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GRAY/02/321

March 13, 2002

Statement by Mr. Kelkar on Safeguard Assessments
(Preliminary)
Executive Board Meeting 02/26
March 14, 2002

<u>*Key Points:*</u>

- *The comprehensive paper with independent review provide all ingredients for taking a fair view (para 1).*

- *The SA should strive to focus and concentrate on high risk area (para 2).*

- *Safeguarding Fund resources should be viewed in the broad context of successful program design and implementation. SA may not meet the requirement of safeguarding Fund resources, in full sense of the term (para 3).*

- *SA is greatly enhanced by providing best practices and governance rules to all economic agents, duly taking into account the country specific circumstances (para 4).*

- *While IAS could serve as a basis, benchmarks should recognize differences and nuances when applied to central banks. A separate code especially for central banks would be welcome (para 5).*

- *It would be useful to engage experts from the central banks during on site assessments (para 6).*

1. We thank the staff for a comprehensive paper reviewing the experience of safeguard assessments adopted as a part of policy for an initial experimental period of 12–18 months. The staff paper along with the independent review, provide all ingredients for taking a fair view in the matter.

2. The background to the efforts on safeguard assessments is rooted in the misreporting instances and allegations of misuse of Fund resources. There cannot be two views on the need for periodically reviewing safeguards of Fund resources and refining the guidelines on misreporting. As this chair brought out in March 2000, the safeguards framework as enunciated and the way forward should strive to focus the assessments exercise to the limited aim of safeguarding Fund’s resources. Looking from this basic objective of the exercise, the operational methodology may require concentration on a fewer items which are perceived to be high risk, to provide meaningful results. Furthermore, with several parallel initiatives taken towards building up an international financial architecture for attaining global financial

stability, continuance of this exercise and its intensity with more vigor should be seen in harmony and coordination with those initiatives so that duplication of efforts is avoided. We will attempt to elaborate on these basic points while addressing the specific issues raised for discussion in the paper.

3. While misreporting is well understood and should be eschewed as part of Fund program, the possible misuse of Fund resources would be very difficult to establish in practice, except in cases where such Funds are blatantly misappropriated and abused. Given the explicit impact of loss of credibility of such actions by authorities, there would not be any incentive to pursue this course. Taking into account the nature of Fund support, aiming at generally attainment of macroeconomic policies and objectives and structural reform programs, monitored through a close reviewing mechanism, it would be rather difficult to establish a one-to-one correspondence between fund use by authorities and performance criteria, as in the case of project tied aid or loans by institutions like the World Bank. In the normal course, a successful program design well implemented by a member country is expected to meet the BoP gap in the short to medium term and put the economy in a path towards sustainability enabling them to meet repurchase obligations as per agreed schedule. In the interregnum, during the program period, what is monitorable is the compliance with performance criteria/conditionalities. It may be recalled that the Fund has taken initiatives in the recent past to review and redesign programs depending upon the emerging challenges thrown up by volatile behavior of international capital markets and private capital flows to emerging and developing economies. On such occasions, we have particularly stressed the importance of reviewing the program design in all its aspects including the attendant risks. We may have to recognize that defaults on payments to Fund are a risk which may arise also due to improper program design though the odds may weigh heavily upon the member country's faulty economic policies. We have therefore been emphasizing that apart from 'country ownership', a joint ownership is implicitly established by the Fund. In this backdrop, the limited point, this chair wants to make is that the safeguards assessments focusing upon auditing and accounting practices and internal control systems of central banks, who serve as fiscal/banking agents of government, may not meet adequately the requirement of safeguarding Fund resources, in full sense of the term.

4. The safeguard assessment, in a very broad sense, we believe will be greatly enhanced by the very significant role played by the Fund as part of international community in providing best practices and governance rules of all economic agents and in particular regulatory authorities like governments and central banks to ensure soundness of the financial system and in the interest of promoting international financial architecture and global financial stability. In this regard, the Fund should pursue with the development and dissemination of financial standards and codes, including for central bank accounting/auditing and governance practices. However, as the Fund paper and also the independent review emphasize, the implementation of standards should duly take into account the country specific circumstances, context and legal and institutional infrastructure. Complete standardization of accounting practices and formats may not be a feasible proposition.

5. While the IAS could serve as the basis for assessing accounting standards and practices by central banks, the differences and nuances arising out of the very nature of central banking functions should be adequately addressed. For instance, the benchmarks relevant for a commercial organization in their securities operations and foreign exchange management cannot be extended to central banks. The benchmarks should keep cost efficiency as a basis rather than return maximization. We welcome the suggestion by the independent review that a separate code of good accounting practices applicable especially to central banks may be evolved based on IAS.

6. The findings of this initial safeguard assessment are really very useful and as stated has rightly helped the staff in further refining the ELRIC framework. The positive aspects of findings also are encouraging. Among the main findings of safeguards assessments listed in Table 2 (page 13), we find that serious attention needs to be paid to items (1) non-existent or deficient external audits, (3) poor controls over foreign exchange reserves, (4) deficient internal audit and (8) inadequate accounting for IMF transactions which are high risk from the point of view of safeguarding Fund's resources. In our view, it will be useful to have the distinction between off-site and on-site assessment reports to economize efforts. We also agree that the existing operational deadlines are important. We understand the limitation of requisite specialized skills in undertaking the exercise. Instead of augmenting internal additional resources, it would be useful to engage experts from other central banks during on-site assessments.

7. While the safeguards assessment could be generally restricted to new program countries, if some other central banks opted for such assessments voluntarily, it could be considered favorably as a part of FSAP/FSSA or ROSC exercises. After the initial assessments, which are 'snapshots', the countries need not be revisited unless serious weaknesses persist. Moving forward, we agree with the proposed shift in focus of safeguards assessment to the monitoring of remedies proposed under previous assessments.