

## Selected Decisions and Selected Documents of the IMF Twenty-Fifth Issue, December 31, 2000

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### ARTICLE V, SECTION 3(a), (b) AND (c)

#### **Use of Fund's Resources**

##### **General Decisions**

*Summing Up by the Acting Chairman  
Strengthening Safeguards on the Use of Fund Resources and  
Misreporting of Information to the Fund-Policies, Procedures, and  
Remedies-Preliminary Considerations<sup>1</sup>  
Executive Board Meeting 00/32, March 23, 2000*

Reliable information is essential to every aspect of the Fund's work-surveillance, financing, and technical assistance-and is particularly important in ensuring that the Fund's resources are used for their intended purposes. As has been the practice over many years, the Fund must depend primarily on trust in members' readiness to provide the information needed and to use the Fund's resources for the purposes envisaged. While known incidents of misreporting and misuse of the Fund's resources have been rare, many Directors noted recent instances involving allegations of misuse of Fund resources and cases of misreporting, and emphasized the importance of preserving the integrity of the Fund's reputation as a careful and prudent provider of financial assistance to members. Directors agreed that these events further underscore the need to strengthen the Fund's existing safeguards on the use of its resources.

The September 1999 Interim Committee emphasized the importance of strengthening governance at the national and international levels, and in this context called on the Fund to perform an authoritative review of its procedures and controls in order to identify ways to strengthen safeguards on the use of its funds and to report on this review at its next meeting.

In considering strengthened safeguards for the use of Fund resources, Directors noted the importance of the safeguards already in place, in particular program design, conditionality and monitoring, the availability of technical assistance, the transparency and governance initiatives, including the establishment and monitoring of codes and standards, and the recent use of special audits and the SDR-account mechanism in selected cases. They stressed that these areas of Fund operations should continue to play a central role in promoting public sector integrity and accountability, thereby contributing to the safeguarding of Fund resources. Directors also noted that policies on noncomplying purchases are ex post in nature, in that they rely on the disincentives of actions taken by the Fund after the fact of misreporting has been established, and they welcomed this opportunity to review relevant aspects of the Fund's legal framework governing misreporting of information to the Fund.

Directors also welcomed the opportunity to consider an approach to assessing the adequacy of member countries' framework of safeguards that could help, ex ante, to prevent the possible misuse of Fund resources and misreporting of information. In considering the staff's proposals, Directors expressed their gratitude to the panel of six eminent outside experts, drawn from the private and public sectors, who had independently assessed these proposals. In light of these proposals, the Board has decided on a number of steps to strengthen key aspects of the Fund's framework for

dealing with these issues.

#### *Ex ante Safeguards*

Directors generally concurred that the proposed two-stage approach to safeguards assessments could provide an appropriate mechanism to strengthen existing safeguards by assessing a central bank's compliance with a series of desirable practices, rules and regulations regarding internal control procedures, financial reporting, and audit mechanisms. Safeguards assessments of central banks have the objective of providing reasonable assurance to the Fund that the central bank's control, accounting, reporting, and auditing systems in place to manage resources, including Fund disbursements, are adequate to ensure the integrity of operations. However, Directors remarked that safeguards assessments would not prevent misuse of resources by a willful override of controls or manipulation of data. They noted the view of the panel of experts that safeguards assessments will greatly enhance the ability of central banks to improve their controls, efficiency, and effectiveness, as well as their view that the assessment framework addresses the protection of member shareholders' resources without threatening the cooperative nature of the Fund.

Directors generally endorsed the framework for the conduct of safeguards assessments and, in particular, the focus on member countries' central banks. They agreed that the safeguards framework would include an assessment of the accountability and transparency of foreign reserves management operations assumed by agencies outside the central bank, which is sometimes the case when the fiscal agent for the Fund is not the central bank. Some Directors, however, emphasized the importance of strengthening controls and financial reporting in the government sector, and took note, in this regard, especially of the need to strengthen the quality and reliability of fiscal data and of other information related to performance criteria used in Fund-supported programs. They noted management's intention to strengthen the approach to handling data in the Fund, to which I will refer later.

Directors endorsed the proposal that an important principle of the strengthened safeguards framework become a standard requirement for Fund financial support, namely, that central banks of member countries making use of Fund resources publish annual financial statements independently audited by auditors external to the central banks in accordance with internationally accepted audit standards. In noting their agreement with the staff proposal on external audits based on international quality standards, several Directors underscored the importance of sound risk and reserve management practices, including transactions on an arm's length basis with related parties. They also endorsed the general principle of basing benchmarks on the Fund's Code of Good Practices on Transparency in Monetary and Financial Policies.

A number of Directors noted that, although they agree in principle with the staff's proposals, country-specific circumstances would need to be taken into account in the conduct of safeguards assessments. In this context, Directors stressed the importance of technical assistance in the implementation of recommendations arising from the safeguards assessments.

In the first stage of the assessment process, the authorities of a member seeking a new Fund arrangement would be expected to furnish the Fund with the documents listed in the attachment to this summing up as early as possible, and grant permission for Fund staff to hold discussions with their independent auditors. The staff would review this information to arrive at a preliminary judgment about the adequacy of the central bank's internal control systems, reporting, and internal and external audit mechanisms.

Directors supported the view that if, based on this information, the staff reaches the conclusion that the central bank's control, reporting, and auditing mechanisms appeared

adequate for safeguarding Fund resources, no further steps would be undertaken. In other cases, and as a second stage, an on-site review would be undertaken by a multidisciplinary team prior to presentation of the arrangement for Board approval, or in any case no later than the first review.

On the modalities of this second stage, Directors considered that multidisciplinary teams were needed, including experts from central banks and private accounting firms. They generally concurred that the teams should be led by the staff to ensure consistency of the approach and to help achieve a continuous improvement of the assessment methodology. Directors emphasized the importance of confidentiality and the need for close monitoring and guidance of outside experts. They also recognized the confidential nature of safeguards assessment reports and, in this regard, generally agreed that the results of safeguards assessments be made available to the Executive Board in a summary form. At the same time, if requested by Board members, information referred to in the summary reports would be made more fully available by management to the Executive Board in an appropriate format and forum.

Directors considered that the introduction of safeguards assessments requires a differentiation between new and current users of Fund resources. For Fund arrangements approved after June 30, 2000, two requirements would be applied: (i) member countries' central banks would be subject to the two-stage assessment approach described above, with the expectation that in many cases the first stage would suffice, and (ii) as part of the safeguards, central banks would publish annual financial statements independently audited by auditors external to the central banks in accordance with internationally accepted audit standards.

For Fund arrangements in effect before June 30, 2000, Directors endorsed the view that, as a transitional arrangement to minimize resource costs, the two-stage assessment approach would not be applied. However, an important part of the safeguards framework would apply- the audit arrangements in place at central banks would be assessed to determine whether the central banks publish annual financial statements independently audited by auditors external to the central banks in accordance with internationally accepted audit standards. Members with possible disbursements subject to program reviews after September 30, 2000 would be required to furnish the Fund with the documents listed in points (1) to (3) of the attachment three months before the first program review after September 30, 2000. The staff would review this information to assess the adequacy of the external audit arrangements and report its findings to management. Where improvements were deemed necessary, these and the authorities' response would be reported to the Board in the documentation for the first program review after September 30, 2000.

The resource implications of safeguards assessments would be kept under review and Directors noted management's intention to return to the Board should the resource requirements exceed those available under the Fund's current fiscal year 2001 budget proposals.

Most Directors expressed the view that safeguards assessments should be carried out on an experimental basis and that a review of the Fund's experience with this approach should be undertaken with the involvement of the outside panel of experts within 12-18 months.

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*List of Information/Documents to Obtain from Member Country Central Banks*

1. Copies of audited (or unaudited if no audit is performed) financial statements for the past three years, together with related audit reports.
2. Copies of all management letters issued by the external auditors in connection with

their audit of the financial statements for the past three years.

3. Copies of all audit reports (including agreed-upon procedures engagements) issued by the external auditors during the past three years.

4. A description of the central bank's management structure, including the organizational reporting structure.

5. A description of the organizational structure and reporting lines of the internal audit department, including details of the senior management staff in the department and a summary of staff resources (experience and qualifications).

6. A summary of high-level internal controls in place for the banking, accounting, and foreign exchange departments of the central bank.

7. Listing of all reports issued by the internal audit department in the past three years and a summary description of findings. Potentially, copies of reports dealing with operational and financial controls during the same period.

8. Details of the full legal names of any subsidiaries of the central bank, and a description of their business and the nature of their relationship with the central bank. A listing of all correspondent banks.

9. A listing of all accounts held by government agencies with the central bank.

10. Copies of current legislation governing the central bank.

<sup>1</sup> Sections on misreporting have been deleted from this summing up in light of subsequent decisions on misreporting (see pp. 64-66 and 158-62).