

Somalia: Technical Assistance Report-Internal Audit and Accounting Training for the Central Bank of Somalia



SOMALIA

TECHNICAL ASSISTANCE REPORT—INTERNAL AUDIT AND ACCOUNTING TRAINING FOR THE CENTRAL BANK OF SOMALIA

October 2018

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SOMALIA

**INTERNAL AUDIT AND ACCOUNTING TRAINING
FOR THE CENTRAL BANK OF SOMALIA**

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March 12, 2018

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GLOSSARY

AGC	Audit Governance Committee
BoD	Board of Directors
CBS	Central Bank of Somalia
CIA	Certified Internal Auditor
CISA	Certified Information System Auditor
IAD	Internal Audit Department
IAS	International Accounting Standards
IFRS	International Financial Reporting Standards
IPPF	International Professional Practice Framework
IIA	Institute of Internal Auditors
IT	Information Technology
HIPC	Heavily Indebted Poor Countries
MCM	Monetary and Capital Markets Department
PP&E	Property, Plant, and Equipment (PP&E)
SDR	Special Drawing Rights
SMP	Staff Monitoring Program

PREFACE

At the request of the Central Bank of Somalia (CBS) a Monetary and Capital Markets (MCM) Department mission visited Kampala, Uganda from September 24 to October 5, 2017 to assist the authorities in developing proper frameworks for internal auditing and accounting to bring them towards international accepted norms. Training sessions were conducted on relevant topics.

The mission met with members of the internal audit and accounting teams. The mission wishes to thank the CBS for their cooperation, productive discussions, and their enthusiasm to learn new topics and apply new skills. The mission is also very appreciative of the logistical support provided by the Somalia Resident Representative office located in Nairobi, Kenya.

This report has been reviewed in IMF Headquarters and comments have been incorporated.

EXECUTIVE SUMMARY

This was the first mission in a series designed to assist the Central Bank of Somalia (CBS) in its development of formal frameworks and professional practices for internal audit and accounting and bring them toward international norms. The mission team conducted a series of training sessions covering accounting and internal audit topics designed to assist the CBS staff in maintaining proper accounting records and preparing proper financial statements and developing and implementing an effective and modern internal audit framework. Specific topics were addressed that reflected the CBS' current operating and limited capacity levels. Group exercises were conducted using real data and information. Assignments were agreed with each team to be completed prior to the next mission.

The Internal Audit Department (IAD), unstructured and in its initial stages of maturity, needs an infrastructure to make the internal audit practices sustainable, repeatable, and professional. To this end, a proper internal audit charter, audit committee charter, and internal auditing manual needs to be drafted and approved by the management and Board of the CBS. In addition, the management of the CBS should appoint a head for the IAD to lead the establishment of internal audit function and consider a flatter organizational structure so that the IAD can mobilize its resources more efficiently. The IAD, with the knowledge and practices obtained from the mission training and workshop, should continue and complete the risk assessments of all the remaining business processes included in the audit universe. The results of the risk assessment will lay a solid foundation to develop a risk-based annual audit plan. The IAD should also update its strategy note based on the discussion during the mission to focus more on near-term objectives and start to get itself familiar with the International Professional Practice Framework (IPPF) for internal audit by downloading and reading relevant international internal auditing standards before the next mission.

The draft trial balance sheets for 2015 and 2016 have not been prepared consistent with International Financial Reporting Standards (IFRS) and inaccurate balances exist resulting from prolonged use of inadequate accounting systems, application of improper accounting procedures, as well as lost knowledge.¹ The CBS has been struggling with balancing these accounts and the mission recommended that the CBS not spend additional time attempting to identify past source documents and journal entries. Instead, the mission agreed with and explained to the accounting team the process that should be taken between now and the end of the year to ensure the balances at December 31, 2017 are accurate so that the reliability of the financial statements increases. This process may

¹ The balance sheet does not include the IMF accounts and for the financial statements to be IFRS compliant, the accounts must be presented. Overdue debt obligations to the Fund would increase the CBS' liabilities by approximately SDR 240 million or about US\$340 million. The mission understands that the Heavily Indebted Poor Countries (HIPC) Initiative debt relief program has been discussed, which could provide for debt forgiveness in the future. The CBS is also undergoing an asset recovery process which will most likely increase the assets of the bank.

result in adjustments to retained earnings. Achieving accurate balances are critical, as the bank is migrating to a new accounting information system (Oracle ERP) and it will be necessary for the computerized system to reflect accurate balances as of January 1, 2018. It is also critical that the accountants continue to have a role in the information technology (IT) project including the ability to guide the vendor in developing the proper configurations necessary to build a reliable accounting framework.

To explain certain IFRS concepts, the mission team spent 40 percent of the training on conducting a gap analysis with the team for the major balance sheet and income statement accounts. The purpose was to identify characteristics of IFRS principles, the impact on income on changing accounting policies to align with IFRS, and other various elements related to IFRS framework. The accounting team dissected the accounts and considered various IFRS concepts in context to the activity represented by the account. Changes in accounting policies were discussed, which included applying the accrual method of accounting to relevant accounts (IAS 1) and applying IAS 16 thoroughly by charging depreciation to buildings and developing and maintaining a proper fixed asset registry.

The 2013/2014 audited financial statements issued in October 2016 carry a qualified opinion. Disagreement between the CBS management and the external auditor regarding the revaluation of the property plant and equipment balance will need to be resolved soon so that the CBS is able to move forward with the 2015/2016 financial statements and, more importantly, be able to produce and issue the 2017 financial statements in a timely manner. The mission team discussed this issue and suggested that the accounting team meet with the Director of Accounting and propose that the disagreement be presented to the Audit Committee with the view that they resolve the disagreement.

Specific assignments were agreed with CBS staff. These included completing the risk assessment of the remaining auditable entities and reconciling the cash accounts with bank statements. Ongoing communication will be maintained to provide CBS staff timely guidance as needed via emails and conference calls. See Table 1.

Table 1. Assignments for Internal Auditing and Accounting

	Technical Assistance	Timeline
Internal Audit		
1	Update the proposed internal audit charter with CBS circumstances and submit it to governor and Audit and Governance Committee or the Board of Directors (BoD) for discussion and approval.	December 31
2	Update and submit the drafted audit committee charter to the governor and the Audit and Governance Committee (or the BoD) for discussion and approval.	December 31
3	Update the organizational chart to reflect a flatter structure to mobilize the limited resources.	December 31
4	Update and adopt the proposed internal audit manual.	December 31
5	Update the strategy note to set specific objectives for next 12 months:(i) develop the first risk-based annual audit plan; (ii) at least one staff sits for the Certified Internal Auditor (CIA) exam.	December 31
6	Selected one auditable entity from the audit universe, complete the risk assessment in line with proposed internal auditing manual (Chapter V).	October 15
7	Upon the feedback of the first risk assessment, continue and finish the risk assessment of all the remaining auditable entities in the audit universe.	December 31
8	Download and read the Institute of Internal Auditors (IIA) Standards.	December 31
Accounting		
1	Reconcile all bank statements and SWIFT notifications as of September 30, 2017 to the cash accounts and prepare and post adjusting entries if necessary to achieve accurate balances consistent with bank balances. Continue to reconcile cash accounts monthly.	November 15
2	Resolve disagreement regarding the Property, Plant, and Equipment revaluation between external auditor and management by proposing to senior management that the issue is taken to the Audit Committee. Consider obtaining a new appraisal for land and buildings for 2017.	December 31
3	Calculate the impact on income of adopting IFRS by completing the IFRS gap analysis.	December 31
4	Prepare proper Note for the financial statements for Property, Plant, and Equipment that includes a roll forward of the balance from January 1, 2015 to December 31, 2017. Separate land and buildings, calculate depreciation for relevant assets, and determine net value. Prepare and post any adjusting entries to reflect proper values and depreciation expense.	December 31
5	Set up Fixed Asset Register based on information provided by Administration Department or other relevant departments.	December 31
6	Ensure the Chart of Accounts are designed to allow for future needs (6 levels of accounts not 5): <ul style="list-style-type: none"> • Update list based on financial statement presentational preferences. • Update list based on IFRS analysis and any changes in accounting policy (e.g., depreciation for buildings). 	November 1
7	Develop sufficient number of accounting test scenarios (e.g., add fixed asset revaluation; verify whether a report can be produced that can be included in financial statements). Obtain feedback from users on interface and gaps in data entry.	November 15
8	Draft accounting policies for the Accounting Manual related to the following areas and submit for review to IMF: <ul style="list-style-type: none"> • Cash and Cash Equivalents. • Property, Plant, and Equipment. • Salary Expenses. 	Next mission date
9	Complete organizational chart and allocate 12 resources to various functions and define tasks.	Next mission date

I. INTRODUCTION

1. **Somalia is a fragile country currently under a 12-month Staff Monitoring Program (SMP) designed to rebuild the country's economic institutions under a difficult environment.** Part of the program includes commitments to enhance the governance of the Central Bank of Somalia (CBS). Capacity to be rebuilt is weak, and technical assistance is critical to achieve the SMP's targets.² Two of the financial sector reforms focus on improving accounting and reporting standards of the CBS, which will involve implementing new accounting and financial reporting systems in line with International Financial Reporting Standards (IFRS) and strengthening the CBS internal oversight including establishing an Executive Committee and Audit Committee.
2. **Currently, the CBS carries out very limited central bank functions as their functional, or de facto, currency is the U.S. dollar.** They do not conduct monetary policy or manage foreign reserves.³ The CBS' main activity is to provide cash and bill paying services to the government. Its main revenue source derives from cash handling fees and its main expenditure comprises staff wages and salaries. As such, the activities of the central bank are limited and consequently, the accounting for such activities is not complex and the auditing universe (i.e., the comprehensive list of auditable entities within the CBS) is limited. The training was commensurate with their current activities.
3. **This TA mission met with the newly staffed internal audit and accounting teams in Kampala, Uganda, and discussions focused on theory and application of various international standards and principles related to internal audit and accounting as applicable to the CBS.**⁴ Training sessions were conducted over a two-week period with the CBS staff participating in discussions and engaged in group exercises. Training materials are included in Appendices VI–IX and a matrix describing the content of future missions is included in Appendix III.

II. INTERNAL AUDIT

A. Background

4. **The Internal Audit Department (IAD) of the CBS is at the initial level in terms of capacity maturity.** The internal audit function is unstructured, conducts isolated single audits of transactions for accuracy or compliance purpose, and has not established any professional practices. The IAD was established over one year ago, and lacks an

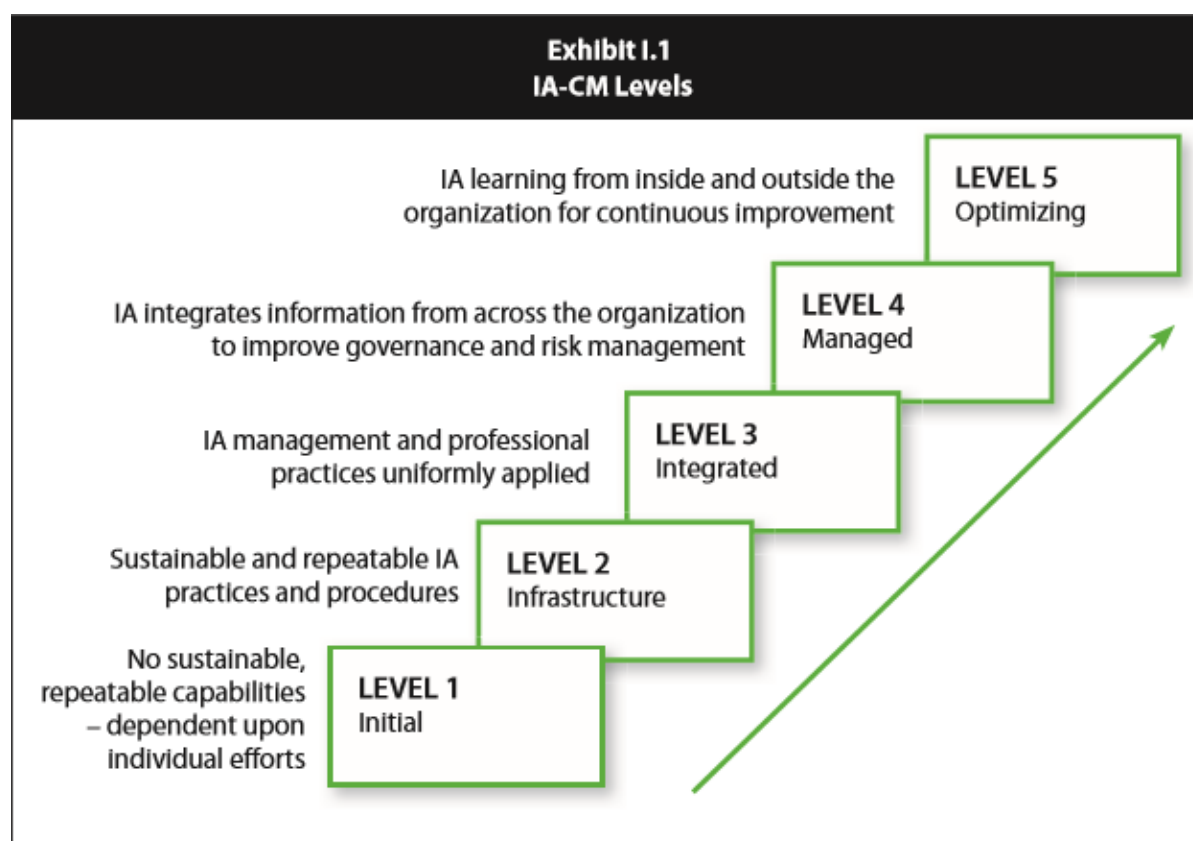
² Under a donors' trust fund, the IMF has delivered more than 60 TA and training missions and workshops over the past two years.

³ Currency reform is a high priority and progress on this reform is underway.

⁴ Both the IAD and accounting department suffer from limited capacity and experience; however, each of the newly recruited three-member teams is committed to obtaining professional certifications.

organizational structure and formal reporting lines. The three internal auditors, without an appointed lead or departmental head, meets with the governor as needed for funding and reporting. There is also no formal and direct reporting line from the IAD to the Audit and Governance Committee (AGC) although AGC receives IAD's periodic reports to the Board of Directors (BoD) since AGC members are non-executive members of BoD. The three internal auditors mainly conduct "surprise cash counting" to safeguard the custody of physical currency (mainly in U.S. dollars and a small portion of Somalia shillings) in the vaults and branches of the CBS. There is no internal audit manual or equivalent guidance to standardize and direct internal audit work. Figure 1 illustrates the characters of internal audit functions at different maturity levels.

Figure 1. Internal Audit Capacity Maturity Model for Public Sector



Source: Internal Audit Capacity Model for the Public Sector published by The Institute of Internal Auditors Research Foundation

5. **The IAD needs to establish the infrastructure so that its internal audit practices can be sustainable, repeatable, and professional.** The infrastructure includes formal dual reporting lines established through an internal audit charter (and in the CBS' case, an audit

committee charter), an organizational structure suitable for the IAD existing capacity, and an internal auditing manual based on the International Professional Practice Framework (IPPF).⁵

B. Internal Audit Charter and Audit Committee Charter

6. **As a newly established department, the IAD lacks formally defined reporting lines to the governor and the AGC, which would normally be documented in an internal audit charter.** The IAD meets with the governor as needed and provides periodic reports to the BoD members, which include the four non-executive BoD members who are also the members of AGC. There is no functional reporting line from the IAD to AGC.

7. **The internal audit charter drafted by the IAD is not in line with the mandatory requirements of IPPF.** First, the drafted charter defines the internal audit as “*independent appraisal function*” with the purpose of “*assist(ing) the board and the management to discharge their responsibilities effectively.*” This definition is narrowly focused and limits the roles of internal audit and does not comply with the definition included in the IPPF, which defines internal audit as “*an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations.*” Second, although the drafted charter states that the IAD reports to the governor administratively, and to the BoD functionally, it lacks definition of or explanation on the meaning of the administrative and functional reporting lines, and therefore, the implementation of the reporting lines is practically difficult. Third, the drafted internal audit charter also inadequately assigns the responsibility and ownership of risk management to the IAD, which should belong to management of the CBS.

8. **The IAD should develop an internal audit charter based on the example provided by the mission team and submit it to the AGC and CBS governor for approval.** The proposed charter (Appendix IV) is based on a model endorsed by the IIA and is aligned with IPPF mandatory requirements. The mission team and the IAD staff agreed a few terms should be modified in the draft charter to reflect CBS circumstances before submitting it for approval. The proposed charter has clearly defined the IAD to provide “*independent and objective assurance and consulting services,*” and authorized the IAD “*full, free, and unrestricted access to any and all of the CBS records, physical properties, and personnel pertinent to carrying out any engagements.*” In particular, the proposed charter has included details to substantiate the IAD’s dual-reporting lines in alignment with IIA Standards, i.e., reporting to the governor administratively and to the AGC functionally. The internal audit charter also explicitly states that management owns the risk management

⁵ IPPF was developed and issued by the Institute of Internal Auditors (IIA) and includes mandatory requirements and non-mandatory requirements. Mandatory requirements include core principles, definition of internal audit, code of ethics, and IIA Standards. Non-mandatory requirements include implementation guidance and supplemental guidance.

function and internal audit can provide assurance and consulting services on risk management in accordance with the charter.

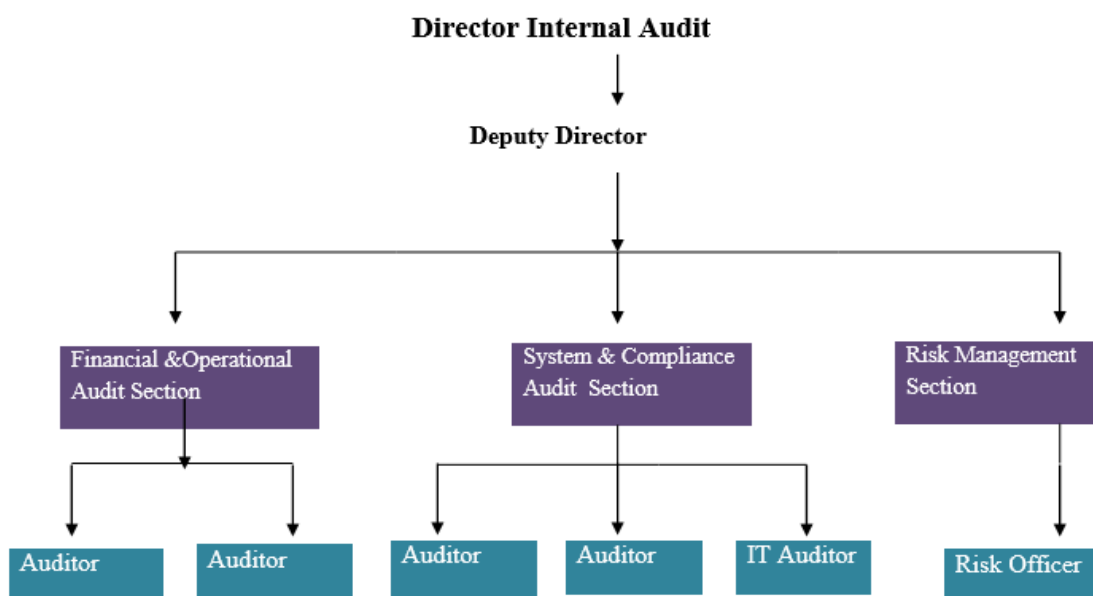
9. **The IAD has prepared a draft audit committee charter; however, it has not been discussed and approved by the AGC and the BoD.** The AGC is the designated audit committee of the CBS under the BoD; it is understood that the communication between the IAD and AGC mainly relies on periodic reporting from the IAD to the BoD because AGC members are also non-executive BoD members. An audit committee charter would help to formalize the roles and responsibilities of AGC in the oversight of CBS' financial reporting, internal control, risk management, and internal auditing, including the functional reporting from the IAD to AGC. An example audit committee charter (Appendix V) was shared with the CBS staff in case they would like to enrich their drafted charter with best practices.

C. Organizational Structure

10. **The IAD is without a department head which places their staff at a disadvantage to other departments.** Currently, no one is responsible for managing the staff and work of internal audit. While the three auditors can meet with the governor as needed, auditing staff lack a "go-to-person" for guidance in daily work. In addition, the lack of a department head may jeopardize IAD's regular communication with other department heads and senior management. As such, the CBS should hire a qualified individual to be the head of IAD on a timely basis. Ideally, the selected candidate should have the Certified Internal Auditor (CIA) certification or equivalent qualifications (e.g., Certified Public Accountant, Chartered Accountant), substantial experience in risk-based auditing methodology, and management skills. If local talents are limited in this aspect, a selected candidate could be hired conditional on the requirement to obtain the equivalent certifications in one or two years.

11. **The current draft organizational chart of the IAD appears too hierarchical for its small staff size (Figure 2).** The proposed structure divides the department into three levels. At the operational level, auditors are segregated into different sections based on types of audits, (e.g., financial/operational audits, and IT audits). Given IAD's current size (three auditors) and anticipated future size (six–seven auditors), maintaining this structure may limit the flexibility of mobilizing resources and developing staff.

Figure 2. Organizational Chart of the Internal Audit Department



Source: The Central Bank of Somalia

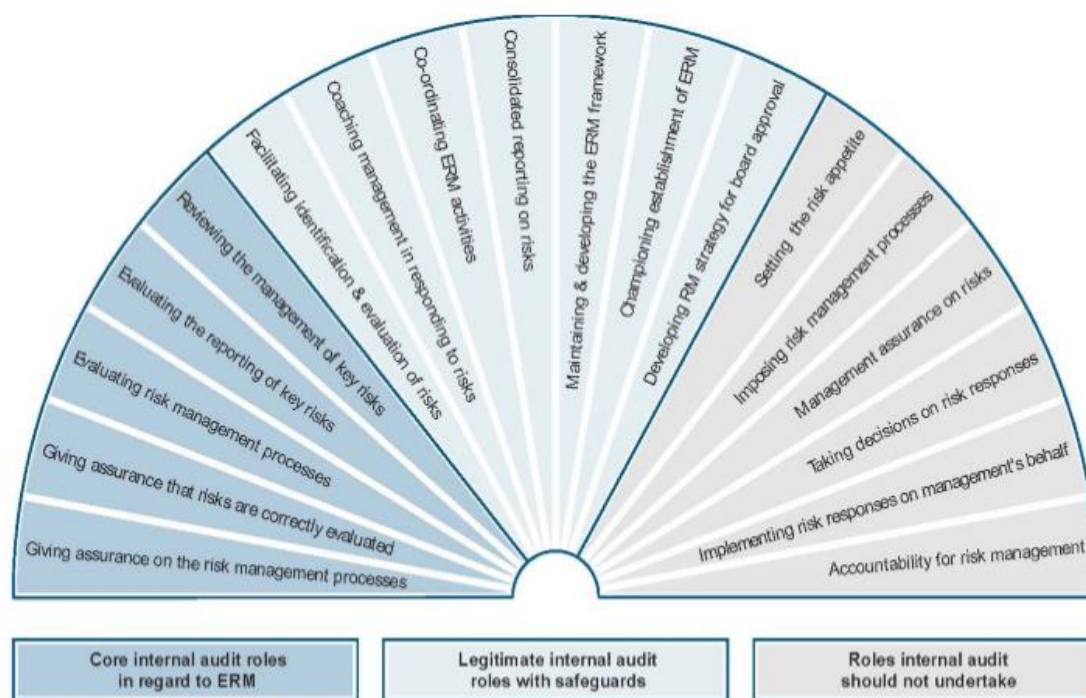
12. **The IAD should adopt a flatter structure to mobilize its limited resources and develop staff.** Instead of segregating its auditing staff into different divisions based on audit types, the IAD should organize its auditing staff in a professional pool and each individual be given roles of team lead or team member in different audits and consulting projects. Under this structure, the IAD can maximize its limited resources; staff are exposed to different auditing experiences, and able to gain management skills. Thus, the auditors become more fungible across all types of audits and develop professionally. Within the professional pool of auditors, different job grades can be created based on staff seniority and merits to provide career path for each individual. Among the pool of professional auditors, at least one individual staff should be encouraged to pursue expertise in risk management and reserve management and at least one individual staff should be encouraged to pursue certificates such as Certified Information System Auditor (CISA)—while the IAD is acquiring IT auditing skills, the IAD could consider hiring consultants to conduct IT audits and make sure that knowledge will be transferred to staff over the time.

13. **The draft organizational chart also includes a risk management unit, which may create the perception that the ownership of risk management belongs to internal audit rather than to the CBS management.** Although the CBS management should be ultimately responsible for risk management as mentioned earlier, it is not uncommon for risk management to start within the internal audit function. Given that the CBS does not have a separate risk management unit and that the IAD anticipates hiring a risk officer, it is more practical for the CBS to foster its risk management capacity within the IAD instead of

establishing a separate risk management unit. However, when the risk management capacity matures in three or five years, a unit focusing on risk management should be formed and separated from the IAD so that IAD can audit the risk management process as required by IIA Standards.

14. **To foster the development of risk management function within the CBS, IAD could advise on risk management given that safeguards are in place to ensure its independence.** Specifically, the internal audit could share with management their risk assessment of the CBS business processes, which is a part of their annual audit planning process. When the capacity of internal audit in risk assessment matures, the IAD will be able to provide additional consulting services in relation to risk management, such as coaching management in risk identification and assessment, and sharing risk assessment tools and techniques. Figure 3 shows the activities appropriate and not appropriate for internal audit. The measures to safeguard the IAD's independence and objectivity should include but are not limited to: (i) a memo on the IAD's roles and responsibilities for each consulting engagement relating to risk management to remove possible perceived impairment on independence and objectivity; (ii) the person who consults on risk management engagements will not be the one to audit risk management; and (iii) discuss with AGC at least once a year on the overall independence and objectivity of the IAD.

Figure 3. Internal Audit's Role in Enterprise Risk Management



Source: The Institute of Internal Auditors Position Paper: The Role of Internal Auditing in Enterprise-wide Risk Management

D. Internal Audit Manual

15. **The IAD does not have any procedural manual to guide its auditing work.** As mentioned earlier, IAD mainly conducts “surprise cash counting” at CBS headquarters and branches to check whether the balances of physical cash stored in the vaults agree with records.⁶ Occasionally, the IAD observes the cash reconciliation activities at the cashier’s office. These tasks do not constitute real auditing work and should be gradually transferred to other business departments.

16. **The IAD should adopt the internal audit manual proposed by the mission team to establish its auditing practices and make them repeatable and professional.** The proposed internal audit manual contains specific guidance to lead auditors to develop an annual audit plan, to conduct auditing and consulting engagements, to follow up on the implementation of audit recommendations, and to establish a quality assurance and improvement program with internal audit function. The IAD staff should use the proposed manual (Chapter 5 specifically) to complete the risk assessment of all the the CBS auditable processes as recommended below in Section E.

17. **The IAD should also update its strategy note, which should clearly focus on near-term objectives and strategies to achieve them.** IAD staff has taken the initiative to develop a three-year strategy note. However, the strategy note somehow mingles with procedures that should be included in an internal audit manual. IAD staff agreed to update the strategy note and refocused it to near-term objectives for the next 12 months since the IAD is transitioning itself to a modern internal audit function. Specifically, IAD, for the next 12 months, aims to: (i) develop its first risk-based annual plan; (ii) have at least 1 staff sit for the CIA exam; and (iii) adopt an internal audit manual in line with IPPF requirements.

E. Risk-Based Auditing

18. **The core of modern internal auditing function is to add value to the organization it serves.** In many organizations, the value-adding focus is interpreted as risk-based auditing because internal audit can be most helpful to management and the board when its audit work is led by risks and provide assurance for areas of significant risks. Risk-based auditing is very different compliance-based auditing, which simply checks if policies and procedures are followed.

⁶ The internal audit’s check is an important control to safeguard the custody of cash, which should be conducted by a business department of the CBS. Since Banking Operation Department oversees cash custody (e.g., Accounting Department, General Administration), another business department such as Accounting Department or General Administration Department can conduct this check to be in line with the rule of segregation of duties.

19. **The starting point of a risk-based auditing methodology is to develop a meaningful audit universe, which is basically a comprehensive list of auditable entities.**

Auditable entities can be a business process, a function, or a business or governance structure. Under the guidance of the mission team, CBS staff has developed the first audit universe of the CBS after taking into consideration the financial statements, organizational structure, budgets, service lines, and other business information accumulated. The audit universe of CBS contains about 18 major business processes, which have basically cover all the activities and functions of the CBS (Appendix X).

20. **As a next step, the CBS should complete the risk assessment of the auditable entities included in the audit universe with full awareness of potential fraud risks.** Since most of the transactions of the CBS are cash based and its asset recovery is ongoing, the potential for fraud risk at CBS can be high. The mission team has walked the CBS through the risk assessment method, which is illustrated in Appendix V Somalia-III and Chapter 5 of the proposed Internal Audit Manual. In addition, the mission team has guided CBS staff on completing the risk assessments of two business processes of the CBS: the travel claim process and the payroll process. However, it is understood that a meaningful risk assessment also requires deep knowledge and insights of CBS business. Since all IAD staff are relative new to the CBS, it will take a few years before they can fully implement the risk-based auditing methodology.

III. ACCOUNTING

A. CBS Financial Statements

21. **The accounting capacity within the CBS is limited.** There are no accounting standards or frameworks being adopted or implemented. Transactions are recorded based on cash inflows and outflows. Accounting data is maintained in two different sources (PeachTree and QuickBooks software) and loaded into Excel-based work papers for processing. Due to the different data depositories and the loss of key accounting data (e.g., closing entries, adjusting entries), the trial balance does not balance and is unable to be reconciled to support financial statements.

22. **The mission team first presented the IFRS conceptual framework, which lays out the concepts that underlie how financial statements are to be prepared and presented.** The main subject areas addressed include the objectives of financial reporting, the qualitative characteristics of financial reporting and definition, recognition, and measurement of the financial statement components. IAS 1 – Presentation of Financial Statements was also discussed. For financial statements to be meaningful for its users, they should be comparable, relevant, verifiable, timely, understandable, and presented consistently each period. These underlying characteristics will provide important benchmarks as the accountants move forward and start to prepare a proper financial statement framework.

23. **The financial statements for 2015–2017 have not been prepared or audited.** The accounting team did not prepare the financial statements for the 2013/2014 and are struggling to balance the accounts, which relies on the figures prepared using a combination of a manually prepared excel spreadsheet and PeachTree accounting software. The trial balance, which is maintained in excel, does not balance with the PeachTree trial balance. The mission team reviewed the spreadsheets and identified certain accounts that did not balance. The mission also recommended that the focus should now be placed on 2017 and ensuring balances at year's end are accurate. The audited 2013/2014 financial statements follow a standard format and presentation; however, the mission team spent time reviewing IAS 1 and discussing options for presenting the cash and cash equivalent accounts.

B. IFRS Analysis

24. **While the external audit opinion for the 2013/2014 financial statements indicates compliance with IFRS, several IFRS elements are missing making the actual application of IFRS inconsistent with the opinion.** There does not appear to be a specific accounting framework to prepare the financial statements as the accounts are not entirely prepared using the accrual method of accounting, the IMF accounts are missing from the presentation, and the notes to the financial statements are minimal and contain errors. The mission team prepared an IFRS gap analysis template, which was completed together with the CBS accountants throughout the week. The purpose of this exercise was to review the major asset and liability accounts and compare the current accounting treatment to IFRS standards including IAS 16 since Property, Plant, and Equipment (PP&E) comprises about 75 percent of the balance sheet. In addition, the exercise required identification of certain accounting concepts included in the IFRS framework and how they relate to the particular account. For example, when reviewing cash balances, the team identified whether a foreign exchange translation calculation or market revaluation was necessary. The exercise also included an analysis of the impact of income if the proper IFRS accounting principle or procedure were to be performed which was not completed but assigned as a homework task.

C. Accounting IT Systems

25. **A new accounting system (Oracle ERP) is being installed with a projected “go live” date in November 2017.** The accounting team has been advised by the vendor that the currency used to record transactions should be the Somalian shilling. The mission team advised that system should record accounting transactions in the functional currency which currently is the U.S. dollar. After the currency reform is completed and the new schilling is introduced and becomes the functional currency, the accounting system will need to be updated to reflect the new functional currency. In addition, the team advised that will be critical that the system reflect accurate balances of all accounts on January 1, 2018 and as such, the accounting team's priority should be to take steps to ensure the accuracy. Homework includes developing a sufficient number of accounting test scenarios and obtaining feedback from the users on the interface and gaps in data entry.

D. Chart of Accounts

26. **The accounting team has developed a tentative chart of accounts anticipating the new Oracle system.** A chart of accounts is a listing of the names of the accounts that an organization has identified and made available for recording transactions in its general ledger. The mission performed a cursory review of the structure of the chart including the hierarchy of accounts and discussed the large number of accounts included in the table. The chart appears reasonable; however, suggestions were made to add accounts that may be necessary to reflect the preferred presentation of financial statements.

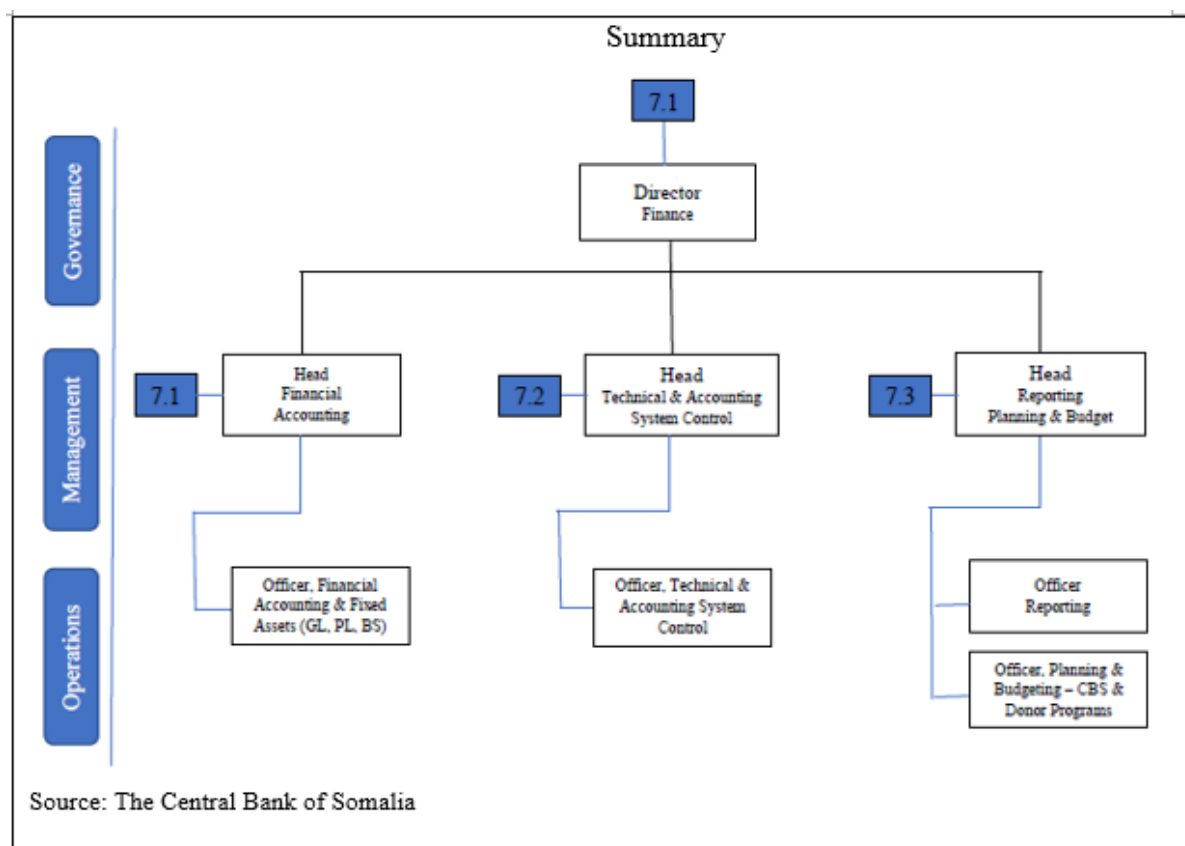
E. Accounting Policies and Procedures

27. **The accounting team has not drafted an accounting manual so the mission team spent time discussing the required contents of a quality accounting manual.** The accountants are keen on preparing a manual that will also serve as a source for proper accounting procedures and controls. An example of a proper manual was provided for guidance and homework includes drafting sections for cash, PP&E, and salary expenses and submitting to the IMF for review.

F. Finance Department Organizational Structure

28. **The accounting team has revised their organizational chart to reflect a department in the central bank that is starting to evolve and increase functionality (Figure 4).** The functions include accounting, budgeting, and IT accounting systems. The team expects 12 staff to be dedicated to the various functions. The mission team reviewed the chart the accounting team prepared and it appeared to represent a reasonable structure for the small department with three levels of staffing and two levels of reporting. Homework includes allocating the 12 resources to various functions and defining clearly the associated tasks.

Figure 4. Organizational Chart of the Finance Department



IV. CONCLUSION

29. The next mission is scheduled for first quarter 2018; however, this is dependent on the homework assignments being completed. See Table 1 for Assignments for Internal Auditing and Accounting. Revised deadlines will be established at that point to take into consideration capacity and sequencing.

Appendix I. Agenda—Internal Audit and Accounting Training Sessions

Central Bank of Somalia
September 24 – October 5, 2017
Serena Hotel – Kampala, Uganda

Internal Audit			
Date September	Session I 8:30 – 10:30	Session II 11:00 – 12:30	Session III 2:00 – 4:00
24	Introduction <ul style="list-style-type: none"> Mission objective and scope related to internal audit Follow-up on Steps Taken Since May 2017 Staff capacity 	Internal Audit Charter <ul style="list-style-type: none"> Three lines of defense model IPPF (internal audit mission and definition) IIA Standard 1000 Reporting lines 	Internal Audit Charter <ul style="list-style-type: none"> Reporting lines Authority Audit Committee CBS draft internal audit charter Example internal audit charter
25	Concepts <ul style="list-style-type: none"> Internal audit vs. internal control Internal audit vs. risk management 	Discussion on CBS draft strategy note <ul style="list-style-type: none"> Objectives Organizational structure Role in risk management 	Discussion on CBS internal control manual <ul style="list-style-type: none"> Objectives Organizational structure Role in risk management
26	Risk-based Auditing Methodology (training)	Risk-based Auditing Methodology <ul style="list-style-type: none"> Apply the methodology in travel claim process and payroll process of CBS 	Risk-based Auditing Methodology <ul style="list-style-type: none"> Apply the methodology in travel claim process and payroll process of CBS
27	Developing the Audit Universe (workshop)	Developing the Audit Universe (workshop)	Developing the Audit Universe (workshop)
28	Recap	Wrap Up and Homework	N/A
Weekend	N/A	N/A	N/A

Accounting			
October	Session I 8:30 – 10:30	Session II 11:00 – 12:30	Session III 2:00 – 5:00
1	Introduction: Mission Objective and Scope; and Stocktaking of Current Practices and Steps Taken Since May 2017	Application of IFRS to Central Banks; IFRS Conceptual Framework: Characteristics of a High-Quality Financial Accounting Framework	IFRS Gap Analysis – Discussion of Financial Statement Accounts; IAS 1 Accrual Method of Accounting, Impact on income of accounting policy change
2	Key Accounting Concepts: IAS 1: Accrual Accounting,	IFRS Analysis: Cash Accounts and related expenses	Chart of Accounts Review; Organizational Structure Review
3	IAS 1 – Presentation of Financial Statements: Linkages between statements	Developing a Proper IFRS Accounting Manual	Accounting Manual continued; Knowledge Exchange with Supervisory Expert;
4	IFRS Analysis – Cash accounts and related expenses	IFRS Analysis – IFRS 16: Property, Plant, and Equipment including Revaluation of PP&E	IFRS Analysis IAS 16 analysis and Note disclosure
5	Wrap Up and Homework	Wrap Up and Homework	N/A

Appendix II. Training Participants**Finance and Internal Audit Department**

Department	Name
Internal Audit	3 members comprising the internal audit team.
Accounting	3 members of the accounting team.

Appendix III. Summary of Topics to be Covered in Training Missions¹

	Mission #1 September/Oct 2017	Mission #2 First Quarter 2018	Mission #3 Second Quarter 2018	Future Missions
Internal Auditing Stream	<ul style="list-style-type: none"> • Basic concepts of internal control, risk management, and internal audit; • Internal Audit Infrastructure (internal audit charter, audit committee charter, internal audit organizational chart, and strategy note); • Introduction on the macro-level risk assessment methodology; • Risk assessment of business processes; and • Development of an audit universe. 	<ul style="list-style-type: none"> • Issues from Homework, including the results of risk assessment conducted by CBS of the business processes included in the audit universe; • Identification of potential audits for next audit year based on the results of risk assessment; • Introduction on the micro-level risk assessment methodology; and • Development of an audit program for a specific audit project. 	<ul style="list-style-type: none"> • Issues from Homework assignments; • Review of the implementation of the audit program for the specific audit project, including audit objectives, scope, findings, and reporting • Review of the implementation of the annual audit plan; and • Walk-through of IIA standards and audit manual relevant to audit engagement planning, fieldwork, documentation, and report. 	<ul style="list-style-type: none"> • Issues from Homework assignments; • Review of the implementation of the annual audit plan and major auditing findings; and • Walk-through of IIA Standards and audit manual relevant to staff proficiency and quality assurance and improvement program
Accounting Stream	<ul style="list-style-type: none"> • IFRS Application for Central Banks; • IFRS Conceptual Framework; • Accounting Manuals; • Chart of Accounts; • IAS 1; • IAS 16; • IFRS gap analysis; • Obtaining accurate year-end balances for 2017; and • Organizational Structure Review 	<ul style="list-style-type: none"> • Issues from Homework Assignments; • Accounting Manuals continued; • IMF accounts; • Notes to Financial Statements; • IAS 21; • Cash Flow Statements; • Retained Earnings and Distributions to Government; • Other current accounting issues • Key Requirements for IFRS 1; and • Role of Audit Committee 	<ul style="list-style-type: none"> • Issues from Homework Assignments; • Review financial statements and notes for 2017; and • IFRS 1 – First Time Adoption of IFRS: How to prepare and establish formal adoption date 	<ul style="list-style-type: none"> • Depends on level of activities conducted by CBS and progress on IFRS implementation; • IFRS 9; and • IAS 7

¹ Assumes one week training sessions for each stream

Appendix IV. Internal Audit Charter (Example)

PURPOSE

The Internal Audit Department (IAD) of XXX is to provide independent and objective assurance and consulting activity designed to add value and improve the operations of XXX. It helps XXX accomplish its objectives by bringing a systematic and disciplined approach to evaluate and improve the effectiveness of XXX's risk management, control, and governance processes.

AUTHORITY

The IAD is authorized full, free, and unrestricted access to any and all of XXX records, physical properties, and personnel pertinent to carrying out any engagements. All employees of XXX are requested to assist the IAD in fulfilling its roles and responsibilities. The IAD also has direct and unrestricted access to XXX management and the Audit Committee.¹

PROFESSIONALISM

The IAD follows the mandatory guidance of the International Professional Practice Framework (IPPF) issued by the Institute of Internal Auditors (IIA), which includes *Core Principles*, *definition of Internal Audit*, *Code of Ethics*, and *the International Standards for the Professional Practice of Internal Auditing (Standards)*. Other recommended guidance by IIA are adhered to as applicable.

ORGANIZATION

The Head of the IAD reports functionally to the Audit Committee and administratively (i.e., day-to-day operations) to the Governor of XXX.

The Audit Committee shall:

- Approve the Internal Audit Charter.
- Approve all decisions regarding the appointment, replacement, and removal of the Head of Internal Audit, including performance evaluation and remuneration.
- Approve the risk-based annual audit plan and all major changes to the plan. Review the internal audit activity's performance relative to its plan and other matters.
- Review and concur with the Governor of XXX on budget, resource plan, and organizational structure of the IAD. Make appropriate inquiries of XXX management and the Head of the IAD to determine whether there is audit scope or budgetary limitations that impede the ability of the IAD to execute its responsibilities.
- Receive communications from the Head of the IAD on the results of internal audit activity and the implementation of audit recommendations, including but not limited to all audit reports, reports of consulting/advisory projects, annual activity report, and report on the implementation of audit recommendations. Make appropriate inquiries of management and

¹ In the absence of Audit Committee, the Board of Directors of CBM assumes the responsibilities of Audit Committee.

the Head of Internal Audit to determine whether management has taken actions to implement audit recommendations.

- At least once per year, meet privately with the Head of the IAD without management present to discuss any matters that the committee or IAD believes should be discussed privately, including but not limited to the independence of IAD. Address potential and existing impairments, either in appearance or in fact, of IAD's independence and objectivity.

The Governor of XXX shall:

- Approve IAD's budget and resource administration, which should be sufficient for the IAD to fulfill its responsibilities and maintain its professional development.
- Invite the Head of the IAD to management meetings that are required for other department heads and include the Head of the IAD in internal communications and information flows for the Head of the IAD to fulfill his/her responsibilities.
- Refrain from engaging the Head of the IAD in making management decisions and owning operational responsibilities and risk management responsibilities other than managing IAD.

INDEPENDENCE AND OBJECTIVITY

The IAD shall remain free from any interference in carrying out its internal audit responsibilities in an unbiased manner, including but not limited to matters of audit selection, scope, procedures, frequency, timing, sample selection, and report content.

Internal auditors of the IAD and personnel working for the IAD (e.g., consultants, XXX employee on rotational basis) shall maintain unbiased mental attitude to allow themselves to perform engagements in such a manner that they believe in their work product and that no quality compromise are made. Internal auditors of the IAD and personnel working for the IAD shall not subordinate their judgment on audit matters to others.

RESPONSIBILITIES:

The IAD shall:

- Develop risk-based annual audit plan to prioritize audit selections and resource deployment to cover all activities.
- Conduct financial, operational, compliance, and IT audits to safeguard XXX's financial resources, the effectiveness and efficiencies of operations, and legal/regulatory/policy compliance.
- Perform advisory or consulting services, upon request of XXX management or Audit Committee, to provide insight and advice on controls, risk management, and governance processes.
- Perform inspection and investigations upon the request of XXX management and under the authorization of Audit Committee.

- Coordinate and share information with other internal oversight functions (e.g., ethics office, safety and security function, compliance unit) and external parties (e.g., external auditor) under the guidance of Audit Committee.
- Follow up, monitor, and evaluate management's implementation of action plans in response to audits to ensure that risks have been mitigated appropriately.
- Develop and maintain a quality assurance and improvement program (QAIP) that covers all aspects of the IAD, including but not limited to an external quality assessment once every five years.
- Develop and maintain a continuous professional development and education plan to improve the internal auditors' skills, knowledge, and other competencies.
- Report to XXX management and Audit Committee on results of audits, advisory and consulting engagements.
- Report periodically to XXX management and Audit Committee on the execution of the annual audit plan, the implementation of management's action plans, significant risks, control, and governance issues, results of the QAIP, and other information upon request.
- Confirm to the Audit Committee, at least annually, the organizational independence of the internal audit activity.
- Play the secretariat role for the Audit Committee and perform other activities upon the request of management of XXX or Audit Committee.

The IAD shall not participate in the risk management of CBS

Approved this _____ day of _____, _____.

Governor and Chairman of Board of
Directors, XXX

Chairman of Audit Committee, XXX

Appendix V. Audit Committee Charter

PURPOSE

To assist the board of directors in fulfilling its oversight responsibilities for the financial reporting process, the system of internal control, the audit process, and CBS' process for monitoring compliance with laws and regulations and the code of conduct.

AUTHORITY

The audit committee has authority to conduct or authorize investigations into any matters within its scope of responsibility. It is empowered to:

- Appoint, compensate, and oversee the work of any registered public accounting firm employed by the CBS or the statutory external auditor.
- Resolve any disagreements between management and the auditor regarding financial reporting and accounting.
- Pre-approve all auditing and non-audit services.
- Retain independent counsel, accountants, or others to advise the committee or assist in the conduct of an investigation.
- Seek any information it requires from employees—all of whom are directed to cooperate with the committee's requests—or external parties.
- Meet with the CBS officials, internal and external auditors, or outside counsel, as necessary.

COMPOSITION

The audit committee will consist of at least three independent members, either selected from the external board of directors or as appointed by the board of directors from outside of the CBS. The board or its nominating committee will appoint committee members and the committee chairperson.

Each committee member will be both independent and financially literate. At least one member shall be designated as the “financial expert,” as defined by applicable legislation and regulation.

MEETINGS

The committee will meet at least four times a year, with authority to convene additional meetings, as circumstances require. All committee members are expected to attend each meeting, in person or via tele- or video-conference. The committee will invite members of management, auditors or others to attend meetings and provide pertinent information, as necessary. It will hold private meetings with auditors (see below) and executive sessions. Meeting agendas will be prepared and provided in advance to members, along with appropriate briefing materials. Minutes will be prepared.

DUTIES AND RESPONSIBILITIES

CBS Management is responsible for the preparation, presentation, and integrity of CBS' financial statements, for the appropriateness of the accounting principles and reporting policies that are used by the CBS, for establishing and maintaining effective internal control over financial reporting.

The external auditor is responsible for auditing CBS' financial statements and the effectiveness of internal control over financial reporting, and for reviewing CBS' unaudited interim financial statements as applicable.

The committee, in carrying out its responsibilities, believes its policies and procedures should remain flexible in order to best react to changing conditions and circumstances. The committee will take appropriate actions to monitor the overall organizational "tone" for quality financial reporting, sound business risk practices, and ethical behavior.

The committee will carry out the following principal duties and responsibilities:

Financial Statements

- Review significant accounting and reporting issues, including complex or unusual transactions and highly judgmental areas, and recent professional and regulatory pronouncements, and understand their impact on the financial statements.
- Review with management and the external auditors the results of the audit, including any difficulties encountered.
- Review the annual financial statements, and consider whether they are complete, consistent with information known to committee members, and reflect appropriate accounting principles.
- Review other sections of the annual report and related regulatory filings before release and consider the accuracy and completeness of the information.
- Review with management and the external auditors all matters required to be communicated to the committee under *International Financial Accounting Standards*.
- Understand how management develops interim financial information, and the nature and extent of internal and external auditor involvement.
- Review interim financial reports with management and the external auditors before filing with regulators, and consider whether they are complete and consistent with the information known to committee members.
- Review annually and approve the accounting policies and procedures, including update and amendments.

Internal Control and Risk Management

- Consider the effectiveness of the CBS' internal control system, including information technology security and control.
- Understand the scope of internal and external auditors' review of internal control over financial reporting, and obtain reports on significant findings and recommendations, together with management's responses.
- Discuss the CBS' policies on risk assessment and risk management, including the risk of fraud, major financial risk exposures, and the steps that CBS management has taken to monitor and control such exposures. Review with the CBS management the antifraud programs and controls as needed.

Internal Audit

- Approve the Internal Audit Charter.
- Concur with the CBS management on all decisions regarding the appointment, replacement, and removal of the Head of Internal Audit, including performance evaluation and remuneration.
- Approve the risk-based annual audit plan and all major changes to the plan. Review the internal audit activity's performance relative to its plan and other matters.
- Review and concur with the Governor of the CBS on budget, resource plan, and organizational structure of the IAD. Make appropriate inquiries of CBS management and the Head of the IAD to determine whether there is audit scope or budgetary limitations that impede the ability of the IAD to execute its responsibilities.
- Receive communications from the Head of the IAD on the results of internal audit activity and the implementation of audit recommendations, including but not limited to all audit reports, reports of consulting/advisory projects, annual activity report, and report on the implementation of audit recommendations. Make appropriate inquiries of management and the Head of Internal Audit to determine whether management has taken actions to implement audit recommendations.
- At least once per year, meet privately with the Head of the IAD without management present to discuss any matters that the committee or the IAD believes should be discussed privately, including but not limited to the independence of the IAD. Address potential and existing impairments, either in appearance or in fact, of the IAD's independence and objectivity.
- Require an external quality assessment (EQA) of internal audit at least once every five years, select or concur in the selection of an EQA provider, review the results of the EQA, and approve and follow up on the IAD's action plans to address issues identified in the EQA.

External Audit

- Review the external auditors' proposed audit scope and approach, including coordination of audit effort with internal audit.
- Review the performance of the external auditors, and exercise final approval on the selection, appointment, and discharge of the external auditors.
- Review and confirm the independence of the external auditors by obtaining statements from the auditors on relationships between the auditors and the CBS, including non-audit services, and discussing the relationships with the auditors.
- On a regular basis, meet separately with the external auditors to discuss any matters that the committee or auditors believe should be discussed privately.

Compliance

- Review the effectiveness of the system for monitoring compliance with laws and regulations and the results of management's investigation and follow-up (including disciplinary action) of any instances of noncompliance.
- Review the findings of any examinations by regulatory agencies, and any auditor observations.
- Review the process for communicating the code of conduct to CBS personnel, and for monitoring compliance therewith.
- Obtain regular updates from management and CBS legal counsel regarding compliance matters.

Reporting Responsibilities

- Regularly report to the board of directors about committee activities, issues, and related recommendations.
- Provide an open avenue of communication between internal audit, the external auditors, and the board of directors.
- Review any other reports that the CBS issues that relate to committee responsibilities.

Other Responsibilities

- Perform other activities related to this charter as requested by the board of directors.
- Institute and oversee special investigations, as needed.

- Review and assess the adequacy of the committee charter annually, requesting board approval for proposed changes, and ensure appropriate disclosure as may be required by law or regulation.
- Confirm annually that all responsibilities have been carried out and evaluate the committee's and individual members' performance on a regular basis.

Appendix VI. IMF Internal Auditing and Accounting Mission at CBS

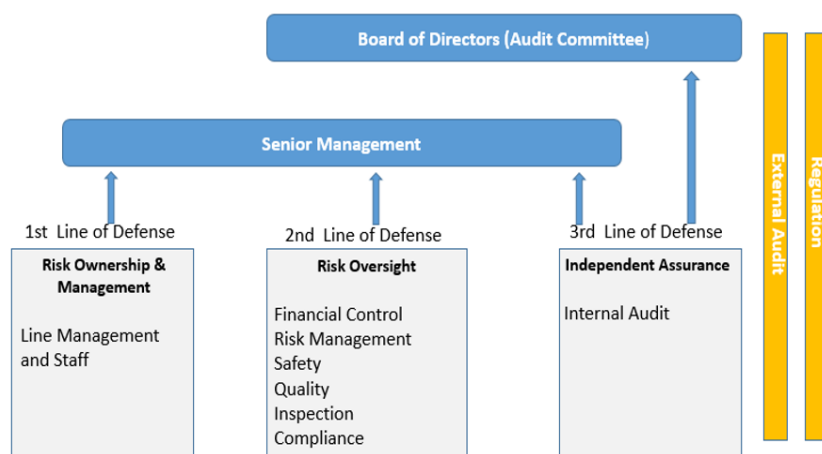
IMF Internal Auditing and Accounting Mission at CBS

--- Internal Auditing Session

Part I: Internal Audit Charter

- ▶ Three lines of defense model
- ▶ International Professional Practice Framework
- ▶ Discussion on on Internal Audit Charter of CBS

Three lines of defense model



International Professional Practice Framework (IPPF)

- ▶ **Mission**
- ▶ **Mandatory Guidance**
 - Core principles
 - Definition
 - Code of Ethics
 - International Standards
- ▶ **Recommended Guidance (non-mandatory)**
 - Implementation Guidance
 - Supplemental Guidance

Internal Audit Mission and Definition

► Mission

To enhance and protect organizational value by providing risk-based and objective assurance, advice, and insight.

► Definition

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.

IIA Standards 1000 - Purpose, Authority, and Responsibility

The purpose, authority, and responsibility of the internal audit activity must be formally defined in an internal audit charter, consistent with the Mission of Internal Audit and the mandatory elements of the IPPF. The Chief Audit Executive (CAE) must periodically review the internal audit charter and present it to senior management and the board for approval.

Interpretation:

The internal audit charter is a formal document that defines the internal audit activity's purpose, authority, and responsibility. The internal audit charter establishes the internal audit activity's position within the organization, including the nature of the CAE's functional reporting relationship with the board; authorizes access to records, personnel, and physical properties relevant to the performance of engagements; and defines the scope of internal audit activities. Final approval of the internal audit charter resides with the board (or Audit Committee).

IIA Standards 1010 - Recognizing Mandatory Guidance in an Internal Audit Charter

The mandatory nature of the Core Principles, the Code of Ethics, the Standards, and the definition of Internal Auditing must be recognized in the internal audit charter. The CAE should discuss the Mission of Internal Audit and the mandatory elements of the IPPF with senior management and the board.

IIA Standards 1100 - Independence and Objectivity

IIA Standards 1100 - Independence and Objectivity

The Internal audit activity must be independent, and internal auditors must be objective in performing their work.

Interpretation:

... to achieve the degree of independence necessary to effectively carry out the responsibilities of the internal audit activity, the CAE has direct and unrestricted access to senior management and the board. This can be achieved through a dual-reporting relationship.....

IIA Standards 1110 – Organizational Independence

The CAE must report to a level within the organization that allows the internal audit activity to fulfill its responsibilities. The CAE must confirm to the board, at least annually, the organizational independence of the internal audit activity.

Interpretation:

Organizational independence is effectively achieved when the CAE reports functionally to the board (or Audit Committee). Examples of functional reporting to the board involve the board (or Audit Committee):

- Approving the internal audit charter
- Approving the risk-based internal audit plan
- Approving the internal audit budget and resource plan
- Receiving communications from the CAE on the internal audit activity's performance relative to its plan and other matters
- Approving decisions regarding the appointment and removal of the CAE
- Approving the remuneration of the CAE
- Making appropriate inquiries of management and the CAE to determine whether there are inappropriate scope or resource limitations

Discussion on CBS Internal Audit Charter

- ▶ Review the Charter in the context of IPPF, including the mission, definition, and standards of internal audit
- ▶ Review the model Internal Audit Charter and an example Internal Audit Charter for central banks
- ▶ Discuss and agree on possible revisions to the Internal Audit Charter of CBS

(pause here and go through CBS Internal Audit Charter, IIA model Internal Audit Charter, and an example Internal Audit Charter for central banks)

Part III: Annual Audit Planning - Macro-level Risk Assessment

- ▶ IIA Standards relevant to risk-based annual audit planning
- ▶ Overview of the Annual Audit Planning Process
- ▶ Detailed discussion on risk assessment (macro-level) process
 - Steps
 - Templates
 - Walk-through using CBS examples if information is available

IIA Standards 2010 - Planning

The CAE must establish a risk-based plan to determine the priorities of the internal audit activity, consistent with the organization's goals.

Interpretation:

To develop the risk-based plan, the CAE consults with senior management and the board and obtains an understanding of the organization's strategies, key business objectives, associated risks, and risk management processes. The CAE must review and adjust the plan, as necessary, in response to changes in the organization's business, risks, operations, programs, systems, and controls.

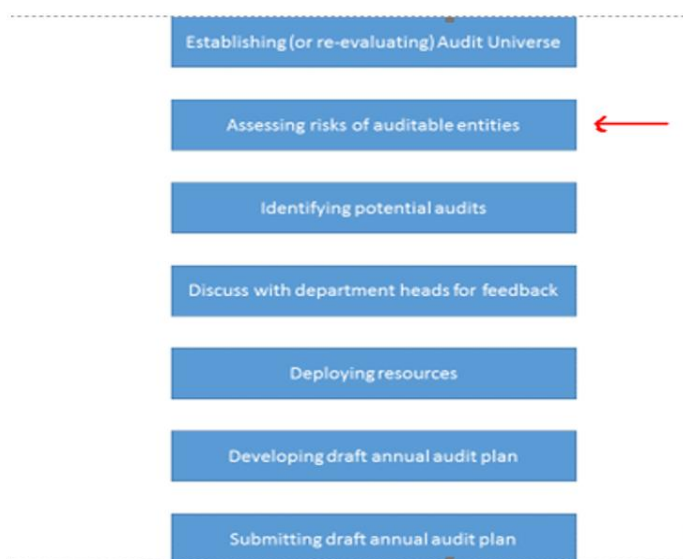
2010.A1 - The internal audit activity's plan of engagements must be based on a documented risk assessment, undertaken at least annually. The input of senior management and the board must be considered in this process.

2010.A2 - The CAE must identify and consider the expectations of senior management, the board, and other stakeholders for internal audit opinions and other conclusions.

IIA Standards 2020 – Communication and Approval

The CAE must communicate the internal audit activity's plans and resource requirements, including significant interim changes, to senior management and the board for review and approval. The CAE must also communicate the impact of resource limitations.

Annual Audit Planning Process: Overview



Macro-level Risk Assessment Process (to assess risks of auditable entities)

Given that CBS has not established a comprehensive risk management oversight process and that IAD is in its initial stage of capacity, the macro-level risk assessment method is designed to be easy to apply and flexible to adapt IAD work to the growth of CBM.

The macro-risk assessment framework consists of the following main components:

- Risk factors and rationales;
- A scoring system (the weights and risk rating system);
- Risk ranking to select potential audits.

Macro-level Risk Assessment Process: Financial Risk Factor

- ▶ Financial risk factor considers the level and extent of financial resources managed by the operations of the unit/process as well as the risk that a loss or error in the financial transactions or assets of the CBS will have a significant impact on the CBS.
- ▶ Rationale: CBS's role in macro-economics and financial stability means that errors in recording or reporting transactions could have a major impact on CBS's reputation and credibility in carrying out its operational work.

Macro-level Risk Assessment Process: Operational risk factor

- ▶ Operational risk factor is related to the *actual conduct of activities or performance of functions*, and based on the complexity of the business processes, including whether there are changes in the operational work affecting the business processes or the organizational units involved in the business processes, or changes in the environment that could impair the ability of the business processes' owners to achieve their objectives.
- ▶ Rationale: Changes in the work and its complexity increase the risk of objectives not being achieved. The environment in which operations are carried out contributes significantly to the potential risk to CBS.

Macro-level Risk Assessment Process: Risk Human Resources Risk Factor

- ▶ Human resources risk factor considers the risk related to the adequacy of management and staff resources. It includes a number of underlying risk elements that have to be considered simultaneously in the risk assessment: clarity of management roles and responsibilities; adequacy and stability of the organizational structure; adequacy of the staffing, intellectual capital and staff expertise; appropriateness of the ethical values and culture; stability of the work environment and practices; stability of key personnel.
- ▶ Rationale: CBS's Staff capacity and stability are key factors in accomplishing its objectives to modernize the central bank as a policy-setter.

Macro-level Risk Assessment Process: Risk Factor (4) – IT Risk Factor

IT risk factor considers the risk that *systems in place to support the work of CBS are not functioning properly* to provide the confidentiality, availability and integrity of information being processed, and to ensure that information management systems provide complete, relevant, up-to-date, and accurate information to support decision-making process. The underlying risk elements that have to be considered simultaneously in the risk assessment are the degree of reliance on information processing capabilities (including in terms of business continuity), the complexity of the systems, and the changes in the technology.

Rationale: Information technology becomes a more and more important aspect of CBS's work. System issues have the potential to affect the accuracy and outcome of CBS's policy work significantly and the safeguard of CBS financial resources

Macro-level Risk Assessment Process: Risk Factor (5) – Fraud Risk Factor

- ▶ Fraud risk considers the vulnerability or exposure the process or business unit has towards fraud. It combines the probability of fraud occurring and the corresponding impact estimated in monetary terms or in terms of impact on CBS's reputation. Fraud has genuine elements such as incentives/pressures to perpetrate fraud; opportunities to carry out the fraud; attitudes/rationalizations to justify fraudulent actions. Its nature (corruption, misappropriation of assets, fraudulent statement) as well as its scale depends on each unit/process.
- ▶ Rationale: Given CBS's status as an independent agent to serve public interest, a fraud incident could have a major impact on CBS's reputation and thus undermine its authority.

Macro-level Risk Assessment Process: Risk Factor (6) - Control Risk Factor

- ▶ Control risk factor considers the degree to which the process or business unit has identified, developed, and applied effective internal controls to mitigate risks as well as whether prior internal or external audit results indicate significant issues
- ▶ Rationale: Controls are established, as well as the control environment, directly impact the extent to which risks are minimized at CBS. Prior internal or external audit results are an indicator of the extent of issues in a process or unit.

Macro-level Risk Assessment - Risk Scoring and Ranking

1. Risk Scoring

- Discuss the risk scoring sheet included in the example Internal Audit Manual (figure 3, page 15)

2. Risk Ranking

High	= Greater than 3 points
Medium	= Between 2 and 3 (inclusive)
Low	= Less than 2 points

Macro-level Risk Assessment Process: Results

- ▶ Discuss the risk assessment matrix included in the example Internal Audit Manual (Appendix III)
- ▶ If possible, walk through a couple of examples of CBS based on staff inputs

Appendix VII. IFRS—Basic Concepts

IFRS – Basic Concepts

IMF Training Mission: Central Bank of Somalia

October 1-5, 2017

Topics Covered

- I. Structure of Financial Statements
- II. Accrual Method of Accounting
- III. Unrealized Gains and Losses
- IV. Effective Interest Rate
- V. Foreign Exchange Revaluations
- VI. Distribution of Profits

I. Structure and Presentation of Financial Statements

IAS 1 requires the following statements to be prepared as part of a complete set of financial statements

- Statement of Profit and Loss and OCI (Income Statement)
- Statement of Financial Position (Balance sheet)
- Statement of Changes in Equity
- Statement of Cash Flows
- Notes to the Financial Statements

Structure of Financial Statements

Statement of Financial Position (Balance Sheet)

- IFRS 1 requires:
 - Certain line items to be presented; and
 - Classifications within the balance sheet for current and non-current assets and liabilities;
- There is no requirement within IFRS for presenting line items in a certain order or format. Must be listed in order of liquidity.
- Other line items can be added, as well as headings and subtotals, if doing so will improve a user's understanding of a balance sheet.

Structure of Financial Statements

- A **current asset** is one that will be sold or consumed within the normal operating cycle of a business or the next 12 months, or which is a cash or cash equivalent. This classification can also include assets held for the purpose of trading.
- A **current liability** is one that will be settled within the normal operating cycle of a business or the next 12 months.
- The presentation of classifications within the balance sheet for current and non-current assets and liabilities is required; the only alternative is to present assets and liabilities in order of liquidity, which can be used when doing so provides information that is more reliable and relevant.

Structure of Financial Statements

Statement of Profit and Loss and OCI

- Profit or loss
- Other comprehensive income
- Comprehensive income for the period
- Single step versus multiple step

Structure of Financial Statements

Statement of Profit and Loss and OCI

- Profit or loss
- Other comprehensive income
- Comprehensive income for the period
- Single step versus multiple step

Structure of Financial Statements

The following items must be included in the income statement:

- Revenue
- Interest revenue, calculated using the effective interest method
- Gains and losses due to the derecognition of financial assets that are measured at their amortized cost
- Financing costs
- Impairment losses
- Gains and losses due to a reclassified financial asset that is now measured at its fair value, based on the difference between its former carrying amount and its fair value on the reclassification date

Structure of Financial Statements

Statement of Changes in Equity

- Roll forward from previous year
- Reconciles equity section of balance sheet so balances tie to balance sheet

Statement of Cash Flows

Structure of Financial Statements

Notes to Financial Statements

- Disclosures to explain policies and provide more details and explanations of balances
- IFRS 7, IFRS 9, IFRS 13, IFRS 16, IFRS 21, IFRS 24
- PWC Disclosure checklist is 236 pages!

Structure of Financial Statements

Good examples of central banks financial statements

- Central Bank of Kenya
- <https://www.centralbank.go.ke/reports/cbk-reports-and-financial-statements/>
- Central Bank of Uganda
- https://www.bou.or.ug/bou/publications_research/annual_reports.html

Structure of Financial Statements

- How do each of the statements interact and link together?
- What statements are included in CBS's set of financials?
- Is anything lacking and if so, why?

II. Accrual Method of Accounting

Two methods of recording expenses and revenues:

- Under the cash method, transactions are only recorded when cash related is either issued or received.
- Under the accrual method revenues and expenses are recorded in the period when they are earned and incurred, irrespective of cash flows
- Accrual method provides a better matching of the actual economics reflected in the transaction

IAS 1 requires that an entity prepare its financial statements, except for cash flow information, using the accrual basis of accounting

Accrual Method of Accounting

- **Accrual principle.** The concept that accounting transactions should be recorded in the accounting periods when they actually occur, rather than in the periods when there are cash flows associated with them.
- **Matching principle.** Revenues are recognized when earned and expenses recognized as incurred.

Need to report on obligations and rights that will affect the institution's cash in the future.

Accrual Method of Accounting

- **Accruals** are earned revenues and incurred expenses that have an overall impact on an income statement. They also affect the **balance sheet**.

- Accrued expenses are reported as current liabilities that are the expenses that a company has incurred as of the balance sheet date, but have not yet been recorded or paid. Typical accrued expenses include wages, interest, utilities, repairs, bonuses, and taxes.
- Accrued revenues are reported in the current assets section of the balance sheet and are the amounts earned by the company as of the balance sheet date that have not yet been recorded and the customers have not yet paid the company.

Accrual Method of Accounting

Journal Entries

For expenses: Accrue when Incurred

Expense	DR	
Accounts Payable		CR

Reverse when paid in cash

For Revenues: Accrue when Earned

Accounts Receivable	DR	
Income		CR

Reverse when cash is collected

Accrual Method of Accounting

- What are the main transactions recorded on CBS balance sheet that should be accrual based?

Accrual Method of Accounting

- Accrued Expenses
 - Salary expense should be accrued as salary payable
 - Other expenses should be accrued as payables
 - Interest paid on loans should be accrued as interest payable
- Accrued Revenues
 - License Fees
 - Rental income
 - Interest collected on loans should be accrued as interest receivable

Accrual Method of Accounting

Group Exercise: Salary Expense

- When do you get paid? What is the period covered?
- When would you record the accrual for salary expense?
- Create journal entries for wages

III. Revaluations from Foreign Exchange Transactions

Foreign Activities arise from transactions in foreign currencies or foreign operations;

- The functional currency is the currency of the primary economic environment in which the entity operates, i.e. in which it primarily generates and expends cash.
- The presentation currency is the one in which the entity presents its financial statements.

Q. What is Somalia's functional currency?

- CBS will record foreign currency transactions using the spot conversion rate to this functional currency on the date of the transaction.

Q. What is Somalia's presentational currency?

- CBS will prepare its financial statements in its presentational currency, which is usually the functional currency but not in all cases

Accrual Method of Accounting

Group Exercise: Salary Expense

- When do you get paid? What is the period covered?
- When would you record the accrual for salary expense?
- Create journal entries for wages

Revaluations from Foreign Exchange Transactions

- IAS 21 *The Effects of Changes in Foreign Exchange Rates* outlines how to account for foreign currency transactions and operations in financial statements, and also how to translate financial statements into a presentation currency.
- An entity is required to determine a functional currency (for each of its operations if necessary) based on the primary economic environment in which it operates and generally records foreign currency transactions using the spot conversion rate to that functional currency on the date of the transaction.

Revaluations from Foreign Currency Transactions

Possible CBS Foreign Currency Denominated Assets and Liabilities

Assets

- Foreign currency held at other institutions
- Balances due from banking institutions (debt)
- Financial instruments at fair value
- Funds held at the IMF

Liabilities

- Deposits from banks and governments
- Debt to other institutions, agencies
- Funds due to the IMF

Revaluations from Foreign Exchange Transactions

- **Initially**, all foreign currency transactions shall be translated to functional currency by applying the **spot exchange rate** between the functional currency and the foreign currency at the date of the transaction.
- **Subsequently, at the end of each reporting period**, you should translate: monetary and non-monetary items
- All exchange rate differences shall be recognized **in profit or loss**, with the following exceptions:
 - Exchange rate gains or losses on non-monetary items are recognized consistently with the recognition of gains or losses on an item itself. For example, when an item is revalued with the changes recognized in other comprehensive income, then also exchange rate component of that gain or loss is recognized in OCI, too.
 - Example: property, plant, and equipment (IAS 16)

Revaluations from Foreign Exchange Transactions

- Exchange gains/losses arising from revaluations of monetary items (e.g., accounts payable, loans) are recorded in net income
- Exchange gains/losses arising from revaluations of non-monetary items recorded at fair market value (e.g., are recorded in net income

Revaluations from Foreign Exchange Transactions

Bank of Uganda Annual Report 2015/16

2.5 Functional and Presentation Currency

The financial statements are presented in Uganda Shillings, in accordance with section 18 of the Bank of Uganda Act (Cap.51) Laws of Uganda 2000, which is the Bank's functional currency. Except where indicated, financial information presented in Uganda shillings has been rounded to the nearest million.

2.22 Foreign Currency Translation

Financial assets and liabilities denominated in foreign currencies are translated into Uganda Shillings at the exchange rate ruling as at the reporting date. Transactions in foreign currencies during the year are converted into Uganda Shillings at the rates ruling at the transaction dates. The resulting differences from conversion and translation are recognised in profit or loss in the year in which they arise.

Non-monetary items that are measured in terms of historical cost in a foreign currency are translated using the exchange rates as at the dates of the initial transactions.

Non-monetary items measured at fair value in a foreign currency are translated using the exchange rates at the date when the fair value was determined.

Revaluations from Foreign Exchange Transactions

18.1 Statement of Profit or Loss and Other Comprehensive Income

Year ended	Note	30-Jun-2016 UGX (m)	30-Jun-2015 UGX (m)
Operating income			
Interest income	3	208,683	133,808
Interest expense	4	(40,630)	(37,828)
Net interest income		167,073	95,980
Profit on domestic foreign exchange trade	5	47,718	21,156
Fees and commissions	6	2,588	3,680
Other income	7	12,601	9,534
Net non interest and other income		62,907	34,370
Net operating income before foreign exchange & fair value gains		229,980	130,350
Net foreign exchange and fair value losses/gains	8	(167,306)	(1,536,077)
Net operating income		147,092	1,666,427
Expenses			
General & administration costs	10	(212,252)	(186,898)
Currency costs	12	(93,893)	(64,058)
Financial and professional charges	13	(15,400)	(13,554)
Impairment loss	14	(279)	(366)
Depreciation	25	(14,204)	(12,984)
Amortization	27	(1,480)	(1,330)
		(337,508)	(279,190)
Net (deficit)/surplus	15	(190,416)	1,387,237
Other comprehensive income			
Other comprehensive income to be reclassified to profit or loss in subsequent periods			
Fair value gains on Available for sale financial instruments	8	34,342	34,276
Other comprehensive income not to be reclassified to profit or loss in subsequent periods			
Actuarial losses on defined benefit pension plan	24	(8,705)	(4,052)
Other comprehensive income for the year		25,577	30,224
Total comprehensive income for the year		(164,839)	1,417,461

9 Net Foreign Exchange and Fair Value (Losses)/Gains

	30-Jun-2016 UGX (m)	30-Jun-2015 UGX (m)
Foreign exchange (losses)/gains	(120,104)	1,545,771
Fair value gains on investments at fair value through P&L	20,166	9,523
Fair value gains/(losses) on investments held for trading	17,050	(19,217)
	(82,888)	1,536,077

The foreign exchange (losses) or gains arise from translation of foreign currency transactions at the at the foreign currency exchange rates prevailing at the date of the transactions and revaluation of financial assets and liabilities denominated in foreign currencies to Uganda Shillings at the foreign currency exchange rates applicable on the reporting date.

Fair value (losses) or gains relate to the valuation gains realised on the AFREXIM Bank shares when compared to their market value (prices) as at year end.

The following exchange rates for major currencies have been used to convert foreign currency financial assets and liabilities to Uganda Shillings for reporting purposes as at year end;

	30-Jun-2016	30-Jun-2015
US Dollars	3,405	3,302
Euro	3,781	3,682
GBP	4,604	5,198
SDR	4,753	4,633

Revaluations from Foreign Exchange Transactions

Revaluations from Foreign Exchange Transactions

Kenya

2 Summary of significant accounting policies (continued)

(d) Functional currency and translation of foreign currencies

i. Functional and presentation currency

Items included in the financial are measured using the currency of the primary economic environment in which the Bank operates (the "Functional Currency"). The financial statements are presented in Kenya Shillings ("Shs") which is the Bank's Functional Currency.

ii. Transactions and balances

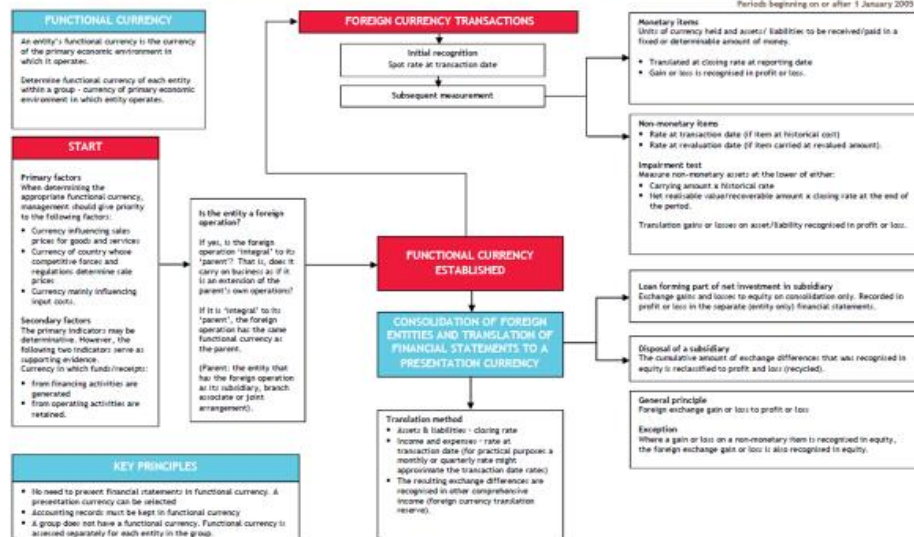
Foreign currency transactions are translated into the Functional Currency using exchange rates prevailing at the dates of the transactions or valuation where items are re-measured. All foreign exchange gains and losses are presented in profit or loss within 'foreign exchange gains/(losses)'.



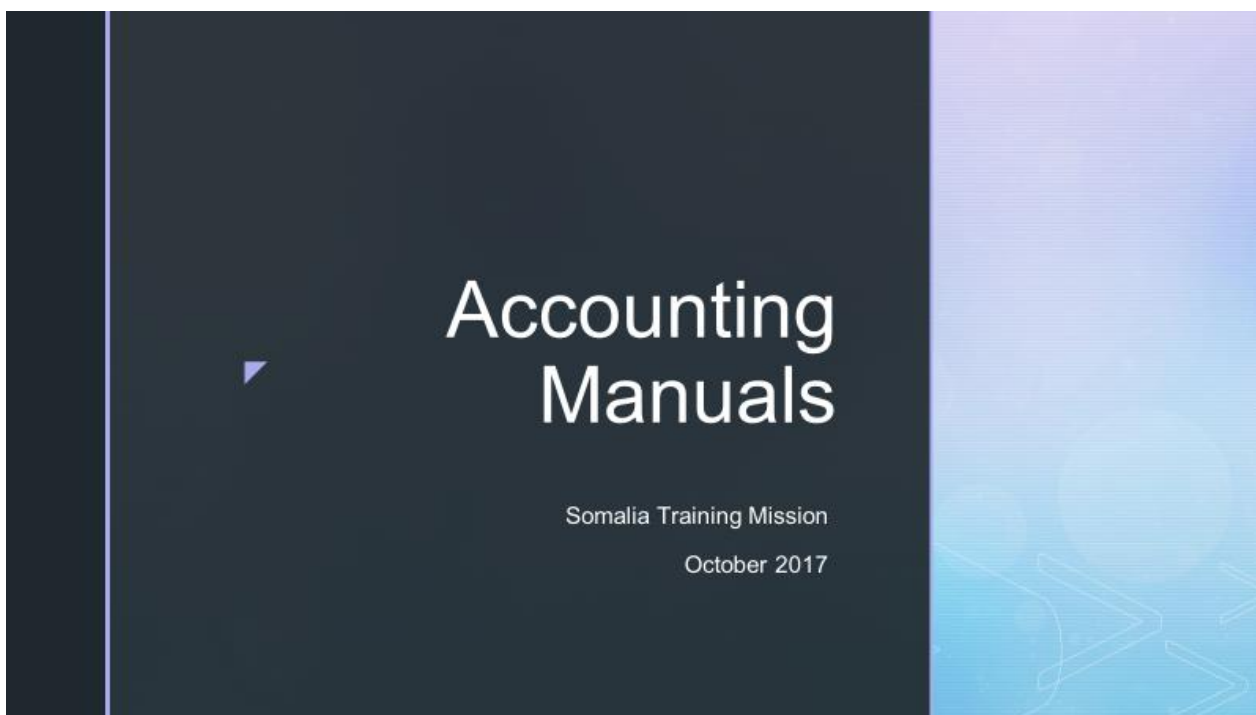
As at 1 January 2016

IAS 21 The Effects of Changes in Foreign Exchange Rates

Effective Date
Periods beginning on or after 1 January 2009



Appendix VIII. Accounting Manuals



Elements of Accounting Manual

- I. Introduction/Preface
- II. Accounting Policy Statement
- III. Roles and Responsibilities
- IV. Presentation of Financial Statements
- V. Assets and Liabilities– which ones?
- VI. Equity Capital
- VII. Income and Expenses
- VIII. Financial Reporting
- IX. Other
- X. Appendixes

COMPONENTS OF EACH SECTION

I. Introduction

- Purpose
- Authors
- Frequency of updates (or in II.)
- Any approvals provided (or in II.)

II. Accounting Policy Statement

- Indication of Accounting Framework
- Description of other guidelines followed (Code of Ethics, laws)
- Updates and amendments
- Other

Components of Each Section

III. Roles and Responsibilities

- Audit Committee
- Management
- Business Departments
- Accounting Department
- Internal Auditors
- External Auditors

Components of Each Section

IV. Presentation of Financial Statements

- Introduction
- Description of set of financial statements
- Relevant accounting standard prescribing presentation
- Sections of accounting standard that need emphasis
- Other important information

Components of Each Section

V. – VII. Assets, Liabilities, Capital, Income, Expenses

- Nature and Definition
- Classification
- Recognition Principles
- Valuation
- Presentation and Disclosure
- Other

Components of Each Section

VIII. Financial Reporting

- Descriptions of each of the individual financial statements (Financial Position, Income Statement, Changes in Equity, Cash Flow Statement, Notes)

IX. Other

- Events after the balance sheet date
- Procedures for each accounting transaction
- Description of internal controls

X. Appendices

- Closing entries description
- Examples of journal entries
- Examples of disclosures

Appendix IX. Property, Plant, and Equipment

PROPERTY, PLANT, AND EQUIPMENT

IFRS training for Somalia
IMF
October 2017



PP&E -- IAS 16

Noncurrent, Long Term, or Fixed Assets

- Land
- Buildings
- Office equipment
- Machinery
- Vehicles
- Furniture and fixtures



INITIAL RECOGNITION -- COST

Initially recognized at Cost (Purchase Price) which can include the following

- Import duties
- Installation and assembly costs
- Non-refundable purchase taxes
- Professional fees
- Site preparation
- Testing costs
- Transport costs
- Wages



SUBSEQUENT RECOGNITION

Once a fixed asset has initially been measured, you have a choice of continuing to measure it at cost (**the cost model**), or of revaluing it on a regular basis (**the revaluation model**).

The Cost Model

- Under the cost model, continue to carry the cost of a fixed asset, minus any accumulated depreciation and accumulated impairment losses. This is the simplest approach, since the least amount of accounting is required.
- When the cost model is selected, it should be applied to an entire class of fixed assets; thus, you cannot shift between the cost and revaluation models for individual items within a class of assets.



THE REVALUATION MODEL

If it is possible to measure the fair value of an asset reliably, there is an option to carry the asset at its revalued amount.

- Subsequent to the revaluation, the amount carried on the books is the fair value, less subsequent accumulated depreciation and accumulated impairment losses. Under this approach, fixed assets must be revalued at sufficiently regular intervals to ensure that the carrying amount does not differ materially from the fair value in any period.
- The fair values of some fixed assets may be quite volatile, necessitating revaluations as frequently as once a year. In most other cases, IFRS considers revaluations once every three to five years to be acceptable.



COST OR REVALUE

Most held at cost less depreciation;

Revalue difficult and volatile but IAS 16 allows it;

Land held at cost, no depreciation, and net of any impairment losses

DEPRECIATION

- Various methods
- Straight-line based on useful lives – easiest
- How is depreciation recorded?
 - Debit?
 - Credit?
- How is asset's value affected by depreciation? Balance sheet value?

CBS PPE SCHEDULE -- 2016

Change for the year	Land And Building	Fixtures and Furnitures	Vehicles	Equipement	Other Equipement
Cost	41,994,008	102,207	267,250	262,522	9,628
Rate	-	0.11	0.20	0.20	-
charge	-	11,243	53,450	52,504	-



CBS PPE SCHEDULE

What is useful lives of these assets?

- Fixture and Furniture?
- Vehicles?
- Equipment?
- Other Equipment?
- Land?

What are journal entries to record depreciation?



THE REVALUATION MODEL

- Use reliable market –based valuation by qualified appraiser
- Land most frequent asset revalued
- Must be performed regularly (3-5 years)



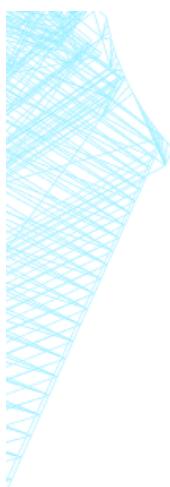
PRESENTATION ON FINANCIAL STATEMENTS

- What are journal entries for Revaluation in 2014?
- Where is revaluation presented on 2014 Audited Statements and Draft 2016 Statements?
- Was the land revalued in 2016?



ACCOUNTING POLICY

- What should be included?
- Where should the policy be visible?



EXAMPLES – BANK OF CANADA

Accounting policy

- *Property and equipment* consists of land, buildings, computer equipment, other equipment and related projects in progress. *Property and equipment* is measured at cost less accumulated depreciation, except for land, which is not depreciated, and is net of any related impairment losses. Projects in progress are measured at cost but are not depreciated until the asset is available for use. Cost includes expenditures that are directly attributable to the acquisition or construction of the asset. When parts of an item of property and equipment have different useful lives, they are accounted for as separate items (major components) of property and equipment. Upon replacing a significant part of an item of property and equipment, the carrying amount of the replaced part is derecognized and any gain or loss recognized in depreciation.
- Depreciation is calculated using the straight-line method and is applied over the estimated useful lives of the assets, as shown below. The estimated useful life and the depreciation method are reviewed at the end of each annual reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.
 - Buildings 15 to 65 years
 - Computer equipment 3 to 10 years
 - Other equipment 5 to 20 years
- Leasehold improvements (included in *Other equipment*) are depreciated over the lesser of the useful life or the term of the lease.

Appendix X. Audit Universe

Audit Universe is a comprehensive list of CBS's auditable entities that covers all of CBS's internal controls, governance, and risk management activities. Under the guidance of IMF experts, the internal audit team of have used information from CBS's organizational chart and financial statements (2014-2016) to build the audit universe. The auditable entities are based on CBS's key business processes (16), functions/structures (1), and service lines (1).

• the policy setting and implementation processes cover the policies related to bank supervision, macroeconomics, monetary policy, currency reform, and reserve management.

Audit Universe (a comprehensive list of Auditable Entities)	Financial Risk	%	Documenta- tion	Operati- on Risks	%	Documenta- tion	HR Risks	%	Documenta- tion	IT Risk s	%	Documenta- tion	Fraud Risk	%	Documentat- ion	Contr- ol Risk	%	Documenta- tion	Risk Score	Risk Ranking (H/M/L)	Documenta- tion
1. Cash Handling Process 1)Treasury Process 2)Execution of Instructions 3)Recording of deposit and withdraws		15%			20%			20%			20%			5%			20%		0		
2. Policy Setting Process * 1)collecting and analyzing data 2)developing policies 3)reviewing policies 4)approving policies		15%			20%			20%			20%			5%			20%		0		
3. Policy Implemntation Process 1)enforcing policies 2)monitoring policies		15%			20%			20%			20%			5%			20%		0		
4. Intellectual Products 1)research 2)statistic reporting		15%			20%			20%			20%			5%			20%		0		
5. Bank Notes Management (Somalia Shilings)		15%			20%			20%			20%			5%			20%		0		
6. Asset Recovery																					
7. Budgeting Process		15%			20%			20%			20%			5%			20%		0		
8. Physical Cash Management 1)physical cash transfers (receipts and disbursements) 2)physical cash custody and safeguard (vaults) 3)recording (both accounting records and physical records)		15%			20%			20%			20%			5%			20%		0		
9. Non-physical Cash Management 1) fund transfers via SWIFT		15%			20%			20%			20%			5%			20%		0		
10. Payroll Expense Process		15%			20%			20%			20%			5%			20%		0		
11. Operational Activity Process 1) expense handling (excluding payroll) 2) income handling (excluding cash handling income)		15%			20%			20%			20%			5%			20%		0		
12. Accounting Processes 1)book-keeping 2)accounting 3)financial reporting 4) accounting systems (Peachtree/Quickbook/Oracle)		15%			20%			20%			20%			5%			20%		0		

13. Human Resources Management Process 1)recrute 2)retain		15%			20%			20%			20%			5%			20%		0		
14. Information Technology 1) IT development (configuration & implementation) 2) information security 3) data integrity/confidentiality (privacy)		15%			20%			20%			20%			5%			20%		0		
15. Business Continuity Plan (BCP) 1) BCP policy 2) security facilities		15%			20%			20%			20%			5%			20%		0		
Operations 1) accountability framework 2)policies and procedures (internal)		15%			20%			20%			20%			5%			20%		0		
17. Risk Management		15%			20%			20%			20%			5%			20%		0		
18. Internal Control Framework 1) control environment 2) ethic value and code of conduct		15%			20%			20%			20%			5%			20%		0		

Source: Mission Team Working Paper