September 13, 2005
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INTERNATIONAL MONETARY FUND

Minutes of Executive Board Meeting 05/38-2

11:35 a.m., April 25, 2005

2. Safeguards Assessments—Review of Experience; Report of the Independent Panel on Safeguards Assessments

Documents: SM/05/116 and SM/05/117

Staff: Kuhn and Trines, FIN

Length: 1 hour, 5 minutes

Executive Board Attendance

T. Kato, Acting Chair

Executive Directors	**Alternate Executive Directors**
	A. Alazzaz (SA)
	G. Meissner (GR)
	O. Cuny (FF)
	J. John (UA), Temporary
S. Kashiwagi (JA)	
W. Kiekens (BE)	
	M. Roovers (NE), Temporary
	R. Campbell (CO), Temporary
	S. Rouai (MD), Temporary
	K. Kanagasabapathy (IN), Temporary
	A. Tolstikov (RU), Temporary
	P. Gakunu (AE)
	C. Amador (AU), Temporary
	M. Sidi Bouna (AF), Temporary
	C. Gola (IT), Temporary
	R. Steiner (BR)
	R. Newton-Smith (UK), Temporary
	R. Calderón-Colín (CE), Temporary
A.S. Shaalan (MI)	
	D. Farelius (NO)
	D. Ayala (AG), Temporary
	H. Ge (CC)
	D. Wang (CC), Temporary
F. Zurbrügg (SZ)	P. Inderbinen (SZ), Temporary
	M. Sukada (ST)

S.J. Anjaria, Secretary
J. Morco, Assistant

Also Present

Asia and Pacific Department: N. Weerasinghe. European Department: F. Rozwadowski. External Relations Department: O. Stankova. Finance Department: P. Frerejacque, J. Grochalska, C. Hemus, A. Kabra, G. Kabwe, B. Keuppens, M. Kuhn, R. Perrelli, I. Rutkowska, S. Sriramchandram, A. Trana, H. Trines, A. Tweedie. Legal Department: R. Leckow, M. Luedersen. Office of Budget and Planning: P. Ganesh. Policy Development and Review Department: M. Allen, A. Feler, M. Fetherston, R. Kincaid. Secretary's Department: P. Martin, P. Ramlogan. Western Hemisphere Department: R. Androgue. Senior Advisors to Executive Directors: S. Beidas (MI), P. Gitton (FF), A. Ismael (AF), J. Masawe (AE), J. Milton (AE), P. Moreno (CE), P. Patrawimolpon (ST), L. Veziroglu (BE). Advisors to Executive Directors:

R. Gesami (AE), S. Kivinen (NO), D. Nintunze (AE), S. Rottier (BE), V. Srinivas (IN), S. Wolff-Hamacher (GR), N. Yamaguchi (JA).

2. SAFEGUARDS ASSESSMENTS—REVIEW OF EXPERIENCE; REPORT OF THE INDEPENDENT PANEL ON SAFEGUARDS ASSESSMENTS

Mr. Shaalan and Ms. Beidas submitted the following statement:

We thank staff and the independent panel of central bank officials for a timely review of the safeguards assessments, which has become a permanent feature of the Fund's fiduciary relationship with members accessing Fund resources. This comes at a time of heightened awareness among the financial community of the need for strengthening prudential regulation and supervision, including the activities of central banks themselves. As expressed by most central banks reviewed, safeguards assessments have contributed to this awareness, as manifested in the high implementation ratios of staff recommendations. We will focus our comments on staff's analysis of the results achieved so far and proposals going forward.

The uniformity of application of the assessments has served the Fund well. Notwithstanding this, we welcome staff's expectation that assessments would become more narrowly focused with targeted follow-ups—in line with the Board's 2002 review. Therefore, it would have been useful to flesh out how this would be achieved going forward, on the basis of the wealth of experience gained so far. Although some examples are referred to in the paper—limiting remedial measures which require legislative amendments or a more compliance-oriented update—we were expecting a more complete treatment, including proposals to narrow down ELRIC components. For example, has staff given consideration to differentiating the depth—rather than scope of the five ELRIC components—of staff monitoring and follow up, commensurate with the Fund's exposure to members, while maintaining uniformity of treatment?

We understand from staff that the diagnostic exercise of the safeguards has triggered specific technical assistance requests. We were pleasantly surprised by this, since in the 2002 review staff argued against direct technical assistance. It would have been useful to elaborate on the experience of technical assistance provision emanating from the assessments and how it has led to strengthening technical assistance delivery in the monetary and statistics areas more generally.

Resources are expected to remain adequate, through a mix of staff redeployment within FIN and continued use of a limited number of external experts or functional departments assistance. However, we would have appreciated a table (in section IV.A) showing the breakdown of the resources allocated to each of the three types of assessments going forward. This would be useful since priorities change; in the 2002 review staff expected a move away from new assessments toward monitoring past commitments, which did not materialize, but now this is expected going forward. We would have liked to see these priorities supported by and coordinated with PDR's expectation of new arrangements, as well as implications of forthcoming reviews (of the role of the Fund in LICs) or new (precautionary) financing arrangements.

We would prefer retaining the on-site component of assessment updates, a preference supported by the findings of the independent panel. On the proposed monitoring of assessments from headquarters, we are supportive but call for more effective Fund-wide coordination. The latter was a weakness pointed out by the independent panel, and, in this context, we would have liked to see a discussion of how FIN proposes to manage this internally—with area departments, resident representatives, and other functional TA providers.

We support the proposed flexible modalities for EPCAs, differentiating members' central banks' institutional capacities. We would, however, welcome some elaboration and tightening in what is meant by a "targeted" assessment in cases of central bank capacity weakness. We also support staff's rationale for the exclusion of ENDA and CFF member countries.

On the envisaged sharing of assessment documents with other IFIs, including the World Bank, we are opposed. It is our view that safeguards are conducted, by accountants and specialists, purely for safeguarding Fund resources and, on this basis, are not official assessments of central banks in any shape or form. On the periodicity of safeguard updates, we can go along with an annual update, rather than a semi-annual one, and the proposed three year review.

Finally, we were encouraged to hear from staff that an IMF institute course on safeguards has been running twice a year, at headquarters and regional institute centers, with participation ranging from those authorities compiling their initial assessment documents to those implementing assessment recommendations.

Mr. Meissner and Ms. Wolff-Hamacher submitted the following statement:

We thank staff and the members of the independent panel for their interesting reports on the experience with safeguard assessments. We broadly share the staff's and the panel's recommendations and we have the following comments:

Safeguard assessments have succeeded in their primary objective to minimize misreporting and misuse of Fund resources associated with the Fund's lending activities. In addition, they have contributed to improving data quality and robustness. While—as noted by staff—safeguard assessments cannot prevent misuse of resources that may occur as a result of a willful override of controls or manipulation of data, they still may help to make these instances less likely. At the end of the day, the success of the safeguard assessments depends on the willingness of central banks to implement the assessments' recommendations. According to Table 1 of the staff paper, only 76 percent of recommendations that were neither under program conditionality nor LOI/MEFP commitments have been implemented compared to almost 97 percent of the recommendations under program conditionality or LOI/MEFP commitments. Therefore, formal commitments from the authorities to implement the assessment recommendations would in general be preferable. We regret that the share of non- or delayed publications of financial statements has increased.

It seems that five years after the introduction of the safeguards assessment policy (SAP), there is still some need to explain the objectives of the SAP and its difference to other Fund activities like FSAPs, statistics and monetary missions, Article IV surveillance, and program reviews. We therefore support the panel's recommendation to improve communication between the IMF and the central banks on safeguard issues. We also support the panel's proposal to improve off-site monitoring, for example through developing a matrix, including general checklists.

We support the proposed classification of safeguard assessments (paragraphs 38 to 41 of the staff paper). Staff suggests that a new assessment would always involve an on-site assessment; on-site assessment in update assessments would however depend on the perceived risk. Could staff comment on how the perceived risk would be assessed? We also suggest that the exposure to the Fund be considered as a risk; staff comments would be welcome.

We support staff's recommendation to extend the SAP to emergency post conflict cases (EPCAs), since the risks to Fund resources in these cases are probably higher than in other cases. As the staff suggests, the modalities for the safeguard assessments in EPCA cases should be determined on a case-by-case basis, taking into account the degree of re-establishment of functioning monetary and financial systems. Indeed, experience suggests that the safeguard assessments' recommendations support the reconstruction process. We are not fully convinced by staff's arguments to exclude emergency assistance for natural disasters and outright purchases under the CFF from the SAP. We feel they should be included, not least with a view to equal treatment. As in the case of EPCAs, the modalities of the assessments should be determined on a case-by-case basis also taking into account capacity constraints, particularly in the case of emergency assistance for natural disaster cases.

We concur with staff that update papers on safeguard assessments should be changed from a semi-annual to an annual basis. We also concur that periodic reviews of the safeguards policy are performed every three years.

Finally, we support the staff's proposal to share safeguard assessment reports with other international organizations under the condition that confidentiality is maintained. Like staff we expect reciprocity of information sharing in similar areas.

Mr. Kremers and Mr. Roovers submitted the following statement:

We welcome this review of the safeguard assessments (SA) policy and thank the independent panel for its work. Indeed, the panel's report confirms the general finding of staff that the effectiveness of the safeguard assessments has much improved, in terms of both securing the efficient use and revolving nature of Fund resources and strengthening the governance and control systems at central banks. Moreover, the policy has added to data transparency, including for Fund program implementation. In this light, the safeguards policy underpins the reputation and credibility of central banks and of the Fund as prudent lender. We broadly agree with staff's analysis and suggested avenues for further work, and would like to raise a few points on the operational aspects of the SA going forward.

First, we note staff's finding that there has been an overall reduction in detected weaknesses among the central banks assessed. We wonder to what extent this trend is interrelated with the relatively high number of re-assessments. In addition, this raises the question why the expected shift from new assessments to updates and monitoring of recommendations has not fully materialized. Given that new Fund arrangements have generally been lower than anticipated (at least in the budget), we wonder whether there may be other reasons that could be relevant going forward.

Second, we note the high implementation rate of SA recommendations, in particular when linked to formal commitment from the authorities, including through program conditionality. We agree that the first review remains an appropriate formal deadline for completing the SA, and wonder whether staff can be more specific on the average timeframe for implementing SA recommendations. Would it indeed be the case that key weaknesses generally are addressed before the second review, either or not through interim remedial actions for vulnerabilities that would take a longer time to correct? In any case, with the shift from assessments toward updates and monitoring, one would expect on average timelier implementation.

Third, regarding obstacles to the implementation of SA recommendations, we support staff's pragmatic line in allowing for flexible approaches, but ensuring minimum standards in order not to compromise the policy. This requires discretion and judgment, and in rare cases could indeed result in the Fund withholding its financing. Here, we note possible legislative difficulties in ensuring de jure central bank independence, as well as the finding in the panel's report that in some circumstances, pursuing amendments to the central bank law following an SA recommendation can work counterproductive. Nevertheless, recommendations in this area may prove fundamental to the central bank's operational independence, where de facto independence may not be compromised. In addition, we think that well-targeted TA and a closely aligned approach through area departments can greatly help in solving obstacles related to capacity and political sensitivities.

Fourth, we support the proposed modalities for the three types of SAs and the proposed approach for EPCA cases. We would appreciate some further elaboration on the issue of applying the safeguard policy in cases when the central bank is not the depository and / or fiscal agent, or in cases when the central bank is both, but Fund financing is effectively provided directly to, and managed by, the government. While we share the arguments for not extending SA to the fiscal area, we wonder how in practice staff has applied the policy in these cases and whether it has been able to find pragmatic solutions to close potentially large gaps in its assessments. Generally, we would also be interested in staff's views on whether these cases would entail higher risks to the goals of the SA policy?

Fifth, we subscribe to the recommendations of the independent panel for improving the SA process. At the previous occasion, we already reflected on our constituency's experience pointing to the need for better and more frequent communication by the staff, both in the SA and in the implementation of its recommendations. As stated above, a better integrated approach within the Fund's organization could also help to target TA and avoid confusion among central banks about other, sometimes overlapping, Fund activities. In addition, we subscribe to the importance of continuing on-site monitoring, when judged appropriate by staff, and see the potential usefulness of a matrix as a tool for off-site monitoring, while leaving room for qualitative judgment by staff. Perhaps staff can give some indication of how it intends to operationalize the panel's recommendations?

Finally, involving possible trade-offs between confidentiality and transparency, we would support sharing SA reports with staff from other IFIs, on the basis of reciprocity and the authorities' consent. We wonder whether in the same vein information sharing with the Board should be further enhanced, e.g., in case recommendations are taken up as part of program conditionality. It seems that such approach could also add to the dissemination of best practices as suggested by the independent panel. We agree on changing the periodicity of the general update to the Board on SAs from semi-annual to an annual basis, and to review the policy every three years.

Mr. Sukada and Mr. Patrawimolpon submitted the following statement:

We thank staff and the member of the independent panel for a set of comprehensive reports. We broadly agree with the thrusts of the reports and have the following comments.

We share the panel's survey results and conclusions that the safeguards policy has made significant progress in accomplishing its main objectives which is to minimize the possibility of misreporting or misuse of Fund reserves associated with the Fund's lending activities. In particular, safeguards assessments have improved the way central banks operate in the areas of external audit, legal structure, financial reporting, internal audit, and internal control. As staff noted, safeguards policy is not a panacea and it can not prevent misuse of resources that may occur as a result of a willful override of controls or manipulation of data. Nonetheless, the safeguards policy could minimize the possibility of misreporting or misuse of Fund resources when an adequate internal control system and an effective external audit mechanism are in place.

We would like to underscore the importance of flexibility in the application of the policy in recognition of country specific circumstances without undermining the essence of the safeguards policy. Even though many central banks noted that the safeguards assessment was applied flexibly (para.20, SM/05/117), a few central banks felt the inflexibility of the safeguards policy and its application in some areas which might contribute to only 80.7 percent implementation rate of the safeguards recommendations, as illustrated in Table 1.

While we support the three types of assessments proposed in paragraph 38-41 of the staff report, we would appreciate staff's comments on the criteria that staff plans to adopt in distinguishing between on- and off-site conducts for an update assessment. In particular, when would a country be perceived to be of "high" or "low" risks? Should a country with strong growth and balance of payments, for example, be subject to a discontinuation of a Fund's Program because of its failure to meet a full compliance of the safeguards? In this respect we agree with the calls by several central banks in the Panel for a concise safeguards monitoring matrix to serve as a template for periodic off-site monitoring and/or another method of central bank self assessment. Further, to achieve a better compliance from members, we also support the suggestions for better communication between the Fund and the central banks, including to promote the central bank ownership of the safeguards assessment process besides the more flexibility in the implementation of the safeguards recommendations already mentioned.

We support staff's recommendation to extend the SAP to emergency post conflict cases (EPCAs) and, as suggested by the staff, the modalities for the safeguards assessments in EPCA cases should be determined on a case-by-case basis, taking into consideration the degree of re-establishment of functioning monetary and financial systems.

Finally, we consider a longer interval of safeguards assessments (e.g., annually instead of semi-annually) as well as the three-year review cycles would remain adequate. Within such a framework, the member countries would also feel less overwhelmed by the challenges of meeting the international standards. At that point, the safeguards assessment reports could be shared on the authorities' consent basis with other IFIs (World Bank, ADB, AfDB, ECB) in line with similar arrangements for the technical assistance reports.

Mr. Farelius and Ms. Kivinen submitted the following statement:

We welcome this review of the SA policy and the interesting report from the independent panel in line with earlier agreement. We support publication of both papers. There is now ample evidence to assess the policy as 111 SAs have been completed for 69 central banks; in addition 26 central banks have responded to the survey by the independent panel. It is encouraging that the central banks, the independent panel, and staff, agree that the SA policy has been successful in achieving its objectives. Furthermore, the policy has had a positive impact on central banks' own operations with a relatively high rate of implementation of SA recommendations (at least for the cases with a formal commitment). In addition, the SA policy has been relatively efficient.

We particularly welcome that the SA policy has resulted in a heightened awareness in central banks of the importance of high-quality audits, accounting standards as well as control and oversight functions. The independent panel emphasizes positive results in two areas: improved controls and enhanced transparency and accountability in central banks as well as reduced risk of misreporting—contributing to enhanced reputation of the Fund as a prudent lender. These results are encouraging as improved governance of financial institutions is certainly an area where the Fund and central banks should lead by example. At the same time, all parties recognize that there are limits to what the SA policy can achieve as it cannot prevent intentional misuse and does not cover the fiscal area. Moreover, there is scope for improvement in some areas when moving forward. We are in broad agreement with staff's suggestions and will comment on some specific issues below.

We agree that the SA policy has been relatively efficient. We welcome the analysis of resource use and budgetary costs in the paper and particularly the indication that a decrease in resources can be expected when moving forward as the focus shifts more towards updates and monitoring.

We underline that the SA policy should continue to be applied consistently, i.e., continuing to be mandatory for all new Fund arrangements. We support staff's suggestion to extend the SA policy to include EPCA cases following the modalities suggested by staff. While we have some sympathy for the remarks by Mr. Meissner and Ms. Wolff-Hamacher on equal treatment, on balance we tend to agree with staff's reasoning for not extending the SA policy to emergency assistance for natural disasters or CFF.

In principle, SAs should be completed before a Fund arrangement is approved. However, in practice, having the first review as a formal deadline seems to have been appropriate. We note that in some cases it was not even possible to adhere to this deadline, but moving forward, such cases should be fewer as emphasis moves more towards updates and monitoring. We find the required completion time, ranging from 3–22 months (with an average of

9 months), surprisingly long. The reasons given for the long cycles, i.e., delays in obtaining documentation, translations and need for clarifications, point to some inefficiency in the process. It should be possible to shorten the required time e.g., by improving communication as recommended by the independent panel. Regarding deadlines for implementing the SA recommendations, we find a case-by-case basis pragmatic. However, in our view, there could be some differentiation based on the size of the program and, thus, risks to the Fund. For instance, in exceptional access cases the requirement could be completion of a SA before approval of the arrangement or at least strict adherence to completion before the first review is completed. Similarly, recommendations should be part of program conditionality with clear timetables. Staff's comments on the feasibility of this procedure would be welcome.

The proposed modalities for the types of assessments going forward seem sensible. We underline that a move towards more focused and targeted follow-up assessments is the appropriate approach. In producing updates, information available and improvements made by the central banks should be appropriately utilized to avoid duplication of work. We can agree that new assessments would always include both off-site and on-site evaluations; the composition of updates would be determined in a flexible manner; and monitoring would normally be off-site, but including on-site visits when deemed necessary by staff.

The SA reports should continue to be confidential documents, but we support the proposal that with the authorities' consent, these reports can be shared with other IFIs under similar guidelines as for TA reports. Regarding the periodicity of update papers presented to the Board, we support a move to an annual basis. We also support a three-year cycle for the reviews of the SA policy.

The independent panel identifies communication as the key area for improvement. We support the panel's recommendations and appreciate that staff is already taking steps to operationalize them. We note that the panel's recommendations are geared towards improving communication between the Fund and the central banks and to some extent also between the central banks. However, in addition, there may also be scope to improve communication within the Fund. Some central banks noted a weak link between SAs and TA and there also seems to be some confusion with regard to overlap with other Fund initiatives. We would appreciate comments from staff on whether there are plans to address these concerns.

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

We thank staff for the concise and well-written report and the panel of experts for their useful report. At the outset, we are pleased with the very positive assessment indicating that the safeguards policy has had a constructive impact on central bank controls helping to protect Fund resources and mitigating problems of misreporting of information to the Fund. The panel evaluation also offered a reassuring picture where central banks have broadly welcomed the recommendations made during safeguards assessments (SA).

We welcome two inter-related trends presented in the staff paper, namely the high implementation rate of SA recommendations—with around 81 percent of total recommendations being implemented, and as high as 97 percent implementation rate for those recommendations that the authorities formally committed to implement—and the fewer weaknesses identified from 2003 onwards, when compared to the initial period of implementation of the SA policy in 2000–02. Fewer deficiencies were identified in key areas such as external auditing, foreign reserve controls, financial reporting, internal auditing, and accounting for Fund transactions.

The success of the recent experience with SAs should not carry us away from the objectives of the exercise, namely, to safeguard Fund resources and to mitigate misreporting to the Fund. To continue to deliver positive results in an efficient and cost-effective manner, the SA policy should keep its focus on these relevant areas. The focus of the SA policy should not be on the development of international best practices, but rather on safeguarding IMF resources. Adherence to this principle should guide all future work on SAs. The framework should not be converted 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 technical assistance. Not only do we want the initiative to continue to deliver favorable results; equally important in these times of tight resource constraints, we want the policy to be as cost effective as feasible.

The experience of countries in our constituency with the safeguards assessment policy has been positive. The exchange of views between Fund staff and the areas responsible for internal auditing at our central banks has help strengthen procedures already in place and has fostered the implementation of new ones, in particular in the areas of internal auditing and internal controls, and in some cases in the appointment of an external auditor. Areas that have had a positive impact from the SA exercise include, inter alia, the reporting process amongst different departments, the auditing procedure used on international reserves management, and the process of independent reconciliation and formal review procedures to ensure accuracy of data submitted to the IMF. However, our authorities are also of the view that, in some cases, the assessments were conducted from a broader perspective than required to ensure the proper use and adequate safeguard of Fund resources. To ensure the SA policy is successful and cost-effective in achieving its objectives, it should keep its focus on the key issues of international reserves management and its reporting.

Keeping resource constraints in mind, we are of the view that the modalities for monitoring SA recommendations should continue to be carried on through the provision of members' annual audited financial statements and related audit reports, including letters to management and special audit reports, for as long as Fund credit remains outstanding. The Fund should refrain from embarking on on-site monitoring, other than following up on particularly important issues related to safeguards policy during surveillance exercises. In any event, there is always the possibility of following up on any particular issue related to past recommendations of SAs from headquarters. Off-site monitoring should be limited to following on past recommendations. We do not agree that monitoring should include updates on central bank's ELRIC areas. Otherwise, we would be expanding the scope of our SAs, with budgetary implications, and with unclear benefits to the Fund, as far as safeguarding Fund resources is concerned.

We can go along with the proposed extension of the safeguards policy to encompass EPCA cases, provided that it is flexibly applied to take into consideration specific country circumstances to determine the timing and procedures to be followed. We agree with staff's proposal to change the report to the Board on safeguard assessment from a semi-annual to an annual basis. Also, we support the next review of the safeguards' policy to be implemented in three years.

Finally, and because of the reasons expressed by Mr. Shaalan and Ms. Beidas, we cannot go along with staff's proposal with respect to sharing safeguards assessments information with other institutions.

Mr. Schwartz and Mr. Martínez submitted the following statement:

We share the staff's overall positive evaluation on the safeguards assessments policy. The assessments have generally been welcomed by central banks and the policy has yielded good results. Its design and features, i.e., the five key areas (ELRIC) of control and governance considered in the assessments, the even-handed application for all members using Fund resources, and the flexibility in the application of the policy that recognizes country specific circumstances while preserving the essence of the safeguards assessment, have proven to be appropriated for assessing central banks financial controls.

To put the discussion into context we think it is relevant to start by remembering that this policy is an integral part of the Fund's lending activity and not technical assistance nor surveillance. There are evident linkages between these two fundamental Fund activities and the safeguards assessments policy, but their final goals are different.

The main objective of the safeguards policy is to minimize the possibility of misreporting or misuse of Fund resources associated with the Fund's lending activity. In this regard, it is striking to read in the report that "the effectiveness of the safeguards assessments with regard to misuse of Fund resources is unknown." While we understand that the policy is an ex-ante mechanism which cannot prevent misuse of resources that may occur as a result of a willful override of controls or manipulation of data, we expected a more in-depth analysis about its effectiveness on one aspect which is considered an overarching objective of the policy.

The outcome of a safeguards assessment is a report that includes recommendations. Measuring the level of implementation of the Fund's advice is a way of assessing the success of the policy. An implementation rate of safeguards recommendations with formal commitment from the authorities of 96.8 percent is a clear success. On the other hand, the recommendations not under program conditionality or LOI/MEFP commitments have reached an implementation rate of 76.2 percent. The difference between these two rates could suggest that there is an advantage in obtaining the authorities' formal commitment. But, it could also indicate that the recommendations not included in the conditionality or in the LOI/MEFP commitments were less relevant for the goals of the policy. We would appreciate the staff comments.

We would like to reiterate that in our view safeguards assessments should be completed no later that the first review of the member's Fund-supported program. Considering that the policy is intended to protect the Fund's resources, it is essential to complete the process as soon as possible and not later than the first review so as to speedily address possible weaknesses. In relation to the deadlines for implementation of the safeguards recommendations, we believe it should continue to be determined on a case-by-case basis.

Regarding the three distinct types and modalities of safeguards assessments proposed by the staff, namely, new, update, and monitoring assessments, we find them appropriate and helpful to make operational the safeguards policy.

In relation to the confidentiality of the safeguards assessments reports, we support the staff's proposal to share these documents with other international organizations provided that the authorities give their explicit consent and on the understanding that the reports will be kept confidential.

We support the extension of the safeguards assessments policy to include Emergency Post-Conflict Assistance (EPCA) cases. The risks to the Fund's resources are especially high in these situations and, therefore, it is difficult to justify their continued exclusion. The modalities for the assessments would be determined on a case-by-case basis, taking into account the specific country circumstances. We find the key guidelines, as stated in paragraph 43, useful to implement this case-by-case approach. On the other hand, we do not consider appropriate the extension of the policy for emergency assistance for natural disaster cases, or outright purchases under the Compensatory Financing Facility.

In our view the information related to the safeguards assessments that the Board receives is adequate. However taking into account that fewer new assessments are expected going forward, we agree that an annual update would be sufficient. We also consider reasonable that the review of the safeguards assessments policy would take place in a three-year basis.

Mr. Murray and Mrs. Amador submitted the following statement:

We thank the staff for the useful review of the safeguards assessment policy. We also thank the panel of eminent experts for their appraisal of the safeguards process and their well-thought-out recommendations, which should strengthen the safeguards framework.

Achieving Policy Objectives

Safeguards assessments have helped preserve the reputation of the Fund as a prudent provider of financial assistance to members by providing reasonable assurance that the financial control and oversight systems that are in place in central banks to manage resources, including Fund disbursements, are adequate to ensure the integrity of operations. We are pleased to note that the safeguards assessments have had a positive impact on central banks' own operations (governance and control systems), including on the quality and robustness of data that they provide to the Fund.

The staff has adopted a flexible yet prudent approach in helping central banks overcome obstacles in the implementation of safeguard recommendations. Like the independent panel, we encourage the staff to continue to carefully take into account—whenever possible and without compromising the essence of the safeguards policy—specific circumstances of individual countries when they undertake assessments and propose (time-bound) remedial measures to address identified vulnerabilities in central bank operations.

Modalities for Assessments

The shift of focus of the safeguards policy to update and monitoring assessments is appropriate. Staff says that in monitoring previously-assessed central bank frameworks, there will be more focused and targeted follow-up assessments. In this regard, it would be important to go beyond monitoring reference benchmarks and focus on the efficacy of the recommendations in achieving the desired objectives. For example, it would do well for the staff not only to see whether its recommendation to establish a supervisory board has been adopted but also to see whether the supervisory board has been empowered adequately (e.g., in terms of providing it with adequate resources and establishing the requisite legal and regulatory structures) so that it is able to discharge its responsibilities effectively.

We support staff's proposal that safeguards assessments under Emergency Post-Conflict Assistance (EPCA) be undertaken on a case-by-case basis, with the assessment differentiated according to the central banks' functional capabilities.

For the reasons given by the staff, we support the exclusion of ENDA and CFF cases from the safeguards assessments policy. With fewer new assessments expected, we agree with the staff that it may be more meaningful to have annual updates of Board papers on safeguards assessments. The safeguards policy can also be reviewed every three years, as staff has proposed. On publication of safeguards assessment reports, this should continue to be at the discretion of the authorities. Reports can be shared with other IFIs if there is a clear reason why they should see such a report, if consent is given by the authorities, and with the understanding that the reports will be kept confidential.

Panel Recommendations

The panel report states that several central banks recommend the development of a safeguards monitoring matrix to serve as a template for periodic off-site monitoring. We agree with this suggestion, which we believe will promote self-assessment by central banks and contribute to an evenhanded application of the Fund's safeguards policy if due care is taken to consider country-specific circumstances and resource constraints in developing recommendation deadlines.

We note the experts' observation that, in some instances, pursuing amendments to the central bank law as an SA recommendation may lead to a weakening of central bank independence during the political process. It would be helpful if staff can elaborate on this statement, as this may provide useful lessons to countries contemplating such actions.

It is telling that the panel found that some central banks felt that technical assistance on the implementation of safeguards recommendations was "sparse at best," constraining their capability to implement the recommended remedial safeguards measures. We consider it critical to have well-designed and well-targeted technical assistance in the implementation of the recommendations that arise from safeguards assessments. This would include ensuring closer coordination of remedial actions with previous and ongoing technical assistance.

We note that country authorities have the opportunity to comment on the safeguards assessment report before it is finalized. However, more interactive consultations would be helpful, and in this regard, we concur with the panel's recommendation to strengthen the communication between the Fund and the authorities on safeguard issues and monitoring commitments. This would help speed up the implementation of needed measures and contribute to a more effective safeguards framework.

Mr. Torres and Mr. Ayala submitted the following statement:

We welcome the staff paper, as well as the report by the independent panel on safeguards assessment (SA), which gives us the opportunity to review the experience on this procedure since its creation in March 2000. Close control focused on central banks has proved to be instrumental in providing reasonable assurances to the Fund that its resources will be well managed. At the same time, the assessments are important in emphasizing the need to provide reliable information and in reducing misreporting to the Fund by mitigating and identifying weaknesses in central banks' operations.

We are glad to note the general acceptance of the findings and the high implementation rate of safeguards recommendations by central banks. The staff also highlights the policy effectiveness in achieving the main objectives of the process, and we are pleased to know that assessments were particularly important for promoting transparency and good governance, and for increasing credibility of central banks by improving their control systems. To this end, we broadly agree with the staff's main conclusions and share the views expressed by the panel. Thus, we endorse their recommendations for further strengthening the procedures of safeguard assessments.

We agree that central banks' ownership is key to facilitate their involvement in the exercise and to ensure that they will follow recommendations in a consistent and timely manner. An important finding of the panel is that improvements in the communication between the Fund and central bank staffs can contribute significantly to increasing the latter's commitment to the process. In this regard, the organization of seminars to explain to central bank officials the meaning of the framework and its importance for their institutions are a step in the right direction. We would also like to emphasize that the Fund should continue to show flexibility in the application of the policy, in particular in establishing implementation deadlines. Specific country circumstances like legal restrictions, capacity constrains, and political sensitivities should be considered when possible, keeping in mind the need to preserve the policy's objectives.

The staff clearly highlights the importance of ensuring a continuous application of safeguards assessments. Changes in senior management, boards of directors, and other personnel are common in many countries involved in Fund programs. Thus, control procedures, as well as the commitment to the process, need to be maintained over time through periodic evaluations. In this vein, we support the three different modalities suggested by the staff to conduct future assessments. A more focused approach involving targeted follow-up will avoid work duplication and reduce resource and budgetary costs. At the same time, the expertise and experience that the Fund's staff has gained during the last five years will contribute to conducting the exercise more efficiently.

Keeping in mind that the goal of the exercise is to safeguard Fund resources, we agree with the staff's proposal to extend the safeguards policy to Emergency Post-Conflict Assistance (EPCA) cases. We also concur that the assessments should be made on a case-by-case basis and that further flexibility should be considered at the initial stages of implementation.

While recognizing the usefulness of the information gathered through the safeguards assessments conducted to date, perhaps update reports can be prepared on an annual basis. Additionally, we agree that periodic reviews of the safeguards policy should be done every three years. Regarding the reports, they should continue to be treated as confidential documents. At the same time, we support the staff's proposal to allow sharing them with other international organizations with the authorities' consent, in accordance with guidelines similar to those applicable to technical assistance reports.

Mr. O'Loghlin and Mr. Campbell submitted the following statement:

Key Points

We welcome this second review of the Fund's safeguards policy and the complementary report of a panel of central bank officials.

Given the staff's assessment that the effectiveness of the safeguards policy with regard to the misuse of Fund resources is unknown, we wonder whether there may be merit in involving the Independent Evaluation Office in future reviews. In any event, this is an area that the Fund may want to examine for further work.

We were somewhat disappointed that progress relating to publication of central bank's financial reports has been mixed, and wonder whether there might be value in assigning more attention to publication of these reports as part of program conditionality.

The flexible approach proposed related to EPCA cases is welcome given the practical difficulties likely to be encountered if a full safeguards assessment is undertaken.

Overview

We welcome this second review of the Fund's safeguards policy since it was introduced in March 2000, this time complemented by the report of a panel of central bank officials. The safeguards assessment has become an important part of the Fund's toolkit to assess the adequacy of central banks' systems to manage resources related to members accessing Fund programs. We believe that the report by the panel of central bank officials provides a unique perspective, since some of these officials themselves may have already been involved in safeguards assessments at their institutions. We welcome the panel's finding that safeguards assessments have ushered in an era of enhanced transparency and accountability and that safeguards communication is a key area for improvement.

Results

The safeguards assessments have led to improved controls and enhanced transparency and, based on the central bank panel's assessment, have succeeded in safeguarding the Fund's resources to a greater extent than at any time in the past. However, the staff seems less confident that this overarching objective has been met in relation to the misuse of funds. We welcome the staff's candor in paragraph 23 of the review, that the effectiveness of the policy with regard to the misuse of Fund resources is unknown. This leads us to wonder whether there might be merit in involving the Independent Evaluation Office in any future review of the policy. At a minimum, it suggests a need for further work to consider how this weakness might be addressed, whether through tighter scrutiny, refinement of audit processes, or otherwise.

Of the other results, both the staff and the central bank panel confidently point to success in achieving the objectives of the safeguards policy. For our part, we welcome the deterrent effect provided by the outside scrutiny as well as the increased transparency provided by the publication of audited central banks' financial statements. Nevertheless, we note from Table 2, that progress relating to publication has been mixed, with an increasing percentage of financial statements either not published or delayed during the 2003 to present period, compared with those related to assessments in the 2000 to 2002 period. We are somewhat disappointed with this and would enquire of the staff what may be behind this and whether there might be value in assigning more attention to publication of central bank financial statements as part of program conditionality?

Confidentiality

Safeguards assessments reports are confidential documents, and should remain so. We would look more sympathetically at the staff's recommendation to share these reports with other international organizations if it were established that reciprocity could be helpful in reducing some of the shortcomings of the Fund's safeguards policy—for example, in areas such as identifying possible misuse of funds.

Way Forward

We note from the staff's review that the expected shift from new to update assessments and the monitoring of proposed remedies did not materialize as had been anticipated in the 2002 review. Given this background it is interesting that the staff appear to be generally confident that resources for future assessments remain adequate. In this case, like Mr. Shaalan and Ms Beidas, we believe that a breakdown of the resources allocated to each of the three types of assessments going forward would have been useful, particularly in convincing us that adequate resources exist for future assessments.

We accept that it is difficult to continue exempting emergency post-conflict assistance (EPCA) members from safeguards assessments. The flexible approach proposed related to EPCA cases is welcome, given the practical difficulties likely to be encountered if a full safeguards assessment is undertaken due to capacity constraints or a less-than-fully functioning central bank. We also support the staff's rationale for continuing the policy of excluding emergency natural disaster assistance (ENDA) and compensatory financing facility (CFF) cases from safeguards assessments.

On the frequency of safeguard assessment updates, we can support the proposal for annual rather than semi-annual updates and believe that three years remains an appropriate period over which the policy can be reviewed.

Finally, despite the safeguards policy success in achieving some of its objectives there are areas for improvement—for example, in minimizing the scope for misuse of funds, increasing publication of central banks' financial statements, and better communication.

Mr. Misra and Mr. Kanagasabapathy submitted the following statement:

We welcome the concise and candid review along with the report of the Independent Panel. We offer some general observations before commenting upon the specific issues.

The objective of Safeguards Assessments (SAs) is to ensure that financial control systems are in place to manage resources and Fund reimbursements. While the experience shows several positive impacts of SAs in improving central bank budgeting, auditing and internal control systems, two important weaknesses have been noted, viz., that the focus is narrowly placed only upon central banks and second, the SAs do not cover fiscal data standards. Significantly, the policy not being a panacea, the possibility of misuse of Fund resources still remains open. We would welcome staff comments on how these inadequacies are proposed to be addressed.

The uniformity of treatment/evenness of application and the flexibility exercised to suit country specific circumstances are encouraging results of the survey. It is interesting to note that under certain circumstances, it would be more prudent to implement safeguards recommendations through resolution of Bank Boards rather than through a change in Central Bank Law. We believe that this conclusion should result in exercise of caution by the staff in pursuing legal amendments or reforms, limiting such amendments to only when they are absolutely necessary, in the interests of safeguarding the independence of central banks. We welcome staff comments.

Coming to specific issues raised, we broadly agree that the safeguard policy has brought about greater awareness of the importance of proper audits, adherence to high-quality accounting standards and appropriate control and oversight functions. In this regard, we would like to reiterate that since the objective of the SAs is to protect Fund resources, the practice of including certain recommendations of the SAs policy as part of Fund conditionality needs to be carefully reviewed. The objective should be to assess whether such inclusions of conditionality contributed to program effectiveness. Secondly, the idea that the safeguards assessments should be completed no later than the first review of the member's Fund supported program also will require a careful review. While this could be a guide, such rigid approach should not result in adverse incentives.

The idea that the basic focus of future SAs should be only on updates is perhaps based on the reprioritization of the use of Fund resources. We support the idea if this change does not result in dilution of effectiveness of SAs. We have no objection to the change in the periodicity.

The safeguards reports by their very scope contain detailed confidential information about the functioning of the central banks. The sharing of such information across institutions should be subject to: clear establishment of the purpose and manner of sharing of information, clear specification of the list of institutions and approval of the Board on a separate proposal for this purpose. Sharing of confidential information should not become a matter of routine in the case of SAs.

Mr. Al-Turki submitted the following statement:

Safeguarding the use of Fund resources and minimizing the risk of misreporting associated with the Fund's lending activities are evidently important issues and I welcome the review of the Fund's policies in this area. In this regard, I thank the staff for a comprehensive and well-written paper on the experience of the safeguards assessment policy since its inception. I also thank the independent panel of central banks officials for conducting a separate appraisal of the safeguards process. The panel's excellent report has helped in evaluating the effectiveness of the safeguards policy and identifying the steps needed to further improve the policy and process in the period ahead.

Turning to the findings of the review, I am encouraged by the overall assessment that the safeguards policy has had a positive impact on central banks' operations by enhancing accountability and strengthening the control frameworks. Indeed, the staff notes that the safeguards recommendations have been implemented by central banks leading to significant improvements in many cases. The high implementation rates of these recommendations suggest the assessments' usefulness, especially as the use of program conditionality for high-priority recommendations seems to have been done judiciously and within the framework of conditionality guidelines.

The assessments have also contributed to enhanced awareness of the importance of data integrity. In this regard, I note that the safeguards policy has led in a number of cases to strengthening of controls related to data provided under new Fund programs. Moreover, the risk of misuse of resources has been reduced as additional control and oversight processes have been established at many central banks as a result of the safeguards policy.

The finding of the independent panel confirming the success of the safeguards policy in enhancing central banks' governance and control frameworks is reassuring. The process for conducting safeguards assessments was found to be generally appropriate and efficient.

I agree with the panel on the importance of even application of safeguards principles and endorse its recommendation that the Fund should continue to demonstrate flexibility in safeguards assessments by taking into account specific country circumstances and resource constraints in the development of recommendation deadlines. The panel has also made useful recommendations in the areas of communications and monitoring procedures. I note that the staff is taking steps to operationalize them.

On the whole, based on the experience with the safeguards policy to date, it seems that the policy has generally achieved its stated objectives. The ELRIC framework has proven to be broadly appropriate. Flexibility in the application of the policy has been shown without undermining its core elements. Moving forward, the current requirement that the monitoring should remain in place for as long as Fund credit remains outstanding is appropriate. The staff paper has rightly recognized that the nature of future safeguards assessments will continue to evolve as central banks will increasingly be covered in follow-up assessments. I can go along with the modalities suggested in the paper for the three distinct types of safeguards assessments.

The proposal to extend the safeguards policy to Emergency Post-Conflict Assistance (EPCA) cases appears reasonable. Indeed, as the staff notes, it is difficult to justify continued exclusion of EPCA from safeguards assessments when the risks to Fund resources are perhaps higher in these cases and there is a presumption that post-conflict countries would subsequently move to an arrangement. However, EPCA cases should be examined on a case-by-case basis, as suggested in the paper, with the scope of the assessment reflecting the degree of re-establishment of functioning monetary and financial systems. I agree with the proposal for not extending the safeguards policy to emergency assistance for natural disasters cases or outright purchases under the CCF.

Regarding periodicity of safeguards update reports to the Board, I can go along with the suggestion to change from a semi-annual to an annual basis. The periodic review of the policy every three years remains appropriate. The safeguards assessment reports should also remain confidential in line with the existing policy.

Mr. Wang and Ms. Wang submitted the following statement:

We thank the staff for the comprehensive paper and welcome the Independent Panel's report.

We are encouraged by recent experience showing the safeguards assessments (SAs) policy's positive impact on central banks' operations, especially the improvement in controls at the central banks. As the Panel's report points out, most central banks have better external audit mechanisms; the SA process has enhanced their operational independence; and their internal auditing functions have improved. In the meantime, the safeguards policy has contributed to the enhanced quality and robustness of data provided to the Fund. We note that although the safeguards policy cannot prevent misuse of resources, it has some effect on their potential misuse through increased transparency.

On the operational aspects of the safeguards policy, although the assessments have not included the fiscal area, there have been important developments in the quality of fiscal data in recent years. We also note that central banks face obstacles in the implementation of safeguards recommendations in certain areas and that flexibility has been exercised in recognition of country-specific circumstances. However, the Panel's report found a few central banks were hampered by the seeming inflexibility of the policy and its application in some areas. While we understand that flexibility should not undermine the essence of the safeguards policy, implementation of the SAs should not fundamentally conflict with the legal framework of a country. Staff's comments are welcome.

Looking forward, we agree with the staff that there is a continued need for the consistent application of safeguards. With the evolution of SAs, it is important to make the assessments more focused and targeted and ensure the compliance with the assessments. The modalities going forward for the three types of assessments, new assessments, update assessments and monitoring assessments, are appropriate. Regarding the application of SAs in EPCA cases, the case-by-case approach proposed by the staff, taking into account the central bank's level of institutional and administrative capacity at the time of access to EPCA, is in the right direction. We can also go along with staff that the safeguards policy should not be extended to emergency assistance for natural disasters or outright purchases under the CFF.

We agree that update Board papers on safeguards assessments could be changed from a semi-annual basis to an annual basis and that the policy should continue to be periodically reviewed every three years. We think that sharing SA reports with other international organizations should be done on a case-by-case basis, with the authorities' explicit consent.

The Panel's report puts forward suggestions to strengthen communication and improve modalities for monitoring procedures. Can staff go into more detail on the further steps to make the recommendations operational?

Mr. Padoan and Mr. Gola submitted the following statement:

We thank staff for the overview of the safeguards assessments. We also welcome the positive assessment of the independent panel. As reported by staff and confirmed by the panel, SA policy has been highly successful in achieving its objectives. The aim of the policy (which is to provide reasonable assurance to the IMF that the central bank's external and internal audits, financial reporting, and controls over foreign reserves and the legal framework are adequate) has been substantially achieved. SA policy had also an important spill-over on the reputation and the credibility of the central banks. For these reasons we are in favor of staff's proposals, namely the extension to post-conflict countries, the disclosure—with authorities' consent—of the SA reports to other IFIs, and the three-year review.

Given these very encouraging results and the positive assessment by the independent panel, we will limit our remarks to the following few points:

It is true—as stated by the staff—that "the safeguard policy cannot prevent misuse of resources that may occur as a result of willful override of control or manipulation of data." However, the Fund should do all that is possible in order minimize the possibilities of such misbehavior. In this regard, the on-site visits and the role of independent internal and external auditors is crucial. Since staff resources are limited, a risk-based approach can be used.

Table 2 offers a very useful representation of the improvement in the five ELRIC standards since the beginning of the SA policy. As noticed by Mr. O'Loghlin and Mr. Campbell, progress regarding the publication of central banks' financial statements has been mixed. We also would like to know from staff the reason for this result. Moreover, it is not immediately clear how many, at the present moment, of the 69 central banks assessed are in "non-compliance" in one or more areas. For instance: how many of the 69 central banks still do not publish a full annual statement? How many do not have an independent, internationally recognized, external auditor? How many central banks still have a poor or inadequate or non-independent internal auditor? Staff comments are welcome.

In some circumstances, capacity constraints seem be the source of the non-compliance. Given the high sensitivity of all the five areas of SA policy, we urge staff to further facilitate adequate and possible prompt support to the country. In the case of obstacles to the implementation of safeguard recommendations, we support staff's approach to proceed along the lines described in par. 28. Prioritizing TA and facilitating donors' funding for improvements is strongly encouraged.

Looking forward, the future application of the SA policy in EPCA cases, following the approach suggested by staff, is supported. We also urge the staff—on the basis of the panel's considerations—to promote a better communication policy, to improve the coordination with other IMF initiatives (TA and FSAP in particular) and to inform adequately resident representatives about this important policy.

Mr. Kashiwagi and Mr. Miyoshi submitted the following statement:

Review of Experience

We welcome the results of the staff's review on the experience of the safeguards assessments policy since its introduction in 2000. We note that this policy has not only contributed to preventing misuse of Fund resources, but also has had a positive impact on all central bank operations of the member countries having received extended financial assistance from the Fund. It is encouraging to note that most of the central bankers in these countries find the Fund's safeguards assessments useful despite the fact that they are mandatory for access to Fund resources.

In view of these positive results of the review, we broadly agree with the staff's view that the current safeguards policy should be maintained. In the following, we will offer a few comments to express our views for emphasis.

First, the follow-up of the safeguards assessments through technical assistance should be strengthened further. Many central banks point out capacity constraints in observing internationally recognized standards in accounting and reporting as one of the major obstacles to implementing recommendations of the safeguards assessments. While the staff claims that they have been prioritizing technical assistance requests related to safeguards recommendations, the panel report seems to indicate the existence of a weak link between the safeguards assessments and technical assistance, a lack of coordination among Fund departments, and limited availability of technical assistance. Unlike FSAPs and ROSCs, the safeguards assessments are mandatory, and implementation of the recommendations is regarded as crucial from the standpoint of safeguarding Fund resources. As such, following up the assessment by appropriate technical assistance becomes paramount. We would thus encourage area departments that play a central role in Fund financial assistance to become more active in coordinating the roles of various departments, including making specific requests to TA departments to place priorities on technical assistance programs in this area.

Second, we are of the view that, as a matter of principle, the safeguards assessments should be undertaken in all cases of Fund financial assistance. The staff paper proposes the extension of safeguards policy, albeit in a limited manner, to emergency post-conflict assistance (EPCA) cases, but does not propose its extension to emergency assistance for natural disaster cases or outright purchases under the Compensatory Financing Facility. While we recognize the absence of the presumption of a subsequent arrangement in the latter cases, and understand the difficulty in finalizing the safeguards assessments in the very short period between the country's request and its purchases, we are of the view that these cases do not differ fundamentally from EPCA cases in the sense that Fund resources are actually involved. We therefore think that some sort of safeguard assessments need to be undertaken even if they are to be conducted ex post. We would appreciate the staff's comments on this point.

Third and finally, we welcome the staff's explicit recognition of the legal and political constraints that can exist in implementing the safeguards assessments and their recommendations, and of the need to explore and agree on compromise measures that take into account country-specific circumstances. Nonetheless, we note that a few central banks have suggested the seeming inflexibility of the safeguards policy and its application in some areas, and that the panel has recommended that the Fund continue to take into account specific country circumstances and resource constraints. What is important regarding the safeguard assessments is safeguarding Fund resources through strengthened internal management and control of the central banks of members with access to these resources. It is therefore essential to come up with and agree on effective measures to achieve this objective without sticking to the particular modalities of the measures. In this regard, we think that the panel's recommendation to strengthen communications between the Fund staff and central banks concerned is appropriate, and hope that the staff will operationalize this recommendation at an early stage.

Mr. Duquesne submitted the following statement:

We thank the staff for an interesting paper as well as the members of the panel for their concise report to the Board. The publication of both papers would be useful.

We commend the staff for what appears to be a success in this relatively new, and of utmost important, Fund's policy. It is comforting to read that SAs are seen by the surveyed central banks themselves as a valuable exercise and as an efficient means to enhance their internal organization. We welcome the fact that the policy seems to have been applied with sufficient independence and flexibility to ensure some ownership. This preventive policy has certainly contributed to enhance financial governance across part of the membership, and it should be maintained. In this perspective, we are ready to approve staff's views on the way forward. Like some other Directors, however, we think that further progress should be made in assessing the effectiveness of the policy as regards its primary goal which is to prevent the misuse of Fund's resources. This is an additional reason to call for a more frequent communication between central banks and the IMF as an important element of the policy.

Following up on the implementation of the Fund's recommendations is key. In this regard, we note in the report that either program conditionality, or formal commitments by the authorities, better guarantee effective implementation. There seems to be a case for encouraging formal commitments, though staff's judgment will always be needed in the definition of the timeframe for implementation. In some cases, following up on the assessment with appropriate technical assistance is also very important. We emphasize the need for good coordination within the Fund among the various departments in this area.

We support staff's suggestion to extend the SA policy to include EPCA cases, following flexible modalities based on a case-by-case analysis as suggested by staff. We can agree with the staff's rationale on the non-application of the policy for emergency assistance for natural disaster cases, or purchases under the Compensatory Financing Facility.

While we emphasize the highly confidential nature of the SA reports, we can support the sharing of SA reports with other IFIs (World Bank, ADB, AfDB, ECB), provided the member has given its consent. We also agree on reciprocity of the exchange of information with the World Bank.

We thank the staff for their analysis of resource use and budgetary costs and we welcome the fact that a decrease in resources can be expected as the focus shifts more towards updates and monitoring. In this regard, if we fully concur with the three types of SAs proposed by staff (new, updated, and monitoring assessments), we tend to believe that updates would require an on-site more often than an off-site assessment.

We agree on changing the periodicity of the general update to the Board on SAs from a semi-annual to an annual basis, and to review the policy every three years.

Mr. Ondo Mañe submitted the following statement:

We welcome the present review of the safeguards assessments and note that the implementation of the policy has been highly successful in achieving its objectives, namely the implementation by central banks of countries with Fund programs, of adequate control, accounting, reporting, and auditing systems, to manage their resources, including Fund disbursements. We also note that the report of the independent panel has indicated that the reputation of the IMF as a prudent lender has been enhanced following the implementation of the safeguards policy.

We particularly welcome the very high implementation rate of the recommendations to address the identified vulnerabilities—whether these recommendations were under program conditionality or not. For serious vulnerabilities in a central bank's control framework and governance, we note the inclusion of recommendations in program conditionality due to the risk of misuse of Fund resources. Nonetheless, we believe that such recommendations should be used judiciously and within the framework of conditionality guidelines to avoid, as much as possible, overloading new arrangements with additional conditionality after the approval of the arrangement, especially since the implementation rate of recommendations that are not under program conditionality is commendable (76 percent), suggesting a strong acceptance by the authorities of the usefulness of the policy.

Flexibility in the application of the policy should also be encouraged—lack of flexibility is cited as a major concern by surveyed central banks in the independent panel report—and we commend staff for taking into account, on several occasions, country specific circumstances when formulating recommendations. We fully support this approach.

Going forward, we believe that the three types of assessments are broadly appropriate, and since fewer new assessments are expected in the future, we support the idea of updating the Board on an annual basis rather than the current semi-annual basis. However, the review of the assessments should continue to be performed every three years.

We will make a few remarks on the results of the assessments.

The Impact on Operations and Governance Structures of Central Banks

In general, central banks have accepted the findings of the safeguards policy and have taken the necessary steps to address key deficiencies in operations, often improving both operations and governance structures. In particular, we note that staff has found heightened awareness among central banks of the importance of proper external audits, the adherence to an established set of accounting standards, and the control and oversight functions performed by internal audit staff and audit committees. As a result, central banks have strengthened external audit mechanisms, accounting standards and internal audit functions. We note that the panel mentions "more effective external audit mechanism," as the most cited improvement in central bank operations by the surveyed banks.

Misreporting Cases

One of the main objectives of the safeguards policy is to minimize the likelihood of misreporting cases. We note that the policy has been successful in contributing to detect a few cases of misreporting. Going forward, we agree that the policy will have a deterrent effect because of outside scrutiny.

Possible Misuse of Fund Resources

Another key objective of the safeguards policy is to minimize the possibility of misuse of Fund resources. In this regard, we also note that the safeguards assessments have contributed to reveal the existence of unusual activities at a few central banks. We welcome the necessary steps taken by the concerned authorities to replace senior management where misuses had taken place and to strengthen controls at their central banks. Such measures should reduce future possibilities of misuse of resources.

We support the extension of the policy to EPCA cases, once functioning monetary and financial systems have been re-established. In addition, in countries where safeguards assessments are not conducted because no formal arrangements are in place with the Fund but where safeguards assessments are considered necessary, we believe that member countries should be informed—in the context of an Article IV, for example—of the main lessons drawn and recommendations implemented under the policy in order to encourage countries to implement these recommendations on their own. However, confidentiality of information of countries that have undergone the assessments should be preserved. The need to enhance communication has been cited as one of the main areas for improvement by the independent panel.

As for confidentiality and the issue of sharing individual country reports with other international organizations, we believe that these reports could be shared only after the countries have given their consent.

We would also like to ask staff whether they had previously raised the issue of sharing the reports with the surveyed countries or with the independent panel? Staff comments are welcome.

Enhanced Awareness of the Quality and Reliability of Data Provided to the Fund

Finally, on two key critical monetary data provided to the Fund, i.e., net international reserves and net domestic assets, we note that the establishment of independent oversight roles undertaken by external auditors and audit committees has been instrumental in the improvement of the reliability and robustness of this date.

We thank staff for the quality of the report.

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

We thank the staff for the well-written and focused paper for today's discussion. We would also like to thank to the independent panel for their valuable contribution to this work. The findings and suggestions of the panel have made clear that the policy framework has significantly helped the Fund in securing its resources while advancing the Fund's reputation as a prudent lender. It has also helped the countries, particularly the Central Banks by increasing awareness of the need for strong safeguards in the areas of external and internal auditing, financial reporting, and internal controls.

We support the types of safeguards assessments that have been proposed in the paper. The panel, in their findings, recommends that on-site assessment is essential for a complete safeguard assessment. Therefore, we suggest that update assessments should also be conducted both off-site and on-site.

Shifting from new assessments to update assessments and monitoring of remedies proposed under previous assessments is important and should be undertaken. We are in favor of allocating more resources, as needed, in order to achieve the targeted goals without delays. However, the costs of safeguards assessments should be paid by the country concerned.

We concur with the staff that the safeguard policy should be extended to include Emergency Post-Conflict Assistance (EPCA) cases as well. The proposed approach and the modalities seem appropriate, given the difficult situation due to inefficient fiscal agents and lack of institutional capacity in some countries. However, such situations should not be perceived as a set of excuses for these countries where the risks to Fund resources are probably higher as rightly noted in the gray statement of Mr. Meissner and Ms. Wolff-Hamacher.

During the first review of the safeguard policy in 2002, the Board had agreed that the staff should raise the issue of safeguards assessments in the context of Article IV consultations. The staff should suggest to the authorities that they should compare their Central Bank practices with the best practices advocated during a safeguards assessment. We would have appreciated some updated information from the staff on this subject. Section II of the report only discusses the impact and results to date of the completed assessments. It makes no reference to the impact and results of the discussions about safeguards assessments conducted in the context of Article IV discussions with eligible non-program countries. Nevertheless, the importance of monitoring financial control systems in central banks of non-borrowing countries with high Fund exposure is not negligible in the light of the safeguards policy overarching objective of protecting the Fund's resources.

We believe that the Board should be regularly informed about the results of safeguards assessments. An annual update seems appropriate.

Based on the findings of the report of the Independent Panel, it is clear that the policy on safeguards assessments has proven to be generally appropriate and has improved over time. The Board should review this policy in three years because of the need for fine-tuning, the proposed approach for EPCA cases and the on-going steps being undertaken to operationalize the recommendations made by the panel. Because it is difficult to fully address the misreporting presented in a safeguard assessment, the Board must closely monitor the progress made in correcting the loopholes. Our next review of safeguards assessments should once again be complemented with an evaluation provided by independent experts.

Although sharing the safeguards assessments reports with staff from other IFIs would be appropriate in order to ensure good coordination and prevent the waste of resources, confidentiality of these reports is still an issue and, therefore, this should be left solely to the discretion of the country authorities.

The suggestions made by the panel for further improving communications and monitoring procedures are appropriate and we fully share the views expressed by it. In addition to technical assistance and training programs conducted by the IMF Institute, we encourage the staff to support the authorities by producing manuals, periodic updates and booklets on safeguards assessments.

Mr. Zurbrügg and Mr. Inderbinen submitted the following statement:

We thank the staff and the members of the Independent Panel for their reports. We gladly note the positive impact of the safeguards policy on all parties involved. Further progress has been made in meeting the policy's objective, i.e., the protection of Fund resources. As the Independent Panel concludes, the assurances on the fit and proper use of Fund credit are probably higher than ever before. This is encouraging. But implementing the recommendations of the Panel should serve to further strengthen the policy moving forward.

An indicator of the effectiveness of safeguards assessments is the high implementation rate of staff's recommendations. By this measure, the policy has made a notable difference. Central banks have improved their regimes of financial control and reporting, which are in any case critical in deterring the misuse of resources. Also, certain Fund-supported programs were interrupted when key recommendations were not implemented. This can be taken as a further indication of the policy's effectiveness. Lastly, safeguards assessments have proven effective in detecting the misreporting of data under Fund arrangements.

The incidences of misreporting cited in the staff paper underline that the misuse of Fund resources can never be fully ruled out. But this does not put the safeguards policy itself into question. In fact, a closer look at the misreporting cases seems to suggest that two of the three incidences can be interpreted as transitory cases. The non-complying disbursements were made under arrangements that were already in place when the policy was introduced, so that the central banks in question were only partially assessed.

This said, we share the concern of Mr. Meissner and Ms. Wolff-Hamacher on the significantly lower implementation rate for recommendations that are not subject some form of Fund conditionality. This suggests that the effectiveness of the safeguards policy would benefit from a broader coverage of recommendations by benchmarks and/or performance criteria. The staff's thoughts on this would be welcome. We are also concerned with the high share of central banks that have deficiencies in the five areas subject to the assessments. For instance, it is astounding that more than half of the central banks assessed since 2003 had inadequate internal audit provisions. Progress in these areas can be gauged as the focus of the safeguards policy shifts from initial assessments to updates. We agree with the modalities that staff suggest for these updates, and for the monitoring.

We also support the proposed modalities for extending the safeguards policy to the Fund's emergency assistance to post-conflict countries. This extension is well warranted, for the reasons given by the staff and other Directors. In applying the policy, the difficulties associated with limited institutional capacity will have to be taken into account.

We note that the safeguards policy will, in concurrence with what most Directors felt at the time of the last review, continue to be limited to central banks. The recipient of disbursements under Fund arrangements is indeed normally a central bank. But, as mentioned in footnote 10, there are many member countries that have designated government ministries as the fiscal agent. If disbursements are in these cases made directly to the fiscal agent, as in Turkey's last program, this should be clearly indicated in the UFR document.

We also take note of the recommendations of the Independent Panel on how to further strengthen the safeguards policy. In particular, these related to improving communication between staff and the central bank officials, and to the 'tracking matrix' for off-site assessments. Could the staff elaborate on if and how they intend to implement these recommendations?

Finally, we agree with the sharing of information of safeguards assessments with other IFIs, as suggested. We also agree that update papers on safeguards assessments henceforth be circulated to the Board on an annual basis from now on, and that the policy next be reviewed in three years.

Mr. Gakunu and Mr. Nintunze submitted the following statement:

We welcome this review and thank staff for a well written paper. We also thank the panel members for their detailed appraisal of the SA policy framework which highlights the results, the impact of the SA on central banks, as well as proposals to take the framework forward.

We are pleased to note that SA policy framework has contributed to the ability of central banks to improve control, enhance transparency and promote accountability. It has also helped reduce the risk of misreporting, and enhanced the reputation of the IMF as a prudent lender. It is also reassuring observe that the SA policy framework has been appropriately and efficiently conducted.

Results of the Safeguards Policy To Date

We are of the view that the SA policy framework has achieved its desired objectives. Indeed, we note that central banks have benefited from the SA and have been implementing the recommendations from the SAs to improve their operations and governance framework. The exercise has contributed to emphasize the role of proper audits, high-quality accounting standards, as well as appropriate control and oversight functions. Furthermore, the policy has assisted central banks in enhancing the quality and robustness of data provided under Fund-supported programs.

We have noted staff's observation in paragraphs 21–22 of the report that SA is not a panacea to prevent misuse of resources, and that several qualitative factors mentioned point to the need for additional measures to strengthen the effectiveness of the SA framework. In this regard we invite the staff to shed some light on such further measures that could be useful to enhance the capability of the SA framework in mitigating the misuse of resources.

The staff paper expresses concern regarding the quality of local auditing firms. However, given the relatively short time since the SA policy has been in place and the fact that there are very few cases where local auditing firms have been engaged in auditing central banks, compared to international firms, it is our view that no firm conclusions should be drawn. In addition, using only international firms to conduct auditing exercises will be costly for central banks. Furthermore, as recent cases have demonstrated, even international firms can overlook critical weaknesses during the conduct of auditing exercises of major private firms. We agree that the objectives of SA should not be compromised. However, we propose that a framework where both local and international auditing firms are jointly engaged will contribute to enhance local capacity building in the medium-term. Also, there should be a mechanism to minimize costs of SAs audits in low-income countries.

We are of the view that more regular communication with central banks' staff, as well as capacity building on SA related issues, through both appropriate technical assistance and training could be instrumental in promoting central banks' ownership of the safeguards process. We also share the view that adequate flexibility in the development of deadlines for implementation of safeguards' recommendations should be applied, taking into account the nature of the vulnerabilities identified and specific country constraints.

Way Forward for the Safeguards Policy

In going forward, staff has proposed three types of SA: (i) new assessments for countries requesting new Fund arrangement but not previously subject to an SA; (ii) update assessments for countries requesting a successor or a new Fund arrangement; and (iii) monitoring assessments. We generally agree with the three types of safeguards assessments. We find that the modalities proposed for the first type of assessment is appropriate. However, regarding the other two types, we think that it would be useful for central banks if the off-site preparations could be completed by an effective on-site mission, since the central banks have found the SA framework helpful for their own operations. We are of the view that, even a short, but effective complementary on-site visit would be important for central banks to benefit from efficient communication, and in order to enhance ownership of the SA process.

We support the extension of the SA policy to central banks with Emergency Post-Conflict Arrangements (EPCA) and agree with the modalities proposed by the review. We would like to emphasize, however, that there is need to take into account the country specific capacity constraints and to provide appropriate TA to accompany the implementation of the SA recommendations. We concur with staff that the SA policy framework should not be extended to emergency assistance for natural disasters or compensatory financing facility cases where safeguards assessments do not already apply.

With regard to the periodicity of updating Board papers on SA, we support that it be done on an annual basis, and we are also of the view that the policy should continue to be reviewed every three years. In addition, we think that it would be useful that staff reports on Fund-program review continue to reflect ongoing developments in the implementation of SA' recommendations.

Confidentiality of Safeguards Reports Under the Policy

Staff has proposed to share central banks' SA reports with other IFIs such as World Bank, regional development banks and ECB. It is our view that this should be done under strict confidentiality, on a case-by-case basis, upon request by the specific IFI, and with approval of the authorities. We agree that information sharing should be on a reciprocal basis in similar areas.

Resources and Budgetary Costs

We concur with staff's analysis as regards resources and budgetary costs to accommodate the demands going forward.

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

We thank the staff and the independent panel for reviewing the Fund's safeguards policy. We have strongly supported safeguards efforts since the outset and are pleased to see that both papers found the policy to be a clear success. It has helped protect Fund resources, strengthen central bank practices, and improve the quality of data, including foreign exchange reporting for Fund-supported programs. Importantly, the independent panel confirms broad acceptance of safeguards assessments by central banks.

It is worth recalling that the safeguards policy was a response to a number of serious misreporting cases and allegations of misappropriation of IMF resources. These cases highlighted the types of poor internal controls addressed by safeguards assessments. The credibility and integrity of the Fund, as well as of the borrowing members, is enhanced by the safeguards policy, and we look forward to its continued implementation.

Table 2 in the staff paper suggests that the importance of internal controls, reporting, and transparency is more widely recognized, as evidenced by a smaller share of deficiencies since 2003 in all categories but one—the publication of central bank financial statements. We join Messrs. O'Loghlin, Campbell, and others in expressing dismay at the lower publication rate, given the importance of transparency to the framework, and we expect improvements in this area. Although advances have been made in the other categories, the still-high levels of deficient internal audits (57 percent of cases) and inadequate financial reporting standards (52 percent of cases) reinforce the importance of the policy.

We continue to believe that safeguards assessments should be completed no later than the first review, and that recommendations should be implemented as soon as possible, with key weaknesses taken care of before the second review. Given the point stressed by Mr. Meissner, Ms. Wolff-Hamacher, and others—that follow-through on recommendations is much better when laid out in formal conditionality or an MEFP—we encourage the use of conditionality for key measures. As mentioned by the independent review panel, better coordination and targeting of technical assistance would be helpful to support country efforts.

We agree with the emphasis of paragraph 25 on uniformity of treatment and the mandatory nature of safeguards assessments as being "critical to the general acceptance of the policy." Accordingly, we would not support any watering down of safeguards standards, for example in the interest of the Fund remaining engaged in a country that is unwilling to follow procedures accepted by all other borrowers. Doing so would seriously and needlessly undermine a policy initiative that has been successful in helping to address demonstrated weaknesses in central banks. We believe there is scope for improved communication, and we urge area departments to make clear to all prospective borrowers the firm requirements of the safeguards policy.

We have backed broad application of the safeguards policy in the past and support its extension to emergency post-conflict assistance cases, as proposed by the staff.

Like Messrs. Kashiwagi and Miyoshi, however, we do not believe that emergency natural disaster assistance and CFF cases should be excluded; in both cases, Fund resources would be outstanding for five years. The policy should apply to CFF cases, and, to the extent possible, to cases under emergency assistance for natural disasters. It is worth emphasizing that since the safeguards assessment would not need to be completed before program approval, the timely disbursement of assistance would not be jeopardized. We also welcome voluntary assessments for countries not seeking IMF-supported programs, and encourage compliance with safeguards standards as a matter of good practice. The staff's proposed modalities for conducting a new assessment, updating a previous assessment, or monitoring in cases where concerns arise seem appropriate.

More frequent communication between Fund staff and country authorities, as well as the creation of a safeguards website—two suggestions made by the independent panel—could be useful. We are not convinced of the value of regional or global forums and note ongoing IMF Institute courses at headquarters and regional centers. As long as country consent is required, we support sharing safeguards assessments with other international financial institutions on a confidential basis.

Now that assessments are a regular feature of Fund lending, we can accept annual rather than semi-annual reports. Reviewing experience with the safeguards assessments every three years is appropriate.

The Acting Chair (Mr. Kato) said that, as agreed by the Board, the Chair of the Independent Panel on Safeguards Assessments (Mr. Binay) was present at the meeting.

The Chairman of the Independent Panel (Mr. Binay) made the following statement:

As you know, the last review of the safeguards assessment policy indicated that an independent panel should be involved in the next review of the policy. As a result, myself and three other central bank officials were asked to participate as an independent panel to provide an evaluation of central banks' experience with the safeguards assessment process. The panel comprised myself, Deputy Governor of the Central Bank of Turkey; Mr. Hernández Correa, Deputy Governor of the Central Bank of Colombia; Mr. Hutapea, Deputy Governor of the Bank of Indonesia; and Ms. Rusagara, First Vice-Governor of the National Bank of Rwanda. All four panel members are from central banks that have undergone safeguards assessments.

The panel selected 23 central banks, plus the four central banks represented by the panel members, for a brief survey that is outlined in the panel report. The criteria for selecting the central banks were primarily based on achieving a wide geographic representation across central banks, while also targeting central banks of countries with a relatively large national economy.

Each panel member was responsible for a group of central banks within their region. In this regard, I must mention that the timeliness of the responses to the survey was quite remarkable. Central banks were very enthusiastic and prompt in their responses. I believe this makes a statement in itself and about the impact of the safeguards assessments of central banks. Survey responses from central banks were followed up by the panel through phone conversations with central bank staff, to clarify the panel's understanding and interpretation of the survey responses. This information was then compiled and used as the basis for the panel's report to the Fund's Executive Board.

As noted in our report, virtually all central banks acknowledged that the safeguards policy has had a positive impact on internal control issues, and has been an educational experience for most central banks. Overall, we found that the safeguards policy has been a success and has made significant progress in accomplishing its objective as set out in 2000. The panel also concluded that safeguards assessments have been conducted very efficiently.

An area where the central bank panel members observed the need for improvements was in communication on safeguards issues. Three possible avenues to improve communication are: more frequent communication between IMF staff and central banks on safeguard issues; dissemination of information and safeguards assessments on the IMF's external website; and regional and global forums on safeguards issues.

On behalf of the panel, I would like to conclude by thanking the Board, management, and staff for the opportunity to serve on the panel and for the cooperation we received in executing our mandate.

Extending his remarks, Mr. Kashiwagi made the following statement:

In my statement I did not comment on the issue of the confidentiality of assessment reports. I would like to express my support for the staff's proposal to share the assessment reports with the other IFIs, but on the condition that the reports shared with any IFI be those pertaining to central banks of countries that are members of the IFI concerned. I would be hesitant to provide to another IFI the assessment reports on central banks of countries that are not members of that IFI. I have no problem with providing information to the World Bank, the Asian Development Bank, or the African Development Bank, for example. The point in question is the European Central Bank (ECB). Is the ECB an IFI in the first place? What is the motivation of the ECB for requesting assessment reports? Does the ECB believe that there are central banks in the euro area that require safeguards assessments? If that is the case, that is fine. But if the ECB requests safeguards assessment reports on non-euro area central banks, I do not believe that would be appropriate. If we allow that, then why not allow similar access for the Bank of Japan or the Federal Reserve to those assessment reports? If the staff could elaborate on this point, I would appreciate it.

Mr. John seconded Mr. Kashiwagi's request for clarification.

Mr. Shaalan wondered whether, if the Asian Development Bank requested a report on a safeguards assessment of a central bank of an African country, the Fund staff would provide it to the bank.

Mr. Rouai made the following statement:

I thank the staff for its concise report and the independent panel for its contribution to the review of experience under the safeguards assessment (SA) policy. Both reports confirm that this policy has been highly successful in achieving its objective. I welcome in particular the conclusion by the independent panel that the SA policy is achieving its main goal of reducing the risk of misreporting by central banks, or misuse of Fund resources associated with Fund lending activity.

Like Mr. Steiner and Mr. Tombini, I believe that the success of this policy has to do with its focus, and I agree with them that for the SA policy to continue to deliver positive results in an efficient and cost-effective manner, it should keep its focus on this relevant area.

The review highlights the progress achieved by central banks in enhancing their accountability and governance, strengthening their control framework through better external as well as internal audit mechanisms, and reinforcing control related to data provided to the Fund. This progress is illustrated by the reliance on experts from central banks to review SA policy, and is confirmed by the fewer weaknesses identified since the last review, and by the high implementation rate of the staff's recommendations.

While I welcome this improvement, I note also with concern from Table 2 of the staff report that a number of central banks' operations continue to require strengthening, in particular with regard to the publication of financial statements.

Like Mr. Shaalan and Ms. Beidas, I welcome the outreach and seminars organized through the IMF Institute to explain the SA policy to central bank staff. The independent panel recommends improving communication with central banks, which could be a cost-effective way to achieve the SA objectives. One way to enhance communication is to broaden the coverage of the outreach exercises by also inviting participants from central banks of countries without Fund-supported arrangements. In addition, a dedicated external website, as proposed by the independent panel, could also be helpful in disseminating safeguards principles and developments.

Looking forward, both the staff and the independent panel make a number of useful recommendations, which I can generally support. I can go along with the modality proposed by the staff for the three distinct types of safeguards assessments. I agree with the staff that the nature of future assessments will continue to evolve and that going forward, SAs will increasingly be covered in follow-up assessments. I can go along with the extension of the SA policy to emergency post-conflict assistance cases. I do not support, however, the extension of the SA policy to emergency assistance for natural disaster cases or outright purchase under the CFF. In any event, it is difficult to imagine under current Fund policy a CFF drawing without a Fund arrangement. I can also support the staff proposal to move from a semi-annual to annual update reporting to the Board and to conduct the review of the policy every three years.

Finally, I note that many Directors support the staff's proposal to share SA reports with staff from other IFIs, after the authorities consent. The staff argue that this is similar to current guidelines applied to technical assistance reports. I disagree. Under current guidelines, technical assistance reports are available to Executive Directors, whereas in the staff's proposal an SA report would be shared with other IFIs, and not with Executive Directors. This is unacceptable. I propose to amend the staff's proposal to make SA reports available to Executive Directors, like technical assistance reports, through the Fund's institutional repository.

Ms. Newton-Smith made the following statement:

We thank the staff and the independent panel for their reports. We very much welcome this review. As we said at the last review, ensuring that Fund resources are used for their intended purposes is a very important element in maintaining public confidence in the Fund. The safeguards program is a clear example of where having proper procedures can have significant effects, both in terms of the primary goal of reducing misreporting and misuse of Fund resources, as well as in building the capacity and risk management of central banks.

The tone of this review and the report of the independent panel is very much one of partnership with central banks. The assessments appear for the most part to have helped central banks improve their own procedures, as part of the welcome trend of increasing central bank transparency and accountability.

We feel, however, that the review could have tackled more head on some of the difficult issues that have arisen with safeguards assessments in recent years, issues that will be particularly important if assessments are extended to post-conflict arrangements. The review and the panel report only looked at the relationship with central banks, and did not discuss some of the broader trade-offs that might arise, or the views of fiscal authorities. Currently, safeguards assessments are mandatory for all users of Fund resources, but the relationship with program conditionality is less clear. Indeed, the strict application of its recommendations has led to the Fund disengaging in some countries, namely Vietnam. We very much agree with Mr. Kashiwagi and Mr. Miyoshi that what is important in assessments is strengthening internal management at central banks to help safeguard Fund resources. The ELRIC criteria do a good job of assessing the internal governance of central banks, but the recommendations and how these are implemented need to be achieved in partnership with central banks without rigid adherence to particular modalities. Like Mr. Sukada and Mr. Patrawimolpon, we favor a flexible approach, particularly since in some countries, as the paper notes, disbursements are made to fiscal agents. We welcome the fact that the number of recommendations incorporated directly in program conditionality have declined over time, in line with guidelines on streamlining conditionality.

We would welcome more objective detailed measures on how many safeguards recommendations have been implemented, apart from those under program conditionality. Table 1 of the staff report does not give a good idea of whether the implementation of recommendations has increased over time. This is crucial in determining how effective those recommendations are and how well tailored they are to country circumstances.

The publication of financial accounts of the central bank is a key requirement, and like Mr. O'Loghlin and Mr. Campbell and many other Directors, we are disappointed that this share has fallen. We understand that there is balance to be made between having a frank assessment from the authorities and the publication of the documents, but an expectation of publication even of only the key recommendations, or at least the sharing of the assessment with the authorities—and perhaps as Mr. Rouai has suggested, with Executive Directors—could help with the implementation of recommendations.

On the ELRIC criteria, like Mr. Shaalan and Ms. Beidas, we would have welcomed more discussion on whether these criteria remain appropriate, as well as more information on the specific criteria and their application. In the area of internal control systems, we wonder whether there is enough focus on the transactional processes, and the systems themselves, rather than just monitoring when these systems fail.

The safeguards at the moment are also silent on operational risk, and this is an increasingly important risk for central banks, and will certainly be more relevant in post-conflict countries. It is also an area which could merit more general discussion at the Fund.

On the proposals outlined in the paper, like Mr. Meissner and Ms. Wolff-Hamacher, and many other Directors, we support extending the assessments to post-conflict countries. The post-conflict period is a time when systems can be most vulnerable and when capacity-building is particularly important. But, again, a flexible approach as suggested by the staff seems sensible.

While in principle we would support moving to a 12-month update for the Board on these assessments, we want to ensure good communication across area departments and within the Fund.

We very much support the sharing of assessment reports with other international financial institutions, both in the interest of better coordination and efficient sharing of resources. This is obviously still several steps away from official publication, and our sense is that it would still be at the discretion of the central bank concerned. The staff could comment further on that point, as well.

Finally, we find the staff proposals for the three types of safeguards assessments going forward sensible, but like Mr. Meissner and Ms. Wolff-Hamacher, we would be interested in more details on how the staff would assess the perceived risk. We believe that the extent of Fund exposure to the country concerned would be a relevant consideration in that regard.

Mr. Tolstikov made the following statement:

We welcome the review of the Safeguards Assessments experience and the report of the Independent Panel. We are encouraged by the overall positive view of the central banks on the results of the policy. We support most of the recommendations proposed by the staff and the Independent Panel, and would like to make some remarks on the issues for discussion, as well as on some questions raised in other statements.

We find appropriate the breakdown of safeguards assessments (SA) into three types, namely new, update and monitoring assessments and with the proposed procedures of dealing with each of these cases. The paper indicates that as the number of new assessments is decreasing for natural reasons, the focus of the safeguard policy shifts to update and monitoring assessments.

We believe that monitoring assessments should not be a priority of the SA policy, at least in the post-program stage. The main goal of the SA policy is to minimize the possibility of misreporting or misuse of Fund's loans, thus preserving the reputation of the Fund. The wrongdoing in the central banks would be most likely associated with the Fund lending during the program period but not in the repayment period. Misreporting can also occur only during the program period. Therefore, for the purposes of the most efficient use of limited Fund recourses we would propose to simplify procedures for monitoring assessments in the post-program countries and to concentrate on the update assessments.

Several statements mentioned the issue of extending the SA to the fiscal area. Before we start dealing with this problem, we need to agree on what constitutes the misuse of Fund resources in the fiscal area. It is difficult due to the use of a single treasury account by many ministries of finance. All tax receipts, loans and other sources of revenue are mixed in this account and, therefore, at a later stage, it can not be distinguished, whether it is the Fund's loan that was used improperly or something else. Unless we earmark the use of Fund resources to easily traceable purposes, for example, external debt payments, we need to obtain extensive information about all government expenditures. Therefore, we do not believe that the SA should be extended to the fiscal area.

On the confidentiality of the SA reports. The SA reports should continue to be confidential documents. The Fund staff may have an option to request the permission of the authorities on sharing them with other multilateral institutions, but the decision should be taken by the appropriate authorities. In such a case it is important to clarify who appropriate authorities are, because in some countries the central banks are not the IMF's fiscal agents. Staff comments are welcome.

The staff's arguments on exclusion of the emergency assistance for natural disaster cases from the SA policy sound reasonable to us. The SA policy should not be applied to such cases just for the sake of equal treatment.

Lending to EPCA countries bear the highest risk for the Fund resources. Therefore, we support the extension of the SA policy to include EPCA cases, and agree with the modalities of the proposed case-by-case approach, which takes into account the existence and the level of institutional and administrative capacity of the central bank.

Taking into account that fewer new assessments are expected, we find it appropriate to provide annual rather than semi-annual updates on SA activity and to perform periodic reviews of the safeguards policy on a three year basis.

The Director of the Finance Department (Mr. Kuhn) made the following statement:

I would like to join Directors in thanking Mr. Binay and the panel of central bank officials for their work. We found the independent review and perspective of the panel—which was composed of senior central bank officials with Mr. Binay as chair—to be particularly useful for our own assessment of the Fund's safeguards policy.

Second, I would like to thank Directors for their many comments and suggestions, and for the broad support for the way the Finance Department has conducted safeguards assessments over the past five years.

The first set of questions from Directors pertains to the implementation of safeguards recommendations. As Directors will recall, a safeguards assessment is not an audit; it is not technical assistance or surveillance; rather, it is a diagnostic exercise to evaluate the system of internal controls and governance in central banks. The assessment is quite different from other activities by the Fund.

The staff aims to ensure that the key weaknesses identified during an assessment and the recommendations to address them are recognized as such by the authorities. We then try to agree with the authorities on realistic and time-bound deadlines for implementing the recommendations. The high-priority recommendations—and this is in answer to Mr. Schwartz—tend to be included as formal commitments or as conditionality if needed. Typically, the authorities recognize those recommendations as having the highest priority.

The fact that some recommendations are included under program conditionality accounts for a slightly higher rate of implementation. Nonetheless, the rate of implementation of recommendations overall is quite high, especially considering that the statistics include programs that went off track.

Mr. Kremers asked whether the identified key weaknesses during a safeguards assessment are generally addressed, even with interim remedial measures. That is indeed the case, and they are typically addressed before the second review under the country's Fund-supported program. Certain issues, however, are linked not to the program cycle, but to the internal cycle of the central bank concerned—for example, the publication of central banks' financial statements—and the implementation of certain recommendations, therefore, may not take place by the time of the second review.

Mr. Murray, Mr. Wang, and Mr. Sukada asked about how the staff takes into account a country's legal framework, as well as the independent panel's observation that, at times, the staff's recommendations that have to do with amendments to the central bank law could tend to weaken the central bank's independence during the political process. The staff has become quite sensitive to this issue. We have been quite careful to make recommendations that are tailored to the country's circumstances. For instance, we have recommended the issuance of Board resolutions where appropriate as an alternative to amending the central bank law. Moreover, for recommendations that do require an amendment, the timetable is typically left open until the next envisaged amendment of the law. Nonetheless, we have also been careful to ensure that the underlying objective of the policy remains in place. Recommendations pertaining to amendments to the central bank law have been a relatively small fraction of total recommendations.

With regard to the proposed extension of the safeguards assessments to EPCA cases, Mr. Shaalan and others asked for clarification of so-called targeted assessments, particularly in cases where there are capacity weaknesses. As an example, it could be that a post-conflict country has a functioning central bank, but the central bank does not have an internal audit mechanism. In that case, the safeguards assessment would focus on only four of the five ELRIC cases, and not include an assessment of the internal audit framework.

On the extension of the policy to ENDA and CFF cases, Directors have expressed a variety of views on this issue. We will reflect further on what can be done in this area. This said, I am somewhat skeptical about ex-post assessments of central banks in ENDA and CFF cases, given that such assessments could be of limited value.

I would also point out that safeguards assessments are now a continuous process. We have covered most of the central banks in the debtor countries—although not all have undergone full assessments—and going forward, we will look at more effective ways to do continuous monitoring.

Some Directors commented on the relatively weak link between safeguards assessments and technical assistance from the Fund. This issue has two components. First, we have found that in some cases, central banks had significant weaknesses at the time of the first assessment, even though they had received a significant amount of technical assistance in the area. In these cases, technical assistance needed to be focused on internal control procedures and other areas that are important for the functioning of the central bank.

Second, as a result of the findings from the safeguard assessments, many central banks have asked for technical assistance from the Fund, and we have coordinated carefully with area departments and other relevant departments in the Fund to make such technical assistance available. In some cases, we facilitated the hiring of external experts.

With regard to future assessments, Ms. Newton-Smith suggested that we expand the assessments in a wide variety of risk areas. Again, we will do what we can do, but a safeguards assessment cannot, and is not meant to, substitute for a full-fledged external independent audit. In our view, that is the most critical area for ensuring that controls at central banks work well. Effectively, much of the work is being outsourced to the experts that perform the external audits. What the staff can do is point out weaknesses and bring together departments within the central bank to see whether those weaknesses could be addressed. The staff does not perform the audits itself.

Mr. Meissner and Mr. Sukada asked how we would assess a central bank's perceived risk to determine whether an on-site assessment is needed. We would take into account a wide variety of factors, including, most importantly, the central bank's track record of implementation of prior safeguards recommendations, information on the central bank's annual financial statements, related audit reports, information from the external auditor of the central bank, and other materials that are regularly submitted by central banks. We would also take into account any new information received.

Mr. Meissner and Mr. Shaalan suggested that Fund exposure to a particular country should be an explicit criterion in deciding on a safeguards assessment. In practice, the level of Fund exposure to the country in question is a factor considered by the staff. Evidently, a higher exposure could result in a bigger loss to the Fund in case of nonpayment, but there does not seem to be a clear link between the level of Fund credit outstanding and the perceived risk in a central bank's internal control processes.

With regard to the question on why our expected shift from new assessments to updates did not fully materialize earlier, the reason is partly due to delays in some program negotiations and approval. For this financial year, we expect to conduct about 20 assessments, of which five would be new assessments, with the remainder being updates.

With regard to sharing assessment reports with other IFIs, our proposal was simply meant to allow the staff to share the report, in the rare cases where some other institution requests it, upon approval by the central bank concerned. However, given the variety of opinions expressed by Directors on the matter, I wonder whether it may not be a good idea to take up Mr. Misra's suggestion to reflect some more on the specific modality for doing this, and come back to the Board with a specific proposal at a later stage.

The staff representative from the Finance Department (Mr. Trines) made the following statement:

Let me give some details on how we intend to proceed with the recommendations that we have received from the panel. On improving our communication with central banks and the public, we have already drafted an updated fact sheet, which will be posted shortly on the external website. This fact sheet contains general information and various links to other websites for related technical information on accounting, auditing standards, and guidelines on internal auditing. Internally, within the department, we are setting up new procedures that are meant to strengthen our assessment of information that we receive from the central banks, as well as improve communication with central banks, including follow-up and response, so that the authorities are properly informed.

In addition, as we mentioned in the paper, we will continue with the seminars. We will have two seminars a year, one in Washington and one in the regional training centers. The next one will be held in Tunis this May. We have invited officials from central banks that have not yet undergone safeguards assessments as well as officials from central banks that have undergone an assessment to facilitate the exchange of experience.We are also looking at other avenues, including the possibility of a seminar on safeguards assessments for Fund staff, and we will explore with the Monetary and Financial Systems Department or the IMF Institute the possibility of holding some forums where experience in safeguards assessments can be shared.

> Regarding the publication of central bank financial statements, several Directors remarked that the number of central banks that did not publish their financial statements has increased recently. There is no particular reason for this development, and the publication rate is not in fact deteriorating. The higher incidence of non-publication was mostly within the group of central banks that the staff assessed within the past two years. Most central banks have addressed or will address this issue as the present assessment cycle comes to a close. At the moment, there are only nine assessed central banks that have not yet published or published their financial statements completely.
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> Finally, Mr. Gola asked how many central banks do not undergo external audits. Our understanding is that there are only two central banks that would not let an independent external audit be performed by an internationally-recognized firm.

Mr. Zurbrügg noted that the staff paper had indicated that when the staff considered an identified vulnerability to be serious it was usually included as part of program conditionality. Was the macro-criticality of a recommendation the main criterion for including it in program conditionality? Could the staff elaborate on the appropriate criteria for including certain recommendations in program conditionality?

The Director of the Finance Department (Mr. Kuhn) replied that the staff usually tried to be sparing in what it included in program conditionality. Generally, when a recommendation was included in program conditionality, the central bank authorities would have agreed that the identified weakness was serious. The macro-criticality of a recommendation was not necessarily the main criterion. The Finance Department worked closely with management and the area departments, and the decision on what recommendation to include in the program conditionality was made as part of the program negotiations with the authorities.

Mr. Kashiwagi noted the staff paper's contention that Fund staff had been approached on several occasions in the past by staff from other institutions like the World Bank and the ECB for information on particular aspects of the safeguards assessment for certain central banks. He wondered about the reasons given for such requests.

The Director of the Finance Department (Mr. Kuhn) replied that the requests had been for assistance. In the case of the ECB, one request had had to do with a country in Eastern Europe to which the ECB was in the process of extending a loan. It had been a specific, one-time request, and not a blanket request for information on different countries. Such requests were usually made to support the requesting institution's decision-making. Thus far, the Fund had not shared any information from the safeguards assessments with any other institution.

The Acting Chair (Mr. Kato) agreed that sharing sensitive information with other parties required careful consideration. Management and staff would look into concrete modalities for doing so, and would come back to the Board with a proposal at an appropriate time.

The Acting Chair (Mr. Kato) thanked Mr. Binay and his panel for their valuable contribution in furthering the Fund's work on safeguards assessment.

The Acting Chair made the following summing up:

Executive Directors welcomed the opportunity to review the experience with the safeguards assessment policy, introduced in March 2000 to provide reasonable assurance that central banks have adequate financial control systems in place to manage their resources and Fund disbursements, and made a permanent feature of Fund operations in March 2002. The policy involves an evaluation of central banks' operations with respect to the external and internal audit mechanisms, the legal structure and independence, the financial reporting framework, and the system of internal controls. Directors noted that the policy continues to be widely welcomed by central banks and has yielded positive results overall, with 111 safeguards assessments of 69 central banks having been completed. Directors also expressed their appreciation to the panel of central bank officials for providing an independent appraisal of the policy's effectiveness.

Directors noted that the policy has had a positive impact on central banks' operations, and in particular, that there have been considerable improvements in the governance and control frameworks at many central banks. They observed that recent safeguards assessments have found a heightened awareness at many central banks of key control issues, such as proper external audits, adherence to established accounting standards, and the oversight functions performed by internal audit staff and audit committees. Directors considered the overall rate of implementation of safeguards assessments recommendations to be commendable, but some expressed concern that there has been a decline in the rate of publication of financial statements in the central banks sampled. Some Directors underscored the contribution to more consistent implementation of recommendations when these form part of formal commitments, either in the authorities' letter of intent or as part of program conditionality. It was also suggested that key recommendations should be implemented by the second review of performance under the member's Fund-supported program. Directors also noted that the policy has led to more attention, by both central banks and Fund staff, to the quality and robustness of data provided under new Fund arrangements.

Directors welcomed the panel of central bank officials' independent appraisal of the safeguards assessment process which took into account views from a large number of central banks that have undergone a safeguards assessment. Directors noted the panel's conclusion that the safeguards policy has been a success so far, and that the conduct of safeguards assessments has been relatively efficient. At the same time, Directors supported the panel's observations that communication with central banks on safeguards issues should be improved, and that the modalities for assessing and monitoring safeguards at central banks should remain flexible.

Directors observed that the overarching objective of the safeguards policy is to safeguard Fund resources, but that the policy cannot prevent misuse of resources that may result from willful override of controls or manipulation of data. They further noted that the scope of the policy is limited to operations of the central bank and does not cover fiscal activities of the government.

Directors considered the existing framework for assessing central banks' operations to be broadly appropriate. Most Directors agreed that flexibility should continue to be exercised in the application of the policy in recognition of country specific circumstances, provided this does not undermine the essence of the safeguards policy's objectives. In this regard, Directors stressed that well-targeted and coordinated Fund technical assistance can often provide critical help in removing implementation difficulties stemming from lack of capacity.

Directors stressed that safeguards assessment reports are confidential documents. Directors discussed the suggestion that the Managing Director transmit these reports, with the authorities' consent, to other international financial institutions on the basis of criteria to be established. The staff will return to the Board with a concrete proposal on those criteria.

Directors concurred with the three distinct types of assessments to be conducted: new, update, and monitoring assessments, and supported the staff's intention to give greater priority to update and monitoring assessments going forward. New assessments will be conducted where a new Fund arrangement or Rights Accumulation Program is requested by a country whose central bank has not previously been engaged in a safeguards assessment, while update assessments will be conducted in cases where a member requests a new arrangement or Rights Accumulation Program and if the central bank has already been subject to an assessment. Update assessments will generally take into account information from the previous assessment, progress in implementing earlier safeguards recommendations, and new developments in safeguards areas at the central bank. Monitoring of previous assessments will be conducted on a continuous basis, and could include on-site follow-up staff visits to central banks whenever the staff considers them necessary to provide reasonable assurance to the Fund that safeguards issues continue to be adequately addressed. A few Directors, however, were not in favor of on-site monitoring assessments.

Directors agreed that the safeguards assessment policy should be extended to include Emergency Post-Conflict Assistance (EPCA) cases, and that the modalities for the assessments in such cases would be determined on a case-by-case basis. The timing and procedures for an assessment will depend on the institutional and administrative capacity of the central bank at the time of access to EPCA. A safeguards assessment may be delayed if there is no functioning central bank, or a targeted assessment aimed at basic control functions may be undertaken in cases where a central bank exists but has limited functional capability. Full assessments will be undertaken once a functioning central bank exists. A few Directors suggested that the safeguards assessment policy also cover central banks drawing under the Emergency Assistance for Natural Disasters and the Compensatory Financing Facility, while most Directors agreed with the view that such extension would in most cases be infeasible.

Directors observed that, in situations where the safeguards assessment cannot be completed prior to the Executive Board's approval of a new Fund arrangement, the first review of performance under a member's Fund-supported program remains an appropriate operational deadline for completion of an assessment. In consideration of the expected smaller volume of new assessments going forward, Directors agreed that safeguards update papers, which provide the Board with a summary of safeguards assessment activities, may henceforth be prepared annually rather than semi-annually. Directors also agreed that the next review of the safeguards policy should take place in three years.

Mr. Rouai asked whether the reports by the staff and the independent panel on the safeguards assessments review would be published before or after the Board had made a decision on the outstanding issue of sharing safeguards assessments reports with other IFIs.

The Director of the Finance Department (Mr. Kuhn) suggested that the Board papers and the PIN for the Board discussion be made public after the staff came back to the Board—within a short period of time—with a concrete proposal on the dissemination of assessment reports.

APPROVAL: September 20, 2005

SHAILENDRA J. ANJARIA
Secretary