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To: Members of the Executive Board

From: The Secretary

Subject: **Strengthening Safeguards on the Use of Fund Resources and
Misreporting of Information—Report of the Acting Managing
Director to the International Monetary and Financial Committee**

Attached for the information of the Executive Directors is the report of the Acting Managing Director to the International Monetary and Financial Committee on strengthening safeguards on the use of Fund resources and misreporting of information, which has been revised to incorporate comments by Executive Directors.

Mr. Lane (ext. 37668), Mr. Catsambas (ext. 34017), and Mr. Leckow (ext. 34799) are available to answer technical or factual questions relating to this paper.

Att: (1)

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Department Heads

INTERNATIONAL MONETARY FUND

Report of the Acting Managing Director to the International Monetary and Financial Committee on Strengthening Safeguards on the Use of Fund Resources and Misreporting of Information

April 10, 2000

1. Reliable information is essential to every aspect of the Fund's work, including surveillance, financing and technical assistance, and is critical to ensure that the Fund's resources are used for their intended purposes. The Fund has relied primarily on a relationship of trust with members as a basis for the integrity of the information it needs to operate effectively within a broad framework of rules and safeguards.
2. The existing safeguards for the reliability of information stem from program design, conditionality, and monitoring, and the availability of technical assistance, as well as the transparency and governance initiatives; the latter include the establishment and monitoring of codes and standards for data dissemination, fiscal transparency, and transparency in monetary and financial policies. The Fund also has legal tools for addressing cases of misreporting that arise.
3. Several recent episodes of misreporting and allegations of misuse of the Fund's resources have led us to reassess the adequacy of the Fund's existing procedures. While such episodes have been rare, the Fund views them with the gravest concern, as they represent a breach of trust by certain members and could undermine the Fund's credibility and reputation as a careful and prudent manager of the resources entrusted to it, and provider of financial assistance and policy advice to its members. This in turn could in the longer term undermine the Fund's ability to operate effectively.
4. In September 1999, the Interim Committee called on the Fund to perform an authoritative review of its procedures and controls to identify ways to strengthen safeguards on the use of its funds. In October 1999, the Fund's Executive Board initiated a review of the Fund's legal framework, policies, and procedures related to misreporting. The review of safeguards was aided by a panel of eminent outside experts, who provided the Executive Board with an independent assessment of staff proposals.
5. Subsequently, the Executive Board has extensively discussed both misreporting and safeguards issues; the Chairman's summing up of these discussions is attached. The discussions resulted in Executive Board agreement on a multi-faceted approach that is now being put in place to strengthen the safeguards on Fund resources.

Safeguards within member countries

6. A key element of safeguards within member countries is that central banks publish annual financial statements, independently audited in accordance with internationally accepted standards. Starting in mid-year 2000, this will be a requirement for all current and future Fund arrangements.

7. The Fund will also introduce two-stage Safeguards Assessments for countries with Fund arrangements to evaluate whether the control, accounting, reporting, and auditing systems within their central banks are adequate to control and monitor the resources entrusted to them, including those provided by the Fund. In the first stage, the central bank will be asked to provide information and documents relating to its internal control and internal and external auditing procedures (see the attachment to the Summing Up). If these procedures are judged to be adequate, the Fund will regard the Safeguards Assessment as complete. In other cases a second stage, of on-site assessment, will follow. The assessment teams for the second stage will be headed by Fund staff, and will include experts from central banks, multilateral agencies, and private accounting firms. The assessment teams will then propose action to address any identified weaknesses in internal procedures.

8. The Safeguards Assessments will be required, on an experimental basis, for all countries with new Fund arrangements approved after mid-year 2000. Members with current arrangements and possible disbursements subject to program review after September 2000 would, in addition to publishing externally audited financial statements, be required to furnish the Fund with reports and management letters pertaining to the external audits; Fund staff would review these documents to assess the adequacy of the external audit arrangements and report to the Board its findings together with any recommendations for improvements. The experience with Safeguards Assessments will be reviewed with the involvement of a panel of eminent outside experts within 12-18 months.

Remedial actions on misreporting

9. Recent experience has underlined the need to ensure that the Fund's framework of rules adequately covers cases of misreporting that may arise. The main pillars of the Fund's existing legal framework for addressing cases of misreporting are its Articles of Agreement and the 1984 Guidelines on Misreporting and Corrective Action for the Fund's general resources (as well as analogous guidelines adopted in 1998 for the Poverty Reduction and Growth Facility (PRGF)). The Articles establish member countries' obligation to provide the Fund with information it needs for its work and specify legal remedies—such as a temporary declaration of ineligibility to use the Fund's resources—in case a country breaches this obligation. The Guidelines state that, if the Board has approved a country's use of the Fund's resources on the basis of information that turns out to be incorrect, the country is expected to repay the Fund promptly.

10. The Executive Board has agreed to broaden the application of the tools for addressing misreporting when it comes to light. In particular, the clear sense of the Executive Board was that action is needed to strengthen the Guidelines by applying them to prior actions and other essential information, lengthening the two-year limitation period, and applying them to outright purchases. The staff will return to the Board with detailed proposals for implementation. The Executive Board has also decided to make public appropriate information on each case of misreporting, after the Board has made its determination, and with Board review of the text.

Fund procedures

11. The Fund's procedures for gathering and using information are being reinforced. These procedures have typically been among the institution's strengths, as the process of assembling information to form an overall assessment of the economic situation provides the opportunity to cross-check, question, and refine the information initially received. Staff are taking steps to tighten up procedures further, and in particular to extend existing best practice throughout the institution. They will continue efforts to ensure that the information on which the Fund's decisions are based is the best available.

Conclusion

12. The Fund has been able in the past to rely primarily on trust in members' readiness to provide needed information, and to use the Fund's resources for the purposes envisaged. It should be able to continue to operate on that basis. However, recent cases of misreporting have driven home the need to strengthen the Fund's procedures. The Fund's response to misreporting of information and the misuse of the Fund's resources combines three elements: strengthening safeguards within member countries, broadening the application and making more systematic use of the available legal tools, and strengthening procedures for handling information in the Fund. None of these is necessarily sufficient in itself to prevent misreporting—particularly if such misreporting is intentional. But a combination of action on all three fronts, as agreed by the Executive Board, represents a constructive way of addressing these issues and narrowing the scope for potential problems. This is an extremely serious issue and the Fund is determined to deal with it with the seriousness it deserves.

