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Report of the 106th meeting of the Audit Committee

Executive Board — Ninety-seventh Session
Rome, 14-15 September 2009

For: **Review**

Note to Executive Board Directors

This document is submitted for review by the Executive Board.

To make the best use of time available at Executive Board sessions, Directors are invited to contact the following focal point with any technical questions about this document:

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Report of the 106th meeting of the Audit Committee

1. The Audit Committee wishes to bring to the attention of the Executive Board the following matters, which were examined at the Committee's 106th meeting held on 13 July 2009.

External auditor's report on internal control and accounting procedures

2. The external auditor, PricewaterhouseCoopers (PwC), presented the report on internal control and accounting procedures for financial year 2008, noting that the main objective of the report was to provide Management with observations and suggestions for improvement. The issues raised by PwC in the 2008 report are:
 - The difficulties resulting from the current state of the Loan and Grant System (LGS). This issue was first raised in 2003 and the weaknesses stemming from the lack of flexibility and limited integration of this system with IFAD's main IT application (PeopleSoft) remain;
 - The need to provide automated support to the accounting activities related to the Heavily Indebted Poor Countries (HIPC) Debt Initiative and the valuation of loans on a fair value basis;
 - Notwithstanding significant progress made with regard to IT controls, some concern remains over the logical security (PeopleSoft and LGS) and physical security (finalization and implementation of a disaster recovery plan/continuity plan);
 - Delayed closure of accruals related to old outstanding expense claims; and
 - The risks related to securities lending activities and cash collateral reinvestment, and the associated controls under the responsibility of the IFAD global custodian bank.
3. PwC noted that Management took a proactive approach in implementing and addressing many of the risks highlighted in this report and that the issues relating to travel claims and securities lending transactions had been largely addressed. Notwithstanding the significant progress noted, PwC urged Management to evaluate carefully the risks and rewards pertaining to securities lending activities and the ongoing involvement of IFAD in this area.
4. Management concurred with the recommendations of the external auditors and explained that several proactive measures had been taken to address these concerns.
5. Committee members viewed positively the proactive approach of Management but raised several concerns, particularly over the controls surrounding the securities lending activities and the long-standing recommendations relating to the LGS project. In response to questions made, the secretariat provided the following additional information:
 - Following the approval by the Executive Board of a capital budget policy in 2008, a business case for a new LGS system identifying costs and benefits was approved and funding was allocated to this project. A full-time project manager was assigned to the project in December 2008 and the detailed business requirements for the replacement solution were developed through a series of workshops, also using external expertise. The most suitable market solutions were identified and presentations were held at IFAD with all potential vendors. A request for proposals is to be issued to a shortlist of vendors in August and it is expected that a

decision on the best solution should be taken by October, with an implementation plan in place by the end of the year. The system should be delivered within 2011.

- In relation to securities lending transactions, considering the persisting volatility in the financial markets in April 2009, Management has instructed Northern Trust to downsize the securities lending activities to a lending level of US\$350 million by the end of 2009 (from US\$526 million as at December 2008). The unrealized market value deficit of US\$18.3 million experienced at year-end had now reduced significantly to approximately US\$6.7 million.

6. Committee members took note of the information and updates provided and urged Management to expedite the implementation of the LGS replacement project.

Internal audit activities during 2008 and plan for 2009

7. The Director of the Office of Audit and Oversight (OA) presented this report and emphasized that its purpose is to assist the Audit Committee in assessing the effectiveness of the internal audit function.
8. Six audit reports and eight audit memoranda were issued by OA in 2008 and in 2009 draft audit reports have been issued for the audits of direct supervision, country presence, and procurement and disbursement functions. Further to its assurance, advisory and investigative work, in 2008 OA also provided support to the Audit Committee in the implementation of changes proposed by the external quality assurance review performed in 2007, including the conduct of a survey of 21 United Nations organizations and international financial institutions (IFIs).
9. The 2009 audit plan was prepared in accordance with International Standards for the Professional Practice of Internal Auditing and on the basis of a risk assessment exercise. The plan includes an audit of the processes for monitoring compliance of the investment managers and custodian bank, to be conducted in coordination with the external auditor. In 2009 OA is also carrying out several ad hoc audits to quickly address emerging issues and will continue its close collaboration with the Enterprise Risk Management Committee to support its role in guiding the development and embedding of risk management into IFAD's culture and processes.
10. Committee members appreciated the work performed by OA in 2008 and requested additional information about the OA study on the costs of oversight and the audit of the Office of the President. One member also suggested that this report should be presented annually to the Executive Board. In responding to queries the secretariat provided the following information:
 - **Costs of oversight.** The high-level desk review of the costs of oversight showed that IFAD has the lowest overall internal oversight costs of those United Nations organizations and IFIs sampled. The expenditures of the Office of Evaluation (OE) are the most significant element, accounting for 71 per cent of IFAD's oversight costs. OA is looking more closely at this and will provide more precise feedback in the context of the peer review of OE.
 - **Audit of the Office of the President.** No significant exceptions were noted in the audits of the Office of the President for 2005-2006 and 2007-2008. Some suggestions were made by OA in terms of how certain expenditures should be reported.
 - **More detailed reporting to the Executive Board.** The format of the OA annual report would be revised in the course of the year to separate the actual plan from the report. This would also permit more structured reporting to the Executive Board if required.

Annual Report on Investigative and Anticorruption Activities

11. In presenting this report, the Director of OA indicated that the implementation of the IFAD anticorruption policy and the establishment of the Sanctions Committee have aligned IFAD with best practices applied by other United Nations agencies and the major multilateral development banks in this area. The investigation section was fully staffed in 2008 enabling it to pursue its dual role of conducting investigations and implementing the IFAD anticorruption agenda.
12. During 2008 thirty cases were reported (13 internal and 17 external). The report analyses the sources of allegations, together with other salient information and statistics on the caseload.
13. The main comments made by members concerned the need for the investigation function to be closely coordinated with internal and external bodies, the sanction process, the reliance of OA on extra-budgetary funds for staffing and IFAD's position on cross-debarment. A question was also raised on whether IFAD Executive Board members adhere to a specific Code of Conduct. In response, the secretariat provided the following additional information:
 - OA works closely with the Office of the General Counsel and is actively engaging other internal and external partners through information campaigns and community monitoring projects, in partnership with civil society and in close cooperation with governments. OA is also considering opportunities for involving OE in assessing corruption as a factor potentially contributing to undermining the impact of IFAD projects and programmes.
 - The publication on the website of the list of debarred or ineligible individuals or companies and the adoption of cross-debarment have legal implications and are being carefully examined.
 - The Sanctions Committee reviews cases relating to both staff and non-staff, and has the authority to decide on appropriate sanctions for non-staff entities and recommend appropriate sanctions to the President for staff members.
 - The possibility of introducing a code of conduct for Executive Board members was discussed by an ad hoc committee of the Board at the time of the Seventh Replenishment, but no decision was taken. The secretariat, at the request of the Committee, will provide a background paper on steps taken so far in this regard.

2008 Annual Report on the Status of Implementation of Internal Audit Recommendations

14. The Director of OA presented a report on the implementation status of internal audit recommendations with an agreed implementation deadline of 31 December 2008. In 2008 OA revisited how it prioritizes issues emerging during its audit work in order to better focus attention on the main risk areas and facilitate Management in discharging its responsibility in this regard. The implementation status is now an embedded key performance indicator within the IFAD results management system. These measures helped Management achieve an improved implementation progress in 2008. The number of outstanding recommendations in the category of high priority has been reduced from 91 at the beginning of the year to 29 at the end of the year.
15. Committee members expressed their appreciation of the progress achieved.

Terms of reference and Rules of Procedure of the Audit Committee of the Executive Board

16. The secretariat provided an overview of the process followed to date in revising the terms of reference and Rules of Procedure of the Audit Committee, and informed

the members of the status of the draft document "Terms of reference and Rules of Procedure of the Audit Committee of the Executive Board" that had been deliberated by the Audit Committee in April 2009. It was clarified that the purpose of the presentation was to brief the new Committee members on the status and not to support a substantial discussion.

17. Several members voiced their views on some sections of the draft document. However, a full discussion of this item was deferred to the next meeting of the Committee scheduled for 1 September 2009. The secretariat undertook to prepare a short note on outstanding issues related to this agenda item and to provide the Committee with information on the practices of other IFIs with regard to the participation of experts and observers in Committee meetings.

Presentation on the proposed reform of the budget

18. In its presentation of this item, the secretariat drew the Committee's attention to two main issues: the implementation of the Governing Council decision taken in the context of the adoption of the Report of the Consultation on the Eighth Replenishment of IFAD's Resources, and the reorganization of the programme of work and budget to allow consideration of the Fund's high-level resource projections not only for 2010 but for the entire period 2010-2012.
19. The secretariat reminded the Committee of the elements of the current budget structure and highlighted the three principal elements of the revised structure: (i) integration of the Programme Development Financing Facility (PDFF) into the administrative budget; (ii) adoption of best practice in results-based budgeting; and (iii) operation within a framework of comparability with the practices of other IFIs. In 2010 there will be one comprehensive administrative budget broken down into four results and process clusters. In order to respect the decision of the Governing Council, one of the four clusters, namely the one focusing on project development and implementation, will be managed with the carry-over terms stipulated by the Governing Council for the PDFF (i.e. will have no cap), while the other three will be covered by the cap arrangements stipulated by the Governing Council for the existing administrative budget (i.e. 3 per cent).
20. The secretariat indicated that no other IFI had a results-based budget (more common in United Nations agencies), with the exception of one regional bank that was undergoing a reform process similar to IFAD.
21. The secretariat indicated that it is projecting a growth in the programme of work of about 12 per cent in 2010, 25 per cent in 2011 and 20 per cent in 2012. The projected real growth in the total administrative budget to support this expansion is 4 per cent in 2010, 4.5 per cent in 2011 and 4.6 per cent in 2012.
22. The Committee expressed appreciation for the presentation made by the secretariat on this particularly difficult and complex topic. Committee members raised a range of questions that were clarified by Management and concerned matters such as inflationary indicators, overlap between clusters, carry-forward provisions, flexibility in annual budgets, overshoot and undershoot, deflator applied to staff costs, and the proposed 4 per cent real growth. With regard to the estimated composite inflator, the Chairperson expressed concern over the proposed level and requested that a paper be prepared for the November meeting explaining its composition and the manner in which it was constructed.

Other business

23. The Chairperson, requested information on the status of implementation of the resolution of the Governing Council adopted in February on the emoluments of the President of IFAD and the President's accommodation/housing.
24. The secretariat provided details of how the salary and allowances, and other entitlements of the President, have been determined and Management gave a detailed report on how the Fund embarked on an extensive survey and a

competitive process for the identification and selection of the house, the rental cost of which is lower than that requested by the landlord of the residence of the previous President. The Committee noted the information and the Chairperson expressed his confidence that Management had pursued this issue giving due consideration to the best interest of the Fund.