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Report of the Chairperson on the 155th Meeting of the Audit Committee

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Executive Board — 128th Session
Rome, 10-12 December 2019

For: **Review**

Report of the Chairperson on the 155th Meeting of the Audit Committee

Executive summary

1. The Audit Committee discussed a large number of documents, most of which would be presented for review or approval at the 128th session of the Executive Board.
2. Some of the documents pertain to current reforms intended to align the organization with best industry standards and to address the Eleventh Replenishment of IFAD's Resources (IFAD11) commitments and mitigate evolving risks:
 - Revision of project procurement guidelines;
 - Anti-Money Laundering and Counter Terrorism Financing;
 - Capital Adequacy Policy;
 - Debt Sustainability Framework Reform; and
 - IFAD's Asset Liability Management Framework.
3. Other documents are presented annually for review and subsequent Executive Board approval, such as the Investment Policy Statement and the Resources Available for Commitment document.
4. Finally, in line with the requirements of the Sovereign Borrowing Framework, as approved in April 2015, the Committee reviewed a proposal for a sovereign borrowing loan from Canada, which would be submitted to the Executive Board for approval.

Report of the Chairperson on the 155th meeting of the Audit Committee

1. The Audit Committee wishes to bring to the attention of the Executive Board the matters examined at the 155th meeting of the Committee held on 25 November 2019.

Adoption of the agenda

2. The agenda, inclusive of a closed session held to discuss an internal audit report as requested by a Committee member prior to the session, was adopted.

Minutes of the 154th meeting

3. The minutes were approved with no changes.

Project financial management: Mechanisms, developments, disclosures and results

4. The Committee was provided with an update of the application and evolution of financial management assurance policies and practice, and results from the last project audit report cycle.
5. Committee members requested additional details about the increasing trend in qualified audit opinions, the late submission of audit reports and the impact of decentralization.
6. Management provided the requested details, noting the closer collaboration with external auditors, the increasing quality of the reports and the positive impact of decentralization in terms of greater proximity to projects and country teams.
7. The document was considered noted.

Annual review of the Conceptual Framework on Financial Reporting and Auditing of IFAD-financed Projects

8. The Committee was provided with an oral update. Management noted that following its approval in 2017, the framework had become mandatory in 2019. It was further noted that the framework had been reviewed and considered satisfactory with no major changes required, which is consistent with Management's expectations given that it is a principles-based approach.
9. The document was considered noted.

Workplan for IFAD's Office of Audit and Oversight for 2020

10. The Office of Audit and Oversight (AUO) introduced the agenda item, highlighting that the 2020 workplan had been prepared by assessing key risks and taking into account indicators deriving from the external risk reviews, audit and investigation activities and data analysis, as well as AUO's advisory role. It was noted that the risk analysis was set out in the paper entitled "Risk-based assurance and resourcing plan for 2020-2021 of the Office and Oversight". The attention given to ensuring prompt investigation of alleged irregularities was also noted. AUO provided a detailed plan of 2020 audit activities and details about recent investigation and anticorruption trends.
11. Committee members requested clarification on the selection criteria for hubs and highlighted the need to concentrate auditing activities on upcoming reforms (e.g. enterprise risk management and governance).
12. The Committee suggested that the areas of risk and workforce management merited additional audit attention in 2020, and AUO provided the necessary clarifications by noting that certain reforms are currently evolving and that AUO is acting in an advisory role.
13. AUO agreed to revise the 2020 workplan to include additional audit work in these areas. The revised workplan will be submitted first to the President for approval

and subsequently to the forthcoming Executive Board in December 2019 for confirmation.

Enterprise Risk Management

(a) Update on enterprise risk management

(b) IFAD's risk dashboard status report

14. Management provided a detailed presentation of the progress made on enhancing enterprise risk management. It was noted that if the Sustainable Development Goals are to be achieved, IFAD cannot pursue business as usual strategies.
15. Management highlighted the progress made since September and the granular approach towards risk. Management is currently leading an extensive set of actions to enhance IFAD's Enterprise Risk Management Framework (ERMF), such as completing the risk taxonomy, developing risk appetite statements and key risk indicators and reviewing the IFAD Policy on Enterprise Risk Management. IFAD will benefit from this in an improved decision-making process, enabling a stronger risk management culture with the application of consistent risk management practices in an integrated and proactive manner. The strengthening of the ERMF is necessary to align it with the more decentralized IFAD11 business model; the reforms introduced, including the recently adopted Private Sector Engagement Strategy; potential changes to financial architecture and IFAD 2.0; and new partnership formats. It was noted that Management is working with Ernst & Young on the formalization of qualitative risk appetite, considering the main strategic, financial, programmatic delivery and operational risk elements. A roadmap of future activities was also presented.
16. Management also provided an update on the main indicators included in the corporate risk dashboard, noting that it is a living instrument that is currently being updated to bring more substance to risk discussions. In relation to the top risks, it was highlighted that IFAD's current liquidity (as at end-September 2019) is in line with the established standard, although liquidity projections show a decreasing trend. It was also noted that the quality of fiduciary oversight is closely tied to the successful and timely implementation of projects and the achievement of their objectives.
17. Some committee members requested clarifications on the sequence of the development of taxonomy and risk appetite vis à vis the approval and development of new documents, and the delegation of authority.
18. Other committee members requested clarifications on the possibility of having the dashboard include indicators on the Debt Sustainability Framework (DSF) and tolerance levels.
19. Management explained that there is regular cross-departmental dialogue to ensure that the instruments are harmonized with the ERM Policy and Framework once they are approved. Management informed the committee that the dashboard could change significantly once the ERM Policy, Framework and risk appetite statement are in place.
20. The items were considered reviewed.

Standard financial reports presented to the Executive Board

• Resources available for commitment

21. Management introduced the Resources available for commitment document, highlighting that it 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 2020 of up to US\$1,062 million. The document was deemed reviewed and would be submitted to the Executive Board session in December 2019 for approval.

• Report on IFAD's Investment Portfolio for the third quarter 2019

22. Management presented the above-referenced document, which contained information as at end-September 2019.
23. The information was noted by the Audit Committee.

• IFAD's interest rates for the fourth quarter of 2019

24. Management presented the document highlighting the interest rates applicable to the fourth quarter of 2019.
25. The Audit Committee reviewed the document.

Audit Committee Work Programme for 2020

26. The Audit Committee reviewed the workplan for 2020, noting the change in the date of its second meeting, which will be held on 2 July rather than at the end of June 2020.
27. The document was approved.

Other business – Internal Audit Report on the Analysis of Consultant Usage

28. The Committee held a closed session with AUO, HRD, ACD and relevant managers to discuss the internal audit report on the analysis of consultant usage.

Annual review of IFAD's Investment Policy Statement

29. Management presented the annual review of IFAD's Investment Policy Statement noting the risk reduction factors deriving from the universe of eligible classes; that equity, emerging market debt and inflation linked bonds have been removed; and that the credit rating floor has been raised from BBB- to A-.
30. The Audit Committee reviewed the document, which will be submitted at the Executive Board in December 2019 for approval.

Revision of project procurement guidelines

31. Management provided a detailed presentation of the revised project procurement guidelines, highlighting their alignment with best practice embedding enterprise risk management elements. Management also noted that this revision responds to IFAD11 commitments to implement the disbursement action plan.
32. The Committee requested clarification on the procurement process based on domestic rules. Management provided the necessary details.
33. The document was considered reviewed and will be presented to the Executive Board for approval.

Anti-Money Laundering and Counter Terrorism Financing Policy

34. Management introduced the agenda item and delivered a presentation noting that the phenomena of money laundering and terrorist financing have raised concerns across the international community in recent times. In line with leading practice, the policy was developed to reaffirm IFAD's strong commitment to mitigate these risks. The policy applies to all parties who provide funds to or receive funds from IFAD. The objective of the policy is to safeguard IFAD's assets and to establish a

culture of risk awareness. To implement the policy, detailed procedures and guidelines will be established and an enhanced system solution is being implemented to this end. Monitoring mechanisms and reporting via the Controller's Scorecard and Corporate Risk Dashboard are also being developed, and governance will be aligned with IFAD's ERM approach.

35. Committee members indicated their strong support and suggested several edits to reflect the firm commitment in this area.
36. Management agreed to accommodate the requests. The document was considered reviewed and, together with an addendum highlighting the suggested changes to the text, will be submitted to the Executive Board at its forthcoming session for approval.

Sovereign borrowing loan from Canada

37. Management introduced the proposal noting that the proceeds of the loan are within the parameters established by the Sovereign Borrowing Framework approved in April 2015.
38. Committee members requested details on the financial terms and the reporting efforts required. Management provided the necessary details.
39. The document was considered reviewed and will be submitted to the Executive Board in December 2019 for approval.

Capital Adequacy Policy

40. Management introduced the Policy by noting that the document now embeds suggestions received at meetings of the Audit Committee and Executive Board in September 2019. It was also noted that Management has continued to work closely with peer institutions on assessing preliminary results and comparing the different approaches. It was highlighted that the establishment of a capital adequacy policy is a natural response to the maturation of IFAD's institutional profile as it gradually evolves and maximizes its development operations and impact. This evolution has entailed the transformation of IFAD's financial structure from a liquidity management approach to a solvency and liquidity management approach that needs to be supported by adequate capital and financial risk management tools.
41. Some Committee members requested information about the time horizon of the assumptions and the sequence of approvals and outcome of stress tests. Management provided the necessary details.
42. The document was considered reviewed and will be submitted to the Executive Board for approval.

Debt Sustainability Framework Reform

43. Management introduced the agenda item by noting the pivotal relevance of this topic for the future development and sustainability of IFAD's business model. The proposed DSF reform aims to build a tailored IFAD response and maximize the use of official development assistance for the poorest countries, while adhering to the international architecture of support for debt distress management. The goal is to create a more predictable link between Member States' support for poor indebted countries and IFAD's ability to provide financing to these countries in a sustainable manner. It also sets clear expectations for Member States in terms of the replenishment funding needed to reach an agreed DSF level and volume of programme of loans and grants. Management is proposing a set of combined measures to address the three issues mentioned above.
44. Members reviewed the document and requested details on voting rights associated with the sustainable replenishment base, the Modified Volume Approach (MVA) mechanism and the methodology to prorate DSF compensations from Member States, and also how the past DSF burden could impact future resource allocation.

The Committee also noted that the DSF is an issue strictly related to IFAD's replenishments and that this reform should be open to proposals of refinement during next year's IFAD12 Replenishment consultations.

45. Management clarified that allocation scenarios will be presented during IFAD12 replenishment consultations and that the MVA remained unchanged because the future DSF mechanism will be based on pre-funding. It was emphasized that future DSF commitments will depend on future replenishment levels.
46. The document was considered reviewed and will be presented at the December session of the Executive Board for approval and subsequent transmission to the Governing Council, for establishment of the new super highly concessional loan instrument.

Proposal for a credit rating for IFAD

47. Management introduced the item by noting the progress made on this topic and that Management is consulting Member States on next steps, in line with the IFAD11 report. It was noted that, with the support of two rating advisors, it would be possible to initiate an informal rating assessment or credit assessment as a stand-alone exercise, ahead of initiating a formal rating process once endorsed by the Member States. Management also noted that obtaining a credit rating is a fundamental step in preparing the institution for a more diversified and efficient funding structure, including an enhanced dialogue with sovereign institutions.
48. Committee members requested information on the timing of the informal credit rating assessment, on the importance of callable capital and access to the market. Members also suggested to compare IFAD with more similar organizations, such as the International Development Association, rather than with multilateral development banks as in the paper.
49. Management clarified that callable capital is not a prerequisite for receiving an appropriate rating and agreed to provide further information on the relationship of the credit assessment to the credit rating. It also committed to include in future financial documents a comparison of financial variables, when available, with those of other similar organizations.
50. The document was considered reviewed. It will be submitted to the Executive Board at its December session, together with an addendum setting forth the additional information requested and highlighting the revised wording.

IFAD's Asset Liability Management Framework

51. Management introduced the agenda item by noting that the proposed Asset and Liability Management (ALM) Framework includes the process and tools for the optimal use of IFAD's assets, to ensure that liabilities are adequately managed in order to protect the balance sheet. The current proposal has evolved from IFAD's first approach to ALM dated December 2003. It was noted that the ALM Framework complements the prevailing policies from different angles: on the one hand, and in line with the Capital Adequacy Policy, the ALM Framework aims to minimize, to the extent possible, the amount of capital consumed by non-core risks in order to optimize its capital allocation to pursue its mandate. In addition, the ALM Framework ensures that the requirements prescribed in the Liquidity Policy and Investment Policy Statement are met. The implementation of the ALM Framework will require subsequent guidelines and adequate systems and standards to be developed, including controls to actively manage ALM risks.
52. The document was considered reviewed and will be submitted to the December Executive Board session for review.

Approach to IFAD's Liquidity Policy: Principles and Guidelines

53. Management introduced the document by noting the main changes from the previous liquidity approach, such as the shortening of the horizon over which

liquidity is measured and the move to net flows rather than gross outflows. It was also noted that a definition of multilayer liquidity will ensure that potential breaches to liquidity requirements are reported in a timely manner. It was clarified that final approval is expected in April 2020.

54. The document was considered reviewed.

Other business

55. There was no other business for discussion.