

EBD/98/44

May 18, 1998

To: Members of the Executive Board

From: The Secretary

Subject: **Independent Review of the Fund's Audit Functions—Terms of Reference**

In response to a request by the U.S. Executive Director, staff will brief the Executive Board on Wednesday, May 20, 1998 on the ongoing review of the Fund's audit functions by independent experts. The terms of reference for the review are attached for the information of Executive Directors.

Mr. Stephen Eccles (former Vice President and Controller of the World Bank and currently Chairman of the International Accounting Standards Advisory Council) has been appointed by management to lead the review in conjunction with a team of three auditors, led by Mr. Burnham from the United States. The remaining two auditors will be nominated by the Institute of Internal Auditors (IIA) from a list of three candidates from South Africa, Australia, and Indonesia.

The IIA team will concentrate on the review of the Office of Internal Audit and Inspection, and Mr. Eccles will concentrate on the review of the external audit process. Their review report is expected to be provided to management in August 1998.

Mr. Baumgartner (ext. 37307), a member of the steering committee appointed by management to draft terms of reference for the above review, is available to answer questions relating to this paper.

Att: (1)

Other Distribution:
Department Heads

Review of the Office of Internal Audit and Inspection

Terms of Reference

Background and Purpose

The IMF is currently undertaking a comprehensive review of a number of internal support activities. As part of this review, the Fund's Office of Internal Audit and Inspection (OIA), which is conducting the review, is itself to be reviewed by outside experts.

The main purpose of the external review of OIA is to give Fund management an independent analysis of the quality and effectiveness of the Fund's internal audit function. The review is to be conducted concomitantly with a review of the current structure of the Fund's external audit process, which will be subject to a separate terms of reference (attached).

Scope of the Review

The scope of the review will be comprehensive and include all of OIA's current responsibilities, notably (i) the internal financial audit function; (ii) operational and system audits; (iii) institutional reviews; and (iv) work practice reviews, as well as the role of the OIA in support of the external evaluation studies now undertaken by outside experts. The assessment will provide an estimate of the general adequacy, cost, and effectiveness of these functions, measure the OIA's delivery of services against generally accepted professional standards for internal auditing, review the internal charter, assess the reporting relationship of OIA and its organizational structure, provide comparisons with best practices and other relevant organizations, conduct a survey of Fund business units participating in the internal review process, and identify the areas of strength, weakness and potential for improvement.

The contents, scope, and general conduct of the review should be broadly consistent with the terms of reference of the General Services Review approved by Fund management. Within this context, the review of OIA will include:

- the OIA's compliance with the Fund's audit policies and procedures as outlined in various Fund documents, and with the Standards for the Professional Practice of Internal Auditing as adopted by the Institute of Internal Auditors;
- the effectiveness, efficiency, and state of the art of the OIA's review procedures of the Fund's accounting, financial and operating controls, measured against generally accepted benchmarks of performance;

- the contribution of internal auditing to the overall system of internal controls, including areas for improvement, and the cost effectiveness of the OIA's services;
- the OIA's current responsibilities and work program in light of professional standards of internal auditing and the practices in similar organizations, including an assessment of the scope of the OIA's responsibilities and their impact on its independence and of potential internal conflicts of interest;
- the quality, competency and efficiency of the OIA's delivery of services, including the proficiency of its staff, and its performance with respect to planning, examination, and evaluation of information and the timeliness and quality of the communication of its findings; and
- the adequacy of OIA resources measured against generally accepted benchmarks.

With respect to the financial audits, the review will also examine the relation between the internal financial audit function and the work performed by the external auditors of the Fund, including the Fund's External Audit Committee as background for the review of the structure of the Fund's external audit process.

Procedures

The review should take account of the standards for the professional practice of internal auditing. The external review team would be expected to develop a full understanding of the current role and functions of the OIA and will interact, as necessary, with the OIA, the Treasurer's Department and other departments for the review of the OIA's financial and operational audits, and its institutional reviews, including through the conduct of an internal survey. Given the nature of the Fund as an international financial institution, the review is expected to consider current practices related to internal audit functions both within and outside the United States.

The external review team will be selected by a Steering Committee composed of four senior staff members in the Fund, who will monitor progress, provide internal assistance as needed, and resolve issues on which guidance is requested. At the completion of the review, an overall written report, covering all aspects of the terms of reference, will be delivered directly to IMF management.

Review of the External Audit Process

Terms of Reference

Background

The IMF is currently in the process of conducting a comprehensive review of a number of its internal support activities. As part of this review, Fund management has decided to conduct an external assessment of the Fund's internal and external audit functions. The review of the audit functions will be conducted in two parts: (i) a general review of the operations and effectiveness of the Office of Internal Audit and Inspection; and (ii) a review of the financial external audit process. These terms of reference deal with the second part of the review.

The external audit of the Fund's financial statements is currently undertaken, in line with the Fund's by-laws and regulations, by an External Audit Committee (EAC), assisted by an independent external auditing firm, which relies in part on the work performed by the Office of Internal Audit and Inspection. The EAC is charged with conducting an examination of the Fund's system of accounting and financial controls and records, and with issuing an opinion with respect to the fairness of the presentation of the financial statements. The EAC is constituted annually by the Executive Board of the Fund and comprises three representatives from the Fund's member countries. The services of the EAC are terminated upon completion of the annual audit and submission of the audit report, though one member of the EAC serves for two years. The EAC convenes in Washington in late May/early June for three weeks.

Purpose

The main objective of the review is to provide Fund management with a comprehensive evaluation of the current structure and effectiveness of the Fund's external financial audit process. As recommended by the 1997 EAC, the review will include a thorough evaluation of the responsibilities and functions of the EAC, comparisons with the external audit procedures of other international financial organizations and corporations, and identification of potential changes that could increase the effectiveness of the external financial audit process.

Scope of the review

The review should be broad and focus in particular on the following issues, while taking into account the requirements under the Fund's Articles of Agreement and By-Laws:

- Study of the adequacy of the existing framework, including legal requirements and audit standards, for the Fund's external financial audit process.

- Evaluation of the current functions and responsibilities of the Fund's EAC in light of recent developments in audit standards, the generally accepted practices of external audit committees, and practices of similar organizations.
- Assessment of the role and reporting of the public accounting firm and its relation to the EAC. Under current procedures, the audit of the Fund's financial statements is largely executed by the accounting firm, and the EAC reviews the audit work performed by the audit firm and issues an audit opinion. Specific questions to be addressed in this context are whether the EAC should continue to have the responsibility of signing the opinion on financial statements and whether alternative arrangements would be appropriate in light of audit standards. The review should include a study of the implications of possible alternatives on the organization and conduct of the external audit process, and on the scope and division of responsibilities of the EAC, the external accounting firm, and the Fund's Office of Internal Audit and Inspection.
- Review of the current practice of constituting the three members of the EAC on an annual basis, with one member serving for two years, and development of possible alternative approaches that could bring greater continuity and thus more effective oversight while maintaining broad participation of the Fund's membership in the audit process.

Procedures

The external consultants are expected to have substantial experience with current external audit practices and financial reporting practices and be familiar with international financial institutions. The consultants will be expected to interact with former members of External Audit Committees, the OIA, the Fund's Treasurer's Department and other departments as necessary, particularly those that participate in the internal audit process.

The external consultants will be selected by a Steering Committee composed of four senior staff members in the Fund, who will monitor progress, provide internal assistance as needed, and resolve issues on which the consultants request guidance. Upon completion of the review, an overall report, covering all aspects of these terms of reference, will be presented directly to Fund management.