

## **Web Box 5.2**

### **Safeguards assessment policy**

The safeguards policy has been an integral part of the Fund's lending operations since 2002. Initiated in 2000 after several instances of misreporting of data to the IMF and allegations of misuse of IMF resources, it supplements conditionality, technical assistance, and other means at the Fund's disposal to ensure the proper use of its financing. A cornerstone of the policy is that central banks of member countries borrowing from the IMF publish annual financial statements that have been independently audited in accordance with international standards. As of April 30, 2010, some 168 assessments of 75 central banks had been conducted since 2000.

In July 2010, the Executive Board concluded its review of the Fund's safeguards assessment policy, which included an appraisal of the safeguards process by an independent panel of experts. The review reiterated the continued effectiveness of the policy and its positive impact on central banks. It observed that the existing framework for assessing and monitoring central banks' operations is broadly appropriate and recommended that the framework be enhanced through a sharper focus on governance and risk management at central banks

#### **Objective of safeguards assessments**

To provide reasonable assurance to the IMF that a central bank's auditing, financial reporting, control systems, and legal structure and independence are adequate to ensure the integrity of operations and minimize the risk of misuse of resources or misreporting of data.

#### **Applicability of safeguards assessments**

Safeguards assessments are obligatory for central banks of (1) member countries with new arrangements for use of IMF resources approved after June 30, 2000, or existing arrangements that are augmented; (2) member countries following a Rights Accumulation Program (RAP) under which resources are being committed; (3) member countries receiving assistance under the Rapid Credit Facility (RCF) and under Emergency Post-Conflict Assistance (EPCA).

Central banks of member countries with a Policy Support Instrument (PSI) are encouraged to undertake a safeguards assessment, which would become a requirement in the event of a need for access to IMF resources.

The assessments are voluntary for central banks of member countries with Staff-Monitored Programs.

They are not applicable to first credit tranche purchases, Emergency Natural Disaster Assistance (ENDA), or the Flexible Credit Line (FCL) arrangement established in April 2009. Limited safeguards procedures are instead performed for central banks of members with FCL arrangements.

#### **Methodology**

Safeguards assessments follow established procedures to ensure consistency in application. All central banks subject to an assessment provide a standard set of documents to IMF staff, who review the information and communicate as needed with central bank officials and external auditors. The review may be supplemented by an on-site visit. Reviews have increasingly taken the form of updates of earlier assessments and risk-based monitoring of central banks' safeguards frameworks.

The assessment covers five key areas (ELRIC): the **E**xternal audit mechanism, the **L**egal structure and independence, the financial **R**eporting framework, the **I**nternal audit mechanism, and the internal **C**ontrols system.

The outcome of a safeguards assessment is a confidential report that identifies vulnerabilities and makes recommendations to mitigate the identified risk. Central bank authorities have the opportunity to comment on all safeguards assessment reports. The conclusions and agreed remedial measures are reported in summary form to the IMF Executive Board when an arrangement is approved or, at the latest, by the time of the first review under the arrangement, but the safeguards report itself is not made available to the Board or the general public. Since 2005, reports have been shared with World Bank staff, subject to certain confidentiality criteria and with the consent of the central bank involved.

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*(concluded)*

Central banks provide their financial statements and related audit reports to IMF staff for as long as IMF credit is outstanding. This information is used to monitor new developments in a central bank's safeguards framework. IMF staff also monitor the implementation of previous safeguards recommendations.

### **Safeguards findings and experience**

The findings of safeguards assessments to date indicate that significant, but avoidable, risks to IMF resources may have existed in certain cases, although identified vulnerabilities have generally declined in significance and frequency over time. Typical recommendations of an assessment include the following:

- independent annual external audits of central bank financial statements in accordance with international audit standards;
- regular reconciliation of the monetary data reported to the IMF with the underlying accounting records of the central bank;
- enhancement of the financial reporting framework, through the adoption of International Financial Reporting Standards (IFRS);
- measures to strengthen the effectiveness of the central bank's internal audit function;
- annual publication of the audited financial statements; and
- strengthening of governance oversight by the appointment of an independent nonexecutive audit committee.

Experience with the safeguards policy has shown that strengthened control and reporting frameworks at central banks contribute to improved information quality and transparency. In addition, more robust audit and oversight processes have contributed to the unearthing of emerging issues sooner rather than later, along with timelier adoption of remedial measures. Control overrides can still occur, however, and strong governance and independent oversight mechanisms are necessary to ensure that controls are working properly and are not subject to abuse.

### **Safeguards Procedures for the Flexible Credit Line (FCL)**

A modified safeguards approach has been adopted for the FCL that takes into account the nature of the FCL arrangement and the underlying presumption that a member country requesting an FCL has strong institutional arrangements in place that mitigate the risks of misuse of IMF resources and misreporting.

For a member requesting an FCL arrangement, the modified safeguards procedures require the member to authorize access to the most recently completed annual independent external audit of its central bank's financial statements and to authorize the central bank's external auditor to hold discussions with Fund staff. Central banks provide their financial statements and related audit reports to IMF staff for as long as IMF credit under the FCL is outstanding.

### **Safeguards outreach**

IMF staff conduct annual seminars on safeguards assessments for central bank officials at IMF headquarters and regional training centers in Singapore, Tunis, and Vienna. As of April 30, 2010, some 513 participants from 125 countries had attended these seminars.

Broader outreach involves publication of the staff's papers, such as periodic reviews of the policy and annual updates on assessment experience, and other background information concerning the safeguards policy on the IMF website, at [www.imf.org/external/fin.htm](http://www.imf.org/external/fin.htm).