INTERNATIONAL MONETARY FUND
THE WORLD BANK

International Standards: Strengthening Surveillance, Domestic Institutions, and International Markets

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March 5, 2003

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EXECUTIVE SUMMARY

The international standards and codes initiative is one of a series of reforms initiated by the international financial community to promote a more stable financial system in the aftermath of the crises of the late 1990s. There has been increasingly broad acceptance that standards can help provide a framework to strengthen the functioning of markets and institutions, and in this way help support the benefits of international economic integration. The objective of the standards initiative is to encourage good practices, identify potential weaknesses in domestic institutions and policies, and improve transparency. In turn, these should help promote needed reforms, make institutions more resilient to shocks, and support better investment decisions and risk assessment. Progress in these areas can help reduce the risk of financial crises even though it can not eliminate them.

This paper reviews the progress made since early 2001 in implementing the Fund's and Bank's joint standards initiative and proposes steps for strengthening it based on the key findings of the review. The main findings, which are complementary to and to be considered in parallel with the findings of the review of the Financial Sector Assessment Program (FSAP), are as follows:

- **Members are adopting and implementing standards: more than 340 ROSCs have been produced for 89 economies.** Many emerging market economies have completed or are in the process of completing one or more Reports on the Observance of Standards and Codes (ROSCs), and most systemically important countries have volunteered for assessments. However, participation has been uneven across regions.

- **The number of ROSCs has increased sharply since the last review in January 2001 and ROSCs (some on an experimental basis) are now produced in all areas endorsed by the Bank and Fund Boards in 2001.** Of the 343 ROSCs produced, 63 percent (217 modules) were financial sector modules, mainly derived from FSAPs. Thirty-two were data modules, 54 were fiscal modules, and 40 were Bank-led market integrity modules (comprising 22 corporate governance, 12 accounting and auditing, and 6 pilot insolvency and creditor rights modules).

- **Standards assessments are increasingly integrated into Fund surveillance**. ROSCs provide an important tool for surveillance, raising the profile of institutional weaknesses in discussions with country authorities. ROSCs have helped to pinpoint concerns, propose specific areas for policy action, and focus technical assistance.

- **The work on standards is also playing a greater role in Bank operations**, underpinning policy dialogue, increasingly contributing to the formulation of Country Assistance Strategies (CASs), and sharpening the focus of capacity-building efforts. The work on standards concerned with market integrity (corporate governance, accounting, auditing, and insolvency and creditor rights) is also beginning to feed into technical assistance.

- **The standards initiative is generating increased attention from financial market participants and rating agencies,** including as part of the process of risk assessment. The program of outreach to the private sector will continue as a mechanism for gaining feedback on the initiative.

Nevertheless, the review raises important issues for consideration of Directors. There are several requirements for the initiative to remain effective:

- **Demand for standards assessments and ROSCs and follow up to ROSCs is growing rapidly. Greater prioritization of assessments is key to focus the scarce capacity of members and Fund and Bank resources on areas where reforms are most needed.** Fund and Bank staffs are examining a variety of ways to implement a regime that allows greater prioritization of standards assessments and ROSCs across countries and standards so that resources are allocated to deliver the highest return in strengthening domestic and international financial systems and members' institutional capacity.

- **ROSCs need to continue to serve as a diagnostic tool; provide input into Fund surveillance and Bank country assistance strategies; inform the private sector's financial decision making; and aid the allocation and coordination of technical assistance.** New ROSCs should be undertaken for members and in areas where they can be most useful. The priority for new ROSCs could be to (i) members where the exercise would have the highest return in terms of stability for the country and the international financial system; and (ii) members for which the developmental impact is likely to be important, including in the regional context.

- **In addition, a range of instruments for providing follow up through updates and periodic reassessments to keep ROSCs sufficiently current and informative to meet the needs of members and markets is required.** This paper proposes that to achieve appropriate prioritization and enhance follow up, participation in the initiative continue to increase through new ROSCs, though for the Fund at a slower pace than currently while for the Bank a modest increase in ROSCs on the market integrity standards is envisaged. Follow up could be enhanced by supplementing factual updates with less frequent reassessments when warranted.

- **Staff will step up efforts to involve other international agencies in producing ROSCs and ROSC updates in some areas of standards (those concerning market integrity and outside the banking areas)** as under the anti-money laundering and combating the financing of terrorism (AML/CFT) pilot program.

- **To improve their usefulness, ROSCs should give a clearer sense of the main findings and conclusions and their significance, and more explicitly prioritize recommendations.** Staff should help members prepare and implement plans to address the weaknesses identified in ROSCs.

- **It is important for standards setters to periodically review and modify existing standards through a process that should provide for input from a broad range of members**. An important near-term priority is the effort under way to draw up regulatory principles for accounting and auditing to address current gaps that have come to the fore in light of recent corporate governance and accounting scandals and to develop a simplified accounting standard for small and medium-sized enterprises. Bank and Fund staffs together with other experts from the international community are also reviewing the Bank's *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems* as well as insolvency principles established by the United Nations Commission on International Trade Law (UNCITRAL) to ensure convergence toward a single standard. The staffs are also working with the Basel Committee on Banking Supervision (BCBS) on the proposed new Capital Accord and revision of the Basel Core Principles.

- For the time being, **Fund and Bank staff do not see a strong case for adding to the area of standards that are now part of the initiative**.

I. Introduction and Background[1]

1. **The standards initiative is part of the international community's wider strategy for strengthening the stability of the international financial system**.[2] The initiative is designed to yield benefits at the national level (by encouraging sound regulation and supervision, greater transparency, and more efficient and robust institutions, markets, and infrastructure) and the international level (by facilitating better-informed lending and investments decisions, greater transparency, improved market integrity, accountability and policy credibility, and by reducing vulnerability to crises). It seeks to do this by:

- Encouraging the development of internationally recognized standards in the areas endorsed by the Executive Boards of the Fund and the Bank as useful to their work;

- Encouraging members' adoption and implementation of standards including through technical assistance; and

- Assessing members' observance of these standards and, with their consent, producing and publishing Reports on the Observance of Standards and Codes (ROSCs).[3]

2. **In early 2001, the Fund and Bank Boards reviewed the experience of assessing and implementing standards.** They endorsed a list of 11 areas useful to their operational work and for which assessments, using ROSCs as the principal tool, will be undertaken as appropriate.[4] At that time, Fund Directors agreed on modalities by which ROSCs would inform the surveillance process.[5] In November 2002, the Executive Boards of both

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[1] This paper was prepared by Fund and Bank staff teams. At the Fund, the main contributions were from PDRCS in collaboration with the Task Force on Monitoring and Assessment of Standards and Codes. At the World Bank, the main contributions were from PRMVP in collaboration with FSEVP, PSIVP, and LEGVP.

[2] Other initiatives designed to strengthen the international financial system include the Financial Sector Assessment Program, improved assessment of countries' vulnerability to crises, and reforms aimed at improving the mechanisms for crisis resolution. See for example, *Managing Director's Report to the International Monetary and Financial Committee—Fund Surveillance and Crisis Prevention and Resolution* (IMFC/Doc/5/02/5, 4/16/02).

[3] See the Annex for a list of acronyms frequently used in this paper.

[4] The Financial Stability Forum (FSF) highlighted 12 widely agreed areas that underlie well-functioning and stable financial markets.

[5] See *Assessing the Implementation of Standards—An IMF Review of Experience and Next Steps* (PIN No. 01/17, 3/5/01).

organizations agreed to add anti-money laundering and combating the financing of terrorism (AML/CFT) to this list (Box 1).[6]

3. **For purposes of discussion, the standards can be grouped into three categories**[7]: *transparency standards* (focused on data, fiscal, and monetary and financial policy transparency); *financial sectors standards* (banking supervision, securities, insurance, payment systems, and AML/CFT); and *standards concerned with market integrity* (corporate governance, accounting, auditing, and insolvency and creditor rights).

4. **This paper reviews the progress made since early 2001 in implementing the Fund's and Bank's standards initiative and proposes next steps.** It is organized as follows: Section II discusses the participation of Fund members and Bank clients in the standards initiative and reports on some of the main findings of ROSCs and how markets are using ROSCs in their investment decisions and credit assessments. Section III examines how standards assessments are feeding into the work of the Fund and the Bank. Section IV considers the coverage of standards under the initiative, and Section V discusses how the ROSC assessment process can remain effective and sustainable. The final section suggests issues for discussion.

5. **The associated IMF background paper** *International Standards: Background Paper on Strengthening Surveillance, Domestic Institutions, and International Markets* (SM/03/86, Supplement 1, 3/06/03) **provides detailed information on which some of the conclusions of the review and staff proposals are based.** Other background papers provide additional background information supporting the assessments of the experience with the standards initiative referenced in this paper.[8]

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[6] See *Report on the Outcome of the FATF Plenary Meeting and Proposal for the Endorsement of the Methodology for Assessing Compliance with Anti Money Laundering and Combating the Financing of Terrorism* (SM/02/349, 11/8/02).

[7] These categories are not mutually exclusive and the dividing line between them is not sharp. For example, the monetary and financial policy transparency standard could be categorized as both a transparency and a financial sector standard.

[8] See *Assessing and Promoting Fiscal Transparency: A Report on Progress* (SM/03/86, Supplement 2, 3/06/03); and *Review of the Fund's Experience with the Data Module ROSCs* (SM/03/86, Supplement 3, 3/06/03) circulated to the Fund Board.

BOX 1: LIST OF STANDARDS , CODES AND PRINCIPLES USEFUL FOR BANK AND FUND OPERATIONAL WORK AND FOR WHICH REPORTS ON THE OBSERVANCE OF STANDARDS AND CODES ARE PRODUCED

Group 1: These are the initial set of areas defined as within the Fund's direct operational focus when the ROSC pilot was initiated.

Data Transparency: the Fund's *Special Data Dissemination Standard/General Data Dissemination System* (SDDS/GDDS).

Fiscal Transparency: the Fund's *Code of Good Practices on Fiscal Transparency.*

Monetary and Financial Policy Transparency: the Fund's *Code of Good Practices on Transparency in Monetary and Financial Policies* (usually assessed by the Fund and the Bank under the Joint Fund-Bank Financial Sector Assessment Program (FSAP)).

Banking Supervision: Basel Committee's *Core Principles for Effective Banking Supervision* (BCP).

Group 2: These additional areas are assessed mainly under the Joint Fund and Bank FSAP.

Securities: International Organization of Securities Commissions' (IOSCO) *Objectives and Principles for Securities Regulation*.

Insurance: International Association of Insurance Supervisors' (IAIS) *Insurance Supervisory Principles.*

Payments and Settlements Systems: Committee on Payments and Settlements Systems' (CPSS) *Core Principles for Systemically Important Payments Systems* and the *Committee of Payments and Settlements Systems* and *IOSCO's Recommendations for Securities Settlements Systems.*

Anti-money Laundering and Combating the Financing of Terrorism: Financial Action Task Force's (FATF's) *40+8 Recommendations*

Group 3: These areas were highlighted as important for the effective operation of domestic and international financial systems and are now being assessed by the Bank.

Corporate Governance: OECD's *Principles of Corporate Governance.*

Accounting: International Accounting Standards Board's *International Accounting Standards (IAS).*

Auditing: International Federation of Accountants' *International Standards on Auditing.*

Insolvency and Creditor Rights: World Bank's *Principles and Guidelines for Insolvency and Creditor Rights System* and United Nations Commission on International Trade Law's (UNCITRAL's) *Legislative Guide on Insolvency Law*.[1/]

1/ There is no agreed-upon standard in this area as yet. In April 2001, the World Bank Executive Directors reviewed the Bank's draft *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems* and asked Bank staff to prepare pilot ROSCs on the basis of the Principles. The Fund's Board has not reviewed these principles and guidelines. In addition, the United Nations Commission on International Trade Law (UNCITRAL) will soon be completing a legislative guide that will include recommendations on the design of a domestic insolvency law. Staffs of the World Bank and UNCITRAL in consultation with Fund staff are working toward a single standard.

II. Progress in Implementation and Findings

A. Progress on Assessments

6. **The number of ROSCs has increased sharply since the last review** and ROSCs (some on an experimental basis) are now produced in all areas endorsed by the Bank and Fund Boards in 2001. AML/CFT ROSCs are also underway in the context of a pilot project.[9] As of December 31, 2002, 343 ROSCs have been produced for 89 economies or 47 percent of the membership (Appendix Table A1.1). The majority of ROSCs have been published, although the publication rate for ROSCs derived from FSAPs (64 percent) is lower than that for other ROSCs (80 percent).[10]

7. **Most systemically important countries are participating in the initiative, though regional participation rates are uneven**, with Central and Eastern Europe having the highest participation rate and Asia the lowest.[11] Several members are close to completing a full set of ROSCs (Brazil, Bulgaria, the Czech Republic, Croatia, Egypt, Estonia, Hungary, Latvia, Lithuania, Philippines, Poland, Slovak Republic, South Africa, Sweden, and Tunisia).[12]

8. **Of the 343 ROSCs produced, 56 percent (193 modules) covered financial sector standards and were derived from FSAPs.** In addition, 24 financial sector ROSCs were produced outside of the FSAP.[13] Thirty-two were data modules, 54 were fiscal modules, and 40 were Bank-led market integrity modules (comprising 22 corporate governance, 12 accounting and auditing, and 6 pilot insolvency and creditor rights modules). ROSCs on the market integrity standards have not yet been prepared for industrial countries though the Financial Sector Assessment Program is flagging shortcomings relevant to the financial sector.[14]

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[9] See Press Release No. 02/52, *IMF Executive Board Approves 12-Month Anti-Money Laundering Pilot Project*, 11/22/02.

[10] See Supplement 1 (Section II).

[11] Some Asian members have said they intend to improve their observance of standards before undertaking ROSCs.

[12] Assessments under all standards may not be relevant for each member given different stages of development. For example, securities and insurance ROSCs are not produced for members where the sector is small and does not raise stability issues.

[13] Since the last review, nearly all financial sector ROSCs have been produced in the context of the FSAP. Prior to this, a number of stand-alone financial sector ROSCs were produced.

[14] The U.K. authorities have recently requested standards assessments/ROSCs in these areas. Assessments under the FSAP have been issue-based and not involved detailed assessment vis-à-vis the standards in these

(continued)

9. **In FY 2003, the Fund plans 127 transparency and FSAP-derived (jointly with the World Bank) ROSCs, of which 91 had been produced as of end-December 2002.** Production of ROSCs concerned with market integrity is expected to rise from 16 in the Bank's FY 2002 to more than 30 in FY 2003. Since the last review, the first accounting and auditing and pilot insolvency and creditor rights ROSCs have been completed. While most of these market-integrity ROSCs have been undertaken by stand-alone missions, some have been produced in the context of the FSAP. In the coming years, the Bank expects to produce about 40 ROSCs a year covering the standards concerned with market integrity. In order to exploit synergies between assessments in the market-based areas, ideally ROSCs should be timed to precede FSAPs. The results would then be used to assess the preconditions for financial sector standards.

10. **For the Fund, follow up to ROSCs, in line with Board guidance, has included short factual updates to ROSC modules prepared in the context of subsequent Article IV missions (46) and reassessments (17).** In some cases, however, factual updates were not prepared and Fund staff are developing a mechanism to address this. Reassessments have been carried out primarily when a country's Financial System Stability Assessment (FSSA) has been updated or when country-specific circumstances indicate significant changes in a country's observance of a standard that warrant reassessment.[15]

B. Findings of ROSCs[16]

11. The staff have reviewed most of the ROSCs produced since the last review to identify their main findings. The results of this review are given below.

12. **Data and fiscal ROSCs found that one of the most severe weaknesses in members' data systems was the coverage and consistency of fiscal data.** While most countries broadly follow international standards in the compilation of macroeconomic statistics, there were cases where nonstandard classifications were used. Countries with strong legal and institutional frameworks generally have more robust statistical systems. The consumers of data generally found more useful that disseminated by central banks than that disseminated by finance ministries. While countries subscribing to the SDDS perform better in terms of data quality, GDDS participants are improving the quality of data.

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areas. See *Financial Sector Assessment Program: Review, Lessons, and Issues Going Forward* (SM/03/77, 2/25/03 and R2003-0026, 3/6/03).

[15] Updates are undertaken by area department missions in the context of Article IV consultations and sometimes involve the participation of an expert from the relevant functional department.

[16] See Supplements 1,2, and 3 and *Background Paper on Standards Review: Assessing Progress and Lessons Learned from Bank–Led ROSC Modules* for details on the findings of standards assessments and ROSCs.

13. **In addition to data weaknesses in many developing countries identified in data ROSCs, fiscal ROSCs have found that quasi-fiscal and off-budget activities are an issue, particularly in transition and some emerging market economies.** Other issues frequently raised in ROSCs include unrealistic budgeting, weaknesses in government audit and internal controls, excessive discretion in tax administration, and the need for a clear definition of fiscal responsibility among the different levels of government. While many countries are becoming more transparent, continued vigilance is needed even in industrial countries.

14. **An important weakness in a number of developing countries' banking supervision regimes is political influence in the management of public banks and handling of weak banks.** The effectiveness of supervision is in some cases undermined by the insufficiency of staff with the necessary training, inadequate coordination and cooperation among regulatory and supervisory bodies, and lack of operational independence. There are also weaknesses in capital adequacy and risk management. Even in a number of advanced economies, supervisors lack the powers to require banks to change their boards or strengthen lending practices and provisioning.

15. **Weaknesses in insurance and securities supervision often reflect inadequate regulatory and supervisory systems and institutional weaknesses.** In part, these stem from regulators having insufficient powers and independence to enforce regulations. While important payments systems in advanced economies in most cases met international standards, several in developing countries are vulnerable to the failure of a single participant.

16. **Accounting and auditing ROSCs confirm that good financial reporting laws, standards, and other requirements are not sufficient without robust regulatory frameworks to ensure adequate monitoring and enforcement.** In all countries, users and regulators expressed concerns about the quality of financial data. The quality of audits is uneven across countries, even when done by national member firms of international accounting networks.

17. **In the area of corporate governance, there is often a discrepancy between laws on the books and actual practice.** Enforcement of shareholder rights and equitable treatment of shareholders need to be strengthened in many countries. Securities regulators often have little direct power to enforce penalties, so that enforcement is generally left to the courts, which are often ineffective in this area.

18. **Weak implementation, rather than inadequate laws, is the most common weakness found in pilot insolvency ROSCs.**[17] This usually reflects inadequate training among judges and ineffective regulation to address problems of corruption and undue influence. Problems on the regulatory side often stem from weak or non-existent procedures to license, qualify, and supervise insolvency administrators.

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[17] See the footnote to Box 1.

C. Standards, Markets, and Crisis Prevention[18]

19. **Standards and ROSCs can contribute to strengthening the functioning of international markets and they appear to be playing a greater role in this regard.** Major market participants appear to be using the information on countries' observance of internationally recognized standards, including ROSCs. A survey of large internationally active financial institutions found that 58 percent of respondents use ROSCs in their financial decision making (Appendix II).[19] A further 25 percent were aware of ROSCs, although they used them less frequently. Use varied greatly between countries and was highest in New York-based institutions and lowest among Japanese institutions. European institutions' use of ROSCs depended on how international their business was and whether the country risk and credit rating functions were carried out by a parent body (in which case, the institution relied on the parent's analysis). Half of respondents said their use of standards assessments had increased over time. Outreach missions by staff, welcomed by both official and private sectors, confirmed these findings. While the major market participants were familiar with the range of standards, the Fund's SDDS is still the most recognized standard in smaller markets.

20. **The standards initiative seems to be becoming more integrated into the risk management practices of the private sector:** observance of the fiscal and data standards are explicit factors used by a major credit rating agency to determine countries' credit ratings; observance of standards is a criterion used in two of the largest U.S.-based investment banks' models of risk; and observance of the Fund's transparency codes is an element in judging whether a country is included on a list of countries in which one of the largest U.S. pension funds will invest.

21. **The theoretical and empirical literature has examined the benefits of countries' adopting policies covered by internationally recognized standards and has produced some encouraging conclusions.**[20] Countries with more transparent policies tend to have lower inflation and fiscal deficits (although the direction of causality is not always clear) while fund managers invest more in transparent economies; financial regulation in line with standards is associated with greater financial development and may reduce the risks associated with financial liberalization; and greater protection of shareholder and creditor rights is associated with more developed financial systems, which in turn allocate capital more efficiently and lead to higher growth.

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[18] See Supplement 1.

[19] Market participants were surveyed by Fund staff and authorities (previous members of the FSF Working Group on Incentives for the Implementation of Standards) in Canada, France, Germany, Italy, Japan, the UK and the US. On average, 40 percent of the top 10 banks in each country responded to the survey.

[20] At the time of the last review of standards, Fund Directors suggested that more research needed to be done to assess the specific benefits of the use of standards and codes in reducing vulnerability to macroeconomic and financial shocks (SUR/01/13, 2/9/01).

22. **Finally, recent studies have found important benefits of adherence to international standards.** That is, for emerging market countries, various indicators of observance of standards are associated with lower spreads and higher credit ratings—both of which are measures of markets' expectations of the probability of crisis.[21] Because of the high degree of correlation between measures of institutional strength, it is hard to separate out the impact of observance in the different areas covered by individual standards. However, it is clear from the analysis that countries with otherwise similar macroeconomic performance have very different spreads, ratings, and probability of crisis depending on the strength of their institutions, including in the areas covered by standards. In some cases, measures of institutional strength are more powerful in explaining spreads, ratings, and the probability of crisis than some standard macroeconomic variables.

III. STRENGTHENING SURVEILLANCE AND CAPACITY BUILDING

23. **Standards assessments are increasingly integrated into Fund surveillance and are playing a greater role in Bank operations.** For the Fund, ROSCs are serving as an important tool for surveillance, raising the profile of institutional weaknesses in discussions with country authorities. ROSCs have also helped to pinpoint concerns, propose specific areas for policy action, and focus technical assistance. For the Bank, the work on standards is underpinning policy dialogue, increasingly contributing to the formulation of Country Assistance Strategies (CASs), and sharpening the focus of capacity-building efforts. The work on standards concerned with market integrity (corporate governance, accounting, auditing, and insolvency and creditor rights) is also beginning to feed into technical assistance.

A. Standards Assessments and Surveillance[22]

24. **Since institutional factors can affect a country's vulnerability to crisis and its growth prospects,** assessments of standards are increasingly being integrated into the surveillance framework (Box 2). Fiscal and BCP ROSCs reviewed were usually reflected in the analysis of staff reports, since nearly 80 percent were considered to have identified important surveillance issues, including substantial off-budget or quasi-fiscal expenditures and weaknesses in the banking system. In comparison, 43 percent of data ROSCs reviewed

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[21] See Supplement 1, Section VI and also *The Link Between Observance of Internationally Recognized Standards of Good Practice, Foreign Exchange Spreads, and Rating* (forthcoming working paper).

[22] The findings reported in this section are based on a review of 62 ROSCs and associated staff reports and summing ups completed and discussed by the Fund Board between March 1, 2001 and February 28, 2002 and a survey of the Article IV mission chiefs as reported in Supplement 1 (circulated to the Fund Board). Notwithstanding the diversity of experiences with individual ROSC modules for individual countries and some unevenness across ROSCs, some common themes emerged across ROSCs .

reported weaknesses whose macroeconomic implications were picked up in staff reports.[23] Securities, insurance, and payments systems assessments for the most part did not raise important macroeconomic surveillance issues that were referenced in staff reports. Since this survey looked only at those items from ROSCs that were actually picked up in Article IV staff reports, there may have been cases where important issues were identified, but where staff failed to pick them up.

25. **In the context of the Biennial Review of Surveillance in April 2002, Fund Directors observed that, given their recent launch and limited availability so far, ROSCs covering the standards concerned with market integrity had not yet made a substantial contribution to coverage of institutional issues**.[24] They indicated that they looked forward to a significant increase in Bank-led ROSCs, and as noted, the number of Bank-led ROSCs is now rising sharply. The Bank intends to establish procedures that allow assessment of the standards on market integrity in industrial countries. The main findings of these assessments will subsequently be incorporated in the Fund's Article IV surveillance.

26. **Directors have encouraged members to participate in the initiative in cases where an assessment is important for surveillance**. In the context of the inter-departmental Task Force on the Assessment and Monitoring of Standards (TAMS), Fund staff intend to develop a more systematic mechanism for determining when a standards assessment is important for surveillance and to ensure that this is flagged in the appropriate staff report. Bank and Fund staffs will work closely together and build on the existing mechanisms for exchanging views between staffs on priorities for standards assessments across members and standards. Where these members have not volunteered for ROSCs, the issues will continue to be covered through alternative means including existing standards-related technical assistance reports and research work, for example, on the financial system

[23] All Article IV reports must include an assessment of whether data provision is adequate for surveillance and it is likely that data ROSCs contributed to this assessment even if they were not explicitly mentioned in the staff report.

[24] See *IMF Executive Board Reviews the Fund's Surveillance* (PIN No. 02/44, 4/18/02)

Box 2. Examples Where ROSCs Contributed to Surveillance

Hungary: The 2001 *data* ROSC found important ways to strengthen the compilation of Hungary's Balance of Payments (BoP) statistics: the BoP was compiled on a cash rather than an accrual basis, the exclusion of reinvested earnings limited the comprehensiveness of the coverage of all resident and non-resident transactions, and the central bank's international transaction reporting system (ITRS) was not without problems. The 2000 Article IV report (SM/01/109; 4/13/01) noted these issues with the data. It indicated that if the current account were calculated according to the internationally recognized definition, it could be some 2-3 percentage points of GDP larger than reported and went on to conclude that the deficit represented a source of vulnerability. In February 2002, the National Bank of Hungary (NBH) announced a major revision to the reported current account deficit for 2001 from 0.5 to 1.3 billion euros. The NBH noted that it "*has begun work on changing over to internationally used method of recording the balance of payments. These new standards of compiling the Hungarian balance of payments are expected to be first used in 2003*".

Uruguay: The 2001 *fiscal* ROSC noted that, while there had been significant improvements in the transparency of Uruguay's fiscal policies in a number of important respects Uruguay did not meet the fiscal code. The ROSC highlighted the fact that the coverage of the budget was not comprehensive in that there were important quasi-fiscal operations, particularly by public sector banks, which had not been quantified, and that local governments were not providing adequate information on a timely basis to the central government. These issues were picked up in the Article IV staff report (where fiscal policy was a key issue) and program reviews (EBS/01/17, 2/14/01 and EBS/01/164, 9/21/01) while several of the recommendations of the ROSC were incorporated into the subsequent Fund-supported program. In response to the ROSC, the staff and authorities undertook a joint effort to quantify some of the most important quasi-fiscal operations of the public sector banks. The resulting staff study concluded that in some years, quasi-fiscal losses in one bank exceeded 1 percent of GDP. Under the current Stand-By Arrangement, the authorities are undertaking a substantial program of reform both of financial and non-financial public enterprises.

Ghana: The 2001 *BCP* ROSC and *FSAP* welcomed the important efforts being made by the authorities to strengthen the financial system (which was under considerable stress); the staff noted a number of serious vulnerabilities and urged the authorities and banks to take immediate actions to address these. The BCP ROSC highlighted weaknesses in the enforcement of regulations, including on loan concentration and foreign exchange exposure, and the conflict of interest between the Bank of Ghana's role as banking supervisor and its ownership of shares in three domestic banks. The ROSC/FSSA noted that capital adequacy ratio in Ghana was not calculated according to Basel methodology, although the outcomes of the Ghanaian methodology were more conservative. In December 2001, the Bank of Ghana divested all its remaining shareholding in financial institutions that it supervises, while a revised Bank of Ghana law was passed enhancing the independence of the Bank of Ghana. Steps are also being taken to enhance the quality of financial data.

Uganda: The update to the fiscal ROSC in 2002 noted that significant progress had been made in the area of fiscal transparency and institution building since the original ROSC was completed in 1999. Actions have been undertaken under each of the four areas underlying the fiscal transparency code: (i) *clarity of roles and responsibilities*—the authorities have divested public enterprises, thereby reducing the number of off-budget quasi-fiscal operations of the central government; compiled statistics of line ministries' revenue, bringing the revenue under the control of the Treasury; and extended the legal framework for budgeting to cover district and local government processes; (ii) *public availability of information*—the authorities have produced annual, semi-annual, and quarterly reports on the outturn of the central government, as well as monthly reports on the central government's revenue outturn; and compiled and aggregated final annual accounts for local governments; (iii) *open budget preparation, execution, and reporting*—the authorities have increased the participation of legislature in fiscal management; started piloting output-oriented budgeting for some of the major spending ministries; and introduced a commitment control system for non-wage recurrent and development expenditures; and (iv) *independent assurances of integrity*—the authorities have enhanced the technical capacity of the auditing functions of government through increasing budget resources and hiring technical experts. Despite these improvements, however, some of the other key recommendations in the original ROSC have not yet been addressed.

27. **Fund area department mission chiefs said ROSCs generally clarified and raised the profile of existing concerns, and in some cases uncovered new issues.** However, they thought that ROSCs needed to be clearer about weaknesses and in their recommendations, blunter where shortcomings were serious, and more explicit on the magnitude of non-observance.[25] The review of ROSCs found that about a quarter of ROSCs needed to be clearer in these areas. To improve the quality of ROSCs, and meet the needs of authorities, staff propose that ROSCs give a clearer sense of the main conclusions and their significance and more explicitly prioritize recommendations. Operational guidance on the structure and content of ROSCs would be revised to address these issues more explicitly.

28. **One factor that may affect the clarity and focus of ROSCs and their recommendations is the circumstances surrounding their finalization.** ROSCs, unlike staff reports, are shared with authorities in draft.[26] The ROSC is often built on a much more detailed assessment which is also shared with the authorities. These allow for greater dialogue with the authorities on the assessment, which is important to ensure accuracy, given their technical nature. However, it is essential that the member and Directors receive a report that clearly identifies institutional weaknesses and prioritizes recommendations. Fund staff are strengthening internal guidelines to address these issues, including by making it even clearer that the judgments expressed in a ROSC are those of the staff, while the views of the authorities should be reflected in an accompanying right of reply (or separately in the ROSC).

B. Standards Assessments as a Benchmark for Capacity Building[27]

29. **ROSCs have proved useful in identifying and raising the profile of institutional weaknesses.** The staffs have elicited the views of authorities from 35 countries in a series of outreach missions and at a Bank-Fund conference in March 2001 attended by high-level officials from 21 members). Members that had participated in the ROSC and FSAP initiatives said the assessments provided valuable in-depth analysis, supplied concrete suggestions to address weaknesses, and added to momentum for reform.[28] These views were

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[25] Some assessors have responded that in their view overly blunt language could undermine efforts to convince the authorities to implement standards and address weaknesses. It should also be noted that detailed assessments of standards are provided in background documentation that accompany ROSCs. See *Financial Sector Assessment Program: Review, Lessons and Issues Going Forward* (SM/03/77, 2/25/03 and R2003-0026, 3/6/03).

[26] See Public Information Notice No. 01/3, January 12, 2001, *IMF Reviews the Experience with the Publication of Staff Reports and Takes Decisions to Enhance the Transparency of the Fund's Operations and the Policies of its Members.*

[27] See Supplement 1.

[28] See Supplement 1 (Section III) circulated to the Fund Board. Standards remain a priority in a wide range of international fora with diverse participation including the G20, Asian Pacific Economic Cooperation, the Commonwealth Secretariat, and the Financial Stability Forum. India has also undertaken a series of extensive reviews of where changes are needed to meet international standards in different areas. The role of standards and ROSCs in providing a coherent agenda for institutional reform and promoting integration into the global

(continued)

echoed by Fund mission chiefs. However, many developing member countries have expressed the desire for adequate technical assistance to help them address weaknesses identified in standards, and further work on appropriate sequencing of the implementation of standards, noting that the standards themselves were costly or burdensome for countries to implement. While Fund and Bank staffs have taken steps to address these concerns, further work particularly on the cost and benefits of the implementation of standards and sequencing of implementation is needed.[29]

30. **There is evidence that members are seeking to redress weaknesses identified in ROSCs.** ROSC updates have generally noted that members have taken steps to implement the recommendations in ROSCs and a quarter of transition and developing countries that have completed ROSCs or FSAPs have received follow up technical assistance.[30] Fund- and Bank-supported programs are, on a selective basis, including reforms designed to help address key weaknesses raised in ROSCs.

31. **In January 2001, the Fund made standards one of the filters for prioritizing technical assistance requests (BUFF/01/2).** In FY 2002 there were 22 staff years of assistance under the standards filter (which is projected to increase to 28 staff years in FY 2003).

32. **Capacity building and provision of technical assistance are key aspects of the World Bank's overall development assistance efforts**. To a large extent, they are an integral element of any Bank project lending. In addition, there is a significant portfolio of targeted technical assistance projects, including in the domains of financial and private sector development. The Bank has a long-standing role in providing and helping to coordinate technical assistance in the areas covered by financial sector assessments and ROSCs, in the context of investment projects, through technical assistance loans and credits, and through various grant facilities. Standard assessments have thus helped provide a more systematic diagnosis and prioritization of technical assistance needs and hence support greater focus and consistency in the provision of technical assistance. Acknowledging the importance of standards-related capacity building efforts, the Bank thus allocated an additional operational funding for this dimension of its overall work on standards and codes.

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economy was recently underlined by African heads of state, in the context of the New Partnership for Africa's Development (NEPAD)(Supplement 1, Box 3).

[29] For example, for data ROSCs members are assessed against the SDDS or GDDS as appropriate. Fiscal ROSCs generally assess countries observance of good practices under the fiscal transparency code but where appropriate also state if a member meets best practices. Under the FSAP members are assessed in those areas most relevant to their situation.

[30] See Supplement 1, 2 and 3 and *Background Paper on Standards Review: Assessing Progress and Lessons Learned from Bank-Led ROSC Modules* (circulated to the World Bank Board). Details on follow up to financial sector standards and FSAPs is provided in the FSAP Review. As noted in that paper, a large amount of follow-up technical assistance is in the pipeline and active use has begun to be made of the Financial Sector Reform and Strengthening (FIRST) initiative.

33. **ROSCs and work on standards in the context of the FSAP exercise are also influencing the World Bank's Country Assistance Strategy in an increasing number of countries**. In the area of accounting and auditing, the World Bank is playing a role in promoting concerted actions to improve the accounting and auditing profession and practice and has taken steps toward provision of technical assistance and capacity building services in these areas. Similarly, the integration of corporate governance into the private sector development (PSD) and financial sector development (FSD) agenda is influencing the Bank's development strategies in client countries. Corporate governance issues are also being addressed in some Bank FSD and PSD policy and project lending operations. Finally, insolvency and creditor rights assessments are beginning to influence the Bank's reform agenda and have resulted in technical assistance activities in a number of countries.

34. **Nevertheless, needed changes are underway to support members' efforts to strengthen their institutions in the areas covered by standards.** Only a third of ROSCs reviewed prioritize the recommendations for reform and few of those for developing and transition economies explicitly identify where technical assistance is likely to be needed to implement reforms. A broader issue is to situate ROSC-identified technical assistance within a framework of national technical assistance priorities, taking account of domestic capacity to implement changes and the availability of external support. These wider issues can be thought through in the context of developing a country action plan which would include a timetable for implementing the recommendations of ROSCs. So far, however, very few members have developed these plans and some members may welcome assistance from Bank and Fund staff in this process. Finally, there are issues relating to the mobilization, utilization and coordination of technical assistance to support the implementation of standards. Among the efforts to address this is the Financial Sector Reform and Strengthening Initiative launched in May 2002.[31]

IV. Coverage of the Standards Initiative and Modifying Standards

A. Coverage of Standards in the Initiative

35. **Recognizing the need to keep under review the appropriateness of the areas of standards for all members, staff have continued to develop and manage Fund and Bank standards and to enhance their collaboration with other standard-setting agencies.** In this process, staffs have kept two broad principles in mind: given the limited participation of developing countries in the formulation of some standards and the resulting concern that standards give undue weight to the experience of advanced economies, any revision should take into account the views and needs of countries at all stages of development, while striving to promote adoption of recognized best practices. A balance must be struck between making a standard more comprehensive and maximizing the number of members for which full observance of the standard is feasible.

[31] The FIRST initiative was established to provide a mechanism to ensure systematic follow-up of technical assistance from FSAP/ROSC efforts and to provide financial support for that effort. The Bank, the Fund, and several national development agencies are participants.

36. **Several of the standards endorsed by the Fund and Bank have been or will be reviewed shortly** (Appendix III). The Fund Board has agreed to important changes to the Code of Good Practices on Fiscal Transparency and the Special Data Dissemination Standards. Standards will need to be developed for public sector-specific topics not covered in International Accounting Standards (IAS), including budget accounting and accounting for development aid, in harmony with the GFS manual. A review is also expected this year of the experience with the Fund's Code of Good Practices on Transparency in Monetary and Financial Policies. Possible modifications in the data standards will be discussed in the forthcoming review of data standards later this year.

37. **Furthermore, a number of financial standards are under revision by standards setters with input from Fund and Bank staffs.** The International Association of Insurance Supervisors (IAIS) has established a task force to revise the Insurance Core Principles and Assessment methodology. The staffs have also actively participated in reviews of standards developed by other organizations (in particular the BCBS and OECD) where views are being solicited from a wider range of countries than were involved earlier in the development of the standards. Finally, the standards setters for payments and securities have developed Recommendations for Securities Settlement Systems (RSSS) which identify the minimum requirements and best practices for securities settlement. The standard is particularly relevant for countries with large and complex systems. **Staff propose to include assessments against the RSSS as an integral part of a payments and settlement system ROSCs for members with large and complex securities settlement systems (Appendix III).**

38. **Bank Directors reviewed the *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems* in April 2001, and asked staff to prepare pilot ROSCs based on the Principles with a subsequent review of this experience.** [32] Corporate governance standards have been found wanting in several countries, particularly in the areas of board independence, audit and remuneration committee independence, and the **accountability regime for company officers** (see Appendix III). The OECD has decided to bring forward to 2004 its comprehensive review of its Principles of Corporate Governance, which is expected to embody specific guidelines to address these issues. Gaps in the standards for accounting and auditing that have become apparent from the assessment process and recent events in the advanced economies include the lack of internationally-agreed codes for the accounting and auditing professions and the inappropriateness of accounting standards for small and medium sized companies that are not publicly traded (Appendix III). The relevant standard setters are taking initiatives to fill these and other gaps and Bank and Fund staffs are supporting this work (see Appendix III).

B. Modifying the List of Areas for Standards Assessments

39. **When Fund and Bank Directors agreed to the areas and associated standards and codes in early 2001, they also agreed that the list might be modified when**

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[32] See the footnote to Box 1.

appropriate.[33] On November 15, 2002, Fund and Bank Directors agreed to add the FATF 40+8 Recommendations to the list of areas and associated standards and codes for which assessments will be undertaken and ROSCs will be prepared and endorsed the comprehensive and integrated methodology that was endorsed at the FATF October Plenary.[34]

40. **The Bank and Fund staffs have assessed whether there are other areas in which standards might be added to fill a gap or otherwise enhance the present list in terms of promoting international financial stability**:

- The idea of a standard based on the Fund-Bank Guidelines for Public Debt Management[35] arose when the Fund and Bank Boards discussed the Guidelines in March 2001.[36] While the guidelines were seen as useful benchmarks, Directors did not agree to add them to the list.

- A public sector governance standard has been considered. Such a standard would involve many complex issues, including an agreed definition of good governance, the development of underlying principles upon which to base such a standard, and the identification of a standard setter. The OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transitions could serve as a starting point for discussing the principles which might underlie such a standard.[37] It is noteworthy that many of the issues that would be covered by a governance standard are already captured in existing standards on fiscal and monetary and financial transparency, corporate governance and anti-money laundering and combating the financing of terrorism. Bank and Fund staffs have concluded that while stepped-up efforts to promote good governance are desirable, agreement on a broad code may be difficult to achieve and its monitoring would lead to duplication of effort.[38]

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[33] See *Assessing the Implementation of Standards—An IMF Review of Experience and Next Steps* (PIN No. 01/17, 3/5/01).

[34] See *Financial Sector Assessment Program (FSAP)—Review, Lessons, and Issues Going Forward* (SM/03/77, 2/25/03 and R2003-0026, 3/6/03).

[35] See *Guidelines for Public Debt Management* (SM/01/27, 2/01/01 and SecM2001-0074, 2/7/01).

[36] See *IMF and World Bank Publish Public Debt Management Guidelines* (News Brief No. 01/36, 4/13/01).

[37] The Financial Stability Forum recently welcomed the decision by the OECD Ministers to bring forward to 2004 their comprehensive review of international Principles of Corporate Governance which is expected to embody specific guidelines to address recent corporate governance problems (including in advanced economies).

[38] Suggestions for a public sector governance standard arose in the context of the meeting of IMFC Deputies in London on September 9, 2002, and in the *Statement to the IMFC by Gordon Brown, Chancellor of the UK Exchequer and IMFC Chairman* (http://www.imf.org/external/am/2002/imfc/state/eng/gbr.htm), which called, for example, for consideration of "a new rules based system of international economic governance for the community of nations."

- Guidelines for multinational corporations, pension fund regulation, stock listing requirements, international trading practices, and core labor standards have also been considered. In some of these areas, international bodies already exist to develop, refine, and promote adherence to rules or standards. In other areas, staff consider that national authorities are addressing the issues and it is not clear that the development of an international standard would be appropriate at this time. In yet other areas, such as good practices for multinational corporations, the staff is keeping the matter under active consideration and is following developments at other involved international bodies. For example, the OECD has developed *Guidelines for Multinational Enterprises* which provide recommendations for responsible business conduct. In addition, the UN's *Global Compact* comprises nine principles of corporate citizenship.

- Several international initiatives are promoting ways to improve transparency related to the exploitation of natural resources. Fund and Bank staffs are considering the possible involvement of these institutions in these efforts.

41. **The Bank and Fund staffs have concluded that at this time, there does not seem to be sufficient basis for adding these or other new areas to the list of standards.** As stated above, where gaps in existing standards need to be filled, standard setters are enhancing principles or modifying standards, generally with broad support from the international community. The staff will keep abreast of the issue of emerging needs for additional standards, and will bring the matter back to the two Boards periodically.

V. Keeping the Standards Initiative Sustainable

A. Managing the ROSC Assessment Process

42. The findings of this review imply that for a sustainable initiative ROSC assessments should have the following features:

- **ROSCs should be a useful diagnostic tool; provide input into Fund surveillance and Bank country assistance strategies; and be a catalyst for members' reforms.** ROSCs should also aim to inform the private sector's financial decision-making and aid the allocation and coordination of technical assistance.

- **New ROSCs should be focused on members and policy areas where they can be most useful.** The pace of ROSC production needs to be responsive to members' requests to participate in the initiative and targeted on areas where institutional challenges are most significant, including where they can have a systemic effect. This calls for greater prioritization.

- **The assessments contained in ROSCs must be kept up-to-date if they are to inform Article IV surveillance, capacity building, and the provision of technical assistance.** For the initiative to be a catalyst for change, countries must know that steps they take to improve observance will be recognized in ROSC updates, and communicated to the markets (if the updates are published). Moreover, ROSCs must be kept current for the financial markets to use information on standards.

- **The program of assessments should remain consistent with the available resources envelope** and Fund and Bank staff and other resources should be focused on areas where reforms are most needed.

43. **The implicit target for the ROSC assessment process, as reflected in the decisions of the Fund and Bank Boards, is that most members would ultimately be covered by ROSCs in all 12 areas.** These ROSCs would be kept up to date through factual updates written in connection with Article IV consultations, and periodic reassessments when circumstances warranted. However, the staffs believe that such a target when considered in light of the requirements for a sustainable initiative (paragraph 42) is too ambitious. In meeting this target, the Boards have recognized the need for flexibility and prioritization in the production of new ROSCs. As the growth in the stock of ROSCs to be maintained increases, follow up will require ever more resources.

44. **For the initiative to remain viable, ambitions will need to be scaled back. In this regard, there are several parameters that can be adjusted.** The first is strict prioritization of new ROSCs and follow-up work within the given resource envelope. This prioritization may affect both the countries and the policy areas to be covered. Since new ROSCs are considerably more resource-intensive than updates or reassessments, resources can be conserved by varying the mix, coverage, and frequency of new ROSCs and updates. More external partnership in the implementation of the initiative can supplement the resources devoted to it.

45. **Given the above, staff have considered a number of ways for placing the initiative on a more viable footing**:

- **Be more selective in country and policy area coverage. Priority for new ROSCs could be given to (i) members where the exercise would have the highest return in terms of stability for the country and the international financial system; and (ii) members for which the developmental impact is likely to be important, including in a regional context.**[39] Article IV reports and Country Economic Memoranda/ Development Policy Reviews would indicate the members and the standards that could most usefully be assessed. Implementation of such a regime would allow greater prioritization of standards assessments and ROSCs across countries and standards so that resources are allocated to deliver the highest return in strengthening domestic and international financial systems and members' institutional capacity.

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[39] Besides giving priority in any one given year to systemically important countries, other criteria that are used to determine FSAP priority countries include: (i) external sector weakness or financial vulnerability; (ii) the likelihood of major reform programs; and (iii) features of the exchange rate and monetary policy regime that make the financial system more vulnerable. Maintaining geographical balance among countries and balance across different levels of financial sector development is important. The FSAP review proposes to reduce the number of standards assessed in a typical FSAP mission to about three (excluding AML/CFT), which will have a marked impact on the growth in the stock of ROSCs.

- **Adjust the intensity and frequency of follow up**. Currently, short updates, largely descriptive in nature, are prepared by Fund area departments in the context of the Article IV consultations.[40] For the transparency standards, these factual updates could be supplemented with more substantive updates of parts of the appraisal when warranted and depending on the availability of resources.[41] Such follow-up would involve the participation of experts in Article IV or separate missions, and so might require more resources than the factual updates; in other cases they might be done in connection with technical assistance missions. When there had been substantial changes in a member's practices, a new ROSC might be prepared. [42] Such reassessments may typically require less resources than new ROSCs prepared from scratch. As for the standards concerned with market integrity, the Bank could reduce or limit the frequency of reassessments. This would reduce resource costs but might reduce the capacity- and awareness-building impact of recurrent and more frequent re-assessments.

- **Apply greater selectivity in updating.** The Fund would limit updates to ROSCs to those areas most central to the Fund's concerns (*i.e.*, the **Data, Fiscal, Monetary and Financial Policy Transparency, and Basel Core Principles modules** —the latter in collaboration with the World Bank if undertaken in the context of the FSAP). The results would be reported in updates to ROSCs or staff reports.[43] The savings from this approach would depend on how intensive the updating work would be.

- **Bank staff would continue to take the lead in assessing standards concerned with market integrity, including for the advanced economies**. It is further proposed that the industrial countries requesting assessments of the market-integrity standards cover the resource costs involved. Fund staff would utilize the results of these assessments

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[40] See "Assessing the Implementation of Standards—An IMF Review of Experience and Next Steps" (PIN No. 01/17, 3/5/01).

[41] Staff experimented with updates that went beyond the factual reporting of information (e.g., substantive updates), in the reports on the Czech Republic ("Czech Republic: Report on the Observance of Standards and Codes--Fiscal Transparency, Banking Supervision, Insurance Regulation, Securities Regulation, Payment Systems, and Monetary and Financial Policy Transparency—Updates," Country Report No. 02/169, 8/2/02) and Hungary ("Hungary: Report on Observance of Standards and Codes- Data Module and Fiscal Transparency-Updates", Country Report No. 02/110, 6/5/02). These more substantive updates included a staff assessment and required more resources—about 25 staff days per update.

[42] Reassessments wholly replace, rather than update, an existing ROSC and are carried out when the staff deem that country circumstances relating to the observance of a standard have changed sufficiently to merit a new principle-by-principle assessment. Reassessments of key financial sector standards will be done as part of the FSAP reassessments and focused updates to the FSAP. See *Financial Sector Assessment Program: Review, Lessons and Issues Going Forward*.

[43] If there were no material change since the last ROSC, this would be flagged in the FSAP/ROSC section of the Fund relations annex to the staff report.

to inform the Article IV surveillance exercise that follows the completion of these assessments.

- **Follow up to the market-integrity standards/ROSCs would be led by the Bank in the context of Country Evaluation Memoranda missions and in collaboration with the relevant standards setters**, and the results would be picked up by Fund staff in the Article IV staff report.

- **Other international agencies could be asked to produce or collaborate on ROSCs and ROSC updates,** as under the AML/CFT pilot program and the agreement with the Inter-American Development Bank in the areas of corporate governance and accounting and auditing.

46. **Mechanisms to prioritize the coverage of ROSCs and updates to ROSCs need to be strengthened**. Fund and Bank staffs are reviewing ways to strengthen internal mechanisms to ensure better prioritization. As discussed in paragraph 26, procedures will be developed to ensure a more systematic mechanism for determining when a standards assessment is important for Fund surveillance. Fund and Bank staffs will work closely together and build on the existing mechanisms for exchanging views in the prioritization process.

47. **Members' economic and financial systems evolve, as will standards and members' needs for assessments and updates.** The above options and staff proposal reflect the current stage of the standards initiative. With growing participation in the initiative, sustained efforts to implement ROSC recommendations, and changes in national and international financial systems over the longer term, these proposals will need to be revisited at a later stage to assess whether the needs for new ROSCs and updates are compatible with the level of resources.

B. Resource Requirements

The Fund

48. **Work under the standards initiative is estimated to cost around 72 staff years (including overtime) in FY 2003.** This cost arises from the production of roughly 127 new ROSCs for the transparency standards and (the Fund's contribution to the) financial sector standards, and purely factual updates to all modules in the context of the Article IV consultation.[44] If the proposals above are implemented, there would be some change in the allocation of resources to new ROSCs and to various forms of update. A modest reduction in the number of new ROSCs a year would allow the devotion of sufficient resources to prepare factual updates in the Fund's areas listed above, together with somewhat more substantive updates or reappraisals when warranted.

[44] Based on experience so far in FY2003, factual updates will not be completed for all existing ROSC modules.

The Bank

49. **The production of ROSCs in the areas concerned with market integrity standards has continued to increase from 9 ROSCs in FY 2001 to 17 in FY 2002, and more than 30 expected in FY 2003.** The production of ROSCs in these areas is envisaged to plateau at around 40 assessments in FY 2004—a level that is planned to be maintained over the following years. As the number of new ROSCs increases, demands for reassessments also will rise steadily. Following the lead of the United Kingdom, other industrialized countries are also expected to request assessments of the areas concerned with market-integrity standards, adding further pressure to the current resource and capacity constraints. In view of the increasing importance attached to these standards, staff believe it is important to maintain the goal of reaching an average of about 40 annual assessments in FY 2004. With the view to strengthen the market-integrity standards in the process, accommodating the demands from industrialized countries may also be considered important. In order to curb the pressures on staff and budget resources, a combination of the following measures could be considered: (i) more selective prioritization of assessments by targeting countries where assessments in compliance with standards are seen as contributing to vulnerability or impeding progress on important policy and institutional reforms; (ii) standard assessments for a given country would be focused on those areas of greatest relevance, and adjusted as appropriate for the stage of development and nature of vulnerabilities; (iii) the frequency of reassessments be limited or reduced; (iv) significantly strengthen the involvement of other international institutions in updating standards and codes and in undertaking assessments; and (v) introduce cost recovery for assessments undertaken in industrial countries.

VI. Issues For Discussion

50. **This review indicates that ROSCs have proved to be a useful diagnostic tool for identifying institutional weaknesses and external vulnerabilities.** However, there is scope for strengthening the ROSCs and the standards initiative more generally. This section review raises issues for discussion for consideration by Executive Directors.

A. Issues for Fund and Bank Directors

51. This review concludes that the standards initiative is broadly meeting its objectives. However, the initiative is costly and will take time for its full effect to be realized. The staff proposals above strike a balance between the requirements of a viable initiative including the provision of more systematic and substantive follow up and the resource and expertise constraints identified. *What are Directors' views on the proposals outlined in paragraph 45? Do they support efforts to improve the prioritization of assessments, including that all Article IV reports and CEM/DPRs should include an indication of those areas in which a standards assessment would be most useful?*

52. To improve the quality of ROSCs, and meet the needs of authorities (see paragraph 27), staff propose that ROSCs give a clearer sense of the weaknesses, main conclusions and their significance and more explicitly prioritize recommendations. *Directors' views would be welcome.*

53. Staff have recommended that for members with large and complex securities settlement systems, the payments and settlement system ROSC should include an assessment of observance against the new RSSS. *Do Directors endorse this proposal as outlined in paragraph 37 and Appendix III, page 34?*

54. Concerns have been expressed by developing country authorities for adequate technical assistance and the need for further work on the appropriate sequencing on the implementation of standards. This review notes that some progress has been made in addressing these issues but that more work is needed (see paragraph 29). *Directors' views would be welcome.*

55. The areas where most fundamental changes to existing standards are needed are corporate governance, accounting, and auditing (see paragraph 38). The staffs propose that the Bank and the Fund continue to support various initiatives underway to strengthen the standards in these areas. *What are Directors' views on the steps to be taken to support the strengthening of existing standards, guidelines and oversight or regulatory mechanisms in the areas of corporate governance and accounting and auditing?*

56. The staffs have considered whether there are other areas (e.g., public debt management and public sector governance) in which the Boards may wish to consider the addition of a standard to the list of areas important to the work of the Bank and the Fund and for which ROSCs are undertaken (see paragraph 41). The staffs have concluded that at this time, there does not seem to be sufficient basis for further adding any new areas to the list of standards. *Directors' views would be welcome.*

B. Issues for Fund Directors

57. This review concludes that ROSCs and standards assessments have helped identify institutional issues important to surveillance and that the modalities of linking standards and surveillance have been working reasonably well. *Are Directors satisfied with the progress achieved so far in this area?*

58. To focus resources on the areas of highest priority and to avoid overburdening the Article IV process, staff are proposing that only data, fiscal, MFPT and BCP ROSCs be routinely followed up in the context of the Article IV consultation. Follow-up that goes beyond largely descriptive to more substantive reporting of information should also be done. Staff are also proposing that the Fund's priority for new ROSCs could be given to (i) members where the exercise would have the highest return in terms of stability for the country and the international financial system; and (ii) members for which the developmental impact is likely to be important, including in a regional context. The choice of standards assessed and ROSCs produced would be tailored to country-specific circumstances. *Directors' views on the relative merits of these proposals would be welcome.*

59. ROSCs unlike staff reports, are shared with authorities in draft. This allows for greater dialogue with the authorities on the assessment, which is important to ensure accuracy, given the technical nature of ROSCs. However, it is essential that the member and Directors receive a report that clearly identifies institutional weaknesses and prioritizes

recommendations (see paragraph 28). This paper proposes to continue the practice of showing draft ROSCs with the authorities. *Directors' views would be welcome.*

C. Issues for Bank Directors

60. As discussed in Section V.B, resource and capacity pressures over the coming years will primarily stem from three elements: (i) increase in new ROSCs; (ii) growing demands for reassessments; and (iii) demands for assessments of market-integrity standards from industrialized countries. In view of the importance attached to the market-integrity standards and as the assessments have only started relatively recently, staff believe it is important to maintain the goal of reaching an average of about 40 assessments in FY 2004. To curb pressures on budget resources and staff capacity, the following options could be considered: (i) more selective prioritization of assessments by targeting countries where weaknesses in compliance with standards are seen as contributing to vulnerability or impeding progress on important policy and institutional reforms; (ii) standard assessments for a given country would be focused on those areas of greatest relevance, and adjusted as appropriate for the stage of development and nature of vulnerabilities; and (iii)the frequency of reassessments be limited or reduced; (iv) significantly strengthen the involvement of other international institutions in updating standards and codes and in undertaking assessments. Moreover, and considering the Bank's mandate, staff is proposing that the industrialized countries requesting assessments of the market-integrity standards cover the resource costs involved. *What are Directors' views on these proposals?*

List of Acronyms

AML/CFT	Anti-Money Laundering and Combating the Financing of Terrorism
BCBS	Basel Committee for Banking Supervision
BCP	Basel Core Principles
BoP	Balance of Payments
CAS	Country Assistance Strategy
CEM	Country Economic Memorandum
CPSS	Committee on Payments and Settlements Systems
DAC	Development Assistance Committee, OECD
DPR	Development Policy Reviews
FATF	Financial Action Task Force
FSF	Financial Stability Forum
FIRST	Financial Sector Reform and Strengthening
FSAP	Financial Sector Assessment Program
FSSA	Financial System Stability Assessments
GDDS	General Data Dissemination System
IADB	Inter-American Development Bank
IAIS	International Association of Insurance Supervisors
IAS	International Accounting Standards[45]
IOSCO	International Organization of Securities Commissions
ITRS	International Transaction Reporting System
MFPT	Monetary and Financial Policy Transparency
NBH	National Bank of Hungary
NEPAD	New Partnership for Africa's Development
OECD	Organization for Economic Cooperation and Development
ROSC	Report on the Observance of Standards and Codes
RSSS	Recommendations for Securities Settlement Systems
SDDS	Special Data Dissemination Standard
UN	United Nations
UNCITRAL	United Nations Commission on International Trade Law
WTO	World Trade Organization

[45] Within this report, International Accounting Standards refer to both International Financing Reporting Standards (IFRS) issued by the International Accounting Standards Board and the standards issued by the Board of the International Accounting Standards Committee.

Table A1.1. ROSC Modules Published
(As of December 31, 2002) 1/

Economies	Data	Fiscal	MFPT*	Banking Supervision*	Insurance*	Securities*	Payments*	Corporate Governance+	Accounting & Auditing+	Insolvency+	Total Published
Albania	P										1
Algeria				P							1
Argentina	P	P	P	P						P	5
Armenia	P	P									2
Australia	P	P	P	P							4
Azerbaijan		P									1
Benin		P									1
Botswana	P										1
Brazil		P									1
Bulgaria	P	P	P, P	P, P	P, P	P	P	P			11
Burkina Faso		P									1
Cameroon 2/	P	P	P	P	P		P				6
Canada		P	P	P	P	P	P				6
Chile	P										1
Costa Rica	P										1
Croatia			P	P	P	P	P	P	P		7
Czech Republic	P	P	P, P	P, P	P	P, P	P	P, P		P	13
Egypt, Arab Rep. of								P			1
Estonia	P	P	P	P	P	P	P				7
Euro Area			P				P				2
Finland			P	P	P	P	P				5
France		P	P								2
Gabon			P	P	P						3
Georgia			P	P	P		P	P			5
Greece		P									1
Honduras		P									1
Hong Kong SAR of China	P	P	P	P							4
Hungary	P	P	P, P	P, P	P, P	P, P	P, P				12
Iceland			P	P	P	P	P				5
India		P						P			2
Iran, Islamic Rep. of		P									1
Ireland			P	P	P	P	P				5
Israel			P	P	P	P	P				5
Italy	P	P									2
Japan		P									1
Jordan	P										1
Kenya									P		1
Korea, Rep. Of		P									1
Kyrgyz Republic		P									1
Latvia		P	P	P	P	P	P	P			7
Lithuania	P	P	P	P	P		P	P	P	P	9
Luxembourg 3/			P	P	P	P	P				5
Malaysia								P			1
Malawi		P									1
Mali		P									1
Mauritania		P									1
Mauritius	P							P			2
Mexico		P	P	P	P	P	P				6
Mongolia	P	P									2
Morocco									P		1
Mozambique		P									1
Namibia	P										1
Nicaragua		P									1
Pakistan		P									1
Papua New Guinea		P									1
Philippines		P						P	P		3
Poland		P	P	P	P	P	P	P	P		8
Romania	P	P									2
Senegal 2/ 4/	P		P	P	P	P					5
Slovak Republic		P	P	P	P	P	P		P	P	8
Slovenia		P		P	P	P	P				5
South Africa	P										1
Sri Lanka	P	P									2
Sweden	P	P	P	P	P	P	P				7
Switzerland			P	P	P	P	P				5
Tanzania		P									1
Tunisia	P	P	P, P	P, P	P	P	P				9
Turkey	P	P						P			3
Uganda	P	P	P	P							4
Ukraine		P									1
United Kingdom	P	P	P	P							4
Uruguay	P	P									2
Zimbabwe								P			1
Total Completed	32	54	55	57	33	31	41	22	12	6	343
Total Published	29	48	34	34	26	22	24	15	7	4	243

Source: Fund staff estimates.

* ROSCs in these areas are usually assessed as part of the FSAP. The exceptions are for the following: Algeria-Banking; Argentina-Monetary, Banking; Australia-Monetary, Banking; Bulgaria-Monetary, Banking, Insurance; Czech Republic-Monetary, Banking, Securities; Euro Area-Monetary, Payments; France-Monetary; Hong Kong-Monetary, Banking; Tunisia-Monetary, Banking; Uganda-Monetary, Banking; United Kingdom-Monetary, Banking. Second-round assessments as part of FSSA-Updates include: Hungary-Monetary, Banking, Insurance, Securities, Payments.
\+ The following ROSCs were assessed as part of the Financial Sector Assessment Program: Corporate Governance-Czech Republic, Georgia, and Latvia; Insolvency-Slovak Republic.

1/ ROSC modules not contained in an FSSA are considered complete once they have been circulated to Directors, and in the case of Bank-led modules, sent in their final form to the authorities. ROSC modules derived from an FSAP are complete only after the FSSA has been discussed by the Executive Board.
2/ In the case of Cameroon and Senegal's Insurance ROSC, an assessment was conducted for the regional insurance supervision council CRCA (Commission Régionale de Contrôle d'Assurance).
3/ As Luxembourg is a member of a monetary union, the module does not include an assessment of the monetary component of the standard.
4/ For Senegal's Banking ROSC, on an exceptional basis, a preliminary assessment was included in the FSSA.

Table A1.2. Comparative Participation in Standards and Codes Initiatives 1/ 2/
(As of December 31, 2002)

	(1) Africa	(2) Developing Asia	(3) Central and Eastern Europe	(4) CIS and Mongolia	(5) Western Hemisphere	(6) Middle East, Malta, and Turkey	(7) Advanced Economies	(8) Total IMF Members
Number of Members	51	29	15	13	32	16	28	184
Initiatives:								
SDDS Subscriber 3/								
Number of members	2	5	9	0	9	1	23	49
GDDS Participant 4/								
Number of members	22	6	3	5	11	5	0	52
ROSC Modules, Completed So Far								
Number of members 5/	23	7	12	8	14	8	15	87
Percentage	45%	24%	80%	62%	44%	50%	54%	47%
ROSC Modules, Completed and Committed								
Number of members 5/	27	9	13	9	22	12	23	115
Percentage	53%	31%	87%	69%	69%	75%	82%	63%
ROSC Modules, Completed So Far								
Number of modules 6/	63	24	81	26	42	25	59	320
Percentage of total modules	20%	8%	25%	8%	13%	8%	18%	
ROSC Modules, Completed and Committed								
Number of modules 7/	108	46	96	53	100	48	110	561
Percentage of total modules	19%	8%	17%	9%	18%	9%	20%	

Source: Fund staff estimates.

1/ This table does not reflect if a member has had more than one full assessment for the same standard. This table does not include territories, special administered regions (SARs), and monetary unions.

2/ The regional groupings are based on the composition of World Economic Outlook (WEO) groups.

3/ The SDDS was established in 1996 to guide countries that have, or might seek, access to international capital markets in the dissemination of economic and financial data to the public. Table includes subscribers in full observance only.

4/ The GDDS was established in 1997 to encourage members to improve data quality, provide a framework for evaluating needs for data improvement and setting priorities in this respect, and guide members in the dissemination to the public of comprehensive, timely, accessible, and reliable economic, financial, and socio-demographic statistics.

5/ The number of members for which at least one ROSC module has been completed. ROSC modules not contained in an FSSA are considered complete once they have been circulated to Directors, and in the case of Bank-led modules, sent in their final form to the authorities. ROSC modules derived from an FSAP are complete only after the FSSA has been discussed by the Executive Board. ROSC modules are committed once a letter is receved from authorities' confirming commitment to produce a ROSC.

6/ On an exceptional basis, this includes one preliminary assessment ROSC module included in a Financial System Stability Assessment. One ROSC module performed for a country on a regional basis is also included.

7/ Unless the actual number of modules committed is known, it is assumed that for each country, an FSAP would produce, on average, four ROSC modules, as an approximation.

Table A2.1. Quantitative Summary of Responses to Selected Survey Questions [1/]

Question	Japan 2/ (consolidated)	United Kingdom 2/ (consolidated)	All respondents, excluding Japan and UK 3/ (36)	Europe (23)	New York 4/ (11)	Canada (2)
Is information on transparency, financial regulation, and corporate governance used in financial decision-making?	Yes	Yes	97%	100%	100%	50%
Is information on standards used directly in risk assessment?	Yes	Yes, but extent of use varies widely	67%	65%	73%	50%
Is the institution aware of ROSCs?	Yes, but limited	Yes	83%	74%	100%	100%
Does the institution use ROSCs directly in risk assessment?	No	No	58%	56%	73%	0%
Is the institution aware of private sector initiatives on standards and codes?	No	Yes	42%	35%	64%	0%

Respondents: columns Japan through Canada.

Source: Fund staff estimates.

1/ The percentages refer to the proportion of affirmative responses among total respondents. The number of institutions surveyed appears in brackets under the country name.
2/ The Japanese and the UK members of the former Financial Stability Forum Working Group network surveyed, respectively, 98 Japanese and 5 UK financial institutions and prepared qualitative consolidated responses.
3/ Because the Japanese and UK responses were reported to staff in a qualitative form, they could not be included in the quantitative summary
4/ Ten individual major international financial institutions headquartered in New York were surveyed. In addition, a consolidated response was prepared for a number of other major institutions that attended an informal meeting with IMF staff on their use of standards and codes.

Recent and Proposed Revisions To Standards

Modifications to standards

Data standards

The Fund's Executive Directors have discussed proposals to modify the Fund's data standards by establishing a framework for the assessment of data quality and extending the scope of data released under the standard. In July 2001, Directors approved a new framework for assessing data quality in the context of ROSCs by looking at issues of integrity, methodological soundness, accuracy and reliability, serviceability, and accessibility, as well as the related institutional prerequisites. The framework was developed by Fund staff in consultation with national statistical offices, international organizations, and data users. The Board also discussed the possible inclusion of financial soundness indicators (FSI) in the SDDS. While a number of Directors believed this would be a useful development, others considered that FSIs should not be included even at a later stage. It was decided to return to the issue at a future date and a Board discussion is planned in 2003.

In May 2002, the Fund's Executive Board reviewed data provision to the Fund for surveillance purposes and in this context discussed the dissemination of data to the public on international reserves under the Fund's SDDS. Most Directors considered that increasing the frequency for the dissemination of the reserves template under the SDDS from monthly to weekly frequency was not necessary at this time. Directors stressed that priority should be given to expanding the number of members subscribing to the SDDS, or participating in the GDDS, as appropriate.

Insolvency and creditor rights standards

Although international standards have not yet been established in the area of insolvency, important work is underway in two different fora. Specifically, the World Bank is preparing its *Principles and Guidelines for Effective Insolvency and Creditor Rights Systems*. In April 2001, the World Bank's Executive Directors reviewed the Principles and asked the staff to prepare experimental ROSCs based on the Principles. In addition, the United Nations Commission on International Trade Law (UNCITRAL) will soon be completing a legislative guide that will include recommendations on the design of a domestic insolvency law. UNCITRAL has already established standards in the area of cross-border insolvency. As a means of facilitating the establishment of a single standard for both developed and developing countries that is recognized by the international community, the Fund and the Bank are working to ensure convergence in this area.

Financial standards

A number of financial standards are under revision by standard setters with input from Fund and Bank staff. The International Associate of Insurance Supervisors' (IAIS) has established a task force (which includes Fund and Bank staff) to revise the Insurance Core

Principles and assessment methodology. The revised Principles are expected to be adopted in September 2003 (see FSAP Review). The Basel Committee has undertaken an extensive consultation process as part of the development of the new Basel Capital Accord. The process has involved much wider country participation than the development of the original Accord reflecting the fact that many countries at different stages of development now use the Accord as an important input into their supervisory regimes. The new Accord is expected to be finalized at the end of 2003 with a target date for implementation of end-2006. The Basel Committee is about to commence work on revising the Basel Core Principles.

Guidance notes and comprehensive assessment methodologies have been developed in collaboration with standard setters. These have been produced in the areas of insurance, securities, payments systems, and monetary and financial policy transparency and provide more detailed guidance on assessment than the standards themselves, which are sometimes at the level of broad principles.

The standards setters for payments and securities have developed Recommendations for Securities Settlement Systems (RSSS) that identifies the minimum requirements and best practices for securities settlement. This paper proposes that assessments against the RSSS would be included as an integral part of payments and settlement system ROSCs for members with large and complex securities settlement systems.

To achieve this, it would be required that:

- **The payments system area is modified to a payments and settlement system area and the RSSS is made an associated standard** under the list of areas and associated standards endorsed by the Fund and Bank as useful for their work.[46]
- In the case of the Fund, **the RSSS is added as a standard to the list of areas and associate standards where standards are important to the conduct of comprehensive analysis under surveillance.**

The fiscal transparency code and accounting standards for the public sector

The Public Sector Committee of the International Federation of Accountants (IFAC-PSC) has developed and published international accounting standards for financial reporting by governments and public sector entities. Bank and Fund staff have been closely involved in this work. The initial objective was to adapt International Accounting Standards (IAS) to a public sector context and the PSC completed work on a set of 20 core standards for accrued accounting and a cash accounting standard in 2002. Going forward,

[46] The RSSS has been added to the Financial Stability Forum's list of 12 areas where standards are key for sound financial systems under the area of Payments and Settlement Systems which replaced the Payment System area.

standards will also be developed for public sector-specific topics not covered in IAS, including comparison and harmonization with the GFS, budget accounting, and accounting for development aid. These standards could inform assessments under the Fund's fiscal transparency code where relevant. For the most part, the standards will be applicable to countries using accrual accounting in their fiscal accounts and those seeking to meet the set of best practices that the fiscal transparency code sets out as a reference point for advanced countries. Standards are also being developed for cash basis accounting. When these are complete, Fund staff will consider whether any elements of these standards should be incorporated into the set of good practices under the fiscal transparency code or elaborated in the fiscal transparency manual. Any changes to the code would be brought to the Fund Board for approval.

Corporate governance

Corporate governance standards have been found wanting in several countries (including advanced economies), particularly in areas of board independence, audit and remuneration committee independence and in the accountability regime for CEOs and CFOs. Conflicts of interest have extended beyond corporate boardrooms and their committees, affecting the behavior of financial analysts, rating agencies, financial institutions of different types and various "gate-keepers" of market integrity. The OECD decided to bring forward to 2004 their comprehensive review of international Principles of Corporate Governance which is expected, to the extent possible, to embody specific guidelines to address these issues.

OECD Ministers have called for a survey of developments on governance in the corporate and financial sectors to identify lessons learned and the implications for the OECD Principles. An extensive dialogue is underway in Asia, Latin America, Eurasia, Russia, and South East Europe through the World Bank/OECD Regional Corporate Governance Roundtables to provide the basis for developing and transition economies to contribute to the review of the standard.

Accounting and auditing

Two important gaps have become apparent as events in advanced countries have demonstrated and as the assessment process has revealed. There are no internationally agreed principles for the regulation of accounting and auditing, including in areas such as appropriate governance structures for professional organizations, accounting and auditing standard-setting bodies, auditing firms, and international auditing firm networks. In addition, IAS are designed for large, publicly held, companies. Most small and medium-sized companies are unlikely to be able to meet the requirements of IAS. Nor would the benefits of implementing the standards be commensurate with the costs where companies have only limited external financing. Bank and Fund staff are therefore in discussions with standard setters on the formulation of regulatory principles for accounting and auditing. They are also encouraging standard setters to develop accounting standards appropriate for small and medium-sized enterprises.

Modifications to the list of areas and associated standards

Adding a new standard to the list requires an evaluation of the importance of the area for the operational work of the Fund and Bank, the likely resources needed to undertake assessments costs, and the potential costs of diluting the focus on existing standards. Executive Board approval would be required to add a new standard to the list.

Anti-money laundering and combating the financing of terrorism

Directors have agreed to modify the list of areas and associated standards useful to the operational work of the Fund and the Bank. In November 2002, Fund and Bank Directors agreed to add Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) to the list of areas where ROSCs will be produced and the Financial Action Task Force 40 + 8 Recommendations as the associated standard. They also endorsed a 12-month pilot program on AML/CFT assessments and accompanying ROSCs that would involve participation of the Fund and the World Bank, the Financial Action Task Force (FATF), and FATF-style Regional Bodies.