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Investing in rural people

## Report of the Chairperson on the 146<sup>th</sup> meeting of the Audit Committee

### Note to Executive Board representatives

#### Focal points:

#### Technical questions:

Advit Nath  
Director and Controller  
Accounting and Controller's Division  
Tel.: +39 06 5459 2829  
e-mail: a.nath@ifad.org

Allegra Saitto  
Chief  
Financial Reporting and Corporate Fiduciary  
Accounting and Controller's Division  
Tel.: +39 06 5459 2405  
e-mail: a.saitto@ifad.org

#### Dispatch of documentation:

William Skinner  
Chief  
Governing Bodies  
Tel.: +39 06 5459 2974  
e-mail: gb@ifad.org

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For: Review

## Report of the Chairperson on the 146<sup>th</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 146<sup>th</sup> meeting of the Committee held on 23 November 2017.

### Adoption of the agenda

2. The agenda was adopted with the inclusion of the minutes of the second special meeting of the Audit Committee and an update on tracking of IFAD's corporate risk under other business.

### Minutes of the Audit Committee

3. The minutes of the 145<sup>th</sup> meeting, and the minutes of the first and second special meetings of the Audit Committee were approved without comments.

IFAD's 2018 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 2018 and indicative plan for 2019-2020, and the HIPC and PBAS progress reports

4. The Committee's discussion of this item is covered in a separate report (EB 2017/122/R.3).

### Workplan for IFAD's Office of Audit and Oversight for 2018

5. The Office of Audit and Oversight (AUO) introduced the agenda item, highlighting that the 2018 workplan was based on the risk assessment exercise conducted by AUO, and took into consideration the overall risk environment and corporate risk register, and the financial and operational impact of business processes. A brief overview of the AUO risk assessment process was presented to the Committee. The risk assessment confirmed the need for continued attention to: decentralization efforts; efficiency in the use of financial resources; and adequacy of financial and investment controls. AUO also highlighted that the selection of the external experts who will conduct the external quality assessment of the internal audit function is in progress. It was noted that the 2018 AUO budget allocation was higher than in previous years, both in terms of staffing and resources and that the office would have a new staff position.

6. Committee members thanked IFAD for the document and the presentation on risk assessment, appreciated the thorough risk assessment process and the consultation with the Audit Committee, and further emphasized the need for increased internal audit attention on country office activities, particularly in programme management, and of financial and other risks.

7. Management provided some clarification about how AUO incorporates forward looking elements, drawing also from benchmarking with peer institutions, in planning its activities, the various ways that AUO seeks to address risks pertaining to the decentralization effort and the evolving financial model, on how AUO uses its non-staff budget to maximize value and on the adequacy of audit coverage of IFAD Country Offices and country programmes. The document was considered reviewed. It would be presented at the December session of the Board for confirmation.

### Increasing transparency for greater accountability – action plan

8. Management introduced the agenda item, highlighting the efforts made to elaborate an action plan that captured all the feedback received from the Executive Board, the Audit Committee and the informal seminar. It was noted that Management was already proceeding with the implementation of some actions (e.g. posting the whistle-blower policy and IFAD's Code of Conduct on the IFAD website). As

requested, Management would provide the Audit Committee and the Executive Board with an update in 2018 on the progress made.

9. Committee members expressed their appreciation for the cross-divisional effort to progress proactively on the actions. Clarification was requested regarding the disclosure of the President's opening and closing remarks to the Executive Board, about the process for disclosing of project audit completion and reports and frequency of uploading data to the International Aid Transparency (IATI) platform.
10. Management clarified that some actions foresee formal communications to borrowers and that these are currently being drafted, for example on the changes foreseen for the revision to project audit guidelines. It was clarified that uploading of data to IATI is now done on a quarterly basis. It was also noted that the President's remarks were already available online and will also be available on the new version of IFAD's website.
11. The document was considered reviewed.

Project financial management: Mechanisms, developments, disclosures and results

12. Management highlighted that the scope of the report had been broadened to present a more holistic picture of project financial management mechanisms and processes. This broadened scope was aligned with IFAD's corporate agenda to increase transparency in the interests of greater accountability. Accordingly, the report provided more information on the application of financial management assurance policies, procedures and practices and adherence to international standards and best practices.
13. It was noted that since 2007, IFAD had strengthened its financial management functions to better meet its fiduciary responsibility to stakeholders. This had involved organizational changes to establish a separate division and the transfer of budgetary resources from the Programme Management Department to the Financial Management Services Division (FMD) to enable the latter to effectively manage this area. To this end, FMD was introducing up-to-date, consistent processes, guidelines, IT tools and reporting. These included a risk-based assurance framework, business re-engineering, mandatory accreditation for financial consultants, regular updates of policies and processes, regular capacity-building for internal and external stakeholders and an increasing commitment to transparency, including the disclosure of project audit reports and information on lending terms and products. IFAD's increasing engagement in international forums and collaboration with other international financial institutions (IFIs) to harmonize procedures and exchange experiences was noted.
14. The report also contained a review of the 2016 project audit reports. It was noted that 42 per cent of project audits were now undertaken by supreme audit institutions, compared to 30 per cent in 2014. Delays in submission of reports were still substantial (approximately 35 per cent in 2016). Major findings by auditors had been followed up and mandatory action plans were being imposed as required. IFAD monitored adherence to international auditing and accounting standards in its review of the audited financial statements.
15. Committee members expressed their appreciation for the document and requested some details about the financial management consultancy accreditation process, and risks associated with project implementation. Members also asked about the implications of using local versus international standards for financial reports.
16. Management provided further details, in particular on the review of ineligible expenditures, which was monitored and regularly followed up on. The Committee requested that further information be provided on these issues in the future.
17. The document was considered reviewed.

- Update on a feasibility study on IFAD borrowing from capital markets
18. Management provided an oral update on the feasibility study on IFAD borrowing from capital markets. The document under preparation would include an assessment of IFAD's readiness for this innovation. Liquidity and risk management policies would be closely analysed. It was noted that the paper would present IFAD's strengths and weakness, and an analysis of the costs associated with the initiative.
  19. Committee members requested further information on the timeline for submission of the study, the costs involved and the issues that would be covered by the study. Members pointed out the usefulness of providing input before the study was presented to the Board.
  20. Management supplied additional details and informed the Committee that the study would be submitted in September 2018, noting that technical seminars would be organized to enable members to evaluate its contents. It was also noted that the study would include the lessons learned from implementing the Concessional Partner Loan (CPL) Framework.
  21. The update was considered noted.

#### Approach to a Transition Framework

22. As agreed under the Eleventh Replenishment of IFAD's Resources (IFAD11) Consultation, Management provided further information on its approach to a transition framework outlining the scope, timeline and mechanisms for developing the framework. The final goal of the transition framework was to provide a package of comprehensive and sustainable support to accompany borrowers in their development efforts.
23. The approach document also proposed changes to the Policies and Criteria for IFAD Financing and foresees the introduction of new instruments to support countries in dealing with their specific development challenges. In the document, practices adopted were developed and tailored to IFAD's specificities based on practices of other IFIs.
24. Management clarified that "transition" referred to the process by which a country transitioned from eligibility for more concessional financing terms to being eligible for less concessional terms, as their financing capacities and needs developed; the process also took into account the borrower's demand for concessional funds, calibrated against its development progress.
25. Management further explained that "reversal" was the process by which a country borrowing on less concessional terms ceases over time to be creditworthy for non-concessional financing or experienced a drop in its per capita income level below the specified threshold, thus becoming eligible for more concessional financing or softened terms. Therefore it was foreseen that the transition process would be implemented through a mix of financing terms and, possibly, through new financing instruments and would make the process more predictable.
26. The definitive transition framework would be established through a participatory mechanism, such as a working group of the Executive Board, supplemented as necessary with informal seminars. This objective was included in the IFAD11 commitment matrix. The framework would be approved by the start of the IFAD11 period. Some members emphasized that the development of the framework should be a participatory process, involving informal and technical seminars, to ensure the engagement of IFAD Membership in the discussions.
27. Committee members requested further information on the framework's alignment with the procedures of the International Development Association, the implications for the Debt Sustainability Framework, the rationale behind transition and predictability, and the timing of the revision of the Policies and Criteria.

28. Management clarified that the transition framework would be treated as a living document, with the flexibility to respond to changes in IFAD's architecture and business model going forward. Further changes were therefore envisaged – including a review of IFAD pricing and associated lending terms – as IFAD moved towards obtaining a credit rating and entered into market borrowing. Management also clarified that revision of the Policies and Criteria was necessary both to align IFAD's financing terms with those of other IFIs and to specifically delegate authority to the Executive Board to finalize the transition framework. In order for the framework to be ready for the start of IFAD11, the revisions to the Policies and Criteria would need to be approved by the Governing Council in February 2018, following their endorsement by the Executive Board in December 2017.
29. The document was deemed reviewed and would be submitted to the Executive Board at its 122<sup>nd</sup> session in December 2017.

#### Audit Committee work programme for 2018

30. The Office of the Secretary presented a revised version of the work programme for 2018, drawing attention to some additional items. It was proposed that a further meeting be held in January to consider the terms of reference of the independent risk assessment provider before the selection process in March.
31. The work programme was approved with the proposed amendments and the revised version would be posted after the meeting.

#### Conceptual Framework on Financial Reporting and Auditing of IFAD-Financed Projects

32. Management introduced the agenda item highlighting that project audit reports were one of the pillars of fiduciary assurance used by IFAD. The document proposed a conceptual framework for the financial reporting and auditing of IFAD-financed projects. It defined strategic concepts for efficient management of the project audit cycle for both investment projects and stand-alone grants. The framework required a single audit opinion as per the practice of several other IFIs. It provided clarification on the types of audits to be performed, about public disclosure of project audit reports, and incorporated grant activities, which were not previously included.
33. Management informed the Committee that the principles contained in the conceptual framework would be operationalized through a handbook for the use of borrowers and grant recipients. The new conceptual framework and handbook would be effective as of 1 January 2018 and become mandatory from 2019, once approved by the Executive Board. Guidance for IFAD staff would be provided in the Financial Management and Administration Manual.
34. Committee members suggested that the framework be reviewed annually. They requested clarification on the disclosure of project audit reports, and on the timing of the implementation of the new framework.
35. Management clarified that project audit reports would be disclosed once borrowers had been informed of the new procedures.
36. The document was considered reviewed and would be submitted to the forthcoming session of the Executive Board in December 2017 for approval.

#### Amendments to the Agreement Establishing IFAD

37. Management introduced the agenda item noting that the adoption of the CPL Framework necessitated changes to the Agreement Establishing IFAD. In particular, it was noted that the "grant element" of the CPL would be treated as an additional contribution under article 4, section 3 of the Agreement, which confers contribution votes in accordance with the provisions of its article 6, section 3(a)(i)(B).

38. The document was considered reviewed and would be submitted to the 122<sup>nd</sup> session of the Executive Board for approval.

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

39. Management presented the annual review of IFAD's Investment Policy Statement, noting changes such as the adoption of callable bonds and the modification of the credit rating floor for money market instruments to include investment grade ratings and the removal of prescription ranges for asset classes.
40. In particular, changes were made in alignment with credit quality requirements for short- and long-term investments and to create more opportunities for the euro-denominated portion of the investment portfolio to be invested at positive yields.
41. The only significant change proposed to the Internal Control Framework was that the Financial Operations Department team would assist and advise the Associate Vice-President, Financial Operations Department, in making decisions on financial or investment management matters that were under his or her authority or under specific delegation of authority from the President of IFAD, and make recommendations to the Investment and Finance Advisory Committee (FISCO) for final decision by the President as appropriate. This group would replace the Asset Liability Committee (FALCO), which was discontinued as per the decision of FISCO in January 2017.
42. Committee members requested clarification on the risks associated with callable bonds, and on strategic asset class allocations.
43. Management provided details about and highlighted the strategy of being more dynamic in order to reduce risk and optimize the placement of IFAD's investments, particularly as a response, in the case of the inclusion of callable bonds, to regulatory changes affecting debt issuance by banks.
44. The document was deemed reviewed and would be submitted to the Executive Board session in December 2017 for approval.

#### Investment Policy Statement for the After-Service Medical Coverage Scheme (ASMCS)

45. Management introduced the agenda item, noting that the Investment Policy Statement had been duly reviewed with the support of an asset and liabilities study conducted by PricewaterhouseCoopers. No changes to the body of the statement had been required. However, some adjustments to the strategic asset allocation of the trust fund were recommended, in particular, an increase in the exposure to emerging market debt and developed market equities. The main aim of the ASMCS Trust Fund was not liquidity management, but rather to provide services to retired employees (much like a pension fund). The banding of asset class allocations was recommended.
46. Committee members requested clarification about the risks associated with this recommendation, about investing in equities and about the accounting disclosure of the ASMCS Trust Fund.
47. Management explained that the risk profile was similar to those adopted by similar trust funds and that ASMCS balances were fully recognized and disclosed in IFAD's consolidated financial statements.
48. A Committee member requested an update on the implementation of the International Civil Service Commission (ICSC) recommendation on the mandatory age of retirement. Management indicated that such update would be given on a bilateral basis.
49. The document was deemed reviewed and would be submitted to the Executive Board at its 122<sup>nd</sup> session for approval.

### Strengthening the strategic role of the Audit Committee

50. In light on the conversation held at the Executive Board retreat in April 2017, the Committee deliberated on how to strengthen its strategic role in contributing to the decision-making process of the Executive Board.
51. Management provided some details about the Terms of Reference of the Audit Committee and the matrix of issues and actions to strengthen IFAD's governance. It was noted that the Office of the Secretary had begun a benchmarking exercise with other IFIs and United Nations agencies to gain an understanding of how their subsidiary bodies operated and reported to their boards, with a view to holding a discussion at the next Executive Board retreat, in April 2018, and submitting a document at the Board's session in September 2018.
52. Members welcomed the opportunity to discuss this issue. They recognized the need to streamline their reporting to the Board by highlighting critical issues, regularly evaluating their own work, and tracking progress on implementing commitments. Some members stressed the need for continuity between the discussions of the Audit Committee and those of the Board. The Chair stated that the Committee would present a position paper on this issue at the retreat in April.

### Standard financial reports presented to the Executive Board

53. Management presented the document on the resources available for commitment and the report on IFAD's investment portfolio for the third quarter of 2017 for the Committee's review.
54. The Treasurer introduced the documents, highlighting that the resources available for commitment provided long-term cash flow projections. On this basis, the Executive Board could authorize the President to conclude agreements for loans and grants approved by the Executive Board in 2018 of up to US\$1.215 billion. He noted that the methodology behind this paper should be reviewed and this will be done in the context of development of a new integrated borrowing framework. The Treasurer also introduced the report on performance of the investment portfolio. He highlighted the good performance of the investment portfolio, which showed a 1.82 per cent net rate of return for the nine months of 2017. Half of the portfolio is now managed internally, with consistent benefits to IFAD in terms of management fee savings and increased staff expertise. The duration of the portfolio continues to be shortened in line with the strategy.
55. The reports were deemed reviewed, and the resources available for commitment document would be submitted to the Executive Board for approval at its 122<sup>nd</sup> session in December 2017.

### Other business

56. Under other business, the Vice-President of IFAD provided an update on the tracking of IFAD's corporate risks. The tracker could be broken down into three clusters: (i) strategic risks related to resource mobilization (e.g. the encashment on the replenishment versus the average of the previous replenishment, the cofinancing ratio, and the performance in mobilizing supplementary funds); (ii) impact assessment (of commitments and results); and (iii) operational risks (e.g. portfolio at risk, specific tracking of the volume of problem projects, level and status of ineligible expenditures, and risk status of projects). The above points would be captured in a draft document for presentation to the Audit Committee.
57. Committee members expressed their appreciation for the work done and for Management's efforts in this regard.
58. The update was considered noted.
59. No other agenda items were further discussed under other business.