



IFAD
INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT
Executive Board - Sixty-Third Session
Rome, 22-23 April 1998

REPORT OF THE AUDIT COMMITTEE

1. The Audit Committee (the Committee) held its Sixty-First and Sixty-Second Meetings on 20 February 1998 and 21 April 1998, respectively. The Committee wishes to report the following matters to report to the Executive Board.

2. **Review of the Audited Financial Statements of IFAD for 1997**

(a) Income from Investments

Investment income in 1997 amounted to USD 163.9 million compared with USD 148.9 million in 1996, an increase of 10%. This includes interest from investments of USD 127.8 million, a slight decrease over 1996. The average rate of return on IFAD's investments for 1997 was 7.54%. Realized capital gains in 1997 amounted to USD 21.5 million, compared to realized losses of USD 100 000 in 1996. The major part of the portfolio was managed by external investment managers whose fees, amounting to USD 5.5 million in 1997, have been charged against investment income.

The Committee discussed the breakdown of IFAD's investment portfolio, as shown in Appendix G, Note 3(b), and the unrealized market gain of covered forwards of USD 2.8 million in 1997 compared to a loss in 1996 of USD 6.1 million. Members of the Committee noted a USD 9.1 million unrealized loss in the market value of equities due to the crisis in the Asian markets. It was noted, however, that more than 57% of the potential loss had been recouped in January 1998 and that, since then, the position had improved even further. Detailed information on IFAD's investment activity is provided in document EB 98/63/R.3.

(b) Income from Loans

Income from loans amounted to USD 42.0 million in 1997, a slight increase over the previous year. Of this, almost USD 2.5 million has been excluded for arrears in repayment. At USD 281.0 million, disbursements to loans and grants in 1997 increased slightly over the 1996 figure.



(c) Administrative Expenses

Expenditures under the 1997 budget have been maintained within the approved level. The 1997 budget expenditures, including staff costs, operational and administrative expenses, payments to cooperating institutions and consultants, and costs of IFAD's governing body meetings, amounted to USD 50.5 million compared with an approved budget of USD 50.7 million.

The Committee noted that, while budget allocation had been made for the Evaluation Committee, there was no such provision for the Audit Committee. It was felt that, despite the Board's desire to keep costs down, the increasing importance of the role played by the Audit Committee required that provision be made in the 1999 budget for Secretariat costs (staffing, document preparation and translation, interpretation, seminars, etc.).

(d) Fourth Replenishment Contributions and Resources Available for Commitment

As at 31 December 1997, Fourth Replenishment contributions of almost USD 149 million had been received, either in cash or promissory notes. Net resources available for commitment at the end of 1997 amounted to almost USD 387.5 million.

(e) Cash in Banks

Cash deposited in banks as at 31 December 1997 amounted to USD 74.4 million in convertible currencies, plus USD 11.3 million in currencies subject to restriction. This includes amounts held pending investment by external managers. As shown in Appendix B of the Financial Statements, at the end of 1997, the net assets of the Fund amounted to USD 5.3 billion.

(f) Exchange Rate Movements

The effect of SDR/USD exchange rate movements at the end of 1997 resulted in an unrealized loss of USD 312 million compared with USD 161 million in 1996.

The Committee noted that exchange rate fluctuations are subject to changes from year to year. These are shown in the financial statements in accordance with International Accounting Standards but have no economic effect on the Fund. Over the period 1990-1997, a net gain of USD 251 million, resulting from the effects of exchange rate movements, had been achieved. The effects of foreign exchange movements are explained in Appendix G, Note 2(d). The Committee discussed the 1978 Executive Board decision to carry out its lending operations in SDR while maintaining its financial reporting in United States dollars. The Secretariat will provide the Committee with details of how this decision came about.

(g) Payments to Cooperating Institutions (CIs)

At the present time, IFAD has entrusted the supervision of approximately 200 projects to its cooperating institutions. Staff of the Programme Management Department/Controller's Office negotiate the rates for this service directly with the cooperating institution. The World Bank has advised IFAD that although its rates will increase significantly in 1999, it will maintain the present level for 1997 and 1998.



3. Private Session with Representatives of the External Auditors, Price Waterhouse

A private session was held with two representatives of Price Waterhouse. The Committee reviewed the Audit Summary Memorandum arising from the audit of the 1997 accounts. The Chairman will hold separate discussions with Price Waterhouse regarding items to be included in the Memorandum on Internal Control and Accounting Procedures and others that will be dealt with directly by the Committee.

4. Introduction of the Euro

As of January 1999, a number of governments will begin to effect payments against public debt in Euro. The Fund has been requested to notify Member Countries of any special problems foreseen in this method of payment. The Treasurer of IFAD informed the Committee that, in the coming months, the International Monetary Fund will decide on the revised basket of currencies that will form the SDR. A suggestion was made that, to avoid problems, Members authorize the encashment of their promissory notes before the introduction of the Euro.

5. Revised Terms of Reference and Rules of Procedure of the Audit Committee

At its Sixty-First Session in September 1997, the Board decided to change the composition of the Audit Committee, thus necessitating a revision of the Committee's Terms of Reference and Rules of Procedure. The Committee began its debate of a draft document provided by the Secretariat and considered possible additions to the Terms of Reference. These included an explicit reference to the role of the Committee in assisting the Board to exercise its responsibility for the conduct of the general operations of the Fund; and, as in the case of at least one other comparable Audit Committee, whether the Committee's responsibility for overseeing particular systems (e.g. procurement) should be mentioned. Owing to time constraints, the Committee adjourned discussion of this item to its September 1998 meeting, at which time a report will be provided to the Board.

6. Rotation of the External Auditor and Provision of Non-Audit Services by the Firm of External Auditors

The Committee reviewed a paper dealing with (a) the case for rotating the external auditor at intervals in the interests of ensuring his independence; and (b) the question of whether the external auditor should be allowed to bid for the provision of non-audit services to IFAD. The Committee's review of item (b) was instigated by the external auditor, who advised that IFAD should have an explicit policy on the matter.

As to item (a), the Committee concluded that there were no grounds for rotating the external auditor as a matter of principle. Such rotation implied significant costs and increased the audit risk, at least in the early years of a new auditor's incumbency. The Committee recommends that:

- (i) the external auditor be appointed on the basis of an annual contract, renewable for a period of up to five years, subject to satisfactory performance. The decision to renew the annual contract would be made by the Board on the recommendation of the Committee (procedure unchanged).



(ii) every five years, the Committee should re-examine the issue of rotation from first principles, with the option of recommending:

- that the external auditor be re-appointed, without competition, under the same arrangements outlined in (i) above; or
- that the provision of external audit services be re-tendered, and that the existing external auditor should be considered eligible to bid; or
- that the services should be re-tendered, and the existing auditor should not be considered eligible to bid.

The next re-examination from first principles would relate to the appointment of the external auditor for the Financial Statements for 2001.

With regard to item (b), provision of non-audit services, the Committee recommended that IFAD management should be at liberty to procure such services, on a single or competitively-tendered basis, subject to the following conditions:

- that the fees are competitive;
- that the external auditor's independence, in accordance with professional practice, is not compromised;
- that the non-audit fees accruing to the firm are disclosed in the financial statements of the Fund; and
- that all contracts for such services are reported to the Committee.

7. Office of Internal Audit

The Committee welcomed the new Chief of Internal Audit and congratulated him on the papers provided for the information of the Committee (Charter of the Office of Internal Audit, the 1998 Strategy Statement, Workplan and Preliminary Risk Assessment).