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IFAD
INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT
Executive Board – Eighty-Third Session
Rome, 1-2 December 2004

REPORT OF THE AUDIT COMMITTEE

1. Further to discussions at its Eighty-Eighth Session on 29 November 2004, the Audit Committee wishes to draw the attention of the Executive Board to the following items.

Report on Project Audit Report Status

2. At its Seventy-Seventh Session, the committee requested to be provided with an annual status report on the submission of project audit reports by IFAD borrowers and cooperating institutions. As recommended by the committee, the status report for financial year 2003 includes a comparison with the previous year's submissions, information on the timeliness of submissions, a detailed analysis of qualifications in the reports, and details of follow-up action with respect to significant qualifications.

3. A positive trend can be noted in the increased level of submissions, which rose by 22% from 2002 to 2003. The proportion of unqualified reports in the submissions also increased by 2%. The factors determining this improvement have been the implementation of a dedicated unit for project audit monitoring and the issuance of the IFAD guidelines and operational procedures for project audits. The secretariat reported that, as at 29 November 2004, the audits received against those due for financial year 2003 stood at 83%. Moreover, there are additional 12 reports that will soon be received, and this would increase the percentage to 88%.

4. The qualifications encountered in the submitted reports were further analysed in order to distinguish whether they were acceptable or not. They were considered acceptable in cases where cooperating institutions confirmed their confidence in resolving the qualifications and where qualifications were due to a different accounting basis or to documents lost in post-conflict areas. However, the qualifications due to a missing audit opinion, ineligible expenditures, inaccuracies in accounting and/or lack of supporting documentation are considered unacceptable.

5. The scope of the analytical exercise on project audit reports includes identifying the difficulties borrowers may face in the submission of their audit reports and providing recommendations for overcoming such difficulties. To strengthen the financial reporting work of a borrower, IFAD may consider providing specific support to those countries that either failed to submit reports or submitted reports with unacceptable qualifications.

6. Formal measures against non-compliance have been developed and have been effective from January 2004. Delays in the submission of project audit reports are addressed through a legal notification after 90 days and are subject to suspension of the loan after 180 days.

7. The committee commended the results of this positive trend and increased financial control.

8. The committee requested to know the current status of project audit reports for financial years 2001 and 2002. The secretariat responded that IFAD had received 84% of the reports due for 2001, while updated data on audits received for 2002 amount to 96% of the reports due. Further details on financial years 2001 and 2002 can be found in Annex II hereto. It should be noted that in September 2003 a total of 218 project audit reports were cited as being due, while today that total is given at 207. The difference in the number of reports due for 2002 arises from the following:

Description	No. of reports
Project in very initial phase, so audit will be done together with 2003 audit	3
Project closed (although closure processes not yet finalized)	7
Project suspended, so audit will be done when disbursements resume	3
Delay in delivery agreed (2003 audit will cover 2002 because project is in final phase)	2
Total	11

9. With respect to the 2002 audit reports still to be received, the situation is as follows:

Description	No. of reports
Audit report expected to be received shortly	4
Audit report relates to project supervised by the Arab Fund for Economic and Social Development or African Development Bank and no information is available*	3
Audit has been delayed due to country's political crisis (project is inactive and could possibly be closed)	1
Audit report not received for 2002 nor for 2003, despite reminders (under the new procedures, which are effective from 2004 only, this project would have been suspended)	1
Total	9

* Mission scheduled in January 2005 to meet with these cooperating institutions to discuss the poor performance.

10. The committee asked if the submission delays and/or inadequate reporting tend to recur in the same countries. The secretariat responded that this tended to be the case.

11. The committee asked this year again if repeated non-compliance could have an impact on the future choices of cooperating institutions. The secretariat responded that, on an ad hoc basis, some cooperating institutions have not been selected as a result of poor compliance.

12. The committee asked if IFAD's external auditor reviewed qualified project audit reports. The secretariat responded that project audit reports are reviewed by the cooperating institution, which brings to IFAD's attention cases where measures should be taken. IFAD's external auditor does not have a direct role in the project audits or reporting thereof.

13. The committee suggested that the borrower's performance in terms of submission of project audit reports should be linked to the Board's approval of new loans. The secretariat responded that IFAD may consider adopting this approach in the future. The committee would appreciate if concrete measures could be taken in this direction.

Guidelines for Procurement under IFAD-Funded Projects

14. IFAD's Procurement Guidelines were approved by the Eighty-First Session of the Executive Board with the understanding that any comments provided by Member States, subsequent to this approval, would be examined before the guidelines were definitively issued. Following comments raised by a Member State, the Audit Committee agreed, at its Eighty-Sixth Session, to discuss those comments at its Eighty-Eighth Session and confirmed that any issues of principle would be referred back to the Executive Board. The secretariat opened the discussion with an oral presentation, the contents of which can be found in the Annex I hereto.

15. The committee commented that the process of reviewing and fine-tuning IFAD's Procurement Guidelines by Executive Board members (which began in December 2003) should really be finalized in order for IFAD to proceed with their implementation. To this effect, the committee proposes the following solution to the Board:

- Approve the four changes to the Procurement Guidelines as described in Annex I hereto and listed under the committee's recommendation to the Board in paragraph 26, inasmuch as they do not change the underlying principles of the approved guidelines but rather improve and strengthen them;
- Charge the secretariat with ensuring sufficient control over the acceptance of national procedures based on their compatibility with IFAD guidelines with respect to the use of national procurement regulations, which reflects the position of the Board when the guidelines were approved in April 2004; and
- Have the operational manuals reflect, to the extent possible, the harmonization effort among the multilateral development banks.

16. The committee asked the secretariat for an audit and review of implementation of the new procurement guidelines after a three-year period.

Report on the Status of Internal Control Memorandum Recommendations Requiring Action

17. As a recurring item at each year-end, the committee reviewed the status of internal control memorandum (ICM) recommendations requiring action. The following questions were asked by the committee and responded to by the secretariat:

- What is the status of the asset-liability management (ALM) projections? The secretariat responded that financial models have been developed, and simulations of balance sheets and income statements under different scenarios can now be achieved for decision-making purposes.
- Will the Board receive budget execution reports in June, September and November? The secretariat responded that this information will become easily available to the departments once the systems are fully implemented and decentralized. However, at this time, these reports are being prepared by the Strategic Planning and Budget Division for the use of management. The committee requested to receive information on budgeted versus actual expenditures as part of the 2006 Programme of Work and Budget review in November. The secretariat responded that this information would be provided.

- Are reconciliations between the general ledger and treasury reports being done on a monthly basis? The secretariat responded that, every month, the accounting section signs off on the figures included in the quarterly reports produced by the investment section for the Executive Board to ensure that there are no discrepancies between figures in the report and those in the general ledger.
- What is the status of the evaluation process for the new financial advisor? The secretariat responded that the relationship with the financial advisor was recent and IFAD was in the process of building knowledge in that regard by visiting them on a quarterly basis and reporting back to management. While IFAD was not generally dissatisfied with the services provided by the financial advisor, the secretariat was expecting more services and at a higher performance level. Therefore, IFAD was not excluding alternative sources of financial advisory services at the end of the contract with the current advisor. The committee welcomed such an initiative, which may increase the service level and at the same time decrease the fees.
- With respect to the manual reconciliation process for investment portfolios by the investment section, the committee requested the secretariat to provide comparative information on the reconciliation process of investment portfolios at other United Nations agencies.

18. The external auditor requested to change the status of ICM Recommendation A 3.2 on project audits from 'closed' to 'in progress' since implementation was still ongoing.

IFAD's Treatment of the Revision to International Accounting Standard (IAS) 21 on the Effects of Changes in Foreign Exchange Rates

19. The revision to IAS 21, which covers the issue of exchange rate impact on the translation of currencies in IFAD's financial systems, will become effective on 1 January 2005. At its Eighty-Sixth Session, the committee requested the secretariat to present IFAD's treatment of this revised standard to the Audit Committee.

20. The purpose of this revision is to reduce or eliminate the use of alternative choices of accounting and also to provide additional guidance on the translation method and on determining the functional and presentation (reporting) currencies. In other words, under the International Financial Reporting Standards (IFRS), a business entity will no longer be able to choose arbitrarily its functional currency. It will, however, continue to have a choice as to reporting currency.

21. The IFRS define the functional currency as the currency of "...the primary economic environment in which an entity operates...normally the one in which it primarily generates and expends cash..."¹ In dealing with the "Effects of Changes in Foreign Exchange Rates", the standard gives greater emphasis to **the currency of the economy that determines the pricing of transactions, as opposed to the currency in which transactions are denominated.**

22. Where the indicators are mixed and the functional currency is not obvious, management uses its judgement to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions. Also, once the functional currency is determined, it can be changed only if there is a change to those underlying transactions, events and conditions.

23. The functional currency of a fund is important as it is the base currency into which all transactions and balances are translated in the accounting system. Based on the analysis of the dominant currencies in IFAD's accounts, it may be said that there are three potential currencies from which to choose, namely the euro, the special drawing right and the United States dollar. However, the thrust of the revised accounting standard now emphasizes both the primary currency for cash

¹ IAS 21, paragraph 9.

flows and the currency that determines the pricing of transactions. On the basis of analyses prepared by management, the United States dollar should continue to be the functional currency for IFAD and most funds.

24. On the basis of the reasoning summarized above and presented in greater detail in document AC 2004/88/R.6, management advises that the following functional currencies be used:

- IFAD: United States dollar
- Debt Initiative for the Heavily Indebted Poor Countries Trust Fund: United States dollar
- After-Service Medical Coverage Scheme Trust Fund: United States dollar
- Italian Government: euro
- Supplementary Funds (USD): United States dollar
- Supplementary Funds (Euro) including Belgian Survival Fund: euro
- Global Mechanism: United States dollar
- International Land Coalition: United States dollar

25. The above confirms the current status quo in IFAD's accounting systems for the functional currency, and therefore no change is required in order for IFAD to comply with the revised IAS 21.

26. Given that IFAD is located in a euro-zone country with an important portion of its expenditures in euros and with loans denominated in special drawing rights, the committee requested to know why the euro was not considered as the primary functional currency for IFAD and other funds. The secretariat responded that the euro had been considered but the analyses made by management showed that the United States dollar was the predominant currency. This was due in particular to the fact that the United States dollar was the currency preferred by borrowers for loan reflows and disbursements. The dollar is also currently the dominant currency for administrative expenditures.

27. The external auditor confirmed that the special drawing right should not be considered as the functional currency because it was, in essence, a synthetic accounting unit rather than a proper currency.

28. The secretariat assured the members that the underlying currency flows of IFAD would be reviewed regularly in the context of normal compliance with accounting standards and that, should the situation change so that the euro became the predominant currency in cash-flow terms, a change to IFAD's financial systems would need to be considered.

Recommendation of the Audit Committee to the Executive Board

29. The committee recommends to the Board that it approve the changes proposed by a Member State and accepted by the secretariat on the *Guidelines for the Procurement of Goods, Works, and Consulting Services under IFAD Loans and Grants*, taking into consideration that the secretariat would ensure sufficient controls over the acceptance of national procedures based on their compatibility with IFAD guidelines with respect to the use of national procurement regulations and that the operational manuals would reflect, to the extent possible, the harmonization effort among the multilateral development banks.

The changes consist of the following:

Change 1: Paragraph 17 of the guidelines will clarify that international competitive bidding is the guiding principle. The latter section of paragraph 24 of the guidelines will read as follows: "In addition, bidding documents shall provide clear instructions on how bids should be submitted, how prices should be offered, and the place and time for submission of bids. Adequate response time for preparation and submission of bids shall be provided. The procedures shall provide for adequate

competition in order to ensure reasonable prices, and methods used in the evaluation of bids and the award of contracts shall be objective and made known to all bidders in the bidding documents and not be applied arbitrarily. The procedures shall also include public opening of bids, publication of results of evaluation and of the award of contract and provisions for bidders to protest.”

Change 2: The following sentence will be included in paragraph 1 of Appendix 1: “As part of project preparation and before loan negotiations, IFAD and the Borrower will agree on a procurement plan for the first 18 months of project implementation and this will be reflected in the project proposal submitted to the Executive Board.”

Change 3: On the disclosure of bid and contract information, paragraph 60 of the guidelines will be changed to reflect the harmonization agreement of the multilateral development banks, i.e. data on all bids received – from the successful bidder and from all other bidders – and their ranking are to be disclosed. Borrowers may use any available means, including electronic means, to disclose this information.

Change 4: IFAD’s Procurement Guidelines will maintain paragraph 6 with a slight revision to read as follows: “Under the overall aegis of the IFAD Guidelines, IFAD may permit the adoption of the borrower’s prevailing national procurement regulations for *specific* contracts to be financed by an IFAD loan provided.” The rest of paragraph 6 remains unchanged.

**Status of the Guidelines for Procurement under IFAD-Financed Projects
Discussions between the Office of the Executive Director for the United States and IFAD
on Outstanding Issues**

The Procurement Guidelines were approved by IFAD's Executive Board in April 2004 with the understanding, *inter alia*, that any comments made by Member States subsequent to the April 2004 meeting would be taken into account before the guidelines were issued in final form and, if necessary, would be resubmitted to the Executive Board for further approval. Below is a summary of the status of issues since April 2004.

1. IFAD received extensive and very constructive comments from the Office of the Executive Director for the United States on 30 June 2004. IFAD has been very involved in responding to those comments and in discussions with the US Treasury Department, culminating in a meeting in Washington, D.C., at the US Treasury Department in August 2004. However, no consensus has been reached between the two parties.
2. At the Eighty-Sixth Session of the Audit Committee (held on 6 September 2004), the secretariat submitted a document (document AC 2004/86/R.7) that contained an annex presenting a number of modifications to the guidelines with the objective of improving and strengthening them.
3. Following the Audit Committee session on 6 September and in the absence of a final decision on the committee's approval of the guidelines, further discussions took place with the US delegation on 7 September, just after the Audit Committee session and before the Executive Board session. The main points of discussion related to the following:
 - (a) **International competitive bidding (ICB).** The Office of the Executive Director for the United States expressed the view that the introductory part of the guidelines (starting at paragraph 17) should reflect the prominence of ICB as a guiding principle. The secretariat accepted this change, as the multilateral development banks have agreed as part of their procurement harmonization effort that the ICB method of procurement would be the main guiding principle underlying such guidelines. It was understood, however, that this would allow for permitting other methods of procurement as appropriate alternatives when ICB was determined to be unsuitable in a given situation.

It was, therefore, recommended that the guidelines be slightly modified to reflect ICB as the guiding principle.

- (b) **Procurement plan.** During the course of the discussions, it became clear that the annex to the Audit Committee paper, while emphasizing the preparation of a procurement plan by every project (the initial plan covering a period of 18 months), left vague the timing for the submission of such plan to IFAD. **It is therefore recommended that the guidelines be amended to require that the procurement plan covering the initial 18 months of project implementation not only be agreed between the borrower and IFAD but that it be submitted as part of the project/loan proposal presented to the Executive Board for approval.**
 - (c) **Disclosure of bid and contract information.** The Office of the Executive Director for the United States was of the view that the approved IFAD guidelines (see paragraphs 38, 39 and 60) did not fully reflect this requirement in that it required borrowers to announce only the successful bidder and not any details on the bids received and evaluated. In view of the importance of full disclosure as part of the principle of transparency in procurement, **it is recommended that the language used in paragraph 60 of the IFAD guidelines be**

changed to reflect the harmonization agreement of the multilateral development banks, i.e. data on all bids received – from the successful bidder and from all other bidders – and their ranking are to be disclosed. Borrowers may use any available means, including electronic means, to disclose this information; for instance, *UN Development Business* and *Development Market (dgMarket)* accept procurement notices and contract award data electronically as well as through any other means. To avoid misinterpretation, paragraph 38 will be slightly modified as the footnote in this paragraph is self-explanatory and clearer than the main text in paragraphs 38 and 39.

- (d) **Use of national procurement regulations.** As this provision is not included in the World Bank guidelines, the US delegation proposed a deletion from the IFAD Procurement Guidelines (2004 version). Following a workshop held at IFAD in September, it emerged that the guidelines of other international financial institutions (IFIs) provide the flexibility of accepting national regulations, provided that such regulations are acceptable to the financing institution. The secretariat pointed out that paragraph 6 and footnote 13 of the guidelines were clear enough to indicate that IFAD would undertake an assessment of national procurement regulations as part of project appraisal and that IFAD may also draw upon country procurement assessments by cooperating institutions or other IFIs. This means that the use of national procedures is not automatic; the decision to accept them is based on IFAD's own assessment or that drawn from an assessment by another IFI. We believe, therefore, that this position provides sufficient control over the acceptance of national procedures based on their compatibility with IFAD guidelines.

AUDIT REPORTS FOR FINANCIAL YEAR 2001 AS AT 29 NOVEMBER 2004										
Cooperating Institution (CI)	Total reports due for year 2001	Total reports received by IFAD and/or CI	Unqualified opinion	Qualified opinion	Disclaimer opinion	Not per standard opinion	Adverse opinion	Reports not yet received	Reports received vs. reports due (%)	Unqualified reports as % of reports received
UNOPS-Nairobi	28	25	16	7	1	1	0	3	89%	64%
UNOPS-Rome	19	15	13	2	0	0	0	4	79%	87%
UNOPS-New York	8	6	6	0	0	0	0	2	75%	100%
UNOPS - Kuala Lumpur	41	37	25	10	0	1	1	4	90%	68%
UNOPS-Dakar	16	16	8	5	1	2	0	0	100%	50%
Subtotal	112	99	68	24	2	4	1	13	88%	69%
IFAD- Directly Supervised	13	12	9	3	0	0	0	1	92%	75%
World Bank	24	22	11	9	2	0	0	12	50%	92%
Andean Development Corporation	15	14	8	6	0	0	0	1	93%	57%
Arab Fund for Economic and Social Development	15	12	6	2	0	4	0	3	80%	50%
Asian Development Bank	6	6	3	3	0	0	0	0	100%	50%
Caribbean Development Bank	4	4	4	0	0	0	0	0	100%	100%
African Development Bank	5	3	1	1	1	0	0	2	60%	0%
West African Development Bank	10	9	4	4	0	1	0	1	90%	44%
Central American Bank for Economic Integration	5	4	4	0	0	0	0	1	80%	100%
Total	209	185	118	52	5	9	1	34	84%	67%

AUDIT REPORTS FOR FINANCIAL YEAR 2002 AS AT 29 NOVEMBER 2004												
Cooperating Institution (CI)	Total reports due for year 2002	Total reports received by IFAD and/or CI	Audit reports received in IFAD	Audit reports received in CI	Unqualified opinion	Qualified opinion	Disclaimer opinion	Not per standard opinion	Adverse opinion	Reports not yet received	Reports received vs. reports due (%)	Unqualified reports as % of reports received
UNOPS-Nairobi	28	27	25	23	19	8	0	0	0	1	96%	70%
UNOPS-Rome	15	14	10	13	13	1	0	0	0	1	93%	93%
UNOPS-New York	15	13	7	10	9	4	0	0	0	2	87%	69%
UNOPS - Kuala Lumpur	34	33	31	31	28	4	0	1	0	1	97%	85%
UNOPS-Dakar	19	19	17	14	8	10	1	0	0	0	100%	42%
Subtotal	111	106	90	91	77	27	1	1	0	5	95%	73%
IFAD- Directly Supervised	12	12	12	0	11	1	0	0	0	0	100%	92%
World Bank	27	27	14	23	21	6	0	0	0	0	100%	78%
Andean Development Corporation	14	13	10	11	7	6	0	0	0	1	93%	54%
Arab Fund for Economic and Social Development	14	13	7	9	6	0	0	7	0	1	93%	46%
Asian Development Bank	6	6	4	5	3	3	0	0	0	0	100%	50%
Caribbean Development Bank	4	4	4	1	4	0	0	0	0	0	100%	100%
African Development Bank	3	1	1	0	0	1	0	0	0	2	33%	0%
West African Development Bank	12	12	10	10	9	3	0	0	0	0	100%	75%
Central American Bank for Economic Integration	4	4	4	4	4	0	0	0	0	0	100%	100%
Total	207	198	156	154	142	47	1	8	0	9	96%	72%

