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Report of the Audit Committee on its 101st meeting

Executive Board — Ninety-fourth Session
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Note to Executive Board Directors

This document is submitted for approval by the Executive Board.

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Report of the Audit Committee on its 101st meeting

1. At its 101st meeting, held on 8 September 2008, the Audit Committee examined the following matters, which it wishes to bring to the attention of the Executive Board.

    External auditor's report on internal control and accounting procedures

2. During its annual audit of IFAD's accounts, the external auditor, in addition to providing an opinion on the financial statements, also provides observations and recommendations on internal control and accounting procedures to IFAD's Management and to the Audit Committee.

3. The external auditor presented the report on internal control and accounting procedures for financial year 2007, emphasizing that its main objective was to provide Management with observations and suggestions for improvement. The external auditor indicated that most of the recommendations are brought forward from prior periods and have been prioritized based on risks. Most of these relate to the modernization and integration of the current Loan and Grant System (LGS) with IFAD's enterprise resource planning system (PeopleSoft). The external auditor indicated that the report also reflects Management's responses to each of the recommendations. Specifically, with respect to the LGS, Management had taken steps towards a long-term solution to integrate systems relating to loans and grants (LGS, PeopleSoft, Excel spreadsheets), and manual controls had been put in place to mitigate the relevant risks. The supervisory monitoring of foreign exchange movements necessitated by IFAD's practice of using the United States dollar as the reporting currency in its financial statements, while using special drawing rights (SDRs) in providing loans and grants, was also highlighted as a risk area. The external auditor indicated that Management would formalize the related control procedures by year-end.

4. The Committee concurred with the report that the LGS represented a significant risk and expressed concern that this matter had not been dealt with by Management in a timelier manner, despite the long history of recommendations and improvement initiatives in this area. It was requested that the secretariat provide a timeframe for the implementation of the recommendations related to the LGS.

5. The secretariat fully concurred with the Committee that the LGS needs to be replaced with urgency and confirmed that it was treating this issue as one of maximum priority. Accordingly, a high-level business case for LGS replacement has been completed and endorsed by the Information Technology Governance Committee, and funding from the capital budget was recently approved by the President. A first phase of the project is to assess possible replacement options. A working group was set up to this end and its work is expected to be completed by October of this year. This assessment will result in a decision on the direction to be taken: outsourcing, upgrading PeopleSoft, purchasing an off-the-shelf package, or building a new system from scratch. This assessment will evaluate the options based on a cost-benefit analysis and business functionalities, from the point of view of IFAD's new business model. It was agreed that Management's decision following this exercise will be presented at the next Audit Committee meeting, including a timeframe for implementation.

6. The recommendation relating to exchange rate movements led to some discussion on, inter alia, the choice of the United States dollar as the reporting currency for IFAD's financial statements. Some members of the

Committee requested further clarifications, which were provided by the external auditor and the secretariat. The external auditor indicated that although the Fund's business (loans and grants) is denominated in SDRs, the SDR could not be used as a reporting currency for financial statements. This decision had been reached after long discussions and consultations with the Audit Committee in previous years.

External auditor's audit strategy memorandum for the year ending 31 December 2008

7. This item was discussed at a private session of the Committee members with IFAD's external auditors. The Committee considered favourably the external auditor's strategy for the audit of the 2008 financial statements. In addition to presenting its audit strategy for the 2008 financial period, the external auditor outlined several elements that had impacted the audit workload since 2006, when the audit fee for the financial year 2007 had been determined. However, the external auditor did not present a formal proposal for the audit fee for 2008, and indicated that a fee proposal would be presented to the Committee at a later date.

8. The Committee continued discussing the external auditor's appointment and fee for 2008 after the closed session. Some members expressed concern that the consideration of this issue was being dealt with at such a late stage. The Chairperson clarified that the Committee was not seeking an expansion of the external audit scope but recognized that recent developments might have increased the audit workload. However, this increase in workload and its potential impact on the fee level was not clear to the Committee; hence it was not in a position to make a recommendation to the Board. After some discussion of options, the Committee concluded that in order to decide whether a fee increase in excess of the annual cost of living was appropriate, it required additional information. The Committee therefore requested the external auditor to prepare a note to be taken up at the next meeting. The Committee also requested the secretariat to provide its own comments on that note. Some members requested clarification on the approval authority for reappointment of the external auditor, considering that in 2006 the Executive Board had endorsed the appointment of PricewaterhouseCoopers for a five-year term. The secretariat indicated that a legal opinion would be submitted to the Committee at its next meeting. The Committee decided to defer the discussion on the annual reappointment and fee of the external auditor for the audit of the financial year 2008 to its next meeting, when the additional information and comments from both the external auditor and the secretariat would be made available.

IFAD Policy on Enterprise Risk Management

9. The Audit Committee was called upon to review document AC 2008/101/R.5, the IFAD Policy on Enterprise Risk Management, which also included the Preliminary Report on Enterprise Risk Management in IFAD, and to provide its comments to the Executive Board.

10. The secretariat introduced the paper, indicating that a triennial review of the Fund's risk-management procedures is included in the terms of reference of the Committee. The secretariat emphasized the importance of risk management for IFAD and the need for it to become part of daily operations as the Fund embarks on major reforms and new processes. Enterprise risk management (ERM) increases the likelihood of achieving objectives, and promotes and develops a more efficient and cost-effective corporate culture. The ERM policy is intended to guide IFAD staff and key stakeholders in embedding a conscious, consistent and comprehensive approach to managing risks and opportunities. It is not a stand-alone initiative, but is and will be integrated with and embedded into IFAD's corporate governance

initiates and existing management processes, such as results-based strategic planning and the internal control systems. The document clarifies roles and responsibilities of staff and other key stakeholders as well as the associated anticipated benefits of implementing the ERM policy. The secretariat also informed the Committee of the various initiatives to implement ERM already carried out and now underway, including, inter alia, the creation of the ERM Committee chaired by the Vice-President; the systematic development of an ERM framework based on the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework; the implementation of more robust project and grant processes and procedures, including quality enhancement and quality assurance of project and programme design; the strengthening of administrative and financial processes and legal instruments; the integration of risk management into IFAD's strategic planning and results management processes through the corporate planning and performance management system; the establishment of investment and finance advisory committees; the strengthening of the Information Technology Governance and Contracts Review Committees; and the adoption and implementation of the IFAD Policy on Preventing Fraud and Corruption in its Activities and Operations, including the establishment of an investigative section and investigation and sanction processes put in place. The secretariat further informed the Committee of activities planned for the short and medium term, which include an ongoing exercise for generating a corporate risk profile to be conducted with the participation of the Chairperson and members of the Committee. The results of this exercise will be included in the annual ERM report to be submitted by the President to the Audit Committee and Executive Board in April 2009.

11. The Committee stated that risk management is very important, and that it had taken stock of and now wished to express satisfaction at what had been done so far and the direction taken by the secretariat. Some members requested further clarification on the parameters of the ERM and the Committee's role in this respect; on the specific steps in the work programme and timeframe for its full implementation; and on the role of internal audit in this initiative. They further indicated that it is important to draw up a corporate risk profile and look forward to its presentation in the first annual report of the ERM Committee in April 2009. The secretariat provided additional information on the workplan of the ERM Committee from 2008 to 2009 covering all facets of ERM policy implementation, including the definition of an IFAD risk map, the generation of a corporate risk profile, the finalization of a draft internal control framework, the launch of an ERM intranet site, the preparation of an accountability framework, training and communication activities, and other related activities.

12. The Committee expressed appreciation for the information provided and requested that a short note be prepared for inclusion in the documentation to be presented to the Executive Board. The Committee concluded by taking note with appreciation of the steps taken by Management in implementing ERM at IFAD and, while recognizing that this is something new and evolving, reminded the secretariat that ERM should be presented in a more coherent manner and therefore requested that the specifics of the ERM Committee's programme of work be included in documents presented to the Executive Board.

Briefing on progress made with respect to the recommendations of the external quality assessment of the internal audit function

13. The November 2007 report of the external quality assessment made a number of recommendations for the attention of the President and the Audit Committee. At its 100th meeting in July 2008, the Committee reviewed the

recommendations, took note of Management's responses and called for further discussion on the implementation of external quality assessment recommendations on the access by Member States to internal audit reports, and on the consultation process for the appointment and termination of the chief audit executive.

14. The secretariat provided an update on actions taken and planned in relation to the issues raised by the Committee during that discussion. An external quality assessment task force was set up by the President for this purpose and a comprehensive survey of 21 international financial institutions and other United Nations organizations was conducted to obtain information on comparative relevant practices. The task force is analysing the results and the secretariat will work with the Chairperson to decide on a suitable time for these results to be shared with the Committee.

15. The secretariat informed the Committee on Management's position on two immediate requests made in July:

   - The Committee had requested that the President agree to consult with the Committee on the upcoming appointment of a new Office of Audit and Oversight (OA) Director following a process to be determined by him. The secretariat conveyed to the Committee the President's decision to exercise his prerogative to appoint staff, as set out in the Agreement Establishing IFAD, in making this appointment. However, without prejudice to future practice, he would do so after consulting with the Chairperson of the Audit Committee.

   - A Committee member had requested a copy of a specific internal audit report on the administration of consultancy services. The secretariat explained that, under the present policy, internal audit reports are considered internal Management documents and therefore are not released to Audit Committee members or to Member States. Instead, summaries and highlights of audits conducted by OA are set out in its annual report, which is submitted to the Committee together with a progress report on the implementation of internal audit recommendations. While the task force's review is now in progress, and without prejudice to these discussions, Management has explored various options for disclosing such information, and these will be discussed directly with the interested Member State in time for presentation of an agreed procedure to the Committee at its meeting in November of this year.

16. The Committee acknowledged the progress report, particularly the update on steps and decisions taken to address outstanding recommendations, and welcomed the President's decision on the consultation on the ongoing selection process for the appointment of the Director of OA. Some members sought and obtained confirmation from the Chairperson that he would consult with other members in this process prior to consulting with the President. Some members expressed concern over the secretariat's delay in taking a decision on the request for access to a specific report, and felt that such access by the Committee was necessary for the performance of its oversight role, as well as on the grounds of transparency. Some members also expressed caution, in that the disclosure of such reports to the Committee could lead to an increase in the volume of work and time expected of the Committee, and potential capacity problems.

17. The Committee also discussed the issue of participation by experts in Audit Committee meetings, and various views were expressed. Some members stated that they were in favour of participation by experts, not as full members but as advisors.

18. The Committee concluded that there was support from some members to provide access to the specific internal audit report, and it was agreed that a procedure for doing so would be discussed with the member concerned and the Committee would be informed at its next meeting. With regard to the more general issue of providing access to internal audit reports, the Committee clarified that the recommendation under consideration is to provide access to full copies of internal audit reports to Audit Committee members only, and that this should be done upon request and not as a regular practice. The Committee agreed that this issue would be further discussed at its next meeting upon presentation of the results of the task force, including a decision on how to handle the participation of experts.