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Report of the Audit Committee

Executive Board — Eighty-ninth Session
Rome, 12-14 December 2006

For: **Approval**

Recommendation for approval

The Executive Board is invited to note the information contained in EB 2006/89/R.45 and to endorse the recommendation on IFAD's General Reserve as contained in paragraph 10.

Report of the Audit Committee

1. At its ninety-fifth meeting, held on 11 December 2006, the Audit Committee discussed the following matters, which it wishes to bring to the attention of the Executive Board.

After-Service Medical Coverage Scheme (ASMCS) and retirement plan: 2005 actuarial valuation results and planning (AC 2006/95/R.3)

2. IFAD participates in the group plan administered by the Food and Agriculture Organization of the United Nations (FAO) and also shared by the World Food Programme (WFP). The Audit Committee reviewed the document prepared by the secretariat. The document gives an overview of the current set-up, main aspects and costs of the ASMCS scheme, as well as of the main criteria on which the actuarial valuations are made. It was noted that the methodology used for the 2005 valuations is in accordance with widely accepted actuarial practice.
3. The Committee noted that IFAD's share of the past-service liability increased significantly from US\$15.0 million at 31 December 2003 to US\$27.9 million at 31 December 2005, as a result of the combination of different components and assumptions, such as the increase in the number of retirees by 1.9 per cent, the increase of about 14 per cent in the number of the Fund's active employees, the estimated medical cost increase, the average pension pay, etc. With regard to the cost expectations for 2006, the secretariat mentioned that the ASMCS valuations should be available by the first week of February 2007. In point of fact, following the external auditor's recommendation, the actuarial valuation should be performed annually in time for the financial statements. Nevertheless, IFAD is dependent on the other Rome-based United Nations agencies in order to finalize the process.
4. The Committee also examined IFAD's participation in the United Nations Joint Staff Pension Fund (UNJSPF), of which IFAD is a member organization. The financial obligation, as a member organization, to the UNJSPF consists of its mandated contribution, at the rate established by the United Nations General Assembly. The latest actuarial valuation, as at 31 December 2005, revealed an actuarial surplus amounting to 1.29 per cent of pensionable remuneration.
5. The secretariat mentioned that the actuarial valuation is performed every two years due to the fact that the United Nations system will not be required to introduce annual valuations until the implementation of the International Public Sector Accounting Standards.
6. As a result of the discussions, the Committee requested the secretariat to provide further information concerning the ASMCS costs and developments. In this respect, the secretariat agreed to make available the actuarial valuation document expected in February 2007.

General Reserve (AC 2006/95/R.4)

7. The Audit Committee examined the recommendation of the secretariat to maintain the General Reserve as part of IFAD's capital and reserves at the current level of US\$95 million. The secretariat informed the Committee that the Governing Council established the General Reserve in 1980 delegating authority to the Executive Board to determine future annual transfers from the Fund's accumulated surplus up to a ceiling of US\$100 million. Annual transfers were accordingly made between 1980

and 1994, based on IFAD's financial position, to reach the present level of US\$95 million.

8. The Committee examined the different risks that led to the creation of the General Reserve.
9. The secretariat informed the Committee of the current situation of IFAD with respect to the above-mentioned risks and, in particular, the different steps taken to mitigate them, such as: the introduction of a new investment policy based on contained value at risk; the general alignment of assets with the basket of currencies making up the special drawing right in order to contain exchange rate fluctuations; the introduction of fair value, net of allowance for impairment in the event of any uncertainty about the receipt of loan principal repayments; the advance commitment authority; and, finally, the new liquidity policy submitted to this session of the Executive Board.
10. On this basis, and in line with the policies adopted by other international financial institutions for specific risk reserves and with current accounting principles, the Audit Committee recommends to the Executive Board that the General Reserve be maintained as part of IFAD's capital and reserves at the current level of US\$95 million.

Policy on rotation and services to be provided by the external auditor of IFAD (AC 2006/95/R.5)

11. Based on discussions at its ninety-third meeting, Audit Committee approval of the policy on rotation and services to be provided by the external auditor was sought. In particular, the policy covers the following areas:
 - (a) length of external auditor's mandate;
 - (b) rotation of audit engagement partner;
 - (c) provision of other services by the external auditor; and
 - (d) implementation of external auditor rotation policy.
12. The Audit Committee instructed the secretariat to amend the policy with regard to its implementation, along the following lines: (i) since the tender procedures for selection of the external auditor were completed following the Executive Board decisions in September 2006, and the mandate was awarded to PricewaterhouseCoopers (PWC) for the period 2007-2011, the Committee decided that the present policy be implemented as of the audit of the 2012 financial statements at the latest; (ii) the contract awarded to PWC for the period 2007-2011 will be considered as a second consecutive mandate for purposes of this policy. Consequently, PWC will not be eligible to bid for the next five-year mandate (2012-2016).

Project audit reports for fiscal year 2005 (AC 2006/95/R.6)

13. At its seventy-seventh meeting, 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 fiscal year 2005 includes a comparison with the previous year's submission, information on timeliness of submissions, a detailed analysis of qualifications in the reports, and details of follow-up action with respect to significant qualifications.
14. The secretariat highlighted that the report submitted for the Committee's review illustrates that further work is needed to address the concerns expressed by Committee members at the September meeting. The

Committee commented that the type of information provided in the report was to be considered more statistical than qualitative and requested that the next report contain more analysis of projects and developments. Nonetheless, a positive trend can be noted in the increased level of submissions.

15. The secretariat drew attention to the short time available for the analysis of project audit reports, from the cut-off date for their receipt (30 September for the great majority) to the review by the Audit Committee. The possibility was mentioned of postponing presentation of the report to the Committee meeting held in March/April of each year.
16. The secretariat pointed out that the quality of project audit reports continued to be a problem, owing to a number of issues:
 - (a) the audit capacity of government auditors and accountants to match IFAD's commitment to harmonization and building capacity;
 - (b) the lack of information in financial statements; and
 - (c) the complex decentralized administration of some of IFAD's borrowers.
17. Also, within the Paris harmonization process, considerable attention is being given to multilateral and bilateral institutions using national auditors. Unfortunately, unlike the World Bank, IFAD does not have the resources required to strengthen these national institutions to bring them to the appropriate level. All these operational concerns would be looked into as part of the intensified supervision work upon which IFAD is embarking.
18. The issue of the quality of audits performed and auditors and the interrelation with IFAD's Oversight Committee was discussed.
19. The Committee instructed the secretariat to provide a report more centred on qualitative aspects at a meeting to be held in the first half of 2007.

Other business

20. It was proposed to hold an information seminar for members of the Executive Board on the tasks of the Audit Committee within IFAD.
21. The next meeting of the Committee to discuss the 2006 financial statements of IFAD will take place on 30 March 2007. The possibility of using videoconferencing will be explored to ensure the participation of non-Rome-based Committee members who are not in a position to attend.