
Report of the Chairperson on the 166th Meeting of the Audit Committee

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Executive summary

1. The Committee reviewed the following documents for presentation to the Executive Board at its 136th session.
For approval:
 - Proposal to enter into a borrowing agreement with the European Investment Bank
 - IFAD's proposed private placement transactions
 - Enhanced Complaints Procedure for Alleged Non-Compliance with IFAD's Social, Environmental and Climate Assessment Procedures (SECAP)For review:
 - High-level preview of IFAD's 2023 results-based programme of work, regular and capital budgets, and medium-term strategic budget outlook for 2024-2025, and the preview of the Independent Office of Evaluation of IFAD's results-based work programme and budget for 2023 and indicative plan for 2024-2025
 - Updated status of IFAD12 resources and commitment capacity
2. The Committee also reviewed, inter alia, the following items:
 - Report on IFAD's investment portfolio for the first semester of 2022
 - Progress report on the workplan for IFAD's Office of Audit and Oversight for 2022
3. The Committee engaged in a strategic conversation on the item "Reflection on substantive agenda items for the Audit Committee in 2023 in view of the IFAD13 upcoming discussions," with a view to sharing a brief with the President-elect.
4. The Committee received an update on IFAD's Borrowed Resource Access Mechanism.
5. Meeting in closed session, the Committee reviewed IFAD's proposed private placement transactions and endorsed submission of the document to the upcoming Executive Board for approval.

Report of the Chairperson on the 166th meeting of the Audit Committee

1. The 166th meeting of the Audit Committee was held on 1 September 2022 in hybrid modality.

Agenda item 2 – Adoption of the agenda (AC 2022/166/R.1)

2. The agenda was adopted with no amendments.

Agenda item 3 – Minutes of the 165th meeting of the Audit Committee (AC 2022/166/R.2) and its closed session (AC 2022/166/R.2/Add.1) – for approval

3. The minutes were approved with some edits to paragraph 16 of document AC 2022/166/R.2.

Agenda item 4 – High-level preview of IFAD's 2023 results-based programme of work, regular and capital budgets, and medium-term strategic budget outlook for 2024-2025, and the preview of the Independent Office of Evaluation of IFAD's results-based work programme and budget for 2023 and indicative plan for 2024-2025 (AC 2022/166/R.3) – for review

4. Management introduced the agenda item, noting IFAD's transformation over recent years, which allowed for the delivery of a growing and more complex portfolio within a zero real growth budget. Between 2016 and 2022, IFAD's portfolio under management increased by 22 per cent, and the share of the portfolio in fragile and conflict situations rose by half. These changes have led to higher costs.
5. Management noted that the document contained two scenarios for IFAD's 2023 regular budget and projections over the medium term: scenario 1, which foresees 3.5 per cent annual real growth for the three years, and scenario 2, which is planned for 2.5 per cent annual real growth.
6. Management reported that these funds are required to implement the jointly agreed Twelfth Replenishment of IFAD's Resources (IFAD12) commitments. While under scenario 1, there is a plan for how IFAD can deliver on the planned ambition, scenario 2 would require additional cuts that would risk harming IFAD. This includes halting work on one of IFAD's mainstreaming themes or increasing the size of IFAD projects, which would divert the Fund from its mandate.
7. The Committee was informed that the level of carry forward was expected to return to a level of up to 3 per cent and that the 2023 capital budget is expected to range from US\$6.25 million to US\$6.8 million. More details on the 2023 budget, including the split between programmatic and overhead costs, as well as inflation compensations, will be included in the final budget document in December 2022.
8. The Independent Office of Evaluation of IFAD (IOE) introduced its work programme and budget for 2023, indicating that IOE would begin a new thematic evaluation on nutrition and food security. IOE noted that in 2023 it would pilot two corporate-level reviews: (i) a review of the Results Management Framework for IFAD12; and (ii) an ex post review of the action taken in response to the recommendations of the 2018 corporate-level evaluation on the financial architecture of IFAD. It was noted that IOE will complete country strategy and programme evaluations in China and Ethiopia and collect data in Argentina, Haiti, India, Mauritania and Rwanda.
9. The proposed IOE budget for 2023 would embed a modest increase in staff resources, which would imply a budget for 2023 in the amount of US\$6.1 million. The proposed IOE budget would therefore be 0.52 per cent of IFAD's expected programme of loans and grants (PoLG) for next year, a figure below the IOE budget cap of 0.9 per cent adopted by the Executive Board.

10. Recognizing IFAD's role in the current global environment, several members agreed that IFAD should be ambitious in its programming delivery and results, especially in fragile contexts. It was noted that this requires an increased country presence through decentralization, more investments funded through core resources, borrowing and other means, and attention to priority activities such as South-South and Triangular Cooperation and private sector engagement. Members welcomed the multi-year view provided.
11. Some concerns were expressed on the real budget increases proposed over a timespan of three years and questions on sequencing/tranching versus savings (including only on future budget increases) were raised. In this vein, Committee members encouraged the prioritization of 2023 activities and called for identifying further structural savings. They also requested clarifications about the decentralization process and related costs as well as transparency both on real and nominal costs (making clear in the scenarios that an additional compensation against inflation of 2 per cent was predicted) and on recurrent and one-time (fixed) costs. In this context, the request was made to have more information to link this year's budget proposal with last year's budget, when a multi-year plan was presented to accommodate the two major cost drivers, namely decentralization and adequacy of staff resources. It was highlighted that IFAD should focus on quality and results and ensure that its structural organization is fit for purpose.
12. Management welcomed the members' feedback, emphasizing that after several years of zero real growth, it would be difficult to find additional savings in IFAD's budget and still maintain high levels of borrowing, supplementary funds, decentralization and investments to meet IFAD12 commitments. Management committed to providing additional information in December on the benefits of decentralization and the costs of IFAD operating in fragile and conflict-affected contexts. There was a call for member support to ensure that IFAD has the necessary resources to respond to the growing needs.
13. Committee members overall considered the IOE budget proposal adequate.
14. The document was considered reviewed and would be submitted to the upcoming Executive Board for review.

Agenda item 5 – Progress report on the workplan for IFAD's Office of Audit and Oversight for 2022 (AC 2022/166/R.4) – for review

15. The Office of Audit and Oversight (AUO) provided an update on the investigation and anticorruption activities already undertaken during fiscal year 2022. It noted that the AUO audit plan was on track for 2022, that several audit reports had been issued since the progress report was posted and that additional reports would be posted on the Audit Committee website in October.
16. AUO noted that the audit focus remained on the effectiveness of IFAD's fiduciary supervision in country programmes; it was also noted that the pace of intake of misconduct and corruption complaints increased slightly during 2022. The Committee was informed that AUO staffing was generally stable but that three colleagues had recently resigned and the recruitment process was progressing. The Committee was also informed that the external review of the investigation function was progressing, the first draft of the report would be issued by the end of September and the President had confirmed his intention to share a redacted version of the final report with the Audit Committee. AUO also informed the Committee that it was considering replacing the pending 2022 audit assignment on project procurement because of the significant attention this area had received from both AUO and Management.
17. Committee members requested information and careful consideration on AUO's intention to replace the procurement audit given the continued findings of non-compliance with procurement procedures and enquired about the measures to

be implemented to ensure full alignment to the related risk identification and assessment in this area. Other Committee members requested details about trends in the investigation cases and individual delays in addressing recommendations.

18. AUO noted the strong focus of auditing efforts on project procurement, commenting that Management had been very proactive in strengthening capacity, systems and training. It further noted that recent audits had observed an improvement in the staffing of supervision missions with an adequate level of procurement expertise. AUO indicated that the trends on investigations were stable and hard to interpret, since the variations year on year were not significant. In response to a question on challenges to investigating project officers, AUO noted that it is aligning its practices with those of other international financial institutions (IFIs) in this regard but that risks of the misuse of IFAD financing are already mitigated through various means.
19. Management also offered assurances that project procurement is one of its highest priorities, indicating that some minimum standards are ensured through mandatory trainings and system improvements. The Committee was informed about the process to monitor project reporting on a quarterly basis and about the revision of some policies like the disbursement handbook. The Audit Committee welcomed Management's proposal that a document containing a comprehensive overview of the actions taken, the action plan put in place by Management, the expected results and related timelines be submitted to a forthcoming Audit Committee meeting.
20. The document was considered reviewed.

Agenda item 7 – Revised SECAP Complaints Procedure (AC 2022/166/R.6) – for review

21. The agenda item was introduced with the observation that the proposal contained in document AC 2022/166/R.6 is consistent with international best practice. The enhanced complaints procedure complements the project-level grievance redress mechanism. The procedure consists of three steps. The first step is the SECAP redress service (SRS), which screens incoming complaints against specific eligibility criteria and carries out an assessment to develop an understanding of the issues and parties involved. At the conclusion of the assessment, the complainants may decide either to have the SRS satisfactorily and quickly address the issue or to proceed to the second step, the problem-solving process.
22. In the problem-solving process, an attempt is made to resolve the issue through a neutral, transparent and collaborative problem-solving approach.
23. Finally, if the complaint is not resolved, the third step is an impartial review process that examines IFAD's compliance with SECAP, assesses eventual harm done and recommends remedial action, as appropriate.
24. To ensure impartiality, the review is carried out by an independent expert housed in AUO and reporting to the Executive Board through the Audit Committee.
25. Committee members welcomed the proposal and requested clarifications about IFAD privileges and cases already incurred. In light of the fact that only one case had arisen since 2015, they also wondered about beneficiary awareness and the communication strategy vis-à-vis stakeholders, and whether NGOs not directly involved could submit complaints for individual stakeholders. Members also asked whether Management had considered joining forces with other United Nations/IFI entities in using a joint structure.
26. Management clarified that the one case incurred in the past was related to a portion of one project implemented by a cofinancier. Management explained that although IFAD enjoys the protection of strong privileges and immunities, it still needs to act responsibly, and the complaints procedure provides a means to resolve grievances,

thereby reducing the risk of litigation and reputational risk. At the same time, keeping these sensitive issues within IFAD was the most cost-efficient approach.

27. The document was considered reviewed and would be submitted to the upcoming Executive Board for approval.

Agenda item 8 – Proposal to enter into a borrowing agreement with the European Investment Bank (AC 2022/166/R.7) – for review

28. Management introduced the proposal, noting that it was the product of a long dialogue with the European Investment Bank (EIB), with the ultimate aim of signing an agreement by the end of 2022, if feasible. The favourable terms of the proposals were highlighted, noting the long amortization schedule and flexible withdrawal modalities, such as the designation of the denomination currency and number of instalments.
29. Committee members welcomed the proposal and asked whether the EIB had expressed a preference for a specific use of the funds. Management explained that the EIB had expressed a preference for a non-binding focus on using the funds in Africa but stated that the loan would be non-earmarked in line with the conditions of the Integrated Borrowing Framework.
30. The document was considered reviewed and would be submitted to the upcoming Executive Board for approval.

Agenda item 9 – Update on IFAD’s Borrowed Resource Access Mechanism

31. Management provided an oral update on implementation of the Borrowed Resource Access Mechanism (BRAM). It noted that 2022 is the first year of the replenishment cycle and hence, the first year of implementation of this financing instrument. The Committee was informed that to date, 90 per cent of eligible countries had expressed interest and that 92 percent of the available BRAM resources (approximately US\$1 billion) were planned for approval by the end of 2024. It was noted that Management will continue to monitor the pipeline with scope to further increase the envelope offered. Management also noted that the Executive Board will receive further information about the 2023 programme of work and budget in December 2022 through the document containing the progress report.
32. Committee members welcomed the update and requested clarifications about BRAM demand in relation to countries’ indebtedness and about geographical distribution.
33. Management clarified that the debt distress of eligible countries was closely monitored and that there was no specific geographical focus.
34. The update was deemed noted.

Agenda item 10 – Updated status of IFAD12 resources and commitment capacity (AC 2022/166/R.8) – for review

35. Management introduced the agenda item, noting that the assessment had been conducted to minimize the risk of overcommitment while maximizing efforts to meet the original replenishment target. Management noted that to sustain the approved PoLG target of US\$3.5 billion and finance the planned level of disbursements, as well as operating expenses, it was critical for IFAD12 replenishment contributions to reach the US\$1.3 billion level. As of July of this year, IFAD had received pledges in the amount of US\$1.278 billion, so this result ensures that Debt Sustainability Framework grants and the regular grant programme will be confirmed at their planned levels for the IFAD12 period.
36. Management also explained how the current macroeconomic and financial context at the global and regional level is the cumulative result of a series of crises (COVID-19, the conflict in Ukraine, climate change/droughts) that have compounded each other, in particular:

- Increases (sometimes significant) in prices (of commodities; factors of production/agricultural inputs such as fertilizers; imports; services; food);
 - The growing fiscal fragility of borrowing countries, and fragility in general;
 - The growing potential for social/political unrest.
37. IFAD is not directly exposed to the conflict in Ukraine; only indirect effects are observable in some of its countries/regions of operation. It was noted, however, that it is more difficult and costly for IFAD to implement business programmes because of a potential deterioration in the quality of the lending portfolio, potential BRAM demand volatility and potential repercussions on the demand for private sector financing.
 38. It was noted that despite credit turbulence in the current environment, the weighted average risk rating of IFAD's portfolio has so far remained relatively stable at B+/B. This is mainly a positive consequence of the low portfolio concentration risk. IFAD's five largest borrowers account for only 28 per cent of the portfolio, and IFAD's non-performing loans continue to be in line with those of the International Development Association. So far, no new default has been recorded in the period 2020-2022, notwithstanding COVID-19 and the conflict in Ukraine.
 39. Monitoring and mitigating measures are an integral part of risk management. Stress testing was conducted to assess the impact of downgrading the loan portfolio by several notches and a deterioration in IFAD's preferred creditor status as a consequence of the deterioration in the economic environment in general. Scenario results showed that the capital buffer could provide adequate protection against the potential impact associated with these severe credit risk scenarios.
 40. The performance-based allocation system (PBAS) was noted as a source of structural risk mitigation, as it enhances a balanced allocation of resources also through the limits it imposes (no more than 5 per cent of resources to any single country), thus facilitating diversification.
 41. Measures such as suspending disbursements of loans that are 75 days in arrears keep the level of performing loans at 79 per cent, and contain underperforming loans at under 20 per cent and that of non-performing loans at around 3 per cent.
 42. It was also noted that loan provisioning is based on an assessment that reflects expected credit loss as per IFRS 9 accounting standards and is assessed by both rating agencies and the external auditor as fully adequate.
 43. Mitigation measures are also ensured through the cautious approach of the BRAM, with eligibility evaluated on the basis of country selectivity and eligibility for accession; an adequate supply of borrowed resources; risk-based country limits; differentiated financing conditions; and demand-based access.
 44. In conclusion, the loan portfolio can be considered resilient and has long maintained its B-level average rating in line with that of peers, though it should be noted that the peers are not as diversified as IFAD.
 45. The update was welcomed by Audit Committee members and considered reviewed.

Agenda item 11 – Reflection on substantive agenda items for the Audit Committee in 2023 in view of the IFAD13 upcoming discussions

46. Under this agenda item, Committee members discussed substantive agenda items to be considered during meetings in 2023 in view of the upcoming IFAD13 discussions – in particular, those to be discussed with the new President-elect. It was noted that the opportunity for this conversation materialized during the proceedings of this 166th meeting, Mr Alvaro Lario being present.
47. The Chairperson noted that IFAD12 saw the introduction of a new financial model with core resources flanked by the use of borrowed resources. The need to maintain

this effective financial model was highlighted, with the key priority of retaining IFAD's rating at AA+ and the consequent need to gear financial policies towards these objectives in order to maximize IFAD's development impact.

48. The Chairperson also noted that the Committee should consider whether strategically, this new financial model could be consistent with further enhancements of IFAD activities, including whether borrowed resources could be augmented. Against the backdrop of the need to increase support for low-income countries (LICs), which may have fewer opportunities to use borrowed resources, there may be a case for exploring ways in which IFAD financing conditions can be adapted to ensure that the price paid for loans is better tailored to a country's capacity to pay.
49. Committee members noted the importance of this conversation in conjunction with other conversations like the one on the IFAD budget and programme of work, as well as the need to revisit the borrowing roadmap taking into account the level of deployable capital. The audit function was flagged as essential also to ensure the highest levels of integrity, as well as the need to remain attractive to highly concessionary funding and grants through quality of results, effectiveness and prioritization.
50. During his intervention, the President-elect stated that the focus will remain on how to support low-income countries and how IFAD can strike a balance with respect to leverage. He noted that a proposal was under preparation on how to increase funding for LICs/lower-middle-income countries to present to the PBAS Working Group, Audit Committee and Executive Board, and in 2023, Management will present a proposal on new revised pricing that would be linked to the cost of funding and reflect the particular characteristics of IFAD.
51. Strategic conversation and priorities were therefore noted.

Agenda item 12 – Business continuity and effectiveness of working methods – Impact of COVID-19

52. Management provided an update on business continuity and adaptation activities in response to the COVID-19 pandemic, highlighting the progress made since the last update. It noted that all offices had reopened and most restrictions had been lifted.
53. Management informed the Committee that the teleworking pilot programme had been extended until 31 December. It was noted that about 287 staff were teleworking at headquarters and that 122 staff were teleworking at the country offices.
54. Management also informed the Committee about operational repercussions, highlighting that 72 per cent of project extensions were linked to the pandemic.
55. The update was considered noted.

Agenda item 13 – Draft provisional agenda for the 167th meeting of the Audit Committee (AC 2022/166/R.9) – for review

56. The draft provisional agenda for the 167th meeting was reviewed, noting the following items:
 - Withdrawal of the item on the People, Processes and Technology Plan and targeted investment in IFAD capacity;
 - Addition of the item "Final external auditor's audit strategy memorandum for the year ending 31 December 2022"; and
 - Addition of the item "Update on the implementation of IFAD's Integrated Borrowing Framework."

Agenda item 14 – Standard financial reports presented to the Executive Board – for review**(a) Report on IFAD’s investment portfolio for the first semester of 2022 (AC 2022/166/R.10)**

57. Management briefed the Committee on the investment portfolio report, which contained information as of the end of June 2022. It was noted that the first half of 2022 was challenging, as credit spreads widened significantly in line with the broader risk-off market sentiment in the context of central bank monetary policy rate increases, heightened geopolitical tensions, strong inflation numbers and weak economic data. IFAD therefore registered an underperformance investment portfolio with an overall negative net rate of return of 0.68 per cent. It was noted that all risk parameters remained within approved thresholds and that the size of the investment portfolio was 1.8 times the level of the minimum liquidity needs.
58. Committee members noted the challenging market conditions impacting on the portfolio and stressed the importance of maintaining a prudent approach.
59. The document was considered reviewed.