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## Report of the Chairperson on the 151<sup>st</sup> Meeting of the Audit Committee

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For: Review

# Report of the Chairperson on the 151<sup>st</sup> Meeting of the Audit Committee

## Executive summary

1. The Audit Committee discussed a large number of documents, most of which were to be presented for review or approval at the 125<sup>th</sup> session of the Executive Board.
2. The Committee took note of the presentation on the implementation of the impairment section of International Financial Reporting Standard (IFRS) 9 and the possible impacts on IFAD's financial statements.
3. The Committee was presented with the 2019 workplan of IFAD's Office of Audit and Oversight (AUO). The Committee commended the risk-based approach of the workplan and deemed it reviewed. Discussions were held on a possible revision of the AUO Charter to allow the workplan to be approved by the Executive Board.
4. The Committee reviewed the proposed amendments to IFAD's basic legal texts to facilitate the Fund's engagement with the private sector. The related document is being submitted by the Committee to the Executive Board for consideration at its 125<sup>th</sup> session with the aim of subsequent presentation to the Governing Council in February 2019. The amendments will enable IFAD to fulfil its commitment for the Eleventh Replenishment of IFAD's Resources (IFAD11) to strengthen engagement with the private sector. The amendments will come into effect only if and when the Executive Board approves the private sector strategy, which is foreseen for submission to the Board in May 2019.
5. The Committee was presented with the External Independent Assessment of IFAD's Financial Risk Management and Corporate-level Evaluation (CLE) on IFAD's Financial Architecture: Management Appraisal and Action Plan. It was noted that the two reviews had many recommendations in common and that their implementation would be necessary to ensure IFAD's long-term financial sustainability and its ability to deliver on its mandate despite the enhanced borrowing activities. The idea of creating a capital adequacy framework in conjunction with the revision of the liquidity policy was welcomed.
6. The Committee welcomed the document on the Review of IFAD's Debt Sustainability Framework (DSF) and Proposal on Future Approach, and the analysis and options presented by Management therein. The Committee noted the urgency and the importance of defining feasible options to solve sustainability issues deriving from the DSF. It was also noted that both the CLE and the independent financial risk management assessment highlighted the criticality of the DSF's implications. Some members expressed concern about the feasibility of options and indicated the need for further discussion, possibility at the level of capitals, given the importance of the matter.
7. The Committee also reviewed additional documents being submitted for the Board's consideration: the Non-Concessional Borrowing Policy, Update of Financing Terms, the revised Policy on Preventing Fraud and Corruption in its Activities and Operations; Policy on Project Restructuring; Proposal for Faster Implementation Project Start-up Instruments and the Cofinancing Strategy and Action Plan.

## Report of the Chairperson on the 151<sup>st</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 151<sup>st</sup> meeting of the Committee, held on 20 November 2018.
 

Adoption of the agenda
2. The agenda was adopted as submitted.
 

Minutes of the 149<sup>th</sup> and 150<sup>th</sup> meetings of the Audit Committee
3. The amendments to the minutes of the 149<sup>th</sup> meeting were approved, along with the minutes of the 150<sup>th</sup> meeting and its closed session.
 

Update on the implementation of the impairment section of International Financial Reporting Standard (IFRS) 9
4. Management provided an update on the implementation of IFRS 9, a mandatory requirement that IFAD must comply with by the end of 2018 in order to be able to support obtaining a clean audit opinion. Management provided some details about the IFAD portfolio composition and about the impact of IFRS 9 on IFAD's accounts. It was also noted that the external audit will be conducted between the end of November 2018 and January 2019.
5. The Committee welcomed the update and requested a briefing paper summarizing the steps taken, results and impact of IFRS 9 once it is fully implemented.
6. The update was deemed noted.
 

Standard financial reports presented to the Executive Board
7. Management presented the following documents for the Committee's review: Resources Available for Commitment, Report on IFAD's Investment Portfolio for the Third Quarter of 2018 and Report on the Status of Contributions to the Eleventh Replenishment of IFAD's Resources.
8. Management introduced Resources Available for Commitment, highlighting that the document 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 2019 of up to US\$1.759 billion. The Committee requested clarification as to the level of liquidity and the methodology and assumptions adopted. Management provided additional details and clarified that both resource definition and the liquidity policy are currently under review. It was also clarified that the main assumptions remained unchanged. The document was deemed reviewed and would be submitted to the Executive Board session in December 2018 for approval.
9. The Audit Committee noted the information provided on IFAD's investment portfolio for the third quarter of 2018.
10. The Committee noted the report on the status of IFAD11 contributions and requested additional information about the strategy to mobilize additional resources to reach the IFAD11 target.
 

Annual Review of the Conceptual Framework on Financial Reporting and Auditing of IFAD-financed Projects
11. Management provided an oral presentation, highlighting that this was the first annual review of the framework. The review confirmed the adequacy and applicability of the principles set forth in the framework. As a result, no revisions were proposed.
12. The annual review was deemed performed.

#### Audit Committee Work Programme for 2019

13. The Chairperson introduced the agenda item noting that the 2019 work programme is particularly full and that additional meetings might be necessary. The Chairperson also requested that at the end of each Committee meeting the agenda for the subsequent meeting be shared with members.
14. The work programme was deemed approved.

#### Workplan for IFAD's Office of Audit and Oversight for 2019

15. The Office of Audit and Oversight (AUO) introduced the agenda item, highlighting that a more strategic approach had been adopted in the 2019 workplan to reflect the significant organizational and business process changes taking place and to respond to the suggestions of the external quality assessment review. The workplan had been formulated considering key elements of the corporate risk dashboard, the IFAD11 commitments and the IFAD Strategic Framework, with the intention of covering all key risk areas over the three-year period. It was also noted that staff and financial resource needs had been adequately taken into consideration. AUO also noted that given the fast pace of change and ongoing reforms, the workplan must be flexible. The Committee will be kept informed of progress during its meetings in 2019.
16. Committee members requested clarification on the resource allocation and noted that according to general industry practice focused on ensuring the organizational independence of the internal audit function, the internal audit workplan should be approved by the Executive Board.
17. AUO provided the necessary clarifications. It was noted that the Committee would be informed about a benchmarking exercise with other United Nations agencies on the process for approving the yearly internal audit workplan.
18. The document was deemed reviewed.

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

19. Management presented the annual review of IFAD's Investment Policy Statement, noting the main changes, such as the adoption of a tranching approach that was a departure from the strategic asset allocation approach. This shift in investment approach was aimed at improving liquidity management and building a more conservative investment portfolio. Consequently, the portfolio credit value-at-risk limit has been reduced from 6 to 3 per cent, with possible further reductions in the future. Management also provided details about possible changes to the delegation of authority from the President to the Chief Financial Officer to ensure greater efficiencies.
20. Committee members requested clarification on the delegation of authority, risk parameters, and environmental, social and government considerations. Management provided the necessary details.
21. The document was deemed reviewed and would be submitted to the Executive Board session in December 2018 for approval.

#### Project Financial Management: Mechanisms, Developments, Disclosures and Results

22. Management introduced the yearly report highlighting that 2018 had been a year of transformation for IFAD's financial management function. Key developments included the decentralization and enhanced transparency of financial data through public disclosure of both project audit reports and lending and financial data on IFAD's website. Key changes had also been made to IFAD's project financial reporting and auditing requirements, bringing IFAD into alignment with evolving international standards and increasing the level of harmonization with other international financial institutions (IFIs).

23. Committee members requested additional details about the most relevant control risk issues. Management provided the necessary details.
24. The document was deemed noted.

#### Proposed Amendments to the Basic Legal Texts of IFAD to Facilitate the Fund's Engagement with the Private Sector

25. Management introduced the agenda item noting that the proposed amendments to IFAD's basic legal texts are required to enable IFAD to fulfil a key IFAD11 commitment. Specifically, IFAD had committed to significantly strengthen its private sector engagement, by developing a purposeful partnership with the private sector and crowding in private sector investment to deliver profit and development at the same time. The amendments were needed to fulfil these commitments and to facilitate better engagement with private sector entities supporting smallholder farmers in developing Member States. IFAD's mission and focus on rural smallholders in developing states would remain unchanged.
26. With these amendments, IFAD would be able to provide smallholders with financing either directly or through appropriate facilities, in addition to its current model of financing smallholders through governments. It was noted that any proposed uses of the new financing methods would follow existing approval procedures, including review and approval by the Executive Board.
27. Committee members expressed concern about the sequencing of events for the approval and implementation of such amendments. Management clarified that the basic legal text amendments are approved by the Governing Council and that waiting until the 2020 session of the Council to make the amendments would significantly hinder IFAD in fulfilling this commitment during the IFAD11 period. Furthermore, following the appropriate hierarchy of governing body documents, the amendments to the basic texts are high-level; in addition, the wording had been benchmarked against the relevant wording in the basic legal texts of similar institutions. Also, in accordance with the appropriate hierarchy of governing documents, granularity would be included in the revised private sector strategy to be presented to the Executive Board in May 2019.
28. In order to solve the sequencing issue, the Committee suggested that the reviewed document be submitted to the Executive Board for consideration and subsequent presentation to the Governing Council in February 2019, but that the amendments come into effect only upon the Board's approval of the private sector strategy.

#### Update on IFAD's Financial Architecture Transformation

##### (a) Management Appraisal and Action Plan of the External Review of IFAD's Financial Risk Management and Corporate-level Evaluation on IFAD's Financial Architecture

29. Management provided an overview of the main findings of the independent assessment of IFAD's financial risks, highlighting that this area was also covered by the CLE on IFAD's Financial Architecture. It was noted that the paper contained a series of recommendations. An action plan by Management on how to implement the adopted recommendations was provided in the document. One of the main recommendations pointed to the need to introduce a capital adequacy framework in conjunction with the review of the liquidity policy. IFAD's Debt Sustainability Framework (DSF) was noted as a key issue to be addressed to ensure long-term financial sustainability. The implementation of the IFRS 9 impairment section would provide a support measure in enhancing credit risk management. The review also assessed IT and governance requirements.
30. Committee members welcomed the document and noted that many of the recommendations were common to both the independent assessment and the CLE. They noted the need to define a corporate management approach and tolerance with regard to financial risks. Management provided additional details and noted

that reforms would be necessary to ensure long-term financial sustainability, irrespective of the possibility of market borrowing.

31. The document was deemed reviewed.
  - (b) Debt Sustainability Framework at IFAD
32. Management introduced the agenda item noting the importance of addressing issues arising from the DSF mechanism and noting that finding a solution to the current trajectory of the DSF is essential to ensure IFAD's financial sustainability.
33. Since the introduction of the DSF in 2007, IFAD has committed DSF financing totalling US\$1.7 billion as at the end of 2017.
34. This amount of DSF financing, which has already been disbursed, is expected to be repaid by Member States between 2017 and 2056.
35. The impact on IFAD's long-term financial sustainability has been highlighted as key in both the CLE on IFAD's Financial Architecture and the Alvarez & Marsal external financial risk assessment.
36. During the Audit Committee meeting, Management summarized the key considerations, indicating that the most practical option would be to establish a separate funding window for the receipt of DSF pledges in order to maintain a prefunded pool of DSF resources from which DSF financing is issued. In parallel, DSF eligibility will be reviewed in order to further harmonize it with that of other IFIs, increase transparency and ensure financial sustainability. Management underscored that IFAD's focus would continue to be on supporting the poorest people and that this could be achieved using a mix of different measures.
37. Committee members expressed their appreciation for the paper and acknowledged the urgent need to solve the issues deriving from the current DSF. At the same time, Committee members expressed some concern about pledging to two separate windows and on the feasibility of the three options presented. Member States agreed on the need to involve capitals in this consultation and to formulate such recommendation for the Board.
38. The document was deemed noted and would be submitted to the Executive Board at its December 2018 session. The importance and urgency of defining feasible options to solve sustainability issues associated with the DSF were underlined.
 

Update of financing terms
39. Management provided an overview of the document, noting that the proposal had been updated based on comments received at previous Audit Committee meetings, Executive Board sessions and informal seminars.
40. The proposal tailors IFAD's financing terms to address strategic topics such as fragility of small states economies within the current pricing methodology. The proposal provides more options to ordinary term borrowers and facilitates debt and risk management and planning practices for both borrowers and IFAD by resolving a critical exchange rate mismatch in the pricing of loans not denominated in special drawing rights. It was noted that some items would require changes to the Policies and Criteria for IFAD Financing.
41. The document was deemed reviewed and would be submitted for approval by the Executive Board in December and for approval of the relevant items by the Governing Council in February 2019.
 

Non-Concessional Borrowing Policy
42. Management introduced the agenda item, highlighting that the International Development Association had introduced a non-concessional borrowing policy in the trail of the Heavily Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative. Other IFIs had adopted similar policies since then. The objective of

such a policy was to serve as a pillar of risk management both for IFAD and for borrowers. It was intended to tackle the moral hazard of countries using concessional financing as a reserve for non-concessional resources. It was noted that IFAD was actively following trends in other IFIs on this topic.

43. The document was deemed reviewed and would be submitted to the Executive Board in December 2018 for approval.

#### Revised IFAD Policy on Preventing Fraud and Corruption in its Activities and Operations

44. AUO introduced the agenda item highlighting that the core elements of the policy adopted in 2005 were still valid; however, some updates had been made to reflect new best practices for the prevention and mitigation of fraud and corruption that have emerged and have been adopted by other United Nations entities and IFIs.
45. The proposed changes are: a minor update to align the definitions of prohibited practices with those of other United Nations entities and IFIs; the introduction of obstructive practice into the category of prohibited practices; clarification and strengthening of borrowers' and grant recipients' responsibilities in relation to donors and partners regarding allegations of prohibited practices and the action taken in response of those allegations; strengthening the communication and application of the policy in relation to project contractors and implementation partners; and better definition of the range of sanctions and operational responses applicable in relation to prohibited practices.
46. It was noted that the new policy focused on principles, responsibilities, processes, sanctions and related measures and not on historical background and implementation details. It was also noted that the proposed revision of the policy would require some revisions to the legal instruments of the Fund.
47. Committee members requested clarification on the clear need to strengthen controls and risk management and the possibility of sharing data and case information on fraud and corruption with Member States. Management provided the necessary information.
48. The policy was deemed reviewed and would be submitted for consideration to the Executive Board in December 2018.

#### Proposal for Faster Implementation of Project Start-up (FIPS) Instruments

49. Management provided a brief overview of the document, highlighting that as part of the IFAD11 business model, the creation of a project preparation advance facility – the FIPS – was being considered to enhance implementation readiness by undertaking certain activities before project approval. The importance of this reform was echoed in a recommendation of the CLE on IFAD's Financial Architecture.
50. Within the FIPS facility, two instruments are proposed: a Project Pre-Financing Facility to provide an advance for all countries that have access to a performance-based allocation system allocation for loans; and a Technical Assistance Project Start-up (TAPS) Facility to support countries that do not have access to loans from core resources.
51. Committee members requested clarification about repayment terms, and enquired about the possibility of supplementary fund contributions for the TAPS facility. Management provided the necessary details.
52. The proposal was deemed reviewed and would be submitted for consideration to the Executive Board in December 2018.

#### IFAD Policy on Project Restructuring

53. Management introduced the agenda item noting that the policy was an IFAD11 deliverable. It was highlighted that the main aim of the policy is to consolidate multiple pre-existing policies and streamline processes into a single policy framework to raise operational efficiency during project implementation. The framework proposed broadly defines restructuring as having three guiding principles: timely and proactive portfolio management; flexibility; and alignment to country strategies. The policy proposes a consolidated approach to project restructuring, financing amendments, additional financing, project cancellation and the reuse of funds. It was noted that the planned comprehensive monitoring would also facilitate an analysis of the use of these policy elements, with the findings reported to the Executive Board regularly.
54. Committee members requested clarification as to what constituted a significant and substantial change in the scope or characteristics of a project. They also had questions about reporting on restructuring. Management provided the necessary details.
55. The proposal was deemed reviewed and would be submitted for consideration to the Executive Board in December 2018.

#### Cofinancing Strategy and Action Plan

56. Management introduced the agenda item, noting that the strategy was aimed at reaching the IFAD11 cofinancing targets and setting a long-term vision of IFAD as an assembler of development finance in line with the IFAD11 business model. The strategy and the action plan were developed based on several inputs, including a detailed analytical study on IFAD's cofinancing performance over the years, feedback from Senior Management and country directors, lessons learned from other IFIs, guidance from the Working Group on the Transition Framework and comments from Member States. The strategy and action plan also put considerable emphasis on better measurement, especially of in-kind contributions, and on enhanced monitoring of cofinancing during implementation.
57. The strategy and action plan were deemed reviewed and would be submitted for consideration to the Executive Board in December 2018.

#### Other business

##### Dispatch of documentation for review by the Audit Committee

58. In view of the Committee's intense work programme in 2019, in order to facilitate the timely review of important documentation, it was agreed that the English versions of the documents would be posted as soon as they were available, and that the other official language versions would be posted subsequently.
59. No additional items were discussed under other business.