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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 02/26

10:00 a.m., March 14, 2002

Contents

Executive Board Attendance

A. Krueger, Acting Chair

Executive Directors	**Alternate Executive Directors**
S.M. Al-Turki	A.S. Alosaimi A.R. Ismael, Temporary P.R. Fenton, Temporary D.C. Guinigundo
R.F. Cippà	R. von Kleist D. Lombardi, Temporary
D.I. Djojosubroto	Low K.M. R.A. Jayatissa C. Josz, Temporary S. Kropas, Temporary M. Lundsager B. Couillault, Temporary
A. Mirakhor	A. Lushin E. González-Sánchez, Temporary M.A. Brooke A.A. Tombini, Temporary
C.D.R. Rustomjee	M.B. Chatah
Wei Benhua	Y.G. Yakusha M. Yanase, Temporary C.E. Pereyra, Temporary

A.S. Linde, Acting Secretary
O. Vongthieres, Assistant

Also Present
ECB: M. Caparello. Asia and Pacific Department: J. Carter. Fiscal Affairs Department: W. Allan. Legal Department: H. Elizalde. Monetary and Exchange Affairs Department: J. Dalton, A. Petersen, P. Stella. Policy Development and Review Department: M. Fetherston. Secretary's Department: A. Mountford, P. Ramlogan. Statistics Department: A.M. Valencia. Treasurer's Department: E. Brau, Treasurer; M.G. Kuhn, Deputy Treasurer; B.S. Newman, Deputy Treasurer; T. Catsambas, B. Christensen, I. Goodwin, C. Hemus, B. Keuppens, J. Kurtzig, M. Manno, C. McCoy, N. Rawlings, I. Rutkowska, A. Sartip, M. Wattleworth. Western Hemisphere Department: R. Balakrishnan, L. Perez. Office of the Managing Director: R. Moghadam. Office of Budget and Planning: T. Wolde-Semait. Office of Internal Audit and Revue: A. Coune, F. Laclavere. Advisors to Executive Directors: S.A. Bakhache, A. Baukol, K. Kanagasabapathy, M.F. Melhem, J. Milton, P.A. Nijsse, H.E. Phang, S. Rouai, F. Zurbrügg. Assistants to Executive Directors: G.M. Campos, N.J. Davidson, C. Harzer, T. Moser, T. Segara, A. Stuart, S. Vtyurina, Wei X.

1. SAFEGUARDS ASSESSMENTS—REVIEW OF EXPERIENCE AND NEXT STEPS, AND INDEPENDENT REVIEW OF SAFEGUARDS ASSESSMENTS FRAMEWORK

Ms. Caparello, Chair of the panel of external experts and Director of Internal Audit at the European Central Bank, participated in the discussions.

Documents: Review of Experience and Next Steps (EBS/02/27, 2/19/02); and Review of Experience and Next Steps—Independent Review of the Safeguards Assessments Framework (EBS/02/28, 2/19/02)

Staff: Brau, TRE; Catsambas, TRE

Length: 3 hours

Mr. Varela and Mr. Beauregard submitted the following statement:

At the outset, we would like to thank staff for the well-written and focused paper prepared for today's discussion. We would also like to highlight the Panel's recognition that, with limited resources, staff has done an impressive job. We commend staff for this effort.

Regarding the content of the staff's paper and the Panel's recommendations, our comments are the following:

Safeguards Assessments (SA) should become a permanent mechanism of the IMF's operations

We agree that the Fund, as a fiduciary agent, should enhance its reputation and credibility as a prudent lender and, in this sense, the SA is a good tool toward that end. Furthermore, it certainly creates the incentives for central banks to be more transparent and vigilant in their actions.

Scope of the SA

We fully share the view expressed by the Panel of experts that although in many cases the SA process could end up proposing program conditionality and timing, only those issues highly relevant to safeguarding Fund's resources should be included in said program conditionality. We also fully share the view that staff should take into account specific circumstances of member countries when proposing remedies and related timing, and that technical assistance plays a key role in this process.

Coordination Among IMF Departments

Given that the ELRIC framework is based on the IMF's Code of Good Practices on Transparency in Monetary and Financial Policies, we strongly encourage staff to pursue that in the case of those countries that have already been assessed in this area, much of the information for the SA be obtained from the relevant ROSC, leaving discussions with country authorities for those issues that need to be updated or re-confirmed.

Stage One/Stage Two Distinction

We strongly support staff's view that conducting the SA in a single stage would increase its efficiency, saving resources to both staff and member countries.

Deadline for Completion of Safeguards Assessments

In principle, we agree that it would be better to complete the SA prior to the Board discussion on the approval of the Fund program. However, we ought to be flexible and, in this sense, the first program review provided this flexibility.

Staff will recommend to the Executive Board that a program review not be completed if one of three criteria, detailed in paragraph 66, applies. We agree with the proposal but we think that in this very serious case the voice of the authorities would also be important to be heard. Thus, we propose that a letter from the authorities of the pertaining country explaining why they were not able—or willing—to comply with remedial measures, be also included in the report to the Executive Board.

Monitoring Process

We fully share staff's proposal to monitor the progress achieved in implementing agreed recommendations to those countries with outstanding Fund loans. For those recommendations that were not included as conditionality, staff suggests that the monitoring process could be carried on every 12–18 months. What would staff's criteria be to conduct in some cases the monitoring process every 18 months rather than in 12 months or vice versa? Would it not be easier and more transparent to uniform the monitoring process to a 12-month cycle?

We agree that in the monitoring process new vulnerabilities could arise. Staff proposes a reassessment of the central bank's ELRIC if the country still has a Fund supported program with the Fund. But if said program has expired, then there will be no reassessment. Although we can go along

with this proposal, we think that in the latter case staff should promptly inform Management and the Executive Board of the new findings.

Budget

Staff's concerns, supported by the Panel of experts, regarding needed resources to conduct SA should be addressed, in order to provide the Treasurer's Department the qualified staff to perform this duty. However, as recognized by staff, more efforts should be done to improve information sharing among departments in the Fund.

Publication

We agree to publish the report after deleting country references.

Ms. Lundsager and Mr. Baukol submitted the following statement:

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 the 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 the staff's recommendation for follow-up for as long as IMF credit remains outstanding.

The 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 the 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 in 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 PRGF-supported programs and many Stand-By Arrangements) 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 the 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

The staff suggests 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. As a main purpose of an SMP is to prepare for a funded arrangement, it makes sense for the 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 the 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 safeguards guidelines. The staff proposes 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 safeguards 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.

Mr. Kiekens and Mr. Josz submitted the following statement:

This independent review of the implementation of the new policy of assessing a country's safeguards before giving it access to Fund resources once more demonstrates the staff's ability to implement new policies quickly, and shows how urgent it is to improve the transparency of countries' central banks and the effectiveness of their control systems.

From Table 2 of the staff's main paper, and particularly from its last column, we obtain a pretty bleak picture of the transparency and operational controls of the central banks surveyed. The many serious defects found so far confirm that prior assessments of the safeguards used by the fiscal agents of countries requesting Fund resources were long overdue. Fortunately, the review also shows that the deficient central banks have recognized their deficiencies and started to correct them. The progress of these remedies must now be adequately reflected in program conditionality and carefully monitored during program reviews.

I support all of the staff's proposals, including their request for more resources (Annex IV) to strengthen the Fund's new policy of safeguards assessment. The Board should be regularly informed about the results of safeguards assessments, perhaps as part of the quarterly financial transaction plans that the staff already submits for the Board's consideration.

The findings of the independent review indicate that the following proposals should also be adopted:

In countries where the fiscal agent is an agency other than the central bank, that other agency should likewise be subject to a safeguards assessment before Fund resources are released.

Safeguards assessments are preferably to be completed before the release of Fund resources, and in all cases before the first program review. Paragraph 12 of the staff's main paper shows that this deadline has sometimes been missed, but does not indicate how many times. Fuller information would be welcome. The number of missed deadlines must be reduced from now on, lest the credibility of our policy of prior assessments of safeguards assessment should suffer.

Progress with the correction of serious deficiencies found during safeguards assessments should be monitored both during the program and as long as post-program monitoring continues.

The Board should again review the new safeguards assessment policy two years from now. The staff has made a good start with its implementation, and the countries surveyed are reacting swiftly. But the Board must closely monitor the progress made in correcting the many remaining loopholes in central banks' controls revealed by this first review. Past abuses by some central banks of Fund resources have severely tarnished the Fund's reputation as a prudent lender. The utmost vigilance must be used to prevent any recurrence of these abuses.

Our next review of safeguards assessments should again be supplemented by the expertise of independent experts. Their opinions have been extremely valuable, both during the design of the policy two years ago, and during the present review. The next time the external experts should contact not only central bank governors but also the central bank board members in charge of internal audits, when seeking information on a central bank's experience with the safeguards assessment exercise. This would make it possible to obtain the viewpoints not only of the official responsible for the central bank's overall management but also that of the person directly responsible for the transparency and the control of central bank operations.

Finally, it would be most welcome if Russia joined the group of member countries not in line for safeguards assessments but whose central banks wish to learn about the safeguards framework and to use it as a benchmark for their own practices. Russia has not made much progress with respect to publishing the central bank's financial statements, reviewing past years' reserve management practices, or reporting its international reserves and foreign currency liquidity to the Fund under the SDDS template—as is known from the staff report for its 2001 Article IV consultation and post-program monitoring discussions. Russia's lack of progress casts a shadow over the headway made elsewhere through the Fund's new policy on safeguards assessment.

Mr. Portugal and Mr. Tombini submitted the following statement:

The safeguarding of the proper use of public resources should be a universal objective of all member countries, independently of the use of Fund money and of the presence of a safeguards assessment mechanism. An IMF safeguards assessment is not, however, the only or even the main instrument to achieve such objective. It is in the interest of every member to keep under periodic review, and to strengthen as needed, its systems of internal and external controls and auditing of the use of public funds in general, including those under the auspices of the central bank. This is a major objective of the countries in our constituency, some of which have already in place robust internal control and external auditing systems.

The staff correctly reminds us in paragraph 10 that "the focus of the evaluation is not on the development of international best practice, but on safeguarding IMF resources." Adherence to this principle should guide all future work on safeguards assessment. In reviewing the experience and assessing common vulnerabilities identified, however, the staff sometimes leaves the impression that the aim is not safeguarding of Fund resources, but indeed looking for the establishment of international best practices. This clearly goes beyond the limited objectives approved by the Board. Likewise, the paper leaves, in many instances, the impression that staff is aiming at a

broader scope, namely assessing the safeguards of central bank resources in general, beyond what would be necessary to constitute reasonable assurances to safeguard the use of Fund resources. The safeguards assessment framework should not be converted either into an institutional capacity building exercise, which is a necessary but completely different activity, based on a voluntary decision of the member country to request Fund's technical assistance.

As the staff acknowledged, while safeguards assessments may inhibit the circumvention of controls, they cannot prevent it. The incidence of misreporting and misuse of Fund resources will not be precluded by the existence and by the strengthening of the safeguards assessment framework. An identified weakness certainly requires prompt remedial action by the part of the member country. This chair supports the transformation of recommendations in conditionality provided that they address key vulnerabilities that endanger Fund resources. On this account, we urge the staff to clarify what is meant by key vulnerabilities in paragraph 66, and based on the experience so far, to exemplify such occurrences.

The staff notes in Chapter III an increased awareness among central banks of the need for strong safeguards in the areas of external and internal auditing, financial reporting, and internal controls, and suggests that this would be a result of the new mechanism of safeguards assessment. At the same time, there has been an increasing concern regarding its own controls by central banks in line with a widespread strengthening of prudential regulation and supervision of financial markets. To disentangle these two effects in order to be able to assess more accurately the value added by the Fund's new assessment framework is not a trivial task.

As the staff points out "an independent and high quality external audit of a central bank's financial statements is the most important control to ensure the reliability and completeness of the information contained in the financial statement." In this connection, the staff found that more than half of the transitional assessments concluded that the existing external audit mechanism was in full compliance with the safeguards framework. This is a very positive development that the staff expects to continue in the future.

In reviewing the assessment process, the staff identifies a series of weaknesses that would require remedial action. However, the question to be addressed is whether this framework has in fact reduced the probability of misuse of Fund resources. The evidence provided in the report is basically analytical, as the staff takes stock of the most common vulnerabilities identified and draws the potential implications of these vulnerabilities on the safeguarding of Fund resources. Given the infancy of the new framework, however, it is impossible to establish the causation between the framework and the prevention of misuse of Fund resources.

The Panel of experts suggests that safeguards assessments have enhanced the IMF's reputation and credibility as a prudent lender. The staff adds that the initial findings have demonstrated the importance of staying vigilant in the areas covered by the safeguards assessment framework and proposes that the safeguards policy be adopted as a permanent feature of the IMF's operations. Despite the limited evidence of the contribution of this new framework to reducing the likelihood of misuse and misreporting, we are of the view that the safeguards assessment framework should be transformed into a permanent policy of the Fund. Moreover, we can support some of the recommendations made by staff with a view to refining the existing mechanism.

One of the most controversial areas of the safeguards assessment framework relates to the role of the legal structure. The staff draws a series of implications from what are considered to be deficiencies of the legal structure. The room for confusion is large. In this respect, we share staff's concerns that the current operational approach may be too broad, and there is the need to refine the scope of the assessment of the legal structure to refocus it more narrowly on issues that may have a direct causal link to the prevention of misuse of Fund's resources and misreporting. The lack of de jure independence of a central bank, for instance, should not be interpreted as vulnerability regarding the safeguards on the use of Fund resources. Even in such a context, an existing legal structure can still provide the statutory assurances for protecting the public resources, safeguarding Fund resources. The potential for confusion in this area of the safeguards assessment should not be underestimated. We, therefore, propose that the area of legal structure, which is subject to assessment by the Fund, be clearly and narrowly defined to encompass exclusively the legal structure pertaining to internal and external auditing and control and financial reporting.

We support the proposition of further developing the diagnostic tools to review the selection of external auditors and the audit rotation policies applied at central banks. As stated before, this chair is of the view that the external auditing area is the most relevant in the whole safeguards assessment framework. It is where the most effective progress can be made in a less intrusive manner, and without an overburden for the IMF staff and resources. Relying as much as possible in external evaluations of central bank's safeguarding policies towards the use of Fund resources and having the capacity to assess the quality of these external evaluators is, in our view, the most promising avenue going forward for developing a sound and cost-effective safeguards policy in the IMF. Along the lines of introducing operational refinements to the existing framework, we could support further development of tools to focus on controls over foreign reserve management and external reporting.

We share the staff's view that the existing two stages in the safeguards assessment process have created confusion among both country authorities and IMF staff. Nevertheless, we diverge from the staff that the solution is to consolidate the two-stage approach into one process. We still believe that for many members, the off-site stage (stage one) would be sufficient to properly assess the safeguarding of Fund resources. This appropriateness of a single stage is likely to increase as the Fund completes more assessments. We would submit, for instance, that for countries that have undergone the stage two assessment and that in the future request further financial assistance from the Fund, a one-stage off-sight assessment would be enough. It is useful, therefore, to retain the flexibility of the two-stage process. However, the circumstances that would trigger the stage two should be more flexibly defined. Currently, the staff engages in the stage two only if it cannot reach the conclusion that the existing safeguards mechanism appears adequate to safeguard the Fund's resources. This language may give the impression that the implementation of a stage two is linked to a deficient auditing, control and reporting mechanism. The reason could be, however, that the case is complex and the documentation not well understood to warrant a conclusion at the off-site phase. This language should, therefore, be clarified, but without losing the flexibility of the two-stage process. In this respect, it is also important that Fund staff should exhaust all means by an off-site assessment to the analysis of a member's safeguards structure, such as for instance further consultation with the authorities, before engaging in the second on-site stage. Any difficulties regarding logistic aspects should be promptly addressed by the Fund staff to avoid unnecessarily triggering a second stage.

We share staff's concern that a wider dissemination of safeguards reports could create disincentives for central banks to cooperate in providing valuable information to the Fund. We do not share, however, the view expressed by staff in paragraph 49 that public dissemination of matters of interest related to safeguards will aid in the establishment of central bank best practices in these areas. On this account, we recall that the objective here is not to foster best practices, rather to safeguard the use of Fund resources. Therefore, we do not see any grounds for changing the existing communication's policy regarding safeguards assessment.

We support the expansion of safeguards assessment to encompass the program's augmentations or Rights Accumulation Programs (RAP). We do not support, however, the contention in paragraph 53 that for "Staff Monitored Programs, central banks should be encouraged to voluntarily undergo a safeguards assessment." Staff-monitored programs do not involve commitment of resources and in some cases do not involve even the perspective of a future commitment, and, therefore, should not be the basis for any recommendation regarding safeguards assessment of Fund resources.

In face of the average time required to complete a safeguards assessment, which ranges from one to eight months, we are not too convinced by staff's proposition to retain the current deadline of completion by no later than the first program review. Perhaps a more realistic deadline would be advisable, without undermining the credibility and effectiveness of the mechanism.

Mr. Kelkar submitted the following statement:

Key Points:

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

The SA should strive to focus and concentrate on high-risk area (paragraph 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 (paragraph 3).

SA is greatly enhanced by providing best practices and governance rules to all economic agents, duly taking into account the country specific circumstances (paragraph 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 (paragraph 5).

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

We thank the staff for a comprehensive paper reviewing the experience of safeguards 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.

The background to the efforts on safeguards 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.

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 balance of payment 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 that 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.

The safeguards 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.

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.

The findings of this initial safeguards 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.

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.

Mr. Lushin and Ms. Vtyurina submitted the following statement:

We are pleased to see that the overall experience with the pilot program on strengthening safeguards of central banks has been positive in view of both the staff and the Panel of external experts. This program has been an important part of enhancing the operational procedures of central banks while improving the Fund's reputation and credibility as a prudent lender. Yet, as the staff rightly notes, these assessments should not be seen as a panacea for preventing the misuse and misreporting under Fund arrangements since even good controls can be overridden. In addition, it would be essential to monitor the implementation of the recommendations given to central banks since the true effectiveness of this assessment exercise could only be seen if and when these recommendations are actually implemented. We thank the staff for a very comprehensive report, which makes it difficult for us to add any substantial comments. Therefore, we would limit ourselves to the following points:

While commending the staff for designing a useful and broad ELRIC framework, we also appreciate their attempts to give due consideration to countries' varying levels of economic development and complexities of central banks' operations and also to recommend corrective actions that range from technical assistance to prior actions. In this context, the difference between the available options has to be carefully identified. We note that so far this distinction has been made fairly well (a good example would be the case of Pakistan where both technical assistance and prior actions have been applied). This said, however, we expect that corrective actions will be applied in an equal manner in countries sharing similar assessment outcomes. In general, though, we agree with continuing to use the ELRIC framework as a basis for assessing safeguards and concur with the staff's proposals for its operational refinements, such as streamlining of the documentation requested from central banks and converging off-site and on-site assessment reports.

In regard to the time required to complete a safeguards assessment, we note good progress made in staying on schedule. However, there have been instances when the deadline was missed because of various difficulties elaborated on by the staff in footnote 5. Since generally review times for the Fund's arrangements range from 3 to 6 months while the safeguards assessments may take up to eight months, delays in presenting assessments to the Board should be expected. We agree with the staff proposal to make the best effort to keep the deadline intact, but, in turn, would appreciate a more comprehensive explanation than at present in the Board papers on the reasons for delays so that to avoid additional elaboration from the staff on this issue during the Board meetings. Otherwise, we are satisfied with the staff proposals on the communication to the Board as stipulated in paragraphs 65-67.

While it is important to single out the positive aspects found in some central banks' safeguards frameworks, unfortunately many deficiencies still exist in many of them. Indeed, the staff's findings of safeguards assessments presented in Table 2 communicate quite serious problems in various areas of banks' ELRICs. In regards to the staff question to the Directors if the existence of the safeguards process provides an incentive for a central bank to be more aware and vigilant in its actions, we see it is rather obvious that if the country is under the Fund arrangement, the corresponding central bank will have no choice but to improve its ELRIC framework. However, we are not so sure that many other central banks are particularly keen on this issue. Therefore, we are pleased to note, that in the staff's view the assessments have raised the awareness of safeguards related issues in central banks. We were also pleasantly surprised that several central banks not subject to safeguards assessments have proactively sought staff's informal assistance in understanding the assessment process and ELRIC framework.

This brings us to the issues of promoting safeguards awareness and resource implications. While the aforementioned banks' interest in safeguards assessments is a most welcome development, we are concerned that given the limits of available resources (see below) the staff's involvement in the dissemination of information to interested parties and participation in external fora will take them away from the current work in countries that need to undergo such assessments. Therefore, while recognizing the importance of increasing awareness in this area, we will have difficulty in supporting this type of involvement by the staff unless staff resources are increased. Our stance on this issue is also supported by the discussion in paragraphs 50-51 and Annex IV on resource implications from which it is apparent that there are not enough trained staff within the Fund to participate in the needed assessments while "the experience with external experts has been mixed". In regards to the latter, we would ask the staff to elaborate on this statement (it would also have been helpful if the external experts who participated in such assessments had expressed their opinion about their experience).

We are troubled by the fact that in FY 2002 the annualized resource utilization is expected to be four staff years in excess of the budget allocation (especially when this results in non-compensation of overtime for a small number of staff conducting assessments). This is not the first time this Chair expressed its dissatisfaction with the way the new initiatives are being undertaken at the Fund, specifically in the area of resource management. This said, we expect those Chairs who are going to be supportive of the activities listed on page 51 also to support the equivalent increase in the FY2003 budget appropriations. If the Fund is trying to ensure an appropriate use of its financial resources by its members, it should lead by example in its own sound allocation of resources across activities.

To get the most out of the assessments exercise adequate monitoring of previous recommendations is essential. We see the staff proposals in this area as adequate. We also suggest conducting another evaluation of the Fund's experience in this area no later than 24 months from now in order to examine the end results of the implementation of recommendations. W also concur with expanding the safeguards assessments program to cover the augmented arrangements and RAPs, and making it a permanent part of the Fund's operations. We do not, however, agree with the proposals of the US Chair on the extension of assessments to other cases and arrangements, not least because the Fund resources are limited. And, as previously, neither do we support conducting assessments in any agency (a fiscal agent) other than a central bank.

Finally, without singling out any particular country since it would be inappropriate at the discussion of a policy paper, we would like to emphasize that in the context of the Fund programs special attention should be paid to high quota users of the Fund resources. Operations of these countries' central banks should be put under the highest degree of scrutiny so that to ensure the full protection of the Fund resources.

Mr. Mirakhor submitted the following statement:

Key Points

Significant progress has been made on safeguards assessments (SAs), with very limited resources.

We agree that SAs should become a permanent feature of Fund policies.

Regarding the way forward, we broadly agree with staff proposal, except the following: (i) the proposed monitoring procedures should apply only during the period of the arrangement and during any post-program monitoring; (ii) SAs should not be extended to government agencies where the fiscal agent is not the central bank, and (iii) paragraph 66 needs clarification, for example:

- What is the status of the proposed criteria within the overall program conditionality framework; and can the proposed criteria admit waivers;

- The meaning of the sentence "staff would recommend that a program review not be completed" is not clear. Usually the request for completion of the review is not brought to the Board unless approval is recommended by staff;

We support additional resources to cover the projected needs.

We propose an IMF Institute course on safeguards assessments.

We thank the staff for a well-written report and for the consultative approach used in conducting the review of experience with safeguards assessments (SAs). We thank also the members of the Panel of experts for their contribution to this important work.

From the findings of the review and our Chair's own experience, it is fair to conclude that the SA initiative has brought largely positive results. We note in particular:

The identification of significant vulnerabilities in the way some central banks are conducting their operations, including lack of external audit, weak legal and governance structure, inadequate accounting standards, deficient internal audit, and poor control over foreign reserves;

The highly encouraging acceptance of the SA approach by central banks and the implementation of much of their recommendations;

The positive contribution of SAs, together with other Fund initiatives, to the emergence of a culture of transparency and accountability in central banks operations reflected in a more timely publication of audited financial statements and in the recognition of the important role of audit in strengthening governance;

The acknowledgment by the Panel of experts that SAs are contributing to enhance the credibility of the Fund as a prudent lender. This is confirmed by the staff's own findings that SAs have identified and addressed several instances of potential misreporting, thus limiting the risks of misuse of Fund resources.

The Panel and the staff are proposing a number of changes and refinements. We agree with the proposal to make SAs a permanent feature of Fund policies. We agree on the extension of the SA exercise to existing arrangements that are augmented. Regarding the case of countries following a Right Accumulation Program (RAP), and in view of the special circumstances and vulnerabilities of these countries, it could be useful to encourage these countries to voluntarily undergo a SA as part of the RAP so as to allow them to initiate, and have enough time to implement, the necessary corrective actions. The conditionality associated with SAs should, however, be applicable only when Fund resources are being committed. We also agree that no requirement for SAs be made for first credit tranche purchases, CFF purchases, or emergency assistance disbursements.

The role of monitoring the implementation of the recommendations made during the course of a safeguards assessment exercise is very important. We would expect that monitoring would be intensive during the period of the Fund-supported program and, in some cases, we can see the need for on-site monitoring. After the expiration of the arrangement, however, our preference is for a more selective and flexible policy. For example, we can support staff's proposed approach in Section V-A only for countries selected for Post-Program Monitoring. An indication from the Legal Department on whether members' obligations could be expanded as suggested in cases where no new Fund financial resources are committed would be helpful. At the expiration of the Post-Program Monitoring or when credits outstanding reach less than 100 percent of quota, the "transitional procedures" now in effect, namely that central banks publish annual financial statements that are audited by external auditors in accordance with internationally accepted standards, should provide enough assurance.

We support staff's proposals to streamline the two-stage process, to enhance awareness about SAs through periodic issuance of non-country specific reports, while keeping the SA documents confidential. We support also the way SAs will be applied to new arrangements, including tailoring the documentation requested from central banks to the specific country. However, SAs should not be extended to government agencies where the fiscal agent is not the central bank as this would entail Fund involvement in complex and time-consuming issues and may be perceived as intrusive.

Paragraph 66 of the report needs some clarification. While staff may wish to recommend noncompletion of a review based on the proposed criteria, it is not clear how these criteria will be treated within the framework of Fund conditionality. Will, for example, waivers be allowed? Will the Board be informed of the authorities' position and reasons why anyone of the proposed criteria has not been met? Will the staff report to the Board when a member has satisfied all other program conditionalities, but has failed to meet the SA criteria? As it appears, paragraph 66 seems to give higher status to the proposed criteria than other program conditionalities. What is the meaning of the sentence "staff would recommend that a program review not be completed?" Usually the request for completion of the review is not brought to the Board unless approval is recommended by the staff.

We support the Panel's proposals for stronger consultation within the Fund and with member countries in the conduct of SAs, close attention to specific conditions in member countries when proposing remedies and related timing, and limiting areas covered by Fund conditionality to highly relevant issues.

We thank the staff for the information provided in Annex IV on the resource implications of SAs. We note with satisfaction the efficiency in use of the limited resource available for this initiative, i.e. 9.8 staff years in FY 2002. We are, however, concerned by the unsustainable reliance on uncompensated overtime. We therefore support increase in resources to cover the projected needs during the next two to three years.

Finally, some non-program countries in our constituency have expressed interest in understanding the SA process. We take this opportunity to thank the Treasurer's Department for its cooperation and for the support provided to our authorities. We suggest formalizing this assistance through development of an IMF Institute course on SAs by the Treasurer's Department.

Mr. Guinigundo submitted the following statement:

Key Issues

We need to be realistic about the extent to which safeguards assessments can safeguards resources and keep the goal of the framework in perspective.

While the framework will not prevent misuse of Fund resources or misreporting to the Fund, safeguards assessments, if followed through, could create an environment that makes misuse and misreporting less likely.

Given the limitations of the framework and the existence of other vehicles to promote transparency and good governance, as well as taking account of the resources requirements, we suggest there is scope for a more focused approach.

The Need for Realism

The Fund has a responsibility to safeguard its resources. While it might be the case that the safeguards assessments approach has enhanced the Fund's reputation and credibility as a prudent lender, the key issue is whether the framework can meet its intended objectives in safeguarding resources. As staff notes, it is too early to determine the long-term effectiveness of the process. In the meantime, we must be realistic about what the safeguards assessments can achieve.

Even if the assessments were to give comfort that there would be no misuse of Fund resources once they enter the central bank's balance sheet, there is still potential for misreporting and misuse of resources—staff outlines the limitations of extending such assessments to treasuries or finance

ministries and spending departments. Furthermore, the Fund cannot control the use of fungible resources.

While safeguards assessments of central banks will not prevent misuse of Fund resources or misreporting to the Fund, if followed through, they could create an environment that makes misuse and misreporting less likely.

Specific Goal of SAs: A Reminder

It is also important to keep in mind that the goal of this whole exercise is safeguarding Fund resources rather than effecting wholesale changes in central bank accounting and governance. In our view, a more effective vehicle to promote best practice central bank accounting and governance is the voluntary Code of Good Practices on Transparency in Monetary and Financial Policies (the MFP code). The staff paper highlights that central banks have willingly embraced changes recommended in the context of the pilot safeguards assessments. We see this as an argument for better promotion of the MFP code rather than an argument for additional safeguards assessments.

We must take care not to present the framework as mitigating the risk of misuse and misreporting. To do so would run the risk of strong criticism in future cases of misuse and misreporting.

Realism is also required in respect of the time is takes to improve financial reporting and corporate governance under the ELRIC model. Changes necessary to create effective corporate governance and financial reporting models can take significant time (and, in some cases, may require significant assistance), which may imply continued risks to Fund resources in the short term.

Scope for a More Focused Approach

While we welcome the staff's suggestions for refining the framework, taking a step back and taking into account the resource implications, we suggest there might be some scope for a more effective and efficient way of safeguarding resources by focusing on cases where Fund resources are most at risk. This may imply a shift from a zero-tolerance based approach to one that is based on an assessment of risks to Fund resources, the mitigation of which should be the central aim of the exercise. On a more general level, safeguarding Fund resources could be built into Fund program reviews by including an assessment of potential risks to its successful completion.

Given the potential drain on both Fund and central bank resources, we would be interested to hear staff's views on ways to more effectively target the assessments, bearing in mind the existing vehicles for promoting

transparency and good governance. The scarcity of both internal and external experts with the skills required to conduct assessments, also argues for a more focused approach. It is essential that assessments be undertaken by people who have some understanding of central bank operations.

It remains to be seen whether safeguards assessment recommendations can be implemented to significantly reduce resource misuse. We recognize the importance of having measures to safeguard resources and that, while the approach had shortcomings, the assessments could foster an environment where misreporting and misuse are less likely. We reiterate that we have some concerns about the effectiveness of the approach and see merit in a more focused approach.

Finally, we find it reassuring that the staff did not endorse the adoption of the Independent Review Panel's recommendation to develop a comprehensive accounting and financial reporting framework for central banks. We do not see central banks as so unique so as to warrant a separate accounting standard.

Mr. Cippà submitted the following statement:

I thank the staff and the Panel of experts for their reports. The experience with safeguards assessments so far confirms the importance and usefulness of this initiative, as the exercise has identified significant vulnerabilities and deficiencies in the areas of control and governance within central banks of program countries. Although the safeguards assessment policy will not prevent deliberate and willful misreporting and misuse of Fund resources, it certainly helps reduce the possibility for such conduct and minimize the scope for unintentional misinformation. I therefore support the proposal to make the safeguards assessment policy a permanent part of the IMF's operations.

Of course, to accomplish the objective of this initiative, assessments have to be followed by remedial actions. The effectiveness of the safeguards assessments policy will thus ultimately have to be measured by the improvements in central bank safeguards. I fully agree with the Panel of experts that the failure to follow up the recommendations resulting from safeguards assessments would raise doubts about country ownership and possibly harm the credibility of Fund lending practices. Therefore, I agree with Ms. Lundsager and Mr. Baukol that the Executive Board would have to consider the interruption or delay of disbursements if country authorities would fail to take reasonable steps to address identified deficiencies. It is my understanding, however, that this is covered under the current policy, insofar as—given the nature of the findings—the staff would incorporate proposed remedies into program conditionality.

I agree that the ELRIC framework should continue to be the basis for assessments. It is a good 5-pillar diagnostic tool to assess the key areas of control and governance within a central bank. At the same time, however, the safeguards assessments are rightly focused on safeguarding Fund resources and should not provide a general assessment of compliance with international best practices in these areas. For this reason, I am reluctant to expand the coverage of safeguards assessments to cases where no Fund resources are involved. Accordingly, I agree with the inclusion of augmentations to existing arrangements and Rights Accumulation Programs. More questionable would be the inclusion of Staff-Monitored Programs. The same is true for voluntary assessments in the case of non-program countries. I would generally prefer not to overburden the exercise and keep its focus on the safeguarding of Fund resources.

Expanding the coverage of safeguards assessments will have consequences for the resources needed, though it is understood that the increase in resources should be temporary, until all program countries will have had their first assessments. The following "update" assessments should require significantly less resources. As to the monitoring of recommendations, I support the proposal to make off-site monitoring the primary tool. It might also be cost effective to connect the monitoring of recommendations with regular program monitoring. Overall, it should thus be possible to meet additional staff requirements mainly by redeployment. The Fund should also continue to utilize external experts. If experience with external experts has been mixed, the staff should try to ascertain the reasons and find ways to improve collaboration.

On the timing of safeguards assessments, I agree that they should be finished preferably before the approval of a new program, and no later than the first review, in order to ensure credibility and effectiveness in safeguarding IMF resources. I also support the proposed refinements to existing procedures, i.e., the preparation of only one safeguards assessment report and the tailoring of documentation requested from the central bank to the specific country. Concerning the information to the Board on safeguarding assessments results, I can accept that normally the Board will not receive the detailed reports and will be informed only by a summary, although I find the confidentiality argument to be somehow at odds with the role of the Board. After all, it is the Board that is responsible for the granting of financial resources.

Finally, regarding the problem of Fund lending to entities other than central banks, it is my understanding that even in cases where the Fiscal Agent for the Fund is not the central bank, it is now common practice that Fund resources are disbursed in a central bank account. I would expect that the

Fund members are requested to follow this practice. Therefore, I believe that the safeguards assessment policy achieves what it intends to achieve, and the broader case of misreporting or misuse by agencies other than central banks, have to be addressed through program conditionality and the Fund's other transparency initiatives.

Mr. Chatah and Mr. Bakhache submitted the following statement:

We welcome this opportunity to review the experimental procedures for central bank safeguards assessments eighteen months after their introduction. The papers before us are quite comprehensive and provide a good basis to evaluate that experience, and to decide where to go from here with the assessments policy. Let me say from the outset that we attach great importance to the Board's responsibility in safeguarding Fund resources, including the effort to reduce the risk that resources are provided to members on the basis of erroneous information. We are under no illusion that safeguards assessments of central banks will eliminate misreporting or misuse of Fund resources altogether. This is so for many reasons, including the fact that in some instances, potential misreporting by other government agencies may be just as relevant as misreporting by central banks. More broadly, erroneous data is only one of many factors, including program design and policy implementation, that determine the extent to which Fund resources are being safeguarded. In our view, the significance of the procedures being reviewed today should not be minimized, but neither should it be exaggerated.

While we understand the distinction between the objectives of safeguards assessments and those of technical assistance, we do not see the two as completely separate. An important purpose of the diagnosis is to make possible the formulation of informed and effective advice on how to correct weaknesses and vulnerabilities in central bank data and control systems. One assumes that assessments reports submitted to central banks include clear and specific steps to be undertaken. Obviously, in many instances central banks may need technical assistance in the implementation of corrective measures, and that is obviously a different undertaking from the diagnostic assessment. But we would not draw too sharp a line between diagnosis and advice, as the staff paper seems to do. In fact, we view—and would encourage the staff and the countries subject to assessments to also view—the policy as part of the broader Fund role in assisting member countries to correct vulnerabilities in their informational and institutional capacities. This does not conflict with the fact that the policy is also motivated by the obligation to protect Fund resources, which is an obligation on our part after all.

The safeguards assessments are pre-emptive in nature, and their impact therefore may not be easy to gauge. To the extent that assessments produce better transparency and more effective control systems, some misreporting

may be preempted, which otherwise would go unnoticed without safeguards assessments, or without the corrective actions produced by such assessments. Therefore, an outcomes-based yardstick would not be meaningful, and one has to rely on information regarding implementation of assessments-related remedial steps on the part of central banks over the past 18 months. On that basis, we are encouraged by the improvements in the reporting quality and practices of many of the central banks involved, although some of that may be related to the increased general awareness in most countries of the importance of accounting, auditing and other similar procedures and standards, which cannot be attributed solely or mainly to the safeguards assessments procedures of the Fund.

In addition to effectiveness of the policy, resource implications are another factor that needs to be taken into account in deciding to make the policy a permanent one. On the basis of the information provided by the staff, while the resource implications are not negligible, they are not particularly excessive either. We also understand that the use of outside experts has been very limited. While the training needs associated with assessments may be somewhat specialized, they fall in areas where the Fund is increasingly involved; and thus should have the added benefit of improving the staff's overall capabilities in these areas.

We are prepared to go along with the staff's main recommendation of making safeguards assessments a regular Fund policy, and wish to offer a number of additional observations and questions.

While safeguards assessments are more limited than the reports on central bank adherence to the code of best practices under the ROSC exercise, the assessments framework is anchored on, and derives from, the principles that constitute that code. However, one advantage of the safeguards assessments is that it permits greater leeway in tailoring the assessment and the associated recommendations to the circumstances of different countries. We welcome, in this connection, the staff's emphasis on the need to take country circumstances and institutional capabilities into account in undertaking assessments and making specific recommendations.

Among the suggestions for the period ahead is to encourage central banks to undergo assessments in cases of Staff Monitored Programs (paragraph 53). We have no difficulty with encouraging central banks, including in SMP cases, electing to undergo assessments of the quality of their reporting. But the suggested extension does seem to blur the rationale of a policy, which aims at safeguarding Fund resources and not combating misreporting generally. Applying it to SMPs, which are often—but not always—preludes to arrangements, may be seen as pushing the policy somewhat in the latter direction.

Among the factors that will determine the nature and periodicity of safeguards monitoring is the extent of Fund credit outstanding (paragraph 58.) It is not clear whether the staff is referring to credit in absolute terms or relative to quotas. From a cost-effectiveness or prudential standpoint the former is clearly more relevant. But it could also be argued that the credibility of information provided to the Fund (including for flows from other sources to the country concerned), and therefore the payoff of assessments, may be at least as important in the case of smaller countries where the absolute exposure of the Fund is small in absolute terms. Staff comment on this would be useful.

Two other questions for clarification by staff relate to the use of on-site monitoring. In paragraph 59, the staff indicates that no such monitoring would be undertaken after the end of program, and that only off-site monitoring will be used in the post-program period as long as there is Fund credit outstanding. First, the schematic on page 52 seems to suggest the possibility of on-site monitoring throughout the period of outstanding Fund credit, and not only during the program period. Perhaps the schematic should be revised to make it consistent with the policy being proposed in para 59. Second, it is not clear what the follow up would be in those cases where off-site monitoring indicates the presence of significant problems. It is possible that the country itself may want to deal with those problem and not simply have them flagged, for example in staff reports, without a complete diagnosis or a plan to undertake the needed corrections. We need to insure that such follow-up and technical support are adequately provided.

Regarding the paper summarizing the views of the Panel of Experts. We have two remarks. First, we have noted the Panel's view that there is an urgent need for the IMF to encourage the development of specific standards or a framework for central bank accounting and financial reporting. The paper does not explain why the Panel felt that such a special set of standards would be needed for central banks. A clarification of the rationale behind this suggestion would be useful. Second, the Panel also suggests that safeguards assessments be adapted to apply to agencies that may serve as government fiscal agents instead of central banks. While recognizing the problem, the staff clearly does not agree with the Panel's recommendation as indicated in para 13 of the main paper. Staff elaboration on this issue would be useful, including on whether central bank assessments would still be undertaken in such cases even though the central bank is not the fiscal agent.

Mr. Barro Chambrier submitted the following statement:

We very much welcome the staff paper as well as the independent Panel's review of the safeguards assessment (SA) process. We view the papers and our present discussions as part of a continuing process to develop an integrated approach to the conduct of SA. We broadly agree with the main

conclusions of the staff and share the views expressed by the Panel, as well as the recommendations to follow-up on the process.

While we note that the original objective of the SA was to provide reasonable assurances to the IMF that its resources will be preserved, we note that the exercise has also been very useful in promoting transparency and good governance, and in improving the reputation of central banks. The SA missions have been useful in revealing weaknesses in the internal audit mechanism and the system of internal control of central banks, and have been instrumental in the setting up of external audits of central banks' financial statements. At the same time it has contributed to enhancing the reputation and credibility of the Fund as a prudent lender.

We also note that the staff, in many cases, has made extensive recommendations to correct identified weaknesses. We are in broad agreement with those recommendations. However, we would note that while a number of these recommendations can be implemented in a short period of time, there are others for which more time as well as external technical assistance will be required. Moreover, in the case of regional central banks, the implementation of some of the recommendations may require a long process of approval, as some of the measures will require not only approval of the Board of Directors, but also approval by each individual country. In other cases, the technical capacity of the central banks may be weak, and external technical assistance will be required.

An important finding of the Panel, as noted in paragraph 37 of the staff paper, is that many of the safeguards recommendations will require one to three years to be fully implemented. We, therefore, think that a longer period should be given to address key weaknesses. However, we also view as very important the safeguards of Fund resources. Therefore, we think that an assessment by the staff that serious progress is being made by the country in the implementation of the recommendations, at the time that the program is presented to the Board, should be given more weight, with the understanding that remedial actions will be taken by a certain time. This assessment will be made on a country-by-country case. We think that this is a more pragmatic approach, which will help to avoid delaying the presentation of programs/reviews to the Board. It will also be important to take into consideration the specific circumstances of each country, its legal and institutional system.

Like the Panel, we agree that the diagnostic tool, ELRIC, allows a balanced assessment and a rapid identification of the main vulnerabilities in the central banks' financial and operational control framework, as well as the legal structure relevant to the safeguards of IMF resources. Accordingly, a broadly standardized framework could be appropriate. However, we are also

of the view that standardization of accounting practices and formats may not be practical, and we welcome the recommendation by the Panel that a separate code of accounting practices applicable to central banks could be developed. We are also of the same view as the Panel that this should not be the occasion for loading Fund program with additional conditionality, in particular, at a time when the Fund is making every effort to streamline conditionality.

On the way forward, as we noted above, we would prefer to see a more pragmatic approach on the timing regarding the completion of SA. We think that the streamlining of the process to combine the two stages will be a move in the right direction. We agree that the SA process should become a permanent mechanism of the IMF's operations, and we can go along with the wider public disclosure of the SA process. On the suggestion to extend the assessment to RAPs, we are of the view that this should be done with the proper technical assistance in place. We have similar views for SMPs. For CFF and emergency assistance, because of the need for quick disbursement, we join others who think that there should not be requirement for SAs for these cases. Overall, we think that the SA should be restricted to program countries, but for other countries, this exercise could be performed in the context of FSAP or ROSC exercises. We also agree that staff should be provided with the needed resources to perform this exercise, especially on technical assistance.

Mr. Rustomjee submitted the following statement:

We thank the staff for the well-written paper, which provides a comprehensive review of the Safeguards Assessments (SA) carried out in the last 18 months and which also recommends the next steps to be based on the lessons learned. We also thank the independent Panel of Experts for the concise report and constructive comments on this issue.

We are pleased to note that the SA process has allowed the IMF to identify and rectify several cases of potential misreporting and reduced the opportunities for misuse of resources and has, therefore, enhanced its reputation and credibility as a prudent lender. We are also encouraged by the fact that it appears that most central banks have welcomed the ELRIC, promptly accepted to put this diagnostic tool into practice and have already started implementing many remedial measures that were recommended. As highlighted in the staff report, the SA process has generated many positive results by helping the central banks to identify vulnerabilities in the control, accounting, reporting, auditing systems and the legal structure. These results are, indeed, very encouraging as the majority of the central banks assessed are now publishing their audited financial statements on a timely basis. Furthermore, central banks have had their external audits strengthened, their financial reporting improved significantly, and are increasingly making use of

internal audits. In this context, it seems that the SA process is not only helping the Fund to safeguard the use of its resources and to enhance its credibility and reputation as a prudent lender but is also contributing to make central banks more effective, more accountable and less vulnerable. As staff have pointed out, there is also an increased awareness among central banks of the need for strong safeguards in the ELRIC areas, especially in the context of possible borrowing on the international capital markets. We, therefore, agree that the SA policy should become a permanent mechanism of the IMF's operations.

The Panel of Experts has carefully reviewed the SA process, expressed a general opinion and, more specifically, commented on the findings and implications of the SA, the lessons learned and the way forward as set out in Chapter V of the staff report. We broadly share the views expressed by the Panel and agree that: (i) the ELRIC framework should continue to be the basis for assessing safeguards at central banks but operational refinements should be implemented according to country specific circumstances and experience accumulated during the conduct of the assessments; (ii) the existing operational deadlines are important and should be maintained; (iii) stages one and two should be merged into one single assessment report; (iv) awareness of safeguards assessments among IMF staff and the Executive Board should be improved, but safeguards reports should remain confidential; (v) coordination among staff, in particular consultation with Area Departments during the SA process, should be strengthened; (vi) the SA process should be appropriately adapted to apply to other government agencies where the fiscal agent is not the CB; and (vii) only issues highly and directly relevant to safeguarding Fund resources should be included as program conditionality.

As regards the resources needed to conduct the SA process, like the Panel, we note that the number of SAs completed to date goes beyond what was originally planned at the start of the SA process and that this was achieved with no additional resources. Nevertheless, in order to effectively sustain the momentum and quality of the SA process and address the future monitoring requirements and the proposed increase in coverage of SAs, we concur with the Panel recommendation that this task should be properly staffed. In addition, the implementation of some safeguards recommendations by the central banks, such as the adoption of International Accounting Standards, requires capacity building as well as technical assistance. To this extent, we are pleased to note that some IMF departments have already been providing technical assistance. Nonetheless, we are of the view that the Fund should continue to stand ready to provide any additional technical assistance and training to central banks in need.

We concur with the views expressed in the staff report regarding the way forward, in particular that the coverage of SA be expanded to include

existing arrangements and also that the focus of SAs be shifted from new assessments to the monitoring of proposed remedies under previous arrangements. We also agree with the principle that member countries receiving a new arrangement from the IMF be subject to a SA. However, as the SA process takes time, we view the initiation of entry into the SA process as a sufficient stipulation for the Board's approval of a new arrangement. We consider that it would be unnecessarily harsh for it to be a requirement that an SA have to be completed prior to approval of a new arrangement.

We agree with the publication of the staff report and the Panel's views after removing country references.

Extending his remarks, Mr. González-Sánchez said that, like Mr. Portugal and Mr. Tombini, he wished to stress that the focus of the safeguards assessments should be on safeguarding Fund resources. Therefore, safeguards assessments should not be converted into an institutional capacity building exercise.

Mr. Josz said that he had made a reference to one country—Russia—in his statement, which was not the usual practice in a policy discussion, and thus wished to offer an explanation. The Board might recall that the Fund's safeguards policy had been adopted in response to the particular problem regarding the transparency of the operation of the Central Bank of Russia. Clearly, the Fund had drawn lessons from that experience. However, it was not clear from the staff report on Russia discussed recently in the Board whether the Central Bank of Russia had learned the lessons to the extent that the Fund had.

Mr. Lushin noted that the Board had concluded the Article IV consultation with Russia only a week ago, and Mr. Josz's chair had had an opportunity to raise all issues related to Russia, including that of the Central Bank of Russia, on that occasion. He would, nevertheless, be willing to address any concerns about the Central Bank of Russia bilaterally.

Mr. Baukol said that, in his statement, he had proposed that the safeguards policy be augmented so that key weaknesses be addressed by the second review. Mr. Cippà had subsequently responded that such a concern was already addressed in program conditionality, which would normally be designed to follow up on any major weaknesses identified. The problem was that different area departments follow up on these issues with different levels of priority. Therefore, setting a specific time-bound target for the completion of major improvements under the safeguards assessment—namely, prior to the second review—would help give guidance to area departments, which should help the safeguards process move forward in a more uniform manner.

The Chair of the Panel of Experts on Safeguards Assessments (Ms. Caparello) made the following statement:

I would like to convey to you, on behalf of the Panel of Experts, our concluding remarks. The Panel of Experts has conceived this review as a

source of feedback. The Panel has met participants and users of safeguards assessments within the IMF. It has also heard the opinion of selected central banks that had been subject to safeguards assessments. The Panel had been provided beforehand with different safeguards assessment reports upon its request to establish this selection.

After this review, the Panel considered that the initial objectives of the safeguards assessment have been met. Indeed, the Panel unanimously supported the majority of the views expressed in the staff paper dated February 19, 2002. The findings of the initial safeguards assessments, including positive trends and areas of improvement, have demonstrated the importance of this ex ante approach to minimizing the risk of misreporting of information and possible misuse of Fund resources.

The Panel recognizes the volume and the quality of safeguards assessments performed under the coordination of the Treasurer's Department, given that it has been far beyond what was originally planned. I would like to mention on behalf of the Panel that we have been impressed by the progress that has been made in such a short time frame.

Importantly, in the light of experience and despite concerns at the outset expressed both by the IMF and by the central banks about the intrusiveness of the safeguards assessment process, central banks themselves have demonstrated a strong willingness to cooperate with IMF staff in accepting recommended remedies. Beyond the primary objectives, that is, to reinforce the reputation and credibility of the IMF as a prudent lender, the safeguards assessments appear to be welcomed by the central banks in promoting best practices in the area of internal control and the adoption of international accounting reporting and auditing standards. This point has been emphasized during the interviews with the central banks. This also confirms the Panel's original view made in February 2000 that 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. This can be viewed as one of the considerations that have already triggered requests by certain non-program countries to learn and understand the safeguards assessment requirements.

I should like to point out that the Panel was surprised by the fact that safeguards assessments seemed to have been better perceived by the central banks themselves than by some departments and Executive Directors within the IMF. The Panel concurred with the view that the safeguards assessment process should continue and become a permanent mechanism of the IMF's operations. The current modalities for safeguards assessments should remain broadly similar to the existing procedures and should be pragmatically refined.

Finally, I would like to mention that the Panel considered that wider public disclosure of the safeguards assessment process and its results should be encouraged by the publication of the staff paper and the paper on the independent review. Also, reference to the safeguards assessment process should become a standard section in the IMF Annual Reports. These are in brief the concluding remarks that I would like to convey to you on behalf of the Panel.

The Treasurer (Mr. Brau) made the following statement:

Let me start by thanking Ms. Caparello and the Panel of Experts for their work. The Panel included four senior central bankers, of whom Ms. Caparello is one, and we found their expert contribution and particularly their critical review very helpful in furthering this policy. I am also grateful for Directors' preliminary statements and the conclusion of all of the statements that the safeguards policy should continue.

I would like to comment on the questions raised, both general and specific ones. Let me start with comments on the general approach. Many Directors viewed the safeguards results as highly useful and effective. However, Mr. Portugal and Mr. Tombini asked if the policy is truly effective in preventing misreporting and possible misuse of IMF resources, what is the causation of the improvements which the staff recommends, and whether central banks will put in place the measures required to help safeguard Fund resources.

Can I prove that the much better care I have been giving my dog in the last weeks has caused him to stop his annoying barking at night? No, I cannot prove that but I can establish a probability that my improvements will help, even though the dog could still bark. The point is that a willful override of improvements can always occur.

What we are doing or attempting to do with the safeguards assessments is to help put in place better controls, better audits, and better reporting, which should reduce, in the longer run, cases of misreporting and misuse of the resources that are disbursed to central banks. We have seen that, in two central banks to which very large Fund resources have been disbursed, there are now for the first time external audits, and, in one case, this has meant very significant improvements in reporting capacities. We have seen central banks being willing to accept our recommendations to adopt International Accounting Standards or the equivalent where no recognized accounting standard was being applied before. That is, in the past a the central bank could go back and forth over time to change the accounting treatment of significant items. This clearly is a significant improvement. We have seen, in case after case, a willingness of central banks to institute procedures by which the data

reported to the IMF for program monitoring purposes are checked against audited accounting records. Clearly, that process will have the promise of preventing misreporting in the future. We have seen several cases where, notwithstanding the undertaking of the central bank in its technical memorandum of understanding to value net foreign assets in a certain way, it had not happened, and valuations were significantly different from what they should have been.

The focus of the safeguards process is on safeguarding Fund resources. As stressed by a number of Directors, the staff thinks that that focus should remain; the safeguards policy should be firmly grounded in this objective, because of the obligation of the Fund to safeguard its resources. It also means, and this is in response to a point raised by Mr. Guinigundo, that the initial coverage of safeguards assessments applies to all users of Fund resource arrangements. It is not initially selective based on the size of access. When the Board initially set the policy, this question was discussed at length, and it was the Board that wished to have it applied to all users of Fund resources through arrangements, and not selectively.

The staff is proposing now that this coverage should continue and also cover augmented arrangements and Rights Accumulation Programs where Fund resources are being committed. The staff does not propose that safeguards assessments should cover outstanding use of Fund resources from prior arrangements, perhaps through an Article IV process, and does not consider that it should cover Staff-Monitored Programs, although we would encourage countries to voluntarily ask for an assessment if the aim of the Staff-Monitored Program is clearly to lead to use of Fund resources. We think that the focus on safeguarding resources is essential.

We very much like the idea of developing an IMF Institute course on safeguards as proposed by Mr. Mirakhor, and we would encourage countries to send officials to that course and to institutionalize this.

Mr. Josz asked whether safeguards assessments would be applied to countries under Post-Program Monitoring.

The Treasurer (Mr. Brau) responded that the safeguards policy would apply where a country had originally been subject to a safeguards assessment. In cases where corrective actions had been needed and had been implemented, monitoring of the implementation of those corrective measures would continue as long as there remained outstanding Fund credit. That monitoring might overlap with the Post-Program Monitoring process, which would last as long as Fund credit outstanding exceeded 100 percent of quota. However, the safeguards policy would not apply to countries that were under Post-Program Monitoring unless they had been subject to safeguards assessments in the first place; those countries would not fall under the safeguards monitoring process.

Mr. Josz raised the question of whether safeguards monitoring would continue beyond the Post-Program Monitoring period.

The Treasurer (Mr. Brau) replied that the monitoring process would continue as long as Fund credit was outstanding.

Ms. Lundsager asked whether countries whose credit outstanding with the Fund remained over 100 percent of their quotas but had not been subject to safeguards assessments could be brought into the fold of safeguards assessments. That seemed a reasonable idea, considering the Fund's fiduciary responsibility.

The Treasurer (Mr. Brau) responded that the staff would certainly encourage those countries to request a safeguards assessment and to avail themselves of information and advice on the safeguards process. Nevertheless, once no new disbursements were being made, the Fund lacked leverage and, currently, it also lacked staff resources to conduct additional safeguards assessments. For those countries having outstanding Fund credit but receiving no further disbursement, a safeguards assessment would become an issue of advisory services or technical assistance, which the authorities could choose to implement or to ignore. In effect, it would not be a safeguarding of resources where the Fund had the ability to ask those countries to implement critical recommendations under program conditionality.

Mr. Chatah wondered if the staff could confirm that the post-program monitoring procedures, which would apply for as long as Fund credit was outstanding, would entail only off-site monitoring. In cases where off-site post-program monitoring revealed the need for a further reassessment, would the staff's proposal preclude an on-site follow-up?

The Treasurer (Mr. Brau) responded that the diagnostic tool for safeguards activity sought to identify potential weaknesses in a central bank's control, accounting, reporting, and auditing mechanisms. Technical assistance, on the other hand, had to be requested by the authorities, which they would normally only do when they were aware of the weaknesses. Moreover, countries receiving technical assistance might choose not to implement staff recommendations, as they were voluntary. The same was true for Financial Sector Stability Assessment (FSSA) recommendations. The safeguards policy went beyond the voluntary principle—if it were critical for safeguarding Fund resources, key remedies would be proposed for conditionality. It was quite frequent, particularly for remedies that required institution building, that the staff recommended technical assistance and countries actually utilized it.

On conditionality, the staff agreed with both the Panel of Experts and many Directors that conditionality in the area of safeguards should be focused on really critical remedies, the Treasurer said. Issues that warranted program conditionality included, for example, improper valuation of net foreign assets, where prior actions would generally be required; and absence of an independent external audit, which, because of the relatively long period required to put in place such a system, would be more amenable to structural benchmarks. The staff had

tried to differentiate problems and the degrees of criticality. In some cases, remedies might be considered useful but not absolutely critical, in which case there would be no link to the disbursement of resources, and decisions would rest with the authorities whether to implement them, while the staff would follow up in future discussions with the authorities.

In response to Mr. Mirakhor's question regarding the circumstances under which the staff would recommend that a program review might not be completed, the Treasurer explained that such a recommendation would be made, in the context of Fund conditionality, if the authorities had not cooperated, which had never happened so far; or a critical remedy, which was part of program conditionality, had not been implemented as agreed. In other words, any issues picked up under conditionality would be handled within the conditionality framework. In certain circumstances, the staff might have to recommend to management non-completion of a program review, but that had not happened so far. Should it happen, however, the staff would raise the issue in informal country discussions and apprise the Board of the view of the authorities as well.

Mr. Mirakhor raised a concern that paragraph 66 of the staff report seemed to suggest that the three criteria listed in that paragraph were being given some kind of veto power over and above the normal treatment of conditionality in a sense that, if a country met all other conditions within its program, violation or noncompliance of one of these requirements could still block the review process. The treatment of these conditionalities should be clarified within the general framework of conditionality, to provide greater clarity regarding waivers and completion of program reviews. Specifically, paragraph 66 should be made clearer that, as with other Fund conditionalities, a waiver and completion of review could be recommended.

The Treasurer (Mr. Brau) agreed on the need to clarify paragraph 66 as suggested by Mr. Mirakhor, to make it clear that these three eventualities would not be treated differently from any other issues that were subject to Fund conditionality. If non-compliance with any of those three criteria occurred, and if the staff and management judged that a review should nevertheless be completed in view of the circumstances, the Board might wish to grant a waiver.

As regards the deadlines for the completion of safeguards assessments, the existing safeguards policy stipulated that a safeguards assessment should be completed no later than the first review of the program and preferably before the Board's consideration of a use of Fund resources, the Treasurer continued. While these deadlines had been missed in some cases, the overall record was satisfactory. Of the 26 cases where a full safeguards assessment had been completed, 18 cases had met the first review deadline. Of the eight cases that had missed the deadline, four were those with widespread weaknesses in the reporting and auditing of financial statements, and the staff had therefore asked the central banks concerned to take certain immediate steps so that a meaningful review could later be undertaken. Those cases could, therefore, be regarded as missing the deadline by deliberate choice. Another two cases had been near misses, as the staff had completed the safeguards assessments, but the authorities' comments had not been received by the time of the first program review. The

remaining two cases were clean misses, due to resource constraints. Since the circulation of the staff report, four more safeguards assessments had been completed, bringing the total to 30. Of these, two cases had missed the deadline. In all, out of 30 completed assessments, four were clean misses. In each of those cases, the staff had informed, or would inform, the Board at the time of the program review, both in the staff report and in the staff appraisal, of the reasons for missing the deadline, the status of the assessment, and the expected completion date.

Mr. Josz remarked that the policy stated that, preferably, the safeguards assessment should be completed even prior to the first use of Fund resources. He asked how many of the 20 cases that had met the deadline had in fact completed the assessments before the first use of the Fund resources.

The Treasurer (Mr. Brau) responded that those cases were relatively rare, as the process had built-in work time and commenting time. The staff would provide the requested information at a later date.

In terms of the lessons learned, one lesson in particular was that, in order to save resources and streamline the process, the staff should no longer prepare two reports separately for Stage One and Stage Two, the Treasurer suggested. Rather, only one report should be prepared—a proposal that had received considerable support from Directors and the Panel of Experts.

On Mr. Portugal's question regarding the elimination of off-site assessments, the distinction between off-site and on-site assessments would be maintained for flexibility purposes, the Treasurer explained. There were a number of cases where off-site assessments would suffice, for example, cases where the control framework of a central bank was satisfactory and this could be clearly ascertained from the records available off-site.

With regard to the fiscal agent, two separate issues were of concern—the quality of fiscal data and the application of the safeguards framework to the fiscal agent other than the central bank, the Treasurer noted. On the former, fiscal data quality problems were addressed in the context of technical assistance by both the Fiscal Affairs and the Statistics Departments, as described in Box 2 of the staff report. On the second issue, problems would arise only where the Finance Ministry, not the central bank, was the fiscal agent at which Fund disbursements were deposited. Such a situation had never been encountered so far, nonetheless. If the Finance Ministry, which was the fiscal agent, did not hold reserves and Fund disbursements were deposited at the central bank, the safeguards framework fully applied, with the central bank's financial statements being fully audited. Russia was the only case where the fiscal agent was the Treasury, but Fund disbursements were deposited with a commercial bank. In the future, the staff would request that the fiscal agent deposit Fund disbursements with the central bank, which would be covered fully by the safeguards framework. A problem might emerge if the fiscal agent chose not to do so, but so far this had not been an issue.

The case of Turkey, which was currently under the safeguards assessment process, was somewhat unusual, the Treasurer related. The Fund-supported program for Turkey contained a performance criterion on net international reserves (NIR) covering resources held in both the Central Bank of Turkey and the Treasury. In particular, short-term external borrowing undertaken by the Treasury was covered in the NIR performance criterion of the program. The accounts of the Central Bank of Turkey were fully audited by an external auditor, but the data on short-term external borrowing by the Treasury, though of good quality, were not audited. In view of those idiosyncrasies, the safeguards mission had therefore suggested that all data that were encompassed in the NIR performance criterion should be fully audited, with which the authorities agreed. As a result, the safeguards framework had been broadened to cover all data relevant to this performance criterion that were not compiled by the central bank.

Ms. Lundsager raised the question of how to ensure that foreign exchange reserves would be available for repaying the Fund when an obligation came due, in cases where the central bank was not an obligor. She asked whether it would be necessary in such cases for the central bank to have local counterpart available or to put in place certain procedures to guarantee the availability of resources when due.

The Treasurer (Mr. Brau) responded that there would be counter-entries in the accounts of the central bank. Ms. Lundsager's concern was related to economic safeguards; that is, whether the Treasury, or the public sector as a whole, had the capacity to raise sufficient resources to meet payment obligations. That was the issue of program design or program adequacy, which was not within the context of safeguards assessments. Rather, it should be addressed under the existing procedures for assessing the country's capacity to repay the Fund, which were routine in program monitoring and in program documents.

Ms. Lundsager suggested that it would be helpful for staff reports on program countries to explain how Fund resources were handled in cases where the fiscal agent was not the central bank.

The Treasurer (Mr. Brau) said that he took note of Ms. Lundsager's request and would address it in due course.

Regarding the monitoring process after a Fund-supported program had expired, the staff would follow up on key recommendations to ensure that previous commitments had been implemented, the Treasurer explained. In most cases, off-site monitoring would be adequate, involving basically submission of documentation and communications with external auditors. In cases where serious problems were detected, however, the staff would inform the Board through the informal country matter sessions. If necessary, on-site monitoring might be resorted to. Such cases, nevertheless, were expected to be rare.

The experience so far with the use of external experts had proved useful, the Treasurer observed. Nevertheless, it was sometimes difficult to find the right experts at the right time, given the very short period of time—2-3 months—between the beginning of a

program and the first program review, when the assessment had to be completed. While the staff would continue to utilize external experts, they would not be the mainstay of the resources used in conducting safeguards assessments.

Staff resources for the safeguards process were rather tight and had been internally redeployed, the Treasurer pointed out. Further redeployment of staff was planned, which should adequately handle the expected increased volume of work, provided the budget of the Treasurer's Department was not reduced. Despite the resource constraints, the staff involved had performed exceptionally well, judging from the number and the quality of safeguards assessment reports.

On publication, the staff recommended that country-specific reports remain confidential, with which most Directors concurred, the Treasurer said. The staff agreed with the advice of the Panel of Experts that more resources should be devoted to a general explanation of the safeguards process.

The staff proposed that a review of the safeguards policy take place in three years, instead of two years as recommended by some Directors, the Treasurer said. One reason was that a key element of the review process would be to review experience in the monitoring of the implementation of previous recommendations, many of which required time before completion. A track record of two years might be too short, as in several cases, particularly in low-income countries or PRGF-supported cases, it would take about two years to set up a good external audit mechanism. Another reason was resource constraints. To keep the Board informed, the staff intended to produce half-yearly summary reports on the general results of safeguards work, reporting the status of safeguards assessment findings that were not country-specific. Such reports were intended for the information of the Board rather than for discussion, unless decided otherwise by the Board.

The staff representative from the Treasurer's Department (Mr. Catsambas) said that he wished to clarify further the question of monitoring. Monitoring was already ongoing, especially in areas that had become part of program conditionality. The Treasurer's Department and area departments had an obligation to follow up on and assess countries' implementation of corrective measures. As suggested in the staff report, monitoring was expected to take place every 12-18 months, at which time the staff would take stock of the progress up to that point. Some flexibility was needed to take account of the difference in the timetables of the implementation of recommendations, with the outer limit being 18 months. The staff would take stock of the progress made and form a comprehensive opinion of whether the implementation of measures and the efficacy was satisfactory in accordance with the safeguards framework.

Mr. Rustomjee said that he was encouraged by the findings of the initial safeguards assessments as summarized in the staff report and by the Panel's review of experience. Several countries in his constituency that had gone through the safeguards assessment process found it useful. While broadly in concurrence with the staff's recommendations, he expressed a concern about the deadline for the completion of the assessment, which,

according to the safeguards policy, was prior to the Board's approval of a new arrangement. Although the staff report pointed out that such a deadline was regarded as a principle, not a rigid rule, a country still had to complete the assessment prior to the first review under the arrangement. That requirement was somewhat harsh for low-income or PRGF-type countries, which had serious capacity constraints, especially in light of the many requirements imposed on them by various international development institutions, including the Fund and the World Bank. While they acknowledged the benefits of complying with international standards, the administrative burden was an issue that perhaps warranted some flexibility in applying the deadlines.

With respect to paragraph 66 of the staff report, Mr. Mirakhor had raised a valid point, Mr. Rustomjee noted. Before publishing the report, the staff should make sure that the language of this paragraph did not suggest the introduction of a new element of program conditionality.

Mr. Tombini requested that the staff elaborate more on the operational refinements of the legal framework of a central bank. The staff noted in Box 4 of the staff report that the current operational approach was too broad and that this needed to be refined—which his chair supported. It would be useful to know how the staff intended to proceed, that is, how to refocus on matters that had a direct causal link to the prevention of misreporting and misuse of Fund resources.

Mr. Chatah said that it might be appropriate to clarify that countries in anticipation of the use of Fund resources were encouraged to voluntarily undertake a safeguards assessment, rather than suggesting all countries under the Staff-Monitored Program (SMP), as an SMP did not involve the use of resources and not every SMP was followed by an arrangement.

There was a recommendation by the Panel of Experts that the staff report did not address, Mr. Chatah observed. The Panel saw an urgent need for the Fund to encourage the development of a comprehensive accounting and financial reporting framework for central banks. It would be useful to know the staff's views on whether that was a valid point—whether the existing frameworks were sufficient or new standards should be developed specifically for central banks.

Ms. Lundsager commented that, while most monitoring would be off-site, the option of on-site monitoring should be left open, as there might be cases where the staff might not be satisfied with the information received through the off-site monitoring procedures and felt the need to conduct on-site monitoring.

The current safeguards policy seemed somewhat inconsistent, as it covered some countries while leaving others where credit outstanding remained high outside the safeguards framework, Ms. Lundsager remarked. For countries that had not been subject to safeguards assessment but still had outstanding credit with the Fund, the Fund had no leverage to start this process, while countries that had been subject to a safeguards assessment remained under continuous monitoring. Therefore, the Fund should try to find ways to strongly encourage

those countries not subject to safeguards assessments to participate in the safeguards assessment process.

It was of some concern that, while the Panel of Experts considered improvement in communication on safeguards assessment issues within the Fund a priority, area departments did not seem to give the issue the same priority as the Treasurer's Department, Ms. Lundsager noted. Effort should be made to permeate this throughout the Fund and ensure that the area departments treat it with the same priority—that should be one of the important outcomes of the current Board discussion. Missions from the area departments should then consistently pursue this issue during discussions with authorities.

Mr. Mirakhor said that paragraph 66 of the staff report could be shortened by simply listing the criteria and suggesting that these would be treated as normal conditions under program conditionality. There was no need to specify further details as to how they would be treated.

On staff resources, the Treasurer's Department was in need of additional staff to carry out the task, Mr. Mirakhor reiterated. The Fund's policy on safeguards assessments had generated impressive results, which should be attributed to the outstanding job of the Treasurer's Department. It was hoped that the Executive Board would support the request for additional resources for the Treasurer's Department, thus reducing the need for redeployment within the Department

As regards the concern raised by Ms. Lundsager about program countries not subject to a safeguards assessment, an incentive structure had already been built into the existing system, Mr. Mirakhor argued. Countries in his constituency that were currently not under a Fund arrangement and did not intend to be users of Fund resources were seriously exploring the possibility of undertaking safeguards assessments. They realized how much credibility would be gained from such an effort. Once the exercise was in full swing, other countries were expected to follow, making it unnecessary to create an incentive particularly for countries that still had large credit outstanding of Fund resources to participate in the exercise. For that reason, the Board should strongly support the request for additional staff resources for this successful project.

Mr. Guinigundo remarked that it could not be overemphasized that the intention of the safeguards initiative was to safeguard Fund resources, and not to be used as a justification for introducing a sea change to central banks' accounting system and governance. The Fund had already developed a Code of Good Practices on Transparency in Monetary and Financial Policies and the so-called "ELRIC" framework. It was thus a matter of matching the right objective with the right instrument. He had pointed out in his preliminary statement that, with central banks willingly embracing the principles or the recommended changes, the argument was in favor of more intensified promotion of the code rather than intensified safeguards assessment policy.

Regarding the development of a comprehensive accounting and financial reporting framework for central banks, there were no compelling reasons for it, Mr. Guinigundo remarked. He endorsed the staff's view on this, as central bank operations were not so unique or highly esoteric as to warrant a separate accounting standard in this respect.

The Treasurer (Mr. Brau) responded that he agreed with Mr. Guinigundo that there was not a need for the development of a separate comprehensive accounting and financial reporting framework for central banks. The Chair of the Panel of Experts might wish to offer her view on this particular issue.

The staff would revise paragraph 66, as suggested by Mr. Mirakhor, the Treasurer asserted.

The staff agreed with Mr. Chatah's point regarding the SMP, the Treasurer said. As currently practiced, the staff would start the process of request for documentation from the authorities on the advice of the area department that there was a prospect of a use of Fund resources.

The staff representative from the Treasurer's Department (Mr. Catsambas) said that, in terms of the legal framework, the staff would not judge the independence of a central bank's monetary policy. That was not in the mandate of safeguards assessments; rather, it was an economic issue, on which the safeguards staff would not take a position. The objective of the safeguards assessment was to ensure that the legal framework of a central bank did not have any loopholes for an undue interference in the operation of the central bank by third parties—typically by the government or, in some cases, by the president. The central bank's structure would, therefore, have to be examined from that perspective. A word of caution was warranted, however, as there was always a possibility that a de jure system that appeared adequate was de facto subject to outside interference—a situation that the safeguards assessment could not prevent.

Mr. Tombini asked that the staff elaborate in more detail what it intended to do specifically to refine the safeguards framework.

The staff representative from the Treasurer's Department (Mr. Catsambas) responded that, in the process of conducting safeguards assessments, the staff had found that the operational approach of the existing framework was too broad on several issues. The framework had to be made more narrow and focused on safeguarding Fund resources; for example, to ensure that a central bank governor or senior staff could not be dismissed without cause, and that international reserves were handled by the central bank.

Mr. Wei made the following statement:

> We welcome this opportunity to review the experiences in conducting safeguards assessments (SA) since the Board's decision on the experiment in

early 2000. I would like to thank staff for its very informative paper and the Panel for its valuable input.

By identifying vulnerabilities in central banks and providing remedial recommendations, the SA contribute to the enhancement of the Fund's reputation and its credibility as a prudent lender, as evidenced by other IFIs and donor communities linking their activities to the Fund's programs. As also pointed out by the Panel, the SA generates a pleasant by-product—the positive image of efficiency and good governance attributable to the assessed institution and, to a large extent, the country. We agree to make the SA a permanent part of the Fund's operations. In going forward, however, we believe it is important for staff to adhere to the principle that the focus of the ELRIC evaluation is to safeguard the Fund's resources rather than the development of international best practices.

We agree with staff's suggestions to improve the ELRIC evaluation process as detailed in lessons learned from the safeguards process. We share the Panel's opinion that evaluation of ELRIC should take account of specific country circumstances. There are cases where a country's practice may not be international practice but imposes no threat to the Fund's resources. In such cases there is no need to require a country to comply with international practice. On coordination among Fund departments and communication with the authorities, we concur with staff's analysis in paragraph 48 of the staff report. We see merits in the suggestion made by Mr. Varela and Mr. Beauregard that where possible the SA should also make use of ROSC's findings to avoid overlapping of staff's work and overburdening the authorities. Communication with the authorities is very important in that they be made aware of the vulnerabilities in the control and governance of their central bank and have a clear picture of what needs to be addressed immediately and what technical assistance is available.

The staff should use caution when factoring safeguards requirements into conditionalities. Several considerations should be taken into account. First, due attention should be paid to streamlining conditionalities. We should avoid overburdening member countries with undue conditionalities, which are not crucial for safeguarding Fund resources. In this regard, we agree with the Panel that only highly relevant issues be included in program conditionalities. Second, capacity building takes a long time. Many program countries have difficulty in capacity building by themselves and in a short time frame. A realistic time frame for implementation should be applied.

I see the resources implication of the SA process as twofold. One is the need for resources for the work spelled out in Annex IV of the staff paper. We support increasing staff resources. The other implication is the resources needed for technical assistance. The staff has rightly identified that one of the

follow-up tasks is to monitor the implementation of recommendations. However, since the SA process identifies the gap between a country's specific practice and international practice based on international standards, successful implementation cannot be achieved without targeted technical assistance. As the staff report shows the vulnerabilities among the assessed central banks are substantial, prospective technical assistance needs must be substantial too. I wonder if staff could estimate how much demand will arise as a result of implementing staff's recommendations. In any case, both needs should be taken into account when we discuss the budget for FY2003.

I support the proposed changes for paragraph 66 by Mr. Mirakhor and others. I also support the suggestion that the IMF Institute develop and establish a course on SAs.

Lastly, I would like to support the two points highlighted in Mr. Mirakhor's preliminary statement. Namely: First, the proposed monitoring procedures should apply only during the period of the arrangement and during any post-program monitoring. Second, SAs should not be extended to government agencies where the fiscal agent is not the central bank.

Mr. von Kleist made the following statement:

Given the large number of preliminary statements and given Mr. Brau's extensive and very informative comments, and considering the discussion which has already taken place, I shall only highlight a few key points:

At the outset, I would like to express our general support for staff's recommendations. The paper before us convincingly summarizes the experience made with the safeguards assessment process so far and derives the appropriate conclusions.

Safeguards assessments have uncovered major weaknesses in the control systems of borrowing members' central banks.

In this context, the amount of deficiencies found is a matter of special concern: 88 percent of assessed central banks did not have adequate accounting standards in place and 67 percent were lacking appropriate external audits. Astoundingly, there are even numerous cases where the publication of the central bank's financial statements has been delayed, occasionally even the time limits set by the respective national legislation have been disregarded, which contradict the spirit of the Code of Good Practices in Monetary and Financial Policies and we therefore welcome the results achieved so far.

Given that safeguarding Fund resources is the main objective behind the whole safeguards assessments exercise, we deem it critical to focus on those deficiencies that could potentially endanger repayments to the Fund, keeping the proper execution of the Fund's surveillance function in mind as well. The need for such a focus is evidenced by the findings according to which more than half of the assessed central banks had only inadequate controls over their foreign reserves and by the fact that internal accounting and control deficiencies resulted in late payments to the Fund in many cases.

In our view, safeguards assessments have already proven their ability to reduce the possibility of misuse of Fund resources and misreporting. Moreover, they obviously provide central banks with sufficient incentives to address detected shortcomings as is demonstrated by the fact that all borrowing member's central banks have committed to implement an external audit mechanism by end-2002. However, as staff rightly points out, those external audits may face their limits when the external auditor concurs with dubious accounting practices of a central bank. Therefore, safeguards assessments should also rely on other kinds of control mechanisms, especially the timely and comprehensive publication of financial statements. The more information is provided to interested parties that enables them to monitor central bank activities, the higher the probability that central banks will adhere to the standards of good governance.

Regarding the proposed "way forward," we strongly support the suggestion to continue the safeguards assessment policy on a permanent basis as well as to expand the policy's coverage to include existing augmented arrangements and RAPs. The envisaged operational refinements to the ELRIC framework seem appropriate.

Additionally, we have the following remarks.

As pointed out in Ms. Lundsager's and Mr. Baukol's preliminary statement, for the sake of safeguarding Fund resources and in order to remain consistent, safeguards assessments could also be extended to cover members with outstanding obligations to the Fund which do not currently have a program as well as to members with stand-alone CFFs. While the inclusion of SMPs is also reasonable, we would not regard it as a top priority, given the Fund's limited resources.

Concerning the procedures for monitoring proposed remedies, we think that on-site monitoring should also be possible for countries whose Fund-supported program has expired, but which still have IMF credit outstanding, provided there are concrete indications of existing deficiencies in central bank's ELRIC areas.

We encourage staff to continue its work to limit the willful override of controls, mentioned in its document.

Regarding the coverage of those cases where IMF funds are disbursed to institutions other than the central bank, we urge staff to keep up and strengthen, if possible, its efforts to ensure the quality of fiscal data and to further develop the respective guidelines. The board should be kept informed about progress achieved in this area through the envisaged periodic summary reports.

We are not convinced, however, regarding the proposal to limit the board's information about safeguards assessments to a summary of main findings and recommendations. The Board must be able to reach its judgment on the fullest amount of information possible.

During its assessment and advisory work, staff should emphasize the importance of an appropriate legal structure for central banks which guarantees their independence. While the ELRIC-assessment in a rather general way merely demands that central bank legislation should not allow for undue interference with central bank operations by outside parties, borrowing Fund members would clearly benefit from a more comprehensive independence of their central banks.

Finally, we are looking forward to a concrete proposal covering an increase of resources to manage the proposed enhancements and extensions.

Mr. Yanase made the following statement:

At the outset, I would like to thank the staff and the Panel of Experts for their contributions to this review, and, like other speakers, I welcome the steady progress made on safeguards assessments and commend the staff for their efforts. Lately, we have come to realize that many preconditions for Fund-supported programs, such as provision of economic data and proper management of public expenditures, are not in place in a large number of countries requesting or under Fund-supported programs. Appropriate financial and reserves management by the central bank is one such precondition. It is indeed an important one, given the Fund's fiduciary responsibility. Thus, this chair associates itself with the view that the safeguards assessment is a high priority exercise for the Fund. The fact noted in the staff paper that the safeguards assessments based on the ELRIC framework completed to date found many deficiencies is disturbing, but it underpins the usefulness and the need for safeguards assessments. Therefore, this chair supports making the safeguards assessment policy a permanent part of Fund operations. While these assessments cannot prevent misuse of Fund resources or misreporting, as noted by the staff, they do not reduce the value of this exercise.

Once a problem has been found, it must be corrected. To ensure that the problem is being addressed, monitoring and follow-up is essential. Thus, I agree with the staff's notion that the emphasis of safeguards assessments will shift to the monitoring of the progress in addressing detected vulnerabilities. I agree that this monitoring should be continued even after the program has been completed or expired, as explained by Mr. Brau. I also agree with those chairs who suggested that the possibility of on-site assessments should be kept open even in the monitoring stage.

I also agree that, if essential and reasonable improvements are not made by the authorities, the Board may need to consider stopping disbursements of Fund resources. However, as noted by Mr. Chatah and Mr. Bakhache and also by Mr. Barro Chambrier and other Directors, we should not forget that the international committee needs to lend a hand, if it wants to see real improvement taking place. We, therefore, need to look at how the Fund can effectively support the authorities' efforts to improve central bank operations, including through the use of technical assistance. For this purpose, I urge the staff to describe in program documents or Article IV staff reports how the authorities are planning to address the findings of a safeguards assessment and how the Fund is helping them. A standard box or an annex to the staff report may help.

Turning to specific proposals, first, on the coverage of safeguards assessments, I support its expansion to include member countries that are following a Rights Accumulation Program with resource being committed. I also agree with the extension of coverage to augmentations of existing arrangements and to stand-alone CFFs. But for SMPs, while I agree that it is useful for the countries under an SMP to voluntarily undertake a safeguards assessment, like Mr. Cippà and Mr. von Kleist, I would be cautious about overburdening the exercise by expanding it beyond the use of Fund resource cases, at least in the initial stage.

Second, I generally support the operational refinement suggested in the staff paper, but, like Mr. Chatah and Mr. Bakhache, I would stress the importance of adjusting the assessments to a particular country or central bank situation. I, therefore, support the suggestion to give some flexibility to the tailoring of the required submitted documents. The differentiation should not, however, infringe upon the principle of equal treatment. For example, the staff should not request a significant amount of documents only for some countries.

Third, I can go along with the staff's suggestion not to require a separate report following a Stage One assessment if a Stage Two assessment is deemed necessary. Even after this requirement of a separate report is

eliminated, however, the staff needs to continue informing the authorities concerned why an on-site assessment is judged to be necessary.

Fourth, I agree with retaining the current deadline to complete the safeguards assessment by the first program review. While I note Mr. Rustomjee's concern, we should retain the deadline in principle. I also agree with Ms. Lundsager's and Mr. Baukol's proposal to require program countries to address the key weaknesses by the second review under an arrangement, provided that requirement is limited to essential and reasonable measures.

On staff resources, I concur that a minimum increase may be necessary. Nonetheless, as the staff notes, since the workload may decrease once first-round assessments have been completed, I would urge the staff to employ flexible measures to respond to the initial heavy workload, such as utilizing external experts or temporary hiring.

On other issues, I can go along with the staff's suggestion to review the safeguards assessment policy in three years. I can also go along with the publication of the staff report and the report of the Panel of Experts. And, last but not least, I join other speakers, particularly Mr. Cippà, in emphasizing the role of the Board in making appropriate decisions on the degree of the authorities' cooperation in safeguards assessments or the status of implementation of measures to address problems found in these assessments. Thus, I strongly urge the staff to continue making full and timely provision of information to the Board.

Mr. Mirakhor said that he was surprised by Mr. Yanase's suggestion, on the one hand, that the safeguards assessment policy should become a permanent feature of the Fund's operations, while suggesting, on the other hand, that the Fund should hire temporary staff to handle the work. The two suggestions were not necessarily consistent.

Mr. Yanase responded that he agreed with Mr. Mirakhor's point, to some extent. Nevertheless, as the staff expected that, once the first-round assessments for program countries were completed, then the monitoring stage following the on-site assessment would likely consume fewer staff resources. If that was the case, there seemed to be room to explore ways to increase staff resources by some temporary means.

Mr. Mirakhor said that it was his understanding that safeguards assessments had been conducted through redeployment of existing staff within the Treasurer's Department, which meant that the work in other areas of the Treasurer's Department had already been compromised. It was, therefore, not consistent to ask the Fund to make the safeguards assessment policy a permanent feature of Fund operations and not to provide the resources needed to continue with the service.

Mr. Yanase concluded that he did not wish to prolong the discussion on this issue, but, to avoid misunderstanding, his chair agreed that some increase in the staff resources was necessary.

Mr. Couillault made the following statement:

Let me first thank the staff for this very good document and the external experts for their valuable contribution to our work on safeguards assessments. Indeed, the IMF now has a consistent framework that places more emphasis on the prevention of misreporting and does not rely only on sanctions to address such a sensitive issue, which is potentially damaging to the credibility of this Institution.

We welcome this review of safeguards assessments and are pleased to see that, despite the complexity of the issue, the first results are encouraging. This new initiative has provided an opportunity to strengthen the dialogue with central banks and to disseminate sound practices. Furthermore, while one could initially have had concerns, the experience has been conducted without a breach in the necessary confidentiality associated with a sensitive issue.

Clearly, it is reassuring to have the confirmation that cases of misreporting are rare. However, we cannot help but be concerned to read that the safeguards assessments have identified serious deficiencies in central bank reporting, especially when staff points out the weakness, if not the absence, of external audits of the central bank accounts. Indeed, we fully share staff's views that an independent and high quality external audit of central banks financial statements is one of the most reliable systems of control. We understand that some progress has been made in this area and we look forward reading that all the central banks have undertaken external audits.

Since we believe that safeguards assessments provide a useful value-added and not only, as staff notes, because it has reduced the opportunities for misuse of IMF resources, we support the proposal to make the safeguards assessments a permanent feature of the IMF toolbox. We also support the extension of the framework to the RAP and to existing arrangements that are augmented. In fact, we believe that we should have safeguards assessments for every new program, including for SMPs on a voluntary basis, and we even could be ready to support Mrs. Lundsager's proposal to have safeguards assessments for countries with outstanding obligations to the Fund. To conclude, with the coverage of this initiative, we would be interested in hearing staff's comments on the potential risks, if any, when the fiscal agent is not the central bank.

Like the staff, we believe that an effective deadline for conducting the safeguards assessments before the first review should be maintained as an

integral part of the discipline associated with any issue dealing with transparency and accountability. In the same vein, we have some concerns that the recommendations of the assessments could take months to be implemented. Ms. Lundsager has here a proposal that is worth examining, and I would be interested in having the staff's comments on this issue. However, like the Panel of Experts, we believe that there should be a necessary prioritization of measures to be taken, and that only issues highly relevant to safeguarding Fund resources should be included in our conditionality.

We also consider that safeguards assessments, as part of the constant dialogue between the IMF and the authorities, should remain confidential and be accompanied by sufficient technical assistance when needed. However, it is necessary to strike a balance between the need of enough confidentiality and the need for the Board to be in a situation to make an informed decision. We trust that the staff could find the appropriate way to report to the Board and encourage it to issue periodic reports on this question.

Finally, the staff pleads in favor of an increase in staff resources devoted to this activity. Even if we have some sympathy with the idea to have additional resources available when defining additional missions, we are not totally convinced that such a role could not be fulfilled by using internal redeployment.

Mr. Pereyra made the following statement:

We would like to thank the staff and the independent Panel for a well-written and detailed set of reports. In the first place, we agree that safeguards assessments of central banks should be considered as a permanent feature of IMF policies. Moreover, by covering key areas of central bank operations, the ELRIC structure provides an adequate framework for a transparent management of IMF resources. Assessments based on it would give a clear signal to member countries that control issues are to be regarded as a central component of IMF program design, and would contribute to improved international reputation.

Concerning the report's findings, keeping a watchful attitude is warranted from the frequency of ELRIC deficiencies reported by staff. Table 2 shows that a significantly high percentage of the central banks assessed present serious weaknesses in key areas such as governing legislation (50 percent) and external audits (67 percent).

We agree in that the legal framework underlies all safeguards issues, because it guarantees central bank independence in the relevant operations. At a more specific level, additional stress should be placed on foreign reserves control, given the repeated cases of unexplained differences between

accounting records and financial statements; on external reporting, given the discrepancies between audited financial statements and data reported to the IMF; and on the selection of external auditors and the audit rotation policies.

Concerning the efficacy of the initiative, it is encouraging from the reports that there is a heightened awareness of safeguards-related issues among central banks, and that safeguards are increasingly viewed as a useful benchmark by authorities. Also, safeguards assessments have reportedly led to rectification of several cases of potential misreporting, reduced the opportunity for misuse of IMF resources, and resulted in availability of more reliable reserves data. Significantly, some member countries not subject to assessments have requested technical assistance to improve their ELRIC, thus confirming the existence of a positive inducement effect.

Efficacy can be enhanced with the refinements proposed by staff. We agree in that there should be flexibility in the application of assessments according to each country's specific conditions and changing requirements. When it is warranted from the first-round off-site assessment, program conditionality—prior actions and structural performance criteria—should be introduced. We also concur that the set of information required for off-site assessments could be more complete and country-specific.

The two-stage approach should be streamlined so that a single assessment report would be issued, and a decision point should be preserved. Additionally, despite rather frequent difficulties in meeting the current deadline for the completion of assessments—that is, before the first review—it is instrumental in signaling the importance of control issues in IMF programs, and therefore should be preserved. We also support staff's views regarding coordination between assessment teams and IMF departments, and enhancement of resources and personnel skills.

Regarding the policies proposed by staff to improve the assessments policy in the future, we consider that the inclusion of augmented arrangements and Rights Accumulation Programs is warranted.

Most ELRIC features—like the legal framework governing the central bank—are prescriptive in nature, and cannot prevent per se a deliberate override of controls. Additionally, some recommendations would take two to three years to be implemented. Therefore, for the purpose of effective monitoring, central banks should submit annually their audited financial statements for as along as IMF credit remains outstanding. Reasonably enough, conditions are to be flexible and contingent upon each country case. Even though the periodicity suggested by staff—12 to 18 months—seems appropriate, the criteria for establishing monitoring frequency should be specified.

Finally, completion a program review should depend significantly on cooperation by authorities in the conclusion or implementation of an assessment. This would be an effective way to signal that safeguards are an essential element of program design. However, we support Mr. Mirakhor and Mr. Rustomjee in their proposal concerning paragraph 66, and we concur with Mr. Varela and Mr. Beauregard in that, given the seriousness of the matter, the authorities could be allowed to present their views if perceived cooperation problems should arise.

Mr. Al-Turki made the following statement:

Let me start by thanking staff and the external Panel of experts for the useful papers. Safeguarding the use of Fund resources is certainly an important issue and I welcome today's review of Fund's policies in this area. Here, I am encouraged that program countries that were subject to safeguards assessments have welcomed the exercise and found it beneficial. I also welcome the finding that good progress is being made by central banks to enhance accountability, improve internal controls, and publish complete audited financial statements in a timely manner.

This progress notwithstanding, the substantial weaknesses as detailed in Table 2, underscore the level of effort that is still needed to strengthen safeguards in many central banks. Here, I am reassured by the authorities' broad acceptance of the remedies proposed by the safeguards assessments. I also welcome the recognition that implementing those remedies would take a long time. In this connection, I agree with staff that while the safeguards assessments preclude definitive statements about preventing the misuse of IMF resources, the resulting improvements will strengthen control over central bank resources, including IMF disbursements.

I can go along with the proposal to make the safeguards assessments policy a permanent part of the IMF operations. Indeed, given the magnitude of the weaknesses uncovered so far, it is clear that further work in this area is needed. However, it is important to achieve the desired outcome in a cost effective way. In this regard, it is essential to minimize any overlap between the safeguards assessment using the ELRIC framework and other Fund initiatives including the FSAP, the codes of good practices on monetary and financial and fiscal policies, and the data dissemination standards.

That said, it is important to strengthen the process based on the lessons learned. Specifically, I agree with the findings that improved coordination between the assessment teams and especially the area departments concerned is needed. This is essential to ensure an efficient use of resources and more importantly to avoid sending mixed signals to the authorities. Moreover, while a summary of the main findings should continue to be included in the staff

report, the safeguards report should remain confidential. In this connection, the proposals in chapter V appear reasonable.

While it is important to ensure that the identified weaknesses in the safeguards have been remedied, it is equally important to limit duplication between monitoring in this area and other surveillance and technical assistance projects. This is essential to enhance efficiency further and avoid undue pressure on the limited administrative capacity of many of the members and here I support the proposal of Mr. Mirakhor to develop an IMF Institute course on Safeguards Assessments. It is also critical to maintain the necessary flexibility when dealing with safeguards assessments and implementation of the needed remedial actions. Here, I am reassured by Mr. Brau's comments on paragraph 66.

Finally, I fully support an increase in resources to meet any additional staff requirements.

Mr. Brooke made the following statement:

Like other Directors, I would like to begin by thanking the staff and the Panel of Experts for their helpful set of papers. In terms of the broad framework of the safeguards assessment, we are very happy with the results that have been achieved so far, and we strongly support the maintenance of the existing approach as a permanent feature of our procedures, ensuring the Fund's resources are used for their intended purposes, which is an extremely important element in maintaining general public confidence in the IMF, and we need to maintain all the efforts we can in that regard.

That being said, I accept the view expressed by some Directors that the safeguards assessment is certainly not a panacea, but I am convinced by the results so far that it is certainly worth continuing with.

Looking at the way forward, we support the staff's call for the coverage of the assessments to be extended to include augmented programs and RAPs. Going beyond this, we also have a lot of sympathy with those Directors who feel that we should extend it to Staff-Monitored Programs, CFFs, and all outstanding Fund credit.

With regard to the Staff-Monitored Programs, I tend to agree with the staff, however, that it should be voluntary. However, where the SMP is intended by the authorities to then lead into a financing program, it should be made very clear that actual implementation of the remedial measures, not just completion of a review, should be prior actions for a Fund arrangement, because the country will have ample time if it is planning on going to a funded program to address those problems in most cases. On many of the key

elements, that should be the case, but I accept that, perhaps on some measures, the Fund would need to take a flexible approach.

With regard to CFF purchases, there is clearly a trade-off between the need for rapid disbursements, which the CFF is designed for, and the time necessary to undertake a safeguards assessment. Thus, I would accept that some flexibility may need to be implemented with regard to the expectations of the Board as to whether an assessment could be completed in time for a Board discussion. While it seems unlikely, it is reasonable to extend our approach to CFFs. By the time of the first review, or second review at the latest, the staff should really have an assessment done and some discussion of what remedial measures are needed.

In regard to the extension more broadly to all outstanding credit cases, I certainly have some sympathy with this. My general feeling is that we would need to address this within the existing staff constraints, but I would support this measure, and, to the extent that we do it, we would definitely want to target it on countries with the largest outstanding amounts of Fund resources, and that it would not necessarily take higher priority over the new program initiations that are already the current practice.

With regard to the operational deadlines for the completion of assessments, we agree that it is important to maintain these as they are currently set out. That certainly will help reinforce the credibility and effectiveness of the process. However, we also need to be aware of some of the resource implications that Mr. Brau mentioned. I was pleasantly surprised actually at how often and how many cases the staff had managed to meet the first review deadline, but certainly we should be aiming to try to get the staff assessments done by the time of the Board discussion, if possible. In that regard, again, one would need to take a flexible approach. Where there are conflicting demands with several country cases coming for assessment at the same time, some prioritization could rationally be implied in terms of larger programs having more resources and ensuring that those are completed by the time of the Board discussion before the smaller programs, which could perhaps be slipped back to the first review stage.

Turning to the issue of whether or not to extend this approach to the fiscal accounts, I found it difficult to reach a firm view on this issue at this stage. I certainly think that this would have significant resource implications and something that we would have to consider very carefully. So, if that is going to be a possibility, that would be a subject for a separate Board discussion. That is probably what Mr. Baukol and Ms. Lundsager were asking for, but I certainly would not want to jump to any conclusions as to whether or not the Board would take that decision. I am open to seeing all the information being presented.

On the resource implications, we have had some discussion through Mr. Mirakhor and some other Directors on this point. I personally was somewhat puzzled by the presentation of this issue in the staff report. I got the impression from reading it that there would be a hump in the Fund's work priorities on the initial assessments. If that were the case, and in the steady state of the regular reviews and monitoring of implementation, one would expect much lower ongoing costs. There would be a case for making use of more outside experts from other central banks and potentially from other private sector accountancy firms.

Even given the concerns that Mr. Brau raised, I would have thought, to some extent, that those would have been surmountable with an ongoing process using the same experts over a period. But, if the staff thought that this was going to be a sustained demand upon staff time in the monitoring process—and maybe because of the uncertainty, the staff has taken this cautious approach—then this chair would certainly support permanent expansion in resources for this effort. It is, however, difficult to reach a decision on that at this stage. Perhaps the approach that the staff has proposed in the report is the appropriate one at this stage. Let us wait and see what the actual resource costs are of the monitoring of ongoing implementation, but leave it as it is for now.

In terms of rectifying weaknesses by countries once they have been identified, we certainly would join those in saying that, where these weaknesses are deemed to be critical for the program, the approach taken by the staff so far has been entirely appropriate. These should be part of prior actions and program conditionality, and we strongly support that. From reading the report, my sense was that there were certainly a number of areas where perhaps we could push a bit harder in this regard. But, I am happy to have this review regularly reported in the Board discussions on the relevant countries and then for the Board to review it on a case-by-case basis.

With regard to Mr. Rustomjee's concern about the pace of implementation by countries with capacity constraints, I have some sympathy with that, but the best way to address that would be for the issue to be raised specifically in the staff report and assessment so that the Board could consider it on a case-by-case basis whether there were any genuine circumstances for pushing back implementation, or whether the Board could then assess the situation with all available and relevant evidence needed to do so.

In terms of publication and extending the virtues of this policy, I strongly agree with the comments made by Ms. Lundsager earlier, and Mr. Al-Turki just now, on the need to expand the knowledge and awareness of this policy to the area departments much more so than is the case, that the area departments should be integrally involved in the discussions over when these

conditions should be part of the program's conditionality, and that there should be consistency across the different area departments in the approach taken to ensure a uniform treatment. That is a very important part of this whole process. Certainly, publishing this paper will help in that regard as well.

I was somewhat confused on other aspects of publication policy, however. As I understand it, the remedial action required of countries with an ongoing outstanding use of Fund resources but without a new Fund-supported program is to publish their central bank's financial accounts that are externally audited. Maybe I misinterpreted some of the information in paragraph 8, which seems to suggest so. However, Table 2 shows quite a small number of countries so far that are complying with that requirement. Is it because it takes a long time to get the external auditors in place or, more substantively, because those countries are not even publishing the financial accounts? If it is the former, then, certainly, it is a cause for some concern, and the Fund should be pushing a bit harder than before.

I support Mr. Mirakhor's call for an IMF Institute course. That would be a very cost-effective way of addressing the cases where countries that do not have a Fund-supported program are still interested in implementing these standards. In those cases where there are conflicting resource requirements, the staff should definitely not be going through a full two-stage on-site assessment. Rather, it should be addressed through an institute course and up to the countries to decide on what measures they want to pursue for themselves. It is only when they come for a funded program that the staff should be actually undertaking the full assessment.

Finally, another link on the publicity and wider dissemination of this work, there certainly would be some benefit in linking this work more closely to some of the aspects of the central banks that are investigated in the FSAP approach. I wonder whether or not that is already being done. If it is, then I fully endorse it. If it is not, then perhaps we could push these aspects a bit further in the FSAP.

Finally, I would support Mr. Brau's call for a review in three years' time. I hope that, at that stage, as he said, we will have more concrete evidence of the benefits of this program and more objective benchmarks. We certainly could start to look at whether or not the incidents of misreporting have actually declined as well as at the more positive externalities that are identified in this paper. We might be able to extend the analysis deeper.

Mr. Mirakhor said that he wished to remark on Mr. Brooke's comment on the resource needs being costed out in the staff report. He hoped that that was in response to the Board's outstanding request that all initiatives that came to the Board be costed out, in an attempt to remove the disconnect between the Board's frequent requests for undertaking new

initiatives and its unwillingness to support them with resources. The staff's effort in that regard was appreciated; the detailed costing out provided by the staff seemed reasonable. Thus, the decision on the provision of additional resources for the safeguards assessment exercise should not be delayed.

Mr. Brooke clarified that he fully agreed with Mr. Mirakhor's comment and was pleased to see Annex IV on resource implications in the staff report. He had been surprised, however, to note that the projected increase in resource costs was not actually matched by the proposal to increase staff budgeting, which implied that the difference represented either extra unpaid overtime or use of external consultants. The staff's approach as presented in Annex IV was not clear.

Mr. Rustomjee said that he appreciated Mr. Brooke's support for flexibility for low-income countries. Other Directors had also shown their willingness to allow flexibility. Going forward, this point should thus be reflected as part of the conclusion of the Board discussion on this subject.

For low-income, PRGF-type countries, where the administrative capacity was already under stress, it was not reasonable to hold up the completion of the first review simply because a member had not completed a safeguards assessment, Mr. Rustomjee reiterated. In the case of a PRGF-type country, the authorities' willingness to cooperate in undergoing the assessment was in itself a demonstration of commitment, considering the fact that they were fully aware of the additional burden expected to be placed on their administration from complying with another set of standards. Judgments should thus be made on a case-by-case basis, recognizing each country's administrative capacity.

Mr. Rustomjee also stated that he supported Mr. Mirakhor's suggestion regarding the IMF Institute courses.

Mr. Baukol said that, in response to Mr. Rustomjee's comment, he had sympathy for countries with capacity constraints, especially PRGF countries. However, in his view, the completion of the safeguards assessment itself was not capital intensive in terms of the amount of resources required for the task. A Stage One assessment entailed only the provision of documentation, which was not a major task. A Stage Two assessment involved discussions with the Fund staff about weaknesses or strengths of the documentation, without actually taking any steps to implement needed improvements by the time of the first review under a Fund arrangement, which, in PRGF cases, usually took place six months after the start of the program. That did not seem to create a tremendous burden on PRGF countries. On the Fund's side, the overriding objective was to safeguard Fund resources, which should be a clear priority.

Mr. Rustomjee said that that was a fair comment, and exactly the point that he had tried to make. Those countries' administrations were utterly burdened with all sorts of questionnaires and multiple visits from the staffs of the Fund and other international institutions, which seemed to continuously increase over time. Mr. Baukol was correct in

saying that the safeguards assessment was not a time-consuming activity at the margin. However, it was not the only requirement; a number of other requirements were simultaneously being placed on those countries, which cumulatively led to serious constraints on their administrations. The Board, for example, always came up with new initiatives for member countries to pursue. While there was no lack of interest on the part of the countries in doing so, the reality was that some countries in his constituency did not even have the administrative capacity to carry out the most mundane activities. Administrative capacity constraints were indeed a reality, not an excuse to delay implementation.

Mr. Kropas made the following statement:

At the outset I would like to thank the staff for an interesting and well-written paper. I found the contributions from the external experts valuable in making the safeguards assessments (SAs) framework more efficient.

General Remarks

I welcome the review of the safeguards assessments as a valuable "ex ante" approach in minimizing the risks of misreporting of information and possible misuse of Fund resources. The SAs framework has been useful in identifying vulnerabilities within central banks and has helped to advance central banks' best practices. In addition, I find the number of completed SAs impressive.

Central Banks should give a good precedent to the financial sector in promoting sound practices. A successful implementation of SAs can be expected to create positive externalities that will benefit other entities in the financial sector as well as governmental institutions.

Lessons

The SAs process has been a useful and a necessary tool to reduce the possibility of misuse of Fund resources or misreporting of data. In addition, it provides incentives for central banks to improve their practices, especially in risk control areas.

The SAs have helped to identify weaknesses in external and internal audit and controls. Also, the SAs process has supported an implementation of an action plan for eliminating the vulnerabilities in these areas. These findings underline, in particular, the importance of making progress with reconciling program data reported to the Fund to audited financial records.

I concur with the staff's conclusion (paragraph 42) that the documentation set required from central banks for off-site assessment might at times have proven to be too prescriptive. Central banks could become

reluctant to use independent advice on sensitive subjects, knowing that they might be obliged to provide any resulting reports to a third party.

The SAs might be made somewhat more interactive, so that internal practices may be increasingly taken into account by the Fund in the review process. This might entail a more direct contact between the Fund's staff and central bank officials and the increased use of self-assessment instruments such as those employed in the FSAP or other Fund Reports on the Observance of Standards and Codes (ROSCs).

I support the opinion expressed in the Independent Review of the SAs Framework (paragraph 13.4.) that there is an urgent need for the Fund to encourage the development of a comprehensive accounting and financial reporting framework for central banks. It is well known that central banks' accounting practices differ, even among the most developed countries. Consequently, it is doubtful whether adherence to a particular accounting framework should be used as a benchmark for SAs. The Fund has advocated the implementation of International Financial Reporting Standards for the central banks. This being said, I support the Fund in encouraging the use of a framework without being too prescriptive.

Finally, it may also be useful to prepare a "guideline on good practices" that describes the safeguards methodology or assessments approach, including a derivation of the safeguards ratings.

Considerations for the Future

I support the proposal of making the safeguards assessments a permanent part of the Fund's operations. However, countries that have shown good performance in the SAs should gradually exit from the framework with the Fund's resources rather than being applied in cases where little progress has taken place.

The Fund should continue to focus on the mitigation of risk in the ELRIC areas. I believe that there may be a scope for some refinements as mentioned above.

I am in favor of a continuation of the safeguards policy and support a moderate expansion of the coverage. As the SAs process is basically a diagnostic tool and does not provide any assurance that progress has taken place, it is important to have an effective monitoring of safeguards issues. One seamless process instead of the Stage One/Stage Two distinction appears to be appropriate.

I also concur with the staff's proposal that safeguards assessments should remain a requirement for countries for approval by the Executive Board of new arrangements.

Other Issues

Final Remarks:

I support the staff's proposal for keeping the Board well informed about the developments in SAs.

I support the staff proposal for response vis-à-vis member countries not cooperating adequately with the Fund concerning SAs.

The staff should do further work in the safeguards area, particularly to examine whether to extend this work beyond the central bank field.

Mr. Djojosubroto made the following statement:

At the outset, we would like to thank the staff for a well-written paper for today's discussion. Since we broadly concur with the introduction of this new framework on safeguards policy, we will limit our comments on the following issues of concern.

Permanent Feature of the IMF's Operation

As Mr. Portugal and Mr. Tombini pointed out in their preliminary statement, safeguarding the Fund resources should be a universal objective of all member countries. Noting the usefulness of such assessment, we agree that every member under the Fund arrangement is subject to the safeguards assessment. We also share the Panel's view that beyond the primary objectives, safeguards assessments could further enhance the IMF's reputation and credibility as a prudent lender. In this regard, we principally support the staff proposal to adopt the safeguards policy as a permanent feature of the IMF's operation.

While we agree that any major findings should be followed up, we should remain cautious to judge whether a review could be completed based merely on those findings and its improvements. We agree with Mr. Kelkar that safeguards assessment may not adequately meet the requirement of safeguarding Fund resources in the full sense of the term. We should keep in mind that the risk of failure to make an on time repurchase is also dependent on the implementation of the overall economic program designed together with staff.

In this respect, we questioned Ms. Lundsager's and Mr. Baukol's suggestion that countries address their key weaknesses identified in this assessment before receiving the second disbursement under any program, as it will become an impediment to the program implementation. As staff pointed out, many of the safeguards recommendations will take one to three years to be fully implemented. Some of them may need technical assistance from the Fund.

Deadline

As we noted, the average time required to complete a safeguards assessment ranges from one to eight months after receipt of the required documentation, depending on the type of assessments. Meanwhile, the existing policy requires that the safeguards assessment for a central bank should be completed no later than the first review under the member's arrangement from the IMF (paragraph 63). In principle, it is quite reasonable. However, since in many cases the deadline has been missed, we would prefer not to use the existing deadline. In this regard, we support Mr. Varela's and Mr. Rustomjee's suggestion for a more flexible deadline. If we want to maintain the present deadline, we may expect to see many deadlines missed and the quality of the safeguards assessment may be of a lower quality due to the intention of meeting the existing deadline.

Completion of a Review

Staff suggested that for countries where safeguards assessments were not completed by the first review, the staff report would contain, in the appraisal, an explicit statement to this effect and the staff's view on completion of the review. In principle, we could go along with this suggestion. However, as Mr. Mirakhor raised in his preliminary statement, we are also confused with regard to paragraph 66. Therefore, we support Mr. Rustomjee's request to revise the paragraph in the staff report as to make it clearer to the readers.

The Way Forward

We support the staff recommendation to streamlining the process so that a single assessment report will be produced for each country. In addition, we also support staff proposal that the coverage of safeguards assessments be slightly expanded. We also agree that, for first credit tranche, stand alone CFF purchases, or emergency assistance, due to the immediate need for disbursement, should not be subject to the safeguards assessment.

Assessment on Governing Legislation

With regard to the assessment on governing legislation, we are concerned with the accuracy of the assessments, since it covers very broad and complicated issues related to the central banks. For example, in the loopholes in governing the legislation, we believe it is difficult to classify whether advise from the government is considered as an intervention to the central bank. It is also difficult to measure the depth of reliance on a dominant senior officer in the central bank operations, or deficient governance oversight. The intention to focus the assessment framework is appreciated but we hope it will not become a straight jacket to the central bank or standard recommendation in remedial the weaknesses, away from country specific feature.

Shifting from Assessment to Monitoring

Since we are aware that safeguards assessments are a diagnostic tool at a point in time, we basically agree with the shifting of the focus of safeguards assessments from new assessment to monitoring.

With regard to the publication of the report, we agree but after erasing the country references.

Mr. Lombardi made the following statement:

We consider safeguards assessments a very important issue and we thank staff for this informative paper on the review of the experience so far achieved. Addressing the issue of vulnerabilities in the use of Fund's resources that could lead to cases of misreporting or even misuse of such resources requires all our efforts. In this regard, we also welcome the independent Panel's evaluation of the safeguards assessment.

Safeguards assessments should definitely become a permanent feature of the IMF operations as they provide a fundamental reference as to whether the central bank of a program country would be able to appropriately signal integrity and awareness in the use of the Fund's resources. Since countries may show significant weaknesses under the safeguards assessment, it is also important that they have clear incentives in taking timely corrective actions. The proposal put forward by Ms. Lundsager and Mr. Baukol in their preliminary statement that key weaknesses be addressed by the time of the second disbursement would provide the program country with an important incentive.

Since we believe the safeguards assessment should become a fundamental pillar in reducing—at least ex ante—possible misreporting cases

that would jeopardize future Fund's programs, it would be important to extend the assessment also to SMP countries. In fact, the aim for a country joining an SMP is usually to resort to the Fund's assistance at a later date.

Regarding the disclosure of safeguards assessments, we agree with the staff the nature of such a report could be relatively critical. While the Board must be provided with timely and accurate information on the potential vulnerabilities in a central bank's ELRIC, we believe that those countries requesting the publication of the report should be allowed to do so, since this would constitute a natural incentive towards implementing good practices.

Though the issue of safeguards assessment should involve various government institutions other than the central bank, we fear that extending such coverage might jeopardize the overall effectiveness of the safeguards program – still at an initial stage. Therefore we would propose that for the time being staff focus on central banks assessment only. Obviously, following the expertise and experience gathered in forthcoming assessments, at a later date we could re-consider whether to extend the assessment to other governmental institutional with the same effectiveness.

On the follow-up: we regard the assessment program as an ongoing process for many central banks. As a result, in addition to the initial assessment the monitoring of the central bank going forward should become part of the overall assessment process, which should continue for as long as the Fund's credit remains outstanding, as pointed out by Ms. Lundsager and Mr. Baukol in their preliminary statement.

As the staff points out, safeguards assessments require relatively new skills as well as more resources devoted to this new task. In this regards, we are definitely supportive towards strengthening the quality and the quantity of resources devoted to safeguards assessments.

Finally, we would also be in favor of the publication of this report since it would increase the awareness of the authorities and of the public regarding such an important issue.

Mr. Fenton made the following statement:

I would like to join other chairs in commending the staff for their extraordinary efforts in implementing this initiative so quickly. Even though a relatively short period of time has passed, the initiative has already demonstrated its value. We also take note of the positive assessment by the Panel of Experts and consider it as a positive sign that some non-program countries have sought information about the process and ELRIC framework.

Accordingly, we agree that SAs should become a permanent feature of Fund operations and we support the staff's proposals. We also agree with the additional suggestions made by Ms. Lundsager and Mr. Baukol, although in the case of SMPs we would agree with the approach outlined by Mr. Brau earlier, and for the low-income PRGF countries, we would support a carefully considered approach to any required remedial action that bears in mind as appropriate the implementation capacity in the individual cases, as suggested by Mr. Rustomjee. Finally, we also support Mr. Mirakhor's proposal of an IMF institute course on safeguards assessments.

Mr. Yakusha made the following statement:

I would like to start by welcoming this Board discussion and the paper provided by the staff as well as the review done by a Panel of Experts. I fully support the safeguards assessments initiative, as it is a useful exercise to ensure that the Fund's resources are used for their intended purposes and to reinforce the reputation and credibility of the IMF as a prudent lender. I also welcome the fact that the number of completed safeguards assessments goes beyond what was originally planned

But I also think that the work on safeguards assessments might need some serious improvement to increase the return on the resources that we invest in it. In the rest of my statement, I will address three points:
First, the procedure of the safeguards assessments and the relation with other instruments. Second, the follow up of safeguards assessments and the role of the Board. Third, the resources necessary for the safeguards assessment exercise.

Let me start with the procedure that decides which countries will undergo a safeguards assessment and which will not, as well as the choice to do only a Stage One or also a Stage Two assessment. The first issue will of course be solved if Safeguards Assessments would be an integral part of Fund policy and like now, all countries making use of Fund resources would have to undergo a safeguards assessment. Equality of treatment can also be guaranteed if we have an objective set of indicators determining which countries should undergo a safeguards assessment.

The second major area of improvement which I see is the follow-up of the Safeguards Assessments. The independent review as well as the staff report mentions this as an area for further work. My own experience from constituency countries is that after a safeguards assessment has been done and recommendations have been given, the communication with the Fund about these weaknesses is not necessarily. Furthermore, the Fund should not only give recommendations, but if necessary also provide assistance in solving the identified problems. I would strongly favor attaching conditionality on

identified weaknesses in Fund programs on the basis of safeguards assessments, given of course that this will be done on an equal basis for all program countries. Another precondition I would like to attach to strengthening conditionality in this respect is that countries can expect technical assistance from the Fund or from bilateral sources to solve the identified weaknesses. Technical assistance in this area is crucial for the success of Fund programs and should therefore have priority above other areas where technical assistance is provided. Maybe more use of bilateral technical assistance resources could be considered.

Another aspect of improving the follow up on safeguards assessments and increasing the effectiveness of the exercise is the need to adequately inform the Board. The staff paper suggests providing the Board with only limited information to prevent countries being reluctant to provide data to the Fund. Despite the long discussion we had about this in an earlier Board meeting, I still think that this is wrong: firstly, central banks are public institutions and should therefore be fully accountable to the wide public. Having accounting secrets is not compatible with this public role. Furthermore, one of the most effective channels to press for improvements of identified weaknesses will be the Executive Director representing the country concerned. And if we start attaching program conditions to identified weaknesses, Directors should have access to the assessment reports. The Board should be informed on an ongoing basis about the progress of the safeguards exercise. We are ready to support the staff's proposal to have detailed review in three years.

Finally, with regard to the resources necessary for the safeguards assessment exercise, I would be interested to know how much resources it would take to keep on assessing all program countries and to follow up on the results. The resources requirement should then be presented next to all other priorities of the Fund during the budget discussion, so that the Board can make a good assessment of the desirability of transferring resources from other areas to safeguards assessment work.

The Treasuer (Mr. Brau) in response to Mr. Josz's question regarding the number of safeguards assessments completed in advance of Board approval, said that the staff did not have the exact number at the moment, but believed that there were less than 5 out of the total of 30 completed assessments. The staff had kept a better record of the number of assessments that had been completed by the first program review. The staff would provide a more accurate answer bilaterally.

With regard to the concern raised particularly by Mr. Rustomjee about the deadlines for completing the safeguards assessment for low-income countries—on which relatively few assessments had been conducted—so far there had been no cases in which the deadlines had

been missed, the Treasurer observed. The authorities had been cooperative, despite the extra burden that the safeguard assessment process had imposed on their central banks.

The staff took careful steps to ensure that the recommended remedies were implemented in a cooperative manner, the Treasurer continued. Discussions with central bank authorities also involved the area departments. In the case of PRGF countries, where the authorities accepted that an identifiable accounting standard should be adopted, the implementation process—which normally took one year in a more developed country—could take as long as two years. That was where flexibility had to be applied and, if necessary, technical assistance would be recommended, in consultation with the authorities and the area department. That practice was reasonably satisfactory, and thus was expected to continue.

In response to Mr. Wei's question on technical assistance, unfortunately, the staff did not have an estimate of the technical assistance needs, although they clearly existed, the Treasurer related. On the other hand, considerable capacity existed in some central banks—especially in one large African central bank—where the officials of the accounting and control departments were willing and able to carry out the recommended steps. Many central banks realized the urgency of putting in place the safeguards recommendations.

Regarding Mr. Brooke's question on the publication of financial statements, that was a critical component of the safeguards framework as well as the Fund's code on good practices, the Treasurer noted. Therefore, improvements in that regard were particularly required in a large number of cases. There were cases in which central banks' financial statements were externally audited, but their publication was only partial or abridged, with no explanatory notes, which rendered them useless. Moreover, in some cases, as noted in the staff paper, the publication was delayed, while, in other cases, the existing central bank law was contravened. As the publication of central bank financial statements comprised an essential component of the framework, the staff had already taken a firm position on this issue by requiring that the statements be published in full and in a timely manner.

With respect to the proposed extension of the coverage of safeguards assessments to all countries with outstanding Fund credit, the issue was different from that related to the monitoring of recommendations or monitoring after a program had expired, the Treasurer explained. Subject to confirmation by the Legal Department, the existing safeguards policy could not be applied to countries that had not been subject to safeguards assessments, in which case no recommendations had been made, and hence to be implemented. A secondary consideration related to the role of safeguards assessments. The Board had expressed different views on this particular issue during the discussion on the safeguards policy two years ago. The conclusion was that safeguards assessments were intended to serve an assurance role, that is, to protect Fund resources, through the application of conditionality on key remedies. Thus, they should not be regarded as technical assistance. In that light, applying a safeguards assessment to all cases with outstanding Fund credit would change its nature from an assurance role, with the possibility of applying conditionality, to technical assistance and advice. The problem was that Fund advice and technical assistance could not be imposed; it could only be requested and implemented on a voluntary basis. Imposing

safeguards assessments on all countries with outstanding Fund credit would only weaken the safeguards instrument, as well as severely stretch the existing staff resources.

Mr. Baukol said that he did not agree with the views expressed by the Treasurer of the Fund. Since the goal was to safeguard Fund resources, it would be reasonable to extend the coverage of safeguards assessments to countries that had never been subject to safeguards assessments but still had current outstanding obligations to the Fund. For those countries in which the Fund had no leverage to impose the remedies, safeguards-related issues could be raised with the authorities on a routine basis in the context of Article IV consultations. In that context, the staff could offer advice on ways to improve their central banks' financial controls and encouraged them to undergo a safeguards assessment. Most of these countries would likely be interested in receiving such an advice from the Fund. That would be useful and consistent with the general safeguards approach, and did not seem to weaken the instrument. The nature of technical assistance provided to those countries did not differ much from the activity that the staff would be expected to conduct in the monitoring phase on countries whose arrangements with the Fund had expired, which was a policy that the staff was proposing for Board approval.

In terms of the resource costs, currently, there were less than ten countries with outstanding obligations to the Fund that had not undergone safeguards assessments, Mr. Baukol observed. It would thus not expected to impose a major burden on the resource budget.

Ms. Vtyurina remarked that Mr. Baukol's proposal did not fall under the safeguards assessment framework, as the current policy required countries to undergo a safeguards assessment and implement the recommendations made by the staff. Fund advice on safeguards issues in the context of Article IV consultations had to take other forms. With respect to the objective of safeguarding Fund resources, the Fund had already put in place a policy on Post-Program Monitoring, with appropriate attention being given to the countries' capacity to repay the Fund.

Mr. Mirakhor said that he had been involved in the initial discussions on safeguards assessments, and recalled that the Board had extensively debated this issue. The Board had generally considered it difficult to impose ex post conditionality on a member country, as it would violate the initial contract between the Fund and the country that had an arrangement with the Fund. For that reason, the Board had decided to institute the current procedures in a forward-looking fashion, and had tried to pursue countries left outside the framework through peer pressure, for example, through Board discussions and suggestions that countries should voluntarily undergo a safeguards assessment. Countries acknowledged the benefits that could be gained from this effort and thus were interested in undertaking an assessment. The Fund, on the other hand, was perhaps underestimating the beneficial effects of the safeguards assessment process on the credibility of central banks, and of countries as a whole. The Board should, therefore, proceed with the forward-looking process, allowing it to evolve before debating the issue again in the future.

Mr. Josz asked whether the policy that had been agreed two years ago required countries with Fund arrangements approved prior to June 30, 2000, to submit audited financial statements under the transitional procedures. If that was the case, the safeguards framework should already cover the ten countries referred to by Mr. Baukol.

The Treasurer (Mr. Brau) responded that not all of those countries were covered by the transitional procedures. The transitional procedures applied to countries that had had ongoing arrangements at the time when the initial policy had been adopted, whereby the Board had decided to require a review of the adequacy of the external audit mechanism, including the publication of externally audited financial statements. The staff would conduct that assessment and, if necessary, would suggest recommendations or even apply conditionality on a forward-looking basis for existing arrangements. That process did not cover all situations where Fund credits were outstanding.

Mr. Baukol's suggestion would have the effect of changing the nature of the safeguards assessment, the Treasurer continued. Mr. Baukol's argument—that the monitoring procedures would, in any case, apply to countries that had completed Fund arrangements but continued to have credit outstanding—seemed to miss one critical point. That is, countries under ongoing Fund arrangements had committed to implementing the recommendations made in the safeguards assessments, which, if considered important, had been incorporated into Fund conditionality. However, this was a policy matter, and the Board might wish to reconsider the issue.

Mr. Baukol said that he recognized that difference. He was not suggesting that the Fund impose any type of conditionality on those countries to ensure that they follow through with the suggested improvements. Rather, he was suggesting that the staff, on a routine basis, raise the issue with the authorities during Article IV consultation or Post-Program Monitoring discussions, as the case might be, and encourage them to do the assessment as well as follow through on any needed improvements.

Countries that fell into this category included Thailand and the Philippines, which were currently under Post-Program Monitoring but had never had, and would not be expected to have, safeguards assessments, Mr. Baukol continued. Russia was another country with current credit outstanding, but the threshold was below that required for Post-Program Monitoring. He apologized for naming specific countries in a policy discussion.

The Treasurer (Mr. Brau) said that, to conclude, the staff would be willing to conduct safeguards assessments for countries that wished to do so, provided that adequate resources were available.

Mr. Baukol reiterated that, going forward, it would be reasonable to have the staff raise the issue of safeguards on a routine basis as part of Article IV consultation discussions on those countries, along with discussions on monetary, fiscal, and exchange rate policies.

The Treasurer (Mr. Brau) stressed that the request for a safeguards assessment in those cases had to be made by the authorities.

Mr. Baukol wondered whether that meant that the staff could not bring up safeguards issues during Article IV consultations unless the authorities initiated such a discussion. In fact, the staff could just explain to the authorities the benefits of participating in the Fund's safeguards program.

The Treasurer (Mr. Brau) said that the staff had no difficulty with the suggested procedures. The Fund staff could call the authorities' attention to a whole range of the Fund's advisory services, for example, through better publicity. But, the request for any of such services had to come from the authorities.

The Acting Chair (Ms. Krueger) remarked that, to reconcile the apparently irreconcilable, the Treasurer had made it clear that the staff could raise the question of safeguards assessments with country authorities during Article IV consultations, and urge them to participate in the process. However, as stressed by the Treasurer, the decision rested with the authorities whether or not to do so. That practice did not differ from Mr. Baukol's suggestion.

The Treasurer (Mr. Brau) confirmed that the Acting Chair's understanding was correct.

On staff resources, it was clear that the expected increase in safeguards activities required additional resources, the Treasurer said. The Treasurer's Department had been quite conservative in terms of staff resource use through redeployment within the department. For some of the reasons mentioned by Mr. Yanase, the demand for resources would reach a plateau in two to three years. The staff was grateful for Directors' support for the request for additional resources.

The resource demand could be met through redeployment within the Treasurer's Department, provided that the aggregate resources of the department were not reduced in the budget—a decision to be reached by the Board and management in the upcoming discussion on the budget proposal, the Treasurer commented. The department could reap the benefits of the improvements in various systems, particularly in information technology, which allowed some of the existing resources to be released to other important needs. That, however, progressed gradually, and, provided that the existing resources were not taken away, the Treasurer's Department should be able to mobilize adequate resources within the department for the safeguards assessment policy.

Mr. Mirakhor noted that Annex IV on page 51 of the staff paper identified four areas where resources would be required. He wondered whether all of those activities could be accomplished by redeployment within the Treasurer's Department without additional new resources.

The Acting Chair (Ms. Krueger) responded that that was her understanding from the Treasurer's statement.

The Treasurer (Mr. Brau) confirmed that the staff resources, through redeployment within the Treasurer's Department alone, were expected to be adequate for carrying out the identified safeguards activities. However, other issues related to the budget—cash resources for the remuneration of experts, for example—had not yet been discussed with the Office of Budget and Planning or with management.

Mr. Mirakhor recalled the sentiment in the Board, in the Budget Committee and elsewhere, in favor of a switch from temporary experts to permanent staff. The Treasurer's Department, and the Board, should be mindful of the importance of the last area where additional resources would be needed—voluntary assessments. According to Annex IV, "the staff has received the requests for safeguards assessments from member countries that do not have an arrangement with the Fund. Such requests are likely to increase, especially in the context of scarce specialized skills in these areas generally at central banks." There were 90 countries that currently did not have Fund-supported programs. Care should be exercised to ensure that the Fund was not promising something that could not be delivered in the future. There was support for additional resources if requested by the Treasurer's Department.

The Acting Chair (Ms. Krueger) said that management would consider that issue in the context of the budget, which was forthcoming.

Mr. Josz suggested that, at the next review of the safeguards policy, which was expected to take place in three years' time, independent experts should again be invited to present their views to the Board. Directors unanimously considered the inputs of independent experts valuable.

The Chair of the Panel of Experts (Ms. Caparello) made the following statement:

> There is a point to which I would like to come back. One of the suggestions that we have made in the paper on the *Independent Review of the Safeguards Assessments Framework*, is that there is an urgent need for the IMF to encourage the development, by an appropriate standard-setting body, of a comprehensive accounting and financial reporting framework for central banks based on IAS. I would like to clarify here our vision in the Panel of Experts. In the European system of central banks, we have developed, and we are applying to the euro area, accounting rules that have been elaborated collectively by the central banks participating in the euro area. We have adopted this system by comparing the various methods, and have, in fact, concluded that, for specific core functions—particularly those relating to foreign reserve assets—specific rules based on the strictest principles of prudence should be applied. This means that it is not an application of the International Accounting Standards per se, but that of the specific rules, which provide that unrealized gains have not to be externalized and distributed,

whereas unrealized losses have to be recognized, externalized, and subtracted from the profit. This is an example that I would like to use. For what is pertaining to the core function of the central banks, this is the strictest prudence principle that applies.

For the remaining part of the financial statements, and particularly what is not considered as pertaining to the core function of the central banks, there has been a common framework based on generally accepted accounting principles, and the idea of adopting the IAS standards more for this part. But, of course, the part that corresponds to the core function, namely, foreign reserves, will still be under the specific framework for establishing prudence. It is this idea that has inspired our statement here in the independent review—that, in order to have a consistent approach and also consistent meaning in the financial statements of the central banks, it would be necessary to envisage and encourage the development of an accounting framework specifically for central banks. This is what I wanted to flag to you. We did not elaborate much in our paper, but it is more of a norm than it appears, taking into consideration the core function and the specificities of the central banks.

The Acting Chair (Ms. Krueger) concluded that the idea of developing an IMF Institute course on safeguards assessments, as proposed by Mr. Mirakhor, was accepted. This point, however, would not be included in the summing up.

The Acting Chair (Ms. Krueger) made the following summing up:

Directors considered the safeguards policy, which was adopted on an experimental basis in March 2000 as an ex ante mechanism to strengthen the IMF's framework of measures to safeguard the use of Fund resources and minimize the possibility for misreporting, to be an unqualified success. The policy has been widely accepted by central banks, and has helped improve their operations and accounting procedures while enhancing the Fund's reputation and credibility as a prudent lender. Directors, therefore, supported the staff proposal that the policy be adopted as a permanent feature of Fund operations. They expressed their gratitude to the Panel of Experts for their contribution in shaping the safeguards policy.

Despite improvements in central banks' safeguards over the past few years, Directors noted that the safeguards assessments completed to date have revealed significant vulnerabilities in the controls employed by a number of central banks of borrowing member countries, which could lead to possible misreporting to the Fund or misuse of central bank resources, including Fund disbursements. In particular, safeguards assessments have revealed that (i) a substantial number of central banks' financial statements are not subject to an independent and external audit conducted in accordance with internationally accepted standards; (ii) several central banks have poor controls over foreign

reserves and data reporting to the IMF; and (iii) a number of central banks have adopted an unclear financial reporting framework and inadequate accounting standards.

Directors noted that these findings indicated that significant, but avoidable, risks to Fund resources may exist in the cases concerned. Accordingly, some of the findings have warranted corrective measures under program conditionality, ranging from prior actions to policy commitments in letters of intent. Directors stressed, however, that Fund conditionality in these cases should be limited to areas highly relevant to safeguarding the use of Fund resources. They welcomed the fact that central banks have generally embraced the staff recommendations and that many have already taken steps to implement them. Directors advised the staff to tailor the assessments and remedial measures to the specific circumstances of individual countries.

Directors agreed that the coverage of safeguards assessments should extend to countries that augment an existing Fund arrangement or that have a Rights Accumulation Program, and a number favored its extension to countries with stand-alone CFFs and to countries with outstanding obligations to the Fund that do not currently have a Fund-supported program. Some Directors also favored its extension to countries with staff-monitored (SMPs), but others felt otherwise since these cases do not involve the use of Fund resources. Most Directors agreed that countries under an SMP should be encouraged to undergo safeguards assessments on a voluntary basis, as in many cases these programs are followed by formal arrangements with the Fund. While recognizing that the safeguards assessments constitute part of the Fund's broader efforts to improve transparency in member countries, Directors stressed that safeguards assessments should not be converted to an institution-building exercise, but should remain narrowly focused on safeguarding use of Fund resources. Most Directors agreed that safeguards assessments should not be applied to fiscal issues and other public agencies, since that would require a new mandate for the staff. Many Directors urged the staff to raise safeguards issues in the context of Article IV consultations with countries that were not subject to a safeguards assessment but that have current outstanding obligations to the Fund, while recognizing that countries would have to voluntarily agree to discuss these issues.

Moving forward, Directors supported the shift of focus of the safeguards policy, during the next three or four years, from initial assessments to the monitoring of past commitments. They welcomed the improvements to external communications during the safeguards process proposed by the staff, and the closer coordination of corrective actions with past and ongoing technical assistance. Directors also underscored the need to strengthen internal communications among Fund staff to ensure consistency in the application of the safeguards policy.

Directors stressed that a key consideration moving forward is the modalities for monitoring the implementation of the remedies proposed by safeguards assessments. They noted that commitments made by the authorities to implement safeguards recommendations would be monitored in conjunction with overall program conditionality and that the main focus of future safeguards work would, therefore, be on the efficacy of implementation. To facilitate the monitoring of recommendations, Directors agreed that central banks should provide annually to Fund staff their annual audited financial statements and related audit reports, including management letters and special audit reports, for as long as Fund credit remains outstanding. They also agreed that the periodicity of monitoring would be influenced by the timing for implementing past recommendations and that, in some cases, on-site monitoring would be necessary.

Directors agreed that the modalities for future safeguards assessments would be broadly similar to existing procedures, except for improvements resulting from the lessons learned during the experimental period to narrow the focus and improve the effectiveness of the assessment. Therefore, all member countries receiving a new arrangement from the IMF after June 30, 2000, would be subject to a full safeguards assessment. However, the nature and extent of a safeguards assessment for new arrangements where a previous assessment had already been conducted would be based on known risk factors, including the findings and date of the previous assessment, the results of the safeguards monitoring process, and possible new developments at the central bank. Also, the distinction between Stage One (off-site) and Stage Two (on-site) assessment reports would no longer apply—a single, confidential safeguards assessment report would be prepared for all new arrangements.

Directors noted the importance of deadlines for the completion of safeguards assessments and indicated that, in principle, the assessment should be completed prior to the Executive Board's approval of a new arrangement. They recognized, however, that various factors may delay the completion of a safeguards assessment and agreed to retain the deadline for completion of the assessment by no later than the first program review under the arrangement. Where the deadline is not met, either due to external factors or as a result of deliberate recommendation by the staff, Directors noted that a staff report recommending completion of a review under the arrangement would contain, in the appraisal, an explicit statement to this effect and the reasons for proposing completion of the review despite the delay in the safeguards assessment. Several Directors suggested that the current policy be augmented so that key weaknesses are addressed as soon as possible and prior to the second review under any program, although the administrative capacity of the country must be taken into account. In view of the importance of safeguards assessments to the integrity of the Fund and the benefits to members, and to minimize delays, many Directors supported the allocation of more staff

resources to this task, although a number of them preferred that this be done through redeployment. Some Directors also encouraged the continued use of technical experts from central banks.

Directors concurred that safeguards assessment reports should remain confidential documents and requested that the Executive Board be kept informed on safeguards issues by (i) a summary of findings and recommendations identified by safeguards assessments in staff reports; and (ii) periodic summary reports to the Executive Board on safeguards assessments findings in general. However, a few Directors believed that countries that wish to publish their reports should be allowed to do so. Directors supported publication of the staff report after deletion of references to individual countries. They agreed that a review of the safeguards policy should take place in three years, if not earlier, and suggested the involvement of external experts in the review process.

Mr. Portugal, in his memorandum to the Secretary dated April 3, 2002 (Annex), objected to the last sentence in paragraph 4 of the summing up, which read, "Many Directors urged the staff to raise safeguards issues in the context of Article IV consultations with countries that were not subject to a safeguards assessment but that have current outstanding obligations to the Fund, ..." The following Directors supported Mr. Portugal: Mr. Al-Turki, Mr. Barro Chambrier, Mr. Callaghan, Mr. Djojosubroto, Mr. Kelkar, Mr. Mirakhor, Mr. Mozhin, Mr. Rustomjee, Mr. Shaalan, Mr. Varela, Mr. Wei, and Mr. Zoccali.

DECISIONS TAKEN SINCE PREVIOUS BOARD MEETING

The following decisions were adopted by the Executive Board without meeting in the period between EBM/02/25 (3/11/02) and EBM/02/26 (3/14/02).

2. EXECUTIVE BOARD COMMITTEE—NOMINATION

The Executive Board approves the nomination by the Managing Director of Mr. Varela to replace Mr. Oyarzábal on the Budget Committee, as set forth in EBD/02/35 (3/6/02).

Adopted March 12, 2002

3. APPROVAL OF MINUTES

The minutes of Executive Board Meetings 02/4 and 02/5 are approved.

4. EXECUTIVE BOARD TRAVEL

Travel by Executive Directors and by an Advisor to Executive Director as set forth in EBAM/02/32 (3/11/02) and EBAM/02/33 (3/12/02) is approved.

APPROVAL: May 23, 2002

SHAILENDRA J. ANJARIA
Secretary

Office Memorandum

To: Mr. Anjaria April 3, 2002

From: Murilo Portugal

Subject: **Changes in the Summing up on Safeguards Assessments**

On April 1, 2002 a message from your office informed us of a change in the last sentence of paragraph 4 of the Summing Up on Safeguards Assessments, which was circulated on its final form on March 20, 2002. The change alters from "a few" to "many" Directors that urged staff to raise safeguard issues during Article IV missions in countries that have outstanding obligations to the Fund.

Based on our own recollection, which was checked with your staff, less than 10 Directors held that view. I would suggest, therefore, that the records of the meeting should be checked further and that the word "many" is changed to "some" or "a number", as appropriate.

Our understanding is that the issue in question, which was not part of the staff report, was raised in the meeting in the context of questions asked by a Director. Because of that most Directors did not address it in their grays or in the meeting. If the issue had been more thoroughly discussed, maybe many Directors would have opposed the idea and these views would need to have been reflected in the summing up.

Moreover, I would like to point out that the change was done after the normal period for suggestions of changes to the summing up, and 10 days after it was circulated, without any explanation of the reasons.

cc: Executive Directors