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To: Members of the Executive Board
From: The Secretary
Subject: Controls over Phase III Related Projects

Attached for consideration by the Executive Directors is a paper on controls over Phase III related projects, which will be scheduled for Board discussion following consideration by the Committee on the Budget on Monday, March 21, 1994

Mr. Caiola (ext. 38634) or Mr. Coune (ext. 38237) is available to answer technical or factual questions relating to this paper.

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INTERNATIONAL MONETARY FUND .

Controls Over Phase III Related Projects

Prepared by the Office of Internal Audit and Review

(In consultation with the Administration Department,
the Treasurer's Department and the Office of Budget and Planning)

Approved by Marcello Caiola

March 14, 1994

I. Introduction

At the briefing of Executive Directors on the Phase III addition to the headquarters building (EBAP/93/68) on November 1, 1993, Executive Directors enquired about the controls that would be implemented, should the construction of the Phase III addition be approved. In response to the request, this paper describes the internal control systems applicable to construction projects. It addresses successively the general control framework in place for all administrative activities (Section II), operational controls in place for Phase III related projects currently being executed (Section III), operational controls specifically envisaged for Phase III construction (Section IV), and the auditing of these projects (Section V).

II. General Control Framework

Construction projects are executed within the framework of an existing general management and control system applicable to all administrative activities. The management system operates on the basis of a hierarchy of operational authorities cascading from the Executive Board, to the Managing Director and the Deputy Managing Director, to the heads of departments and to operational staff. The control system, which consists of operational controls and audits, is based on the principle of checks and balances, whereby no single authority would have entire control over a decision or a process, and audits are conducted independently.

Operational controls of administrative activities are prescribed in General Administrative Order No. 2, Rev. 6, (attached) which addresses the respective authorities and responsibilities of the Office of the Managing Director (OMD), the Administration Department (ADM), the Treasurer's Department (TRE), and the Office of Budget and Planning (OBP) for the budgeting and control of expenditures. It also addresses the duties of these parties vis-a-vis the Executive Board by stating, inter alia, that "Commitments for administrative and capital expenditures will be approved and processed only if they are in accordance with the budget approved by the Executive Board." GAO 2 vests heads of designated departments with the

responsibility for the planning and execution of capital projects in accordance with authorized budgets, schedules, and objectives. GAO 2 further states that, during the execution of capital projects, heads of these departments shall be responsible for compliance with relevant budgetary controls and reporting requirements.

OBP is vested with the responsibility for analyzing and reviewing budget estimates prepared by departments; for monitoring the status of budgets and projects, and proposing to management corrective measures when necessary; and for preparing for management review and submission to the Executive Board periodic reports for information and, whenever necessary, for decision. For capital projects, such as construction projects, OBP has further issued directives (Definition and Rules For the Budget and Management of Capital Projects) aimed at ensuring that the managing department, i.e., ADM in the case of construction projects, will not make commitments that would exceed the budgetary appropriations.

TRE, in the role of controller, is entrusted, inter alia, with the responsibility for maintaining an accounting and control system that provides support for financial reporting, the administration of expenditure and financial controls, and the safeguarding of assets. In addition, TRE is responsible for verifying that sufficient provision exists in the relevant budget accounts to meet financial commitments, for ensuring that expenditures match commitments, and for ascertaining that requests for payment are certified and supported by adequate documentation.

Audit functions are vested in the Office of Internal Audit and Review (OIAR). GAO 14, Rev. 2, issued in 1991 following the broadening of the work of OIAR, states that OIAR will undertake, without limitation, examinations and appraisals of the soundness, adequacy and application of accounting, financial and administrative controls and of the effectiveness of procedures and operations.

Also, under Section 20 (f) of the By-Laws, the External Audit Committee (EAC) is authorized to furnish to the Managing Director and the Executive Board views and suggestions concerning the system of accounting, internal financial control, and documentary or other procedures which may technically strengthen or improve the administration of the Fund's financial affairs.

III. Operational Controls of Phase III Related Projects

Two ongoing capital projects related to Phase III have been approved by the Executive Board. Project 511 (for \$31.75 million) includes the acquisition of a new site for and construction of a new Western Presbyterian Church (WPC), and acquisition of zoning approval for Phase III. Project 526 (for \$9.9 million) covers the design of Phase III based on approved zoning drawings, as well as other associated long-term space planning and studies involving the existing headquarters building. In both cases, project management responsibilities have been delegated by the Managing Director to senior staff members of ADM.

The main operating controls of the two projects aim to ensure: (1) that applications for payment are justified, properly certified and supported by documentary evidence; (2) that the financial system records commitments, and that expenditures are paid accurately and in a timely fashion; (3) that there are adequate controls to insure that budgetary allocations will not be exceeded; and (4) that construction progress is in accordance with plans and expenditure rates.

The process of authorization and certification of payments follows a proven construction payment process model. The general contractor 1/ records and forwards applications for payment received from subcontractors. The architect, assisted if necessary by specialized consultants, reviews the applications for conformity with the work specifications contained in the contract documents, verifies the percentage of completion of work and the amounts of materials claimed on the applications, certifies the applications and forwards them to the Fund for approval and payment. The project manager, a Fund employee, verifies that the services have been rendered and/or that the equipment or material has been used/installed, and certifies the applications. Upon receipt of the applications, TRE ensures that all proper authorizations and certifications have been obtained, that the payment will not exceed the line item budgets established by OBP, and that the application is properly supported by invoices and other necessary documentation.

Project cost data are recorded through two independent processes. The first set of cost data is produced by ADM in two steps: (1) On the basis of subcontract bids and other obligations incurred to complete the work described in contract documents, the general contractor prepares a monthly status of estimated commitments (Schedule of Values) for each major part of the construction project (e.g., site work, engineered systems, building finishes). Upon review and recommendation by the architect and further review by the Fund, the Schedule of Values is then approved by the Fund, and forms the basis for the general contractor's monthly applications for payment. (2) In addition, data are compiled by ADM into monthly cost tracking reports that itemize budgets, commitments to-date, expenditures to-date, spending variances, and estimated costs-to-complete for each major category of work. TRE, OBP and OIAR are regular recipients of these reports.

In parallel, Fund staff maintain records of project budgets, commitments, expenditures and budget variances, on the shared computer system (Millennium system) used for recording administrative expenditure

1/ In the cases of the WPC and Phase III, the general contractor also serves as construction manager. A construction manager works with the owner and the architect to ensure that the proposed design can be built, to seek alternative methods and materials, and to prepare a project budget and develop a detailed project schedule. The general contractor manages the actual construction of the building by himself or through subcontractors, the bidding of subcontracts, and the review and transmission of applications for payment.

data, which is accessible to all parties concerned. Data include requisition and purchase order commitments input by procurement (ADM) staff, and invoice receipt and payment data input by TRE. Should there be instances where commitments are at risk of exceeding the allocated budget, either OBP or TRE can use the system to close off any further processing of commitments or expenditures until the risk of cost overrun is evaluated with the project manager.

Project cost data are recorded in the Fund's financial accounting system and form the basis for the information included in the Fund's financial statements. TRE determines which cost elements are expended or capitalized, in accordance with generally accepted accounting principles and with Executive Board Decision EBS/93/40. The accumulated financial costs are aggregated to support depreciation accounting. Financial accounts are maintained by TRE as an independent control over the detailed administrative budget accounts.

Assessment of construction progress against base-line and revised plans, and comparison of physical completion with expenditure rates (earned value), are monitored by OBP and TRE through reviews of the regular cost-to-complete reports. In addition, regular meetings are held by representatives of ADM, OBP, and TRE to share information on the progress of the project. When project events deviate from the plan, or line item costs vary from the budget, ADM provides OBP with background data, explanations, and recommendations. Should the revised scope vary substantially from the approved scope, or should estimated costs exceed the budget approved for the project, OBP would seek alternatives from ADM to keep the costs within the budget. If alternatives are not feasible or not supported by ADM, OBP would inform management and make recommendations to either reduce the scope of the project in order to remain within the project budget ceiling, or to proceed with the project subject to the approval of supplemental funding by the Executive Board.

IV. Operational Controls for Phase III Construction

To prepare for the possible approval by the Board of the Phase III addition, a number of measures have been agreed upon between ADM, TRE and OBP. To a large extent, this agreement refines and codifies the procedures described in Section III above. This agreement provides a broad framework of controls and will be refined after approval as project execution takes place. The salient features of the agreement can be summarized as follows.

Organizational controls aim at defining the responsibilities of the various organizational units. The procurement and management authority for the construction of Phase III will be delegated by the Managing Director to appropriate senior officials of ADM. This delegation of authority will be exercised within the constraints of GAO 2 and the agreement mentioned above. ADM will in turn exercise supervisory and management control over all staff, vendors, and consultants, including the architect and the construction manager, involved in the construction process.

Project management safeguards aim at minimizing risks of cost overruns. During the design phase, ADM formed a project management team with experience in this type of construction, and a construction management firm provided cost estimates of the design at various stages, and searched for ways to reduce costs. Also, a cost estimating firm was hired to provide ADM with a separate construction cost estimate. These efforts have been incorporated into the construction budget, based on substantially completed design drawings, which is being submitted to the Executive Board for approval. Simultaneously, as the work on the design phase progresses, OBP staff are being kept informed of the main design options, so that they may review the options from a cost perspective to ensure that costs are reasonable and prudent. Furthermore TRE has strengthened its expenditure control function by securing the assistance of a construction controller, as had previously been the case for Phase II.

The agreed upon budgetary and accounting controls may be summarized as follows. To facilitate Executive Board and management reviews, the Phase III budget will be divided into four main components: design services, project operations, construction services, and management contingency. To ensure internal financial controls, the main budget category of construction services will be further divided into nine "cost centers", such as site work, landscaping, general conditions, etc. Rules have been instituted by OBP and TRE, and agreed upon by ADM, to set conditions under which "cost center" budgetary ceilings could be exceeded by transfers of budgetary funds across cost centers or by use of the contingency. The accounting for commitments and expenditures, the frequency and conditions of reporting, and the periodicity and content of meetings between ADM project management, TRE, and OBP have also been specified.

Other administrative controls will also to be exercised. The procurement functions will be assumed by the Procurement Section, assisted by the Legal Department, and will be carried out in accordance with established procedures as set forth in the Fund's Procurement Manual. As was the case with Phase III related projects described above, the Legal Department will review the contractual undertakings involved to ensure that they are legally valid and adequately protect the interests of the Fund. OIAR will continue to carry out audits, as the various phases of construction progress.

V. Audits of Phase III Related Projects

In line with the recommendations of the FY 1992 EAC to management, 1/ OIAR has been reviewing the operational controls applicable to Phase III related projects over the past two financial years. Since the

1/ "The Committee encourages the Fund to establish procedures to ensure management's control on every step of the investment. The Office of Internal Audit and Review, which is already involved in this area, should receive an important mission of control and overview of all procedures and decisions."

projects started in earnest, OIAR annual work programs have made provision for assessments of the controls in place for the WPC project and, more specifically this year, for an examination of the planning, management, procurement and reporting processes for Phase III related projects.

Since the beginning of FY 1993, four formal audits on WPC and Phase III projects have been concluded. In accordance with GAO 14, Rev. 2, OIAR periodically follows up on the status of implementation of the recommendations contained in the audit reports and brings pending recommendations to the attention of management for information and, when necessary, for resolution, if significant audit issues cannot be resolved between OIAR and the department concerned.

To stay current on possible risk areas in order to adequately target audits, OIAR remains closely abreast of the latest developments 1/. OIAR periodically updates its information through interviews, requests and receives reports, and analyses documents, contracts, and financial data. Whenever necessary, specific analyses are conducted, the results of which are shared with the concerned parties and management when it is deemed useful to operating functions. In selected circumstances, and keeping in mind the need to preserve the objectivity of the audit function, OIAR may also be involved in ensuring, before the fact, that adequate control mechanisms are being planned.

Attachment

1/ As prescribed in GAO 14, Section 6.02, OIAR has access to any information, in whatever form, as needed for the proper discharge of audit and review duties.

Subject: BUDGETING AND EXPENDITURES CONTROL

Section 1. Purpose

1.01 *General.* The purpose of this Order is: (a) to set forth the principal elements of the formulation, approval, management, and control of the administrative and capital budgets of the Fund and to delegate the authority and responsibility necessary for their proper administration, including financial control of the administrative and capital expenditures of the Fund, and (b) to define the respective roles of Departments, Bureaus and Offices¹ in the process of appropriating funds for, and authorizing payment of, expenditures.

1.02 *Definitions.* For purposes of this Order, the following definitions will apply:

(a) "authorized appropriations" mean expenditure ceilings authorized by resolution of the Executive Board;

(b) "administrative expenditures" mean personnel, travel, and other expenses incurred by the Fund on an on-going basis to support its work program activities;

(c) "allocated budgets" mean budgetary funds that are distributed to departments for their use;

(d) "capital expenditures" mean expenses for the acquisition of fixed assets, such as land, buildings and equipment. For budgeting purposes only, capital expenditures may also include other associated costs;

(e) "commitment" means a contractual obligation to effect a future payment;

(f) "Office of the Managing Director" (OMD) means the Managing Director or the Deputy Managing Director.

Section 2. Principles

2.01 Commitments for administrative and capital expenditures will be approved and processed only if they are in accordance with the budget approved by the Executive Board;

2.02 Payments will be processed only if there is evidence that the goods or services have been received or prepayment has been authorized, or, for benefit expenditures, that the requirements for entitlement have been met.

2.03 Staffing resources will be approved and processed only if they are in accordance with the budget approved by the Executive Board.

¹Referred to in this Order as "departments." References to the role and responsibilities of "departments" as budget units shall also apply to the Administration Department, the Treasurer's Department, and the Office of Budget and Planning.

Subject: BUDGETING AND EXPENDITURES CONTROL

Section 3. Budget Formulation and Approval

3.01 Heads of departments shall submit, whenever and in the form requested by the Office of Budget and Planning, their proposed work programs and the attendant estimates of their needs for staffing and for administrative and capital expenditures. The work programs will be prepared in the context of the medium-term budgetary framework, will include disaggregated levels of staffing requirements by major activities and shall be in accordance with the broad functions and responsibilities of departments (to be updated as and when necessary) as approved by OMD.

3.02 The proposed work programs and attendant estimates of needs will be analyzed, reviewed and consolidated by the Office of Budget and Planning and presented to OMD. After consultation with the relevant departments and review by OMD, the revised work programs and attendant estimates will be presented into annual and, whenever necessary, supplemental administrative and capital budget documents and shall be submitted to the Executive Board for decision.

Section 4. Budget Management

4.01 The Director of the Office of Budget and Planning shall:

(a) report to OMD on the status of actual performance and expenditure relative to original programs and budgets;

(b) propose for OMD's approval, after consultation with the relevant departments, measures to limit expenditures and staffing to the levels approved by the Executive Board, when it is anticipated that these levels may be exceeded. Measures shall include the proposed curtailment or postponement of activities with a concomitant reduction in allocated budgets;

(c) propose for OMD's approval operational directives necessary for effective budget management. Directives shall provide for the distribution of some or all of the authorized appropriations to departments by type of staffing, expenses, programs, projects, and source of funds, in a manner that is consistent with the budget approved by the Executive Board. Directives shall also provide for the budgetary authority and reporting requirements of departments.

4.02 The Director of the Office of Budget and Planning shall notify departments, including the Administration Department and the Treasurer's Department, of the allocation of budgets pursuant to the directives mentioned in 4.01(c). The Director of the Office of Budget and Planning shall also provide departments, on a regular basis, with the timely information required by them to ensure that their planned activities and resource commitments conform to these budgets.

4.03 In order to meet changing conditions or to ensure optimum utilization of authorized appropriations that have not yet been committed, the Director of the Office of

Subject: BUDGETING AND EXPENDITURES CONTROL

Budget and Planning may, after consultation with the affected departments as needed, propose to OMD for decision the redeployment of resources across departments that would result in changes in the allocated budgets mentioned in 4.02. The Director of the Office of Budget and Planning shall notify affected departments of any changes decided by OMD.

4.04 The Director of the Office of Budget and Planning shall prepare for OMD review and submission to the Executive Board periodic reports for information and, whenever necessary, for decision.

Section 5. Budget Utilization and Review

5.01 Heads of departments shall be responsible for ensuring that their commitments and expenditures remain within their allocated budgets.

5.02 Heads of designated departments shall be responsible for the planning and execution of capital projects in accordance with authorized budgets, schedules, and objectives. During the execution of the projects, heads of these departments shall be responsible for compliance with the relevant budgetary controls and reporting requirements detailed in the directives mentioned in 4.01(c).

5.03 Heads of departments shall be responsible for reporting to the Director of the Office of Budget and Planning or, if so directed, to OMD on the status of budget utilization in relation to authorized budgets, schedules and objectives. In the event of actual or prospective deviations in the utilization of budgetary resources, the responsible head of department shall so report to the Director of the Office of Budget and Planning, who will advise OMD accordingly.

5.04 Heads of departments may request through the Director of the Office of Budget and Planning that OMD approve changes in allocated budgets in the course of a financial year. Such requests shall be considered in accordance with the directives approved pursuant to Section 4.01(c). In the absence of a governing directive, such requests shall be decided by the Director of the Office of Budget and Planning, subject to further review and final decision by OMD at the behest of the affected heads of departments.

5.05 Heads of departments shall submit any proposal that would require the commitment of resources in excess of allocated budgets to OMD through the Director of the Office of Budget and Planning, who shall advise OMD on the budgetary aspects of such proposals.

Section 6. Specification of Needs, Commitments, and Certification of Expenditures

6.01 Heads of departments shall be responsible for defining and justifying their needs prior to submitting requests or proposals for staffing resources and for the acquisition of goods or services.

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6.02 The Director of Administration shall be responsible for the procurement of goods and services on behalf of the Fund, including staffing resources, for the observance of applicable policies and procedures, and for the issuance of attendant commitment documents.

6.03 The Director of Administration shall certify that the goods or services have been received and that they are in compliance with the requirements of the contract. In the exercise of this responsibility, the Director of Administration may in turn require actual recipients of the goods or services to provide him¹ with their own certification.² For benefit expenditures, the Director of Administration shall ensure that the requirements for benefit entitlement have been met.

6.04 The Administration Department shall maintain records of staffing resources. The Treasurer's Department shall ensure that the commitments of financial resources pertaining to acquisitions of goods and services are duly recorded. All records shall be available to the Office of Budget and Planning for the exercise of its responsibilities.

Section 7. Standards for the Control of Expenditures

7.01 The Director of Administration shall be responsible for ensuring that the commitments of staffing resources are within the approved ceilings.

7.02 The Treasurer shall be responsible for:

(a) verifying that sufficient provision exists in the relevant budget accounts for the posting of financial commitments;

(b) ensuring that the requests for payment have been properly certified and are supported by all necessary documentation;

(c) verifying, where appropriate, that the expenditures match existing commitments or ensuring, in the absence of a previously existing commitment, that sufficient provision exists in the relevant budget account;

(d) verifying the mathematical accuracy of requests for payment;

(e) authorizing and processing payments in a timely manner;

(f) ensuring that administrative and capital expenditures are accurately reflected in the Fund's financial accounts.

¹The masculine pronoun is used in this Order for the sake of brevity. However, the provisions of this Order apply equally to both sexes.

²In cases where the contractual agreement makes provision for payment prior to the receipt of goods or services (prepayment), invoices for such prepayments shall be processed only if they are in accordance with the terms and conditions of the contract.

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7.03 Commitments and requests for payment that do not satisfy the conditions stated in this section shall not be processed. In this event, the Director of Administration, with respect to staffing resources, or the Treasurer, with respect to other resources, shall inform the relevant department and the Office of Budget and Planning and, in consultation with them, seek early resolution of the issue.

Section 8. Records and Systems

8.01 Accounting, administrative, and budgetary records shall be maintained to register the budget, commitment, certification, and payment of expenditures.

8.02 The Treasurer's Department shall operate and maintain an accounting system that provides support for financial reporting, the administration of budgetary and financial controls, and the safeguarding of assets. The Fund practice of conforming to generally accepted accounting principles shall also apply to the accounting for administrative and capital expenditures.

8.03 The Fund accounting system shall include subsidiary accounts that will record all administrative and capital expenditures and constitute a detailed and accurate record of the amount and use of all expenditures in accordance with the chart of accounts maintained by the Treasurer's Department.

8.04 The Director of the Office of Budget and Planning shall establish and maintain information systems that allow for analyzing and monitoring of, and reporting on, the status and execution of the budgets. To that effect, the Director of the Office of Budget and Planning, in consultation with the Treasurer, may choose to rely in part on the Fund accounting system to provide the basis for this information.

8.05 In accordance with 4.01(c), the Director of the Office of Budget and Planning may, from time to time, request departments to provide information that will assist in the management and control of the Fund's budgetary affairs.

Section 9. Delegation of Authority

9.01 Heads of departments shall have the authority to delegate any of the functions described in this Order, except the procurement of goods and services mentioned in 6.02, for which delegation may only be granted by the Managing Director.

Section 10. Relationship to Other Administrative Orders and Effective Date

10.01 This Order supersedes General Administrative Order No. 2, Rev. 5, dated November 1, 1969.

10.02 The effective date of this Order is June 1, 1993.



Richard L. Erb
Deputy Managing Director

