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Report of the Chairperson on the 152nd Meeting of the Audit Committee

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Executive Board — 126th Session
Rome, 2-3 May 2019

For: Review

Executive summary

1. The Audit Committee discussed a large number of documents, most of which would be presented for review or approval at the 126th session of the Executive Board.
2. The external auditors issued a clean audit opinion on the 2018 Consolidated Financial Statements and on the effectiveness on the internal control framework over financial reporting. The financial statements would be submitted to the Executive Board for endorsement.
3. Most relevant items:
 - Annual Report on the Activities of the Office of Audit and Oversight during 2018 and review of the adequacy of the internal oversight mechanisms. The Committee appreciated the increasing level of detail of the report and the verbal update on the 2019 audit plan. The report, which was extensively discussed in all its sections, would be presented to the Executive Board for information.
 - Committee members welcomed the progress made in implementing the Transparency Action Plan.
 - The 2019 draw down requirements were reviewed and would be submitted to the Executive Board for approval.
 - Eligibility for Debt Sustainability Framework in IFAD11. Management's proposal was reviewed and supported by List A. Lists B and C at the time of the Audit Committee meeting were not yet in a position to express their final views. The item is crucial for the delivery of the programme of loans and grants (PoLG) for the Eleventh Replenishment of IFAD's Resources (IFAD11). The document would be submitted to the Executive Board for approval.
 - Financially sustainable Debt Sustainability Framework mechanism. List A expressed appreciation for Management's work on this important item and their support to IFAD Management's developing an alternative mechanism to provide more predictability in the compensation of DSF contributions and options for funding the Debt Sustainability Framework (DSF) upfront as from IFAD12. Lists B and C were not yet ready to share their views on this item. The document would be submitted to the Executive Board for review.
 - Findings of IFAD's Independent Assessment of Strategic and Operational Risks. Committee members thoroughly discussed the report and voiced their opinions with Management. They expressed their appreciation for the report content and the actions taken to date by Management to implement the main recommendations. The document would be submitted to the Executive Board for review.
 - Committee members also welcomed the improved IFAD dashboard. The related document would be submitted to the Executive Board for review.

Report of the Chairperson on the 152nd meeting of the Audit Committee

1. The Audit Committee wishes to bring to the attention of the Executive Board the matters examined at the 152nd meeting of the Committee held on 15 April 2019.

Adoption of the agenda
2. The agenda was adopted with the inclusion of a closed session to discuss some internal audit reports.

Minutes of the 151st meeting of the Audit Committee

The amendments to the minutes of the 151st meeting were approved with no changes.

Annual Report on the Activities of the Office of Audit and Oversight during 2018 and review of the adequacy of the internal oversight mechanisms
3. The Office of Audit and Oversight (AUO) presented the report and highlighted that the new format of the document was linked more closely to AUO's outputs on key risks. The report included an analysis of the causes and trends underlying the investigation activities in 2018 and a separate section on sexual exploitation and abuse and sexual harassment allegations. AUO highlighted that among the areas where oversight must constantly be reinforced were programme management and project procurement; the prevention of fraud and corruption risks; and the assessment and measurement of results achieved by the introduction of the several initiatives under way to deal with these issues.
4. Members requested Management to address the concerns and took note that anticorruption awareness had been strengthened through workshops and specialist sessions at the Operations Academy. It was noted that AUO had coordinated the revision of the IFAD anticorruption policy and an assessment of IFAD's management of compliance risks, such as money-laundering and terrorism financing. It was also noted that Management had maintained its record of timely implementation of audit recommendations.
5. AUO also presented an update on some of the items in the 2019 audit plan, highlighting the continued focus on the evolving decentralized business model (through data analytics) and financial architecture (through audits on risk-based disbursements and fraud risks related to cash flows and assets, and internal investment portfolio transactions).
6. Committee members expressed their appreciation for the reporting and the more granular information on investigations. The Committee focused on risks and weaknesses in controls relating to IFAD's oversight of programme procurement activities, and sought more information from Management on the extent and nature of this risk and on the actions being taken. The Committee expressed concern about IFAD's continued exposure to procurement-related fraud and corruption risks, particularly due to its impact on reputational risk and programme delivery.
7. AUO and Management noted that notwithstanding the difficulty in quantifying the fraud losses in IFAD-funded activities and the existence of mitigating measures, exposure to such risks was high. Mitigation of fraud and corruption risk in this area remains therefore a top priority for IFAD. In order to move forward with improvements, Management is committed to putting in place the new measures described in the revised anticorruption policy and to strengthening both first and second line defence measures. The Committee requested regular updates from both AUO and Management on the progress being made in strengthening the IFAD anticorruption framework in relation to programme procurement activities. A written response from Management was requested on measures taken by IFAD to

address fraud and related risks. More generally, Committee members indicated the need to intensify the use of written communications from AUO of updates on specific topics, given that during Committee meetings it was not always possible to have long conversations on all items.

8. The document was deemed noted and would be presented to the Executive Board session for information.

Revised Audit Committee Work Programme for 2019

9. The revised work programme of the Audit Committee was reviewed and deemed approved.

Annual progress report on the implementation of the Transparency Action Plan

10. AUO introduced the agenda item, highlighting that implementation of the action plan had been an interdivisional effort led by the Operational Policy and Results Division. It was noted that AUO had independently reviewed the implementation status, had confirmed that progress was in line with the time frame, and indicated that 16 of 22 initiatives had been completed by the reporting date.
11. Committee members thanked Management for the actions taken and asked about the challenges faced by IFAD with regard to the transparency agenda and for improved accessibility to project audit reports.
12. Management provided additional information and committed to improving the access to documents. Management also agreed, at the request of the Committee, to hold a dedicated briefing on accessing information on IFAD's website.
13. The document was deemed reviewed.

Standard financial reports

- Report on IFAD's Investment Portfolio for 2018
 - Report on the Status of Contributions to the Eleventh Replenishment of IFAD's Resources
 - Requirements for the Fortieth Draw down of Member State Contributions in 2019
14. Management presented the above-referenced documents, which contained information as at end-March 2019. In addition, Management presented some slides to support the discussion on the fortieth draw down requirements. The documents were considered reviewed. The drawdown document would be submitted at the forthcoming Executive Board session for approval inclusive of a revised annex I.

Draft provisional agenda for the 153rd meeting of the Audit Committee

15. The draft agenda was approved with no changes.

Consolidated Financial Statements of IFAD as at 31 December 2018 (including the Management assertion report and an independent external attestation on the effectiveness of internal controls over financial reporting)

16. Management introduced this agenda item, noting the external auditor's unqualified/clean audit opinion on the Consolidated Financial Statements of IFAD as at 31 December 2018. For fiscal year 2018, AUO and the external auditor 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.
17. 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 impacting the financial statements, and the

various currency risk mitigation measures adopted. It was noted that at the end of December 2018, IFAD's liquidity was above the minimum liquidity requirement. The impact of 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. Finally, Management confirmed that International Financial Reporting Standard (IFRS) 9 had been successfully implemented.

18. IFAD's external auditor provided a brief commentary on the main focus areas of the 2018 audit. These included both standard audit procedures (such as the assessment of the correctness of fair-value accounting for IFAD's loan portfolio and of the Management assumptions used for revenue recognition) and more specific controls (such as fraud risk assessments).
19. Committee members took note of the financial results and of the completed implementation of IFRS 9. The achievement of a clean audit opinion in 2018 was appreciated. Detailed information was requested regarding the US\$411 million loss recorded in 2018. Management clarified that this was primarily attributable to two factors: an unrealized foreign exchange loss of US\$151 million due to the strengthening of the United States dollar relative to the SDR, and the large number of DSF and regular grants provided, amounting to US\$206 million.
20. Lastly, Management indicated that external audit fees, which had seen an increase in 2018 due to the need to perform specific additional work as a consequence of starting implementation of IFRS 9, would decrease in 2019 to EUR 146,215 (see AC 2018/149/R.6).
21. The Consolidated Financial Statements were deemed reviewed and would be presented to the 126th session of the Executive Board for endorsement, prior to the Governing Council's formal approval in February 2020.

Eligibility for Debt Sustainability Framework in IFAD11

22. Management introduced the agenda item, noting the importance of addressing issues arising from the current DSF mechanism and the need to ensure IFAD's long-term financial sustainability. Management had discussed a possible option with the Board that could be applied to the Eleventh Replenishment of IFAD's Resources (IFAD11) cycle to reduce the percentage of DSF grant resources to 17 per cent while maintaining a high level of concessionality for DSF-eligible countries.
23. List A expressed its support for the option indicated by Management to allow for a reduction in the percentage of DSF grant resources offered to eligible countries through the use of a formula. Some List A members, although supporting and understanding of the tight deadlines, expressed some reservations on how the deliberations on this issue had played out, clarifying that given the relevance of the subject it would have been preferable to have explored a wider set of potential options. The other Lists were not in a position to express their views during the meeting. Some Member States reiterated the importance of ensuring adequate support to the poorest countries and alignment with the practices in other international financial institutions. The need to ensure IFAD's long-term financial sustainability was adequately emphasized.
24. The document was deemed noted and would be submitted to the Executive Board in May 2019 for approval.

Financial Impact of Principal Due and Service Charges Forgone as a Result of the Implementation of the Debt Sustainability Framework

25. Management introduced the agenda item noting that total approved DSF projects amounted to approximately US\$2.0 billion at the end of December 2018 and that in accordance with the agreement establishing the DSF, this balance should be repaid in the period 2017 to 2058.

26. The document was deemed reviewed.
- Financially sustainable Debt Sustainability Framework mechanism
27. Management introduced the agenda item and reiterated the importance of addressing issues associated with the DSF mechanism and ensuring IFAD's financial sustainability. After the discussions at the Board session in December 2018, Management had identified a possible mechanism, as contained in document AC 2019/152/R.7/Rev.1, to facilitate the pledging process while ensuring ex ante DSF compensation. This mechanism would attempt at creating a more predictable link between Member States' appetite to support poor and indebted countries and IFAD's ability to provide financing to these countries. It was noted that the proposed mechanism would allow countries to contribute to: core contributions; compensation for DSF projects approved up to the end of the IFAD11 period; and ex ante financing for future DSF projects approved from the IFAD12 period onwards.
28. List A expressed appreciation to Management and in particular to the Chief Financial Officer for the document and the efforts made to engage proactively with Member States on this topic. List A also expressed its support to IFAD Management's developing an alternative mechanism to provide more predictability in the compensation of DSF contributions and options for funding DSF upfront as from IFAD12. The other Lists were not yet ready to share their views at the time of the meeting.
29. Some Committee members highlighted the importance of ensuring some flexibility and the need for the Working Group of the Performance-Based Allocation System to consider the issue of eligibility criteria in accordance with the final decision. There was no unified view among members on what should be the steps taken in the case of a Member State not reimbursing IFAD for commitments made with regard to the DSF. This point would need to be further discussed at the Executive Board level.
30. The document was deemed reviewed and would be submitted to the Executive Board for review.
- Concessional partner loan agreement proposals: Finland, India, France
31. Management introduced the three proposals. The Committee conveyed to the countries its appreciation for the generous loans, which carry significant concessional conditions.
32. The documents were deemed reviewed and would be submitted to the Executive Board for approval.
- Private credit rating assessment
33. Management introduced the item, highlighting the importance of a successful credit rating exercise as a prerequisite for enhanced borrowing activities and its usefulness not only with respect to market access.
34. Member States expressed appreciation for the quality and completeness of the information, which gave a full view of the scope, process and potential use of a private credit assessment.
35. Management clarified that the rating exercise was being undertaken as part of IFAD's approach to a more complex and more complete configuration of its financial architecture. It would provide IFAD with a reliable assessment of its own credit risk profile.
36. The document was considered reviewed.

Enterprise Risk Management

Findings of IFAD's Independent Assessment of Strategic and Operational Risks

37. The findings of IFAD's Independent Assessment of Strategic and Operational Risks were presented to the Committee by Marsh Risk Consulting. The findings highlighted that IFAD is an institution undergoing adjustments to its business model through its expanded country presence, and by placing emphasis on strategic partnership and exploring enhanced borrowing activities. The assessment sought to capture strategic and operational risk aspects and assess the adequacy of IFAD's risk profile. The principal recommendations related to governance and culture; strategic definition of the IFAD's risk appetite; and improvements to existing policies and tools.
38. Management expressed general support for the recommendations, noting that some of them needed further consideration and some risks needed to be discussed in detail. A cross-departmental working group led by the Vice-President has been set up to tailor the recommendations to the IFAD context. The working group has been tasked with defining IFAD's risk appetite statement and presenting it to the Executive Board for assessment and evaluation. The working group would also provide Management with considerations on options for the setting up of a holistic governance structure including a time-bound action plan with granular actions to address the recommendations.
39. One member highlighted the need to focus on the principles of independence and effectiveness of reporting lines, as well as consistency with best practice. The need to take into due account the preparedness of IFAD's staff and the adequacy of resources was also mentioned. Members requested IFAD to take into due account its decentralization model when designing the enterprise risk management organizational scheme, and to focus on how to obtain buy-in from the first line functions, including the country offices. They also reiterated the importance of defining a meaningful risk appetite for the entire institution. One member cautioned against an overly ambitious implementation period for key actions to realize this substantive change in risk culture.
40. The document was considered noted and would be submitted to the Executive Board for review.

IFAD's Risk Dashboard

41. Management presented the document, highlighting that the dashboard incorporated suggestions arising from the Marsh review and from the Audit Committee. It was noted that risks were now categorized into three areas: strategic, financial and operational.
42. Committee Members welcomed the paper, made suggestions for improvements, and requested an update on the status at each session of the Executive Board.
43. The document was considered noted and would be submitted to the Board for review.

Other business

44. The Committee held a closed session with AUO and relevant managers to discuss the internal audit reports on grant recipient selection, and some specific aspects of the audit of the ICO and country programme in China.