

**FOR
AGENDA**

EBS/04/110

July 23, 2004

To: Members of the Executive Board

From: The Secretary

Subject: **Dominica—Report on Noncomplying Purchases and Disbursement and Breach of Obligation Under Article VIII, Section 5**

Attached for consideration by the Executive Directors is the Managing Director's report on noncomplying purchases and disbursement made to Dominica and Dominica's breach of obligation under Article VIII, Section 5, which will be brought to the agenda for discussion on **a date to be announced**. Draft decisions appear on page 4.

Questions may be referred to Mr. A.G. Santos (ext. 36629), Ms. Randall (ext. 38615), and Mr. Njoroge (ext. 38785) in AFR.

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

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Department Heads

To: Members of the Executive Board

July 22, 2004

From: The Managing Director

Subject: **Dominica—Report on Noncomplying Purchases and Disbursement and Breach of Obligation Under Article VIII, Section 5**

I. INTRODUCTION

1. The Dominican authorities' efforts to reconcile the public debt, in the context of the debt restructuring exercise launched in early 2004, have revealed that three purchases under the 2002 Stand-By Arrangement (SBA) and a disbursement under the current PRGF Arrangement were noncomplying under the Guidelines on Misreporting and Noncomplying Purchases in the General Resources Account and the Guidelines on Misreporting and Noncomplying Disbursements in Arrangements under Poverty Reduction and Growth Facility (together, the "Misreporting Guidelines), respectively. These purchases and disbursement were made on the basis of, inter alia, reported data on external payments arrears. Moreover, the arrears in question give rise to a breach of obligations under Article VIII, Section 5. This report sets out the reasons for the difference between the reported and revised data and proposes that (i) waivers be granted for the nonobservance of the continuous performance criterion on nonaccumulation of external payments arrears that gave rise to the noncomplying purchases and disbursement and (ii) no action be taken by the Executive Board with respect to the breach of obligation under Article VIII, Section 5.

II. NONCOMPLYING PURCHASES AND DISBURSEMENTS

2. On August 28, 2002, the Executive Board approved a 12-month Stand-By Arrangement for Dominica in the amount of SDR 3.28 million (40.0 percent of quota). The arrangement was nearly fully drawn, with purchases made as follows: (1) SDR 2.05 million on August 28, 2002 (upon Board approval of the SBA); (2) SDR 0.308 million on July 25, 2003 (after completion of the first review and approval of a six-month extension of the arrangement); (3) SDR 0.308 million on September 22, 2003 (reflecting end-July performance criteria) and (4) SDR 0.308 million on December 29, 2003 (after completion of the second review). The second purchase under the SBA was premised on the observance (or waiver) of performance criteria, including a continuous performance criterion on nonaccumulation of external payments arrears. The third and fourth purchases were premised on the observance of all relevant performance criteria. The SBA was approved with some existing external arrears, and a waiver of nonobservance of the performance criterion on external payments arrears was granted at the time of the first review.

3. On December 29, 2003, the Executive Board approved a three-year arrangement under the Poverty Reduction and Growth Facility (PRGF) in the amount of SDR 7.7 million (94 percent of quota). So far, two disbursements have been made: (1) SDR 2.358 million (upon Board approval of the PRGF arrangement); and (2) SDR 0.308 million on

March 24, 2004 (after completion of the first review). The PRGF arrangement was approved with some existing arrears to private creditors which have now been settled.¹ The second disbursement under the arrangement was premised on the observance of all relevant performance criteria, including the continuous performance criterion on external payments arrears.

4. At the time of the purchases made under the SBA and disbursements made under the PRGF arrangement, the authorities had reported to the staff that no external arrears had been accumulated under the program, beyond those noted above.

5. The authorities have informed the staff that following the announcement of the debt exchange offer in April 2004, an external supplier came forward with a claim in arrears that the authorities had previously recorded as a domestic claim. The supplier's credit dates from October 2000, amounts to US\$326.3 thousand, and the scheduled monthly repayments had been in arrears since July 2001.²

6. The second purchase under the SBA became available on the specific condition that the data on observance of the continuous performance criterion on external payments arrears provided by Dominica were accurate. Given the information provided by the authorities about an additional external obligation in arrears, that purchase has been determined to be noncomplying. In addition, the third and fourth purchases under the SBA and the second disbursement under the PRGF arrangement were made on the basis that all relevant performance criteria were observed. The additional external arrears reported by the authorities resulted in the nonobservance of the continuous performance criterion on external arrears and therefore these purchases and disbursement are noncomplying under the Misreporting Guidelines.³

7. On July 20, 2004, management wrote to the Dominican Minister of Finance and Planning informing him of the staff's findings and seeking the authorities' views before making a recommendation to the Executive Board on how to proceed (Attachment I).

III. THE AUTHORITIES' RESPONSE AND CORRECTIVE ACTION

8. In his response (Attachment II) dated July 21, 2004, the Minister explained that the claims in question had previously been classified and reported as domestic arrears. He

¹ See EBS/04/109.

² To be repaid in 36 installments (over 41 months) of US\$10.7 thousand starting from April 1, 2001. While the first three scheduled payments were made (totaling US\$32.0 thousand), the remaining payments were not made.

³ See, in particular, the Board decision on Strengthening the Application of the Guidelines on Misreporting (EBS/00/1; Supplement 2; 8/1/00).

emphasized that the reclassification as an *external* claim in arrears arose in the context of the authorities' own efforts to reconcile the public debt, following the announcement of the debt restructuring exercise in early 2004. The Minister stressed that ongoing efforts to reconcile the public debt would lead to a significant strengthening of Dominica's monitoring capabilities in this area. Moreover, he noted that the supplier has tendered these claims into the government's debt exchange offer, resulting in elimination of the respective arrears under the program.

IV. RECOMMENDATION

9. Under the Misreporting Guidelines, a waiver is normally granted only if the deviation from the relevant performance criterion or other condition was minor or temporary, or if, subsequent to the purchase or disbursement, the member has adopted additional measures appropriate to achieve the objectives of the program supported by the relevant decision or by the arrangement. In the present case, the difference between the reported and revised data on arrears can be considered minor. In addition, the arrears in question were recently tendered in the exchange offer. Finally, the authorities reiterated in their July 21, 2004 letter their firm commitment to the debt management objectives under the Fund-supported program. In view of the above, I recommend that waivers be granted for the nonobservance of the performance criterion on external payments arrears for the three noncomplying purchases under the SBA and the noncomplying disbursement under the PRGF arrangement.

V. ARTICLE VIII, SECTION 5

10. The staff also considered whether the provision of inaccurate information gives rise to a breach of obligation under Article VIII, Section 5, which obligates members to provide the Fund with information that the Fund deems necessary for its activities, including, *inter alia*, information that is necessary to assess whether or not performance criteria have been met. As noted above, the inaccurate information concerning external arrears was related to performance under the continuous criterion on external payments arrears. The authorities confirmed in their July 21, 2004 letter that the provision of inaccurate information on external payments arrears was not due to a lack of capacity on the part of Dominica. In my judgment, therefore, the inaccurate information provided by Dominica gives rise to a breach of obligations under Article VIII, Section 5. However, in view of the minor program deviation entailed in these arrears and the corrective measures that have been taken by the authorities to improve debt management, I recommend that no action be taken by the Executive Board.

Attachments

PROPOSED DECISIONS

The following draft decisions are proposed for adoption by the Executive Board:

A. Noncomplying Purchases and Disbursement Under the Misreporting Guidelines

“The Fund notes the report of the Managing Director set forth in EBS/04/110 on the (i) noncomplying purchases made by Dominica on July 25, 2003 after the completion of the first review, on September 22, 2003, and on December 29, 2003 after the completion of the second review, respectively, under the Stand-By Arrangement for Dominica (EBS/02/152, Supplement 1) and (ii) noncomplying disbursement made to Dominica following the first review under the Poverty Reduction and Growth Facility arrangement for Dominica (EBS/03/167, Supplement 2). The Fund decides to waive Dominica’s nonobservance of the continuous performance criterion on nonaccumulation of external payments arrears that gave rise to the noncomplying purchases and disbursement, on the condition that the information provided by Dominica on performance under this criterion is accurate.”

B. Breach of Obligations Under Article VIII, Section 5

“The Fund has reviewed the report of the Managing Director set forth in EBS/04/110 on the misreporting by Dominica of information under the Stand-By Arrangement (EBS/02/152, Supplement 1) and the Poverty Reduction and Growth Facility arrangement (EBS/03/167, Supplement 2) for Dominica. The Fund finds that, with respect to the inaccurate reporting of information on external payments arrears specified in paragraphs 5 and 6 of the report, Dominica has breached its obligations under Article VIII, Section 5 to report accurate information to the Fund.”



RODRIGO DE RATO Y FIGAREDO
MANAGING DIRECTOR

INTERNATIONAL MONETARY FUND
WASHINGTON, D.C. 20431

CABLE ADDRESS
INTERFUND

July 20, 2004

The Honorable Roosevelt Skerrit
Prime Minister and Minister of Finance and Planning
Roseau, Dominica

A handwritten signature in dark ink, appearing to read "R. Skerrit", written over the printed name.

Dear Mr. Minister:

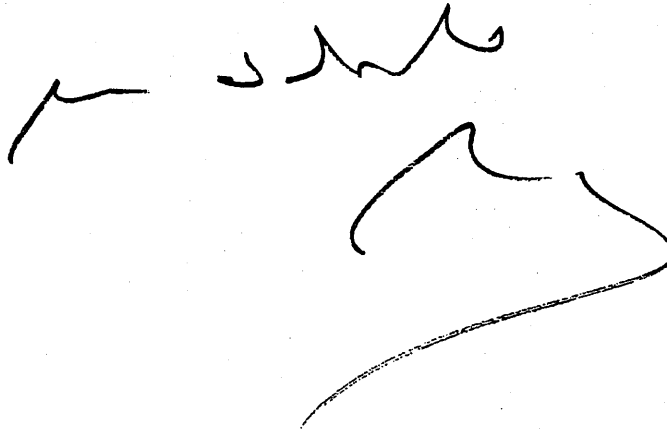
I am encouraged to learn of the favorable performance under the Fund-supported program.

It has come to our attention, however, that a case of misreporting under the Poverty Reduction and Growth Facility (PRGF) arrangement and the previous Stand-By Arrangement (SBA) has emerged in the course of the debt reconciliation exercise you have undertaken following the announcement of the debt exchange offer. We understand that an external supplier's credit extended by IBM was in arrears from July 2001 to April 2004, which you previously recorded as a domestic claim (IBM arrears). As you know, both the SBA and the PRGF arrangement contain a continuous performance criterion on nonaccumulation of external payments arrears. Although the SBA and the PRGF arrangement were approved with some existing external arrears, and a waiver of nonobservance of the performance criterion on external payments arrears was granted at the first review of the SBA in July 2003, the actual amount of arrears upon approval of these arrangements and at the first SBA review was higher than reported to the Board due to the IBM arrears. As a result, Dominica may have received three noncomplying purchases under the SBA (i.e., the purchase in the amount of SDR 0.308 million made after the completion of the first review in July 2003, the purchase in the amount of SDR 0.308 million made in September 2003, and the purchase in the amount of SDR 0.308 million made after the completion of the second review in December 2003), and a noncomplying disbursement in the amount of SDR 0.308 million made in March 2004 after the completion of the first review under the PRGF arrangement.

Under the Fund's policies on misreporting and noncomplying purchases in the General Resources Account and noncomplying disbursements under the PRGF arrangements, I am required to report any instances of noncomplying purchases to the Executive Board. The Executive Board may decide either to call upon Dominica to make an early repurchase/repayments, or it may grant a waiver for the nonobservance. The Fund's policy allows for waiver to be granted only if the deviation is minor or temporary, or if the member has subsequently taken additional measures appropriate to achieve the objectives of the program.

I would be grateful if you would confirm our understanding of the facts, and outline the steps that you have taken to ensure that there will be no further accumulation of arrears, as well as the steps that you have taken to resolve the arrears to IBM. I would appreciate receiving your views on this matter before I make a recommendation to the Executive Board on how to proceed. As this issue must be resolved before the Board can consider the second review, I would welcome a response at your earliest convenience.

Very truly yours,

A handwritten signature in black ink, consisting of a series of loops and a long, sweeping underline.



Government of the Commonwealth of Dominica
MINISTRY OF FINANCE & PLANNING

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Commonwealth of Dominica
West Indies

Ref:

July 21, 2004

Mr. Rodrigo de Rato
Managing Director
International Monetary Fund
700 19th Street, NW
Washington, DC 20431
USA

Dear Mr. de Rato:

Thank you for your letter of July 20, 2004, regarding the possibility that Dominica may have misreported on some external payments arrears, in the context of its use of IMF resources.


As we had indicated to Fund staff, the government of Dominica has acknowledged the claims in question and reported them as arrears as we committed to report under the Stand-by and PRGF programs. However, due to a misclassification, these claims were treated as domestic arrears and were not identified as external payments arrears. The arrears in question relate to a supplier's loan that was contracted in October 2000 to purchase computer equipment, totaling US\$326,303.00, and was to have been repaid in 36 monthly payments from April 1, 2001. No payments have been made on this loan since July 2001.

I regret this misclassification, and recognize that it has triggered the IMF's misreporting procedures. I would like to take this opportunity to assure you that steps have been taken to ensure that all arrears are correctly classified. As you are aware, we are engaged in a comprehensive exercise to reconcile our external debt, in connection with our ongoing debt restructuring exercise, which will help improve significantly our monitoring capabilities in this area. Moreover, the supplier has tendered these claims for participation in the government's ongoing debt exchange offer, which we understand has led to the elimination of the arrears for the purposes of the program.

We understand that this misclassification led to a breach of obligations under Article VIII, section 5. Let me reiterate that this problem has been corrected and confirm that the provision of inaccurate information concerning external payments is not due to a lack of capacity on the part of Dominica.

In light of the small amounts involved, the improvements being made to our monitoring capabilities, and the settlement of the claim, we request waivers for the non-observance of the performance criteria on external arrears under the 2002 Stand-By Arrangement as well as the current PRGF arrangement.

Very truly yours,


HON. ROOSEVELT SKERRIT
PRIME MINISTER AND MINISTER
OF FINANCE AND PLANNING

cc: *Mr. Ian Bennett, Executive Director for Dominica*