



# SOMALIA

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

January 2019

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# **INTERNATIONAL MONETARY FUND**

Monetary and Capital Markets Department



**SOMALIA**

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

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**November 14, 2018**

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**GLOSSARY**

AFD	Accounting and Finance Department
BoD	Board of Directors
CBS	Central Bank of Somalia
CIA	Certified Internal Auditor
CIC	Currency in Circulation
IT	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
MCM	Monetary and Capital Markets Department
PP&E	Property, Plant, and Equipment
ToR	Terms of Reference

## PREFACE

At the request of the Central Bank of Somalia (CBS), a Monetary and Capital Markets (MCM) Department mission visited Kampala, Uganda during March 10–21, 2018 to assist the authorities in developing proper frameworks for internal auditing and accounting to bring them toward internationally accepted norms. Training sessions were conducted on relevant topics.<sup>1</sup>

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 enthusiasm to learn new topics and apply new skills. The mission is also very appreciative of the logistical support provided by Ms. Fowzia Ibrahim of the Somalia Resident Representative office located in Nairobi, Kenya.

The report's key takeaways and recommendations, which are reflected in the Executive Summary, were discussed and agreed upon with the participants during the mission. The participants also held discussions with their management and the governor post-mission, who also agreed to these action items.

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<sup>1</sup> Ms. Wen led the internal audit training sessions and Ms. Rawlings led the accounting training sessions. Mr. Garcia Hernando provided accounting expertise.

## EXECUTIVE SUMMARY

**The CBS has taken steps to establish important pillars of a proper policy framework for financial reporting, auditing, and internal controls by approving the Internal Audit and Audit Committee Charters and is committed to address the remaining shortcomings in these areas.** The Internal Audit Department (IAD) has made progress by initiating risk assessments of the various CBS business units and recruiting an Information Technology (IT) professional to join the team. The Accounting and Finance Department (AFD) is making progress in implementing accrual accounting, and accounting for foreign exchange operations (International Accounting Standard (IAS) 21), and has created a new role of Reconciliation Officer to ensure all cash transactions are recorded properly. However, the IAD functions without a director, which places the internal audit staff at a severe disadvantage to other departments and limits their authority to effectively implement their program. Also, while the mission team has stressed the importance of adopting International Financial Reporting Standards (IFRS) during this mission and the previous mission, the CBS has not formally indicated that it will adopt this framework.<sup>2</sup> High priority recommendations were made to address these shortcomings. See Table 1 for homework assignments and high priority tasks.<sup>3</sup>

**The mission was pleased to learn that the accounting team is making progress in implementing certain IFRS standards as applicable to their operations, and that the new Oracle system is expected to go live in April 2018.** Technical issues related to the implementation of IAS 21 were discussed and resolved, and instructions were provided regarding certain central bank activities not specifically addressed by the IFRS; namely, accounting for gold holdings and the IMF accounts. The mission adopted a forward-looking approach by covering accounting for future operations such as currency in circulation. The components of an IFRS transition plan to adopt IFRS in its entirety as applicable to central banks (i.e., roadmap) and the need to develop such a roadmap were also reviewed and discussed.

**The assets and liabilities related to the IMF accounts, a key component of a central bank's financial statements, are not recognized, which significantly decreases the transparency regarding the CBS's operations and true financial condition.** As a result, the financial statements are less reliable and meaningful for users, including the IMF. It is unclear whether the external auditors are aware of the absence of these accounts; however, if

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<sup>2</sup> Post-mission, on May 19, the governor, who is also the Chairman of the Board, signed a proposal to implement IFRS and on May 26 established an IFRS team to undertake the implementation project.

<sup>3</sup> These missions are designed to address shortcomings in the accounting and internal audit frameworks which are part of Somalia's financial sector roadmap.

so, this issue should be brought to their attention during audit discussions.<sup>4</sup> The mission provided general instructions on how to account for IMF transactions, explained the importance of recognizing all assets and liabilities that meet the definition under a credible accounting framework and recommended that Somalia's financial position with the Fund be presented on the CBS' balance sheet.<sup>5</sup>

**No formal accounting policies exist that would shape the accounting framework and provide consistent guidance for implementing IFRS.** The accounting policy manual is a vital component of an accounting framework. The mission discussed the components of a robust accounting policy and provided instructions on how to draft such a policy. To practice these skills, the mission and the CBS accounting team worked collaboratively in the preparation of four draft policies, and as homework, the CBS accounting team was requested to prepare formal draft policies.

**The CBS has made solid progress in establishing the internal audit and internal control infrastructure in the past six months.** In March 2018, the Board of Directors (BoD) formally approved the Audit Committee Charter and the Internal Audit Charter as proposed during the last mission in September 2017. The approval of these two charters establishes an appropriate policy framework to strengthen the CBS's financial reporting, auditing mechanism, and internal controls. In addition, the internal audit team has increased their knowledge of the risk-based auditing methodology by completing the majority of their homework assignments. The team needs to continue to practice the methodology by completing the risk assessments of the remaining eight business processes, and start the audit fieldwork of financial controls in accordance with the audit program collaboratively developed during this mission. The internal audit team will also increase its capacity by adding a new IT professional, who was scheduled to join the team in April 2018.

**However, the internal audit team is still without a director, which places them at a disadvantage to other departments.** As a result, the team faces resistance from other business departments and is excluded from the management communication loop. As a high priority, the mission recommends that the CBS governor appoint a director to lead the internal audit team and represent the Audit Department. The mission also recommends that the governor approve: (i) the proposed internal audit manual and the internal audit strategy note; (ii) a flatter organization structure of the IAD to mobilize the limited auditing

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<sup>4</sup> By recognizing the IMF accounts, the impact would be a net effect of SDR 224 million.

<sup>5</sup> Articles 36 and 37 of the CBS law indicate that the central bank is the fiscal agent for the government and acts as a depository for currency holdings owned by the IMF. The mission assumes that the institutional arrangements are such that the CBS recognize all assets and liabilities regarding their membership in the IMF and Special Drawing Rights department and loan obligations on the balance sheet.



resources; and (iii) additional budgetary resources to obtain a group membership of the Institute of Internal Auditors (IIA).

**Specific assignments were agreed with the CBS staff and are listed in Table 1 with corresponding suggested deadlines.** Ongoing communication will be maintained to provide the CBS staff with timely guidance as needed.

**Table 1. Assignments and Recommendations for Internal Audit and Accounting**

	<b>Assignment or Recommendation</b>	<b>Timeline</b>
<b>Governor/Board of Directors/Audit Committee</b>		
1	Issue formal commitment to adopt IFRS. (High Priority)	By next mission
2	Appoint a director to lead and manage the IAD. (High Priority)	June 30, 2018
<b>Senior Management</b>		
3	Approve the five potential audits proposed by the internal audit team.	June 30, 2018
4	Circulate the Internal Audit Charter approved by the BoD to raise awareness of internal audit within the CBS.	June 30, 2018
5	Approve the proposed Internal Audit Manual (follow-up of a previous recommendation).	June 30, 2018
6	Provide budgetary support for the internal audit team to obtain a group membership to the IIA (or IIA Kenya).	June 30, 2018
<b>Internal Audit</b>		
7	Continue to complete the risk assessment of the remaining six auditable entities (e.g., business processes) included in the audit universe.	By next mission
8	Prepare an Audit Notification for the audit of financial controls.	By next mission
9	Prepare the Terms of Reference (ToR) of the audit of financial controls for the kick-off meeting with the CBS auditees.	By next mission
10	Complete the fieldwork of the audit of financial controls in accordance with the auditing program collaboratively developed by the IMF and CBS team.	By next mission
<b>Accounting</b>		
11	Draft accounting policies for IAS 21, Property, Plant, and Equipment (PP&E), Accruals, Currency in Circulation, and Gold Holdings; and assign someone to be in charge of the Accounting Manual to prepare initial drafts of policies, maintain the manual, etc.	April-September 2018 April 2018
12	Develop transition plan and roadmap for IFRS implementation including deadlines for each phase.	September 2018
13	Complete the Gap analysis started in the first mission including calculating the financial impact on CBS financial statements of adopting IFRS.	September 2018
14	Identify new operations that will be conducted by the CBS in the future that will need to be accounted for properly under IFRS.	September 2018

## I. INTRODUCTION

**1. This was the second mission in a series designed to assist the CBS in its development of formal infrastructures and professional practices for internal audit and accounting.** The first mission took place during September 24–October 5, 2017.<sup>6</sup> The mission met with the internal audit and accounting teams in Kampala, Uganda, and discussions focused on application of various international standards and principles related to internal audit and accounting as applicable to the CBS.<sup>7</sup> Training sessions were conducted over a two-week period, with the CBS staff participating in discussions and engaging in group exercises. The training agenda, list of training participants, training materials, guidance notes, and a matrix describing the content of future missions are included in the Appendices.

## II. INTERNAL AUDIT

### A. Progress Since the Previous Mission

**2. The CBS has made solid progress in establishing the audit and internal control infrastructure in the last six months.** In March 2018, the BoD formally approved the Audit Committee Charter and the Internal Audit Charter proposed during the last mission of September 2017. The former strengthens the oversight over financial reporting, auditing, and internal controls, and the latter establishes the authority and independence of internal audit at the CBS.

**3. In addition, the internal audit team has accomplished the majority of the assignments proposed by the mission during the last mission.** Specifically, these included assessing the risks of six business processes, identifying one potential audit, and updating the strategy note of internal audit. See Appendix V for the implementation status of recommendations (“homework assignment”) of last mission.

### B. Accomplishments of this Mission

**4. The internal audit team’s understanding of risk assessment methodology has improved.** First, the mission reviewed and edited the results of the six risk assessments completed by the internal audit team of the CBS and introduced a cross-checking technique to the internal auditing team to ensure consistent risk ratings across different business processes. Second, the mission and the CBS internal audit team agreed to increase the weights of financial risk and fraud risk factors in the overall risk rating framework to reflect the fact that almost all of the transactions were conducted in cash at the CBS—a single

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<sup>6</sup> See DMSDR1S-#6335020 for full report.

<sup>7</sup> Both the IAD and the AFD suffer from limited capacity and experience; however, each of the newly recruited three-member teams is committed to obtaining professional certifications.

transaction could involve US\$3–5 million. Third, the internal audit team led a risk assessment of the CBS's governance structure to demonstrate their improved understanding of risk assessment.

**5. Subject to the approval of the CBS governor, the internal audit team has identified five potential audits based on the results of their risk assessments.** The five auditable areas include: (i) financial controls over accounting and cash payments; (ii) the cash handling process, which generates about 90 percent of the CBS's revenue and delivers hundreds of millions of cash on behalf of the Somalia government; (iii) the budgeting process, which lacks budgetary controls of various levels and monitoring; (iv) the SWIFT process, which directs the transactions between the CBS and its corresponding banks; and (v) the procurement process. The internal audit team should discuss the five potential audits and the related risk assessment results with the governor for his approval.

**6. An audit program was developed collaboratively by the mission and the internal audit team of the CBS for the audit of financial controls over accounting and cash payments.** The rationale of selecting this audit as the first risk-based audit for the CBS auditing team includes: (i) the CBS overspent last year, partly due to the absence of budgetary controls over cash payments at transaction level; (ii) the internal audit team could leverage their previous experience and knowledge to conduct the fieldwork; and (iii) the audit may serve as a catalyst to drive stronger controls over the CBS accounting. See Appendix VII for the audit program, which includes an evaluation of the control designs and testing/auditing procedures on control compliances—the former was accomplished during the mission; the latter will be carried on by the internal audit team as fieldwork.

### **C. Challenges and Recommendations**

**7. The internal audit team is still without a director, which places them at a disadvantage to other departments.** As a result, the team faces resistance from other business departments and is excluded from the management communication loop. For example, the internal audit team has not been represented at the Disciplinary Committee, which comprises all department heads (directors) to oversee the misconduct of the CBS staff—misconduct incidents can be good indicators for internal audit on potential fraud or control deficiency. 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 talent is limited in this aspect, selected candidates can be hired on condition they obtain the equivalent certifications in one or two years.

**8. While the Internal Audit Charter has been approved by the BoD, the staff of the CBS are unaware of this action and its implications for their work.** Circulating the approved Internal Audit Charter within the CBS will promote the IAD and business

departments will become aware of the internal audit team. It will also strengthen cooperation before, during, and after the audits. An email has been drafted by the internal audit team on behalf of the governor to be circulated with the Charter. In addition, the governor should provide additional budgetary support for the internal audit team to obtain a group membership of the IIA, which possesses a large knowledge body of auditing and internal controls, including IIA Standards.

**9. The Internal Audit Manual has been updated with the new risk ratings during this mission, but it has not been approved.** The internal audit team should provide the governor and the Audit Committee (if possible) an overview of the manual and seek their approval to make the manual a guide for auditors, and as a reference for business departments.

**10. Although the internal audit team has made progress in understanding the risk assessment methodology, they still lack sufficient experience in applying the concepts and principles consistently.** Therefore, it is very important for the internal audit team to continue practicing and to finish the risk assessment of the remaining six business processes. Before that, the internal audit team should update the risk ratings and the rationale documentation for the eight business processes that were reviewed during the mission.<sup>8</sup>

**11. The internal audit team should also complete the fieldwork of the audit of financial controls in accordance with the audit program developed collaboratively during the mission.** Before they start on the fieldwork, the team should circulate an audit notification to relevant departments and prepare a ToR of the audit to include the audit objective, scope, approach, duration, and resources before the kick-off meeting. The components of the audit notification and the ToR have been discussed and listed out during the mission collaboratively by the mission and the internal audit team.

**12. As a follow-up on the recommendations of the last mission, the internal audit team should update its organizational structure to reflect a flatter structure.** During the last mission, the mission and the internal audit team agreed that the existing organizational chart was too hierarchical, considering the small size of the audit team. Therefore, a two-level organizational structure was recommended for internal audit: director/deputy director at management level and auditors (including a Risk Officer) at the professional level. The benefits of the flatter structure include better mobilizing the limited resources and bringing more exposures for individual auditors for professional growth.

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<sup>8</sup> The CBS's internal audit team completed six risk assessments as homework assignments and two risk assessments during this mission and the previous ones.

### III. ACCOUNTING

#### A. Progress Since the Previous Mission

**13. The accounting team has made progress in certain areas since the September 2017 mission, but capacity is currently constrained by the implementation of the Oracle system, and several vacancies will continue to exist in the short term.** As suggested by the mission during the first mission, a Reconciliation Officer role has been created within the AFD, which is designed to ensure that all cash transactions have been recorded properly with the objective being to reconcile all cash accounts on a monthly basis. Previously, the AFD did not receive SWIFT messages detailing transaction information; so, accurate balances could not be maintained. The accounting team is also implementing more accrual accounting and applying IAS 21 to the transactions conducted in foreign currency, which are currently limited and only involve the Euro currency.

**14. To address the shortage of staff, the Accounting Department is slowly expanding, as the governor has hired two new staff to lead the financial reporting and financial management teams.** The department has been reorganized into these two areas, and the lead accountant has recently been promoted to deputy director. The external recruits are from Pakistan and Uganda and have Master's degrees in accounting and five years of experience. Three additional staff are being recruited for accounting officer roles, which will increase the total number of staff of the department from 11 to 14. While the increase in staff is welcome, as the deputy director is stretched in many directions and the Oracle implementation is consuming many resources, the CBS will need to consider appointing one person who is able to dedicate the majority of his/her time to be in charge of accounting reform at the CBS in the near future. This action would become part of a transition plan or IFRS roadmap (see Para. 20).

**15. The 2015 and 2016 audited financial statements, which will continue to carry a qualified opinion, have not been issued to date.** The mission understands that the delay appears to be related to receiving confirmations of the CBS's gold holdings at the Federal Reserve. To address the qualification, a new appraiser will be hired to conduct an appraisal for the revaluation of PP&E, as suggested during the first mission. The first mission also raised concerns regarding the quality of the 2013/2014 external audits and during this mission, the participants informed the mission team they were not pleased with the audit quality. Article 48 of the Central Bank Law indicates that auditors should not be appointed consecutively for a period exceeding three years. During the past few months, the CBS has interviewed other audit firms; however, due to various reasons, has been unable to rotate firms. However, a new team of auditors from the current audit firm, including partner and manager, will be assigned to the CBS 2017 audit.

**16. No progress has been made on drafting accounting policies for the Accounting Manual, completing the IFRS Gap analysis, or establishing a fixed asset register.** See status of previous recommendations and assignments in Appendix V.

### **B. Accomplishments During this Mission**

**17. The mission worked collaboratively with the accounting team on developing initial draft accounting policies.** During the first mission, time was devoted to explaining the importance of drafting and maintaining an Audit Manual, which includes accounting policies. During this mission, the accounting team was eager to commence work and agreed that a manual will serve various needs, including: (i) providing guidance to new and existing staff; (ii) supporting consistent accounting application; and (iii) specifying procedures for recording accounting entries. To this end, the mission spent two days discussing the components of a high-quality accounting policy, and demonstrating how the policies used for the manual could also serve as a basis for the accounting policy notes in the financial statements. The accounting team thoughtfully considered an outline and major points to include for their foreign exchange operations (IAS 21) and PP&E. The mission also led them through the thought process for drafting policies for gold holdings and currency in circulation. The mission also suggested that the accounting team discuss the operations and related transactions with the relevant departments prior to drafting the policy, so that the AFD would increase its understanding of the activities.

**18. The accounting team's exposure to the IMF accounts has been limited; thus, another focus of this mission included a review of the accounting and a discussion regarding the CBS's current IMF balance sheet position.**<sup>9</sup> The IMF accounts are not recognized on the CBS's financial statements, which is a significant deviation from standards under any credible accounting framework, as a central bank's relations with the IMF give rise to assets and liabilities. It is unclear whether discussions with the auditors during the 2013/2014 and the 2015/2016 audits included the IMF accounts. The mission guided the accounting team through the various debit and credit entries related to the IMF transactions and recreated the balance sheet positions. Future missions would benefit from further discussions explaining the linkages with the IFRS.<sup>10</sup> As of January 31, 2018, the CBS's IMF accounts reflect approximately US\$155 million in assets and US\$479 million in liabilities. See Appendix VI for an illustration of the balance sheet position reflecting IMF accounts.

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<sup>9</sup> Per Articles 36 and 37 of The Central Bank of Somalia Act Law No. 130 of April 22, 2011, the CBS is both the fiscal agent and acts as a depository for the for currency holding owned by the IMF and as such, should present Somalia's financial position in the Fund in their balance sheet. This is the general practice with IMF member's central banks.

<sup>10</sup> While the accounting for the IMF operations is not addressed specifically by the IFRS, the substance of the transactions is supported by IFRS standards. For example, IFRS 9 and 13 and IAS 21 may be applied to IMF quota, borrowings, Special Drawing Rights holdings and allocations, and the currency valuation adjustments.

**19. Implementing the IFRS is a significant challenge for central banks as it takes time and resources.** To assist the CBS in adopting an organized approach in establishing an accounting framework aligned with the IFRS, the mission spent time reviewing IFRS 1 requirements, including a separate discussion on designing a proper roadmap for the transition. Most central banks find that a roadmap with deadlines is useful to guide them through the transition. On average, an IFRS conversion for central banks takes about 3–5 years, and it can be approached and managed similarly to other large-scale projects such as the Oracle implementation.

**20. Understanding the various impacts on adopting the IFRS is critical in order to be able to take action and mitigate risks in the adoption of a new accounting framework.** Developing a detailed Gap analysis will provide valuable insights into the financial, IT, and processes impact. Certain CBS staff were quite eager to move from the current fragmented approach to one that is organized and includes deadlines.<sup>11</sup> The roadmap would include three major components: the policy decision, the transition plan, and resources (see Appendix XI for presentation). The policy decision would involve the CBS issuing a statement indicating that the IFRS will be implemented (see Para. 25); the transition plan would include conducting a Gap analysis of the financial impact and the IT and processes impact on adopting the IFRS; and the resources component would include obtaining support from various stakeholders, including the external auditors and management.<sup>12</sup>

**21. The CBS accounting team is making progress implementing IAS 21 *The Effects of Changes In Foreign Exchange Rates*; however, they are encountering certain issues related to Euro translations that were discussed and resolved during the mission.** Currently, Somalia's functional currency is the US dollar and the CBS maintains most of its accounts in US dollar in foreign banks; however, they also conduct a few transactions in Euros through their Euro accounts in foreign banks.<sup>13</sup> The IAS framework provides guidance to restate operations conducted in a foreign currency into the functional currency. For the CBS, the Euro transactions must be restated into US dollar equivalents before they can be recorded.<sup>14</sup> The accounting team questioned how to calculate the value of Euro holdings when translating their Euro operations into US dollars, as well as how to calculate the gains or losses on the transactions. Foreign exchange gains or losses are recognized when a sale (or

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<sup>11</sup> The roadmap is based on the IFRS Foundation Recommended Action Plan.

<sup>12</sup> A Gap analysis was started during the first mission.

<sup>13</sup> Somalia will issue their own national currency in the future and the volume of transactions in other currencies, including those related to investment activities, will most likely increase.

<sup>14</sup> Consideration under the IAS framework is given to whether the operations are connected to monetary or to non-monetary items. For the CBS, the main concern related to monetary items as the number of transactions with non-monetary items is small.

OUT) of foreign currency is made or at any balance sheet date when translation from Euro to US dollar is required.

**22. The mission explained the fundamentals of IAS 21 and presented different alternatives to determine the cost of the foreign currencies, following IAS 2, *Inventories*.**

The mission recommended the average weighted cost method be used in the determination of the cost of Euro holdings, and the results of the purchases and sales of foreign currencies.

The average weighted cost method will provide the accounting team with a clear and relatively simple approach to control the operations in foreign currency. To assist the accounting team in developing an accounting policy in this area, the mission prepared a series of documents that describe the average weighted cost method and include examples of journal entries and explanatory notes. See Appendix IX.

**23. The mission adopted a forward-looking approach and discussed the accounting associated with the CBS's future operations related to issuing a national currency.**

Currently, Somalia does not have official shilling banknotes in circulation; however, counterfeit banknotes that have been printed in the shadow market are circulating in the country and these notes are outside the control of the CBS. Nevertheless, the CBS is engaged in some residual cash handling with the counterfeit notes, which involve deposits and withdrawals by the same clients. No US dollars are swapped for shillings.<sup>15</sup> Somalia is undergoing currency reform, and while the CBS is not currently issuing banknotes, there are plans to issue banknotes in the near future. Therefore, the mission spent time reviewing the accounting for Currency in Circulation (CIC), which is a core activity for a central bank. The CIC lifecycle involves many stages, and proper accounting is required during each stage except the printing stages.

**24. While the IFRS does not cover central bank operations related to CIC specifically, there is common understanding in the industry regarding the recording of basic transactions.** IAS 8 provides support for the development of an accounting policy that is relevant and reliable, so the CBS will be able to develop their own policy to reflect their own practices.<sup>16</sup> Developing a proper accounting policy as well as a very strong system of internal controls for the different stages of the currency lifecycle will be critical for the CBS going forward. Prior to developing such a policy, it would be advantageous for the

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<sup>15</sup> The counterfeit banknotes will represent a loss and an adjustment to equity when the CBS withdraws them from circulation, so the conversion process should be very short; otherwise, it will be difficult for the CBS to control the continued circulation of the counterfeit banknotes.

<sup>16</sup> Banknotes have characteristics of both assets (IAS 16) and inventories (IAS 2); however, in the absence of a specific IFRS standard that applies to a transaction, IAS 8 allows management to use its judgement in developing and applying an accounting policy that results in information that is relevant and reliable and reflects the economic substance of the transaction.



accounting team to discuss the CIC lifecycle with the Cash Management Department and with the CIC operations team to ensure their understanding of each process. Both sides would benefit in these discussions.<sup>17</sup> See Appendix VIII for the detailed Accounting Guidance Note on CIC.

### C. Challenges and Recommendations

**25. While the CBS law provides for the IFRS to be followed by the central bank, no implementing accounting policy statement has been issued by the BoD, Audit Committee, or Management.**<sup>18</sup> The CBS management is responsible for the preparation, presentation, and integrity of the CBS's financial statements; for the appropriateness of the accounting principles and reporting policies that are used by the CBS; and for establishing and maintaining effective internal control over financial reporting. This includes establishing an accounting framework and policies.<sup>19</sup> Issuing an accounting statement policy would establish a fundamental pillar of the accounting infrastructure. Discussions regarding this type of action were held with the accounting team and the mission understands that management has expressed interest in joining with other stakeholders in the country to further discuss the most appropriate accounting framework for the country to adopt.<sup>20</sup> Pursuing this path could be quite lengthy and complex, with no guarantee of achieving any results in a timely manner. The CBS is functioning without a credible accounting framework, and waiting for consensus to be achieved throughout the country would not be effective or efficient. In addition, this statement forms a vital element of the overall roadmap for IFRS adoption and accounting manual discussed in Para. 17. The mission recommends that the CBS move forward with the implementation of IFRS and issue an accounting policy supporting the law.

**26. Without documented accounting policies, the accounting framework and team suffer.** Formal documentation of accounting policies and procedures can assist organizations to ensure accountability and consistency in daily transactions, and for financial reporting. The policies offer a solid framework to follow, so the CBS may adhere to the right structure

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<sup>17</sup> For example, the central bank may use single or multiple vaults for storing banknotes and CIC accounting for the currency that is returned from circulation will differ depending on whether the banknotes are under the central bank's control or still considered CIC. If multiple vaults are used, the central bank will need to devise a system to control the returns.

<sup>18</sup> Article 48 of the CBS law indicates that "The Bank shall maintain accounts and records in accordance with the International Financial Reporting Standards, or other subsequent internationally widely accepted accounting standards for central banks and other international major financial institutions, to reflect its operations and financial condition."

<sup>19</sup> These responsibilities are set forth in the Audit Committee Charter approved by the BoD in March 2018.

<sup>20</sup> Commercial banks are also required by law to follow the IFRS.

and prepare its financial statements. The policies form key elements of accounting guidance and reflect the main accounting concepts practiced by the institution. Documented accounting policies and procedures can be used as a training tool for new staff, and can play an important role in the event that key financial and administrative employees leave the CBS. The accounting procedures can also serve to contribute to the design and implementation of the internal control system. This documentation should be readily available to all staff. Management is responsible for developing appropriate accounting policies and procedures and for ensuring proper documentation of the central bank's policies, procedures, and controls. Assigning a leader to this project will promote accountability and efficient use of resources. The mission recommends that senior management appoint one person in charge of ensuring accounting policies are drafted for the Accounting Manual.

#### IV. SUBSEQUENT MISSIONS

**27. The next internal audit mission is scheduled for the second quarter of 2018, and the next accounting mission is scheduled for the third quarter of 2018.** However, this is dependent on the homework assignments being completed. See Table 1 for Assignments for Internal Auditing and Accounting.

**Appendix I. Agenda – Internal Audit and Accounting Training  
Central Bank of Somalia**

<b>Internal Audit Sessions</b>			
<b>Date March</b>	<b>Session 1 8:30–10:30</b>	<b>Session II 11:00–12:30</b>	<b>Session III 2:00–4:00</b>
14	<b>Introduction</b> <ul style="list-style-type: none"> <li>• Mission objective</li> <li>• Stocktaking of current assignments</li> <li>• Steps taken since September 2017</li> </ul>	<b>Follow up on</b> <ul style="list-style-type: none"> <li>• Internal audit charter</li> <li>• A/C charter</li> <li>• Organizational Chart</li> <li>• Strategy note</li> <li>• Internal audit manual</li> <li>• International Professional Practice Framework (IPPF) knowledge</li> </ul>	<b>Follow up on and Review</b> <ul style="list-style-type: none"> <li>• Risk assessment (fraud risk as a key risk factor)</li> </ul>
15	<b>Follow up on and Review</b> <ul style="list-style-type: none"> <li>• Risk assessment</li> </ul>	<b>Follow up on and Review</b> <ul style="list-style-type: none"> <li>• Risk assessment</li> </ul>	<b>Identification of Potential Audits</b>
16	<b>Audit Planning (including micro-level risk assessment)</b> <ul style="list-style-type: none"> <li>• IIA Standards</li> <li>• Relevant audit manual chapters</li> <li>• Steps</li> </ul>	<b>Audit Planning (including micro-level risk assessment)</b> <ul style="list-style-type: none"> <li>• IIA Standards</li> <li>• Relevant audit manual chapters</li> <li>• Steps</li> </ul>	<b>Audit Planning (including micro-level risk assessment)</b> <ul style="list-style-type: none"> <li>• IIA Standards</li> <li>• Relevant audit manual chapters</li> <li>• Steps</li> </ul>
17	<b>Development of Audit Program</b>	<b>Development of Audit Program</b>	<b>Development of Audit Program</b>
18	<b>Development of Audit Program</b>	<b>Development of Audit Program</b>	<b>Wrap Up and Assignments</b>

<b>Accounting Sessions</b>			
<b>Date March</b>	<b>Session 1 9:00–10:30</b>	<b>Session II 11:00–12:30</b>	<b>Session III 2:00–5:00</b>
17	<b>Introduction and Stocktaking of Current Assignments and Steps taken since September 2017</b>	<b>Stocktaking Continued</b>	<b>IAS 21 Changes in Foreign Exchange Rates and Application to the CBS</b>
18	<b>Exercise: Building a Central Bank Balance Sheet</b>	<b>IAS 21 Changes in Foreign Exchange Rates and Application to the CBS</b>	<b>Understanding MOF accounts: TSA (“Account 21”) and MDA accounts</b>  <b>Accounting for Currency in Circulation</b>
19	<b>Drafting Accounting Policies for the Accounting Manual</b>  <b>Components of a robust policy</b>	<b>Drafting Accounting Policies for the Accounting Manual</b>  <b>Exercise: Draft accounting policy: PP&amp;E</b>	<b>Drafting Accounting Policies for the Accounting Manual</b>  <b>Exercise: Draft accounting policy: Gold Holdings</b>
20	<b>Drafting Accounting Policies for the Accounting Manual</b>  <b>Exercise: Draft accounting policy: IAS 21</b>	<b>Drafting Accounting Policies for the Accounting Manual</b>  <b>Exercise: Draft accounting policy: IAS 21</b>	<b>Transitioning to IFRS— IFRS 1 Requirements Development of a Road Map or Transition Plan</b>
21	<b>IMF Positions and presentation and impact on financial statements</b>	<b>IMF Positions and presentation and impact on financial statements</b>	<b>Wrap Up and Assignments</b>
Note: Times are approximate with some areas receiving more or less attention. Topics may vary slightly depending on current issues.			

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

<b>Department</b>	<b>Name</b>
Internal audit	3 members comprising of internal audit team.
Accounting	3 members of the accounting team.

### Appendix III. Summary of Proposed Topics to be Covered in Training Missions<sup>1</sup>

	<b>Mission #1 September/Oct 2017</b>	<b>Mission #2 First Quarter 2018</b>	<b>Mission #3 Second Quarter 2018</b>	<b>Future Missions</b>
<b>Internal Auditing Stream</b>	<ul style="list-style-type: none"> <li>• Basic concepts of internal control, risk management, and internal audit</li> <li>• Internal Audit Infrastructure (internal audit charter, audit committee charter, internal audit organizational chart, and strategy note)</li> <li>• Introduction on the macro-level risk assessment methodology</li> <li>• Risk assessment of business processes;</li> <li>• Development of an audit universe</li> </ul>	<ul style="list-style-type: none"> <li>• Issues from Homework, including the results of risk assessment conducted by the CBS of the business processes included in the audit universe</li> <li>• Identification of potential audits for next audit year based on the results of risk assessment</li> <li>• Introduction on the micro-level risk assessment methodology</li> <li>• Development of an audit program for a specific audit project</li> </ul>	<ul style="list-style-type: none"> <li>• Issues from homework assignments.</li> <li>• Review of the risk assessment results</li> <li>• Critical review of Audit Program</li> <li>• Review of fieldwork of the audit of financial controls and generate an audit report</li> <li>• Develop 3 year audit plan</li> <li>• Audit Recommendations</li> <li>• Auditing techniques such as interviewing, flowcharting, and root cause analysis</li> </ul>	<ul style="list-style-type: none"> <li>• Review audit programs</li> <li>• Audit reporting</li> <li>• Working papers</li> <li>• Follow up on Audit Recommendations</li> <li>• Controls over central-bank-specific processes</li> <li>• Quality assurance</li> <li>• Fine tuning techniques and reporting and following up on recommendations</li> <li>• Internal self-assessment</li> <li>• Identify main gaps in complying with IPPF and developing action plans to close gaps</li> </ul>
<b>Accounting Stream</b>	<ul style="list-style-type: none"> <li>• IFRS Application for Central Banks</li> <li>• IFRS Conceptual Framework</li> <li>• Accounting Manuals</li> <li>• Chart of Accounts</li> <li>• IAS 1</li> <li>• IAS 16</li> <li>• IFRS Gap analysis</li> <li>• Obtaining accurate year-end balances for 2017</li> <li>• Organizational Structure Review</li> </ul>	<ul style="list-style-type: none"> <li>• Issues from homework Assignments</li> <li>• Accounting Manuals continued</li> <li>• IMF accounts</li> <li>• Notes to Financial Statements</li> <li>• IAS 21</li> <li>• Key Requirements for IFRS 1</li> <li>• Currency in Circulation.</li> <li>• Golding Holdings</li> </ul>	<ul style="list-style-type: none"> <li>• Currency in Circulation</li> <li>• Bank Note Production Cost</li> <li>• Gold Holdings</li> <li>• IMF accounts</li> <li>• Foreign currency translation</li> <li>• Impact on Equity position</li> <li>• First Time Adoption</li> <li>• IFRS Note Disclosure</li> <li>• Detailed Project Plan</li> </ul>	<ul style="list-style-type: none"> <li>• Review structure of financial statements compliance with IFRS</li> <li>• Financial Statement Notes – accounting policy notes, risk notes, currency in circulation notes, fixed asset notes, etc.</li> <li>• Key Budgeting principles, financial management and internal reporting</li> </ul>

<sup>1</sup> Assumes two week training sessions for each stream for missions #3 and future missions.

### Appendix IV. Status of Assignments and Recommendations

<b>Internal Audit</b>			
<b>First Mission: September 24–28, 2017</b>			
<b>Recommendation or Homework Assignment</b>	<b>Status</b>	<b>Comments</b>	<b>Revised Deadline</b>
Update the proposed internal audit charter with the CBS circumstances and submit it to governor and Audit and Governance Committee or the BoD for discussion and approval.	<b>Completed</b>	The Charter was updated by IAD and approved by BoD in March 2018.	
Update and submit the drafted audit committee charter to the governor and the Audit and Governance Committee (or the BoD) for discussion and approval.	<b>Completed</b>	The Charter was updated by IAD and approved by BoD in March 2018.	
Update the organizational chart to reflect a flatter structure to mobilize the limited resources.	<b>Not started</b>		June 30, 2018
Update and adopt the proposed internal audit manual.	<b>Underway</b>		June 30, 2018
Update the strategy note to set specific objectives for next 12 months (i) develop the first risk-based annual audit plan; and (ii) at least one staff sits for the CIA exam.	<b>Completed</b>	The Strategy Note was updated by IAD and reviewed by IMF team to verify that it includes the two components proposed.	
Selected one auditable entity from the audit universe, complete the risk assessment in line with proposed internal auditing manual (Para. 17).	<b>Completed</b>	The financial control processing (including both financial reporting and cash payments) was selected	
Upon the feedback of the first risk assessment, continue and finish the risk assessment of all the remaining auditable entities in the audit universe.	<b>Underway</b>	IAD has completed six out of eighteen auditable entities.	June 30, 2018
Download and read IIA Standards.	<b>Underway</b>	This recommendation is replaced by the recommendation that the CBS should obtain group membership of IIA to give internal auditors access to IIA's knowledge body, including IIA Standards.	June 30, 2018

<b>Accounting</b>			
<b>First Mission: October 1–5, 2017</b>			
<b>Recommendation or Homework Assignment</b>	<b>Status</b>	<b>Comments</b>	<b>Revised Deadline</b>
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 on a monthly basis.	<b>Completed</b>	Established new function: Reconciliation Officer.	September 2018
Resolve disagreement regarding the PP&E 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.	<b>Underway</b>	Will hire a new appraiser for 2017 after auditor releases 2016; the governor will travel to Kenya and find appraiser based on external auditors' recommendations. 2015 and 2016 audit opinions will reflect qualified opinions.	September 2018
Calculate the impact on income of adopting IFRS by completing the IFRS Gap analysis.	<b>Not started</b>	Discussed the components of a road map which includes a Gap analysis during the second mission in March. See new assignment.	September 2018
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.	<b>Not started</b>	Practiced skills in drafting accounting policies during the second mission in March. See new assignment.	
Set up Fixed Asset Register based on information provided by Administration Department or other relevant departments.	<b>Not started</b>	Created new area in department for asset management and have hired a new leader. Will establish the register once the new leader is on board.	September 2018
Revise Chart of Accounts to reflect more simple structure (three levels of accounts, not five); <ul style="list-style-type: none"> <li>• Update list based on financial statement presentational preferences</li> </ul> Update list based on IFRS analysis and any changes in accounting policy (e.g., depreciation for buildings)	<b>Underway</b>	Continue to revise chart of accounts as Oracle implementation moves forward.	September 2018
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.	<b>Underway</b>	Oracle implementation is expected to go live in April 2018. The second mock run was underway at the time of the second mission in March.	September 2018
Draft accounting policies for the Accounting Manual related to the following areas and submit for review to IMF: <ul style="list-style-type: none"> <li>• Cash and Cash Equivalents</li> <li>• PP&amp;E</li> </ul> Salary Expenses	<b>Not started</b>	Reviewed components of an accounting policy during the second mission and practiced skills by drafting accounting policies for PP&E and IAS 21. See new assignment.	September 2018
Complete organizational chart and allocate 12 resources to various functions and define tasks.	<b>Completed</b>	Have established a new organizational chart with 14 positions.	

## Appendix V. Balance Sheet Presentation with IMF Accounts

Somalia								
Statement of Position								
As of January 31, 2018								
SDR/US Dollar								
ASSETS	SDRs	US Dollars	Local Currency	LIABILITIES	SDRs	US Dollars	Local Currency	
<b>Quota</b>	44,200,000	64,159,231	1,442,563,454,842	<b>IMF Current Accounts</b>				
				Securities	128,563	186,618	4,195,909,422	
				No. 1 Account	44,066,254	63,965,090	1,438,198,362,266	
				No. 2 Account	6,345	9,210	207,089,719	
				Currency Valuation Accounts	1,395	2,025	45,555,708	
				<b>Total Current Accounts due to IMF</b>	<b>44,202,557</b>	<b>64,162,943</b>	<b>1,442,646,917,115</b>	
				<b>Borrowings (Principle)</b>				
				GRA				
				Stand-by Arrangements	67,720,000	98,300,071	2,210,189,981,038	
				Contingency and Compensatory	28,530,000	41,413,187	931,138,809,200	
				<b>Total GRA Borrowings</b>	<b>96,250,000</b>	<b>139,713,258</b>	<b>3,141,328,790,238</b>	
				Other				
				Trust Fund	6,460,000	9,377,118		
				SAF	8,840,000	12,831,846		
				<b>Total Other Borrowings</b>	<b>15,300,000</b>	<b>22,208,965</b>		
				<b>Charges (Interest and Special Charges)</b>				
				Overdue Interest and Special Charges				
				GRA borrowings	124,282,569	180,404,390		
				SAF and Trust Fund Interest	2,256,608	3,275,616		
				SAF special charges	973,966	1,413,776		
				Trust Fund special charges	26,967	39,144		
				<b>Total Overdue Interest and Special Charges</b>	<b>127,540,110</b>	<b>185,132,927</b>		
				Accrued Interest and Charges				
				GRA borrowings	423,084	614,134		
				SAF	4,117	5,976		
				Trust Fund	3,010	4,369		
				<b>Total Accrued Interest and Charges</b>	<b>430,211</b>	<b>624,480</b>		
<b>Special Drawing Rights (SDRs)</b>				<b>Special Drawing Rights (SDRs)</b>				
SDR Holdings (International Reserves)	18,148,829	26,344,229		SDR Allocation	46,462,893	67,443,970		
Accrued Interest on SDR Holdings	33,803	49,067		Accrued Charges on SDR Allocations	86,543	125,623		
<b>Total SDR Holdings</b>	<b>62,382,632</b>	<b>90,552,527</b>		<b>Total SDR Allocation</b>	<b>46,549,436</b>	<b>67,569,593</b>		
<b>Total Assets</b>	<b>106,582,632</b>	<b>154,711,758</b>	<b>1,442,563,454,842</b>	<b>Total Liabilities Due to the IMF</b>	<b>330,272,314</b>	<b>479,412,165</b>	<b>4,583,975,707,353</b>	
Exchange Rate USD/SDR: 1 USD =	0.688911	4/4/18						
Exchange Rate SDR/Somali Schillings =	0.000030639900							
<b>Net Effect (Assets-Liabilities)</b>	<b>-223,689,682</b>	<b>-324,700,407</b>	<b>-3,141,412,252,511</b>					

Note: The functional and presentational currency for Somalia is the U.S. dollar.



## Appendix VI. Audit Program

Business Objectives (what does operational management want to achieve?)	Inherent Risks (what can go wrong?)	Key Controls in Existence (what major processes or controls has the operational management established to mitigate risks?)	Adequacy of Control Design (assuming the controls are followed, can the controls mitigate risks to acceptable level?)	Deficiency of Control Design (What controls are missing?)	Testing Plan (to determine whether the controls followed in practice?)	Staff Assignment	Projected Hours	Findings from Testing (are controls followed? If not, why?)
to provide full financial information of CBS's assets, liabilities, equities, income, and expenses.	Accounting Department lacks information because they are not in the communication loop of business activities that impact the financial statements or generate financial information or they lack internal procedures to ensure information circulation within the department.	The written procedure on CBS cash payments ensures that Accounting Director's signature is required for any cash payments.  Existing practices of CBS licensing/registration fee collection ensures that Accounting Department is notified when CBS receives the cash payments of licensing and registration.  Existing practices of cash handling (generating 90% of CBS's income) indicates that Accounting Department is notified of cash deposits and payments (by government agencies).	Not adequate	1. An overall accounting policy to clearly define 1) the authority, responsibility, and accountability of accounting department; 2) the roles and responsibilities of related stakeholders (audit committee, senior management, other business departments, internal auditors external auditor). 2. Written accounting procedures to document 1) cashing handling process; 2) collection of licensing/registration fees; 3) asset recovery; 4) IMF accounts; 5) other non-cash based transactions, including accrual of interest; and 6) fixed-asset registry.	1. Interview relevant business departments (e.g., General Administration, SWIFT team, Bank Operation) to 1) ascertain their existing practices to distribute information; 2) understand if incidents (e.g., forgetting to inform Accounting Department) happen and causes. 2. Obtain and review adjusting journal entries of the manual accounting books (of last quarter) to determine if there are any adjusting entries and the reasons for the adjustments. 3. Obtain and review the daily reconciliation documents of last month to determine if there are any adjusting entries and the reasons for the adjustments.			
	Accounting Department does not record fully the assets, liabilities, equities, income, and expenditure even they have such information.	BoD (AC) receives periodic financial reports, including financial statements.  Central Bank Law mandates that IFRS is the accounting standards for CBS.	Not adequate	1. An accounting manual to support the IFRS adoption/implementation. 2. Oversight of AC over financial reporting and external auditor's work and credibility.	1. Obtain and review the minutes of BoD/AC meetings of last year and determine if BoD/AC has exerted its oversight over financial reporting and controls. 2. Interview selected BoD/AC members to understand how they exercise their financial oversight, whether they have any concerns, and what's their view on financial reporting, e.g., IMF accounts, value of land/properties.			
To provide reliable financial information for CBS's management and BoD/AC on assets, liabilities, equities, income, and expenses.	Accounting Department does not have or maintain supporting documents for the accounting records.	Existing procedure requires that Accounting Department review supporting documents before approving the cash payments.	Adequate		1. Review the payment procedure and identify the control points. 2. Select 30 payments (diversified in terms of amount, payees, and types of expenses, etc.) randomly of last quarter to verify the payment procedure has been implemented - document the testing results in a working paper. 3. Obtain the existing fixed-asset registry for land and properties, request and review the supporting documents to verify the historical costs or fair value.			
	There are inconsistent accounting records in CBS's accounting information depository: 1. manual book for USD transactions, 2. manual book for Shilling-based transactions, 3. PeachTree, 4. QuickBook, 5. Excel of trial balance, and 6. financial statements.	Daily reconciliation between 1, 2, and 3.  Daily reconciliation between 1, and 4.  Daily reconciliation of CBS's customer account balances between 3, 4, and 5.	Not adequate	1. One accounting system/depository (e.g., Oracle) adaptive to IFRS adoption. 2. A reconciliation and accrual process for monthly trial balance. 3. A reconciliation and review process for monthly financial statements.	1. Interview relevant accounting staff on how they conduct the three daily reconciliations. 2. Ask relevant accounting staff for a walk-through for each reconciliation process. 3. Select 10 daily reconciliations of last quarter to verify the reconciliation (1,2,3) has been conducted and documented. 4. Select 10 daily reconciliation of last quarter to verify the reconciliation (1&4) has been conducted and documented. 5. Select 10 daily reconciliation of last quarter to verify the reconciliation (3,4,5) has been conducted and documented. 6. Contact 5 CBS clients to verify their account balances.			
	PeachTree and QuickBook may fail due to technical problems.	Software CDs are kept in safe to recover the software.  PeachTree and QuickBook are backed-up daily and saved in separate hard drives. Hard drives are put into a safe of Accounting Department.  Two manual records are maintained.	Adequate		1. Interview the accounting staff on the PeachTree and QuickBook on how to operate, back-up, and maintain the software. 2. Observe whether the software CDs and the hard drives are kept in safe. 3. Request a back-up of the previous day and a back-up of 30 days ago and compare them to the corresponding manual records of those time (one day ago and 30 days ago) to see if the back-up has captured all the accounting data properly.			
	Key accounting information is kept by one accounting staff only and may be lost if there is a sudden turnover of that staff.	Cross-training among accounting staff on PeachTree and QuickBook skills.	Not adequate	1. Shared drive for accounting staff to store shared information.	1. After getting access to Quick Book, ask an accounting staff to walk you through the system. 2. After getting access to PeachTree, ask an accounting staff to walk through you the system. See cell F15.			
to execute financial controls over CBS payments.	Payments are made without appropriate approval or authorization.	Written procedures on cash payments require accounting department's approval.	Adequate					
	Payments are made without budgetary control.		Not adequate	1. Budgetary controls at transaction level by department and at account level by Accounting Department. 2. Periodic reporting on execution of budgetary by Accounting Department to management and department heads.	1. Discuss with the Accounting Director on how to set up the budgetary controls at transaction and account levels.			
	Ineligible payments are made as a result of fraudulent actions or collusion.	1. There is a Code of Conduct for CBS staff. 2. There is a Disciplinary Committee at CBS. 3. Cash is always picked up by designated representative from government agencies. 4. There is a daily reconciliation between accounting and bank operation department. 5. There must be supporting documents and authorization from governor/deputy governor even for miscellaneous expenses.	Adequate	1. Provide a list of signature to Business Operation department. 2. Review and update fixed-asset registry monthly. 3. Review miscellaneous expense account monthly.	1. Review the Code of Conduct and enquire with HR when was the last time that the Code of Conduct was circulated; discuss with HR on the possibility of establishing employees' annual self-certification exercise. 2. Interview selected Disciplinary Committee on possible fraudulent incidents related to cash payments. 3. Review and test the daily reconciliation (30 samples) between Business Operation Department and Accounting Department.			

## Appendix VII. Guidance Note on Currency in Circulation

### Introduction

Issuing currency is one of the core activities of a central bank. Most central banks issue banknotes and coins while a few only issue banknotes as the coins are placed in circulation through the central bank on behalf of the Treasury. This guidance assumes the central bank issues both banknotes and coins, so, further reference will be to banknotes.

Banknotes will take on two different “lives” and represent either:

- Currency in Circulation (CIC), which is a liability for a central bank and includes the total banknotes issued by the central bank<sup>1</sup>; or
- “Simple paper”, which are held by the central bank as inventory, and does not represent a liability but obviously possess a very special value.

The framework for accounting for CIC consists of three elements:

- Recording the transactions that reflect the life cycle of CIC in the financial statements;
- Recording the cost of the printing or minting of banknotes in the financial statements; and
- Controlling the inventory of the “simple paper” or banknotes that have not been placed in circulation or have been withdrawn from circulation by recording related transactions in off-balance sheet accounts.

The accounting for CIC will reflect the various stages of the CIC life cycle which holds true for other operations in the central bank:

- Printing process;
- Receiving new banknotes in the central bank from the printing company and storing in the central bank vaults;
- Placing Banknotes into circulation;
- Withdrawing Banknotes from circulation;
- Counting and sorting used banknotes;
  - a. Good for recirculation
  - b. Non-suitable for recirculation
  - c. Counterfeit banknotes
- Destruction of banknotes non-suitable for recirculation;
- Transferring currency to branches; and
- Printing cost.

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<sup>1</sup> Banknotes are considered a financial asset under the IFRS conceptual framework; however, IFRS does not address CIC which is an activity unique to central banks. It is accepted practice that CIC is recognized as a liability among central banks since it creates an obligation of the central bank to the banknote holder.

## Accounting

The following journal entries relate to each stage of the life cycle and reflect the three elements in the framework referred to above.

### A. Printing process

There are no accounting entries recorded at the initial stage of the life cycle as this normally occurs external to the central bank.

### B. Reception of new banknotes in the central bank from the printing company (stored in vault)

Record in “control accounts” that are maintained off-balance sheet since the banknotes are “simply paper” at this point. See discussion below on Control Accounts.

<b>CONTROL ACCOUNTS – OFF BALANCE SHEET ACCOUNTS (NON-REFLECTED IN THE PUBLIC FINANCIAL STATEMENTS)</b>		
	Debit	Credit
Notes on hand	XXXX	
Notes on existence		XXXX
To reflect the total face value of the new printing banknotes stored in central bank vaults.		

### C. Placing banknotes in circulation

	Debit	Credit
Accounts receivable	XXX	
Currency in circulation		XXXX
To reflect the obligation of the central bank when the Banknotes are place in circulation. CIC is a liability account. Account Receivable represents consideration received for currency (usually another currency)		

<b>CONTROL ACCOUNTS – OFF BALANCE SHEET ACCOUNTS (NON-REFLECTED IN THE PUBLIC FINANCIAL STATEMENTS)</b>		
	Debit	Credit
Notes on existence	XXXX	
Notes on hand		XXXX
To reflect the reduction of the Banknotes held in the vault of the Central Bank		

### D. Withdrawing banknotes from circulation

	Debit	Credit
Currency in circulation	XXX	
Accounts payable		XXXX
To reflect the decrease in a central bank’s obligation or liability when banknotes are withdrawn from circulation.		

<b>CONTROL ACCOUNTS – OFF BALANCE SHEET ACCOUNTS (NON-REFLECTED IN THE PUBLIC FINANCIAL STATEMENTS)</b>		
	Debit	Credit
Notes on hand	XXXX	
Notes on existence		XXXX
To reflect the increase of the banknotes held in the vault of the Central Bank		

## **E. Counting and sorting used banknotes withdrawn from circulation**

Banknotes that are withdrawn from circulation and returned to the central bank will be cleaned, sorted and classified and possibly destroyed. This is an activity conducted by the cash management function. The banknotes that are not destroyed will remain in the vault of the central bank. These notes are considered “pending to be classified and counted.”

Most central banks have agreements with commercial banks to process the notes and consider the treatment of possible differences between the amount declared by the commercial bank and the final result after the counting and sorting.

In addition, central banks may use single or multiple vaults for storing banknotes and when banknotes are returned from circulation they may or may not be considered under the central bank’s control. If multiple vaults are used, the central bank will need to devise a system to control the returns.

Control accounts may be used for these operations:

- Notes on hand - Pending to be counted and sorted and the contra-account.
- Notes in existence - Pending to be counted and sorted.
- Both accounts will reflect the same outstanding balance.

The banknotes deemed to be fit to be recirculated need to be reflected in the control accounts: “Notes on hand” and “Notes on existence”. The banknotes classified as not deemed to be fit to recirculate also need to be reflected through the accounts.

The result of the counting normally reflects three different situations:

- Banknotes fit to be recirculated so they will need to be stored in the vaults pending circulation.
- Banknotes not suitable to continuous circulation, and they have to be stored pending to be destroyed.
- Banknotes suspicious of being counterfeit need to be analyzed. Normally the agreements with commercial banks indicate that the banknotes deemed to be counterfeit are not accepted as valid and will be destroyed. They need to be stored pending a further analysis.

## **F. Banknotes in transit**

These are banknotes outside the central bank, but under its control. For example, banknotes in transit between branches are considered as banknotes in the vault of the central bank and consequently are not considered CIC and thus no liability will need to be recorded. Only entries in off-balance sheet accounts reflecting the “on transit” should be made.

## **G. Accounting for the printing cost**

The cost of banknotes (“currency not yet placed in circulation”) should be expensed as the banknotes are placed into circulation in accordance with the accrual concept of accounting (the “inventory approach”). Under this approach, the central bank will need to start maintaining

inventory records for banknotes (by denomination) using either the first-in/first-out (FIFO) or weighted average cost method for determining cost.

The central bank will record inventory when shipments are received:

	Debit	Credit
Inventory	XXX	
Accounts payable		XXXX
To reflect the total of printing cost due		

Upon each issuance of banknotes into circulation, the central bank will recognize the expense of the printing cost associated with the banknotes.

	Debit	Credit
Banknotes printing cost expense	XXX	
Inventory		XXXX
To recognize the expense after banknotes are issued into circulation.		

Given that the CBS will be issuing the first new notes into circulation very rapidly (during an ‘introduction period’), this would support a policy that would effectively establish a deferred asset for those notes issued into circulation during the introduction period and amortize the production cost of these notes over a reasonable ‘useful’ life. Thus, instead of recognizing the production costs of the notes issued initially during the introduction period as an expense all at once, the printing expense would be amortized over a reasonable amount of time—e.g, four years—thus smoothing the expense recognition over the period in which the benefit is obtained. The ‘introduction period’ could be defined as the lesser of (i) the timeframe over which the CBS expects to issue approximately 90 percent of its target level of notes; and (ii) one year. For this amortization of the deferred asset, the sum-of-years digits cost formula could be used and a notional banknote asset or deferred cost account would be created which would then be charged for the expense over the four year period. The sum-of-years digit formula is recommended as it will provide a smooth expense profile over the period as replacement notes begin to be introduced in years subsequent to the initial introduction. All new notes issued into circulation after the initial introduction on a regular basis would be accounted for under the inventory approach described above.

## H. Use of “Control” accounts

These accounts are normally off- balance sheet accounts and not reflected in the public financial statements. The accounts only reflect the banknotes that are physically inside the central bank. The central bank needs to “control” the inventory of notes.

- Notes on hand. Reflect the asset side of the off- balance sheet account.
- Notes in existence (in vaults). Reflect the liability side of the off-balance sheet account.
- Both accounts, Notes on hand and Notes in existence, off-set each other so if one is debited the other must be credited by the same amount, and vice versa.
- Notes on hand and Notes in existence can be split into sub accounts to reflect the existences of different banknotes distributed by face value.

- Normally at the end of each working day, a single entry either increasing or decreasing the banknotes in the central bank must be made to reflect the total movements of banknotes during the day.

Other examples that reflect the period of time the banknotes are inside the central bank will include: banknotes pending to be sorted and classified; banknotes pending to be destroyed; and banknotes in transit.

## Appendix VIII. Foreign Currency Operations

### Description

Currently the CBS is conducting operations using a single currency, the USD, so this can also be considered their functional currency as it is used in the vast majority of the transactions. In the near future with the introduction of a national currency in Somalia, the USD should not be the functional currency. At that time, cross-currency, or foreign currency operations will increase.

A simple definition of cross-currency operation is the use of two foreign currencies to complete an operation. In the future, the CBS will receive funds in accounts in USD, EUR, GBP or others that will need to be converted to other currencies. As an example, the CBS can initiate a transfer of funds in EUR using an USD account, or can receive some funds in EUR to credit an account in USD.

### Basic assumption

As explained in other documents connected to forex operations, the CBS should establish a source and criteria to determine the rate of exchange to use in forex operations to obtain an equivalent in local currency. In the case of operations involving two foreign currencies, it is necessary to establish an additional condition to register the operation.

If we follow the normal rules to transform foreign currency into domestic currency for the two currencies of the operation, the rate of exchange will vary each time. For this reason, it is necessary to establish a rule to obtain the cross/currency rate.

A proposal to consider, as reference, is the price in term of domestic currency of one of the foreign currency involved in the operation, and with the amount of local currency equivalent to the foreign currency to obtain the rate of exchange that permit transform the foreign currency into local currency.

We can consider the currency purchased as Leg 1, and the currency sold as Leg 2. As an example, we will consider the rate associated with selling currency as the relevant rate, in our example, Leg 2.

### Example

The CBS receives two statements from different correspondent commercial banks, one in USD and other in EUR, both operations are linked.

The amounts that appear in the statements are the following:

- Statement 1. Account in USD, transfer received on behalf of CBS 100 USD, IN-PURCHASE
- Statement 2. Account in EUR, withdrawn from the CBS account, to send to the correspondent in USD 85 EUR, OUR-SALE

To transform into local currency (85 EUR), it is necessary to consider the local rules. According to those rules, the relevant rate of exchange is 20 units of local currency is equivalent to 1 EUR.

In terms of local currency, the amount is an OUT of  $(20 * 85 = 1,700)$

With this, the amount of IN in terms of local currency for the received transfer of 100 USD is, 17 units of local currency per 1 USD.

The transformation of USD is an IN of  $(1,700 = 100 * 17)$

### Examples of entries

All the monetary holdings of a single foreign currency (FC) must be considered as a fungible item and all of them have the same cost, without considering the nature of the account that reflect those holdings, as examples, accounts in correspondent banks, investments (deposits, securities, loans, and so on and so for.

The holdings in FC and the cost of the holdings must be maintained in a separate register with the capacity to determine the holdings, the cost, and the gain or loss of the operation.

Date	Accounts	Debit	Credit
02-01-2001	Accounts in Foreign Currency Any account in FC Purchase of 25 units of FC	300	
	Accounts in LC		300
The operation reflects the purchase of FC, as example, a transfer received in a correspondent bank in FC, the credit account reflects the reception of the purchase and the final destination of the funds, as example a Government account.			
The rate of exchange used to determine the amount in LC of the FC purchases according to local rules.			

Date	Accounts	Debit	Credit
04-01-2001	Accounts in LC	220	
	Profit and loss for the current year	20	
	Accounts in Foreign Currency Any account in FC Sale of 20 units of FC		240
The operation reflects the sale of FC, as example, a transfer sent to a customer in FC, the credit account reflects the exit of the funds in our correspondent bank, and the debit the charge of those funds in the sender, as example a Government account that gives the order to pay an amount in FC through the Central Bank accounts.			
The second debit account reflects the gain/loss of the operation, according to the calculations and explanations (see documents 1 and 2).			
The rate of exchange used to determine the amount in LC of the FC sales according to local rules.			

Date	Accounts	Debit	Credit
09-01-2001	Accounts in Foreign Currency Any account in FC Purchase of 1.000 units of FC	13.000	
	Accounts in LC Any account in LC		13.000
The operation reflects the purchase of FC.			
The rate of exchange used to determine the amount in LC of the FC purchases according to local rules.			



Date	Accounts	Debit	Credit
09-01-2001	Accounts in LC	1.188	
	Profit and loss for the current year	99	
	Accounts in Foreign Currency Any account in FC Sale of 99 units of FC		1.287
	The operation reflects the sale of FC.  The second debit account reflects the gain/loss of the operation, according to the calculations and explanations (see documents 1 and 2).  The rate of exchange used to determine the amount in LC of the FC sales according to local rules.		

Date	Accounts	Debit	Credit
10-01-2001	Accounts in Foreign Currency Any account in FC Purchase of 100 units of FC	1.200	
	Accounts in LC Any account in LC		1.200
	The operation reflects the purchase of FC.  The rate of exchange used to determine the amount in LC of the FC purchases according to local rules.		

Date	Accounts	Debit	Credit
10-01-2001	Accounts in LC	1.800	
	Accounts in Foreign Currency Any account in FC Sale of 120 units of FC		1.457,43
	Profit and loss for the current year		342,57
	The operation reflects the sale of FC, the amount, is the cost of the purchases of the day, plus, the net sale of 20 multiplied by the average cost of holdings.  The second credit account reflects the gain/loss of the operation, according to the calculations and explanations (see documents 1 and 2).  The rate of exchange used to determine the amount in LC of the FC sales according to local rules.		

### Forex calculations spreadsheet – Explanatory notes

The spreadsheet reflects the movements of **Monetary** foreign currency and how to convert those movements into local currency. The method to calculate the cost of the holdings and the exchange gain or loss is the Weighted average cost formula, according to IAS 2 Inventories.

This document is organized as follows:

- A. Basic definitions
- B. Previous considerations
- C. Explanation of the columns and in/out and the spreadsheet

### **Basic definitions (IAS 21. The effects of changes in foreign exchange rates:**

- 8 Spot exchange rate is the exchange rate for immediate delivery.  
Closing rate is the spot exchange rate at the end of the reporting period.  
Exchange difference is the difference resulting from translating a given number of units of one currency into another currency at different exchange rates.  
Exchange rate is the ratio of exchange for two currencies.  
Monetary items are units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency.
- 21 A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.
- 22 The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with IFRS.
- 23 At the end of each reporting period:
  - (a) foreign currency monetary items shall be translated using the closing rate.
- 28 Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous financial statements shall be recognized in profit or loss in the period in which they arise, except as described in Para. 32.

### **Previous considerations**

#### **Source of rates of exchange**

It is necessary to establish a source of information to serve as repository of data. It is advisable to obtain a source easily accessible and reliable. As an example, the European Central Bank provides daily rate of exchange of the Euro versus the most frequent trades currencies.

#### **Basic conventions**

Normally operations in the foreign market have some conventions to establish the settlement date and the trade date. The trade date is the date in which the operation was conducted, and settlement date is the date in which the operation is completely fulfilled. A normal convention in forex transactions is “Settlement date = Date trade + 2 (working days)”, other possibilities could be considered.

Other agreements to determine the date to obtain the rate of exchange can be considered, in operations with special customers (treasury, employees).

Number of decimal positions when the rate of exchange is calculated.

In some occasions the rate of exchange for purchase or for sales are not the same and are included surcharges for the sales to obtain a gain in sales operations. This normally involves some discretionally and the gains obtained are very small.

## Explanation of the columns and in/outs and the spreadsheet

### Date

Accounting date. As this is a simple spreadsheet, the rest of relevant dates for the determination of cost of inventories, should be considered outside this spreadsheet, as example, settlement date, transaction date, and so on and so for, In an accounting date can be included more than one operation in forex with different settlement dates and for any of them should be included the rate of exchange to determine the total foreign currency to transform in local currency. The most noticeable could be a transaction not received in the central bank and posted in the accounts in a later moment in time.

### Holdings

- a. (2) initial and (16) final FC Inventories in Foreign currency. The total inventories in one single currency (monetary items) as example, total inventories of EUR.
- b. (3) initial and (17) final LC. Holdings of foreign currency valued in local currency.
- c. (4) initial and (18) final rate. Is the result of the division between LC and FC.

$$(4) = (3) / (2)$$

$$(18) = (17) / (16)$$

The operation changes depending if the rate of exchange is direct or indirect, but the sense is the same.

### IN Purchases

- d. (5) FC. It determines one of the data in the spreadsheet, this amount is normally reflected in the statement of the forex correspondent (as example a transfer received in a foreign commercial bank).
- e. (7) Rate. The rate of exchange to convert foreign currency into local currency, According to the source of information.
- f. (6) LC. It is the result of multiply (7) Rate by (5) FC and represents the transformation of the IN Purchase in Local currency, If there is in the same day more than one operation, according to the rules to determine the rate to apply, more than one rate of exchange can be applied. An adequate registry of all the operations performed should be maintained.

$$(6) = (7) \times (5)$$

### Out Sales

- g. (8) FC It determines one of the data in the spreadsheet, this amount is normally reflected in the statement of the forex correspondent (as example a transfer sent to a foreign commercial bank)
- h. (10) Rate. The rate of exchange to convert foreign currency into local currency, According to the source of information.
- i. (9) LC It is the result of multiply (10) Rate by (8) FC and represents the transformation of the OUT Sales in Local currency, If there is in the same day more than one operation, according to the rules to determine the rate to apply, more than one rate of exchange can be applied, an adequate registry of all the operations performed should be maintained.

### Net In-Out

- j. Column (11) is used to determine the total amount of FC that has to be included into the holdings, if column (5) is bigger than (8) or detracted from the holdings, if there is a Sale net (8) bigger than (5),

$$(11) = (5) - (8)$$

- k. Column (12) is used to determine the total amount of LC that has to be included or deducted from the holdings.

The formula is

If Purchase  $\geq$  Sales, total purchases in LC minus Sales in FC transformed in LC with the average rate of purchases.

If Purchases  $<$  Sales, the net sales multiplied by the average rate of exchange in column 4.

If Purchases = Sales in LC are equal at Purchases in LC.

### **Cost of Sales Net**

- l. Column (13) is used to determine the cost of the total amount of sales. The sales of the day, first are compared with the purchases of the day, to determine the gain or loss within the day, and later on if there are more sales, they are compared with the average cost at the beginning of that day to register the total gain or loss of the day.

If purchase  $\geq$  sales, the total of sales is compared with the purchases of the day.

If purchases  $<$  sales, the cost of sales is formed by two amounts, the first is the total amount of purchases of the day in LC and the second is the difference between purchases and sales in Forex (the sales net), multiplied by the average rate of exchange at the beginning of the day.

### **Gains/Losses**

- m. Column (14) shows the gain/loss of the day.

If column (11) is a purchase net, the gain or the loss is the difference between the rate of purchase and the rate of sale multiplied by the FC sold. The first comparison to calculate the gain or the loss is to compare the price of purchases and the price of sales.

If FC purchase  $>$  FC sold, net gain or loss is (rate of purchases – rates of sales) multiplied by the FC sold.

If column (11) is a sale net, the gain or the loss is the total of two different amounts, the first is the comparison between the rate of the purchase for that day and the rate of sales for that date for the sales than are equals in FC to the purchases, and the difference between the rate of exchange of the rest of the sales compared with the average cost at the beginning of that day.

If FC purchases  $<$  FC sold, net gain or loss is (rate of purchases – rates of sales) multiplied by the FC purchases, plus, (rate of sales – average holdings rate at the beginning of that day) multiplied by the net sales FC.

### **Accumulated gain or loss for the year.**

- n. Column (14) Is the accumulation of gains and losses for the current year.

## Explanation of Some of the Lines

- 01-01-01. Reflect the holdings at the beginning of the exercise, amount in FC and in LC are data and the rate of exchange is a calculation  $(4) = (3) / (2)$
- 01-01-02. Columns (2), (3) and (4) reflect the information at the beginning of that day. Column (5) is data and represents the total of purchases on that day. Column (7) reflects the rate of exchange for that day, according to the conventions used in the central bank. Column (6) is the calculation in LC,  $(6) = (5) * (7)$   
Columns (11) and (12) reflect the Net Purchase.
- 01-01-03. Columns (2), (3) and (4) reflect the information at the beginning of that day. Columns (16), (17) and (18) reflect the information at the end of that day. Column (16) is the sum of previous holdings and net purchase of the day. Column (17) is the sum of previous holdings and net purchase of the day. Column (18) is the new rate of exchange after the purchases. THE AVERAGE RATE OF EXCHANGE CHANGES WHEN THERE ARE PURCHASES NET AND REMAIN CONSTANT WHEN THERE ARE SALES NET.  
New Purchase and equal treatment
- 01-01-04. Column (8) is a data and represents the total of sales of that day. Column (10) reflects the rate of exchange for that day (for the sales, it can be the same that for the purchases, to follow the examples different rates of exchanges have been used) according to the conventions used in the central bank. Column (9) is a calculation in LC,  $(9) = (8) * (10)$   
Column (11) is the sale net of the day. Column (12) represents the transformation in LC of the FC sold, on that day there is not any purchase, and for this reason, all the sales have to be valued at average cost of the holdings, to determine the amount to deduct from previous holdings and to determine the gain or loss of the day.  
The sale of that day is 20, and the rate 11,00000, the LC is  $(20 * 11 = 220)$ , compared with the holdings  $(20 * 12 \text{ (average cost)} = 240)$  represents a net out of 240 and a net loss of 20 (column (14))
- 01-01-05. Sale net
- 01-01-06. Sale net
- 01-01-07. Sale net
- 01-01-08. In this line there is a purchase and a sale for the same amount, the result in FC net is zero and in LC, the cost of sales (12,75) is 12, (the purchase price) and the gain or loss, is 0,75, the difference between the purchase price and the sale price.
- 01-01-09. The purchase is FC 1.000 and LC 13.000; the sale is FC 99 and LC 1.188, the net in-out is FC 901 and LC 11.713.  $(901 * 13)$ ; the gain or loss of the day is  $-99 (99 * (12-13))$
- 01-01-10. Similar operations till the end of the year
- 01-12-31. Holdings at year end, FC 621, LC 7.946,80 Rate of exchange 12,796778.  
Rate of exchange al the year end (closing rate) is, according to the convention established in the central bank is 13, the valuation at the year-end is  $(621 * 13,10 = 8.135,10)$ , and the difference with the holdings in LC 7.946,80 is the revaluation at the year-end, 188,30.  
The holdings carried on to the following year are in FC 621, and in LC 8.135,10 with a rate of exchange of 13,10  
The year 2002 presents the same type of operations, and at the year-end the holdings are in FC 610 and in LC 7.761,63, with the average rate of exchange, 12,723978; and the closing rate of exchange 12,40, this involves a loss of 197,63.  $(610 * (12,40 - 12,723978)) = -197,63$

## Appendix IX. Average Method of Calculating the Exchange Rate for Foreign Currency Transactions

Date	Initial Holdings			IN Purchases			OUT SALES			NET IN-OUT		Final Holdings			Cost of sales NETS	Gains Loss	Accumulated Gains/Losses	
	FC	LC	Rate	FC	LC	Rate	FC	LC	Rates	FC	LC	FC	LC	Rate				
1/19/2001	759.00	9,711.54	12.795172	12.00	156.00	13.000000	6.00	84.00	14.000000	6.00	78.00	765.00	9,789.54	12.796778	0.00	6.00	232.29	
12/31/2001	765.00	9,789.54	12.796778	100.00	1,150.00	11.500000	244.00	3,172.00	13.000000	-144.00	-1,842.74	621.00	7,946.80	12.796778	2,992.74	179.26	<b>411.55</b>	accumulated during the year
<b>year-end</b>	621.00	7,946.80	12.796778				621.00	8,135.10	13.100000	-621.00	-7,946.80	<b>621.00</b>	<b>8,135.10</b>	<b>13.100000</b>	7,946.80	188.30	<b>188.30</b>	revaluation at the year end
<b>new-year</b>																		
1/1/2002	621.00	8,135.10	13.100000	200.00	2,246.00	11.230000	100.00	1,400.00	14.000000	100.00	1,123.00	721.00	9,258.10	12.840638	0.00	277.00	277.00	
1/2/2002	721.00	9,258.10	12.840638	120.00	1,608.00	13.400000	120.00	1,350.00	11.250000	0.00	0.00	721.00	9,258.10	12.840638	1,608.00	-258.00	19.00	
1/3/2002	721.00	9,258.10	12.840638	234.00	2,808.00	12.000000	290.00	3,575.70	12.330000	-56.00	-719.08	665.00	8,539.02	12.840638	3,527.08	48.62	67.62	
1/4/2002	665.00	8,539.02	12.840638	190.00	2,090.00	11.000000	145.00	1,798.00	12.400000	45.00	495.00	710.00	9,034.02	12.723978	0.00	203.00	270.62	
12/31/2002	710.00	9,034.02	12.723978	228.00	2,565.00	11.250000	328.00	4,132.80	12.600000	-100.00	-1,272.40	610.00	7,761.63	12.723978	3,837.40	295.40	<b>566.03</b>	accumulated during the year
<b>year-end</b>	610.00	7,761.63	12.723978				610.00	7,564.00	12.400000	-610.00	-7,761.63	<b>610.00</b>	<b>7,564.00</b>	<b>12.400000</b>	7,761.63	-197.63	<b>-197.63</b>	revaluation at the year end
<b>new-year</b>																		
1/1/2003	610.00	7,564.00	12.400000	136.00	1,632.00	12.000000	89.00	1,085.80	12.200000	47.00	564.00	657.00	8,128.00	12.371385	0.00	17.80	17.80	
1/2/2003	657.00	8,128.00	12.371385	26.00	309.14	11.890000	56.00	672.00	12.000000	-30.00	-371.14	627.00	7,756.86	12.371385	680.28	-8.28	9.52	
1/3/2003	627.00	7,756.86	12.371385	224.00	2,688.00	12.000000	224.00	2,665.60	11.900000	0.00	0.00	627.00	7,756.86	12.371385	2,688.00	-22.40	-12.88	
1/4/2003	627.00	7,756.86	12.371385	100.00	1,200.00	12.000000	100.00	1,300.00	13.000000	0.00	0.00	627.00	7,756.86	12.371385	1,200.00	100.00	87.12	
1/5/2003	627.00	7,756.86	12.371385	226.00	2,712.00	12.000000	224.00	3,158.40	14.100000	2.00	24.00	629.00	7,780.86	12.370204	0.00	470.40	557.52	
1/6/2003	629.00	7,780.86	12.370204	1.00	13.00	13.000000	2.00	30.00	15.000000	-1.00	-12.37	628.00	7,768.49	12.370204	25.37	4.63	562.15	
1/7/2003	628.00	7,768.49	12.370204	2.00	24.00	12.000000	1.00	13.00	13.000000	1.00	12.00	629.00	7,780.49	12.369616	0.00	1.00	563.15	
1/8/2003	629.00	7,780.49	12.369616	100.00	1,200.00	12.000000	100.00	1,250.00	12.500000	0.00	0.00	629.00	7,780.49	12.369616	1,200.00	50.00	613.15	
1/9/2003	629.00	7,780.49	12.369616		0.00	12.120000	224.00	2,464.00	11.000000	-224.00	-2,770.79	405.00	5,009.69	12.369616	2,770.79	-306.79	306.35	
1/10/2003	405.00	5,009.69	12.369616	1.00	12.25	12.250000	2.00	24.80	12.400000	-1.00	-12.37	404.00	4,997.32	12.369616	24.62	0.18	306.53	
1/11/2003	404.00	4,997.32	12.369616	1.00	11.00	11.000000	159.00	2,067.00	13.000000	-158.00	-1,954.40	246.00	3,042.93	12.369616	1,965.40	101.60	408.14	
1/12/2003	246.00	3,042.93	12.369616	233.00	3,262.00	14.000000	224.00	2,800.00	12.500000	9.00	126.00	255.00	3,168.93	12.427159	0.00	-336.00	72.14	
1/13/2003	255.00	3,168.93	12.427159															

**Appendix X. Transitioning to IFRS**

## I. Policy Decision

- Obtain commitment from Governor to adopt IFRS by X date
- Draft Accounting Policy Statement and obtain approval from Board and Audit Committee
  - Carve outs allowed?
  - Big bang or convergence approach?
- Who is in charge of the IFRS project?

### ACCOUNTING POLICY STATEMENT

The Board of Directors of Bank has approved [Name of Bank's] adoption of International Financial Reporting Standards (IFRS) as its accounting standards in [Date 20XX]. Accordingly, [Name of Bank] is committed to issue its first IFRS-complied financial statements as of [Date 20XX] and onward. The adoption of IFRS will significantly enhance the transparency, comparability, and relevance of [Name of Bank's] financial statements and allow stakeholders to gain a better understanding of its operations and management practices.



## II. The Transition Plan

- Form an IFRS team
  - Leader must be able to devote 100 percent of their time
  - Include all business departments
- Develop Timeline (including deadlines and milestones)
- Consider issues not covered by IFRS
  - Gold holdings
  - Currency in circulation

## II. The Transition Plan Continued

- Measure impacts
  - Financial statements
  - IT systems
  - Processes
- Start applying accounting policies and practices (i.e., accounting framework establishment)
  - Apply accrual accounting
  - Recognize liabilities
- Ensure continuous training
- Study IFRS 1

### Matrix of Impacts

Components	Impacts		
	Financial	Technological	Processes
Cash USD	Low impact		
Cash SOS	Moderate impact		
Gold	Moderate impact		
Balances due from Financial Institutions			
IMF Accounts	High impact	High impact	High impact
Property Plant Equipment			
Intangible Assets			
Treasury deposits			
Security deposits			
Microfinance grant			
Other payables			
Administrative Expenses			
Foreign Exchange Revaluations	Moderate impact	Moderate impact	High impact
Reserves			
Equity	High impact		

Low impact	Green
Moderate impact	Yellow
High impact	Red

### Financial Impact



A.1 Effect of IFRS adoption for the statement of financial position

CU million	Notes	As at 01/01/2013 [date of transition]		As at 31/12/2012 [end of last period presented under previous GAAP]			
		Previous GAAP	Effect of transition to IFRS	Opening IFRS Statement of Financial position			
				Previous GAAP	Effect of transition to IFRS	IFRS	
Property, plant and equipment		75,973	-	75,973	96,680	-	96,680
Goodwill	f	1,567	-	1,567	5,504	739	6,234
Intangible assets	k	200	2,056	2,256	943	2,458	3,401
Financial assets	j	2,080	16	2,716	4,065	16	4,081
<b>Total non-current assets</b>		<b>80,420</b>	<b>2,092</b>	<b>82,512</b>	<b>107,192</b>	<b>3,204</b>	<b>110,396</b>
Trade and other receivables		12,943	-	12,943	14,630	-	14,630
Inventories	m	6,868	1,286	8,154	12,270	1,571	13,841
Other receivables		4,711	-	4,711	4,963	-	4,963
Long-term bonds held for sale		7,158	-	7,158	3,902	-	3,902
Cash and cash equivalents		13,959	-	13,959	19,547	-	19,547
<b>Total current assets</b>		<b>45,639</b>	<b>1,286</b>	<b>46,925</b>	<b>55,322</b>	<b>1,571</b>	<b>56,896</b>
<b>Total assets</b>		<b>126,059</b>	<b>3,378</b>	<b>129,437</b>	<b>162,514</b>	<b>4,775</b>	<b>167,292</b>
Interest-bearing loans	n	36,111	(1,405)	34,706	59,087	(2,272)	56,815
Trade and other payables	c	9,574	309	9,883	10,045	238	10,283
Reserve for provisions	g	1,000	(1,000)	-	2,180	(2,180)	-
Dividends to shareholders	d	1,560	(1,560)	-	1,824	(1,824)	-
Current tax liability		1,053	-	1,053	962	-	962
Deferred tax liability	h	2,384	1,736	4,120	4,855	2,249	7,104
<b>Total liabilities</b>		<b>51,690</b>	<b>(1,920)</b>	<b>49,770</b>	<b>79,753</b>	<b>(2,789)</b>	<b>76,964</b>
<b>Total assets less total liabilities</b>		<b>74,369</b>	<b>5,306</b>	<b>79,675</b>	<b>82,761</b>	<b>7,564</b>	<b>90,328</b>
Issued capital		22,800	-	22,800	22,800	-	22,800
Share premium		16,559	-	16,559	16,559	-	16,559
Revaluation reserve		1,313	-	1,313	1,899	-	1,899
Available-for-sale securities reserve	j	-	25	25	-	11	11
Hedging reserve	c	-	(309)	(309)	-	(238)	(238)
<b>Retained earnings</b>	<b>3.3.4.4.4</b>	<b>33,697</b>	<b>5,590</b>	<b>39,287</b>	<b>41,503</b>	<b>7,791</b>	<b>49,294</b>
<b>Total equity</b>		<b>74,369</b>	<b>5,306</b>	<b>79,675</b>	<b>82,761</b>	<b>7,564</b>	<b>90,328</b>

### III. The Resources

- Who will provide support?
  - Management
  - High Quality External Auditor
  - Network of colleagues at other central banks
  - Colleagues in other departments
  - IASB
  - <http://www.ifrs.org/>
  - IMF, World Bank
- Who will assist?
  - Sufficient internal resources

## Phases of IFRS Project



## Starting Point -- Initial Steps

Obtain Commitment from Governor to Implement IFRS and Issue Accounting Policy Statement

Appoint someone in charge to lead project who is able to commit 100 percent of time

Design Road Map for transition with deadlines

## Starting Point -- Initial Steps

Obtain Commitment from Governor to Implement IFRS and Issue Accounting Policy Statement

Appoint someone in charge to lead project who is able to commit 100 percent of time

Design Road Map for transition with deadlines

## Summary of IFRS 1

1. An opening IFRS statement of financial position is prepared at the date of transition. This is the starting point for an entity's accounting in accordance with IFRSs. The date of transition is the beginning of the first period for which an entity presents full comparative information under IFRSs in its first IFRS financial statements. For entities that present one year of comparative information in their financial reports, the date of transition is the first day of the comparative period.
2. In its first IFRS financial statements, an entity applies the version of IFRSs effective at the end of its first IFRS reporting period. As a general principle, all IFRSs effective at that date are applied retrospectively, subject to certain exceptions and exemptions set out in IFRS 1. For example, an entity with a December year end that presents its first IFRS financial statements for its 2009 reporting period applies all IFRSs effective at 31 December 2009.
3. The entity recognises all assets and liabilities in accordance with the requirements of IFRSs, and derecognises assets and liabilities that do not qualify for recognition under IFRSs.
4. All adjustments resulting from the application of IFRSs to the opening IFRS statement of financial position are recognised in retained earnings (or, if appropriate, another category of equity) at the date of transition, except for reclassifications between goodwill and intangible assets.
5. With limited exceptions, estimates in accordance with IFRSs at the date of transition must be consistent with estimates made for the same date under previous GAAP.
6. An entity's first IFRS financial statements include at least three statements of financial position (including one at the date of transition, i.e. at the beginning of the comparative period), two statements of comprehensive income, two income statements (if presented), two statements of cash flows and two statements of changes in equity. All of these statements must be in compliance with IFRSs.
7. Entities are permitted to present historical summaries of certain data for periods before the date of transition which do not comply with IFRSs, as long as the information is prominently labelled as not being prepared in accordance with IFRSs. Where such information is presented, the entity must also explain the nature of the main adjustments that would be required to render the information compliant with IFRSs.

## IFRS 1 – First Set of IFRS Statements

- 3 statements of financial position (including one at the date of transition, i.e. at the beginning of the comparative period),
- 2 statements of comprehensive income,
- 2 income statements,
- 2 statements of cash flows and
- 2 statements of changes in equity

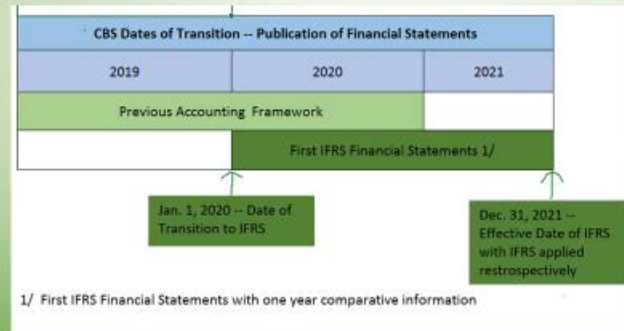
\*\* All of these statements must be in compliance with IFRS. \*\*

## IFRS 1

### Concepts

- Previous GAAP: Basis of accounting used before adopting IFRS
- Date of Transition to IFRS
  - First day of the comparative period
  - An opening IFRS statement of financial position is prepared at the date of transition
- Effective Date of IFRS
  - IFRS is applied retrospectively to comparative period
  - Use the version of IFRS that is effective at the end of the first reporting period

## Suggested Timeline for IFRS Adoption



## Major Points

- The entity **recognizes** all assets and liabilities in accordance with the requirements of IFRSs, and **derecognizes** assets and liabilities that do not qualify for recognition under IFRSs.
- All adjustments resulting from the application of IFRSs to the opening IFRS statement of financial position are **recognized in retained earnings** (or, if appropriate, another category of equity) at the date of transition, except for reclassifications between goodwill and intangible assets.

## Major Points

- Additional Disclosures for First IFRS Statements
  - Reconciliations between amounts reported under previous GAAP and IFRS
- Explaining the Transition
  - The transition to IFRSs has resulted in the following changes in accounting policies:
- Supplementary Explanations
- What might apply in CBS case?

### Recognition and derecognition examples under IFRSs

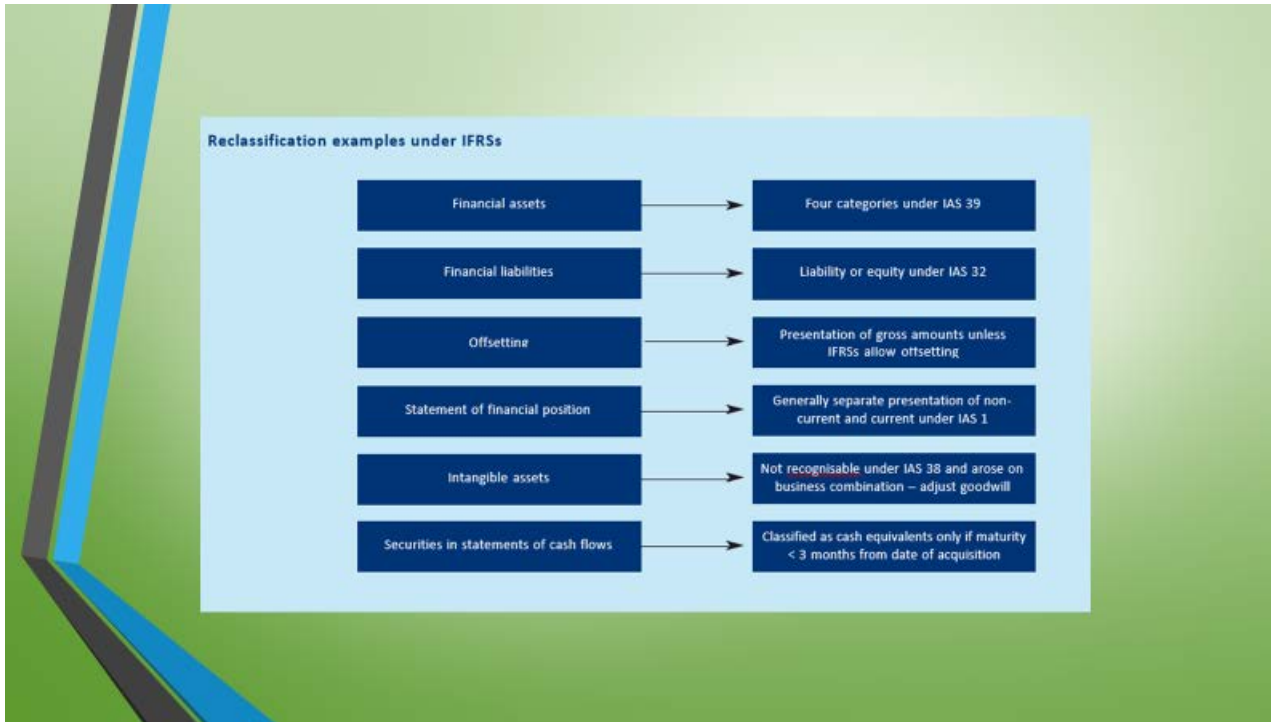
#### Recognise

Pension liabilities  
Deferred tax assets and liabilities  
Finance lease assets and liabilities  
Provisions, only if legal or constructive  
Derivative financial instruments  
Acquired intangible assets  
Internal development costs

#### Derecognise

Provisions, if no present obligation  
General reserves as liabilities  
Deferred tax assets, if not probable  
Treasury shares as assets  
Intangible assets not meeting criteria







## IFRS 1

- Deloitte First-time adoption of International Financial Reporting Standards
  - A guide to IFRS 1
  - <https://www.iasplus.com/en/news/2009/November/news5221>

**Appendix XI. Internal Audit Training**

# IMF & Central Bank of Somalia

## Internal Auditing Training Session

### Introductory Meeting

March 10-14, 2018

Kampala, Uganda

## Agenda

- ▶ Introduction
- ▶ Mission Objective
- ▶ Product
- ▶ Agenda for the week
- ▶ Stocktaking

## Introduction-IMF

- ▶ Nancy Rawlings: Mission Chief
- ▶ Jose-Miguel Garcia: Expert
- ▶ Sha Wen: Expert

## Introduction-CBS Internal Auditing Team

Please introduce yourself!

- ▶ Hussein Shuaib Osman
- ▶ Faisal Abukar Sufi
- ▶ Mohamoud Ahmed Yusuf
- ▶ Background
  - ▶ How long have you worked at the CBS?
  - ▶ What role/ responsibilities do you have in the accounting department?
  - ▶ What do you hope to accomplish this week?

## Objectives of Mission - Internal Auditing

- ▶ To conduct a stocktaking of the previous assignments and discuss issues arising from the assignments, including deadline adjustments.
- ▶ To review the risk assessment methodology covered in previous mission with focus on issues arising from the assignments
- ▶ To identify potential audits for next audit year (or next quarter).
- ▶ To introduce methodology to plan an audit (including risk assessment at micro-level)
- ▶ To develop one audit program for at least one selected audit

## Products

- ▶ A report will be produced summarizing the mission discussions, homework assigned, and expectations for the next training mission.

## Agenda for the Week

- ▶ Agenda is a broad outline of topics we will cover
- ▶ Flexibility based on length of time we spend on each topic
  - ▶ 8:30 start
  - ▶ Mid morning break
  - ▶ Lunch break
  - ▶ Afternoon break
  - ▶ 4:00 end
- ▶ Review Agenda

## II. Stocktaking

### Objectives

- ▶ Understand the updates and on-goings related to internal audit, governance, and risk management at CBS (e.g., new strategy, expectation change from senior management, meetings of BoD or the Audit and Governance Committee)
- ▶ Understand and document the progress by CBS team on implementing the recommendations (homework assignments) of last mission
- ▶ Identify and discuss challenges, issues, and updates since the last mission

## Updates of CBS

- ▶ Updates about internal audit  
(staff, new training, expectation changes from management, new assignments)
- ▶ Updates about governance arrangements
- ▶ Updates about risk management function
- ▶ Updates about CBS overall  
(initiatives, strategy change, new functions or major IT systems, leadership)

## Internal Audit Charter

Recommendation: Update the proposed internal audit charter with CBS circumstances and submit it to governor and Audit and Governance Committee (or the BoD) for discussion and approval.

Targeted timeline: 12/31/2017

Status:

Challenges:

Other Issues:

## Internal Audit Charter

Recommendation: Update the proposed internal audit charter with CBS circumstances and submit it to governor and Audit and Governance Committee (or the BoD) for discussion and approval.

Targeted timeline: 12/31/2017

Status:

Challenges:

Other Issues:

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Targeted timeline: 12/31/2017

Status:

Challenges:

Other Issues:



## Audit Committee Charter

Recommendation: Update and submit the drafted audit committee charter to the governor and the Audit and Governance Committee (or the BoD) for discussion and approval.

Targeted timeline: 12/31/2017

Status:

Challenges:

Other Issues:

## Audit Committee Charter

Recommendation: Update and submit the drafted audit committee charter to the governor and the Audit and Governance Committee (or the BoD) for discussion and approval.

Targeted timeline: 12/31/2017

Status:

Challenges:

Other Issues:

## Organizational Chart

Recommendation: Update the organizational chart to reflect a flatter structure to mobilize the limited resources.

Targeted timeline: 12/31/2017

Status:

Challenges:

Other Issues:

## Internal Audit Manual

Recommendation: Update and adopt the proposed internal audit manual.

Targeted timeline: 12/31/2017

Status:

Challenges:

Other Issues:

## Internal Audit Strategy Note

Recommendation: 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 CIA exam.

Targeted timeline: 12/31/2017

Status:

Challenges:

Other Issues:

## Internal Audit Strategy Note

Recommendation: 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 CIA exam.

Targeted timeline: 12/31/2017

Status:

Challenges:

Other Issues:

## Assessing the risks of one selected auditable entity

Recommendation: select one auditable entity from the audit universe, complete the risk assessment in line with proposed internal auditing manual (Chapter V).

Targeted timeline: 10/15/2017

Status: fully implemented.

Challenges:

Other Issues:

## Comprehensive Risk Assessment

Recommendation: upon the feedback of the first risk assessment, continue and finish the risk assessment of all the remaining auditable entities in the audit universe..

Targeted timeline: 12/31/2017

Status: completed seven risk assessments.

Challenges: confusion over financial and fraud risk factors.

Other Issues:

## IIA Standards

Recommendation: download and read IIA Standards..

Targeted timeline: 12/31/2017

Status:

Challenges:

Other Issues:

## Stocktaking

Mission conducted by IMF in April 2017

Financial Statements

- ▶ Audit 2014 produced Qualified Opinion
  - ▶ Opening balances could not be verified
  - ▶ Cash on hand could not be verified
  - ▶ Property valuation could not be verified
- ▶ Management Letter?
- ▶ Discuss Qualification
- ▶ Steps taken to remedy Qualification?

## Internal Audit Strategy Note

Recommendation: 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 CIA exam.

Targeted timeline: 12/31/2017

Status:

Challenges:

Other Issues:

## Stocktaking

- ▶ Status of 2015 and 2016 financial statements?
  - ▶ Audit completion target date?
  - ▶ Why delayed?
- ▶ Discussions with external auditors?
- ▶ Did they perform any work in December 2016?
  - ▶ Verify Cash count procedures?

## Stocktaking

### Accounting Information Systems

- ▶ Quick books, Peachtree
- ▶ Status of migration to new system - Temeros T24 and Oracle eBusiness enterprise resource planning (ERP)

Finally.....

Questions?  
Challenges? Issues?

## Part III: Review of the Macro-level Risk Assessment Methodology

- ▶ Overview of Annual Audit Planning Process
- ▶ Review of Financial and Fraud Risk Factors
- ▶ Results by CBS Team
- ▶ Potential Adjustments of Risk Factors' Weight
- ▶ Reference Materials (PPTs from prior mission)

## Annual Audit Planning Process: Overview





## 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: Risk Factor - 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: 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, or volume of transactions, or the number of major control points.
- ▶ 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: 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 - IT Risk Factor

IT risk factor considers the risk that *systems or tools or templates 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 - 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.

## CBS Risk Assessment Results

- ▶ Listen to CBS's team on their risk assessment results
- ▶ Identify challenges and issues

## Weights of Financial and Fraud Risk Factors

- ▶ Current Weights of Risk Factors

Risk Factors	Weights
Financial factors	15%
Operational factors	20%
Human Resources	20%
IT	20%
Fraud	5%
Control	20%

## Potential Reasons to Increase Weights of Financial and Fraud Risk Factors

- ▶ Financial Risk Factors
  - Size of CBS's financial resources
- ▶ Fraud Risk Factors
  - Lack of internal control framework/policies
  - Macro environment
  - Cash-based working environment

## Updates to the Weights of Risk Factors (for discussion)

Risk Factors	Current Weights	Updated Weights
Financial factors	15%	20%
Operational factors	20%	20%
Human Resources	20%	0%
IT	20%	20%
Fraud	5%	20%
Control	20%	20%

Human Resource related issues will be considered and weighted under "Operational Factors."

## If the new weights are accepted

Auditable Entities	Risk Scores (current)	Risk Scores (updated)
Cash Handling Process	2.15	2.6
Budgeting Process	2.7	3
Physical Cash Management	2	2.4
Non-physical Cash Management	2.2	2.6
Payroll	2.15	2.4
Operational Activity Process	2.1	2.4
Accounting	2.3	2.6

## If the new weights are accepted

- ▶ Update the risk assessment matrix (template) with new weights
- ▶ Update the risk rating for operational risk factor in consideration of HR risk factors
- ▶ Update the proposed Internal Audit Manual-Chapter 5

## Reference Material: Risk Scoring and Ranking

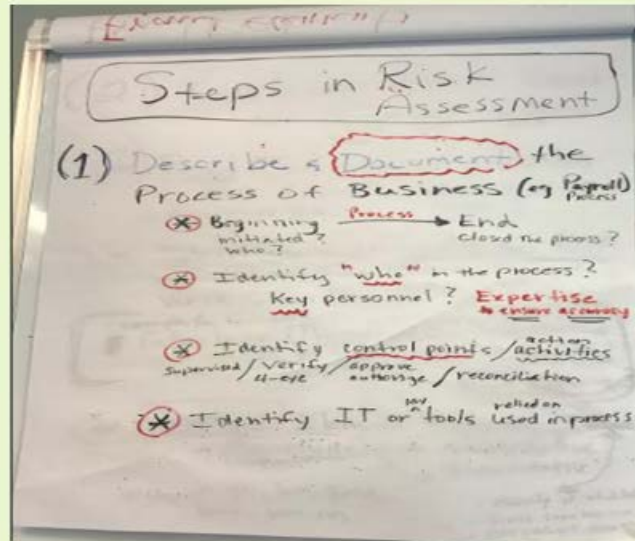
### 1. Risk Scoring

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

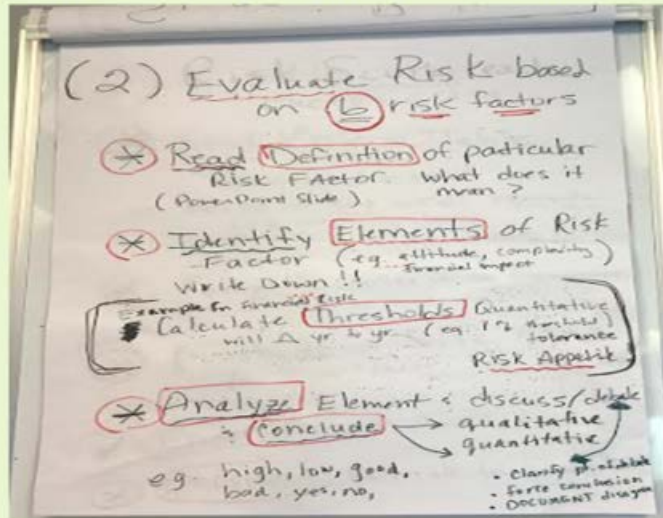
### 2. Risk Ranking

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

## Reference Material: Risk Assessment Step (1)



## Reference Material: Risk Assessment Step (2)

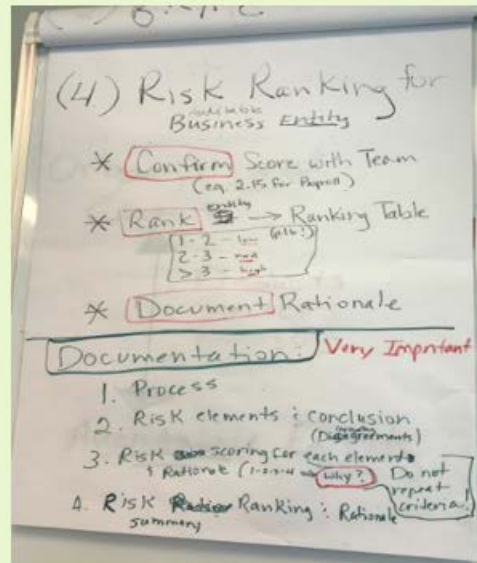


## Reference Material: Risk Assessment Step (3)





## Reference Material: Risk Assessment Step (4)



## VI. Audit Engagement Planning

- Relevant IIA Standards
- Planning Steps
- Example(s)

## IIA Standards

### 2200 - Engagement Planning

Internal auditors must develop and document a plan for each engagement, including the engagement's objectives, scope, timing, and resource allocations. The plan must consider the organization's strategies, objectives, and risks relevant to the engagement.

## IIA Standards

### 2201 - Planning Considerations

In planning the engagement, internal auditors must consider:

- ▶ The strategies and objectives of the activity being reviewed and the means by which the activity controls its performance;
- ▶ The significant risks to the activity's objectives, resources, and operations and the means by which the potential impact of risk is kept to an acceptable level.
- ▶ The adequacy and effectiveness of the activity's governance, risk management, control processes compared to a relevant framework or model.
- ▶ The opportunities for making significant improvements to the activity's governance, risk management, and control processes.

## IIA Standards

### 2210 - Engagement Objectives

Objectives must be established for each engagement.

A1 - Internal auditors must conduct a preliminary assessment of the risks relevant to the activity under review. Engagement objectives must reflect the results of this assessment.

A2 - Internal auditors must consider the probability of significant errors, fraud, noncompliance, and other exposure when developing the engagement objectives.

A3 - Adequate criteria are needed to evaluate governance, risk management, and controls. Internal auditors must ascertain the extent to which management and/or the board has established adequate criteria to determine whether objectives and goals have been accomplished. If adequate, internal auditors must use such criteria in their evaluation. If inadequate, internal auditors must identify appropriate evaluation criteria through discussion with management and / or the board. Criteria may be internal policies and procedures or external laws or regulations or best practices.

## IIA Standards

### 2220 - Engagement Scope

The established scope must be sufficient to achieve the objective of the engagement.

A1 - the scope of the engagement must include consideration of relevant systems, records, personnel, and physical properties, including those under the control of third parties.

A2 - if significant consulting opportunities arise during an assurance engagement, a specific written understanding as the objectives, scope, respective responsibilities, and other expectations should be reached and the results of the consulting engagement communicated in accordance with consulting standards.

## IIA Standards

### 2230 - Engagement Resource Allocation

Internal auditors must determine appropriate and sufficient resources to achieve engagement objectives based on an evaluation of the nature and complexity of each engagement, time constraints, and available resources.

*Appropriate refers to the mix of knowledge, skills, and other competencies needed to perform the engagement. Sufficient refers to the quantity of resources needed to accomplish the engagement with due professional care.*

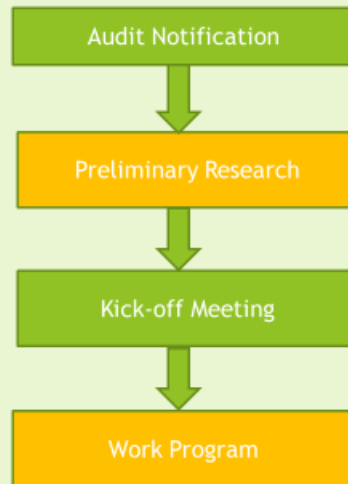
## IIA Standards

### 2240 - Engagement Work Program

Internal auditors must develop and document work programs that achieve the engagement objectives.

A1 - work programs must include the procedures for identifying, analyzing, evaluating, and documenting information during the engagement. The work program must be approved prior to its implementation, and any adjustments approved promptly.

## Audit Engagement Planning: Overview



## Audit Engagement Planning Step: Preliminary Research

Auditors should conduct preliminary research to obtain background information and outline audit objectives and scope.

- Flow chart major business processes/controls
- Conduct micro-level risk assessment
- Product: Terms of Reference, which includes rationale for the audit, audit objectives, scope, and approach.

## Preliminary Research: Considerations of Micro-Level Risk Assessment

- ▶ Read through Appendix VI of Internal Audit Manual
- ▶ Discuss the considerations
- ▶ Compare the macro-level and micro-level risk assessments

## Preliminary Research - Three Key Questions

- ▶ What does business want to achieve (what's the business objective)?
- ▶ What can go wrong?
- ▶ What controls established by management to mitigate risks?

## Audit Engagement Planning Step: Audit Program

Audit program is a plan to achieve the audit objective. It includes:

- A list of procedures that will be performed in the fieldwork to identify, analyze, evaluate, and document evidence to achieve audit objectives. Specific procedures to cover fraud risk should be included in the work program if applicable.
- Resource allocation, including auditor assignment and allocation of staff hours on each action items of the work program.

## Audit Program - Key Questions

- ▶ Are the controls adequately designed?
- ▶ If designed adequately, are the controls effectively complied with?
- ▶ What can be done more efficiently?

## Audit Program

- Review Appendix VIII of Internal Audit Manual as a template
- Discuss the informational flow from preliminary research to work program to audit findings
- Discuss how this template can be applied in audits of CBS

## Example 1: Design an Audit Program

- ▶ Identify a potential audit with CBS
- ▶ Discuss the audit objectives and scope
- ▶ Design an audit program (share a template based on Appendix VIII)



## Group Discussion on Preliminary Research

- ▶ What are the business objectives of the audited area?
- ▶ What could prevent management from achieving the business objectives?
- ▶ Is fraud risk a concern in the related engagement?
- ▶ What are the areas of concerns in the related engagement?
- ▶ Is any there any regulatory requirements related to the engagement?

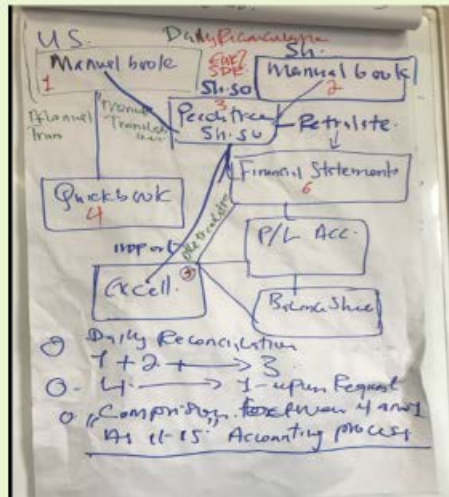
## Group Discussion - Auditing Procedures

- ▶ Are the controls designed effectively?
- ▶ Are the controls followed in practice?
- ▶ What testing can you do to test if the controls are designed effectively?
- ▶ What testing can you do to test if the controls are followed effectively?
- ▶ What are the audit procedures/techniques used in your daily work?

## Group Discussion on Scope

- ▶ How to describe the scope of your audit?
- ▶ Does it include an IT system?
- ▶ Does it cover certain period of time?
- ▶ Does it include any accounting records, accounting accounts?
- ▶ Does it include any offices of different locations?
- ▶ If taken a process view, would it be better to describe the processes that are to be covered in the scope?

## Audit Program of Financial Controls - Flowchart of Business Process (by Somalia team)



## Audit Objective, Scope, and Approach (based on discussion with Somalia Team)

- ▶ Objective: to provide reasonable assurance to CBS senior management and Audit Committee on whether CBS has established effective financial controls to ensure complete and reliable accounting information and proper cash payments.
- ▶ Scope: the review will cover relevant accounting records and supporting documents of the last 12 months, including relevant processes such as cash payment and accounting reconciliations, etc.
- ▶ Approach: review of relevant policies, procedures, and records; interviewing relevant accounting staff, business departments, and audit committee; and testing of relevant transactions.

## Audit Program (1) - Risk Assessment, Control Design Adequacy, and Testing Procedures (based on collaboration of IMF team and Somalia team)

Business Objectives (what does operational management want to achieve?)	Inherent Risks (what can go wrong?)	Key Controls in Existence (what major processes or controls has the operational management establish to mitigate risks?)	Adequacy of Control design (assuming the controls are followed, can the controls mitigate risks to acceptable level?)	Deficiency of Control Design (What controls are missing?)	Testing Plan (to determine whether the controls followed in practice?)
to provide full financial information of CBS's assets, liabilities, equities, income, and expenses.	Accounting Department lacks information because they are not in the communication loop of business activities that impact the financial statements or generate financial information or they lack internal procedures to ensure information circulation within the department.	<p>The written procedure on CBS cash payments ensures that Accounting Director's signature is required for any cash payments.</p> <p>Existing practices of CBS licensing/registration fee collection ensures that Accounting Department is notified when CBS receives the cash payments of licensing and registration.</p> <p>Existing practices of cash handling (generating 90% of CBS's income) indicates that Accounting Department is notified of cash deposits and payments (by government agencies).</p>	not adequate	<p>1. an overall accounting policy to clearly define 1) the authority, responsibility, and accountability of accounting department; 2) the roles and responsibilities of related stakeholders (audit committee, senior management, other business departments, internal auditors external auditor.</p> <p>2. written accounting procedures to document 1) cashing handling process; 2) collection of licensing/registration fees; 3) asset recovery; 4) IMF accounts; 5) other non-cash based transactions, including accrual of interest; and 6) fixed-asset registry.</p>	<p>1. interview relevant business departments (e.g., General Administration, SWIFT team, Bank Operation) to 1) ascertain their existing practices to distribute information; 2) understand if incidents (e.g., forgetting to inform Accounting Department) happen and causes.</p> <p>2. obtain and review adjusting journal entries of the manual accounting books (of last quarter) to determine if there are any adjusting entries and the reasons for the adjustments.</p> <p>3. obtain and review the daily reconciliation documents of last month to determine if there are any adjusting entries and the reasons for the adjustments.</p>
	Accounting Department does not record fully the assets, liabilities, equities, income, and expenditure even they have such information.	<p>BoD (AC) receives periodic financial reports, including financial statements.</p> <p>Central Bank Law mandates that IFRS is the accounting standards for CBS.</p>	not adequate	<p>1. an accounting manual to support the IFRS adoption/implementation.</p> <p>2. oversight of AC over financial reporting and external auditor's work and credibility.</p>	<p>1. obtain and review the minutes of BoD/AC meetings of last year and determine if BoD/AC has exerted its oversight over financial reporting and controls.</p> <p>2. interview selected BoD/AC members to understand how they exercise their financial oversight, whether they have any concerns, and what's their view on financial reporting, e.g., IMF accounts, value of land/properties</p>

## Audit Program (2) - Risk Assessment, Control Design Adequacy, and Testing Procedures (based on collaboration between IMF team and Somalia team)

Business Objectives (what does operational management want to achieve?)	Inherent Risks (what can go wrong?)	Key Controls in Existence (what major processes or controls has the operational management establish to mitigate risks?)	Adequacy of Control design (assuming the controls are followed, can the controls mitigate risks to acceptable level?)	Deficiency of Control Design (What controls are missing?)	Testing Plan (to determine whether the controls followed in practice?)
To provide reliable financial information for CBS's management and BoD/AC on assets, liabilities, equities, income, and expenses.	There are inconsistent accounting records in CBS's accounting information depository: 1. manual book for USD transactions, 2. manual book for Shilling-based transactions, 3. PeachTree, 4. QuickBook, 5. Excel of trial balance, and 6. financial statements.	daily reconciliation between 1. 2. and 3. daily reconciliation between 1. and 4. daily reconciliation of CBS's customer account balances between 3, 4, and 5.	not adequate	1. one accounting system/depository (e.g., Oracle) adaptive to IFRS adoption. 2. a reconciliation and accrual process for monthly trial balance. 3. a reconciliation and review process for monthly financial statements.	1. interview relevant accounting staff on how they conduct the three daily reconciliations. 2. ask relevant accounting staff for a walk-through for each reconciliation process. 3. select 10 daily reconciliations of last quarter to verify the reconciliation (1,2,&3) has been conducted and documented. 4. select 10 daily reconciliation of last quarter to verify the reconciliation (1&4) has been conducted and documented. 5. select 10 daily reconciliation of last quarter to verify the reconciliation (3,4,&5) has been conducted and documented.
	PeachTree and QuickBook may fail due to technical problems.	Software CDs are kept in Safe to recover the software.  PeachTree and QuickBook are backed-up daily and saved in separate hard drives. Hard drives are put into a safe of Accounting Department. Two manual records are maintained.	adequate		1. interview the accounting staff on the PeachTree and QuickBook on how to operate, back-up, and maintain the software. 2. observe whether the software CDs and the hard drives are kept in safe. 3. request a back-up of the previous day and a back-up of 30 days ago and compare them to the corresponding manual records of those time (one day ago and 30 days ago) to see if the back-up has captured all the accounting data properly.
	Key accounting information is kept by one accounting staff only and may be lost if there is a sudden turnover of that staff.	cross-training among accounting staff on PeachTree and QuickBook skills.	not adequate	1. shared drive for accounting staff to store shared information.	1. after getting access to Quick Book, ask an accounting staff to walk you through the system. 2. after getting access to PeachTree, ask an accounting staff to walk though you the system.

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Business Objectives (what does operational management want to achieve?)	Inherent Risks (what can go wrong?)	Key Controls in Existence (what major processes or controls has the operational management establish to mitigate risks?)	Adequacy of Control design (assuming the controls are followed, can the controls mitigate risks to acceptable level?)	Deficiency of control Design (What controls are missing?)	Testing Plan (to determine whether the controls followed in practice?)
To provide reliable financial information for CBS's management and BoD/AC on assets, liabilities, equities, income, and expenses.	There are inconsistent accounting records in CBS's accounting information depository: 1. manual book for USD transactions, 2. manual book for Shilling-based transactions, 3. PeachTree, 4. QuickBook, 5. Excel of trial balance, and 6. financial statements.	daily reconciliation between 1. 2. and 3. daily reconciliation between 1. and 4. daily reconciliation of CBS's customer account balances between 3, 4, and 5.	not adequate	1. one accounting system/depository (e.g., Oracle) adaptive to IFRS adoption. 2. a reconciliation and accrual process for monthly trial balance. 3. a reconciliation and review process for monthly financial statements.	1. interview relevant accounting staff on how they conduct the three daily reconciliations. 2. ask relevant accounting staff for a walk-through for each reconciliation process. 3. select 10 daily reconciliations of last quarter to verify the reconciliation (1,2,&3) has been conducted and documented. 4. select 10 daily reconciliation of last quarter to verify the reconciliation (1&4) has been conducted and documented. 5. select 10 daily reconciliation of last quarter to verify the reconciliation (3,4,&5) has been conducted and documented.
	PeachTree and QuickBook may fail due to technical problems.	Software CDs are kept in Safe to recover the software.  PeachTree and QuickBook are backed-up daily and saved in separate hard drives. Hard drives are put into a safe of Accounting Department. Two manual records are maintained.	adequate		1. interview the accounting staff on the PeachTree and QuickBook on how to operate, back-up, and maintain the software. 2. observe whether the software CDs and the hard drives are kept in safe. 3. request a back-up of the previous day and a back-up of 30 days ago and compare them to the corresponding manual records of those time (one day ago and 30 days ago) to see if the back-up has captured all the accounting data properly.
	Key accounting information is kept by one accounting staff only and may be lost if there is a sudden turnover of that staff.	cross-training among accounting staff on PeachTree and QuickBook skills.	not adequate	1. shared drive for accounting staff to store shared information.	1. after getting access to Quick Book, ask an accounting staff to walk you through the system. 2. after getting access to PeachTree, ask an accounting staff to walk though you the system.