

Report of the Independent Panel on Safeguards Assessments

Presented to the Executive Board  
of the  
International Monetary Fund

January 31, 2005

Panel Members:

Mr. Şükrü Binay, Central Bank of Turkey

Mr. Gerardo Hernández Correa, Central Bank of Colombia

Mr. Bun Bunan E.J. Hutapea, Bank Indonesia

Mrs. Consolate Rusagara, National Bank of Rwanda

Table of Contents	Page
Executive Summary .....	3
I. Impact of the Safeguards Assessments Policy .....	3
II. The Safeguards Assessments Process and Monitoring .....	5
III. Other Suggested Improvements .....	6
IV. Conclusion .....	7
Attachments	
I. List of Independent Panel Members .....	8
II. Terms of Reference for the Independent Panel of Central Bank Officials .....	9
III. Sample Survey and List of Central Banks Surveyed .....	12

## EXECUTIVE SUMMARY

1. In its March 2002 review of the Safeguards Assessments (SA) policy, the Executive Board of the IMF indicated that an independent panel should be involved in the next review of the SA policy in early 2005. To meet this requirement, a panel of four deputy central bank governors from different regions was convened (see Attachment I). The panel was asked to determine whether safeguards assessments have been successful in meeting their stated objectives, and what, if any, improvements could be made to the safeguards policy and process going forward. The panel's terms of reference are included as Attachment II.
2. To those ends, the panel developed a brief survey and distributed it to 27 central banks that have undergone a safeguards assessment. Central banks were chosen to reflect the geographic and economic diversity of members to which the IMF lends. Of the central banks surveyed, 26 responded. See Attachment III for the survey questions and a list of central banks surveyed. The panel used the survey responses, follow-up conversations with central bank staff, and its own perspective, to draft this report.
3. **Central banks and panel members agree that the SA policy has been highly successful in achieving its objectives.** Interviews with central bank officials suggest that the SA policy has yielded positive results in two areas. First, SAs have ushered in an era of improved controls and enhanced transparency and accountability at central banks. Second, the safeguards policy has reduced the risk of misreporting and enhanced the reputation of the IMF as a prudent lender. Central banks and panel members also noted that the process by which safeguards assessments have been conducted has been for the most part appropriate and efficient.
4. Looking forward, **the panel agrees with several central banks that safeguards communication is a key area for improvement.** In addition, central banks and panel members posited ideas on the modalities for the next stage of monitoring safeguards requirements, which should include both off-site and on-site components.

### I. IMPACT OF THE SAFEGUARDS ASSESSMENTS POLICY

5. **Surveyed central banks agreed that SAs improved the way they operated in the areas of external audit, legal structure, financial reporting, internal audit, and internal control.** Each of the responding central banks noted that safeguards assessments have had a positive impact on central bank operations and management. Several banks noted "significant progress" or "great advantage" accruing from the safeguards process. A majority of central banks noted that SAs helped them implement initiatives that were already being contemplated.
6. **The most oft-cited improvement in central bank operations as a result of SAs was a more effective external audit mechanism.** A majority of central banks noted improved external audit mechanisms as a direct result of the safeguards process. The most striking improvement was the first-time appointment of independent and qualified external

auditors. Other improvements in the area of external audit included increased transparency in the appointment of the external auditor, more frequent auditor rotation, and enhanced cooperation between the external and internal audit functions.

7. **In the legal area, some central banks used the safeguards assessments process to initiate changes in central bank regulation that will, *inter alia*, enhance operational independence.** SAs appeared to provide central banks leverage in negotiations with parliaments, ministries, and other state entities. Generally, central banks implemented safeguards recommendations through a resolution of the bank's board rather than a change in the central bank law. Panel members believe that in certain circumstances, pursuing amendments to the central bank law as an SA recommendation may inadvertently result in a weakening of central bank independence during the political process.

8. **Among the benefits cited by central banks were changes in the area of financial reporting.** Many surveyed central banks have adopted internationally recognized financial reporting frameworks (either IFRS or ECB accounting guidelines) or substantially improved their financial reporting as a result of SAs. Movement towards internationally recognized financial reporting frameworks has considerably enhanced the transparency and credibility of central bank financial statements. The first-time publication of audited financial statements was another common improvement among surveyed central banks.

9. **The majority of central banks noted improvements in their internal auditing functions and internal controls.** Specific improvements included the establishment of an internal audit function, capacity building in the auditing and accounting areas, development of a risk-based approach to internal auditing, and improvements in reserves management. Central bank managers also cited safeguards assessments as helpful in the development of internal management systems for better control over key risk areas, including those related to IMF data reporting. Panel members agree that the development of credible internal audit and control functions at central banks is of long-term value for both central banks and the IMF.

10. **A few central banks noted other benefits accruing from SAs.** In most cases, these benefits were areas related to the safeguarding of bank resources. In one case, the advent of a financial controller function to integrate budgeting, accounting, and reporting controls helped reduce financial risk to the institution. In another case, the adoption of a risk management framework that identified vulnerabilities allowed "appropriate measures to be taken to control and minimize risk." Another central bank noted that its internal risk score had improved after implementing SA recommendations. In a few cases, the SA process provided impetus for other non-SA related improvements.

11. **Central banks and panel members agree that the SA process has increased transparency at, and accountability of, central banks.** The vast majority of central banks noted that enhanced transparency accompanied the publication of financial reports prepared in accordance with an international accounting framework. Central banks also remarked that the appointment of international accounting firms as auditors significantly enhanced their credibility with stakeholders.

12. Overall, **panel members strongly agree with the surveyed central banks that the SA process has had a markedly positive impact on central banks.** In addition, panel members agree that the perception of the IMF as a prudent lender has been enhanced by the safeguards assessment policy. The SAs have reduced the risk of misreporting and substantially improved controls over central bank and IMF resources, key components of the policy's objectives. Finally, panel members observed that SAs were part of a process of improvement in governance at financial institutions around the world.

## II. THE SAFEGUARDS ASSESSMENTS PROCESS AND MONITORING

13. **Most central banks agreed that the process of performing safeguards assessments has been efficient.** In particular, off-site preparations in Washington followed by short but effective on-site missions were cited as useful and appropriate. However, some central banks would have preferred more time to gather the necessary documents for the off-site assessment, while others would have liked longer on-site missions to allow for more detailed discovery and analysis. Some central banks noted that on-site missions were critical for the first assessment to ensure central bank ownership of the safeguards process and cited the benefits of communication during on-site missions.

14. **Panel members agree that the general process of conducting safeguards assessments seems efficient, though certain improvements could be implemented.** In particular, IMF staff should be in closer and more regular communication with their designated counterparts at the central banks (see below for more discussion of communication).

15. The majority of central banks felt that **some combination of on-site and off-site monitoring was appropriate to ensure the implementation and continuous tracking of safeguards recommendations.** In particular, off-site monitoring should continue to include the submission of annual external audit reports and management letters.<sup>1</sup> Several central banks recommended the development of a concise safeguards monitoring matrix to serve as a template for periodic off-site monitoring and/or another method for central bank self assessment (see below).

16. **Panel members agree that some combination of on-site and off-site safeguards monitoring would be ideal, and that the IMF should continue to perform on-site monitoring as needed.** As suggested by some central banks, some form of matrix should be

---

<sup>1</sup>A few central banks suggested that the terms of reference for external auditors include a tailored SA-related audit in the ELRIC areas. The submission of this special audit, in conjunction with the regular annual audit and the management letter, could serve as a general basis for IMF staff to monitor safeguards issues at central banks. Panel members felt that the inclusion of a special SA external audit would, *inter alia*, constitute a conflict of interest and possibly represent a loss of control by the IMF over safeguards issues.

developed to aid in off-site monitoring. Such a matrix would include general checklists related to each of the ELRIC areas. In addition, the matrix would track individual safeguards recommendations related to the specific central bank. The completion of the SA tracking matrix should not substitute for the opinions of IMF staff on the viability of controls at central banks. The panel agreed that IMF staff should determine when an on-site monitoring mission is required on a case-by-case basis.

### III. OTHER SUGGESTED IMPROVEMENTS<sup>2</sup>

17. **Central banks had suggestions for improving the safeguards policy and process.** Two areas were of particular interest to central banks: (i) safeguards communications, including the exchange of safeguards experiences among central banks; and (ii) flexibility in the implementation of safeguards recommendations.

18. **Many central banks cited communication of general safeguards principles and developments as a major area for improvement.** Some suggested the establishment of an SA website, and periodic e-mails regarding developments in safeguards areas. A compendium of safeguards best practices was also advanced by a number of central banks as a way of communicating with key safeguards stakeholders. Several central banks recommended regional training and conferences on safeguards issues. Many central banks noted that more frequent communication will improve the monitoring capacity of IMF staff and enhance the IMF-central bank relationship. A few central banks also noted that the link between SAs and the technical assistance is weak, and there appears to be a lack of coordination among IMF departments in this respect. A few central banks noted that the technical assistance available to assist with the implementation of safeguards recommendations was sparse at best. Panel members also observed **confusion among central banks about the difference between safeguards assessments and overlapping IMF initiatives**, such as FSAPs, statistics missions, monetary missions, Article IV surveillance, and program reviews. Often IMF resident representatives were relatively unaware of specific safeguards issues.

19. **Panel members agree that the communication involved in the safeguards assessments process needs improvement.** Panel members stressed the need for the IMF to promote central bank ownership of the safeguards process and lay the foundation for future cooperation on safeguards by (i) communicating more regularly with central bank staff on safeguards issues; (ii) establishing a website containing a compendium of safeguards knowledge; and (iii) facilitating regional and global forums on safeguards issues. Such

---

<sup>2</sup>Although not part of the survey, several central banks commented on the scope of the safeguards policy. For example, three central banks felt that safeguards assessments ignored IT issues that have a direct bearing on safeguarding bank and IMF resources. Another central bank recommended that the SA process be expanded to include choice and relevance of benchmarks and tools for reserves management.

initiatives would encourage the exchange of safeguards experiences among central banks around the world.

20. **Many central banks noted that the SA policy was applied flexibly. Nevertheless, a few central banks noted the seeming inflexibility of the safeguards policy and its application in some areas.** The panel members recommend the IMF continue to exhibit flexibility in safeguards assessments taking into account specific country circumstances and resource constraints in the development of recommendation deadlines.

#### IV. CONCLUSION

21. **Overall, the panel finds that the safeguards policy has been a success.** Not only has it improved control systems at central banks, but it has also succeeded in safeguarding IMF resources to a greater extent than at any time in the past. Surveyed central banks seemed roundly pleased with the effects of the safeguards policy on their operations despite some difficulties in implementing some proposed recommendations. Virtually all central banks acknowledged that the policy has had a positive impact on all relevant stakeholders, including the IMF. Thus, the safeguards policy has made significant progress in accomplishing its main objectives as set out in 2000.

22. **The panel also concludes that the process of conducting safeguards has been relatively efficient and has encouraged central bank ownership of the process.** Going forward, the IMF's modalities for monitoring safeguards should continue to include off-site and on-site components. Off-site monitoring should include an SA tracking matrix to be submitted by central banks to the IMF. The on-site component should remain at the discretion of IMF staff. The juxtaposition of these two elements will ensure the active monitoring of safeguards issues, while maintaining appropriate flexibility for both central banks and the IMF.

23. **Central banks and panel members observed the need for better and more frequent communication between the IMF and central banks on safeguards issues.** To address this issue, the panel recommends that the IMF enhance its communication with key safeguards stakeholders by employing a variety of channels including workshops and the establishment of a website.

24. The panel underscores the importance of even application of safeguards principles and recommends the IMF continue to take into account specific country circumstances and resource constraints in the development of recommendation deadlines.

**List of Independent Panel Members**

Mr. Şükrü Binay, Chairman  
Deputy Governor  
Central Bank of Turkey

Mr. Gerardo Hernández Correa  
Deputy Governor  
Central Bank of Colombia

Mr. Bun Bunan E.J. Hutapea  
Deputy Governor  
Bank Indonesia

Mrs. Consolate Rusagara  
First Vice Governor  
National Bank of Rwanda

External Coordinator:  
Mr. Joshua Kurtzig  
Partner  
Shanghai Global Partners LLC



## **Terms of Reference for the Independent Panel of Central Bank Officials**

### **1. Background**

The safeguards assessment policy was adopted as a permanent feature of IMF lending operations in March 2002, after a two-year trial period. The overarching objective of the policy is to protect the Fund's resources through an ex ante assessment of member countries' framework of safeguards in their respective central banks for preventing the possible misuse of Fund resources and misreporting of information. The aim of the policy is to provide reasonable assurance to the IMF that a central bank's control, accounting, reporting and auditing systems in place to manage resources, including IMF disbursements, are adequate to ensure the integrity of operations. The safeguards assessment policy was last reviewed by the IMF Executive Board (the Board) in March 2002.

### **2. Purpose and Main Modalities of the External Panel and Coordinator**

Pursuant to the Board's decision, a review of the operational experience with the safeguards policy will take place in March 2005. IMF staff will prepare a paper for the Board on its experience with safeguards assessments and assess whether the policy has achieved its objectives. A panel of four central bank officials, drawn from different regions representing the IMF's diverse geographical membership will provide the Board with an independent appraisal of the policy's effectiveness, including the value-added to a central bank's operations. The panel will be supported by an external consultant, who shall attend all meetings, analyze and summarize the survey results and assist in the drafting of the panel's report. The views and contributions of the panel will be presented to the Board in conjunction with the staff paper.

### **3. Focus of the External Panel's Review**

The panel will carry out its review as indicated in section 4 below. One of the principal tasks is to elicit the views of a group of other central banks that have experienced a safeguards assessment. In particular, the panel will:

- Assess whether safeguards assessments provide added value to the governance structure of central banks.
- Assess whether safeguards assessments assisted, or provided leverage, in implementing changes that had already been contemplated and/or initiated by central banks.
- Consider the efficacy of safeguards process and note whether there are any areas of concern for the central banks.
- Identify areas, if any, of the safeguards policy that can be improved or enhanced.

#### 4. **Procedures**

The panel will conduct its review freely and objectively. The panel will have access to all information in possession of the IMF in regard of safeguards assessments and will elicit the views of central bank authorities that have undergone a safeguards assessment. Each panel member undertakes to protect the confidentiality of all information obtained in the course of the review.

The panel's review will be conducted during the period November 2004–January 2005, and will require attendance at meetings in Washington, D.C. (November 18–19, 2004) and Paris, France (scheduled for January 27–28, 2005).

Background information on the safeguards experience, a list of central banks that have undergone a safeguards assessment, suggested survey questions and a draft outline of the IMF staff paper will be made available to panel members in advance of the November meetings in Washington, D.C. During that visit, panel members will obtain all additional documentation necessary for their assessment and meet with the external consultant and IMF staff. At the conclusion of the first visit, the panel should agree on the following:

- The number of central banks to be surveyed.
- The specific central banks to be surveyed.
- The content of the survey.
- The central banks that each panel member will contact by phone for follow-up interviews.
- The procedural modalities for the remainder of the review process, including the dates of the meeting in Paris procedures to review the draft report prepared by the external consultant under the guidance of the panel; and allocation of areas of responsibility for finalizing the report, etc.

At the second meeting, which is scheduled for January 27–28, 2005, the panel will finalize its report with the assistance of the external consultant. IMF staff will provide a draft of its board paper to the panel in advance of the second meeting and the panel will make its report available to IMF staff before its finalization. Both the staff report and the panel's report will be issued to the Board for its consideration; the chair of the panel will be invited to be present at the Board meeting, which is scheduled for March 2005.

The IMF reserves the exclusive rights to the written views of the panel and panel members undertake not to publish any part of these views separately.

5. **Logistics**

The first meeting will take place in Washington, D.C. The second meeting will take place in Paris, France.

Administrative services will be provided to the panel members by the IMF.

### Sample Survey and List of Central Banks Surveyed

The safeguards policy is an *ex ante* mechanism to strengthen the IMF's framework of measures to safeguard the use of Fund resources and minimize the possibility for misreporting. Safeguards Assessments are conducted for central banks and consider the adequacy of five key areas of control and governance within a central bank under the acronym **ELRIC**, that is (i) the **E**xternal audit mechanism, (ii) the **L**egal structure and independence of the central bank, (iii) the financial **R**eporting, (iv) the **I**nternal audit mechanism, and (v) the system of internal **C**ontrols.

The objective of this survey is to determine the effectiveness of the IMF's safeguards assessment policy, and whether the policy has met the objectives listed above. The survey also seeks to elicit views from central banks on the efficiency of the safeguards assessments and suggest ways of improving the process. The answers to the survey will be reflected in a report submitted by the independent panel to the Executive Board of the IMF.

1. Did the safeguards assessment improve the way your central bank operates in the areas of external audit, legal structure, financial reporting, internal audit, and internal controls?
2. Do you believe that safeguards assessments have helped to reduce risk, increase transparency, and add to the accountability and credibility of the central bank and of the IMF as a prudent lender? Please explain, as necessary.
3. Have safeguards assessments assisted or helped leverage changes that were already being contemplated at the central bank?
4. Was the safeguards assessment conducted in an efficient manner? Please explain how any underlying concerns affected the efficacy of the process.
5. What is the best way for the IMF to monitor safeguards at your central bank?
6. Do you have any suggestions to improve the modalities of safeguards assessments to enhance their effectiveness and efficiency?
7. Please provide any other general comments you wish to make.

The surveyed central banks were:

Albania	Ghana	Rwanda
Argentina	Guinea	Sri Lanka
Armenia	Honduras	Tanzania
Banque des Etats de l'Afrique Centrale	Indonesia	Turkey
Bolivia	Jordan	Ukraine
Bosnia and Herzegovina	Malawi	Vietnam
Brazil	Mauritania	
Bulgaria	Mongolia	
Colombia	Pakistan	
Georgia	Paraguay	
	Romania	

