

SM/87/258

November 9, 1987

To: Members of the Executive Board  
From: The Secretary  
Subject: The Audit Process in the Fund

There is attached for the information of the Executive Directors a paper outlining the audit process in the Fund.

Mr. Noë (ext. 8943) is available to answer technical or factual questions relating to this paper.

Att: (1)

Other Distribution:  
Department Heads



# INTERNATIONAL MONETARY FUND

## The Audit Process in the Fund

Prepared by the Office of the Internal Auditor

Approved by Robert Noë

November 5, 1987

### I. Introduction

An Executive Director recently asked that a brief paper be prepared that would provide information about the audit process in the Fund. The purpose of this paper is to be responsive to this request. It describes how that audit process was established, has adapted to the changing requirements of the Fund's operations and is now being carried out.

To safeguard the financial integrity of the organization, the founders of the Fund had the foresight to establish both (1) an external audit function composed of representatives from its membership, in 1946 (Section 20 of the By-Laws, Attachment I) and (2) an internal audit function, in 1948 (GAO No.14, Attachment II). Each year a new audit committee convenes. It is charged with conducting an examination of the Fund's financial records and system of accounting and financial controls and issues an opinion with respect to the financial statements for the year then ended. The Internal Auditor is responsible for providing the Managing Director with continuing assurance throughout the year that the accounts are properly administered and the methods of financial control assure protection and conservation of the Fund's assets. Both were established to operate with a considerable degree of organizational independence, to ensure objective reporting, by requiring that the External Audit Committee report to the Board of Governors and that the Internal Auditor be responsible solely to the Managing Director.

The By-Laws specify that assistance be provided to the External Audit Committee each year by a firm of independent accountants. This assistance has become more extensive in recent years due to the increasing number of IMF facilities, the complexity of transactions and the growth in the volume of the work. The Internal Auditor coordinates the selection of the members of the new Committee each year, primarily to ensure wide geographical representation among member countries; handles the administrative arrangements for the Committee members; and assists in the selection of the firm of independent accountants and coordinates their work with successive Audit Committees. The members of the External Audit Committee provide their services at no fee to the Fund.

## II. Evolution of the External Audit Process

Prior to financial year 1981, the work of the External Audit Committee was limited to a six-week visit and review of the financial records and statements. The independent accounting firm only provided two assistants concurrent with the Audit Committee's visit. With little preparation in advance of their arrival, the Committee was pressed to assure itself that financial and administrative controls were operating effectively and used the limited time available to review and issue an opinion on the presentation of the financial statements. However, since 1982, the decision was taken to select Committee members earlier in the financial year and commence the assistance of the independent accounting firm shortly thereafter, substantially increasing the assistance provided and permitting the audit work to be completed prior to the arrival of the Committee in Washington. In this way, the Committee has a greater degree of assurance that its review work has been thorough and complete by the time it is required to express an opinion on the financial statements. With the increased assistance, the Committee was able to reduce its work schedule from six to four weeks.

### 1. Composition and Selection of the Committee

Section 20 of the By-Laws (Attachment I) requires that an annual audit be performed on the financial statements of the Fund, and the accounts administered by it. In addition, it specifies that an audit be performed by an External Audit Committee, and establishes the procedures for selecting the members of the Committee. The Audit Committee may consist of from three to five persons (past practice has been to select only three members), each nominated by a different member of the Fund and confirmed by the Executive Board. At least one person serving on each Audit Committee is nominated from one of the six members of the Fund having the largest quotas and at least one by a member that is also a participant in the Special Drawing Rights Department. Traditionally, two members of the Committee serve for only one year and the third for two years, thus providing some continuity. Each Audit Committee elects one of its members as chairman, determines its own procedures and is independent of the Management of the Fund in conducting the annual audit. Early in the financial year the Internal Auditor coordinates the selection of the Committee members. After approval by Management, Executive Board Papers which provide for the appointment of each External Audit Committee are prepared.

### 2. Internal Audit's Technical and Administrative Support of External Audit

One of the essential functions that the Office of the Internal Auditor (OIA) carries out is its technical and administrative support of the external audit. OIA handles all the administrative arrangements for the external audit, including the fee negotiations with the accounting firm selected to assist the External Audit Committee.

In the conduct of its annual audit, the members of the External Audit Committee and their assistants rely heavily upon OIA's work. Throughout the year OIA undertakes audits and issues reports on the Fund's financial, administrative and EDP operations. These reports are available to the External Audit Committee and their assistants. They also rely upon OIA's expertise on the workings of the Fund. This expertise includes knowledge of the various technical areas of operations including each of the Fund's facilities and the concomitant transactions, administrative rules and procedures and developments in the data processing environment. In addition, the OIA has resident expertise on International Auditing Standards and Accounting Standards, data processing, law and taxes. Collectively, the staff of the OIA possesses a comprehensive knowledge of the Fund, its history and operations, which the Audit Committee draws upon. The data processing environment, for example, has become increasingly complex in the Fund and OIA's expertise and reports in this area are necessary to the Committee's work. The external audit culminates in the rendering by the Committee of an audit opinion. The Fund has, to date, always received an unencumbered audit opinion.

### III. Evolution of the Internal Audit Process

The authority for the Internal Auditor to conduct his work is contained in General Administrative Order No. 14. Broadly, this document establishes the role of OIA and its privileged access to documents necessary for the execution of its work. The Internal Auditor carries out the Fund's policy on internal audit in order to assure the Managing Director that proper procedures and controls are being maintained in the Fund. To discharge this responsibility, the Internal Auditor develops and executes a comprehensive program of audit, securing the benefits of a systematic verification and objective appraisal of the operations of the Fund. The Internal Auditor and his staff are attached to the Office of the Managing Director, thus assuring the independence of the function.

Prior to 1981, the Internal Auditor seldom issued reports on the results of his work, and did not formulate annual audit plans. Instead, he limited his work largely to the preaudit of financial transactions. In FY 1981 a major change occurred in the approach the Office had taken. Instead of focusing entirely on individual transactions a systems based approach was adopted, wherein the primary thrust is to understand and evaluate accounting and administrative systems, supplemented by reviews of individual transactions. At the same time with the change in approach, development of the Audit Manual began, EDP auditing was introduced and a small audit reference library was established. OIA adopted as its professional standards the International Auditing and Accounting Standards subscribed to by the International Federation of Accountants and its sister organization, the International Accounting Standards Committee. The Internal Auditor recognized that in addition to following internationally recognized

standards of auditing and reporting, the audit function could only be carried out effectively if there was a comprehensive understanding of the audit environment. Professional literature usually addresses the assessment of the audit environment primarily in terms of the commercial enterprise operating in a competitive market. The audit environment for an international institution, however, is rather different. Established precedent and even the history of the organization have a continuing effect on the financial and administrative functions and, consequently, on the audit function. The Internal Audit staff has also found it necessary to develop expertise in the use of new Fund financial and administrative systems as they are developed and adopted by the Fund, in order to be in a position to evaluate them and make constructive suggestions when warranted. To this end the OIA has established a staff training program which includes training not only in audit methodology but also in EDP technology and in those systems which the Fund staff regularly rely upon to perform its work.

#### 1. Audit Plan

Each year the Office of the Internal Auditor submits an Audit Plan to Management for approval. The plan outlines the following major activities:

- a. Financial audits,
- b. Administrative audits,
- c. EDP systems development reviews,
- d. Audit software development,
- e. External audit and
- f. Audit administration.

It also includes a review of the work of the preceding financial year, specifies overall audit objectives and includes a five-year projection of audit assignments. It should be emphasized that this plan is sufficiently flexible so that special assignments or special concerns can be accommodated and new priorities set at any time. During the development of the plan care is taken not to overlap the work of the OIA with that of the outside accountants. The independent accountants are provided with a copy of the Audit Plan to assure that there will be no duplication of effort.

#### 2. Types of Work Undertaken

All of the financial activities of the Fund are reviewed by OIA. They include the General Department, the Special Drawing Rights Department, the Supplementary Financing Facility Subsidy Account, the Trust

Fund, the Staff Retirement Plan, and Bretton Woods Recreation Center. OIA audits the financial statements and underlying records and accounts of all these areas. While financial audits are an important activity, they consume somewhat less than 50 percent of the OIA's total resources and will probably consume even less in future years.

The fastest growing area is administrative audits which focus on economy, effectiveness and efficiency. Another growing activity is systems development reviews. OIA conducts reviews of EDP systems while they are still in development. The objectives of these reviews are to determine whether controls will be in place to assure that information is reliable, that security is adequate, that the system will be audit-able and that mechanisms for successful recovery from software or hardware failures are built in. Examples of system development reviews which have been concluded are: the Burroughs Disaster Recovery System, the Secretary's Department Cable System and the Rates Database of the Treasurer's Integrated Financial System (TIFS). Systems development reviews currently under way are the IBM Disaster Recovery System and TIFS Repurchases/Repayment Databases.

The Internal Auditor is frequently consulted in the development of policies, procedures and systems (e.g. security, the revision of GAOs and proposed changes in accounting policies) when his knowledge of procedures and experience stemming from evaluations of Fund systems are called upon.

### 3. Resources Available

OIA has a professional staff which includes the Internal Auditor, the Assistant Internal Auditor, one EDP Auditor and five Auditors. The Office also has a full-time Secretary, one contractual Auditor and a part-time Clerk Typist. Without a significant increase in its staff resources, OIA has been able to accommodate a steady increase in its workload primarily through the application of EDP resources. These resources include: (1) a personal computer for each auditor with linkage to the Fund's mainframe computers, (2) a library of the most recent versions of audit software both purchased and custom-made by OIA and (3) a training program for the auditors in the use of these systems. In addition, some limited financial resources are made available to OIA which permit it to obtain specialized technical assistance in the event that it is needed.

### 4. Audit Administration

OIA conducts a wide variety of audits. About thirty formal reports are issued each year which are addressed to the appropriate Department Heads. In each case a draft report is first circulated for comment before it is finalized. In addition, for administrative audits, a preliminary survey report is sent to the department concerned for comment prior to initiating the audit. This is done to reach an understanding with the auditee on the scope, timing of the review work

and terms of reference after some preliminary fact finding, but before the review is undertaken. Copies of the final reports are sent to Management, the External Audit Committee, the independent accountants and the appropriate Department Heads.

Audit administration consists largely of administering the execution of the Audit Plan. It includes audit planning, planning and coordination of staff training, review of audit reports and supporting documentation, supervision and exit conferences at the conclusion of the audits.

#### 5. Reports to Management

The Internal Auditor issues semiannual reports to Management covering the main activities of OIA. In addition, the Internal Auditor provides the External Audit Committee, upon their arrival in Washington, with a comprehensive report on the work of the OIA for the past year. These reports cover administrative matters of the office, an outline of the main activities of the OIA during the period, audit issues which have arisen during the period and a complete status report on all outstanding audit recommendations, including the responses of the departments involved, made by both past External Audit Committees and OIA in their reports. The Internal Auditor is expected to express an opinion as to the adequacy of these responses. He also keeps Management informed of important developments in the audit process as they occur throughout the year.

#### 6. Evaluations of OIA

The External Audit serves as a quality review function over Internal Audit. Each year the External Audit Committee issues a memorandum to the Managing Director which, in part, comments on the performance of OIA and its work for the year. The Committee normally also addresses a memorandum to the Internal Auditor outlining its views on the accomplishments of OIA and makes suggestions with respect to refocusing audit attention.

### IV. Development and Utilization of EDP in the Audit Process

During the last few years a number of factors have become evident in the audit environment at the IMF: (1) the majority of the Fund's work is processed on and its reports are generated from computer application systems; (2) the vast majority of the Fund's records are maintained in computer files; and (3) the audit function, to be relevant and effective, must make use of the same systems to evaluate the validity and efficiency with which those operations are carried out. The computer is also used to perform audit procedures more efficiently and economically than was possible previously.



OIA develops its own audit software to assure independence and objectivity in the conduct of audit tests, many of which are carried out electronically. One EDP Auditor is assigned to the office, but the rest of the auditors are expected to be sufficiently knowledgeable of data processing to audit complex computer-supported accounting systems. Three members of the Internal Auditor's staff are capable of developing audit software in a mainframe environment and have done so.

#### V. Concluding Comments

There is a continuous collaboration between OIA, the External Audit Committee (including the outside accountants) and Management. The work of the External Audit Committee and OIA are complementary. OIA provides continuous quality assurance throughout the year on the operation of financial and administrative systems upon which the organization relies in performing its work. The External Audit Committee, on the other hand, provides for an independent assessment of the presentation of the financial statements. In doing so, the Audit Committee relies upon the work of OIA and the outside accountants, but is also in a position to review their work and alert the Managing Director of its concerns if any.

BL 19(c)-20(c)

BY-LAWS

(c) Whenever the Executive Board is to consider a matter which has been determined particularly to affect a member not entitled to appoint an Executive Director in accordance with Article XII, Section 3(b)(i), the member shall be promptly informed by rapid means of communication of the date set for its consideration. No final action shall be taken by the Executive Board with respect to such matter, nor any question particularly affecting such member submitted to the Board of Governors, until the member has either waived its rights under paragraph (a) of this Section or has been given an opportunity to present its views through an appropriately authorized representative at a meeting of the Executive Board, of which the member has had reasonable notice.

*Adopted March 16, 1946, amended September 17, 1947, and June 13, 1978*

Section 20. BUDGET AND AUDITS

(a) The Managing Director shall prepare an annual administrative budget to be presented to the Executive Board for approval. The budget so approved shall be incorporated in the annual report presented to the Board of Governors.

(b) An external audit of the financial statements of the Fund and of Accounts administered under Article V, Section 2(b), including the financial statements of the Staff Retirement Fund, shall be made annually and such audit shall relate to the period representing the financial year.

(c) The annual audit shall be made by an external audit committee consisting of either three or five persons each of whom shall be nominated by a different member of the Fund and confirmed by the Executive Board. At least one person serving on each audit committee shall be nominated by one of the six members of the Fund having the largest quotas, and at least one person shall be nominated by a member that is also a participant

BL 20(c)-(d)

SEC. 20. BUDGET AND AUDITS

in the Special Drawing Rights Department. The Executive Board shall determine, in the case of each audit, whether the audit committee shall consist of three or five persons and which members of the Fund shall be requested to nominate persons to serve on the committee. The service of the members of each audit committee shall terminate upon completion of the annual audit and submission of the audit report. The Managing Director shall arrange for auditing services by persons outside the Fund to assist the audit committee in the performance of its functions. The members of the audit committee and any outside assistants shall respect the confidential nature of their service and the information made available for purposes of the audit.

Each audit committee shall elect one of its members as chairman, shall determine its own procedure, and shall otherwise be independent of the Management of the Fund in conducting the annual audit.

(d) The annual audit shall be conducted in accordance with generally accepted auditing standards, and shall include such tests of the accounting records and such other auditing procedures as are considered necessary. The audit shall be comprehensive with respect to examination of the financial records of the General Department, the Special Drawing Rights Department, and Accounts administered under Article V, Section 2(b), including the Staff Retirement Fund; shall extend, insofar as practicable, to the ascertainment that operations and transactions conducted during the period under review are supported by the necessary authority; and shall determine that there is adequate and faithful accounting for the assets and liabilities of the General Department and Accounts administered under Article V, Section 2(b), including the Staff Retirement Fund, and for special drawing rights. On the basis of this audit, the audit committee shall state whether the financial statements as presented give a true and fair view of the financial position at the close of the financial year of the General Department, and of Accounts administered under Article V, Section 2(b), including the Staff

BL 20(d)-(f)

BY-LAWS

Retirement Fund, and, with respect to the Special Drawing Rights Department, of the allocations and holdings of special drawing rights, and of the results of operations and transactions during that year. For these purposes, the audit committee shall have access to the accounting records of the Fund and other supporting evidence of its operations and transactions, and of its administration of Accounts under Article V, Section 2(b), including the Staff Retirement Fund. The Managing Director of the Fund shall furnish the audit committee with such information and representations as may be required in connection with the audit.

(e) The Executive Board shall decide all questions of policy raised by requests of the audit committee for particular information or the inspection of particular records or documents. The refusal of any such requests for reasons of policy shall be explained in the comments of the Executive Board forwarded to the Board of Governors with the audit report.

Any question the audit committee may have concerning interpretation of the Articles of Agreement, the By-Laws, the Rules and Regulations, or the decisions of the Fund shall be discussed with the Managing Director, or officials designated by him, and if the reply is not completely satisfactory to the audit committee, the matter shall be referred to the Executive Board through the Managing Director.

(f) The audit committee shall submit the audit report to the Board of Governors for consideration by it. Such submission shall be made through the Managing Director and the Executive Board which shall forward with the audit report its comments thereon. The audit committee shall afford the Managing Director an opportunity for explanation to it before deciding that any matter seems to require criticism in the report. The audit report shall be submitted to the Board of Governors within a reasonable time after its completion.

BL 20(f)-22

SEC. 21. APPLICATIONS FOR MEMBERSHIP

The audit committee may formally furnish to the Managing Director and the Executive Board the committee's views and suggestions concerning the system of accounting, internal financial control, and documentary or other procedure which may technically strengthen or improve the administration of the Fund's financial affairs. Such matters need not be dealt with in the audit report unless the audit committee believes they are of such moment as to warrant inclusion.

(g) The Managing Director shall determine what expenses are necessary and reasonable in connection with each annual audit, and the Fund shall bear such expenses.

*Adopted March 16, 1946, amended September 17, 1947, October 2, 1969, March 20, 1972, and June 13, 1978*

Section 21. APPLICATIONS FOR MEMBERSHIP

(a) Any country may apply for membership in the Fund by filing with the Fund an application, which shall set forth all relevant facts.

(b) The Executive Board shall report on all applications to the Board of Governors. When an application is submitted to the Board of Governors with a recommendation that the applicant country be admitted to membership, the Executive Board after consultation with the applicant country shall recommend to the Board of Governors the amount of the quota, the form of payment of the subscription, and such other conditions as, in the opinion of the Executive Board, the Board of Governors may wish to prescribe.

*Adopted March 16, 1946, amended June 13, 1978*

Section 22. COMPULSORY WITHDRAWAL

Before any member is required to withdraw from membership in the Fund, the matter shall be considered by the Executive

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|  | <p style="text-align: center;"><b>INTERNATIONAL<br/>MONETARY FUND<br/>ADMINISTRATIVE MANUAL</b></p> | <p style="text-align: center;">General Administrative Order No. 14, Rev. 1</p> |                             |
|  |   | <p>Effective Date:<br/><br/>November 1, 1969</p>                               | <p>Page<br/><br/>1 of 3</p> |
|  | <p><b>Subject: INTERNAL AUDIT OF THE FUND</b></p>   |  |                             |
| <p><i>Section 1. Purpose</i></p> <p>The purpose of this Order is to:</p> <ul style="list-style-type: none"> <li>.01 Set forth the policy of the Fund with respect to internal audit;</li> <li>.02 Define the organization of this activity;</li> <li>.03 Outline the objective of the audit;</li> <li>.04 Set forth generally the scope of the internal audit;</li> <li>.05 Define the authority of the Internal Auditor;</li> <li>.06 Define working relationship of the Internal Auditor with the members of the staff.</li> </ul> <p><i>Section 2. Policy</i></p> <ul style="list-style-type: none"> <li>.01 It is the policy of the Fund to have an internal audit such as will assure the Managing Director of proper adherence to the Fund's financial requirements and procedure and will secure the benefits of a systematic and objective verification and constructive analysis of the accounting aspects of the Fund's operations.</li> <li>.02 The internal audit shall be complete in itself, comprehensive in its range and generally recognized as a part of the general machinery of the Fund for exercising financial control.</li> </ul> <p><i>Section 3. Organization</i></p> <ul style="list-style-type: none"> <li>.01 The Internal Auditor shall be attached to the Office of the Managing Director of the Fund.</li> </ul> <p><i>Section 4. Objective</i></p> <ul style="list-style-type: none"> <li>.01 The ultimate objective of the internal audit shall be directed at a determination that: <ul style="list-style-type: none"> <li>.011 The accounts are correct and that the methods of the financial control assure protection and conservation of the Fund's assets.</li> <li>.012 All financial transactions of the Fund are consummated in compliance with the Articles of Agreement, By-Laws, Rules and Regulations, Decisions of the Executive Board and Managing Director, and other underlying administrative authority.</li> </ul> </li> </ul> |   |  |                             |

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*Section 5. Scope of Audit*

Basically the principal functions of the internal audit will be to:

.01 Review and appraise the soundness, adequacy and application of accounting, financial and operating controls;

.02 Conduct a continuing examination of the accounts of the Fund and of related records and documents presenting evidence in support of financial transactions, including a selective preaudit of expenditures;

.03 Determine whether accounts, records and procedures conform to present instructions and requirements and to generally accepted accounting principles;

.04 Review, prior to issuance, financial statements and related data prepared from the accounts;

.05 Study and evaluate the effectiveness of existing procedures, including all phases of internal check and control, to safeguard the financial interests of the Fund.

.06 Report such audit findings and make such recommendations concerning the system of accounting, internal financial control, and documentary or other procedure as may strengthen and improve the administration of the Fund's financial affairs.

.07 Collaborate with the external audit committee in its annual audit of the Fund made in pursuance of Section 20 of the By-Laws.

*Section 6. Authority of the Internal Auditor*

.01 The Internal Auditor shall be responsible solely to the Managing Director under whose general direction he will perform his duties.


.02 The Internal Auditor is charged with the duty to report to the Managing Director on matters within the scope of the internal audit.

.03 After consultation with the Treasurer, the Internal Auditor shall determine which transactions and operations shall be subject to preaudit.

.04 If the Internal Auditor is of the opinion that a proposed transaction or operation does not comply with the provisions of Section 4 hereof, he shall communicate his views to the Treasurer. In the event the Treasurer and the Internal Auditor are unable to reach agreement, the matter shall be submitted to the Managing Director for decision.

*Section 7. Working Relationships*

.01 In carrying out the aforementioned functions, the Internal Auditor shall have access to the accounting records of the Fund and other supporting evidence of its financial

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| <p>transactions, and, by arrangements with appropriate officers of the Fund, shall be furnished with such information and cooperation as may be required in the proper discharge of audit duties.</p> <p><i>Section 8. Relationship to Other Administrative Orders</i></p> <p>.01 This Order supersedes General Administrative Order No. 14, dated January 1, 1948.</p> <p><i>Section 9. Effective Date</i></p> <p>.01 The effective date of this Order is November 1, 1969.</p> <div style="text-align: center;"><br/>Frank A. Southard, Jr.<br/>Deputy Managing Director</div> |  |                           |