

INTERNATIONAL MONETARY FUND

Safeguards Assessments—Review of Experience and Next Steps

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In consultation with other Departments

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EXECUTIVE SUMMARY

On March 23, 2000 the Executive Board adopted a strengthened framework of measures to safeguard the use of IMF resources through the introduction of safeguards assessments of central banks. The safeguards policy was adopted for an initial experimental period of 12-18 months, after which the Executive Board would review experience with safeguards assessments, aided by the same panel of experts that independently reviewed and endorsed the introduction of the new framework. This paper, together with the accompanying paper EBS/02/28 of the panel of experts, provides a framework for the Executive Board's review of the safeguards policy.

The overall findings of the initial safeguards assessments reveal significant vulnerabilities in the safeguards employed by a number of central banks of borrowing member countries, which could lead to possible misreporting to the IMF or misuse of central bank resources, including IMF disbursements. The central banks concerned have generally embraced the staff recommendations made in the context of safeguards assessments and have taken steps to implement many of the proposed corrective actions. The most important findings of the safeguards program to date have included the following:

- **A substantial number of central banks' financial statements were not subject to an independent and external audit** conducted in accordance with internationally accepted standards. Of the central banks that had been audited, many were found not to publish a complete set of audited statements, or to have delayed the publication for six months or more.
- **Several central banks have poor controls over foreign reserves and data reporting to the IMF.** In a few cases, net foreign assets were discovered to be improperly valued in data submitted to staff for program monitoring.
- **Numerous cases of inadequate accounting standards were identified,** which could lead to questionable accounting balances.

These findings mean that significant but avoidable risks to IMF resources exist in the cases concerned, and the findings have accordingly warranted strong program conditionality in certain cases, ranging from prior actions to policy commitments in letters of intent. The acceptance by central bank officials of the remedies proposed by safeguards assessments is encouraging, but is only the first step; a key consideration moving forward would be the modalities for monitoring the implementation of the remedies proposed by safeguards assessments.

In the panel of experts' view, safeguards assessments have further enhanced the IMF's reputation and credibility as a prudent lender and **staff proposes that the safeguards policy be adopted as a permanent feature of the IMF's operations.** However, moving forward it would be important to consider several lessons learned from the experimental period:

- **The operational framework** approved by the Board in March 2000 is **generally adequate**, but requires ongoing refinement, including removal of the distinction between Stage One (off-site) and Stage Two (on-site) assessment reports.
- The existing operational **deadlines** in the safeguards process are important for ensuring credibility and effectiveness of safeguarding IMF resources and **should be retained**.
- **Communication and coordination** of the safeguards work and its findings are important, both externally and internally, and **require improvement**. The safeguards assessment reports, however, should remain confidential documents.
- Resources allocated to the safeguards initiative, while relatively modest, have been managed effectively, **but additional resources will be needed to ensure the proper monitoring of safeguards adequacy**.

During the next three or four years, as the safeguards process shifts its focus from initial assessments to monitoring, two distinct primary activities will emerge:

(i) monitoring the recommendations made in connection with previous safeguards assessments, and (ii) conducting initial safeguards assessments for those members that are requesting a new arrangement from the IMF.

Staff proposes that the nature and periodicity of safeguards monitoring be based on the results of the previous safeguards assessment, primarily the criticality of identified vulnerabilities, as well as their possible impact on misuse and misreporting. The nature and extent of the safeguards assessment for new arrangements where a previous assessment has been conducted would be based on similar factors, including the findings and timing of the previous assessment, the results of the safeguards monitoring process, and new developments at the central bank.

The modalities for safeguards assessment would be broadly similar to existing procedures, but appropriate refinements will be made, taking into account experience to date. Also, the coverage of safeguards assessments would be slightly expanded to include existing arrangements that are augmented, and member countries following a Rights Accumulation Program (RAP), where resources are being committed. The Executive Board would be kept informed of safeguards issues by: (i) a summary of vulnerabilities identified by safeguards assessments in staff reports, and (ii) periodic summary reports to the Executive Board on safeguards findings in general.

I. INTRODUCTION

1. On March 23, 2000 the Executive Board adopted a strengthened framework of measures to safeguard the use of IMF resources through the introduction of **safeguards assessments of central banks**.¹ The framework was introduced in the wake of several misreporting instances and allegations of misuse of Fund resources. Revised guidelines on misreporting were put in place and safeguards assessments were adopted as an *ex ante* mechanism to help prevent the possible misuse of IMF resources and misreporting of information.
2. **The purpose of safeguards assessments is to identify vulnerabilities in a central bank's control, accounting, reporting, auditing systems and legal structure** that may impair the integrity of central bank operations. The objective of the assessments is to provide reasonable assurance to the IMF that significant vulnerabilities in these areas have been identified and that steps have been, or will be, taken to rectify the underlying concern. The scope of safeguards assessments is limited to central banks and does not extend to other agencies of the country's government. Critical to safeguarding against misuse and misreporting of IMF resources is the independent nature of the safeguards process, which fulfills an assurance role, as distinct from the IMF's advisory functions.
3. **Safeguards assessments facilitate informed decision making by the Executive Board in the context of arrangement approval and review** by (i) identifying vulnerabilities, (ii) recommending appropriate remedial measures, and (iii) indicating progress by the member country in implementing the remedies. Known risks related to the central bank's safeguards can therefore be considered in the context of wider issues affecting the member's economic program with the IMF. The implementation of remedial measures resulting from safeguards assessments is also expected to reduce the possibility for the misuse of IMF resources or the misreporting of economic data to the IMF.
4. **The safeguards policy also seeks to contribute to the ongoing efforts to promote transparency and governance initiatives**, including the establishment and monitoring of codes and standards. The International Monetary and Financial Committee (IMFC), at its

¹ See *Summing Up by the Acting Chairman on Strengthening Safeguards on the Use of Fund Resources and Misreporting of Information to the Fund—Policies, Procedures, and Remedies—Preliminary Considerations*, BUFF/00/48 (3/30/00). See, also, the related background papers: *Strengthening Safeguards on the Use of Fund Resources*, EBS/00/29 (2/24/00), *Strengthening Safeguards on the Use of Fund Resources—Independent Review of IMF Staff Proposals*, EBS/00/30 (2/24/00), *Statement by the Staff Representatives on Strengthening Safeguards on the Use of Fund Resources and Independent Review of IMF Staff Proposals*, BUFF/00/33 (3/14/00), *Supplementary Statement by the Staff on Strengthening Safeguards on the Use of Fund Resources*, BUFF/00/39 (3/22/00), *Safeguards Assessments—An Update*, EBS/01/42 (3/20/01).

2000 meetings, endorsed the Executive Board's decision and stressed the "forceful application of the strengthened framework."²

5. The **safeguards policy was adopted for an initial experimental period of 12-18 months, after which the Executive Board would review experience with safeguards assessments**, aided by the same panel of experts that independently reviewed and endorsed the introduction of the new framework. The purpose of this paper is to provide a summary of the experience to date with the safeguards program as the basis for the Board's review. This paper covers the following three main areas:

- The **findings and main conclusions** during the initial period of safeguards assessments.
- The **lessons learned** about the application of the safeguards framework.
- The **evolving modalities for the next phase** of safeguards assessments, which will include monitoring of compliance by central banks with the recommendations arising from safeguards assessments.

6. **This paper has benefited from the contribution of the panel of external experts.**

The panel comprises Ms. Michèle Caparello, Director of Internal Audit, European Central Bank (Chair of the panel); Mr. Eduardo Grinberg, President of the Court of Accounts, Province of Buenos Aires; Mr. Jeremy Foster, Head of Central Bank Services, PricewaterhouseCoopers, Moscow; Mr. M.R. Rasheed, Deputy Governor, Central Bank of Nigeria; Mrs. Tanya Sirivedhin, Deputy Governor, Financial Institutions Stability, Bank of Thailand; and Mr. Edgar A. Martindale, Assistant Director, Federal Reserve Board, Washington, D.C. Attachment I summarizes the main contribution of the panel of experts and Attachment II contains its terms of reference. The panel of experts has issued a separate paper (EBS/02/28) that provides an independent assessment of the staff's review of experience with safeguards assessments. The chair of the panel is expected to be present at the Executive Board discussion of this paper.

II. THE SAFEGUARDS FRAMEWORK

7. Safeguards assessments consider the adequacy of **five key areas** of control and governance within a central bank. These five areas can be summarized under the acronym **ELRIC**, as follows:

² Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund, April 16, 2000, paragraphs 10-11. See also Communiqué of the International Monetary and Financial Committee of the Board of Governors of the International Monetary Fund, September 24, 2000, paragraph 23, which stressed the importance of improving the reliability of information and welcomed the application of the safeguards framework.

- External audit mechanism,
- Legal structure and independence,
- financial Reporting,
- Internal audit mechanism, and
- system of internal Controls.

8. **Safeguards assessments apply to all members with arrangements for use of IMF resources approved after June 30, 2000.** Member countries with arrangements in effect prior to June 30, 2000 are subject to “**transitional procedures**”. These countries are required to demonstrate the adequacy of only one, key element of the safeguards framework, namely that their central banks publish annual financial statements that are audited by external auditors in accordance with internationally accepted standards.

9. **A description of each of the ELRIC areas** and the objectives in assessing these controls are contained in Annex I. The **operational modalities** for the conduct of safeguards assessments are described in Box 1.

Box 1. Existing Modalities for Safeguards Assessments

Safeguards assessments are undertaken in two stages. **Stage One (off-site) is a preliminary assessment** of the adequacy of the central bank's ELRIC based on a review of documentation provided by the authorities and, if necessary, discussions with the external auditors. Vulnerabilities identified during a Stage One assessment are documented, together with the staff's judgment about whether or not a Stage Two (on-site) assessment is necessary. The decision about whether a Stage Two assessment would be undertaken is made by Fund management. In cases where a Stage Two assessment is not considered necessary, but vulnerabilities are nonetheless identified, the staff recommends remedial actions which, if endorsed by management, are discussed with country authorities and presented to the Executive Board in conjunction with other program issues.

Stage Two (on-site) assessment missions confirm or modify the preliminary conclusions drawn by the Stage One assessment and propose specific remedial measures to alleviate confirmed vulnerabilities in a central bank's ELRIC. Multidisciplinary teams led by Fund staff and including external experts conduct Stage Two assessments, which are to be concluded no later than the first review under the Fund arrangement. The draft Stage Two assessment report is discussed with country authorities and their official response is included in the final report, which is transmitted to Fund management. Subject to management's approval, the remedial actions are incorporated into the member's program of reforms.

The results of safeguards assessments are made available to the Executive Board in summary form through staff reports related to the ongoing use of Fund resources under arrangements. A copy of the final report is provided to the authorities.

The modalities for **transitional procedures** (which are applicable to countries with Fund arrangements in effect prior to June 30, 2000) are similar to a Stage One assessment, except that the central bank is subject to assessment in only one of the areas of the safeguards framework, namely the **external audit mechanism**, and normally there is no on-site assessment. In this respect, the authorities are required to demonstrate that their central banks publish annual financial statements that are audited by external auditors in accordance with internationally accepted standards.

10. **The ELRIC framework is derived from the IMF's *Code of Good Practices on Transparency in Monetary and Financial Policies* and employs certain benchmarks for assessing each of the ELRIC categories.** These include, *inter alia*, International Standards on Auditing (ISA), International Accounting Standards (IAS),³ standards promulgated by the Institute of Internal Auditors (IIA) and the IMF's data dissemination standards (SDDS and

³ The term "IAS" encompasses the standards endorsed by the International Accounting Standards Board (IASB), including those designated "International Financial Reporting Standards" (IFRS).

GDDS).⁴ In the area of the legal structure and independence (“L”), there is no generally accepted benchmark. The framework, therefore, calls for the identification in the legislation governing the central bank of any provision that could allow for undue interference with central bank operations by outside parties. Although the safeguards assessment uses benchmarks in the evaluation of ELRIC, the focus of the evaluation is not on the development of international best practice, but on safeguarding IMF resources.

11. In order to ensure a reasonable degree of consistency across countries, **staff has developed standardized analytical techniques and assessment tools for each element of ELRIC**. At the same time, in applying the benchmarks, due consideration is given to the country’s degree of economic development, and to the complexity of its central bank’s operations. Such flexibility in the assessment framework is considered necessary to allow for a variety of appropriate remedial actions, which are tailored to fit the differing circumstances of the banks and the severity of identified vulnerabilities. The actions range from long-term technical assistance to the possibility of prior actions for further IMF disbursements.

12. The **average time required to complete a safeguards assessment ranges from one to eight months** after receipt of the required documentation, depending on the type of assessment and nature of the findings. Assessments have been completed for nearly three quarters of the central banks subject to an assessment under the policy, with 40 percent of the completed assessments for transitional cases (Table 1). Countries that have been subject to the transitional procedures may be subject to a full Stage One assessments in the future if the country seeks a new arrangement from the IMF. Although the existing safeguards policy requires the assessment to be completed no later than the first review of the member’s arrangement with the IMF, in some cases this deadline has been missed.⁵ A complete listing of safeguards assessments completed to date is contained in Annex II.

⁴ The IMF’s Special Data Dissemination Standard (SDDS) was established by the Fund’s Executive Board in March 1996, with the aim of enhancing the availability of timely, reliable, and comprehensive economic and financial statistics. The SDDS was intended to guide member countries that have, or might seek, access to international capital markets in their provision of economic and financial data to the public. More information on the SDDS can be found on the IMF’s website (<http://dsbb.imf.org/guide.htm>).

⁵ Most of the missed deadlines can be explained by (i) the lengthy process of obtaining the initial documentation; (ii) the need for extensive translations in many cases; (iii) the need for follow-up in the clarification of certain issues, (iv) the nature and extent of identified vulnerabilities, (v) the extent of cooperation by the external auditors, and (vi) the logistics of staff visits and missions, including the involvement of external experts.

Table 1. Status of Assessments¹

	Off-Site Assessments			On-Site Assessments
	Transitional Procedures	Stage One	Total Number	Stage Two
Central banks subject to assessment²	28	45	73	18
Assessments Completed	25	26	51	10
Assessments In-Progress	2	14	16	5
Assessments Delayed ³	1	1	2	3
Awaiting Documentation	0	4	4	n/a

¹ Data as of February 8, 2002.

² The total number of central banks reflects 76 member countries subject to safeguards assessments. This is because (i) the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO) and the Banque des Etats de l'Afrique Centrale (BEAC), include 12 member countries with IMF arrangements (increasing the total of 73 central banks to 83 countries), and (ii) so far seven central banks are subject to both a transitional procedures and Stage One assessment (reducing the 83 countries to 76). The number of central banks subject to an on-site assessment is dependent on the outcome of the off-site Stage One assessment.

³ Off-site assessments have been delayed by the preemptive appointment of external auditors by the central bank. On-site assessments are delayed until the implementation of certain critical safeguards.

13. **The ELRIC framework is focused solely on the central bank and does not provide assurances about misuse or misreporting by other agencies.** Therefore, in cases where IMF resources are provided directly to the government, the safeguards assessment does not provide the same level of assurance about minimizing the risk for misuse of IMF resources as in the majority of cases for the use of IMF credit, which is for balance of payments support. Similarly, safeguards assessments provide no assurances on the quality and reliability of fiscal data and other information related to performance criteria used in IMF-supported programs. While staff does not propose expanding or altering the ELRIC framework to address such situations in the context of this review, the staff has strengthened its assessment of fiscal data quality in several cases, as described in Box 2.

Box 2. Fiscal Data Quality Issues

Safeguards assessments focus only on central banks, but misreporting can also arise from the provision of inaccurate fiscal data to the Fund in the context of a program. In some cases the authorities have acknowledged the existence of inaccuracies, have sought technical assistance and given full cooperation to Fund missions to help improve the quality of fiscal data. FAD's work on technical assistance, fiscal transparency Reports on the Observance of Standards and Codes (ROSCs), tracking poverty-reducing spending in Highly Indebted Poor Countries (HIPC)s, and more general assistance in improving budget management, has highlighted many weaknesses in fiscal data in a wide sample of countries—implying that the possibility of future episodes of misreporting cannot be ruled out.

Since fiscal data quality problems can arise from any of a country's numerous government institutions (which together manage transactions typically accounting for 20-40 percent of GDP), the intensive scrutiny accorded to central bank accounts under safeguard assessments cannot be effectively extended to the fiscal sector. Moreover, revisions to fiscal data over various stages of the accounting and auditing process are far more frequent and significant than for monetary accounts. While such revisions are to be encouraged since they signal the existence of a functioning oversight process within government, they nonetheless run the risk of leading to a breach in formal misreporting requirements.

In recent years, FAD and STA have given particular emphasis to addressing questions of data quality among Fund member countries. STA has developed a fiscal data quality framework that allows a comprehensive overview of the institutional capacity of countries to produce adequate fiscal statistics. Fiscal data quality has also been given increased emphasis in the revised *Code of Good Practices on Fiscal Transparency* and in fiscal transparency ROSCs (which look both at the quality of fiscal statistics and the quality of budget estimates, as well as the underlying institutional framework). Technical assistance by both FAD and STA has increasingly addressed these issues. In response to the demand for safeguards, a number of joint FAD/STA missions have been specifically aimed at establishing a more accountable fiscal management framework.

Looking to the future, FAD has taken a number of steps to develop more comprehensive guidelines to further improve the quality of fiscal data, particularly in the context of Fund-supported programs. Preliminary guidelines on integrating data quality with program design and monitoring have been issued. Further development of these guidelines is underway with the objectives, first, of developing a comprehensive methodology for fiscal data quality work based on recent TA experience (along the lines of ELRIC but taking into account the different characteristics of fiscal data cited above), and, second, giving appropriate priority to future TA work on these issues.

III. FINDINGS AND IMPLICATIONS

A. Positive Trends in Central Bank Safeguards

14. Safeguards assessments are a diagnostic tool and, as such, are focused on the identification of weaknesses in a central bank's ELRIC framework. In many cases, however, the assessments have also revealed **positive aspects of a central bank's safeguards**. Staff has noted an increased awareness among central banks of the need for strong safeguards in the ELRIC areas, especially in the context of possible borrowing on the international capital markets. Safeguards assessments have identified the following positive trends, which help to safeguard IMF resources and reduce the risk of misreporting (Annex III provides further details):

- **The majority of central banks now publish their complete audited financial statements on a timely basis**, representing a significant improvement over the previous three to four years.
- External audits of central banks are being strengthened. More than half of the transitional procedures assessments concluded that **the external audit mechanism was in full compliance with the safeguards framework**, a trend that is expected to continue.
- **Central bank financial reporting has improved significantly**. While there remain areas for improvement in most central banks, many central banks have adopted IAS or the equivalent, for full implementation over the next two or three years.
- **Central banks are increasingly recognizing the importance of internal audit**. The focus of internal audit in many central banks is moving towards a preventative role for ensuring the integrity of central bank operations and away from narrow checks on transactional accuracy.

15. **In general, the importance of transparency and accountability in central bank operations is increasingly recognized by central bank officials and member country authorities**. Safeguards assessments have identified a positive trend in central bank control, accounting, reporting, and auditing systems over the past several years. This trend may be in part attributable to the publication of the IMF's *Code of Good Practices in Monetary and Financial Policies* and the provision of technical assistance. On a more general level, while central banks may be unique with respect to their function and position in the economy, they are no longer perceived as unique with respect to control and governance issues.

16. A noteworthy improvement in the transparency and accountability of central bank operations is the first-time application of an external audit of many central banks' financial

statements. **At the time of the approval of the safeguards policy in March 2000, at least 14 central banks of member countries using IMF resources were not subject to an independent external audit**, conducted in accordance with internationally accepted standards. All of these central banks have subsequently implemented, or committed to implement, an external audit mechanism; independent external audits should, therefore, be in place for all central banks of member countries using IMF resources by end-2002. In this context, it is worth noting the better-than-expected cooperation between assessment teams and external auditors experienced during the conduct of safeguards assessments.

B. Areas for Improvement in Central Bank Safeguards

17. **Notwithstanding the recent improvements in central bank safeguards, safeguards assessments have identified serious deficiencies in central bank ELRIC frameworks.** The findings have been classified into eight categories (in the staff’s view of order of importance), as summarized in Table 2. The findings are not classified by ELRIC area since the five areas of ELRIC are not mutually exclusive—there is a strong relationship between each component and ultimately each component is a “control” integral to ensuring the integrity of a central bank’s operations. Thus, an identified weakness can have an impact on the effectiveness of more than one area of ELRIC.

Table 2. Main Findings of Safeguards Assessments¹

	<u>Type of Assessment</u>		Total Identified ²	Total Assessed ³	Identified as Percent of Assessed
	Transitional Procedures	Full			
Central banks assessed	25	26			(in percent)
1. Non-existent or deficient external audits.	13	20	33	49	67
2. No, or delayed, publication of financial statements.	7	13	20	49	41
3. Poor controls over foreign reserves.	2	14	14	26	54
4. Inadequate accounting standards.	8	23	23	26	88
5. Deficient governance oversight.	5	20	20	26	77
6. Deficient internal audit.	1	23	23	26	88
7. Loopholes in governing legislation.	-	13	13	26	50
8. Inadequate accounting for IMF transactions.	2	9	9	26	35

¹ Data as of February 8, 2002.

² Given the nature of transitional procedures, findings 3 through 8 (shaded) are not *prima facie* principal objectives of such assessments and, therefore, are excluded from the calculation of total identified cases.

³ For findings 1 and 2, the total assessed has been reduced by two to reflect that both a transitional procedures and a full safeguards assessment have been completed for two countries.

18. **A detailed presentation and analysis of the findings, including country cases, is contained in Annex III.** A brief description of the link between the findings and the potential vulnerability to IMF resources and misreporting, together with examples of specific deficiencies identified by safeguards assessments, is presented below under each category of findings listed in Table 2.

19. **Non-existent or deficient external audits.** An independent and high quality external audit of a central bank's financial statements is the most important control to ensure the reliability and completeness of the information contained in the financial statements. The audit also provides some assurances on the adequacy of procedural controls, which are important for the integrity of the bank's financial operations. An effective external audit, therefore, reduces the possibility for misuse of IMF resources and strengthens the reliance that the IMF can place on critical central bank data such as foreign assets and liabilities.

20. Deficiencies in external audits identified by safeguards assessments include: (a) the absence of any external audit mechanism, (b) impaired independence of the auditors from the central bank, (c) uneven application by the auditors of ISA or an equivalent framework, (d) inconsistencies between the financial report and the audit report, or delayed issuance of the audit report, (e) insufficient qualifications and experience of the external auditor, and (f) concurrence by the external auditor with dubious accounting practices of the central bank.

21. **No, or delayed, publication of financial statements.** Transparency of central bank operations, which is an important component of the *Code of Good Practices in Monetary and Financial Policies*, promotes accountability and good governance. The publication of financial statements, therefore, is a key requirement of the safeguards framework. Likewise, the timeliness of publication is essential as outdated information loses its relevance and could lead to misleading conclusions. The publication of *comprehensive* data is important to ensure full transparency and understandability of the underlying data.

22. Safeguards assessments have identified several central banks that have not published their financial statements, while others were selective in their publication. A common finding was the publication by central banks of abridged financial statements only. Some central banks delayed publication of their financial statements beyond six, and even twelve, months after the financial year-end (and in some instances, in contravention of the legislation governing the central bank).

23. **Poor controls over foreign reserves.** Inadequate internal controls over foreign reserves significantly increase the possibility of misreporting (e.g., through incorrect valuations, or maintaining incomplete or inaccurate records), and misuse of IMF resources. The risk of misreporting increases significantly in the absence of robust reconciliation processes between the accounting records, which are audited, and data reported to the IMF for program monitoring purposes, while an effective framework of controls over the management of foreign reserves mitigates the risk of misuse. The Fund's data template on

international reserves and foreign currency liquidity is the appropriate framework for compiling and reporting these data.

24. Deficiencies identified by safeguards assessments include inadequate controls over foreign reserves (e.g., poor segregation of duties, improper valuation techniques, and unresolved differences between the accounting records and correspondent bank statements). A frequent finding is that central banks do not reconcile data reported to the IMF for program monitoring purposes to the underlying accounting records, which are audited.

25. **Inadequate accounting standards.** Applying inadequate accounting standards not only hampers transparency, but allows central banks to make exceptions in the recording, measurement, and reporting of transactions. This flexibility affords a central bank the opportunity to set its own accounting framework for a given purpose. The application of a benchmark financial reporting framework (e.g., IAS or equivalent) provides additional assurance that balances such as credit to government and foreign reserves are accurate, complete and determined on a consistent basis. The experience in past cases of misreporting to the IMF demonstrates that adherence to IAS or an equivalent framework, would have helped prevent or detect intentional or unintentional misreporting.

26. A common finding of safeguards assessments was the lack of a benchmark financial reporting framework by central banks, coupled with inadequate explanatory notes to the financial statements. Some central banks were found not to apply accrual accounting principles to all transactions, while others did not adequately account for foreign exchange gains and losses, government-related assets, and off-balance sheet items.

27. **Deficient governance oversight.** Oversight by a central bank board is a key component of effective governance of central bank operations. This includes oversight of both the senior management team and of the internal and external audit mechanisms. Too much reliance on a dominant senior officer creates the potential for abuse and deficient governance oversight increases the potential for misreporting and misuse.⁶ A properly structured audit committee or equivalent oversight mechanism is key to mitigating the risks arising from deficient governance oversight.

28. Safeguards assessments identified many indicators of possible impaired oversight of governance issues, including (a) the presence of quasi-fiscal activities being undertaken by

⁶ However, not all questionable activities may be the result of decisions of the central bank. Central banks may be subject to undue external influences and willful determination to override or evade existing controls may not be detected by safeguards assessments.

central banks,⁷ (b) absence of an effective mechanism to enable a central bank board to fulfill its oversight responsibilities for the audit process,⁸ and (c) instances of over reliance on the Governor for decision-making and oversight of all aspects of central bank operations.

29. **Deficient internal audit.** Internal audit is an essential part of the risk management, control and governance processes in a central bank. An effective internal audit mechanism strengthens the integrity of the central bank's control functions, thereby providing additional assurance to the IMF that risks related to misuse and misreporting of IMF resources are more likely to be addressed.

30. The identified deficiencies in internal audit practices include (a) insufficient expertise and professional qualifications among internal audit staff, (b) a narrow focus of the internal audit department on operational transactions and procedural audits, to the exclusion of high-risk areas such as foreign reserves management, and (c) inadequate monitoring of the implementation of audit recommendations.

31. **Loopholes in governing legislation.** Government interference with central bank operations can undermine a central bank's autonomy and expose it to additional risks. Therefore, assessments have focused on: (a) ensuring compliance with legal regulations and assurance that the government has not interfered with these regulations where credit has been extended to the government; (b) the legal basis of the relationship to the central bank for those agencies that share monetary authority with the central bank, and (c) ensuring protection is granted to the governing board, including appointment and dismissal of board members.

32. Safeguards assessments identified various provisions in central bank laws that could increase the risk of misreporting and misuse of IMF resources, including (a) insufficient clarity in the statutory provisions governing the ownership and management of foreign exchange reserves, and (b) provisions in the legislation that enable potential abuse by the government or parliament in the appointment and dismissal of central bank officials. In certain cases, it was determined that while there are *de jure* concerns in this area, *de facto* the central bank enjoyed an appropriate degree of autonomy.

33. **Inadequate accounting for IMF transactions.** Safeguards assessments have helped the staff ensure that a member country's use of IMF credit is transparently and accurately

⁷ The misclassification of quasi-fiscal activities as central bank expenses (as opposed to credit to government) is often an indication of inaccurate fiscal data, which could potentially result in misreporting.

⁸ A common complaint of external auditors was that they were precluded from communicating serious audit concerns to board members because their only point of contact was with the Governor.

reflected in the central bank's balance sheet. Deficient accounting procedures for IMF transactions impairs timely payments to the IMF.

34. Safeguards assessments identified several cases of inadequate accounting for IMF transactions, including: (a) no disclosure of the liability to the IMF, (b) retention of IMF accounts as off-balance sheet items, (c) non-revaluation of IMF accounts, and (d) late payments to the IMF resulting from internal accounting and control deficiencies.

C. Evaluation of the Findings

35. The findings of the safeguards assessments to date have **heightened awareness of safeguards-related issues among central banks and the Fund staff, and the safeguards framework is increasingly viewed as a useful benchmark by member country authorities.**

36. **The findings have resulted in a wide range of specific recommendations to correct the identified weaknesses.** In certain cases, given the nature of the findings and remedies proposed by staff, strong program conditionality has been warranted. In other cases, country authorities have committed to implement safeguards recommendations through policy commitments in the Letter of Intent (LOI) or correspondence with IMF staff.⁹ Member country authorities have cooperated during the safeguards process and the broad acceptance by central bank officials of the initial remedies proposed by safeguards assessments is encouraging. However, it is too early to determine the long term effectiveness of the safeguards process because the monitoring of the implementation and effectiveness has not commenced. Therefore, an important implication of the findings is to ensure that, moving forward, the quality of implementation is even and that remedies are established in both form and substance. Chapter V discusses these aspects in more detail. Box 3 provides examples of proposed remedies for both off- and on-site assessments.

⁹ Country-specific conditionality is limited in the cases of the regional central banks and commitments are obtained from the central bank authorities.

Box 3. Examples of Remedies Proposed After Completion of a Safeguards Assessment

Below are two examples of the remedies proposed to address vulnerabilities identified after: (i) an off-site assessment where an on-site assessment was not considered necessary, and (ii) an on-site assessment.

<i>Country A: Off-site assessment: Summary of Recommendations</i>	
<p>Priority Measures</p> <ol style="list-style-type: none"> 1. Appoint external consultants to: <ol style="list-style-type: none"> (a) prepare a financial reporting template for the central bank's financial statements that ensures compliance with International Accounting Standards (IAS), and (b) prepare a reconciliation between foreign reserves on the IAS balance sheet and economic data reported to the Fund. 2. Strengthen the external audit mechanism by ensuring the full application of International Standards on Auditing (ISA) through the contract between the auditors and the central bank and through the establishment of an audit committee. <p>Other Measures</p> <ol style="list-style-type: none"> 1. Strengthened procedures to ensure timely payments to the Fund should be implemented. 2. The nature and scope of the operations of the Internal Audit Department should be strengthened and should acquire expertise in information technology audits. 3. A formal policy to ensure implementation of audit recommendations should be adopted. 	<p>Timing</p> <p>For the 2001 financial statements</p> <p>For the 2002 financial statements</p> <p>By end-2001</p> <p>By end-2001</p> <p>For the 2001 external audit</p>
<i>Country B: On-site assessment: Summary of Proposed Remedies</i>	
<p>Proposed Prior Actions</p> <ol style="list-style-type: none"> 1. The Board of the central bank to adopt resolutions in the areas of accounting and audit to require compliance with internationally recognized standards. 2. The central bank to establish a formal process for reconciling data reported to the IMF and to adopt formal guidelines that prohibit operations that pledge or encumber reserves, place restrictions on, or otherwise impair the availability of foreign exchange reserves outside an authorized framework. <p>Proposed Structural Performance Criteria</p> <ol style="list-style-type: none"> 1. Prepare an IAS-compliant reporting format and comparative IAS financial statements for the previous year ended June 30, 2000. 2. Reduce the central bank's deposits with branches of the national banks abroad to a maximum of US\$200 million and formulate plan to further reduce placements with national banks abroad. <p>Stated Intentions in the Letter of Intent (LOI)</p> <ol style="list-style-type: none"> 1. Commission and complete an independent review of the central bank's internal audit function. 2. Prepare draft revisions to the banking law and issue resolutions by the government (i) to ensure that the governor and other central bank board members can only be removed by legal cause and (ii) to guarantee autonomy of the central bank in respect of the management of reserves. 	<p>Timing</p> <p>Prior to 1st program review (mid-March 2001)</p> <p>Prior to 1st program review (mid-March 2001)</p> <p>End-June 2001</p> <p>End-June 2001</p> <p>End-June 2001</p> <p>End-August 2001</p>

37. **An implication of the findings is that many of the safeguards recommendations will take one to three years to be fully implemented.** The nature of certain findings; e.g., absence of an external audit, is such that the relevant corrective measure can be applied only over a relatively long period. Similarly, implementation of other safeguards recommendations, e.g., the adoption of IAS, requires capacity building at many central banks, a process that lengthens the implementation period. In contrast, certain recommendations have been implemented immediately, e.g., the correction of foreign reserves valuation. The recommendation for the provision of technical assistance that may be provided by several IMF departments in the implementation of safeguards recommendations is frequent.

38. **The following are indicators of the value-added of safeguards assessments:**

- **In the panel of experts' view, safeguards assessments have enhanced the IMF's reputation and credibility as a prudent lender.** The safeguards framework was introduced in the wake of several misreporting instances and allegations of misuse of IMF resources and the initial findings have demonstrated the importance of remaining vigilant in these areas. The conduct of safeguards assessments provides an important signal to both member country central banks and other IMF stakeholders, including the general public, that the IMF views control issues (i.e., the ELRIC framework) as a critical component of the overall program design.
- **Safeguards assessments have identified and rectified several cases of potential misreporting.** Because safeguards assessments are performed *ex ante*, they provide the IMF with the ability to detect the potential for misuse and misreporting before they occur. To date, staff has identified several instances in which *potential* misreporting may have been avoided through the discovery of inaccuracies in the NIR data submitted for program monitoring purposes and by the misclassification of credit to government data. In addition, improvements to controls over the management of, and accounting for, foreign reserves resulting from the recommendations of safeguards assessments have resulted in the availability of more accurate, reliable, and timely reserves data.
- **Safeguards assessments have likely reduced opportunities for misuse of IMF resources.** Although the *ex ante* nature of safeguards assessments precludes definitive statements about the prevention of misuse of IMF resources, the resultant improvements to central bank safeguards will *de facto* strengthen controls over central bank resources, including IMF disbursements. For example, improvements expected in external audits as a result of the deficiencies identified in two thirds of the central banks assessed are likely to significantly reduce the risk of misuse of IMF resources.
- **The results of safeguards assessments have been validated by subsequent events.** For example, the safeguards assessment for a country subject to only a

transitional procedures assessment identified high risks in the external audit mechanism, and recommended the prompt replacement of the external auditors. This signal of potential vulnerabilities in the overall control environment at the central bank was subsequently confirmed when the new central bank Governor alerted the IMF to misreporting of monetary data.

- **The new policy has resulted in a few requests for technical assistance from IMF member countries not subject to safeguards assessments.** Representatives from the central banks visit the IMF to learn about the safeguards framework and to benchmark their own practices against the framework. In this context, IMF staff organizes a program of seminars for the representatives and supplies appropriate background materials, including the safeguards methodology and checklists.

39. Finally, notwithstanding the benefits arising from the implementation of the safeguards policy, the assessments should not be viewed as a panacea for misreporting and misuse—the assessments have resulted in improvements to controls, but they cannot prevent the willful override of controls that have been known to give rise to previous cases of misreporting. However, safeguards assessments do provide some deterrence against the willful override of control and should, therefore, contribute to a reduction in such activity.

IV. LESSONS LEARNED FROM THE SAFEGUARDS PROCESS

40. This section describes the lessons learned by staff during the conduct of safeguards assessments and the feedback received from the panel of experts. **The lessons are in the following five areas:** (i) adequacy of the ELRIC framework and the documentation set;¹⁰ (ii) the usefulness of the Stage One/Stage Two distinction; (iii) the deadline for the completion of assessments; (iv) communication and coordination; and (v) resource usage.

A. Adequacy of the ELRIC Framework and the Documentation Set

41. **The ELRIC framework is generally adequate, but requires some operational refinement.** A strength of the framework is its breadth, which allows flexibility to respond to the changing requirements of each member's safeguards assessment. As described in Box 4, operational refinements to the application of the ELRIC framework have been made during the course of safeguards assessments and in response to comments made by the panel of experts. Consistent with the evolution of the safeguards process, staff proposes that **the ELRIC framework continue to be the basis for assessing safeguards at central banks.**

¹⁰ Central banks are required to submit ten documents for a Stage One (off-site) safeguards assessment. The documentation set was specified in the Board's adoption of the safeguards assessment framework.

Operational improvements would continue to be implemented on the basis of ongoing experience accumulated during the conduct of the assessments.

42. **The documentation set required from central banks for off-site assessments has generally been appropriate for the conduct of an assessment.** However, at times the documentation set has proven too prescriptive. It has also constrained staff in certain cases since, unlike during on-site assessments, the staff cannot readily request additional information. To clarify the information requirements and to ease the burden on the authorities, the panel of experts has also noted that individual items on the documentation set could be clearer and country-specific, and take account of all publicly available information. Experience so far suggests, therefore, that the documentation set should be retained as *indicative* of the information required for a safeguards assessment, thereby allowing staff the flexibility to tailor the documentation needed according to country specific circumstances.

Box 4. Operational Refinements to the ELRIC Framework

As the safeguards process continues to evolve, refinements to its operational aspects and the tools used to assess the areas of ELRIC are required. So far, a strength of these tools has been their consistent, but non-rigid, application, resulting in the ability to make adjustments according to the features of each central bank. However, reflecting experience gained to date, these tools need to evolve as the safeguards process moves forward. Staff expects to make on-going refinements to the tools and methods used to assess safeguards at central banks. For example:

- The findings suggest that the legal framework of a central bank is a critical foundation underlying all safeguards issues. However, the current operational approach may be too broad; staff has, therefore, recognized the need to refine the scope of the legal mandate so as to focus on matters that have a *direct causal link* to the prevention of misuse and misreporting.
- Assessments have also revealed the frequent absence of procedures at central banks for reconciling program data reported to the IMF with the audited financial records, as well as unresolved differences between the accounting records and bank financial statements. As a result, there should be further development of safeguards assessment tools to focus on controls over foreign reserves management and external reporting.
- Reflecting the role of the external auditor as a key pillar in the safeguards framework, staff has noted the need to further develop diagnostic tools to review the selection of auditors and the audit rotation policies applied at central banks.

B. Usefulness of the Stage One/Stage Two Distinction

43. **The current practice of preparing both Stage One (off-site) and Stage Two (on-site) assessment reports has created confusion among both IMF staff and country authorities.** In practice, Stage One assessment reports have served alternatively as (i) the definitive assessment report on a central bank in cases where an on-site assessment is deemed unnecessary; or (ii) a preliminary review of vulnerabilities and the decision point for conducting a Stage Two assessment. In the latter case, Stage Two reports, issued on return from on-site visits, confirm or modify the Stage One conclusions, and become the definitive assessment report. Such a bifurcated reporting process has created some confusion among stakeholders, and has also led to redundancies and inefficiencies, as well as a prolongation of the report life cycle.

44. **Staff views a safeguards assessment as essentially one seamless process.** Moving forward, staff would recommend streamlining the process so that a single assessment report will be produced for each country, regardless of whether an on-site assessment is required. However, staff recognizes the importance of a decision point to determine whether an on-site assessment is needed; therefore, all on-site assessments will be based on staff's recommendation in the form of a planning document derived from an off-site review, complemented by a mission brief. All on-site assessments will remain subject to the approval of IMF management and central banks will continue to be informed of the staff's preliminary views prior to the conduct of the on-site assessment. Thus safeguards reporting should, in the future, comprise a single definitive assessment report. Modalities of safeguards assessments going forward are proposed in Chapter V and revised operational guidelines would reflect such a new process.

C. Deadline for Completion of Safeguards Assessments

45. **The existing operational deadlines in the safeguards process are important for ensuring credibility and effectiveness in safeguarding IMF resources.** The existing policy states that the safeguards assessment for a central bank would be completed by no later than the first review under the member's arrangement from the IMF. As noted in paragraph 12, it has not always been possible to complete the assessment by the first review, and deadlines have been missed in certain cases. For countries where the safeguards assessment has not been completed by the approval of a new arrangement, the staff report notes this fact and indicates that the assessment is expected to be completed by the first review. For countries where the safeguards assessment has not been completed by the first review, the staff report would contain, in the appraisal, an explicit statement to this effect and the staff's view on completion of the review. Informing the Board of the progress of the assessment and the reasons that may delay the issuance of a safeguards assessment report beyond the first program review has become standard practice. Notwithstanding the missed deadlines, staff views specific deadlines (i.e., completion of the assessment by no later than the first review of the program) as essential for the discipline of the safeguards process (see paragraph 63).

D. Communication and Coordination

46. **Communication and coordination of the safeguards work and its findings are important, both externally and internally, and require improvement.** Three areas in particular need to be addressed to enhance the communication of safeguards issues. They are (i) the breadth of report dissemination; (ii) coordination among IMF staff during the safeguards process; and (iii) awareness of safeguards both within and outside the IMF.

47. **The external panel of experts noted that awareness of safeguards assessments among IMF staff and the Executive Board needs to be improved, but that safeguards reports should remain confidential.** Staff agrees with this view. Safeguards assessments are confidential documents and are available only to IMF management and staff and to relevant country authorities. The reports are not made available to the IMF's Executive Board, nor to the public. A summary of the main findings and recommendations, however, is included in the staff report related to the country concerned and certain staff reports are available on the Fund's website. A wider dissemination of safeguards reports could create disincentives for central banks to cooperate in providing valuable information to IMF staff. However, to raise overall awareness, the general results of safeguards work (on a non-country specific basis) should be better communicated among staff and the Executive Board by the issuance of periodic reports.

48. **Experience has shown the need for improved coordination among staff during the safeguards process.** In particular, staff recognizes the need for closer coordination between the assessment teams and IMF departments, without compromising the independence of the assessment process. Departments providing technical assistance and area departments need to be kept informed from an early stage of potential major weaknesses in a central bank's safeguards to ensure that (i) program requirements are considered and incorporated into the assessment, and (ii) adequate technical assistance is provided to enable the authorities to implement the recommendations. Also, the past provision of technical assistance by staff in areas that affect safeguards (e.g., central bank accounting and auditing) needs to be fully considered when conducting an assessment. However, there is a fundamental difference between the objective of safeguards assessments (which is diagnostic) and that of technical assistance (which is advisory). As a result, there may be potential for confusion among authorities over the relationship between safeguards assessments and technical assistance. Staff recognizes the need for better communication with country authorities to clarify this distinction and to ensure the consistency of policy advice.

49. **The public dissemination of matters of interest related to safeguards will aid in the establishment of central bank best practice in these areas.** Staff believes that fundamental to the safeguards initiative is the need to increase awareness of safeguards issues among central banks, external auditors, and other related stakeholders, including the World Bank and regional development banks. Indeed, as noted in paragraph 38, some central banks that are not currently subject to the safeguards process have proactively sought staff's informal assistance in understanding the safeguards process. To improve communication to

external parties, staff proposes the preparation and distribution of an update of summary information arising from safeguards to central banks and external auditors to reinforce areas of importance for safeguarding IMF resources. Furthermore, the continued participation of staff in external fora related to safeguard issues will increase awareness of the need for safeguards and will contribute to the on-going development of best practices in these areas. The enhancement of communication should improve the understanding among key stakeholders of the objectives of safeguards assessments.

E. Resources

50. **There are very few IMF staff with the requisite specialized skills to undertake safeguards assessments.** The Treasurer's department takes the lead in the conduct of safeguards assessments, with the assistance of other Fund-wide specialized staff (notably in OIA and MAE) to ensure effective resource use. Nonetheless, specialized skills in this area remain scarce. To address this scarcity, staff has employed various means to ensure that the safeguards process continues to meet its objectives, including intensified development of in-house expertise and external recruitment. The staff has also utilized external experts during on-site missions in order to leverage outside expertise and will continue to do so. However, experience with external experts has been mixed. Full outsourcing of safeguards assessments to third parties remains infeasible because, *inter alia*, of concerns about uniformity of recommendations and lack of familiarity with Fund procedures where findings may give rise to measures under program conditionality.

51. **The external panel has noted that additional resources would enable staff to manage an increasing volume of work, including monitoring the implementation of recommendations and meeting the tight deadlines of safeguards assessments more consistently.** In particular, staff believes that there is a need to continue building specialized skills in the safeguards areas through training and further external recruitment. The development of in-house expertise is an important factor in ensuring the even application of the ELRIC framework. Further discussion of resource issues can be found in Annex IV.

V. THE WAY FORWARD

52. **In the staff's view, the results and findings of the safeguards policy during the experimental period strongly support the continuation of the policy.** Moving forward, therefore, staff proposes that safeguards assessments remain a requirement for all countries with new arrangements approved by the Executive Board.

53. **Compared to existing modalities, staff proposes that the coverage of safeguards assessments be slightly expanded to include existing arrangements that are augmented, and member countries following a Rights Accumulation Program (RAP), where resources are being committed.** Thus an augmentation of an arrangement approved before the initiation of the policy would be considered akin to a new arrangement for safeguards purposes. In the case of RAPs, the intention is to conduct the safeguards assessment at the

earliest practicable time. The safeguards assessment would be undertaken during the RAP to enable the authorities to implement needed safeguards improvements prior to approval of the anticipated follow-on arrangement. For Staff Monitored Programs, central banks should be encouraged to voluntarily undergo a safeguards assessment, but this would not be a requirement. Safeguards assessments would continue not to be undertaken for first credit tranche purchases, stand alone CFF purchases, or emergency assistance disbursements.

54. **Moving forward, the focus of safeguards assessments would shift from new assessments to the monitoring of proposed remedies under previous arrangements.** During this phase, which may take up to three years, two distinct primary activities will emerge:

- Monitoring recommendations made to alleviate material weaknesses identified in previous safeguards assessments.
- Conducting safeguards assessments for those members who are applying for a new arrangement from the IMF. Initially, such assessments will comprise both member countries that were subject to a full assessment in the past and those not previously subject to a full safeguards assessment, but in the steady state most safeguards assessments are expected to be “update” assessments.

55. The **fundamental modalities would remain unchanged, but in moving forward staff will take into account the lessons learned** (described in Chapter IV). Annex V provides a schematic of the proposed next steps, which are described below.

A. Monitoring Recommendations of Previous Safeguards Assessments

56. **Safeguards assessments are a diagnostic tool at a point in time and provide no assurance that identified material weaknesses will be adequately and continuously alleviated.** Effective monitoring of safeguards issues would, therefore, be a critical component of the safeguards policy in the future. The monitoring process would primarily entail following-up on the recommendations arising from previous safeguards assessments to ensure that (i) commitments made by the authorities have been fulfilled, and (ii) the recommendations have been satisfactorily implemented. In general, commitments made by the authorities would be monitored in conjunction with overall program conditionality and the main focus of safeguards monitoring would, therefore, be on the efficacy of implementation. Key considerations for effective monitoring include the provision of relevant information by authorities and the nature and periodicity of monitoring.

57. To facilitate the monitoring of recommendations, **central banks would provide annually to IMF staff their audited annual financial statements and related audit reports**, including management letters and special audit reports, for as long as IMF credit remains outstanding. As part of this process, staff might request specific documents necessary to conduct effective monitoring.

58. **The nature and periodicity of safeguards monitoring would depend on the results of the previous safeguards assessment, primarily the criticality of identified vulnerabilities, as well as their possible impact on misuse and misreporting.** Other risk factors would also be considered, such as the track record of implementing safeguard recommendations, a history of misreporting, and the amount of IMF credit outstanding. The monitoring procedures would apply for as long as IMF credit is outstanding and would cover all members who were subject to safeguards assessments, including those under the transitional procedures. The periodicity of monitoring would be influenced by the agreed timing for implementing the recommendations, but in general terms staff expects to monitor the implementation of safeguards recommendations every 12-18 months.

59. **It is expected that off-site monitoring would be the primary monitoring tool,** particularly for tracking the implementation of those safeguards recommendations that are easily verifiable by submission of a letter or report (e.g., appointment of external auditors, establishment of an audit committee, etc.). In some cases staff expects that on-site monitoring might be necessary, which would be subject to IMF management approval. However no on-site monitoring would be conducted for countries whose Fund-supported program has expired, even if it still has IMF credit outstanding.

60. **The monitoring process may result in the identification of new vulnerabilities in a central bank's ELRIC.** The identification of new vulnerabilities could, depending on the circumstances and other risk factors, trigger a reassessment of the adequacy of a central bank's ELRIC. As before, this would not be undertaken in countries with outstanding credit, but whose Fund-supported program has expired.

B. Conducting Safeguards Assessments for New Arrangements

61. **Member countries receiving a new arrangement from the IMF would be subject to a full safeguards assessment.**¹¹ These members include those that (i) have been previously subject to the transitional procedures, (ii) have undergone a full Stage One (and Stage Two, if necessary) assessment, or (iii) have never been subject to a safeguards assessment. The objective of the safeguards assessment would be unchanged from the existing modalities, i.e., to provide reasonable assurance that a central bank's ELRIC is adequate to manage resources, including IMF disbursements. However, the nature and extent of the safeguards assessment for central banks that have previously been subject to a full safeguards assessment would be based on known risk factors affecting the possible misuse and misreporting of IMF resources, including the findings and timing of the previous assessment, the results of the safeguards monitoring process, and new developments at the

¹¹ As noted in paragraph 53, "new" arrangements would include augmented arrangements. For RAPs, the safeguards assessment would be conducted in advance of the expected follow-on arrangement approval date.

central bank. For example, a central bank whose initial safeguards assessment was conducted within the previous 12-18 months and appropriate monitoring has been conducted may not be subject to as much review as a central bank whose initial safeguards assessment was conducted five years earlier.

62. It is expected, therefore, that some safeguards assessments would be concluded quickly, based on updated documents and discussions with the authorities and auditors, while others (including member countries not yet subject to an initial safeguards assessment) would require a *de novo* assessment, possibly including an on-site visit. In all cases, however, the safeguards assessment would update, at a minimum, the adequacy of safeguards in each of the ELRIC areas and make recommendations to remedy identified vulnerabilities, including identifying the types and possible sources of needed technical assistance.

63. **In principle, the safeguards assessment should be completed prior to the Executive Board's approval of a new arrangement.**¹² Such a deadline for the completion of a safeguards assessment allows for informed decision making by the Executive Board *ex ante* and facilitates the implementation of remedial safeguards measures by central banks, possibly under program conditionality. Although this deadline may not be met in all cases, as discussed in paragraph 45, **staff proposes that the current deadline of completion of the safeguards assessment by no later than the first program review under the arrangement be retained.**

64. **The modalities for future safeguards assessments would be broadly similar to existing procedures,** but as noted in Chapter IV, continuous refinements in the operational application of the ELRIC framework are expected as the staff learns from experience. Expected refinements to existing procedures include (i) the preparation of only one safeguards assessment report (i.e., the Stage One/Stage Two distinction would be dropped for report purposes, but not in respect to the retention of a decision point for an on-site assessment), and (ii) the tailoring of documentation requested from the central bank to the specific country, although still broadly based on the existing document set.

C. Communicating the Results of Safeguards Assessments to the Executive Board

65. **Safeguards assessments allow the Executive Board to make decisions concerning the use of IMF resources with a reasonable degree of assurance that known vulnerabilities in a central bank's ELRIC are being, or will be, addressed.**

Moving forward into the next phase of safeguards assessments, it will be important to ensure that the Executive Board continues to receive accurate, timely, and relevant information. In particular, the Executive Board should be kept informed of the status of outstanding

¹² With the exception of those countries that are members of the regional central banks, which will be subject to new safeguards assessments every four years.

recommendations from previous safeguards assessments and the identification by staff of any new vulnerabilities in a central bank's framework of safeguards.

66. **In principle, the text of the staff report for a country's request for the approval of a new arrangement will summarize the result of the safeguards assessment**, including the identification of outstanding vulnerabilities in a central bank's ELRIC and the history of safeguards assessments and monitoring thereof. As discussed in paragraph 45, the staff report and appraisal would also explain any issues related to missed deadlines. In this context, and abstracting from other issues that may affect a program for which Fund financial support is considered, management may choose not to present to the Executive Board an arrangement for approval, or a program review for completion, if any one of three occurrences applied: (i) the staff had been unable to make an assessment of the adequacy of a central bank's ELRIC because of non-cooperation by the authorities, (ii) the authorities were unwilling to commit to take appropriate remedial measures to alleviate key vulnerabilities, or (iii) key commitments on remedial measures have not been implemented as agreed. In such situations, the Executive Board would be kept informed of circumstances, in keeping with existing practice.

67. **The Executive Board will be informed on an ongoing basis of the progress in implementing safeguards recommendations through staff reports, whether concerning a Fund-supported program or an Article IV consultation, as applicable.** This approach will ensure that the Executive Board is kept informed when deadlines for recommendations included under program conditionality are not met. The Executive Board will also be kept informed of the general results of safeguards work through periodic summary reports on a non-country specific basis. Such reports would provide general information on the status of safeguards assessment findings and highlight other matters of importance related to safeguard issues.

VI. ISSUES FOR DISCUSSION

68. The staff has addressed the major issues related to safeguards assessments by considering the experience with the program over the past 18 months, and has made proposals for next steps in the continued implementation of the policy. Directors may wish to comment on the following issues:

- Chapter III of the report discusses the main findings of the safeguards program to date. **Staff would welcome Directors' views on the findings of safeguards assessments during the initial period of the policy**, especially the identification of significant vulnerabilities concerning program monitoring.
- **What are Directors' views on the efficacy of the safeguards assessment policy to help reduce the possibility of misuse of IMF resources or misreporting?** Does the existence of a safeguards process and anticipation of a safeguards assessment provide an incentive for a central bank to be more aware and vigilant in its actions?
- **What are Directors' views on the proposal to make the safeguards assessment policy a permanent part of the IMF's operations?** The safeguards assessment policy was adopted for an experimental period and the assessments provide a "snapshot" of any weaknesses in a central bank's ELRIC. Do Directors agree that the Fund should continue to have reasonable assurances about the mitigation of risk in the ELRIC areas?
- **What are Directors' views on the proposed way forward as set out in Chapter V?** Do Directors agree with the expanded coverage of safeguards assessments to include augmentations to existing arrangements and Rights Accumulation Programs, and the proposed operational refinements?

GLOSSARY

Accounting system—An accounting system is the series of tasks and records of an entity by which transactions are processed as a means of maintaining financial records. Such systems identify, assemble, analyze, calculate, classify, record, summarize and report transactions and other events.

Audit Committee—an independent body charged with the oversight of governance in an organization. An audit committee may be viewed as an extension of the central bank’s Board which has the responsibility of monitoring the governance process with respect to the financial reporting framework and internal control system of the bank.

Auditor—The auditor is the person with final responsibility for the audit. This term is also used to refer to an audit firm or a Supreme Audit Institution. (The term “auditor” is used to describe both auditing of financial statements and related services that may be performed.)

BCEAO— the Central Bank of the West African States whose eight member countries comprise the West African Economic and Monetary Union and are Benin, Burkina Faso, Côte d’Ivoire, Guinea Bissau, Mali, Niger, Senegal and Togo.

BEAC— Bank of the Central African States, whose six member countries comprise the Central African Economic and Monetary Community and are Cameroon, the Central African Republic, Chad, the Republic of Congo, Equatorial Guinea, and Gabon.

Central Bank—The institutional arrangements for assigning responsibility for the conduct of a country's monetary policy differ among the IMF's membership. For most IMF members, this responsibility is assigned to the central bank or to a system of constituent national central banks in a multinational central bank arrangement. There are a number of countries, however, where this role is designated to a "monetary authority" or to a "currency board." To facilitate presentation, the term "central bank" in the Code refers to the institution responsible for conducting monetary policy, which may or may not be a central bank.

ELRIC— The framework used to conduct safeguards assessments. External audit mechanism; Legal structure; financial Reporting framework; Internal audit mechanism; internal Control system.

External Audit Mechanism—The practices and procedures in place to enable the external auditor to express an opinion whether the **financial statements** are prepared, in all material respects, in accordance with an identified financial reporting framework. The phrases used to express the auditor’s opinion are “give a true and fair view” or “present fairly, in all material respects,” which are equivalent terms. A similar objective applies to the audit of financial or other information prepared in accordance with appropriate criteria.

External auditor (sometimes also referred to as Independent Auditor)—Where appropriate the terms “external auditor” and “external audit” are used to distinguish the external auditor from an internal auditor and to distinguish the external audit from the activities of the internal audit department that is typically part of a central bank.

External expert—Professionally qualified accountants, auditors and central bank specialists with specific expertise in governance principles, risk management issues, international accounting and auditing standards, forensic accounting and central bank operations.

Fiscal agent — Upon membership with the IMF, a member country designates a fiscal agent to deal with the IMF. The fiscal agent acts as the member country’s agent. The fiscal agent may be the central bank or the member’s treasury (i.e., ministry of finance) or a stabilization fund.

IAS—The International Accounting Standards issued by the International Accounting Standards Committee, which has been superseded by the International Accounting Standards Board (IASB).

IASB — The International Accounting Standards Board. An organization which promulgates International Financial Reporting Standards (IFRS), which are intended to replace IAS. Pending the issuance of IFRS, the IASB has adopted IAS.

IFAC—The International Federation of Accountants.

IFRS — International Financial Reporting Standards, issued by the IASB.

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

Internal Control—The process, effected by an entity’s management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in (i) the effectiveness of operations, (ii) the reliability of financial reporting, and (iii) compliance with applicable laws and regulations.

Internal control system—An internal control system consists of all the policies and procedures (internal controls) adopted by the management of an entity to assist in achieving management’s objective of ensuring, as far as practicable, the orderly and efficient conduct of its business, including adherence to management policies, the safeguarding of assets, the prevention and detection of fraud and error, the accuracy and completeness of the accounting records, and the timely preparation of reliable financial information. The internal control

system, therefore, extends beyond matters that relate directly to the functions of the accounting system.

INTOSAI—The International Organization of Supreme Audit Institutions.

ISA—The International Standards on Auditing issued by IFAC.

Management Letter—A letter, frequently in the form of a short report, issued by an external auditor that draws attention to material weaknesses in the internal control systems that have come to the attention of the auditor during the audit of the financial statements. Management letters are confidential documents.

Special audits—A report issued in connection with the external (independent) audit of financial information **other than** the external auditor's report on financial statements.

Stage One safeguards assessment— a preliminary assessment of the adequacy of the central bank's ELRIC based on a review of documentation provided by the authorities and, if necessary, discussions with the external auditors.

Stage Two safeguards assessment—On-site assessment mission which confirms or modify the preliminary conclusions drawn by the Stage One assessment and proposes specific remedial measures to alleviate confirmed vulnerabilities in a central bank's ELRIC.

Supreme Audit Institution—The public body of a State which, however designated, constituted or organized, exercises by virtue of law the highest public auditing function of that State. In addition to auditing the financial records of government ministries and departments, Supreme Audit Institutions often fulfill an investigative function at the behest of the legislature.

Transitional Procedures— Procedures that apply to countries with IMF arrangements in effect prior to June 30, 2000 and are similar to a Stage One assessment, except that the central bank is subject to assessment in only one of the areas of the safeguards framework, namely the external audit mechanism and normally there is no on-site assessment.

Annex I. The Safeguards Framework

The five key areas of the safeguards framework, summarized under the acronym *ELRIC*, are as follows:

The External Audit Mechanism. The external audit mechanism comprises the practices and procedures in place to enable an independent auditor to express an opinion whether the financial statements are prepared, in all material respects, in accordance with an established financial reporting framework. An external audit mechanism is important for the credibility of a central bank; the objective of the assessment is to establish whether an independent and high-quality external audit of the central bank's financial statements is conducted regularly and whether previous recommendations made by the auditors have been implemented. The assessment will also ascertain whether an audit opinion is published with the financial statements.

The Legal Structure and Independence. Government interference with central bank operations can undermine a central bank's autonomy and increase the risks to which it is exposed, particularly if agencies other than the central bank have responsibility for reserves management. The objective in assessing this area is to ensure that (i) the arrangements whereby the central bank extends credits, advances or overdrafts to the government follow legal procedures, and that the government has not interfered with these regulations; and (ii) for those agencies that share monetary authority with the central bank, the legal basis of their relationship to the central bank, their role as a monetary authority, and the responsibility for reserves management are transparent and explicit.

The Financial Reporting. Adequate financial reporting practices are an essential element of effective central bank operations and encompass the provision of both internal information (including financial, operational and compliance data) and external market information about events and conditions that support decision-making. For such information to be useful it must be relevant, reliable, timely, accessible and provided in a consistent format. The objective in assessing financial reporting practices is to ensure that the central bank adheres to international good practices in its accounting principles, financial statement presentation and disclosures, coverage of operations, and reporting of statistical data. Non-adherence to accepted good practices might be an indicator of a lack of transparency and accountability.

The Internal Audit Mechanism. Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of its risk management, control, and governance processes. The objective in assessing the internal audit function at a central bank is to evaluate its effectiveness by considering the organizational independence and objectivity that allows the internal audit activity to fulfill the nature and scope of its work program and the procedures for communicating results unencumbered from external interference.

System of Internal Controls. Internal control is a process comprising all the policies and procedures effected by the board, management, and other personnel of a central bank to assist in achieving (i) the effective and efficient conduct of its business, (ii) its compliance with applicable laws, regulations, policies, plans and internal rules and procedures, and (iii) the timely preparation of reliable financial information. A system of effective internal controls is a critical component for the sound operation of central bank activities, including the safeguarding of assets, the prevention and detection of fraud and error, and the accuracy and completeness of accounting records. The objective in assessing internal control systems is to determine whether appropriate procedures are in place, at all levels, to provide reasonable assurance that material risks that could adversely affect the central bank's operations are being continuously recognized, assessed, and mitigated. The main focus is on controls over the banking, accounting and foreign exchange operations of the bank.

ANNEX II. COMPLETED SAFEGUARDS REPORTS AS OF FEBRUARY 8, 2002

Transitional Procedures - Report on the External Audit Mechanism (25)	Stage-One (Off-Site) Safeguards Assessments (26)	Stage-Two (On-Site) Safeguards Assessments (10)
Argentina Bolivia Bosnia Herzegovina Bulgaria Cambodia Colombia Djibouti Estonia Ghana Guyana Honduras Jordan Latvia Lithuania Mozambique Panama Papua New Guinea Romania São Tome & Príncipe Tanzania Turkey Ukraine Uruguay Yemen Zambia	Albania Armenia Azerbaijan BCEAO BEAC Ethiopia Georgia Guinea Kenya Kyrgyz Republic Lao PDR Latvia Lesotho Lithuania Macedonia (FYR) Madagascar Malawi Mongolia Nicaragua Nigeria Pakistan Peru Sri Lanka Tajikistan Vietnam Yugoslavia	BEAC Ethiopia Georgia Kenya Kyrgyz Republic Nigeria Pakistan Sri Lanka Tajikistan Yugoslavia

ANNEX III. ANALYSIS OF THE FINDINGS OF SAFEGUARDS ASSESSMENTS

A. Positive Trends Identified by Safeguards Assessments

Background

As a diagnostic tool, the primary purpose of safeguards assessments is to identify vulnerabilities in a central bank's safeguards. In many areas, no significant vulnerabilities have been identified by the safeguards assessment process. This section highlights some positive trends identified by safeguards assessments. It also lists those cases where the central bank was found to publish its audited financial statements and where the safeguards assessment concluded that the central bank's safeguards appeared to meet the requirement of the safeguards framework in the ELRIC categories, with the exception of the financial reporting category, where no central bank fully met the requirements.

Positive Trends

- **An increasing number of central banks publish audited financial statements.** The overall trend is one of fuller and wider publication of audited financial statements. Whereas previously many central banks published only a summary balance sheet and possibly an income statement, an increasing number of central bank annual reports now include the complete financial statements, including explanatory notes and the external audit report. In addition, more and more central banks are publishing financial statements on their external websites.
- **External audits are being strengthened.** Until recently, in many countries the central bank was audited by the government auditor. The trend now apparent is that many central banks have recognized the potential added value from external auditors who have extensive experience with financial institutions and audits thereof. Central banks, therefore, are increasingly turning to international accounting firms for their audits, often in partnership with the government auditor. In addition to leveraging the expertise of private firms, such an involvement allows for auditor rotation while protecting the integrity of the audit process.
- **Central bank financial reporting has improved significantly.** Many central banks have adopted, or are planning to adopt, International Accounting Standards—or another suitable framework such as the Guidelines of the European Central Bank—for the preparation of financial statements. Although the application of such standards (refer finding 4 below) is often uneven, increased transparency is

evident in central bank financial statements, especially in the area of complex financial instruments, such as derivatives.

- **Central banks are increasingly recognizing the importance of internal audit.** Previously, internal audit has been perceived as a “control” over operational procedures to ensure that transactions are appropriately authorized and accounted for, i.e., internal audit fulfilled a detection role. However, internal audit is increasingly viewed as an essential function for providing assurance to central bank management that the risk management, control and governance processes operate effectively, i.e., a preventative role. Although safeguards assessments have identified that many central banks have not yet revamped their internal audit functions (refer finding 6 below), many central banks have recognized the added value function that internal audit can play and intend to overhaul their existing practices accordingly.

Country Cases

- Countries whose central bank publishes its complete audited financial statements: 29.
- Countries whose central bank met the requirements of the safeguards framework in the area of the External Audit Mechanism: 16.
- Countries whose central bank met the requirements of the safeguards framework in the area of the Legal Structure and Independence: Nine.
- Countries whose central bank met the requirements of the safeguards framework in the area of the Internal Audit Mechanism: Three.
- One country’s central bank met the requirements of the safeguards framework in the area of the Internal Control System.

B. Areas for Improvement Identified by Safeguards Assessments

1. Non-existent or Deficient External Audit Mechanism

Findings

- Insufficient or too frequent rotation of external auditors.
- Non-adherence by auditors to ISA or equivalent.
- Concurrence by auditors with dubious accounting practices by the central bank.
- Insufficient experience and qualifications of the external auditors.
- Non-financial audits conducted by the Auditor General or equivalent (focus on operational issues such as cafeteria usage).
- Inconsistencies between the audit report and the financial statements (e.g., incorrect references, report dated before management approval, absence of notes to the financial statements).
- Long delay in the issuance of audit reports.

Potential Vulnerabilities to IMF Resources and Misreporting

An independent and high quality external audit of a central bank's financial statements is a critical control to ensure the reliability and completeness of the information contained in the financial statements. (especially important for encumbrances etc.). The audit also provides some assurances on the adequacy of procedural controls in place at the bank, which are important for ensuring the integrity of the bank's financial operations.

An effective external audit therefore reduces the possibility for misuse of IMF resources and strengthens the reliance which the IMF can place on critical central bank data such as foreign assets, provided such data are reconciled with the accounting data.

An effective external audit is also important for the central bank's credibility and reputation (as well as reducing the IMF's reputation risk). This is particularly true where the audit is conducted by an established outside firm.

In addition, the quality of external audits is impaired when the auditors do not apply ISA or equivalent, and where the length of the audit engagement creates the appearance of a lack of

independence. Also, inadequate experience and qualification of the external auditors and long delays in the finalization by auditors of their reports reduces overall audit effectiveness.

These types of issues undermine the reliance that can be placed on the financial statements and the underlying operations at the central bank.

Country Cases (33)

Number of Countries with Non-existent External Audit Mechanism: Six.

Number of Countries with Inadequate External Audit Mechanism: 27.

Remedies and Timing

- Engagement of external auditors.
- Rotation policies to meet international best practice.
- Engagement of existing auditors in conjunction with a private firm.
- Adoption of ISA.
- Peer review of ISA application by auditors.
- End-2001 through end-2002.

2. No, or Delayed, Publication of Audited Financial Statements

Findings

- Non-publication of the complete set of financial statements.
- Publication of a summary balance sheet only.
- Delays of at least a year in publication of the full financial statements.
- Selective publication.
- Non-publication of the audit report.
- Non-preparation of a complete set of financial statements.

Potential Vulnerabilities to IMF Resources and Misreporting

Timeliness of data is important – outdated audited information may be reliable, but it is no longer relevant.

The publication of *comprehensive* data is also important to ensure transparency and understandability of the underlying data.

Country Cases (20)

Number of Countries whose Central Banks did not Publish Full Financial Statements: 14.

Number of Countries whose Central Banks Published Financial Statements with a Delay of More Than Six Months: Six.

Remedies and Timing

- Publish audited financial statements in full.
- Improve timeliness of publication.
- Through end-2002.

3. Poor Controls over Foreign Reserves and Data Reporting to the IMF

Findings

- Inadequate procedures to ensure the valuation of foreign reserves in accordance with the Technical Memorandum of Understanding under Fund arrangements or the valuation principles determined by the balance of payments methodology and guidelines for a data template on *International Reserves and Foreign Currency Liquidity*.
- Poor control environment over the management of foreign reserves and inadequate procedural controls, such as segregation of duties and unresolved differences between the accounting records and bank statements.
- Inaccurate or incomplete record keeping arising from inadequate information systems.
- Non-reconciliation of audited foreign reserves balances to net foreign asset data reported to the IMF.

Potential Vulnerabilities to IMF Resources and Misreporting

Inadequate internal controls over foreign reserves significantly increases the possibility of misreporting, either by incorrect valuation of reserves, or the maintenance of incomplete or inaccurate records.

Inadequate controls could also place IMF resources at risk since reserves may be susceptible to misuse or misappropriation.

The reliability of data reporting to the IMF is impaired when the data are not reconciled with the accounting records.

Country Cases

Number of countries whose central banks had poor controls over foreign reserves and data reporting to the IMF: 14.

Remedies and Timing

- Correct valuation problems with foreign reserves and establish appropriate control procedures.
- Resolve long outstanding reconciliation items on foreign deposits held at institutions abroad.
- Improve the overall system of operational controls over foreign reserves (e.g., separate front and back offices).
- Implement reconciliation procedures of accounting records with data reported to the IMF for program monitoring purposes (sometimes under the auspices of Internal Audit Department).
- Through end-2002.

4. Inadequate Accounting Standards

Findings

- Absence of a benchmark framework, thereby affording the central bank the discretion to amend policies and disclosures at will.
- Inadequate explanatory notes in the financial statements.
- Inappropriate accounting treatment of certain balances, including valuation gains and losses, advances to government, and off-balance sheet items.
- Use of cash basis of accounting for certain transactions.

Potential Vulnerabilities to IMF Resources and Misreporting

Inadequate implementation of internationally recognized accounting standards (e.g., IAS or an equivalent framework) not only hampers transparency, but also allows central banks to make exceptions in the recording, measurement, and reporting of transactions.

Implementation of internationally recognized accounting standards ensures:

- Consistency in the presentation of data.
- A common yardstick for measurement and valuation principles.
- Comprehensive disclosures.
- The identification of contingencies and encumbrances.

The IMF's experience in certain past cases of misreporting has demonstrated that adherence to IAS would have helped prevent or detect intentional or unintentional misreporting.

Country Cases

Number of countries whose central banks had inadequate accounting standards: 23.

Remedies and Timing

- Implement IAS, or equivalent.
- Enhance specific disclosures.
- Through end-2003

5. Deficient Governance Oversight

Findings

- Over reliance on Governor for decision-making and oversight of operational transactions.
- Lack of monitoring and follow-up of internal and external audit recommendations by management.
- Absence of an audit committee or an equivalent oversight body.
- Quasi-fiscal activities expensed by the central bank, including construction costs for government buildings, purchase of computer system for government, purchase of vehicles for outside agencies, inappropriate payments to national sports champions.

Potential Vulnerabilities to IMF Resources and Misreporting

Oversight by a central bank Board is a key component of effective governance, especially the oversight of the senior management team. Another important component of good governance is oversight of the audit mechanisms to ensure satisfactory implementation and follow up of audit recommendations and high quality audits.

Undertaking quasi-fiscal transactions could be indicative of limited independence and autonomy of the central bank, which could place IMF resources at potential risk. Quasi-fiscal activities are also indicative of impaired governance at the central bank—internal checks and balances should ensure that inappropriate transactions are not contracted.

The misclassification of quasi-fiscal activities as central bank expenses (as opposed to credit to government) is often an indication of inaccurate fiscal data, which could affect monitoring of the IMF program.

Country Cases

Number of countries whose central banks had deficient governance oversight: 20.

Remedies and Timing

- Establish a supervisory Board.
- Establish audit committee to ensure Board oversight of all aspects of the audit mechanisms, the financial reporting, and the operation of internal controls, including the implementation of audit recommendations.
- Cease all quasi-fiscal activities.
- Adopt IAS to ensure appropriate accounting for previous quasi-fiscal activities.
- Through end-2002.

6. Deficient Internal Audit

Findings

- Insufficient expertise and professional qualifications.
- Narrow focus on operational transactions and audits.
- Inadequate follow up of internal audit recommendations.
- Internal audit is a start-up operation with limited resources.
- Internal audit executes operational transactions.
- Inadequate IT experience.

Potential Vulnerabilities to IMF Resources and Misreporting

Internal audit is an essential element of a central bank to ensure that it accomplishes its objectives through a systematic and disciplined approach to evaluating and improving the effectiveness of risk management, control and governance processes. An effective internal audit mechanism would strengthen the integrity of the central bank's operations and control functions, thereby providing additional assurance to the IMF that the chances of misuse of IMF resources and misreporting are reduced.

Country Cases

Number of countries whose central banks had deficient internal audit: 23.

Remedies and Timing

- Commission a review of internal audit.
- Initiate training program for IAD staff.
- Implement a risk-based internal audit approach.
- Expand the role of internal audit, including strengthening the staff complement.
- Through end-2002.

7. Loopholes in Governing Legislation

Findings

- Lack of clarity in the statutory provisions governing the ownership and management of reserves.
- Provisions in the central bank law that enabled potential abuse by the government or parliament in the appointment and dismissal of central bank officials.

Potential Vulnerabilities to IMF Resources and Misreporting

A central bank without autonomy may place IMF resources at risk since the central bank's resources could be directed by agents outside of the central bank.

Country Cases

Number of countries whose central banks had loopholes in the governing legislation: 13.

Remedies and Timing

- Amend the relevant legislation.
- At the time of the next amendment to existing legislation.

8. Inadequate Accounting for IMF Transactions

Findings

- No disclosure of liability to the IMF.
- Retention of IMF accounts as off-balance sheet items.
- Non-revaluation of IMF accounts.
- Late payments to the IMF resulting from internal accounting and control deficiencies.

Potential Vulnerabilities to IMF Resources and Misreporting

Incomplete accounting for IMF transactions provides no assurance that the member country's use of IMF credit is transparently and accurately reflected in the central bank's balance sheet.

Also, inadequate accounting may impair timely payments to the IMF.

Country Cases

Number of countries whose central banks had inadequate accounting for IMF transactions: Nine.

Remedies and Timing

- Adopt IAS for IMF accounts.
- Seek technical assistance.
- Use IMF's standing authorization facility to debit the SDR account.
- Through end-2002.

ANNEX IV. RESOURCE IMPLICATIONS

The Treasurer’s department (TRE) takes the lead on safeguards assessments. The FY2001 budget allocated a total of six staff years for this initiative: four staff years for TRE, and one staff year each for MAE and OIA.

At the time of the approval of the safeguards policy in March 2000, the IMF had few staff members with the requisite specialized skills to conduct safeguards assessments. Resources have been utilized through a combination of:

- External recruitment;
- Use of external experts;
- Redeployment of TRE staff; and
- Partnering of TRE with other IMF departments for the conduct of assessments, notably MAE and OIA.

Staff resources used to date are summarized in the table below. The overall resource usage is minimal relative to other IMF initiatives. Nevertheless, the annualized resource utilization in FY2002 is expected to be 9.8 staff years, four years in excess of the budget allocation.¹³ The additional resources have been provided by internal redeployment within TRE and uncompensated overtime, but the latter has placed a significant burden on the small number of staff conducting the assessments and is not sustainable in the longer term.

Table. 3 Resources Utilized on Safeguards Assessments¹

	Staff Years
Allocated by FY2001 budget	6.0
Actual usage in FY2001	7.1
Projected actual usage in FY2002	9.8

¹ Source: BRS data, annualized and adjusted to reflect that the IMF expects 44 weeks from a full time staff member in a single year.

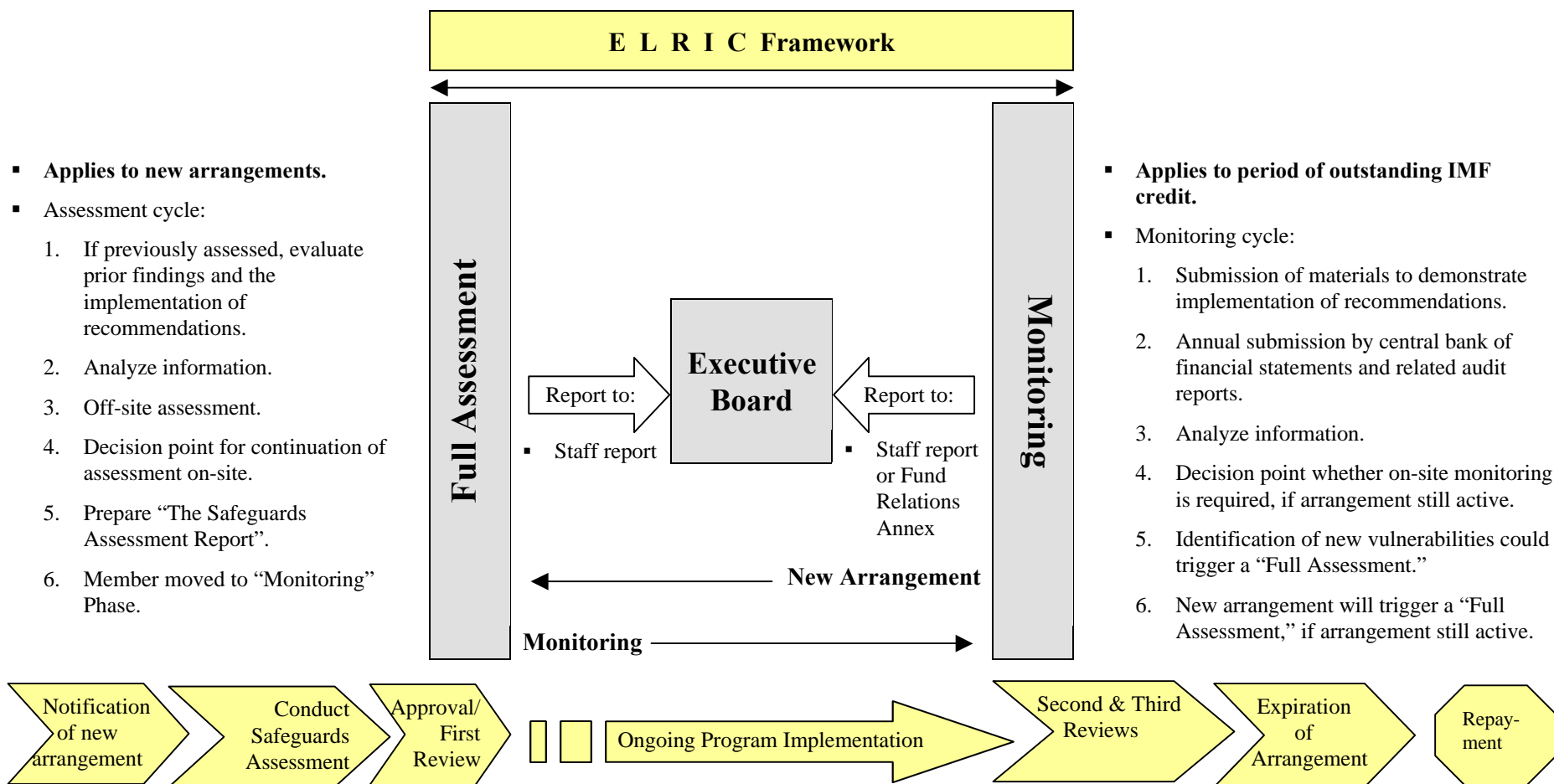
The ongoing evolution of the safeguards assessment work will continue to place a significant demand on staff resources. In anticipating future requirements, the following activities will require additional resources:

¹³ Excluded from this number is the staff year equivalent arising from the use of external experts by the Fund to perform safeguards assessments.

- **Outstanding first time assessments** – **Almost half** of member countries using IMF credit have yet to be subject to full safeguards assessments.
- **Monitoring process** – Member countries that have already undergone a first time assessment will require monitoring of previous recommendation implementation.
- **New assessments** – Member countries applying for a new arrangement with the IMF will require a safeguard assessment, albeit scaled down if a previous assessment had been undertaken.
- **Voluntary assessments** – Staff has received requests for safeguards assessments from member countries that do not have an arrangement with the IMF. Such requests are likely to increase, especially in the context of scarce specialized skills in these areas generally at central banks.

The combination of the above activities indicates that the need for safeguards assessment resources will increase over the next two to three years, before plateauing, and possibly decreasing, in the longer term.

ANNEX V. SCHEMATIC OF THE PROPOSED SAFEGUARDS MODALITIES MOVING FORWARD



ATTACHMENT I. INVOLVEMENT OF EXTERNAL EXPERTS

The 2001-02 panel of experts has undertaken an independent appraisal of the staff's review of experience with safeguards assessments and proposals for the way forward. Staff appreciates the technical contributions and advice received from panel members throughout the review process. The panel commented at an early stage on the adequacy of the staff's review framework, including the analysis and presentation of the safeguards findings. The panel's commentary included useful feedback resulting from the meetings held by members of the panel with all stakeholders in the safeguards process, comprising Executive Directors, staff of area and functional departments, and central banks subject to safeguards assessment. The staff is grateful for the input of the members of the panel and has incorporated their comments and suggestions throughout the paper. In particular, staff acknowledges the following principal contributions:

- Expanding the refinements to the ELRIC framework and the documentation set (paragraphs 41-42 and Box 4).
- A more explicit recognition of the shortcomings of the Stage One/Stage Two distinction (paragraphs 43-44).
- The importance of retaining deadlines for the completion of safeguards assessments (paragraphs 45, 63 and 66).
- Identifying the need for better internal and external communication and coordination of safeguards work (paragraphs 46-49).
- Expanding the scope of safeguards assessments to other cases where Fund resources are being committed, such as Rights Accumulation Programs (paragraph 53).

As noted in paragraph 6, the panel's assessment of the staff's review of experience with safeguards has been issued as a separate paper. The chair of the panel is expected to be present at the Executive Board discussion of this paper.

ATTACHMENT II. TERMS OF REFERENCE FOR PANEL OF EXTERNAL EXPERTS

Safeguards Assessments—Review of Experience

Terms of Reference for Panel of Experts

1. Background

On March 23, 2000 the Executive Board adopted a strengthened framework of measures to safeguard the use of IMF resources through the introduction of **safeguards assessments of central banks**. The framework, which was independently reviewed and endorsed by a panel of external experts, was introduced in the wake of several misreporting instances and allegations of misuse of IMF resources.

The specific objective of safeguards assessments is to provide reasonable assurance to the IMF that a central bank's control, accounting, reporting and auditing systems in place to manage resources, including IMF disbursements, are adequate to ensure the integrity of operations. The International Monetary and Financial Committee (IMFC), at its 2000 meetings, endorsed the Executive Board's decision and stressed the "forceful application of the strengthened framework." The new approach was adopted for an initial experimental period of 12-18 months, after which time the Executive Board would review the IMF's experience with safeguards assessments, aided by the panel of experts (Attachment).

2. Purpose and Main Modalities of the External Review

Pursuant to the Board's decision, an external review of the operational experience with the safeguards policy will take place in late 2001-early 2002. IMF staff will prepare a paper for the Board that reviews experience with safeguards assessments and proposes next steps. The panel of experts is expected to analyze, assess and contribute to the staff's findings and recommendations. The main purpose of the assessment by the panel of external experts is to provide the Executive Board with an independent and authoritative appraisal of the staff's review. The views and contributions of the members of the panel will be presented to the IMF Executive Board in conjunction with the staff paper.

3. Focus of the External Panel Assessment

The panel of external experts will carry out the assessment as indicated in section 4 below. The panel will also comment at an early stage on the envisaged framework of the review to be conducted by staff. In particular, the panel will:

- Analyze and comment on the scope and nature of the review framework envisaged by staff.
- Respond to the staff recommendations for resolving identified issues during the safeguards assessment process.
- Identify additional issues, if any, arising from the implementation of, and experience with, safeguards assessments for further review and analysis by the staff.
- Contribute to the analysis and recommendations concerning the evolution of the safeguards assessments process.

4. **Procedures**

The members¹⁴ of the panel have agreed to conduct the review; the Chair will be Ms. Michèle Caparelo. The panel will conduct its review freely and objectively, and members will contribute to the best of their professional abilities.

The panel will have access to information in possession of the Fund as needed for carrying out its work, including all documentation obtained during the conduct of safeguards assessments. Panel members will also have the opportunity to meet with Executive Directors or elicit the views of member country authorities. Each member of the panel undertakes to protect the confidentiality of information in possession of the Fund obtained in the course of the review.

The panel assessment will be carried out in **two stages**. Background information on the safeguards experience, on the envisaged framework for the conduct of the review and a list of initial issues for consideration will be made available to panel members in early November, 2001 for a meeting on November 26-27, 2001. At that meeting panel members will obtain all documentation requested for the completion of their assessment, meet with participants in the process, offer initial comments and a preliminary assessment, and request further information, if necessary.

Taking into consideration the views of the panel members at the first meeting, the staff will prepare a draft Board paper, which will be made available to the panel in advance of its second and final meeting, which will be held on January 28-29, 2002. At the second meeting the panel will prepare written views on the draft of the staff paper. The panel's written views,

¹⁴ Of the six original panel members, two are no longer able to serve on the panel. The replacement panel members are indicated in the attachment.

together with the staff paper, will be issued to the Executive Board in late February for an Executive Board consideration in March 2002; the chair of the panel will be invited to be present at that meeting.

The Fund reserves the exclusive rights to the written views of the panel and members of the panel undertake not to publish any part of these views separately.

5. Logistics

The first meeting will take place in Washington, D.C. The second meeting will take place in Paris, France, or at another agreed location.

The compensation for panel members will be a lump-sum payment of US\$8,000 (eight thousand US dollars). In addition, the cost of transportation, travel allowances, hotel, and subsistence will be provided by the Fund in accordance with standard business travel policies.

Panel of Experts, 2001 - 2002

1. Chair: Ms. Michèle Caparelo
Director, Internal Audit, European Central Bank
Chair, Internal Audit Committee of European System of Central Banks
2. Mr. Eduardo Grinberg
President of the Court of Accounts
Province of Buenos Aires, Argentina
3. Mr. Jeremy Foster
Head of Central Bank Services
PricewaterhouseCoopers
Moscow
4. Mr. M.R. Rasheed
Deputy Governor
Central Bank of Nigeria
5. Mrs. Tanya Sirivedhin¹⁵
Deputy Governor, Financial Institutions Stability
Bank of Thailand
6. Mr. Edgar A. Martindale¹⁶
Assistant Director
Federal Reserve Board
Washington, D.C.

¹⁵ Replacement for Mr. Suparut Kawatkul, Director General, Revenue Department, Ministry of Finance, Thailand, of the 2000 Panel.

¹⁶ Replacement for Mr. Lynn Turner, Chief Accountant, Securities and Exchange Commission, of the 2000 Panel.