INTERNATIONAL MONETARY FUND

IMF POLICY PAPER

SAFEGUARDS ASSESSMENTS: REVIEW OF EXPERIENCE

OCTOBER 2015

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- The **Staff Report** on the Safeguards Assessments: Review of Experience prepared by IMF staff and completed on September 23, 2015 for the Executive Board's consideration on October 23, 2015. The report should be read in conjunction with the Safeguards Assessments Policy: External Expert Panel's Advisory Report.
- The **Independent Panel** report on the Safeguards Assessments Policy: External Expert Panel's Advisory Report to the Executive Board of the IMF.
- A **Press Release** summarizing the views of the Executive Board as expressed during its October 23, 2015 consideration of the reports.

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International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

SAFEGUARDS ASSESSMENTS: REVIEW OF EXPERIENCE

September 23, 2015

EXECUTIVE SUMMARY

This paper reviews experience with the safeguards assessment policy since the last review in 2010. The policy is subject to periodic reviews by the Executive Board. The policy's main objective is to mitigate risks of misuse of Fund resources and misreporting of monetary data under Fund arrangements. Consistent with past reviews, an external panel of experts provided an independent perspective on the implementation of the policy.

The current review has been conducted in wide consultation with stakeholders. Staff engaged at an early stage among area and functional departments on the scope and focus of the review. The external panel visited headquarters and sought the views of Executive Directors, central bank officials, and staff from area and functional departments on the effectiveness and implementation of the safeguards assessment policy.

Experience over the past five years indicates that central banks have continued to strengthen their frameworks, but challenges remain in some areas. Progress seen at the last review of a general shift toward greater transparency in financial reporting and external audits conducted in accordance with international standards has been maintained. However, as operating environments and practices evolve, some central banks lag behind, particularly in the areas of oversight, internal audit capacity, and modern central bank legislation.

Staff considers that the general design of the policy continues to be appropriate, but proposes refinements to reflect the evolving nature of safeguards risks. The proposals include a risk-based approach for fiscal safeguards reviews for arrangements involving budget financing; changes to safeguards modalities as part of the Fund-wide streamlining efforts to identify resource savings; and enhancements within the safeguards framework for continued emphasis on governance and risk management.

The panel concluded that during the review period the safeguards assessment policy was applied in an effective manner that allowed its objectives to be met. The panel noted that key stakeholders in the safeguards process voiced their approval and support for the policy. The panel's report, which is being circulated concurrently, recommends some refinements to safeguards modalities. The staff concurs with the panel's observations and recommendations, which have been taken into account in staff's proposals.

Approved By
Andrew Tweedie (FIN)

Prepared by a staff team in the Finance Department, led by Mr. Kabwe and consisting of Mses. Grochalska, Mburu, Mohlala, Trana and Messrs. Chamoun, Gororo, Majewski, Sriramachandran and van Greuning (all FIN). Messrs. Hughes and Olden (both FAD) also provided input. Mr. Bradbury (FIN) provided guidance to the team.

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ANNEXES

INTRODUCTION AND BACKGROUND

1. **This paper reviews experience with the safeguards assessment policy since the last review in 2010.**[1] Consistent with previous reviews, an external panel of experts (panel) provided an independent perspective on the implementation of the policy, including through the review of the confidential safeguards reports.[2] The panel's report is being circulated concurrently to the Executive Board with this paper and the Chair of the panel is scheduled to attend the Board discussion.

2. **The safeguards assessment policy was introduced in 2000.** Initially, the work was undertaken on a two-year trial basis, and in 2002 the Executive Board endorsed the policy as an integral part of the Fund's risk management framework for its financing operations. The policy (Box 1) was established to provide reasonable assurance that central banks of member countries seeking financial arrangements from the Fund have control, audit and reporting systems in place to properly manage resources. The policy's main objective is to mitigate risks of misuse of Fund resources and misreporting of information on monetary data under Fund arrangements. The safeguards assessment policy complements other risk mitigation measures in the Fund's financing operations, such as access limits, program conditionality and design, and post-program monitoring.

3. **The policy is subject to periodic reviews by the Executive Board.** The last quinquennial review in 2010 strongly endorsed the policy and identified areas for enhancements, which included a sharper focus on governance and risk management, increased collaboration with stakeholders such as external audit firms, and a heightened focus on fiscal safeguards and risks in Fund-supported programs that involve budget financing.[3] The 2010 external panel affirmed the existing framework's effectiveness in achieving the safeguards objectives, and found that a beneficial by-product had been progress at central banks toward adopting international standards and leading practices.

4. **The current review has been conducted in wide consultation with stakeholders**. Staff in the Finance Department (FIN) has primary responsibility for conducting safeguards assessments and engaged at an early stage with area and functional departments on the scope and focus of the review. The panel visited headquarters twice in the course of its work and sought the views of Executive Directors, central bank officials, and staff from area and functional departments on the effectiveness and implementation of the safeguards assessments policy.

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[1] *Safeguards Assessments—Review of Experience* (2010) and *The Safeguards Policy—Independent Panel's Advisory Report*. The current policy review covers the period from April 2010 to August 2015. The 2010 policy review covered the period March 2005 to March 2010.

[2] The panel comprises Mr. Thomas O'Neill (Chair), current Chair of the Board of the Bank of Nova Scotia (Canada) and Bell Canada Enterprises, former IMF External Audit Committee member (FY 2008-10), and member of the 2011 External Panel for the Review of the Fund's Risk Management Framework; Ms. Caroline Abel, Governor of the Central Bank of Seychelles (CBS); and Mr. Archil Mestvirishvili, Deputy Governor of the National Bank of Georgia (NBG) and a member of the NBG Board. Panel members were subject to confidentiality obligations.

[3] For the purposes of this paper, reference to "program(s)" encompasses all Fund instruments, facilities or arrangements.

5. This paper is structured as follows. Section II outlines developments since the 2010 review. Section III takes stock of trends in safeguards work, including safeguards findings, lessons learned, and staff resources in safeguards work. Section IV makes proposals for changes in the following areas: conduct of fiscal safeguards reviews; a risk-based streamlining of safeguards modalities; and enhancements in certain areas based on lessons learned, experience, and the panel's recommendations. Section V outlines issues for the Executive Board's discussion.

Box 1. Safeguards Assessment Policy

A safeguards assessment is a diagnostic review of a central bank's governance and control framework. Assessments focus on central banks as they are typically responsible for managing Fund resources and reporting on key statistics used for program monitoring. Safeguards assessments cover five key areas within central banks of borrowing countries, namely, the **e**xternal audit, **l**egal structure, financial **r**eporting, **i**nternal audit and **c**ontrol mechanisms, i.e., the ELRIC framework. Safeguards assessments are conducted for each new Fund financing arrangement and augmentations (except for Flexible Credit Line (FCL) arrangements for which limited procedures are applied owing to the rigorous requirements that must be met to qualify for an FCL). See Annex I on the applicability of the safeguards assessment policy, and Annex II for details on the ELRIC framework.

A cornerstone of the policy is that central banks of member countries that borrow from the Fund should publish annual financial statements that have been independently audited by external auditors in accordance with International Standards on Auditing. Safeguards assessments are distinct from audits in that they entail high-level diagnostic reviews of the structures and mechanisms in place rather than a detailed test of transactions or verification of assets. The assessments are conducted independently from program discussions, and although the safeguards recommendations may lead to technical assistance from the Fund or other agencies to implement remedial measures, safeguards work remains separate from such activities, in order to maintain the independence of the safeguards function.

The main output of a safeguards assessment is a confidential report that establishes time-bound recommendations to address key vulnerabilities in a central bank's safeguards framework. The recommendations are discussed and agreed with the central bank authorities and implementation is monitored in the context of the member's financing arrangement with the Fund. While the safeguards report is not circulated to the Executive Board, the Executive Director in whose constituency the borrowing member country falls receives a copy. The Executive Board, however, is informed of the main findings and recommendations in summary form in country reports. In accordance with past Executive Board decisions, safeguards reports can also be shared, upon request, with the World Bank and the European Central Bank staff, subject to strict confidentiality restrictions and with the consent of the concerned central bank.

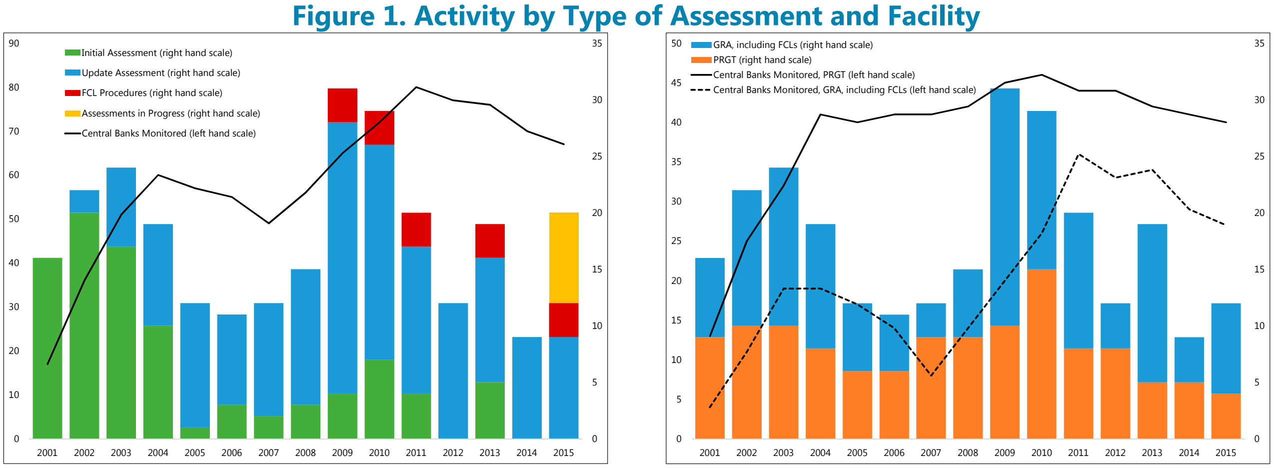
DEVELOPMENTS SINCE THE 2010 REVIEW

A. Activities

6. Safeguards work involves two main activities: conduct of assessments; and monitoring of developments. Assessments are conducted at central banks of member countries in connection with new financial arrangements with the Fund, or augmentations. Assessments may also be conducted on a voluntary basis at the request of a member country. Following completion of the assessment, the safeguards framework at the central bank is subject to monitoring for as long as Fund credit remains outstanding. In addition to the review of annual audited financial statements and management letters on internal control issues, monitoring includes follow-up on the implementation status of safeguards recommendations and other safeguards-related developments through regular contact with central bank officials, their external auditors, and IMF area and functional departmental staff.

7. During the current review period, 83 assessments of 57 central banks were completed. The level of activity is similar to the 2010 review period, which had 81 assessments of 61 central banks. In total, 248 safeguards assessments of 90 central banks have been completed since the inception of the policy.[4] The intensity of assessment activity (see Figure 1) in any given year broadly follows the level of Fund-supported programs approved by the Executive Board. As a result, safeguards activity was at a peak during the global financial crisis, with annual assessments rising to over 25 annually in 2009 and 2010. Activity since then has averaged about 13 assessments per year. The current review period had 15 first–time assessments, compared to 14 during the 2010 review. A notable shift seen in the current review period is the increased use of extended arrangements, the Extended Fund Facility (EFF), relative to Stand-By Arrangements (SBA) in the Fund's non-concessional financing. EFFs accounted for just over one-third of 30 new arrangements, compared with ten percent of 35 new arrangements during the 2010 review period. This, combined with the increase in financing during the crisis, will have continuing effects on the level of monitoring activity. Since the policy was introduced, the volume of new financing arrangements has remained broadly evenly weighted between Poverty Reduction and Growth Trust (PRGT) and the General Resources Account (GRA). In addition, limited safeguards procedures for 12 FCLs were performed during 2010-15 (three during 2005-10).

Figure 1. Activity by Type of Assessment and Facility

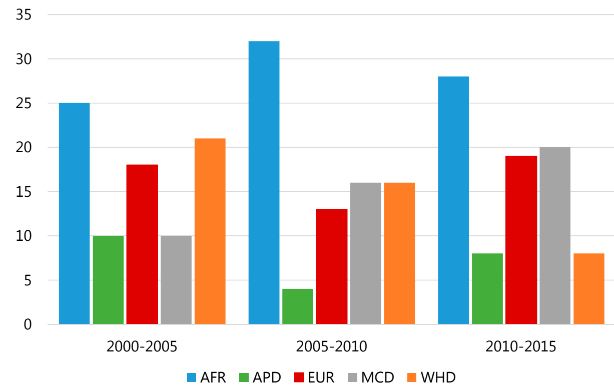


Source: FINSA database.

[4] A further 27 abbreviated assessments of only the external audit mechanism, including publication of audited financial statements, were conducted in 2000-2002 under transitional procedures during the initial experimental phase. Transitional procedures were applicable to countries with Fund arrangements in effect prior to June 30, 2000. Annex III lists all completed assessments.

8. The geographic distribution of assessments over the last five years reflects a shift from that of the pre-crisis years. Aside from Africa, which continues to account for the largest number of assessments completed, the geographic distribution during the current review period tilted towards Europe and Middle East and North Africa, which accounted for 48 percent of the assessments, reflecting the effects of the global financial crisis and the emergence of the Arab Spring. This pattern was also reflected in the first-time assessments, which included four national central banks in the Eurosystem, five countries from the Middle East and North Africa, and four small Asia-Pacific islands.

Regional Distribution of Assessments
(by Policy Review Period)



Source: FINSA database.

9. Monitoring activity remained elevated during the current review period. Monitoring reached a peak during 2011-13 with 80 central banks being monitored, reflecting the heightened financing activity during the financial crisis. Overall, some 67 central banks were subject to safeguards monitoring at end-August 2015 (see Figure 1), following the full repayment of Fund credit by about a dozen member countries during 2013-15. As discussed in paragraph 7, monitoring activity remains elevated relative to the pre-crisis period. FIN staff conducting safeguards assessments ("safeguards staff") communicates with area departments on significant developments identified during the monitoring phase, as well as instances of delays in receiving requested information.[5] There were several instances during the current review period that necessitated intensive engagement with central bank staff, external auditors, and area department counterparts to resolve issues. In two cases (Bank of the Central African States (BEAC), Albania), monitoring staff visits were conducted to follow-up on governance and control issues. Staff also accompanied an area department mission (Armenia) to clarify issues on monetary data reporting and to assess the effectiveness of the audit committee.

B. Enhancements to safeguards modalities since 2010

10. Safeguards modalities continue to evolve in line with experience and lessons learned. In its 2010 review of the safeguards assessment policy, the Executive Board endorsed the external panel's recommendations to have a sharper focus on governance and risk management in the ELRIC framework, and to enhance collaboration with stakeholders.[6] In addition, while it was acknowledged that safeguards assessments focus on central banks, staff was encouraged to highlight fiscal risks in

[5] The 2010 policy review endorsed the requirement that instances of non-receipt of monitoring information be explicitly flagged in staff reports. In total, seven occurrences were flagged during the current review period.

[6] The 2010 review reported on a number of high-profile governance abuse cases in which controls override by executive management was a common theme.

staff reports by drawing on existing diagnostic technical assistance work in the fiscal area. Steps taken in these, and other, areas are outlined below.

11. Staff has placed increased emphasis on governance. Following the 2010 review, safeguards work has been adapted to evaluate governance at central banks through the assessment of control and oversight practices. This includes closer review of key governance bodies such as boards and audit committees. Factors considered include their composition, appointment practices, members' independence and expertise, and the efficacy of their role and responsibilities. Other areas of governance, such as the control culture and the existence of appropriate "checks and balances" in key central bank operations, have also been integrated into staff's work. Remedial measures to address identified governance weaknesses often require changes to central bank legislation to help assure sustained change in practices.

12. The focus of assessments has been broadened to take stock of risk management functions at central banks, which remain a work in progress. Staff continues to find that few central banks have completed, or embarked on, the process of formalizing and implementing an integrated risk management framework (IRMF).[7] Most central banks manage risk within functional areas under the broad oversight of senior management and the Board. To the extent an IRMF in place, or steps to establish one are in process, assessments review such frameworks' coverage of key risk areas and the governance arrangements, i.e., reporting on main findings and remedial measures. More generally, staff discuss risk management options with central banks that have not yet adopted IRMFs and evaluate the oversight of risks within the functional areas. Experience shows that risk management is technically demanding and therefore its application requires a sufficient level of institutional capacity.

13. Engagement with the accounting and auditing profession has been increased. Staff has established high-level contacts with the accounting and auditing profession in order to raise awareness of instances of audit quality issues at central banks. Under the umbrella of the International Federation of Accountants (IFAC), staff has briefed IFAC's Forum of Firms on audit quality issues encountered in safeguards work.[8] In addition, staff has observer representation at the Consultative Advisory Group of the International Auditing and Assurance Standards Board (IAASB) and the International Ethics Standards Board for Accountants (IESBA).[9]

[7] A key feature of an IRMF is that it moves away from an exclusive silo approach and instead promotes a holistic risk management function that covers both financial and non-financial risks. Only two of the 57 central banks assessed in the review period had a fully functioning and mature IRMF in place. A further eight central banks were implementing an IRMF with additional work in train to ensure full integration of practices with all bank operations.

[8] The large international audit firms participate in the Forum of Firms, which aims to promote consistent and high-quality standards of financial reporting and auditing practices worldwide.

[9] The IAASB sets international standards for auditing and assurance related services, including quality control, and facilitates the convergence of international and national standards. The IESBA develops and promotes ethical standards and guidance for professional accountants.

14. Staff has also intensified collaboration with central banks and external auditors. New initiatives taken since the last review have included an inaugural forum on governance for high-level central bank officials and their external auditors in 2013. The forum provided a platform for exchange of cross-regional experiences on governance issues, and targeted central banks that had undergone safeguards assessments; primarily central banks in the Middle East, Africa, and Europe, reflecting the concentration in the Fund's financing activities. The external auditors' participation helped raise awareness of governance and audit quality issues and facilitated the sharing of best practices in oversight and auditors' communication with audit committees. A second forum was held in 2014, and both events were very well received by the participants.[10] Staff has also presented at seminars and conferences involving the central banking community, audit firms, and standard setters.[11]

15. Formal frameworks between the central bank and the ministry of finance in Fund arrangements involving budget financing are more broadly used. The 2010 policy review called for frameworks that outline repayment and servicing responsibilities. As part of these arrangements, the policy requires that IMF resources be deposited at the central bank. Safeguards staff coordinate with area departments and, since the 2010 review, such frameworks are now typically finalized before the first program review, or earlier. Work on a pilot for fiscal safeguards reviews is discussed in the next section of this paper.

16. A self-evaluation questionnaire has been developed. The objective is to raise awareness and knowledge of key safeguards attributes and the questionnaire has been disseminated to central bank officials at regional safeguards seminars since 2014.[12] The questionnaire sets out the basic principles of a sound safeguards framework in the areas of transparency, internal and external audits, selected internal controls, as well as oversight responsibilities.[13] Going forward, consideration could be given to expanding use of the tool to information gathering as part of ongoing assessments. However, experience from other areas of Fund work (e.g., in Public Financial Management evaluations) and from professional quality review programs suggests that a self-evaluation exercise cannot be expected to replace staff's judgment and independent assessment.[14] Firstly, it is not possible to develop a one-size-fits-all questionnaire as country circumstances and

[10] The events each attracted close to 100 participants. In addition, staff continues to conduct periodic seminars on the safeguards framework. These seminars target senior central bank officials and are held in various regions on a rotational basis and continue to be highly rated by participants.

[11] Counterparts included the World Bank, the Central Banking International Operational Risk Working Group, the Federal Reserve Bank of New York, and the European Central Bank (ECB).

[12] Seminars in Singapore (October 2014); Vienna, Austria (May 2015); and Pretoria, South Africa (July 2015).

[13] Examples of safeguards risks and related mitigating measures are also included, along with questions prompting the central banks to compare their institutions against these broad benchmarks.

[14] For example, quality assessments in internal and external audit professions require a peer and/or independent evaluation to support periodic assessment exercises.

program nuances differ. Secondly, due to inherent subjectivity of self-evaluations, it would be difficult to conclude whether some reported safeguards exist in substance as well as in form.

17. In the 2010 review, the Executive Board endorsed the confidential nature of safeguards reports. Safeguards reports are shared only with the World Bank and ECB where relevant and if requested.[15, 16] In addition, confidential briefings can be provided to donors. In all instances, in accordance with the Executive Board decision, staff must obtain prior consent from the concerned central bank to share the safeguards report. While safeguards reports are not shared with the Executive Board as a whole, the respective member's Executive Director receives a copy of the report. Separately, a summary paragraph of key findings and recommendations is included in the relevant country's staff report.

18. Technology is being increasingly utilized to facilitate monitoring. The use of "traditional" communication technology (tele- and video-conference) coupled with new platforms (Skype, Polycom, FaceTime) has allowed for increased engagement with central banks and external auditors. This facilitates timely follow-up on the status of safeguards recommendations and early identification of emerging safeguards risks. The reporting capabilities of the safeguards information database (Paisley) were also strengthened with new automated reports to aid monitoring of developments at central banks, including the status of recommendations and other key metrics.

C. Budget financing and fiscal safeguards reviews[17]

19. The scope of the safeguards framework, which focuses solely on central banks, was discussed at the 2010 review. The mandate has so far been limited to the central bank, which is the primary counterparty in the Fund's financing activities. While consideration has been given in past reviews to extending the mandate beyond the central bank, practical difficulties in replicating safeguards assessments in other government entities have been acknowledged as a major challenge.[18] As noted in the 2010 review, practical obstacles to replicating safeguards assessments in the whole of government include: informational obstacles in the quality of, and delays in finalizing, government accounts; the wide dispersion of practices which could preclude application of a uniform approach for such assessments; the infeasibility of obtaining safeguards assurances beyond

[15] The Executive Board in 2011 approved the transmittal of safeguards reports to the ECB for national central banks in the European System of Central Banks where the member state received financial assistance jointly from the European Union and the Fund.

[16] Staff shared 47 safeguards assessment reports, including eight with the ECB during the current review period. Comparatively, 44 reports were shared with the World Bank during the period of the last review. One central bank withheld consent for such sharing, as compared with three during the previous review period.

[17] The Fund may only provide financial assistance to members to address balance of payments (BoP) problems, and such financing must be used in support of a program designed to resolve the member's BoP difficulties. Under these conditions, it is possible for a member's program to provide for the use of the domestic counterpart of Fund disbursements for budgetary purposes. See *Staff Guidance Note on the Use of Fund Resources for Budget Support.*

[18] At the 2002 review, the Board noted that safeguards assessments should not be applied to fiscal issues since that would require a new mandate for staff, and this view was reaffirmed at the 2005 and 2010 reviews.

the central government to the activities of state enterprises and lower tiers of government; and weaknesses in Public Financial Management (PFM) systems in developing countries, especially at the line ministry and agency level.

20. At the 2010 review, Directors acknowledged that replicating safeguards assessments for budget financing cases remains challenging, but encouraged staff to highlight fiscal safeguards risks. At that time, the number of arrangements involving the use of Fund resources for budget financing (i.e., direct budget support) had increased.[19] The Executive Board endorsed application of frameworks between central banks and their corresponding state treasuries for the timely servicing of members' obligations to the Fund as a standard procedure in such cases. In addition, many Directors encouraged staff to explore possible approaches to identifying fiscal safeguards risks in staff reports, drawing on a variety of available PFM diagnostic sources and a number of Directors encouraged exploration of a more ambitious approach to conduct targeted safeguards assessments at the level of state treasuries.

21. A pilot exercise was concluded in 2013 to consider possible approaches to identifying fiscal safeguards risks.[20] Staff from the Fiscal Affairs Department (FAD) covered five budget financing cases (Antigua and Barbuda, Cyprus, Greece, Ireland, and Kyrgyz Republic) under the pilot. Staff prepared a questionnaire, based on criteria developed in the 2010 review, to assess the extent to which existing institutional arrangements and reporting requirements were satisfactory with respect to the identification and monitoring of fiscal safeguards risks.[21] The questionnaire supplements existing information from diagnostic sources.[22]

22. The pilots provided some lessons on the scope and modalities for fiscal safeguards reviews. The pilots confirmed that most information required to conduct the fiscal safeguards review can be derived from existing diagnostic evaluations, to the extent these are available, since there is substantial overlap. The diagnostics provide a good basis for identifying fiscal safeguards risks, though additional information and approaches may be necessary on a case-by-case basis. In

[19] In such cases, the central bank acts as (i) the government's banker and a custodian of official foreign exchange reserves, including Fund's disbursements and resources to service obligations to the Fund; and (ii) the Fund's depository for the holdings of the member's currency. Safeguards procedures in these cases are designed to ensure that (i) the Fund's disbursements are maintained at the central bank pending their use; (ii) the central bank is the only monetary authority entrusted with management of member's reserve assets and that the government holds foreign exchange balances only with the central bank; and (iii) an appropriate framework between the central bank and the government is in place to ensure timely servicing of the member's financial obligations to the Fund.

[20] See *Report on Fiscal Safeguards Pilots*.

[21] The questionnaire covered thematic areas on: the legal framework for budgetary appropriations; government banking arrangements through the treasury; internal controls of public expenditure; the reporting of financial data; and the independent audit of government financial statements. Annex V provides more detail.

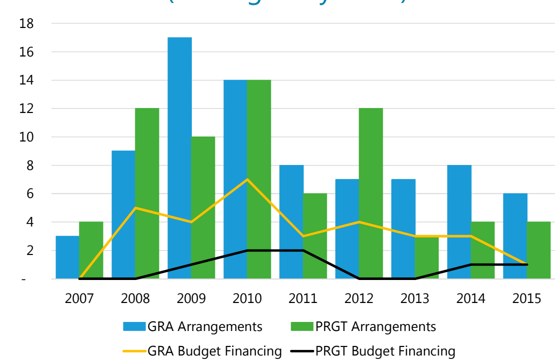
[22] Two main diagnostic evaluations are relevant: (i) the Public Expenditure and Accountability Framework (PEFA); and (ii) Fiscal Transparency Evaluations (FTE) that were launched in 2014 and replaced the fiscal module of the Reports on the Observance of Standards and Codes (fiscal ROSC).

addition, in some cases it may be advisable to look beyond the state treasury to adequately highlight fiscal safeguards risks.[23]

23. In light of this experience, staff proposed that fiscal safeguards reviews be anchored on a risk-based approach. Given the scope and resource challenges, a risk-based approach was considered to be a cost-effective strategy to address the concerns raised in the 2010 review, while also being readily absorbed within the Fund's existing resource envelope amid other competing demands. Thus, the pilot proposed that existing diagnostic tools and evaluations would be used to identify fiscal safeguards risks for countries that channel a significant proportion of Fund resources to the budget. In addition, under this risk-based approach, fiscal safeguards reviews would only be conducted for countries with both (i) exceptional access to Fund resources, and (ii) more than half of the financing directed to budget support. These criteria were considered to be appropriate in light of the above-mentioned resource constraints for such additional work. Experience with the fiscal safeguards reviews has been limited since the pilot as the number of budget financing cases has decreased as discussed below. Proposals to further operationalize the fiscal safeguards work are outlined in Section IV.

24. The number of budget financing cases has decreased considerably since the global financial crisis. GRA arrangements involving budget financing averaged three per year during 2011-2014, compared with seven in 2010 at the height of the global crisis.[24] Of the new arrangements in the 2010-14 period, about half were exceptional access cases. That said, the exceptional access cases were concentrated in the 2010-12 period. In the period following the pilot, i.e., 2014-2015, only one country, Ukraine, had a program with exceptional access involving budget financing. A fiscal safeguards review was conducted for Ukraine since it met the risk-based criteria, i.e., exceptional access and half of resources directed to budget financing. The review did not uncover any significant shortcomings based on the standardized questionnaire on the domestic institutional framework.

Fund Arrangements and Budget Financing
(Through July 2015)



Source: Staff estimates.

[23] For example, not all countries have a centralized treasury function as a separate entity. Some key safeguard functions, such as accounting, control, and reporting, may be decentralized at line ministries.

[24] Budget financing data does not include emergency assistance (RFI, RCF), 2014-2015 assistance to members impacted by the Ebola epidemic through augmentations of arrangements or RCFs. Arrangements with members of the BEAC and the BCEAO are also excluded as these countries are part of currency unions with no national central banks.

Box 2. Fiscal Safeguards Reviews

Fiscal safeguards risks arise when funds are channeled through the treasury for budget financing. The fiduciary risks that could arise include possible misuse due to weaknesses in the legal framework, government banking arrangements, internal controls, audit procedures, or other areas of budget execution.

Institutional coverage of fiscal safeguards reviews. Fiscal safeguards risks are generally evaluated through a review of treasury operations, which may not extend to the country's PFM system as a whole. Coverage of fiscal safeguards reviews is therefore inherently limited, since a review of the whole of government is not feasible. The fiscal safeguards reviews utilize the questionnaire outlined in Annex IV.

How does this differ from assessing safeguards at central banks?

- Different institutional context - safeguards assessments cover one institution with reporting and control systems generally well defined. Treasury functions may be decentralized.
- Central bank assessments are conducted independently of technical assistance (TA) work. Fiscal safeguards reviews draw on TA information and may be conducted alongside TA activities.
- Approach: Fiscal safeguards reviews are a high level exercise to ascertain the design of institutional safeguards at the state treasury, with a primary focus on indicators rather than a verification of actual practices. They do not necessarily assess the effectiveness of control and accountability systems, unless such information is available from other diagnostics. For example, the reviews would not assess whether the Auditor General in fact adheres to stated international standards. Safeguards assessments aim to independently assess the effectiveness of governance, control and audit frameworks at central banks.
- Financial reporting practices are more advanced at central banks; consequently, program data accuracy is more easily identifiable.

D. Misreporting and misuse

25. Safeguards assessments are a key element of the broader framework for managing financial risks that the Fund faces in its financing operations.[25] Since it was introduced in 2000, the safeguards assessment policy has played an important role in helping to mitigate the risks of misreporting and misuse of Fund resources, and to maintain the Fund's reputation as a prudent lender. Experience has shown that the safeguards framework has helped identify serious governance and misreporting issues at central banks, but is no panacea against intentional lapses in controls or fraud.[26] The increased emphasis on governance aims to mitigate such incidents by bringing out the importance of independent oversight on bank operations as a counterweight to possible risks of high level overrides of controls.

26. Owing to the ex-ante nature of safeguards assessments, a counterfactual on the extent to which potential misreporting and misuse is prevented is not determinable. Nevertheless, there has been no serious misreporting on monetary data since 2010. In the period from January 2010-May 2015, the Executive Board considered 26 cases of misreporting of program data, of which only two related to program monetary data. One case (Ukraine, July 2010) involved inaccurate reporting of Net International Reserves, due to a technical discrepancy between the central bank's investment policy and the definitions in the Technical Memorandum of Understanding (TMU) and a

[25] Other policies include program design and conditionality, access limits, and the exceptional access framework.

[26] See *Safeguards Assessments—Review of Experience* (2005) and *Safeguards Assessments—Review of Experience* (2010).

second case (Angola) involved misreporting on monetary data caused by misreporting on fiscal revenues used for program adjustors, rather than data originating from the central bank. The remaining misreporting cases were outside of the safeguards assessment scope and primarily involved debt management or non-compliance with continuous performance criteria on nonconcessional external debt.

27. **Evaluation of controls and processes surrounding program data reporting by central banks is a core component of the safeguards work**. In cases where additional assurances are needed, staff recommends the involvement of central bank internal auditors and, where warranted, an external audit verification. Safeguards staff have also increased collaboration with area departments on data definition issues, in light of the increasing complexity of central banks' balance sheets and accounting treatments of financial instruments (e.g., Ghana, Honduras, Pakistan, Serbia, and Tunisia). Such early engagement helped clarify data components and TMU definitions to avoid potential errors in subsequent reporting. Staff's experience in the review of audited financial statements has also aided understanding of monetary data composition in some difficult cases.

28. **When concerns emerge regarding possible misuse of public resources, safeguards staff assist in formulating remedial measures.** There have been no observed cases of direct misuse of Fund resources by central banks since the 2010 review. However, assessments have identified cases where resources were exposed to substantive risks in the management of foreign reserves. In addition, safeguards staff collaborated with concerned area departments in other cases involving fiscal fraud or other misappropriation of public resources, including providing input on governance issues, terms of reference for special audits and forensic investigations; and review and analysis of audit/investigation results.

GENERAL TRENDS IN SAFEGUARDS WORK

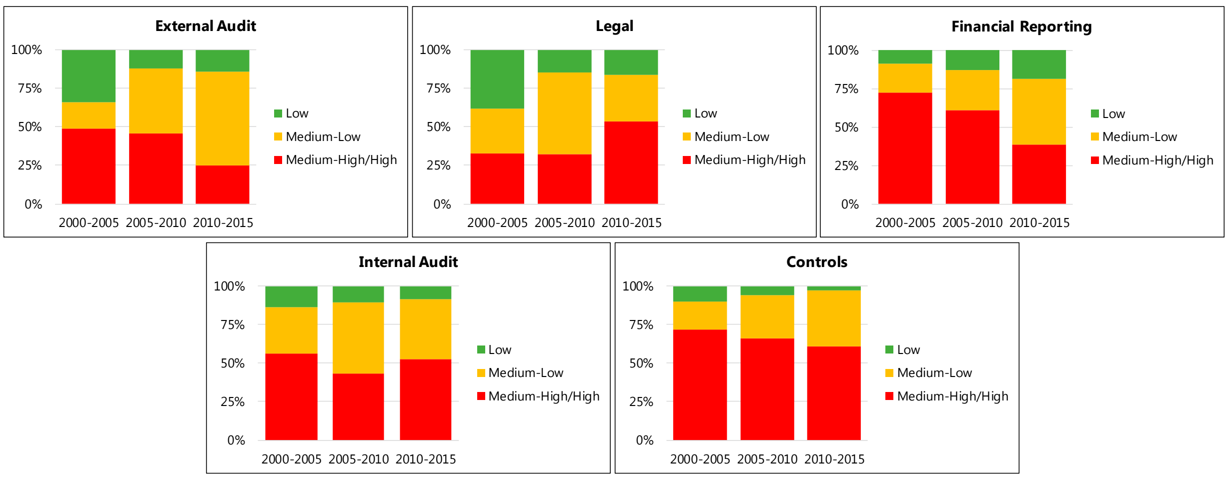
A. Safeguards findings

29. **The findings of safeguards assessments continue to evolve, as central banks have strengthened their frameworks, but challenges remain in some areas.** Figure 2 provides a trend analysis of safeguards findings and risk ratings in the five ELRIC pillars, over three time periods: 2000-2005, 2005-2010, and 2010-2015. [27] External audit and financial reporting practices in particular have improved significantly with 75 percent and 62 percent, respectively, of assessments found to be low or medium-low risk in these areas over the past five years. However, as operating environments, benchmarks and best practices evolve, some central banks lag behind, particularly in the areas of oversight, internal audit capacity, and modern central bank legislation. Consequently, the proportion of assessments with medium or high risks identified in the areas of internal audit and legal structures increased in the past five years.

[27] The assessment assigns a rating to each ELRIC category. The four-level internal and confidential risk ratings are Low, Medium-Low, Medium-High and High.

30. The risk ratings in the ELRIC areas are also indicative of the renewed emphasis on governance following the 2010 review, in addition to developments in international standards and increased complexity of central bank operations. Greater rigor has been applied in the review of central bank legislation. In addition, the trend reflects, to some degree, the emergence of first-time assessments in the past five years, principally from the Middle East and North Africa region.

Figure 2. Safeguards Findings and Risk Ratings Across the ELRIC Framework



Source: FINSA database.

31. Notable safeguards areas that show significant improvements include the following:

- Virtually all central banks assessed in the last five years have external audits that state compliance with International Standards on Auditing (ISA). Central banks have generally improved their external audit arrangements, and assessments now tend to focus on more nuanced evaluations of the audit quality and compliance with ISA.

- The general move seen at the last review toward greater transparency in financial reporting has been maintained. Over 90 percent of central banks now publish their full financial statements compared with 75 percent at the last review and 55 percent at the 2005 review.

- Central banks have also continued to adopt leading international financial reporting practices. Of the 67 central banks subject to monitoring as at end-August 2015, almost two-thirds apply International Financial Reporting Standards (IFRS) or ECB guidelines, i.e., 56 and 7 percent, respectively.[28] Six central banks that partially applied IFRS during the 2010 review have now become fully compliant, while three central banks that had no external framework have now partially implemented IFRS.

[28] Of the remaining banks, about 20 percent do not have an externally defined accounting framework, 7 percent apply IFRS with exceptions, and 9 percent use country specific generally accepted accounting practices.

- Supported by increased automation of processes and implementation of IT systems, institutional frameworks for reserves management also improved. During the review period, about 16 percent of central banks were found to have shortcomings in controls over foreign reserves, compared with 20 percent at the last review.

- Data reporting practices have also improved as central banks strengthen operational controls and processes. The trend was also supported by increased participation of internal audit in the review of program monetary data compilation and reconciliations. However, the treatment of complex financial instruments poses difficulties in some cases.

32. Notwithstanding the above improvements, challenges remain in some areas. In particular, progress in central banks' legal structure, internal audit, and internal controls has been limited. Figure 3 further highlights continuing challenges in these areas.

33. Legal structure and independence. Strengthening legislation is frequently a challenge due to difficulties in enacting new laws, a process that involves parties external to the central bank.[29] Nonetheless, staff has engaged more closely with central banks to move to legislation that provides greater central bank autonomy (financial, personal, and institutional) while also seeking to ensure that independent oversight of bank operations is commensurately strong. Other observations in this area have been the *de jure* need to strengthen provisions on transparency and accountability, namely, explicit provisions on use of international accounting and audit standards, publication of financial statements, and the need for well-functioning audit committees.

34. Internal audit. Internal audit functions were found to have areas for improvement in about 50 percent of central banks compared with 40 percent in the last review period. Notably, some 6 central banks were found to have no internal audit practice. Central banks assessed face three key challenges:

- **Capacity Constraints**. Limitations in staffing levels, audit expertise, and/or professional qualifications were observed in about 40 percent of the central banks. Risks are heightened when the internal audit function is ill-equipped to keep up with changes and complexity in bank operations. These shortcomings can be exacerbated by competition for talent, particularly in small countries.

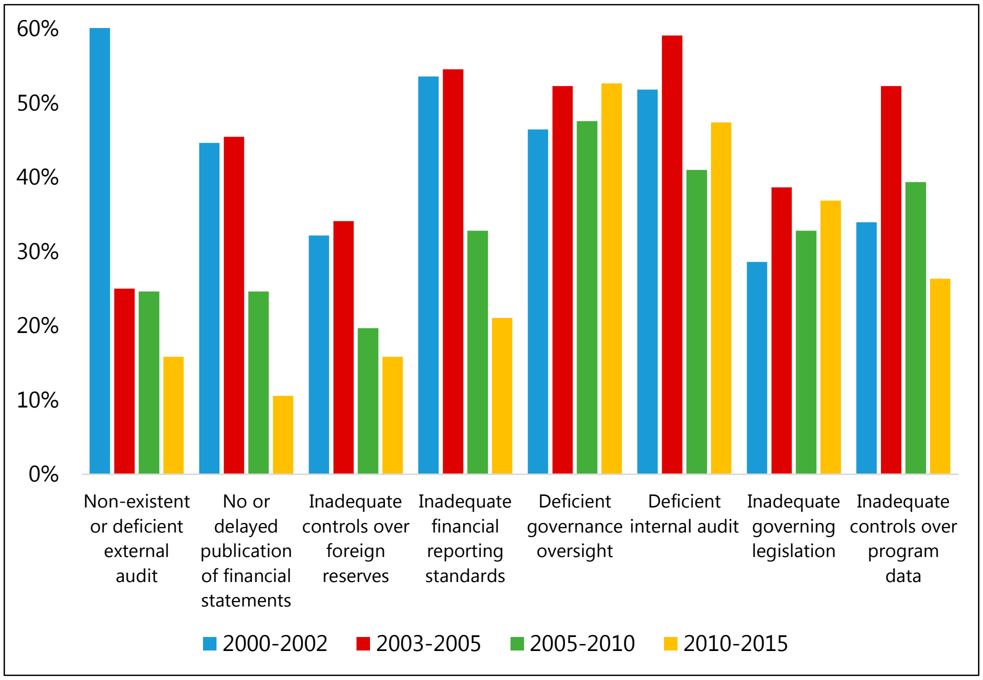
- **Independence and authority.** Some 35 percent of central banks' internal audit departments had weak institutional status, i.e., lack of functional reporting to the Board or the continued performance of operational responsibilities, which may compromise the objectivity of the internal audit function. A function that does not have direct access to the Board can also

[29] Central bank legislation provides the basis for governance structures and mandates of oversight bodies and audit mechanisms. Over half of the assessments conducted in the last five years included recommendations to amend the central bank legislation. Of these, 20 percent included recommendations of which half were incorporated as program conditionality (structural benchmarks).

suffer from inadequate review and/or actions on recommendations, or insufficient allocation of resources to carry out its responsibilities.

- **Oversight.** Inadequate oversight of internal audit was observed in nearly 50 percent of central banks. Shortcomings included the use of non-risk based audit methodologies, inadequate monitoring of audit plan completion and recommendations, and infrequent reporting to the Board.

Figure 3. Key Vulnerabilities Identified at Central Banks, 2000-2015



Source: FINSA database.

35. Internal controls. An evaluation of internal controls within the ELRIC framework aims to capture and assess evolution in control environments and good governance.[30] An important element of governance is oversight of key operations by the Board and audit committee. While over 70 percent of central banks assessed in the past five years have audit committees, the effectiveness of the oversight has been found to be lacking in many cases. Specifically, some 53 percent of central banks assessed in the current review period were found to fall short of good governance practices. In addition to recommending the establishment of an audit committee, other remedial measures to strengthen overall controls included: (i) expanding audit committee oversight scope to include internal and external audit arrangements; (ii) reviewing the composition and appointment practices for Board and audit committee members to ensure independence; (iii) hiring an advisor with

[30] While governance is an overarching theme of the ELRIC framework, the assessment of internal controls places greater emphasis on the quality of the control environment and the degree of governance and oversight exercised from the highest levels of a central bank.

expertise in the areas of financial reporting and auditing to assist the audit committee; and (iv) encouraging accountability through publication of the audit committee annual activity report.

36. During the current review period, the implementation rate for safeguards recommendations remained high at 94 percent for those included under program conditionality and 72 percent overall (see Annex V). In comparison, at the last review, implementation rates were 95 percent and 77 percent, respectively, for the cumulative period to March 2010. When vulnerabilities are identified in a central bank's governance and control framework, targeted mitigating measures may include recommendations that are included as part of program conditionality.[31] Such recommendations are extensively discussed with central bank counterparts to ensure ownership and understanding of possible program implications, and their commitment is reflected in the high implementation rate.

B. Lessons learned

37. Trends in safeguards findings discussed above show that building an effective assurance framework requires time. Staff is mindful that the approach to identifying risks and proposing mitigating measures should also evolve and take into account the dynamic nature of control environments. In this context, lessons learned through the safeguards experience of the past five years include:

- **The safeguards ELRIC framework remains appropriate and sufficiently flexible.** Central banks' operating and control environments are evolving, including financial market deepening and exposure to new financial instruments that can heighten risks. The safeguards framework allows for tailoring of assessments to take into consideration specific country circumstances, evolving central bank operations, and leading practices. For example, developments in international accounting and audit standards are considered in an adaptive manner within the "R" and "E" pillars of the framework. New international standards on auditing require increased communications between the external auditor and entities' senior management on governance issues—these developments have been integrated in safeguards work; and new IFRS on valuation of financial instruments and related disclosures facilitate staff's assessment of potential linkages to misreporting of monetary data under Fund-supported programs. Annex VI includes examples of the developments and challenges in central banks' operations and their impact on safeguards risks. The panel's observations on the ELRIC framework are discussed in Section IV.

- **An effective audit committee is key to enabling a strong governance environment.** Audit committee members with an appropriate degree of financial expertise can help identify capacity and process issues, engage effectively with external and internal auditors, and highlight deficiencies and possible remedial measures to central bank boards and senior

[31] Recommendations may be included under program conditionality, as well as commitments by country authorities in their Letters of Intent (LOI) and Memoranda of Economic and Financial Policies (MEFP). The need for conditionality varies according to country specific circumstances and the timing for implementation of safeguards measures.

management. In particular, an audit committee's relationship with external auditors continues to be important in the safeguards process. In addition to providing an important independent source of *assurance* on the robustness of central banks' financial reporting practices and control environments, external auditors have helped to engage central banks on the need for, and benefits of, strong oversight.[32]

- **Control systems cannot guarantee against a willful override of checks-and-balances or collusion**. The 2010 review saw a number of high-profile governance abuse cases involving misuse of public funds, and the current review period has seen similar cases of varying scale emerge (e.g., Malawi and Albania). While no system can provide absolute assurance against misuse of funds, good governance arrangements with independent oversight in unison with robust control systems can help mitigate the risks of such abuse and facilitate early detection.

- **Close collaboration with stakeholders is key for early identification and resolution of issues, and reinforcing key messages on the safeguards framework.** Proactive and frequent communication with central banks and their auditors has contributed to a more collaborative relationship that has allowed staff to preemptively address issues, particularly those related to controls and reporting on program data, which is an important ex-ante measure to minimize risks of misreporting. Similarly, interdepartmental collaboration is important for broader awareness of safeguards issues.

- **Outreach initiatives to central banks and their external auditors have proved to be a valuable forum for cross-regional dialogue on challenges faced by central banks.** These initiatives allow for an exchange of information on experiences, particularly where some banks may be more advanced than others in certain areas. FIN has also collaborated with LEG and MCM on outreach events and at the regional safeguards seminars to underscore good practices and legal underpinnings for governance. Staff encourages continued peer discussions among central banks utilizing the contacts established at such events.

C. Staff resources

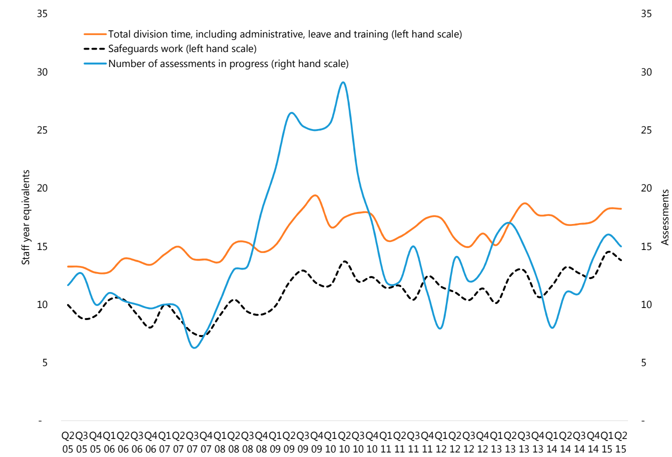
38. Safeguards work is conducted by specialized professional staff. The work involves staff with specialized backgrounds in accounting, auditing, central banking, and risk-management. Assessments also rely on the contributions from LEG staff to conduct desk reviews of central bank legislation, and when necessary participate in missions to hold discussions with counterparts at central banks.[33] Staff resources are not easily scalable in light of the specialized expertise involved. Indeed, experience shows that staff qualifications and experience are increasingly important given the evolving complexity of central bank operations and safeguards risks (Annex VI).

[32] It is understood that external audits do not "certify" financial statements and thus the assurance is not absolute but they nonetheless provide an important independent verification process.

[33] Other activity includes regional safeguards seminars, outreach, policy reviews, and update papers to the Board.

39. The safeguards staff complement averaged 15 FTEs since 2011.[34] The overall safeguards activity level remained broadly stable. Safeguards work comprises primarily professional staff time on assessments and monitoring, including overtime. Assessment activity since 2010 included several challenging cases that placed additional demands on staff time, such as first-time assessments in emerging new regions: four members of the Eurosystem, and four members in the Middle East and North Africa region; and complex update assessments for Afghanistan, BEAC, Djibouti, Pakistan, and Ukraine. The proposed streamlining measures outlined in Section IV are expected to generate efficiency gains equivalent to two FTEs.

Safeguards Activity



Source: Staff estimates based on TRS (up to September 2010) and TRACES (thereafter).

40. Safeguards work continues to represent a relatively modest portion of overall staff costs. Safeguards staff represents 0.6 percent of total Fund personnel positions in recent years. In dollar terms, the overall budget envelope for staff resources (i.e., personnel expenses) averaged $3.4 million per fiscal year during FY 2011–15, some 0.4 percent of the Fund-wide budget in the personnel expenditure category for FY 2015, and a decrease from $3.8 million in FY 2010. Safeguards work continues to represent a relatively modest portion of the use of Fund resources (UFR) cost with a safeguards labor cost of about four percent of the Fund-wide labor costs in the UFR category during FY 2011-14, compared to three percent over 2005-2009. As noted in Section II, safeguards UFR-related monitoring work has a longer cycle that continues beyond the term of an arrangement. Travel costs fluctuated in line with mission and outreach activity and averaged $0.5 million per fiscal year. The average number of mission days remained stable at nine per mission.

GOING FORWARD: PROPOSALS FOR CHANGE

41. The safeguards assessment policy continues to be an important element of the Fund's risk-management framework. This conclusion is strongly echoed in the independent panel's report. The panel notes that the policy has met its primary objective to mitigate potential risks of misuse of Fund resources and misreporting of monetary program data. In addition, the panel views the notable improvements in central banks' governance and control frameworks as substantial "collateral benefits" that flow from the safeguards assessment process.

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[34] The FTEs comprised 10–11 accountants, division management (Division Chief and a deputy), one research assistant, and two staff assistants. In the FY2005–2010 period, the staff complement averaged 14 FTEs.

42. Staff considers that the general design of the policy continues to be appropriate, but refinements are proposed to reflect the evolving nature of safeguards risks and the panel's recommendations. The proposals build on the issues identified in the previous policy review, reflect developments in central banks' operations and institutional safeguards, and take account of the independent panel's recommendations in the current review. Consistent with the recommendations of the 2010 review, and the 2015 independent panel's recommendations, governance and risk-management continue to be areas for further focus and development. Streamlining proposals to the safeguards modalities are made on a risk-based approach as part of the Fund-wide effort to identify resource savings. The proposed changes in this section also cover the panel's recommendations on disclosure of safeguards information in staff reports and staff's discussions with parties outside the central bank in cases involving recommendations to amend the central bank legislation; applicability and modalities for fiscal safeguards reviews; and internal audit issues. Following conclusion of the current review, staff will update the Operational Guidelines on safeguards modalities.

A. Fiscal safeguards

Way Forward

43. As noted in Section II, upon completion of the pilot fiscal safeguards reviews, staff developed an evaluation framework and a risk-based approach to the applicability of such reviews. Staff proposes that this approach be retained and incorporated in the safeguards assessment policy with some modification. In addition, to ensure that the evaluations are timely and coordinated with Fund-supported programs, operational guidelines for such reviews would also be developed. The following safeguards requirements and operational modalities are proposed for arrangements involving budget financing:

- *Applicability*. Fiscal safeguards reviews should be conducted for all arrangements where a member requests exceptional access to Fund resources, with an expectation that a significant proportion, i.e., at least 25 percent, of the funds will be directed to financing of the state budget.[35] The 2013 paper on fiscal safeguards pilots proposed that reviews be conducted for countries that receive exceptional access to Fund resources and channel more than half of the financial support to the budget. However, experience shows that it is often difficult to establish *ex-ante* the proportion of Fund resources that would be directed to the budget, as these decisions are normally taken at the time of discussions for program reviews (e.g., Tunisia, Ukraine). Therefore, staff proposes to require a fiscal safeguards review if there is an expectation when the program is initially approved that a significant proportion, i.e., at least 25 percent of the funds, will be directed toward budget financing. Such modification to

[35] Access limits are defined with reference to annual and cumulative limits. For GRA resources, excluding requests for FCLs, access limits are normally set at (i) 200 percent of quota over a 12-month period; and (ii) 600 percent of quota cumulatively, net of scheduled repurchases. Total access to concessional financing should normally not exceed 150 percent of quota a year and 450 percent of quota cumulatively. Since the 2013 pilot, there have been no PRGT financing arrangements that exceeded the applicable normal access limits in the PRGT. The above limits for access to concessional facilities were revised recently; see *Financing for Development—Enhancing the Financial Safety Net for Developing Countries*.

the criteria for fiscal safeguards reviews would also be consistent with the panel's recommendation to revisit the criteria on the 50 percent threshold. While the panel highlighted that fiscal safeguards reviews do not give the same level of assurance as safeguards assessments, they questioned the justification for the 50 percent threshold.

To the extent the above criteria are met during an arrangement, as a result of further budget financing or RCF/RFI disbursements, a fiscal safeguards review would need to be conducted. However, consistent with the proposals on update safeguards assessments, an update fiscal safeguards review would not need to be conducted if one was completed not more than 18 months prior. Staff will need to ensure that the review process during an arrangement, at program dates, identifies any new instances of budget financing that would not have been indicated at program approval. Experience with the above proposed criteria would be monitored and staff would come back with further refinements, as needed.

- *Modalities*. The reviews would be based on available PFM diagnostics that were conducted within the past six years, supplemented by a questionnaire that covers thematic areas as discussed in Section II. Specifically, where either a PEFA assessment or an FTE has been carried out within the past six years, the fiscal safeguards review would primarily be based on an evaluation by FAD staff of the relevant PEFA indicators or FTE practices/indicators, in addition to recent TA reports and other publicly available information. Where there is no recent PFM assessment and no plans to conduct such an assessment in the near future, FAD would conduct a stand-alone review of fiscal safeguards risks.

- *Timing*. To ensure risks to Fund resources are identified in a timely manner, a fiscal safeguards review should in principle be completed no later than the first program review (consistent with the deadline for safeguards assessments of central banks). Arrangements where a decision to direct the Fund's resources to budget financing is taken at subsequent reviews and the above applicability criteria are met will be treated on a case-by-case basis with respect to the timing for completion of the fiscal safeguards review.

- *Reporting*. Fiscal safeguards review reports prepared by FAD would be subject to the normal review process by relevant departments (Area, FIN, LEG, MCM, SPR), before completion. The reports would include a summary of key findings to be included in staff reports, along with measures to mitigate any potential risks. The reports would be approved by senior FAD management.

- *Report confidentiality*. Confidentiality requirements would mirror those of the reports for assessments of central banks. Accordingly, the reports would be confidential Fund documents shared with the country authorities and, if relevant and subject to authorities' consent, with the World Bank and the European Central Bank if so requested.

B. Streamlining and safeguards modalities

44. In light of the Fund's flat budget environment in recent years, efforts to reallocate resources and achieve efficiency gains have been stepped up across the institution to help meet new demands within a fixed envelope. Against this background, and as part of the review of the policy, staff has considered possible areas to identify streamlining opportunities in safeguards modalities.

45. Overall, central banks have made improvements to their control, audit and reporting frameworks since the framework was introduced. Accordingly, staff has considered possible risk-based streamlining of safeguards procedures, while also taking care not to jeopardize the degree of assurance provided by safeguards work. As noted in Section III, while central banks strengthened their frameworks, challenges remain in some areas, notably oversight, internal audit and legal structures. Experience suggests that existing weaknesses can persist and new vulnerabilities can arise, and therefore the streamlining proposals are calibrated to achieve efficiencies while preserving the fundamental objectives of the policy. The panel, in its report, considers staff's proposals for risk-based streamlining to be appropriate.

46. The paper makes specific proposals in the following areas, taking account of relevant factors, including the degree of assessed safeguards risk, progress on prior safeguards assessments and broad criteria used for post-program monitoring (PPM). Estimated annual staff savings as a result of these initiatives are of the order of two FTEs.[36] While the recommendations of the independent panel on enhancements to the safeguards approach may result in additional work, for example, on the proposed coverage of risk management frameworks, staff expects that this could be absorbed while still allowing for the above estimated savings.

Assessments

47. Staff proposes to discontinue conducting update safeguards assessments for augmentations of existing arrangements and in specific circumstances for successor arrangements, namely, if a prior assessment was conducted recently, i.e., time-based criteria; or if the central bank in question has a strong track record and the prior assessment was completed not more than four years prior.[37]

- **Augmentations**. Currently, the safeguards assessment policy requires update assessments for any augmentations of existing arrangements.[38] The 2002 policy review expanded the coverage of safeguards assessments to include augmentations in order to capture instances

[36] These are derived from proposed changes in the approach for augmentations (1 FTE), central banks with strong track records (0.5 FTE) and monitoring (0.5 FTE).

[37] Monitoring of the member's central bank would continue to be conducted and could entail on-site visits in the event of significant adverse developments.

[38] Augmentations increase access, i.e., amount of financing available under an arrangement, while extensions increase the duration of the arrangement, normally by several months up to a year.

where fresh resources were being committed.[39] At the time, this increased the coverage of central banks that would be subject to an assessment since the policy was in its infancy and some arrangements were approved prior to the introduction of the policy. However, at this stage, countries requesting an augmentation would have already been subject to an assessment at approval of the arrangement and the change in access should not necessarily translate to heightened safeguards risks.[40] Accordingly, staff proposes to discontinue update assessments for augmentations. In the past ten years, the Fund has approved on average three augmentations per year.

- **Successor arrangements (time-based)**. Under the current policy, an update assessment must be conducted for a successor arrangement irrespective of the proximity of a prior safeguards assessment. There have been instances where an arrangement is cancelled soon after approval and replaced with a successor arrangement, e.g., Ukraine most recently.[41] Most safeguards recommendations have target implementation dates within 1-2 years of the assessment, depending on the nature of remedial measures. In the event of successor arrangements that occur within such a close timeframe, staff proposes that in cases where a safeguards assessment was completed no more than 18 months prior to the approval of the successor arrangement, no update assessment would be necessary.[42, 43] Instead, ongoing monitoring work would continue to follow up on the implementation status of the prior safeguards recommendations.

- **Central banks with strong track records**. Staff proposes streamlined modalities for update assessments in cases where the central bank has a strong track record of implementing recommendations and no substantial issues were identified in the prior assessment or subsequent monitoring. Safeguards assessments are a snapshot, and since control environments are dynamic and can change over time, the streamlined procedures in such cases would also need to be subject to a "shelf-life" for the previous assessment, i.e., four years, and supported by a written representation by the authorities in the letter of intent for the successor arrangement that the central bank's safeguards framework remains robust. The streamlined modalities would be based on those conducted for FCL

[39] See *Safeguards Review—Review of Experience and Next Steps*.

[40] The safeguards framework is applied consistently irrespective of the size of the arrangement.

[41] The SBA approved in April 2014 was cancelled and a successor extended arrangement under the EFF approved in March 2015. The safeguards assessment was completed in August 2014, just ahead of the first review of the program supported by the SBA.

[42] If the new arrangement includes budget support, current requirements for (i) an appropriate framework between the central bank and state treasury to ensure timely servicing of financial obligations to the Fund, and (ii) a fiscal safeguards review to the extent relevant criteria are met, would continue to apply.

[43] Staff considered an alternative approach of dropping the assessment requirement for all countries that have had an assessment within four years prior to Board approval of a new program, if there had been no significant adverse developments. However, this approach would expose the Fund to significant risks, as experience suggests that existing weaknesses can persist and new vulnerabilities can arise that would likely go undetected if an update assessment were not conducted.

arrangements, i.e., limited review of external audit arrangements.[44] The proposed conditions that would need to be met for eligibility to the streamlined modalities are:[45]

- The recommendations from the previous safeguards assessment have been implemented;
- The previous assessment did not identify any substantial issues, i.e., the risk assessment for each of the ELRIC pillars was either low or medium-low;
- The previous assessment was completed no more than four years prior to the Board's approval of the new arrangement;
- No substantial political or governance changes, such as overhaul of central bank management, have taken place;
- Monitoring activities since the previous assessment did not uncover any significant adverse developments at the central bank; and
- The authorities represent in the letter of intent for the new arrangement that the safeguards framework remains robust.

Monitoring

48. The 2010 policy review endorsed a risk-based framework for the monitoring of safeguards risks at central banks. Under this framework, a monitoring intensity is assigned to individual central banks based on risk criteria. High intensity monitoring involves frequent contact with central banks and their auditors, and may include a monitoring mission. At a minimum, monitoring provides for follow-up on outstanding recommendations and a review of annual external audit results.

49. The monitoring framework could be further refined to reflect diminishing safeguards risks as credit outstanding is repaid over time. The refinements could be based on the Fund's Post-Program Monitoring (PPM). During a program, a member country's policies come under close scrutiny. Member countries typically have substantial Fund credit outstanding following a program. Under PPM, countries undertake more frequent consultations than is the case under normal IMF surveillance. PPM remains in effect until outstanding credit falls below a particular threshold, currently 200 percent of quota.

[44] Given the rigor of qualification under the FCL, including the requirement that a member must have very strong institutional frameworks in place, the normal safeguards modalities are not conducted for FCL arrangements. Instead modified procedures apply that are limited to the review of the central bank's annual external audit results and staff's discussions with the external auditors.

[45] Staff would need to report on its assessment of these conditions in the staff paper seeking Board approval of the arrangement.

50. Staff proposes that the monitoring framework be modified to follow the PPM practices, as follows: once a member's credit outstanding falls below the PPM threshold, the monitoring intensity would be limited to only require a desk-review of the annual external audit results, i.e., the financial statements and management letters, of the member's central bank. Safeguards monitoring would therefore follow institutional practices for PPM, including the exceptions.[46] The decision on PPM is normally made during the last program review by the Executive Board.

51. The panel's report encouraged staff to consider integrating metrics for more first-hand verification in the post-program period. Staff agrees with the notion that the greater the time span since the on-site assessment, the less relevant the single "snapshot" obtained by an assessment becomes. That said, staff will need to balance this with other competing demands, including the time-sensitive initial and update assessments, which under the policy are to be completed before the first review of a program. Staff will explore options such as combining travel for assessments with short monitoring visits in the region; participation in area department missions to follow up on specific safeguards developments, as has been done in the past; and further coordination with area department staff to follow up on safeguards issues during program or Article IV missions.

C. Further enhancements within the safeguards framework

52. Staff proposes that the five pillars of the ELRIC framework be retained, albeit with broader coverage in some areas. The broader coverage would include the areas identified by the panel, namely, continued emphasis on governance, deeper evaluation of risk management, and a more proactive engagement in cases where amendments to the central bank legislation are proposed.[47] The ELRIC framework continues to provide an adequate basis for safeguards work, as it covers the key areas required for a strong control framework and allows staff to exercise flexibility in the conduct of assessments notwithstanding the size or complexity of a particular central bank. The framework's general scope and objectives in the five ELRIC areas cover good governance, autonomy, audit and control systems (see Annex II). On the one hand, the framework enables a structured approach, while on the other hand the objectives are sufficiently broad to allow tailoring the assessments to specific cases and adjusting focus as central banks develop.

53. Governance should continue to be a common theme transcending the ELRIC pillars. The panel's report strongly endorses the sharper focus on governance effectiveness that followed the 2010 review and recommends that this work continue either as an apex concept, i.e., prism through which safeguards are viewed, or as a separate pillar alongside the ELRIC components. Given

[46] It is presumed that PPM applies after a member country's program has ended and its credit outstanding exceeds a threshold, currently 200 percent of quota. In some cases, PPM does not apply where a successor program is expected within six months of the conclusion of the current program or where the policies or the external position of the country are deemed to be strong. Conversely, PPM may be recommended in some cases where although outstanding credit is below the threshold, economic developments call into question the country's progress toward external viability.

[47] Safeguards staff would continue to collaborate with counterparts in LEG and MCM, particularly with respect to subsequent delivery of technical assistance.

that there is no common code of good governance for central banks, staff proposes to continue to assess governance as an overarching theme across all five ELRIC pillars with increased clarity and guidance taking account of emerging leading practices.[48]

54. The panel's recommendations to expand the coverage of risk management could also be incorporated within the existing framework. The panel observed that a new pillar could be introduced to the ELRIC framework to give this area more attention, or that it could be integrated in the core safeguards framework. In staff's view, an analysis of the risk management function fits well within the discussion on the overall control systems (i.e., the "C" pillar), but could be given more prominence. The level of analysis would be expanded from the current focus on stock-taking to a deeper evaluation of the function's effectiveness. As noted in Section II, risk management continues to be a relatively underdeveloped area at many central banks that have been subject to safeguards assessments. Progress has lagged on development of risk management structures, and this may well be indicative of the absence of a specific standard or international framework in this area. That said, staff agrees with the panel's recommendation for a tailored approach that would foster simple building blocks for central banks that are in the nascent stages of this work, or that have capacity constraints, while those at the other end of the spectrum with more advanced frameworks would benefit from engagement on observations and leading practices in this area. Going forward, staff will develop an internal framework for assessing, and providing modular recommendations that take account of country circumstances, on steps needed to establish and build an integrated risk management framework. This work normally demands a proactive assessment of risks, which in turn should strengthen central bank controls as their frameworks mature. To underscore this shift, additional text is proposed in Annex II on the ELRIC framework.

55. Broader engagement is proposed on amendments to the legal framework. The panel recommends a more proactive approach to engage key domestic players in cases where the assessment recommends amendments to the central bank legislation. While staff agrees with the panel's observations, such broader engagement will need to be considered carefully. First, engagement with key domestic players will need to sequenced following discussion with the central bank on findings and recommendations, which normally takes place at the conclusion of the mission. Therefore, as a practical matter, there may be cases where the broader engagement will need to be followed up in a subsequent visit, or in conjunction with program missions. Continuing close coordination with area department staff will be necessary. Second, such broader engagement would typically involve discussions with the ministry of finance, in close collaboration with the

[48] A comprehensive 2009 report by the Central Bank Governance Group established by the Bank of International Settlements (BIS) presents the following opening statement "… central banks differ significantly – in the scope and nature of their functions, in their history and in the political and economic conditions in which they operate. What is suitable for one country will not be for another. Hence, setting down a single set of "best practices" is not feasible".

central bank, to inform them on the rationale for the recommendations to amend legal frameworks.[49]

56. Staff's approach in applying the framework will continue to use international standards as benchmarks for financial reporting and external and internal audits. Going forward, staff will continue to take account of developments in audit and accounting standards. As noted in Section III, standards are continually evolving to keep pace with developments in governance and the financial sector. For example, audit standards, with the increased focus on governance, are placing greater emphasis on reporting by external auditors and audit committees. Specifically, coming standards in the pipeline will introduce new elements in the external auditor's report on communications with audit committees during the audit. This should help further highlight significant risks identified during the audits. Staff will maintain close review of such developments and adapt the approach as needed.

D. Increased outreach on internal audit issues

57. As noted in Section III, capacity constraints in internal audit remain a challenge. Internal audit has an important role in managing and strengthening the internal control environment of an organization given the interdependencies that arise from this function. Internal audit is often referred to as the third line of defense against any risk as it provides independent and objective assurance intended to add value and improve operations.[50] Going forward, staff proposes to have increased focus on internal audit issues. Areas for change include increased coverage of topical issues to elevate awareness of leading good practices in regional safeguards seminars; actively promoting peer central bank dialogue between mature and developing functions of central banks based on safeguards findings; and identifying external experts/speakers with deep audit knowledge and experience for initial and continuing engagement bilaterally with the central banks.

E. Transparency and confidentiality

58. Staff continues to consider confidentiality of safeguards reports to be a key factor for the success of the policy. Staff is granted access to sensitive information during assessments, including data on foreign reserves and confidential client information contained in external auditor management letters.[51] Confidentiality supports the due diligence objective of the assessments, enables the candor of reports, and facilitates open collaboration with third parties, such as external auditors of the central banks. As noted at the 2010 review, while publication could promote a "race to the top" among central banks, help promote accountability for the reports themselves, and fulfill

[49] Staff would not envisage engagement with the legislative entities but rather would limit the interaction to the ministry, since this is the party that often interacts directly with the central bank on matters that are within the scope of issues of a safeguards nature.

[50] Control functions put in place by management in its business operations are the first line of defense; oversight functions on business processes and risks are the second line of defense.

[51] The management letters typically contain information on the external auditors' observations during the audit on matters pertaining to the internal control environment.

a need for the public good element of the reports, the downside risks are significant. Key risks include the need for redactions of potentially market sensitive information, which could delay reports and consume staff resources to reach agreement; likely deterioration in frank and open discussions with external auditors and central bank authorities; and possible sharply reduced access to confidential information, including external auditor reports that are subject to stringent third party restrictions. The Executive Board observed at the last review that the existing confidentiality of safeguards reports has served the due diligence aspects of the policy well.

59. The panel endorsed the confidential nature of safeguards reports. The panel's report notes that wider dissemination of reports would affect central bank candor and could create disincentives for central banks and their external auditors to provide information to Fund staff.

60. While acknowledging the need for confidentiality, the panel recommended more consistency in the summary paragraph on safeguards issues in staff reports. The panel considered that since staff reports and periodic safeguard activity reports for the Board are key channels through which the Executive Directors are informed about safeguards matters, the safeguards paragraph should be featured in the main body of the staff report and that it should at a minimum cover: any instances of misuse or misreporting; significant recommendations on legislative amendment that fall outside the powers of the central bank to effect; problems in obtaining access to data; and deviations from commitments in relation to safeguards recommendations. Staff agrees with the panel's observation that a consistent and adequate level of information be provided on key safeguards findings and recommendations, as well as monitoring developments. In practice, safeguards issues are sometimes covered in informational annexes, and therefore a more consistent placement in the body of the report along with the above key principles on minimum content would be a positive development that staff can integrate in its practices fairly quickly.

ISSUES FOR BOARD DISCUSSION

61. Directors may wish to focus their observations in the following areas:

- The appropriateness and effectiveness of the safeguards assessment policy in helping to mitigate the risks of misreporting and misuse of Fund resources, and maintaining the Fund's reputation as a prudent lender.

- The proposals to adopt fiscal safeguards reviews, as part of the safeguards assessment policy, to help identify and highlight fiscal risks in Fund arrangements involving budget financing.

- The proposals for a risk-based streamlining of the modalities for safeguards assessments and monitoring.

- The proposed enhancements within the safeguards framework for continued emphasis on governance, broader coverage of risk management and internal audit issues, and a more proactive approach to engage key domestic stakeholders in cases with recommendations on amendments to central bank legislation.

- The confidentiality of safeguards assessment reports and reporting of key findings and recommendations in country staff reports.

Annex I. Safeguards Policy: Applicability

Current Policy Requirements:

The safeguards assessments policy applies to members seeking financial arrangements with the IMF, with the exception of Flexible Credit Line (FCL) arrangements. The policy applies to new and successor arrangements, augmentation of existing arrangements, and arrangements treated as precautionary. A member following a Rights Accumulation Program (RAP), where resources are being committed but no arrangement is in place, would also be subject to an assessment. Safeguards assessments do not apply to financing extended through first credit tranche purchases.

Safeguards assessment requirements also apply to disbursements involving liquidity and emergency assistance under the Rapid Credit Facility (RCF), Rapid Financing Instrument (RFI), and a 6-month Precautionary and Liquidity Line (PLL). A member's request for assistance under these programs requires commitment to a safeguards assessment, IMF staff access to the central bank's most recently completed external audit reports, and authorization for the central bank's external auditors to hold discussions with IMF staff. The timing and modalities of the assessment for such programs are determined on a case-by-case basis, [1]but typically the assessment must be completed before Executive Board approval of any subsequent arrangement to which the IMF's safeguards assessment policy applies. [2]

For members of currency unions with no autonomous national central banks, a periodic assessment cycle was established, irrespective of the timing of the member countries' programs. Accordingly, the Central Bank of West African Countries (BCEAO), the Central Bank of Central African Countries (BEAC), and the Eastern Caribbean Central Bank (ECCB) are assessed every four years.

Voluntary assessments are encouraged for members that have a Policy Support Instrument (PSI) in place or those that are implementing a Staff-Monitored Program (SMP).

Safeguards assessments are not conducted for members with FCL arrangements, on the grounds that qualifying countries have strong institutional arrangements in place. However, limited safeguards procedures, focused on discussions with external auditors of central banks are conducted.

All members subject to a safeguards assessment continue to be monitored under the safeguards assessment policy for as long as they have credit outstanding to the Fund.

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[1] The following principles serve to guide the case-by-case approach in emergency assistance cases: (i) if there is no functioning central bank, the safeguards assessment will be delayed until the reconstruction process establishes a sufficient degree of functional capability for the central bank to enable a meaningful assessment; or (ii) if a central bank exists, the degree of its functional capability will be evaluated in order to determine the scope of the safeguards assessment, which may include an initial targeted assessment aimed at basic control functions, to be followed by a full assessment once a functioning central bank exists and/or the security situation permits.

[2] One-to-two year PLL arrangements are subject to the standard requirement for the assessments to be completed at least by the time of the first review under the arrangement.

Streamlined Policy Requirements:

Under the proposed streamlining measures, safeguards assessments would not be updated for (i) augmentations, (ii) successor arrangements where a safeguards assessment was completed no more than 18 months prior to the approval of the successor arrangement; and (iii) central banks with a strong track record, if the previous assessment was completed within the past four years and no substantial issues were identified in the prior assessment or subsequent monitoring. In this last case, staff would only conduct safeguards monitoring procedures based on a review of external audit arrangements and audit results (i.e., similar to the procedures applicable to FCLs).

Limited monitoring intensity would apply to countries that are exempt from Post Program Monitoring (PPM). Monitoring activity would be reduced for central banks of members whose credit outstanding is below the PPM threshold, currently 200 percent of quota, have no active program, and where no program is expected in the near future. The limited monitoring would encompass a desk-review of the annual external audit results.

Annex II. An Updated ELRIC Framework

A safeguards assessment is a diagnostic exercise carried out by the IMF staff to evaluate the adequacy of five key areas of control and governance within a central bank. These areas are denoted by the acronym ELRIC, and its pillars are explained below. Governance is an overarching theme of the ELRIC framework, and the assessments consider the following key attributes of good governance relevant to central banks:

- *discipline*, represented by senior management's commitment to promoting good governance
- *transparency*, necessary to facilitate effective communication to, and meaningful analysis and decision making by, third parties
- *autonomy*, which is essential for a top decision-making body—for example, a central bank board—to operate without risk of undue influence or conflict of interest
- *accountability*, under which decision makers have effective mechanisms for reporting to a designated public authority, such as the parliament
- *responsibility*, which entails high priority on ethical standards and corrective action, including for mismanagement where appropriate.

The five ELRIC pillars and the main safeguards assessment objectives for each of these are as follows:

1. **External Audit Mechanism**. This encompasses the practices and procedures in place to enable an independent auditor to express an opinion on whether the financial statements are prepared in accordance with an established financial reporting framework, such as IFRS. This mechanism is important for the credibility of a central bank. *The objective of assessing the external audit mechanism is to establish whether an independent external audit of the central bank's financial statements is conducted regularly in accordance with internationally accepted auditing standards such as ISA, previous audit recommendations have been implemented, and to ensure that the external audit opinion is published with the full audited financial statements*.

2. **Legal Structure and Autonomy**. Government interference in central bank operations undermines central bank autonomy and could increase the risks facing the central bank. A sound legal framework enshrines central bank autonomy and complementary transparency and accountability. *The objective of assessing the legal framework and its application in practice is to: (i) establish whether the legal framework provides the central bank with an appropriate level of autonomy (including institutional and operational autonomy) along with adequate internal and external checks and balances; (ii) ascertain whether key legal requirements are complied with without interference or override; (iii) clarify if other legislation exists that could impair central bank autonomy; (iv) determine whether the respective roles and responsibilities of the central bank and other agencies are transparently and explicitly defined in cases of shared monetary authority; and (v) ascertain that the legal framework supports the other four ELRIC pillars*.

3. **Financial Reporting Framework**. Strong financial reporting principles and practices are essential elements of effective central bank operations that encompass the provision of financial information to both central bank management and to external parties, the latter typically through

published interim and annual financial statements. For such information to be useful, it must be relevant, reliable, timely, readily available, consistent in presentation over time, and based upon recognized standards, such as IFRS. Non-adherence to accepted international practices could indicate a lack of transparency or accountability. *The objective of assessing financial reporting is to ensure that the central bank adheres to international good practices in the adoption of accounting principles for internal reporting to management, and the published annual and interim financial statements.*

4. **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 achieve its objectives by bringing a systematic, disciplined approach that adheres to international standards, to evaluate and improve the effectiveness of risk management, control, and governance processes. *The objective of assessing a central bank's internal audit function is to determine whether internal audits are performed in accordance with international standards, such as International Standards for the Professional Practice of Internal Auditing, and whether the function is assigned sufficient independence and authority to fulfill its mandate effectively, including whether procedures exist for communicating results without interference.*

5. **System of Internal Controls**.[1] A sound system of internal controls encompasses a thorough assessment of risks and the design of adequate mitigating controls. It includes the set of behaviors, policies and procedures ~~is a process~~ put in place by an entity's board, senior management, or staff with the intent to manage risks and provide reasonable assurance regarding the achievement of objectives in the following categories: (i) conducting ethical, effective and efficient operations; (ii) fulfilling accountability obligations, including through reliable financial reporting; (iii) safeguarding resources against loss and misuse; and (iv) compliance with applicable laws and regulations. Together, risk management and internal controls ~~systems is~~ are a key component of ~~an entity's risk management framework and essential in safeguarding the integrity of its operations, resources and reputation~~ good governance. They are effective if built on rules of conduct and integrity upheld by the governance bodies at a central bank. *The objective in assessing the internal control system in a central bank is to ascertain the quality of high level governance and oversight, employee integrity, and the bank's commitment to building and maintaining ~~internal competence~~ a robust control environment. The assessment looks in particular at risk management and controls in areas of high importance for central bank operations and of significant relevance to a Fund arrangement, including ~~controls in the areas of~~ reserves management, accounting, currency and banking operations, and measures in place to ensure accurate and timely reporting of monetary program data.*

[1] This component of the framework is proposed to be updated as shown to take account of the increased coverage of risk management functions, as recommended by the panel.

Annex III. Assessments Completed

Table. Assessments Completed since 2000
(Calendar Years 2000-August 2015)

Year	Countries	Total
2015	Ghana, Honduras, Kenya, Madagascar, Morocco, Serbia, Sierra Leone, Ukraine, Yemen	**9**
2014	Albania, Armenia, Bosnia and Herzegovina, Georgia, Romania, Samoa, Seychelles, Sierra Leone, Ukraine	**9**
2013	BCEAO, BEAC, Bosnia and Herzegovina, Cyprus, Egypt, Jamaica, Jordan, Liberia, Libya, Morocco, Pakistan, São Tomé and Príncipe, Seychelles, Solomon Islands, Tunisia, Yemen	**16**
2012	Burundi, Djibouti, ECCB, Gambia, Greece, Guinea, Kenya, Kosovo, Lesotho, Malawi, Solomon Islands, Tanzania	**12**
2011	Afghanistan, Bangladesh, Fiji, Georgia, Haiti, Honduras, Ireland, Kenya, Kyrgyz Republic, Liberia, Macedonia, Nepal, Portugal, Romania, Serbia, Ukraine, Yemen	**17**
2010	Angola, Armenia, BCEAO, Cambodia, Comoros, Democratic Rep. of the Congo, Dominican Republic, El Salvador, Georgia, Greece, Iraq, Jamaica, Kosovo, Lesotho, Malawi, Maldives, Mauritania, Moldova, Mozambique, Pakistan, Samoa, Seychelles, Sierra Leone, Solomon Islands, Tajikistan, Zambia	**26**
2009	Armenia, BEAC, Belarus, Bosnia and Herzegovina, Costa Rica, Djibouti, El Salvador, Ethiopia, Ghana, Guatemala, Hungary, Iceland, Kenya, Kyrgyz Rep., Latvia, Lebanon, Mongolia, Nicaragua, Pakistan, Romania, Sao Tome & Principe, Serbia, Sierra Leone, Sri Lanka, Tanzania, The Gambia, Ukraine, Zambia	**28**
2008	Afghanistan, Burundi, Cape Verde, Congo Dem. Rep., Georgia, Haiti, Honduras, Iraq, Lebanon, Liberia, Madagascar, Malawi, Mozambique, Seychelles, Tanzania	**15**
2007	Comoros, ECCB, Guinea, Guyana, Haiti, Liberia, Mauritania, Nicaragua, Peru, Rwanda, The Gambia, Uganda	**12**
2006	Afghanistan, Albania, Burundi, Croatia, Iraq, Macedonia, Madagascar, Malawi, Moldova, Paraguay, Sierra Leone	**11**
2005	Armenia, Bangladesh, BCEAO, Bosnia and Herzegovina, Colombia, Croatia, Dominican Republic, Haiti, Kenya, Kyrgyz Republic, Turkey, Uruguay	**12**
2004	Argentina, BEAC, Belarus, Bolivia, Brazil, Bulgaria, Burundi, Cambodia, Georgia, Honduras, Mauritania, Mozambique, Nepal, Peru, Romania, Sao tome & Principe, The Gambia, Ukraine, Zambia	**19**
2003	Bolivia, Colombia, Congo Dem. Rep., Croatia, Dominican Republic, ECCB, Ecuador, Ghana, Guyana, Jordan, Kenya, Lao People's Republic, Lesotho, Macedonia, Malawi, Mongolia, Nicaragua, Paraguay, Rwanda, Sri Lanka, Tajikistan, Tanzania, Uganda, Uruguay	**24**
2002	Albania, Argentina, Armenia, Azerbaijan, Bangladesh, BCEAO, Bosnia and Herzegovina, Brazil, Brazil, Bulgaria, Cape Verde, El Salvador, Georgia, Guatemala, Guinea, Kyrgyz Republic, Moldova, Mongolia, Nepal, Romania, Sierra Leone, Turkey	**22**
2001	Albania, BEAC, Ethiopia, Kenya, Latvia, Lesotho, Lithuania, Madagascar, Malawi, Nicaragua, Nigeria, Pakistan, Peru, Serbia, Sri Lanka, Tajikistan	**16**
Transitional Assessments	Argentina, Bolivia, Bosnia and Herzegovina, Bulgaria, Cambodia, Colombia, Djibouti, Estonia, Ghana, Guyana, Honduras, Indonesia, Jordan, Latvia, Lithuania, Mauritania, Mozambique, Panama, Papua New Guinea, Romania, Sao Tome & Principe, Tanzania, Turkey, Ukraine, Uruguay, Yemen, Zambia	**27**

Source: FINSA database.

Annex IV. Questionnaire on Fiscal Safeguards

The broad aim of a fiscal safeguard exercise is to give "reasonable" assurance that the funds provided for budget financing:

- Will be spent on **LE**gally appropriated expenditures;
- Will be paid into a **T**reasury account from which all legally appropriated central government expenditures are financed;
- Will be financing transactions carried out through a central government budget, that is subject to transparent and effective **I**nternal budget execution procedures and controls;
- Will be supporting and financing a central government budget that is subject of comprehensive, timely and regular **F**iscal monitoring and reporting; and
- Is also subject both to effective internal **A**udit procedures and to an external audit conducted by an independent auditor, who reports to the Parliament rather than the central government.

The Questionnaire[1]

Legal Authorization

1. What are the provisions in the Constitution (if any) and what are the principal laws in place that govern Parliamentary approval of the overall central government budget (and component appropriations)? Is there a consolidated organic budget law?
2. Are there annual budget and finance laws authorizing central government expenditures and the tax regime respectively?
3. Are significant changes to the annual budget only permissible by secondary legislation (supplementary budgets/Excess Votes)?
4. Can any extra-budgetary expenditure (beyond that approved by supplementary budgets and or Excess Votes) by central government (excluding authorized extra-budgetary funds) take place legally and if so how?

Treasury Account

5. Is there a single treasury bank account (TSA) for central government expenditures and revenues held at the central bank? How is it structured; main sub-accounts etc?
6. How will Fund budgetary support/financing be paid into this account; can Fund monies be drawn down into any other account and if so how?
7. What is the legal basis for the TSA?
8. Are any line ministries or central government agencies authorized to hold bank accounts in commercial banks outside the TSA (and associated structure of accounts)? If so are any balances in such accounts consolidated into the TSA single account overnight?
9. Does the Ministry of Finance (MOF)[2] maintain records of all bank accounts opened in its (or line ministries and agencies) name?

[1] Prepared by FAD staff.

[2] The Ministry of Finance is used as a generic term for the finance ministry of the central government.

Internal Controls i) Budget Execution System

10. What are the rules for virements (transfers of appropriation across and within Appropriation Heads)? How does the MOF ensure it is always controlling against the most up to date budget (reflecting approved virements)?
11. Are the internal budget execution controls documented and subject to periodic review and update?
12. How are the separate roles for authorizing central government expenditures and for paying bills defined under the budget execution system? Are separate roles or functions enshrined in primary legislation or can significant changes be made through secondary legislation or administrative direction?
13. Does the MOF (or other party such as the Auditor General) exercise any ex-ante control over release of budget funds from the TSA?
14. Are line ministries or government agencies required to record and monitor their expenditure commitments or obligations either in a "Financial Information Management System" or manually? Are there mechanisms to control expenditure commitments or obligations within either appropriations (including administrative controls set to planned profiles of expenditures) and/or budget releases to prevent excess expenditures and the accumulation of payment arrears?
15. In an emergency (or otherwise) can the MOF, other senior Ministers or senior officials override the control system for central government expenditures and if so how?

Internal Controls ii) Indicators

16. Over each of the last three years, what was the average percentage variance between the original central government budget approved by Parliament and the outturn? Was this variance all legally authorized through supplementary budgets and /or Excess Votes?
17. Is there a legal definition of what constitutes a payment arrear (e.g. a bill outstanding for more than 60 days after the prescribed payment date)?
18. Are outstanding payment arrears in central government identifiable and monitored? If so what was the average size of central government monthly payment arrears outstanding against monthly actual expenditures in each of the last three years?
19. Does the central government (or component Ministries/agencies) hold suspense accounts? If so are the amounts held identified and monitored by the MOF? If so what was the average percentage amount held in suspense accounts against monthly actual expenditures over each of the last three years?

Fiscal Monitoring and Reporting

20. How frequently (daily/weekly/monthly) are reports on central government expenditures and revenues provided to the MOF of:
    i) Above the line data (derived from line ministry budget execution information);
    ii) Below the line data (derived from bank statements);
    iii) Reconciliations of above and below the line data; and
    iv) Reconciliation of flow of debt operations with changes in the stock of government debt?
21. What are the lags in receipt of the various reports by the MOF?
22. Does the MOF require in-year reports on outturn of line ministries' budgets relative to budget plans/profiles? Are the plans/profiles modified in-year in the light of emerging actuals data?

23. In each of the last three years, what was the average number of months (after financial year end) before comprehensive central government accounts were available internally within government and submitted to the external auditor for audit?
24. In those years, what was the average number of months (after financial year end) before central government accounts were made available to the public and Parliament?

Audit i) Internal

25. Is there an internal audit system/mechanism within central government? If so is it under MOF or individual line ministry supervision?
26. Are all internal audit reports made available to the Minister of Finance or only to the relevant line ministries?
27. Are all internal audit reports available to the external auditor?
28. What is the scope of internal audit work?
29. What mechanism exists for follow up on internal audit recommendations? Is a report on actions taken in response to internal audit recommendations available to the Minister of Finance and Head of External Audit?

Audit ii) External

30. What is the legal basis of the external audit function for central government? Does the head of external audit (or the audit board) report to the executive (and if so to the President or a Minister), or to the legislature, or is (s)he part of the judiciary and thus fully independent? Who appoints the head of external audit for central government accounts? Who can dismiss the head of external audit?
31. Who sets the standards for external audit? Are these consistent with international standards such as INTOSAI or ISAs?
32. Who sets the standards for government accounts? How far are these set or influenced by international standards such as IPSAS or IFRS?
33. Do the reports prepared and issued to the public also include information on central government debt operations, other liabilities and contingent liabilities, and financial assets?
34. Do they provide information on the accounting basis policies in operation?
35. Is there an established mechanism for following up on external auditor recommendations? Is the legislature informed by reports from central government on actions taken in response to recommendations from the external auditor?
36. In each of the last three years, what was average lag between the publication of accounts by central government and the external auditor's report? Was a formal audit opinion issued and published?

Annex V. Safeguards Recommendations

Table. Implementation of Safeguards Recommendations
(for the period April 2010 to August 2015)

		Total number of recommendations	Implementation Rate (percentage)
1. Recommendations with formal commitment from the authorities that are due		70	
a. Under program conditionality 1/		48	93.8
	Of which: Implemented	45	
b. LOI/MEFP commitments 2/		22	63.6
	Of which: Implemented	14	
2. Other recommendations		469	
	Of which: Implemented	328	69.9
3. Total recommendations (1+2)		539	71.8
	Of which: Implemented	387	

Source: FINSA database.

1/ The three outstanding recommendations with program conditionality all involve amendment of the central bank legislation, which is at different stages of progress.

2/ Six of the eight recommendations relate to two member countries with poor implementation track records.

Annex VI. Developments in Operating Environments

<table>
<tr><th colspan="2">Table. Examples of Developments in Central Banks' Operating Environments</th></tr>
<tr><th>Trends and Developments</th><th>Safeguards Risks</th></tr>
<tr><td colspan="2">Currency Management</td></tr>
<tr><td>
Cash management continues to be a core function. The use of electronic money has not reduced currency in circulation.
Increased automation and use of technology – for processing and vault security.
Interface of currency processing and vault systems with the accounting system.
Increased reliance on external suppliers (software, equipment, engineering).
More involvement of private sector (e.g., sorting and processing) and more outsourcing. More cash centers – i.e., vaults and processing in outside locations.
Banknote production is more demanding – counterfeit risks, life expectancy, environmental impact of notes.
The Banknote Ethics Initiative established in 2013, to provide business practice with a focus on the prevention of corruption and on compliance with anti-trust law. The industry acknowledges that there is a problem.
Increase in public awareness of incidents of currency fraud involving central bank staff.
</td><td>
Inadequate capacity to operate advanced equipment.
Capacity of internal and external audit – audit trail of cash processing activities more difficult.
IT risks – audit trails; lack of qualified IT auditors; override of controls possible from locations outside the central bank; less human oversight.
Insufficient storage space increases custody risks.
Procurement of high-value equipment and notes. Incentives to award contracts to selected suppliers.
Impact on program monetary data – misstatement of currency in circulation/reserve money.
</td></tr>
<tr><td colspan="2">Reserves Management</td></tr>
<tr><td>
Low-return environment creates incentives to pursue "unorthodox" investment opportunities. For example,

Increased investments in instruments with embedded derivatives. (e.g., BIS dual-currency deposits; high-risk repos)
Investment in equities & emerging market bonds
Currency diversification – may involve not freely convertible currencies
Excessive concentration and/or counterparty risk (e.g., large proportion of reserves invested with a single counterparty)

Increased use of external asset managers.
Higher price of gold – more attractive investment including unrefined gold.
IT developments:
</td><td>
Governance bodies may not have the relevant experience to oversee and challenge investment decisions.
Inadequate staff capacity to manage complex instruments and monitor the risks.
Internal and external audit lack special expertise to audit complex investments and the related IT systems.
Misreporting risks increase: (i) difficulties in measuring the value of investments; (ii) it may also be difficult to confirm whether these instruments exist, are in freely convertible currencies, and readily available.
</td></tr>
</table>

Table. Examples of Developments in Central Banks' Operating Environments	
Trends and Developments	**Safeguards Risks**
○ Increased use of straight-through processing (dealing/settlement/recording) ○ Increase in automated controls around SWIFT. • Establishment of local "development funds" and sovereign wealth funds – resulting in the central bank not being the sole holder of the country's reserves. • Increased use of fx swap lines between central banks.	• Higher risk of loss in underlying investments –resulting in erosion of equity, and reputational losses. • Off balance sheet commitments related to complex or derivative instruments may be difficult to identify.
Domestic FX Operations	
• Development of financial markets - increased use of foreign exchange swaps and other derivative transactions. • Foreign currency auctions have become more prevalent; development of auction systems. • Currency swaps that may have undisclosed objectives; e.g., requirement that counterparties invest related resources in government securities. • Central banks acquiring from domestic entities non-convertible cash balances in foreign currency that cannot be repatriated.	• Impact on data reporting, including compliance with definitions on readily available and convertible foreign exchange reserves. • Challenges in valuation of the derivative instrument. • Lack of transparency regarding objective and counterparties. Lack of adequate disclosures in financial statements. • Limited capacity of internal and external auditors to review these transactions and the related systems.
Lending/Financial Assistance to Banks and Other Institutions	
• Financial stability objective now more frequently incorporated in central bank legislation; increased lender of last resort (LOLR) exposure. • LOLR evolved from traditional easing (standing facilities) to extraordinary targeting specific institutions and provision of FX liquidity. • Easing requirements on the quality of collateral. • Providing solvency support together with liquidity support. • Trends to reduce fiscal dominance may lead to less transparent and indirect lending to government (i.e., round tripping). Lending to state-owned enterprises/government entities using intermediary banks for the purpose of financing quasi-fiscal activity.	• Lack of a clear ELA legal framework to ensure minimum requirements are met (solvency, collateral, interest rate, repayment terms). • Inadequate governance arrangements and transparency on decision-making. • Balance sheet risks (sustained drainage of central bank capital). • Solvency is difficult to establish during a crisis • Lack of autonomy – political interference in decision-making.