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Investing in rural people

Conceptual Framework on Financial Reporting and Auditing of IFAD-Financed Projects

Note to Executive Board representatives

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For: Approval

Recommendation for approval

The Executive Board is invited to approve the Conceptual Framework on Financial Reporting and Auditing of IFAD-Financed Projects as presented in annex I.

Conceptual Framework on Financial Reporting and Auditing of IFAD-Financed Projects

Introduction

1. Proper oversight and management of financial resources are key to IFAD's ability to reach its objectives and demonstrate to its stakeholders that appropriate governance arrangements are in place. In accordance with article 7, section 1(c) of the Agreement Establishing IFAD, the Fund has the obligation to ensure that the proceeds of any financing are used solely for their intended purpose. Furthermore, in accordance with article IX, section 9.03(a) of the General Conditions for Agricultural Development Financing (the General Conditions), project accounts are to be audited regularly observing acceptable standards.
2. The IFAD Guidelines on Project Audits for Borrowers' Use (the Audit Guidelines) were first issued in 2003 to document IFAD's procedures in relation to the project audit cycle, and to standardize and improve the quality of project audits. The current Audit Guidelines were issued in 2011. The revision to the original guidelines reflected changes in the IFAD business model, the revision of the General Conditions and the shift to direct supervision of projects.
3. Since 2011, there have been rapid and significant changes in international auditing standards and international reporting standards and in IFAD's way of doing business and its contribution to the international financial management harmonization agenda. Accordingly, IFAD is proposing a series of changes to the Audit Guidelines. The Conceptual Framework for Financial Reporting and External Audit of IFAD-Financed Projects (the Framework) replaces the Audit Guidelines. The framework draws on emerging best practices and lessons learned through the implementation of IFAD-financed projects and reflects IFAD's continued commitment to support the development of good governance, transparency and anticorruption policies. The Framework fulfils the role envisaged for the Audit Guidelines in the General Conditions.
4. The theory of change proposed in the Framework is to move from a static, rules-based approach to a principles-based conceptual framework that provides the pillar for flexible and agile operational guidelines.
5. The current IFAD approach to project audits is addressed in two documents, namely:
 - (a) The IFAD Guidelines on Project Audits for Borrowers' Use, which is publicly disclosed and approved by the Executive Board; and
 - (b) Operational Procedures for Project and Programme Audits for the Use of IFAD and Cooperating Institutions, which is an internal document approved by the President of IFAD.

6. The proposed changes foresee the introduction of a new set of documents, which will replace the existing guidelines and procedures referred to in paragraph 5 above, namely:
 - (a) Conceptual Framework on Financial Reporting and Auditing for IFAD-Financed Projects, to be approved by the Executive Board following endorsement by the Audit Committee;
 - (b) Operational Handbook on Financial Reporting and Auditing of IFAD-Financed Projects (the Operational Handbook), intended for borrowers and recipients, to be disclosed as a public document issued by IFAD's Chief Financial Officer and Chief Controller; and
 - (c) A specific module on "Financial Reporting and Auditing of Projects" as part of the Financial Management and Administration Manual (FAM), for internal use by IFAD's workforce and for use by cooperating institutions where applicable, to be approved by the Director, Financial Management Services Division (FMD).
7. The Framework defines the strategic concepts (guiding principles) in financial reporting and auditing of IFAD-financed projects; it sets the context for the detailed operational guidelines contained within the Operational Handbook and the FAM. This Framework – which refers to the General Conditions as its regulatory pillar – addresses audit quality, IFAD's risk-based assurance framework including audit, harmonization with other multilateral development banks (MDBs), disclosure policy and delegation of authority.
8. The main changes envisaged to the project audit guidelines relate to: the structure of documents; number and type of financial audit opinions required, in alignment with several other multilateral development banks; clarification of the different types of audit (financial, compliance and/or value for money), and public disclosure of project audit reports.

Framework on Financial Reporting and External Audit of IFAD-Financed Projects¹

I. Abbreviations, acronyms and definitions

IESBA	International Ethics Standards Board for Accountants
IAASB	International Auditing and Assurance Standards Board
IFI	international financial institution
IFRS	International Financial Reporting Standards
ISRS	International Standard on Related Services
ISAE	International Standard on Assurance Engagements
INTOSAI	International Organization of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standards
ISA	International Standards on Auditing
ISSAI	International Standards of Supreme Audit Institutions
PFS	project financial statements
SAI	Supreme Audit Institution

Borrower: A Member State that receives a loan is called the borrower. A political subdivision of a Member State may be designated as the borrower, with appropriate safeguards.

Recipient: A Member State or other entity that receives a grant is called the recipient. If the Member State receives both a loan and a grant, it is referred to as the borrower/recipient.

Project/programme: Project or programme that has been provided with financing by or through IFAD by means of either a loan or a grant.

II. Background

1. In accordance with article 7, section 1(c) – Use of Resources and Conditions of Financing – of the Agreement Establishing IFAD, "the Fund shall make arrangements to ensure that the proceeds of any financing are used only for the purposes for which the financing was provided, with due attention to considerations of economy, efficiency and social equity." Accordingly, IFAD requires that financial records and financial reporting are prepared in accordance with practices and procedures acceptable to IFAD and that financial accounts of projects are audited regularly.
2. Proper oversight and management of financial resources are key to IFAD's ability to reach its objectives and demonstrate to its stakeholders that appropriate governance arrangements are in place.
3. The primary responsibility for implementing and maintaining financial management arrangements, including financial reporting and audit, lies with Member States or other entities that receive a loan or grant from IFAD. Although IFAD seeks to support borrowers and recipients in carrying out their legal responsibility to provide evidence of proper use of IFAD financing, the ultimate responsibility to do so lies with the borrowers and recipients.

¹ The framework fulfils the role envisaged for the Audit Guidelines in the General Conditions.

III. Guiding Principles

4. The following strategic concepts (guiding principles) reinforce the financial reporting and auditing of IFAD-financed projects.

Delegation of Authority

5. This framework introduces a principles-based approach to financial reporting and auditing of IFAD-funded projects. It sets the context for the detailed guidance provided in the “Handbook on Financial Reporting and Auditing for IFAD-Funded Projects”, as approved by IFAD Management. In line with the principles described in the following sections, IFAD will provide project staff, ministries, auditors and its internal workforce with additional guidance on developments in standards and organizational requirements, as and when required.

General Principles

6. The General Conditions, section 9 (Financial Reporting and Information), section 10.03 (Visits, Inspections and Enquiries) and section 10.04 (Audits Initiated by the Fund), and the IFAD Policy on Grant Financing (IFAD Grant Policy) remain the reference points for establishing financial reporting and audit arrangements for IFAD-funded projects. The principles outlined below do not replace the General Conditions and/or the general provisions of the IFAD Grant Policy but provide the framework for the operationalization thereof.

Ethics

7. In performing their respective duties, auditors and finance managers of IFAD-funded projects must observe ethical behaviours and, where appropriate, comply with an appropriate code of ethics, such as those issued by the International Ethics Standards Board for Accountants (IESBA)² or the relevant International Standards of Supreme Audit Institutions (ISSAI),³ or the national code of ethics.

Risk-Based Approach to Financial Reporting and Auditing

8. Project financial reporting and audit arrangements are determined during the project design phase according to the type and size of financing provided and in relation to identified project risks. Risk factors can be linked to country, institution and/or project characteristics. IFAD assesses accounting and audit capacity based on experience from past or ongoing projects and draws upon assessments conducted by other institutions.⁴
9. To mitigate identified project risks, IFAD may require audits with additional scope to be performed in accordance with the International Standard on Assurance Engagements (ISAE), International Standard on Related Services (ISRS) or relevant ISSAI.
10. Use of public financial management systems, including financial reporting and audit systems, is encouraged provided that these have been positively assessed by IFAD. The assessment is carried out in consultation with the borrower/recipient during project design and reviewed during project implementation.
11. Country and project risks are continuously monitored by IFAD to ensure that adequate and effective financial reporting and audit safeguards are in place throughout the project cycle.

² Issued by International Federation of Accountants (IFAC).

³ Issued by INTOSAI.

⁴ Such as other international financial institutions, the Public Expenditure and Financial Accountability (PEFA) Secretariat, bilateral donors and other specialized agencies of the United Nations.

Financial Reporting and Auditing Standards

12. IFAD requires the use of internationally accepted accounting standards, namely the International Financial Reporting Standards (IFRS) and the International Public Sector Accounting Standards (IPSAS) in the preparation and presentation of financial statements of IFAD-funded projects. National/regional accounting standards issued by relevant local authorities may also be acceptable to IFAD.
13. IFAD requires the use of the International Standards on Auditing (ISA) or the International Standards of Supreme Audit Institutions (ISSAI) in auditing the financial statements of IFAD-funded projects. National/regional standards for auditing may also be acceptable to IFAD.

Transparency and Disclosure

14. IFAD promotes public disclosure of project financial information to enhance the level of transparency and accountability. Borrowers/recipients are encouraged to make project audit reports publicly available. IFAD will publish project audit reports, as appropriate, in line with IFAD's Disclosure Policy. Management Letters issued by auditors are not subject to public disclosure by IFAD.

Appointment of External Auditor

15. Section 9.03(a) of the General Conditions requires that appointed auditors are independent and acceptable to IFAD.
16. Project external auditors acceptable to IFAD include the country's Supreme Audit Institution (SAI), if a member of INTOSAI; other public bodies accountable under national legislation; or private audit firms registered with the local professional accounting and auditing bodies.

Harmonization and Coordination

17. IFAD is committed to using public financial management systems in the projects that it finances to the greatest extent possible. In this context, IFAD seeks to harmonize its requirements with those of other partners and donor institutions.

IV. Adoption

18. This framework will take effect on 1 January 2018. Borrowers/recipients will be required to adopt it progressively, up to 1 January 2019, after which its application will become mandatory.