Report of the Chairperson on the 148th Meeting of the Audit Committee

Note to Executive Board representatives

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
Tel.: +39 06 5459 2405
e-mail: a.saitto@ifad.org

Focal points:

Dispatch of documentation:

Alessandra Zusi Bergés
Senior Governing Bodies Officer
Governing Bodies
Tel.: +39 06 5459 2092
e-mail: gb@ifad.org

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Report of the Chairperson on the 148th Meeting of the Audit Committee

1. The Audit Committee wishes to bring to the attention of the Executive Board the matters examined at the 148th meeting of the Committee, held on 27 March 2018.

   **Adoption of the agenda**

2. The agenda was adopted, including the following topics under “other business”:
   - Annual confirmation of the external auditor's contract;
   - Review of audit/oversight committees in the United Nations system by the Joint Inspection Unit;
   - Revised Work Programme of the Audit Committee for 2018.

**Minutes of the 146th and 147th meetings of the Audit Committee**

3. The minutes were approved without comments.

**Consolidated Financial Statements of IFAD as at 31 December 2017 (including the Management assertion report and an independent external attestation on the effectiveness of internal controls over financial reporting)**

4. Management introduced this agenda item by noting the external auditor’s unqualified/clean audit opinion on the Consolidated Financial Statements of IFAD as at 31 December 2017. For fiscal year 2017, Management confirmed the operational effectiveness of all key internal controls over financial reporting in the management assertion report, with an independent external attestation by IFAD’s external auditor.

5. Management identified the key factors affecting IFAD’s financial position and reported results, emphasizing that the overall financial situation was sound and that long-term viability was being monitored closely. Additional details were provided on foreign exchange volatility positively impacting the financial statements, as well as on the various currency risk mitigation measures adopted by the Fund. It was noted that at the end of December 2017, IFAD’s liquidity was above the minimum liquidity requirement. The impact of Debt Sustainability Framework (DSF) expenses on IFAD’s financial position and the importance of DSF compensation from Member States to IFAD were underscored as a major consideration for long-term financial viability.

6. IFAD’s external auditor provided a brief commentary on the main focus areas of the 2017 audit, i.e. fair-value accounting for IFAD’s loan portfolio, foreign exchange impact and management assumptions for revenue recognition, which were standard audit procedures.

7. Members commended IFAD Management for the quality of the document and reaffirmed the importance of the additional information provided as a supplement to the Consolidated Financial Statements also in view of increasing scrutiny by stakeholders and the public.

8. The Consolidated Financial Statements were reviewed by the Audit Committee and would be presented to the 123rd session of the Executive Board for endorsement, prior to the Governing Council’s formal approval in February 2019.

**Annual Report on the Activities of the Office of Audit and Oversight during 2017**

9. The Office of Audit and Oversight (AUO) presented the report, highlighting that the purpose of the document was to provide details of its activities in 2017. It was noted that this would be the first time that the report would be disclosed to the Executive Board.
10. In 2017, AUO completed 18 assurance assignments, with the emphasis on decentralized functions and IFAD Country Offices (ICOs). It was noted that during 2017, AUO coordinated the action plan for "increasing transparency for greater accountability". It was also noted that during 2017 Management implemented AUO’s recommendations on a timely basis.

11. AUO had contributed to mitigating ethical and corruption risks by completing work on 49 complaints of wrongdoing. To raise anticorruption awareness, AUO participated in workshops, contributed to the IFAD Operations Academy and launched an anticorruption e-learning module.

12. AUO informed the Committee about the conclusion of the external quality assessment of the internal audit function and the attainment of the highest possible rating.

13. The Committee commended the report and praised the attention that AUO had given in the document to the issue of data quality and integrity, as well as to ethical behaviour, through the detailed analysis conducted on alleged instances of wrongdoing. Members requested additional details on trends in the control environment; the strong focus on compliance issues in the ICO audits; the investigation observations on control lapses underlying alleged wrongdoing; the potential impact of decentralization on fraud and corruption risks; the trend in ratings of ICO audits; and staff capacity of AUO. The necessary clarifications were provided. AUO also noted that it was fully aware that project procurement was an area that must be carefully monitored and that it would remain a priority area for both AUO and Management.

14. The report was deemed reviewed and would be presented to the 123rd Executive Board session for information.

Revision to the Charter of the IFAD Office of Audit and Oversight

15. AUO presented the revised Charter of the Office of Audit and Oversight.

16. AUO noted that the proposed changes stemmed from the new disclosure modalities for internal audit reports and the need to ensure that AUO remained aligned with best practices as set forth in the International Professional Practices Framework of the Institute of Internal Auditors. In this regard, the revised charter contained provisions to strengthen the independence of AUO and reinforce the oversight role of the Audit Committee.

17. Committee members requested additional details about AUO reporting lines. AUO provided clarifications, referring also to the conclusions of the external quality assessment of the internal audit function in this regard. The Chairperson, in agreement with members, emphasized that the Committee would probably discuss the opportunity to raise some points regarding the reporting lines of AUO in the near future, in particular with reference to the approval of the audit plan, in the wider context of the issue of AUO independence.

18. The document was deemed reviewed and would be presented to the 123rd Executive Board session for confirmation.

Independent financial risk assessment

19. The Executive Board requested the services of an independent assessment provider to review and assess the relevant aspects of IFAD's risk management capabilities. Management presented the revised terms of reference for an independent financial risk assessment based on the feedback received at the Audit Committee at its 147th meeting.

20. Appreciation was expressed to the delegate for Argentina who had made himself available to participate in the panel for the selection of the consulting firm.
21. The document was deemed reviewed and Management would proceed with the selection of the consulting firm.

**Strengthening the Strategic Role of the Audit Committee**

22. The Office of the Secretary presented a summary of the results of a benchmarking exercise on the strategic role of the Board’s subsidiary bodies. The presentation was welcomed by Committee members, who noted that the results demonstrated that IFAD was in line with best practice. The position paper prepared by the Audit Committee and the results of the benchmarking exercise would be presented to the Executive Board at its forthcoming retreat. The topic would be further discussed at the June meeting of the Committee. A consolidated paper would then be presented to the Committee and to the Board in September.

**Update on the Implementation of the Impairment Section of International Financial Reporting Standard (IFRS) 9**

23. Management provided an oral update on the implementation of the impairment section of IFRS 9 (Financial Instruments). It was noted that the application of this particular and significant accounting standard was onerous for the financial industry and for international financial institutions, including IFAD. Management provided highlights of the main changes required by the standard and informed the Committee about the milestones already achieved by IFAD and main steps required for full implementation.

24. It was clarified that the 2018 Consolidated Financial Statements would be fully compliant with this accounting standard and that updates would be presented at future Audit Committee meetings.

25. The update was deemed noted.

**Timeline for the Review, Update and Strengthening of IFAD’s Enterprise Risk Management Covering Strategic, Operational and Financial Risks**

26. Management presented the agenda item highlighting that the timeline – which had been prepared for the Audit Committee’s review – provided details about risk-related processes and milestones, both financial and non-financial. It also contained the main steps that would be taken to strengthen risk management in IFAD up to the end of the year.

27. The Committee noted Management’s preference to postpone the informal seminar scheduled to take place in May. This would allow for the completion of the necessary reviews and assessments and thereby provide a more holistic view of financial operations.

28. The document was deemed reviewed and would be presented at the 123rd Executive Board session for review.

**Standard financial reports presented to the Executive Board**

29. Management presented the following reports for the review of the Audit Committee:

- Report on IFAD’s Investment Portfolio for 2017;
- Report on the Status of Contributions to the Tenth Replenishment of IFAD’s Resources;
- Report on the Status of Contributions to the Eleventh Replenishment of IFAD’s Resources;
- Requirements for the Thirty-ninth Drawdown of Member State Contributions in 2018;
- Status Report on Arrears in Principal, Interest and Service Charge Payments; and
30. Management provided an update on the status of pledges to the Eleventh Replenishment of IFAD’s Resources (IFAD11), instruments of contribution, service charge payments and DSF commitments.

31. Management updated Audit Committee members on the latest investment portfolio developments, highlighting the positive performance recorded in 2017 (with a net rate of return of 2.21 per cent) and the investment in the Reserves Advisory and Management Program within the World Bank Treasury. Management estimated performance for the first two months of 2018 to be in the region of negative 0.25 basis points.

32. The Committee reviewed the draw-down requirements for 2018, which would be presented to the 123rd session of the Executive Board for approval.

33. The Committee was also informed of the financial impact of the DSF. Management stated that since the introduction of the DSF in IFAD in 2007, IFAD had committed a total of US$1.7 billion, as of the end of 2017. It was expected that the DSF financing disbursed would be repaid between 2017 and 2056. As requested by some members during the IFAD11 Consultation, Management for the first time also presented the financial impact of approvals under the DSF continuing for 10 years and 20 years into the future. The financial impact of approvals continuing for 20 years from now would amount to US$6.2 billion of principal due from Member States and US$1.1 billion absorbed by IFAD for interest forgone. Management highlighted the potential negative impact on IFAD's programme of loans and grants (PoLG) if DSF grant approvals continued and core contributions in real terms remained steady. This would ultimately result in a maximum cumulative financial impact of a reduced PoLG of US$4.9 billion by the end of IFAD16, i.e. in 20 years from the present time.

34. The Chairperson emphasized the importance of the DSF issue and thanked Management for the detailed and relevant analysis presented. It was highly appreciated that simulations on the potential impact had been produced, and different scenarios considered.

35. Through the Chairperson, the Committee asked Management to provide Member States with additional considerations useful for the discussion of the DSF mechanism and to identify and evaluate alternative options for solving the underlying issues.

36. The reports were deemed reviewed.

Other business

37. Three sub-items were considered by the Committee under other business.

(a) Annual confirmation of the contract for the external auditor

38. Management presented the agenda item on behalf of the external auditor, highlighting that in accordance with the Audit Committee's Terms of Reference, the Committee's permanent responsibilities included reviewing any significant changes in the scope or financial terms of the external auditor's appointment, and reporting to the Board any issues related thereto requiring its attention.

39. For the 2018 audit exercise and subsequent audits within the remaining mandate of the external auditor, Deloitte & Touche had submitted a proposal for an increase in audit fees due to:

- Additional auditing activities associated with the implementation and application of the new accounting standard IFRS 9; and
- Cost-of-living adjustment.
40. Deloitte & Touche had proposed that the audit fees be increased from EUR 135,000 for fiscal year 2017 to EUR 151,215 for fiscal year 2018, inclusive of:

- Recurring additional annual audit activities resulting from revised auditing standards associated with IFRS 9 implementation amounting to EUR 10,000;
- An adjustment in the cost of living of EUR 1,215; and
- One-off additional audit activities during the year of transition of EUR 5,000.

41. Audit fees for fiscal years 2019 to 2021 would be EUR 146,215 per year.

42. Committee members asked the external auditor for details about the changes in the audit scope envisaged as a consequence of the implementation of IFRS 9.

43. The external auditor explained that the new accounting criteria would imply several managerial assumptions associated with the expected credit loss of financial instruments and that this measure should be monitored at the moment of origination as well as at the reporting date. The peculiarity of IFAD's business model and the complexity of the accounting criteria to apply would result in significant additional audit work particularly during the first year of its implementation.

44. The Committee discussed the proposal, without the external auditor present. Members asked Management to provide them with an analytical review of the rationale for approving the request.

45. The item will therefore be discussed again at the Audit Committee’s meeting in June 2018.

(b) Review of audit/oversight committees in the United Nations system by the Joint Inspection Unit

46. The Chairperson informed the Committee that the Joint Inspection Unit would perform a review of the audit/oversight committees in the United Nations system, and that most likely the Committee would be called on to support this initiative.

(c) Revised Work Programme of the Audit Committee for 2018

47. The Office of the Secretary presented the revised work programme of the Audit Committee, noting the updates, which were mostly based on the revised timeline for the review, update and strengthening of IFAD’s Enterprise Risk Management covering strategic, operational and financial risks.

48. The revised work programme for 2018 was reviewed and approved.