REPORT OF THE AUDIT COMMITTEE

1. Following its seventy-ninth meeting on 9 December 2002, the Audit Committee wishes to draw the attention of the Executive Board to the following matters.

Chairman

2. The previous chairperson of the Audit Committee, Mr Anthony Beattie, resigned from his post on 4 November 2002. Since it had been agreed by Executive Board members that a List A member should chair the Audit Committee, the List A members were consulted regarding his replacement. They proposed that Mr Alain Giullouett chair the seventy-ninth meeting and that the member for Spain volunteer to fill the position in the Audit Committee vacated by the United Kingdom.

3. At the start of the seventy-ninth meeting, Audit Committee members endorsed Mr Giullouett as chairperson of this meeting and at the same time expressed appreciation of Mr Beattie’s excellent direction of the Audit Committee over the last five years. He has worked with great dedication and enthusiasm, and his presence on the Committee will be missed.

After-Service Medical Provision

4. The After-Service Medical Coverage Scheme is administered by the Food and Agriculture Organization of the United Nations (FAO) for staff receiving a United Nations pension and eligible former staff on a cost-sharing basis. Formerly the costs of this scheme were met on a pay-as-you-go basis. International Accounting Standard (IAS) No. 19, Employee Benefits, which became effective in 1999, requires IFAD to recognize a liability for IFAD’s part in funding employee and former-employee benefits to be paid in the future. The value of these benefits is estimated by an actuary engaged by FAO for the entire scheme; IFAD is allocated a share of these benefits in proportion to pensionable remuneration. Actuarial valuations are prepared every two years.

5. The funding of the liability is not pooled; the assets are separately held by each participating organization. Therefore, any benefits of funding a higher liability accrue to IFAD in future years.
6. In December 1998 and in December 2000, the Executive Board authorized the transfer of USD 12.9 million and USD 6.8 million respectively to the income statement over the period (1999-2003).

7. A copy of the actuarial report with the new valuation updated to 31 December 2001 has just been received. According to the report, IFAD has been apportioned a liability for past service costs of USD 23.3 million. This represents an increase of USD 3.6 million from the previous valuation.

8. IAS 19 requires IFAD to record these costs in 2002 as a one-off charge, since the Fund knows about this change in the liability estimate in advance of closing its annual accounts. IFAD is no longer permitted to spread the cost over five years, but should recognize the whole cost (or income, should the valuation show a gain in the future) in the year in which the information is available. Accordingly, **the Audit Committee recommends**:

   The Executive Board authorize the transfer of USD 3.6 million from IFAD’s resources in 2002 as a one-off cost to fund the actuarial deficit of the After-Service Medical Coverage Scheme as at 31 December 2001.

9. IAS 19 requires IFAD to set up a separate legal entity into which it should transfer assets, in order for them to qualify as scheme assets that can be used to offset the liability. IFAD has effectively ‘ring-fenced’ the funds since 2001 so that it accrues interest on them. However, setting up a separate legal entity requires that the Governing Council adopt a resolution, following the recommendation of the Executive Board. Accordingly, **the Audit Committee recommends**:

   The Executive Board recommend to the Governing Council the setting up of a separate legal entity, namely a trust fund, into which assets for the After-Service Medical Coverage Scheme will be transferred.

10. It was noted that maintaining the funds in a separate legal entity will not affect IFAD’s ability to access these funds when required, as they will be consolidated in IFAD’s accounts exactly like those relating to the Debt Initiative for Heavily Indebted Poor Countries Trust Fund.

11. Due to the importance and growth of the liability, the Audit Committee requested that the Secretariat review options available to IFAD with respect to the valuation of After-Service Medical Coverage Scheme liabilities. This review should address the costs and benefits of, first, another actuary being engaged by IFAD to value IFAD’s deemed share of the current scheme; and, second, IFAD’s setting up a separate after-service medical coverage scheme. The Secretariat also pointed out that the level of the liability is substantially linked to the method of allocation among the plan participants. To date, IFAD has not participated in establishing the basis on which this allocation has been made. IFAD management has agreed with FAO that IFAD will in the future be involved at a timely stage in this process. Therefore, as a third option, IFAD will also evaluate the costs and benefits of remaining within the FAO group plan, taking into account the Fund’s ability to influence existing arrangements. The Secretariat agreed to provide a progress report in September 2003, at which point the Audit Committee can provide further guidance as to steps to be taken.

**Accounting for Grants**

12. At its Twenty-Fourth Session in February 2001, the Governing Council approved the establishment of the programme development financing facility (PDFF), separate from IFAD’s programme of work and budget, to finance the expenditures required for the design, implementation and supervision of projects and programmes financed by loans and grants from IFAD.
13. IFAD management was given authority to establish a new set of financial and administrative guidelines and procedures for the PDFF. Following the drafting of procedures for the new PDFF, the accounting for all other grants was reviewed. As a result of this review, management proposes that the accounting principle for all other grants should be changed, to align with those adopted for the PDFF and also in line with the accounting principle adopted for commitments made under the Debt Initiative. This change will result in a more appropriate and consistent presentation of these transactions in the Fund’s financial statements.

14. The Audit Committee hereby recommends that:

The Executive Board approve the change in the accounting principle for non-PDFF grants, in order to align the treatment thereof to other similar transactions in the Fund’s financial statements, in accordance with current accounting standards. These grants will be recorded as expenditures (along with the corresponding liability) on approval by the Executive Board or a person with appropriate delegated authority. Cancellations of undisbursed balances will be recognized as an offset to the expense in the period in which they occur. The total net charge will be included as a separate line item following administrative expenses in the Statement of Activities and Changes in Net Assets. Further details of the net charge, including the cumulative effect on the Fund’s net assets, will be given in the notes to the financial statements.