mainly with the United Nations Development Programme, the Food and Agriculture Organization of the United Nations and the World Food Programme. The cost of the increased staffing in country offices was contained as local remuneration conditions generally apply and these are generally lower than at IFAD headquarters.

IV. IFAD financing activities

10. The adoption of the resolution on the Tenth Replenishment of IFAD's Resources in February 2015 by the Governing Council and the declaration of effectiveness within the same year meant that the vast majority of instrument of contributions were deposited within the year. This is reflected in a significant increase in equity (contributions) between 2014 and 2015 of about US$624.3 million.

11. During 2015, US$1.6 million was recognized as compensation for the Debt Sustainability Framework, which affected retained earnings positively.

12. At the end of December 2015, instruments of contribution for the ASAP Trust Fund amounted to US$366.1 million, of which US$87.4 million was paid in cash and US$217.4 million was paid with the deposit of a promissory note (see appendix E).

13. In November 2014 IFAD entered into a framework borrowing agreement with KfW Development Bank for an amount of EUR 400 million. During 2015, IFAD drew down two instalments amounting to EUR 150 million, equivalent to US$168.8 million.

V. IFAD-only balance sheet

14. The following analysis is based on appendix A of the Consolidated Financial Statements.

Assets

15. Cash and investments. The value of the cash and investment portfolio, including investment receivables and payables, decreased from US$1.7 billion as at 31 December 2014 to US$1.5 billion as at 31 December 2015. This decrease is wholly in line with adopted replenishment scenarios.

16. Receivables for instruments of contribution and promissory notes. Net receivables increased from US$0.3 billion as at 31 December 2014 to US$0.6 billion at 31 December 2015. This is in line with the IFAD10 cycle, as reported in paragraph 10 above.

17. Loans outstanding. Loans outstanding, net of accumulated allowances for loan impairment losses and the HIPC Debt Initiative, remained stable at US$5.0 billion

as a result of the net effect of additional disbursements, loan repayments and negative exchange rate movements.

18. The fair value adjustment in United States dollar terms decreased from US$1.23 billion in 2014 to US$1.18 billion in 2015, owing to the net effect of an additional fair value annual charge and the unwinding effect on loans valued at fair value in prior years. The fair value was also affected by a positive exchange rate movement.

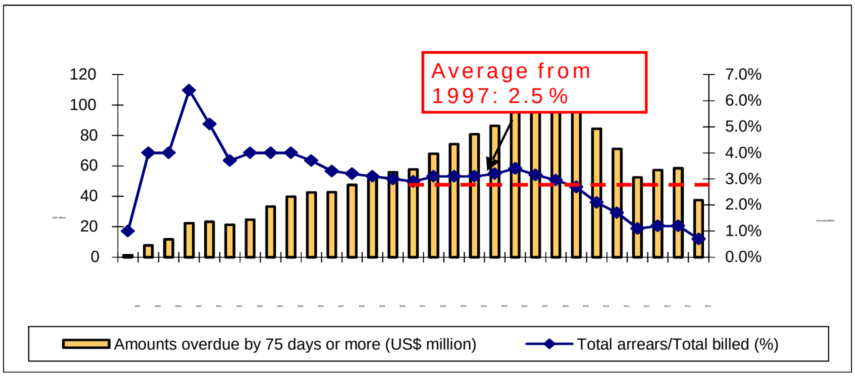
Table 3
Loans outstanding
(Millions of United States dollars)

	2015	*2014*
Loans outstanding at nominal value	**6 270.4**	**6 269.3**
Less fair value adjustment	(1 188.1)	(1 233.6)
Loans outstanding at fair value	**5 082. 3**	**5 035.7**
Key operational data:		
Loans approved in the year	1 005.6	593.1
Loan disbursements	486.7	485.5
Loan repayments	274.4	271.3

19. Allowance for loan impairment losses. During 2015, IFAD signed a debt settlement plan with Zimbabwe. This resulted in a decrease in the balance of the allowance in nominal terms (from US$58.2 million in 2014 to US$35.5 million in 2015). An impairment provision is set up in the accounts for any uncertainty on the receipt of loan principal repayments according to the repayment schedule. As at 31 December 2015, this allowance amounted to 0.6 per cent of the balance of loans outstanding (US$6,207 million), well below the historical average of 2.6 per cent.

20. IFAD undertakes operational measures to reduce the risk of accumulating arrears balances. These include discontinuing disbursements of loans that are 75 days in arrears and/or suspending the entire portfolio. The figure below presents the percentage of amounts in arrears for more than 75 days in comparison with the overall billed amounts.

Figure 2
Amounts in arrears for more than 75 days over billed amounts



21. HIPC Debt Initiative expenses. The decrease from US$25.7 million in 2014 to US$19.7 million in 2015 is mainly related to debt relief provided to eligible countries. IFAD has been participating in the HIPC Debt Initiative since 1997. As shown in appendix I, the total cumulative cost of debt relief approved by the Executive Board was US$484.3 million in nominal terms as at 31 December 2015. The debt relief provided up to that date amounted to US$334.5 million in terms of principal and US$105.5 million in interest.

Liabilities and equity

22. Borrowing liabilities. In November 2014 IFAD entered into a borrowing framework agreement with KfW for an overall amount of EUR 400 million. During 2015, IFAD drew down two instalments amounting to EUR 150 million, equivalent to US$162.9 million.

23. Contributions. Cumulative contributions for regular resources, net of provisions increased from US$7.3 billion as at 31 December 2014 to US$7.9 billion as at 31 December 2015. This results principally from deposits and payments of contributions towards IFAD10. The table below provides key information on the status of the IFAD9 and IFAD10.

Table 4
Key contribution flows
(Millions of United States dollars)

IFAD9	*2015*	*2014*
(A) Cumulative pledges to date	1 431.6	1 427.5
(B) Instruments of contribution (IOC) received inclusive of payments of cash and promissory notes not supported by IOC	1 422.7	1 396.9
Outstanding pledges (A-B)	**8.9**	**30.6**
Cash payments received	513.5	371.3
Promissory notes deposited	874.9	844.9
Total payments	**1 388.4**	**1 216.2**

IFAD10	*2015*	*2014*
(A) Cumulative pledges to date	1 173.7	872.2
(B) IOC received inclusive of payments of cash and promissory notes not supported by IOC	680.9	0.2
Outstanding pledges (A-B)	**492.8**	**872.0**
Cash payments received	27.8	0.2
Promissory notes deposited	**51.5**	0
Total payments	**79.4**	**0.2**

24. Full details of Members' replenishment contributions are shown in appendix G of the Consolidated Financial Statements.

VI. IFAD-only statement of comprehensive income

Revenue

25. Income from interest and service charges on loans amounted to US$57.9 million in 2015, compared with US$52.2 million in 2014.

26. Income from cash and investments. Gross income from cash and investments decreased from US$52.2 million in 2014 to US$0.9 million in 2015. Volatility in the financial markets affected the investment portfolio, leaving IFAD's investment portfolio in 2015 with a negative net return of 0.06 per cent compared with positive 2.58 per cent in 2014. As mentioned above (paragraph 3), the internally managed portfolio registered the strongest performance among all the asset classes.

27. Expenses reported in 2015 include those incurred under the annual administrative budget expenditures in 2015 but funded by carry-forward funds from the prior year's budget, costs for the Independent Office of Evaluation of IFAD (IOE) and the annual after-service medical costs. The level of administrative expenditure has decreased in all categories as reported below.

Table 5
Administrative expenses

	Millions of United States dollars		
	2015	*2014*	*Movement*
Administrative expenses			
Staff salaries and benefits	85.2	92.2	(7.0)
Office and general expenses	34.6	36.2	(1.6)
Consultants and other non-staff costs	34.1	37.9	(3.8)
Cooperating institutions	1.3	2.2	(0.9)
Direct investment costs	2.4	2.9	(0.5)
Total	**157.6**	**171.4**	**(13.8)**

28. Total balances above include expenditures funded by other sources (US$14.5 million in 2015; US$18.5 million in 2014), principally by the Italian Government for reimbursable expenses (US$7.2 million in 2015 – US$9.6 million in 2014), matched by associated revenue.

29. Staff salaries and benefits. The decrease in staff salaries and other entitlements from US$92.2 million in 2014 to US$85.2 million in 2015 is mainly attributable to the strengthening of the United States dollar against the euro by approximately 10.2 per cent (in December 2014 the US$/EUR rate was 1:1.121 while in December 2015 it was 1:1.086). These balances were also affected by a reduction in the post adjustment, which decreased from an average of 67.32 in 2014, to an average of 40.28 in 2015.

30. Office and general expenses. Administrative expenditures are strongly linked to the euro environment. During 2015 all related activities registered a decrease in value in United States dollar terms (2015 US$34.6 million; 2014 US$36.2 million), due to the appreciation of the dollar against the euro.

31. Consultants and other non-staff costs. During 2015 there was a general decrease in the costs pertaining to consultants, translators and interpreters (2014 US$37.9 million in 2015 US$34.1 million). This was mainly related to the lower value of expenditures incurred during the year and a lower number of official meetings in 2015 (the IFAD10 Consultation took place in 2014).

32. Loan interest expenditures. During 2015, IFAD accrued interest expenditures and paid fees amounting to approximately US$1.7 million in relation to KfW borrowing activities (as mentioned in paragraph 13).

33. Adjustment for changes in fair value. The 2015 accounts registered a negative fair value adjustments of US$29.5 million, compared to a positive fair value impact of US$22.7 million in 2014. The 2015 negative effect was mainly attributable to higher market rates prevailing during 2015, thus leading to a higher discount rate being used in calculating the fair value of the loan portfolio. The average SDR curve was 1.01 per cent at the end of 2015, while at the end of 2014 it stood at 0.95 per cent.

34. *Exchange rate movements.* An analysis is provided in table 6 below.

Table 6
Exchange rate movements

	Millions of United States dollars	
	2015	*2014*
Cumulative balance 1 January	**464.0**	**889.1**
Exchange rate movement on:		
Cash and investments	(67.8)	(104.4)
Net receivables/payables	6.9	7.0
Loans and grants outstanding	(213.4)	(326.4)
Promissory notes and Members' receivables	(17.3)	(34.5)
Members' contributions	16.9	33.1
Total movement in the year	*(274.7)*	*(425.1)*
Cumulative balance 31 December	**189.3**	**464.0**

35. As stated above (paragraphs 5 and 6), IFAD assets are mainly denominated in SDR, or kept in assets replicating the SDR basket; therefore the translation of such assets into United States dollars for reporting purposes has generated an unrealized loss during 2015. At the end of December 2015, cumulative unrealized gains amounted to US$189.3 million (see table 6).

36. *Provision for after-service medical benefits.* As in prior years, in 2015, IFAD engaged an independent actuary to perform an independent valuation of the scheme. The methodology adopted was in line with the previous year's valuation. The assumptions used reflected prevailing market conditions. The 2015 ASMCS actuarial valuation showed a liability of US$80.0 million for IFAD, compared with US$95.9 million at 31 December 2014. IFAD recorded a net charge for current service costs of US$5.3 million during 2015 (comprising interest and current service charges). This resulted in a net actuarial gain of US$21.1 million (compared to a loss of US$22.3 million in 2014). The change in liability was caused principally by prevailing market conditions with increasing market yields, which also affected the discount rate used in the 2015 valuation (i.e. 3.2 per cent in 2015, 2.8 per cent in 2014) and by the strengthening of the dollar versus the euro.

VII. Statement of retained earnings

37. The retained earnings balance decreased to negative US$1,064.8 million at the end of 2015. This balance represents the accumulation of yearly reported accounting results derived from operations and from the impact of exchange rate movements, which relate mainly to the translation of loan balances denominated in SDR into IFAD's reporting currency, the United States dollar. The decrease stemmed from the negative results for 2015, which represented an overall deficit or total comprehensive loss of US$531.8 million, partially compensated by DSF contributions amounting to US$1.6 million. This loss is mainly attributable to negative foreign exchange movements of US$274.7 million and additional grant and DSF expenditures amounting to US$170.4 million. Overall revenue amounted to US$70.6 million. Operating expenses (staff, consultancy supplier expenditures) amounted to US$157.6 million.

VIII. Consolidated cash flow statement

38. The movements in liquid unrestricted cash and investments in the balance sheet are detailed in appendix C (consolidated cash flow) of the Consolidated Financial Statements. Some 82.5 per cent of consolidated cash and investment balances relate to IFAD (87.8 per cent in 2014).

39. IFAD grant disbursements decreased from US$56.2 million in 2014 to US$48.2 million in 2015. Non-IFAD grant disbursements decreased from US$95.8 million in 2014 to US$78.8 million in 2015.

40. Disbursements under DSF financing decreased from US$157.4 million in 2014 to US$125.6 million in 2015.

41. IFAD loan disbursements increased from US$485.5 million in 2014 to US$486.7 million in 2015. Non-IFAD loan disbursements increased from US$29.7 million in 2014 to US$50.3 million in 2015.

42. In November 2014, IFAD entered into a borrowing framework agreement with KfW for an overall amount of EUR 400 million. During 2015, IFAD drew down instalments amounting to EUR 150 million, equivalent to US$168 million.

43. Receipts from cash and promissory notes for replenishment contributions totalled US$287.0 million in 2015, compared with US$372.4 million in 2014.

IX. Financial situation of the Fund (IFAD-only)

44. As at 31 December 2015, the liquidity position of the Fund remained strong, with sufficient liquid assets to cover projected disbursement needs for more than two years.[1]

45. The long-term financial viability of the Fund is monitored closely through an asset liability model and reviewed by IFAD Management regularly, as well as by IFAD's Member States during replenishment consultations.

46. Term structure risks are the financial risks that usually result when the timing and/or financial maturity of cash flows (i.e. principal and interest) between assets and their funding liabilities do not match. Funding, refinancing and reinvestment risks are three of the most typical term structure risks.

47. IFAD has no significant exposure to term structure risks because it is mainly funded by equity (i.e. reserves and contributions), which, by definition, do not entail specific interest/principal payments.

48. Under the current financial mechanism (inclusive of borrowing), and despite negative retained earnings, IFAD's net equity is positive and its financial situation is sound. At the end of December 2015, total equity (contributions plus General Reserve) over total assets was equivalent to 93.5 per cent in nominal terms.

49. As an additional indicator of risk, the Sovereign Borrowing Framework requires that the debt/equity ratio[2] shall not be higher than 35 per cent. The ratio stands at 2.0 per cent as at the end of December 2015.

50. All financial risk parameters are well within the thresholds established by the Sovereign Borrowing Framework as adopted in April 2015. The financial ratios are summarized in the table below.

Table 7
Financial ratios as at December 2015

	Dec-15	*Threshold*
Equity/total assets	93.5%	>60%*
Debt/equity	2.0%	<35%
Liquidity/total assets	17.8%	>5%
Liquidity/disbursement needs	2.2 years	
Debt service coverage	0.1%	<50%

*Threshold established in the Framework Agreement with KfW.

[1] IFAD liquidity US$1,513.7 million/net disbursement needs as per the minimum liquidity ratio of US$680 million= 2.2 years.
[2] The debt/equity ratio is (a) the ratio of (i) principal portion of total outstanding debt to (ii) total contributions plus General Reserve (expressed in percentage terms); (b) calculated as (total outstanding debt principal/contributions plus General Reserve).