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## Report of the Chairperson on the 150<sup>th</sup> meeting of the Audit Committee

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Executive Board — 124<sup>th</sup> Session  
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For: Review

# Report of the Chairperson on the 150<sup>th</sup> meeting of the Audit Committee

## Executive summary

1. The Committee took note that the Eleventh Replenishment of IFAD's Resources (IFAD11) became effective on 14 August 2018 with instruments of contribution amounting to the equivalent of 67 per cent of total pledges.
2. The discussion on the progress report of the Office of Audit and Oversight (AUO) focused both on the reasons for overdue recommendations and on the need to draw lessons from the results of investigations.
3. The Committee was presented with the corporate-level evaluation on IFAD's financial architecture. In its review, the Committee highlighted the importance of the document, and praised the rigorous financial and economic analysis of the strengths and weaknesses of the present business model. Members stressed that the solutions suggested merited further analysis. To this end, the Chair announced that the Committee was finalizing a position paper that would be brought to the next session of the Executive Board to facilitate discussion of the issues of financial sustainability, the Debt Sustainability Framework (DSF) and ways to encourage growth in the programme of loans and grants (PoLG) in the medium to long term.
4. The Committee also considered the High-level Preview of IFAD's 2019 Results-based Programme of Work and Regular and Capital Budgets, and the Preview of the Independent Office of Evaluation of IFAD's Results-based Work Programme and Budget for 2019 and Indicative Plan for 2020-2021. The budget proposal was discussed extensively. Of note was the ambitious frontloading foreseen in 2019 of almost 50 per cent of the IFAD11 PoLG, and the nominal regular budget increase of 2.4 per cent, which was considered high and not yet sufficiently supported by analytical information, presumably since this was only the high-level preview stage.
5. The Update of Financing Terms was presented for review. Several members recognized that the proposed update would enhance the competitiveness of IFAD's offering of financial options to borrowers. A fuller explanation of the forecasted impact was requested.

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6. The Audit Committee wishes to bring to the attention of the Executive Board the matters examined at the 150<sup>th</sup> meeting of the Committee, held on 3 September 2018.

Adoption of the agenda

7. The agenda was adopted as submitted.

Minutes of the 149<sup>th</sup> meeting of the Audit Committee

8. The minutes will be revised based on the suggestions provided by Committee members. They will be resubmitted for approval at the Committee meeting in November 2018.

Progress Report on the Workplan for IFAD's Office of Audit and Oversight for 2018

9. The Committee was provided with a summary of the activities of the AUO for the first six months of 2018. The rate of implementation of audit recommendations had slowed over the period; however, Management took significant action in July and August on pending recommendations, with encouraging results. In the area of investigations, the number of complaints submitted to AUO during the first half of 2018 had risen and such complaints related mainly to project procurement, which continues to be an area needing constant attention.

10. The Committee enquired as to risk mitigation in case of delayed implementation actions and sought more information on the reasons for the increase in investigative complaints. AUO provided feedback on its approach of prioritizing actions based on level of risk. Representatives of the Programme Management Department and the Office of Budget and Organizational Development updated the Committee on action taken or planned in order to fully implement the majority of the pending recommendations. AUO noted that the increased incidence of investigative complaints was possibly due to the intensified anticorruption awareness activities undertaken in the last two years.
11. The Committee requested that more information be provided in the future on the cases under investigation, including any trends and lessons learned, and on the nature of the pending recommendations, including any risk mitigation actions taken in the interim. AUO agreed to provide such information.
12. The progress report was considered reviewed.  
Update on Concessional Partner Loan Framework
13. Management provided an oral update on the Concessional Partner Loan (CPL) Framework, highlighting that the IFAD11 Consultation had closed with a target financing package that included, along with US\$1.2 billion in Member State contributions, US\$430 million in debt, half of which was expected to be raised in the form of CPLs. India and France had formalized their pledges to offer CPLs with loans of US\$20 million and US\$57 million equivalent, respectively.
14. The update was considered reviewed.  
Update on the implementation of the impairment section of International Financial Reporting Standard (IFRS) 9: Financial instruments
15. Management provided the Committee with a presentation on the progress made towards implementation of the IFRS 9 impairment section with respect to loan credit risk. It was highlighted that IFRS 9 had been designed in response to the 2008 financial crisis, and required IFAD to build a complex financial model with forward-looking information to calculate and record expected credit losses of loans throughout their life cycle. It was noted that the project was on track and on budget, with a view to ensuring full implementation and compliance with the IFRS for preparation of the 2018 financial statements.
16. Committee members welcomed the update and requested that information on challenges encountered be submitted at a future session.
17. The update was considered noted.  
Report on the Eleventh Replenishment of IFAD's Resources
18. Management provided detailed information on the status of IFAD11 and on the votes created. It was noted that as at 14 August 2018 the level of pledges equated to 78 per cent of the target of US\$1.2 billion. Thanks to the strong support from IFAD's Member States, IFAD11 had reached effectiveness as at 14 August 2018, with instruments of contributions received amounting to 67 per cent of the total pledged amount.
19. The report was considered reviewed.  
Standard financial reports presented to the Executive Committee
20. The Audit Committee noted the information provided in the report on IFAD's investment portfolio for the second quarter of 2018.

### Corporate-level Evaluation on IFAD's Financial Architecture

21. The Committee was provided with a summary of the main findings of the Corporate-level Evaluation of IFAD's Financial Architecture undertaken by the Independent Office of Evaluation of IFAD (IOE). It was highlighted that periodic replenishments are at the heart of IFAD's financial architecture and its main source of financing. While in the past the organization's reliance on replenishment had allowed for considerable growth in the volume of the PoLG, this model had shown its limitations in recent years. In its review, the Committee welcomed the analysis provided by IOE and noted that the implications and recommendations regarding IFAD's long-term financial sustainability, the DSF, and increasing revenues from loans while enhancing efficiency, warranted further discussion among members.
22. Several points were made with reference to methodological aspects of the CLE. The need to improve the analysis of the main factors (operational costs and demand for loans on ordinary terms) that could affect the ability to increase the PoLG through increased leverage on the financial markets was discussed. Management commended the CLE and welcomed its timing and recommendations, given the work being undertaken to enhance IFAD's financial model. Management noted the hybrid nature of IFAD's business model, and the close link between the resource allocation mechanism, loan pricing and leverage. Management also highlighted the prudent approach that had been adopted to address DSF-related challenges. While agreeing with the recommendations, Management remarked that the final evaluation report could have been more firmly anchored to the far-reaching institutional reforms and transformation under way. Management also emphasized the need to introduce a coherent transition framework and reforms to better deliver on IFAD's mandate of promoting sustainable and inclusive rural transformation.
23. Committee members emphasized the need to define IFAD's risk appetite and requested details on several technical aspects of the CLE. These were provided by Management.
24. The Committee announced that it was finalizing a written statement on the Corporate-level Evaluation of IFAD Financial Architecture for consideration by the Executive Board at its 124<sup>th</sup> session.
25. The document was considered reviewed.

### Update on IFAD's financial architecture transformation

26. Management gave a presentation on the ongoing transformation of IFAD's financial architecture, highlighting the vision, milestones and goals of the transition process. The main goal was to enhance flexibility while improving financial sustainability and increasing risk management activities. Many policies were still under review or had yet to be prepared for discussion (e.g. update of financing terms, internal control framework and controller scorecard, liquidity policy, capital adequacy, DSF, impairment policy, etc.).
27. Committee members commended the update and mentioned the importance of continued communication regarding the various initiatives.
28. The update was considered noted.

### High-level preview of IFAD's 2019 Results-based Programme of Work and Regular and Capital Budgets, and the Preview of the Independent Office of Evaluation of IFAD's Results-based Work Programme and Budget for 2019 and Indicative Plan for 2020-2021

29. Management presented the preview document, which included the proposal for the IOE budget and work programme. Management noted that 2018 had been an important year for defining and implementing reforms and that 2019 would be a year of consolidation and increased delivery. The primary objectives identified for 2019 were to: (i) achieve the planned PoLG with better and faster delivery, and

- improved project performance during implementation; (ii) implement IFAD's financial strategy through a more robust financial architecture; (iii) complete decentralization and enhance institutional effectiveness and efficiency; and (iv) increase the visibility of IFAD's work.
30. The planned PoLG for 2019 totals US\$1.76 billion, a record high to follow up on the promises made during the IFAD11 Consultation and to respond to strong demand for support from borrowing Member States.
  31. The major cost drivers for the 2019 budget – which includes a nominal increase of 2.4 per cent – are primarily staff costs for completing decentralization and costs arising from proposed organizational changes, and the increased contribution called for by the United Nations Development Group Cost-sharing Agreement.
  32. The regular budget for 2019 was proposed at US\$159.29 million compared to an approved budget of US\$155.54 million in 2018, reflecting a 2.4 per cent nominal increase, composed of a real increase of 0.7 per cent and a price increase of 1.7 per cent.
  33. The total capital budget for 2019 would amount to approximately US\$2.0 million or slightly above, to cover regular capital expenditures and major IT and other investment projects. For 2019 such expenditures could include investments to establish a more robust financial architecture to support the financial strategy and respond to the findings of the related CLE and the costs of the ongoing risk assessment exercises.
  34. IOE introduced its programme of work and budget for 2019 (reflecting a nominal increase of 1.37 per cent), highlighting that it planned to conduct a corporate-level evaluation of IFAD's support to innovation and productivity growth for inclusive and sustainable smallholder agriculture, and five country strategy and programme evaluations. IOE added that during 2019 the peer review of IFAD's evaluation function will be finalized.
  35. Members requested clarification on a further cost increase after last year's increase of 4.1 per cent.
  36. Management explained that last year's commitment excluded the scenario of a significantly increased PoLG in 2019. However, Management acknowledged the nominal rise in expenditures; these would be thoroughly re-analysed before the submission of the final budget document.
  37. One member encouraged Management to pursue the goal of zero real growth; another member advised caution to ensure that cost reductions did not adversely affect delivery, quality or achieving the 2030 Agenda for Sustainable Development objectives. One member also recognized that the cost of additional contributions to the United Nations development coordination system, required as part of the United Nations reform, would place a heavy burden on the budgets of institutions such as IFAD.
  38. A member sought clarification on Management's intention to generate additional savings for a possible carry-forward of more than 3 per cent.
  39. Management clarified that the requested carry-forward per cent figure would depend on more precise utilization figures, which would be obtained as part of the final budget preparation. It was also indicated that the Mandatory Age of Separation 65 (MAS65) implementation considerations could be seen as a priority driver for this request.
  40. It was noted that an agile change management, delivery and innovation unit would be established to ensure that reforms were sustained, monitored and strengthened going forward.

41. Committee members welcomed the information provided and looked forward to receiving more details in the future budget proposal.
42. The budget preview document was considered reviewed.  
Update of financing terms
43. Management provided an overview of the document, highlighting that the proposal had been updated based on comments received during previous Audit Committee meetings and the informal seminar held in July.
44. It was noted that the proposal was set in the context of IFAD11 reforms to tailor operations to the demands and needs of borrowers and to develop IFAD's financial framework. The following changes were proposed:
  - (a) Ordinary terms:
    - (i) Offer variable spread loans with different "buckets" of maturities/grace periods and set pricing accordingly;
    - (ii) Introduce a fixed spread using different buckets of maturities as per the International Bank for Reconstruction and Development; this is not a fixed interest rate since the base London Interbank Offered Rate (LIBOR) is variable; and
    - (iii) Introduce a differentiated maturity premium (surcharge or discount) by income category of borrower (as announced by World Bank in April 2018).
  - (b) Highly concessional and blend terms: introduce matching of service charge and interest (blend only) financing terms, to the financing denomination currency.
  - (c) Highly concessional: introduce a new repayment profile that differentiate regular countries from the small states economies while maintaining the current maturity and grace periods of 40 and 10 years respectively.
  - (d) All loans: Set interest rates on a quarterly basis using the 6-month LIBOR.
45. Committee members took note of the changes introduced to the document and noted that the proposal to update the financing terms was broadly in line with the recommendations of the corporate-level evaluation on financial architecture. Members requested additional details on the overall financial impact on IFAD's financial sustainability, the advantages and disadvantages for borrowers of the new terms and how these changes would be communicated to borrowers.
46. Management provided additional clarifications, and pointed out that some proposed changes were optional for borrowers. The changes would nonetheless provide wider choices that could stimulate demand for loans and facilitate the delivery of IFAD11.
47. Management clarified that work was ongoing on communicating the proposed changes to borrowers and staff, for example through technical materials, direct meetings with contacts in ministries of finance and information on IFAD's website.
48. The document was considered reviewed.  
IFAD's risk dashboard
49. Management provided an update on the corporate risk dashboard. It was noted that the dashboard would assist the Audit Committee and the Executive Board in fulfilling their oversight responsibilities concerning risk management. It was also noted that the dashboard would evolve based on the recommendations emanating from the risk assessments currently under way.
50. Committee members requested the following enhancements: a clearer definition of the risk appetite, a legend and the organization of a seminar on reading and interpreting the dashboard.

51. The document was considered reviewed.  
Other business
  - (a) Update on Management's follow-up on recommendations arising from the Audit Committee meetings
  - (b) Instruments to facilitate the Board's guidance and governance of progress on implementation of Management commitments
52. Management provided a brief update on the progress made towards the implementation of additional tools to support the Audit Committee proceedings while ensuring coordination with other existing instruments.
53. The update was considered noted.
  - (c) Review of internal audit reports
54. Committee held a closed session to review the following internal audit reports: Audit on IFAD Country Office and country programme – Indonesia; Audit on IFAD Country Office and country programme – Mali; and Year-end testing of internal control framework over financial reporting.
55. No additional items were discussed under other business.