

Document: EB 2008/93/R.25
Agenda: 11(e)
Date: 24 April 2008
Distribution: Public
Original: English

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Report of the Audit Committee

Executive Board — Ninety-third Session
Rome, 24-25 April 2008

For: **Approval**

Recommendation for approval

The Executive Board is invited to endorse the recommendation on IFAD's consolidated financial statements for 2007 for presentation to the thirty-second session of the Governing Council for approval as stated in paragraph 5.

Report of the Audit Committee

1. The Audit Committee held its ninety-ninth meeting on 10 April 2008. The meeting started with a private session of Committee members with IFAD's external auditors, PricewaterhouseCoopers, and then proceeded with the open session.
2. The Audit Committee discussed the following matters at the meeting, which it wishes to bring to the attention of the Executive Board.

Consolidated financial statements of IFAD as at 31 December 2007 for the review of the Audit Committee (AC 2008/99/R.3) and High-level review of IFAD-only financial statements for 2007 (AC 2008/99/R.4)

3. The Committee considered the consolidated financial statements for 2007 together with the high-level review of IFAD-only financial statements. The Controller summarized the main aspects of the presentation, the additional disclosures made and the content of the consolidated financial statements compared with that of the previous year. In particular, he highlighted the changes introduced to appendix G, Statement of contributions; the new disclosures on financial risks required by International Financial Reporting Standard 7; the accounting principles applied to the contributions received in connection with IFAD's participation in the Debt Initiative for Heavily Indebted Poor Countries (HIPC) from the World Bank-administered HIPC Trust Fund; the impact of the exchange rate; and the return on investment.
4. The Committee, in particular the representatives of China, the Netherlands and Spain, requested further information on some specific items:
 - (a) Disclosures on financial risks and risk management;
 - (b) Funding of the After-Service Medical Coverage Scheme;
 - (c) Accumulated provisions related to overdue loan repayments;
 - (d) Level of diversification of the investment portfolio; and
 - (e) HIPC past and future costs in relation to the Debt Sustainability Framework.

The secretariat provided the necessary clarifications on all items.

5. After having expressed appreciation for the clarity of the document and the additional disclosures provided, the Committee recommended that the Executive Board endorse the IFAD consolidated financial statements for 2007 for presentation to the thirty-second session of the Governing Council.

Internal audit activities during 2007 and plan for 2008 (AC 2008/99/R.5) and implementation of internal audit recommendations (AC 2008/99/R.6)

6. The Committee considered the activities of IFAD's Office of Audit and Oversight (OA) during 2007 and its strategic directions and plan for 2008, and it examined the implementation status of internal audit recommendations as at end-2007. The Committee recognized that the audit output was higher than in previous years (13 audit reports and several audit memorandums covering all facets of IFAD operations). In particular, it noted that the audit work had identified significant opportunities for efficiency and control improvements, notably in areas of consultant administration, grant supervision, and technology support for IFAD's operational, financial and administrative processes. The Committee further noted that there had been improvements in implementation rate of internal audit recommendations, through which the accountability and performance of IFAD's core processes (project design and supervision) had been significantly strengthened.
7. In addition, the Committee observed that sound governance and planning processes had been put in place for the introduction and use of information technology at

IFAD. This would ensure that issues related to this area were addressed in a more cost-effective way.

8. The Director, OA, provided some explanations at the request of Committee members. In particular, he indicated that the IFAD risk management structure had been strengthened with the establishment of the Enterprise Risk Management Committee. Moreover, control and efficiency gaps in payment and travel processes had been addressed. The full support provided and the priority given by the new Management team to the implementation of audit recommendations and the platform provided by the Action Plan had been critical to the improvements achieved.
9. Following an agreement reached last year, for the first time Management's comments on the implementation of recommendations were included as part of the report presented to the Audit Committee.
10. The Director, OA, reported that key performance indicators to track the timeliness and relevance of audit work had been introduced to improve effectiveness.
11. The Audit Committee requested that, in future, a system be introduced for prioritizing audit recommendations and for highlighting those considered to entail high risk.
12. With regard to the request to have access to the executive summaries of the internal audit reports, the secretariat mentioned that, in line with the approach of other international financial institutions, such access should be based on an agreed procedure. The Audit Committee recognized the importance of the matter and agreed to discuss a procedural scheme at a future meeting.

**External quality assessment of the internal audit function
(AC 2008/99/R.7)**

13. In 2007, an external consulting firm qualified in this type of assignment conducted the first external quality assessment of the IFAD internal audit function. This assessment is a requirement of the International Standards for the Professional Practice of Internal Auditing, to which the IFAD internal audit function adheres. As this was the first review of this kind, and in order to maximize learning opportunities, it was decided to undergo a full external assessment rather than the alternative of a self-assessment with external validation of results. The outcome of the assessment determined that IFAD's internal audit "generally conforms" to the Standards.
14. The Audit Committee was informed of the results of the assessment, as required by the Standards. The secretariat highlighted the section on "areas for improvement for the Executive Management's consideration", which contains recommendations for the attention of the Audit Committee and the President. A status briefing will be included in the next annual report to the President and the Audit Committee, tentatively scheduled for April 2009.
15. It should be noted that OA has already changed its practices to implement many external quality assessment recommendations related to its internal working processes, both through improved audit planning and during the performance of individual assignments. However, there are some recommendations for Senior Management consideration and others addressed to the Audit Committee and the President that need to be examined with special attention by the Audit Committee. Therefore, discussion on the external quality assessment was deferred to the next meeting of the Audit Committee.

**Annual report on investigative and anti-corruption activities
(AC 2008/99/R.8)**

16. The Investigation Section, OA, presented the report, highlighting the structure of the function, the changes that had taken place in 2007 and the results achieved. In

particular, the establishment of the Sanctions Committee and the development of debarment procedures in February 2007 further bolstered the effectiveness of the IFAD investigative and sanctions process. These changes aligned IFAD with best practices applied by other United Nations agencies and the major multilateral development banks in this area.

17. As concerns investigative work in 2007, the Committee noted that complaints of irregular practices relating to IFAD staff, consultants and contractors (internal cases) and allegations in connection with IFAD-financed projects and programmes (external cases) had been received in equal numbers, with the percentage of internal cases decreasing from 67 per cent in 2006 to 50 per cent in 2007.
18. The Committee further noted the systematic efforts made to educate staff on anti-corruption policies at both the headquarters and the project level during the second half of 2007. In addition, the Investigation Section had continued to improve its operating procedures and practices, by, among others, introducing and tracking key performance indicators for the timeliness of investigative activities, and redesigning the anti-corruption leaflet to encourage wider dissemination and exposure.
19. In the context of discussions on the report, the secretariat clarified aspects of the revision of the project procurement guidelines. It was confirmed that the revision would be submitted to the Audit Committee based on relevant and adequate information collected from more recent experience on direct supervision and on the implementation of the guidelines.
20. The Chair concluded mentioning the need to provide the Committee with more information on the detailed procedures put in place by the secretariat in the area of fraud and corruption.