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## IMF POLICY PAPER

### REPORT ON FISCAL SAFEGUARDS PILOTS

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**International Monetary Fund**  
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## REPORT ON FISCAL SAFEGUARDS PILOTS

October 4, 2013

### EXECUTIVE SUMMARY

This paper reports on the results of a pilot exercise on fiscal safeguards conducted by the Fiscal Affairs Department (FAD) during FY2013. The exercise was launched following an independent review of the existing safeguards policy in 2010 in which many Directors encouraged staff to highlight fiscal safeguards risks in cases where a substantial portion of the resources provided by the Fund for balance of payments support is channeled to state treasuries for budget purposes. Pilot fiscal safeguards exercises were conducted for five countries: Antigua and Barbuda, Cyprus, Greece, Ireland, and Kyrgyz Republic.

The experience from the pilots highlighted three key lessons. First, most information required to conduct such a review can be derived from more comprehensive diagnostic evaluations of countries' public financial management (PFM) systems and processes, such as the Public Expenditure and Financial Accountability (PEFA) framework or the Fund's new pilot Fiscal Transparency Assessment (FTA) tool, as well as from available technical assistance (TA) reports. Second, while these tools can provide a useful basis for identifying fiscal safeguards issues, additional information to highlight fiscal safeguards risks may be needed on a case-by-case basis. Third, in certain cases, it may be advisable to look beyond the state treasury toward the integrity of a country's entire PFM system to highlight fiscal safeguards risks.

In light of this, the paper recommends the following approach for ensuring an appropriate level of fiscal safeguards in countries which receive exceptional access to Fund resources for balance of payments support and channel more than half of that support to the budget. First, in countries that have undergone a PEFA or FTA within the past six years, the review of fiscal safeguards would be based in the first instance on the relevant findings of those evaluations, supplemented by information from recent TA reports and other publicly available sources. Second, in cases where countries have not undergone one of these diagnostic assessments in the last six years, the authorities could be encouraged to initiate a PEFA assessment or an FTA within a reasonable timeframe. Third, when a country does not volunteer for a PEFA or FTA in the foreseeable future, FAD would conduct a review based on information from FAD PFM TA reports, other publicly available sources, and, in very limited cases, a dedicated mission to the country. In all instances, staff reports would provide a brief summary description of fiscal safeguards risks. The additional costs to conduct this work are expected to be about \$100,000 a year.

Approved By  
**Carlo Cottarelli**

Prepared by a staff team led by Johannes Mueller and Richard Hughes and comprising Richard Allen, Barry Potter, Brian Olden, Gösta Ljungman, Pokar Khemani, Christopher Iles, Delphine Moretti, and Xavier Rame. General guidance was provided by Sanjeev Gupta (all FAD). Production assistance was provided by Veronique Catany, Sasha Pitrof and Ted Twinting (all FAD).

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## INTRODUCTION

**1. This paper reports on the results of a pilot exercise on fiscal safeguards conducted by FAD during FY2013.** It arises from the call of many Directors to highlight fiscal safeguards risks.<sup>1</sup> The paper draws on the lessons from five pilot fiscal safeguards evaluations and proposes an approach that reviews fiscal safeguards risks in cases where a member country channels a significant portion of the resources provided by the Fund for balance of payments support to the state treasury for budget purposes. However, it does not provide recommendations for a full-fledged fiscal safeguards assessment.

## BACKGROUND

**2. The safeguards policy is currently applied to Fund resources that are made available to member countries in support of programs that address their balance of payments needs.** In the design of such programs, all or part of the domestic counterpart of the funds provided may be made available for budgetary purposes.<sup>2</sup> Recent programs have sharply increased the share of Fund financing made available for budget purposes, accounting for 87 percent of GRA resources and 37 percent of PRGT resources at end-May 2013. This highlights potential concerns about fiscal safeguards risks. In the 2010 review of the Fund's Safeguards Assessment Policy, which included a report of a panel of independent advisors, the Executive Board encouraged staff to highlight fiscal safeguards risks. The Board did not request staff to develop the methodology for a fiscal safeguards assessment of the member states' treasury comparable to the existing safeguards assessment framework for central banks.<sup>3</sup>

**3. A pilot exercise for fiscal safeguards was launched by FAD in FY2013.**<sup>4</sup> The exercise was meant to cover several large budget financing cases over the following 12 months. Contrary to the existing safeguards assessment framework for central banks, participation in the pilot would be voluntary but follow similar procedures in terms of confidentiality. A consolidated report drawing on

<sup>1</sup> Fiscal safeguards risks arise when funds channeled through the treasury as budget support are exposed to possible misappropriation because of weaknesses in the legal framework, government banking arrangements, internal controls, audit procedures, and other areas of budget execution. Such risks are sometimes also referred to as "fiduciary risks".

<sup>2</sup> The Fund may only provide financial assistance to members to address balance of payments problems, and such financing must be used in support of a program designed to resolve the member's balance of payments difficulties. Under these conditions, it is possible for a member's program to provide for the use of the domestic counterpart of Fund disbursements for budgetary purposes.

<sup>3</sup> At the time of the 2010 review, the only element concerning fiscal safeguards that was endorsed by the Executive Board was the application, as a standard procedure, of frameworks between central banks and their corresponding state treasuries for the timely servicing of the member's obligations to the Fund. In addition, while "many directors encouraged staff to highlight fiscal safeguards risk in the staff reports involving budget financing", only "a number of Directors ... encouraged exploration of a possible more ambitious approach to conduct targeted safeguards assessments at the level of the state treasuries, which would require a parallel assessment mandate and product" (see BUFF/10/115).

<sup>4</sup> *Fiscal Safeguards* (SM/12/100, 05/08/12).

the lessons of the pilots would be made available to the Executive Board, including suggestions for strengthening fiscal safeguards in Fund-supported programs with high levels of budget financing and discussing the costs and benefits of various approaches to conduct a fiscal safeguards exercise.

## THE PILOTS

**4. Five countries participated in the pilot exercises.**<sup>5</sup> They were Antigua and Barbuda (March 2013), Cyprus (May 2013), Greece (February 2013), Ireland (June 2012), and Kyrgyz Republic (April 2013). The countries were chosen in consultation with area departments and based on a range of criteria (Table 1): they had a large share of budgetary use of Fund financing; they varied in size, income, and geographic region; and the authorities volunteered to participate in the pilots and provide logistical support. The work entailed both a desk review of documents, including recent PFM diagnostic assessments by the Fund and other institutions, as well as FAD PFM TA reports and relevant work carried out by other organizations, such as the World Bank. This was supplemented by field work lasting two to three days by one or two FAD staff or experts to gather supplementary information and discuss the assessment results with the authorities. In some cases, to minimize the burden on the authorities, the work was combined with a FAD PFM TA mission or with the inspection of an advisor in the field. The missions interacted closely with senior officials in ministries of finance, state treasuries, central banks, and other public bodies, and left a draft report with the authorities for their review. The total costs associated with this exercise (staff and contractual time and travel) amounted to about US\$120,000, with the cost per assessment varying between US\$5,000 and US\$35,000.

**Table 1. Budget Support in the Pilot Countries**  
(as of May 31, 2013)

Country	Population (mn.)	Lending Facility	Access (SDR mn.)	Quota (SDR mn.)	Budget Support (SDR mn.)	Budget Support (% access)	Budget Support (% quota)
Cyprus	0.9	GRA	891	158.2	891	100	563
Greece	11.3	GRA	23,785	1101.8	23,785	100	2,159
Ireland	4.7	GRA	19,466	1257.6	15,573	80	1,238
Antigua & Barbuda	0.01	GRA	67.50	13.5	67.50	100	500
Kyrgyz Republic	5.5	PRGT/ECF	67	88.8	67	100	75

Source: Fund staff estimates.

<sup>5</sup> A sixth pilot assessment of Portugal was planned for spring 2013 but cancelled at a late stage because of a constitutional court decision that required a major revision to the national budget for 2013. In these circumstances, the Ministry of Finance was not able to provide FAD with the support it required to undertake the assessment.

**5. To assist the teams undertaking the pilot exercise, staff prepared a questionnaire which was based on seven criteria proposed in the 2010 review (Box 1).** The questionnaire covered the following thematic areas: the legal framework for budgetary appropriations; government banking arrangements through the treasury; reconciliation of government bank accounts; internal control of public expenditure; the monitoring and reporting of financial data; and the independent audit of government financial statements together with a mechanism to ensure that audit recommendations feed back into improved financial management practices. The framework aimed to assess the extent to which existing institutional arrangements and reporting requirements were satisfactory with respect to the identification and monitoring of fiscal safeguards risks.

### Box 1. Criteria Used in Evaluating the State Treasury

1. Does the State Treasury operate a main bank account at the central bank, through which all government transactions are processed?
2. Is all central government expenditure authorized by the budgetary appropriation or other law?
3. Is the main bank account at the central bank (and other possible authorized accounts) reconciled regularly?
4. Are all central government transactions executed through the State Treasury properly accounted for, using clearly defined national accounting standards that are on major issues aligned with international standards such as International Public Sector Accounting Standards (IPSAS), and are all final accounts under the responsibility of the State Treasury produced in a timely fashion?
5. Are the final accounts prepared by the State Treasury audited by an independent commercial or state audit institution, according to national standards aligned (on major issues) with international standards such as the International Standards on Auditing (ISA) and/or standards issued by the International Organization of Supreme Audit Institutions (INTOSAI), and are audit reports on the final accounts provided to parliament in a timely way?
6. Are observations by the commercial and/or the state auditor addressed to the State Treasury to improve financial management processes taken on board systematically?
7. Are adequate internal control procedures in place at the State Treasury to safeguard public resources, generate reliable financial reports, and comply with applicable laws and regulations?

Source: *Safeguards Assessment—Review of Experience* (SM/10/178, 07/06/10), Box 6, page 31.

## EVALUATION OF THE PILOTS

**6. The following lessons emerge from the pilot exercise:**

- The bulk of information required for an identification of fiscal safeguards risks is already available in countries that either recently had undergone a comprehensive PFM diagnostic evaluation or where the Fund had an active PFM TA program. The two main widely recognized

diagnostic PFM evaluations are the PEFA assessments<sup>6</sup> and the fiscal ROSCs/FTAs.<sup>7</sup> Of the 17 countries where programs provided for the use of Fund purchases for budgetary purposes, two-thirds have benefited from a PEFA assessment within the last six years; many others undertook a fiscal ROSC in the early or mid-2000s; and almost all have been regular users of Fund TA in PFM in recent years (Table 2). Annex I illustrates that most questions listed in Box 1 are covered by the PEFA and FTA frameworks.<sup>8</sup> Issues that are less well represented in either the PEFA or FTA frameworks—in particular, indicators on the coverage and effectiveness of government banking arrangements and internal controls—will be considered for inclusion in the PEFA framework which is currently being revised.

- While information from diagnostic tools and TA reports can thus provide a useful basis for identifying fiscal safeguards risks, the additional information needed for this purpose can vary by country. The different modes applied in undertaking the five pilots suggest that there are various ways of obtaining the additional information, suggesting that pursuing a “one-size-fits-all” approach is neither cost-effective nor justifiable, as it may also impose an undue burden on the country authorities in terms of being subjected to repeat assessments on similar issues.
- Although the focus on treasury operations is generally appropriate in safeguarding Fund resources, the integrity of a country’s PFM system as a whole may be important as well. Fund resources are fungible and mixed with other funds which may be used to finance activities both within the central government budget and outside. Moreover, the propriety and efficiency with which Fund resources are used will depend on all aspects of the budget and financial management system, not only the functions and transactions for which the treasury is directly responsible. Indeed, in many advanced and middle-income countries, “the treasury” no longer

<sup>6</sup> The Public Expenditure and Accountability (PEFA) framework is a multi-donor partnership of seven donor agencies and international financial institutions (the European Commission, the French Ministry of Foreign and European Affairs, the IMF, the Norwegian Ministry of Finance, the Swiss State Secretariat for Economic Affairs (SECO), the U.K. Department for International Development (DFID), and the World Bank). It was established in 2001 to: (i) assess the condition of countries’ public expenditure, procurement and financial accountability systems, and (ii) develop a practical sequence for reform and capacity building actions. The PEFA framework currently comprises 31 indicators, and is in the process of being revised. In excess of 300 PEFA assessments have been carried out in more than 130 countries, including some advanced economies.

<sup>7</sup> The FTAs, which are currently being piloted, replace the Fiscal Reports on the Observance of Standards and Codes (fiscal ROSC) which were launched in 1999. The FTA is based on a draft of the revised Code of Good Practice on Fiscal Transparency, which is currently the subject of a public consultation. The new draft Code and FTA provide countries with: (i) a summary of their transparency strengths and weaknesses; (ii) a quantitative assessment of the gaps in their reported fiscal data; (iii) a prioritized and sequenced action plan for addressing their most pressing transparency problems; and (iv) a modular assessment framework focusing on issues such as a country’s internal risk management procedures or its fiscal management of natural resource revenues. The first FTA on Ireland has been published on the Fund’s external website (<http://www.imf.org/external/pubs/cat/longres.aspx?sk=40780.0>).

<sup>8</sup> Of the 33 questions in the safeguards questionnaire, more than half are also covered wholly or partially by the PEFA framework, and other relevant information is usually provided in the narrative sections of PEFA reports. The new FTA framework also has a relatively broad coverage of relevant issues, notably on budget authorization, fiscal reporting, the standards and coverage of government accounts, and external audit. While their coverage is broadly similar, however, the two frameworks are complementary, and provide information on different aspects of the various topics covered.

exists as a separate entity, but has been broken up over time into a wide array of functions—such as accounting, control, and financial reporting—carried out largely by line ministries and other decentralized entities. These nuances need to be well understood when seeking to identify fiscal safeguards risks.

**Table 2. Technical Assistance by FAD to Countries Receiving Budget Support**

Financing Facility/Country	Access as % of Quota	Year of Latest PEFA Assessment	Year of Latest Fiscal ROSC/FTA	PFM TA by FAD in Past 6 years 1/
<b>GRA</b>				
Antigua & Barbuda	500	2010; 2014 (plan)	-	High
Bosnia	200	-	-	Medium
Cyprus	563	-	2005	Medium
Greece	2,159	-	2006	High
Ireland	1,548	-	2012 (FTA)	Low
Jordan	800	2011	2006	Medium
Jamaica	225	2007	-	High
Portugal	2,305	-	2003	High
<b>PRGT</b>				
Armenia	145	2008	2002	Low
Benin	120	2007; 2013 (plan)	2002	Medium
Burkina Faso	136	2010	2002	High
Comoros	157	2008	-	Medium
Cote d'Ivoire	120	2008	-	High
Georgia	83	2008	2003	Low
Kyrgyz Republic	75	2009	2008	Medium
Mali	11	2011	2002	High
Niger	120	2013	-	High

Source: SPR database, FAD staff.

1/ High = more than 250 FTE days of TA over the past six years; Medium = between 125-250 FTE days of TA; Low = less than 125 FTE days of TA. The figures include TA delivered by HQ-led missions, RTACs and short-term expert missions.

**7. Table 3 provides some examples of the findings and recommendations of the pilot exercises without attribution to the countries concerned (given the confidentiality of the reports prepared by FAD).** Examples are given for each of the five main thematic areas covered by the questionnaire.



**Table 3. Examples of Findings from the Five Pilot Exercises**

<b>Theme</b>	<b>Findings</b>	<b>Recommendations</b>
Legal	The budget law permits additional expenditure to be incurred through rules on supplementary budgets that are not adequately controlled by the treasury, and liberal use of special warrants.	Amend the law to tighten the use of supplementary budgets and special warrants. Reactivate the supplementary estimates process to ensure proper recording of all financial transactions and efficient utilization of public funds.
Treasury and banking arrangements	Inadequate information is available to the treasury on the balance of the many commercial bank accounts held by line ministries outside the treasury single account (TSA).	Provide the treasury with on-line access to all commercial bank accounts. Convert such accounts into sub-accounts under the TSA.
Internal control	To reduce the risk of payment arrears accumulation, the commitment control system needs to be extended to all types of expenditure and for all entities in the central government sector.	Develop a comprehensive commitment control system that requires all expenditures to be recognized as commitments, and automates the commitment approval process.
Fiscal monitoring and reporting	Financial data is unreliable as bank reconciliation is a very slow process. There is a lack of comprehensive data on revenues collected by the treasury and the own-revenues of line ministries. No independent authority has been established to advise on accounting standards.	Improve the comprehensiveness, reliability and timeliness of financial reports. Establish a process for setting accounting standards based on IPSAS. Disclose with financial statements a statement of accounting policies and expand supporting notes.
Audit	The role of the auditor general is not fully independent as recommended by international audit standards. The internal audit function is weak.	Strengthen the legal framework for external audit. Establish internal audit units in all government agencies and build their capacity to conduct audits in line with international standards.

Source: Fund staff.

## THE WAY FORWARD

**8. A cost-effective and risk-based approach would be to rely, in the first instance, on existing diagnostic tools and evaluations to identify fiscal safeguards risks for those countries that channel a significant proportion of Fund resources to the budget.** This would be preferable to requiring a stand-alone fiscal safeguards assessment mission for countries making use of high levels of Fund financing for budgetary purposes, which would to a large extent duplicate work already done in the context of FTAs, PEFA assessments, and TA engagement. A stand-alone assessment would also put an additional burden on country authorities where a clear road map to reform may have already been established.

**9. Accordingly, the risk-based approach would apply to countries that receive exceptional access to Fund resources (more than 600 percent of quota) to address their balance of payments need and channel more than half of that support to the budget:**

- First, in cases where either a PEFA assessment or an FTA has been carried out within the past six years, the fiscal safeguards risk exercise would primarily be based on an evaluation by FAD staff of the relevant PEFA indicators or FTA practices/indicators, supplemented by recent TA reports and other publicly available information.
- Second, in cases where a recent diagnostic assessment has not taken place, countries could be encouraged to initiate a PEFA or an FTA, given that both assessment tools are strictly voluntary. Identifying resources to undertake such assessments, however, could take time and might shift the exercise into the next fiscal year.
- Third, when a country has not carried out either a PEFA assessment or an FTA within the last six years and is not volunteering for one within a reasonable timeframe, or if resources for such assessments cannot be lined up in the near future, FAD would conduct an evaluation of fiscal safeguards risks modeled on the framework and questionnaire used in the pilot exercise. Such an evaluation would draw on available information, including past TA reports and other documentary sources, supplemented by a field visit in cases with limited recent information.

**10. In all such cases, staff reports would provide a summary description of fiscal safeguards risks** The description, to be prepared by FAD, would highlight any fiscal safeguards risks found, together with a description of remedial measures in train to address those risks.

**11. There would be minor implications for FAD's budget.** The additional costs to conduct the work are expected to be about \$100,000 a year to compensate for staff time and travel costs for five or six assessments; the funding for this exercise would compete with other demands on the FY2014/15 budgets. Most reviews can be completed solely based on desk work, given the available information from PEFAs, FTAs, and TA reports, with complementary field trips in selected cases. To the extent that "red flags" from a fiscal safeguards risk point of view were to emerge in the evaluations (e.g., weak internal controls, or large discrepancies in data derived from fiscal reports and government bank accounts), these could be addressed through appropriate remedial measures,

including well-targeted future TA to provide advice to the relevant country on the measures required to achieve the necessary improvements in its PFM systems.

**12. The safeguards policy is scheduled for review in 2015.** This could be an opportune time to review whether the approach suggested above is working satisfactorily, and whether any amendments need to be made to it.

## ANNEX I. COVERAGE OF FISCAL SAFEGUARDS CRITERIA IN THE PEFA AND FTA FRAMEWORKS

Fiscal Safeguards Criteria 1/	Coverage in the PEFA Framework	Coverage in FTA
1. Does the state treasury operate a main bank account at the central bank, through which all government transactions are processed?	Partial	Partial
2. Is all central government expenditure authorized by the budgetary appropriation or other law?	Substantial	Substantial
3. Is the main bank account at the central bank (and other possible authorized accounts) reconciled regularly?	Substantial	Substantial
4. Are all central government transactions executed through the state treasury using clearly defined national accounting standards, and are all final accounts under the responsibility of the state treasury produced in a timely fashion?	Substantial	Substantial
5. Are all final accounts prepared by the state treasury audited by an independent commercial or state audit institution in line with international standards, and are audit reports on the final accounts provided to parliament in a timely way?	Substantial	Substantial
6. Are observations by the commercial and/or state auditor addressed to the state treasury to improve financial management practices taken on board systematically?	Substantial	Substantial
7. Are adequate internal control procedures in place in the state treasury to safeguard public resources, generate reliable financial reports, and comply with applicable laws and regulations?	Partial	Partial
Source: FAD staff and PEFA Secretariat, <i>Public Financial Management: Performance Measurement Framework</i> , January 2011 (revised).		
1/ As defined in Box 1.		