
Report of the Chairperson on the 167th meeting of the Audit Committee

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Action: The Executive Board is invited to take note of the information provided herein.

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Executive summary

The Committee reviewed the following documents for presentation to the Executive Board at its 137th session.

For approval:

- Investment Policy Statement
- Resources available for commitment
- Amendments to the General Conditions for Agricultural Development Financing

For confirmation:

- Workplan for IFAD's Office of Audit and Oversight for 2023

The Committee also reviewed, inter alia, the following items:

- Capital Adequacy Report – June 2022
- Update on Asset and Liability Management
- Update on the implementation of IFAD's Integrated Borrowing Framework
- Update on investigation and anticorruption activities
- Update on IFAD's project procurement reform and key improvements on fiduciary oversight
- Project financial management: Annual progress report including review of the Conceptual Framework on Financial Reporting and Auditing of IFAD-financed Projects
- Update on the implementation of Anti-Money-Laundering and Countering the Financing of Terrorism Policy, and controllership

The Committee reviewed and approved the Audit Committee work programme for 2023.

The Committee decided to postpone the revision of the terms of reference and rules of procedure of the Audit Committee to the meeting in April 2023.

Report of the Chairperson on the 167th meeting of the Audit Committee

1. The 167th meeting of the Audit Committee was held on 28 November 2022 in hybrid modality.
Agenda item 2 – Adoption of the agenda (AC 2022/167/R.1) – for approval
2. The agenda was adopted with the inclusion of two internal audit reports for consideration in closed session under other business.
Agenda item 3 – Minutes of the 166th meeting of the Audit Committee (AC 2022/167/R.2) and its closed session (AC 2022/166/R.2/Add.1) – for approval
3. The minutes were approved with no amendments.
Agenda item 5 – Resources available for commitment (AC 2022/167/R.4) – for review
4. Management introduced the agenda item, noting that market conditions had been challenging in 2022: highly volatile exchange rates, inflation trends and interest rate hikes. The Committee was informed that the projected 2023 programme of loans and grants of US\$1.555 billion was deemed financially sustainable, taking into consideration financial model assumptions, the proposed funding plan and expected level of available capital. The Committee was informed that the sovereign loan with the European Investment Bank (EIB) had been signed on 11 November and that the remaining borrowing of US\$250 million in private placement could be shifted to next year. It was highlighted that the debt-to-equity ratio was projected to increase to 41 per cent in the Thirteenth Replenishment of IFAD’s Resources (IFAD13) period and to 45 per cent in IFAD14. Management would submit a proposed upward revision of the current limit associated with such ratio in 2023.
5. Committee members requested details about: measures to mitigate exchange rate risk, trends in liquidity ratios, policies concerning thresholds for the debt-to-equity ratio and trends in loan repayments. Some concern was expressed on the low disbursement ratio and the growing undisbursed balance which needed close monitoring.
6. Management provided the necessary clarifications noting that the assessment performed for the resources available for commitment allowed for future sustainable cash flows. Management also provided details about the exchange rate framework and risk mitigating measures, and clarified that loan reflows presented an increasing trend.
7. **Outcome and follow up:** The document was considered reviewed and would be submitted to the forthcoming Executive Board session for approval.
Agenda item 6- Amendments to the General Conditions for Agricultural Development Financing (AC 2022/166/R.5) – for review.
8. Management introduced the agenda item noting that the purpose of the revised General Conditions was to capture amendments deriving from policies approved in the last 24 months, such as the Anti-Money Laundering and Countering Financing of Terrorism Policy, the Social, Environmental and Climate Assessment Procedures (SECAP), the Data Privacy Guidelines and the Project Procurement Guidelines.
9. **Outcome and follow up:** The document was considered reviewed and would be submitted to the upcoming Executive Board for approval with a revision to section 7.05 (d).¹

¹ “By notice to the Borrower/Recipient, the Fund may shall require that all bidding Project procurement documents and contracts for procurement of goods, works and services financed by the Financing include provisions requiring bidders, suppliers, contractors, sub-contractors and consultants ...”.

Agenda item 7 – Office of Audit and Oversight

(a) Update on investigation and anticorruption activities

10. The Office of Audit and Oversight (AUO) provided an update on trends and salient issues arising from recent investigations and sanctions cases up to 15 November 2022. It was noted that the number of internal cases was stable compared with the prior year, while the number of external cases had increased by 20 per cent. The anticorruption mailbox continued to be the most favoured channel to report complaints. Allegations were most prevalent in the area of fraud.
11. The Committee was informed of cases in which IFAD's main logo and staff identities had been misused by an unidentified third party for recruitment fraud. IFAD immediately contacted possible victims, notifying them not to trust the source, issued a cease-and-desist letter and requested the closure of the domain name used in this fraudulent scheme in collaboration with the Information and Communications Technology Division.
12. It was noted that IFAD had stepped up its response to fraud and corruption and that in 2022 it had levied the highest-ever number of sanctions in a given year, demonstrating IFAD's effective zero tolerance approach to fraud and corruption cases.
13. In addition, AUO, in collaboration with the Financial Controller's Division, had launched the integrity due diligence list as an ex ante risk mitigation mechanism.
14. **Outcome and follow up:** The update was noted.

(b) Workplan for IFAD's Office of Audit and Oversight for 2023 (AC 2022/166/R.6) – for review

15. AUO introduced the agenda item, noting that this was the second year of the division's strategic planning period and that the selection of audits for 2023 was based on risk considerations and audit priorities underlying strategic planning for IFAD12. The audit emphasis would remain on decentralized and country programme activities but would also include aspects of financial and third-party risk management. The priority in the area of investigations and anticorruption remained the prompt and effective investigation of alleged irregularities. In terms of capacity-building, AUO would engage actively in implementing the recommendations of the external review of the investigation function due to be completed in 2022, and of the external quality assurance review of the internal audit function to be conducted in mid-2023. In 2022, AUO had experienced a high staff turnover in the investigation area and would therefore need to rely on external resources until all vacant positions had been filled. It was noted that not all budget resources required in 2023 by AUO would be immediately allocated.
16. Committee members requested clarifications about the possibility of having a more risk-based approach rather than one of compliance. Members also noted the vacancy rate within AUO and expressed concern about Management's response to AUO's budgeting needs.
17. AUO provided clarifications about compliance and risk-based activities, noting that the limited-scope compliance reviews in the workplan enabled AUO to gauge the effectiveness of financial controls. AUO also noted that the synergy between investigation and operational risk mitigation (through the systematic sharing of case information with operations divisions at an early stage) had been critical for early risk mitigation in 2022, as the high volume of cases had required almost all staff investigative time being spent on investigative responses.
18. AUO clarified that having a lower than needed budget allotment at the start of the year had been observed also in previous years but that all needed funds had always been provided to AUO promptly when needed. Management stated that the necessary resources to deliver the programme of work had always been allocated to AUO, even if this process occurred in a phased approach.

19. **Outcome and follow up:** The document was considered reviewed. The Committee wished to remain abreast of the evolution of AUO budgeting needs and related resource allocation. AUO confirmed that the Audit Committee would be kept duly updated. The document would be submitted to the forthcoming Executive Board for confirmation.

Agenda item 9 –Enterprise Risk Management

(a) Capital Adequacy Report – June 2022 (AC 2022/167/R.7) – for review

20. Management introduced the agenda item, noting that as at June 2022 IFAD was compliant with all risk limits established in the Capital Adequacy Policy. The deployable capital ratio had decreased slightly, from 40.2 per cent in December 2021 to 39.7 per cent in June 2022. It was noted that the ratio complied with the zero per cent limit indicating that IFAD’s current capital position was sufficient to absorb potential losses arising from its development operations, including losses that could potentially arise from unexpected stress events. The Committee was informed that the deployable capital ratio was expected to decrease over time in line with the leverage ratio, which had increased from 19.5 per cent in December to 24.8 per cent in June 2022. It was noted that the leverage ratio was gradually approaching the 35 per cent limit established in the Integrated Borrowing Framework, and that this threshold was expected to be reassessed, taking into consideration the evolution of IFAD’s business model. The Committee was also informed about the future revision of the capital adequacy framework, to be linked to the outcomes of the G20 Independent Review of Multilateral Development Banks’ Capital Adequacy Frameworks.
21. Committee members requested clarification about the trend in the leverage ratio and how it might affect the deployable capital ratio. Management highlighted that the deployable capital ratio had decreased slightly due to the combined effect of declining initial capital available (including due to foreign exchange unrealized losses) and additional requirements for non-core risks. Management also noted that the debt-to-equity ratio threshold had been established in 2013 and would eventually be reconsidered based on a thorough assessment.

22. **Outcome and follow up:** The report was considered reviewed.

(b) Asset and Liability Management Risk Report (AC2022/167/R.8) – for review

23. Management informed the Committee about the significant progress made by the Treasury Services Division (TRE) in establishing the foundations of appropriate asset and liability management (ALM), which would increase regular reporting of key metrics during 2023. It was noted that ALM risks were limited, but that the increased borrowing activities would need to continue to be effectively monitored, including with some improvements in ALM analytics. It was also noted that the introduction of private placement was changing IFAD’s payment profile and that the liquidity coverage of undisbursed balances was not yet comparable with that of other institutions. Sound derivative management capacity needed to be ensured in order to implement increasingly effective ALM strategies. The Office of Enterprise Risk Management (RMO) was closely monitoring the evolution of equity vis-à-vis unrealized foreign exchanges losses to assess the trajectory of financial ratios.
24. Committee members drew attention to the liquidity coverage of the undisbursed balance and requested clarification about the concentration of derivatives counterparts.
25. Management clarified that IFAD was operating with counterparts that were compliant with some rating requirements and that TRE was currently working with the Office of the General Counsel to on-board more counterparts with the purpose of building a more diversified counterpart universe.

26. **Outcome and follow up:** The report was considered reviewed.
- (c) Update on Enterprise Risk Management Framework operationalization - for information**
27. Management provided an update on the Enterprise Risk Management Framework (ERMF), noting that implementation was on schedule and that the targets – closing gaps in policies, processes and tools, and embedding risk considerations into decisions – were being effectively pursued. It was noted that the ERMF implementation medium-term plan had adopted some prioritization criteria based on a risk-based approach and that most key performance indicators had been achieved. The embedding of risk considerations into decisions had been fully recognized also by rating agencies.
28. **Outcome and follow up:** The update was considered noted.
- Corporate Risk Dashboard – for information**
29. Management presented an update on the recent corporate risk dashboard indicators for the second quarter of 2022, noting that the dashboard was maintained by RMO, with the cooperation of all departments. Management informed the Committee that there were no materially relevant breaches. The newly introduced executive summary provided an explanation of trends and, in the case of key risk indicators approaching or surpassing the set thresholds, also an indication of the initiatives under way to address the root causes of the highlighted trajectories.
30. Committee members welcomed the presentation and noted that many issues discussed during Committee meetings were reflected in the dashboard.
31. **Outcome and follow up:** The presentation was considered noted.
- Agenda item 9 – Updated on the implementation of IFAD’s Integrated Borrowing Framework (AC 2022/166/R.9) – for review**
32. Management provided an update on the implementation of the Integrated Borrowing Framework (IBF), noting that in order to finance the IFAD12 programme of loans and grants, US\$650 million needed to be secured as borrowing. The Committee was informed that the loan from EIB would provide the remaining resources required to fund IFAD12 needs. Management noted that the strategic choice to allow borrowing from private investors and multilateral development institutions had delivered successful results; however, there were some significant limiting factors that could increase funding risks for IFAD. A review of the IBF should be undertaken in the lead-up to IFAD13 to equip IFAD with the necessary tools to increase its resources to maximize finance for development.
33. Some Committee members requested clarification about demand in relation to the sizing of the borrowing programme.
34. Management clarified that the sizing has been determined in close collaboration with TRE and the Programme Management Department (PMD).
35. **Outcome and follow up:** The update was considered reviewed.
- Agenda item 10 – Updated on IFAD’s project procurement reform and key improvements on fiduciary oversight (AC 2022/167/R.10) – for review**
36. Management introduced the agenda item, noting the efforts made to increase project procurement capacity. In particular, Management highlighted the roll-out of a public procurement certification system for country directors and project management unit (PMU) staff. To date, 272 procurement officers had been trained under this capacity-building programme, and all country directors had been certified. It was noted that other multilateral development banks were considering scaling of the IFAD BUILDPROC grant to build capacity of staff in their projects. Furthermore, PMD had introduced an action plan on procurement-related issues deriving from internal audit reports in order to roll out best practices across IFAD operations.

37. Committee members welcomed the significant progress made and requested clarifications on the issuance of the procurement manual and details about capacity-building of external parties.
38. Management informed the Committee that the manual would be issued in January 2023 and provided details of training efforts under way with PMUs.
39. **Outcome and follow up:** The update was reviewed.

Agenda item 11 - Annual review of IFAD's Investment Policy Statement - (AC 2022/167/R.11 – Add.1 – Add.2) – for review

40. Management introduced the item, noting that the Investment Policy Statement (IPS) had already been reviewed and endorsed internally by the Financial Risk Management Committee and the Executive Management Committee. The proposed changes would align IFAD's methodology with that of the World Bank to improve efficiency of credit risk management in the liquidity portfolio. The Committee was also informed that once Treasury systems were in place, the current second-best rating rule would be replaced by a numerical rating floor composed of the average of the available ratings from at least two of the three credit rating agencies. Other changes in the IPS include:
 - (i) the amendment of the minimum credit rating requirements for covered bonds from A- to AAA;
 - (ii) the matching of Treasury assets and liabilities in respect of currency risk management;
 - (iii) the clarification of the purpose of each liquidity tranche;
 - (iv) specification that the buffer amount will be defined and monitored by the Financial Risk Management Committee;
 - (v) the clarification on the cap to the total exposure on investments transacted through the World Bank's Reserve Advisory and Management Partnership (RAMP) programme, which will be determined and monitored by the Financial Risk Management Committee;
 - (vi) the inclusion of inflation-linked bonds as eligible instruments.
41. Committee members requested clarification about global investment performance standards and reporting on investment performance.
42. Management clarified that global investment performance standards are a set of voluntary guidelines used by investment management firms throughout the world to encourage full disclosure and fair representation of investment performance. Management confirmed full compliance with such standards. Management clarified that fees are established by asset managers and are very transparent. Details were provided about pre- and post-compliance screening processes in trading activities, which is performed using global environmental, social and governance (ESG) system providers such as Bloomberg and Sustainalytics. It was also noted that, under the RAMP programme, IFAD had awarded the World Bank an investment mandate to manage funds on behalf of the Fund in 2017 across a number of supplementary and trust funds, with the aim of enhancing diversification of benefits and achieving cost-efficiency, while benefiting from the World Bank's technical advisory and training resources.
43. **Outcome and follow up:** The IPS was considered reviewed and would be submitted to the forthcoming Executive Board session for approval.

Agenda item 12 - Project financial management: Annual progress report including review of the Conceptual Framework on Financial Reporting and Auditing of IFAD-financed Projects (AC 2022/167/R.12) – for review

44. Management informed the Committee about the progress made in implementing reform of the project financial management (FM) functions. In particular, going forward, disbursement requests would be based on interim financial reports. The Committee was also informed about other achievements, such as: (i) introduction of interim financial reports for all ongoing projects; (ii) application of “straight-through” processing disbursements for low and moderate risk projects; (iii) updated IT tools and systems; (iv) modernization of FM policies and procedures to be principles-based rather than transaction-based and the shifting of checks to higher-risk projects. These achievements had repositioned IFAD at the forefront in terms of public financial management practices in international financial institutions. Management reconfirmed the ongoing applicability of the Conceptual Framework for Financial Reporting and Auditing of IFAD-financed Projects.
45. Committee members requested details about systems in place to support country teams to better understand reporting practices, and about action taken for ineligible expenditures and overdue audit reports.
46. Management provided the necessary clarifications, noting that monitoring functions are supported by software that provides alerts on project audit reports and that ineligible expenditures are closely monitored by operational staff and remedies are applied according to the underlying situation.
47. **Outcome and follow up:** The document was considered reviewed.

Agenda item 13 – Final external auditor’s audit strategy memorandum for the year ending 31 December 2022. (AC 2022/167/R.13) – for review

48. The external auditors provided a brief update on the external audit strategy presented at the 165th meeting on the basis of the interim audit work performed so far. It was noted that the risks pertaining to fair value calculation of loans at inception and to foreign currency translation, which had previously been communicated as significant, had been reassessed as normal; this revision was due to the mechanical nature of the processes.
49. Management informed the Committee about the recent impacts of exchange rate volatility. It was noted that IFAD conducts operations in various currencies. For reporting purposes, the accounting records are maintained in United States dollars. As a consequence, any material fluctuation in the exchange rates have always generated a retranslation impact on IFAD's accounts. Over the years, IFAD had reported both unrealized translation gains and unrealized losses. During 2022, the United States dollar, IFAD's reporting currency, had appreciated significantly against other currencies. In particular, appreciation against special drawing rights (SDR), in which IFAD still maintains most of its loans, was approximately 8.6 per cent. The unrealized translation loss in dollar terms was approximately US\$599 million at the end of September 2022 and US\$459 million as at 25 November 2022.
50. The Committee was also informed about the possibility of improving the accounting policy on measurement of financial instruments. With the support of KPMG International, Management was reassessing the appropriateness of the current measurement criteria of the loan portfolio, with a view to aligning IFAD’s financial statements with the balance sheet already disclosed in nominal terms and with the practice adopted by other international financial institutions. It was noted that IFAD's nominal financial statements have been always representative of IFAD's business model and used as a reference during the external rating exercises as well as for financial planning purposes.
51. **Outcome and follow up:** The item was considered noted.

Agenda item 14 – Update on the implementation of Anti-Money Laundering and Countering the Financing of Terrorism Policy, and controllership (AC 2022/167/R.14) – for review

52. The Committee was informed about the progress made in the functions of anti-financial crime and controllership. Since its inception, in 2020, the financial crime function had prevented IFAD from doing business with 34 parties and had enhanced monitoring on 71 parties. The controllership function had provided support in the review of 22 IFAD offices, standardizing and automating processes, enhancing controls, and building a culture of due diligence across IFAD’s global presence. During 2022, the financial crime prevention software was fully implemented to allow the screening of every vendor, consultant, partner, donor and staff member on a daily basis against 2 billion entries in the LexisNexis databases, which cover risks such as money-laundering, terrorism financing, tax evasion, fraud and corruption.
53. Management also noted the launch of detailed financial crime prevention procedures and dynamic dashboards to visualize and report on screening results. The revised “Know your Customer” questionnaires, aligned to industry standards, are conducted on a risk basis. IFAD personal data privacy was also advanced with the launch of gold standard guidelines, processes and system tools, all enabling IFAD to successfully pass the European Union Pillar Assessment. The Controllership function launched digital signatures for IFAD documents and implemented the delegation of authority with budget decentralization to country directors in the East and Southern Africa Region and the West and Central Africa Region. Management informed the Committee about the extensive training programme conducted on financial crime prevention, personal data privacy and controllership.
54. Committee members welcomed the update and requested details about screening measures in some countries as a result of internal audit reports.
55. Management clarified that IFAD took immediate action on such issues in accordance with the policy and in collaboration with AUO, the Ethics Office and the Office of the General Counsel.
56. **Outcome and follow up:** The document was considered reviewed.

Agenda item 15 – Revised terms of reference and rules of procedures of the Audit Committee (AC 2022/167/R.15) - for review

57. Committee members briefly discussed document AC2022/167/R.15, which contained amendments to operationalize the complaints procedures for alleged non-compliance with IFAD's SECAP within the terms of reference and rules of procedures of the Audit Committee.
58. **Outcome and follow up:** To allow for more substantive consideration of the amendments proposed, the Committee decided to postpone the agenda item to the meeting in April 2023, thus removing the item from the December Board agenda. In the meanwhile, Committee members would circulate their observations.

Agenda item 16 – Audit Committee work programme for 2023 – (AC 2022/167/R.16) - for approval

59. **Outcome and follow up:** The work programme for 2023 was approved, with the following changes:
- (i) inclusion of one structured review on business continuity at the June meeting;
 - (ii) consideration of the revised terms of reference and rules of procedures of the Audit Committee at the meeting in April 2023.

Furthermore the work programme would be revised to reflect the following changes:

- (i) as presented under agenda item 4; quarterly loan arrears and quarterly IFAD12 contribution reports will no longer be produced as stand-alone documents and instead be embedded as supplementary appendices in the annual financial statement highlights prepared by FCD, in order to reduce the volume of documents presented to governing bodies;
- (ii) as presented under agenda item 14; updates on the controllership and financial crime functions will be provided on an ad hoc basis when significant changes are noted, including any updates to the Internal Control Framework and the Anti Money Laundering and Countering the Financing of Terrorism Policy.

Agenda item 17 - Business continuity and effectiveness of working methods – Impact of COVID-19

- 60. Management provided an update on business continuity and adaptation activities in response to the COVID-19 pandemic, highlighting the progress made since the last meeting and noting lesson learned.
- 61. Management informed the Committee that it is still working on return-to-office plans in collaboration with the other Rome-based agencies, UN country teams and United Nations medical directors.
- 62. The Committee was informed that all offices are open with the exception of Haiti and Burkina Faso (currently closed for security reasons); headquarters occupancy is approximately 50 per cent of the workforce and teleworking arrangements will be extended.
- 63. Management informed the Committee of progress made in implementing the Rural Poor Stimulus Facility, noting that approximately US\$85 million had been disbursed to about 64 projects across all regions.

Management noted the following lessons learned:

- (i) the importance of resilient fit-for-purpose technology and cybersecurity;
 - (ii) the importance of workplace security, safety and healthcare, including access to medical services and vaccines;
 - (iii) the relevance of effective coordination with sister agencies and UN country teams on the ground;
 - (iv) the positive and negative impacts of teleworking on work/life balance, i.e. the increased flexibility that was very positive for staff, counterbalanced by some challenges with regard to respecting work boundaries. Overall a mixture of on-site and remote work appeared to be the most efficient and effective option.
64. **Outcome and follow up:** The Committee welcomed the update and requested the inclusion of one structured review on business continuity at June 2023 Audit Committee meeting, including a stocktake of the lessons learned in recent years and IFAD's adaptation to the new normal.

Agenda item 18 – Other business

- 65. The following internal audit reports were discussed in closed session:
 - (a) IAR/22/08 - Audit of the supervision of the country programme in Madagascar
 - (b) IAR/22/10 - Audit of the People, Processes and Technology Plan (PPTP)