



## **Verification Commission**

### **FIDE 2019 Financial Statements**

#### **VC Report to the 2020 General Assembly**

The Commission met multiple times via electronic means in September, October, and November 2020. Members of the Commission are Chairman Lakhdar Mazouz, Panu Laine, Margaret Murphy, Rajai Al-Susi and Secretary Allen Priest. We were joined on various calls as needed by FIDE Treasurer Zhu Chen, COO Willy Iclicki and Accounting Consultant Alexander Volzhin.

We had an open meeting on 2 December 2020. In addition to all the Commission members, we were joined by FIDE President Arkady Dvorkovich, Bachar Kouatly, Nigel Short, Zhu Chen, Willy Iclicki, Jorge Vega, Lewis Ncube, Alexander Volzhin, Allan Herbert, Hal Bond, Berick Bagalbaez, Ali Nihat Yazici, Daid Sedgwick, Ronald Zarza Pelissier, Patrick Van Hoolandt, and Carol Meyer.

We received the Representation letter provided by FIDE management to the independent auditor which included the internal financial statements, the Report of the statutory auditor on the financial statements, and the Comprehensive report of the auditor to the Council in accordance with article 728b CO. The Commission made several requests for additional information which was provided to us. We were able to meet by phone with the Swiss audit partner from Ernst and Young.

The Representation letter includes the assertions FIDE management is making to the auditors. It outlines the basis of accounting FIDE elects to use, critical assumptions made in determining certain estimates, and the footnotes to the financial statements which provide additional explanations of the amounts reported.

The Report of the statutory auditor on the financial statements contains an explanation of the duties of both the auditor and management in the production of the financial statements, the auditors' opinion as to the compliance of the financial statements with Swiss law and the articles of association, a statement of auditor independence, and an acknowledgement of the existence of a FIDE system of internal controls. The auditor issued an unqualified. This is the type of opinion we want to see. This does not mean the financial statements are perfect. It means the auditor found no errors that combined would cause, in the auditors' opinion, a reader to draw a different conclusion as to the state of FIDE finances at and of the year ended December 31, 2019. The audit partner referred to this as a "clean opinion".

The Comprehensive report of the auditor to the Council in accordance with article 728b CO This report contains the auditors' issues and concerns regarding several issues including:

- Performance of the audit
- Results of the audit
- Comments on the financial reporting
- Comments on the internal control system
- Findings pursuant to the Financial Market Infrastructure Act (FMIA)
- Updates on current developments

The auditors noted they did not test the system of internal control. They noted it was present and did walk throughs of various transactions to verify their understanding of the controls. The auditor noted this approach is not unusual in the audits of small entities like FIDE. We noted nothing in this report that raised concerns.

In our conversation with the audit partner we asked about the cooperation they received from management. He indicated EY had received answers to all their requests and expressed no concerns about management cooperation. We discussed the challenges in the audit process presented by the pandemic.

## **Comments**

The Commission noted the work was not completed in time for our work to be concluded before the original dates of the General Assembly. Both management and the auditor attributed that to the shutdowns and delays related to the pandemic. We reviewed with them the schedule and timeline for the audit of the 2020 financial statements. If that schedule is met, we will have time to complete our work for the 2021 General Assembly. If they encounter delays, we will be challenged to meet our deadlines. In accordance with the revised FIDE Charter we discussed with both the auditor and management the new requirement for the Commission to be involved in discussions with the auditor while they are planning their engagement so we can discuss any concerns before the work is performed. This meeting can impact the auditors' scope and focus.

The audit work performed for 2019 was similar to the work performed for the 2018 financial statements. These engagements had a broader scope than those of prior years. Those engagements consisted primarily of inquiries of management and analysis of various financial ratios. It was the minimum required under Swiss law for entities the size of FIDE. For 2018 and 2019 the work was expanded to a full scope audit. In this type of engagement, the external auditor does not just make inquiries of management, but also seeks independent verification of amounts reported by management. This audit evidence includes the confirmation of the existence and the amount of accounts with counterparties. The auditor also reviews by inquiry and observation the system of internal control to make sure such system exists. The Auditor does not test the effectiveness of the system of internal control throughout the year.

**In our meetings we noted the following items.**

FIDE has made progress on collecting delinquent accounts from member Federations. While there remain several Federations with large old outstanding balances, management has set up payment plans with some Federations and appears to be focusing on collecting these debts.

The account in FIDE's name for benefit of the Americas Continental Association (CCA) was closed in 2019 and the money transferred to an account established by the CCA. Accordingly, it was not included as a FIDE asset on 31 December 2019.

There was a significant increase in new employees of FIDE. The roles, job descriptions and lines of authority of each was not clear to the Commission. We requested and received an organizational chart which helped us understand the lines of communication within FIDE. We also received a document with job descriptions for employees with contracts. We requested, but never received, detailed job descriptions for presidential advisors. We were informed these advisors do not have job contracts.

The contributions/sponsorship income fell significantly short of the budget. The shortfall resulting in a reduction of the development budget. Income from Federations exceeded budget. The budget was set contemplating a change in the fee schedule. No such change was presented to or passed by the General Assembly.

We noted there was a significant amount of reserves set up in 2018 that were reversed in 2019. These are amounts that were set up as liabilities at 31 December 2018 for expected obligations of FIDE. During 2019 management decided these reserves were no longer necessary. The reversal of these reserves caused the 2019 loss to be smaller than it would otherwise have been. Such accounting treatment is permissible under Swiss statutory accounting principles. Without the reversal of these excess reserves the 2019 loss would have been EUR 811,609. The reserves released were as follows: Management had a tax reserve of EUR 57,814 that was released because the Swiss government approved FIDE's tax-exempt application retroactive to 2017. Management had reserved EUR 233,250 for expected costs for an extraordinary General Assembly that was released because management found a sponsor for the event. Finally, management had reserved EUR 207,885 for 2019 events costs as those events were conducted and competed in 2019.

We noted two members of the FIDE Management Board are spouses. We agree this does not create a conflict per se. It did bring to light a lack of formal policy to prevent undue influence regarding hiring and compensation decisions for relatives.

We noted a sponsor made a EUR 120,000 contribution to FIDE with the stipulation it be passed through to a chess education program run by FIDE Executive Director Mr. Bologan. It is our understanding this program is unincorporated and therefore these funds were paid directly to an individual bank account of Mr. Bologan. We believe such arrangements are fraught with problems and should be avoided since FIDE officials have a fiduciary duty to place the interests of FIDE above their own interests. We noted this arrangement was vetted by FIDE management, which concluded there were no conflicts and accepted the arrangement. The Commission was able to review the sponsor contract and discussed with the appropriate FIDE officials the process they used to review and approve the arrangement. We recognize FIDE management carefully considered the details of the arrangement, determined it was acceptable, and accepted the contract. However, the Commission is concerned such arrangements can create the appearance of self-dealing, inappropriate influence, and violation of that fiduciary duty to FIDE even if such does not exist. If FIDE is going to administer such restricted grants for donors, then FIDE must have a robust system to require proper documentation of expenditures for reimbursement to assure the terms of the grant are being met.

## **Recommendations of the Verification Commission**

1. FIDE should continue to make its financial statements in accordance with Swiss accounting standards and engage the audit firm to conduct a full scope independent audit as it has done for 2018 and 2019. The limited scope audit and the presentation of financial statements under FIDE's own accounting rules as was done prior to 2018 does not provide adequate assurance as to FIDE accounts.
2. A cash flow statement made under the indirect method was added to the FIDE internal financial statements in accordance with our prior recommendation. This should be included in the audited financial statement for 2020. (We understand management has already discussed this increase in scope with the audit firm). We recommend preparing this statement using the direct method. The direct method lists details of the sources and uses of funds. While using this method will take additional time, it will provide better information to FIDE financial statement users. Since FIDE is a relatively small organization, the direct method will not be as much of an additional challenge as it can be for larger, more complex organizations.
3. We support management's efforts to replace the custom Greek accounting program with a more standard commercial program. Such accounting program should employ standard double entry accounting. The numbers of users who can post transactions to the accounts should be limited. But financial information should be widely available. Managers need financial information to be properly held accountable for financial results. Member federations and other interested parties need access to financial information to determine the effectiveness of FIDE management. And donors increasingly insist on financial information, so they know their donations are being properly spent.
4. The auditor raised a question about proper documentation of expenses. It is critical for management to enforce internal control rules for adequate documentation of expense. FIDE should refuse to reimburse expenses for anyone who does not provide adequate details until they comply with the documentation rules. Expense reports should all be approved by someone else – even expense reports of the President.
5. The Planning and Development Commission seems to have robust grant requirements. Those requirements and the application process, as well as the forms for the documentation of program results, should be easily available on the FIDE website.
6. In the interest of transparency, development grants made should also be posted to the FIDE website.
7. The audited financial statement reports should be posted separately to the FIDE website. While they may be included as annexes to the FIDE General Assembly material, this can be hard for users to find.
8. FIDE should not administer restricted grants that are received for the benefit of specific individuals or organizations. In the future FIDE should only accept grants for which FIDE can determine the recipients. As there are contractual obligations for the present arrangement, we believe FIDE must continue to administer the arrangement.