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## **Minutes of the 169<sup>th</sup> meeting of the Audit Committee**

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## **Minutes of the 169<sup>th</sup> meeting of the Audit Committee**

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## Minutes of the 169<sup>th</sup> meeting of the Audit Committee

1. The 169<sup>th</sup> meeting of the Audit Committee was held on 22 June 2023 in hybrid modality.
2. The meeting was attended by Committee members representing Algeria, Angola, Argentina, China, Germany, Italy, United Kingdom, United States and Bolivarian Republic of Venezuela. Representatives for the Dominican Republic participated as observers. The meeting was also attended by: the Associate Vice-President and General Counsel, Office of the General Counsel (LEG); the Associate Vice-President, Chief Financial Officer and Chief Controller, Financial Operations Department; the Associate Vice-President and Chief Risk Officer, Office of Enterprise Risk Management; the Associate Vice-President, Programme Management Department (PMD); the Director and Controller, Financial Controller's Division; the Director and Treasurer, Treasury Services Division; the Director, Office of Audit and Oversight (AUO); the Secretary of IFAD; the Chief of Ethics, Ethics Office; the Director, Operational Policy and Results Division; the Director, Information and Communications Technology Division; the Director, Administrative Services Division; and a number of other IFAD staff members.

### **Agenda item 2 – Adoption of the agenda (AC 2023/169/R.1) – for approval**

3. The agenda was adopted, with the following specifications:
  - The Update on IAR/23/01 - Audit of the supervision of the country programme in Niger would be discussed in open session.
  - The external review of IFAD's investigation practices and update on investigations undertaken by the Office of Audit and Oversight (for which an addendum has been posted confidentially) would be split into two separate items:
    - (a) The external review of IFAD's investigation practices – discussed in closed session; and
    - (b) The update on investigations undertaken by the Office of Audit and Oversight – discussed in open session.

### **Agenda item 3 – Minutes of the closed session of the 168<sup>th</sup> meeting of the Audit Committee (AC 2023/169/R.2) – for approval**

4. The minutes of the closed session of the 168<sup>th</sup> meeting were approved with no amendments.

### **Agenda item 4 – External auditor's report on internal control and accounting procedures (AC 2023/169/R.3) – for review**

5. The external auditor provided an overview of the report on internal control and accounting procedures. It was noted that observations did not represent deficiencies in internal controls over financial reporting and that some observations related to improving efficiencies. Of the five recommendations, two had high priority while the others were of moderate priority. The external auditor's recommendations related to:
  - Refreshing cybersecurity and other financial systems controls (cybersecurity was increasingly pervasive and risks were growing in most company environments);
  - Enhancing focus and efficiency of the financial reporting process over the investment portfolio;

- Automation in accounting and financial reporting to further improve technological solutions and eliminate manual intervention and controls to the greatest extent possible;
  - Internal controls over environmental, social and governance (ESG) principles would become an important requirement under the International Financial Reporting Standards (IFRS); it was recommended that controls be developed also to cover key performance indicators (KPIs) related to ESG with the ultimate aim of producing a financial reporting disclosure framework or tracking such KPIs in the IFAD Annual Report;
  - Addressing the increasing operational risks deriving from decentralized functions.
6. Management welcomed the report and recommendations of the external auditor, and expressed its commitment to implementing such recommendations in a detailed action plan. Management noted that cybersecurity was a risk of relevance to all institutions. Management expressed its commitment to strengthening controls, and added that financial reporting would benefit from several initiatives such the Treasury management system and the enhanced IFRS9 loan credit risk system. Some progress had been made on ESG reporting following a cross-departmental effort to begin certain disclosures for the 2023 fiscal year. Management acknowledged the increasing risks concerning oversight of decentralized functions and highlighted some initiatives and controls that were currently being undertaken or being planned to address this.
7. **Outcome and follow-up.** The report was deemed noted. The Committee would be updated on the implementation of the external auditor's recommendations at a future meeting, including the identification of the responsible area, the resources required and the specific timeline to address each recommendation.

**Agenda item 5 – External auditor's audit strategy memorandum for the year ending 31 December 2023 (AC 2023/169/R.4) – for review**

8. The external auditor provided an overview of the audit strategy for the year ending 31 December 2023, the audit opinion on the consolidated financial statements of IFAD, as well as IFAD-only, and the attestation report over Management's report on the effectiveness of internal controls. It was highlighted that the audit strategy was based on a top-down methodology, based on the auditor's understanding of the entity environment, the risks and the controls. The audit work on controls integrated substantive testing. The external auditor explained audit materiality and the reasons for its value. The only significant presumptive risk pertained to Management override of controls, which was aligned to industry requirements. The risk of fraud and revenue recognition was noted as rebutted. The reporting timetable would be aligned to that adopted for the 2022 audit. The external auditor would rely on the support of IT technical specialists and actuarial specialists.
9. Committee members welcomed the overview of the audit strategy. They requested clarification about rebuttable risk assumptions and significant risks, and details about processes and key controls.
10. The external auditor clarified that, in line with audit literature, the risk of fraud and revenue recognition could be rebutted. In the case of IFAD, the risk of fraud on revenue recognition was very narrow (revenue derived from the loan portfolio and the investment portfolio was objectively determinable as being at low risk). The external auditor explained that the materiality assessment of uncorrected misstatements over a certain threshold would lead to considering the financial statements as not presented in a true and fair manner. If the misstatement was less than de minimis, it was not considered as relevant for the Audit Committee. The external auditor also clarified that the determination of the number of process flows and key controls was a Management prerogative and provided some

examples (e.g. bank reconciliations, investment reconciliations, data integrity due to process interfaces).

11. Management informed the Committee that the external auditor's fees for fiscal year 2023 had been adjusted to EUR 167,000 to reflect increased cost of living.
12. **Outcome and follow-up.** The agenda item was noted.

**Agenda item 6 – Proposed dates for meetings of the Audit Committee in 2024 (AC 2023/169/R.5 + Corr.1) – for approval**

13. **Outcome and follow-up.** The document was approved.

**Agenda item 7 – Enterprise risk management**

**(a) Capital Adequacy Report – December 2022 (AC 2023/169/R.6) – for review**

14. Management introduced the agenda item noting that the document provided a synopsis of IFAD's capital consumption and trends in its deployable capital (DC) ratio. It was noted that the DC ratio had decreased slightly, from 40.2 per cent in December 2021 to 39.5 per cent in December 2022, above the 0 per cent threshold, indicating that IFAD's current capital position could absorb potential losses arising from its development operations, including those that could potentially arise from stress events. Furthermore, the DC ratio was expected to decrease over time as leverage increased, and IFAD's capital position was showing resilience, notwithstanding the credit deterioration observed in the loan portfolio, whose average rating was currently B. Management also noted that stress testing indicated that the capital buffers were sufficient to cover adverse events. The Committee was informed about the future revision of the Capital Adequacy Policy, as per best practice, and of a future review of methodological assumptions to assess the relevance of the G20 recommendations for IFAD. Finally, members were advised that AUO was in the process of conducting an audit of the Capital Adequacy Framework, which was expected to give useful indications for the constant improvement of IFAD's risk management architecture.
15. Committee members welcomed the document and requested clarification about the possibility of IFAD attracting more investments and increasing leverage; a timeline for the review of the Capital Adequacy Policy; and the methodology to reflect grant disbursements to countries in debt distress or at risk thereof. Members also asked for details of the stress tests, suggesting that the three adverse scenarios presented denote some degree of correlation between one another.
16. Management clarified that the review of the Capital Adequacy Policy was at the preliminary stage and that the intention was to submit a comprehensive review as soon as possible for the attention of the Audit Committee. Management noted that grants to countries in debt distress or at risk thereof were computed as consumption of equity and that stress tests were based on the best standards currently in place for this kind of exercise.
17. **Outcome and follow-up.** The document was deemed reviewed and would be submitted to the forthcoming Executive Board session for review.

**(b) Update on Enterprise Risk Management Framework operationalization**

18. Management presented the progress made on the operationalization of the Enterprise Risk Management Framework in 2023, following the 2022 report. It was noted that the majority of the structural activities envisaged in the 2023 workplan had been already defined and finalized or were in the process of being launched. In addition, the Committee was informed that: initiatives to enhance risk culture within the organization were already under way (a specifically designed compulsory e-learning module for staff was being launched); risk-focused analyses of non-

sovereign operations' processes and tools were being conducted; and operational risk assessment tools (in particular the operational control risk self-assessment process) were being enhanced in order to build mitigation capacity.

**(c) Corporate Risk Dashboard**

19. Management presented the main outputs of the Corporate Risk Dashboard (CRD). It was noted that, for the first quarter of 2023, 90.6 per cent of the key risk indicators (KRIs) were within tolerance parameters.
20. Management informed the Committee about future developments in the pipeline, subject to prioritization, such as the revision of KRIs and the development of early warning indicators.
21. Committee members welcomed the updates and requested clarification about early warning indicators, and details about some KRIs, such as the vacancy rate and the pledge rates.
22. Management clarified that early warning indicators on the KRIs' potential trajectory were under development as part of the goal of continuing to improve the relevance of the CRD. Management also clarified that the vacancy rate was linked to recruitment process technicalities and that the measures necessary to improve it were being implemented and would progressively bear fruit. For the level of pledges, it was noted that the dashboard provided information based on projections as well as on actual pledges, which was useful for gauging how the encashment of pledges affected both the financial and the strategic profile of the Fund.
23. **Outcome and follow-up.** The documents were deemed reviewed and would be submitted to the forthcoming Executive Board session for information.

**Agenda item 8**

**(a) External review of IFAD's investigation practices (AC 2023/169/R.7) – for review**

24. Meeting in closed session, the Audit Committee considered the final report of the external review of IFAD's investigation practices, together with Management's plan for addressing the recommendations contained therein, which had been shared with Committee members confidentially.
25. Members welcomed the positive findings, noting that the procedures and practices in place at IFAD met internationally recognized standards and best practice, and that there was trust in the impartiality and confidentiality of the investigations. Furthermore, the report facilitated a greater understanding of the investigation function and related challenges, including those related to interaction with national systems and authorities.
26. AUO thanked the Committee members for their positive feedback, noting the benefit of the consultative process in finalizing the terms of reference for the review. Management also reassured members that cost-effectiveness would be a criterion in implementing the recommendations, in particular those related to caseload management and staffing. Management accepted the kind offer of one Committee member to share the operating procedures in use in their investigation unit, as input for the development of comprehensive operating procedures for IFAD's investigation unit.
27. **Outcome and follow-up.** The report was deemed reviewed.

**(b) Update on investigations undertaken by the Office of Audit and Oversight**

28. Returning to open session, AUO provided an update on the trends and salient issues arising from recent investigation and sanctions cases. It was noted that the

average number of internal and external cases had increased by 44 per cent. This was partly explained by an increase in the referrals from audits of country programmes as well as increased reporting by project staff. Fraud and corruption were still the prevailing types of allegations (accounting for over 80 per cent, of which 75 per cent related to project staff and government officials, and 5 per cent related to project implementers). Due to the continued high number of cases involving project staff and government officials, the integrity due diligence list was launched in 2022.

29. AUO reported that its response rate to allegations was improving, mainly due to streamlining intake and preliminary analysis, and through better prioritization. During this period, IFAD had once again delivered a high number of sanctions emphasizing its effective zero-tolerance approach to proven fraud and corruption cases. Joint audit/investigation missions had increased, which allowed lessons learned from investigations to inform audit recommendations and the reports on cross-cutting issues. Lessons learned were also shared through communications to Management on specific issues.
30. Committee members welcomed the update and requested details about referrals; AUO's approach in relation to project officials, who were the subject of the majority of fraud and corruption allegations; the reasons for the increase in allegations; and financial exposure.
31. AUO noted that formal and legal referrals by IFAD to national anticorruption or law enforcement authorities were rare. "Soft" referrals were more frequent, whereby IFAD contacted the implementing counterpart ministry and requested them to address a specific issue, while at the same time putting in place actions to address the relevant project risk. Such actions were undertaken in coordination with PMD, the Financial Management Services Division and LEG. AUO informed the Committee that the recently concluded external review of the investigation function also contained a recommendation on how to formalize the process and determine the criteria to apply for referrals, and how to reconcile the legal risks and potential benefits. AUO noted that the increase in allegations was also linked to several recent internal audit missions to higher risk country programmes and the increased visibility of communication channels. AUO clarified that IFAD had investigative and sanctions authority over most project officials, the remuneration of whom was funded through the IFAD loan or grant. Even in cases where IFAD had no sanctions authority over project officials suspected of involvement in prohibited practices, the risk was mitigated through operational actions (placing the name of the officials on the internal integrity due diligence list, declaring associated project expenditure as ineligible and objecting to the continuing role of such officials in IFAD-funded activities). It was noted that the IFAD debarment list was not considered as a cross-debarment list by multilateral development banks; however, information on debarments was shared on a need-to-know basis, with restrictions as to its use or disclosure.
32. **Outcome and follow-up.** The update was deemed noted.

**Agenda item 9 – Business continuity and effectiveness of working methods – Impact of COVID-19: Lessons learned**

33. Management provided an update on business continuity practices. It was highlighted that no activities were currently being performed by the task force on COVID-19. It was noted that IFAD remained closely aligned with the other Rome-based agencies. The Committee was informed that at present no offices were closed because of COVID restrictions, but that the Sudan office was closed due to the prevailing security situation. The office occupancy levels varied by duty station. At headquarters, occupancy stood at approximately 50 per cent. The Committee was informed of the adoption of a new teleworking policy, which foresaw the possibility of remote working for up to 3 days per week. It also included some

exceptional arrangements (e.g. up to 10 consecutive teleworking days once in a calendar month, subject to an overall ceiling of 35 cumulative days per year). Management provided details about the impacts on operations, noting that approximately US\$85 million had been disbursed to 64 projects across all regions to address the effects of the pandemic, just over 51 per cent to low-income countries and the other 49 per cent to lower-middle-income, middle-income and upper-middle-income countries. Nine out of 10 projects reported provision of inputs of productive packages; many projects adopted practices focused on digital services (e.g. e-vouchers for inputs, early warning advisory services, digital banking services). It was noted that a comprehensive report on the Rural Poor Stimulus Facility (RPSF) would be submitted to the forthcoming Executive Board session in September. The Committee was also told that Management was reviewing the business continuity policy, embedding lessons learned from COVID-19, Decentralization 2.0 and the core elements of the United Nations Organizational Resilience Management System.

34. Committee members welcomed the update and requested some additional details on lessons learned from the RPSF and on IT security risks.
35. Management highlighted that a key lesson learned was the need to continue working very closely with the other Rome-based agencies, other international organizations at headquarters and sister agencies in the field, and to refine robust crisis communications systems and protocols. Management clarified that the RPSF aimed to protect beneficiaries from immediate shocks resulting from pandemic-related restrictions (e.g. closing down of markets, lack of access to credit). Management also noted that lessons learned were embedded in the design of new projects under the Crisis Response Initiative. Management was glad to report that, during the pandemic, everything had worked better from an IT perspective than in other institutions thanks to specific testing exercises conducted prior to and during the pandemic.
36. **Outcome and follow-up.** The update was deemed noted.

**Agenda item 10 – Draft provisional agenda for the 170<sup>th</sup> meeting of the Audit Committee (AC 2023/169/R.8) – for review**

37. **Outcome and follow-up.** Document AC 2023/169/R.8 containing the draft agenda for the 170<sup>th</sup> meeting was reviewed with the inclusion of an additional item on the oversight of the IFAD ethics function.

**Agenda item 11 – Asset and liability management report as at December 2022 (AC 2023/169/R.9) – for review**

38. Management presented the first semi-annual asset and liability management (ALM) report, noting that the report covered the main risk areas such as liquidity risk, interest rate risk and currency risk. It was highlighted that prior to its submission to the Audit Committee, the report was reviewed by the Financial Risk Management Committee (FRMC). Management explained that the report introduced additional metrics to assess mismatches between sources and uses of funds and exposures, and the sensitivity of the balance sheet to interest rate and currency risk measures. It was noted that, as at December 2022, all liquidity and capital ratios were compliant with their policy limits. In addition, the undisbursed balance of loans and grants was expected to grow in 2023 and the interest rate and currency risks were mainly associated with the concessional loan portfolio.
39. Audit Committee members requested details on the quality of data and periodicity of checks, and trends with regard to the undisbursed balance and refinancing risk.
40. Management provided the requested details, confirming that the ALM tool was set up with in-depth interdivisional work to ensure adequate data quality and also confirmed that monitoring activities on liquidity risk were carried out frequently –



on a weekly basis – while comprehensive reports were provided to FRMC on a quarterly basis. Management noted that refinancing risk was natural for institutions with borrowing activities and that such risk was mitigated with proper planning. Management also clarified that future reporting would include a simpler explanation of the significance of the results, a trend analysis and some technical financial definitions.

41. **Outcome and follow-up.** The document was deemed reviewed and would be submitted to the forthcoming Executive Board session for information.

**Agenda item 12 – Other business**

**(a) Update on IAR/23/01 - Audit of the Supervision of the Country Programme in Niger**

**(b) Internal audit reports**

42. In response to a Committee member's request, Management and AUO provided an update on the implementation of the risk mitigation actions in relation to the findings of the audit of IFAD's supervision of the country programme. AUO reported that four out of five agreed actions due for completion by 30 April 2023 were implemented. Just one recommendation was overdue and this was expected to be addressed in the forthcoming "Updated Approach for IFAD's Engagement in Fragile Situations". The other recommendations would fall due at end-June and end-December 2023 and would be followed up in subsequent Audit Committee meetings. Management updated the Committee on initiatives under way to strengthen fiduciary elements and transparency; in particular the Committee was informed about the issuance of a revamped procurement manual and roll-out of the new end-to-end procurement system. As part of the activities to strengthen government fiduciary capacity in countries with weak institutions, there would be an informal seminar in July focused on fragility diagnostics and risk management in fragile situations. In addition, the Integrated Risk Management Framework would address specificity for fragile situations. The Committee was informed that guidelines for financial management and procurement in fragile situations were under review and that the updated approach would rely on better use of ICT digital systems.
43. Committee members requested clarification about reporting on control weaknesses and significant findings. Some members requested Management to explore the possibility of sharing the main findings of internal audits with governments for information and offered to share templates that could be adapted by IFAD.
44. AUO clarified that common findings of an institutional scope and issues arising from this type of audit were included in a periodic cross-cutting audit report to be circulated later in the year. It was noted that the findings were welcomed by Operations, especially for lessons learned in challenging contexts.
45. **Outcome and follow-up.** The update was deemed noted. The next Audit Committee meeting would include a status update and Management was requested to come back with some lessons learned and implementation points.