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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 84/185

10:00 a.m., December 17, 1984

J. de Larosière, Chairman

Executive Directors	Alternate Executive Directors
A. Alfidja	T. Ramtoolah, Temporary
C. H. Dallara	M. K. Bush
J. de Groote	
B. de Maulde	X. Blandin
M. Finaish	T. Alhaimus
H. Fujino	M. Sugita
G. Grosche	B. Goos
J. E. Ismael	Jaafar A.
R. K. Joyce	
A. Kafka	C. Robalino
	A. S. Jayawardena
	A. Vasudevan, Temporary
E. I. M. Mtei	A. Abdallah
	C. A. Salinas, Temporary
Y. A. Nimatallah	
P. Pérez	
J. J. Polak	
A. R. G. Prowse	
	O. Kabbaj
J. Tvedt	
N. Wicks	
S. Zecchini	N. Coumbis
	Wang E.

L. Van Houtven, Secretary
R. S. Franklin, Assistant

Also Present

Exchange and Trade Relations Department: K. M. Huh. External Relations Department: H. O. Hartmann, H. P. Puentes. Legal Department: G. P. Nicoletopoulos, Director; J. G. Evans, Jr., Deputy General Counsel; Ph. Lachman, A. O. Liuksila, S. A. Silard. Middle Eastern Department: M. Arif. Research Department: W. C. Hood, Economic Counsellor and Director. Secretary's Department: A. P. Bhagwat. Treasurer's Department: W. O. Habermeier, Counsellor and Treasurer; D. Williams, Deputy Treasurer; D. Berthet, D. H. Brown, D. Gupta, B. E. Keuppens, A. W. Lake, T. B. C. Leddy, G. Wittich. Bureau of Statistics: A. C. Bouter, J. B. Gupta. Office of the Managing Director: C. P. McCoy. Personal Assistant to the Managing Director: S. P. Collins. Advisors to Executive Directors: H. A. Arias, G. R. Castellanos, D. Hammann, S. M. Hassan, G. E. L. Nguyen, P. Pêterfalvy, G. W. K. Pickering, T. Sirivedhin, N. Toé. Assistants to Executive Directors: H. Alaoui-Abdallaoui, I. Angeloni, M. B. Chatah, L. E. J. M. Coene, V. Govindarajan, J. de la Herrán, Z. b. Ismail, A. K. Juusela, H. Kobayashi, S. Kolb, R. Msadek, J. A. K. Munthali, A. Mustafa, R. G. Toulmin, L. Tornetta, A. J. Tregilgas, A. H. van Ee, E. L. Walker, Wang C.-Y., B. D. White.

1. GROUP OF TEN - DEPUTIES' MEETING - REPORT BY STAFF

The Economic Counsellor observed that the December 13-14 meeting of the Group of Ten Deputies in Paris had been the latest in a series of meetings on ways to improve the functioning of the international monetary system. The three main topics covered by the Deputies were surveillance, Fund/Bank cooperation, and the role of the SDR.

The Deputies' discussion of surveillance had been based on papers provided by one of the Deputies on two topics: increased publicity in Fund surveillance and enhanced surveillance for debtor countries, the Economic Counsellor continued. The Deputies had examined a number of suggestions for giving greater publicity to Fund surveillance procedures, focusing on the degree to which surveillance documents and conclusions could be better disseminated. Note had been taken of the emergence of enhanced surveillance as provided for in conjunction with the multiyear rescheduling agreement for Mexico; and there had been some discussion of possible application of enhanced surveillance in other situations.

A World Bank staff member had been present for the discussion on Fund/Bank cooperation, which had been based on two papers already reviewed by members of the Executive Board, the Economic Counsellor remarked. On that topic, the views of the Deputies were similar to those of Executive Directors.

For the discussion of the SDR, the Deputies of the Group of Ten had had before them two Fund staff papers on the role of the SDR in the control of international liquidity and in reserve creation as well as two papers put forward by individual Deputies on the role of the SDR in the system, the Economic Counsellor noted. In a wide-ranging discussion, note had been taken of the changes in the international monetary system since the late 1960s and their possible implications for the SDR; consideration had also been given to the contribution to the stability and general functioning of the system that might be expected from the SDR in the near future and in the longer term. The Group of Ten Deputies had agreed to meet again in January 1985 to consider the outline of their report to Ministers, the target date for the completion of which remained June 30, 1985. Some sort of status report was expected to be ready for circulation to Ministers in April.

2. OVERDUE FINANCIAL OBLIGATIONS - EFFECT ON INCOME AND TREATMENT IN FINANCIAL STATEMENTS

The Executive Directors considered a staff paper on the effect on income and the treatment in financial statements of overdue financial obligations to the Fund (EBS/84/231, 11/14/84). They also had before them a six-monthly report on arrears to the Fund (EBS/84/211, 10/11/84; and Sup. 1, 11/16/84).

The Treasurer, updating some of the information provided in EBS/84/231, explained that the World Bank management had very recently changed certain of its procedures for dealing with overdue obligations to the Bank. Specifically, the Bank had decided that loans on which interest payments were overdue by more than 180 days should be considered nonproducing and that the overdue interest should no longer be included in accrued income unless it were judged that it would be paid very shortly thereafter. That decision had already been applied in respect of one member country in the Bank, the relevant amount had been excluded from the Bank's accrued income, and Bank management had decided to use the lower income figure in the prospectuses supplied to underwriters and to the market. Moreover, the Bank was considering whether or not special provision should be made for the principal in the case of the member in question, although no conclusion on that matter had yet been reached. The authorities had flatly stated that they would meet their obligations to repay the loan, and the Bank might find it difficult to adopt an accounting approach that seemed to contradict the stated intention of the member. In general, the position of the Bank seemed to be similar to that taken so far by the Fund: so long as there was no serious doubt about the ultimate collectability of a loan, generally accepted accounting principles suggested continuing with accrual of income; there did not appear, at present, to be any strong reason to depart from those principles.

On the question of publicity on late payments, the Treasurer recalled that different types of reporting on, or publicity of, overdue obligations had been mentioned in the staff paper. One type was the regular disclosure of members' overdue obligations in the Fund's quarterly financial statements whenever the amounts were judged to be "material" to those statements. As of December 14, 1984, total overdue financial obligations to the Fund had amounted to SDR 160.5 million, owed by 11 countries. Of that total, SDR 55.7 million, owed by 4 countries, had been overdue for six months or more, and the total overdue obligations of those same 4 countries amounted to SDR 72.7 million. If it were judged that those amounts were material, then generally accepted accounting principles dictated that the underlying obligations should be disclosed in the notes to the Fund's quarterly financial statements.

Beyond the question of what it was desirable for the Fund to publish in accordance with generally accepted accounting principles was the matter of the Fund's publication policy, under which the Executive Board might decide to go beyond the absolute minimum in releasing information about members' arrears, the Treasurer commented. In that regard, the staff had inadvertently omitted from EBS/84/231 an earlier suggestion to publish in the Fund's Annual Reports any decisions taken by the Executive Board to limit a member's use of Fund resources or to declare a member ineligible to use those resources, as well as any reversal of such actions.

A further issue to be considered by Directors was the possibility of a more "active" policy on publicity, which might lead, for example, to the issuance of a press release should the Executive Board decide to declare a member ineligible to use the Fund's resources, the Treasurer remarked. That matter had come up in an earlier meeting but had not been resolved. In recent discussions on the overdue obligations of Viet Nam, Guyana, and Nicaragua, the Executive Board had expressed its intention to give further consideration to the role that publicity might play in inducing members to settle their overdue obligations and the position that might be taken by the Fund as creditor in order to safeguard its resources.

Mr. Polak remarked that beyond the usual reasons for concern about members' arrears to the Fund, it should be noted that the Fund lost money on two counts as a result of overdue payments. First, it collected a rate of charge lower than the rate of remuneration that it paid and much lower than the rate that it paid on borrowed money. In principle, that loss could be compensated easily by a corrective charge. The Fund also lost money on overdue charges because it did not charge interest on interest; a procedure for compensating that loss would also be welcome, although he understood that it might be difficult to find a remedy consistent with the Articles of Agreement.

On the topics for discussion in EBS/84/231, Mr. Polak agreed that overdue payments required some reflection in the financial statements of the Fund, and he found the proposal in Appendix II to be reasonable in that regard. He could also go along with publication of the same information in the Fund's Annual Reports. However, if the Fund were to begin publishing such information on members, it also must be prepared to move quickly to publish information on more positive developments when they occurred. Decisions to limit a member's use of the Fund's resources also could be published in the Annual Report, although declarations of ineligibility should be more immediately publicized in a press release.

With regard to the use of the Balance of Payments Yearbook and International Financial Statistics as vehicles for publishing information on members' arrears, Mr. Polak considered that the Bureau of Statistics should be closely involved in any decision on the issue at hand. He doubted that it would be appropriate for the Board to give precise guidelines for publishing balance of payments statistics, even if they related to Fund transactions. On balance, he would not wish to go any further than to advise the Bureau that it should not refrain from publishing data on arrears to the Fund that it would normally publish under its general presentational guidelines. It was in any event his understanding that such an approach, in due course, would lead to a reasonable presentation of the information in question.

On the effect of overdue financial obligations on the Fund's income, Mr. Polak agreed with the staff that the appropriate response to overdue charges was not to deduct them from accrued income. A better solution to the problem lay in a higher net income target, which needed increasing in any event. The target for increasing the reserves of the Fund had been set in 1981 when the volume of the Fund's transactions had been very much smaller than at present. Appendix Table 1 in EBS/84/231 showed that the charges estimated to be collected by the Fund in FY 1986 were five times as large as those collected in FY 1982 when the present policy had been decided; of course, the outstanding amounts also would be very much higher. Equally striking was a projection in a recent paper showing that the total of the arrears that might at the end of the decade be owed the Fund by just one country--Sudan--was equivalent to nearly the whole of the Fund's present reserves which were just over SDR 1 billion. He had no doubt in the circumstances that the target for increasing the Fund's reserves should be at least doubled.

Various ways of increasing the Fund's reserves had been proposed in the staff paper, Mr. Polak noted. Formulas 2 and 3 in Table 1 on page 15 were not at all suitable because they made the annual target a function of the size of the outstanding overdue payments, and there were problems with such an approach. The results would necessarily be erratic, depending on the amount that happened to be overdue on a particular date; indeed, the two formulas could lead to no increase in reserves if all arrears were paid off at the time of the calculation. He had no objection to Formula 1, which was not related to overdue payments; nor did he have an objection to a decision to increase reserves arbitrarily without relying on any formula. On balance, however, his preference was for the Executive Board to acknowledge that it had not chosen a good formula in 1981 and to begin searching for a new one that would determine charges directly as a function of, say, the rate of remuneration and that would normally, over the years, produce an adequate addition to reserves. Such a solution had not been possible in 1981, because net income at that time had depended far too much on the level of Fund lending, which was of course always difficult to predict. At present, however, when the SDR interest rate, the rate of remuneration, and the rate of charge had all been brought much closer to the same level, it might be possible to find a more sensible way of determining the rate of charge, which would fluctuate automatically in line with changes in the rate of remuneration if his suggested approach were adopted. He realized that it would be difficult to reach agreement on such an approach, although one protracted discussion that finally produced agreement would certainly be preferable to debates every half year as at present.

Mr. Prowse remarked that the current level of outstanding obligations to the Fund, even taking account of the figures most recently provided by the Treasurer, was comparatively modest in relation to the Fund's total reserves. Moreover, the probability of the Fund having to write off any of those amounts seemed to be slight indeed; hence, the problem of outstanding obligations did not present any significant or immediate threat to the financial viability of the institution. Nonetheless, such obligations should be reported in the Fund's financial statements. As noted by Mr. Polak, some reporting was done already, and the question was only whether it was sufficient. In that regard, any further action taken by the Fund in reporting information on members' overdue obligations should be consistent with existing practice.

The staff had appropriately reminded Directors that some information was published because accounting principles demanded that the institution present a true and fair financial picture of itself, Mr. Prowse noted. On the other hand, it was important to avoid the problems that could be created in the Fund's relations with its members through premature reporting of information, and a balance must be struck, preferably in the adoption of guidelines for the staff's day-to-day operations. He was prepared to accept the idea that the Fund should report overdue obligations late by six months or more. If such a benchmark were to be adopted as the basis for more elaborate reporting, he agreed with the staff that the reporting that was done should comprehend all overdue obligations of members having some obligations in excess of six months.

The more difficult issue covered in the staff paper was how to treat the overdue obligations in the accounting process, Mr. Prowse continued. It would in his view be inappropriate to make special provision for potential ultimate failure of members to discharge their repurchase obligations; and estimates of income that the Fund expected to accrue from members in any forthcoming period should not be adjusted in advance for amounts of expected income loss. Behind that view lay the important principle that the Executive Board should take no action that appeared to promote or condone rescheduling of arrears by members. Also, since the Fund was built in part on the idea that all obligations would be discharged by member countries, he was forced to conclude against any specific provision being made for overdue obligations that were considered noncollectible.

The question was not so much what to do about potential ultimate losses from debtor interest payments as how to deal with income losses in the interim, Mr. Prowse considered. Such losses at present were relatively insignificant; indeed, the staff had estimated that, in fiscal year 1985, the loss resulting from overdue charges and repurchases would amount to only about SDR 3 million. The real issue was whether or not the Fund's targets for income and reserves were adequate in all circumstances, including the emerging but not yet serious problem of overdue obligations. In that regard, of the three options on page 18 of the staff paper, his preference was for the so-called ad hoc approach, which might have the advantage of producing more stability in charges than the application of a formula approach. In adopting an ad hoc approach to income and reserves targets on each occasion, the Executive Board should be fully informed by the staff about the extent of overdue obligations and should be given projections about what losses in income might occur as a result of delayed payments. He agreed with the staff that the existing reserves accumulation target--which had been in place for some time--should be increased should be subject to regular adjustments over time. Not only were the frequency and amount of overdue obligations on the rise, reserves were declining in relation to quotas and to commitments, and there was some degree of uncertainty in the international financial environment.

Mr. Nimatallah observed that the Fund apparently followed internationally accepted accounting principles; and any change in its practices regarding the reporting of information would be justified only if the particular item had a material effect on the operations of the institution, a determination that was largely a matter of judgment. In his view, overdue obligations had become more than negligible in relation to the Fund's income target and to the annual addition to its reserves and were therefore sufficiently important to be reported.

As part of the effort to maintain the Fund's financial integrity and credibility, it was important that news of overdue financial obligations to the Fund should be provided by the institution itself, Mr. Nimatallah continued. The only question in his mind was at what point the information should be published. The staff had suggested publication after an obligation had been overdue for six months, although that might be somewhat late if the objective was to keep the international financial community up to date on relevant information. Besides, given the inevitable lags in publishing the Annual Report or the Fund's quarterly financial statements, the information would become available only a long time after the threshold had been reached and certainly a long time after the arrears had affected the Fund's financial position. In the circumstances, he would prefer to see the relevant information published after three months, an approach that would be consistent with the recently agreed procedure whereby the Managing Director was to circulate documents concerning a complaint no later than three months after an obligation became due. On balance, however, he could go along with a consensus in favor of the staff proposal, so long as improvements in the member's position were reported somewhat more quickly.

A related question concerned how much detail should be published by the Fund, Mr. Nimatallah said. The staff proposal and format suggested in Appendix II in the staff paper seemed reasonable, although he was also willing to give management discretion to report additional relevant facts in individual cases.

The staff had suggested three places--annual reports, the balance of payments statistics, and Fund's quarterly financial statements--in which to publish the information in question, Mr. Nimatallah commented. Those would seem to be sufficient if the objective was simply to place such information on record, irrespective of the circulation of those reports and the currentness of the information. As for what action should be taken with respect to a declaration of ineligibility, his own feeling was that a Board decision on ineligibility without a press communiqué informing the international financial community of that sanction would not be effective. In fulfilling its responsibility to inform the international community of all relevant information concerning its relations with members, the Fund could, of course, where appropriate, provide a brief summary of the latest arrears position of members; but a declaration of ineligibility should be reported more immediately in a press release.

On the extent to which the Fund should take account of overdue obligations in its policies on charges, income, and reserves, Mr. Nimatallah agreed with the staff that the Fund must assume that all overdue obligations would ultimately be collected. Hence, at least for the present, the Fund need not remove unpaid charges from its accrued income or set aside separate provisions against potential default on purchase obligations. However, the Fund should exercise prudence in taking steps to protect itself from the adverse effects of overdue obligations on its income and its financial integrity. There might come a time when it would no longer be realistic to go on treating all unpaid charges as accrued income; and it might also happen that a member withdrew from the Fund without settling its obligations. The Fund had to be ready to protect itself in such circumstances.

The Fund should take account of the total of overdue obligations and their duration in determining the net income target in each financial year, Mr. Nimatallah remarked. Of the three approaches mentioned in the staff paper, he could go along with the idea that, in principle, the net income target should be increased if the total and duration of overdue obligations were to worsen. He had an open mind on the second, more mechanical, approach in the absence of the precise components of the formula. More attractive, perhaps, was the third approach under which the results produced by a formula would be assessed by the Executive Board after account was taken of all relevant circumstances surrounding the setting of a net income target each year.

Mr. Pérez considered that the matter of publicity must be viewed as only one step in the process of dealing with members' overdue financial obligations to the Fund. Once that was accepted, it remained only to determine at what moment in the process the tool of publicity should be used. No less important was the related question of the effects that giving publicity to information on members' arrears to the Fund would have on the relevant countries and on the institution itself.

As a general principle, his chair accepted the fact that publication of information on overdue obligations was necessary, Mr. Pérez remarked. Nevertheless, he could not support the staff proposal to publicize information on those arrears in existence for more than six months; the effects of the tool of publicity were too serious to convert it into an automatic mechanism triggered only by the passage of a certain period of time. In considering whether or when to publish information on members' arrears, Directors should rather focus on the extent to which such action might be helpful or harmful to the Fund's debt collection effort. The Fund's decision to publish information on members' arrears could complicate debt rescheduling negotiations and hamper the attempt of members to obtain additional capital inflows from the financial community.

Another factor to be considered was the Fund's role within the financial community, Mr. Pérez commented. As the arrears problem grew in amount and duration, it could necessitate a change in the accounting principles employed by the Fund in producing its financial statements; in that regard, he understood that the rules already followed in establishing rates of remuneration and income targets demanded that provision be made for developments that could endanger the stability of those variables. Obviously, such provision should be made once the Executive Board had decided to give publicity to some of the overdue obligations. On the other hand, the omission of overdue obligations from the financial statements could create accounting distortions. The determining factor in such an exercise was the "materiality" of the arrears, which in his view made the exercise more one of judgment than the application of clear criteria.

Remarking on the different effects that publication of information on members' arrears could have on the relevant members and on the institution itself, Mr. Pérez observed that the effect on countries was clearly negative; and it was possible that publishing information on the overdue payments situation of those members that had not yet been declared ineligible to use the Fund's resources could seriously affect the integrity and stability of the Fund as well. As noted in the first paragraph on page 7 of EBS/84/231, "the total of the Fund's overdue obligations cannot be regarded as significant in the sense that the Fund in the present circumstances expects that a proportion of the overdue obligations would be uncollectable." If that was true, then the publication of information on those overdue obligations--which might suggest to the financial community that those amounts were uncollectable only could be harmful to the Fund's credibility.

If a country with overdue payments to the Fund were to reach the point at which it was declared to be ineligible to use the Fund's resources, then the Fund should publicize information on those arrears, but it should not publish such information beforehand, Mr. Pérez commented. It was not in his view time to change the guidelines, particularly not on the basis of a comparison with the policies of other institutions. In simple terms, publishing information on overdue obligations was itself an obligation of the Fund as a financial institution; however, given the potential adverse effects of giving publicity to information on members' arrears, such action should be taken only once a member had been declared ineligible to use the Fund's resources.

Mr. de Groote said he agreed that, since the Fund expected ultimate repayment of overdue obligations, there was no need to make specific provisions for the possibility that some proportion of those obligations would not be made or to qualify in any way the amount of income that the Fund expected to accrue in any given period from members.

On the form in which overdue obligations should be reported, it seemed reasonable that publicity should be given in the financial statements to all overdue obligations of six months or more, Mr. de Groote continued. While he was open minded about whether the Fund should report only the total of those overdue obligations or whether it should identify individual member countries, he tended toward the reporting of aggregate data. On the issue of whether to publish Board decisions declaring a member country ineligible to use the Fund's resources, he saw some advantage in employing a two-step procedure whereby the publication would be the second step; such an approach might increase the Fund's leverage with members in the effort to collect arrears.

Just as there did not seem to be any need for making adjustments to the published and audited income statements of the Fund in respect of overdue charges, he saw no need for special provisions in the establishment of net income targets, although account must be taken of overdue obligations in deciding on the rate of charge to be set and on the disposition of net income, Mr. de Groote commented. He was not opposed to following Mr. Polak's proposal to look toward higher reserve targets, although such action should be taken only for general reasons of coverage against risk and should not in any way become a mechanical function of specific overdue obligations. Of course, whatever the reason given for increaseing reserves, the world might well assume that the Fund was entertaining fears about its future financial position. The encouraging of such an assumption would not be appropriate, and caution should therefore be exercised in any discussion of a higher target for reserves.

Mr. Goos recalled that his chair had expressed on more than one occasion its concern about overdue obligations to the Fund, which had been increasing of late at an extraordinary pace; indeed, as he understood it, total outstanding obligations to the Fund had virtually doubled in the course of 1984. In that respect, the amounts must be regarded as "material" in both the accounting sense and with respect to the Fund's responsibilities vis-à-vis the international community. It followed from that view that overdue obligations must be taken into account in the Fund's financial statements and in its policies on income and reserves.

The possibility of inflicting harm on Fund members and the Fund itself through inappropriate reporting of information on members' arrears should be resolved in the first instance by the establishment of a time period beyond which it was clear that overdue obligations were no longer caused merely by technical or administrative difficulties, Mr. Goos continued. As a supplementary measure, even earlier reporting could be triggered if the amounts in arrears were particularly large. Concealing information on outstanding obligations beyond a critical time period or amount would probably do more harm to the institution than would reporting of that information. Of course, there might be drawbacks for individual members if information on their arrears to the Fund were to be published, but the overriding objective should be to protect the integrity and credibility of the institution as a whole.

Remarking on the topics for discussion in EBS/84/231, Mr. Goos considered that all overdue obligations of members that were late by six months or more should be included in the notes to the financial statements of the Fund and should be broken down by debtor and by category of payments. Also warranted was the reporting of overdue obligations in the financial statements before the cutoff period of six months was reached if the amounts involved were considered significant. In that respect, the problem of determining what was significant could perhaps be resolved by establishing a critical relationship between the size of overdue obligations and the size of the targeted addition to reserves. It was true that, by introducing too short a reporting period, the Fund might run the risk of premature reporting of short-term delays; however, that risk would appear negligible with the establishment of a minimum period of three months, during which time the Board should formally have received the complaint of the Managing Director on the overdue obligations. On balance, if the additional consideration of the size of the overdue obligations should appear too complex or cumbersome to his colleagues, he could go along with reporting all obligations, regardless of their size, whenever there were delays of three months or more. In addition, for reasons given by the staff, he was in favor of publishing aggregate information on all obligations to the Fund, including outstanding purchases that were not yet due.

For the time being, there was no need to make special provision in the Fund's income statements for overdue payments, Mr. Goos remarked. By continuing with present practice, the Fund would clearly underline its expectations that all overdue obligations would be settled with the shortest possible delay; any premature correction of the Fund's income statements could turn out to be counterproductive by weakening members' efforts to make timely settlements.

In setting its net income and reserve targets, the Fund should adopt an approach that provided it with flexibility to consider all relevant aspects, including the overdue obligations of members, Mr. Goos said. Such an ad hoc approach would also avoid the impression that the Fund considered overdue obligations as a permanent problem that called for permanent guidelines; in that respect, he would advise against the adoption of any formula approach, although he saw some merit in an agreed formula, inasmuch as it might help avoid difficult and protracted discussions at a time when the income target was to be established. On balance, he could go along with the combined approach if there was a consensus in favor of that solution. As to the extent to which the income target should be corrected, care should be taken to avoid inconsistency with the approach followed in the financial statements. He would have no difficulty if the income targets were to be increased by the amount of income lost, including anticipated losses; however, stress should not be placed on the uncertainties surrounding the ultimate collectability of such payments, since consistency might then require corresponding adjustments in the Fund's income statements.

It had been observed by Mr. Polak that adjustments directly related to income actually lost could lead to erratic fluctuations in charges, Mr. Goos noted. He would welcome staff comment on that matter; and he would go along with any solution that would eliminate that undesirable effect so long as some relationship to actual income lost was maintained. One possible solution might be to increase the general reserves target, which he also considered to be on the low side.

He agreed with the staff and others that circulating press releases or using other special forms of "active" publicity as soon as obligations became overdue did not seem advisable, although a press release should be published in all cases when members had been declared ineligible, Mr. Goos said. He felt strongly that overdue obligations should be reported on a regular basis in the Fund's Annual Report and in its balance of payments statistics, reporting that would be in conformity with the Fund's obligation to present a fair and accurate picture of its relations with members and should encourage members to discharge their obligations to the Fund in a timely manner. Moreover, the establishment of time limits for triggering the reporting of information on members' arrears should be consistent with what was decided with respect to reporting in the notes to the Fund's financial statements. Beyond that, he could agree with the suggestions in EBS/84/211, including the proposal to mention complaints by the Managing Director and subsequent Board action on those complaints in the Annual Report. Finally, he continued to be interested in a review of the possibility of introducing penalty charges for members in arrears to the Fund and hoped that a staff paper could be circulated as the basis for a discussion of the matter.

Mr. Zecchini remarked that Directors were faced with two different questions concerning the problem of overdue financial obligations to the Fund. The first related to the forms of publicity that should be given to overdue obligations; the second pertained to the negative impact of arrears on the Fund's net income.

In considering the form and extent of publicity that should be given to overdue obligations to the Fund, Directors must first distinguish between publicity of information on arrears that was required under accepted accounting principles and more "active" publicity that might as a matter of policy be given to information on the arrears of individual members or to certain Board decisions, such as the decision to declare a member ineligible to use the general resources of the Fund. Information under the first type of publicity should be published if that information was considered significant or "material," while agreement on more active publicity should take account of the deterrent effects that such publicity might have on the attitude of countries toward incurring overdue obligations to the Fund.

Total overdue obligations represented, according to the data included in the staff report, over 300 percent of targeted net income for fiscal year 1985 and 9.25 percent of the Fund's reserves, Mr. Zecchini continued. Moreover, the negative impact of overdue obligations on the Fund's net income was estimated at SDR 3 million, which was equivalent to around 10 percent of the net income target. Against that background, the reporting of overdue obligations seemed necessary in order to give a precise picture of the Fund's financial and income position. As most delays in payments lasted only for a short period of time and were due mainly to administrative reasons, an effort should be made to avoid premature publicity of information on arrears; rather, overdue obligations should be reported only when member countries had not been current for prolonged periods. In that respect, he could support the suggestion to report all overdue obligations that had been late by six months or more. Also, no reporting should be made until the Board had taken a decision of substance on a complaint, because there might be exceptional cases calling for a waiver or cases in which the Board might decide to reschedule purchases. Following the changes in procedures recently approved by the Executive Board, substantive consideration of a complaint by the Managing Director should take place within the outside limit of six months.

Remarking on the extent of detail that should be published, Mr. Zecchini said that individual countries with arrears might be specified, including the amounts due. He also favored giving more active publicity--perhaps in the form of a press communiqué--to certain decisions of the Executive Board. The threat of such publicity could be a useful deterrent to the incurrence of overdue obligations; however, given the possible negative effects on a country's credit rating and reputation, he could support such an approach only when a country was declared ineligible to use the general resources of the Fund. In such a case it was important to report not only the declaration of ineligibility but also the amount of the arrears, the period during which obligations had been overdue, and the main measures taken by the Fund before the declaration of ineligibility.

With regard to the impact of overdue obligations on the Fund's net income and reserve position, Mr. Zecchini stated that all overdue obligations would eventually be met; there was no need to set aside special funds against any failure to meet those obligations. However, overdue payments could affect the Fund's net income and should be taken into account in the review of the Fund's income position, perhaps by making an estimate of the expected shortfall due to the overdue obligations and including it in the calculations of the appropriate rate of charge needed to obtain a given net income. He could also go along with the idea that the 3 percent net income target rate might be adjusted to take account of the rise in overdue payments, even though it was generally believed that overdue obligations would eventually be discharged.

Of the alternatives described in the staff paper for adjusting reserve targets, his preference was for the so-called "combined approach," Mr. Zecchini commented. The "formula approach" alone was too rigid in his view, and the "ad hoc approach" needed to be supported by some quantitative reference point in order to avoid any misuse of discretionary powers. The optional formulas outlined on page 14 of EBS/84/231 all yielded results that depended heavily on the size and duration of overdue obligations at the time of the calculation, elements that were not very predictable; even the third proposed formula--which was the one that would achieve the smallest percentage growth in the income target for 1985--added to the estimated shortfall in projected income 100 percent of all overdue charges plus one third of overdue repurchases for members having overdue obligations in excess of six months. Such an approach did not seem to be consistent with the argument in the report that most delays in payments were due to administrative difficulties and lasted for only a short time, and that there did not seem at present to be a significant probability of nonpayment. Consequently, smaller increases to the 3 percent target rate than those stemming from the proposed formulas could be envisaged.

Finally, Mr. Zecchini observed that, as projected, net income for FY 1985 of SDR 34 million considerably exceeded the net income target of SDR 10 million. Perhaps it would be better to refrain at present from any action in relation to the current fiscal year and to wait until April when the final figures for FY 1985 would be available.

Mr. Wicks considered that two basic principles should be kept in mind in dealing with the issue of publicity. First, the published financial statements of the Fund had to give a "true and fair view" of the institution's financial position, particularly, to those who voted the finance necessary for it to carry out its functions. Second, Directors should be conscious of the key role currently played by the Fund in mobilizing finance from other sources. That role imposed a responsibility to make available information which might be material to assessments of the creditworthiness of members by banks and others. He could go along with the view that reporting of arrears in the Fund's financial statements should be limited to obligations overdue for six months or more and should include the arrears owed by each member. He could also accept that similar information should be published in the Annual Report and in the Balance of Payments Yearbook. On the other hand, he noted that some other institutions reported arrears in their financial statements after only three months; like Mr. Nimatallah, he wondered whether a shorter reporting period in the Fund would not be preferable.

The identification of individual members in arrears would be helpful, Mr. Wicks commented. Indeed, it might encourage members to settle their overdue obligations to the Fund. More important, perhaps, the Fund had some responsibility to provide such information to other creditors, particularly banks, not only because of the Fund's role in arranging financing packages but also to avoid unfounded inferences by creditors about those members that were current in their payments to the Fund.

With regard to the more difficult question of possible adjustment to the Fund's accounts, Mr. Wicks noted on page 11 of EBS/84/231 that no adjustment should be made to the accounts for overdue charges mainly because "the Fund expects that all overdue obligations will be discharged by member countries." However, on page 14, the staff had noted the reasonableness of raising the reserve target and had suggested that adopting such an approach "would be a prudent acknowledgement of the uncertainties created for the Fund by overdue payments." The failure of the staff to reconcile those two ideas was confusing, not least because the staff had based its view that the income statements of the Fund should not be adjusted on account of accrued but unpaid interest charges on its reading of a passage in the relevant accounting standard that suggested that debts should be counted as revenue if it was not unreasonable to expect their ultimate collection.

The point was not so much whether members would honor their obligations as when they would do so, and it was fair to say that the answer to that question was uncertain, Mr. Wicks continued. In his view, the Fund should make some prudent acknowledgement in its income statements to reflect that uncertainty, and one such acknowledgement would be a decision not to accrue as income members' obligations that were, say, 180 days overdue. He advocated such an approach not because it was analogous to a decision recently adopted by the World Bank but because he frankly doubted whether the authors of the accounting standards employed by the Fund had in mind the position of the Fund and the unpaid obligations by its members when they had established those standards; surely they must have had in mind the position of a commercial body in which legal processes could be brought to bear for the collection of unpaid payments. The Fund was unable to pursue the sort of legal course of action open to other creditors and, while members' overdue obligations to it might ultimately be paid, circumstances were such that repayment might not be received for a very long time. Hence, prudence suggested that the Fund should not pretend in its financial statements that it was in fact receiving income when it was unclear when that income would be received; and if the Fund were going to make a change in its accounting policies, the time for change should be when the problem of overdue obligations was relatively small.

If the approach he had suggested were to be adopted, many complications would fall away, Mr. Wicks commented. The basic issue would then be a simple matter of whether or not the 3 percent target was adequate in the new circumstances. He himself had some doubts about the adequacy of the 3 percent figure, which should be reviewed. He would much prefer changing it rather than making specific provisions for late payments. In sum, therefore, he could agree to the recommendations for greater publicity of members' overdue obligations, but he could not accept the staff's views on accruing income in the Fund's financial statements. Unpaid charges should be accounted for as deferred income but not put to accured income at the time, while overdue repurchases should be dealt with through the reserves.

Mr. Kafka stated that his views were identical to those of Mr. Pérez and Mr. de Groote. Whenever the volume of overdue obligations was considered "material," those obligations should be reported, but he believed that the Fund should be worrying only about obligations overdue for six months or more. In addition, the initial reporting of such overdue obligations should be done in aggregate; individual countries and their arrears should be mentioned only after the member's failure to meet several due dates.

Reporting of information relating to members' arrears should appear only in the Fund's official periodic publications, Mr. Kafka continued. There should certainly be no effort to give special publicity to such information; in fact, the Fund should not be seen as attempting to call attention to something that by itself was already unfortunate, especially when such an approach would probably not help very much in collecting the amounts in question. The same principle should apply to a declaration of ineligibility; and, in any event, there should be no publicity of any kind before the matter had been discussed and decided upon by the Executive Board. Finally, there was no need in his view for making special provision for debts or for adjusting income statements in a way that would suggest that the amounts were uncollectable. As for the adjustment of the Fund's net income target, the ad hoc approach mentioned on page 18 was preferable, although he was cognizant of the technical advantages of Mr. Wicks' formula approach.

Mr. Fujino remarked that he could generally endorse the staff's suggestions on the issue of reporting in the Fund's quarterly financial statements and balance of payments statistics. Like others, he preferred to work on the assumption that, ultimately, no overdue obligations would be uncollectable; however, in order to maintain the integrity and credibility of the institution, its financial statements always should paint a fair picture of the financial position. Outstanding overdue obligations at present were by no means insignificant in relation to the target for net income and the growth of reserves. In the circumstances, at least the aggregate amount of obligations overdue by six months or more should be reported in the financial statements. While care should be taken not to exacerbate the difficulties of individual members through premature disclosure of information on their arrears, it would seem reasonable to assume that the international financial community would already be well aware of the identities of those countries with financial obligations to the Fund overdue by six months or more. Moreover, if it was decided that information on members in arrears for six months should be reported in the Fund's financial statements, the further reporting of the identity of such members in other publications should not exacerbate their financial difficulties.

Some steps should be taken to safeguard the financial position of the Fund from the adverse effects of overdue obligations, Mr. Fujino considered. Delays in discharging obligations led to a loss of interest for the Fund; in addition, if repayments of principal were delayed, the financial position of the institution could be threatened, particularly if all obligations were on a rising trend.

If the problem of overdue obligations were to persist, it might be desirable to seek a somewhat faster accumulation of reserves than the normal 3 percent target, Mr. Fujino noted. While he had no strong views regarding a specific approach to adjusting reserve targets, he believed that any method chosen should be flexible. He preferred Executive Board discretion combined with a reasonable formula. Also, he could support the request of Mr. Polak, Mr. Goos, and others for a more detailed staff look at the issue of penalty charges.

Mr. Dallara commented that in their ongoing consideration of the problem of arrears and the appropriate response of the Fund to it, Executive Directors should continue to be guided by two general principles. First, because the Fund played a unique role in the international monetary system, it must adopt and follow practices that were fully transparent and that promoted and maintained confidence in the Fund. Second, because the growth in arrears was a serious matter that was fundamentally inconsistent with the basic purposes and operations of the institution, Directors should understand that it fell to the Board and management to ensure that Fund practices reflected the financial effect of the problem and the concern with which it was viewed.

The Fund did not at present take into account overdue obligations in the financial statements of the General Department, Mr. Dallara continued. In part, that choice reflected the general expectation that all members would fulfill their responsibilities to the Fund and would discharge their financial obligations on time; it also reflected the long-standing experience under which Fund members had generally met their obligations in a timely fashion. However, it was clear from the most recent six-monthly report on overdue obligations to the Fund (EBS/84/211, 10/11/84) that outstanding arrears had increased threefold over the course of 1984. In such circumstances, past experience might no longer be a fully appropriate guide to future action, and he noted the recent changes in World Bank policy for dealing with overdue obligations.

He recognized that public disclosure of information on arrears of individual members could have important consequences, Mr. Dallara remarked. Care must therefore be taken in order to avoid creating unnecessary complications for the Fund or for its members individually. In that context, he could support the staff's proposal to include in the notes to the quarterly financial statements a listing of all members with prolonged arrears, including an indication of the amount of arrears associated with each member. He understood that arrears also would be referred to in the Fund's Balance of Payments Yearbook and IFS. He saw no compelling reason to wait until obligations were overdue by six months or more before publishing information on them in the quarterly financial statements. In fact, a more appropriate trigger for disclosure should perhaps be the Managing Director's issuance of a formal complaint, which occurred within three months after the arrears problem emerged. His judgment on that matter was influenced in part by the fact that the decision to issue a complaint under the guidelines established by the Executive Board clearly reflected concern regarding the magnitude and duration of the arrears. And the issuance by the Managing Director of a formal complaint could therefore be viewed as analogous to a judgment, in an accounting sense, that the arrears were "material." Accordingly, he joined other Directors in supporting Mr. Nimatallah's proposal to include in the quarterly financial statements arrears data by an individual country on all members with financial obligations overdue by three months or more.

On a related matter, Mr. Dallara expressed an interest in knowing how the staff proposed to treat cases in which a member had been in arrears on a continuous basis for more than three months--or for more than six months if the Board decided on the longer period--but without any individual obligation being in arrears for that length of time. That issue had been raised in connection with discussion of EBS/84/211, and he would welcome any new thought that staff or management might have on the matter.

The existence of arrears in effect meant that the Fund's reported income and reserves were somewhat overstated, Mr. Dallara observed. Such an overstatement could contribute to a misleading impression of the Fund's overall financial position; hence, consideration should perhaps be given to placing charges that were in arrears for more than three months on a nonaccrual basis. He was motivated by concerns similar to those expressed by Mr. Wicks, and he did not believe that a judgment to place income or charges on a nonaccrual basis would necessarily have to rest on a judgment that said charges were uncollectable. After all, there was a distinction between the determination that a debt was ultimately uncollectable and uncertainty regarding the timing with which the obligations would be discharged. It was on the basis of concern for the latter that he could support Mr. Wicks' approach, although his preference was to put those charges on a nonaccrual basis that related to obligations in arrears for more than three months, rather than six months as suggested by Mr. Wicks.

The treatment of overdue repurchases in the balance sheet was somewhat different from the treatment of overdue charges; and he could not accept that overdue principal should be placed on a nonaccrual basis, Mr. Dallara continued. It might be necessary at some point, and in certain cases, to adjust the Fund's assets, although any decision that might ultimately be taken regarding the placing of charges or principal on a nonaccrual basis should not be seen in any way as relieving the member of its obligations; nor should it be viewed as a statement by the institution that it no longer expected the asset ultimately to be discharged.

One financial implication of the current treatment of arrears in the Fund's financial statements was that the levels of income and reserves were not as high as they might appear, Mr. Dallara said. A certain proportion of income and reserves was accounted for by accrual of past interest that had not actually been paid; moreover, the Fund was projecting future income on the basis of assets that it did not in fact currently have. At a time when the Fund's reserves could be viewed as relatively low for a financial institution the size of the Fund, it would seem both prudent and desirable to increase reserves to take care of the problem. Of the various approaches to increasing reserves outlined in the staff paper, his own preference was for the formula approach. An ad hoc approach could invite some confusion and inject a degree of uncertainty in the exercise that would not necessarily be helpful in promoting confidence in the Fund's financial position. Of the three possible formulas presented in the staff paper, he could generally support the third, although he recognized that it might lead to erratic changes in reserve targets. On a technical matter, it was not entirely clear whether, if Mr. Wicks' suggestion regarding nonaccrual of charges were to be adopted, it would still be appropriate to include, in Formula 3, 100 percent of the overdue charges. It was also not clear on what basis it was proposed to select one third of overdue repurchases. On balance, he could support an amendment to Formula 3 that would adjust for 100 percent of the arrears on repurchases, although he would be interested in knowing what the financial implications of such a formula might be, based on current circumstances.

If the Board did not wish to adopt Formula 3, or a modified version of it, he could go along with a more general approach, although some link to the actual existence and amount of arrears would seem to be desirable, Mr. Dallara commented. He wondered whether the problem could partially be resolved under a formula approach by basing calculations on the average level of arrears rather than on a "snapshot" of the problem of arrears at a particular point in time.

Some more active publicity of information on members' arrears could augment the disclosures outlined in the Fund's financial statements and might serve a useful purpose, although such publicity should be handled carefully and should not be too frequent, Mr. Dallara considered. He joined other Directors in supporting a Board decision to issue a press release on any occasion when the Board had formally declared a member ineligible to use the Fund's resources. Ideally, that press release should indicate the size and duration of the arrears that had led to the declaration and should carefully explain the legal ramifications of the decision.

Mr. Joyce said that he favored as full disclosure as possible of information on members' arrears as the best way to preserve the credibility of the institution. Also, such disclosure could have a chastening effect on the countries concerned and on the Fund itself. Overdue obligations might at present appear relatively small, but they were by no means negligible and could grow substantially in future. Indeed, the present and prospective size of the problem of arrears in relation to either total reserves or net income targets suggested that the level of overdue payments was sufficiently "material" to justify some greater disclosure in order to permit the financial statements of the Fund adequately to reflect the institution's true financial position.

In accepting the staff's recommendations on disclosure, his chair tended to agree that short delays in payments should not be made public, Mr. Joyce continued, although the appropriate period for triggering such disclosure was not easy to determine. Procedures in the World Bank and in the commercial banks would suggest a period of three months, and a number of Directors--including Mr. Nimatallah, Mr. Wicks, and Mr. Dallara--had expressed themselves in favor of disclosure of obligations overdue for three months or more. However, procedures in the Fund at present provided for discussion by the Executive Board of the substance of a complaint by the Managing Director within five months of the obligation falling due and, in any event, not later than six months. Board consideration should precede the listing of a member, and that listing should not occur automatically when the Managing Director issued a notice of complaint. Hence, reporting should begin whenever a member had arrears that exceeded six months. Also, he could agree that all arrears with a member that had at least one obligation overdue by six months or more should be included in the disclosure. In that respect, members should be identified individually as a way of preventing uninformed speculation--about which members were heavily in arrears--that could damage members that had been making an effort to keep up with their payments. The fact that full disclosure would be made once any arrear had been overdue by more than six months could provide additional incentive for keeping payments up to date. In passing, he considered that the practices being suggested for the Fund's financial statements should be applied to the Annual Report and the Balance of Payments Yearbook as well.

The approach to overdue obligations must be based on the assumption that payments would ultimately be made, Mr. Joyce continued. He was not in favor of making special provision for those payments or of moving away from the present practice of accrual accounting; however, he remained uncertain about how allowance should be made in income targets and the setting of charges for the undeniable risk of extended nonpayment of some of the arrears. The system of targeting small reserve increases had been developed in the belief that such increases were an indication of sound financial practice and because the system would protect the Fund in the event the institution operated at a loss for a time. In that regard, and in considering the appropriate response by the Fund to the worsening arrears situation, it was the overall reserve level rather than the increase in the level of reserves in any given year that needed to be reviewed. In his opinion, the appropriate level of reserves and the implications for annual income targets probably should be examined at the time of the next yearly income exercise in May, in the context of the overdue obligations existing at that time. Such an approach would allow the Fund to take account of improvements that might have taken place by then in the stock of overdue payments; for the moment, the existence of overdue payments was additional reason for not lowering the rate of charge. More generally, he was in favor of an ad hoc approach to adjusting the next income target and charges to deal with overdue payments. Finally, he strongly could support Mr. Polak's proposal to look at the possibility of levying corrective charges to offset lost income due to unpaid charges on purchases from the Fund.

Mr. Abdallah, stating that his chair was opposed to some of the suggestions put forward by the staff, noted that the relevant aggregates in any consideration of the "materiality" of overdue obligations to the Fund were the Fund's operational income from periodic charges and the level and growth of reserves. Overdue charges and purchases were directly related to, and were an integral part of, periodic charges that constituted the Fund's operational income and balances pursuant to repurchases. The updated information on overdue obligations provided by the staff at the beginning of the meeting indicated that such obligations represented less than 0.5 percent of the total outstanding repurchases in fiscal year 1985. It was thus obvious that overdue obligations to the Fund, as important in principle as they might be, were not of material significance and therefore should not be referred to in Fund financial statements.

Another consideration stressed by the staff was the role of the Fund and its responsibilities to provide appropriate and accurate information on its financial position as well as on its transactions with members, Mr. Abdallah observed. He joined others in believing that all overdue obligations to the Fund ultimately would be repaid, even if the time of repayment remained uncertain. In that respect, the disclosure of such members' obligations could undermine the credibility and integrity of the institution. The Executive Board was already giving considerable attention to the incidence of overdue obligations and had adopted policies and practices that should help to reduce or avoid them; since members were kept up to date on the subject, publication in the financial statements would not be particularly informative.

He was concerned about the Fund's responsibility in making available information on its financial relations with members to the general public and to the international community, Mr. Abdallah said. He was uncertain whether it was in fact the responsibility of the Fund to disclose information on arrears to the international community and about the extent to which such action was consistent with the principle of confidentiality that governed the Fund's relations with its members. Besides, such disclosure might affect members' willingness to make information available to the Fund in the first place, and premature disclosure of information or of immaterial items could cause damage not only to members but also to the institution itself. It was his understanding that even commercial banks were reluctant to disclose information on their financial operations and transactions with their customers.

In general, moreover, practices of other major public financial institutions, while not uniform, did not seem to support publication of detailed information on overdue obligations, Mr. Abdallah commented. In cases where arrears had been mentioned, the reference had either been in the form of a general statement--the approach adopted by the Inter-American Development Bank--or the amount shown had been aggregated, as was done in the World Bank. He was not convinced by the argument that consistency of approach to reduce overdue obligations would require publication of those obligations in the Annual Report and the balance of payments statistics. It was not clear how such publication would help to reduce the overdue obligations, particularly in those cases where the cause of failure to repurchase was an inability to pay and nonavailability of foreign exchange rather than an unwillingness to pay. In sum, his chair was opposed to the recommendation to publish or report on all obligations overdue by six months or more because such reporting would serve only to exacerbate an already difficult situation for members.

On the assumption that all overdue obligations would ultimately be settled, no adjustment needed to be made to the published income statements for overdue charges and no deductions from income or provision for losses due to ultimate failure to repurchase obligations seemed called for at present, Mr. Abdallah said. Furthermore, given the relative insignificance of the total of overdue obligations in quantitative terms, no adjustment in Fund charges, the net income target, or the rate of reserve accumulation seemed warranted. Most delays lasted for only a short period and were caused by technical and administrative difficulties. While overdue payments lasting longer might have increased recently, reflecting the difficult economic and financial situations facing some members, the arrears were small in amount and their impact on the Fund's income and level of reserves was negligible. In the circumstances, he could not support the proposal to make provision for overdue obligations in the Fund's net income or to accelerate the rate of reserve accumulation.

Mr. Ramtoolah considered that a key question in the present discussion was whether, in light of the evolution of overdue obligations to the Fund, there needed to be a change in the institution's policy on reporting those obligations; if so, the extent and nature of such reporting would need to be reviewed. He was cognizant of the importance that should be attached to ensuring that the Fund abided by accounting principles consistent with the highest standard of the profession; however, it should not be forgotten that the Fund was a cooperative institution, one purpose of which was to help member countries facing temporary difficulties that could vary in nature and severity. Those difficulties could at times force members to be less punctilious than they would otherwise like to be in their relationship with the Fund. Therefore, in deciding on the extent of publicity to be given to overdue obligations to the Fund, Executive Directors should look not only at the amount of those obligations; other aspects could be equally important.

Even if consideration were given only to the amount of the overdue obligations, it would be seen that the level of arrears was minuscule in relation to the Fund's operational income, Mr. Ramtoolah remarked. He supported the note of caution sounded in paragraph 2(d) on page 16 of EBS/84/231 regarding "the disclosure of immaterial items or...premature disclosure." The dangers of premature disclosure could be illustrated clearly in the recent case of a country that had an institutional relationship to a regional organization. Because of that relationship, certain procedures had had to be followed before the problem of the member's arrears to the Fund could be resolved; and it would have been unseemly if the Fund had reported in any detail on that member's arrears while the authorities had been working to meet their obligations. He was opposed to the recommendations in paragraph 3 on page 17 of EBS/84/231; however, he would go along with the consensus if a majority of Directors wished to give publicity to information on arrears overdue by more than six months, provided that the names of individual member countries were not revealed.

He could not accept the idea that any agreement on the reporting of overdue obligations would have a direct bearing on the issue of "what steps the Fund should take regarding overdue obligations in determining its policies on charges, income, and reserves", Mr. Ramtoolah continued. The determination of those steps was part of a complex process and demanded further study before any conclusions were reached. In particular, the Fund should immediately reassess its policy on charges on the basis of EBS/84/231. Finally, if the staff's views concerning the ultimate collectibility of overdue payments to the Fund were correct, he could not understand why a significant departure from past policies was being recommended.

Mr. Vasudevan considered the present discussion to be significant because it heightened the need for furthering the cooperative spirit of the institution and because it could lead to the adoption of accounting practices that were obviously quite different from those employed in the past. Overdue financial obligations to the Fund had thus far been limited in amount and confined to very few members. Moreover, they were "not large in relation to the Fund's operational income or the total of repurchases due from members." In fact, if large amounts of arrears by one or two members were considered as exceptional cases, the total of overdue obligations to the Fund would be very small indeed.

So far, the financial statements of the General Department had not reported members' arrears to the Fund, with one exception, Mr. Vasudevan continued. The staff had argued that the appropriateness of disclosure in the Fund's financial statements of information on members' arrears should be viewed against (a) the position of the Fund as a major international financial institution with responsibilities to inform its members and the public of its activities; (b) the consistency of such disclosure with decisions adopted or with views taken by the Fund in the past; and (c) the assurance that the disclosure was "in accordance with appropriate accounting principles and reporting standards." The latest opinion from the auditors was that the Fund's financial statements were indeed in accordance with accepted accounting principles and gave a true and fair picture of the Fund's financial position. Since the Fund could not be accused of not informing its members and the public of its activities, the appropriateness of disclosure must be judged only on the basis of the extent to which such action was consistent with past decisions and views. Unfortunately, the staff paper provided no rationale for the actions taken in the past; and the staff seemed to have avoided the logic of its own argument in suggesting that disclosure was appropriate when it was judged that the arrears in question were material. The staff went on to say that the materiality of data should be assessed "taking into account its (the Fund's) purposes, policies, and operations."

If the purposes, policies, and operations of the Fund had indeed been taken into account by the staff, he would have been happy, Mr. Vasudevan continued. In the end, however, the staff had chosen only a few financial magnitudes to define materiality. It had stated correctly that the total overdue obligations were not large in relation to the Fund's operational income or in relation to the total of repurchases due from members, but it had gone on to argue that it was perhaps more important that overdue obligations should be viewed in relation to the Fund's targeted net income and growth in reserves; yet, the staff gave no indication of why those targets were appropriate bases for evaluating the importance of overdue obligations. Overdue obligations were ex post data, while the targets for net income and reserve growth were policy determined; clearly, it was improper to relate an ex post magnitude to a desirable magnitude. Since the previous audit, accounting practices had not changed to the extent that they would necessitate the inclusion of overdue obligations in the financial statements of the General Department; hence, he failed to understand how arrears to the Fund could influence decisions on the Fund's net income target and the rate of charge, especially when it was known that such arrears were not significant and were limited only to a few members. Besides, given that the arrears were considered ultimately to be collectible, they should be viewed as potential repayments rather than as losses.

In three recent cases of overdue obligations, the Fund had acted in a manner behooving the grace and dignity of the Executive Board, Mr. Vasudevan considered. The procedures adopted seemed sufficient to meet a problem that had arisen at the time of widespread hardship but that was likely to diminish significantly with the anticipated economic recovery. The staff was currently proposing that information on members' arrears should be published in the Fund's Annual Report and other relevant publications in order to strengthen those procedures. He failed to see any relationship between publication and the strengthening of procedures to alleviate the arrears problem. also, it had been suggested that a breakdown--by category of payment and debtor--of obligations overdue for six months or more "may be thought significant for judging the Fund's net income position and the level of reserves." The staff had gone on to say that "it might be considered appropriate if it (the Fund) were to identify individual member countries that are in arrears in the interest of helping a reader of the Fund's financial statements to form his own judgment on the Fund's financial position." He found it difficult to accept the logic of the first statement and observed that the noble intention of the second would in practice be offset by placing countries in arrears in an unfavorable light. Detailed publication of information on members' arrears would in his view split the membership into "bad boys" with overdue debts to the Fund and "good boys" who met their obligations on time. His chair believed that publication of information on members' arrears to the Fund would not cure the problem; it would only place the concerned member in a more difficult situation.

He had noted with satisfaction the staff's view that, in accordance with generally accepted international accounting principles and the Fund's experience, no adjustment should be made to the published and audited income statements of the Fund for overdue charges, and no deduction for income should be made and specially set aside against potential ultimate failure to discharge repurchase obligations, Mr. Vasudevan remarked. He believed that overdue obligations were not significant and were ultimately collectible; and, as such, they did not place the Fund's financial position at risk. At worst, such arrears reduced the amount of credit that could be given to other members until the arrears were paid. It might be improper, both on grounds of accounting and of logic, to consider the total and duration of overdue obligations to the Fund as the basis for determining the net income target; and it would be particularly inappropriate to base the net income target on projections of arrears, which could easily be inaccurate. He wondered whether the various methods outlined on pages 13 and 14 for setting the income target had been based on the projections of overdue obligations in Appendix Table 1 of the staff paper. Those projections, which had been based on estimated use of Fund resources in FY 1985, were clearly on the high side and should be revised in light of the actual data through October 1984 shown in the paper on the midyear review of the Fund's income position (EBS/84/235, 11/19/84). Assuming the outcome for the remainder of the year did not change significantly, the projections for overdue obligations in FY 1986 could be lowered, which meant that income estimates could be increased. In the circumstances, it would seem unnecessary at present to consider any of the approaches outlined by the staff for adjusting the reserve target of 3 percent to take account of overdue payments. Of course, the situation should be kept under review in case overdue obligations were to increase substantially in future, at which time appropriate action could be taken.

Finally, noting Mr. Polak's proposal to re-examine the bases for determining charges and the net income target, Mr. Vasudevan remarked that he could not go along with any proposal to increase charges. Even at present, the methodology for determining charges on a residual basis placed the entire burden of ensuring appropriate increases in reserves on the borrowers. That burden was highly inequitable in his view. The reserves of the Fund should be of concern to, and the responsibility of, all members, borrowers and nonborrowers alike.

Mr. Tvedt agreed with those who felt that the procedures for dealing with overdue payments needed strengthening and that publication in the Fund's financial statements of information on members' arrears would be appropriate. In general, the Fund should report on the extent of overdue payments, provided the reporting was done in such a way that it was not possible to infer which countries were in arrears to the Fund. However, if it was agreed not to reveal the overdue obligations of individual countries, even relatively short-term arrears should be reported in the financial statements. Of course, after due consideration, the Board should be free to provide information on the arrears of individual members when such cases were deemed to be exceptionally serious.

He agreed that increasing uncertainty about the timing of the payment of overdue repurchases and charges should in principle demand a higher level of reserves, Mr. Tvedt continued. However, even though the risk of uncollectible debt was considered to be greater than in the past, it nonetheless remained quite low; and the situation at present did not call for any change in the procedure for determining the rate of reserve buildup. An automatic rule for adjustment in the reserve target could jeopardize stability and might reduce opportunities for the Executive Board to weigh the desire to build up reserves against other objectives.

Mr. Wang considered that the Fund should refrain from disclosing to the general public information on members' overdue obligations to the Fund. Since the aggregate level of arrears to the Fund was at present small in absolute amount and in relation to the Fund's operational income and the total of repurchases due from members, he was by no means certain that the arrears were uncollectible. Moreover, relatively few members were in arrears to the Fund, and the individual amounts were not so significant that publicity about them was called for.

Since the arrears problem involved sovereign countries rather than commercial enterprises, great care must be taken in addressing it, Mr. Wang considered. Any premature publication of information or reporting of immaterial items could damage the image of member countries and pose problems for them. Hence, except on the basis of Board discussion of individual cases, it would seem inappropriate to include information on overdue obligations in publications like the Annual Report and the Balance of Payments Yearbook.

Another issue raised in the staff paper concerned how overdue payments should be taken into account in determining the Fund's net income target, Mr. Wang noted. While he was not opposed to giving serious consideration to that issue, it seemed premature to take action on the matter at the present stage.

Mr. Finaish stated that he was in broad agreement with the staff on the considerations which needed to be taken into account in deciding on the matter of reporting information in the Fund's financial statements on members' overdue obligations to the Fund. Clearly, the credibility and financial integrity of the institution should be above suspicion, and the financial statements should therefore be prepared on the basis of generally accepted accounting principles. At the same time, and in light of the margin for judgment allowed by those principles, unnecessary disclosure of information in the financial statements should be avoided to prevent an unintended negative impact on the members concerned. Any decision about how those two desirable goals should be met depended mainly on whether overdue payments to the Fund could be considered at the present stage to be material; and such a determination was not easily made, although he agreed with the staff that the present total of overdue charges and repurchases could not be considered negligible. If the Executive Board were to decide that the reporting of overdue obligations in financial statements was appropriate, his preference would be for a general rule of including only the total amount which had been overdue for six months or more. A general rule on the "flagging" of individual members in arrears could make less meaningful the use of active publicity as a further step in the process of dealing with overdue obligations in individual cases. In any event, it was important to consider whether it was appropriate to include members that, in the past, had incurred overdue obligations to the Fund but were current at the time of the preparation of the financial statements. Excluding such members might give an added incentive to members to settle their obligations as quickly as possible.

A decision to change accounting practices and no longer to count unpaid charges as part of the Fund's income would not be appropriate at present, Mr. Finaish considered. The collectibility of such charges should not be perceived as subject to uncertainty. On proposals to increase the reserves target, questions had arisen about the fairness of distribution of costs associated with such an increase. Given the way in which charges were determined, an increase in the net income target would have to be met through an increase in charges to all users of Fund resources, a large majority of whom were current in their obligations to the Fund. This would be tantamount to a penalty imposed on one part of the membership. Notwithstanding that consideration, if the Board decided that account should be taken of overdue obligations in setting income targets, a flexible means of determining those targets would be more appropriate than the rigid application of a single formula. Hence, he would prefer something along the lines of the first approach suggested by the staff on page 18 of EBS/84/231, although he would not wish his preference to prejudge the question of whether the Board would consider it appropriate to increase the income target at some point. Unfortunately, the staff seemed to assume that an increase would be agreed and that the only question remaining was its size.

Mr. Kabbaj remarked that, in defining "materiality" as it related to overdue financial obligations to the Fund, it was clear, first, that Executive Directors found the arrears problem to be serious and were troubled about its effects on the credibility and viability of the Fund. Second, if a matter was to be treated as material when a failure to disclose it, a misstatement about it, or omission of it was likely to distort the Fund's financial statements, then the relative significance of the total amount of overdue obligations became a relevant factor in the definition of materiality. According to Table 1 in the Appendix to EBS/84/231, total obligations overdue for more than six months would be equivalent to 0.66 percent of total charges in FY 1986, up from the figure of 0.5 percent in FY 1985. If those figures were correct, the materiality of arrears in an accounting sense appeared to be insignificant, since it could not be said that the failure to disclose those amounts would make the Fund's financial statements less representative of the institution's actual position.

The staff's arguments on the role of the Fund vis-à-vis the commercial banks needed further elaboration, Mr. Kabbaj considered. The question of whether the international financial community, when judging the financial position of Fund members, should know which members were in arrears to the Fund was separate from the issue of whether the Fund should expose such details to the financial community lest any nondisclosure might have a negative impact on the institution's financial credibility. The first part of the question was more academic than practical, since the financial community usually became aware of developments with respect to members' overdue obligations quite rapidly. Moreover, members with persistent arrears to the Fund were usually those that had already explored all the normal commercial channels to the capital markets and had been denied access. The Fund as yet did not deal with the operational aspects of the capital markets, and there should be no sense of urgency of the sort felt in other financial institutions to lay before the business world the exact details of the Fund's finances. By the same token, the Fund's immediate and ultimate financial responsibility was toward its soverign member states and not to the general public.

In a broader sense, however, the financial viability and credibility of the Fund could not be separated from the general fortunes of its members, Mr. Kabbaj continued. The issue was not so much the existence of arrears as the general economic "health" of the member countries that were the ultimate supporters of the institution. The steps advocated by the staff were premature and carried the risk of profoundly altering the cooperative spirit of the Fund. Specifically, he had not been convinced by the arguments that the Fund should publicize information on members' arrears in its financial statements or other official publications.

Alternative methods of adjusting reserve targets had been outlined by the staff in EBS/84/231, Mr. Kabbaj noted. His desire was that the methods remained as flexible as possible. At present, the problem of arrears was not particularly serious; and, only in the case of a worsening situation, should consideration be given to an approach based on a recognition of the need for adjusting the net income target.

Mr. de Maulde considered that three points should be taken into account in deciding whether or not to report information on members' overdue obligations. First, it was expected that arrears would be discharged by member countries; second, it was desirable to allow the Executive Board to exercise its responsibilities on a case-by-case basis; and, third, the recovery record of the Fund thus far had been quite good. With those ideas in mind, he saw no need for an automatic or indiscriminate publication of all obligations overdue by six months or more, although such a need might well arise once the Fund had made other efforts at debt recovery and had taken a decision formally to declare a member ineligible to use the Fund's resources. In such cases, the ineligibility would be widely known in the international financial community, even if no press release were to be issued. While he had no firm instructions on whether or in what form the Fund should give publicity to a declaration of ineligibility, it did seem that, once such a declaration was made, it would be illogical not to make some reference to it in the form of a footnote in the Fund's financial statements.

He supported Mr. Wicks' views on overdue charges, Mr. de Maulde continued. Certainly, interest payments should be counted as accrued income only if and when they were received; and he was in fact distressed to have discovered that a very different practice was followed in the Fund.

With regard to the relationship between overdue financial obligations and possible adjustment of the income target, Mr. de Maulde noted that the staff had outlined three possible methods for increasing the target either "in the light of a worsening record of overdue obligations" or on the basis of a formula relating directly to the size of the outstanding overdue payments. Since the setting of a target by definition referred to a future period, his preference was to base that target on expectations or forecasts for overdue obligations in future rather than on data from the present or the past. A reasonable approach would be to follow Mr. Wicks' logic and take into consideration for the forthcoming fiscal year the forecast of real net income diminished by the amount of real payments on charges that might remain overdue at the end of the period. If that could be done, no other changes would be necessary, because the targets for income and reserves could be established in the same way they had been in the past.

Mr. Salinas stated that his chair supported the views of Mr. Kafka on the two main issues. First, financial obligations overdue by six months or more should be reported in regular publications of the Fund, subject to approval by the Executive Board. However, reference to specific countries and/or a more detailed breakdown of the arrears was not advisable. Second, no special provision should be made at present in the Fund's accounts for overdue financial obligations, especially given the level of arrears at present and their temporary character.

Mr. Polak, said that he continued to have doubts about a formula approach, despite Mr. Dallara's suggestion that smoothing out was possible through averaging. In Appendix II of the staff paper, four small countries had been listed, and the average of their overdue obligations probably would not be so significant as to greatly affect the target for the Fund's net income. However, if the next country for which management had raised a complaint were to be added to the list and thrown into the average, the change in the target for net income, under whatever formula was applied, would more than double, since overdue charges for the country in question were twice as large as the total of overdue charges for the four countries in Appendix II. In that respect, no formula would be able to protect the Fund from erratic and perhaps unbearable results.

The Treasurer recalled that it had been suggested in the latest six-monthly report on overdue obligations to the Fund (EBS/84/211, 10/11/84) that if the financial obligations of a member were overdue by six months or more, they should appear as arrears to the Fund in the Balance of Payments Yearbook and without identification as arrears to the Fund in the summary presentations of members' balance of payments and external positions in more frequent Fund publications such as IFS. That proposal had been fully discussed and agreed with the Bureau of Statistics and was consistent with the latest proposal outlined in paragraph 3 on page 17 of EBS/84/231.

Some Directors had argued that a comparison of the level of arrears with the net income target of the Fund should not be given weight in assessing the materiality of the arrears, the Treasurer recalled. The materiality of arrears to the Fund remained a matter of judgment; however, under applicable accounting principles, it was not to be judged solely on the basis of the size of the arrears or in isolation from other views and decisions of the institution on related matters. He had come to the view, and he had reason to believe that his view was shared by the external auditors, that an amount of arrears equivalent to 2-3 percent of the Fund's reserves would be judged by the Executive Board as material, since, in its decisions regarding charges, the Executive Board had been strongly influenced by similar magnitudes. When Executive Directors looked at the question of what was material, they should in his view make their judgment in the context of the general approach of the Fund to what was regarded in its financial dealings as material.

In response to Mr. Wicks' question of whether it was consistent for the staff to accept the inclusion of long overdue charges in accrued income while at the same time suggesting that some account be taken of arrears in setting the net income target, the Treasurer noted that the staff had been guided by the accounting principle which suggested that revenues arising from resources yielding interest--namely, the charges of the Fund--should be recognized when no significant uncertainty as to their collectibility existed. The key words were "significant uncertainty," and the staff would of course be guided by the views of the Executive Board on that matter. If it was felt that accrued charges might not be collectible, then they would logically have to be excluded from income. Of course, the staff also had taken into account the commentary accompanying the principle, which stated that "if it would not be unreasonable to expect ultimate collection, then revenue should be recognized." Again, it was a matter of judgment how to apply the standards in question, and it was evident from the recent action taken by the World Bank that that institution had made a somewhat different judgment from that being recommended by the Fund staff.

The issue of whether or not to count unpaid charges as accrued income raised another difficult question about whether to treat arrears of interest differently from arrears of principal, the Treasurer commented. It had been argued by Mr. Wicks that treating the two elements alike, and deciding not to count them as income could have a significant temporary impact upon the Fund's liquidity and reserve position. On a related matter, if the Fund were to decide to exclude unpaid charges from its net income, then it would by definition be making provision for temporary noncollection of arrears of certain members. Such an approach might encourage those debtors to perceive that their debts had been accounted for in the Fund's income statements, thus making it less necessary for them to act to repay their debts.

The question of how to deal with overdue obligations was one that also had to be resolved by institutions other than the Fund, the Treasurer observed. Commercial banks, for example, needed to determine whether it would be harmful to their negotiations on collection and on rescheduling if the debts were written off or the institution's income were otherwise diminished. Of course, the solutions adopted by the commercial banks were rather different, and often depended upon the regulations applying in each country; hence, the approach of the banks provided very little guidance to the Fund on the issue at hand. Whether the staff's proposed approach or Mr. Wicks' approach was the more appropriate was a matter of judgment. The staff had not proposed to deal with the special risks surrounding overdue charges by eliminating them from net income; rather, it had proposed to deal with the risk on a more general level by establishing a somewhat higher reserve target, taking account of the level of overdue obligations. Of course, at some point, it would have to be determined that the member had failed to pay charges for such a long period that counting those charges as net income was no longer warranted. In the case of Kampuchea, for example, it had been decided that accrued charges--which had at the time been overdue for four years--should no longer be counted as net income and should be placed to deferred income.

Recalling Mr. Polak's argument that the use of a formula to adjust the net income target on the basis of the size of outstanding overdue payments could lead to rather erratic results, the Treasurer noted that an effort to follow Mr. Wicks' proposal no longer to count accrued charges as net income could have an even more erratic impact on income. Moreover, there would be no opportunity for the Executive Board to modify or soften the impact of Mr. Wicks' proposed method of accounting. At present, if the Fund were to adopt a three-month rule of the kind favored by some Directors, it would have to exclude SDR 66 million from the accrued net income of the Fund, which would demand a significant upward adjustment in charges; if the approach were to be adopted only for arrears overdue by six months or more, the amount would naturally be less but by no means insignificant. On balance, therefore, and after considering all the issues he had raised, the staff had made its recommendation not to exclude accrued charges from net income for the time being.

Mr. de Maulde asked for figures on the forecast for real net income diminished by the amount of payments on real charges that were likely to be unpaid at the end of the fiscal year. Using historical data and relationships as a guide to those projections, he would guess that the likely reduction in income would not exceed SDR 2-3 million.

The Treasurer replied that it was nearly impossible to forecast with any accuracy the overdue charges that might remain unpaid at the end of the fiscal year.

Mr. Wicks observed that the Treasurer had supported a number of his points with a reference to the fact that the Fund was a rather unique institution; at the same time he had justified certain other arguments by referring to an accounting standard that certainly had not been drafted with the unique character of the Fund in mind. He would appreciate some help in reconciling those two references.

Recalling the Treasurer's description of action taken in the case of Kampuchea, Mr. Wicks observed that waiting too long to decide no longer to accrue overdue charges as part of current income in the case of a country like, say, Sudan, could have a far more dramatic effect on the rate of charge than would be the case if his proposal were enacted immediately. Under his approach, charges would of course rise, but the increase would come in stages; if, in time, a decision was adopted no longer to count Sudan's arrears in the Fund's income, the sheer amounts of money involved would make the effect on charges quite staggering.

The Executive Directors agreed to continue their discussion at 3:00 p.m.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/84/184 (12/14/84) and EBM/84/185 (12/17/84).

3. ASSISTANT TO EXECUTIVE DIRECTOR

The Executive Board approves the appointment of an Assistant to an Executive Director as set forth in EBAP/84/271 (12/11/84).

Adopted December 14, 1984

4. ASSISTANT TO EXECUTIVE DIRECTOR

The Executive Board approves the appointment of an Assistant to an Executive Director as set forth in EBAP/84/273 (12/11/84).

Adopted December 14, 1984

5. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors as set forth in EBAP/84/277 (12/13/84) is approved.

APPROVED: September 30, 1985

ALAN WRIGHT
Acting Secretary