INTERNATIONAL MONETARY FUND

Safeguards Assessments—2009 Update

Prepared by the Finance Department
(In consultation with other departments)

Approved by Andrew Tweedie

December 15, 2009

Contents Page

I. Introduction and Background

1. **This paper provides Executive Directors with an update of safeguards assessment activities from July 1, 2008 through June 30, 2009.** In common with previous updates,[1] it covers the various types of safeguards activities undertaken during the year, highlighting the increased activity associated with the "twin crises" of food and fuel price shocks and the global financial crisis during 2008/09. It also briefly discusses developments in the latter part of that year, including the separate safeguards procedures introduced for members accessing the Flexible Credit Line (FCL).

2. **Safeguards assessments involve a diagnostic review of five key areas of a central bank's operations with respect to its external and internal audit mechanisms, legal framework, financial reporting practices, and system of internal controls** (denoted by the acronym ELRIC). The Fund introduced the safeguards policy in 2000 to obtain reasonable assurance that central banks of member countries using Fund resources have appropriate control systems in place to manage the resources adequately and provide reliable information. Countries requesting a loan from the Fund under most lending facilities undergo such a safeguards assessment (Box 1 and Annex I).

3. **The paper is organized as follows**. Section II describes the level and composition of assessment activity in 2008/09 and important safeguard findings identified in the context of assessments and monitoring during the year. Section III provides an overview of findings since 2000 and flags issues for consideration in the forthcoming review of the safeguards policy in 2010. Section IV describes key outreach activities undertaken during the year to enhance communication and dissemination of information on the safeguards policy.

II. Safeguards Activity in 2008/09

A. Safeguards Assessments Completed and In Progress

4. **Safeguards activity increased significantly in 2008/09.** Activity at the beginning of the year was predominantly associated with the augmentation of many low income countries' financing arrangements due to the food and fuel price shocks. With the emergence of the global financial crisis, however, safeguards activity focused increasingly on member countries seeking exceptional access to General Resource Account (GRA) facilities (Table 1). Budget support was a feature of several large financing arrangements. Accommodating the increased demand for assessments, which often involved emergency procedures as well as exceptional access, required both adaptation of procedures to identify potentially significant safeguards issues at an early stage of program negotiations, and additional staff resources.

[1] See, for example: *Safeguards Assessments—2008 Update*.on the IMF website: http://www.imf.org/external/np/exr/facts/safe.htm

Box 1. The Fund's Safeguards Policy—Applicability[2]

The safeguards policy, through the conduct of safeguards assessments, aims at providing reasonable assurance that a central bank's control, accounting, reporting, legal framework, and auditing systems are adequate to safeguard Fund resources and ensure the integrity of financial operations and reporting to the Fund. Safeguards assessments are an integral part of the Fund's interaction with members in the context of the use of resources provided under financing arrangements with the Fund. They are conducted at central banks that are typically responsible for managing Fund disbursements and reporting on key data used for program monitoring. 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 critical or necessary in accordance with the conditionality guidelines, 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 financing from the Fund, except for the Flexible Credit Line (FCL) arrangement, First Credit Tranche Purchases, and disbursements under the Emergency Assistance for Natural Disasters. The policy applies to new and successor arrangements, augmentations of existing arrangements, precautionary arrangements, and disbursements involving Emergency Post-Conflict Assistance (EPCA). A member following a Rights Accumulation Program (RAP), where resources are being committed but no arrangement is in place, is also subject to a safeguards assessment. A member's request for assistance under the Rapid Credit Facility (RCF) requires a commitment to undergo a safeguards assessment and an authorization for Fund staff to have access to the central banks' most recently completed external audit reports and to hold discussions with the auditors. The timing and modalities of the assessment for members with assistance under the RCF are determined on a case-by-case basis; it is presumed, however, that the safeguards assessment would have been completed before Executive Board approval of any subsequent arrangement to which the Fund's safeguards policy applies.

Safeguards assessments are not conducted for members under FCL arrangements, on the grounds that eligible countries have strong institutional arrangements in place. Instead, certain safeguards procedures are conducted. A member requesting FCL resources is required to provide authorization for the central bank's auditors to hold discussions with Fund staff and for Fund staff to have access to the central bank's most recently completed external audit reports (Annex II).

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).

[2] The applicability of the safeguards policy also refers to new financing facilities approved by the Board as part of the new Low-Income Countries (LIC) Facilities Architecture that are expected to become effective soon.

Table 1: Summary of Safeguards Assessments Activity for the Year Ended June 30, 2009

	2008	2009
Assessments completed	**10**	**21**
PRGF-ESF financing[1/]	6	7
GRA financing	4	14
Central banks monitored or under assessment:[2/]	**55**	**65**
PRGF-ESF financing[3/]	43	46
GRA financing	12	19

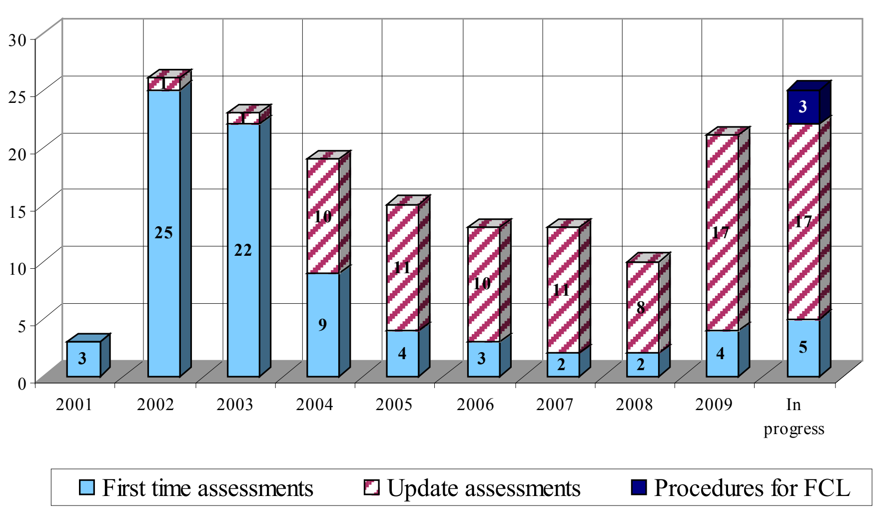
Source: Finance Department, Safeguards Assessments Division

1/ Poverty Reduction and Growth Facility (PRGF), Exogenous Shocks Facility (ESF)
2/ Includes central banks of three countries subject to FCL procedures (Colombia, Mexico and Poland).
3/ Includes member countries represented by three regional central banks (BCEAO, BEAC, and ECCB).

5. **Specific highlights of safeguards activity for the year ending June 30, 2009** include:

- **The total number of full safeguards assessments of central banks completed since the policy's inception in 2000 reached 143**, of which 74 were first-time assessments and 69 update assessments (Chart 1);

Chart 1: Assessments Completed Each Year of the Safeguards Policy



- **Increased activity in both first-time and update assessments** (Table 2) with 21 safeguards assessments completed in the year (as compared to 10 in 2008),[3] and a further 25 assessments in progress for completion (as compared to 12 in the previous year).

Table 2: Assessments Completed and In Progress at End-June 2009

Type of Activity	Assessments Completed	Assessments In Progress[1/]	Total
First-time assessments	Djibouti, Hungary, Liberia, and Seychelles	Costa Rica, Iceland, and Maldives	**7**
Update assessments	Armenia, Belarus, Cape Verde, El Salvador, Georgia, Haiti, Honduras, Kyrgyz Republic, Madagascar, Malawi, Mongolia, Nicaragua, Pakistan, Serbia, Tanzania, Ukraine, and Zambia	BEAC, Bosnia & Herzegovina, Cambodia, Ethiopia, Ghana, Guatemala, Guinea, Kenya, Latvia, Lebanon, Mozambique, Sao Tome & Principe, Romania, Sierra Leone, Sri Lanka, Tajikistan, Tanzania, The Gambia, and Turkey	**36**
Procedures for FCL		Colombia, Mexico, and Poland	**3**
Total	**21**	**25**	**46**

Source: Finance Department, Safeguards Assessments Division

1/ 17 assessments have been completed by the date of this Executive Board paper.

- **A broader dispersion of assessment activity across regions as a result of increased GRA financing associated with the global financial crisis** (Table 3, Chart 2, and Annex III): Across the regions, 18 assessments in respect of Stand-by Arrangements (SBA) were conducted for eight central banks in Europe, four in the Western Hemisphere, three in Middle East and Central Asia, two in Asia and the Pacific and one in Africa. In addition, there were three cases associated with the introduction of the FCL arrangement. GRA-related financing accounted for 67 percent of assessments in 2008/09 as compared with 40 percent in 2007/08.

[3] All assessments that required completion by the first review under the respective financing arrangement met the safeguards policy deadline.

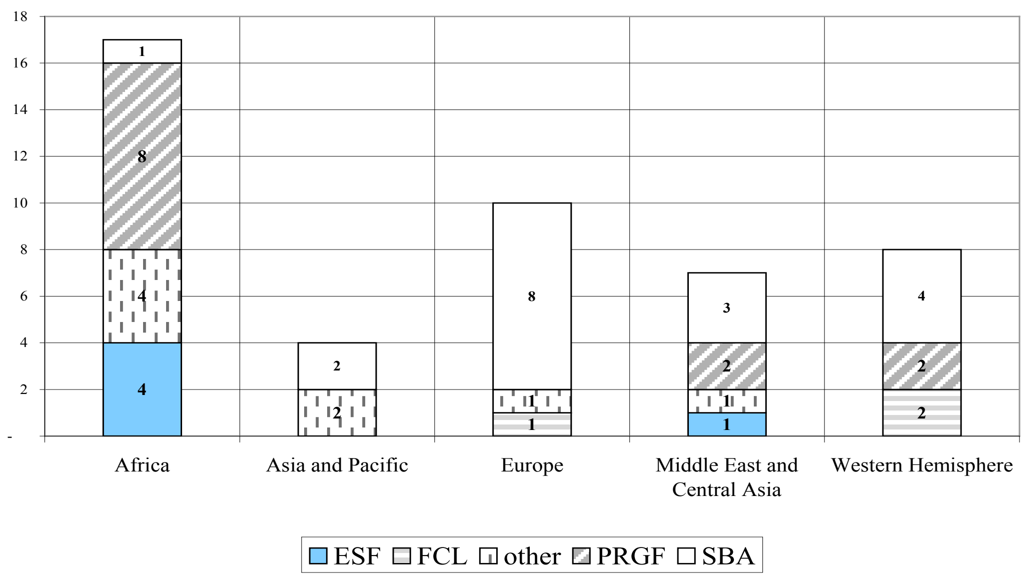
Table 3: Assessments by Lending Facility in 2008/09

	SBA	FCL	PRGF[1/]	ESF	Other[2/]	Total
Total number of assessments	18	3	12	5	8	**46**
Total amount committed in billions of SDR	53.8	52.2	0.8	0.6	n/a	**107.4**

Source: Finance Department, Safeguards Assessments Division

1/ Includes six assessments conducted in respect of augmentations of existing PRGF arrangements that are not quantified.
2/ Consists of assessments initiated in respect of expected new arrangements for which amounts are not known or voluntary assessments.

Chart 2: Financing Arrangements in Central Banks Assessed in 2008/09



- **The number of central banks subject to ongoing monitoring also increased.** Some 65 central banks, representing 78 member countries, were subject to safeguards monitoring work at end-June 2009 (as compared to 55 central banks in 2008).[4]

6. **The year also saw increased assessment activity in cases that involved the use of Fund resources for direct budgetary support.** Financing arrangements to Armenia, Georgia, Hungary, Latvia, Pakistan, Romania, and Ukraine included varying and sometimes large proportions of direct budgetary support. In the cases of Armenia, Georgia and Latvia,

[4] Including countries with credit outstanding represented by the three regional banks of the Central Bank of West African States (BCEAO), the Bank of Central African States (BEAC), and the Eastern Caribbean Central Bank (ECCB).

direct disbursements were made to the respective Treasuries, rather than the central bank, because of legislative prohibition on central bank lending to government. In Ukraine, direct budgetary support from the Fund was seen as preferable to straight central bank financing of the deficit as it helped preserve the independence of the central bank, while for Pakistan a large portion of Fund credit was used to finance the social spending element of the expanded budget as a bridge loan in advance of the pledged donor support. For Hungary, the November 2008, March 2009, and September 2009 purchases were directed to the government, and were used for different purposes, including as backing for the bank support package, lending to domestic credit institutions to help them meet foreign exchange funding needs, and to cover the government's financing need as non-residents reduced their holdings of domestic-currency government bonds. The June 2009 purchase was channeled to the central bank.

7. **In such cases, safeguards assessments cover the role central banks play in channeling funds to government,** and seek additional safeguards. While assessments do not extend to other government entities, they do seek to establish that appropriate controls are in place to ensure timely servicing of member obligations to the Fund. An important element in this regard is that a clear framework exists between the central bank and the government for the servicing of Fund lending so that their respective roles and obligations are transparent and understood. Staff have also sought agreement between the authorities (typically the ministry of finance and central bank) that Fund purchases be deposited in a government account at the central bank. Finally, in a very few cases where components of NIR performance criteria are sourced outside the central bank, safeguards assessments have sought independent audits of these data to ensure that a consolidated monetary authorities position is reflected in program data. The objective in seeking these arrangements has been to replicate, as far as possible, the situation and associated safeguards measures where Fund purchases are on-lent to the government by the central bank. A thorough discussion of safeguards in the context of direct budgetary support will form part of the 2010 review of the Safeguards Assessment Policy.

8. **The increased demand for assessments required adjustments to both safeguards procedures and staff resources.** In the context of emergency financing cases, safeguards procedures were adapted to flag potentially significant issues to Area Departments at the earliest stages of program negotiation. This involved, for example, drawing on information available from central bank websites and safeguards monitoring records, along with discussions with external auditors, even before the formal initiation of a safeguards assessment. Additional resources, which raised the professional staffing of the Division from 11 to 15, were also provided with the support of a temporary allocation of budget funds.

9. **The introduction of the FCL arrangement had implications for safeguards operational procedures.** FCL arrangements are not subject to the safeguards assessment policy because a member requesting an FCL has to meet rigorous qualification criteria, including having in place very strong institutional arrangements that would mitigate risks of misuse and misreporting. Instead, a modified safeguards approach is applied that focuses on an expedited review of the external audit mechanism of central banks. For the three FCL

cases in 2009, such reviews were carried out ahead of the Executive Board's approval of the respective financing arrangements.

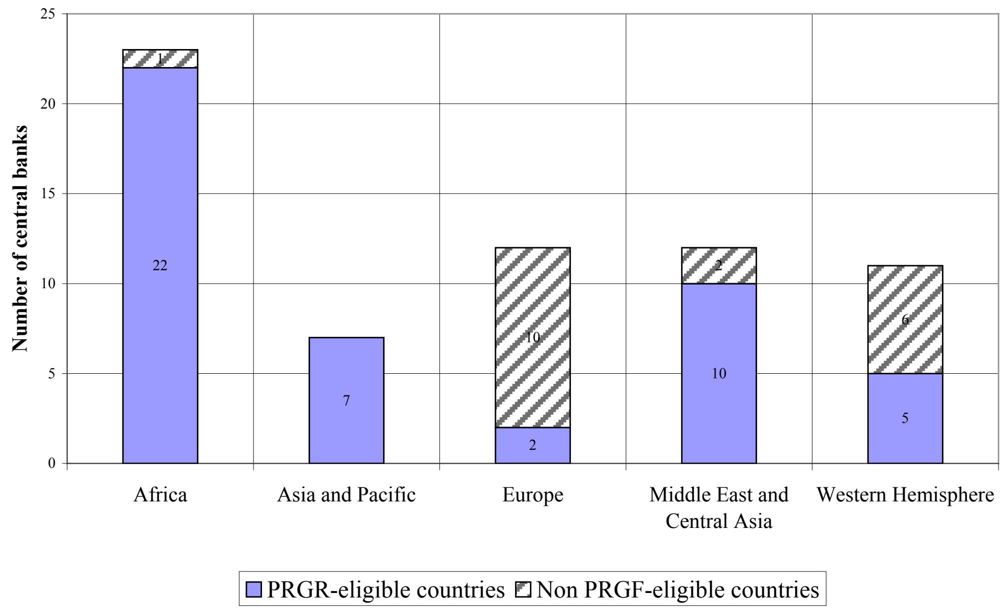
B. Ongoing Safeguards Monitoring of Central Banks

10. **Monitoring was conducted for 65 central banks in the period under review representing 78 member countries,** of which 56 are low income countries (Table 4 and Chart 3). Monitoring largely involves headquarters-based work, and is conducted for as long as Fund credit remains outstanding. A risk-based approach aims at identifying possible new vulnerabilities in a central bank's safeguards framework at the earliest possible stage (Box 2). This work is supported by the use of a software application to manage work programs, and document the implementation of key safeguard measures in individual countries. The results of the monitoring work are a key input into the conduct of update assessments.

Table 4: Central Banks Monitored at End-June 2009

PRGF-eligible countries	Non PRGF-eligible countries
Afghanistan, Albania, Armenia, Azerbaijan, Bangladesh, BCEAO, BEAC, Burundi, Cambodia, Cape Verde, Comoros, Democratic Republic of Congo, Djibouti, ECCB, Ethiopia, Georgia, Ghana, Guinea, Guyana, Haiti, Honduras, Kenya, Kyrgyz Republic, Lesotho, Liberia, Madagascar, Malawi, Maldives, Mauritania, Moldova, Mongolia, Mozambique, Nepal, Nicaragua, Pakistan, Lao People's Democratic Republic, Rwanda, Sao Tome & Principe, Sierra Leone, Sri Lanka, Tajikistan, Tanzania, The Gambia, Uganda, Zambia, Yemen	Belarus, Bosnia & Herzegovina, Colombia, Costa Rica, Dominican Republic, El Salvador, Hungary, Guatemala, Iceland, Jordan, Latvia, Lebanon, Mexico, Serbia, Poland, Romania, Seychelles, Turkey, Ukraine
46	**19**
Source: Finance Department, Safeguards Assessments Division	

Chart 3: Central Banks Monitored at End-June 2009



11. **Communication with external auditors continued to play an important role in monitoring and assessment work during 2008/09**. Specific examples in the current period where contact with the external auditors proved to be particularly helpful included discussions to: (i) follow up on the results of special audits, such as for the Democratic Republic of Congo, that have been conducted as part of program conditionality to verify the proper authorization and recording of government expenditure transactions at the central bank; (ii) determine during the early stages of assessments whether there were any significant issues that needed to be addressed; and (iii) obtain information on evolving safeguards issues at the BEAC, where high-level override of controls appeared to have facilitated fraudulent activities in the Paris Office.

12. **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 require a written authorization to discuss relevant issues with Fund staff due to confidentiality provisions. 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 routinely obtain the audited financial statements from public sources such as central bank websites. Delays can still occur in the receipt of management letters and other confidential audit reports, however, which may signal possible safeguards weaknesses. Follow-up by Area

Department staff and Resident Representatives can be particularly useful in achieving completion and transmission of relevant documents.

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) ascertaining the status of earlier safeguards recommendations through regular contacts with central bank counterparts and auditors; (ii) analysis of the most recent audited financial statements and audit management letters; (iii) the follow-up of indicators of emerging safeguards issues; and (iv) 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 are re-evaluated and adjusted as needed. These indicators include: (i) unexpected changes in external audit mechanisms, 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.

13. **A key aspect of the monitoring process is the follow-up of prior recommendations** (Annex IV). During the period, implementation of priority safeguards recommendations continued at high levels of around 95 percent,[5] and of all recommendations of around 75 percent. Fund-supported technical assistance that is carefully aligned with priority safeguards measures can also play an important role in successful implementation. In some cases, implementation of recommendations was delayed by practical constraints, such as legislative delays in planned amendments to the central bank law. Non implementation of previous recommendations is often a reflection of a program going off track. Staff uses update assessments, when conducted, to determine the reasons for non implementation of previous recommendations and suggests adjustments where necessary.

C. Safeguards Findings and Recommendations

14. **Assessment activity in 2008/09 identified findings across the range of the ELRIC categories.** A total of 188 recommendations were issued during the period under review. Specific examples include:

- **In some cases the quality of the external audit process was found to be suboptimal.** Common occurences included late appointments of external auditors, poor application of International Standards on Auditing (ISA), insufficient qualifications and experience of the external auditors particularly in central bank

[5] Priority recommendations include commitments in Letters of Intent (LOI) and Memoranda of Economic and Financial Policies (MEFP) under program conditionality.

audits, and impaired independence. These occurrences typically manifested themselves in delays in the completion of the audits, limitations in the scope and coverage of the audits, or erroneous audit opinions. Safeguards recommendations in these cases called for adoption of comprehensive policies by the central banks for the selection and appointment of external auditors that require: (i) timely appointments of the external auditors; (ii) multi-year mandates subject to rotation; (iii) audit team experience in ISA, International Financial Reporting Standards (IFRS), and audits of other central banks; and (iv) audit committee oversight of all phases of the audit cycle.

- **In one case, the central bank did not have in place an annual external audit of its financial statements,** and therefore could not meet meet the key requirement of the safeguards policy for the publication of annual financial statements that have been audited in accordance with international standards. Upon the staff's recommendation, the central bank authorities selected and appointed external auditors with a multi year mandate for the conduct of the annual audit.

- **In some instances safeguard measures were included as prior actions or commitments by country authorities.**[6] Two cases, Iceland and the Seychelles, involved external audits of the central banks' financial statements that were found to not fully meet safeguards requirements. In each of these cases the authorities committed to, and subsequently appointed, an auditor with recognized experience in central bank audits. Elsewhere, in the cases of Belarus and Ukraine, special audits by independent external auditors of central banks' monetary program data reported to the Fund or foreign exchange operations were prior actions for the first review under the approved financing arrangement. Furthermore, in the Democratic Republic of Congo, the special audits of government expenditure transactions and of monetary program data have been a key element of the actions required to be completed before the Executive Board discussion of a new financing arrangement.

- **External audit procedures for confirming central bank's financial assets and liabilities underlying the monetary data reported to the Fund were on occasion found to be weak.** In some cases, the external auditors' requests for confirmation from counterparties did not seek to identify guarantees, contingent liabilities, pledges, or other encumbrances of the central banks' reserve assets. In other central banks, the process was not fully controlled by the auditor, which could allow scope for manipulation of confirmation responses. Such weaknesses can threaten the reliability and accuracy of the monetary data reported by central banks to the Fund, such as net international reserves, that are typically sourced from the central bank's accounting records that form the basis for the audited financial statements. In most cases, these weaknesses were promptly addressed when drawn to the auditors' attention by the staff.

---

[6] Prior actions and country authority commitments have become particularly relevant in the context of framing safeguards priority recommendations following the introduction of conditionality reforms in March 2009. See also on the IMF website: http://www.imf.org/external/np/exr/facts/conditio.htm.

- **Recommendations to address weaknesses in central banks' legal frameworks have focused on independence, however their implementation can take some time.** Recent assessments have identified a number of areas requiring attention in central bank laws including: (i) inadequate provisions for protecting key officials from wrongful dismissal; (ii) ambiguity concerning the functioning of the central bank as fiscal agent of the government; (iii) lack of limits for direct credit to the government; and (iv) inadequate provisions concerning capital resources and profit distribution. In the case of Seychelles, several revisions to strengthen governance and operations were approved in the central bank law shortly after the respective safeguards recommendation. In other cases, however, legislative amendments may take time due to the need to involve other government entities and consult with key stakeholders prior to parliamentary consideration. Alternatively, and where appropriate under the applicable legal framework, staff has also proposed interim measures, such as the adoption of Board or Governor-approved by-laws or memoranda of understanding, until formal amendments of the central bank's statutes can be enacted. The Fund's Legal Department provides technical guidance to central banks on these aspects.

- **The adoption of internationally recognized financial reporting standards, such as IFRS or the framework in the European System of Central Banks (ESCB), is progressing but the pace of implementation can vary.** While many central banks have formally adopted or agreed to adopt an internationally recognized framework, actual implementation and full compliance frequently remains a work in progress over several years. Often this reflects lack of local capacity in staff skills and information technology. To promote transparency during the implementation phase, assessments often recommend disclosure in the central bank's financial statements of the differences between the currently applied and the future financial reporting framework. Furthermore, the timely publication of the full audited financial statements in the central bank's website or Annual Report has been recommended in several assessments, including those for Cape Verde, Djibouti, Honduras, Liberia, and the Seychelles.

- **Update assessments during the year confirmed continuing improvements in internal audit capacity in central banks.** In particular, many central banks were found to have acted on earlier safeguards recommendations and now have audit practices that comply with the standards of the Institute of Internal Auditors (IIA). Accompanying this, audit independence has been strengthened with the establishment of reporting lines to central banks' audit committees, and technical capacity improved through the professional certification of internal auditors. With a view to sustaining these developments, update assessments frequently recommended the periodic conduct of external quality assessments by qualified independent reviewers, as required by the IIA standards, and clearer mandates for oversight by central banks' audit committees. In other cases, such as Malawi, the assessments found that the central bank's internal auditors had developed adequate capacity to independently review compilation and reporting procedures for program monetary data reported to the Fund under the respective financing arrangements.

- **Audit committees are now accepted and established as independent oversight bodies of central banks' operations, but are not always found to be effective.** As in 2008, cases arose where committees were found to have lost momentum over time or become ineffective due to insufficient clarity of mandate or coverage of functions, inadequate composition and expertise, and infrequent meetings. Recommendations in this area promote the application of best practices such as: (i) the appointment in the audit committee of at least one member with technical expertise in financial reporting and external audit matters; and (ii) a committee mandate or charter that clearly includes oversight responsibilities for the financial reporting process, the system of internal controls, and the external and internal audit functions.

- **Safeguards assessments have found strengthened operational controls, which in some cases need the support of better governance arrangements.** Foreign reserve management practices, in particular, have strengthened, often through the provision of technical assistance by the Fund, or participation of central banks in the World Bank Reserves Advisory and Management Program. Most of this year's assessments found, however, that work on a broader bank-wide operational risk management framework was either absent or only in its early stages. In other cases, such as Honduras and Tanzania, the staff has also recommended the establishment of an integrity assurance mechanism, such as external *whistle blowing*, for handling allegations of staff misconduct.

- **Recent experience has underscored, however, that improved safeguards at central banks cannot be a panacea against governance abuse.** Safeguards assessments have played a significant role in strengthening financial safeguards at central banks and improving control systems. They have raised awareness of governance issues, including the potential for misreporting of monetary data by the central banks to the Fund, and in some instances aided the identification of breakdowns in controls. However, these safeguards have not proved effective in preventing abuse involving control overrides at the highest level, and the apparent failure of oversight bodies, such as executive boards and audit committees, and ineffective internal audit functions. In such cases, special audits of monetary data or control systems conducted by external auditors are often priority measures for addressing identified safeguards weaknesses. But these should be seen as short-term expedients until the integrity of control mechanisms is reestablished. Most recently, control overrides at the BEAC caused the central bank to initiate a number of special audits and investigations. Some steps are being taken to start the process of resolving the underlying weaknesses, and continued close cooperation with staff in addressing safeguards issues will be required to ensure that reviews under Fund arrangements with BEAC-represented member countries can proceed without delay.

III. DEVELOPMENTS IN SAFEGUARDS FINDINGS AND FORTHCOMING POLICY REVIEW

15. **Since the inception of the safeguards policy in 2000, central banks have made significant progress in strengthening their governance and transparency mechanisms** that are the core of the safeguards framework. Table 5 summarizes the evolution of the first-time introduction of key safeguards measures by central banks.

Table 5: Key Safeguards Measures Implemented by Central Banks

Safeguards Recommendation	**2002 (cum.)**	**2005 (cum.)**	**2009 (cum.)**
First-time appointment of an international auditor	14	18	23
First-time reconciliation of key program data with accounting records	20	34	43
First-time publication of full audited financial statements	10	19	30
Introduction of an internationally recognized financial reporting framework introduced	12	16	26
Adoption of an internal audit charter	9	14	23
Establishment of a new audit committee	10	15	26

16. **Specific points of note in relation to the central banks assessed through end-June 2009** include:

- Since the inception of the policy, 23 central banks have made first-time appointments of international accounting firms to conduct the external audit of the bank's annual financial statements. At end-June 2009, all central banks monitored were subject to an annual independent external audit, including one central bank that was in progress of selecting an audit firm following a recent first-time safeguards assessment recommendation.
- 30 central banks began publishing their audited financial statements. At end-June 2009, the majority of 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.
- 26 central banks have either implemented, or are in the process of implementing, an internationally recognized financial reporting framework, such as IFRS or the framework in the European System of Central Banks (ESCB).
- Internal audit functions have become more prevalent with 23 central banks having introduced formal charters in accordance with international standards. Accompanying

this, some 26 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. In addition, in order to safeguard against misreporting of monetary data to the Fund, assessments have recommended the automated compilation and independent audit of data reported by the central banks to the Fund for program monitoring purposes. Most central banks now also have the capacity to reconcile program data with their accounting records and audited financial statements.

17. **The review of the safeguards policy has been deferred to 2010** due to the review and adoption of a new architecture for LIC facilities, as well as the increased safeguards workload during 2008/09.[7] As foreshadowed in last year's update report, the policy review is expected to revisit the scope for safeguards assessments, their role in reducing misreporting, and possible wider dissemination of the results of safeguards assessments activity. Against the background of developments in 2008/09, the review will consider the approach adopted by staff to, as far as possible, ensure that monitoring of direct budget support replicates procedures for indirect support that is on-lent by central banks to finance ministries. In this context, the review will also revisit the pros and cons of broadening the scope for safeguards assessments to encompass agencies other than the central bank.

IV. OUTREACH

18. **FIN staff continued the emphasis on outreach and communication as recommended by the independent panel of experts at the last review of the safeguards policy.**[8] 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. Principal activities by FIN staff in the current period included:

- **Two seminars on financial safeguards at central banks, which were attended by 55 participants from 36 countries' central banks.** The semi-annual seminars are organized under the auspices of the IMF Institute and hosted on a rotational basis at regional training centers. They provide a forum for senior central bank staff to discuss their experiences in strengthening external and internal audit mechanisms, financial reporting practices, and internal control systems. This year's seminars were held at regional training centers in Abu Dhabi (January 2009) and Vienna (April 2009), and were complemented by external speakers with experience in external audits of central banks, management of foreign reserves, risk assessment, and the internal audit function. Looking ahead, the next seminar will be delivered at the Singapore Training

[7] The review is included in the Managing Director's work program with completion envisaged in the quarter commencing May 1, 2010.

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

Institute in December 2009 and is expected to be attended by 32 participants from 24 countries. In 2010, two five-day courses will be offered at the Joint Africa Institute in Tunis (April), and the Joint Regional Center for Latin America in Brasilia (October).

- **Continuing provision of guidance to central banks 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. This guidance draws on the staff's multilateral experience across regions, which central banks have found particularly helpful in designing and implementing their own financial safeguards.

- **Contributing an essay to a comparative study of central bank financial reporting practices** published by KPMG Financial Services on October 28, 2009.[9] The study was authored by KPMG member firms' staff experienced in the audit of central banks, and provides insight into the financial reporting practices of 13 central banks from the countries of Brazil, Bulgaria, Canada, Chile, the United Kingdom, France, Germany, India, New Zealand, Russia, South Africa, as well as the European Central Bank and the United States Federal Reserve System. The IMF contribution presents relevant aggregated findings on the developments in the financial safeguards frameworks of 62 central banks representing 75 low income and emerging market countries that have been monitored under the safeguards assessments policy.

Table 6: Participating Countries in Safeguards Seminars in 2008/09

Regional training center in Abu Dhabi	**Regional training center in Vienna**
Algeria, Bahrain, Egypt, Iraq, Jordan, Lebanon, Libya, Morocco, Oman, Saudi Arabia, Sudan, Syria Arabic Republic, Tunisia, West Bank, Yemen	Armenia, Azerbaijan, Belarus, Bulgaria, Croatia, Czech Republic, Georgia, Kazakhstan, Kyrgyz Republic, Latvia, Lithuania, Macedonia, Moldova, Montenegro, Poland, Romania, Serbia, Kosovo, Tajikistan, Turkey, Uzbekistan
15	**21**
Source: Finance Department, Safeguards Assessments Division	

[9] The study is entitled "Central bank accountability and transparency" and can be found at www.kpmg.com.

Annex I: Safeguards Assessment Policy—A Summary

Origin of the Safeguards Assessments Policy:[10]

The safeguards policy was introduced in March 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.

Overall Objectives of Safeguards Assessments:

To policy aims 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.

Scope of Policy—Central Bank ELRIC:

The safeguards framework covers five key areas of control and governance within central banks, and incorporates International Financial Reporting Standards (IFRS), International Standards on Auditing (ISA), and guidelines promulgated by the Institute of Internal Auditors (IIA) as benchmarks. The five key areas of the framework and safeguards objectives for each area are:

- ***E****xternal Audit Mechanism*—The publication of annual financial statements that are audited in accordance with internationally accepted audit standards by auditors independent from the central bank is a key requirement under the safeguards policy. The assessments consider the process for the selection of external auditors, the audit rotation policy, and external auditors' compliance with ISA or equivalent standards.

- ***L****egal Structure and Independence*—Government interference can undermine a central bank's autonomy and increase risks in its operations. The assessment therefore considers laws and regulations governing a central bank, focusing on the central bank's independence and the safeguards prescribed with respect to the independence of the members of its decision-making bodies, and arrangements for the extension of credit by the central bank to the government, as well as actual practices in these areas.

- *Financial* ***R****eporting Framework*—Safeguards assessments consider whether the central bank's financial statements are prepared in accordance with an internationally recognized financial reporting framework, such as the *International Financial Reporting Standards,* and whether the annual audited financial statements are published in a timely manner.

- ***I****nternal Audit Mechanism*—The internal audit function helps the central bank to evaluate and improve the effectiveness of risk management, control, and governance processes.

[10] See also on the IMF external website: http://www.imf.org/external/np/exr/facts/safe.htm

The assessment reviews the effectiveness of the internal audit function by considering its organizational independence and the audit methodology used.

- *System of Internal **C**ontrols*—The assessment considers whether there is adequate oversight of the external and internal audits and reviews the nature of controls over banking, accounting, foreign exchange, and reserves management functions as well as controls over data reported to the IMF.

The Outcome of a Safeguards Assessment:

An assessment concludes with a report that identifies key vulnerabilities in each of the five ELRIC areas of a central bank's safeguards framework and recommends measures to alleviate them under a mutually agreed timeframe.

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. A total of 43 reports have been shared with the World Bank since these arrangements were established in 2006, and experience has shown an almost universal willingness by central banks to share reports.[11]

[11] To date only three central banks have withheld such consent.

Annex II: Safeguards Procedures Applicable to FCL Financing Arrangements

FCL arrangements are not subject to the safeguards assessment policy applicable for other Fund financing arrangements. This is because a member requesting an FCL has to meet rigorous qualification criteria, including having in place very strong institutional arrangements that would mitigate risks of misuse and misreporting. Instead, a modified safeguards approach applies. At the time of making a formal written request for an FCL, the member is required to provide authorization for Fund staff to have access to the most recently completed annual independent audit of its central bank's financial statements, whether or not the audit is published. This also includes authorizing its central bank's external auditors to discuss the audit findings with Fund staff.

FIN staff reviews the external audit reports and discusses the findings with the external auditor. The overall objective is to ensure that recent external audit results do not raise significant issues that could place FCL purchases at risk. No deadline is specified for these procedures, but staff should make best efforts to complete the process before the Executive Board decision on approval of an FCL arrangement. No discussions are held with the authorities unless significant issues arise.

Safeguards procedures are documented in a brief report and management is informed of the overall conclusion. A courtesy copy of the report is sent to the relevant Executive Director and the central bank governor. If the authorities choose to comment on the report, such comments are subsequently incorporated. Similar to the confidentiality arrangements that apply to safeguard assessment reports, the FCL report remains confidential and is not circulated to the Executive Board; the overall conclusion of the FCL report is circulated to the Executive Board in the next available staff report for the country.

Central banks under FCL arrangements are subject to safeguards monitoring. During the period of an FCL arrangement, and as long as credit is outstanding (in the event of FCL purchases), FIN staff conducts reviews of annual financial statements and audit reports.

Annex III: Financing Arrangements in Central Banks Assessed in 2008/09

Area	Type of facility	Safeguards Assessments	Amount in billions of SDR
Africa	ESF	4	0.54
	PRGF[1/]	8	0.63
	SBA	1	0.02
	Other[2/]	4	n/a
Total		**17**	**1.19**
Asia and Pacific	SBA	2	1.81
	Other[2/]	2	n/a
Total		**4**	**1.81**
Europe	FCL	1	13.69
	SBA	8	41.80
	Other[2/]	1	n/a
Total		**10**	**55.49**
Middle East and Central Asia	ESF	1	0.07
	PRGF	2	0.09
	SBA	3	8.52
	Other[2/]	1	n/a
Total		**7**	**8.67**
Western Hemisphere	FCL	2	38.49
	PRGF[3/]	2	0.08
	SBA	4	1.68
Total		**8**	**40.25**
Grand Total		**46**	**107.41**

Source: Finance Department, Safeguards Assessments Division

1/ Includes five assessments conducted in respect of augmentations of existing PRGF arrangements that are not quantified.
2/ Consists of safeguards assessments conducted in respect of expected new arrangements for which amounts are not known, or voluntary assessments.
3/ Includes one assessment conducted in respect of augmentation of an existing PRGF arrangement that is not quantified.

Annex IV: Implementation Rate of Safeguards Recommendations

	Total number at end-June 09	Rate of Implementation (in percent) end-June 09	end-June 08	end-June 07
1. Recommendations with formal commitment from the authorities	**172**			
a. Under program conditionality	100			
Of which: Implemented	95	95	90	93
Not Implemented	5			
b. LOI/MEFP commitments	72			
Of which: Implemented	68	94	97	98
Not Implemented	4			
2. Other recommendations	**746**			
Of which: Implemented	521	70	77	79
Not Implemented	225			
3. Total recommendations (1+2)	**918**			
Of which: Implemented	684	75	80	82
Not Implemented	234			
Of which: Overdue less than 3 months	63			
Overdue 3 months to one year	70			
Overdue more than one year	44			
Overdue more than two years	57			

Source: Finance Department, Safeguards Assessments Division