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Investing in rural people

High-level review of IFAD's financial statements for 2016

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For: Information

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I. Introduction

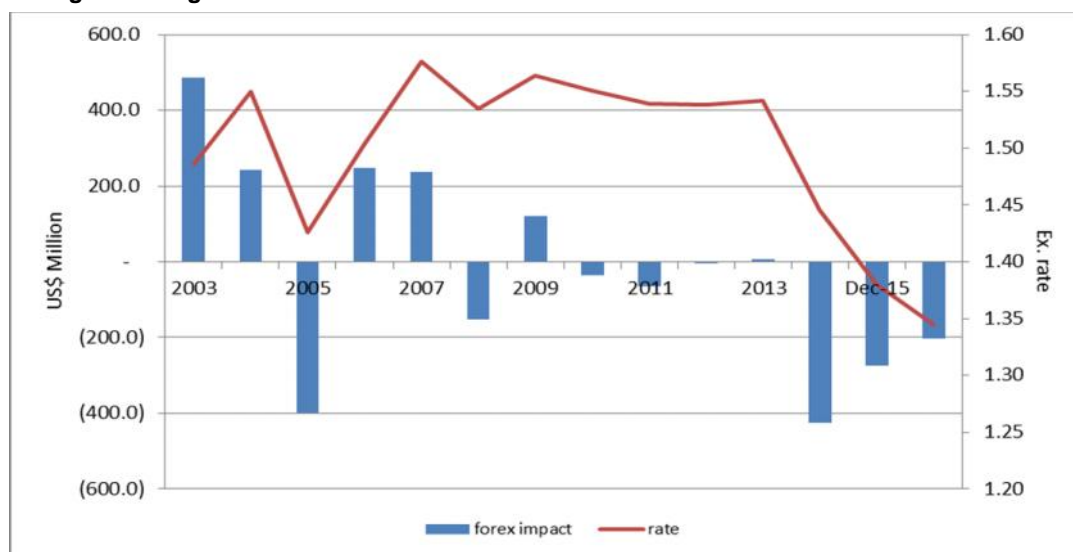
1. This document provides additional information to assist readers in interpreting IFAD's financial statements. Its analysis mainly focuses on the IFAD-only financial statements, which reflect the financial status and transactions of the Fund's core business.
2. The Consolidated financial statements of IFAD as at 31 December 2016 are prepared in accordance with International Financial Reporting Standards. They include the transactions and balances of IFAD as well as of the Special Programme for sub-Saharan African Countries Affected by Drought and Desertification, consolidated with the following entities:
 - Supplementary funds, including the Global Environment Facility, associate professional officer fund and programmatic supplementary funds;
 - Spanish Food Security Cofinancing Facility Trust Fund;
 - Adaptation for Smallholder Agriculture Programme (ASAP) Trust Fund;
 - IFAD's After-Service Medical Coverage Scheme (ASMCS) Trust Fund;
 - Haiti Debt Relief Initiative;
 - Heavily Indebted Poor Countries (HIPC) Debt Initiative Trust Fund; and
 - IFAD Fund for Gaza and the West Bank.

II. External financial environment

3. In 2016, financial markets remained volatile. Nonetheless, IFAD's overall investment portfolio posted a positive net rate of return of 2.91 per cent compared to negative 0.06 per cent in 2015.
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 1:1.3837 at end-December 2015 to 1:1.34472 a year later (a drop of roughly 2.8 per cent from 2015 to 2016, compared to a fall of approximately 4.3 per cent from 2014 to 2015). The US\$/EUR exchange rate moved from 1:1.086 to 1:1.054 during the same period (down by 2.9 per cent from 2015 to 2016, compared to a fall of 10.2 per cent in the previous year).
5. Loans are mainly denominated in SDR, and the investment portfolio is held in assets that replicate the SDR basket. The translation of those assets into United States dollars for reporting purposes sometimes generates unrealized losses. For the 12 months of 2016, dollar strengthening caused IFAD an unrealized consolidated exchange loss of US\$169.5 million on the translation of monetary assets and liabilities. This generated negative impacts of US\$146.0 million on the balance of loans outstanding, and US\$28.5 million on the investment portfolio, offset by a positive impact of US\$5.0 million on other assets.
6. Foreign exchange movements appear as unrealized gains/losses on IFAD's Statement of comprehensive income: in other words, they do not have repercussions on IFAD's financial stability because the Fund makes sure it has enough liquidity to meet its disbursement requirements. IFAD's currency risk is mitigated by ensuring that commitments for undisbursed loans and grants (mainly denominated in SDR) are supported by assets denominated in the same currency. Foreign-exchange movements are always anticipated in institutions, like IFAD, which work in a multi-currency environment. Any material fluctuations in the

US\$/SDR exchange rate creates volatility in IFAD's accounts; but, 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. Financial situation of the Fund (IFAD-only)

7. As at 31 December 2016, IFAD's financial position is sound, despite the unrealized foreign-exchange losses discussed above.
8. The Fund's liquidity position remained within policy thresholds, with sufficient liquid assets to cover projected disbursement needs for more than two years.¹
9. The Fund's long-term financial viability 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.
10. Term-structure risks are the financial risks that arise when the timing and/or financial maturity of cash flows (i.e. principal and interest) from assets do not match those of their funding liabilities. Funding, refinancing and reinvestment risks are three of the most typical term-structure risks.
11. IFAD has no significant exposure to term-structure risks since it is mostly funded by equity (i.e. reserves and contributions), which, by definition, does not entail specific interest/principal payments.
12. Under the current financial mechanism (inclusive of borrowing), and despite negative retained earnings (explained below), IFAD's net equity is positive. At end-December 2016, total equity (contributions plus General Reserve) represented 97.3 per cent of total assets in nominal terms. It should also be noted that, as of 31 December 2016, IFAD's total assets (i.e. US\$7.2 billion) (at fair value) were sufficient relative to total liabilities (US\$0.6 million), undisbursed commitments for loans (US\$3.3 billion) and undisbursed loans under the Debt Sustainability Framework (DSF) (US\$0.7 billion).
13. As an additional risk indicator, the Sovereign Borrowing Framework requires the debt/equity ratio² to be no higher than 35 per cent. At the end of December 2016, the ratio was calculated as 3.3 per cent.

¹ IFAD liquidity US\$1,334.5 million / net disbursement needs of US\$582.5 million as per the minimum liquidity ratio = 2.3 years.

² The debt/equity ratio is: (a) the ratio of principal portion of total outstanding debt to total contributions plus General Reserve (expressed in percentage terms); (b) calculated as (total outstanding debt principal / contributions plus General Reserve).

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

Table 1
Financial ratios as at December 2016

	<i>Dec-16</i>	<i>Threshold</i>
Equity/total assets	97.3%	>60%*
Debt/equity	3.3%	<35%
Liquidity/assets	15.9%	>5%
Liquidity/disbursement needs	2.2 years	
Debt service coverage	0.1%	<50%

* Threshold established in the Framework Agreement with KfW Development Bank.

IV. IFAD's operational activities

15. Fiscal year 2016 was the first year of the Tenth Replenishment of IFAD's Resources (IFAD10). During that year, the Fund approved loans and grants totalling US\$822.0 million (2015: US\$1,304.4 million). This is within the replenishment cycle. Table 2 below shows the volume of operational activities, which is based on figures extracted from the financial statements.

Table 2
Loan and grant flows and balances
(Millions of United States dollars – nominal values)

	<i>2016</i>	<i>2015</i>
Approvals		
Loans approved*	657.6	1 005.7
DSF loans approved	105.5	224.4
Grants approved	58.9	74.3
Total approvals	822.0	1 304.4
Outstanding/undisbursed		
Loans outstanding**	6 377.2	6 270.4
Undisbursed DSF**	740.0	780.4
Undisbursed grants**	80.5	68.1
Disbursements		
Loan disbursements	539.4	486.7
DSF disbursements	123.9	125.6
Grant disbursements	39.3	48.2
Total disbursements	702.6	660.5
Loan repayments	299.2	274.4

* Inclusive of loans approved under the debt financing facility.

** Balances as at 31 December.

16. During 2016, the overall volume of loan repayments and disbursements was higher than in the previous year in denomination currency-terms. In the period reflecting IFAD's reference interest rates for 2016, loan-interest income was higher than in 2015 in denomination currency, but it was down in dollar terms. Table 3 below shows the interest earned and prevailing interest rates/service charge on SDR loans.

Table 3
Lending terms

	2016				2015			
	<i>Highly concessional</i>	<i>Blend terms</i>	<i>Intermediate</i>	<i>Ordinary</i>	<i>Highly concessional</i>	<i>Blend terms</i>	<i>Intermediate</i>	<i>Ordinary</i>
Interest rate first semester (percentage)	0.75	2	0.67	1.34	0.75	2	0.56	1.12
Interest rate second semester (percentage)	0.75	2	0.66	1.31	0.75	2	0.58	1.16
Interest income earned by IFAD	US\$51 million				US\$57 million			

17. IFAD Country Office (ICO) administration is managed through service-level 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 ICOs was contained as local remuneration conditions apply, which are generally lower than at IFAD headquarters.

V. IFAD financing activities

18. In line with the replenishment cycle, in 2016 additional instruments of contribution (IOCs) have been received towards IFAD10. This is reflected in an increase in equity (contributions) between 2015 and 2016 of about US\$164.3 million.
19. During 2016, additional compensation for the Debt Sustainability Framework (DSF) of US\$0.6 million was recognized and positively contributed to retained earnings.
20. At the end of December 2016, contributions encashed for the ASAP Trust Fund amounted to US\$111.7 million, while contributions paid through the deposit of promissory notes totalled US\$182.2 million (see appendix F in the consolidated financial statements).
21. In November 2014, IFAD entered into a framework borrowing agreement with KfW Development Bank for an amount of EUR 400 million. During 2016, IFAD drew down two additional instalments of EUR 100 million; and the overall borrowing liability amounted to EUR 250 million at year-end, equivalent to US\$263.7 million.

VI. IFAD-only balance sheet

22. The following analysis is based on appendix A of the consolidated financial statements and related notes (appendix D).

Assets

23. Cash and investments. The value of the cash and investments portfolio, including investment receivables and payables, decreased from US\$1.5 billion at 31 December 2015 to US\$1.3 billion a year later. This decrease is consistent with the adopted replenishment scenarios, for which detailed information is contained in the Report on IFAD's Investment Portfolio for 2016.
24. Receivables for IOCs and promissory notes. Net receivables decreased from US\$0.65 billion as at 31 December 2015 to US\$0.58 billion at 31 December 2016, in line with the IFAD10 cycle as reported in paragraphs 18 and 31 of this document.
25. Loans outstanding. Loans outstanding, net of accumulated allowances for loan impairment losses and the HIPC Debt Initiative, grew from US\$5.0 billion in 2015 to US\$5.2 billion in 2016. This movement is a result of the net effect of additional disbursements, loan repayments and negative exchange rate movements.

26. The fair-value adjustment in United States dollar terms decreased owing to the net effect of an additional fair-value annual charge and the unwinding effect of loans valued at fair value in earlier years.

Table 4

Loans outstanding

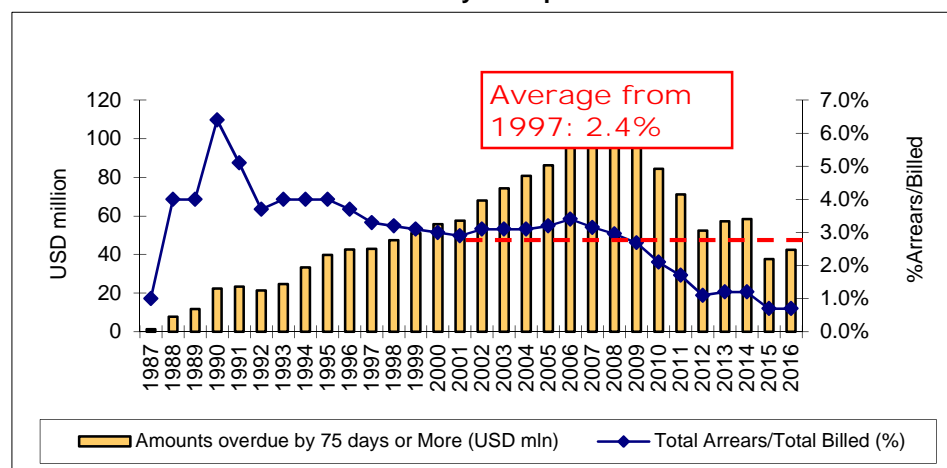
(Millions of United States dollars)

	2016	2015
Loans outstanding at nominal value*	6 377.2	6 270.4
Less fair-value adjustment	(1 182.8)	(1 188.1)
Loans outstanding at fair value*	5 194.4	5 082.3
Key operational data for 2016		
Loan approvals	657.7	1 005.6
Loan disbursements	539.4	486.7
Loan repayments	299.2	274.4

*Balances as at 31 December.

27. Allowance for loan-impairment losses. The balance of the allowance for loan-impairment losses in nominal terms rose from US\$35.5 million in 2015 to US\$59.6 million in 2016, reflecting a deterioration in the creditworthiness of two IFAD borrowers. As at 31 December 2016, this allowance represented 0.9 per cent of the balance of loans outstanding (US\$6,377 million), below the historical average of 2.4 per cent.
28. IFAD adopts operational measures to reduce the risk of accumulating arrears balances. These include suspending disbursements on loans that are 75 days in arrears and/or suspending the entire country portfolio. The figure below shows the percentage of amounts in arrears for more than 75 days, relative to overall billed amounts.

Figure 2

Amounts in arrears for more than 75 days compared to billed amounts

29. HIPC Debt Initiative allowance. The reduction from US\$27.6 million in 2015 to US\$17.7 million in 2016, in nominal terms, mainly reflects the debt relief provided to eligible countries. IFAD has been participating in the HIPC Debt Initiative since 1997 (see details in appendix J). As at 31 December 2016, the total cumulative cost of debt relief approved by the Executive Board was US\$478.0 million (in nominal terms); the amount of debt relief provided was US\$339.7 million in respect of principal and US\$105.3 million for interest.

Liabilities and equity

30. Borrowing liabilities. At end-December 2016, borrowing liabilities amounted to EUR 250 million, equivalent to US\$263.7 million.

31. Contributions. Cumulative contributions for regular resources, net of impairment allowances, rose from US\$7.9 billion at 31 December 2015 to US\$8.0 billion a year later, consistent with the IFAD10 replenishment cycle. Table 5 below provides important information on the status of contributions for IFAD10.

Table 5
Contribution flows
(Millions of United States dollars)

<i>IFAD10</i>	<i>2016</i>	<i>2015</i>
Pledges		
Regular resources	1 126.7	1 170.8
DSF compensation	2.9	2.9
Cumulative pledges to date*	1 129.6	1 173.7
Less: IOCs received	905.7	680.9
Outstanding pledges	223.9	492.8
Payments received		
Cash	512.1	79.4
DSF	2.3	-
Total payments	514.4	79.4

* During 2016, two Member States decreased their level of pledges announced towards IFAD10.

32. Full details of Members' replenishment contributions are shown in appendix H of the consolidated financial statements.

VII. IFAD-only statement of comprehensive income (appendix B)

Revenue

33. Income from loan interest and service charges amounted to US\$51.8 million in 2016, compared to US\$57.4 million in the previous year.
34. Income from cash and investments grew from US\$0.9 million in 2015 to US\$46.0 million in 2016.
35. Expenses reported in 2016 include those incurred under the annual administrative expenses budget in that year, but funded by carry-forward funds from the previous year's budget, plus the costs of IFAD's Independent Office of Evaluation and annual after-service medical costs. Table 6 compares expenses incurred in 2015 and in 2016.

Table 6
Operating expenses
(Millions of United States dollars)

Operating expense	<i>2016</i>	<i>2015</i>	<i>Movement +(-)</i>
Staff salaries and benefits	80.5	85.2	(4.6)
Office and general expenses	33.1	34.6	(1.5)
Consultants and other non-staff costs	40.1	35.4	4.7
Direct investment costs	2.4	2.4	-
Total	156.1	157.6	(1.4)

36. The total balances shown above include expenses funded from other sources (US\$16.9 million in 2016; US\$14.5 million in 2015), mainly by the Italian Government in the case of reimbursable expenses (US\$7.7 million in 2016 and US\$7.2 million in 2015), matched by associated revenue.
37. The above balances also include local staffing costs at ICOs, totalling US\$3.5 million in 2016 (US\$3.2 million in 2015) and operating and consultancy expenses for US\$4.7 million (US\$3.9 million in 2015).

38. Staff salaries and benefits. The drop in staff salaries and other entitlements from US\$85.2 million in 2015 to US\$80.5 million in 2016 reflects the strengthening of the United States dollar against the euro by approximately 2.8 per cent, and, following the successful outcome of a legal case, the release of a provision established in earlier years.
39. Office and general expenses. Administrative expenses are closely linked to the euro environment. In 2016 there was an overall decrease in value in United States dollar terms (US\$33.1 million in 2016 compared to US\$34.6 million in the previous year), owing to the appreciation of the United States dollar against the euro.
40. Consultants and other non-staff costs. The rise from US\$35.4 million in 2015 to US\$40.1 million a year later mainly reflects the larger volume of services provided by consultants and other organizations.
41. Loan interest expenditures. In 2016, IFAD accrued interest expenses and paid fees amounting to approximately US\$0.9 million in respect of KfW Development Bank borrowing activities (as mentioned in paragraph 13 above).
42. Adjustment for changes in fair value. In 2016, a negative fair-value adjustment of US\$5.3 million was made. This was mainly attributable to the higher market rates prevailing during 2016, thus leading to a higher discount rate being used when calculating the fair value of the loan portfolio. The average SDR curve was 1.26 per cent at end-2016, compared to 1.01 per cent at the end of the previous year.
43. Exchange rate movements. An analysis is provided in table 7 below.

Table 7

Exchange rate movements
(Millions of United States dollars)

	2016	2015
Cumulative net unrealized gain as at 1 January	189.3	464.0
Exchange rate movement on:		
Cash and investments	(28.6)	(67.8)
Net receivables/payables	4.6	6.9
Loans and grants outstanding	(146.0)	(213.4)
Promissory notes and Members' receivables	(9.8)	(17.3)
Members' contributions	10.3	16.9
Total movement in the year	(169.5)	(274.7)
Cumulative net unrealized gain as at 31 December	19.8	189.3

44. As stated above (paragraphs 5 and 6), IFAD assets are mainly denominated in SDR, or held in assets replicating the SDR basket; so the translation of such assets into United States dollars for reporting purposes generated an unrealized loss in 2016. At end-December 2016, cumulative net unrealized gains amounted to US\$19.8 million (see table 7).
45. After-service medical benefits. In 2016, as in previous years, IFAD engaged an independent actuary to perform an independent valuation of the ASMCS. The methodology adopted is consistent with the previous year's valuation, and the assumptions used reflect prevailing market conditions. The 2016 ASMCS actuarial valuation calculated a liability of US\$106.5 million at 31 December 2016, compared to US\$80.0 million a year earlier. IFAD recorded a net charge for current service costs of US\$4.3 million during 2016 (comprising interest costs and current service charges). This resulted in a net unrealized actuarial loss of US\$22.2 million (compared to an unrealized actuarial gain of US\$21.1 million in 2015). The change in liability was caused principally by prevailing market conditions, which also

affected the discount rate used in the 2016 valuation (i.e. 2.5 per cent compared to 3.2 per cent in 2015) and by the rising inflation rate in medical services.

VIII. Statement of retained earnings (appendix B1)

46. The retained earnings balance declined to a negative US\$1,511.6 million at the end of 2016. This balance represents the accumulation of yearly reported financial results from operations and the impact of exchange rate movements – mainly relating to the translation of loan balances denominated in SDR into United States dollars, IFAD's reporting currency. The total annual comprehensive loss of US\$447.4 million for 2016 contributed to the aforementioned retained earnings balance; nonetheless, there was a partial offset from DSF compensation amounting to US\$0.6 million.
47. The 2016 annual results are mainly attributable to additional financing in the form of grants, and DSF expenses amounting to US\$178.9 million, operating expenses (staff, consulting services, supplier expenses) totalling US\$156.1 million, and revenues of US\$118.2 million.

IX. Consolidated cash flow statement (appendix C)

48. Movements in liquid unrestricted cash and investments in the balance sheet are detailed in appendix C (consolidated cash flow) of the consolidated financial statements. It is noted that 80.1 per cent of consolidated cash and investment balances relate to IFAD (82.5 per cent in 2015).
49. IFAD grant disbursements decreased from US\$48.2 million in 2015 to US\$39.3 million a year later. Non-IFAD grant disbursements grew from US\$78.8 million in 2015 to US\$90.5 million in 2016.
50. Disbursements under DSF financing decreased from US\$125.6 million in 2015 to US\$123.9 million in the following year.
51. IFAD loan disbursements rose from US\$486.7 million in 2015 to US\$539.4 million in 2016. Non-IFAD loan disbursements remained relatively stable at US\$50.4 million in 2016 compared to US\$50.3 million in 2015.
52. During 2016, IFAD drew down additional instalments under the KFW Development Bank borrowing facility amounting to EUR 100 million, equivalent to US\$106 million.
53. Receipts from cash and promissory notes as replenishment contributions totalled US\$287.0 million in 2015, compared to US\$242.7 million in 2016.