

**IMMEDIATE
ATTENTION**

SM/04/81

March 9, 2004

To: Members of the Executive Board

From: The Secretary

Subject: **Safeguards Assessments—Semi-Annual Update**

Attached for the **information** of Executive Directors is the semi-annual update, for the period to December 31, 2003, on safeguards assessments.

It is intended that this paper will be published on the Fund's external website. If no objections are received by **noon on Tuesday, March 16, 2004**, the paper will be posted.

Questions may be referred to Mr. Catsambas (ext. 34017) and Mr. Trines (ext. 35639) in FIN.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (1)

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INTERNATIONAL MONETARY FUND

Safeguards Assessments—Semi-Annual Update

Prepared by the Finance Department

In consultation with other Departments

Approved by Eduard Brau

March 8, 2004

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I. OVERVIEW

1. Since the review of the safeguards assessment policy by the Executive Board in March 2002¹ staff has prepared semi-annual summary reports on the activities and results of the safeguards program.² This fourth summary report provides an update on the status of work, the results of assessments completed in the second half of 2003, and the implementation status of recommendations as of December 31, 2003. A comprehensive review of the safeguards policy is scheduled to take place by March 2005. Box 1 highlights the main features of the safeguards policy.

2. Section II provides statistical information on the status of assessments and the implementation rates for safeguards assessment recommendations. Section III describes the results of safeguards assessments over the six month period ended December 31, 2003, including examples of specific findings. Section IV summarizes the outreach activities undertaken by staff to enhance communication and dissemination of information on the safeguards policy.

3. **Ten safeguards assessments were completed during the period July 1 through December 31, 2003 and the results are consistent with earlier findings.** Weaknesses continue to be identified in important areas of central banks' controls, including the external audit function and the financial reporting framework, but, at the same time, the range of identified weaknesses is narrowing, partly because central banks that undergo follow-up assessments have successfully implemented earlier recommendations, and many central banks have a greater awareness of safeguards issues. Central banks in general remain receptive to the assessments and proposed remedies for risk mitigation, although implementation of recommendations varies depending on whether or not they were included in program conditionality.

¹ See *Safeguards Assessments—Review of Experience and Next Steps* (EBS/02/27, 2/19/02); *Safeguards Assessments—Review of Experience and Next Steps—Independent Review of the Safeguards Assessment Framework* (EBS/02/28, 2/19/02); and *The Acting Chair's Summing Up on Safeguards Assessment—Review of Experience and Next Steps* (BUFF/02/43, 3/20/02, revised 4/1/02).

² The third such report was issued in August 2003: *Safeguards Assessments—Semi-Annual Update* (SM/03/298, 8/22/03).

Box 1. Safeguards Assessment Policy—A Summary¹

- *Policy approved by the Executive Board on March 14, 2002, following a two year experimental period.*
- *Objective of Safeguards Assessments*
 - to provide reasonable assurance to the Fund that a central bank's control, accounting, reporting and auditing systems in place to manage resources and Fund disbursements are adequate to ensure the integrity of financial operations and reporting to the Fund.
- *Applicability of Safeguards Assessments*
 - central banks of members with arrangements for use of Fund resources approved after June 30, 2000;
 - transitional assessments of external audit mechanism only for member countries with arrangements in effect prior to June 30, 2000;
 - also to existing arrangements that are augmented, and member countries following a Rights Accumulation Program (RAP), where resources are being committed;
 - not applicable to emergency assistance, first credit tranche purchases, and stand-alone CFFs;
 - voluntary for members with Staff Monitored Programs.
- *Scope of Policy – **ELRIC** of a Central Bank*
 - the **E**xternal audit mechanism;
 - the **L**egal structure and independence;
 - the financial **R**eporting framework;
 - the **I**nternal audit mechanism;
 - the internal **C**ontrols system.

¹ See also <http://www.imf.org/external/np/tre/safegrds/complete/index.asp>

II. STATISTICAL UPDATE

A. Status of Assessments

4. **In the six month period July 1 to December 31, 2003, assessments were finalized for 10 member countries**, namely the Dominican Republic, Ghana, Kenya, Lesotho, Malawi, Mongolia, Nicaragua, Sri Lanka, Tanzania, and Tajikistan. All of these assessments were completed by the deadline required under the safeguards policy, i.e., the first review of the respective arrangement with the Fund, except in the case of Tajikistan, where the assessment was formally finalized just after the review.³ One additional assessment (Vietnam) could not be completed due to disagreements with the authorities on the recommendations; discussions with the authorities continue while the review under the country's current PRGF arrangement is not yet completed.

5. **Since inception of the safeguards policy, staff has completed 89 safeguards assessments**, comprising 62 full assessments and 27 transitional assessments (see the Annex). These assessments cover a total of 66 central banks, because 14 central banks have been subject to both a transitional and a full assessment, and 9 central banks have had two full assessments.⁴

6. **At end-December 2003, 14 safeguards assessments were in progress at various stages of completion.** Of these, three assessments have since been finalized, and three more are in the report finalization stage. The remaining eight assessments (along with others required for additional Fund arrangements not yet foreseen at this time) will comprise a significant part of the work program over the next six months.

B. Implementation of Recommendations

7. **The rate of implementation of safeguards recommendations remains high** (Table 1).⁵ Implementation rates vary depending on whether the recommendations were

³ The assessment was completed on July 23, 2003, following receipt of the authorities' official response. However, the findings of the assessment were reported in the staff report for the first review under the PRGF arrangement (EBS/03/96, July 1, 2003).

⁴ Central banks are subject to a full safeguards assessment in respect of every arrangement approved after June 30, 2000. A safeguards assessment for a new arrangement updates the findings and conclusions of the previous assessment. To date, Albania, Brazil, Kenya, Lesotho, Malawi, Mongolia, Nicaragua, Sri Lanka, and Tajikistan have had two full assessments. In addition to the 89 assessments completed, a partial (Stage One) assessment for one central bank (Vietnam) was completed in 2001.

⁵ Information on the implementation of recommendations was, in most cases, provided by central banks, sometimes supplemented by information gathered by area departments.

included in program conditionality⁶ and reflected in LOI/MEFP commitments, or were not formally included in the Fund-supported program. However, the overall high implementation rate reflects the growing acceptance by central bank authorities of the findings of safeguards assessments, especially as the policy is better understood (see also Section IV).

8. **The implementation rate for measures included under program conditionality or as commitments in the LOI/MEFP remained high at about 85 percent on average for both categories.** The implementation rate for recommendations formally included in Fund-supported programs is higher than for other recommendations, demonstrating that well-targeted conditionality has been successful in strengthening central banks' safeguards. For the 18 measures formally included in Fund-supported programs that have not been implemented, substantial progress has been made on ten, while five of the remaining eight relate to one country whose program is not currently on track.

Table 1. Implementation Rate of Safeguards Recommendations¹
(as of December 31, 2003)

	Number	Implementation Rate (Percent)
1. Recommendations with formal commitment from the authorities	121	-
a. Under program conditionality ²	48	-
<i>of which: Implemented</i>	(44)	91.7
<i>Not Implemented</i>	(4)	-
b. LOI/MEFP commitments	73	-
<i>of which: Implemented</i>	(59)	80.8
<i>Not Implemented</i>	(14)	-
2. Recommendations not under program conditionality or LOI/MEFP commitments	331	-
<i>of which: Implemented</i>	(239)	72.2
<i>Not Implemented</i>	(92)	-
3. Total recommendations (1+2)	452	75.7

¹Excludes recommendations for which the suggested implementation date is in 2004 or later and recommendations which are not monitored.

²Includes 11 prior actions (all implemented), 11 structural performance criteria (10 implemented), and 26 structural benchmarks (23 implemented).

⁶ Program conditionality includes prior actions, structural performance criteria, and structural benchmarks and is limited to issues highly relevant to safeguarding the use of Fund resources. Issues covered have mainly related to achieving adequate external audits, ascertaining international reserve data and control over foreign reserve operations, and achieving reliable data reporting to the IMF.

9. **The average implementation rate for measures not included under program commitments improved measurably, although results vary from country to country.** The implementation rate for recommendations for which the authorities made no formal commitments increased from 63.6 percent at end-June 2003 to 72.2 percent at end-December, reflecting continued efforts of central banks to address identified weaknesses in their safeguards frameworks, but also, partly, a bunching of proposed implementation deadlines in the second half of the year. There also appears to be considerable progress on many of the remaining recommendations: some two thirds of the 92 measures not implemented by end-December 2003 have been outstanding for less than six months and most are at an advanced stage of implementation or have been partially implemented. For some 15 percent of these measures the authorities now indicate that they cannot be implemented (for instance, because the existing legal framework does not permit implementation), that alternative steps have been taken, or that they no longer consider them necessary. For the remaining 15 percent, the authorities have not indicated when they expect to implement the measures or the current Fund-supported programs are off-track.

III. FINDINGS OF SAFEGUARDS ASSESSMENTS: JULY 1 TO DECEMBER 31, 2003

10. **The findings of the ten assessments completed since June 30, 2003 are broadly consistent with earlier findings.** The safeguards assessments have noticed progress in the strengthening of central banks' safeguards frameworks, although weaknesses continue to be identified, especially in their financial reporting, auditing, and control mechanisms. The ten most recent assessments did not reveal major weaknesses in the legal frameworks of the central banks that required high priority recommendations for corrective action, and, in contrast to assessments completed before 2003, all central banks were found to have an external audit function and an internal audit department. The most common weaknesses identified in the recent assessments included: (i) poor controls over data reporting to the IMF, (ii) inadequate financial reporting framework or disclosures, (iii) ineffective internal audit mechanisms, and (iv) weak governance oversight. Examples of the general vulnerabilities revealed by the most recent assessments and proposed remedies included:

- Half the central banks had **inadequate control procedures with respect to data reporting to the Fund**. Recommendations entailed establishing formal internal procedures for reconciling accounting data with data reported to the Fund and, in two cases, proposing an audit of the data as part of the annual external audit.
- Four central banks with **ineffective oversight of external and internal audits and internal controls** were asked to improve or establish such oversight mechanisms; one central bank was asked to fill long-standing vacancies on its Board.
- To address **weaknesses in financial reporting**, in six cases recommendations were made to consider or complete implementation of an internationally recognized framework, to improve disclosures in the financial statements, and/or to prepare financial statements in accordance with International Financial Reporting Standards (IFRS).

- **Timely publication of audited financial statements** was recommended to one central bank which did not publish audited financial statements at all and to three central banks where publication was regularly delayed significantly.
- In three cases, the assessments identified significant **weaknesses in the external audit framework**, to be addressed by contracting an external audit to be conducted in accordance with International Standards on Auditing (one case) or requiring that the audit opinions be co-signed by more experienced auditors (in two cases).
- In six banks requiring various degrees of **improvements in the internal audit function**, recommendations were made to conduct risk-focused audits, establish an appropriate audit mandate, or improve staff qualifications.
- In two central banks the assessments identified **weaknesses in reserves management** and recommendations were made for improving controls, including special audits of international reserves.

11. **Central banks have generally agreed with the safeguards findings and are making progress in implementing the recommendations.** In most countries for which assessments were completed in the second half of 2003 proposed timelines for addressing the identified vulnerabilities extended beyond December 31, 2003. However, in several of these cases, measures were already implemented well in advance of the deadlines.

12. **In general, the safeguards policy appears to be a positive factor in strengthening central banks' safeguards frameworks.** The range of weaknesses identified during safeguards assessments has been narrowing as central banks undergo follow-up assessments and have already addressed vulnerabilities observed earlier. In particular, efforts to strengthen the external and internal audit functions of central banks (which imply structural improvements in the safeguards framework) could be expected to have positive effects, as they enable central banks to assess their overall system of controls on a regular basis and take corrective measures as necessary. There is also a greater awareness among central bank staff (partly as a result of the Fund's outreach activities in this area (see below)) of the benefits of a strong safeguards framework both with respect to central banks' day-to-day operations and in their relations with the Fund.

IV. SAFEGUARDS ASSESSMENTS OUTREACH

13. **Outreach activities to communicate and disseminate information related to safeguards continued.** As noted, outreach efforts have helped establish a better understanding of the importance of a strong safeguards framework in central banks. In particular, the periodic courses on safeguards assessments, which are organized jointly by the IMF Institute and the Finance Department, have proven popular and have contributed to familiarizing central bank staff with the concepts and methodology followed by staff in the implementation of the policy.

A one-week course on safeguards assessments, attended by 28 central bank officials,⁷ was held in Washington in November 2003. Other outreach activities have included a staff article on the IMF safeguards policy in a publication on accounting standards for central banks; presentations at a BIS conference on risk management topics and at a Cambridge, U.K., conference on central bank accounting, financial reporting, and risk management; and staff meetings with central bank delegations visiting Washington, DC.

⁷ A total of 112 central bank officials from some 87 countries have attended IMF Institute courses on safeguards assessments since the beginning of 2003.

**Safeguards Assessments Completed
as of December 31, 2003¹**

Full Assessments: Total 62			
Country	Date completed	Country	Date completed
Albania	June 28, 2002	Lao, PDR	April 8, 2003
Albania	March 15, 2001	Latvia	October 25, 2001
Argentina	September 5, 2002	Lesotho	July 2, 2001
Armenia	February 19, 2002	Lesotho	July 24, 2003
Azerbaijan	March 8, 2002	Lithuania	December 10, 2001
Bangladesh	September 20, 2002	Macedonia	April 24, 2003
BCEAO	March 4, 2002	Madagascar	November 12, 2001
BEAC	July 20, 2001	Malawi	July 12, 2001
Bolivia	June 27, 2003	Malawi	July 24, 2003
Bosnia and Herzegovina	October 28, 2002	Moldova	June 12, 2002
Brazil	June 14, 2002	Mongolia	March 4, 2002
Brazil	September 16, 2002	Mongolia	November 25, 2003
Bulgaria	June 12, 2002	Nepal	September 3, 2002
Cape Verde	December 9, 2002	Nicaragua	December 7, 2001
Colombia	May 14, 2003	Nicaragua	August 29, 2003
Congo, D.R.	January 3, 2003	Nigeria	November 28, 2001
Croatia	January 3, 2003	Pakistan	February 1, 2001
Dominican Republic	December 4, 2003	Paraguay	January 31, 2003
ECCB	February 20, 2003	Peru	July 26, 2001
Ecuador	June 23, 2003	Romania	May 13, 2002
El Salvador	February 6, 2002	Rwanda	April 14, 2003
Ethiopia	September 6, 2001	Sierra Leone	July 29, 2002
Georgia	January 24, 2002	Sri Lanka	August 24, 2001
Ghana	October 15, 2003	Sri Lanka	July 30, 2003
Guatemala	August 9, 2002	Tajikistan	November 27, 2001
Guinea	July 11, 2002	Tajikistan	July 23, 2003
Guyana	April 16, 2003	Tanzania	December 5, 2003
Jordan	June 27, 2003	Turkey	March 22, 2002
Kenya	January 30, 2001	Serbia & Montenegro	November 29, 2001
Kenya	October 21, 2003	Uganda	April 13, 2003
Kyrgyz Republic	January 18, 2002	Uruguay	January 6, 2003
Transitional Assessments: Total 27			
Country	Date completed	Country	Date completed
Argentina	March 7, 2001	Latvia	October 25, 2000
Bolivia	October 19, 2000	Lithuania	November 6, 2000
Bosnia/Herzegovina	April 12, 2001	Mauritania	April 9, 2002
Bulgaria	March 21, 2001	Mozambique	October 11, 2001
Cambodia	August 1, 2001	Panama	July 12, 2001
Colombia	May 28, 2001	Papua New Guinea	May 4, 2001
Djibouti	July 24, 2001	Romania	December 1, 2000
Estonia	December 13, 2000	São Tome & Príncipe	February 6, 2001
Ghana	October 31, 2001	Tanzania	April 3, 2001
Guyana	December 5, 2001	Turkey	August 21, 2001
Honduras	May 2, 2001	Ukraine	February 3, 2001
Indonesia	April 5, 2002	Uruguay	October 19, 2000
Jordan	May 22, 2001	Yemen	May 23, 2001
		Zambia	July 2, 2001

¹ Countries with arrangements in effect prior to June 30, 2000 were subject to a transitional assessment that evaluated only the external audit mechanism. Subsequently, full assessments were required for each new arrangement with the Fund. As a result, some central banks have undergone more than one assessment. In addition to the 89 completed assessments, one partial assessment (Vietnam, 2001) was completed under the original procedures of the safeguards policy.