

GRAY/02/318

March 13, 2002

**Statement by Ms. Lundsager and Mr. Baukol on Safeguard Assessments
(Preliminary)
Executive Board Meeting 02/26
March 14, 2002**

Key points:

- We are very pleased at the progress made under the safeguards procedures.
- Safeguards assessments should be a permanent feature of IMF operations.
- Assessments so far have shown significant weaknesses in operations of many central banks. Follow-up on these weaknesses should be a clear priority.
- Given the weaknesses identified, countries should improve the key financial practices and controls that are in place in their central banks before the second disbursement under any program.
- We agree with staff's recommendations to extend assessments to RAP cases and augmented programs. We also support extension to SMPs, CFFs, and to members with current outstanding obligations to the IMF.
- As most countries finish the initial safeguards assessments and implement needed improvements, monitoring of central banks going forward will become a more important part of the assessment process. We support staff's recommendation for follow-up for as long as IMF credit remains outstanding.
- Staff should examine and offer recommendations by the 2002 Annual Meetings on issues posed by Fund lending to entities other than central banks.

One and a half years ago, the safeguards program was launched with considerable questioning by many Board members. But already in a short period, it has more than proven its worth. It has done so with widespread acceptance from member central banks because, in a low-key manner, it has helped them upgrade their basic processes and systems, which is part and parcel of the process of building sound institutions. And it has done so in a manner that helps safeguard this institution's resources from misuse while enhancing the Fund's public integrity. In our judgment, the papers make clear that the safeguards program is an unqualified success and should be a permanent feature of IMF operations.

We thank staff for presenting a useful summary of the results of the safeguards assessment process so far, along with reasonable suggestions for future work on this important topic. We also would like to give particular thanks to the work of the independent panel, which clearly fulfilled its task thoughtfully.

Strong management and integrity of operations of member countries' central banks are important for several reasons. From a parochial point of view, the integrity of central banks' operations is helpful in reducing misreporting episodes and providing greater assurance that IMF resources will be used for the purposes identified in the IMF program. Misuse of IMF funds could seriously undermine a country's economic program as well as raise questions about future IMF support to that country. And, widespread misuse of IMF resources could undermine support for the IMF and its integrity as a public institution.

While helping protect IMF resources, the safeguards assessments also provide a strong positive externality in improving public and official confidence in central bank operations more broadly. As noted by the independent panel, "the main by-product of the safeguards assessments is indisputably the positive image of efficiency and good governance that will be attributed to the assessed institution and to a larger extent to the member country."

Suggested Enhancements

The serious deficiencies identified by safeguards assessments so far reinforce the importance of this effort and the need to follow up closely on various improvements in central bank operations to remedy the deficiencies. It is striking that fully 88 percent of assessments so far have identified inadequate accounting standards in central banks, underlining the critical importance of requiring early assessments □prior to program approval or at the latest by the first review. We note the conclusion of the panel that exceptions to this policy could undermine the credibility of the process.

We are concerned that, under the current safeguards policy, improvements to strengthen central banks' financial controls can take many months while IMF disbursements continue to be made. Current policy, as reinforced by the comments of the independent panel, calls for assessments to be completed by the time the Board approves a new program, or no later than the first review. But, the policy does not give guidance on when improvements to financial controls of central banks need to be implemented.

We suggest that current policy be augmented so that key weaknesses be addressed as soon as possible and prior to the second review under any program. Countries should remedy major deficiencies by the time of a second review to avoid long-term violations of key safeguards requirements that increase the potential for misreporting and misuse. If safeguards assessments are conducted quickly and on-site assessments conducted prior to approval of a program, as currently advised, then almost all countries would have at least six months (or at least 12 months in PRGFs and many SBAs) to implement the most important improvements. Thus, we believe that the potential for actual delays in programs as a result would be relatively limited and of short duration while the value added in advancing the integrity of the Fund and improving central bank management would be significant.

As staff has described, the distinction between stage one and stage two of the assessment has not proved useful and has given rise to confusion. We support getting rid of the formal distinction, but would reiterate the need for assessments to be completed for the

Board to consider at the initial program or first review.

Extension of Assessments

Staff suggest extending the assessments to RAPs and to augmented programs. We strongly support these extensions and would also support extending safeguards assessments to other cases, including:

- SMPs. Since a main purpose of an SMP is to prepare for a funded arrangement, it makes sense for staff and the member to get a head start on the assessment so that it can be completed before the start of the prospective funded program, as envisioned in the current guidelines. This could also help improve coordination within the IMF, as recommended by the external panel.
- Stand-alone CFFs. Although stand-alone CFF programs should be very rare, the goal of safeguarding IMF resources suggests that an assessment is needed in any case where sizable IMF resources are at risk.
- Members with outstanding obligations to the IMF but that do not currently have a program. Assessments in these cases would help improve the reputations of central banks while also safeguarding IMF resources. Such assessments could be conducted in the context of Article IV reviews.

Given the concerns highlighted regarding Fund lending to entities other than central banks, such as directly to the government, we ask that staff examine this issue and offer specific recommendations to address this concern before the 2002 Annual Meetings.

Follow Up

Looking to the future, the staff report correctly notes that assessments provide only a snapshot of central bank operations. As a result, further monitoring going forward is needed to ensure that central banks continue to follow safeguard guidelines. Staff propose to monitor central bank audited financial statements annually going forward for as long as IMF credit remains outstanding. We support this approach and hope that monitoring, as well as safeguards assessments more broadly, will be embraced by area departments to ensure sufficient focus on key safeguards concerns.

Also, as advised by the external panel, we support publication of the staff report and inclusion of safeguard issues in the annual report. On a further transparency point, we believe that countries that wish to publish their safeguards assessments should be allowed to do so. If a country wants to communicate to markets and others that the strengths and weaknesses of its central bank are being assessed with a view toward upgrading its accounting, controls, and reporting procedures, it seems that it should be free to do so.

Finally, given the importance to the integrity of IMF operations and in light of the benefits to members, the safeguards effort should be appropriately staffed.