FOR AGENDA

SM/09/44

February 13, 2009

To: Members of the Executive Board

From: The Acting Secretary

Subject: **2009 Report on Risk Management**

Attached for consideration by the Executive Directors is the 2009 report on risk management, prepared by the Advisory Committee on Risk Management (ACRM), which is tentatively scheduled for discussion on **Monday, March 2, 2009**. Issues for discussion appear on pages 19 and 20.

The staff does not propose the publication of this paper.

Questions may be referred to Mr. Andrews, FIN (ext. 38318) on financial risks; Ms. Mateos y Lago, SPR (ext. 37219) on strategic and core mission risk; and Mr. Trines, OIA (ext. 35639) on the ACRM Secretariat and operational risks.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

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INTERNATIONAL MONETARY FUND

2009 Report on Risk Management

Prepared by the Advisory Committee on Risk Management

February 13, 2009

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I. Introduction

1. **This report presents an overview of the risks currently facing the Fund, as assessed by departments and the Advisory Committee on Risk Management (ACRM).**[1]

2. **An annual comprehensive assessment of risks is a key element of the risk management framework established in 2006—see Box 1.** The most recent report of the ACRM in June 2008 to the Executive Board presented the results of an interim, targeted, survey of departments on the risks of the downsizing and associated restructuring of the Fund.[2] This is the first full assessment since early 2007[3] and was prepared following a comprehensive survey of departments and offices conducted in November/December 2008.

3. **Since the June 2008 report, the environment and the potential risks facing the Fund have changed significantly**.

- First, important steps have been taken in the last six months to refocus the Fund and cut back on administrative expenditures. The medium-term budget envelope requires substantial savings of some $100 million (12 percent of the net administrative budget) over three years, most of it in the first year; and the Fund needs to accommodate the separation of some 500 staff—most of which are scheduled for the current year.

- Second, however, even as the staff separation program was being put into effect, the sudden and sharp deterioration in global economic and financial conditions placed significant new demands on the Fund in general, and certain departments in particular.

Many departments thus now find themselves facing a higher than planned workload, against a reduced budgeted level of staff and the actual or imminent loss of experienced staff. This sequence of events has given rise to a changed perception of strategic/core mission risks; a significant shift in certain financial risks; and a different profile of operational risks, with staffing and resource risks more prominent.

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[1] The ACRM is chaired by Mr. Kato and has representatives at department/office head level of area, functional and support departments. To strengthen the role of the ACRM, its membership was expanded to include senior representatives of EXR and HRD as ex-officio members in October 2008.

[2] *Risk Management—Interim Update* (FO/DIS/08/53, 06/02/08). The ACRM also reported to the Board in early 2008 (*Risk Management—Update* (FO/DIS/08/7, 01/16/08).

[3] *2007 Report on Risk Management* (SM/07/90, 3/6/07), *Report on Strategic and Core Mission risks in the Fund* (SM/07/90, Supplement 1, 03/09/07), *Report on Financial Risk in the Fund* (SM/07/90, Supplement 2, 03/09/07), *Statement by the Managing Director on the 2007 Report on Risk Management* (BUFF/07/42, 03/23/07) and *The Acting Chair's Summing Up* (BUFF/07/65, 05/04/07).

Box 1. The Fund's Risk Management Framework

The Fund's risk management framework is broadly based on Enterprise Risk Management (ERM) principles.[1] It consolidates previous risk management practices adopted over the years in the Fund, while broadening and formalizing it in a number of other areas.

As part of this framework, the ACRM was established to assist Fund management in: analyzing, synthesizing, and reporting risks; enhancing the awareness in departments of the importance of risk management; and reporting to the Board on risk management matters.

Annual assessments of risks are conducted to: (i) inform management and the Board about the perception of residual risks by departments, after taking account of mitigation measures in place; (ii) apprise departments of risks and efforts to mitigate risks in other areas of the Fund ; and (iii) bring to the attention of OIA areas of residual risk, so that these can be taken into account in the design of annual audit plans.

The risk management framework endorsed by the Board groups risks at the Fund into four categories:

Strategic risk — The risk that the definition of its medium- and longer-term objectives and the formulation of its strategies does not meet the evolving needs of Fund membership.

Core mission risk — The risk that the Fund will not achieve its core mission objectives, including macroeconomic and financial stability in member countries, promoting international macroeconomic cooperation, contributing to debt and development initiatives in low-income countries, and providing capacity-building services.

Financial risk — The possibility of direct or indirect loss or other negative effects on the Fund's financial position arising from risks including in the areas of credit, income, liquidity, and investment.

Operational risk — The exposure of the Fund (and individual Fund organizational units) to direct or indirect losses or negative effects, including reputational, resulting from internal failures or inadequacies in business processes, people, or systems, or from external events.

Reputational risk, which is of key importance to the Fund, is not included as a separate category but rather implicitly covered in the four other categories, as it can materialize as a consequence of adverse events in any or all of the other risk categories.

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[1] *Report of the Task Force on Risk Management* (EBS/06/4, 1/09/06) and *Second Report of the Task Force on Risk Management—Task Force Proposals on the Implementation of a Risk Management Framework at the Fund* (EBS/06/74, 6/26/06), *Risk Management—Further Considerations* (SM/06/386, 12/04/06).

4. **The 2008 risk assessment draws principally on a survey of strategic/core mission and operational risks administered to 22 departments and offices in late 2008 (Box 2).** The ACRM is conscious that, even in the relatively brief period since the survey was conducted and completed (early December), work pressures have further intensified and some risks have no doubt changed. Departments were reporting their then current perception of the risks—given the pressures they could see, their existing medium term budgets, etc. On the one hand, work pressures on several departments have increased since then; on the other, OBP has also begun to redeploy resources from reserves and anticipated underspends to the most hard-pressed departments, while HRD has accelerated its efforts to recruit new staff. The ACRM will thus keep a close eye on developments so that the External Audit Committee (EAC) and the Executive Board can be updated as needed.

Box 2. Scoring of the Survey

Consistent with the methodology used for the June 2008 survey, the survey asked departments and offices to rate the severity of impact and likelihood on a scale of 1 through 4 as follows:

	Severity of Impact		Likelihood of Occurrence
4	Serious	4	Very Likely
3	Medium-High	3	Likely
2	Medium-Low	2	Unlikely
1	Minor	1	Very Unlikely

Additional guidance was provided to help achieve consistent interpretation of these ratings (see the survey in Appendix I). The survey was completed by 22 departments and offices.

For analytical purposes, for the common risks, ratings were averaged for department groups (area (AFR, APD, EUR, MCD, WHD), functional (EXR, FAD, FIN, INS, LEG, MCM,OTM, RES, SPR, STA) and support departments (HRD, INV, OBP, OIA, SEC, TGS, EUO)) and the Fund as a whole.

Overall risk scores were derived by multiplying the impact and likelihood ratings for the individual risks. This allowed the ranking of risks and comparison across segments of the Fund. The range of possible overall risk scores thus was 1-16. Average scores were ranked as follows:

High	> 9
Medium-High	$> 6 \leq 9$
Medium-Low	$> 4 \leq 6$
Low	≤ 4

5. **The paper is organized as follows.** Section II provides an assessment of strategic and core mission risks; Section III discusses financial risks; and Section IV reports on operational risks. Each of these sections presents the main results of the risk assessment, notes any changes to perceived risks over the last year, and identifies current or planned mitigation measures. Finally, Section V raises a number of issues for discussion by Executive Directors and discusses next steps.

II. Strategic and Core Mission Risks

6. **This section provides an overview of strategic and core mission risks at the Fund, describes mitigation strategies, and identifies some important residual risks.** The key points are that (i) the Fund faces a variety of such risks, some of which have emerged as a result of the institution's recent restructuring and the global financial crisis which placed significant new demands on the Fund; (ii) the Executive Board and Fund management and staff are taking important steps to mitigate key strategic and core mission risks; and (iii) despite these efforts, important residual risks will remain with regard to the Fund's ability to meet the evolving expectations of its membership.

Key risks

7. **The Fund's strategic directions and human resources were assessed to be the most important categories of strategic risk.**[4]

- In the area of ***strategic directions***, concerns focused on four issues: meeting the expectations of the membership to perform in the current crisis and to participate meaningfully in the design of the new financial architecture; addressing the perception that the Fund's responsiveness to its membership is unbalanced; and the adequacy of budget resources for carrying out its various mandates.
- In the ***human resources category***, risks identified related primarily to staffing in terms of both quality and quantity of staff; morale issues in the post-downsizing environment; the loss of institutional knowledge caused by staff departures; and the challenge of building a strong and diverse leadership pipeline.
- Survey responses outside these two risk categories revealed concerns mainly about progress in reforming the Fund's governance structure; the adequacy of outreach and communication efforts to sustain the Fund's relevance and improve its image; potential communication mistakes; and the institution's culture, including its capacity to support the growth of more junior and diverse staff.

8. **Core mission risks were associated mainly with the Fund's lending and surveillance activities, but issues also surfaced in other areas.**

- Regarding ***lending***, departments' concerns centered on program design issues, including the potential impact of weak conditionality and a lack of country ownership on program success, and the Fund's financial soundness. Inequality of treatment across countries was seen as a second important risk dimension.
- The ***surveillance-related risks*** identified related mainly to the Fund's capacity to analyze adequately current economic issues and to produce high-quality surveillance products; inequality of treatment, including due to difficulties with the implementation of the 2007 Surveillance Decision; and, to a lesser extent, the communication of surveillance results.
- Many departments also felt that the Fund's ***technical assistance*** program, and country relations more broadly, could suffer significantly from the introduction of charging at the time of a global financial crisis; and were concerned about enhanced reliance on

[4] Survey responses were aggregated into nine risk categories: for strategic risks— strategic directions, human resources, governance/ethics/culture, and communications; and for core mission risks —lending, surveillance, technical assistance, liaison, and other. See Appendix II for a more detailed discussion of the results.

third-party funding as well as the impact of staff departures on the capacity to deliver TA in vital areas such as financial sector policies.

- Some risks were highlighted only by a few departments, but are worth reporting because of the high likelihood and potential damage associated with them. These risks include failure to (i) maintain high standards in the review of country papers when the new review process is phased in, particularly in specialized areas; (ii) adequately prepare teams covering vulnerable countries for the shift from surveillance to crisis mode; and (iii) move toward activity-based costing.

Mitigating Measures

9. **The Fund is continuing to strengthen its policies and procedures to mitigate strategic and core mission risks.**

- ***Strategic directions.*** Beyond addressing many of the residual risks identified in the 2007 risk report (see Box 3), the Fund has adopted a new approach to meeting strategic challenges, including: assigning responsibility for strategy development and implementation to one department—the Strategy, Policy, and Review Department and, within it, the creation of the two strategy units (a generalist one and another for LIC matters); issuing a medium-term strategic directions statement at the time of the last budget discussion, and injecting a greater strategic perspective in Work Program statements. The Executive Board also undertook several important policy reviews in 2008,[5] and adopted a modified Exogenous Shocks Facility and the Short-Term Liquidity Facility. At the request of the IMFC, the Fund has also started to take the lead in drawing the necessary policy lessons from the current crisis, recommending effective actions to restore confidence and stability; and has enhanced cooperation with the Financial Stability Forum, the G-20, and others on this issue in an inclusive setting.[6]

- ***Human resources.*** These risks have both operational and strategic dimensions. Measures to address the direct operational dimension, mainly aimed at alleviating staffing shortages, are described in Section IV. To strengthen the institution's longer-

[5] See, in particular, *2008 Triennial Surveillance Review—Overview Paper* (SM/08/287, 9/2/08); *Review of the Fund's Financing Role in Member Countries* (SM/08/283, 8/29/08); and *The Role of the Fund in Low-Income Countries* (SM/08/170, 6/16/08).

[6] See International Monetary and Financial Committee, *Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund*, October 11, 2008.

Box 3. Mitigating Key Residual Strategic and Core Mission Risks Identified in the 2007 Risk Report

The Fund has made significant progress in addressing the key residual risks identified in the 2007 report on risk management, which were related to the institution's legitimacy, relevance and effectiveness, and effective management:[1]

- The April 2008 decision by the Executive Board on the new income model and the medium-term budget has laid the basis for strengthening the Fund's ***income position*** through a reduced reliance on interest income from lending activities, once the model becomes effective; and has provided more clarity about the ***size of the Fund.***
- The April 2008 decision of the Board of Governors on quota and voice reform was an important step toward restoring the Fund's ***legitimacy***, with some redistribution of voting shares toward dynamic emerging market and developing countries in the first stage and a subsequent process for a continued rebalancing of shares. To make the reforms on quota and voice and on the income model effective, however, members need to work urgently toward the early completion of the required domestic legislative steps. Work has also been underway to identify further reforms of the Fund's decision-making processes that would help the institution fulfill its global mandate more effectively, including by the Committee of Eminent Persons under the chairmanship of Mr. Trevor Manuel; further discussions on governance reform are therefore expected, including under the auspices of the Joint Steering Committee.
- Building on the Fund's Medium-Term Strategy, the Strategic Directions Paper delivered to the IMFC in April 2008 and the September 2008 progress report to the IMFC strengthened the strategic focus of the Fund on areas of competitive advantage, which, together with the other reforms mentioned above, prepared the ground for a ***more relevant and more effective Fund*** in the future.[2]

[1] See *2007 Report on Risk Management* (SM/07/90, 3/6/07) *and Report on Strategic and Core Mission Risks in the Fund* (SM/07/90, Supplement 1, 3/9/07).

[2] See *Statement by the Managing Director on Strategic Directions in the Medium-Term Budget* (IMFC/Doc/17/08/4, 4/9/08); and *Draft Progress Report of the Managing Director to the International Monetary and Financial Committee on the IMF's Policy Agenda—IMF Response to Global Economic Challenges* (SM/08/308, 9/23/08).

term staffing model and employee value proposition[7] and improve staff morale, the Fund has begun to delegate more responsibilities to its non-managerial staff and to introduce policy changes to enhance performance management, promotion decisions, and succession planning.

- ***Lending.*** Since the onset of the global financial crisis in October 2008, the Fund has responded quickly and flexibly to requests for exceptional access arrangements from members facing pressures on their external capital accounts and financial systems. While large resources were made available upon approval of the arrangements, the quarterly review schedule will help limit the risk of program failure. Internally,

[7] The employee value proposition is, simply put, a statement of what employees expect from their employer in return for their service.

various mechanisms, including an inter-departmental crisis group and web-based collaboration tools, were established to support adequate quality control and facilitate a close dialogue between country teams, reviewers, and crisis veterans even under tight deadlines.

- ***Surveillance.*** A number of initiatives are underway to make further progress in the four operational areas that the Board highlighted in its Statement of Surveillance Priorities for 2008-11, namely risk assessment; financial sector surveillance and real-financial linkages; a multilateral perspective; and analysis of exchange rates and external stability risks. Examples include the creation of the macro-financial unit in RES, the planned conduct of early warning exercises, and the extension of the vulnerability exercise to advanced economies.

- ***Technical assistance.*** The fact that low-income members and all countries with Fund arrangements will be exempted from charging will mitigate the risks to members' capacity building efforts and country relations associated with the new cost-sharing mechanism in large parts of the membership. Particular vigilance to these risks will be required in other countries, as relevant. Moreover, to limit dependence on third-party contributions, the Fund will continue dedicating its own resources to finance a substantial part of its TA work; and the new TA performance management system should soon allow the Fund to prioritize better among members' requests.

- ***Other categories of strategic and core mission risk.*** The External Relations Department has responded swiftly to new ***communications challenges*** linked to the current crisis, including through a departmental crisis group and the contracting of specialized public relations firms. In response to the changing global outlook, the Fund has strengthened its liaison with ***country authorities*** in a number of program/near-program cases through maintaining or re-opening Resident Representative Offices originally slated for closure. Finally, the phasing in of the new review process has proceeded with great care and consultation among departments to minimize negative effects on quality control, and its implementation is being monitored.

10. **Notwithstanding these risk-mitigation efforts, significant residual risks remain.** Most importantly, in the strategic directions category, the Fund could still fall short of meeting the expectations of its members. This scenario would become more likely were the Fund's resources to prove inadequate for covering all of its mandates or if the institution failed to contribute successfully to resolving the current generation of financial crises. Management's commitment to meet legitimate financing needs from the crisis, if required through a supplementary budget, helps to address this issue. To some extent, however, a residual risk is unavoidable as crisis dynamics are inherently difficult to understand and an effective policy response depends on mutually consistent actions of a multitude of actors.

III. Financial Risks

11. **With the sharp increase in Fund lending in response to the global crisis, the near-term balance of financial risks has moved toward credit and liquidity risks, and away from income risks**. This section summarizes the evolution of financial risks and their mitigation. The framework for the control of financial risks is summarized in Box 4, and is discussed in detail in the 2007 Report on Financial Risks in the Fund.[8]

Credit risk

12. **The sharp expansion in Fund lending in support of members' adjustment programs (most of which involve exceptional access), has exposed the Fund to significant credit risk**. Recent arrangements provide for the extension of credit on a scale that is large in relation to previous metrics of Fund lending (e.g., quotas and GDP) and in relation to previous credit exposures to the members concerned. Outstanding credit increased from SDR 7.6 billion at end-September 2008 to SDR 17.9 billion at end-January 2009. Commitments rose over the same period by SDR 33.7 billion. Moreover, the approval of several arrangements under the accelerated procedures of the Emergency Financing Mechanism (EFM) led to a compression in the timeline for their development, review, and approval.

13. **Credit is expected to continue rising in the near term as members draw under existing arrangements and as additional members seek Fund support to address the systemic crisis**. The financing needs of a number of emerging market countries are large, and in an environment of global deleveraging, could be larger than currently projected. In this environment, Fund lending is unlikely to catalyze substantial private financing, at least initially, suggesting that the Fund, working with the official community, may need to cover a higher than usual portion of the near-term financing needs. To the extent that the recovery of capital flows is slower and smaller than projected, some combination of additional adjustment measures and successor arrangements may be required.

14. **A further factor potentially increasing credit risks is that members with arrangements face a variety of challenges to returning to a sustainable external position, and thereby ensuring their capacity to repay the Fund.** In most cases the resolution of crises will require rebuilding balance sheets, particularly of the household and financial sectors. In other cases members may require substantial fiscal adjustment. Implementation risks may be significant, particularly in cases in which difficult adjustment policies will need to be sustained for extended periods, and where it has been difficult to achieve a political consensus in support of the reform program.

15. In addition to the recent upswing in lending, the Fund's exposure to relatively few large borrowers has remained high—the concentration of lending to the top five **borrowers**

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[8] *Report on Financial Risks in the Fund* (SM/07/90, Supplement 2, 3/9/07).

Box 4. The Fund's Financial Control Framework[1]

The Fund relies on a multilayered control structure to safeguard against financial risks. The Fund's financial policies and risk mitigation measures are established by the Executive Board. Management oversees their implementation, while staff carry out day-to-day procedures and adhere to controls established to mitigate risks.

The Executive Board has the central role in the management of financial risks. All decisions involving the use of Fund resources are taken by the Board, and all financial policies are reviewed and approved by the Board prior to implementation by management.

The **Managing Director** conducts the ordinary business of the Fund under the direction of the Board. Management oversees the extensive system of checks and balances. The **Finance Department (FIN)** has responsibility for managing and safeguarding the Fund's financial resources to ensure that they are deployed in a manner consistent with the policies approved by the Board. FIN is also responsible for the conduct of **safeguards assessments**.

External service providers, notably expert investment managers and custodians have been retained by the Fund according to their areas of specialization and expertise in serving sophisticated institutional clients like the Fund. Under contractual agreements, staff conduct on-going due diligence to ensure compliance with stated objectives and investment guidelines/limits. In addition, staff and auditors review the internal controls in effect with these external service providers.

The Fund has a comprehensive audit framework. This comprises the complementary, yet distinct, roles of the external audit, internal audit, and external audit committee (EAC) functions. The **EAC** is independent from management and staff, and oversees the Fund's internal control processes and external and internal audit functions in an ex-post oversight role.

The Fund's **external auditors** are selected by the Board, and conduct an annual audit of the Fund's financial statements, including the Trust accounts, other administered accounts, and the accounts relating to the Staff Retirement Plan, in accordance with International Standards on Auditing.

The **Office of Internal Audit and Inspection (OIA)** provides, inter alia, independent and objective reviews of the effectiveness of risk management, control, and governance processes of the Fund. OIA is operationally independent from the Fund's activities and forms part of, and reports directly to, the Office of the Managing Director, and functionally to the EAC. OIA follows internationally accepted standards for the practice of internal audit as promulgated by the Institute of Internal Auditors.

The Fund discloses its financial risk management policies in the audited financial statements, as required by International Financial Reporting Standards (IFRS). The external audit firm and the EAC review and assess the adequacy of these disclosures at least annually to ensure that the information disclosed enables the public to evaluate the nature and extent of financial risks arising from the Fund's activities. Financial risk management vis-à-vis the Trusts and other administered accounts is similarly disclosed in the financial statements and subject to internal and external audit.

In the interests of transparency, the Fund provides extensive information to the public on the Fund Financing pages of the IMF website.

[1] For further details, see SM/07/90, Supplement 2, 3/9/07.

stood at close to 90 percent at end-2008. Were one or more of these larger borrowers to incur arrears to the Fund, the interest arrears could exceed the Fund's capacity to compensate for these losses through the burden-sharing mechanism. This result in part arises because the decline in the SDR interest rate to very low levels has significantly offset the increase in burden-sharing capacity resulting from the higher level of outstanding credit.[9]

[9] As further described in EBS/08/110, Annex II, the Fund's maximum burden sharing capacity depends on the feasible reduction in remuneration expenses. Under the Articles, the rate of remuneration may be no less than

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16. **The Fund has in place a comprehensive set of general measures to mitigate credit risk.** Mitigation mechanisms in place include the policies on access (including on exceptional access); program design and monitoring, notably the conditionality attached to its financing and the financing assurances policy; safeguards assessments; and the preventative, precautionary, and remedial measures to cope with the financial consequences of protracted arrears, including the establishment of precautionary balances. The Fund's preferred creditor status also serves to mitigate credit risk. Furthermore, each request for exceptional access is accompanied by a Board paper that presents an assessment of the risks to the Fund and the impact on the Fund's liquidity position, in accordance with the access policy.[10]

17. **The increased lending activity underscores the need for the Fund to build up precautionary balances, as an essential buffer to protect against losses arising from credit (and income) risks.** In recent discussions, Directors stressed that developments underscore the need for a forward-looking approach to assessing the adequacy of precautionary balances.[11] On balance, Directors were willing to retain the current target of SDR 10 billion while stressing that this target should be kept under close review. A number of Directors observed that it might need to be raised if lending remained high or expanded.

18. **Further mitigation measures also have been put into place for new facilities.** In the case of the recently approved Short-Term Liquidity Facility (SLF), risks are mitigated by a combination of the stringent eligibility criteria, and the short-term self correcting nature of the balance of payments needs. Forthcoming papers will provide a discussion of the design of Fund facilities and application of conditionality, which may have implications for financial risks.

19. **Finally, the introduction of new lending instruments and the increased credit exposure have also heightened safeguards risks, not least as a result of accelerated schedules**. Faster disbursements and shorter-term facilities have required some changes to the modalities for safeguards assessments. In particular, greater reliance is placed on the work of external auditors as the first line of defense. For the SLF, staff will be authorized by central bank authorities and external auditors to hold discussions on audit findings that may place Fund disbursements at risk. Similarly, for the EFM, staff have accelerated procedures for holding discussions with external auditors before the formal initiation of the safeguards assessment and the first Fund disbursement. While these discussions cannot be a guarantee

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80 percent of the SDR interest rate, which limits the downward adjustment to the rate of remuneration for burden sharing to 20 percent of the SDR interest rate.

[10]See: *The Acting Chairman's Summing Up of the Review of Access Policy Under the Credit Tranches and the Extended Fund Facility*, and *Access in Capital Account Crises—Modifications to the Supplemental Reserve Facility*, and *Follow-up Issues Relating to Exceptional Access Policy* (BUFF/03/28, 3/5/03).

[11] *Review of the Adequacy of the Fund's Precautionary Balances* (EBS/08/110, 9/24/08, and Supplement 1), and *The Acting Chair's Summing Up Review of the Adequacy of Precautionary Balances* (EBM 08/107, 12/8/08) (BUFF/08/175, 12/11/08).

against abuse, they seek to identify relevant risks at the earliest time, which can then be addressed immediately or taken up during the conduct of the safeguards assessment.

Income Risk

20. **Since the 2007 review, two developments have significantly mitigated income risks**.

- First, the membership agreed on a new income model that would put the Fund's income onto a sustainable basis. Under the new model, the profits from limited sales of Fund gold would be invested in an endowment that would generate a sustainable income stream. The model also envisages increased earnings on the Fund's investments through a broadening of the Fund's investment mandate.

- Second, the increase in Fund lending has increased earnings from charges and surcharges. The revised medium-term outlook for the Fund's income was discussed in a recent Board paper.[12] A key conclusion was that the new income model remains essential, as the current increase in the Fund's income associated with higher lending is likely to be temporary, and provides the opportunity for a needed build up in precautionary balances as noted above.

At the same time, it should be noted, that while the short-term income outlook has improved, the medium-term sustainability remains vulnerable to possible delays in securing the necessary legislative approval, and adverse market developments including in the price of gold, interest and exchange rates.

Liquidity risk

21. **As lending has expanded, liquidity risk has increased.** Fund liquidity has declined from historic highs following the onset of the current crisis. The Fund's forward commitment capacity (FCC) declined from SDR 127.6 billion in September 2008 to SDR 95.2 billion at end-January 2009. A recent analysis of the likely demand for Fund credit in the period ahead pointed to the possibility that the Fund's liquidity could come under strain, with a sharp decline or even exhaustion of the FCC.[13] Against this background, the Board recently considered a management recommendation to double the Fund's pre-crisis lending capacity, with borrowing identified as the main option in the short-run. Borrowing by the Fund could pose a number of potential financial risks for the Fund, which would need to be carefully managed, in part through the design of borrowing agreements; these risks are discussed in an earlier paper.[14]

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[12] *Consolidated Medium-Term Income and Budget Framework* (EB/CB/08/6, 12/29/08).

[13] *Review of the Adequacy of and Options for Supplementing Fund Resources* (EBS/09/7, 1/12/09).

[14] Op cit.

22. **The crisis could also have important implications for LIC's financing needs, and the adequacy of the Fund's concessional resources**, which will need to be kept under close review. Forthcoming papers will discuss the implications of the global financial crisis on low-income countries, and will review the Fund's concessional lending facilities.

Investments

23. **While counterparty and exchange rate risks associated with the Investment Account and balances in the Trusts are limited, returns are significantly affected by interest rate developments**.

- Counterparty risk is mitigated by limiting holdings of the Investment Account to securities issued by sovereigns (and their central banks or eligible national agencies) that issue the currencies included in the SDR, and by international financial institutions. Trust fund resources are invested in a somewhat broader range of assets including deposits placed with the BIS. [15]

- Exchange rate risk is mitigated by holding investments denominated in the constituent currencies of the SDR in proportion to the weight of each currency in the SDR basket. The residual risk that cash flows generated by investments do not match the composition of the SDR is mitigated by regular rebalancing.

- The rapid and unprecedented decline in SDR yields has boosted portfolio performance in the short term, but the risk of underperformance, should yields rise, has also increased. From a longer term perspective, there is a risk that the existing investment mandate will not be able to generate the 3 percent real annual return assumed in the income model.

Other

24. **The comprehensive audit framework continues to focus on risk management, the control environment, and the Fund's financial results as reported in the audited financial statements** (see also Box 5). The external audit, internal audit and External Audit Committee (EAC) functions each assess evolving risks to determine the impact on their work plans. Both the external audit firm and OIA have adopted a risk based approach to the audit plan that will help identify activities or changes in circumstances which could potentially impact the financial statements or other areas. In light of the financial crisis and the evolving composition of the Fund's loan portfolio, the EAC has indicated an increased focus in the FY 2009 audit on loan processes, precautionary balances, impairment analysis, and financial asset valuations.

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[15] As a precautionary measure, in the context of extraordinary risk aversion in credit markets and dislocation in interbank money markets, the Fund's securities' lending program was temporarily suspended on October 1, 2008, in order to mitigate the very small counterparty and reputational risk entailed by this activity.

Box 5. Risk Disclosures and the Fund's Financial Statements

Over the past two years, the notes to the financial statements have been enhanced for disclosures on risk management to comply with the new requirements under International Financial Reporting Standards (IFRS). Overall the disclosures have been expanded to cover each category of financial risk. In particular, additional disclosures have included information and data on: credit risks in the investment portfolio; the securities lending program; income risk; and sensitivity analysis for interest and exchange rate scenarios. Staff continues to monitor developments in IFRS to determine their impact on the notes to the financial statements.

IV. Operational Risks

25. **The survey on operational risks included common (that is Fund-wide risks), identified by the ACRM on the basis of the results of the 2006 survey (updated to reflect the changing environment), as well as open questions to seek feedback on department-specific risks**. The risks were divided into five broad categories:

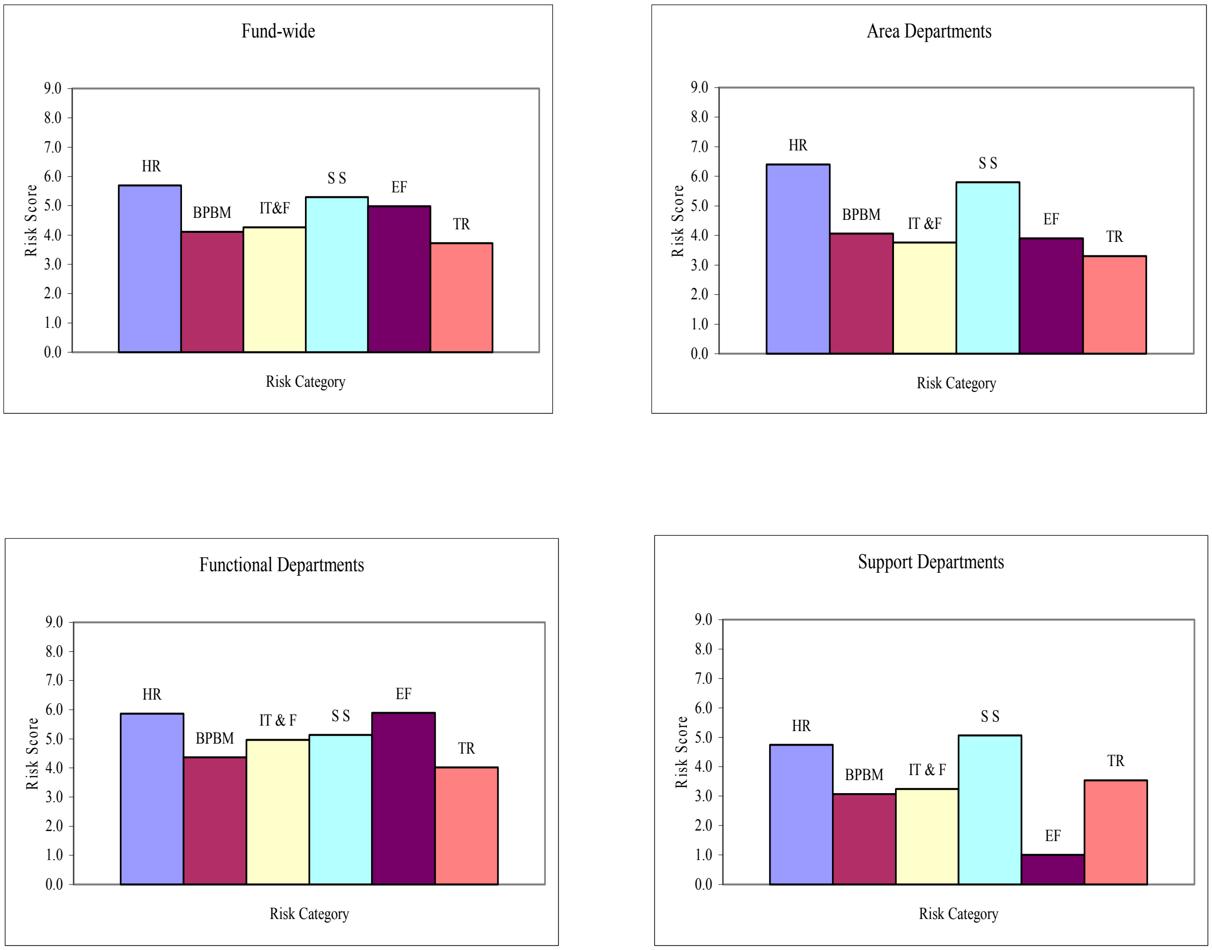
- staffing/human resources;
- business processes and business management;
- IT and facilities;
- safety and security; and
- external funding.

The survey also included follow-up questions on a number of risks that had been raised in the context of the restructuring.

26. **Among these five main categories of operational risk, departments scored staffing-related risks highest on average, followed by safety and security-linked risks.** This was the case both Fund-wide and across most department groups (Figure 1). Functional departments, however, rated external financing risks as more important than safety and security concerns.

27. **Overall, however, departments scored even these, the greatest risks, as medium-low in intensity—staffing risks ranked "medium-high" only in area departments**. Transitional risks related to the restructuring were scored lowest. This latter result should be interpreted with some caution, however: a benevolent interpretation would be that departments now have in place strategies to cope with actual and planned separations; a less optimistic view might be that, with less than half of the total separations completed as of end-2008, departments may not yet have fully appreciated the problems to come.

Figure 1. Overall Operational Risk Scores[16]



28. **In terms of individual components within each category of risk, the main findings were as follows.**

- The risk that budget constraints and/or changing work demands might impede departments' ability to deliver core or expanded outputs was scored highest.
- The second highest risk identified was that of being unable to staff departments with the right people to deliver the work program, alongside the related risk of maintaining an appropriate level of staff skills and knowledge (Table 1).

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[16] The legends to these figures are : HR is human resources, BPBM is business processes and business management, IT & F is IT and facilities, SS is safety and security, EF is external funding and TR is transitional risks.

Table 1. 2008 Risk Survey: Operational Risks—Summary Results

	Average Risk Score 1/	Standard Deviation	Change in last year (number of departments) 2/ Greater	Same	Smaller
Human Resources					
1. Staffing the department/office with the right people and recruiting a and retaining them to deliver the FY2009 business plan and medium-term budget. (HR 1)	7.3	3.3	16	1	3
2. Maintaining an appropriate level of staff skills and knowledge. (HR 2)	6.7	2.8	11	7	3
3. Unethical behavior or misconduct by staff, either intentional or unintentional, at headquarters or in the field. (HR 3)	2.8	1.4	0	15	3
4. Low morale and productivity, for example because of perceived limited opportunities for promotion. (HR 4)	6.0	2.4	4	11	4
Business processes/business management					
1. Budget constraints and/or changing work demands constrain department's ability to deliver core or expanded outputs (e.g. unanticipated Fund programs). (BPBM 1)	8.7	3.2	20	0	1
2. Leaks of confidential information. (BPBM 2)	3.0	1.7	0	15	3
3. Significant inconsistencies in the application of policies, in the provision of policy or technical advice, or assignment of assessment ratings (in ROSCs, FSAPs, AML/CFTs, etc.) both within or across departments. (BPBM 3)	3.6	2.4	2	8	3
4. Inadequate procedures for the development of new policies and business processes. (BPBM 4)	3.0	1.9	2	9	3
5. Potential errors in procedures for the provision, processing, or calculation of economic data. (BPBM 5)	4.1	2.5	2	7	2
6. Potential errors in preparation, processing, and accounting for financial transactions (including budget, payments, benefits). (BPBM 6)	2.9	2.1	4	10	3
7. Inadequate or untimely communication with the public either in the field or at headquarters. (BPBM 7)	3.4	2.4	4	9	1
IT and Facilities					
1. The Fund's IT technology does not meet changing departmental business and/or analytical needs (IT&F 1)	5.5	3.0	8	10	1
2. The Fund's facilities do not meet changing departmental business needs. (IT&F 2)	3.3	2.6	2	11	1
3. Failure of building or other systems (e.g., telecommunications) disrupting daily activities. (IT&F 3)	3.8	2.5	2	14	1
4. Unauthorized access to secure information. (IT&F 4)	4.8	3.4	2	14	1
5. Serious lapses in department's own systems and/or insufficient preparedness to operate in the event of a disaster. (IT&F 5)	4.0	2.4	1	12	4
Safety and Security					
1. Terrorist activities, civil unrest, or other disturbances affecting staff on mission or resident representative. (SS 1)	6.6	3.6	5	11	0
2. Department insufficiently prepared to operate in case of large staff absences (e.g. flu epidemic) (SS 2)	4.0	2.6	0	14	4
External Funding					
1. Insufficient external funding sources to deliver departmental business plans. (EF 1)	5.3	3.5	4	5	0
2. Priorities of external donors for TA/capacity building do not match departmental priorities. (EF 2)	4.7	3.0	3	5	1
Transitional risks					
1. Relatively protracted period for departing staff undermines overall staff productivity. (AT 1)	3.8	2.7	5	6	7
2. Departmental work programs are (temporarily) disrupted by the reorganization of work units and/or the departure of key staff, including senior staff. (AT 2)	5.0	2.5	7	4	7
3. Attention to existing control on work processes is (temporarily) weakened (e.g., deliberate leaks by disgruntled employees, IT systems sabotage, etc.) (AT 3)	2.6	1.3	3	7	8
4. Morale issues for refused volunteers. (AT 4)	3.5	2.9	4	6	7

1/ Calculated as the average of the product of likelihood and severity of impact ratings. Maximum score is 16, minimum score is 1.

2/ Totals vary by risk because some risks did not apply to all departments and some departments did not provide input.

- Other risks that were relatively highly rated included low morale and productivity, the risks that the Fund's technology would not meet changing departmental business or analytical needs, and safety and security on mission.

29. **Two other risks were highlighted.** First, many departments underscored in their submissions the risk that all the IT tools and associated streamlining, as well as more general streamlining of processes, necessary to achieve the budgeted savings, were not yet in place. Second, functional and some area departments flagged the risk that, with an expanding TA agenda, especially through regional technical assistance centers, backstopping efforts at headquarters could suffer, potentially compromising quality of the TA. At a time when departments face reduced resources, they are also having to take on some tasks previously undertaken in support departments.

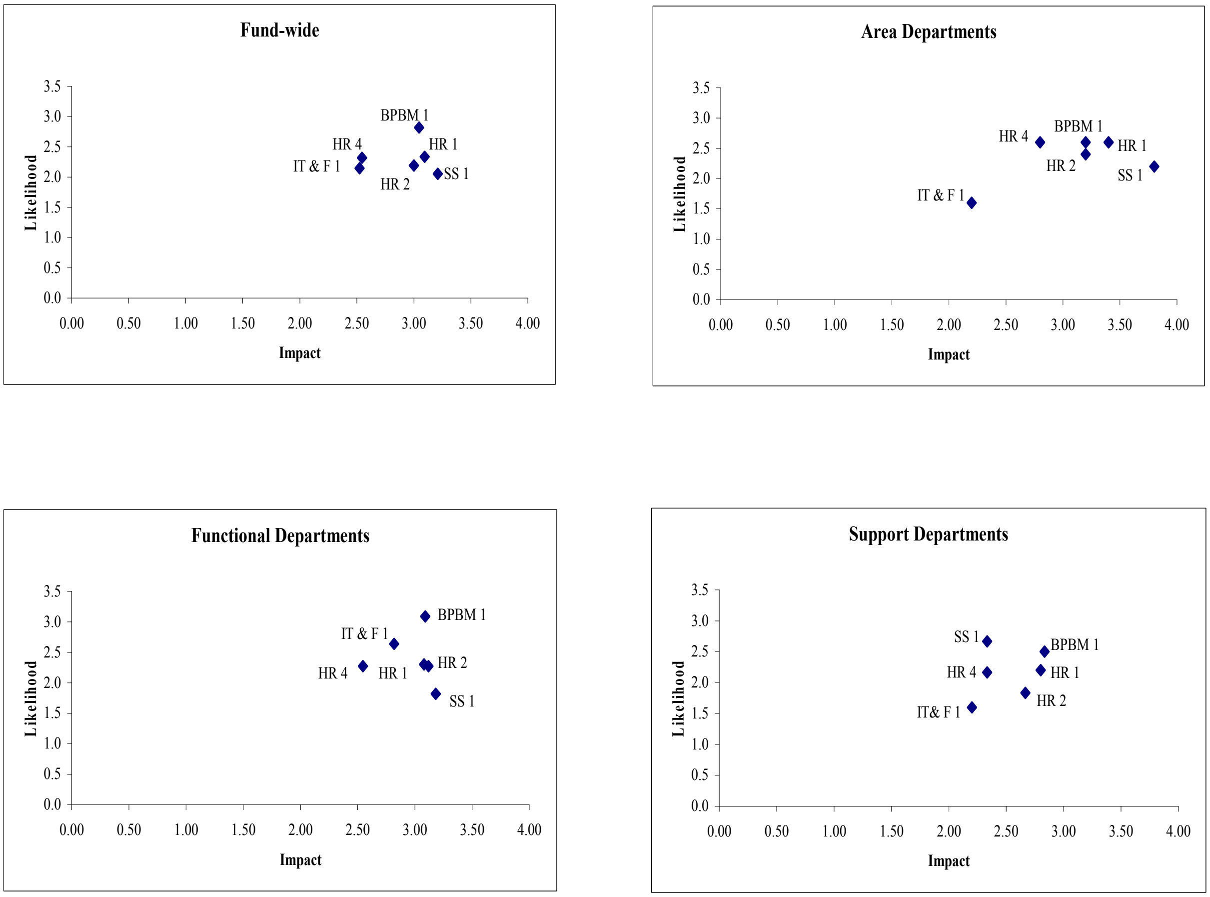
30. **The assessments of individual risks varied considerably across departments.** Departments are affected differently or may perceive risks differently. Thus, some departments are losing a lot of experienced staff, while others are less affected and staff in some departments travel more and thus have a different view of the importance of security related risks.

- Thus, for the six overall highest scoring risks, half or more responding departments ranked risks related to staffing (both being able to deliver on the work program and maintaining knowledge and skills) as well as security risks on missions as "high" or "medium-high."

- More than half of all departments also ranked budget constraints at this level.

- By contrast, only one department ranked unethical behavior as anything other than an exceedingly low risk. The dispersion of the risk ratings for these six risks is shown in Figure 2.

Figure 2. Dispersion of Risk Ratings for Top Six Operational Risks[17]



31. **The results of the survey suggest that, while many risks have generally not changed, some have become more prominent.** In particular, virtually all departments considered that the combination of current budget constraints and changing work demands had raised the risk that they would be unable to deliver core or expanded outputs. Staffing constraints also had become more prominent and, with greater pressures since November and upcoming departures of staff, could have further escalated. Most departments viewed IT, facilities, security and safety related risks as broadly unchanged and indicated that transitional (restructuring related) risks had remained the same or declined (Table 1 above).

32. **Steps are being taken in a number of areas to further mitigate the risks reflected in the 2008 assessment.** More details on mitigation measures are contained in Appendix II.

[17] Please refer to Table 1 for a definition of the risks presented in these figures.

- With respect to **human resources**, the Fund is well advanced in a recruitment campaign to fill quickly about 100 permanent economist positions, as well as a number of short-term positions in departments with urgent staffing needs. Steps are also being taken to redeploy existing staff toward priority areas and possibly defer some departures; additional efforts will be needed to hire non-economist experts. Departments also have intensified training and reassignments of staff to strengthen knowledge management.

- On budget-related risks, OBP has allocated some $8 million from the FY 2009 contingency reserves to departmental budgets. These resources, along with active redeployment of staff, are designed to receive the pressures on the most hard pressed departments.

- While efforts have been intensified to streamline and change **business processes**, as noted above, much remains to be done. Proposals for further streamlining and redeployment, consistent with the medium-term budget, that will need to be acted upon, will be presented to the Executive Board next month.

- In the area of **IT** an extensive strategic planning review is being conducted to ensure alignment of the IT plans with changing business needs. Significant steps have been taken to establish and test business continuity and disaster recovery plans and access controls to Fund systems and information are being further strengthened. Areas of risk identified in the survey—for example for outsourced IT support services—have already shaped OIA's work program.

V. Issues for Discussion and Next Steps

33. **Executive Director's views are sought on the following issues:**

- Do Directors agree with the general findings of the report and the areas highlighted, as well as the direction of actions indicated?

- Are there any significant risks that Directors find missing in the ACRM report?

34. **As noted at the time of the introduction of the risk management framework in 2006, its modalities will be reviewed after three years of implementation.** The ACRM will consider ways to further refine and focus the risk framework drawing on the experience so far, reviews of best practices in other International Financial Institutions (IFIs), and other

organizations, and based on discussions with members of the EAC. [18] The results of this work will be presented to the Executive Board.

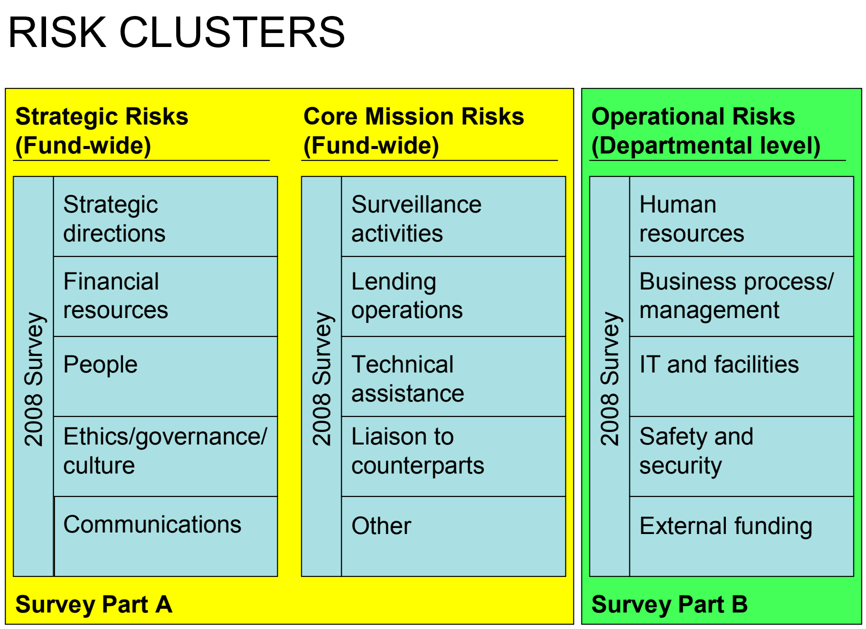
35. **As in the past, it is not proposed to publish this report** as it is considered part of the internal control framework of the Fund and should be used to inform management and the Executive Board about risks and aid in the decision making process.

[18] An operational risk forum, with participation by most multilateral development banks and a number of other international financial organizations (jointly organized by the IFC, the IDB, the Fund, and the World Bank), is planned for May 2009. This will be an opportunity to further exchange experiences and discuss developments.

Appendix I. Survey Template

2008 Risk Survey

1. **The purpose of the survey is to collect (and collate) departmental views on strategic, core mission, and operational risks facing the Fund.** To ensure a comprehensive coverage of risks while providing room for discovery, the survey categorizes risks into 15 clusters, that are expected to remain constant over time (see figure). In addition, the survey also seeks follow-up information on the main transitional risks associated with the downsizing exercise, as reported by departments and offices in May 2008.



2. **The survey is divided into two separate parts (A and B) for the strategic/core mission risks and operational risks, respectively.** Both parts seek views on the severity of impact of risks and their likelihood, using a four-point rating scale (1, 2, 3, or 4).

3. **The ratings for severity of impact are as follows.**

Rating 1: **Minor**: This rating would be consistent with a low impact, requiring only minor corrective action.

Rating 2: Medium-Low: This rating would involve moderate or modest impact; and may require remedial measures, but not necessarily the involvement of senior management.

Rating 3: Medium-High: A medium-high rating would often imply significant impact or disruption, requiring speedy action; and may require some involvement of senior management.

Rating 4: Serious: A risk rated serious would typically involve: a major disruption to work, a crisis, or a major deleterious impact, financial or otherwise, on desired outcomes; require urgent action by senior management; and have a major impact on the Fund's reputation.

4. **The likelihood ratings are:**

Rating 1: Very unlikely but not negligible.
Rating 2: Unlikely but possible.
Rating 3: Likely.
Rating 4: Very likely/Almost certain.

Part A. Strategic and Core Mission Risks

5. **Strategic risks are defined as:** the risk that the Fund's medium- and longer-term objectives and the formulation of its strategies may not meet the evolving needs of the membership.

6. **Core mission risks are defined as:** the risk that the Fund will not achieve its core mission objectives, including contributing to macroeconomic and financial stability in member countries, promoting international macroeconomic cooperation, contributing to debt and development initiatives in low-income countries, and providing capacity-building services.

7. **Part A of the survey aims to collect departments' views on these strategic and core mission risks**. Departments are encouraged to canvas a wide range of views within their department in formulating the risk assessment.

- For each cluster, except that covering financial resources, departments should identify the risks—at least two, but, to ensure prioritization, ideally no more than four—that are considered to be most relevant for the Fund in the year ahead and report these in the survey template.[1] With regard to core mission risks, departments should use the "Other" category to report risks that cannot be readily classified under one of the four clusters identified.
- Departments should assign to each risk a severity of impact and likelihood rating in line with the categories indicated above.

[1] Financial risks will not be covered by the survey; FIN will report separately on these issues.

- To provide some guidance on the risk discovery process, the survey template is accompanied by an indicative list of risks, that could be used as a starting point for the departmental exercises. This list is purely illustrative: departments should feel free to ignore these risks in their submissions if they do not rank them as priorities.

Part B. Operational Risks

8**.** **Operational risks are defined as** : the exposure to direct or indirect losses or other negative effects, including reputational, resulting from internal failures or inadequacies in business processes, people, or systems, or from external events.

9**.** **Part B thus seeks views on operational risks identified in the survey and provides an opportunity for departments to add any other specific risks.** Operational risks are to be classified under five clusters: (i) human resources; (ii) business processes/business management; (iii) IT and facilities; (iv) safety and security; and (v) external funding.

10**.** **The focus in the Part B survey is on the risks in operational areas facing the department itself, rather than the Fund-wide perspective of the Part A survey.** Some overlap arises—for example, in the area of human resources. The Part B survey responses should reflect risks that may directly impact departmental operations or processes now or in the near future. The risks under the "people cluster" in Part A, should have both a longer-term (but still only over the next year or two) dimension and materialize at the Fund-wide level. The last section of Part B lists risks included in the May 2008 survey on transitional risks associated with the downsizing.

11**.** **Information is also sought on any steps already taken, or planned, to address the various risks, on proposed/necessary mitigation measures**—both at the departmental or at the Fund level—and on changes perceived in the risks relative to last year (or May for transitional risks).

12**.** **Finally, following completion of the survey, the ACRM will meet with departmental groups to discuss the results and seek further input.** At that stage, there will also be an opportunity for departments to reconsider the assigned ratings.

2008 Departmental Risk Survey. Part A: Strategic/Core Mission Risks

Department:_______________________________

Strategic Risks		
Please indicate your department's views on strategic risks.		
	Impact 1/	**Likelihood 2/**
Strategic directions cluster		
1.		
2.		
3.		
4.		
Financial resources cluster (FIN only)		
1.		
2.		
3.		
4.		
People cluster		
1.		
2.		
3.		
4.		
Ethics/governance/culture cluster		
1.		
2.		
3.		
4.		
Communications cluster		
1.		
2.		
3.		
4.		

Core Mission Risks		
Please indicate your department's views on core mission risks.		
	Impact 1/	**Likelihood 2/**
Surveillance activities cluster		
1.		
2.		
3.		
4.		
Lending operations cluster		
1.		
2.		
3.		
4.		
Technical assistance cluster		
1.		
2.		
3.		
4.		
Liaison to counterparts cluster		
1.		
2.		
3.		
4.		
Other		
1.		
2.		
3.		
4.		

Strategic risk: The risk that the Fund's medium- and longer-term objectives and the formulation of its strategies may not meet the evolving needs of the members.
Core mission risk: The risk that the Fund will not achieve its core mission objectives.

1/ Impact should be classified as: (4) Serious, (3) Medium-High, (2) Medium-Low, (1) Minor.
2/ Likelihood should be classified as: (4) Very Likely, (3) Likely, (2) Unlikely, (1) Very Unlikely.

2008 Risk Survey. Part A: Strategic/Core Mission Risks—Indicative List

Strategic risks

Strategic directions cluster

1. Prominent involvement in the current financial crisis exposes the Fund to criticism if the crisis deepens, and weakens our credibility in advising members.

2. A failure to respond effectively to the new expectations of the membership and the opportunities for increasing the Fund's relevance leads to weakened credibility and to the Fund's being marginalized as a provider of global public goods, particularly after the high-profile "refocusing of the Fund's initiative."

3. The Fund does not establish itself as a key player in the debate on the international financial architecture.

4. Diverging interests and positions across the membership lead to the inability to create effective instruments for crisis lending to fill gaps in the Fund's toolkit.

5. The Fund is perceived as focusing its efforts on the needs of its higher-income members (large financing, low conditionality) while neglecting to address the needs of its low-income members (little financing, high conditionality).

Financial resources cluster (to be completed by FIN only)

People cluster

1. The Fund is not staffed adequately, both in terms of employee strength and staff core capacity, to deal with the sharply expanded work program focused on crisis management; and fails to achieve medium-term strategic goals. It does not succeed in quickly redeploying/retraining current staff or hire new staff to meet the core and emerging expertise required.

2. The Fund fails to move the right people into leadership positions, fails to demonstrate progress in diversity goals, and fails in implementing/supporting effective leadership development in the short and medium term.

3. Experience of restructuring continues to weigh on staff morale; engagement and employee retention become issues.

4. The Fund's employee value proposition[2] is perceived to be weak due to the institution's antiquated HR strategies and lack of an adequate compensation package.

[2] The employee value proposition summarizes what employees can expect from their employer in return for their service.

Ethics/governance/culture cluster

1. Failure or delay in making progress with reforming the Fund's governance framework may undermine the institution's long-term effectiveness.

2. The Fund does not succeed in maintaining an adequate ethics framework.

3. The Fund fails to move toward a more inclusive culture, which capitalizes more on the staff's diverse cultural background and on the ideas and knowledge of its more junior staff.

Communications cluster

1. Outreach and communication efforts are insufficient in volume or inadequately targeted to sustain the Fund's relevance or improve its image.

2. Negative campaigning targets the Fund or its management.

3. Communication mistakes by Fund staff undermine the institution's ability to carry out its mandate.

4. A piecemeal or incoherent approach to communicating Fund policies and programs undermines the institution's ability to carry out its mandate.

Core Mission Risks

Surveillance activities cluster

1. Inadequate capacity to analyze key economic issues, including due to weak cross-country analysis or a failure to understand financial-real sector linkages.

2. Weak or misleading communication of staff views, including due to lack of candor and insufficient quality/timeliness of surveillance products.

3. Inequality of treatment across countries, including due to difficulties with the implementation of the 2007 Surveillance Decision.

4. Inability to spot or prevent the next crisis, WEO/GSFR projections seen as incorrect or insufficiently forceful.

Lending operations cluster

1. Weak conditionality or lack of candor affects Fund's reputation, leads to sub-optimal policy advice/poor implementation, and puts financial soundness at risk.

2. The Fund fails to assess program ownership correctly, thus lending into situations that quickly go off track.

3. Inequality of treatment across countries in terms of access or conditionality.

4. Inability to line up co-lenders in big bailout situations.

5. Inability to adequately assess the size of financing needs leads to successive programs, protracted instability, or credibility loss.

Technical assistance cluster

1. Dependence on external funding skews TA provision away from the priorities of the member authorities or the Fund.

2. The use of conditionality in areas covered by Fund TA undermines nonpolitical nature of dialogue on TA.

3. Excessive reduction in demand for TA through introduction of charging.

Liaison to counterparts cluster

1. Closure of Res rep offices in near-program/program or systemic countries weakens policy implementation and outreach.

2. The Fund is not regarded as a trusted advisor in important member countries.

3. Candor remains lacking in relations between the Fund and members.

4. Initiatives to strengthen collaboration with partner institutions (including the World Bank, regional development banks, the Financial Stability Forum, and the OECD) prove to be ineffective.

2008 Departmental Risk Survey Part B: Operational Risks

Department: ___________________________

Departmental Operational Risks					
Please provide views on the following operational risks facing your department					
Risk	**Impact** 1/	**Likeli-hood** 2/	**Any mitigation measures implemented in FY2008 or FY2009 (to date)**	**Further planned mitigation measures**	**Is residual risk greater, smaller or the same as last year?**
Human resources 3/					
1. Staffing the department/office with the right people and recruiting and retaining them to deliver the FY2009 business plan and medium-term budget.					
2. Maintaining an appropriate level of staff skills and knowledge.					
3. Unethical behavior or misconduct by staff, either intentional or unintentional, at headquarters or in the field.					
4. Low morale and productivity, for example because of perceived limited opportunities for promotion.					
5. Any additional staffing risks facing the department.					
Business processes/business management					
1. Budget constraints and/or changing work demands constrain department's ability to deliver core or expanded outputs (e.g., unanticipated Fund programs).					
2. Leaks of confidential information.					

3. Significant inconsistencies in the application of policies, in the provision of policy or technical advice, or assignment of assessment ratings (in ROSCs, FSAPs, AML/CFTs, etc.) both within or across departments.					
4. Inadequate procedures for the development of new policies and business processes.					
5. Potential errors in procedures for the provision, processing, or calculation of economic data.					
6. Potential errors in preparation, processing, and accounting for financial transactions (including budget, payments, benefits).					
7. Inadequate or untimely communication with the public either in the field or at headquarters.					
8. Additional business-related risks.					
IT and Facilities					
1. The Fund's IT technology does not meet changing departmental business and/or analytical needs.					
2. The Fund's facilities do not meet changing departmental business needs.					
3. Failure of building or other systems (e.g., telecommunications) disrupting daily operations.					
4. Unauthorized access to secure information.					
5. Serious lapses in department's own systems and/or insufficient preparedness to operate in the event of a disaster.					
6. Any additional IT- and facilities-related risks.					
Safety and Security					
1. Terrorist activities, civil unrest, or other disturbances affecting staff on mission or resident representatives.					

2. Department insufficiently prepared to operate in case of large staff absences (e.g., from flu epidemic).					
3. Any additional safety and security risks.					
External Funding					
1. Insufficient external funding sources to deliver departmental business plans.					
2. Priorities of external donors for TA/capacity building do not match departmental priorities.					
3. Any additional external related risks.					
Additional "transitional" risks (not included above) included in the April 2008 survey					
1. Relatively protracted period for departing staff undermines overall staff productivity.					
2. Departmental work programs are (temporarily) disrupted by the reorganization of work units and/or the departure of key staff, including senior staff.					
3. Attention to existing controls on work processes is (temporarily) weakened (e.g., deliberate leaks by disgruntled employees, IT systems sabotage, etc.)					
4. Morale issues for refused volunteers.					

1/ Impact should be classified as: (4) Serious, (3) Medium-High, (2) Medium-Low, (1) Minor.

2/ Likelihood should be classified as: (4) Very Likely, (3) Likely, (2) Unlikely, (1) Very Unlikely.

Operational risks: The exposure to direct or indirect losses or other negative effects, including reputational, resulting from internal failures or inadequacies in business processes, people, or systems, or from external events.

3/ Other HR-related transitional risks associated with the downsizing and covered in the April 2008 survey are presented at the end.

Appendix II. Strategic and Core Mission Risks—Detailed Findings

Methodology. Strategic and core mission risks were assessed in a survey administered to 22 departments and offices in December 2008. The open survey generated 392 individual risk submissions, which were aggregated into 35 risk areas and nine broad risk categories to facilitate analysis.

FROM INDIVIDUAL RISKS TO RISK AREAS: THE CASE OF STRATEGIC DIRECTIONS

Individual risks

#	Description
1	Fund is perceived as focusing efforts on needs of higher-income members while neglecting to address needs of others
2	Excessive focus on crisis countries leads to criticism that the Fund has forgotten the needs of other members, particularly those in low-income countries, and loss of credibility in those countries
3	The Fund does not establish itself as a key player in the debate on international financial architecture on-going in Europe
...	...
64	A failure to respond effectively to the new expectations of the membership and the opportunities for increasing the Fund's relevance leads to weakened credibility and to the Fund's being marginalized as a provider of global public goods

Risk Components

#	Description
1	Bias in responsiveness to shareholders
2	Lack of focus
3	Meeting expectations of membership
4	Resource adequacy, strategy
5	Inability to create effective instruments

Two indicators were used to capture survey respondents' risk perceptions.

TWO WAYS OF MEASURING RISK

Risk frequency

Concept: the number of times survey respondents identified risks associated with a particular risk area or category as a share of all 392 risk submissions

Interpretation: provides a sense of what staff typically perceive as relevant risk areas; a high score implies high/generalized awareness of the respective risk area or category

Presentation in risk maps: the maps sort the risk areas in declining order (highest frequency risk on top of chart)

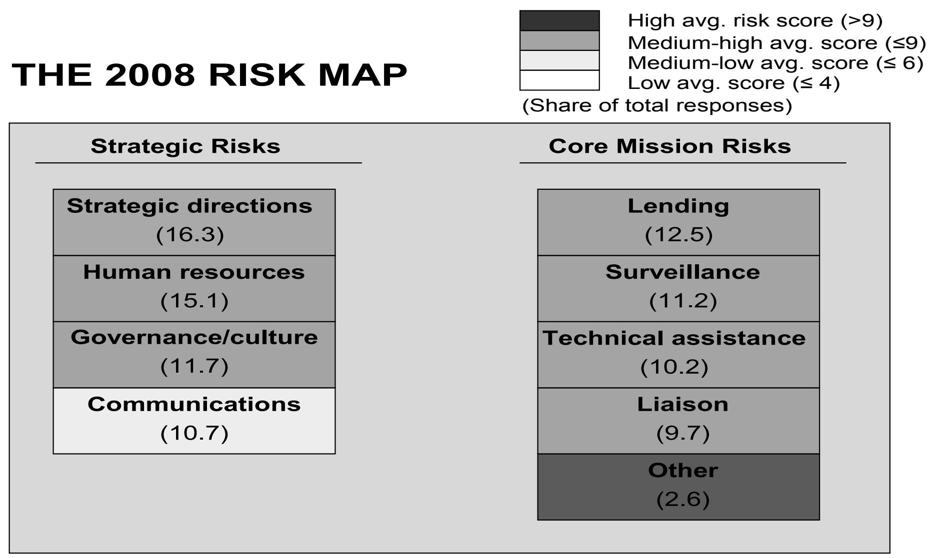
Risk intensity

Concept: the average risk score (likelihood x impact) of the risks identified within a given risk area or category

Interpretation: measures the potential damage that could arise from the respective risk area or category. The higher the score, the higher the potential damage

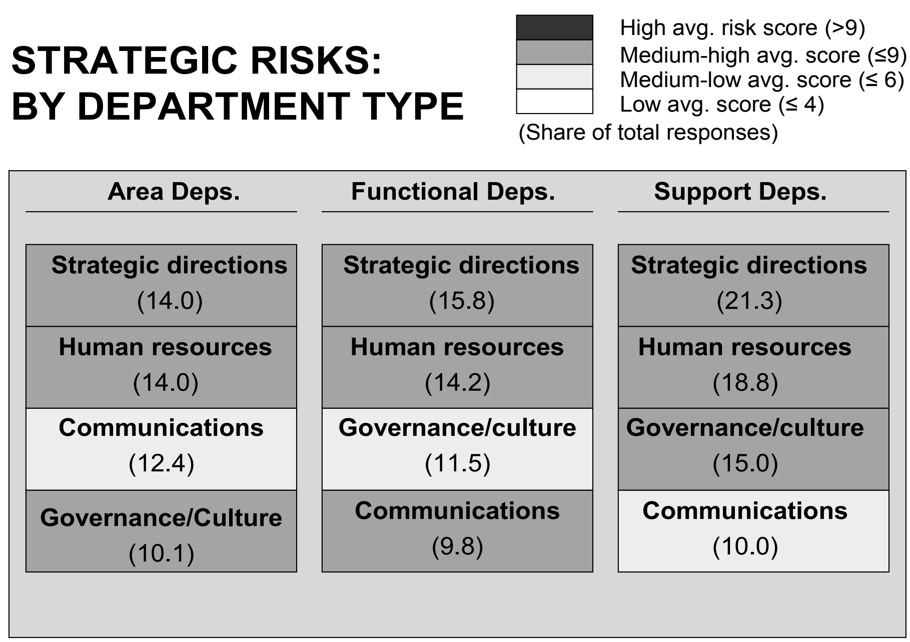
Presentation in risk maps: the maps use a color scheme to visualize risk intensity, ranging from green (low) to red (high)

Awareness was particularly high about risks associated with the Fund's strategic directions and its human resource strategy, but issues surfaced also in other risk categories. Except for communications, average potential damage for the broad risk categories was perceived to be at least medium-high.



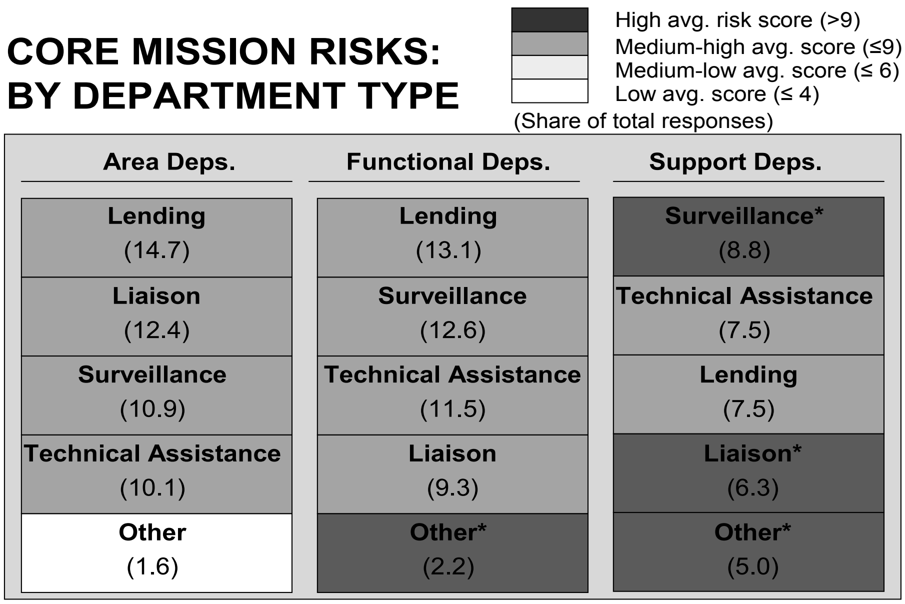
Source: 2008 departmental risk survey.

Assessments of strategic risks were broadly comparable across department types.



Source: 2008 departmental risk survey.

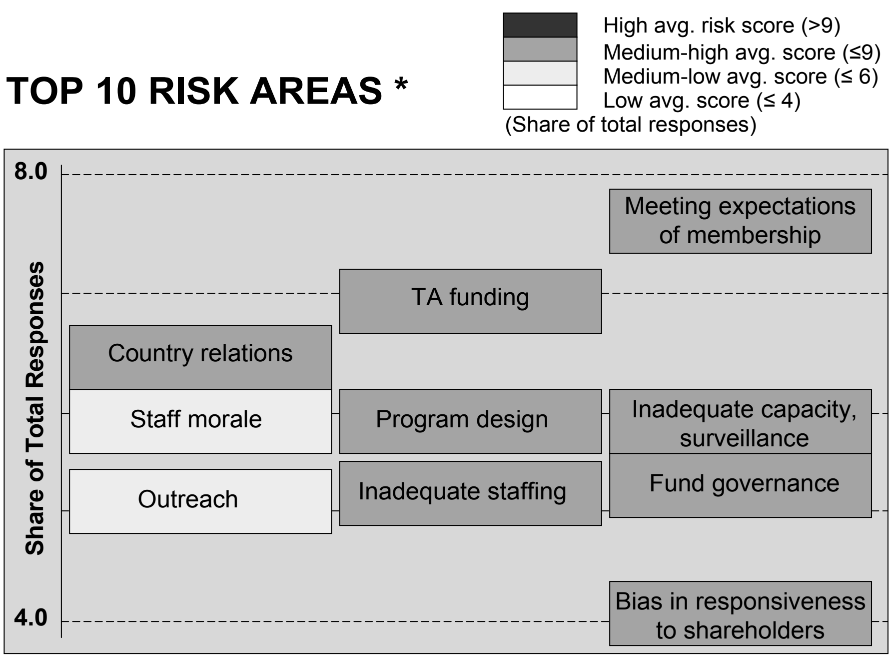
Perceptions of core mission risks diverged across department types. Area departments identified mainly risks related to lending and liaison with country authorities, while functional departments were equally concerned about lending, surveillance, and capacity building. Support departments saw fewer sources of core mission risks, but emphasized high potential damage associated with some risk areas.



*The high risk rating assigned to the "Other" category for functional deps. reflects concerns about decentralization and quality control issues related to the review process. High risk ratings for support deps. reflect mainly concerns about (i) inequality of treatment and inadequate capacity in surveillance; (ii) relations to country authorities; and (iii) the Fund's budget.

Source: 2008 departmental risk survey.

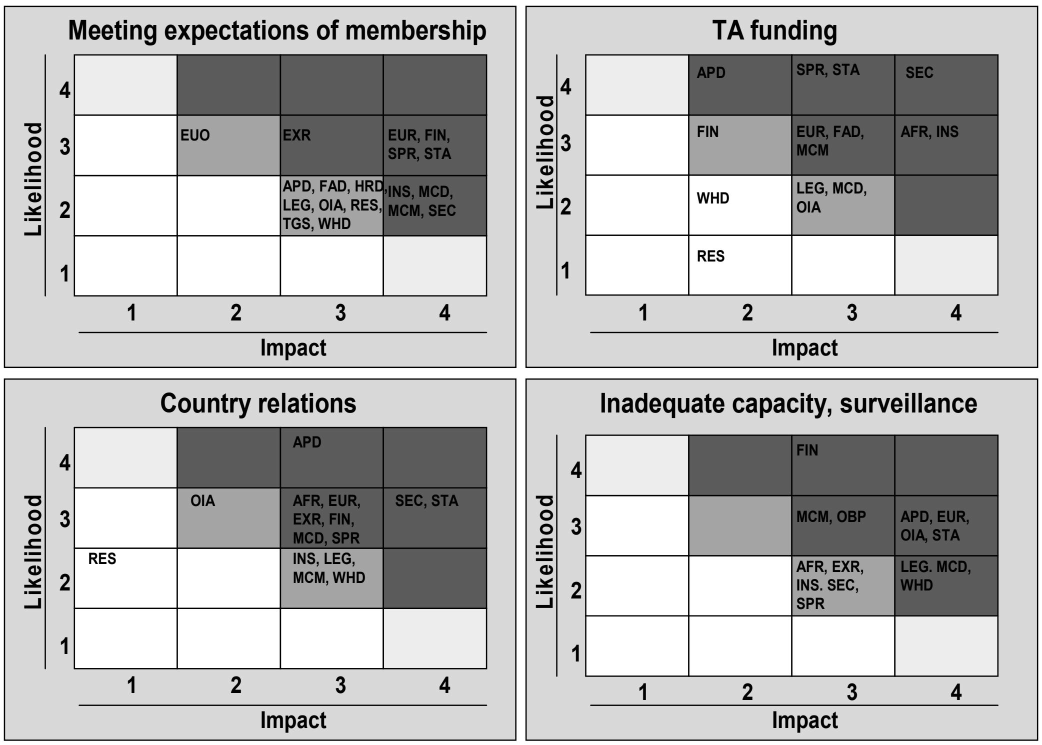
A more disaggregated view on the top risk areas provides a good impression of the **key issues identified by staff, typically with medium-to-high potential damage.**



* Out of a total of 35 risk areas, based on risk frequency.
Source: 2008 departmental risk survey.

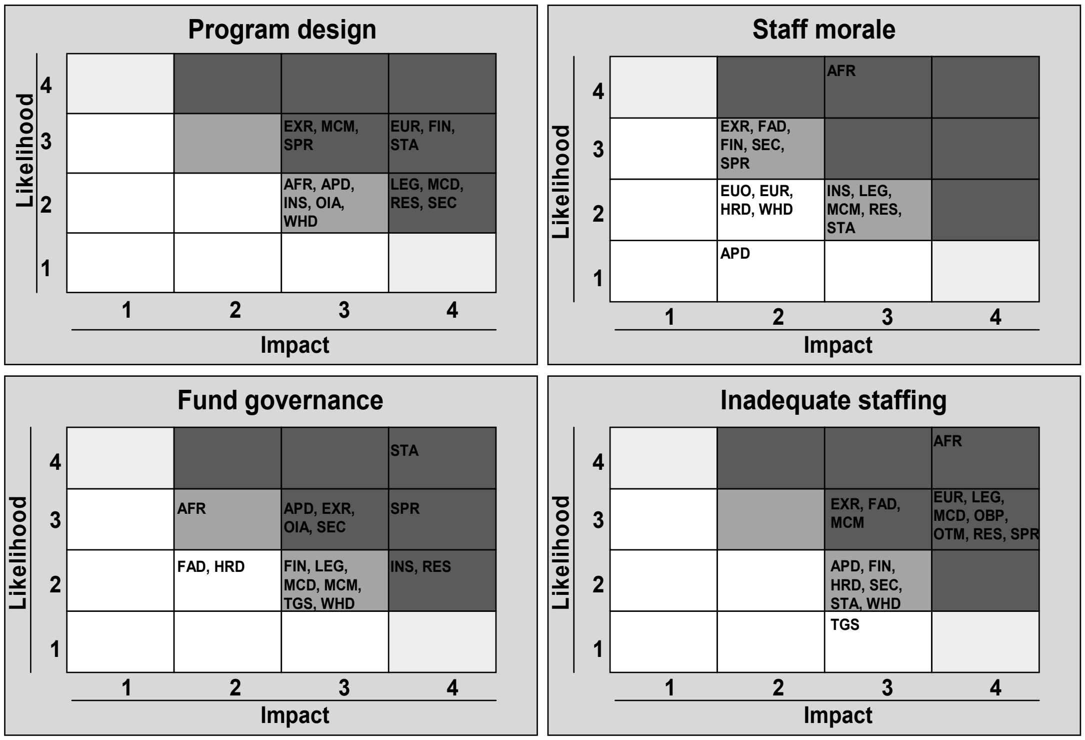
For some of the top risk areas, departmental views differed significantly on potential damage (risk likelihood x risk impact).

HIGHEST RATED RISK AREAS: DEPARTMENTAL VIEWS (1/2)*



* Based on mean of individual risk scores within each risk area.

HIGHEST RATED RISK AREAS: DEPARTMENTAL VIEWS (2/2)*



* Based on mean of individual risk scores within each risk area.

One or a few departments assessed some risks to be associated with high potential damage. SPR has taken the view that these risks should be reported a leading indicators, flagging issues that could be come relevant for the Fund as a whole in 2009.

LEADING RISK INDICATORS*

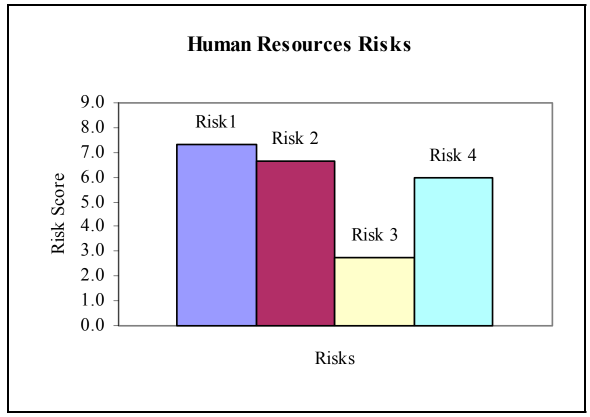
Risk area	Individual risks (selection)
Inequality of treat-ment, surveillance	Inequality of treatment across countries, including due to difficulties with the implementation of the 2007 surveillance decision
Lack of focus/resource adequacy, Fund strategy	Inability to keep focus on core needs beyond current crisis, because the Fund fails to reprioritize work or the institution fails to secure adequate income sources
Quality control	Changes in review process could weaken quality of programs and surveillance products; more mistakes are possible through significantly increased workload, less senior staff, and more delegation
TA capacity	Insufficient resources to provide sufficient TA in financial sector; and to ensure quality control/ backstopping function for RTACs
Budget reform	Failure to adopt carry-forward policy needed to cope with short-term resource demands; application of external deflator to budget envelope leads to add'l FTE reduction; delays in introduction of activity-based costing weighs on strengthening budget preparation
Crisis preparedness, lending	Lack of preparedness for shift from surveillance to program mode (lack of skills, data, and adequate spreadsheets)
Decentralization	Devolution of authority without adequate staffing for tasks performed earlier by TGS, HRD, and FIN raises concerns about compliance with policies and procedures

*Risk areas outside the top 10 with an average risk score exceeding 9.

Appendix III. Operational Risks—Detailed Findings

1. This appendix reports in more detail on the various categories of operational risk identified in the survey.[1]

Human resources/staffing related risks



2. **Staffing related risks scored highest in the survey, with three subcomponents ranked as "medium-high."** These components were: (i) staffing departments with the right people and recruiting and retaining them to deliver the FY 2009 business plan; (ii) maintaining an appropriate level of staff and knowledge, and; (iii) low morale and productivity. Nearly half of the departments ranked these risks a "medium-high" or "high." These interrelated risks all to some extent flow from the actual or forthcoming loss of experienced staff as a result of the downsizing.

3. **However, most departments have embarked on recruitment initiatives, including developing pipelines of potential future candidates—and the benefits of a new inflow of staff have yet to be realized**. A significant number of economists are being recruited externally to help meet staffing needs through the Economist Program and mid-career hires. Departments have also intensified training and reassignments of staff to strengthen knowledge management. Efforts to delegate responsibility to A14 economist staff, better prioritize work to improve work-life balances, as well as job reassignments are aimed at boosting morale. At the same time, many departments stressed the need for greater flexibility and streamlining in recruitment in order to find the right candidates in a timely manner. The recent introduction of the Joblink feature on the Fund's web is a positive factor in this regard.

4. **Ethics related risks did not figure prominently in the risk survey**, with an average score in the "low" category. Nevertheless, as noted in the report of the ACRM to the Board in January 2008, there is room to further heighten ethics awareness so that Fund staff are better equipped to recognize, appreciate, and resolve emerging ethical and reputational risks. Following initial steps to improve accessibility of information about the Fund's rules and expectations (e.g., the "Ethics & Integrity" page on the Fund's intranet), in December 2008 a working group was established to identify gaps in ethics policies and make recommendations for improvement.

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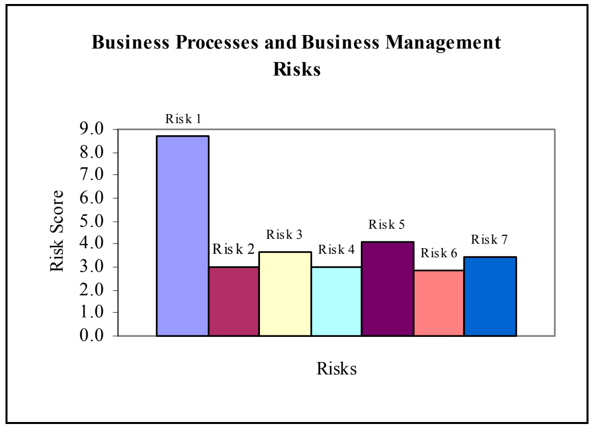
[1] Please refer to Table 1 in the main text for a definition of the risks presented in these figures.

Business processes and business management



5. **In this category, departments considered that budget constraints and changing (increasing) work demands constituted a "medium-high" risk. Functional departments (including SPR and MCM) rated this risk as "high."** Moreover, this risk has been increasing in recent months, despite efforts by departments to shift priorities to make resource available within their budgets to address new work demands. Management has recognized that those departments that are most heavily affected by the crisis at this time need additional staff urgently and beyond what is envisaged in their medium-term budgets. Drawing on contingency resources and redeployment from other departments, these departments have received additional temporary resources though FY 2011, including through an allocation a additional second-year EP positions .

6. **Two other business process risks were flagged by departments as "medium-high" or "high":**

- **Functional and some area departments expressed concerns about their ability to provide sufficient backstopping of technical experts,** including at regional technical assistance centers, in an environment of increasingly constrained resources at headquarters and at a time when certain administrative functions are devolved to these departments. This issue was also raised at a recent retreat of RTAC coordinators at headquarters. The establishment of topical trust funds that will be able to fund these activities is being explored aggressively, although it is unlikely to provide significant funding in the immediate future. The introduction of a new TA costing framework will help better identify backstopping costs.

- **A number of departments also noted that part of the savings to be achieved in coming years depends on changes in work processes (e.g., fewer assistants, budget processes) and streamlining;** and that much remains to be done to be able to reap the benefits.

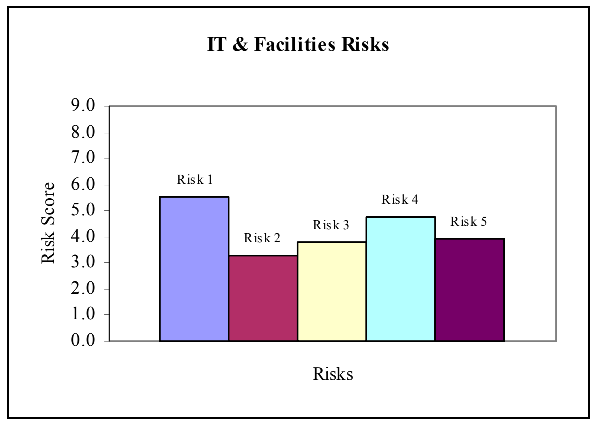
7. **A few departments noted that the Fund risks losing access to countries without programs as the result of the introduction of charges for technical assistance.** These departments felt that in these countries the Fund's relationship can often only be furthered by timely and amicable TA interventions and that charging could lead to loss of membership loyalty.

8. **Outside these business process risks, departments did not consider that they face significant operational risks, with almost all common risks ranked as "low."** Controls, such as internal review procedures, and in some departments the establishment of internal working groups aimed a quality control, are in place[2]. Following restructuring a number of departments have reorganized review responsibilities. Furthermore a number of departments stressed internal training and supervision and further automation of processes as mitigation measures. A major initiative, the Human Capital Management (HCM) project, aims at further improving internal procedures in the area of human resource management.

9. A few other issues raised by individual departments included the risk of different or inconsistent data being provided by different departments of the Fund (e.g., for statistical purposes and the WEO), risks associated with the complexity of introducing activity based costing, and excessive reliance on consultants.

IT and Facilities

10. **IT and facilities- related operational related risks were generally rated "low" or "medium-low."** Following the appointment of a Chief Information Officer (CIO), TGS has taken several steps to mitigate risks in the IT area. An extensive strategic planning review was conducted to ensure alignment of IT plans with changing business needs and customization has been reduced. The off-site Business Continuity Center has been fitted out for critical systems; communications have been split to ensure backup; full 'redundant' power systems have been installed; and remote access tools improved. Disaster recovery plans are regularly tested. Departments have established business continuity plans and these are regularly tested. In terms of unauthorized access the Fund has obtained ISO 27001 certification, requiring extensive protection to be in place, access control processes for external service providers have been strengthened, and laptops have been fully encrypted.



11. **Notwithstanding this progress, several departments highlighted risks related to the Fund's IT technology being unable to keep up with changing business needs**. In particular functional departments rated this risk as "medium-high" and this may well have reflected a more generally perceived need to further improve business processes and

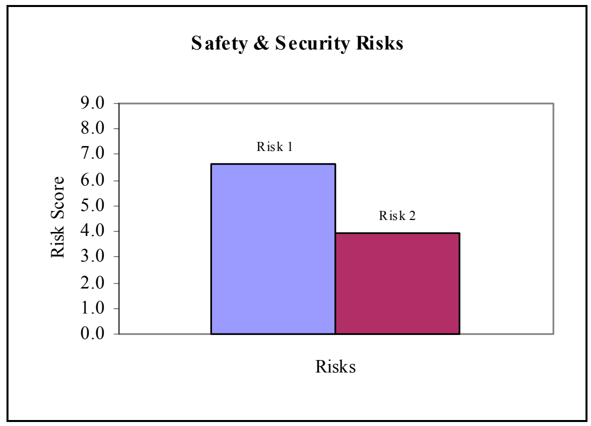
[2] Following the recent discussions with the EAC, the Fund's external auditors will review the paperwork related to processes and procedures being followed for recent program cases.

streamlining. Departments noted in particular issues related to the Technical Assistance Information Management System (TAIMS) and iBISS (the budget system). Several support and functional departments also flagged the risks related to the outsourcing of IT applications and support, which had caused problems and in some cases delays in implementing necessary system changes. (This is the subject of a separate OIA review.) Mitigation measures in this area are particularly important as the Fund moves to more extensive outsourcing.

12. **On IT systems security, some risks remain.** While generally not flagged as a serious risk by departments, and although no sensitive information was accessed, the recent breach of the Fund's network serves as a warning that strengthened vigilance is required in this area. TGS continues to take additional steps in this area to protect the Fund's systems.

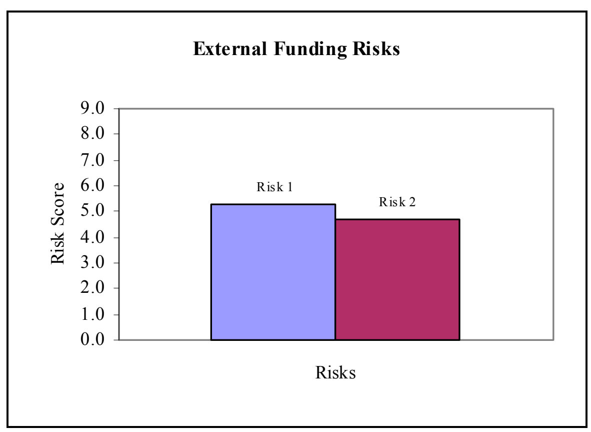
Safety and security

13. **Safety related risks, particularly with respect to mission travel and the safety of resident representatives, were rated as "high" or "medium-high" by a majority of departments.** Extensive monitoring of security developments, mission clearance procedures and security briefings and continued education are ongoing mitigation measures to enhance preparedness of staff, although these risks will remain and may increase with more intensive travel. TGS is developing a Fund Security Framework to further raise awareness in this area.



External funding

14. **While the overall score related to risks of inadequate external funding for some of the Fund's activities, was medium-low, several departments, especially functional departments ranked the impact of this risk as high or medium-high.** Understandably technical assistance departments rated this risk a little higher, at "medium-high", than other departments. However, several noted the substantial fund-raising effort that is underway as part of the Fund's new medium-term strategy, as well as efforts to secure financing before the start of the fiscal year. Limiting earmarking of external funding through the planned establishment of topical trust funds should allow more flexibility and support backstopping efforts.



Coordination with other donors in determining priorities was not considered a major problem.

Transitional risks

15. **Finally, most departments noted that transitional risks associated with the restructuring had diminished.** Overall, the four transitional risks specifically included in the survey were rated as "medium-low," with a broadly uniform response across departments. Nevertheless a number of departments considered that some of these risks had increased. In particular some departments noted the risk of disruption as a result of the reorganization of work and departure of key staff as having risen. To some extent this may be attributed to increased work demands as a result of the global crisis which has exacerbated the effect of staff departures, particularly in departments that have suddenly seen a large increase in program work. And in part it may reflect the particular profile of separations—some departments may not yet have faced a large enough outflow of experienced staff to notice the impact. The full impact is likely to become clear in May.