Report of the Chairperson on the 158th Meeting of the Audit Committee
Executive summary

1. In light of the COVID-19 pandemic, the 158th meeting of the Audit Committee was held remotely.

2. The Audit Committee discussed a large number of documents, most of which would be presented to the Executive Board for review or approval at its 130th session.

3. Items included:

   **Progress report on the workplan of the Office of Audit and Oversight for 2020**

4. The Committee reviewed the mid-year progress of the Office of Audit and Oversight (AUO) in implementing its workplan for 2020 and noted that pandemic-related restrictions had slowed down the implementation of planned activities and recommendations. Some key audits, including audits of hubs, were expected to be completed soon. The Committee requested, and AUO agreed, that future progress reports should include more specific indications on the expected delay for each assignment. The Committee further reiterated its request that Management, as responsible for overdue high priority recommendations, should present in the meeting to provide the Committee with explanations on progress. The number of allegations and investigations had increased compared to previous periods. The Committee took note of AUO staff challenges and highlighted the need for proper resourcing of oversight functions. The progress report was considered reviewed.

   **High-level preview of IFAD’s 2021 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 2021 and indicative plan for 2022-2023 (for review)**

5. The Committee reviewed the budget preview, noting in particular the high level of carry-forward proposed by Management. While cognizant of the exceptional situation and expressing uncertainty about the items to be financed by the carry-forward, the Committee showed willingness to engage with Management in this regard. The budget proposal was currently set at US$159.4 million, representing zero real growth and a nominal increase of 0.96 per cent over the 2020 budget. The capital budget proposal was estimated in the range of US$6.5 million to US$7.5 million. The level of delivery of the target programme of loans and grants (PoLG) was set at US$0.68 billion. Finally, the Independent Office of Evaluation of IFAD budget proposal for 2020 was set at approximately US$5.81 million. Management would submit a revised, more detailed and final version of the budget proposal at the forthcoming Committee meeting in November 2020.

   **Integrated Borrowing Framework**

6. The Committee reviewed the Integrated Borrowing Framework to be submitted to the Executive Board, noting, inter alia:

   - Improvements in governance (each borrowing proposal would be approved by the Executive Board);
   - Executive Board approval of yearly funding plans as part of the document on IFAD’s resources available for commitment; and
   - Removal of the additionality clause for loans other than concessional partner loans.

7. Committee members insisted on the correct implementation of the Asset and Liability Management (ALM) framework and the due diligence process for new lenders. A couple of members expressed doubts about the possibility of inter-lending among international financial institutions (inter-IFI lending).
New Liquidity Policy

8. The Committee reviewed the new liquidity policy. It was noted that the policy considered the evolution of IFAD’s financial architecture and best practices among peer institutions. The main changes proposed were:

- Consideration of a shorter time horizon for measuring future cash flows and liquidity needs (in line with the recommendation by the independent review of IFAD’s financial risks);

- A two-tiered limit structure, currently a single measure, with a minimum liquidity requirement and target liquidity level; and

- Assessment of the liquidity portfolio to embed the estimated value of investments and include stressed cash flow projections and contingency plans to react to unexpected developments.

9. The new liquidity policy would become effective from the Twelfth Replenishment of IFAD’s Resources (IFAD12) onwards. However, Management undertook a commitment to observe the new minimum liquidity requirement (or anchor policy limit), as requested by Committee members, and to report to the Executive Board on plans and progress made towards achieving the targeted liquidity levels until the end of the transition period.

10. The new liquidity policy would be submitted to the Executive Board for review.

Accelerated Repayment and Voluntary Prepayment Framework (for review)

11. The Committee reviewed the Accelerated and Voluntary Prepayment Framework. This was part of Management’s efforts to identify ways to increase IFAD’s commitment capacity and liquidity profile while minimizing the associated risks and costs, increasing the availability of funds to finance the PoLG and building on the practices of other international financial institutions (IFIs).

12. Management proposed an accelerated repayments mechanism. Related legal clauses would be included in the financing agreements of highly concessional and blend terms loans approved under IFAD12 and onwards.

13. In addition, borrowers currently eligible for ordinary term lending had benefited, during economic development, from loans provided by IFAD on highly concessional terms. IFAD was proposing a voluntary prepayment of these outstanding highly concessional loans with the commitment to redirect these resources to countries most in need.

14. Both frameworks will be applied prospectively, without retroactive effect, and will enter into effect once the related amendments to the Fund’s legal texts are effective. The General Counsel informed the Committee that, before the end of the year, further proposed amendments to IFAD’s legal and policy documents, including the Agreement Establishing IFAD, would also be reviewed by the Executive Board to reflect the outcomes of the ongoing IFAD12 Replenishment Consultation, in order to increase IFAD’s access to diverse sources of funding and bring new policies and procedures into effect.

15. The document would be submitted for the Executive Board’s approval with a revision of the text in paragraph 31, as recommended by members.

Update on the determination of IFAD’s resources available for commitment

16. The Committee reviewed the new methodology for the determination of IFAD’s resources available for commitment. The revision of the methodology derived from the evolution of IFAD’s financial architecture. The new methodology would be
based on liquidity levels as per the new liquidity policy, capital adequacy and funding plan.

**Update on IFAD’s Investment Policy Statement**

17. Management provided an update on the progress made on the revision of the investment policy, noting three important changes:

- Previously all investments needed to carry an investment grade rating by at least one rating agency (S&P, Moody’s and Fitch). In line with practices observed at other IFIs, this requirement had been increased to two agencies;

- The share of fixed-income investments in IFAD’s investment portfolio with a rating category of AA- (or equivalent) and above should be at least 60 per cent; and

- Operational cash counterparties below investment grade are allowed, provided that these counterparties are used for payments and petty cash purposes and not used to handle large cash balances.

18. The update was considered noted.

**Other business**

**New sovereign loan proposal from Agence Française de Développement**

19. Management presented a new sovereign loan proposal from Agence Française de Développement. It was agreed that the document would be open for review by the Audit Committee until 14 September 2020, after which, in the absence of any objection from Committee members, the proposal would be submitted to the Executive Board for approval through a vote by correspondence.

**Oral update on the credit rating exercise (closed session)**

20. In a closed session, Audit Committee members were updated on developments in IFAD’s credit rating exercise.
Report of the Chairperson on the 158th meeting of the Audit Committee

1. The Audit Committee wishes to bring to the attention of the Executive Board the matters examined at the 158th meeting of the Committee held on 1 September 2020. In light of the COVID-19 emergency, the meeting was held remotely through Zoom videoconferencing.

Adoption of the agenda

2. It was noted that Management would provide a brief oral update on progress made on enterprise risk management (ERM), with a slight adjustment to the order of the items.

3. The agenda was then adopted with the inclusion, under other business, of a new sovereign loan proposal from Agence Française de Développement (AFD) which was being submitted for review to the Audit Committee.

Minutes of the 157th meeting

4. The minutes were approved with no changes.

Progress report on the workplan of the Office of Audit and Oversight for 2020 (for review)

5. The Committee was provided with a summary of the Office of Audit and Oversight (AUO) activities for the first six months of 2020. The Committee was informed that COVID-19 related restrictions had slowed down the implementation of the 2020 audit plan. Several key assignments, such as the audits of hubs, the management of fraud risks and the IFAD Client Portal security, were under way. The committee was informed that the audits of the country programmes in Bangladesh, Benin, Kenya and Nigeria had been completed. AUO highlighted its advisory role in the ERM reform, particularly in relation to the IFAD risk appetite statements and overall risk taxonomy. The Committee requested, and AUO agreed, that future progress reports should include more specific indications on the expected delay for each assignment.

6. It was indicated that the slowdown in implementation of audit recommendations during the first semester of 2020 as a result of the pandemic was largely attributable to human resources actions that had to be aligned with the ongoing business process review. The Committee reviewed the implementation status of audit recommendations, noting the increase in the average time for implementing recommendations and, after obtaining explanations from AUO and Management, reiterated its request that managers responsible for overdue high-priority recommendations should be present in the meeting to provide the Committee with explanations on progress. AUO noted that the pandemic had not had any impact on the intake of investigation complaints. The Chair noted that there were multiple allegations of fraud and corruption related to IFAD-financed projects and that AUO had advised that slightly more complaints had been received than in previous periods. Of these, four investigation cases had been substantiated and submitted for sanctions.

7. In terms of resourcing, AUO had experienced significant staff turnover with the consequent need to rely on external expertise to conduct the workplan. AUO noted the limitations of this solution and intended to present proposals to Management regarding AUO staffing capacity in 2021. The Committee highlighted the need for proper resourcing of the oversight function.

8. The progress report was considered reviewed.
Draft provisional agenda of the 159th meeting of the Audit Committee (for approval)

9. The draft provisional agenda of the 159th meeting of the Audit Committee was approved with clarifications on the timing for approval of the Integrated Borrowing Framework as well as the new Liquidity Policy.

10. Members were invited to consider a possible change of dates for the 159th meeting of the Audit Committee meeting with the addition of a second day. It was proposed that the meeting be held on 24 and 25 November 2020.

Standard financial reports presented to the Executive Board (for review)

a. Report on IFAD’s Investment Portfolio for the Second Quarter of 2020
b. IFAD’s Interest Rates and Service Charges Applicable to the Second and Third Quarter of 2020

11. Management briefed the Committee on the investment portfolio document, which contained information as at end-June 2020. It was noted that the year’s performance to June 2020 was slightly negative as a result of the turbulence generated by the pandemic situation.

High-level preview of IFAD’s 2021 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 2021 and indicative plan for 2022-2023 (for review)

12. Management presented the budget preview proposal, noting that it incorporated recurrent costs of the main elements of the programme of work, and regular and capital budgets of IFAD. The document also presented the preview of the Independent Office of Evaluation of IFAD’s results-based work programme and budget for 2021 and indicative plan for 2022-2023. It was noted that 2021 would be a year of consolidation with the primary objectives of strengthening the agility, capacity and adaptability of IFAD’s workforce and field presence, as well as its proximity to beneficiaries; diversifying and expanding IFAD’s resource base; and ensuring fiscal responsibility through greater financial sustainability and enhanced ERM.

13. It was noted that IFAD expected to attain the programme of loans and grants (PoLG) target of at least US$3.5 billion for the IFAD11 period (2019-2021) and a PoLG of US$0.68 billion in 2021.

14. The proposed overall 2021 budget was as follows:

1. Regular budget: The 2021 regular budget had been proposed at US$159.4 million, representing zero real growth and a nominal increase of 0.96 per cent over 2020;
2. Capital budget: The total capital budget for 2021 was expected to be in the range of US$6.5 million to US$7.5 million. It was noted that the COVID-19 crisis had shown the importance of state-of-the-art information, communication and technology systems and infrastructure for business continuity. Increased demand for digitization was therefore expected, which would require a return to historical capital budget levels; and
3. The 2021 budget was therefore expected to further consolidate higher levels of carry forward up to 10 per cent.

15. The Independent Office of Evaluation of IFAD (IOE) introduced its programme of work and budget for 2021, highlighting that IOE would pilot new products such as: (i) a subregional evaluation of small countries with situations of fragility in West Africa, and (ii) a project cluster evaluation of rural enterprise development.
16. As recommended by the peer review, IOE would: (i) draft a new evaluation manual in 2021; and (ii) prepare a multi-year evaluation strategy. At the country level, IOE planned to undertake five country strategy and programme evaluations in the Plurinational State of Bolivia, Eswatini, Indonesia, Malawi and Uzbekistan. At the project level, IOE planned to undertake four project performance evaluations. In terms of promoting learning, IOE planned to undertake an evaluation synthesis on government performance.

17. In 2021, IOE planned to validate 100 per cent of project completion reports and to undertake the nineteenth Annual Report on Results and Impact to consolidate evaluation findings and analyse trends.

18. The proposed IOE budget for 2021 was US$5.81 million, representing a 0.85 per cent nominal decrease against the 2020 approved budget. The proposed IOE budget therefore stood at 0.86 per cent of IFAD’s expected PoLG for next year, below the IOE budget cap of 0.9 per cent adopted by the Executive Board.

19. The Committee reviewed the document. Members requested several clarifications, in particular about the amount and usage of the carry-forward budget, capital budget levels and the usage of staffing and consultancy expenditures.

20. In respect of the carry-forward, the Committee was cognizant of the exceptional situation in the current year due to the COVID-19 crisis and was willing to engage with Management on this issue. However, it noted the large discrepancy between the ordinary 3 per cent rule and the 10 per cent proposal for 2021; thus, it expressed the wish that difficult precedents not be set. In addition, members argued that the proposed carry-forward would go to financing foreseeable expenditure, which, as such, should have been placed in the regular budget, given that it was claimed that this was the reason why the 2021 budget was not fully in line with the zero real growth principle. Finally, some costs were seen not as one-off but as recurrent (also in relation to the capital budget), creating the risk of a “snowball” effect after 2021.

21. In response, Management indicated that the carry-forward budget was additional to the regular budget and linked mainly to one-time expenditures that would not generate future or recurrent expenditures. Over the medium term, it was also highlighted that the level of ambition of the work programme to be set by IFAD12 Consultation would have an impact on the budget, even if not in a strictly proportional way. Management explained the reasons for a higher carry-forward on an exceptional basis, and clarified that the level of capital budget was attributable to the implementation of reforms approved in the past. Management also informed the Committee that the final version of the document would include the detailed tables and additional information requested by members.

22. The document would be submitted to the Executive Board at its forthcoming meeting for review.

**Enterprise risk management (oral update)**

23. Management provided a brief oral update on progress made, indicating that recommendations had been implemented as planned. It was noted that the focus in recent months had been on the development of IFAD’s preliminary risk appetite statements, risk metrics and thresholds for all major risk drivers. This exercise implied some refinements of the risk taxonomy and the identification and development of a total of 296 risk metrics. As part of the development of the risk metrics for programme delivery, a new programme delivery risk system was being piloted in two regions, West and Central Africa and Asia and the Pacific.

24. It was noted that a dedicated Office of Enterprise Risk Management (RMO) had been set up, to strengthen IFAD’s second line of defence. The RMO would support the President and the Vice-President in the management of all risks across the
organization and would implement, monitor and maintain the Enterprise Risk Management Framework (ERMF).

25. The RMO would be headed by a Chief Risk Officer (CRO), a newly created role at the senior director level. The CRO would be responsible for IFAD’s efficient ERM by providing strategic risk management leadership and working with the executive management team to establish risk management goals and strategies and oversee their implementation to ensure IFAD’s sustainability in delivering risk management services in support of IFAD-funded programmes and projects.

26. Future key priorities would include completion and adoption of the key policies to govern the ERMF, review of the risk metrics identified and developed, validation of historical data and consideration of the technology changes required for implementation. Management proposed that a discussion on ERM take place at the next Audit Committee meeting in November to allow the new CRO to review and assess the work done so far.

27. The update was noted, considering that this work, in particular to determine the Board’s risk appetite and to bridge operational and financial risk, was a necessary complement to the reform of IFAD’s financial architecture. Members welcomed the fact that the CRO would soon take up duties and looked forward to engaging with him.

**Integrated Borrowing Framework (for review)**

28. Management presented the agenda item, stating that the document had been amended to incorporate suggestions provided during the previous meeting of the Audit Committee. It was noted that each borrowing proposal, including those from existing lenders, would continue to be approved by the Executive Board individually. Furthermore, it was noted that the integrated borrowing framework (IBF) governance was being amended to ensure that the Executive Board approved the annual funding plan as part of the resources available for commitment (RAC) document. In this regard, it was proposed that the additionality clause be removed for non-concessional partner loans. It was noted that the IBF did not call for IFAD to undertake any borrowing from financial markets through public bond issuance.

29. Committee members welcomed the new version of the document, welcoming the new governance rules and the proposed deletion of the substitution clause, and encouraged the adoption of this borrowing tool for on-lending to Member States. Committee members also requested clarification about the possible impact and changes to the ALM framework, and about its correct operationalization in order not to incur risks or negative income. The due diligence process to assess new lenders was the other item subject to attentive scrutiny by members, also for possible risks of a reputational nature. Finally, a couple of members expressed scepticism on the possibility of inter-IFI lending and a suggestion was made to explore cofinancing opportunities.

30. Management clarified that the Audit Committee would receive an ALM report prior to year-end and that some future policy improvements could be considered as a consequence. Management would also strengthen existing due diligence procedures.

31. The document was considered reviewed and would be submitted to the Executive Board for review.

**New Liquidity Policy (for review)**

32. Management presented the document, noting that liquidity, together with capital, is one of the two pillars of IFAD’s new financial architecture and commitment capacity. The current policy had been adopted in 2006, and IFAD’s financial architecture and business model had evolved since then. At the same time, global and regional crises had become more frequent, leading to an increased need for
IFAD to play a countercyclical role. The new policy considered the above factors as well as best practices by IFAD’s peers. The main changes proposed were:

1. Consideration of a shorter time horizon for liquidity measures (in line with the recommendation of the independent review of IFADs’ financial risks);
2. A two-tiered limit structure, currently a single measure, with a minimum liquidity requirement and a target liquidity level (TLL); and
3. Assessment of the liquidity portfolio to embed the value of invested assets in a stressed market environment and include contingency plans to react to unexpected developments.

33. It was noted that the new Liquidity Policy is based on the principles of prudence and balance. To avoid any disruption in the operationalization of IFAD11, the new Liquidity Policy will become effective from the Twelfth Replenishment of IFAD’s Resources (IFAD12) onwards. However, Management has undertaken a commitment to monitor the new minimum liquidity requirement (or anchor policy limit) in IFAD11. Management will report to the Executive Board on progress made towards achieving the targeted liquidity levels until the end of the transition period.

34. Committee members welcomed the document as broadly heading in the right direction. They requested clarification about the transition process in order to comply with the more demanding TLL, and forward-looking scenarios on liquidity ratios, liquidity trends and the risks related to the undisbursed balances that have grown substantially in the past few years, especially when compared to liquidity levels.

35. Management clarified that yearly disbursements amount to approximately US$1 billion and that undisbursed balances are influenced by project approval levels. It was also noted that slower disbursement trends would improve the liquidity ratio but could generate a negative effect on the efficiency ratio. Management will embed Committee feedback in the future version of this document.

36. The document was considered reviewed and would be submitted to the Executive Board at its forthcoming meeting for review.

Accelerated Repayment and Voluntary Prepayment Framework (for review)

37. Management presented the document, noting the efforts made to increase IFAD’s commitment capacity and liquidity profile while minimizing the associated risks and costs. It was highlighted that several borrowers currently eligible for ordinary terms have benefited, during their economic journeys, from loans provided by IFAD on highly concessional terms. Similarly to peer international financial institutions (IFIs), IFAD is now proposing a voluntary prepayment for these outstanding highly concessional loans with the commitment to redirect these resources to countries most in need.

38. In addition, Management is proposing an accelerated repayment mechanism. Related legal clauses would be included in the financing agreements of highly concessional and blended terms loans approved in IFAD12 and onwards.

39. It was noted that this version of the document embeds feedback from members provided during the June meeting and that the new policy would become effective once the Governing Council, at its session to be held in February 2021, had approved the revised Policies and Criteria for IFAD financing.

40. Committee members welcomed the document and requested clarifications about the generation of voting rights and the approaches adopted by other IFIs in comparison to the option proposed by IFAD and the timing of the amendment IFAD’s basic documents. Several Committee members requested revisions to
paragraph 31; others asked that the voluntary prepayment framework be put in place swiftly, after the necessary amendments to the Policies and Criteria for IFAD Financing.

41. Management provided clarifications, indicating that the option adopted by IFAD was the one with the largest uptake by other IFIs. It was clarified that relevant borrowers could seek to use the voluntary prepayments framework once effective. It was also clarified that, before the end of the year, further proposed amendments to IFAD’s legal and policy documents, including the Agreement Establishing IFAD, would also be reviewed by the Executive Board to reflect the outcomes of the ongoing IFAD12 Consultation, in order to increase IFAD’s access to diverse sources of funding and to bring into effect the new policies and procedures, with some of these documents as appropriate for potential approval by the Governing Council in February 2021.

42. The document, including a revised paragraph 31, would be submitted to the Executive Board at its forthcoming meeting for approval.

**Update on the determination of IFAD’s resources available for commitment (for review)**

43. Management provided an update on the progress made on revision of the RAC methodology. As a result of the enhancements to IFAD’s financial architecture, the methodology to assess RAC also requires updating to comply with the newly implemented policies.

44. It was noted that long-term financial strength would be enhanced by the introduction of deployable capital as an available resource in addition to projected levels of contributions, loan reflows and planned and new borrowing. The Executive Board approval of the funding plan would be key in this regard.

45. Committee members requested clarifications about the linkages between the commitment authority definition and the new liquidity measures.

46. Management clarified that liquidity is one of the measures to determine commitment authority; the other measures are capital availability and funding plan.

47. The document was considered reviewed and would be submitted to the Executive Board at its forthcoming meeting for review.

**Update on IFAD’s Investment Policy Statement**

48. Management provided an update on the progress made on revision of the investment policy statement, noting that this particular review placed emphasis on ensuring that the Fund’s policies are aligned with the requirements of the credit rating agencies. Three important changes were made with respect to credit and counterparty risk:

1. Previously all investments needed to carry an investment grade rating by at least one rating agency (S&P, Moody’s and Fitch). In line with practices observed at other IFIs, this requirement has been increased to two agencies.

2. The share of fixed-income investments in IFAD’s investment portfolio that have a rating category of AA- (or equivalent) and above should be at least 60 per cent.

3. Operational cash counterparties below investment grade are allowed, provided that these counterparties are used for payments and petty cash purposes and not used to handle large cash balances.

49. Some Committee members requested clarification about the role of the Investment and Finance Advisory Committee (FISCO).
50. Management explained that FISCO is the internal investment advisory committee and that with the arrival of the new CRO, new internal governance committees will be created.

51. The document was considered reviewed.

**Other business**

**New sovereign loan proposal from Agence Française de Développement**

52. Management presented a new sovereign loan proposal from AFD in the amount of EUR 300 million. It was noted that the negotiation process with AFD had been finalized in the days prior to the Audit Committee meeting, and Management expressed its appreciation to Audit Committee members for reviewing the proposal at such short notice.

53. It was further noted that the loan was fully compliant with the requirements defined in the Sovereign Borrowing Framework. IFAD’s leverage, with this loan, will increase from 8.1 to 11.3 per cent, well within the maximum leverage of 35 per cent. The committee was reassured that measures would be put in place to mitigate all financial risks.

54. It was agreed that the document would be open for review by the Audit Committee until 14 September 2020, after which, in the absence of any objection from Committee members, the proposal would be submitted to the Executive Board for approval through a vote by correspondence.

**Other business**

55. No additional items were put forward as other business.

**Oral update on the credit rating exercise (closed session)**

56. In a closed session, Audit Committee members were updated on developments in IFAD’s credit rating exercise.