

**Audit and Risk Committee
Annual Report to the Board of Directors
June 2023–May 2024**

1.0 Introduction

1.1 The Annual Report covers the period from June 2023 to May 2024 and presents the activities of the Audit and Risk Committee (ARC or the Committee) of the Asian Infrastructure Investment Bank (AIIB or the Bank). The ARC has played a critical role in overseeing AIIB's financial activities, risk management practices, internal controls, and governance processes. Through regular meetings, consultations, and comprehensive briefings aligned with the Committee's Terms of Reference (ToR)¹, the Committee ensured effective oversight and provided informed recommendations to AIIB's Board of Directors. The Committee Chair consistently updated the Board of Directors on the Committee's activities, fostering transparency and accountability. By maintaining a robust control environment, effectively managing risk, and adhering to best practices and international standards, the Committee has played a vital role in safeguarding AIIB's operations and upholding its commitment to high standards.

2.0 Terms of Reference

2.1 The responsibilities of the Committee are as follows:

- (a) Review AIIB's financial statements and accounting, auditing and financial reporting practices, procedures and issues.
- (b) Review the selection procedures for and the qualification and performance of the external auditors; review the reports from the external auditors and ensure appropriate action be taken in respect of major improvement areas identified.
- (c) Review the scope of work, the internal audit work plan and the effectiveness of the internal audit function.
- (d) Review the adequacy and the effectiveness of the internal control system.
- (e) Review AIIB's financial policies, including the Bank's borrowing and investment authorities, and the asset and liability management policy.
- (f) Review AIIB's risk-related policies; annually review the Bank's risk management framework and its risk appetite statement.
- (g) Receive reports on violations of the Prohibited Practices Policy (PPP) from the Managing Director of the Complaints-resolution, Evaluation and Integrity Unit (CEIU).

2.2 The Committee's ToR were originally adopted on May 31, 2018, and first amended on July 10, 2019. On December 21, 2020, the Board of Directors approved further revisions. The Committee reviewed the ToR again in September 2021 and September 2023, confirming its relevance and effectiveness. These periodic reviews ensure compliance with the Bank's

¹ [Asian-Infrastructure-Investment-Bank-Terms-of-Reference-for-the-Audit-and-Risk-Committee.pdf](https://www.aiib.org/Asian-Infrastructure-Investment-Bank-Terms-of-Reference-for-the-Audit-and-Risk-Committee.pdf)
([aiib.org](https://www.aiib.org))

policies and alignment with the Committee's current practices, maintaining the ToR's relevance to the evolving needs of the Bank.

3.0 Composition of the Committee

3.1 As of the date of this report, the membership of the Committee is as follows:

- Fabrizio COSTA (Chair)
- R.M.P. RATHNAYAKE (Vice Chair)
- Zhijun CHENG
- Ahmed KOUCHOUK
- Teresa LIN (External Member)
- Elisabeth STHEEMAN (External Member)

Committee members' biographies are available [here](#).

3.2 Throughout the reporting period, there were no changes to the Director Members of the Committee. In April 2024, Elisabeth Stheeman, an External Member of the ARC, was reappointed for a three-year term effective May 1, 2024. Teresa Lin has been an External Member since May 10, 2023.

4.0 Areas of Focus

4.1 **Financial Statements.** The Committee reviewed the 2023 AIB Annual Financial Statements, where Management reported a record operating profit of USD1.03 billion. Factors contributing to this included increased interest rates, growth in investment operations, and effective treasury management. Discussions covered AIB's financial strategy, anticipated interest rate movements, and investment portfolio sensitivities. Management provided detailed clarification on these topics. Additionally, the Committee discussed AIB's bond issuance program, investor sentiment, credit-impaired investments, other comprehensive income, and the 2024 financial outlook. Committee Members acknowledged Management's responses and recommended the review of the 2023 AIB Annual Financial Statements by the Bank's Board of Directors.

4.2 **Quarterly Financial Statements.** Throughout the reporting period, Management held regular consultations with the Committee to review quarterly financial statements for Q2 2023, Q3 2023, and Q1 2024. These statements, prepared by Management, underwent thorough review by the Committee before publication. Key topics covered during the consultations included expected credit losses, key risks for 2023, cost-to-income ratio, LIBOR transition, resource allocation, and market volatility. Additionally, discussions encompassed AIB's credit spreads, duration management, engagement with investors, new products and processes, sustainability reporting requirements, stress testing, portfolio clarification, foreign exchange analysis, financial improvements, expense scrutiny, and Special Funds.

4.3 **Quarterly Financial Activities Updates.** In addition to the quarterly consultations on the financial statements, Management provided comprehensive updates to the Committee on the broader scope of AIB's financial activities. These updates encompassed various aspects,

including the Bank's liquidity management, the development of its liquidity portfolio, the growth and expansion of its Treasury functions, and the impact of interest rate hikes on funding costs.

4.4 External Auditor's Feedback and Updates. In both September 2023 and March 2024, the Committee convened meetings with the Bank's external auditor, PricewaterhouseCoopers (PwC), to deliberate on matters concerning the Audit Plan and Findings. During these sessions, PwC provided a comprehensive overview of audit highlights, particularly focusing on expected credit loss evaluations and financial instrument valuations. Their audit completion report for FY2023 commenced with a thorough examination of significant financial achievements, encompassing key performance indicators and milestones attained. Notably, the findings underscored critical audit areas such as expected credit loss and financial instrument valuations. PwC also conducted a comparative analysis of AIIB's information systems performance vis-à-vis other MDBs and financial institutions, spotlighting cybersecurity initiatives implemented in response to industry challenges. Discussions further revolved around AIIB's fair value calculation, with PwC recommending an augmentation of in-house valuation capabilities—an initiative already in progress. Despite AIIB's successful return to operational normalcy post-COVID, challenges persist in ensuring accurate accounting treatment amidst the organization's rapid expansion into new markets and products.

4.5 Internal Audit Office Updates. Quarterly briefings with the Internal Audit Office provided the Committee with comprehensive updates on the internal audit plan, its resourcing, significant observations, and corresponding agreed management actions. These sessions encompassed various key areas including IT governance, investment operations, management of outsourcing services, implementation of the Policy on Personal Data Privacy, and the results of the External Quality Assurance exercise. The Committee actively engaged in substantive discussions with Management on these matters, ensuring robust oversight and effective risk management. Additionally, in accordance with the Committee's ToR, a closed-door session was convened with the Chief Internal Audit Officer in November 2023.

4.6 COSO / ICFR Implementation Updates. The Committee received regular updates on the implementation of the Internal Control over Financial Reporting (ICFR) framework, which aligns with the Committee of Sponsoring Organizations of the Treadway Commission (COSO) principles. The Committee closely monitored the effectiveness of controls and addressed challenges related to maintaining quality assurance. IT controls, cybersecurity, and data security received special attention, along with the continued need for manual workarounds. Management assured the Committee that the ICFR workplan is agile and well-suited to the Bank's institutional and business development, considering the changing landscape. Additionally, during their report to the Committee in March 2024, PwC provided an attestation report on Management's assertion regarding the effectiveness of the Bank's internal controls over financial reporting, further reinforcing the Committee's confidence in the Bank's control environment.

4.7 Global Borrowing Authority. Management presented the proposed Global Borrowing Authority (GBA) for 2024 to the Committee, accompanied by a detailed explanation from Management on how it would bolster the Bank's presence in capital markets. Despite widening credit spreads since March 2022, the Bank has made significant strides in narrowing spreads through consistent investor communication and education, maintaining market presence, issuing benchmark sizes for liquidity provision, and accessing new funding markets. The 2024

GBA aims to maintain liquidity neutrality, aligning with projected cash flows and enabling sustained presence in existing markets, expansion into new markets, diversification into longer tenors, and engagement in reverse enquiry activities. Management provided insights into considerations for public benchmarks and reverse enquiries, with a focus on diversifying the investor base. Committee members expressed their support for the 2024 GBA and recommended its approval by the Board of Directors.

4.8 Risk Management Updates. Throughout the reporting period, the Committee maintained a steadfast focus on risk management, receiving regular updates and evaluations of Level 1 Key Risk Indicators (KRIs) and Key Performance Indicators (KPIs) on a quarterly basis. In addition to quarterly risk reporting, the Committee's inquiries over the year included assessing the impact of the Risk Management Framework on the Bank's portfolio rating, computation of various KRIs, analysis of concentration risk measures, and subsequent KRI updates. Management consistently provided updates on the credit quality of investment operations, trends in the investment pipeline's credit quality, market and liquidity risks, operational risks, and compliance risk. Management provided a dedicated report over compliance and operational risks, highlighting AIB's tax transparency implementation, including becoming an Observer to the Organisation for Economic Co-operation and Development (OECD) Global Forum on Tax Transparency, and improvements to both the Know Your Customer (KYC) and operational risk management systems. Committee members actively engaged in technical briefings and teach-ins to deepen their understanding. Furthermore, a briefing was conducted on transitioning to a prevailing Risk-adjusted Return on Capital (RAROC) to further support the Committee's comprehension in this area.

4.9 Risk Appetite Statement and Report on Stress Testing. The Committee reviewed the updated 2024 Risk Appetite Statement (RAS) for AIB, considering the Bank's governance frameworks and risk management practices. Management provided updates on routine stress testing exercises, with discussions focusing on scenario design and underlying assumptions. The Committee scrutinized the choice of the scenario adopted, which was devised to cover a range of eventualities, including inflation, climate change, deglobalization, and external liquidity crunches, as well as other potential triggers. Management assured the Committee of AIB's commitment to maintaining robust capital adequacy levels and adherence to the Bank's RAS throughout the business planning and budget horizon, demonstrating prudent risk management practices. The Committee agreed to recommend the updated RAS for approval by the Board of Directors.

4.10 G20 Capital Adequacy Framework Working Group Recommendations. The Committee received updates from Management over their responses to the G20 Capital Adequacy Framework (CAF) Working Group recommendations. Management outlined any changes made to the parameterization of metrics and the corresponding implications for lending volumes. Additionally, Management highlighted the impact of the USD1 billion guarantee made by AIB to the International Bank for Reconstruction and Development (IBRD), which utilized the spare capital surplus of AIB to provide capital relief to IBRD, while improving the Bank's weighted average credit rating (WACR) and increasing AIB's lending capacity for lower-rated borrowers.

5.0 Committee Priorities for the Coming Year

5.1 The Committee's mandate for the upcoming reporting period, June 2024 through May 2025, involves actively assisting the Board of Directors in accordance with its ToR. To address prevailing financial market conditions and the Bank's continued transition into its growth phase, the Committee identified several key areas of focus for its review and oversight:

- (a) **Financial Health Review:** The Committee will continue to monitor the Bank's financial health, assessing capital adequacy, liquidity management, and overall financial stability, while noting that the budget is deliberated within the Budget and Human Resources Committee (BHRC). This includes monitoring the implications of debt issuance and ensuring effective management of financial resources. Additionally, the Committee will consider the loss experience disclosed by its peers for the parameterization of its loss-given-default and ratings to ensure its preferred creditor status is appropriately modeled within capital adequacy and expected credit losses.
- (b) **Enhancing Treasury, Internal Controls, and IT Functions:** The Committee will prioritize the continuous development of the Bank's Treasury function, internal controls, and IT functions. Through its reviews, the Committee will assess the adoption of advanced technologies, cybersecurity measures, data governance, systems integration, and operational efficiency improvements to align with the Bank's evolving operations.
- (c) **Loan Portfolio Quality Assessment:** The Committee will closely monitor the Weighted Average Credit Rating (WACR) as part of its risk management oversight. By reviewing the WACR regularly, the Committee will ensure that the Bank maintains a balanced and diversified loan portfolio that aligns with its risk appetite and supports sustainable lending practices. As per the G20 CAF working group recommendations, the Committee will also review the Bank's conclusions of the comparison exercises of AIIB relative to its peers to identify improvements in its metrics. Through its reviews, it will support AIIB in using its capital base as efficiently as possible to maximize its lending capacity while remaining prudent and will pay particular attention to the Bank's five-year capital review paper in 2025.
- (d) **Strengthening Risk Management Framework:** The Committee will actively review Management's steps to enhance the Bank's Risk Management Framework. This includes strengthening risk identification, assessment, and mitigation processes, as well as ensuring the adequacy of risk appetite and tolerance levels across the organization. Particular attention will be placed on monitoring Treasury-related risks, particularly with respect to asset and liability management, and enabling the Bank to take measured risks to provide additional local currency lending to meet clients' needs. Operational risk will also be of greater focus, with capacities growing to meet the increasing complexity of Bank processes, refining risk and control assessments, and a review of the associated Capital Adequacy requirements.
- (e) **Promoting a Strong Risk Culture:** Recognizing the critical role of nurturing a robust risk culture within the Bank, the Committee is committed to actively fostering a mindset that is keenly attuned to risk factors and promoting best risk

management practices throughout the organization. This entails raising awareness of individual responsibilities related to risk, fostering open channels of communication on risk-related matters, and advocating for the integration of risk considerations into decision-making processes at all levels. By placing a premium on cultivating a strong risk culture, the Committee endeavors to fortify the Bank's overall Risk Management Framework and bolster its capacity to identify, assess, and mitigate risks effectively. Furthermore, the Committee applauds the Bank's adoption of a no-blame culture, which facilitates greater transparency in reporting operational risk incidents across all business units, thereby facilitating valuable lessons learned as the Bank expands its product offerings.

- (f) **Climate Risks:** The Committee is dedicated to scrutinizing the Bank's progress in integrating climate-related financial risks into its risk profile across all risk categories. Additionally, it will assess the Bank's strategies to fulfill the disclosure requirements set forth by the International Sustainability Standards Board (ISSB) within its financial reporting. It acknowledges the iterative nature of these efforts, particularly as they commence in 2025, and underscores the importance of aligning with global sustainability standards to enhance transparency and accountability in managing climate risks.

- (g) **Selection of the External Auditor:** In pursuit of maintaining financial transparency and excellence, the Bank will spearhead the selection of a new external auditor starting from the fiscal year 2026. This process will be overseen by a dedicated panel, including representation from the ARC, ensuring adherence to best practices and regulatory standards. Regular updates on the progress will be provided to the Committee, with the aim of finalizing the selection by Q2 2025.

Annex A: Agenda of Committee Meetings (June 2023-May 2024)

June 12, 2023: ARC Briefing

1. Briefing on Tax Transparency
2. Briefing on the Effects of Recent Market Dynamics on AIIB Sovereign Loan Pricing

August 15, 2023: ARC Consultation

1. Q2 2023 Financial Statements (Consultation with ARC members on Quarterly Financial Statements)

September 4-5, 2023: Audit and Risk Committee Meeting

1. Risk Report Dashboard
2. Internal Audit Office Update
3. COSO/ICFR Implementation Update
4. PwC Audit Work Plan 2023
5. Review of the ARC Terms of Reference
6. Briefing on the Scenarios for 2024 Stress Testing
7. LIBOR Transition

November 15, 2023: ARC Meeting and Consultation

1. Q3 2023 Financial Statements (Consultation with ARC members on Quarterly Financial Statements)
2. LIBOR Transition
3. Briefing on the Selection of the External Auditor

November 27-28, 2023: Audit and Risk Committee Meeting

1. Risk Report Dashboard
2. Risk Appetite Statement & Report on Stress Testing
3. Internal Audit Office Update
4. 2024 Global Borrowing Authority
5. Discussion with CIAO (closed door session)
6. IT Annual Report (2022)

December 12, 2023: ARC Briefing

1. Briefing on the International Sustainability Standards Board Report Gap Analysis

March 11-12, 2024: Audit and Risk Committee Meeting

1. 2023 Financial Statements
2. COSO/ICFR Implementation Update
3. PwC Independent Auditor's Reports and ICFR Opinion
4. Discussion with External Auditors (closed session)
5. Internal Audit Office Update
6. Risk Reporting Dashboard
7. Annual Update on Compliance and Operational Risk

March 20, 2024: ARC Briefing

1. Briefing on RAROC
2. Briefing on CTL Processes and Volume Growth

May 14, 2024: ARC Consultation

1. Q1 2024 Financial Statements (Consultation with ARC members on Quarterly Financial Statements), including External Auditor's Performance Assessment
2. Treasury Portfolio Performance Report Q1 2024

Annex B: Summary of Committee Recommendations (June 2023 to May 2024)

Key Observations		Audit and Risk Committee's Recommendations to the Board of Directors
1	Financial Reporting	The Committee supported the 2023 Financial Statements and recommended that (i) the Board of Directors submit the audited 2023 Financial Statements of the Bank and the Special Funds to the Board of Governors with a recommendation for approval and (ii) the Board of Directors recommend to the Board of Governors to determine that the Bank's net income for financial year 2023 be allocated to retained earnings.
2	External Auditor	The Committee recognized that PwC had maintained high standards of professionalism in discharging their duties and reported this to the Board of Directors.
3	Global Borrowing Authority	The Committee recommended the 2024 Global Borrowing Authority to be approved by the Board of Directors.
4	Risk Appetite Statement	The Committee recommended that the Board of Directors support the 2024 Risk Appetite Statement.
5	Committee Terms of Reference	The Committee reviewed its Terms of Reference and found them suitable without any recommended changes. Any necessary modifications will be promptly presented to the Committee for consideration.
Key Observations		Audit and Risk Committee's Recommendations to AIIB Management
1	Enhanced focus on IT (governance and operations)	The Committee recommended Management to focus on ensuring that the governance of the Bank's IT systems and its architecture are fit-for-purpose to support a 21 st century multilateral development bank – with a focus on reduction of manual processes, cybersecurity, system alignment and management of operational risks.
2	Climate Risk	The Committee recommended Management to ensure adequate coverage of climate risk, both at the organizational level (e.g., financial sustainability, operational resilience, reputation and stakeholder confidence), and at the project level (e.g., project viability, long-term sustainability, social and environmental impacts), along with consideration of the policy / regulatory environment and global development agendas. Updates to the ARC in the coming year on these topics were requested.

Annex C: Indicative Committee Workplan (2024-2025)**June 10-11, 2024: Audit and Risk Committee Meeting**

- Risk Report Dashboard
- Internal Audit Office Update
- IT Strategic Plan Review: Scope and Initial Assessment
- ARC Annual Report
- ISSB Reporting Update
- Equity Portfolio Review
- Briefing on Scenarios for Stress Testing
- Briefing on Sanctions
- COSO/ICFR Implementation Update (circulation only)

June 24, 2024: ARC Briefing

- Briefing on Asset and Liability Management

August 13, 2024: ARC Consultation

- Q2 2024 Financial Statements (Consultation with ARC members on Quarterly Financial Statements)
- Liquidity Portfolio Update
- Update on the Selection of the External Auditor
- Briefing on the Future Funding Program

September 4-5, 2024: Audit and Risk Committee Meeting

- Selection of Chair and Vice Chair
- Risk Report Dashboard
- Internal Audit Office Update
- COSO/ICFR Implementation Update
- PwC Audit Work Plan 2024
- Cybersecurity

November 14, 2024: ARC Consultation

- Q3 2024 Financial Statements (Consultation with ARC members on Quarterly Financial Statements)

November 26-27, 2024: Audit and Risk Committee Meeting

- Internal Audit Office Update
- 2025 Global Borrowing Authority
- Discussion with CIAO (closed session)
- Briefing on Climate Risk
- IT Manual Processes
- COSO/ICFR Implementation Update (circulation only)

December 10, 2024: Audit and Risk Committee Meeting

- Risk Report Dashboard
- Risk Appetite Statement & Report on Stress Testing

March 17-18, 2025: Audit and Risk Committee Meeting

- Risk Report Dashboard
- Internal Audit Office Update
- 2024 Financial Statements
- Discussion with External Auditors (closed session)
- COSO/ICFR Implementation Update