

INTERNATIONAL MONETARY FUND

Safeguards Assessments—2006 Update

Prepared by the Finance Department

(In consultation with other departments)

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I. OVERVIEW

1. **This paper provides Executive Directors with an update of safeguards assessment activities through the first half of 2006.** This is the first update report following the review of the safeguards policy in April 2005, when Directors agreed that such reports should be prepared on an annual basis going forward rather than on a semi-annual basis.¹
2. Section II describes general developments in the modalities for the safeguards policy, following the review of the policy, and the level of activity. Section III summarizes recent findings from safeguards activities. Section IV summarizes the outreach activities undertaken to enhance communication and dissemination of information on the safeguards policy. Annex I highlights the main features of the safeguards policy, Annex II provides the list of central banks currently monitored, and Annex III provides details on the status of recommendations.

II. DEVELOPMENTS AND ACTIVITIES

3. With the maturing of the safeguards policy, the focus of the work has shifted from initial assessments toward the monitoring of the safeguards frameworks of central banks and the conduct of update assessments in respect of new arrangements. This shift reflects the strengthened safeguards frameworks at central banks as a result of implementing prior safeguards recommendations. Therefore, while update assessments continue to identify new areas for improvement, serious vulnerabilities are identified less frequently than during initial assessments. For example, three of the 15 assessments completed recently found no new significant vulnerabilities. However, because new vulnerabilities can emerge subsequent to the conduct of a safeguards assessment, the ongoing monitoring of central banks subject to a previous assessment has become an increasingly important component of the safeguards work.
4. **The starting point for monitoring activities is the existing information set from previous assessments.** A key aspect of safeguards monitoring is the follow-up of prior recommendations through regular contacts with central bank counterparts and auditors. Another key aspect involves the reviews of the most recent audited financial statements and management letters to identify emerging developments that could affect the safeguards framework. In this context, and in line with suggestions from the panel of independent experts involved in the 2005 policy review, a questionnaire for central banks has been developed. The questionnaire has proven helpful in obtaining relevant information on the

¹ See *Safeguards Assessment—Review of Experience* (04/01/05) and *The Acting Chair's Summing Up on Safeguards Assessments—Review of Experience* (04/28/05).

status of the safeguards framework at central banks for which a safeguards assessment was previously conducted.²

5. Modalities have been established to reflect the increased importance of the monitoring framework, including the use of a risk-based approach to ensure efficient use of resources, developing a series of triggers based on previous safeguards experiences to detect early signs of emerging safeguards issues, and tailoring work programs that set out, inter alia, contact points with central bank counterparts and external auditors.

6. **During the period under review, staff monitored 59 central banks that have been subject to a previous safeguards assessment.**³ The monitoring of recommendations revealed that the overall implementation rate for recommendations made in the context of safeguards assessments remains broadly unchanged at just over 80 percent (see Annex III). Almost all recommendations that have been included under program conditionality and about 79 percent of other recommendations have been implemented. In a number of cases where programs went off-track, implementation rates have been lower than this average. Based on available information, about half of the overdue recommendations are in progress or partially implemented. The monitoring work also revealed emerging safeguards issues that have been resolved through early intervention of staff, in close consultation with area departments and the authorities.

7. **Fifteen safeguards assessments were completed in the period under review.**⁴ Two of these were new assessments and the remainder were update assessments. In line with the revised policy following the 2005 policy review, one of the two new assessments (Haiti) was with respect to a request for access under the Emergency Post Conflict Assistance (EPCA) facility. The total number of assessments completed so far reached 126.⁵

8. **Modalities have also been put in place for sharing safeguards reports with the World Bank.** Following the approval by the Executive Board in December 2005 of a proposal to allow sharing of safeguards assessment reports with the World Bank subject to certain criteria, staff has developed modalities for this process to ensure that reports are only shared on a limited basis. These include a request by World Bank staff for the purpose of

² Section III summarizes recent findings from ongoing safeguards work.

³ Staff also follows closely developments for a number of central banks for which assessments are under preparation or expected in the near future (Comoros, Iraq, Liberia).

⁴ These assessments covered Afghanistan, Armenia, the Banque Centrale des Etats de l'Afrique de l'Ouest (BCEAO), Burundi, Colombia, Dominican Republic, Haiti, Kenya, Kyrgyz Republic, Macedonia (FYR), Madagascar, Malawi, Sierra Leone, Turkey, and Uruguay.

⁵ Central banks are subject to safeguards assessments in respect of arrangements with the Fund approved after June 30, 2000. The total of 126 covers 72 central banks, with 17 central banks having been subject to both a transitional and regular assessment, and 37 central banks having had two or more assessments. The total number also includes three regional central banks (Banque des Etats d'Afrique Centrale (BEAC), BCEAO and Eastern Caribbean Central Bank (ECCB)), each representing a number of member countries.

conducting a fiduciary assessment, and require that the relevant central bank agrees, that the report's confidentiality is maintained and that internal distribution is restricted.

III. RECENT FINDINGS

9. **Examples of vulnerabilities identified in the context of (update) assessments and monitoring** in the period covered by this report include the following:

- One central bank did not yet have in place a regular external audit. Following the assessment, an audit firm was engaged. In two other cases, it was recommended that the external audit firm be required to strengthen its audit team. For six central banks, recommendations were made to establish or reinforce deadlines for completion and/or publication of audited financial statements. Recommendations were also made to establish or lengthen formal audit rotation policies for six central banks and in two cases staff assisted the authorities at an early stage to ensure that policies on re-appointments were in line with international standards.
- In several instances, central banks did not yet (fully) adhere to a transparent financial reporting framework. Recommendations were made to adopt International Financial Reporting Standards (IFRS) (five cases) and/or expand disclosures in financial statements (seven cases).
- Vulnerabilities of varying degrees were identified in the internal audit functions of eight central banks, ranging from inadequate follow-up on recommendations to lack of an audit charter and inadequate operational independence. Proposed remedies included steps to address these issues. In four cases, recommendations were made to expand the audit work beyond compliance audits.
- Four central banks had ineffective oversight of external and internal audits and internal controls. In two cases, central banks were advised to establish oversight bodies, such as an audit committee, while in the two other cases, recommendations aimed at making existing audit committees more effective.
- In ten cases, recommendations were made to strengthen controls over the process of monetary data reporting to the Fund, including through the commissioning of external reviews (one case), reviews by internal audit (eight cases) and strengthening of procedures (four cases). The external audit documents in two cases revealed possible problems with the data on international reserves, resulting in a special audit of end-2005 reserves in one case and further investigation in another. In three other cases, the assessments identified minor errors in the data that were reported and recommended a tightening of the technical memoranda of understanding. In one case, steps were recommended to strengthen foreign reserves management.
- In eight central banks, weaknesses were identified in the legal framework or *de facto* independence. Proposed recommendations included amendments to the legal framework to protect central bank staff from arbitrary dismissals or specify credit relations between

the central bank and the government. In one central bank, the assessment found that the board of directors had not been reconstituted following dismissal of the previous board.

10. **Consistent with past experience, central banks have generally agreed with the proposed recommendations.** In two cases, central banks expressed concern about recommendations related to the full adoption of IFRS, but subsequently did take steps to implement this measure. Central banks have already implemented many of the recommendations or are in the process of taking the recommended steps.

IV. OUTREACH ACTIVITIES

11. **The 2005 policy review endorsed the need to strengthen outreach activities.** The focus is to communicate and disseminate information related to the safeguards process and framework and familiarize central bank staff with the underlying concepts and methodology. The main outreach tool is the conduct of seminars, organized jointly by the IMF and Regional Institutes and the Finance Department, once a year in Washington and once a year at a regional training center. Approximately 60–65 officials attend the seminars on an annual basis. To date, a total of 266 officials from 107 countries have attended nine seminars on safeguards assessments, three of which were conducted in the period under review. Information about safeguards assessments is also disseminated through publications and other fora. In this regard, staff presented a lecture on the safeguards assessments process at a conference organized by the *Central Banking Journal* in September 2005. New mechanisms have also been put in place to strengthen communications with central banks, including the periodic use of questionnaires to ascertain developments in the safeguards of central banks.

Annex I: Safeguards Assessment Policy—A Summary⁶

- The Safeguards Assessments policy was approved by the Executive Board on March 14, 2002, following a two-year experimental period. It was last reviewed in April 2005.
- Objective of Safeguards Assessments
 - to provide reasonable assurance to the Fund that a central bank's control, accounting, reporting and auditing systems in place to manage resources and Fund disbursements are adequate to ensure the integrity of financial operations and reporting to the Fund.
- Applicability of Safeguards Assessments⁷
 - Central banks of members with arrangements for use of Fund resources, including precautionary arrangements and central banks of members receiving Emergency Post-Conflict Assistance.
 - Existing arrangements that are augmented, and member countries following a Rights Accumulation Program, where resources are being committed;
 - Not applicable to first credit tranche purchases, stand-alone CFFs, and drawings under the Emergency Assistance for Natural Disasters facility.
 - Voluntary for members with Policy Support Instrument and Staff Monitored Programs.
- Scope of Policy—ELRIC of a Central Bank
 - the **E**xternal audit mechanism;
 - the **L**egal structure and independence;
 - the financial **R**eporting framework;
 - the **I**nternal audit mechanism; and
 - the internal **C**ontrols system.
- The outcome of a safeguards assessment is a report that identifying vulnerabilities, if any, in the ELRIC areas of a central bank and proposing measures to address them.
- Safeguards assessment reports are confidential documents. In accordance with procedures agreed by the Executive Board, reports may be shared with World Bank staff upon specific request, provided the relevant central bank consents and the report's confidentiality is maintained.

⁶ See also <http://www.imf.org/external/np/tre/safegrds/complete/index.asp>

⁷ Transitional assessments of the central bank's external audit mechanism only for member countries with arrangements in effect prior to June 30, 2000.

Annex II: Safeguards Policy: Central Banks Monitored

Country ^{1/}	Date of Most Recent Assessment	Country	Date of Most Recent Assessment
Afghanistan	June 12, 2006	Kenya	September 7, 2005
Albania	July 14, 2006	Kyrgyz Republic	October 14, 2005
Armenia	November 5, 2005	Lao, PDR	April 8, 2003
Azerbaijan	March 8, 2002	Lesotho	July 24, 2003
Bangladesh	January 25, 2005	Liberia	n.a.
BCEAO ^{1/}	November 4, 2005	Macedonia, FYR	February 28, 2006
BEAC ^{1/}	August 30, 2004	Madagascar	March 17, 2006
Bolivia	September 27, 2004	Malawi	January 27, 2006
Bosnia and Herzegovina	January 24, 2005	Mauritania	May 21, 2004
Bulgaria	November 23, 2004	Moldova	June 12, 2002
Burundi	January 18, 2006	Mongolia	November 25, 2003
Cambodia	March 24, 2004	Mozambique	August 18, 2004
Cape Verde	December 9, 2002	Nepal	October 15, 2004
Colombia	October 24, 2005	Nicaragua	August 23, 2003
Comoros	n.a.	Pakistan	February 1, 2001
Congo, D.R.	January 3, 2003	Paraguay	January 31, 2003
Croatia	August 24, 2006	Peru	October 26, 2004
Dominican Republic	April 27, 2005	Romania	June 17, 2004
Djibouti	July 24, 2001	Rwanda	April 14, 2003
ECCB ^{1/}	February 20, 2003	Sao Tome and Principe	August 2, 2004
Ecuador	June 23, 2003	Serbia	November 29, 2001
The Gambia	February 3, 2004	Sierra Leone	June 12, 2006
Georgia	December 10, 2004	Sri Lanka	July 30, 2003
Ghana	October 15, 2003	Tajikistan	July 23, 2003
Guinea	July 11, 2002	Tanzania	August 5, 2003
Guyana	April 16, 2003	Turkey	June 29, 2005
Haiti	August 5, 2005	Uganda	April 13, 2003
Honduras	February 17, 2004	Ukraine	July 14, 2004
Indonesia	May 22, 2001	Uruguay	September 22, 2005
Iraq	n.a.	Yemen	May 23, 2001
Jordan	June 27, 2003	Zambia	October 20, 2004

^{1/}Name of central bank for regional central banks covering more than one member country.

Annex III: Safeguards Assessments: Status of Recommendations

The overall rate of implementation of recommendations made in the context of safeguards assessments was 82 percent (Table 1). In line with earlier experience, the implementation rate for measures included under either program conditionality or as commitments in the LOI/MEFP was higher than for other recommendations at almost 100 percent. All but three of these recommendations had been implemented.

The average implementation rate for recommendations not included under program conditionality was around 79 percent, slightly higher than at the time of the 2005 review of the policy. Implementation rates vary from country to country, with nine central banks accounting for just over half the overdue recommendations.

- Based on available information, a significant share (about half) of overdue recommendations are in progress or partially implemented as more time was needed than initially expected. This frequently was the case in the area of internal audit.
- About 7 percent of the total outstanding recommendations involve legal changes for which the authorities have not yet found appropriate timing for parliamentary approval.⁸
- Further, just under 10 percent of overdue recommendations refer to measures the central bank authorities have subsequently decided not to implement (e.g., a few central banks decided not to establish audit committees or publish audited financial statements—the latter mostly in the earlier years), or programs have lapsed, without measures being implemented.

It is expected that in cases with prospective new programs, these measures would be addressed in the context of an update assessment.

⁸ Most recent assessments do not include proposed timing for changes to legislation.

Table 1. Implementation Rate of Safeguards Recommendations¹

	Number	Implementation Rate (Percent)
1. Recommendations with formal commitment from the authorities	123	-
a. Under program conditionality ²	56	-
<i>Of which: Implemented</i>	55	98.2
<i>Not Implemented</i>	1	-
b. LOI/MEFP commitments	67	-
<i>Of which: Implemented</i>	65	97.0
<i>Not Implemented</i>	2	-
2. Other recommendations	521	-
<i>of which: Implemented</i>	411	78.9
<i>Not Implemented</i>	110	-
<i>Of which: Overdue less than 3 months</i>	10	-
<i>Overdue 3 months to one year</i>	35	-
<i>Overdue more than one year</i>	65	-
<i>Overdue more than two years</i>	27	-
3. Total recommendations (1+2)	644	-
<i>of which: Implemented</i>	531	82.4
<i>Not implemented</i>	113	-

^{1/}Implementation rates at end-June of recommendations due on or before May 31, 2006 and recommendations due after May 31, but already implemented. Covers recommendations included in safeguards assessment reports. Excludes recommendations which no longer require monitoring, and safeguards related measures implemented as prior actions or other conditions but not included in reports as recommendations.

^{2/}Includes 11 prior actions (all implemented), 14 structural performance criteria (13 implemented), and 31 structural benchmarks (all implemented).