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Report of the Chairperson on the 113th meeting of the Audit Committee

Executive Board — Ninety-ninth Session
Rome, 21-22 April 2010

For: **Review**

Note to Executive Board members

This document is submitted for review by the Executive Board.

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Report of the Chairperson on the 113th meeting of the Audit Committee

1. The Audit Committee wishes to bring to the attention of the Executive Board the matters examined at the 113th meeting of the Committee held on 8 April 2010.

Review of the consolidated financial statements of IFAD as at 31 December 2009 and high-level review of IFAD-only financial statements for 2009
2. The Committee considered the audited consolidated financial statements for 2009 together with the high-level review of the IFAD-only financial statements. The Committee was informed that PricewaterhouseCoopers have audited the financial statements and their opinion would be finalized after the meeting.
3. The Director, Financial Services Division highlighted the main factors in 2009 affecting financial performance and the results reported in the financial statements as follows:
 - In 2009, the growth in IFAD's Programme of Work continued. This is reflected in higher amounts for loans outstanding and undisbursed grants in the balance sheet than in the previous year.
 - Interest rates in most western economies decreased further and remained at their lowest levels throughout 2009. This had an impact on the valuation of long-term assets and liabilities which are stated at fair value or net present value due to the lower discount rates applied. The significant increase in After-Service Medical Coverage Scheme liabilities was attributable to the discount rate applied.
 - The weakening of the United States dollar against the special drawing right currencies towards the end of the year resulted in exchange gains in the case of assets denominated in such currencies. The overall effect was a positive US\$122 million.
 - The implementation of Management's decision to downsize the securities lending programme led to a reduction in the volume of securities lent by more than 50 per cent at year-end with a corresponding decrease in assets held as collateral.
 - The completion of the Consultation on the Eighth Replenishment of IFAD's Resources in February 2009 led to a significant inflow of instruments of contribution in 2009 and promissory notes towards the latter part of the year. In 2009, IFAD experienced a significant increase in activities funded by supplementary contributions.
4. The external audit was constructive and transparent and the few issues raised were duly addressed prior to the conclusion of the audit. A clean audit opinion shall be issued.
5. The Chief Finance and Administration Officer (CFAO) briefed the Committee on that the status of securities lending – which had been a matter of concern during the discussion of the 2008 financial statements – and reported on action taken in 2009. This includes: the downsizing of the securities lending programme, close monitoring of the downgraded securities within the custom collateral account and liquidation of IFAD's riskier securities. In addition, a due diligence visit was undertaken to the Global Custodian in July 2009 and close cooperation continued throughout the year to enhance the accounting and reporting of securities lending in 2010.
6. In concluding her presentation, the CFAO thanked, on behalf of IFAD Management, the departing audit engagement partner from PricewaterhouseCoopers (PWC), Mr John McQuiston, for his long and important contribution to IFAD's financial reporting practices. The Chair also expressed appreciation on behalf of the Committee.

7. In response to questions from the Committee, Management provided the following clarifications.
- Market conditions led to the unrealized losses in 2008 for the cash collateral of the securities lending portfolio. These were almost fully recovered in 2009 through an appreciation of the market value of said securities.
 - The disclosure of areas for which significant judgement is exercised by Management is required by the International Financial Reporting Standards (IFRS). The judgement in the case of the Debt Initiative for Heavily Indebted Poor Countries (HIPC) relates to discount rates adopted for discounting future cash flows; exchange rates, etc. These are based on World Bank assumptions and IFAD has to abide by them.
 - Some calculations are still performed through spreadsheets due to outdated systems, however, the new Loans and Grants System under development will address these functionalities and will lead to significant reduction in the level of manual intervention.
 - The approval by the Board of the revised General Conditions for Agricultural Development Financing in 2009 affected some key accounting trigger dates for grants. This caused cut-off problems at year-end, which were noted by the external auditor. A thorough review was conducted of all of the grants and any errors were rectified prior to the conclusion of the audit.
 - The presentation of the financial results of the year changed as a result of a new IFRS requirement. The Statement of Comprehensive Income now provides a more meaningful picture. The reported deficit in revenue over expenditure before fair value adjustment is most representative of the result from financial and operational activities in the year.
 - Income from contributions was higher because IFAD received significant amounts of supplementary fund contributions for 2009 activities.
 - More detailed information on the Debt Sustainability Framework was requested and Management confirmed that this would be provided in a table to be prepared as an addendum to the financial statements that will be submitted to the Board.
8. After a closed session held between the external auditors and the Audit Committee, the Chairperson requested Management to undertake an assessment of IFAD's continued involvement in securities lending activities since the return from the activities was modest and most institutions no longer pursue this route.
9. The Committee agreed with the concerns expressed by the external auditor on the accounting and recording of grants, and on the continuing use of spreadsheets of fair value and HIPC accounting computations. Although it had not read the report nor listened to the external auditor's presentation, Management indicated that actions are already being implemented to address both of these issues. Details would be provided under the next agenda item on the report on internal controls.
10. Regarding other items raised on the PWC report, the CFAO informed the Committee that Management had not been provided with a copy of the report from PWC and would make comments once this was received. The Committee will be provided with the response at its next meeting.
11. The Committee recommends that the Executive Board endorse and submit the financial statements for 2009 to the thirty-fourth session of the Governing Council in February 2011.

Report on internal controls over financial reporting

12. The Manager, Accounting and Financial Reporting introduced this item. This initiative is a self-review by the Financial Services Division of controls over financial reporting and mirrors the best practice of other international financial institutions (IFIs). The objective was to enable the Financial Services Division to make an assessment on the state of controls affecting reported transactions and balances in Financial Statements. This is one of the preparatory activities towards independent audit attestation. The approach involved process mapping and review; desk review gap analysis and high-level compliance reviews of the mapped processes. This phase did not include detailed transaction testing; this is scheduled for later in 2010. Control weaknesses identified were in the following areas:
- Manual intervention in determining certain accounting estimates (HIPC and fair-value accounting).
 - Operational and procedural concerns.
 - Year-end financial reporting and harmonized accounting reporting with custodian banks.
 - Internal management reports and documentation of systems and procedures.
13. Management has instigated mitigating actions such as manual and supervisory compensatory control mechanisms which address the control concerns identified.
14. Following the presentation, a number of issues were raised concerning the attestation process and who will conduct it, the effect of manual intervention and the process of automating the manual processes, and the potential role of the current external auditor in this process. Management provided the following clarifications:
- Management clarified that this review is the first step towards adopting best practices of management assertion and of attestation.
 - The formal Management assertion is planned to be issued in conjunction with the financial statements for the year ended December 2011, while the external auditors are to provide an independent attestation in relation to the Management assertion in the financial statements for the year ended December 2012, in line with the renewal of the external audit mandate.
 - The Management assertion will be supported by an assessment and testing to be conducted by the Office of Internal Audit and Oversight as part of their 2010 audit programme.
 - The Director of the Office of Audit and Oversight commented that they planned to undertake tests of operational effectiveness of key controls. The external auditor also commented that significant internal work was required to be ready for formal attestation and urged IFAD to move quickly in this regard.
 - It was also clarified that it is standard practice to have the external auditors also provide the attestation on the controls assertion. However, for IFAD no specific plans are yet in place for the engagement of the current external auditor for this exercise and any such engagement will need to be endorsed by the appropriate governing bodies.
 - Most control weaknesses noted will be addressed with the automation of the manual processes through the implementation of the Loans and Grants System and the technical upgrade of Peoplesoft this year. It was

emphasized that technical concerns identified by auditors were also raised in the report.

- Management plans to conduct a more comprehensive assessment next year in preparation for the formal attestation. Some of the concerns on automating manual processes will be resolved with the ongoing IT projects that are being funded from the capital budget. The Committee took note of the report, appreciated the clarifications given and encouraged Management to explore internal synergies in this initiative and take into account concerns raised by Committee members.

Review of the annotated outline for the proposed revision of the Project Procurement Guidelines

15. The Associate Vice-President, Operations introduced the item. During the Executive Board's ninety-eighth session (December 2009), IFAD Management submitted a review of IFAD's project procurement guidelines and their implementation. Some concerns were raised by Member States. In its efforts to address these issues and in order to demonstrate IFAD's preparedness and capacity to implement the revised guidelines, Senior Management committed to present to the Audit Committee an annotated outline of the proposed revision for review in early 2010.
16. The following aspects were considered: (i) experience gained; (ii) building on experience of other IFIs; (iii) revised General Conditions; and (iv) Paris Declaration and Accra Agenda for Action.
17. It was decided that the use of the national procurement national systems of Borrowers or Recipients should be supported given the increased responsibility that direct supervision entails.
18. Additionally, IFAD is focusing on building in-house capacity through procurement training for 120 staff, delivered by an external company. A certification training programme will be conducted later this month.
19. The Chairman thanked the presenter and invited comments from Committee members. Their questions focused on standards versus principles; benchmarking with the World Bank and other IFIs; and use of national procurement systems of IFAD Borrowers or Recipients, including capacity-building in these countries.
20. The presenter thanked members for their comments and stated that IFAD would work on the guidelines taking into consideration the comments provided by Committee members. The Committee was informed that the guidelines will present the proposed standards and outline IFAD's perception of local capacity-building in borrower/recipient Member States. On the involvement of the Financial Services Division, it was explained that the guidelines are being prepared by a task force involving the Programme Management Department (PMD), Finance and Administration Department (FAD), Office of the General Counsel (LEG) and the Office of Audit and Oversight (AUI). The Director, Financial Services Division is also involved in the review of the guidelines. In comparison with the World Bank, the Committee was informed that it may not be possible to carry out a direct comparison as the thresholds are different in the two institutions.
21. The Chairman thanked the Associate Vice-President, Operations and stated that the Committee looked forward to the presentation of the revised guidelines in September.

Review of the Revised Charter of the IFAD Office of Audit and Oversight

22. The Director, AUI provided an overview of the revisions made to the Charter of the Office of Audit and Oversight in order to address proposals made by members of the Audit Committee at its 112th meeting for consideration by the President. The Director, AUI was confident that all proposals raised had been addressed. The resulting changes were primarily to ensure consistency with IFAD's Financial

Regulations and well-recognized international standards; clarify certain aspects of the functional relationship between AUI and the Audit Committee; and provide for AUI's charter and workplan to be submitted for confirmation to the Executive Board. Members sought clarification on the reporting relationship of the Director, AUI with the Audit Committee. The Director clarified that the nature of the functional relationship is described in the charter.

23. The Audit Committee agreed with the proposed changes and recommended that, in accordance with the revised charter, both the 2010 AUI Workplan and the revised charter be submitted for confirmation to the Executive Board.

Audit Committee work programme for 2010

24. The Director, Financial Services Division introduced this item. The programme previously presented at the 112th meeting has been revised to include a number of financial topics as agenda items for the September and December sessions of the Executive Board. This inclusion would require the Executive Board's approval, as advised by the General Counsel. The Secretary of IFAD intimated that the increase in workload would have budgetary implications.
25. The Committee endorsed the programme as presented with one item added for the September meeting, i.e. the discussion of the revised project procurement guidelines.
26. The Committee further agreed to make the following recommendation for the Executive Board's approval:
27. In order to enhance the value of the Audit Committee's contribution to the work of the Executive Board, the Committee recommends that the Executive Board authorize the Committee to review at its discretion any question related to the financial administration and internal oversight of the Fund for which the Executive Board is responsible under the Agreement Establishing IFAD and the Financial Regulations of IFAD and inform the Board of the matters it has chosen to consider and the conclusions reached in this respect.

Other business

28. Concern was voiced by the Director, AUI about the presentation by the external auditors of their report to the Committee in closed session, as this had not been discussed with Management. The CFAO echoed this concern, noting that it has been brought to the attention of the Committee on several occasions and that such a procedure is not considered as a best practice. The Chair acknowledged comments and suggested confirmation was needed as to whether this is best practice and the procedure to be followed in future.