

Document: EB 2006/89/R.7
Agenda: 7
Date: 12 December 2006
Distribution: Restricted
Original: English

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Report of the Audit Committee on the programme of work and budget of IFAD and its Office of Evaluation for 2007

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

For: **Approval**

Note to Executive Board Directors

This document is submitted for approval by the Executive Board.

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Recommendation for approval

The Executive Board is invited to take note of this report and endorse the recommendations contained therein.

Report of the Audit Committee on the programme of work and budget of IFAD and its Office of Evaluation for 2007

I. Introduction

1. In accordance with procedures adopted by the Executive Board at its eighty-first session, the proposed programme of work and budget is submitted for examination by the Audit Committee prior to presentation to the Executive Board in December 2006 and subsequent submission to the Governing Council.
2. The Audit Committee's technical review does not bring any changes to the policy decisions made by the Board in September 2006 and does not make any recommendation regarding approval of the POW&B document. The committee's mandate is limited to preparing a report for the Executive Board after reviewing the POW&B document in November.
3. The Audit Committee reviewed the POW&B of IFAD and its Office of Evaluation for 2007 (document EB 2006/89/R.6) at its ninety-fourth meeting on 13 November 2006.
4. This report presents the topics pertaining to the proposed 2007 POW and Budget that the Committee would like the Executive Board to be aware of.

II. Audit Committee's review of the programme of work and budget of IFAD and its Office of Evaluation for 2007

A. Structure of the budget

5. The Audit Committee recognized that IFAD has made progress in the transparency of its budget. Nonetheless, it was recommended that: IFAD should consider practices followed in other international financial institutions (IFIs) with regard to the content of the administrative and development costs headings. In this regard, notwithstanding the historical roots of the practice, IFAD should be forward-looking and consider presenting a single budget encompassing the administrative, Programme Development Financing Facility (PDFF) and OE budgets. Furthermore the elimination of the notional transfer from the grant programme to the PDFF should also be considered.
6. IFAD response. At the September 2006 session of the Executive Board, IFAD proposed to review the structure of the budget with the Audit Committee in advance of the preparation of IFAD's programme of work and budget for 2008. This review would include budget structure, the issue of the PDFF having a separate approval mechanism from the budget, and the significance of the notional transfer from the grant programme. In support of this review, IFAD is continuing discussions with other IFIs on their practices relative to budget structure and the identification and allocation of administrative and development/operative costs.

B. The proposed administrative budget

7. The Audit Committee recognized that the proposed 2007 administrative budget includes the support to an expanded programme of work and additional activities while maintaining zero real growth relative to the 2006 administrative budget when adjusted for the impact of price increases and the evolution of the United States dollar.

8. IFAD response. The administrative budget for 2007 is based upon a policy of ensuring that any real increase of resources under the administrative budget and PDFF would be reserved exclusively for the PDFF. This reflected a commitment to further efficiency gains in the administrative area – as well as the fact that the 2006 budget made provisions for strengthening some activities financed out of the administrative budget. The nominal increase proposed in the 2007 budget reflects the absorption of the International Civil Service Commission's (ICSC) recommended pay increase for General Service staff, other costs associated with staff, the general price inflator effect on the non-staff costs, and the effects of the depreciation of the dollar against the euro. Once these effects are taken into account, the real increase of the administrative budget relative to 2006 is close to zero. The parameters of future administrative budgets should further reflect the real issues with regard to the administration of the Fund, its resources, its portfolio and the programme of work. Nonetheless, the intention of the Fund is to seek all prudent economies in administration and to prioritize the need of strengthening IFAD's development impact.

C. Exploring and achieving cost savings in administration

9. The Audit Committee observed that IFAD should continue to seek effectiveness in administration through internal efficiencies, the exploration of synergies with the other United Nations agencies in Rome, outsourcing and offshoring. Furthermore, the Committee appreciated the work done in the Common Performance Assessment System (COMPAS) initiative as well as in other comparable ones and expressed the wish to pursue such endeavours, and at the same time recognized that IFAD has a justifiable comparative disadvantage in benchmarking.
10. IFAD response. This is being actively investigated by IFAD, and some activities are already being undertaken jointly with the other Rome-based United Nations agencies – including some procurement, management development and (in prospect) outsourcing of travel services. IFAD is reviewing options for joint offshoring of some administrative activities and expanding outsourcing. These issues are being assessed carefully with regard to the benefits and risks. In this regard, IFAD is an IFI and many of its administrative processes involve considerable risks – which, in turn, require high standards of governance. In this case potential savings must be balanced against the likelihood and impact associated with the risks, and the need to maintain the very positive assessment of IFAD's internal financial procedures by its External Auditors. An option of potentially positive benefit to IFAD and other Rome-based United Nations agencies is for IFAD to be a common service provider to the other Rome-based United Nations agencies in processes in which IFAD has comparative advantage (accounting and fund management) but in which loosening direct control may be prejudicial to the Fund.
11. It should be recognized, however, that IFAD already is a leader in subcontracting among United Nations agencies: the vast majority of supervision services are already outsourced; and much of IFAD's work on project development is contracted to consulting groups and individual consultants.
12. With regard to internal efficiencies, IFAD has followed the Executive Board suggestion to benchmark its processes with similar organizations. It has completed the survey of general accounting costs, is in the second stage of iteration of information technology costs analysis, and will launch the analysis of human resource management costs in the near future. The first results of this benchmarking exercise show that IFAD's results are satisfactory considering its size and structure compared to larger IFIs.

D. Relation between the PDFF and the programme of work

13. The Audit Committee observed that, whereas the proposed administrative budget involves zero real increase, the PDFF is proposed to increase significantly in nominal (10.3 per cent) and real terms. While this increase falls within the envelope of the proposed administrative costs ratio of 16.8 per cent when expressed in constant dollar values, the Audit Committee considered that **as a rule** the PDFF should not automatically increase *pari passu* with the increase in the programme of work – and that the proposed increase for 2007 (10.3 per cent) actually exceeded the proposed increase in the programme of work (10 per cent). In this context, the Audit Committee recommended that IFAD reduce the proposed increase to the PDFF to no more than 10 per cent.
14. IFAD response. The proposed increase in the PDFF within the envelope of the agreed administrative costs ratio reflects the priority that the Fund places on strengthening its loan and grants programme, encompassing the implementation of the existing portfolio and the design of new projects. The PDFF increased only very little in 2006 notwithstanding the increase in the programme of work, and there is urgent work required to improve quality to sustain progress in IFAD's development effectiveness. In this regard, the bulk of the proposed increase is focused on improving support to borrowing Member States in the area of project implementation. IFAD agrees to reducing the PDFF increase to 10 per cent (see appendix for revised PDFF tables), but notes that a major factor in the increase is a proposal by the United Nations Office for Project Services to increase supervision charges by more than 15 per cent. In this case, reduction in the proposed PDFF will eat into the resources IFAD has at its disposal for direct support to implementation – notwithstanding the OE conclusion that such direct support is often highly effective. IFAD is actively exploring diversification of supervision partners to ensure greater value for money – and greater leverage in bargaining with individual service suppliers.

E. The administrative costs ratio

15. In December 2005, the Executive Board asked IFAD to use an administrative cost ratio as a benchmark of its efficiency in its consideration of the proposed programme of work and budget for 2007. It noted that the ratio adopted for 2006 was 17.1 per cent. The Audit Committee notes that in September 2006 IFAD proposed an administrative costs ratio, as an overall envelope of the administrative budget and PDFF combined, of 16.8 per cent, reflecting a commitment to increased efficiency.
16. The purpose of a benchmark is to provide a fixed point of reference enabling specific values and changes to be tracked. The Audit Committee notes that the benchmark ratio of 16.8 per cent is consistent with the proposed combined administrative budget and PDFF combined **at a constant EUR:US\$ exchange rate of 0.819**. Nonetheless, the ratio between the nominal value of the combined administrative budget and PDFF and the programme of work for 2007 (ex transfer to the PDFF) is higher than 16.8 per cent - at 17.2 per cent. This variance is due to the weakening of the dollar against the euro in 2006, and raises the issue of how the administrative costs ratio can be presented in such a way as to exclude the effect of exchange rate fluctuations. One approach is to express the budget proposal at the EUR:US\$ exchange rate used in the calculation of the benchmark ratio in 2006.
17. Another is to adjust the size of the programme of work to reflect the variation of the value of the dollar in terms of the special drawing right (SDR), which is the official currency in which loans are issued and in which the original volume of activity can be expressed. In such case, the numerator would also be expressed at the current exchange rate. For example, the initial year (2006) value of the programme of work can be expressed in SDR, and future years can be stated in

terms of the agreed increase applied to the SDR figure – with conversion to dollars at the current rate for the purpose of the statement of the programme of work and the calculation of the administrative costs ratio.

18. Adoption of the first alternative would free the ratio from the effects of exchange rate fluctuations, but does not reflect costs realistically. Adoption of the second would treat the numerator and denominator consistently by taking into account exchange rate fluctuations in both. However, whichever approach is adopted, it would allow calculation of efficiency in terms of the underlying real values and to eliminate the overall exchange rate effects in the ratio.
19. IFAD response. The impact of the issue highlighted by the Audit Committee was not considered when the benchmark ratio was adopted in December 2005. The proposal for 2007 does, indeed, involve a ratio of 16.8 per cent net of the effect of exchange rate fluctuation – and, specifically, net of the weakening of the dollar in the second quarter of 2006. IFAD is aware that different institutions manage this issue differently – for example, by stating the budget according to currency of expenditure – and is studying the applicability of these alternatives to IFAD itself. With regard to the benchmark, the focus is on efficiency and it is important to isolate the impact of exchange rate changes from the calculation of the ratio. IFAD undertakes to explore this issue with the Audit Committee with a view to integrating a new, more adequate process into the preparation and presentation of the budget for 2008.
20. IFAD recognizes that the nominal (uncorrected for exchange rate fluctuation) ratio for 2007 is 17.2 per cent, and that this appears to represent an increase relative to 2006. It does note, however, that a reduction of real expenditures to significantly reduce the nominal ratio at this point may prejudice plans for enhancing development effectiveness – in response to a currency price phenomenon that is subject to very short-term movements.

F. Balance of human resources allocations among departments

21. The Audit Committee noted that IFAD should seek to maximize the resources devoted to its field-level impact, while at the same time ensuring that its obligations relative to prudent resource management are fully respected. This should be reflected in the balance of resource and staff allocations among departments.
22. IFAD response. IFAD is very conscious of the need to ensure that its resource management remains at the highest standard. In human resource terms, the capacity of the Programme Management Department and the External Affairs Department has been expanding to service development objectives, and this is clear when departmental staff numbers are combined with the interdepartmental distribution of consultant person-years. In responding to future requirements, special attention will be paid to the opportunities for mobilizing specialized labour inputs under more flexible labour regimes (e.g. consultancy).

G. Managing for development results

23. The Audit Committee noted IFAD's commitment to building a more performance oriented organization to enhance development effectiveness. The Committee emphasized the importance of working with other organizations, using their tools, such as the Common Performance Assessment System (COMPAS), and learning from their experience in the introduction of a results-based management framework, but said that it was concerned as to whether enough progress has been made to be able to deliver a results-based budget for 2008.
24. IFAD response. IFAD has consulted with other organizations regarding results-based management and budgeting as well as with experts in the field of results-based strategic frameworks. Within IFAD, various elements of a results-based

framework, such as the revised corporate strategic framework, the results-based country strategic opportunities programme (COSOP), the knowledge management policy and a strengthened quality assurance system, have been completed or are under completion. Strengthening performance management is however the key to success in managing for development results and, to that end, a set of corporate management results and key performance indicators have been approved by IFAD Management. They represent the first iteration that will be reviewed and refined in 2007 in light of experience gained. At the same time, IFAD divisions are currently developing their results-based work plans, which include key performance indicators with which their progress towards results will be measured. A review is taking place of the structure of the budget and its presentation, and it will be modified in a way that best fits a results-based budget. All of the aforesaid should enable IFAD to deliver a results-based budget for 2008, it being understood that the full application of results-based budgeting is in its infancy in all United Nations organizations – and that, as a result, the 2008 budget will be very much the first major step in a process that will take some time to complete.

H. Office of Evaluation (OE)

25. The Chairman of the Evaluation Committee (EC), who attended the session as an observer, conveyed that – as the advisory committee of the Executive Board responsible for evaluation matters – the EC reviewed thoroughly the OE work programme and budget during its forty-fourth session in September and forty-fifth session in October. The Chairman expressed the EC's broad support towards OE's proposed priorities, work programme and budget for 2007. In particular, he expressed that the Committee was satisfied by the way in which OE had responded to the main concerns and comments of the Committee in the process leading up to the submission of the 2007 OE work programme and budget. He also noted that the Committee found the proposed increase in the budget fully justified, as it is entirely driven by the scope of OE's 2007 planned annual work programme containing evaluations that, in the view of the Committee, are all essential for achieving the objective of IFAD's independent evaluation function.
26. On its part, the Audit Committee (AC) noted that OE had addressed the Board's request to limit the increase in its 2007 budget, realizing that the real increase proposed now is 11 per cent, as against the 21 per cent real increase included in the OE preview document considered by the Board in September 2006. In this regard, OE clarified that, as requested by the Evaluation Committee, the reduction has been achieved by deferring the commencement date of some evaluations to the latter part of 2007, without compromising their overall usefulness for the Fund. Furthermore, OE shared with the AC the costs – based on historical averages – for conducting the different types of evaluations contained in the work programme.
27. The AC's attention was drawn to the increase in the budget allocation towards country programme evaluations (CPEs) and a reduction in project evaluations. In this regard, OE conveyed that there was a reduction in the 2006 budget for CPEs to make space for an appropriate allocation for corporate-level evaluations that were considered a priority by the Board, and that in 2007 the CPE allocation went back to the level of the past. In addition, OE noted that the enhanced CPE methodology allows OE to derive efficiency gains, as the methodology also allows for the evaluation of individual projects as part of the overall CPE analysis, at a total cost several times lower than for the conduct of individual project evaluations. Through this, and as highlighted in this year's annual report on results and impact of IFAD's operations, OE is now in fact delivering a much higher number of project evaluations than in the past.
28. There was a discussion on benchmarking OE's budget with that of evaluation entities of other development organizations. In this regard, as discussed in the Board and in the EC in the past, OE underlined that it is difficult to benchmark OE's

budget with that of others, especially in the light of IFAD's overall organizational structure, mandate and specificity. First of all, IFAD's relatively small size does not allow OE to derive benefits from economies of scale. OE also explained that, based on previous analysis, the ratio of OE's annual budget in relation to IFAD's total administrative budget is favourable when a comparison is made of similar ratios in smaller organizations (such as the Global Environment Facility) and less favourable if a comparison is made with larger organizations (such as the World Bank or other regional banks). Furthermore, the Fund's exclusive focus on rural and remote areas, as well as its limited – though slowly improving – self-evaluation capacities, require that OE evaluations be conducted with a large part of the evaluation work in the field. It was also underlined that OE evaluations, as mandated by IFAD's Evaluation Policy, place enhanced emphasis on promoting learning among partners through the organization of learning workshops at the end of each evaluation, which have cost implications that need to be accommodated.

29. The Audit Committee requested that a table be presented showing the historical evolution of the OE budget.
30. Finally, AC requested that OE investigate the possibility of developing a fixed ratio of OE's budget to either IFAD's administrative budget or its programme of work. In this regard, it was noted by OE that fixing a ratio would limit the scope of assessing the merits and quality of the planned evaluation activities in determining the overall budget of OE. It would also reduce the flexibility in developing OE's work programme that meets the requirements of diverse partners including the Board. On this, OE noted that such a practice does not appear to be current in other international financial institutions or United Nations agencies.

III. Conclusion

31. The Audit Committee wishes to report that the 4.1 per cent increase in the administrative budget reflects a containment of costs for administrative purposes and the 10.3 per cent nominal increase in the PDFF is in line with the Board's wish to have an emphasis on operations. However, it recommends that the nominal increase in the proposed PDFF be reduced to 10 per cent so as to be in line with the proposed 10 per cent increase in the POW.
32. The Fund has fulfilled its commitment to stay within the agreed administrative costs benchmark ratio. However, the Committee feels that IFAD should explore fully the alternative methods of calculating this ratio, taking into particular consideration the effect of exchange rates. The findings of this exercise should be presented in a report to the Audit Committee in the first half of 2007.
33. The 11 per cent real increase in the administrative budget of the Office of Evaluation is substantial and in order to be better able to judge any future increases, the Committee requests that the Office of Evaluation investigate the option of establishing a benchmark ratio.
34. The Committee suggests that IFAD should consider presenting a single budget encompassing the administrative, PDFF and OE budgets. Furthermore, the elimination of the notional transfer from the grant programme to the PDFF should also be considered. The Committee would like to receive a report during the first half of 2007 on how IFAD's budget structure and presentation can be improved.
35. To improve the efficiency of use of the PDFF, the Committee encourages the Fund to explore diversification of supervision partners to ensure greater value for money, thereby creating greater bargaining power with individual suppliers.
36. The Committee recognizes the Fund's efforts to introduce a results-based management framework, noting that this will facilitate the making of more informed decisions regarding the use of resources.

Table 1
2005 Budget execution by institutional priority – PDFF
 (Thousands of United States dollars)

<i>Institutional Priority</i>	<i>Restated budget @ 0.801</i>	<i>2005 actual^a</i>	<i>Balance</i>	<i>Percentage utilized</i>
IP1: Manage loan/grant-funded country programmes for results	31 052	25 324	5 728	82%
IP2: Manage grant-funded research and capacity-building programmes for results	1 438	912	526	63%
IP3: Promote inclusive and enabling poverty reduction policies at local, national, regional and global levels	3 270	2 575	695	79%
IP4: Manage knowledge relevant to effective rural poverty reduction	351	202	149	58%
IP5: Mobilize and manage financial resources for rural poverty reduction programmes	148	13	135	9%
IP6: Build strategic partnership with other actors in rural poverty reduction	314	95	219	30%
IP7: Develop innovative approaches to rural poverty reduction	82	7	75	9%
IP8a: Institutional governance	1	-	1	0%
IP8b: Institutional management	45	6	39	13%
Total	36 701	29 134	7 567	79%

^a Staff costs have been prorated on the same basis as the original allocations due to the fact that they are not all recorded by activity within the accounting system

Table 2
2006 budget execution by institutional priority to 30 September 2006 - PDFF^a
 (Thousands of United States dollars)

<i>Institutional priority</i>	<i>Approved budget @ 0.819</i>	<i>Pre-encumbrance</i>	<i>Encumbrance</i>	<i>Expense</i>	<i>Available budget</i>	<i>Percentage utilized</i>
IP1: Manage loan/grant-funded country programmes for results	31 873	804	18 322	7 974	4 773	85%
IP2: Manage grant-funded research and capacity-building programmes for results	1 777	1	912	442	422	76%
IP3: Promote inclusive and enabling poverty reduction policies at local, national, regional and global levels	3 210	43	1 570	1 084	513	84%
IP4: Manage knowledge relevant to effective rural poverty reduction	557	34	172	171	180	68%
IP5: Mobilize and manage financial resources for rural poverty reduction programmes	71	-	26	2	43	39%
IP6: Build strategic partnership with other actors in rural poverty reduction	349	-	114	62	173	50%
IP7: Develop innovative approaches to rural poverty reduction	110	-	80	2	28	75%
IP8b: Institutional management	35	-	32	1	2	94%
Total	37 982	882	21 228	9 738	6 134	84%

^a Includes PDFF carry-forward.

Table 3
2007 Programme Development Financing Facility by institutional priority and by department
 (Thousands of United States dollars)

	Office of the President and the Vice-President (OPV)			External Affairs Department (EAD)		Finance and Administration Department (FAD)			Programme Management Department (PMD)			Total budget		
	2006 ^a	2007	% inc. (Dec)	2006 ^a	2007	2006 ^a	2007	% inc. (Dec)	2006 ^a	2007	% inc. (Dec)	2006 ^a	2007	% inc. (Dec)
IP1: Manage loan/grant-funded country programmes for results	51	52	2%	-	-	22	73	232%	25 179	28 119	12%	25 252	28 244	12%
IP2: Manage grant-funded research and capacity- building programmes for results	-	-	-	-	-	11	-	-100%	1 438	1 066	-26%	1 449	1 066	-26%
IP3: Promote inclusive and enabling poverty reduction policies at local, national, regional and global levels	-	-	-	-	-	-	-	-	2 946	2 894	-2%	2 946	2 894	-2%
IP4: Manage knowledge relevant to effective rural poverty reduction	-	-	-	-	-	-	-	-	558	907	63%	558	907	63%
IP5: Mobilize and manage financial resources for rural poverty reduction programmes	-	-	-	-	-	14	-	-100%	68	-	-100%	82	-	-100%
IP6: Build strategic partnership with other actors in rural poverty reduction	-	-	-	-	-	-	-	-	328	468	43%	328	468	43%
IP7: Develop innovative approaches to rural poverty reduction	-	-	-	-	-	-	-	-	56	20	-64%	56	20	-64%
IP8a: Institutional governance	-	-	-	-	-	-	-	-	-	-	-	-	-	-
IP8b: Institutional management	-	-	-	-	-	-	-	-	57	201	253%	57	201	253%
Total	51	52	2%	-	-	47	73	55%	30 630	33 675	10%	30 728	33 800	10%

^a 2006 figures do not include the 12.16 percent increase in General Service staff cost and are restated at EUR/US\$ exchange rate of 0.786 to facilitate comparison with the 2007 budget.

Table 4
2007 Programme Development Financing Facility by expense and by department

(Thousands of United States dollars)

	Office of the President and the Vice-President (OPV)			External Affairs Department (EAD)		Finance and Administration Department (FAD)			Programme Management Department (PMD)			Total budget		
	2006 ^b	2007	% inc. (Dec)	2006 ^b	2007	2006 ^b	2007	% inc. (Dec)	2006 ^b	2007	% inc. (Dec)	2006 ^b	2007	% inc. (Dec)
Duty travel	51	52	2%	-	-	47		55%	1 924	2 392	24%	2 022	2 517	24%
ICT&S Information and communication technology services	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Other ^a		-	-	-	-	-	-	-	1 284	107	-92%	1 284	107	-92%
Staff costs	-	-	-	-	-	-	-	-	3 640	3 965	9%	3 640	3 965	9%
Consultants	-	-	-	-	-	-	-	-	12 985	14 044	8%	12 985	14 044	8%
Cooperating institutions	-	-	-	-	-	-	-	-	10 797	13 167	22%	10 797	13 167	22%
Total	51	52	2%	-	-	47	73	55%	30 630	33 675	10%	30 728	33 800	10%

^a Includes workshops, goods and services (maps), publications, hospitality, miscellaneous, etc.

^b 2006 figures do not include the 12.16 per cent increase in General Service staff costs and are restated at EUR/US\$ exchange rate of 0.786 to facilitate comparison with the 2007 budget.

Table 5
Office of Evaluation – budget evolution

	2003 ^a		2004		2005 ^b		2006		2007	
	<i>Restated at 0.898</i>	<i>Approved at 0.898</i>	<i>Restated at 0.819</i>	<i>Approved at 0.819</i>	<i>Approved at 0.819</i>	<i>Approved at 0.819</i>	<i>Restated at 0.786</i>	<i>Proposed at 0.786</i>		
Staff costs	1756	1 780	1 972	2 139	2 148	2 221	2 221	2 757		
Evaluations	1976	1 955	2 014	2 108	2 307	2 333	2 574			
Evaluation Committee	0	60	66	67	74	77	78			
Staff travel	240	245	257	263	268	274	279			
Contingency	0	202	202	114	0	0	0			
Total	3972	4 242	4 511	4 692	4 797	4 905	5 688			
Percentage nominal increase between years ^c		7%		4%	2%		16%			(11% real)

^a 2003 is presented here for comparison with 2004. Prior to 2004, the Office of Evaluation was not independent and was an IFAD division reporting to the President.

^b 2005 did not have to be restated because the same exchange rate was used to prepare the 2005 budget.

^c This increase represents the nominal increase excluding exchange rate movements