



**ASIAN INFRASTRUCTURE
INVESTMENT BANK**

**Annual Report of the Audit and Risk Committee
Of the Board of Directors for 2018-2019**

July 19, 2019

Background

1. According to the Terms of Reference (ToR) for the Audit and Risk Committee of the Asian Infrastructure Investment Bank (Bank), paragraph 25, the Committee shall prepare an annual report to the Board of Directors of its activities. The ToR of the Committee is attached as appendix.
2. This annual report of the Committee covers the discussions at the Committee meetings held from June 2018 to May 2019.

I. Composition and Meetings

3. As of the date of this report, the membership of the Committee is as follows:
 - Jan Engström (External Member)
 - Andin Hadiyanto
 - Sameer Kumar Khare (Vice Chair)
 - Emil Levendoğlu (Chair)
 - Chaly Mah (External Member)
 - Zhang Wencai
4. In September 2018, Director Emil Levendoğlu was selected as the Chair of the Committee. In April 2019, Director Sameer Kumar Khare was selected as the Vice Chair of the Committee.
5. Five meetings of the Committee were convened during the reporting period, with the meeting dates of June 22, 2018, September 26, 2018, December 4, 2018, April 2, 2019 and May 9, 2019. Four of the meetings took place physically alongside the Board of Directors meetings, and one meeting was convened by virtual means.
6. The attendance rate of the ARC members for these meetings during 2018-2019 was 93%.

II. Areas of Focus during 2018-2019

a. Financial Statements

7. The Committee reviewed the quarterly and annual financial statements of the Bank and the Project Preparation Special Fund (Special Fund).
8. The Committee discussed the Bank's operational results, its financial activities, the related party transaction disclosure, as well as the accounting treatment of loan fair value and

expected credit losses (ECL). The Committee suggested that Management consider disclosing more information as to the loan fair value in its financial statements; this suggestion was subsequently implemented in the 2018 Financial Statements that were released in April 2019.

9. The Committee has been consulted on the interim financial statements for the Bank and the Special Fund after the new AIIB Public Information Policy, which led to a change of the review and approval procedure regarding the Bank's interim financial statements, came into effect in September 2018.
10. The Committee recommended that (i) the Board of Directors submit the audited 2018 financial statements of the Bank and of the Special Fund to the Board of Governors with the recommendation for approval and; (ii) the Board of Directors recommend to the Board of Governors to determine that AIIB's net income for the financial year 2018 be allocated to retained earnings.

b. COSO/ICFR

11. During the reporting period, the Committee was updated quarterly on the progress of the COSO/ICFR implementation project, within which the COSO deliverables were related to setting up the Bank's control environment, whereas the ICFR implementation work relates to the developing and ongoing testing of key controls in processes that would impact the financial reporting.
12. The Committee discussed the issues of the COSO/ICFR implementation and recommended that Management ensures sufficient resources be allocated to the project and manages the changes arising from the new products and IT systems.

c. Risk Management

(i) Financial and Risk-related Policies

13. A three-year review of the financial policies was required by the Board of Directors. In this connection the Committee reviewed the AIIB Financial Policies, supported the new financial and risk policy framework as well as the work plan of revising policies as had been proposed by Management.
14. During the reporting period the Committee further reviewed the Financial and Risk Management Framework which provides the framework for the financial and risk-related policies of the Bank. The Committee reviewed the following policies and recommended approval by the Board of Directors: Capital Adequacy Stress Testing (CAST) Policy, Pricing Policy, Financial and Risk Management Policy, and General Investment and Financial Derivative Authority.

(ii) Risk Management Framework

15. During the reporting period, the Committee was updated by Management on the implementation of the Risk Management Framework. The Committee was satisfied that the risk management of the Bank was on the right path and requested Management to report on the progress with the implementation of the framework.

(iii) Risk Appetite Statement

16. The Committee was briefed on the status of the 2019 update of the Risk Appetite Statement and its accompanying stress test report and was noted that the Bank would be adequately capitalized in the event of a stressed scenario. The Committee recommended the Board of Directors to support the Risk Appetite Statement 2019 Update and to approve its top-down allocation of risk.

(iv) Regular Updates on Risk Management

17. During the reporting period, the Committee received risk management updates from Management on a quarterly basis and discussed the Bank's management of its credit risk, market risk, liquidity risk, compliance risk, operational risk and economic capital. The Committee was informed of the capital adequacy status of the Bank over 2018 and observed that the Bank enjoyed a very strong level of capital adequacy.

d. Update by Internal Audit

18. In the reporting period, the Committee had been updated by Chief Internal Audit Officer on a quarterly basis. The Committee reviewed the 2019-2023 Audit Plan and was updated on its implementation, the internal audit findings and the control reports regularly. The audit of CEIU as per ARC's recommendation was also included in the Audit Plan.

19. The Committee reviewed and supported the proposal for the external auditors' performance assessment and requested to be updated on the results of the performance assessment.

20. The Committee had a closed discussion with the Chief Internal Audit Officer in April 2019.

e. Engagement with External Auditors

21. The Committee reviewed the 2018 interim review completion reports and the audit completion report for the 2018 Financial Statements.

22. The Committee further reviewed the external auditor's 2018 audit plan in September 2018 and in April 2019 had a closed discussion with the external auditor.

f. Skill and Knowledge Development Program (SKDP)

23. During the reporting period, the COSO/ICFR workshop was organized as a part of the Skill and Knowledge Development Program of the Committee.

III. Indicative Work Program for 2019-2020

24. During 2019-2020, the Committee is expected to focus on reviews of the Bank's internal control environment, comprehensive risk management, and the internal and external audit functions.

Appendix: Terms of Reference of the ARC

ASIAN INFRASTRUCTURE INVESTMENT BANK
TERMS OF REFERENCE FOR THE AUDIT AND RISK COMMITTEE

(Adopted May 31, 2018 by the Board of Directors)

SECTION A: PURPOSE

1. The Audit and Risk Committee is a committee of the Board of Directors (Board) established pursuant to Article 26 (vi) of the Bank's Articles of Agreement and Section 5 (b) of By-Laws of the Asian Infrastructure Investment Bank. Its function is to assist the Board in carrying out its responsibilities as they relate to the Bank's financial reporting and audits, including internal controls and risk management.

SECTION B: RESPONSIBILITY AND AUTHORITY

2. The Committee shall:
 - (i) Review the Bank's financial statements and accounting, auditing and financial reporting practices, procedures and issues;
 - (ii) Review the selection procedures for and the qualification and performance of the external auditors, and review the reports from the external auditors and ensure appropriate action be taken in respect of major improvement areas identified;
 - (iii) Review the scope of work and internal audit plan and the effectiveness of the internal audit function;
 - (iv) Review the effectiveness of internal control system; and
 - (v) Review the Bank's financial and risk-related policies, annually review the Bank's risk management framework and its risk appetite statement.
3. The Committee:
 - (i) May seek briefings on relevant auditing, accounting, financial reporting and internal controls, and risk assessment and management matters by staff member(s) designated by the President, including those the Committee has suggested;
 - (ii) May seek any pertinent information from the Bank as is necessary, and which shall not be unreasonably withheld;
 - (iii) May meet with the external and internal auditors as needed, and meet the external and internal auditors without Management presence at least once a year; and
 - (iv) Shall consider the independence of the external auditors, including the provision of non-audit services by the external auditors to the Bank.

4. The Committee members shall fully respect and observe the confidentiality of any information provided to them.

SECTION C: COMPOSITION, APPOINTMENT AND TERMS

5. The Committee shall consist of at least three and up to four Directors of the Board and two external members, including at least one regional Director and one non-regional Director.
6. The Committee members shall be free from any relationship that, in the opinion of the President, would interfere or conflict with the exercise of their independent judgment as members of the Committee. The Committee members shall inform the President of any circumstances which reasonably may be perceived to interfere or conflict with the exercise of their independent judgment as members of the Committee.
7. The term of the Committee shall be the same as the two-year term of the Board.

Chair and Vice Chair

8. The Committee shall have a Chair and a Vice Chair, selected by the Committee from among its Director members.
9. In the absence of the Chair, the Vice Chair shall serve as Chair of the Committee. When a Chair or Vice Chair ceases to be a member of the Committee, a new Chair or Vice Chair shall be selected from among the members of the Committee. No Director shall serve more than two consecutive terms (full or partial) as Chair or Vice Chair of the Committee.

Director Member

10. The Board member appointment(s) shall be approved by the Board, based on proposals made by the President after consultations with Directors organized by the Corporate Secretary, whether for initial appointments or the filling of vacancies during the term.
11. A Director may serve on the Committee for up to two consecutive terms.
12. Each Director may be represented in his or her absence by his designated Alternate Director or Temporary Alternate Director.

External Member

13. The external members of the Committee shall be chosen on the basis of merit from among persons having a qualification and proven experience in a field relating to the Committee's activities.
14. To ensure the application of the immunities and privileges under the Articles of Agreement to the external Committee members, they should be hired as experts or consultants. The external members shall be appointed by the President, subject to no objection being received from the Board of Directors within 10 days of their being informed of the proposed appointment. The

terms of their appointment shall incorporate the *AIIB Code of Conduct for Bank Personnel*, and provide for such compensation as may be deemed appropriate.

15. External members of the Committee shall be appointed for a term of three years, and may be reappointed once for either a full term of three years or a shorter term of one to two years.

SECTION D: MEETINGS, DOCUMENTS AND PROCEDURES

Meetings

16. The Committee may have physical or electronic meetings. It is expected that the Committee shall meet at least four times a year, with physical meetings scheduled to the extent possible in connection with the quarterly meetings of the Board. A summary of the meeting shared promptly afterwards with non-Committee-member Directors.
17. Meetings of the Committee are convened by the Chair, or in the Chair's absence, by the Vice Chair. If both of Chair and Vice Chair are absent, the remaining Committee members shall select acting Chair from among its Director members.
18. Two Board members and one external member constitute a quorum for meetings of the Committee, and Alternate Directors or Temporary Alternate Directors duly designated to attend in the absence of a Director shall count for the purposes of a quorum.
19. A Director, or his designated Alternate Director, Temporary Alternate Director, or Advisor may attend a Committee meeting as observer with the approval of the Chair. Such observer will not normally have speaking rights, unless permitted by the Chair. The Chair may decide to hold a Committee meeting in executive session which shall be attended only by Committee members, designated staff from the Office of the Vice President, Corporate Secretary and the Office of the General Counsel to provide administrative support and advice to the Committee, and such other persons as are specifically invited by the Chair.
20. In addition to Committee members and observers, a Committee meeting shall be open to attendance only by such members of the Bank's staff as the President may designate and such other persons as the Chair may invite.
21. The Committee Secretary shall be the Corporate Secretary, or another member of staff appointed by the Corporate Secretary.

Documents and Reports

22. The Chair shall circulate in advance the agenda for each meeting, as well as all relevant documents for the meeting. Minutes of Committee meeting shall be approved by the Committee, normally on a no-objection basis. Unless a particular matter is required to be treated on a confidential basis, Committee agendas, documents and minutes shall also be copied to Directors who are not Committee members at the same time as they are circulated to the Committee.

23. The Committee may also report to the Board on their deliberations, and such reports shall be circulated to the Board reasonably in advance of its consideration of the matter.
24. The Committee shall submit minutes of its formal meetings to the Board. Its Chair shall brief the Board on the work of the Committee at the conclusion of the annual audit.
25. The Committee shall prepare an annual report to the Board of its activities.

Procedures

26. As far as practicable, an item of business shall be considered by only one committee of the Board, unless otherwise agreed between the respective committee chairs, or, if need be, by the Board.
27. The Committee is not a decision-making body, but provides advice to the Board and guidance to Management. There is no formal voting in Committee on matters under consideration. The Chair shall ascertain the sense of the meeting to be included in the minutes. Reports to the Board shall reflect the views of Committee members, including minority views.
28. Where the Committee is reporting on a matter to be considered by the Board, the Committee report shall be transmitted reasonably in advance of Board consideration. When the Committee needs to take a decision on procedural or administrative matters, the decision shall be taken by a simple majority of those present.
29. The external members of the Committee may attend Board discussions on matters within the remit of the Committee, if so requested by the Board.
30. The Committee shall review its terms of reference periodically and may recommend amendments for consideration and approval by the Board.

SECTION E: ADMINISTRATIVE ARRANGEMENTS

31. The channel of communication between the Committee and Management and staff shall be through the Office of the Vice President, Corporate Secretary, which shall be responsible for providing the necessary administrative services for the functioning of the Committee including providing a secretariat for the Committee and maintaining its records.