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Investing in rural people

## Report of the Chairperson on the 142<sup>nd</sup> meeting of the Audit Committee

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For: Review

## Report of the Chairperson on the 142<sup>nd</sup> meeting of the Audit Committee

1. The Audit Committee wishes to bring to the attention of the Executive Board the matters examined at the 142<sup>nd</sup> meeting of the Committee held on 1 December 2016.

### Adoption of the agenda

2. The agenda was adopted with the addition of an item on the implementation of the borrower portal under the agenda item "other business".

### Minutes of the 141<sup>st</sup> meeting of the Audit Committee

3. The minutes were approved without comment.

IFAD's 2017 results-based programme of work and regular and capital budgets, and the Independent Office of Evaluation of IFAD's results-based work programme and budget for 2017 and indicative plan for 2018-2019

4. The Committee's discussion of this item is covered in a separate report (EB 2016/119/R.3).

### Workplan for IFAD's Office of Audit and Oversight for 2017

5. The Director, Office of Audit and Oversight (AUO), presented the proposed AUO workplan for 2017, stating that the plan took into consideration the evolving environment and, in particular, risks related to financial and administrative reforms initiated in recent years, many of which had now been mainstreamed into IFAD's business processes. The proposed workplan therefore placed greater emphasis on fiduciary aspects and maintained a strong focus on decentralization by including audits on several IFAD Country Offices, procurement, delegation of authority and supplementary funds. AUO would continue to provide input for major institutional projects, such as the IFAD Client Portal.
6. The Committee was informed that the investigative caseload had been more stable during 2016.
7. The Director, AUO, explained that the proposed AUO budget allocation for 2017 was slightly higher than in 2016 and, as in previous years, additional non-staff resources might be required.
8. Members expressed full support for the proposed workplan and appreciation for its well-articulated strategy and focus on decentralization, fiduciary controls and supplementary funds. With respect to the proposed audit on supplementary funds, members suggested that this entail a review of the entire supplementary fund architecture. Members also emphasized the importance of the planned external quality assessment and expressed the expectation that this would extend to the governance of the internal audit function, its relationship to and the roles of the Audit Committee and Executive Board. The Director, AUO, welcomed the positive feedback and clarified that the two previous external quality assessments had included interviews with some Committee members and had covered the governance arrangements and independence of the internal audit function. Similar coverage was therefore expected in this assessment. The Director, AUO, further noted that as had been the practice for the previous assessments AUO would identify potential external parties but that the President would make the final selection so as to ensure independence and objectivity of the assessment.
9. The AUO workplan was deemed reviewed and would be submitted for confirmation to the Executive Board at its 119<sup>th</sup> session in December 2016.

#### Annual review of IFAD's Investment Policy Statement

10. Management presented the background and rationale for the Investment Policy Statement. The aim of the 2016 revision was to ensure that a comprehensive range of tools were in place for the main economic and financial scenarios; it was also intended to improve the efficiency of treasury operations.
11. Building on improvements already made, the 2016 revision focused only on:
  - (a) The possibility of including covered bonds as eligible instruments;
  - (b) An updated risk budget for individual portfolios to reflect the parameters of the newly established portfolios (the global liquidity portfolio and the renminbi portfolio);
  - (c) Restatement of asset class allocation at portfolio name level, which would widen the possibility of tactical flexibility to 10 per cent.
12. Management also clarified that the restated asset class allocation resulted in slightly lower conditional value at risk.
13. The Committee requested clarification on the current allocation in the emerging market portfolio, the balance between the internally and externally managed portfolio, and the rationale for setting up a stand-alone portfolio for the renminbi.
14. Management provided detailed answers, clarifying that while "emerging market" was deemed as a strategic asset class, in August 2016 Management had proceeded with significant divestment from this market exposure with the aim of reducing possible negative repercussions generated by the high volatility of the sector. Management also clarified that during 2016 some investment activities had been internalized, and that the Committee would be informed about the implication of the introduction of the Chinese renminbi into the special drawing rights (SDR) basket under agenda item 11.
15. The Investment Policy Statement was deemed reviewed and would be submitted for approval to the Executive Board at its 119<sup>th</sup> session in December 2016.

#### Audit Committee work programme for 2017

16. The Audit Committee work programme for 2017 was presented by the Chairperson and adopted by the Committee. The Chairperson noted, further to his request, that a possible discussion on one of the internal audit reports had been added to the agenda of the July 2017 meeting, in order to discuss one of the reports and call for a discussion at the Board. Although the option of discussing an internal audit report was always available to the Committee, this was not yet done and including a specific reference to this would act as a reminder to members to exercise this option and would foster a closer relationship between the Committee and AUO. The discussion would be held at the July meeting as that agenda contained few items for consideration.

#### Project audit reports for fiscal year 2015

17. Management provided an update on the status of project audit reports and the related project financial management activities undertaken by IFAD in 2015. Management also suggested that the title of the document be modified, from 2017, to reflect an emphasis on overall project financial management rather than a sole focus on project audits. Management informed members of the:
  - (a) Stable proportion of unqualified opinion compared to the previous period (from 88 per cent in 2014 to around 89 per cent in 2015);
  - (b) Slight increase in the timely submission of audit reports, from 60 per cent in 2014 to 62 per cent in 2015;
  - (c) Increased trend in the use of supreme audit institutions (SAIs), to 36 per cent in 2015 from 30 per cent in 2014.

18. The Committee was informed about additional financial management activities performed during 2016 (e.g. IFAD had joined the Multilateral Development Bank Financial Management Harmonization Working Group, regular capacity-building learning events had been organized to support projects and ministries, and a mandatory accreditation process had been launched for financial management staff).
19. The Committee requested further information in certain areas and acknowledged the progress made in project audit and financial management.  
 Proposal to enter into a borrowing agreement with the Agence Française de Développement (AFD) to support the IFAD10 programme of loans and grants
20. Management introduced the agenda item by providing details of the proposal and clarifying that the loan would provide sustainable additional funding to finance the programme of loans and grants (PoLG) of the Tenth Replenishment of IFAD's Resources of US\$3.2 billion.
21. The Committee requested clarification about encashment schedules and financial sustainability, compliance with the Sovereign Borrowing Framework (SBF) parameters, and the possible effect on allocations under the performance-based allocation system.
22. Management provided additional information and clarified that the lending terms proposed by KfW Development Bank and by Agence Française de Développement reflected the different rating standing of the two institutions.
23. The document was deemed reviewed and would be submitted to the Executive Board at its 119<sup>th</sup> session in December 2016.  
 Briefing on technical issues related to borrowing from the capital markets
24. Management made a detailed presentation on the technical issues pertaining to borrowing from the capital markets. It was highlighted that the SBF was a useful tool for diversifying IFAD's financing sources but that replenishment contributions would remain the primary source of funding. Borrowing from capital markets would open up a further opportunity.
25. Management provided an overview of the steps taken to date by the Fund to improve financial planning activities. It was noted that borrowing from capital markets could ensure further flexibility and provide a cheaper option than the one currently affordable under the SBF. As a lesson learned from the recent experience with the International Development Association (IDA) ratings process, Management described further activities that would ensure a successful rating process, in particular, emphasizing the importance of ensuring timely and reliable compensation for Debt Sustainability Framework (DSF) grants.
26. Members shared their feedback on the possible credit rating of IFAD and enquired about possible implications for IFAD's operations, staffing requirements and governance.
27. The Committee welcomed the update.  
 Updated on the implication for IFAD of the introduction of the Chinese renminbi into the special drawing rights (SDR) basket
28. Management gave a detailed presentation on the implications of the introduction of the Chinese renminbi into the SDR basket (since October 2016, with a weight of 11 per cent of the basket). It was noted that the renminbi market was a dual market with onshore and offshore components. The CNY was the currency used for trading onshore (inside China), however it was not usable for international transactions without the prior authorization of the People's Bank of China. The CNH was the currency used for international transactions.

29. Considering the above, the creation of an ad hoc portfolio with an exposure denominated in renminbi was deemed the most cost-effective and flexible solution to ensure alignment with the SDR basket in order to minimize foreign exchange risks.

30. The Committee welcomed the update.

Standard financial reports presented to the Executive Board

31. Management presented the following documents:

- (a) Resources available for commitment (for review); and
- (b) Report on IFAD's investment portfolio for the third quarter of 2016 (for review).

32. Management confirmed that resources available for commitment for IFAD's PoLG were now defined under a sustainable cash flow approach.

33. Management provided an update on the performance of the investment portfolio, reporting a positive net investment income of US\$56.5 million on a year-to-date basis as at 30 September 2016, with a return of 3.87 per cent net of all investment-related fees. Management noted that all risk parameters remained below the budget level, as required by the Investment Policy Statement.

34. The reports were reviewed with no further comments.

Other business

- (a) Update on the working group on assessment of IFAD policies and criteria for financing and terms

35. Management provided an oral update on the progress of the corporate working group reviewing IFAD's financing policies and criteria. It was noted that the working group had been set up in direct response to the requests of the Audit Committee and Executive Board and as best practice to regularly review IFAD's policies and procedures. The working group was mainly focused on: (i) reviewing current policies and procedures for financing; (ii) benchmarking products, terms and prices with those of other international financial institutions; (iii) reviewing pricing and flexibility considerations of IFAD's financial products; (iv) examining the SBF's implications for IFAD's cost of capital and the continued alignment of IFAD's spread with that of the International Bank for Reconstruction and Development; (v) collating the borrowing demands of clients; (vi) reviewing the experience of the single currency lending framework to date; (vii) looking into the availability of additional products to offer flexibility to borrowers and generate additional income for IFAD both within and outside the PBAS; and (viii) reviewing the DSF.

36. It was noted that that IFAD offered a more limited number and flexible lending products than other IFIs, but that these products were more concessional. Moreover, it was noted that the DSF implementation modalities adopted by IFAD differed from those followed by other IFIs and were having a negative impact on IFAD's financial sustainability.

37. The Committee welcomed the update, noting that the review was still in progress and that the Audit Committee work programme for 2017 envisaged a review of the recommendations.

- (b) Update on the implementation of the borrower portal

38. The Committee received an oral update on the implementation status of the IFAD Client Portal (ICP). Management noted that the ICP was the most visible component of the Loans and Grants System replacement project as it catered to external stakeholders and provided better services for borrowers and recipients. The main driver of the project was to improve the experience of clients in doing business with IFAD. Indeed, the ICP's main benefits and efficiencies would accrue to the borrowers and recipients of IFAD financing through improved service

delivery, reduced cycle times and better visibility and access to data. Overall, the ICP project was critical for the future positioning of IFAD as a modern development institution able to serve its stakeholders with cutting-edge business solutions and a leader among development finance institutions. The Committee was informed that the portal would go live on 5 December 2016. Details were provided about the additional measures taken to address cyber security risks.

39. The Committee welcomed the update.

Closing

40. The member for Sweden announced the Swedish Government's decision to withdraw from the Audit Committee, having served on the Committee for four and a half years.