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IFAD

INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT

Executive Board – Eightieth Session

Rome, 17-18 December 2003

REPORT OF THE AUDIT COMMITTEE

1. Following its Eighty-Third Meeting on 16 December 2003, the Audit Committee wishes to draw the attention of the Executive Board to the following matters.

Asset Liability Management Review

2. In response to the Chairman's request for preliminary comments on the revised asset liability management (ALM) document, the external auditor said that it saw IFAD's establishment of an ALM framework as a positive move and the focus of the ALM document to redefine committable resources as being a sensible approach worthy of further debate.

3. The Committee endorsed the underlying principle of a permanent framework and a systematic approach to asset and liability management as this will involve adopting best practice and align IFAD with other major international financial institutions (IFIs).

4. In view of the Fund's numerous activities, the Committee was concerned with the implications for IFAD's staff resources of implementing the ALM framework as well as the time frame involved.

5. The Committee stated that IFAD's investment policy differed from that of other IFIs inasmuch as it invested in equities. The Secretariat responded that, while it was true that other IFIs did not have equities in their portfolios, the extensive study on IFAD's investment policy – conducted by an expert group in 2001 – concluded that, in order to strike a prudent balance between risk and return, it would be appropriate to reduce the equities allocation from 44% to 18%. The final allocation to equities agreed upon was at an even more conservative level of 10%. The ALM report had not analysed the level of equity investments any further, both because the expert group's report was very recent and because a 10% equity level was considered to be within acceptable limits.

6. The Committee requested the Secretariat to ensure that the wording on page 14 of the Madison report – to the effect that the yield rate of 5% was considered reasonable – was suppressed in time for the presentation to the Board as that did not comply with the institution's investment policy. The Secretariat assured the meeting that a corrigendum would be immediately requested of Madison, the originator of the document.

7. It was agreed that a seminar would be held in June 2004 to present the analysis made by the ALM group on IFAD investment risk management. Participation at this seminar will be extended to country representatives who are not members of the Audit Committee.

Financial Statement Changes

8. The Committee commended the Secretariat on its proposals regarding ways of facilitating the reading of the organization's financial statements and complying with international accounting standards (IAS) in the interests of greater transparency and best practice. The proposal was in response to requests by the Committee and the Executive Board for clearer and more understandable financial statements.

9. The Secretariat informed the Committee that the changes had been recommended by and discussed with the external auditor in 2002 and that they were taken into consideration in the context of implementing the Strategic Change Programme. The required changes in the accounting principles (which were adopted for IFAD's supplementary funds in 2002) are subject to evolving best practice.

10. The external auditor confirmed that reclassification of the accounts would reflect IFAD's activities more faithfully, but added a word of caution regarding the complexity of the task and the challenging work involved in undertaking this simplification exercise.

11. The Committee also requested the Secretariat to provide an explanatory guide on the new format of the financial statements, providing details on major changes to the accounting principles.

Alignment of Contributions, Provisions and Exclusions

12. As part of its implementation of the Fund's new financial systems under the Strategic Change Programme and related streamlining of procedures, management has reviewed the basis used for provisioning for overdue Member contributions.

13. When specific time parameters are exceeded, the Fund's current practice is to make a provision in its balance sheet for overdue contributions from Member States. It also excludes overdue promissory notes from its statement of resources available for commitment following lapse of a different specified time period. Provision/exclusion status is removed when the Member State pays the minimum amount required to comply with the underlying procedure, without necessarily paying all amounts overdue.

14. The recommendations of the Secretariat are as follows:
- (a) Alignment of time frames for provision status for overdue contributions and exclusion status from the resources available for commitment, with the first trigger 24 months after the due date of payment and the second trigger after 48 months.
 - (b) Overdue contributions in the resources statement shown as being in provision and no longer indicated as being in exclusion status.
 - (c) The provisioning policy should align with the existing loan provisioning policy with regard to the requirement that the total amount overdue from Members must be fully paid up in order for provision status to be removed.
 - (d) If a special arrangement with a donor regarding the deposit of Instruments of Contribution and/or payment schedule is not respected, the payment due dates agreed in the arrangement will constitute the basis from which the 24-month and 48-month time frames will be reckoned.
15. The external auditor confirmed its agreement with the proposed streamlining of processes in the alignment of the time frame between the balance sheet and the resources available, in the interests of greater transparency and suitability within the context of IFAD's financial history.
16. The sanctions currently applied when Members fall into provision status are:
- (a) loss of eligibility for appointment or election to membership of the Executive Board; and
 - (b) a possible reduction in contribution voting rights.
17. If approved, these recommendations would not result in any change with regard to which Members fell into provision status or to the trigger periods involved, but would imply that the full amount overdue must be paid by the Member in provision status in order for that status to be removed.
18. The Secretariat confirmed that provision status was calculated from the agreed due date for payment in the case of special arrangements.

Project Audits

19. The status report on 2002 project audits showed a clear improvement with regard to number of audit reports submitted.
20. The Committee expressed satisfaction with the status report and improved submission of project audits, but asked that information on the timeliness of submission and quality of the reports should be provided to it at a future meeting.
21. In this regard, the Committee recommended that the 2004 report should include:
- (a) a table showing comparative statistics with the previous year's audit reports;
 - (b) information on the timeliness of submitting project audits;
 - (c) an explanation of qualifications in the reports, distinguishing between acceptable and unacceptable qualifications, and expanding on the reasons for such qualified reports; and
 - (d) details of follow-up action with respect to significant qualifications.

22. The Secretariat was requested to provide further information on difficulties faced by borrowers in submitting their audit reports and suggestions for overcoming such difficulties.

23. The Secretariat was also requested to closely monitor the performance of cooperating institutions with regard to audit reports, taking account of their supervisory role in the projects.

Procurement under IFAD-Funded Projects

24. The Committee welcomed the *Guidelines for Procurement of Goods, Works and Consulting Services under IFAD Loans and Grants* (document AC 2003/83/R.8) and commended the Secretariat on such a comprehensive report.

25. It was noted that the guidelines were applicable only to procurement funded by loans and grants provided under IFAD's General Conditions, and not to IFAD procurement for administrative costs (the Secretariat advised that all administrative contracts over a certain limit go out to tender and are reviewed by the Contract Review Committee).

26. The Committee drew attention to an inconsistency with respect to application of domestic preferences between goods and works and consulting services, and requested that text on domestic preferences be included in the section "Selection of Consulting Services".

27. In reply to a question regarding the incidence of fraud, the Secretariat stated that information about fraud was received from many sources and was handled by IFAD's Oversight Committee.

28. The Committee recommended that the Secretariat objectively review the level of resources available to effectively monitor borrowers' adherence to IFAD financial management guidelines.

29. The Committee also recommended that the *Guidelines for Procurement of Goods, Works and Consulting Services under IFAD Loans and Grants* be revised as follows: paragraphs 55-59 should be repeated in Section C, with appropriate editing to reflect consulting services.

30. In the light of the discussions on harmonization currently taking place within the IFI community and with respect to the new World Bank guidelines, the Committee proposed that the revised procurement guidelines should be submitted to the Audit Committee for review and recommendation to the Executive Board for approval at its April 2004 Session following consideration of the comments made by the Committee and the new harmonized rules.

Report on the Status of Internal Control Memorandum Recommendations Requiring Action

31. The external auditor reviews and makes recommendations with respect to IFAD's internal control structure, as part of the regular audit of the organization's financial statements. The document presented to the Committee outlined the current status of recommendations made in the 2003 report, as well as outstanding issues from prior years. The Committee approved the report but stressed that it wished to have more details regarding the proposed timing for implementing the recommendations.

After-Service Medical Coverage Scheme (ASMCS)

32. The report on the ASMCS provided the Committee with updated information on progress made in the 2003 valuation of the scheme's liabilities and outlined options available to IFAD with respect to its overall valuation and management. IFAD management has attended two meetings at the Food and Agriculture Organization of the United Nations (FAO) to discuss the basis for and timing of the 2003 valuation.

33. The preliminary results of the valuation are expected to be available in March 2004, which implies that IFAD will be able to reflect the results of the valuation only in the 2004 financial statements. If the results show a significant change from those of the 2001 valuation, IFAD will be required, under international accounting standards, to record the resulting gain or loss as a one-off cost or income for the year in which the information was made available.

34. World Food Programme (WFP) shares IFAD's concern with regard to the basis and method of allocation used for the actuarial valuation and has confirmed that, while remaining part of the FAO group scheme, as of 2003 it would no longer participate in the group actuarial valuation. Following a regular bidding process, WFP has selected Hewitt Associates to undertake its actuarial studies and has suggested that IFAD might join with it in its independent valuation in future years. IFAD would thus provide base data for the valuation and share the actuarial costs. In theory, this would result in a valuation reflecting more closely the actual characteristics of the IFAD workforce.

35. Following the advice of WFP and based on such practical considerations as additional administrative and human resource requirements within the current context of a zero-based budgetary framework, management does not agree that IFAD should set up an independent scheme. It should remain in the FAO group scheme, at least for the foreseeable future.

36. Once the results of the 2003 valuation are available, management will provide the Committee with an assessment of the assumptions underlying the valuation and of IFAD's ability to participate in planning and taking operational decisions for the 2003 group valuation. Management may then wish to recommend a change in the process for future years.