

INTERNATIONAL MONETARY FUND

Safeguards Assessments—2008 Update

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(In consultation with other departments)

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I. EXECUTIVE SUMMARY

1. **Safeguards Activities.** In the year to June 30, 2008, 10 safeguards assessments were conducted bringing the total number of assessments completed since 2000 to 122. At year-end, 72 central banks were subject to ongoing safeguards monitoring. Assessment activity has also included several recent high-profile cases of misreporting or misuse, along with intensive analysis of special audit reports initiated in such cases. In the latter part of 2008, staff developed modalities for expedited safeguards assessments under the Emergency Financing Mechanism.

2. **The review of the safeguards policy** has been delayed pending the completion of the review of the Fund's Facilities. Against this background, the paper presents a broader perspective of safeguards work and issues. Key themes include:

- **Central Banks have made significant progress in strengthening governance and transparency mechanisms.** This has included the adoption of recognized international best practices in financial reporting, auditing, control systems, and Audit Committee oversight.
- **The implementation rate of priority safeguards recommendations has remained close to 90 percent.** In several cases this has included central banks' implementation of special audits for reviewing program data, or key operational controls. Fund technical assistance has helped support implementation rates of priority measures.
- **Recent experience has underscored some emerging issues and challenges:**
 - Improved safeguards cannot be a panacea against abuse or override of governance measures.
 - Some central banks face difficulties in sustaining previously implemented safeguards measures.
 - International donors and other interested parties have shown increasing interest in the results of safeguards assessments.
 - The Fund faces challenges in retaining specialized staff needed for safeguards assessments.

3. **Possible issues for consideration at the forthcoming safeguards review include:**

- The scope for refocusing safeguards activity by, for example, placing greater emphasis on risk management practices and operational controls.
- The role of safeguards in reducing misreporting.
- The scope for wider dissemination of the results of safeguards assessments, including the sharing of cross-country experiences.

II. INTRODUCTION

4. **This paper provides Executive Directors with an update of safeguards assessment activities from July 1, 2007 through June 30, 2008.** In common with the two previous updates prepared since the review of the safeguards policy in 2005, this paper covers the various types of safeguards activities undertaken during the year. It also briefly discusses key developments in the latter part of 2008, including implementation of the safeguards policy for arrangements requested in an expedited manner using the Emergency Financing Mechanism.

5. **At the time of the last review of the safeguards policy in 2005, it was envisaged that the policy would again be reviewed on a three-year cycle.**¹ However, the forthcoming review has been delayed so that it can take into account the results of the ongoing review of Fund facilities. Against this background, this update paper also takes a somewhat longer perspective than the two previous annual updates, by providing an overview of the development of the safeguard frameworks of members' central banks since the inception of the Fund's safeguards policy in 2000. Drawing upon this experience, it also presents some issues that could be considered in the forthcoming review, including the potential need for a re-focus after 8 years of safeguards activity and the future role of safeguards in reducing misreporting.

6. **Safeguards assessments involve an evaluation of a central bank's operations with respect to its external and internal audit mechanisms, legal framework, financial reporting practices, and its system of internal controls (Annex I).**² Safeguards assessments are generally conducted for central banks of members that have a financial arrangement with the Fund (Box 1).

¹ *Safeguards Assessments—Review of Experience* and *The Acting Chair's Summing Up*. See, also, the 2007 activity report: *Safeguards Assessments—2007 Update*.

² The Fund introduced the safeguards policy in 2000 to obtain reasonable assurance that central banks of member countries using Fund resources have adequate control systems in place to manage resources, and Fund disbursements.

Box 1. The Fund’s Safeguards Policy—Applicability

The safeguards policy, through the conduct of safeguards assessments, aims at providing reasonable assurance that a central bank’s control, accounting, reporting, and auditing systems are adequate to safeguard Fund resources and ensure the integrity of financial operations and reporting to the Fund. The policy is an integral part of the Fund’s interaction with members in the context of the use of resources provided under financial arrangements with the Fund. A cornerstone of the policy is the publication of central bank financial statements that have been audited by external auditors in accordance with international standards. When necessary, key safeguards recommendations may become part of program conditionality. The financial safeguards at central banks continue to be monitored for as long as Fund credit is outstanding.

The safeguards policy applies to members seeking financial arrangements from the Fund, including those approved under the Emergency Financing Mechanism, augmentation of existing arrangements, arrangements treated as precautionary, disbursements involving Emergency Post-Conflict Assistance (EPCA), and to members following a Rights Accumulation Program (RAP) where resources are being committed. Assessments are undertaken for any new or successor arrangement requested by a member. A commitment to undergo a safeguards assessment will be required prior to initial disbursement under the rapid access component of the Exogenous Shocks Facility (ESF), and the assessment would normally need to be completed before approval of disbursements under the rapid access component for a second shock within a five year period following initial disbursement.

Voluntary assessments are encouraged for PRGF-eligible members that have a Policy Support Instrument (PSI) in place or those that are implementing a Staff Monitored Program (SMP). Safeguards assessments do not apply to first credit tranche purchases, stand alone Compensatory Financing Facility (CFF) purchases, or disbursements under the Emergency Assistance for Natural Disasters.

7. **The paper is organized as follows.** Section II describes the level and composition of assessment activity in 2007/08, and Section III summarizes the trends in the evolution of safeguards at central banks while Section IV outlines emerging issues for both central banks and the safeguards modalities. Section V describes key outreach activities undertaken during the year to enhance communication and dissemination of information on the safeguards policy, and Section VI notes possible issues to be taken up in the forthcoming review of the safeguards policy. Annexes also provide further background information on the policy, central banks currently subject to the policy, the status of recommendations, and outreach activities.

III. SAFEGUARDS ACTIVITY IN 2007/08

8. **Safeguards work in the year to June 30, 2008 involved both assessments and monitoring activity.** As has been the case in recent years, activity focused predominantly on the conduct of update assessments in respect of successor arrangements or augmentations (the latter mostly to address shocks associated with rising food and fuel costs), and the monitoring of central banks for the emergence of new safeguards issues.³

³ The modalities for the various aspects of the safeguards work are described in the Operational Guidelines for Safeguards Assessments, which may be found at: <http://www-int.imf.org/depts/fin/safeguard/safeguard.htm>.

9. **Specific highlights of safeguards activity in the last year** (Table 1) include:

- The completion of 10 safeguards assessments. This brought the total number of assessments completed since the program's inception in 2000 to 122, covering 69 central banks. A further 12 assessments were in progress at June 30, 2008 several of which have since been finalized (Annex II).
- Ongoing monitoring of 55 central banks, representing 72 member countries.
- PRGF eligible countries accounted for some 70 percent of completed assessments and over 80 percent of countries monitored.

Table 1 : Safeguards Assessments Activity
(Number of central banks covered)

Type of Activity	Year ended June 30			Total assessments since 2000
	2006	2007	2008	
Assessments completed:	13	13	10	122
Initial assessment 1/	3	2	2	70
<i>of which: PRGF eligible countries</i>	-	-	-	45
Update assessment	10	11	8	52
<i>of which: PRGF eligible countries</i>	10	9	7	34
Monitoring	65	54	55	
<i>of which: PRGF eligible countries</i>	45	44	43	
1/ Includes an interim report issued for 1 central bank prior to finalization of the complete safeguards assessment.				

A. Assessments Completed

10. **Assessment activity in the year to June 30, 2008⁴** (Annexes II and III):

- ***Eight update assessments completed*** for the central banks of Afghanistan, Burundi, Congo, D.R., Guinea, Iraq, Mozambique, and Nicaragua, as well as a periodic assessment of the Eastern Caribbean Central Bank;
- ***Two first-time assessments completed*** for the central banks of Comoros and Lebanon; and
- ***Twelve assessments in progress*** for the central banks of Armenia, BEAC, Cape Verde, Djibouti, Haiti, Honduras, Liberia, Madagascar, Malawi, Nicaragua, Tanzania, and Zambia.

11. **Since July 1, 2008, a further 8 assessments have been initiated**, following the start of formal discussions for new Fund arrangements and augmentations of existing arrangements. These include 5 assessments for Stand-by Arrangements considered under the Emergency Financing Mechanism. In these cases, given the accelerated timetable and high levels of frontloaded access involved, the staff is taking special steps to ensure that assessments are completed promptly:

- ***In cases where a central bank has previously undertaken a safeguards assessment***, a member's past cooperation with the Fund on safeguards issues coupled with the results of safeguards monitoring has enabled staff to report at the time of the initial request for the use of Fund resources on whether the central bank follows key safeguards requirements. Such an approach has been used for assessments in respect of Georgia, Pakistan, and Ukraine.
- ***Where a central bank has not previously undertaken a safeguards assessment***, consent has been sought to make contact with central bank's external auditors to obtain and discuss confidential information relating to the audit of the financial statements. This approach has been used for the assessments for Hungary and Iceland.

12. **The nature and intensity of work during 2008 varied across the completed assessments.** Update assessment work benefited from the existence of information readily available from past assessments and monitoring work. Several cases, however, saw new issues emerge that required intensive staff engagement and collaboration with country authorities to first develop remedial measures, often framed in the context of program design, and thereafter closely monitor compliance. FIN staff worked closely with the central banks

⁴ All assessments that required completion by the first review of the respective arrangement met the safeguards policy deadline.

and respective area department teams to ensure that the underlying issues were clearly understood and satisfactorily addressed.

13. The assessments of Burundi, the Democratic Republic of Congo, and Guinea provide specific examples of the collaborative arrangements between staff and the authorities, while at the same time maintaining the independence of the assessment process:

- In **Burundi**, the assessment was conducted amid allegations of a high level override of controls at the central bank that facilitated significant misappropriations of government resources. The assessment identified the need for two specific prior actions in respect of the PRGF arrangement approved by the Executive Board in July 2008: (i) the introduction of a stronger authorized signatory control over transfers and disbursements from the government's accounts at the central bank; and (ii) the contracting of a special audit of the bank's controls over significant disbursements and transfers to be conducted by an international auditor. The authorities completed both prior actions, and the staff will be monitoring the results of the special audits to determine whether any further remedial measures are required.
- In the **Democratic Republic of Congo**, the external audits of the central bank identified weaknesses in the procedures for the approval and payment of government expenditures. The 2007 safeguards assessment that was conducted in the context of a possible PRGF arrangement found that these problems had continued, subsequent events saw a further instance of nonobservance of performance criteria and a report on new cases of misreporting was circulated in June 2008. Board consideration of the new cases, however, has been awaiting the completion of remedial measures. Safeguards measures became key elements of the waivers granted in respect of the misreporting, and for actions required to be completed before a Board discussion of a possible new PRGF arrangement. These measures included the completion of special audits of: (i) government expenditure transactions for which required authorizations or supporting documentation was lacking; and, separately (ii) monetary data to be submitted for each test date. FIN staff continue to work with the authorities and the AFR team in reviewing the results of the special audits and compliance with waivers granted.
- In **Guinea**, and following an adverse opinion on the central bank's financial statements by the external auditor, a range of safeguards measures were put in place before the Executive Board's approval of a new PRGF arrangement in December 2007. These included the use of special audits to verify program data, and a number of measures forming part of structural conditionality for the first year of the program. Staff continue to work closely with the area department team in reviewing information provided, and actions taken, by the authorities.

14. Assessments completed for Afghanistan and Iraq highlighted the ongoing difficulties that can be faced in re-establishing basic reporting and control mechanisms. In both cases, ongoing special audit work is required to ensure the accuracy of monetary data,

in the absence of reliable and fully functioning financial accounting systems. In the case of Iraq, a fire that destroyed a large part of the central bank's infrastructure placed further strains on the existing limited staff capacity at the central bank, but did not interrupt core operations.

15. **Other assessments found varying degrees of progress in safeguards areas.** **Lebanon** (EPCA), **Mozambique** (voluntary/PSI), and **Nicaragua** (new PRGF), for example, are at various stages of multi-year plans for implementing International Financial Reporting Standards (IFRS). The respective assessments for each, however, also noted the need for stronger independent governance oversight mechanisms. The assessments of **Comoros** and the **ECCB** involved relatively small central banks that nonetheless have an important role in the respective country/region. Issues for attention in Comoros centered around improving transparency and external audit arrangements, while the ECCB was found to have fully adopted IFRS, and also has appropriate control mechanisms in place.

B. Monitoring

16. **Monitoring was conducted for 55 central banks in the period under review.** Monitoring largely involves headquarters-based work, and is conducted for as long as Fund resources remain outstanding. It is aimed at identifying possible new vulnerabilities in a central bank's safeguards framework at the earliest possible stage (Box 2). The results of the monitoring work are a key input into the conduct of update assessments. In 2008, monitoring also increasingly included analysis of quarterly or half yearly special audits reports on targeted central bank activities. **Monitoring work increased with the emergence of several high profile cases of misreporting and governance abuses, some of which came to light as a result of safeguards work.**

17. **The central banks subject to monitoring at end-June 2008 represented 72 member countries, of which 62 are low income countries** (Annex IV), and include central banks for which assessments were completed during the year. Monitoring is conducted on a risk-based approach for the identification of emerging issues that was developed over 2006/07. Beginning in 2008, this work has been supported by the use of new risk management software, which the staff adapted to the needs of the safeguards policy, to manage work programs and document the implementation of key safeguard measures in individual countries.

18. **A key aspect of the monitoring process is the follow-up of prior recommendations** (Annex V). During the period, implementation of priority safeguards recommendations continued at high levels of around 90 percent.⁵ Slightly less than 80 percent of all safeguards recommendations were implemented on average. Fund-supported technical assistance that is carefully aligned with priority safeguards measures plays an important role in successful implementation. For example, technical assistance provided in

⁵ These measures include LOI/MEFP commitments and other measures included under program conditionality.

the context of structural conditionality has been beneficial in guiding the authorities in their implementation

Box 2. Risk-Based Safeguards Monitoring

The starting point for the monitoring process is the existing information from earlier assessments, augmented by information provided by the authorities and external auditors over time. Key aspects of monitoring activities include: (i) a focus on high-risk areas to ensure efficient use of resources; (ii) ascertaining the status of earlier safeguards recommendations through regular contacts with central bank counterparts and auditors; (iii) analysis of the most recent audited financial statements and audit management letters; (iv) the follow up of indicators of emerging safeguards issues; (v) tailoring work programs that set out, inter alia, contact points with central bank counterparts and external auditors; and (vi) targeted reviews to identify and/or resolve issues that could impact the adequacy of the safeguards framework at the central bank.

A risk-based approach for monitoring is used to ensure efficient use of resources and a focus on high-impact cases, in particular countries where there is a high likelihood of future disbursements under active financing arrangements with the Fund. Drawing on past experience, staff has developed a set of indicators for emerging safeguards issues, and the monitoring work plans for central banks exhibiting one or more of these are re-evaluated and adjusted as needed. These indicators include (i) unexpected changes in external audit arrangements, such as a dismissal of auditor; (ii) governance, control or financial reporting issues raised by internal or external auditors; (iii) delayed publication of audited financial statements; and (iv) unexpected changes in the governance structure or legal framework.

of internationally recognized financial reporting practices. Non-implementation of previous recommendations is often a reflection of the program going off-track. In other cases, implementation of recommendations was typically delayed by practical constraints. For example, planned amendments to central bank laws can be delayed by the legislative process and calendar. Staff uses update assessments, when conducted, to determine the reasons for non-implementation of previous recommendations and suggests adjustments where necessary.

19. **Special audit reports have become an increasingly important component of the monitoring process.** In response to the emergence of data problems and governance abuses, staff has, in some cases, recommended special audits and provided advice on their scope, as reflected in the terms of reference for special audits. During 2007-08, increasing resources were also devoted to analyzing a range of special audit reports received from central banks. Typically such reports are prepared by independent external auditors who conduct forensic accounting investigations, address weaknesses in the reporting of monetary data to the Fund, or provide assurances about the operation of key controls. The objectives of the staff analysis are to ensure the adequacy of the audits, determine whether the program objectives are met, and to monitor for signs of strengthened internal capacity that indicate such reports were no longer necessary.

20. **Communication with external auditors plays an important role in monitoring and other safeguards work.** Such communication in conjunction with the analysis of audited financial statements and management letters were integral elements of the monitoring work in 2008. Experience has shown that establishing strong links to the external auditors of

the consent of the central bank involved, are typically conducted from headquarters via tele- or video-conferencing, and always take place in the context of missions. Some specific examples in the current period where contact with the external auditors proved to be particularly helpful were:

- **Tanzania.** The authorities requested a voluntary safeguards assessment, in the context of the PSI with the Fund. The safeguards assessment was conducted in the wake of a forensic audit that had investigated serious fiduciary misconduct at the central bank.⁶ During the course of the forensic audit and the safeguards assessment, staff was able to communicate with the international audit firm leading the investigation, as well as the Controller and Auditor General. The information enabled the staff to formulate recommendations for strengthening governance and control mechanisms that were consistent with the findings of the special audit, and with which the authorities concurred.
- **Tajikistan.** In late 2007, the authorities provided information that was subsequently confirmed as giving rise to misreporting in the context of the last PRGF arrangement that concluded in February 2006. As part of the measures approved by the Executive Board to address the misreporting, the Tajik authorities commissioned a special investigative and forensic audit of the underlying transactions that gave rise to the misreporting and to verify revised data provided by the authorities. Staff provided guidance to the authorities on the terms of reference for the special audit and in this regard, discussions with the incumbent external auditor proved valuable in clarifying the standard of work performed by the auditors in the periods leading up to the authorities' disclosures, and the information to which they had access.

21. **Monitoring can be hampered, however, by delays in the provision of information by central banks.** To facilitate monitoring, central banks are required to provide their annual audited financial statements and related audit reports (including confidential “management letters”) to Fund staff for as long as Fund credit is outstanding. In addition, external audit firms often require a written authorization to discuss relevant issues with Fund staff.⁷ Previously these documents were not always provided on a timely basis, particularly for those central banks where the safeguards assessment was conducted several years ago. More recently, and reflecting improved transparency on the part of central banks monitored, staff has been able to obtain the audited financial statements from public sources such as central bank websites. Delays can still occur, however, in the receipt of management letters and other confidential audit reports.

⁶ As reported in the 2007 update, the fiduciary misconduct had first been identified by the previous external auditor, which had brought its concerns to the attention of Fund staff.

⁷ This authorization is required for obtaining a better understanding of the overall audit findings and does not extend to the provision of confidential audit information, which would require a specific confidentiality release.

C. Sharing Reports with the World Bank

22. **Safeguards reports continue to be shared with World Bank staff, subject to strict confidentiality restrictions.**⁸ Reports are shared on the basis of established criteria, including that the relevant central bank agrees, the report's confidentiality is maintained, and internal distribution within the Bank is restricted. A total of 31 reports have been shared since these arrangements were established in 2006, and experience has shown an almost universal willingness by central banks to share reports.⁹

IV. PROGRESS IN STRENGTHENING SAFEGUARDS

23. **Since the initial inception of the safeguards policy in 2000, central banks have made significant progress in strengthening the governance and transparency mechanisms** that are the core of the safeguards framework. Table 2 summarizes the evolution of the first time introduction of key safeguards measures by central banks. Further points of note include:

- All 55 central banks monitored under the safeguards program are subject to an annual external audit, with the majority utilizing the services of a member of one of the four largest global accounting firms. Twenty three of the 69 central banks assessed since inception of the policy have made first-time appointments of international accounting firms to conduct the external audit of the bank's annual financial statements.
- Particularly impressive progress has been evident in the publication of financial statements that have been prepared and independently audited in accordance with recognized international standards. Nearly all central banks monitored publish their full audited financial statements on their websites or in Annual Reports, while the remainder publish a set of summary audited financial statements.
- 25 central banks have either implemented, or are in the process of implementing, International Financial Reporting Standards as their accounting and financial reporting framework.
- Internal audit functions have also become more prevalent with 21 central banks having introduced formal charters in accordance with international standards for this function. Accompanying this some 23 central banks have strengthened governance oversight through the establishment of an audit committee.
- Central banks have also strengthened their mechanisms for managing foreign exchange reserves, by introducing formal Board approved investment policies, and for reporting data to the Fund for program monitoring purposes by automating data

⁸ Safeguards reports are confidential and only a high-level summary of the main issues is included in the staff report for that country.

⁹ To date only two central bank have withheld such consent.

compilation and introducing independent internal audit review of data compilation and reconciliation with the audited financial accounts.

Table 2: Key Safeguards Measures Implemented by Central Banks

(Number of central banks)

Safeguards Recommendation	2002	2005	2008
First time appointment of an international auditor	14	18	23
First time reconciliation of key program data with accounting records	20	34	41
First time publication of full audited financial statements	10	19	30
Internationally recognized financial reporting framework introduced	12	16	25
Adoption of an internal audit charter	9	14	21
Establishment of a new audit committee	10	15	23

24. **The current year saw a continuation of longer term trends and progress, but some signs of weakness continued to emerge for central bank safeguards.** Specific examples included:

- Long delays in the completion of audits and the publication of financial statements. In one case the delays have extended beyond one year because of the inability of the auditor to obtain satisfactory confirmation of balances from a government ministry. This required measures to reconcile accounting differences between the two institutions, and for the State Controller General to expedite clearance of the audit report. At end June 2008, however, the audit remained unfinished—some 18 months after the respective year-end.
- Weaknesses in auditor selection processes and concerns about the implementation of International Standards on Auditing (ISA). These weaknesses are typically resolved through formal board approved guidelines that govern auditor selection and rotation, and ensure audit independence. In some cases, concerns about the application of ISA by local firms (in particular those affiliated with international firms) were addressed by the addition of a concurring partner, along with the provision of technical guidance, from another international office of the firm concerned.
- IFRS implementation continues through multi-year transition programs, typically spanning 3-4 years, that also includes the development of professional capacity supported by technical assistance. In two cases in 2007 accounting firms played a key

role in providing guidance through IFRS technical training, and the review of pro-forma IFRS financial statements prepared by central bank staff.

- Internal audit capacity continues to improve, although 2008 assessments saw some cases where central banks lacked staff resources or capacity to perform risk-based auditing. Some cases also saw a mixture of inspection and control functions with risk based auditing responsibilities, which hindered the execution of internal audit work plans.
- The need for further strengthening of foreign exchange reserve management practices was a feature of some assessments, particularly those conducted on a first time basis, and in situations where central banks' reserves had grown in size and been invested in a wider range of asset classes, but without adequate attention to management of associated risks. Adoption of formal investment guidelines along with stronger operational controls were key elements of recommended remedial measures.
- Audit committees continue to be established as independent oversight bodies of central bank operations, although cases have arisen where committees appear to have lost momentum over time, through infrequent meetings and inadequate coverage of key functions. Remedial measure have included the need for formal agendas to steer committee work including regular schedules of meetings to monitor developments in the annual financial reporting and audit cycle, and internal audit reporting on the performance of control systems.

V. EMERGING ISSUES AND CHALLENGES

25. **Recent experience has also underscored that improved safeguards cannot be a panacea against abuse.** Safeguards assessments have played a significant role in improving mechanisms for accountability and giving control systems greater teeth. These mechanisms and controls have raised awareness of governance issues, including misreporting, and have even proven helpful to the early identification of breakdowns in controls (e.g., D.R. Congo). Despite these mechanisms, however, controls are not always effective in enforcing accountability. Recent cases (e.g., Tajikistan) have seen an emergence of misreporting involving control overrides at the highest level, the apparent failure of oversight bodies such as Boards and audit committees, and ineffective internal audit. Special audits of data or control systems are therefore often priority measures for addressing identified safeguards weaknesses. But these should be seen as short-term expedients until the integrity of control mechanisms is re-established.

26. **Recurring findings suggest that there are challenges for some central banks in sustaining previously implemented safeguards measures.** Some newly established safeguards, such as internal audit functions, have proven vulnerable to the departure of key personnel. In other cases, a control may be implemented in form, such as a reorganized segregation of duties in reserve management operations, but with little or no change in substance. Safeguards assessment staff are, therefore, increasingly being called upon to provide advice and assist with implementation issues, often by request for examples of practices of other countries that have implemented safeguards measures. Ways to leverage the

extensive cross-country experience gained from safeguards assessments need to be found, without undermining the independence of the assessment process given the potential for conflicts of interest between assessors and the assessee.

27. **While the risk-based monitoring strategy is providing an indication of emerging issues, it can consume significant resources.** As indicated above, monitoring becomes increasingly more complex and resource intensive when investigative measures such as special audits come into play. Monitoring can also present challenges once an arrangement is no longer active or has expired, as the staff seek to obtain and review documents, as well hold discussions with external auditors over an extended period (for up to 10 years in the case of a PRGF). Nevertheless, active monitoring is proving effective in improving the efficiency and timeliness of update assessments (recent examples beyond the reporting period are Haiti and Madagascar) and in identifying emerging risks.

28. **During the year under review, international donors, and other parties, expressed interest in the results of safeguards assessments.** During 2008, for example, donors in both Mozambique and Tanzania enquired about the possibility of obtaining information on the findings of the respective voluntary assessments being conducted for these countries.¹⁰ Current policy requirements for confidentiality generally preclude disclosure of safeguards information beyond that provided to the Executive Board (Box 3). Staff therefore provided donors with a description of the scope and coverage of the safeguards assessment, and a general flavor of the findings and recommendations, similar to that which is included in country staff reports.

29. **Streamlining and efficiencies have been introduced, but retaining specialized staffing has become increasingly challenging.** In line with Fund-wide streamlining efforts, safeguards reports are more tightly focused and opportunities for back-to-back missions have been utilized. As noted above staff has also introduced a new database system for tracking the conduct of assessments and subsequent monitoring. The current staff complement for safeguards work is 13 specialized staff, mostly Chartered Accountants or Certified Public Accountants with external audit experience. Recruitment and retention of staff proved difficult during the period for a variety of reasons, including the strong external market for accountants and career options in the Fund which are more limited for accountants than for economists. More recently, and in an effort to handle increased work associated with new use of Fund resources, internal staff secondment through mobility has been utilized.

¹⁰ The voluntary safeguards assessment were requested by the members in respect of their Policy Support Instrument with the Fund.

Box 3: Confidentiality and the Sharing of Safeguards Information

- The confidentiality of safeguards assessments has been an important consideration since the inception of the safeguards policy. Confidentiality is regarded as an important factor in the successful implementation of the policy, because member country authorities are more open to providing sensitive information to staff during safeguards assessments.
- The confidentiality regime is applied to both mandatory and voluntary assessments, the latter mostly arising from requests by member countries in the context of a PSI with the Fund.
- Within the Fund, safeguards assessments reports are provided to the Executive Director for the particular member country concerned. The Executive Board does not receive safeguards reports, but is informed of the findings and recommendations in summary form in staff reports.
- Beyond the Fund, confidentiality requirements limit the circulation of safeguards reports to central banks concerned. The Executive Board decision in December 2005 authorized the sharing of reports with the World Bank staff and requires that the Managing Director obtains, in particular: (i) satisfactory assurances from the Bank that the report will be kept confidential, its internal distribution restricted and the report will not, either in whole or in part, be quoted from, cited or used in publications; and (ii) the consent of the central bank concerned to the transmittal of the report.
- The 2005 decision focused on sharing of safeguards assessments reports upon request by World Bank staff as other large regional development banks did not conduct systematic due diligence assessments similar to the Fund's safeguards assessments policy—primarily because their financial operations involved mostly project lending that was not conducted through a central bank.
- Upon the request of a central bank, and with consent by the Managing Director, Fund staff may share summary results of safeguards assessments, which are included in staff reports, and available to the Executive Board, with other financial organizations or bilateral partners of that central bank.

VI. OUTREACH

30. **Outreach activities aim to disseminate information related to the safeguards framework and process** (both internally and externally), and to familiarize central bank staff with the underlying concepts and methodology.¹¹ Principal activities in the current period included:

- **Two seminars on safeguards assessments for central bank officials were conducted by FIN staff.**¹² These seven-day seminars, which are aimed at strengthening the safeguards framework of central banks, were very well received by 68 participants. The seminars are organized under the auspices of the IMF Institute and are hosted on a rotational basis at headquarters and the regional training centers. The December 2007 seminar at headquarters included representatives from 26 member countries from all geographic regions. The second seminar was held at the Joint Africa Institute (JAI) Tunis, in April 2008 and included officials from 29 eligible member countries. The JAI seminar did not include as many participants from

¹¹ The panel of central bank deputy governors that assisted the Board with the 2005 policy review called for better communication on the safeguards policy, notably with central banks.

¹² Annex VI includes a list of the 53 countries that sent representatives to the two safeguards seminars conducted during the period under review.

countries with active programs as the December seminar, but was equally well received because of the general relevance of the safeguards framework as a risk-mitigation tool at all central banks. Seminars have shown increasing demand from central banks for cross-country information on safeguards challenges, as well as participants' interest in a centralized forum to learn from peers.

- **The provision of guidance, including templates, for safeguards related measures,** such as information concerning prevailing international practice for the composition and responsibilities of audit committees, selection and appointment of external auditors, and terms of reference for special audits of monetary program data. These guidance notes draw on the staff's multilateral experience across regions, which central banks have found particularly helpful in designing and implementing their own financial safeguards.
- **FIN staff has strengthened collaboration with Resident Representatives and area department mission teams.** This has improved the flow of information from central banks, for example, special audit reports associated with program conditionality, confidential management letters, and supported timely implementation of safeguards recommendations. Such collaboration also permits the staff to better advise the authorities on the basis for the request, and the application of the safeguards policy more generally. As a related measure, staff has also taken the opportunity to meet with country authorities during the Spring and Annual meetings to discuss safeguards monitoring issues and information requests, as well as modalities and next steps in cases where an update or new assessment is about to be initiated.
- **Periodic meetings with audit partners of the big accounting firms** to discuss experiences and issues arising from audits by individual firms. This can take the form of periodic teleconference calls, visits en-route to or from a mission, at the margins of the IMF annual meetings or other conferences. Such high level contact is useful in encouraging the adoption of uniform practices across individual firms' sometimes diverse membership structures and franchise operations in a region by, for example, drawing partners' attention to particular audit practices that have been observed in our safeguards work. Spreading the outreach across the big firms, including at the regional and global partner levels, is important for delivering a uniform message that consistent application of audit standards and methodologies is key to the effectiveness of the safeguards policy.

VII. FORTHCOMING REVIEW OF THE SAFEGUARDS POLICY

31. **The next review of safeguards policy is tentatively scheduled in mid-2009,** following completion of the review of facilities. The information contained in this paper, along with experience noted in earlier update papers, suggests several issues that could be considered in the forthcoming review. These include:

- **The implications of the evolving nature of the Fund’s financing, against the backdrop of the considerable strengthening of the safeguards frameworks at central banks.** Accelerated disbursements and shorter-term facilities have already required some changes to the modalities of safeguards assessments and the forthcoming review of facilities could necessitate further changes. At the same time, the nature of staff’s findings and recommendations has evolved with changes in central bank practices. Given this, and with some 8 years of safeguards experience covering 69 central banks, it may be timely to consider whether a change of focus is required. For example, given the improvements generally seen in external audit procedures, should greater emphasis be placed on other elements of the ELRIC framework, such as strengthening the controls environment and assessment of risk management practices applied by the central banks? Will benefits derived from safeguards assessments continue to outweigh the costs of the policy? Related aspects to consider in this context could include whether the current risk based monitoring modality remains an effective and appropriate tool, and whether monitoring should continue for as long as Fund credit is outstanding.
- **The role of safeguards assessments in reducing instances of misreporting.** The review could examine this issue against the background of one of the intentions behind the introduction of the policy, namely to minimize the possibility for misreporting.
- **The confidentiality and dissemination of safeguards reports, against the backdrop of increased donor and other stakeholders’ interest and the significant lessons learned from cross-country experience.** Recent enquiries indicate growing awareness of, and interest in, the findings of safeguards assessments. This raises questions of how best the results of safeguards assessments be communicated both internally (to the Executive Board) and externally (e.g., donors, Parliaments), and whether the findings of individual assessments could be more widely disseminated. Broadening the access to safeguards assessments would be consistent with increased transparency of information in other areas, both within and outside the Fund. If a wider dissemination is possible, it will be prudent to advise third parties of the scope of safeguards assessments, so as to limit reputational risks to the Fund. Also, in the context of limited capacity facing some central banks, the question arises as to how can the significant cross-country knowledge and experience gained by staff conducting assessments be shared with the membership.

Annex I: Safeguards Assessment Policy—A Summary¹³

1. **Origin of the Safeguards Assessments Policy:** The safeguards policy was introduced in 2000 in the wake of allegations of misuse of Fund resources by recipient countries, and has been adopted as an integral part of the Fund’s financing operations since 2002. It was last reviewed by the Executive Board in April 2005.
2. **Overall Objectives of Safeguards Assessments:** To provide reasonable assurance to the Fund that a central bank’s control, accounting, reporting and auditing systems in place to manage resources and Fund disbursements are adequate to ensure the integrity of financial operations and reporting to the Fund.
3. **Applicability of Safeguards Assessments:**
 - Central banks of members with arrangements for use of Fund resources, including precautionary arrangements and central banks of members receiving Emergency Post-Conflict Assistance.
 - Existing arrangements that are augmented, rapid access component of the ESF, and member countries following a Rights Accumulation Program, where resources are being committed.
 - Not applicable to first credit tranche purchases, stand-alone CFFs, and drawings under the Emergency Assistance for Natural Disasters facility.
 - Voluntary, but encouraged, for members with Policy Support Instrument and Staff Monitored Programs.
4. **Scope of Policy—Central Bank ELRIC:** The safeguards framework covers five prime areas of control and governance within central banks, and incorporates International Financial Reporting Standards (IFRS) and International Standards on Auditing (ISA) as benchmarks. The five key areas of the framework and the key safeguards objectives for each area are as follows:
 - *External Audit Mechanism*—Establish whether regular independent external audits are being conducted in accordance with international standards, such as ISA, and to ensure that previous audit recommendations are implemented and the audit opinion and audited financial statements are published on a timely basis.
 - *Legal Structure and Independence*—Ascertain whether: (i) the legal arrangements for extension of credit to government are adequate and implemented without government interference; and (ii) for agencies that share monetary authority with the

¹³ See also <http://www.imf.org/external/np/tre/safegrds/complete/index.asp>

central bank, the legal basis of their relationship to the central bank, their role as a monetary authority, and the responsibility for reserves management are transparent and explicit.

- *Financial Reporting Framework*—Evaluate a central bank’s accounting practices and promote adoption and adherence to international good practices in the adoption of its accounting principles, financial statement presentation and disclosures, and reporting on operations.
 - *Internal Audit Mechanism*—Evaluate the effectiveness and independence of internal audit by considering: (i) the nature and scope of work programs and past audits; and (ii) the existence of audit oversight, preferably in the form of an independent audit committee or similar Board committee, as well as adequate reporting lines, both to the audit committee and the central bank governor.
 - *System of Internal Controls*—Ascertain whether sufficient procedures are in place to provide reasonable assurance that material risks are continually recognized and assessed. The main focus is on internal controls in the areas of accounting and foreign exchange operations, as well as on controls established to ensure accurate and timely reporting of monetary program data to the Fund.
5. **The Outcome of a Safeguards Assessment:** A report that identifies existing key vulnerabilities in each of the five ELRIC areas of a central bank’s safeguards framework and recommends measures to alleviate these under a mutually agreed timeframe.
 6. **Confidentiality:** Safeguards assessment reports are confidential documents. In accordance with procedures agreed by the Executive Board, reports may be shared with World Bank staff upon specific request, provided the relevant central bank consents and the report’s confidentiality is maintained.

Annex II: Assessments Completed July 1, 2007–June 30, 2008

Country	Type of Assessment	Completion Date
Afghanistan	Update assessment	3/18/2008
Burundi	Update assessment	6/10/2008
Comoros	First time assessment	8/8/2007
Congo, D.R.	Update assessment	1/25/2008
ECCB	Update assessment	7/11/2007
Guinea	Update assessment	10/21/2007
Iraq	Two stage phased assessment ¹⁴	3/7/2008
Lebanon	First time assessment	3/10/2008
Mozambique	Voluntary update assessment	6/3/2008
Nicaragua	Update assessment	11/7/2007

Assessments in Progress as at June 30, 2008

Country	Type of Assessment	Completion Date
Armenia	Update assessment	
BEAC	Update assessment	
Cape Verde	Voluntary assessment	12/5/2008
Djibouti	First time assessment	
Haiti	Update assessment	9/15/2008
Honduras	Update assessment	8/27/2008
Liberia	Two stage phased assessment	8/12/2008
Madagascar	Update assessment	9/20/2008
Malawi	Update assessment	12/1/2008
Nicaragua	Update assessment	
Tanzania	Voluntary update assessment	8/25/2008
Zambia	Update assessment	

¹⁴ The assessments for Iraq, and Liberia, were conducted under a phased approach. This approach provides a central bank with limited resources and only basic controls an opportunity to build operating capacity and related controls prior to the issuance of a final safeguards report.

Annex III: Summaries of Safeguards Assessments Completed in 2007-08

Afghanistan

Da Afghanistan Bank (DAB) is subject to a safeguards assessment with respect to PRGF arrangement approved on June 26, 2006. The safeguards assessment of DAB completed on June 12, 2006 revealed serious vulnerabilities in DAB's external and internal audit mechanisms, as well as in its financial reporting framework and system of internal controls. Capacity constraints, however, hampered the effective implementation of measures recommended by the assessment, and a follow-up staff visit conducted in November 2007 found that while external audit arrangements had been strengthened, financial reporting and controls were insufficient to ensure the accuracy of monetary data and the accounting system remained unreliable. Depending on the outcome of KPMG's ongoing external audit of financial year 1386 (ended March 19, 2008), staff will assess the need to continue special audits to verify reserve assets at test dates (a special audit was completed in January 2008 as a prior action for completion of the third review of the PRGF arrangement). DAB is continuing its implementation of outstanding safeguards recommendations. These efforts are being monitored by staff in the context of the program.

Burundi

An update assessment of the Banque de la République du Burundi (BRB) was completed in June 2008 and found that since the previous assessment, certain safeguards had been strengthened (e.g., external audits have been completed on a timelier basis and audited financial statements comply with IFRS and are published). However, the 2008 assessment also identified significant control weaknesses and recommended more robust controls over domestic disbursements to the government and its creditors, including contracting an external auditor to review such controls (prior actions for the PRGF arrangement approved by the Executive Board on July 7, 2008). Other key safeguards recommendations include a system to monitor the status of audit and safeguards recommendations, continuation of semi-annual audits of disbursements to the government, and establishing guidelines for investment operations.

Comoros

A safeguards assessment of the Banque Centrale des Comores (BCC) was completed in August 2007 and found that the BCC was taking steps to strengthen its safeguards framework and its financial statements were subject to an external audit. The main remaining vulnerabilities concern the quality of the external audit mechanism, the absence of a recognized accounting framework, and the non publication of audited financial statements. The assessment recommended measures to alleviate these weaknesses.

Congo, DR

Pursuant to Fund policy, the Banque Centrale du Congo (BCC) was subject to an updated safeguards assessment in conjunction with a possible PRGF arrangement. The safeguards assessment report that was completed on January 25, 2008, found a strengthened external audit mechanism, but also that significant safeguards risks remain in the control framework of the central bank, including serious concerns regarding the bank's independence. As a result, the assessment recommended several specific measures for implementation in advance of a Board discussion of a new PRGF arrangement. The BCC has agreed with the findings of the assessment and is committed to implementing the safeguards recommendations, some of which will be prior actions for a possible new PRGF arrangement and others will become performance criteria and structural benchmarks in the event of a new PRGF arrangement.

ECCB

Under the Fund's safeguards assessment policy, the Eastern Caribbean Central Bank (ECCB) is subject to a full safeguards assessment under a four year cycle. The most recent assessment was completed in July 2007, and concluded that the ECCB continues to have appropriate control mechanisms in place, which have strengthened since the first safeguards assessment completed in 2003. ECCB management places emphasis on good governance and sound controls, and has enhanced the bank's transparency and accountability since the last assessment, including the publication of audited financial statements that comply with International Financial Reporting Standards. The assessment made some recommendations to sustain the ECCB's safeguards framework going forward.

Guinea

The Central Bank of the Republic of Guinea (BCRG) was subject to an updated safeguards assessment in conjunction with a PRGF arrangement approved by the executive Board in December 2007. The safeguards assessment, which was completed on October 21, 2007, confirmed the continued existence of critical vulnerabilities in the BCRG safeguards framework, which would pose a high risk to the proper safeguarding of IMF disbursements. Overall, a system of strong internal controls, financial governance, and accountability needed to be urgently re-established and maintained at the BCRG. The assessment recommended measures that should help mitigate the safeguards risks, though significant risks would still remain. The BCRG agreed to implement critically important measures as prior actions for the PRGF. Several other recommendations became performance criteria and structural benchmarks for the program, and staff will monitor their implementation as part of program conditionality.

Iraq

The Central Bank of Iraq (CBI) is subject to a safeguards assessment in conjunction with the SBA approved on December 19, 2007. The assessment was finalized on March 7, 2008, and concluded that accounting and control governance at the CBI needs to be strengthened. Steps

are being taken to address the issues that continue to give rise to heavily qualified external audit opinions, but accounting and internal control procedures are not yet fully effective. The ongoing SBA incorporates measures to mitigate the safeguards risk, notably through continued external audits and adoption of foreign reserves management guidelines.

Lebanon

The Fund completed a safeguards assessment of the Banque du Liban in March 2008. The report suggested areas for enhancing the BDL's financial reporting, audit, and control procedures, and the authorities have outlined steps to follow up on these recommendations. The report has also suggested an update of the central bank law. An update of the safeguards assessment is currently underway.

Mozambique

In response to the Bank of Mozambique's (BoM) request for a voluntary safeguards assessment, an assessment of the BoM was completed on June 3, 2008. The assessment noted vulnerabilities in the oversight mechanism for external and internal auditing, controls, and financial reporting and BoM legal structure. In particular, the assessment recommended that the Audit Board assume the role of the audit committee and adopt terms of reference for this function. The BoM has also agreed to adopt an internal audit charter and commission an external quality assurance review of the internal audit function. Since the completion of the assessment, the BoM has adopted an internal audit charter and terms of reference for the Audit Board. Staff will continue to monitor on progress in implementing the assessment's recommendations.

Nicaragua

An update safeguards assessment of the Central Bank of Nicaragua (BCN), required in conjunction with the September 2008 augmentation of access under the PRGF arrangement, is substantially completed. This assessment updates the status of recommendations of the previous assessment that was finalized on November 2007, but does not reassess the risk ratings. Progress at the BCN has been slow and it has yet to implement a number of key safeguards recommendations, including the timely completion of its annual external audit and publication of the audited financial statements, strengthening Board oversight of the strategic plan to implement International Financial Reporting Standards, formalizing the oversight role of the Audit Committee, and introducing regular internal audits of controls in the foreign reserves operations area. In addition, the priority recommendations of the 2003 assessment in the legal area have not been implemented.

Annex IV: Central Banks Monitored at End-June 2008

Country	Date of Most Recent Assessment
Afghanistan	March 18, 2008
Albania	July 14, 2006
Armenia	November 7, 2005
Azerbaijan	March 8, 2002
Bangladesh	January 24, 2005
BCEAO ¹⁵	November 4, 2005
BEAC ¹⁶	August 30, 2004
Bosnia/Herzegovina	January 24, 2005
Burundi	June 10, 2008
Cambodia	March 24, 2004
Cape Verde	December 9, 2002
Comoros	August 8, 2007
Congo, D.R.	January 25, 2008
Djibouti	July 24, 2001
Dominican Republic	April 27, 2005
ECCB ¹⁷	July 11, 2007
Gambia	February 10, 2007
Georgia	December 10, 2004
Ghana	October 15, 2003
Guinea	October 21, 2007
Guyana	May 31, 2007
Haiti	March 5, 2007
Honduras	February 11, 2004
Iraq	March 7, 2008
Jordan	June 27, 2003

¹⁵ The BCEAO assessment is applicable for the following eight members of the Fund: Benin, Burkina Faso, Côte d'Ivoire, Guinea-Bissau, Mali, Niger, Senegal, and Togo.

¹⁶ The BEAC assessment is applicable for the following six members of the Fund: Cameroon, Central African Republic, Chad, Republic of Congo, Equatorial Guinea, and Gabon.

¹⁷ The ECCB assessment is applicable for the following six members of the Fund: Antigua and Barbuda, Dominica, Grenada, St. Kitts and Nevis, St. Lucia, and St. Vincent and the Grenadines.

Annex IV: Central Banks Monitored at End-June 2008 (*continued*)

Country	Date of Most Recent Assessment
Kenya	September 7, 2005
Kyrgyz Republic	October 14, 2005
Lao, People's Democratic Republic	April 8, 2003
Lebanon	March 10, 2008
Lesotho	July 24, 2003
Liberia	August 11, 2008
Macedonia (F.Y.R.)	February 28, 2006
Madagascar	March 17, 2006
Malawi	January 27, 2006
Mauritania	April 16, 2007
Moldova	October 13, 2006
Mongolia	November 25, 2003
Mozambique	June 6, 2008
Nepal	October 15, 2004
Nicaragua	November 7, 2007
Pakistan	February 1, 2001
Paraguay	October 30, 2006
Peru	June 15, 2007
Rwanda	January 26, 2007
Sao Tome & Principe	August 2, 2004
Seychelles	First time assessment in progress
Sierra Leone	June 12, 2006
Sri Lanka	July 30, 2003
Tajikistan	July 23, 2003
Tanzania	August 22, 2008
Turkey	June 29, 2005
Uganda	April 10, 2007
Ukraine	July 14, 2004
Yemen	May 23, 2001
Zambia	October 20, 2004

Annex V: Implementation Rate of Safeguards Recommendations

	Number of Recs. at end June 08	Rate of Implementation (in percent)		
		end June 08	end June 07	end June 06
1. Recommendations with formal commitment from the authorities	154			
a. Under program conditionality ¹⁸	93			
<i>Of which: Implemented</i>	84	90	93	98
<i>Not Implemented</i>	9			
b. LOI/MEFP commitments	61			
<i>Of which: Implemented</i>	59	97	98	97
<i>Not Implemented</i>	2			
2. Other recommendations	621			
<i>Of which: Implemented</i>	479	77	79	79
<i>Not Implemented</i>	142			
3. Total recommendations (1+2)	775			
<i>Of which: Implemented</i>	622	80	82	82
<i>Not Implemented</i>	153			
<i>Of which: Overdue less than 3 months</i>	21			
<i>Overdue 3 months to one year</i>	61			
<i>Overdue more than one year</i>	71			

¹⁸ Includes 26 prior actions (23 implemented), 22 structural performance criteria (all implemented), and 45 structural benchmarks (39 implemented).

Annex VI: Safeguards Seminars—Participating Member Countries

In the period July 2007 through July 2008, two seminars were held, one at IMF headquarters and one at the Joint Africa Training Institute. Overall, there were 68 participants representing 53 member countries.¹⁹

Afghanistan	Kyrgyz Republic
Albania	Lebanon
Algeria	Lesotho
Armenia	Liberia
Azerbaijan	Madagascar
Bosnia and Herzegovina	Malawi
Burundi	Mauritania
Cameroon	Mauritius
Cape Verde	Moldova
China	Montenegro
Comoros	Mozambique
Democratic Republic of Congo	Nicaragua
Djibouti	Paraguay
Dominican Republic	Peru
Ethiopia	Philippines
Gambia, The	Rwanda
Georgia	St. Kitts and Nevis
Ghana	Sao Tome and Principe
Guinea	Senegal
Guyana	Seychelles
Haiti	Sierra Leone
Hong Kong SAR	Solomon Islands
Iraq	Sudan
Jordan	Tanzania
Kenya	Tunisia
	Turkey
	Uganda
	Zambia

¹⁹ Four member countries had more than one participant, and a further nine member countries participated in both seminars.