
Project financial management: Annual progress report, including review of the Conceptual Framework on Financial Reporting and Auditing of IFAD-Financed Projects

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Action: The Executive Board is invited to take note of the report on project financial management.

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I. Introduction and summary

1. IFAD reports annually to the Audit Committee on:
 - (i) the application of project financial management assurance policies and practices, including developments, trends and results of the most recent project audit cycle; and
 - (ii) the ongoing applicability of the Conceptual Framework on Financial Reporting and Auditing on IFAD-Financed Projects.
2. The current annual review confirmed the continuing adequacy and applicability of the principles spelled out in this framework.
3. IFAD's policies and practices for project financial management are core elements of the arrangements to meet its fiduciary obligations – i.e. to provide reasonable assurance that the proceeds of financing are used economically and efficiently only for their intended purposes and are fully and transparently accounted for. These arrangements often rely on the public financial management systems and processes of borrower countries, when appropriate. The core objective of these policies is to support achievement of the development objectives of each operation financed, in line with IFAD's mandate.
4. The extensive reforms of project financial management and disbursement processes that were introduced in 2021 have successfully been completed. With these reforms, other multilateral development banks (MDBs) have acknowledged IFAD's practices as being at the forefront of international best practices. Greater focus has been placed on increasing project financial discipline geared to the achievement of the development objectives. These reforms, centred on the corporate People, Processes and Technology Plan strategy, have generated both internal and external efficiencies and entailed people upskilling and the streamlining of internal work flows through IT developments and enhancements. Relevant financial management policies and procedures have been updated to make them principles-based, and the risk-based disbursement validation functions have been integrated with project financial management. The key assurance pillars have been expanded to emphasize external audits, participation in field missions and regular financial reporting during project implementation. These reforms contribute to a framework for strengthened fiduciary assurance and timely availability of funds to projects.
5. The role of the Financial Management Services Division (FMD) is gradually evolving, aligned with corporate responsibilities. As staff of a front-line and largely decentralized division, finance officers are often called upon to act as finance ambassadors, interacting with ministries on financial and debt matters, with projects and programme teams on fiduciary arrangements, playing a key role in financing negotiations. In this increasingly complex role, they support the management of evolving issues on financing conditions, such as uptake of the Borrowed Resource Access Mechanism and the level of concessionality in IFAD financing packages.
Project audit reports/financial management ratings
6. Project audit reports remain a key tool for fiduciary assurance. The timeliness and quality of audit and accounting standards are generally considered adequate. As of this writing, 92 per cent (226) of project audit reports due for financial year

(FY) 2022 had been received, leaving 19 overdue; 67 per cent were received on time (see annex II, table 2), a slight deterioration over last year (70 per cent).

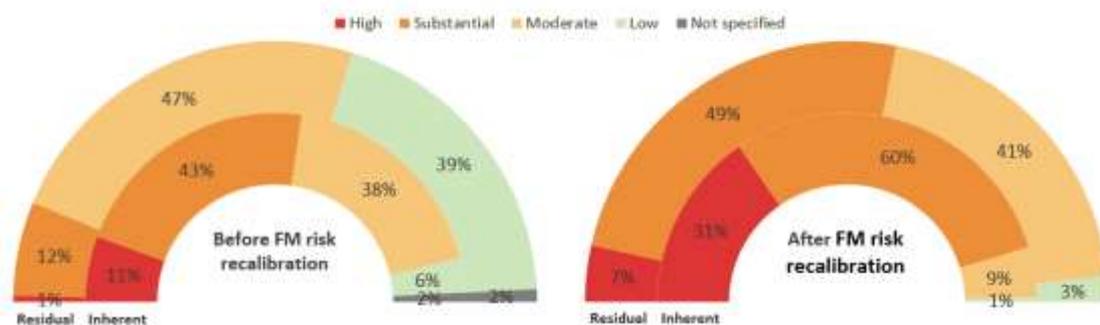
7. The quality of financial reporting rated satisfactory or highly satisfactory deteriorated from the highest record of 55 per cent in FY 2021 to 33 per cent in FY 2022, while those rated either moderately unsatisfactory or unsatisfactory increased from 11 per cent in FY 2021 to 26 per cent in FY 2022. This change is significant and reflects the risk rating recalibration process described in section II. Capacity-building efforts have been intensified to address this change.

II. Financial management practices and oversight

8. **Enhancement of financial management risk calibration.** The project financial management risk-based assurance framework, which falls within IFAD's programme delivery risk domain,¹ underpins the activities of the FMD. In 2023, FMD introduced a revised framework to align more fully with the updated corporate guidelines and ensure a consistent approach within countries, regions and globally.² The main changes relate to a consistent distinction between inherent³ and residual risks, where residual risk⁴ ratings recognize the expected benefits of mitigating measures only when they have been implemented. The recalibration pivots attention towards mitigating actions during implementation, thereby strengthening assurance arrangements.
9. After extensive review and rebalancing across regions, the consolidated updated risk profile for the portfolio is shown in figure 1. The proportion of high or substantial inherent risk projects increased from 54 per cent to 91 per cent, reflecting the country environment and project financial management arrangements at design without mitigation actions. The proportion of high or substantial residual risk projects increased as well, from 13 per cent to 56 per cent. Financial management risk ratings continue to influence the volume and timing of checks and balances, including the frequency of missions and disbursement modalities.

Figure 1

Financial management (FM) risk profiles of investment projects and country grants before and after the enhancement of financial management risk calibration (as at 30 September 2023)



10. **Completion of FMD structural reform.** The two-year journey of structural reforms (see annex I) is complete. These reforms, outlined below, have helped

¹ Risks to the ability to achieve the expected results in IFAD-supported projects, programmes or strategies and the risk of unintended consequences.

² "Enhancing Risk Management in IFAD Investment Projects – Guidance for Staff," Operational Policy and Results Division, IFAD, March 2021.

³ Inherent risk is the risk that the project financial management system will not operate as intended due to factors related to the project implementation environment, which IFAD has a limited ability to control. It is the level of risk before/without factoring in the effect of any mitigation measures or controls applied or to be applied by the borrower.

⁴ Residual risk is the level of risk remaining after recognizing the actual implementation of the mitigation measures/controls and thus reflects the actual risk identified at the time of the assessment. Residual risk is assessed at design and during implementation.

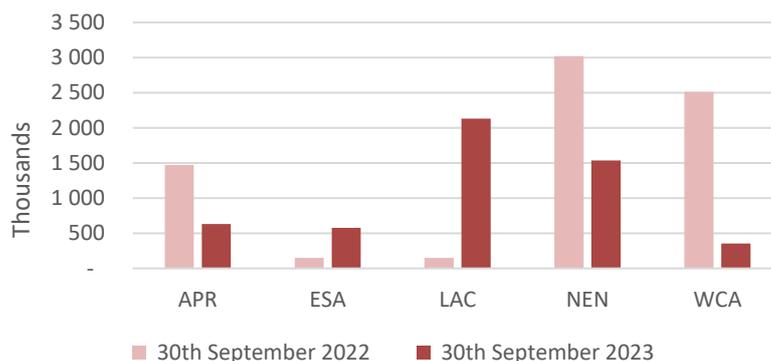
rebalance fiduciary oversight and checks across disbursement, supervision and project auditing.

- (i) Improved liquidity management in projects, by introducing 6-monthly forward planning of funding needs for disbursement purposes;
 - (ii) Enhanced project financial discipline and monitoring, with quarterly financial reporting.
 - (iii) Strengthened mutual reliance on corporate risk assurance frameworks, aligning mission participation as well as the validation of disbursement requests to documented financial management risks. This fosters higher risk tolerance and management, emphasizing implementation support.
11. The milestones achieved in 2023 include the following:
- (i) Modified disbursement validation workflow in the IFAD Client Portal has successfully been implemented, streamlining processes for the review and validation of withdrawal applications based on interim financial reports and automated online borrower submission of financial documents.
 - (ii) The IFAD Handbook for Financial Reporting and Auditing has been updated to reflect the requirement of regular interim financial reporting, developments in acceptable accounting and reporting standards and the updating of auditors' terms of reference, incorporating lessons from the audit review exercises and experience in the field.
 - (iii) The disbursement and financial control instructions to borrowers ("Project Financial Management and Financial Control Arrangements Letter – FMFCL") is fully automated, yielding increased efficiencies.
12. **Ineligible expenditures.** FMD regularly tracks and monitors potential and/or confirmed ineligible expenditures,⁵ which are often identified through supervision missions and external project audits.
13. The total amount of ineligible expenditures is volatile, as the amounts recorded are continuously reviewed, adjusted, confirmed and resolved. At the time of reporting, the total amount outstanding was US\$5.2 million, lower than the figure reported in 2022 (US\$7.3 million).
14. **Remedies.** Ineligible expenditure and late submission of audit reports are common reasons for remedial action by IFAD. When non-compliance is identified, early engagement with projects and ministries is sought to encourage prompt compliance, and where possible, soft remedies considered, to avoid a more detrimental impact on project implementation.⁶
15. When delays arise in the submission of audit reports, warning notices are issued to borrowers for delays beyond 90 days, with formal suspension of the right to withdraw funds due after 180 days. As reported last year, the only country subject to suspension measures stemming from unresolved financial management issues was the Bolivarian Republic of Venezuela, due to its failure to submit project audit reports for 2017 and 2018; these measures are still in effect. Further details on compliance with the audit policy across IFAD's portfolio are presented in section III.

⁵ The term "ineligible expenditures" refers to the use of financing proceeds for expenditure not compliant with the financing agreement or otherwise not in line with the General Conditions for Agricultural Development Financing, section 4.07.

⁶ Soft remedies may include temporarily suspending the borrower's right to use an advance account and requesting substitute expenditure that meets IFAD's eligibility criteria.

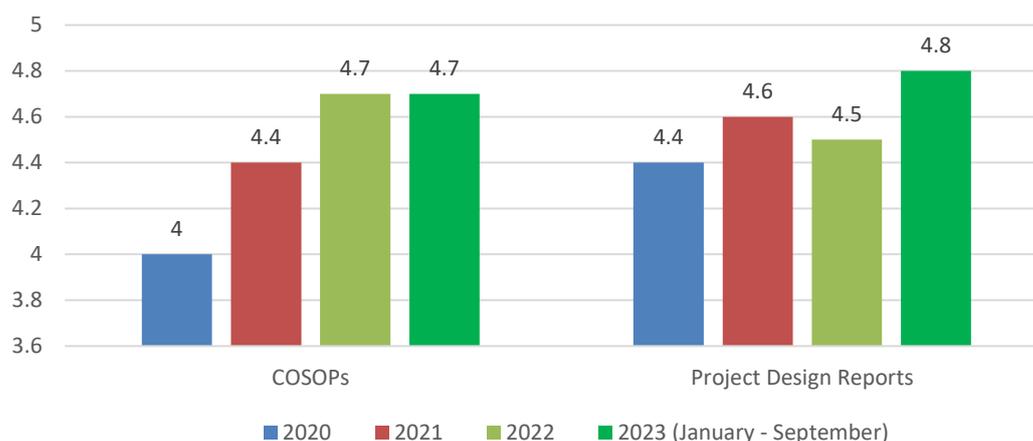
Figure 2
Unconfirmed and confirmed ineligible expenditures by region*
(Thousands of United States dollars)



* The following abbreviations are used for regions: Asia and the Pacific (APR); East and Southern Africa (ESA); Latin America and the Caribbean (LAC); Near East, North Africa and Europe (NEN); West and Central Africa (WCA).

16. **Participation in design and supervision.** In-person participation in missions has resumed in 2023 post-COVID-19, although security restrictions may apply. A total of 202 financial management missions⁷ were fielded from January to September 2023, with 47 per cent participation by finance officers. The resumption of in-person missions facilitates closer monitoring of financial management aspects in the field, strengthens fiduciary assurance and allows for the development of closer relationships with project finance staff, thereby identifying capacity-building needs.

Figure 3
Financial management enhanced development effectiveness matrix (DEM+) average ratings (all regions) by year



Quality assurance

17. As part of the corporate quality assurance processes, an independent FMD unit conducts DEM+ reviews of financial management aspects for all country strategic opportunities programmes (COSOPs), concept notes and project design reports submitted to OSC for management approval. The process enables FMD to gradually build learning into our work. Compared to the previous year, the average rating for COSOPs remains unvaried, while there has been some improvement in the quality of financial management contributions at the project design stage (see figure 3).
18. The DEM+ review results are analysed to highlight good practices and areas of further improvement, which are compiled into quarterly Learning Notes for front-line teams.

⁷ These include: design, start-up, supervision and completion missions, implementation support and midterm reviews.

19. In 2023, FMD launched regional deep dives as a channel for tailored review of practices in the decentralized teams, feedback on the results of quality assurance, knowledge and skills transfer and facilitation of harmonized approaches across the decentralized teams. In 2023, two regional deep dives have been conducted, one for APR and the other, for WCA.
20. As part of FMD’s quality assurance procedures, project audit reports are subject to internal peer review on a sample basis, with the object of developing a standardized approach. Further assurance was sought on the quality of project audit reports and the relevance of audit and financial reporting arrangements applied through the sixth annual independent review of project external audit reports.

Table 1

Number of DEM+ reviews conducted by document type

	<i>Number of DEM+ reviews conducted by document type</i>			
	<i>2020</i>	<i>2021</i>	<i>2022</i>	<i>2023 (January – September)</i>
COSOPs	1	7	11	5
Project concept notes	17	16	20	21
Project design reports	19	19	20	16

21. **Financial management capacity-building.** Capacity-building is conducted internally for financial management consultants and at the project, country, subregional and regional levels. So far in 2023, FMD has held five in-person regional workshops for project staff, as well as external auditors and ministry representatives, focusing on the update of recent FMD reforms and best practices, including the importance of using international standards.
22. The Chartered Institute of Public Finance and Accountancy conducted a professional certification programme for IFAD entitled Achieving Project Excellence in Financial Management, which ran from 2021 to 2023, reaching 169 IFAD-funded projects and training 230 project staff. The programme completion rate was only 64 per cent, due, among other things, to staff turnover, which is a persistent issue for many projects.
23. **Lending term operations.** FMD is responsible for the financial side of financing negotiations. A refresher course on lending terms was conducted in April 2023 for all FMD finance officers, followed by a mandatory internal exam, which all have passed.
24. **Transparency.** In keeping with IFAD’s commitment to increasing transparency and accountability in the use of donor funds, the Fund systematically discloses project audit reports on its website.
25. **Strategic engagement.** Strategic engagement with MDBs in 2023 continued virtually as well as in-person and through international forums. Seven working group sessions have been held this year. In-person meetings have been held with the International Organization of Supreme Audit Institutions Donors Working Group, the World Bank, the Inter-American Development Bank, the International Monetary Fund and the MDB financial management working groups, following up as well on potential developments in artificial intelligence for the review of project audit reports and related areas.

III. Project audit reports for financial year 2022⁸

26. **Audit arrangements.** External audit of IFAD-financed projects is a key tool for fiduciary assurance, given its greater geographical coverage than supervision missions. IFAD's review of project audit reports includes:
 - (i) Reliance on country systems – i.e. the use of Supreme Audit Institutions, currently at 43 per cent (see annex II, table 1);
 - (ii) Adherence to international standards (financial reporting and audit); and
 - (iii) Assessment of audit quality and the timeliness of audit report submission.
27. The main findings for 245 projects analysed for FY 2022 are summarized below.
28. **Timeliness.** As at 30 September 2023, 92 per cent (226) of project audit reports due for FY 2022 had been received, leaving 19 overdue. Only 67 per cent were received on time (see annex II, table 2) (2021: 70 per cent).
29. The timeliness of internal FMD review of audit reports is closely monitored, with 72 per cent of audit reports signed off on within the prescribed timeline of 60 days (2021: 68 per cent).
30. **Audit report findings.** The percentage of qualified audit opinions in FY 2022 was similar to that of the previous year (9 per cent), as reported in annex II, table 3; ten projects received qualified audit opinions with exceptions and three projects qualified opinions with limitation in scope.
31. Analysis shows that the main control issues are recurrent and common across all five regions. They include: (i) weak internal controls over project implementation or non-compliance with approved procedures; (ii) inadequate procurement procedures and/or poor contract management; (iii) ineffective use of accounting systems; (iv) failure to provide adequate supporting documentation; (v) limited use of or deviation from international accounting standards; and (vi) ineligible expenditures.
32. **Quality of financial reporting.** During 2022, the quality of project financial reporting deteriorated overall, while the adoption of relevant accounting standards remained at roughly the same level. Greater complexity in the financing mix, deficiencies in project accounting systems and weak technical capacities have contributed to this trend. Further analysis of these trends is provided in annex III.

⁸ The term "financial year 2022" covers all financial periods ending between 1 January and 31 December 2022.

Financial management structural reforms 2021-2023

Table 1
Financial management structural reforms 2021-2023

Goal	How	Task	
People	Invest in workforce	Restructure division to create headquarters anchor units	
		Restructure the management of grants to align with portfolio management at hubs	
		Decentralize staff not in headquarters anchor	
		Review use of national officers to ensure fit for purpose	
		Staff training – risk management and public financial management	
		Create portfolio support pool and roll-out	
		Actively participate in development finance institution community	
		Enhance knowledge management action plan and strategy	
Process	Strengthen corporate dynamics on fiduciary safeguards	Offer guidance to regional teams on financial management role and responsibilities; ensure roles of project delivery team are respected	
		Update delegation of authority for new disbursement roles, including letter to borrower	
		Restructure internal actors in disbursement processes to reflect corporate roles: Financial Management Services Division, Financial Controller's Division, Programme Management Department	
		Introduce mandatory training on financial management aspects for operational teams in operations academy	
		Coordinate to put sustainable solutions in place for annual liquidity ratio targets	
		Reintegrate grant management into regional portfolio allocations	
		Introduce quarterly interim financial reports for all ongoing projects	
		Introduce cash flow forecasting in annual workplan and budget and interim financial reports	
	Promote greater use of country systems ⁹		Introduce straight-through processing for all low- and moderate-risk projects
			Reduce use of direct payment disbursements
			Recalibrate ex ante checks, confining them to high-/some substantial-risk projects
			Share desk review analysis with officers
			Hold workshop on use of country systems
			Enroll FMD staff in Public Expenditure and Financial Accountability trainings
Tech	Overhaul financial management policies and procedures	Have finance officers consider greater use of country systems in new/ongoing projects	
		Reposition Loan Disbursement Handbook as a guide containing high-level principles for borrowers	
		Disassemble Financial Management Manual and embed sections in Operational Manual	
		Repackage letter to borrower and streamline for project guidance	
		Update FMD delegations of authority	
		Introduce principles-based approach in the revised handbook	
		Promote increased use of taxation in project financing	
		Strengthen reporting on in-kind contributions	
	Harness technology		Review use of recurrent costs
			Provide updated list of remedies to offer greater options in the event of non-compliance
			Roll out updated disbursement procedures in the IFAD Client Portal
			Introduce web-based availability for FMD Manual
			Automate letter to borrower and embed in the Operational Results Management System
			Enhance the Financial Management Database and the Audit Report Tracking System
Introduce and maintain financial management and lending terms bot			
Upgrade monthly reporting on operations and budget with escalation to senior management in dashboards			

⁹ To be further expanded after additional diagnostics and staff training.

Project audit reports – financial year 2022

Table 1
Audit arrangements for financial years 2021 and 2022
(Audit reports received and signed off)

Region	Financial year 2022			Financial year 2021		
	Undertaken by government auditors ^a	Undertaken by private auditor ^b	Total	Undertaken by government auditors	Undertaken by private auditor	Total
Asia and the Pacific	32	22	54	32	31	63
East and Southern Africa	26	24	50	25	22	47
Latin America and the Caribbean	2	12	14	10	25	35
Near East, North Africa and Europe	6	18	24	14	24	38
West and Central Africa	16	32	48	10	29	39
Total	82	108	190	91	131	222
Percentage	43	57	100	41	59	100

^a Includes 12 audits conducted by national entities that are not the Supreme Audit Institutions (previous year: 7 audits).

^b Three audits were outsourced by government auditors to a private firm for financial year 2022 (previous year: none).

Table 2
Timeliness of project audit report submission for financial years 2021 and 2022
(Audit reports received)

Audit reports	2022		2021	
	Number	%	Number	%
Received on time	163	67	183	70
Received with delay	63	26	65	25
Subtotal	226	92	248	95
Still due as at 30 September	19	8	14	5
Total reports due for year	245	100	262	100

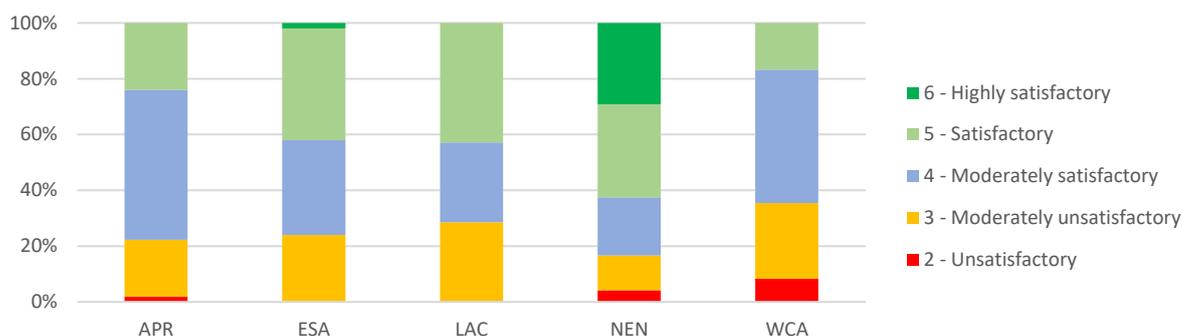
Table 3
Audit opinion expressed on project financial statements for financial years 2021 and 2022
(Audit reports received and signed off)

Region	Financial year 2022			Financial year 2021		
	Audit reports received	Unqualified	Qualified	Audit reports received	Unqualified	Qualified
Asia and the Pacific	42	40	2	49	45	4
East and Southern Africa	44	38	6	38	33	5
Latin America and the Caribbean	7	5	1	10	10	0
Near East, North Africa and Europe	20	19	1	32	30	2
West and Central Africa	41	38	3	31	29	2
Total	154	140	13	160	147	13
Percentage	100	91	9	100	92	8

Quality of financial and audit reports - 2022

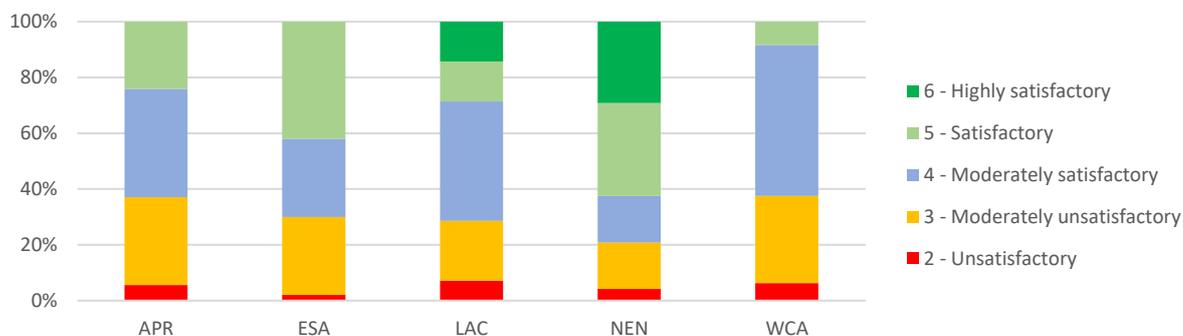
1. In financial year (FY) 2022, 51 per cent of financial reports were prepared using international standards (FY 2021: 45 per cent) and 43 per cent using national or regional standards (FY 2021: 33 per cent). Other standards or "modifications/deviations from international standards" were used in 6 per cent of projects.
2. The quality of financial reporting rated satisfactory or highly satisfactory deteriorated from 55 per cent in FY 2021 to 33 per cent in FY 2022. The proportion of reports rated moderately satisfactory was 41 per cent, compared to 34 per cent in FY 2021, while those rated either moderately unsatisfactory or unsatisfactory increased from 11 per cent in FY 2021 to 26 per cent.¹⁰

Figure 1
Quality of financial reporting FY 2022¹¹



3. The quality and timeliness of audit reports are measured as part of IFAD's corporate methodology for the assessment of project performance. This indicator consists of two elements: the quality of the audit work and the timeliness of audit report submission. Even a high-quality audit report is penalized if submitted late.¹²
4. The quality and timeliness of audit reports also deteriorated in FY 2022, with 30 per cent of audits rated highly satisfactory or satisfactory (55 per cent in FY 2021), 37 per cent rated moderately satisfactory (27 per cent in FY 2021) and 33 per cent rated moderately unsatisfactory or unsatisfactory (17 per cent in FY 2021). Mandatory action plans are put into place as needed to underpin minimum standards and address internal control weaknesses.

Figure 2
Quality and timeliness of audit, FY 2022¹³



¹⁰ See paragraph 7 for a description of IFAD actions in the case of poor performers.

¹¹ Ratings were based on the 190 audit reports.

¹² Audit reports submitted after the due date cannot be rated higher than 3 (moderately unsatisfactory).

¹³ Ratings were based on the 190 audit reports.

5. In FY 2022, 83 per cent of auditors used international standards (2021: 83 per cent) and 16 per cent used national or regional standards (2021: 17 per cent).