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Report of the Chairperson on the 139th meeting of the Audit Committee

Note to Executive Board representatives

Focal points:

Technical questions:

Ruth Farrant
Director and Controller
Controller's and Financial Services Division
Tel.: +39 06 5459 2281
e-mail: r.farrant@ifad.org

Allegra Saitto
Manager, Accounting and Financial Reporting
Controller's and Financial Services Division
Tel.: +39 06 5459 2405
e-mail: a.saitto@ifad.org

Dispatch of documentation:

Alessandra Zusi Bergés
Officer-in-Charge
Governing Bodies Office
Tel.: +39 06 5459 2092
e-mail: gb_office@ifad.org

Executive Board — 117th Session
Rome, 13-14 April 2016

For: Review

Report of the Chairperson on the 139th meeting of the Audit Committee

1. The Audit Committee wishes to bring to the attention of the Executive Board the matters examined at the 139th meeting of the Committee held on 22 March 2016.
Adoption of the agenda
2. The agenda was adopted with changes in the order of presentation of some agenda items and with the request for inclusion under “other business” of two items:
 - Access to verbatim transcripts of Audit Committee meetings
 - Reporting procedures for the Audit and Evaluation Committees (for drafting and reviewing minutes and reports to the Executive Board)
3. The Chairperson of the Audit Committee advised that due to an apparent conflict of interest he wished to recuse himself from deliberations on items 4, 7 and 8. The Committee agreed that the representative for Germany, Mr Otmar Greiff, would take the chair for consideration of these items.
Minutes of the 138th meeting of the Audit Committee
4. The minutes were approved without comments.
Submission of the result-based work programme and budget documents of IFAD and the Independent Office of Evaluation of IFAD
5. As requested by the Audit Committee at its 137th meeting in September 2015, the Office of the Secretary provided historical information on the submission and approval process of IFAD’s budget, including the component dealing with the Independent Office of Evaluation of IFAD (IOE). It was noted that even if the various components of IFAD’s budget were separately identified they were kept in the same document to facilitate the eventual transmittal to and approval by the Governing Council of the entire budget. The General Counsel confirmed that the Agreement Establishing IFAD supported this approach and noted the practice at Governing Council sessions whereby, in recognition of the independence of IOE, the IOE budget was presented by the Director, IOE. The Chairperson, on the basis of this explanation, noted that, accordingly, a resolution of the Governing Council would be required to modify this approach. The Director, IOE, welcomed any changes to the current arrangements that would further enhance the independence of IOE. Audit Committee members did not express interest in proposing any changes at this stage.
Review of the Consolidated Financial Statements of IFAD as at 31 December 2015 (including the Management assertion report and an independent external attestation on the effectiveness of internal controls over financial reporting)
6. Management introduced the agenda item, noting the external auditor’s unqualified opinion on the 2015 Consolidated Financial Statements. IFAD Management stated that it had once again confirmed, for fiscal year 2015, the operational effectiveness of all key internal controls over financial reporting in the Management assertion report, with an independent external attestation by IFAD’s external auditor.
7. Management identified the key factors affecting IFAD’s financial position and reported on results, highlighting that the overall financial situation was sound. In particular it was noted that: fiscal year 2015 was the final year of the Ninth Replenishment of IFAD’s Resources (IFAD9) period, which had enabled the Fund to reach the highest-ever volume of projects and programmes approved – US\$1.34 billion in a single year and US\$3.09 billion in the programme of loans and grants for IFAD9 – exceeding the target level of US\$3.0 billion. IFAD’s 2015 Consolidated Statement of Comprehensive Income presented a total consolidated

comprehensive loss of US\$545.4 million. The 2015 operating results had been significantly affected by currency volatility and the strengthening of the United States dollar against both special drawing rights (SDR) and the euro. The resulting impact for IFAD was a total unrealized consolidated exchange rate loss of about US\$290 million. It was noted that, as reported in the past, unrealized foreign exchange losses did not have a material impact on IFAD's operations or its financial viability. At the end of December 2015, IFAD's overall financial situation was sound; the liquidity position at the end of 2015 remained strong, while the net equity – equivalent to 93.5 per cent of total assets – covering term risks. The remaining US\$255 million of operational loss shown in the accounts was a net result inclusive of grant and Debt Sustainability Framework (DSF) expenditures of US\$340 million, which were reflected as costs. IFAD's income from Members' contributions, including those for DSF compensation, was taken directly to equity in the balance sheet, in line with internationally accepted accounting principles. It should be noted that during 2015, IFAD received US\$1.6 million towards DSF compensation.

8. Some members commended the sound financial position of IFAD. However, concerns were also expressed regarding the significant loss in retained earnings, especially in the past two years and its negative impact on IFAD's financial sustainability. Management acknowledged these concerns and advised that some recommendations were already being drafted for consideration by the Audit Committee and the Executive Board. Clarifications were provided by the external auditor and Management in response to members' technical questions and comments.
9. The Chairperson summarized the agenda item, noting that the discussions had been detailed and constructive. The Consolidated Financial Statements were deemed reviewed and would be presented to the 117th session of the Executive Board for endorsement and transmitted to the Governing Council for formal approval in February 2017.

Annual confirmation of the contract for the external auditor

10. Under this item, Management brought to the attention of the Committee the confirmation of the annual contract of the external auditor for 2015-2016. Management noted that the appointment of Deloitte & Touche had been approved by the Executive Board for the period 2012-2016, and that the contract was confirmed on an annual basis, subject to satisfactory performance. Management confirmed its satisfaction with the performance of Deloitte & Touche and informed the Committee that the only change in the terms was a cost-of-living adjustment, which was foreseen in the contract. On the basis of the foregoing, and given that the change in the financial terms of the contract was not significant, the Audit Committee confirmed the contract of the external auditor for 2016.

External auditor contract 2017-2021

11. Under this item, Management brought to the attention of the Committee that, as reported under the previous agenda item, the first five-year mandate (2012-2016) of the contract with Deloitte & Touche was due to expire after the audit of the 2016 accounts. To ensure timely selection of an external audit firm, the procurement process should be launched soon so as to nominate an external audit firm by the end of 2016.
12. As stipulated in its terms of reference, the Audit Committee was responsible for overseeing the selection process of the external auditor and recommending to the Executive Board the appointment of a firm, following review of the scope, costs and contractual terms. Management would facilitate the process and fully support the Audit Committee in this task.
13. Audit Committee members were invited to participate actively during technical presentations and evaluation meetings. It was agreed that the Audit Committee

Chair would liaise with members following the meeting with a view to nominating a member to act as focal point for IFAD Management during this process.

Introduction of single currency lending pilot programme

14. Management introduced this agenda item highlighting that in view of best practices at other international financial institutions, the possibility for IFAD to broaden its set of financial products was considered during the IFAD10 Consultation. The General Conditions approved by the Executive Board in 2014 provided the legal basis for offering financing in currencies other than SDR.
15. During 2014, IFAD commissioned a study to be conducted by the World Bank Treasury to review IFAD's currency hedging framework and to assess the feasibility of offering single currency lending. Based on the study, Management concluded that an initial phase of US\$200 million was feasible, operating within IFAD's current risk framework.
16. It was pointed out that the Fund already had experience in managing single currency loans in United States dollars and euros: the very first 10 loans approved by IFAD were denominated in United States dollars (of which US\$21 million was still outstanding). More recently, some euro-denominated loans had been approved by the Executive Board on the back of the borrowing facility with KfW Development Bank. The Committee was informed of the decision to mainstream single currency lending, with an initial phase of US\$200 million, in line with the World Bank's recommendations.
17. The Committee welcomed the single currency lending programme and appreciated the presentation. Questions were raised on Member States' right to choose this new product; the availability of the programme to interested low-income countries (LICs); and the sustainability of the ordinary terms for euro-denominated loans, particularly under the Sovereign Borrowing Framework, given the presently negative course of the Euribor and the zero floor included in the legal borrowing agreements with KfW Development Bank. Management explained that this pilot would be a demand-driven process and that the borrowing Members would have the final say on whether or not to borrow under it. Management also provided some clarifications about the full eligibility of LICs and the legal basis of single currency lending and about pricing methodology.

Annual Report on the Activities of the Office of Audit and Oversight during 2015

18. The Office of Audit and Oversight (AUO) presented the report, highlighting that the purpose of the document was to provide details about AUO's activities in 2015. The document included a substantial summary of each audit report issued in 2015 and gave detailed information on the open recommendations. It also provided information on investigation activities.
19. In particular, it was noted that during 2015 AUO had contributed significantly to institutional efforts through the audits performed on IFAD Country Offices (ICOs) and the processes pertaining to consultants, travel and procurement. The audit work revealed that the application of financial controls by ICOs and headquarters divisions was generally good and that efficiency had increased in key business processes through recent automation initiatives. Scope for improvement in some areas and further simplification of procedures was noted. The prompt implementation of AUO recommendations by Management had provided a significant boost to institutional risk mitigation. It was also noted that the implementation of AUO recommendations had reached its highest rate ever (in terms of both volume and percentage).
20. AUO had faced a challenging year in the area of investigations in terms of the high volume and complexity of new complaints, accompanied by a range of reforms to be implemented and key staff changes early in the year. Significant additional

budget support was provided by Management, which had allowed the engagement of external expertise to deal with the increased workload.

21. In 2015, cooperation with the World Food Programme (WFP) and Food and Agriculture Organization of the United Nations (FAO) had been solid and included joint training and staff networking activities; active coordination among audit and investigation team leaders; common consultant rosters and mutual assistance and support in staff recruitment efforts; and the issuance of a joint report. WFP was particularly supportive in assisting AUO in filling the staffing gaps by agreeing to the secondment of two professional officers to AUO during the year.
22. Committee members expressed appreciation and commended AUO for the work done during the year. The solid cooperation with the internal oversight offices of FAO and WFP and the prompt implementation of AUO recommendations by Management were particularly appreciated also as a concrete application of the concept of enhanced Rome-based agency collaboration. Some members requested additional details and reassurance on the adequacy of resources, in particular staff resources. Clarification was also requested on several security non-compliance cases in ICOs, and the reasons for an unusual increase in harassment allegations between 2014 and 2015. The Director, AUO responded that the unusually high workload in 2015 had created challenges for AUO and that there may be a need to discuss the matter further with Management if the heavy workload continued during 2016.
23. The report was deemed reviewed.

Audit Committee work programme for 2016

24. As a follow-up to the related discussion at its 138th meeting, the Audit Committee considered whether to include the item "Review of lending terms" in its 2016 work programme. In making this determination, the Audit Committee had the benefit of a legal opinion prepared by the General Counsel in response to an earlier request from the Committee. The General Counsel summarized the key elements of the legal opinion, noting that the current arrangement for calculating the interest rate for ordinary loans was legally valid and was supported by the Agreement Establishing IFAD, by decisions of the Governing Council and the Executive Board, and by the authorization granted in 1995 by the Board to the President to calculate and set interest rates and to notify the Board of the rates established. Accordingly, there were no additional or different steps that the Executive Board needed to take in order for it to meet its obligations regarding the setting of interest rates. However, the General Counsel made it clear that the Executive Board and Committee were free to review the arrangements that were in place should they so wish, although there was no obligation to do so.
25. Following an extended discussion and exchange of views, it was concluded that the review of the lending terms would not be added to the work programme. Rather, it was understood that the review of the Sovereign Borrowing Framework would include an assessment of its financial sustainability, including the potential mismatch between the base rate adopted in IFAD borrowing agreements (Euribor) and that embedded in IFAD lending terms (the International Bank for Reconstruction and Development funding cost), and of the feasibility of achieving the IFAD10 borrowing target in a timely manner. It was also agreed to leave it to Management whether to provide in the same meeting an informal presentation on lending terms. It was also noted that the review of the Sovereign Borrowing Framework would be moved from the July meeting to the September meeting of the Audit Committee.

- Standard financial reports presented to the Executive Board
26. Management presented six reports for the Audit Committee's review:
 - Report on the status of contributions to the Ninth Replenishment of IFAD's Resources
 - Report on the status of contributions to the Tenth Replenishment of IFAD's Resources
 - Report on IFAD's investment portfolio for 2015
 - Status report on arrears in principal, interest and service charge payments
 - Estimated principal and net service charge payments forgone as a result of the implementation of the Debt Sustainability Framework
 - Requirements for the thirty-seventh drawdown of Member States' contributions in 2016.
 27. Management provided an update on the status of IFAD10 and on the investment portfolio performance. In particular it was highlighted that IFAD10 pledges corresponded to US\$1.13 billion. Some additional details were requested by Audit Committee members. In particular, clarification was sought on any legally-binding rule for countries having cancelled or reduced their pledges. Management explained that the general assumption was that members would honour their pledges in good faith. Sometimes this was not possible and there were no legally-binding provisions, as legal commitments applied as of the time of the deposit of the instrument of contribution but not at the stage of pledges.
 28. The Treasurer updated the Committee on the latest portfolio developments, highlighting the positive performance – in the region of 0.82 basis points – during the first quarter of 2016.
 29. The reports were deemed reviewed.
- Other business
30. As requested at the beginning of the meeting, the Audit Committee discussed the following items under other business:
 - Access to verbatim transcripts of Audit Committee meetings
 - Reporting procedures for the Audit and Evaluation Committees (for drafting and reviewing minutes and reports to the Executive Board)
 31. One member requested access to several verbatim transcripts of previous Audit Committee meetings and the informal meetings on the Sovereign Borrowing Framework. The Secretary of IFAD highlighted that the official records of IFAD meetings were the minutes and that free access to verbatim transcripts was not encouraged as meetings were meant to be a forum for open discussions to facilitate consensus and sound conclusions. Regarding the informal meetings, he reminded members that these events were not considered part of governing body meetings, and no official records were maintained. It was also recalled that, as per the IFAD Policy on the Disclosure of Documents, access to verbatim transcripts was subject to the agreement of the body concerned. Members expressed general support for granting access to ensure full transparency. The Chairperson requested some time to check the content of the meetings in question. It was agreed that the Office of the Secretary would convey in written form the requests of the Member States to Audit Committee members and in the absence of objection by a given short deadline, access would be granted.
 32. The Secretary briefed the Committee on past and current reporting practices of the Evaluation Committee. After a long discussion, it was agreed that the Office of the Secretary would prepare a document on the topic to be presented at the Audit Committee meeting in July 2016.