REPORT OF THE AUDIT COMMITTEE

1. Following its Seventy-Fifth Meeting on 3 December 2001, the Audit Committee wishes to draw the attention of the Executive Board to the following matters.

Comments from the President on the Review of the Internal Audit Function

2. The President was requested to provide informal feedback on the outcome of his review of the internal audit function, including consideration of the staffing and resources of the internal audit unit. The President commenced by emphasizing the importance of the audit function within IFAD. He noted that his review of this function has just begun and that his initial impression is that the system is a good one, but that improvements could be made in the implementation of internal audit recommendations. With respect to staffing, the President remarked that the level of resources that IFAD devotes to internal audit is similar to that in other international financial institutions. The internal audit unit did not function at full capacity during the last year because of unfilled vacancies, but it is expected to be fully manned and working at a normal level in 2002. The President concluded that he will continue his review of the internal audit function concentrating on how internal audit recommendations can be implemented more effectively rather than on merely increasing the size of the audit function.

3. The President agreed to provide further feedback to the Committee at its April 2002 meeting.

Structure, Mandate and Terms of Reference of the Audit Committee

4. The Audit Committee had an informal meeting on 20 November 2001 to review and discuss its structure, mandate and terms of reference with a view to providing advice to the Executive Board on a wider range of financial issues. This meeting concluded that there was a prima facie case for reviewing the Audit Committee function and that the following action would be taken:

(a) The Chairperson, with the help of the Secretariat, will determine how audit/finance committees in other similar organizations operate.
(b) Based on the above information and discussions during the informal meeting, the
Chairperson will prepare a paper outlining issues and options with respect to the
expansion of the Audit Committee’s mandate.

(c) The Audit Committee will meet at the beginning of 2002 to discuss the paper and will
report its conclusions to the Seventy-Fifth Session of the Executive Board in April 2002.

External Auditor’s Summary on Earlier Recommendations Regarding Internal Controls

5. During its September 2001 review of the external auditor’s memorandum on internal control
arising from his audit of the 2000 financial statements, the Committee requested a full list of previous
external auditor recommendations on internal controls and accounting procedures, together with a
description of actions taken. The Committee reviewed the resulting summary; asked for it to be
expanded to show deadlines for actions still outstanding; and agreed that the summary should be
brought up for annual review.

6. The Committee agreed that a paper should be prepared on the systems security issues
mentioned in the summary for review at the next Audit Committee Meeting.

Contract with the External Auditor

7. The external auditor’s contract for audit of the 2001 accounts was tabled for information. The
Committee discussed the issue of the limited liability and asked for further information on what
recourse IFAD would have if the external auditing service were to fail in its duties. The Committee
decided that the draft contract for services should be submitted to it when it considered the
appointment of the external auditor.

8. The Committee agreed that the issue of whether it should review major contracts entered into
by IFAD would be addressed when considering the expansion of the Audit Committee’s mandate.

Rotation of Auditing Firm

9. The Committee commenced its periodic review of the rotation of the external auditing service
and discussed in detail the benefits and drawbacks of rotating the external auditors on a regular basis.
Even though IFAD has been satisfied with the work of the existing auditors, PricewaterhouseCoopers
(PwC), it was agreed that competition was an important factor. Since PwC had been IFAD’s auditors
for 23 years, the Committee agreed that the Fund should re-tender these services. This should be done
as soon as possible in order to complete the process in time to appoint the auditors for the 2002 audit.
It was agreed that PwC would be considered eligible to bid.

10. The Chairperson requested that the Secretariat prepare a paper, to be presented to the members
of the Audit Committee at the conclusion of the Executive Board Session on Thursday,
6 December 2001, on the key steps required in the proposed re-tender process, based on the need to
make a recommendation to the Seventy-Fifth Session of the Executive Board in April 2002.

After-Service Medical Benefits

11. The Seventy-Third Meeting of the Committee in April 2001 requested the Secretariat to
provide a paper outlining the principles of the after-service medical benefits scheme and the reasons
for the increase in IFAD’s share of the liability. The principal plan provisions were provided to the
Committee members, and the reasons for the increase in IFAD’s share were explained as follows:
(a) the difference in the type of actuarial valuation report commissioned in 1997 and 1999;

(b) a 5% reduction in the number of active Food and Agriculture Organization of the United Nations (FAO) staff participating in the plan (which results in a larger allocation to IFAD of the actuarial liability). It was pointed out that assets of the plan are not pooled. Each organization separately holds the assets of its portion of the after-service medical plan. As such, any overfunding in the current period will enure to IFAD in future periods;

(c) an increase in the number of active IFAD staff participating in the plan due to a change in the contractual terms of staff under the long-term temporary category in March 2000.

12. The next actuarial review is scheduled for the end of 2001.

**Proposal for Global Custodian and Ancillary Services**

13. At its Seventy-Third Meeting, the Committee decided that custodian services should be re-tendered. A tender for custodian and ancillary services was accordingly issued to eight firms in September 2001, as a result of which seven bids were received by 30 October 2001. The technical bids were opened on 5 November 2001, and the process of evaluation is currently under way. The price information will be opened once the technical evaluation is completed, which is expected to be before the end of December 2001.

14. The Committee will review the outcome of the tender at its March 2002 Meeting.

**Custodian Fees**

15. State Street has been unable to provide a detailed breakdown of custody fees. The Secretariat were pursuing the matter. It was suggested that one of the following solutions may eventually be resorted to:

   (a) a letter of comfort could be obtained from the external auditors of State Street regarding the method of calculating the custody fees charged to IFAD (the cost of preparing this letter would have to be borne by IFAD);

   (b) a letter of comfort could be obtained from the compliance officer of State Street regarding the method of calculating the custody fees charged to IFAD;

   (c) members of IFAD’s internal audit unit along with IFAD’s treasury staff could visit the State Street premises to review the method of calculating the custody fees charged to IFAD.

16. The Committee suggested that State Street should no longer be eligible to bid for the custodian and ancillary services if they are unable to provide details on how they calculate the fees they charge to IFAD.
Common Services Agreement with FAO and the World Food Programme (WFP)

17. At its Seventy-Third Meeting, the Committee welcomed in principle the idea of a common services agreement for the monitoring of investments, but it was not convinced that the costs, benefits and risks of such an agreement had been fully appraised. The Committee was advised that after discussions with WFP and FAO, IFAD had decided not to enter into such a shared services agreement. The Committee, however, noted and endorsed the close working relationship among the three organizations in the investment area.

Loans and Grants System (LGS)

18. The Committee was advised at its Seventy-Fourth Meeting that IFAD management has taken note of the urgent need to replace the obsolete LGS. The Committee requested that an implementation plan be presented to it. It was informed that as part of the Process Re-Engineering Programme, management agreed that the existing LGS system should be replaced with a new design that could be integrated into other IFAD systems and fulfil the functional requirements of all users. This integrated system would therefore be part of the Strategic Change Programme (SCP) initiative, which means that the LGS replacement timetable is linked to the schedule for SCP implementation. IFAD senior management is currently reviewing this schedule, and it is anticipated that these activities will be commenced in 2002. The costs entailed will be part of the SCP.

19. In order for users to continue to use the existing LGS, the original LGS design consultant has been contracted to work on software modification, software development and documentation. The consultant will provide full ‘technical documentation’ on the LGS programme, which will be used for data conversion to the new LGS.

20. Planned activities include the establishment of a multidisciplinary design team to elaborate the business processes compatible with the information technology (IT) processes envisaged. During the first half of 2002, the expertise of other financial institutions will be drawn on (for example, the Asian Development Bank whose loan financial information system provides a web-based linkage with all projects under implementation). During the second half of 2002, there will be further elaboration of design to ensure that elaborate customization is kept to a minimum. In the event that any delays become apparent, it will be necessary, with senior management approval, to initiate detailed IT system design work specific to the future LGS requirements, ensuring the compatibility of the interface with the institution.