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Report of the Audit Committee

Executive Board — Ninety-fourth Session
Rome, 10-11 September 2008

For: **Approval**

Note to Executive Board Directors

This document is submitted for approval by the Executive Board.

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Report of the Audit Committee

1. At its 100th meeting, held on 7 July 2008, the Audit Committee examined the following matters, which it wishes to bring to the attention of the Executive Board.

External quality assessment of the internal audit function (AC 2008/100/R.3)

2. IFAD's internal audit function applies international standards for the professional practice of internal auditing, and these standards require that internal audit undergo an external quality assessment (EQA) at least once every five years. Consequently, this review was included in the 2007 workplan of the Office of Audit and Oversight (OA).
3. As this was the first review, and in order to maximize learning opportunities, OA opted for a full external assessment of its internal audit function. The assessment was performed by Control Consulting, a qualified private consulting firm selected by the President, following a formal tendering process.
4. The Audit Committee was informed of the results of the assessment in the last meeting.
5. The overall opinion of the EQA team is that IFAD's internal audit activity "generally conforms" to the standards, which means that the evaluator (EQA) has concluded that "the relevant structures, policies, and procedures of the activity, as well as the processes by which they are applied, comply with the requirements of the individual Standard or element of the Code of Ethics in all material respects." The report includes a section on "Areas for improvement for the Executive Management's consideration", containing recommendations for the attention of the President and of the Audit Committee.

(i) Recommendations addressed to the President and the Audit Committee:

- The EQA team recommends that the relationship and reporting line from OA to the Audit Committee should be revisited (the Chief Audit Executive [CAE] should report functionally to the board [Audit Committee] and administratively to the chief executive officer of the organization).
- In order to fulfill its monitoring obligation, the Audit Committee should review an overall opinion on the level of risk management, and on the control and corporate governance processes.
- It is further recommended that the head of OA discuss and agree on the format and frequency of OA reports to the Audit Committee, with the Committee Chairman (e.g. a more limited report with only the critical and major findings, implementation status of previous critical and major findings, and any potential limitations on executing the rest of the approved audit programme for the year).
- The review of risk exposure by the Audit Committee should be performed at least annually.
- "The legislative bodies of each organization should decide that the proposed budget of the internal oversight entity should be drawn up by the entity itself and submitted to the external oversight board, together with any comments of the executive head, for review and transmittal to the appropriate governing body."
- "Individual internal audit, inspection and evaluation reports to be provided to the oversight board, on request."

- The internal audit charter should be updated to describe: the services provided to outside parties; advisory services provided by OA and the modalities of reporting to the Audit Committee. It should also describe the role of the Audit Committee in confirming the OA's budget and annual workplan, in recruiting and discharging the CAE, and in evaluating the CAE's work.
- (ii) Recommendations addressed to the Audit Committee:
- Review with Management and the CAE the charter, plans, activities, staffing and organizational structure of the internal audit function.
 - Ensure that there are no unjustified restrictions or limitations, and review and concur in the appointment, replacement or dismissal of the chief audit executive.
 - Review the effectiveness of the internal audit function, with respect to compliance with the Institute of Internal Auditors' International Standards for the Professional Practice of Internal Auditing.
 - On a regular basis, meet separately with the CAE to discuss any matters that the Committee or internal audit believes should be dealt with privately.
 - Provide an open avenue of communication between internal audit, the external auditors and the board of directors.
 - The present terms of reference of the Audit Committee does not include approval of the OA charter or annual plan, or annual review of the CAE's performance.
6. Management generally agreed with the above recommendations, but noted the need for caution with regard to the recommendations concerning access to internal audit reports and on the process to be followed for the appointment of the CAE.
7. The Committee examined the EQA recommendations with interest; some areas requiring a cautious approach emerged. The Committee made the following comments on the recommendations:
- The Committee took note of the establishment of an Enterprise Risk Management (ERM) Committee. An annual report on ERM will be prepared for the President and will also be submitted to the Audit Committee.
 - The recommendation on the Committee's access to internal audit reports and/or to the executive summaries of such reports was endorsed by the Committee and a request for access to a specific report was made. Management undertook to come back to the Committee with a proposal for this process and a response to the specific request. It intends to carry out an in-depth review of current practices in international financial institutions and relevant United Nations organizations.
 - Several Committee members felt that the Committee should be consulted with regard to the appointment of the CAE, both as standard practice and as regards the impending appointment of a new OA Director. The Secretariat clarified the institutional responsibilities of the President and the Committee in this regard and undertook to convey the request regarding the ongoing recruitment process for the new Director to the President. On the more long-term arrangement for consultation on the appointment and termination of the Director, the Secretariat will share information on the practices of similar institutions with the Committee.

- The Committee endorsed the recommendation that it would meet separately with the chief audit executive on a regular basis and noted the agreement of Management in this regard.
8. The Committee also considered the issue of the role and membership of the Committee. In the light also of the above recommendations to both the Audit Committee and the President, several members proposed that the Committee's terms of reference be updated. These issues will be further discussed at a future Audit Committee meeting.

Report on the implementation of the IFAD Policy on Preventing Fraud and Corruption in its Activities and Operations (AC 2008/100/R.4)

9. The Executive Board adopted the IFAD Policy on Preventing Fraud and Corruption in its Activities and Operations in 2005. By means of the Anticorruption Action Plan, IFAD committed itself to taking specific measures to improve the prevention, detection and investigation of fraud, corruption and misconduct in its activities and operations and to apply appropriate sanctions whenever required. Prior to this meeting, the Secretariat had provided updates on the implementation of the anticorruption policy to the Executive Board in April 2007 and again as part of the Annual Report on Investigative and Anticorruption Activities submitted to the Audit Committee at its ninety-ninth meeting in April 2008. The Secretariat reported that most of the planned actions have been completed, in that investigation and sanction processes have been put in place. The Secretariat highlighted the improvements made over the past year with regard to strengthening the anticorruption provisions in the general terms and conditions for the procurement of goods and services, in loan and grant agreements and in the new guidelines for direct supervision. Some Committee members were of the opinion that more work was required on the implementation of human resources procedures, particularly in the hiring of consultants; the financial disclosure policy and the project procurement and consulting guidelines. The Secretariat noted that further progress on these outstanding items will be reported in the Annual Report on Investigative and Anticorruption Activities that is submitted to the Audit Committee on a yearly basis, normally during the April meeting.