



**IFAD**  
**INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT**  
**Executive Board – Seventy-Fifth Session**

Rome, 22-23 April 2002

**REPORT OF THE AUDIT COMMITTEE**

1. Following its seventy-sixth and seventy-seventh meetings on 15 March and 17 April 2002, the Audit Committee wishes to draw the attention of the Executive Board to the following matters.

**Review of the Audited Financial Statements of IFAD for 2001**

2. The committee reviewed the Financial Statements of IFAD for the year ending 31 December 2001. It noted with satisfaction the opinion of the External Auditor, PricewaterhouseCoopers, that the statements gave a true and fair view of the financial position of IFAD, the results of its operations and its cash flows, in accordance with international accounting standards.

3. The Secretariat noted the following salient points from the Financial Statements:

**Investments**

The net loss from investments amounted to USD 43.0 million in 2001 compared with the net loss of USD 47.0 million for 2000. The loss position has improved, and the new investment policy of holding fewer equities is being implemented.

**Income from loans**

Income from loans amounted to USD 42.3 million in 2001 compared with a total of USD 44.3 million in 2000.

**Operating and administrative expenses**

Actual expenses in 2001 amounted to USD 49 240 000 compared with an approved budget figure of USD 52 331 000.



### **Cash in banks**

Cash balances in convertible currencies at 31 December 2001 amounted to USD 71.7 million, which included funds held pending investment by external fund managers.

### **Assets**

Total assets have decreased from USD 5 458 million in 2000 to USD 5 206 million as at 31 December 2001.

### **Operational statistics**

Loan disbursements increased from USD 285.0 million in 2000 to USD 299.6 million in 2001. Loan principal repayments decreased from USD 132.9 million to 128.04 million. Grant disbursements remained constant at USD 27.0 million. During 2001 there was a net resource outflow of USD 158.0 million.

4. In its discussion on the Financial Statements, the committee noted the following points:
  - (a) The principal reasons for the decrease in the net assets of the Fund are first, the introduction of a provision for loan impairment losses of USD 72 million in accordance with International Accounting Standard (IAS) 39; second, the accumulated allowance for the Heavily Indebted Poor Countries Debt Initiative of USD 189 million; and third, exchange rate fluctuations.
  - (b) It was noted that the net loss from investments includes a realized net capital loss from equities of USD 87 million. The Secretariat explained that the realized and unrealized gains or losses from investment reflect the movement in market value. Investment managers are actively managing IFAD's portfolios, and they consider each portfolio's overall position in the market. For this reason, they may sell equities to gain a better position if, for instance, they think the value of the current equity holding will decrease. The current equity market is still volatile, and investment managers may take a loss in order to switch sector allocation to more stable sectors. A paper outlining further details about the capital gains and losses on equities was presented to the committee's April meeting. The Secretariat explained that the analysis shows that there is a strong correlation between the cumulative return on IFAD's equities portfolio and the benchmark. Moreover, it can be demonstrated that the external equities managers would have performed no better had they kept the stocks that they had at the beginning of the year. There would have been no realized capital losses, but there would have been an equivalent increase in unrealized losses.
  - (c) The committee asked why there were such a large number of open 'buy' options, as shown in Note 3 to the Financial Statements. The Secretariat explained that the buying of options is a way to hedge and protect the portfolio, which involves very little cash outlay.
  - (d) It was noted that in Schedule 3, "2001 Approved Budget versus Actual Expenses", the 2001 budget was higher than the 2000 actual expenses even though the budget was prepared on a zero-growth basis. The Secretariat explained that despite zero growth in the number of posts, the budget had increased because of the exchange movement in General Service salaries, which are paid in Italian lire/euro. Also, the budget included expected salary increases that are dictated by the United Nations salary scale. The committee also noted that in a number of cases the actual expenditure exactly equalled the budgeted amount and that it was unusual to achieve such accuracy. The Secretariat explained that these represented cases where the budget had been fully used. Other differences between budget and actual expenses were explained by the reclassification of staff from short-term temporary to fixed-term staff.



5. The committee recommends endorsement of the IFAD Financial Statements for 2001 by the Executive Board to the next session of the Governing Council.

### **Structure, Mandate and Terms of Reference of the Audit Committee**

6. As advised in its report to the December Executive Board, the Audit Committee has been reviewing the Audit Committee function and discussing the committee's structure, mandate and terms of reference with a view to providing advice to the Executive Board on a wider range of financial issues. The committee emphasizes that the aim of expanding its terms of reference is to strengthen the governance of the Fund by adding value to the deliberations of the Board on financial matters. The committee has prepared a proposal for discussion with the Fund's management. It has also requested the Secretariat to provide information on the costs and modalities of the proposal. The committee will make a formal proposal to the Fund in September.

### **Review of the Internal Audit Function**

7. The chairperson recalled that the responsibility of the Audit Committee is to "satisfy itself that the Fund has an effective and efficient Internal Audit function".

8. The Secretariat presented the paper on the Internal Audit activities and plans, which details the activities of 2001 and the programme of work, and summarized discussion on the implementation of Internal Audit recommendations.

9. Six programmed audits were approved for 2001 of which four are in progress and two have been postponed until 2002 due to reduced staff levels. It was, however, foreseen that the position of audit officer would be filled during the second half of 2002.

10. The committee expressed a concern about the low level of implementation of Internal Audit recommendations. The Secretariat explained that steps had been taken to ensure better follow-up of recommendations including the presentation of major issues arising from audits to senior management for endorsement and assignment of implementation responsibilities.

11. The Secretariat assured the committee that the review of the Internal Audit function will be given top priority and that a progress report will be presented to the committee's September meeting.

### **Appointment of External Auditor**

12. At its seventy-fifth meeting on 3 December 2001, the Audit Committee decided that the annual audit of the Fund and the specialist funds under IFAD's administration should be re-tendered. The tender process, details of which are given in the Annex, is now complete. The committee recommends that PricewaterhouseCoopers be reappointed as external auditors. The reappointment would be on the basis of a contract to be settled and agreed in September 2002 following a review by the Audit Committee of the External Auditor's memorandum on strategic planning for the 2002 audit. Under the 'five-year rule' established in 1998 – which requires a review from first principles of the appointment of the External Auditor – the tenure of PricewaterhouseCoopers would be assumed to run for five years, subject to satisfactory performance. The process of annual reappointment by the Executive Board would, as now, permit the Board to look elsewhere for external audit services, if it so chose, before that period had elapsed. In practice, there are substantial costs and risks associated with changing external auditors, and the case for making a change would need very careful consideration.



### **External Auditor: Limitation of Liability**

13. During the committee's seventy-fifth meeting, the issue of limited liability of external auditors was discussed. The General Counsel briefed the meeting on what recourse IFAD would have if an external auditor were to fail in its duties. IFAD's current contract with the External Auditor is governed by Italian law and any action would have to be taken accordingly. IFAD has immunity, and to bring an action this immunity would have to be raised. The General Counsel advised that when preparing the new contract with the external auditor, IFAD should endeavour to remove the limited liability clause and include an arbitration clause. The committee suggested that before the new contract is concluded, information should be obtained regarding the External Auditor's financial resources and insurance cover.

### **Custody Fees and Proposal for Global Custodian and Ancillary Services**

14. At its seventy-third meeting in April 2001, 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. On 28 March 2002, the six-member technical evaluation team unanimously proposed a shortlist of three candidates, for final evaluation

15. The planned site visits should be completed by mid-May 2002, and the final selection will be made by the end of May 2002.

16. The committee noted that State Street had taken an unacceptably long time to provide details of their custody fees. This should be taken into account during the evaluation. Furthermore, all shortlisted candidates should be asked to provide similar details of proposed fees.

17. The Secretariat presented and explained the breakdown of the USD 2.4 million in fees paid to State Street during 2001. Principal services of USD 2.1 million were made up of accounting and administration fees (10%), custody fees (37%) and transaction costs (53%).

### **Project Audit Reports**

18. The Secretariat presented a paper on the project audit reports, which analyses the rate of current submission of audit reports and presents recommendations for improving the procedures surrounding their receipt and review. The Secretariat noted that it is committed to improving the procedures and that the following two documents are currently being finalized:

- Guidelines on Project Audits for IFAD Loans
- Operational Procedures for Project Audit

19. The committee noted the report and requested an annual progress report framed on the basis of performance targets. The committee also noted that the relationship between IFAD and the cooperating institutions was a commercial one. It should accordingly be expressed in terms of a contract clearly specifying what services the cooperating institutions are to provide and including sanctions for non-performance.



## **APPOINTMENT OF THE EXTERNAL AUDITOR OF IFAD REPORT ON THE EVALUATION**

### **Background**

1. At its seventy-fifth meeting on 3 December 2001, the Audit Committee discussed the issue of External Auditor rotation based on a paper prepared by the Secretariat. The committee decided to invite independent audit firms of international standing to tender for the annual audit of the Fund and the specialist funds under IFAD administration. The committee decided that the incumbent External Auditor, PricewaterhouseCoopers, should be eligible to bid.
2. This note reports on the evaluation process and makes a recommendation to the Executive Board.

### **The Tender Process**

3. The main criteria for inviting firms to tender were that they had international standing and presence in Rome. The invitations to tender were issued on 21 February 2002, and the deadline for a reply was 28 March 2002, 16.30 hours, Rome time.
4. The Audit Committee reviewed progress with the tender at its seventy-sixth meeting on 15 March 2002. Copies of the request for proposal (RFP) for audit services were distributed to members of the committee at the meeting.
5. In accordance with the tender process, the Secretariat formed an evaluation panel to conduct an appraisal of the written proposals.

### **The Appraisal Scheme**

6. The appraisal scheme was based on experience in other United Nations Agencies – especially the Rome-based agencies, which had recently gone through a similar process – and other IFIs.

### **Evaluation of the Technical Proposals**

7. Under the auspices of the Office of the Internal Auditor and in accordance with IFAD's internal procedures on procurement, the technical proposals received by the deadline were opened and validated on 28 March 2002.
8. Three firms, Deloitte & Touche S.p.A., PricewaterhouseCoopers S.p.A. and Reconta Ernst & Young S.p.A., responded to the invitation to tender. KPMG indicated that it would be interested in a future tender but was not able to prepare a professional proposal at this time.
9. The technical proposals were distributed to the members of the evaluation panel, who marked them individually and then met on 3 April to discuss each proposal and confirm the scores awarded.

### **Oral Presentation**

10. All three firms were invited to make an oral presentation on 10 April. The chairperson of the Audit Committee chaired these sessions, together with the review of the cost proposals and the discussion of conclusions and recommendations. In preparation for the oral presentations, the evaluation panel reviewed the issues and areas that needed further clarification, and information from

ANNEX

the candidates. Each candidate firm was allotted two hours – from 45 minutes to one hour for the presentation and one hour for questions and answers. To maintain consistency with the RFP, the questions were organized under the following four main headings: (a) the firm; (b) audit team; (c) audit approach; and (d) communication with IFAD.

11. The three candidates made their oral presentations individually. The panel asked questions, as necessary, to clarify the presentations and the replies provided. After each presentation, the panel immediately scored and discussed the presentation

### **Evaluation of Cost Proposal**

12. Under the auspices of the Office of the Internal Auditor and in accordance with IFAD's internal procedures on procurement, the cost proposals were opened and validated on 11 April 2002. On the same day, the cost proposals were distributed to the members of the evaluation panel for ranking. The panel considered the overall cost, the cost per hour and the skill mix proposed by each candidate and awarded points in accordance with the agreed rating system.

### **Overall Rating**

13. After discussing the cost proposals on 11 April, the evaluation panel agreed the overall ratings. On a scale of 780 points, PricewaterhouseCoopers obtained the highest score, 655.5 points. Deloitte & Touche was second, with 598.5 points. Reconta Ernst & Young came third, with 369.5 points.

### **Conclusion and Recommendation**

14. Based on the review of the technical proposals, oral presentations, cost proposals and the recommendation of the evaluation panel, the Audit Committee recommends that PricewaterhouseCoopers should be reappointed as the External Auditor of IFAD. The appointment should be on the basis of a contract to be settled and agreed with the Audit Committee in September 2002 based on PricewaterhouseCoopers' memorandum on strategic planning for the 2002 audit.

15. The Audit Committee further recommends that, subject to satisfactory performance, PricewaterhouseCoopers' term of office as External Auditor should be presumed to run for five years, i.e. until the committee next reviews the question of rotation under the 'five-year rule' established in 1998. In practice, this amounts to no more than an informal understanding, since formally speaking the External Auditor is appointed each year on the decision of the Executive Board. (One member of the committee preferred a term of office of four rather than five years.)

16. There may be advantage in bringing forward the annual reappointment of the External Auditor from September to April. The earliest practicable date for making such a change would be April 2003. The committee will discuss this at its meeting in September.