

**EXECUTIVE
BOARD
MEETING**

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July 9, 2020

To: Members of the Executive Board

From: The Secretary

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

Board Action: Background for the External Audit Committee briefing to the Executive Board

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International Monetary Fund
2020 Report of the External Audit Committee to the Executive Board
July 8, 2020

Executive Summary

This report summarizes the work of the External Audit Committee (EAC) of the International Monetary Fund (“the Fund”) for the financial year ended April 30, 2020. Our work benefited from the cooperation and support of the Executive Directors (EDs), management, relevant departments, and external auditors.

The EAC oversaw the process for the external audit of the 2020 financial statements and, in the context of our oversight, commented on those financial statements. In order to discharge our oversight responsibilities, the EAC also considered the Fund’s financial reporting practices, the external audit framework and the system of internal controls. In reviewing the internal audit framework of the Fund, the EAC considered the reports issued by the Office of Internal Audit (OIA) during 2020 and its 2021 proposed internal Audit Work Plan. In light of the current global pandemic, the EAC also considered its impact on the Fund to date based on the best available information; the overall impact remains uncertain as it is dependent on future developments that cannot be accurately predicted at the date of this report.

Outline of the EAC’s Activities

This report, together with our informal briefing of the Executive Board (“the Board”) on January 30, 2020 for our audit planning visit, covers the EAC oversight activities relating to the financial year ended April 30, 2020. In connection with financial year 2020, the EAC made an in-person visit to the Fund in January 2020 focusing on the audit planning process, where we met with the Finance Department (FIN), OIA, Office of Risk Management (ORM) and other departments. We also met with the external auditors, PricewaterhouseCoopers (PwC) and our discussion focused on the external audit planning process.

Throughout the year we maintained contact with FIN and OIA to receive updates and discuss relevant developments with staff. We also provided input on the FIN paper put to the Board in relation to provisioning under IFRS 9 and provided commentary both on the proforma and April 30, 2020 financial statements. We return virtually in July to present formally the EAC’s report to the Board, concluding the EAC’s audit oversight for financial year 2020. The 2020 audited financial statements will be submitted by the EAC to the Board of Governors through the Managing Director and the Executive Board after the EAC’s briefing of the Board, on July 14, 2020.

The June virtual visit focused on the completion of the audit and the finalisation of the financial statements. We had meetings with the following: FIN, PwC, OIA, ORM, Information Technology Department (ITD), Human Resources Department (HRD), the Office of Budget Planning (OBP), the Crisis Management Team (CMT), the Ethics Advisor, the Office of Internal Investigations (OII), and the EDs in two groups. In addition, we met with Deputy Managing Director (DMD) Mr. Furusawa and we concluded this year’s audit completion visit by meeting with the Fund’s Managing Director, Ms. Georgieva.

As noted, and unusually, our June visit was carried out virtually due to the COVID-19 crisis. Although we spread our meetings over two weeks rather than one week in order to manage time differences and availability, we wish to reassure the Board that there has been no degradation in the quality of our engagement with the Fund staff and with PwC.

Given the unprecedented nature of the crisis, we begin our report by reflecting on the impact that the global pandemic has had on the Fund, how the Fund has responded and the risks still facing the Fund as a result of the ongoing effects of the crisis.

Briefing by FIN and Others on the Impact of COVID 19

We have been impressed with the way the Fund and all its staff have risen to the challenges presented by the COVID-19 pandemic. The unprecedented demand for support by member countries has probably never been seen before. In response, the Fund has operated at speed and with decisiveness. Although the major exposures (Argentina, Egypt, Ukraine, Pakistan, Greece) at the financial year end have not changed since then, the number of applications over the year end period has been extremely high, including for short term financing, blended financing and precautionary arrangements. In addition, the Fund has approved and set up a new GRA Short-term Liquidity Line to provide another facility for its members. The Fund has facilitated these requests and related work at a pace that has inevitably tested the Fund's staff, systems and processes, but these have proved resilient.

We have been briefed by FIN on the Fund's provision of emergency assistance, including doubling the access to emergency facilities, and the impact this has had on the Fund's resources. We were advised on the Fund's initiatives to strengthen the resource envelope to meet the increasing demand for funds, such as the renewal of the New Arrangements to Borrow (NAB) until 2025, doubling of the NAB commitments to SDR365B and the Board approval of a framework for a new round of Bilateral Borrowing Agreements which will become effective on January 1, 2021, as well as the plans to address potential resource constraints of the PRGT and CCRT. We had an update on the 15th and 16th quota reviews.

FIN discussed with us the approach to credit risk management through the crisis in the light of less ex-post conditionality and temporary increases in higher access limits. Undoubtedly risk has increased, not surprisingly in the circumstances. The safeguards of assessing sustainability of debt and capacity to repay remain crucial, as well as maintaining the loss-absorbing capability of the Fund's precautionary balances.

In spite of the crisis, the Fund has managed to put into effect the long-planned clearance of the Somalia arrears, involving a complicated series of numerous transactions over a very short time period. We commend the successful outcome of such an important initiative, recognising the last steps are still to be completed.

The Fund's handling of the crisis lending has been impressive given that staff have been working at home since mid-March. We have received updates on how off-site working has been achieved successfully and at short notice, including logistics, staff welfare, IT and communications. The CMT has updated the EAC on its work in dealing with the immense challenges this has created for the Fund but also for each individual staff member. The CMT

briefed us on the Fund's Roadmap for resumption of regular operations at HQ, which we found to have fully considered staff safety, security and welfare.

FIN Update on the 2020 Financial Statements and External Audit Process

One of the primary purposes of our June meeting is to carry out discussions with the various stakeholders relating to the finalisation of the financial statements of the Fund for the year ended April 30, 2020 and the audit of those financial statements.

In spite of the COVID-19 crisis hitting at the peak of financial statement preparation and the external audit, FIN has kept to the timetable to produce the financial statements, with its usual robust processes and controls in place. We commend the diligence and hard work of FIN; the EAC is cognisant of how difficult this has been in the circumstances and with so many other calls on FIN staff time.

The EAC was pleased to note the further improvements made by FIN to presentation and disclosures in the financial statements to make them more informative and readable. We have encouraged full disclosures about the impact of the pandemic, even though a significant portion of activity took place after the year end of April 30, 2020 as International Financial Reporting Standards (IFRS) require disclosures of major post-balance sheet events. The uncertainties caused by COVID 19 have the potential to impact certain estimates and judgements used in the preparation of the 2020 financial statements. Nevertheless, the financial statements for FY2021 will bear the brunt of reporting the COVID-related activity.

We discussed with FIN the application of the expected loss provisioning model under accounting standard IFRS 9. We remain supportive of the model developed by the Fund in applying the standard and are satisfied with the process and results of that work this year, leading to the conclusion that no provision is required in the Fund's FY2020 financial statements. We discussed this issue in some depth with both FIN and PwC, including testing the approach in relation to the largest credit balance outstanding.

We realise that were a credit loss provision to arise, this would be a significant issue for the Fund, and we support FIN's work in bringing a paper on provisioning to the Board. The crisis has briefly delayed that discussion but emphasised its importance. We underline here the significance for the Fund's reputation and credibility in applying, on a rigorous basis, widely-accepted international accounting standards.

The discussion with FIN on the Fund's income for FY2020 included the impact of IAS 19 (pensions accounting) on the Fund's reserves. The EAC appreciates that the effect is volatile and can be substantial: this year the adverse swing in the overall net liabilities of the pension plans more than offset a positive operational result. IFRSs apply this approach to give a transparent picture of the current position of pension plans and especially the defined benefit obligation at a specific point in time, that is the balance sheet date. It is different from the actuarial funding assessment of the pension fund position, the objective of which is to ensure that sufficient funds will be accumulated to deliver the promised benefits on an ongoing basis. The EAC discussed FIN's work in progress to consider how to ameliorate the impact

of IAS 19 on the Fund's reserves and we have made various suggestions about how this might be done in light of our experience with other entities with similar issues.

External Audit Matters

We met with PwC to gain an understanding of the audit process and their findings. We were pleased to gain reassurance from our discussions with PwC that their audit work was of a quality consistent with prior years even though carried out remotely, and we commend them for their flexibility and diligence in completing a high-quality audit in difficult circumstances.

PwC advised that there were no changes in the audit approach, as laid out in their Audit Plan which they previously presented to the EAC during the planning meeting on January 27, 2020. They highlighted that the Significant Audit Risks were substantively the same as last year, being:

- The assessment of a significant increase in credit risk
- Valuation of illiquid investments
- Management override of internal controls (which applies to all audits under International Standards on Auditing)

PwC confirmed that sufficient appropriate audit evidence was obtained by them through their audit process, thus enabling them to suitably address the significant risks. PwC also looked at certain items assessed as risks, but not significant, including the fair value of investments that are not classed as illiquid and accounting for post-retirement benefits, on both of which PwC's reports were also positive.

PwC gave various confirmations to us and Fund management arising from their audit work, the most noteworthy of which are as follows:

- PwC did not identify any matters to report as part of their design assessment over controls that impact on financial reporting.
- PwC confirmed that there were no significant adjustments, unposted adjustments or omitted disclosures arising from the external audit.
- PwC has noted no fraud or illegal activities or pending litigation during the execution of their audit.

Since the year end, PwC has noted no reportable subsequent events. We specifically noted that they have reviewed Argentina's credit outstanding position as a part of their subsequent events process. As a result of COVID 19, PwC will reassess events subsequent to the balance sheet date up to just before the Annual Report is issued; while this is normal audit practice, it is of greater significance in such a fast-moving crisis environment.

PwC confirmed their independence of the Fund and provided details of non-audit services rendered to the Fund during the year, for independent review of the EAC. Fees for the 2020 external audit were \$1,340,000. Fees for non-audit services billed by PwC in FY2020 were \$140,150, which are below the threshold that would require Board approval. The EAC

reviewed non-audit services provided by PwC during 2020 and concurred with management and PwC that these services do not compromise the independence of the external auditors.

Review of Internal Audit and Internal Control

We have been briefed by OIA on its work during the year as well as its proposed future work program.

OIA's productivity has increased substantially which we commend: the number of pieces of work delivered and near completion for FY2020 showed an increase in volume on prior years. This reflects OIA's new and better ways of working with relatively tight resources (the sufficiency of which should be kept under review) considering the scale of the Fund's activities in comparison to other IFIs.

We discussed the four advisory reviews, five audits, and a Periodic Monitoring Report (PMR) that have been produced by OIA (including two in process of finalisation). We also discussed progress made to date on the audit of the Fund's Enterprise Risk Management Framework (discussed further below), the audit of the Fund's Administration of the G-5 Program and the review of specific IHR Program components (data migration, security and internal controls configuration).

OIA is a valuable resource for the Fund's management. While management attention is rightly focused on the Fund's response to the current crisis, in the EAC's view it is more important than ever that OIA should be used to provide comfort on the corporate administrative side of the organisation, and in particular the major modernisation and transformation projects, to give timely objective perspectives to aid decision-making. The EAC encourages those responsible for the projects to see OIA's proactive and timely involvement as a means to better delivery and decision-making, increasing stakeholder support through objective and independent assessment.

OIA discussed with us the modification of their work plan for FY2021 in light of the crisis, emphasising the decision to shift to focus on advisory work in the first six months and leave the later part of the year fluid in order to react to events, a strategy with which we concur. Nonetheless, internal audits are vital to the Fund and should only be postponed when it is not possible for the relevant department to deal with the audit; and even then, they should only be postponed for as short a time as possible. The Fund may wish to consider using OIA to confirm that the change in working practices as a result of COVID 19, including working from home and the high volume of transactions, did not compromise the controls and the delegation of authorities in place and the likelihood of fraud.

We note that the outstanding issues in the Tenth Periodic Monitoring Report need to be addressed and recommend that these be cleared, and that a rigorous process is adopted to allocate accountability and timescales for these and all future findings to ensure timely improvements in the Fund's systems and controls.

Risk Management

The EAC received an update from ORM, indicating that the function continues to develop within the confines of its remit. We are encouraged by the substantial engagement that ORM has had with the Board as the COVID-19 crisis has developed, the progress it has made and the ambition for future improvement.

We discussed identified enterprise risks with ORM, including those arising in relation to both resources (particularly in light of the huge increase in applications for support) and programs. We have been very pleased to see the significant developments made on risk management by ORM, including laying the foundations for ex-ante risk assessment and enhanced reporting to the Board on enterprise and financial risks. We discussed the risk map and landscape with ORM and received updates on third party risk management and information security. We also discussed emerging global risks and ORM's work priorities, which we strongly support.

The EAC believes that the impact of the COVID-19 crisis should be viewed as an opportunity to undertake a fundamental review of risk management across the Fund, including its governance. As you are aware, the OIA Audit on the Fund's Enterprise Risk Management (ERM) framework is currently in progress, with the fieldwork completed and a validation process of key findings and recommendations with stakeholders is ongoing. The audit should provide a credible and objective viewpoint in not only taking stock of the Fund's current ERM capabilities but more importantly giving the Fund a set of practical and actionable recommendations to consider so that the Fund can derive greater value from its ERM activities. OIA's report should also provide a comprehensive roadmap in informing the structural and process changes necessary to more effectively operationalise the Board-endorsed risk acceptance statements, drive greater accountability and ownership for risk mitigation, and foster a more risk-aware culture.

Updates from Other Departments

While the extraordinary effect of the COVID-19 crisis is affecting the Fund's core activities, other important changes within the Fund remain under development and vital to the future efficient working of the Fund. The EAC has explored progress on the major transformation projects, hearing from HRD and ITD, as well as OIA, ORM and FIN. We have also had briefings from some of the other independent offices of the Fund, such as the Ethics Office, OII and OBP.

HRD: On the largest and most advanced project, 1HR, we have been keen to understand the extent of success while appreciating the challenges to come. There are delays in the stages to complete the project and complexity caused by the interaction with CCBR outcomes. We appreciate that an additional step has been introduced to aid data cleansing for data migration. As the project finalises controls documentation, it will be important to build in time to properly validate configured controls. As we have noted, the timely involvement of OIA should be seen as a means to provide valuable support in achieving success, as there can be an objective assessment of the readiness for go-live and the capture of benefits of the project, and to validate the state of the project for key stakeholders.

ITD: The COVID-19 crisis has placed strain on the IT systems within the Fund and ITD has responded effectively, moving services to the cloud, issuing new hardware and expanding licence capacity for homeworking. ITD has briefed us on their enhancements to cyber security in light of the move to off-site working and managing such large volumes of remote meetings, including those that are extremely sensitive such as the Spring meetings, G7 and WEF. Work on the access management and privileged access management systems is still in progress and we are concerned about the delays in being able to leverage the full benefits of the new IAM tools and governance arrangements for the HR controls environment. The move to transition to new vendors arising from the previously identified data breach is also continuing, albeit over a fairly long period.

ITD is undergoing a major reorganisation at the same time as being a key partner in all the transformation projects. While we were pleased to hear of the progress made to date, we recognise the pressure ITD is under. We again encourage partnership with OIA in helping to move ITD forward, particularly in light of ITD's reorganisation and the need to review a culture that has, for example, allowed relationships with vendors that are perhaps too close and familiar.

OBP: The EAC heard from OBP the system and process of setting budgets for the Fund, and the adjustments that have been made to allow temporary increases in resources for FY21 to respond to the COVID crisis on a more sustainable basis. It is important to retain a tight focus on expenditures, but the EAC notes that although maintaining a flat operational budget has elicited efficiencies, both the operating and capital budgets should be considered from an investment standpoint: a lack of investment in both expensed and capitalised resource could curtail future Fund capacity.

Ethics Office: The EAC received a briefing from the Fund's Ethics Advisor from which we observed the embedding of ethical principles within the Fund's culture through ongoing information sharing and training, which have continued through the COVID-19 crisis. We noted the publication of a new Retaliations Policy.

OII: We were pleased to note the recruitment to the OII to maintain its strength and discussed the work of the OII through 2019.

Meetings with the Executive Directors

During our visits, we met with the EDs in two groups. These meetings, conducted on an informal basis, enabled us to follow up on issues raised at similar meetings and to learn of other issues of concern to the EDs. The questions we were asked included subjects such as: provisioning under IFRS 9; pensions accounting under IAS 19 and the impact on the Fund's reserves; risk management at the Fund; the major transformation projects; how the Fund had dealt with COVID-19; the work of OIA; and the effect of the crisis (and virtual meetings) on the audit and our visit.

We provided the EDs with an overview of the external audit results and a summary of our oversight. The EAC highlighted for the EDs that the implementation of IFRS 9, with its forward-looking impairment model, did not result in any impairment provision being

recognized in the FY2020 financial statements. The EAC's work continues to benefit from the high level of engagement with the Executive Board, and we continue to welcome your input going forward.

EAC Recommendations

The EAC recommends four items for follow up arising from this year's oversight activities:

1. We encourage the Executive Board to continue its discussions with FIN on important financial reporting issues that have wider implications for the Fund. In particular, the Fund should consider the wider consequences for the Fund were a provision for credit losses be required in future under IFRS 9. We also support the work FIN is undertaking to ameliorate the impact of the accounting for the Fund's post-retirement benefits under IAS 19 on the Fund's reserves.
2. The work in progress by OIA on Enterprise Risk Management Framework (ERM), due to report shortly, should be used to revisit the Fund's approach to risk management at a fundamental level, including the remit of ORM. The Fund should also take advantage of the insights gleaned through its response to the COVID-19 crisis in undertaking this work. It is important to ensure the Fund moves to gain the benefits of strong ERM by making structural changes to its approach in order to meet best practice. This also addressed our previous recommendation on strengthening the internal risk governance framework (originated in FY2016).
3. The issue of third-party contract management remains in many ways a concern: while procurement is important, the ongoing management of contracts after procurement is vital to ensure controls are maintained and that the Fund obtains value through delivery to agreed service levels. This is an issue not only affecting ITD: across the Fund there needs to be more accountability for the delivery of contract benefits, particularly in an environment where there is a considerable amount of outsourcing, as will be the case for ITD as it moves to a managed service delivery model.
4. As well as a Fund-wide approach to risk management, the EAC recommends that the Fund should also look at instituting a Fund-wide institutional control framework. A control framework to assist in building risk and control awareness and the capacity to sustain an effective control environment should have been built in from the start on the transformation projects; but as has been made clear from our briefing on IHR, this has not necessarily been the case. While the HRD internal controls framework design has recently been approved by management, achievement of the desired maturity level could take several years and should be expedited. This does not mean that there are no strong control systems within the Fund. However, the extremely strong controls instituted and run by FIN, for example, should not be used as a substitute for strong control frameworks across all other departments.

The EAC wishes to repeat some items it recommended for follow up in its previous reports. Our overall view is that the Fund has made progress in all areas; remediations are ongoing and these will continue over a few years given the nature of the recommendations. For these remaining applicable recommendations, we have enhanced the points and summarised them substantially as they can be read more fully in earlier reports.

- The Fund and its staff should continue to closely monitor the various work-streams of the modernization and transformation projects, including making use of the Change Management Unit (CMU). We add this year, as we noted above, that the involvement of OIA can also be strategically beneficial to the successful completion of these projects, and assessing other areas and activities of the Fund where the CMU involvement would be most beneficial. *(Originated in FY2019)*
- The EAC encourages the Fund to fast-track the Board-endorsed triage/follow-up framework that has been formulated by OIA to address the backlog of open management actions in the near-term, to implement IEO's recommendations thereby enhancing the Fund's governance. *(Originated in FY2019)*
- As noted again this year, the Fund should monitor the execution of the 1HR Project and the implementation of the results of the benefits review in terms of new benefits and transitional arrangements for old ones through to completion under the revised timelines. There appears to be some risk that the original objectives may not all be achieved as the project comes to be finalised and accountability here is key. *(Originated in FY2018)*
- The Fund should continue to monitor the remediation of the recommendations in OIA's Audit of the Fund's Approach to Identity and Access Management through to final dispensation. Timely remediation of the current identity and access management issues is necessary to reduce the potential risk exposure that can arise from unrestricted and/or unauthorised access to the Fund's information. We understand that the completion of this initiative has been aligned with the revised timelines for the 1HR project. *(Originated in FY2017)*
- The EAC encourages the Fund and the external auditor to monitor developments in leading practice regarding Key Audit Matters (KAM), once the new relevant US audit standard comes into force for listed companies later this year. *(Originated in FY2016)*

Appreciations

We take this opportunity to thank FIN, OIA, PwC, and the other departments and groups mentioned in this report for their help and cooperation in the execution of our mandate. We also thank Managing Director Ms. Georgieva, Deputy Managing Director Mr. Furusawa, and the Executive Board members for their time and attention. We look forward to presenting our report to the Board on July 14, 2020.

We wish the Fund well in its continuing efforts to aid the world economy and its member countries as the effects of the pandemic continue to unfold.

Respectfully submitted,

Kathryn Cearns, Chair

Judith Lopez

Bassam Hage