

## **FINANCIAL MANAGEMENT ASSESSMENT, TRANSFER OF FUNDS, AND RISK ASSESSMENT AND MANAGEMENT PLAN**

### **A. Introduction**

1. The technical assistance (TA) supports, through ADB's financial contribution, the IMF's Caucasus, Central Asia and Mongolia Regional Technical Assistance Center (CCAMTAC) to undertake capacity development in macroeconomic-related areas for Armenia, Azerbaijan, Georgia, Kazakhstan, the Kyrgyz Republic, Mongolia, Tajikistan, Turkmenistan, and Uzbekistan. The CCAMTAC will be physically established in Almaty, Kazakhstan in 2021. The first phase of the CCAMTAC runs through 2021-2026. CCAMTAC will be managed by a center coordinator (an experienced IMF staff) with strong backstop by departments concerned, guided by the steering committee. CCAMTAC's capacity development will be delivered by its resident advisors and short-term experts.

2. The assessment was undertaken to assess the adequacy of IMF and CCAMTAC fund flows, staffing, accounting policies and procedures, internal controls, financial reporting and monitoring, internal and external audit arrangements, and planning and budgeting processes. The financial management assessment procedures included: (i) an assessment of financial management systems and capacity of the implementing agency, including potential strengths / weaknesses of project specific financial management arrangements; (ii) risk assessment and preparation of a risk management plan; (iii) initial draft of the project's financial management, funds flow, accounting and auditing arrangements; and (iv) annual financial statements analysis.<sup>1</sup> The IMF is a multilateral agency which is governed by and accountable to the 189 countries and has a separate set of governing documents and policies which are not directly affected by Kazakhstan's legislative and public financial management framework.

3. The IMF's fundamental mission is to ensure the stability of the international monetary system. It does so in three ways: keeping track of the global economy and the economies of member countries; lending to countries with balance of payments difficulties; and giving practical help to members. It is headquartered in Washington, DC, USA. The IMF conducts its operations and transactions through the General Department. The General Department comprises three accounts: (i) the General Resources Account (GRA); (ii) the Investment Account (IA); and (iii) the Special Disbursement Account (SDA). The IMF has a global network of 16 regional capacity development centers, and its independent external evaluations have consistently given them high marks for quality of advice and training, and speed and flexibility of response to member-country needs. The TA implementation arrangement follows the successful model established by ADB's previous contribution to the IMF's Pacific Financial Technical Assistance Centre (PFTAC). Since 1994, ADB has been providing \$7.2 million to the PFTAC under 11 consecutive regional TA projects.

4. The proposed TA provides capacity development in the areas relevant to public financial management and debt management through ADB's financial contribution to the IMF's CCAMTAC. The center will provide capacity development services to all nine DMCs in the CCAM region. Work

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<sup>1</sup> Risk can be defined as a probability or threat of damage, injury, liability, loss or other negative occurrence that is caused by external or internal vulnerabilities that may be avoided through preemptive action. Risks can be divided into (i) inherent, arising from the overall environment in which the executing or implementing agency operates before considering the impact of the agency's financial management systems and controls; and (ii) control risks, the risk that the project's financial management and internal control arrangements are inadequate to ensure that project funds are used economically and efficiently and for the intended purpose.

is expected to cover six priority areas, comprising: public financial management, revenue administration, monetary policy, financial sector supervision, macroeconomic statistics, and macroeconomic framework. CCAMTAC's proposed budget envelope is \$45 million for Phase I. The budget will be financed by the IMF, the host country—Kazakhstan, other CCAM countries, and donor partners. Kazakhstan has committed to cover approximately a half of the externally financed portion of the budget— \$20 million. All other CCAMTAC member countries are expected to provide a financial contribution to demonstrate ownership and ensure sustainability. The IMF's contribution will be approximately \$3.3 million over five years to cover the coordinator's salary, benefits, and residence. External partners are expected to provide the remaining funds.

## **B. Project Financial Management System**

### **1. Overview of CCAMTAC's Financial Management and Institutional Context**

5. CCAMTAC is an office of the IMF without separate legal identity distinct from the IMF. IMF as an organization is assessed as competent to financially manage implementation of the TA in compliance with Essential Terms and Conditions for the Administration of the CCAMTAC Subaccount. IMF has adequate administrative and accounting capacity to manage the financial management and disbursement procedures in accordance with the IMF's policies, rules and regulations.

### **2. Strengths and Weaknesses**

6. IMF has an accounting information system with capacity to perform offsite back-up storage and project-based reporting customization. IMF has experienced and well-trained accounting and FM staff with low turnover and good adherence to policies and procedures, and is adequately audited by an independent external audit firm. IMF has extensive prior experience managing donor-funded projects.

### **3. Personnel**

7. The IMF will ensure the appointment and retention of required staff at the CCAMTAC. Dedicated staff will be responsible for financial management and accounting functions.

### **4. Accounting Policies and Procedures**

8. IMF's accounting policies and procedures are adequate. IMF has formalized policies and procedures with respect to financial accounting and reporting, internal audit, and risk management. The financial statements of the General Department are prepared in accordance with International Financial Reporting Standards (IFRS) issued by the International Accounting Standards Board (IASB). The financial statements are prepared under the historical cost convention, except for the revaluation of financial instruments at fair value through profit or loss.

### **5. Internal Audit**

9. The IMF's audit mechanisms comprise an external audit firm, an internal audit function, and an independent External Audit Committee (EAC), which, under the IMF's bylaws, exercises general oversight of the annual audit. The Office of Internal Audit (OIA) is an independent assurance and advisory function designed to protect and strengthen the IMF. The OIA's mandate is twofold: (i) assessing the effectiveness of the IMF's governance, risk management, and internal

controls; and (ii) acting as a consultant and catalyst for improvement of the IMF's business processes by advising on best practice and development of cost-effective control solutions.

## **6. External Audit**

10. The three members of the EAC are selected by the Executive Board and appointed by the Managing Director. Members serve three-year terms on a staggered basis and are independent of the IMF. EAC members are nationals of different member countries and must possess the expertise and qualifications required to carry out the oversight of the annual audit. Typically, EAC members have significant experience in international public accounting firms, the public sector, or academia. The EAC selects one of its members as chair, determines its own procedures, and is independent of the IMF's management in overseeing the annual audit. It meets in Washington, DC, each year, normally in January or February, to oversee the planning for the annual audit; in June, after the completion of the audit; and in July, to brief the Executive Board. The IMF staff and the external auditors consult with EAC members throughout the year. The 2019 EAC members were Kathy David (Chair), a chartered accountant and partner in an international accounting firm in Antigua and Barbuda; Kathryn Cearns, an independent consultant in the United Kingdom, providing advice on corporate reporting, auditing, and corporate governance; and Judith Lopez, a certified public accountant and former senior partner in an international accounting firm in the Philippines and audit committee chair of a commercial bank in the Philippines

11. The external audit firm, which is selected by the Executive Board in consultation with the EAC and appointed by the Managing Director, is responsible for conducting the IMF's annual external audit and expressing an opinion on the IMF's financial statements, including the accounts administered under Article V, Section 2(b), of the Articles of Agreement, and the Staff Retirement Plan. At the conclusion of the annual audit, the EAC briefs the Executive Board on the results of the audit and transmits the report issued by the external audit firm through the Managing Director and the Executive Board for consideration by the Board of Governors. The external audit firm is appointed for a term of five years, which may be renewed for up to an additional five years. PricewaterhouseCoopers was appointed as the IMF's external audit firm in November 2014. The external audit firm may perform certain consulting services, except for prohibited services, subject to robust safeguards to protect the audit firm's independence. These safeguards involve the IMF's External Audit Committee and, for consulting fees above a certain threshold, the Executive Board's approval.

## **7. Financial Reporting and Monitoring**

12. ADB requires audited financial statements annually. Required reports summarized in Table 1 are to be prepared by the IMF. For the annual audited financial statement, the IMF will prepare Special Fund Activities (SFA) Framework Account financial statements in accordance with cash-basis International Public Sector Accounting Standard. The project financial statements are to be audited in accordance with International Standards on Auditing by an independent auditor. The IMF will keep ADB informed on the progress of the activities under the subaccount, by posting once a year on the IMF's external portal to which each contributor has access (i) a financial statement regarding the operations and transactions under the subaccount, (ii) a progress report, and (iii) a list of key decisions taken at the annual steering committee meeting.<sup>2</sup>

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<sup>2</sup> Partners Connect is a secure website that contributors may access. The IMF will inform ADB when the documents have been posted on the external portal. The financial statement is expected to help ensure that ADB's contribution, together with other contributions to the subaccount, are used for the purposes approved for activities of CCAMTAC.

**Table 1. Summary of Required Financial Reports**

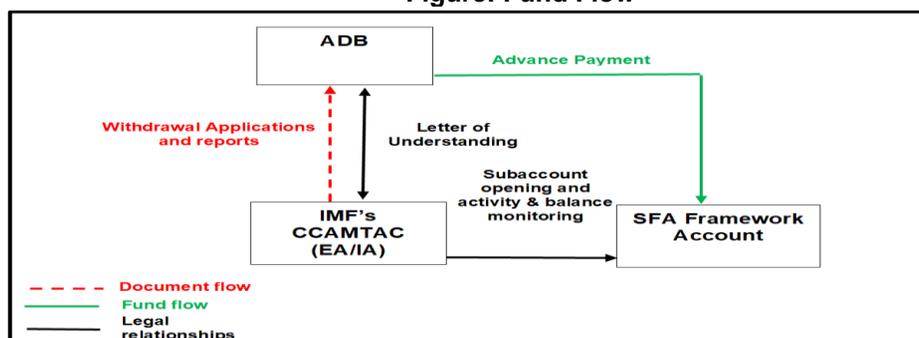
Report	Frequency	Basis	Duration	Due date
Audited Annual Financial Statements	Annual	Annual	Annual	Within six months after the end of financial year.

## 8. Information Systems

13. IMF uses an enterprise-scale IFRS-compliant platform. The system reflects IFRS-standard accounting rules. The system covers all enterprise accounting and financial reporting requirements of the CCAMTAC. The assessment finds that this accounting system provides a solid foundation for the IMF's accounting and financial management.

## 9. Proposed Funds Flow Mechanism

**Figure: Fund Flow**



ADB = Asian Development Bank, CCAMTAC = Caucasus, Central Asia, and Mongolia Technical Assistance Center, IMF = International Monetary Fund, SFA Framework Account = Framework Administered Account for Selected Fund Activities.

## C. Risk Description and Rating

14. By virtue of its role established through the Articles of Agreement, the IMF faces a range of financial and nonfinancial risks. The Executive Board has approved a risk acceptance statement guiding risk acceptance and assessment across the IMF's activities. The IMF has adopted the three lines of defense model for risk management:

- Risks inherent in day-to-day operations are mitigated by establishing and maintaining a system of internal controls.
- A risk management function is responsible for developing and maintaining the risk management framework, fostering the development of risk management tools, and reporting on the General Department's overall risk profile, highlighting areas where additional mitigation efforts are needed.
- An internal audit function is responsible for providing an independent assessment of the effectiveness of governance and internal control processes.

15. Oversight is provided by committees established to monitor and make decisions in specific risk areas, which supports the cycle of risk assessment, ownership, and mitigation vis-à-vis risk acceptance. Financial assets and liabilities are exposed to credit, market, and liquidity risks.

16. The foregoing assessment of IMF's FM systems, policies, procedures and overall capacity has identified the following key risks and with suggested mitigation measures:

**Table 2: Financial Management and Internal Control Risk Assessment**

<b>Risk</b>	<b>Risk Assessment</b>	<b>Risk Rating</b>	<b>Risk Mitigation Measures</b>
<b>Inherent Risk</b>			
1. Country-specific <sup>3</sup>	Not applicable.	Low	Not applicable.
2. Entity-specific	Compliance risk – Audit requirements are not fully complied with due to change in IMF financial management policies.	Low	ADB and IMF relationships will be governed by acceptable to ADB letter of understanding (LOU) with applicable annexes. <sup>4</sup> LOU may be amended only by the mutual agreement between the IMF and ADB.
<b>Overall Inherent Risk</b>		<b>Low</b>	
<b>Control Risk-</b>	<b>Project-specific risks</b>		
1. Implementing entity	Donor and host country support may not be adequate to launch CCAMTAC.	Low	IMF to allocate sufficient internal resources to execute programmed CCAMTAC operations.
2. Funds flow	Execution risk –advance balance is not managed and recorded properly; and staff resources are inadequate.	Low	IMF to ensure sufficient accounting resources.
3. Staffing	Execution risk – staff have limited understanding of LOU stipulated financial management requirements and procedures which contributes to project delay and noncompliance of financial management requirements.	Low	IMF staff is familiarized with LOU requirements.
4. Accounting policies and procedures	IMF not following IFRS and its own accounting and financial reporting standards, policies and procedures. It fails to update its accounting policies based on the latest IFRS changes.	Low	IMF to ensure sufficient accounting resources.
5. Internal audit	Compliance risk - Internal audit scope does not cover financial activities of the project	Moderate	Include the project in IMF internal audit plan.
6. External audit	Compliance risk - IMF's financial statements not audited by external auditor.	Low	Continue to retain external auditor to audit annual project financial statements.
7. Reporting and monitoring	Compliance risk - Delayed submission of financial reports undermines ADB's ability to assess IMF's financial performance to implement, maintain, and operate the project.	Low	IMF to ensure timely submission of reports and sufficient accounting resources.
8. Information systems	Potential loss of accounting data due to cybersecurity threat.	Low	IMF to ensure adequate data cybersecurity measures.
<b>Overall Control Risk</b>		<b>Low</b>	
<b>Overall Combined Risk</b>		<b>Low</b>	

CCAMTAC = Caucasus, Central Asia and Mongolia Regional Technical Assistance Center; IFRS = International Financial Reporting Standard; IMF = International Monetary Fund.

17 Risk monitoring and the project's overall exposure to risk must be reviewed throughout the life of a project and where necessary actions to mitigate risks must be changed or revisions

<sup>3</sup> For country specific financial management risks please see Public Expenditure and Financial Accountability (PEFA) performance assessment done in 2018.

<sup>4</sup> Annexes: (i) SFA Framework Instrument; (ii) Essential Terms and Conditions for the Administration of the CCAMTAC Subaccount; and (iii) CCAMTAC Program Document.

to the project must be considered. The overall pre-mitigation financial management risk for the project is assessed as *Low* and IMF's financial management is considered *adequate*.

#### **D. Proposed Action Plan**

18. IMF has a sound record in implementing donor funded projects and programs. No financial management action plan is proposed.

#### **E. IMF Financial Performance**

19. IMF financial performance assessment is based on audited financial statements. 2019 financial statements are audited by US office of PricewaterhouseCoopers.<sup>5</sup> Table 3 shows key IMF historical financial performance indicators for the last two years. IMF financial statements indicate positive operational income and stable assets.

**Table 3: Financial Performance Indicators**

(in millions of SDRs)	<b>2019</b>	<b>2018</b>
Total Assets	513,430	518,821
Total Currencies	464,022	466,787
Total Liabilities	491,454	497,470
Total liabilities, reserves, retained earnings, and resources	513,430	518,821
Total operational income	2,648	1,733
Net operational income	990	396

Source: International Monetary Fund. 2019. *IMF Annual Report 2019: Financial Statements*. Washington, DC.

#### **F. Conclusion**

20. The assessment concludes that IMF has low financial management and internal control risks and no time-bound mitigation measures are needed. IMF has a sound record in implementing donor funded projects and programs.

21. The assessment finds that IMF and CCAMTAC have enough financial management capacity as executing and implementing agencies for the project, provided that:

- The audited SFA Framework Account financial statements will identify the sources and uses of funds;
- The report of an external audit firm on the SFA Framework Account will be posted on the IMF's external website as part of the IMF's Annual Report within six months from the end of each fiscal year; and
- IMF will provide ADB access through IMF's external portal to: (i) a financial statement regarding the operations and transactions under the subaccount, (ii) a progress report; and (iii) a list of key decisions taken at the annual CCAMTAC steering committee meeting.

<sup>5</sup> <https://www.imf.org/external/pubs/ft/ar/2019/eng/assets/pdf/imf-ar-2019-financial-statements.pdf>