

Document: EB 2021/134/R.58
Agenda: 23(c)
Date: 10 December 2021
Distribution: Public
Original: English

E



Investing in rural people

Report of the Chairperson on the 163rd Meeting of the Audit Committee

Note to Executive Board representatives

Focal points:

Technical questions:

Advit Nath
Director and Controller
Financial Controller's Division
Tel.: +39 06 5459 2829
e-mail: a.nath@ifad.org

Allegra Saitto
Chief
Financial Reporting and Corporate Finance
Tel.: +39 06 5459 2405
e-mail: a.saitto@ifad.org

Dispatch of documentation:

Deirdre Mc Grenra
Chief
Institutional Governance and
Member Relations
Tel.: +39 06 5459 2374
e-mail: gb@ifad.org

Executive Board — 134th Session
Rome, 13-16 December 2021

For: Information

Executive summary

1. In light of the COVID-19 pandemic, the 163rd meeting of the Audit Committee was held remotely.
2. The Committee reviewed the following documents, to be presented to the Executive Board at its 134th session:
 - **For approval:**
 - IFAD Risk Appetite Statement (AC 2021/163/R.13)
 - Proposal for Enhanced Efficiency and Resource Management (AC 2021/163/R.4)
 - IFAD's Investment Policy Statement 2022 (AC 2021/163/R.5)
 - Resources Available for Commitment (AC 2021/163/R.10)
 - IFAD After-Service Medical Coverage Scheme Trust Fund Investment Policy Statement (AC 2021/163/R.6)
 - IFAD's proposed private placement borrowing transactions (AC 2021/163/R.11)
 - **For confirmation:**
 - Workplan for IFAD's Office of Audit and Oversight for 2022 (AC 2021/163/R.7)
 - Revision of the Charter of the Office of Audit and Oversight (AC 2021/163/R.8)

Report of the Chairperson on the 163rd Meeting of the Audit Committee

1. The Audit Committee wishes to draw the attention of the Executive Board to the matters examined at the 163rd meeting of the Committee held on 23 November 2021. In light of the COVID-19 emergency, the meeting was held remotely through Zoom videoconferencing.

Adoption of the agenda (AC 2021/163/R.1)

2. The agenda was adopted with no changes.

Minutes of the 162nd meeting of the Audit Committee (AC 2021/163/R.2+Add.1) – for approval

3. The minutes were approved with no changes.

People, Processes and Technology Plan: Implementation of a Targeted Investment in IFAD's Capacity (TCI) – for information

4. Management presented an update of the PPTP focusing on progress made, challenges, budget usage and proposed drawdown for 2022. It was noted that the first phase of the PPTP was either implemented (e.g. the Enterprise Risk Management Framework) or nearing completion. In particular, it was highlighted that the automation pilots have been a great success. The final phase of the PPTP will focus on project procurement, project disbursements, document processing, automation, upskilling and reskilling, and the separation programme. The challenges noted were associated with the COVID-19 pandemic and the increased need for automation and digital solutions, as well as reporting on benefits already achieved. Finally, Management provided an update on budget utilization and the drawdown request for fiscal year 2022.
5. Committee members commended the progress made and requested some clarifications about budget utilization and the 2022 drawdown request. The Committee also requested further details on the automation strategy and on staff engagement in view of the many parallel ongoing reforms, most notably decentralization.
6. Management provided responses to the details requested. The update was noted.

Update on enhanced efficiency and resource management (Smart Budget Allocation) (AC 2021/163/R.4) – for review

7. Management introduced the agenda item, noting that the main purpose of the document was to enhance transparency and provide an overview of evolving trends in IFAD efficiencies and effectiveness. It was indicated that a better representation of the IFAD business model would result from segregating administrative expenses from the operational envelope.
8. Committee members asked whether there was a possibility of a reduction in resources available for programming. Members requested details on the impact on resources and IT needs. Finally, some members asked about a possible revision of key performance indicators and the option of screening more than one at the same time.
9. Management clarified that this proposal would not imply a reduction in the programme of loans and grants (PoLG) and clarified that it could lead to a revision of key performance indicators.
10. The document was considered reviewed and would be submitted to the Executive Board at its forthcoming session for approval.

Annual review of IFAD's Investment Policy Statement (AC 2021/163/R.5) – for review

11. Management presented the agenda item, noting the main changes, such as the systematic integration of environmental, social and governance (ESG) considerations in the management of IFAD's investments. It was highlighted that investments in green bonds and other thematic ESG securities are subject to the availability of market issuance and compliance with agreed risk tolerance levels. Further changes to the IPS included some edits in the section on privileges and immunities and the inclusion of IFAD's Anti-Money Laundering and Countering the Financing of Terrorism Policy.
12. Committee members welcomed the document and requested clarifications regarding the ESG investment framework, specifically on the exclusion of weapon producers, suggesting a reflection on whether this should be stricter, as well as clarifications about the selection process for external managers. Finally, it was noted that ESG investment criteria have also implications for the control framework to make sure the ESG policy is applied correctly.
13. Management provided the clarifications requested, noting that securities issued by weapon and/or ammunition producers are not eligible investments, and that the IPS remains aligned with the United Nations Global Compact principles as reflected in the previous IPS. Management mentioned that the framework will continue to be developed to strengthen efforts towards responsible investing. It was clarified that external managers are selected in accordance with IFAD procurement policies and procedures under fixed-term contracts.
14. The Investment Policy Framework was considered reviewed and would be submitted to the Executive Board at its forthcoming session for approval.

Review of the IFAD After-Service Medical Coverage Scheme Trust Fund Investment Policy Statement (AC 2021/163/R.6) – for review

15. Management presented the agenda item. It was noted that the Trust Fund had been established in 2003 to set aside funds to provide medical insurance to retirees. The Committee was informed about the results of the recent asset and liability review conducted by Blackrock. The study outlined the need to enhance the matching of asset duration with the liabilities profile and to allow for further diversification and higher returns. It was also noted that the proposed IPS included a shift to the relative conditional value at risk (CVaR) while limiting exposure to developed market equities to 30 per cent of the portfolio, introducing high yield bonds as a new asset class with a limit of up to 10 per cent, and extending exposure to investment grade asset-backed securities.
16. Committee members requested clarifications about the changes in CVaR. Management clarified that this amendment in CVaR measures would better align the risk and return characteristics of the asset portfolio with those of the liabilities, which the Trust Fund is intended to cover, in the best interests of IFAD, in both the short and the long term. Finally, it was noted that the presence in portfolio of equities and non-investment grade bonds was suitable in a well-diversified long-term portfolio but could also lead to volatility of returns in the short term.
17. The After-Service Medical Coverage Scheme Trust Fund Investment Policy Statement was considered reviewed and would be submitted to the Executive Board at its forthcoming session for approval.

Audit and Oversight

(a) Update on investigation and anticorruption activities – for information

18. The Office of Audit and Oversight (AUO) provided an update highlighting recent trends in the number of complaints and closed cases. It was noted that investigation cases

were being processed faster in 2021, especially complaints received in 2021, and that a strengthened triage process for incoming cases had been introduced to increase the timeliness of investigative responses and mitigation actions. The Committee was also informed that the quarterly meetings on pending cases between AUO and staff from the Programme Management Department and Financial Management Services Division (FMD) facilitate the confidential sharing of information and early operational mitigation actions on ongoing cases. In responding to the Committee's enquiry about the absence of sexual harassment or sexual exploitation and abuse (SH/SEA) referrals in 2021, AUO highlighted the extensive prevention and awareness efforts, the strengthened complainant and whistle-blower protection measures, the extensive training of staff and project personnel and the transparent reporting to the Executive Board on such matters.

19. The update was considered noted.

(b) Workplan for IFAD's Office of Audit and Oversight for 2022 (AC 2021/163/R.7) – for review

20. AUO provided an overview of its 2022 workplan, noting that the main work areas would be Decentralization 2.0, the renewed and strengthened delegation of authority framework and the ongoing business reforms. Accordingly, the main focus of audit work in 2022 would continue to be the IFAD country programmes and the IFAD country offices. The priority placed on investigations and anticorruption would remain high. It was also noted that risks such as financial or data loss, cybersecurity, legal and reputational risks had also been taken into account.
21. The Committee members welcomed the document and requested clarifications about both the adequacy of resources for 2022 and the significant projected increase in AUO staffing over the coming 2-3 years; the impact on planned audits of recent findings in country programme and hub audits; possible capacity-building for audit consultants engaged for field audit work; the possibility of benchmarking whistle-blower practices among peer institutions; the possibility of reviewing expenditures relevant to the Food Systems Summit; auditing of investments; collaboration with other United Nations entities in the context of decentralization; and oversight responsibility for the planned external review of the investigation function. The Committee further highlighted the importance of maintaining vigilance on project procurement matters.
22. AUO confirmed that project procurement remained the top audit priority in 2022 and provided clarifications about the 2022 budget allocation and projected staffing levels, the methodology and priorities applied in selecting audits and how some of the items noted by the Committee could be addressed through the planned activities in 2022. In addition, AUO indicated that previous external reviews of the IFAD investigation and sanctions procedures had been conducted under the oversight of the IFAD President and provided other information requested. Management provided an update on the outcomes of the Food Systems Summit and agreed to provide additional details.
23. The Committee reviewed the workplan and took note that its full implementation would be dependent on the budgeted additional resources for next year. The workplan would be submitted to the Executive Board at its forthcoming session for confirmation.

(c) Revision of the Charter of the Office of Audit and Oversight (AC 2021/163/R.8) – for review

24. AUO introduced the agenda item, noting that the most recent review of the AUO Charter had taken place in 2018 and that the purpose of this revision was to update some outdated references, introduce changes requested by the Audit Committee and clarify AUO's role in providing administrative support to the impartial review of the enhanced complaints procedure for alleged non-compliance with IFAD's Social, Environmental and Climate Assessment Procedures (SECAP).

25. Some Committee members requested clarifications about SECAP complaints mechanisms. AUO provided the necessary details.
26. The Charter was considered reviewed and would be submitted to the Executive Board at its forthcoming session for confirmation.

Project financial management: annual progress report including review of the Conceptual Framework for Financial Reporting and Auditing of IFAD-financed Projects (AC 2021/163/R.9) – for review

27. Management introduced the yearly report on project financial management trends and results, noting that the project financial management reforms being introduced will improve workforce skills and motivation, increase fiduciary assurance and enhance service delivery to both internal and external clients. A holistic risk framework is being adopted, interconnecting internal roles, rebalancing checks on higher risk areas and promoting less risk-averse approaches to redirect resources to support implementation. As part of these reforms, there will be a reduction in burdensome requirements parallel to country systems while enhancing financial discipline and introducing automation and efficiencies.
28. Management also highlighted the continued exceptional circumstances associated with the management of COVID-19 impact. The need to update the definition of the term "borrower" was noted, in order to capture broader applicability to private sector and subnational entities.
29. Committee members requested clarifications about COVID-19 measures and the new definition of the term "borrower". Management provided the necessary clarifications, noting that missions and fieldwork are slowly being resumed and that some flexibility was being provided to fragile countries impacted by the COVID-19 pandemic in connection with the management of ineligible expenses.
30. The document was considered reviewed.

Resources available for commitment (AC 2021/163/R.10) – for review

31. Management introduced the agenda item, noting that the definition of resources available for commitment now takes into account short-term and long-term financial sustainability to ensure that financing capacity is prudently deployed to meet past and new commitments. It was noted that the document now comprised four sections:
 - Financing capacity, which includes an assessment of the sustainable replenishment baseline;
 - Commitment capacity, which is the capacity of the Fund to sustain levels of future operations, for disbursement over a multi-year period;
 - Funding plan, which defines more clearly how funding gaps will be covered through borrowings; and
 - Deployable capital, which is added to the projections as an indicator of IFAD's risk-bearing capacity and the capacity for future operations.
32. It was noted that the PoLG for 2022 to be authorized by the Executive Board (estimated at up to US\$1.167 billion) would be in line with the revised Twelfth Replenishment of IFAD's Resources (IFAD12) scenario approved by the Board in September.
33. Committee members drew attention to the evolution of financial variables in the long term and requested clarifications on assumptions for scenarios beyond the IFAD12 period and on extreme scenarios.
34. Management provided the necessary details, clarifying that replenishments and PoLG are assumed flat beyond the IFAD12 period and that the scenario 2022/B in annex I does not consider borrowing options to test the resilience of IFAD's stock of resources in extreme circumstances.

35. The document was considered reviewed and would be submitted to the Executive Board at its forthcoming session for approval.

IFAD's proposed private placement borrowing transactions (AC 2021/163/R.11) – for review

36. The Audit Committee reviewed, in a closed session, the proposed list of investors and private placement transactions as set forth in the above document.
37. Management provided clarifications on the engagement and exclusion criteria in particular vis-à-vis weapon producers, the expected average funding and on-lending spread.
38. The document was considered reviewed and would be submitted to the Executive Board at its forthcoming session for approval.

Enterprise risk management

(a) Capital Adequacy Report (AC 2021/163/R.12) – for review

39. Management introduced the agenda item, noting that the deployable capital ratio had fallen from 39.3 per cent in December 2020 to 37.8 per cent in June 2021 and was expected to decrease further over time with increasing leverage. During the same period the leverage ratio had increased from 14.6 per cent to 17.3 per cent, remaining nonetheless in compliance with the limits established in the Integrated Borrowing Framework. It was noted that IFAD's possible credit deterioration continues to be one of the main risks faced by the Fund, particularly in the context of the COVID-19 pandemic. In spite of the current downward pressure on the credit quality of borrowing Member States, IFAD's deployable capital ratio has not been materially affected. This reflects the resilience of IFAD's loan portfolio, which benefits from both diversification and preferred creditor status.
40. Committee members requested clarifications about the level of the investment portfolio, the exposure of IFAD in the case of a country in a difficult situation and future trends in disbursements and commitments. Management clarified that during the first six months of 2021 IFAD had encashed some tranches of borrowed resources, while the disbursement trends reflect historical trends and project disbursement capacity.
41. The document was considered reviewed and would be submitted to the Executive Board at its forthcoming session for review.

(b) Corporate Risk Dashboard – for review

42. Management presented the agenda item, noting that the Corporate Risk Dashboard is an executive level reporting mechanism that displays risk exposure on financial and non-financial risk data and trends across major risk domains. It supports the Executive Board and Management in overseeing progress made towards the achievement of the strategic objectives of the Fund.
43. It was noted that the dashboard is structured around IFAD's four major risk domains – financial, operational, programme delivery and strategic – and displays indicators.
44. The presentation was noted.

(c) Risk Appetite Statement (AC 2021/163/R.13) – for review

45. Management introduced the agenda item, noting that the risk appetite is an instrument that contributes to resource allocation and enhances transparency in decision-making. A risk appetite level had been defined for each risk identified in the taxonomy and expressed on a scale from high to low, representing IFAD's attitudes towards risks. The risk appetite is proportionate and relevant to the impact that such risks may have on the Fund. It was noted that the individual risk appetites had been established in consultation with relevant departments and would enable the Executive Board to assess current and forward-looking risks.

46. Committee members welcomed the document and observed that it would benefit from an executive summary, which Management committed to provide. The Committee requested clarifications about the level of risk associated with implementation capacity and sustainability of operations, as well as risk associated with business continuity and cyber risk, which would also impact other risk areas. Management provided the necessary clarifications.
47. The document was considered reviewed and would be submitted to the Executive Board at its forthcoming session for approval.

(d) Update on Asset and Liability Management (AC 2021/163/R.14) – for review

48. Management introduced the agenda item, noting that this is the first oversight report since the approval of the Asset and Liability Framework in December 2020. It was also highlighted that in May 2021 the Financial Risk Management Committee, which is responsible for asset and liability management (ALM) risk oversight and control, had been established to strengthen oversight on financial risks, including ALM risks. It was noted that IFAD's ALM risks remain limited but could become more significant in the future with enhanced borrowing activities. The importance of continuous strengthening in the area of derivative management was highlighted, as derivatives will be one of the main tools to be used to hedge ALM risks. The need to enhance data extraction for ALM purposes was also noted.
49. Committee members requested clarifications on the inclusion in the ALM framework of the Integrated Borrowing Framework and on the use of derivatives.
50. Management clarified that the Integrated Borrowing Framework is already embedded in the ALM framework and that a wider borrowing programme inclusive of private placement would require the use of derivatives for hedging purposes as well as the possible set up of adequate collateral management.
51. The document was considered reviewed and would be submitted to the Executive Board at its forthcoming session for review.

Audit Committee work programme for 2022 (AC 2021/163/R.15) – for approval

52. The tentative Audit Committee work programme for 2022 was approved with the inclusion of an update on IFAD's credit rating.

Update on the implementation of Anti-Money Laundering and Countering the Financing of Terrorism Policy and Controllership (AC 2021/163/R.16) – for review

53. Management introduced the item, noting the progress made in the Financial Crime and Controllership functions, both from a staffing perspective and in terms of the development and implementation of software solutions, tools, procedures and training in the respective areas. With regard to financial crime, the Committee was informed about the extensive automated screening conducted on vendor and partner master files, the deployment of know-your-customer questionnaires and the enhanced due diligence assessments performed. On the controllership function, the Committee was informed about the Controllership review, support of virtual missions conducted and issuance of a Controller's scorecard for each country office, receipt of digital certification on internal control effectiveness, business process mapping, as well as the roll-out of delegation of authority, with 25 changes already made since the launch.
54. Committee members requested additional information on the effect of countries that are listed under the Financial Action Task Force (FATF) or are under United Nations or other international sanctions (or of clients/companies listed) and on the concrete implementation of standards in operations (identification of clients, beneficial owners, monitoring of business processes, treatment of high-risk clients, responsibility to

assure rules are followed and the jurisdiction applicable). Management provided the necessary information. Committee members welcomed the update and commended Management on the progress made. The document was considered reviewed and would be submitted to the Executive Board at its forthcoming session for review.

Oral update on the implementation of the Borrowed Resource Access Mechanism – for information

55. The Committee was updated on milestones reached. It was noted that IFAD is ready to commence lending for both the performance-based allocation system and the Borrowed Resource Access Mechanism (BRAM) during 2022, and that countries are expressing their demand for BRAM resources. Management shared that the pipeline was reflected in the budget document, and is in line with the RAC. It was noted that indicative country-based limits have been set up and that both risk and financial management teams have been included in the conversations with country teams and governments to ensure full understanding of the potential size and cost of BRAM resources.
56. The update was noted.

Update on business continuity and effectiveness of working methods: Impact of COVID-19 – for information

57. Management provided an oral update on the business continuity measures adopted during the COVID-19 emergency. Management provided details on the flexible and phased return-to-office plan for headquarters and country offices. It was noted that since the previous Audit Committee meeting (held in September) the pilot on teleworking had been completed.
58. The update was noted.

Report on the Twelfth Replenishment of IFAD's Resources (AC 2021/163/R.17) – for information

59. Management introduced the agenda item, providing some updates on IFAD12 and noting that, as at the meeting date, pledges amounted to US\$1.17 billion, instruments of contribution amounted to US\$869 million and payments amounted to US\$85 million.
60. The document was considered noted and would be submitted to the Executive Board at its forthcoming session for information.

Standard financial reports presented to the Executive Board

Report on IFAD's Investment Portfolio for the Third Quarter of 2021 (AC 2021/163/R.18) – for review

61. Management briefed the Committee on the investment portfolio report, which contained information as at end-September 2021. It was noted that performance up to September 2021 was slightly positive.
62. The document was considered reviewed.

Other business

(a) Oral update on IFAD's credit rating – for information

63. Management provided an oral update on the credit rating exercise. It was noted that Fitch had published an updated rating report on 10 November with a stable outlook and had confirmed IFAD's rating at AA+. Standard & Poor's is expected to publish an updated report later this month.
64. The update was noted.

(b) Oral update on interbank offered rates – for information

65. Management provided a comprehensive presentation on the interbank offered rate (IBOR) transition and possible impact on IFAD's financial instruments and procedures,

as assessed by an interdivisional working group. It was noted that IFAD is well placed to implement the reform since no amendments are required to existing loan financing agreements and no customization of IT tools is envisaged following testing of IFAD systems. The main change will be in the pricing of United States dollar-denominated ordinary loans that use the United States dollar six-month London Interbank Offered Rate (LIBOR) as the market reference rate. As recommended by the Alternative Reference Rate Committee and following practices at other development finance institutions (DFIs), IFAD will replace the United States dollar LIBOR with the Secured Overnight Refinancing Rate (SOFR). The transition will begin on 1 April 2022, which means that interest rates will continue to be calculated using the current methodology for the first quarter of 2022 and the SOFR will be adopted as the market-based reference rate as of 1 April 2022. Unlike LIBOR, which is an ex-ante rate, the SOFR is an ex-post rate. Therefore, IFAD will no longer be in a position to communicate the full interest rate at the beginning of each quarter. Rather, it will be communicating only the spread over the market reference rate in line with other DFIs. The billing cycle will remain unchanged. IFAD is working on a communication plan and will liaise with borrowers to clarify and address any questions that may arise. Other financial instruments and reporting will also be linked to SOFR.

66. The update was considered reviewed.

(c) Oral update on the implementation of digital signatures at IFAD – for information

67. Management informed the Committee about progress made to support business efficiency automation through the introduction of digital signatures, by rolling out a tool, DocuSign, which provides secure and encrypted signatures. This tool could also support the classification of documents by risk level.

68. The update was welcomed by Committee members.