

**IMMEDIATE  
ATTENTION**

EBAP/10/5

January 15, 2010

To: Members of the Executive Board

From: The Secretary

Subject: **Report of the External Audit Committee to the Executive Board**

Attached for the **information** of the Executive Directors is a report by Mr. O'Neill, Chair of the External Audit Committee for FY 2010, for the briefing that he will give to the Executive Board on **Tuesday, January 19, 2010, at 2:30 pm.**

It is not intended that this paper will be published on the Fund's external website.

Questions may be referred to Mr. Thomas O'Neill (e-mail: [thomas.oneill@bell.ca](mailto:thomas.oneill@bell.ca)), Mr. Ulrich Graf (e-mail: [Ulrich.Graf@brh.bund.de](mailto:Ulrich.Graf@brh.bund.de)), and Ms. Amelia Cabal (e-mail: [Amelia.B.Cabal@ph.ey.com](mailto:Amelia.B.Cabal@ph.ey.com)).

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

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Department Heads



## **Report to the Executive Board**

### **Minutes of the outcomes of the External Audit Committee meetings of January 11-14, 2010: mid-year review of developments and FY2010 audit plan**

#### **Introduction**

1. The External Audit Committee (EAC) of the IMF has completed a mid-year review of developments and activities and of the FY2010 internal and external audit plans.
2. The primary role of the EAC is to oversee the annual audit process (in accordance with Section 20 of the By-laws of the IMF). The EAC is entrusted with the responsibility to ensure that the Fund's audit process is robust, relevant, comprehensive, and of an acceptable high quality. In order to fulfill this oversight responsibility, the EAC holds formal and informal meetings with the external audit firm (Deloitte & Touche) and various department heads of the IMF. In addition to reviewing and analyzing reports, the financial statements and other information provided, the EAC relies on the substantive audit work of the internal audit function and the external auditors to reach our conclusions.
3. This year's EAC committee members are:
  - **Mr. Tom O'Neill, CA (Canada):** third year and Chair of the EAC, Corporate Director since 2003, COO PwC Global prior to that;
  - **Mr. Ulrich Graf (Germany):** second year, Audit Director in charge of federal debt and financial policy for the Supreme Audit Institution (SAI) of the Federal Republic of Germany; and
  - **Ms. Amelia Cabal, CPA (Philippines):** first year, Corporate Director since 2009, financial services partner at SyCip Gorres Velayo & Co., a member practice of Ernst & Young Global prior to that.

### **Purpose of the January Visit**

4. The purpose of our January 2010 visit is to review the plan for the FY2010 audit, upon which we will report to the Board in July.

In attachment 1, we have listed the departmental groups that we met. Our objectives in such meetings include:

- Reviewing with the Finance Department the current status of major developments since our last visit to Washington in July 2009 (e.g. new loans, commitments, sources of funding, gold sales, quotas and voice, changes to concessional lending framework, SDR allocation, etc.)
  - Reviewing developments in financial reporting, if any, with the Finance Department;
  - Reviewing with both internal audit (OIA) and D&T reports, activities, and progress towards completion of the FY2010 internal and external audit cycles, as well as any significant findings to date;
  - Reviewing with the Office of Budget and Planning, the Technology and General Services Department, the Finance Department's Control Unit, the Advisory Committee on Risk Management, the Investment Office, and the Legal Department, developments in their respective areas, with particular emphasis on the systems of internal controls and anything impacting the financial statements; and
  - In meetings with members of the Executive Board, to better understand any significant matters from their perspective, and to be able to address directly any specific concerns as we went through our work programme.
5. In preparation for the January meetings in Washington, we held conference calls or otherwise communicated from time to time with senior staff of FIN, OIA, and D&T. We were updated on the key financial developments, audit arrangements and risk management. Since our July 2009 visit, we have

continued to receive information on relevant financial, reporting and audit-related developments from senior staff.

6. As there were changes in some staffing roles on the external audit and within the IMF, we also had introductory conference calls with Mr. Duncan Barks, the new external audit engagement partner from D&T, and with Mr. Kincaid, the new Director of OIA.

With respect to Mr. Kincaid's appointment, Fund Management engaged with us as soon as they were apprised by Mr. Potter that he would be leaving the Fund. We discussed with Fund Management the assessment of the situation and the process and timeline to find a replacement. When they had finalized the search process, they reengaged with us and reviewed with us Mr. Kincaid's experience and qualifications in the IMF, prior to his appointment.

You may recall that when Mr. Potter was appointed as Director of OIA, the EAC was not involved in the process and we commented on that omission. We were pleased to be involved and consulted on this occasion and thank management for adopting this process.

7. We had several consultations with the Executive Board's ad hoc Audit Selection Committee chaired by Mr. Bakker regarding the expiry of the five-year external audit contract with D&T following the FY2009 audit, as well as the process for appointing an external audit firm for FY2010 and future years.

We appreciated being part of this process in which we discussed:

- Current practices in the audit profession;
- Procurement guidelines at the IMF;
- Options which are available in the procurement process, including the necessity or desirability for a change in the external audit firm and/or the pursuit of a formal request for proposal (RFP) process;
- The value of accumulated D&T knowledge during a time of significant change for the IMF; and
- The past performance of D&T at the IMF.

You are aware that the Executive Board's conclusion was to reappoint D&T for a five-year period without a formal RFP process.

The EAC appreciated being asked to consult with Mr. Bakker and his committee, and we are totally supportive of the decision.

### **Plan for FY2010**

8. Our overall work plan for FY2010, which is consistent with the expanded EAC approach followed in FY2009, is as follows;

Formal meetings:

- January visit: January 11-14;
- Audit planning phase briefing of the Executive Board: January 19;
- June visit: June 21-25; and
- Briefing of the Executive Board at the conclusion of the audit: July 19.

Review of Financial Statements:

- Semi-annual unaudited financial statements as of October 31, 2009, which was completed on this visit;
- Pro forma financial statements for the year ending April 30, 2010; telephone conference is planned for April 2010; and
- Annual audited financial statements as of April 30, 2010; May-June 2010.

Review of OIA reports:

- The review of OIA reports issued as of December 2009 and of the semi-annual report on the implementation of audit recommendations was

completed on this visit; further OIA reports and OIA's annual activity report to be reviewed when available in Spring.

Review of developments:

- Informal telephone conferences and communication with FIN, OIA, D&T and others as issues arise.

### **Meeting with the Executive Directors and Outcome**

9. On January 11 and 12, 2010, we held a meeting with Deputy Managing Director Kato and three separate meetings with groups of Executive Directors. As planned, these meetings were conducted on an informal, candid basis. The Executive Directors were very engaged in raising issues of significance to them, and in so doing greatly enhanced our understanding of the core operations of the IMF. The following points were discussed:

- The nature and extent of consultations between the EAC members and with Executive Directors, management or staff between meetings, and the topics discussed;
- Enterprise risk management (process, procedures, best practices), and whether a Chief Risk Officer role would be desirable;
- Safeguards assessments;
- Discussion of increased risk in a non-conditional loan/loan commitment;
- The basis for determination of the appropriate level of precautionary balances (current level of SDR 7 billion, "target" of SDR 10 billion – is it sufficient?);
- Given the current environment, the increased risk of certain countries not being able to ultimately repay IMF loans;

- A comment that the gross or absolute risk of the IMF is directionally fairly constant, but relative risks change as new activities are introduced, greater operational risks in country to achieve budget targets, etc.;
- Gold sales and use of proceeds;
- Discussion of the extent and depth of disclosure in interim financial statements (most recently, the period ended October 31, 2009) in comparison to the more detailed and extensive disclosure in the year end financial statements. Also linked to this point is the importance of the information contained in the annual report about the IMF's core operations, programs and outcomes, as well as the section entitled "Finances, Organization and Accountability";
- A general discussion of the adequacy of the Fund's human resources (both quantity and quality) to execute the mission of the IMF, in the current state, and the impact of possible new activities (e.g. early warning exercise). In the context of this question, the EAC specifically reviewed resources within FIN, OIA and TGS. Each noted that while budget challenges are normal in an institution, each has the resources to conduct its duties and not put the IMF at risk from a control environment perspective;
- There is some discussion at the Executive Board level on the relevant merits or issues in having an Audit Committee (within the Board) in lieu of the current EAC setup. The EAC suggested that the criteria of (i) independence; (ii) financial expertise; and (iii) audit expertise be considered; and
- Longer term balance sheet management, liquidity and solvency, but at the same time noting that these are not current issues.

10. The EAC was very encouraged and grateful for the preceding inputs. We will track relevant matters through our visits in June and July, and have ensured that we communicated the enhanced risk matters raised for both D&T and



OIA on January 13, 2010 for inclusion in their planning and scoping decisions through the end of FY2010.

### **Review of Major Financial Developments and Semi- annual Financial Statements**

11. We have reviewed and discussed with the Finance Department during this visit (and will review through the end of the FY2010 audit) the accounting and financial reporting considerations related to major financial developments at the Fund (e.g. new lending products, gold sales, implementation of revised concessional lending framework for low-income countries, SDR allocations, bilateral borrowings and NAB expansion, quota and voice, precautionary balances, etc.).
12. We have reviewed and discussed with the Finance Department the unaudited financial statements for the semi-annual period ended October 31, 2009 for the General Department, SDR Department and Trust Accounts. With respect to the financial statements, there are no significant matters to report.

### **Review of Internal Audit Process**

13. We have reviewed and discussed with OIA the status of its work program for FY2010. In particular, we reviewed progress toward the completion of audits, the results of audits conducted thus far, and implementation status of outstanding recommendations, particularly “high impact” ones. The OIA work program for FY2010 is on target. The approach adopted by internal audit compares favourably with our experience in other organizations.

An adequate framework for follow-up of OIA’s recommendations is in place, with semi-annual reporting of the status of open recommendations.

14. As the result of the above review and discussion, we have found that there are no matters of a serious nature from a financial or internal control perspective to warrant your attention at this time.

15. We also note that there continues to be a productive relationship and coordination between OIA and D&T in its conduct of the external audit.

### **Review of Risk Management**

16. We acknowledged earlier that risk management was an important topic to the Executive Directors. Certain parts of risk management are important and in the purview of the EAC, and we will complete our observations in June 2010 after the conclusion of the audit. Two items from prior reports have been actioned in the risk area – the whistleblower process and the incident reporting process, and the EAC appreciates management's progress in this area.
17. In our meeting with the Advisory Committee on Risk Management (ACRM), we reviewed recent developments in the evolution of the risk management framework, a work program and an overview of summary observations in the strategic, operational and financial risk areas. As there is an informal briefing of the Executive Board scheduled for February and an Executive Board meeting on the FY2010 risk management assessment, the EAC undertakes to follow up in our closing FY2010 report after the work has been completed.
18. We did review the results of pilot incident reporting, which is tracked by the ACRM in three categories: serious, less serious and near misses. We focused most closely on the serious incidents, which we understand were communicated to the Executive Board, including the IT outage, as well as GSFR data reporting and other issues reported in the media. While these events have no direct impact on the financial statements, they raise reputational and other risks related to Fund core outputs and operations. We note that mitigation measures are in process to consider further processes, procedures and policies to ensure there are strong controls. We will assess progress during our next visit in June.

### **Office of Budget and Planning**

19. In our meetings with OBP, we focused our attention on the ACES project. The medium-term budget paper is still a work in process to be presented to

the Committee on the Budget later in January; we will review those budget matters in June 2010.

20. We were advised last year of the expert panel for the activity-based costing initiative consultation process. Since then, a project design has been completed, with participation from outside consultants. While this project is not directly related to external financial reporting, we will continue to track its progress to ensure that there is integrity in the costs to be used in the analysis. Some cost inputs will be derived from the financial accounting system, which is within our purview.

### **Review of External Audit Plan**

21. We have reviewed and discussed the draft audit plan for FY2010 with D&T. In the view of the EAC they have adopted an appropriate risk based approach fully recognizing the change in the inherent risks and risk profile between years. The plan will cover the key areas of audit including an overall internal control review, application of new accounting standards, information technology audit, audit of any significant new activities in FY2010, impairment analysis review, and the audit of the benefit plans. Appropriate emphasis will be placed on the recent increase in financial support activity for various countries by the Fund.
22. In our review of the external audit plan, we discussed the level of planning materiality which D&T will use for FY2010. For FY2010, materiality for the General Department is set at approximately the same level as last year, SDR 160 million. Setting materiality is a normal practice in the auditing profession and in our opinion, the materiality level to be used by D&T reflects an appropriate level for the Fund's General Department.
23. We have inquired of D&T about their review of the firm and audit team independence in conducting the external audit of the IMF. We note that their procedures appear to be adequate and in accordance with independence required by the applicable professional standards.

24. As noted earlier, the external audit contract was renewed with D&T from November 1, 2009. As part of our work, we read the contract to ensure that its contents were consistent with our discussions noted earlier. We can report that the contract reflects appropriate commercial terms and conditions between the parties. Estimated fees and expenses for the FY2010 audit are US\$1,011,250 (FY2009: US\$1,148,700).

### **Gold Sales**

25. The EAC members are encouraged to note the progress made by the IMF in its plans to sell 403 metric tons of its gold holdings. We do however note that the sales proceeds are currently being held in currencies by the General Resources Account. While these currency holdings will reduce the Fund's remuneration expense, and thus have an implied return at the SDR interest rate, there may be an opportunity cost being borne by the Fund to the extent that risk-adjusted returns above the SDR interest rate are not being realized on the profits from gold sales. We also recognize that there was no yield arising from the gold itself. We wish the Executive Board, management and staff well in their ongoing efforts to secure the needed member country consents to the proposed amendments to the Fund's Articles of Agreement on voice and participation and expansion of the Fund's investment authority, so that the income generation potential of the profits from gold sales may be better realized.

### **Conclusion**

26. The EAC concludes that:

- There are no significant weaknesses in the control environment at the IMF at this time;
- The internal and external audit plans for FY2010 are appropriate to the size of the IMF and to address the inherent financial risks; and
- There have been no limitations on our work or our ability to access relevant management, staff, and/or information.

We continue to receive management's full cooperation in the execution of our responsibilities.

We look forward to our meeting with the Executive Board on January 19, 2010.

**Signature of Committee Members**

Amelia Cabal

Ulrich Graf

Tom O'Neill

**ATTACHMENT 1**

**International Monetary Fund  
January 11-19, 2010 EAC Visit  
Agenda**

<b>Monday January 11</b>	<b>9:30 a.m.–10:30 a.m.</b>	Introduction with FIN
	<b>10:30 a.m.–11:30 a.m.</b>	Introduction with OIA
	<b>11:30 a.m.–12:30 p.m.</b>	Meeting with Office of Budget and Planning
	<b>2:30 p.m.–3:30 p.m.</b>	Meeting with Technology and General Services
	<b>4:00 p.m.–4:30 p.m.</b>	Meeting with Mr. Kato, Deputy Managing Director (including FIN and OIA directors)

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<b>Tuesday January 12</b>	<b>9:30 a.m.–11:00 a.m.</b>	Meeting with OIA
	<b>11:00 a.m.–12:00 p.m.</b>	Meeting with FIN Control Unit
	<b>2:00 p.m.–2:45 p.m.</b>	Meeting with Executive Directors, Group 1
	<b>3:00 p.m.–3:45 p.m.</b>	Meeting with Executive Directors, Group 2
	<b>4:00 p.m.–4:45 p.m.</b>	Meeting with Executive Directors, Group 3

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<b>Wednesday January 13</b>	<b>9:00 a.m.–10:30 a.m.</b>	Meeting with FIN
	<b>10:30 a.m.–12:00 p.m.</b>	Meeting with Deloitte & Touche
	<b>2:30 p.m.–3:30 p.m.</b>	Meeting with Advisory Committee on Risk Management
	<b>3:30 p.m.–4:30 p.m.</b>	Meeting with Investment Office
	<b>4:30 p.m.–5:30 p.m.</b>	Meeting with Legal

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