INTERNATIONAL MONETARY FUND

IMF POLICY PAPER

SAFEGUARDS ASSESSMENT—2017 UPDATE

October 2017

IMF staff regularly produces papers proposing new IMF policies, exploring options for reform, or reviewing existing IMF policies and operations. The following document has been released and is included in this package:

- The **Staff Report** on Safeguards Assessment—2017 Update, prepared by IMF staff and completed on October 6, 2017.

The staff report was issued to the Executive Board for information.

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SAFEGUARDS ASSESSMENTS—2017 UPDATE

October 6, 2017

EXECUTIVE SUMMARY

The volume of safeguards activity remained consistent with recent years. 21 assessments were completed during the update period (September 2015-April 2017) and five were in progress at the end of the period. Activity continues to average around 13 assessments per year. While the number of central banks under monitoring decreased slightly from 67 to 63, some monitoring cases required intense engagement due to safeguards challenges that emerged. These related to forensic investigations, governance reforms, and a deterioration in safeguards frameworks of central banks facing difficult external conditions.

Safeguards assessments during the period covered central banks with a relatively high risk profile. About half of the assessments were conducted at central banks of fragile states with weak capacity and included two first-time assessments, which typically show vulnerabilities against safeguards requirements for good governance and autonomy. Further, streamlining measures discontinued update assessments for some central banks with robust safeguards frameworks, which also impacted the overall risk ratings.

Assessment results highlight the challenges in strengthening institutions in a dynamic risk environment. Common threads that emerged from assessments were capacity needs amongst most developing country central banks, especially in the areas of governance, internal audit, and risk management, and the need for legal reforms to strengthen autonomy. However, making progress with legal and governance reforms typically requires time.

Following the 2015 safeguards policy review, staff have developed tools to refine the safeguards approach and introduce new policy requirements. To enhance emphasis on governance, a tool for a structured evaluation approach was implemented and work is in progress on a similar methodology to assess risk management at central banks. Staff increased interactions with ministries of finance to clarify safeguards recommendations on legal reforms and internal audit outreach has been intensified. The recommended streamlining of assessments and monitoring is now in place, and a framework for conducting fiscal safeguards reviews has been incorporated into operational modalities.

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INTRODUCTION

1. **Safeguards assessments evaluate the adequacy of a central bank's governance framework, focusing in particular on external audit, legal structure and autonomy, financial reporting, internal audit, and internal controls of countries borrowing from the Fund.** The main objective of the safeguards policy is to mitigate the risks of misuse of Fund resources and misreporting of program monetary data under Fund arrangements (see Annex I). The policy is subject to periodic Board reviews (every five years), with the most recent having been completed in October 2015.[1]

2. **The 2015 review confirmed the policy's effectiveness as part of the Fund's overall risk-management framework**. The approach to assessing the central banks' governance and control mechanisms was considered appropriate, but some enhancements to the existing modalities were recommended. These included a sharper focus on governance and broadening coverage of integrated risk management functions at central banks, as well increased outreach and engagement with stakeholders in some areas. The review also recognized that the safeguards process contributes to the strengthening of central banks' institutional frameworks.

3. **This paper is the first biennial update on safeguards activity since the 2015 policy review and covers the period from September 1, 2015 to April 30, 2017 (the period).**[2] Safeguards work involves two main activities: conduct of assessments and monitoring of developments at central banks for as long as Fund credit remains outstanding. Section I provides an overview of safeguards assessment and monitoring activities, and the main themes that emerged during the period. Section II discusses the progress in addressing the 2015 policy review recommendations. Section III describes outreach activities.

SAFEGUARDS ACTIVITY DURING THE PERIOD

A. Assessments

4. **The level of safeguards assessment activity in the period remained consistent with recent years.** On an annual basis, activity continues to average around 13 assessments per year (see Figure 1). During the period, a total of 21 assessments were completed and a further five were in progress at the end of the FY2017 (Annex II). These assessments included primarily update assessments and only two first-time assessments were conducted. In addition, limited safeguards procedures for two Flexible Credit Line (FCL) arrangements were performed.

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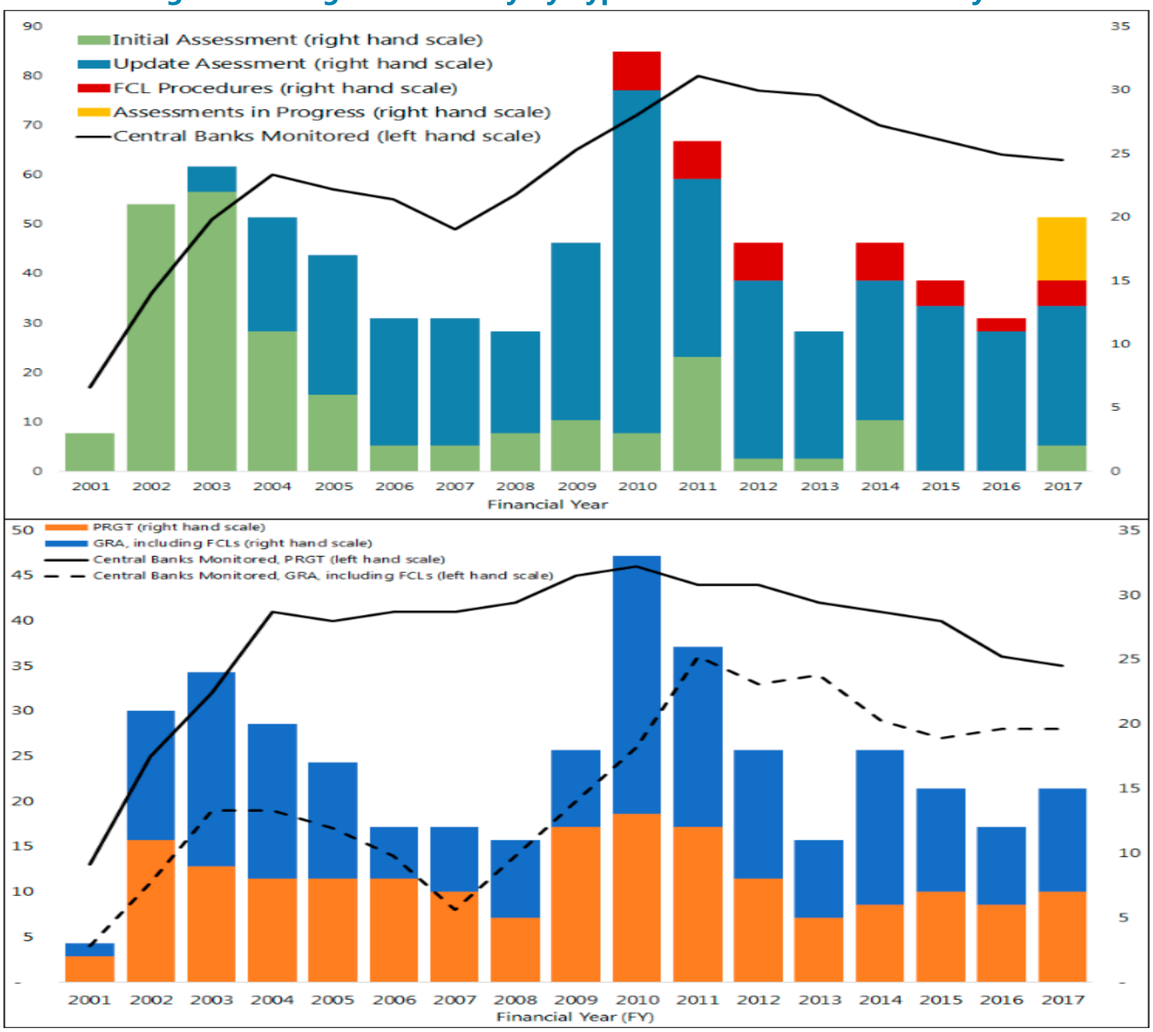
[1] See *Safeguards Assessments—Review of Experience* (2015). As with previous reviews, an external panel of experts provided an independent perspective on the implementation of the policy; see *Safeguards Assessments Policy—External Expert Panel's Advisory Report*.

[2] Safeguards activity reports were moved from an annual to a two-year cycle following the streamlining of the Fund's periodic reports and operational reviews introduced in 2015 (Decision No. 15765-(15/39)).

Uncertainty in the timing of reaching agreements on Fund-supported programs at times continues to affect the planning of assessments. Close engagement and communication with area departments has enabled timely completion of assessments, and all assessments except one were completed before the first review.[3]

5. **Fund lending activity continues to evolve towards longer term arrangements, with a greater use of the Extended Fund Facility (EFF) relative to Stand-By Arrangements.** During the period, EFFs accounted for two-thirds of the 12 new arrangements in the General Resources Account (GRA), compared with only one-third (ten) during the 2015 policy review period. This will extend the monitoring activity period. The overall volume of new financing arrangements has remained evenly weighted between Poverty Reduction and Growth Trust (PRGT) and the GRA.

Figure 1. Safeguards Activity by Type of Assessment and Facility

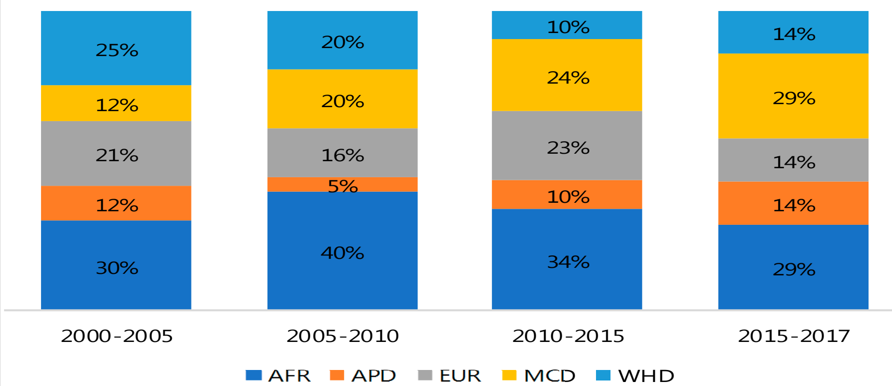


Source: FINSA database.

[3] The delay was caused by late formal response on the safeguards report from the authorities. However, the assessment was substantially complete at the time of the first review and a summary of findings was included in the staff report.

6. **The geographic distribution of assessments remains broadly comparable to previous periods** (see Figure 2). Africa (29 percent) and the Middle East and Central Asia regions (29 percent) accounted for the majority of the assessments completed in the period. The remaining assessments (nine) were evenly split amongst the other regions. Assessments completed included two first-time assessments, one in Western Hemisphere and one in the Asia and Pacific region.

Figure 2. Regional Distribution of Assessments



Source: FINSA database.

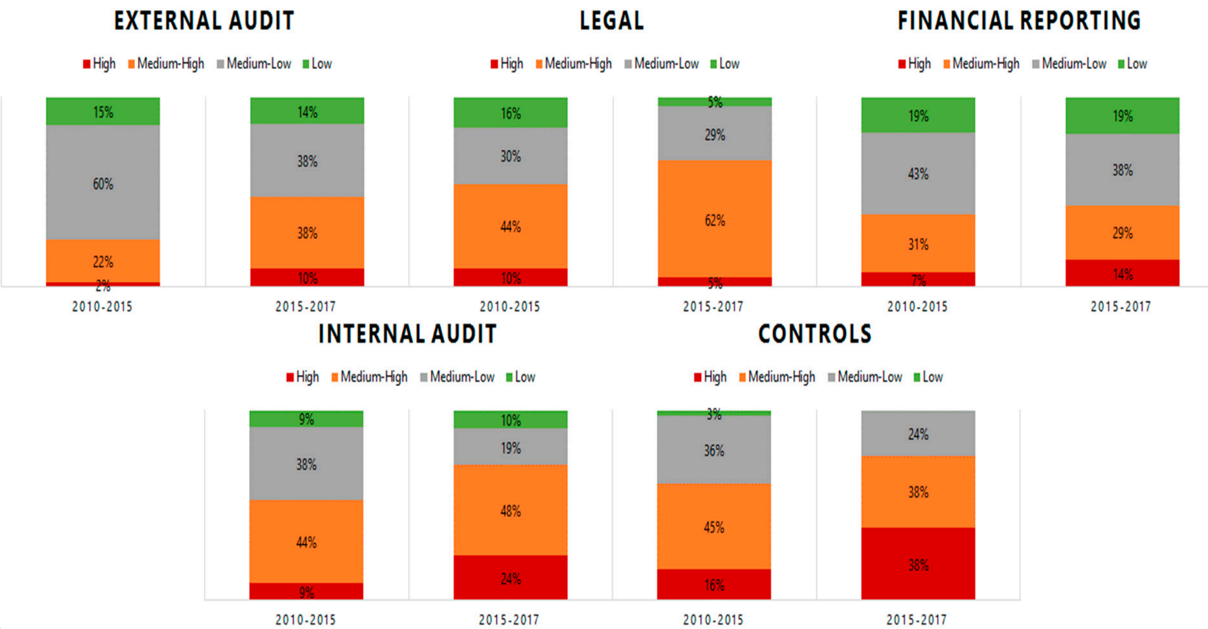
B. Safeguards Findings and Recommendations

7. **Assessments during the period covered banks with a relatively higher risk profile.**[4] The findings of safeguards assessments indicated increased vulnerabilities across all ELRIC pillars when compared to the 2010-2015 policy review period (see Figure 3). In contrast to assessments during the 2015 policy review period, the current period included a smaller share of banks from developed economies with stronger institutions. Of the 21 assessments completed, eight were at the central banks of fragile states with weak capacity.[5] In addition, there were two first-time assessments, which typically show vulnerabilities against safeguards requirements for autonomy, governance arrangements, and transparency. Further, the streamlining measures introduced following the 2015 policy review (see Section II) discontinued update assessments for central banks with a strong track record and generally robust safeguards frameworks to the extent the previous assessment was completed during the past four years.

[4] For a discussion on general trends in safeguards work since the policy's inception, i.e., March 2000, see *Safeguards Assessments—Review of Experience* (2015). It was noted that central banks continued to strengthen their institutional frameworks and progress was evident in greater transparency, improved external audits, and in some control areas. However, as operating environments evolve and standards for good governance and autonomy become more stringent, some banks lag behind.

[5] Fragile states are defined as those having either weak institutional capacity measured by the World Bank Country Policy and Institutional Assessment (CPIA) score (average of 3.2 or lower) and/or experience of conflict (signaled by presence of a peace-keeping or peace-building operation in the most recent three-year period).

Figure 3. Safeguards Findings and Risk Ratings Across the ELRIC Framework



Note: Safeguards assessments assign a rating to each ELRIC category. The four-level internal and confidential risk ratings are Low, Medium-Low, Medium-High, High.
Source: FINSA database.

8. **While the 2015 policy review recognized that central banks are making progress in strengthening their institutions, weaknesses persist in some areas and new vulnerabilities can arise in a dynamic control environment.** Building capacity, enhancing governance, and progressing legal reforms are all long-term endeavors. Key findings and risk drivers from assessments conducted during the update period are discussed below.

External audit

9. **While most central banks are subject to external audits in accordance with International Standards on Auditing (ISA), assessments during this period found elevated risks in several cases.** These primarily related to quality issues at audit firms and weaknesses in processes at central banks. Audit firm quality issues related to weak capacity resulting in non-adherence to ISA, and in one case (a first-time assessment) staff noted a lack of independence.[6] Weaknesses in internal policies and procedures supporting external audits showed insufficient follow-up on audit recommendations, and inadequate safeguards to sustain audit quality and independence (i.e., through audit selection and rotation policies).

[6] During the period, only about 50 percent of central banks assessed were audited by large international firms versus 70 percent in the population between April 2010 – August 2015. International affiliation provides audit firms with expertise and improves compliance with ISA.

Legal framework

10. **Strengthening central bank legislation continues to be a challenge due to the difficult process of enacting legal reforms.** The increased risk profile is partly due to the extended implementation period of previous safeguards recommendations and new evaluations of laws against more stringent good practices for central bank autonomy and governance. On the latter, gaps were particularly noticeable in first-time assessments.[7] Notwithstanding this, assessments noted successful implementation of legal reforms in three cases, where strengthening the law was part of structural program measures.

Financial reporting

11. **Central banks are making progress towards implementing International Financial Reporting Standards (IFRS), but challenges remain.** While 60 percent of the banks assessed during the period fully adopted IFRS, the remaining banks that are working towards implementation continue to face capacity challenges, particularly as the complexity of the standards increases. Poor timeliness of financial reporting was another key factor that affected the ratings. Nevertheless, virtually all central banks continue to publish their full financial statements, a trend observed during the 2015 policy review.

Internal audit

12. **Assessments continue to flag that internal audit functions need modernization.** While the risks faced by central banks continue to evolve, capacity building to address these risks lags behind. In particular, internal audit functions have generally not taken steps to address increasing IT risks (e.g., cybersecurity) by including them in audit plans or shoring up skills to audit these areas.[8] Some assessments also raised concerns regarding internal audit independence, where functions were involved in operational activities and/or had insufficient reporting lines.

Governance and oversight

13. **The effectiveness of governance bodies is undermined by both inadequate arrangements and capacity.** Vulnerabilities noted included: (i) conflict of interest or independence issues; (ii) insufficient expertise among audit committee members; and (iii) audit committee mandates that lacked coverage of important areas. Five banks did not have an audit committee, due to omissions in the governance structures established by the legal framework

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[7] In recent years, best practices for central bank legal frameworks have evolved towards greater autonomy requirements (financial, personal, and institutional) and commensurately strong oversight.

[8] When conducting assessments, staff review the general IT controls that affect the main operations and inquire about key safeguards in this area through discussion with the external and internal auditors on the audit mechanisms and operational risk management practices.

(see above). Importantly, in cases where central banks showed an improvement in the risk profile, this was typically led by legal and governance oversight reforms.

Reserves management

14. **In the continued low-return environment, assessments found increased credit and concentration risks in investment practices.** Central banks with overall capacity constraints not surprisingly faced issues with proper segregation of duties. On the other hand, some banks that did not have capacity issues at the operational level required stronger oversight of investment activities.

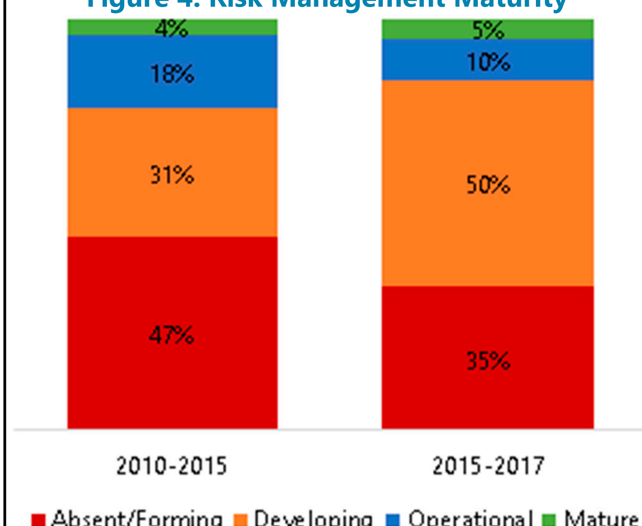
Program monetary data

15. **Deficiencies noted in the compilation of program monetary data were primarily linked to the overall weak capacity and internal audit quality concerns.** In three assessments, the overall control environment was so weak that it was recommended to have program monetary data externally verified.

Risk management

16. **Risk management at many central banks is a work in progress.** Safeguards assessments have shown that most central banks have dedicated structures to monitor financial risks (e.g., credit, market, liquidity). However, the management of other risks such as operational, reputational, and strategic risks, continues to be underdeveloped. Nevertheless, central banks have made progress in establishing an enterprise risk management (ERM) framework (see Figure 4). Hence, similar to the governance area above, the evaluation is shifting from reviewing the existence of basic risk management structures to assessing their effectiveness, including their role in protecting Fund resources and mitigating the risk of misreporting.

Figure 4. Risk Management Maturity



Source: FINSA database.

17. **Safeguards recommendations are often implemented with delays, particularly in cases where programs are off-track or expired.** Measures intended to address significant vulnerabilities are often included as program conditionality and commitments. In the period, these primarily related to the need for legal reforms, financial statement transparency, financial autonomy, as well as assurances on program monetary data. While the overall cumulative implementation rate for recommendations remains satisfactory and comparable to the previous periods, staff noted a slower implementation pace for recommendations made during the current period (see Table 1). There are two main reasons for this. First, in nine cases a Fund program did not follow the initial disbursement (i.e., under the Rapid Credit Facility) or it went off-track. This usually slows developments in safeguards areas. In contrast, countries that had an active program showed better progress with a 78 percent implementation rate through end-FY2017. Second, some recommendations may take longer to implement than originally envisaged. The delays are often experienced by central banks with low capacity or where recommendations are of a structural nature, such as strengthening the central bank law and/or improving governance structures.[9]

18. **Safeguards staff continue to collaborate with counterparts in LEG and MCM on TA needs to advance the implementation of recommendations.** In particular, LEG engages with the authorities on legal reforms recommended by safeguards assessments. MCM continues its TA activities in the areas of relevance to safeguards, including central bank governance structures, risk management, reserves management, recapitalization, and financial reporting practices.

Table 1. Implementation of Safeguards Recommendations

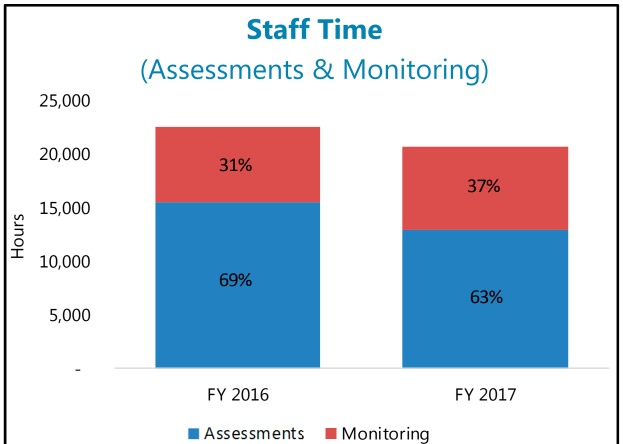
	September 2000 to April 2017		September 2015 to April 2017	
	Recommendations	Implementation Rate (percentage)	Recommendations	Implementation Rate (percentage)
1. Program Commitments	268		23	
Of which: Implemented	253	94	13	57
2. Other recommendations	1366		169	
Of which: Implemented	1238	91	85	50
3. Total recommendations (1+2)	1634		192	
Of which: Implemented	1491	91	98	51
4. Recommendations not yet due	95		34	

Source : FINSA database.

[9] As of end-September 2017, the implementation rate has improved by 4 percent to 55 percent.

C. Monitoring

19. **Monitoring activity fluctuates in line with the dynamic risk profiles of central banks.** There was a slight decrease in the number of central banks under monitoring, from 67 to 63, following repayments and repurchases of outstanding credit. As discussed in Section II, about nine central banks were reclassified to limited monitoring under the streamlining procedures recommended by the 2015 policy review. Total time spent on assessments and monitoring decreased in FY2017 (partly reflecting the streamlining initiatives), but the proportion of monitoring time was elevated. This is primarily due to more intense follow-up from staff, stemming from slow progress at central banks in implementing recommendations and challenging individual cases that emerged during the period.



Source: Staff estimates

20. **Some monitoring cases required intense engagement.** Safeguards staff conducted five monitoring missions in the review period and collaborated with other stakeholders on individual cases that presented safeguards challenges. These challenges stemmed from:

- **Governance matters.** Staff continued to be involved in one long-term case concerning a comprehensive governance reform. Close engagement with the authorities, and other departments within the Fund, through a multi-stage legal technical assistance program resulted in important changes to the central bank's Charter being endorsed in support of governance reforms. Staff were also engaged in two ad-hoc cases where conflict-of-interest issues emerged in the decision-making bodies. In one case, staff's early engagement on the needed legal reforms following a banking crisis helped address governance gaps before subsequent program approval.

- **Forensic investigations.** In one case, concerns about the use of resources by a central bank for liquidity lending to a failed bank led to a recommendation for a forensic audit. Staff was involved in reviewing audit independence and quality, and work continues on the audit results and remedial measures. Safeguards staff also assisted area departments and provided input on terms of reference for forensic audits in the areas not directly related to central banks (i.e., fiscal and external debt).

- **Deterioration in the safeguards framework.** Four central banks emerging from difficult external conditions, such as the Ebola crisis or political turmoil, experienced a worsening of their governance and control environments. In some other cases, staff also observed compromised audit quality and/or increased risks in reserves management practices. Monitoring missions were conducted to evaluate the developments and safeguards staff worked with area departments on the remedial measures.

D. Misreporting

21. **A primary objective of the safeguards assessments policy is to evaluate the risks of misreporting monetary program data to the Fund.** Similar to the period under the 2015 policy review, there were no cases of misreporting of program monetary data during the current period.[10] As part of the assessments, staff reviews the data compilation process and the reconciliation of key monetary data with information in the accounting records or the audited financial statements of the central bank. This ex-ante work has in some cases uncovered issues early on, that if unresolved could have led to misreporting. As with the prior review periods, assessments continue to identify issues with program definitions and the need to strengthen the compilation procedures. Key recurring themes were as follows:

- *TMU definitions*. In fourteen cases staff found that the generic definitions were not tailored and did not capture all elements of the central bank's financial position. Examples included the treatment of non-convertible currencies and poor quality assets in the calculation of Net International Reserves (NIR).

- *Non-regular financial instruments*. Assessments found more central banks engaging in currency swaps, both with domestic banks and with other central banks, which in some cases followed inconsistent accounting treatments (i.e., derivative or loan). Staff engaged in discussions on the nature of these transactions to ensure the appropriate recognition for program NIR purposes. Other issues included the treatment of certain claims on the government in the net credit to government data.

- *Off-balance sheet items*. Staff encountered instances where off-balance sheet commitments were not taken into account when compiling program monetary data. This related primarily to guarantees issued on behalf of the government.

- *Program data compilation controls*. Staff continues to identify weaknesses, especially in new arrangements where previous programs expired several years earlier. Key drivers include lack of internal coordination, ownership, poor quality of accounting records, and division of responsibilities within the central bank. Further, verification procedures can be undermined by capacity constraints in internal audit functions.

[10] Misreporting cases reviewed by the Executive Board during the period related mainly to breaches of program requirements on external arrears, external debt, and non-concessional finance.

22. **Mitigating the risk of misreporting requires close collaboration with central banks and area departments.** Staff engages in inter-departmental consultations on the treatment of complex items as soon as safeguards work reveals potential issues. In cases where additional assurances are needed, staff's recommendations included: (i) reviews of monetary data compilation procedures by external or internal auditors at test dates; (ii) the establishment of documented procedures for the compilation of monetary data; and (iii) clarification of program definitions related to the treatment of certain types of assets and liabilities.

FOLLOW UP TO THE 2015 POLICY REVIEW

23. **The majority of the 2015 policy review recommendations have been operationalized** (see Box 1). As discussed in more detail below, to strengthen the emphasis on governance, staff developed and adopted a tool to support a structured evaluation approach. Work remains in progress on a similar tool for risk management. Further, when deemed necessary, staff has increased its interactions with ministries of finance to clarify safeguards recommendations on legal reforms. The recommended streamlining of assessments and monitoring is now in place and a framework for conducting fiscal safeguards reviews has been incorporated into staff's modalities, including the Operational Guidelines for Safeguards Assessments.[11] Internal audit outreach is an ongoing initiative and has been intensified, including through a governance event and a revamp of materials used in regional safeguards seminars (see Section III).

Streamlining of Safeguards Activities[12]

24. **The streamlining of the policy requirement for update assessments resulted in six fewer assessments being conducted.** Update assessments are no longer required for augmentations, for certain successor arrangements, or for central banks with a strong track record (see Annex I). When compared to the total number of assessments that would have been performed under the previous policy framework (27 assessments) this represents a saving of about 22 percent.

[11] Operational Guidelines are an internal Fund document that outlines the policy requirements and operational aspects of safeguards work, including interdepartmental coordination and the procedures for disseminating safeguards findings. The Guidelines were updated in March 2017 to reflect the fiscal safeguards framework, streamlining measures and the changes to the policy applicability.

[12] The streamlining of safeguards activity has facilitated a reduction in staff complement. As envisaged in the policy review, safeguards staff was reduced by two positions. As of end-April 2017, the division consisted of 14 FTEs, previously 16 FTEs, comprising division management (Division Chief and a deputy), nine professionals, two staff assistants, and one research assistant.

25. **Safeguards monitoring is conducted to mitigate the risk of misreporting of program monetary data for the duration of the program, and misuse of Fund resources for as long as credit is outstanding.** The existing risk-based monitoring framework was modified to follow post-program monitoring (PPM) practices as part of the streamlining measures. Once a member country is no longer subject to PPM, monitoring procedures are limited to a review of annual external audit results, i.e., the financial statements and management letters, and follow-up of priority safeguards recommendations. As of end-April 2017, nine of the 63 central banks (about 14 percent) were subject to limited monitoring procedures. This has allowed staff to shift and focus the limited resources on higher risk cases (see Section I).

Box 1. 2015 Safeguards Policy Review – Conclusions and Recommendations

The 2015 safeguards policy review endorsed the policy as an integral part of the overall risk management framework of the Fund. It confirmed the policy's effectiveness in helping to mitigate the risks of misreporting, and in maintaining the Fund's reputation as a prudent lender. In addition, the Executive Board recognized that safeguards assessments have helped central banks strengthen their audit, control, and transparency practices, and the external panel of experts noted the improvements in the central banks' safeguards frameworks and progress toward adopting international standards as important collateral benefits of the safeguards policy.

The overall approach to conducting the assessments and monitoring of central banks' governance and control systems was found to be appropriate and flexible, but some refinements were proposed to reflect the evolving nature of safeguards risks. It particular, the approach should provide for a sharper focus on governance as an overarching principle of the safeguards framework and broader coverage of integrated risk management tailored to each central bank's capacity. Staff was also encouraged to engage with key domestic stakeholders, if deemed necessary, to advance reforms to central bank legislation. Further, in view of the challenges observed in internal audit functions, increased outreach in this area was also recommended.

New elements were incorporated in the safeguards policy. The policy review introduced some streamlining measures for conducting assessments and monitoring activities (see Annex I) and a requirement for fiscal safeguards reviews. Such reviews follow a risk-based approach and apply to cases where a member requests exceptional access to Fund resources and there is an expectation that a substantial portion of the resources (at least 25 percent) will be directed towards financing the state budget.

Enhancements to the Safeguards Framework

Governance

26. **Staff developed internal guidance to facilitate a structured approach to the assessment of governance arrangements.**[13] Staff recognizes that there is no uniform standard for good governance applicable to central banks.[14] Further, political and legal environments and capacity constraints may present difficulties in adopting best practice solutions from leading central banks. Staff was mindful of these challenges and the work on an internal guidance tool for assessments was anchored in a common set of principles and attributes of good governance. These were used to develop questionnaires for evaluation of decision-making and oversight bodies. Such bodies include central bank boards, as well as audit, risk, and investment committees. The tool is used to evaluate mandates, autonomy, composition, operational modalities, and oversight responsibilities of these bodies. Staff also inquire about performance reviews for such bodies, including through self-assessments.

27. **Evaluation of governance has featured in safeguards assessments since their inception, but the approach has evolved from determining existence of the relevant oversight bodies to assessing their effectiveness.** For example, at the inception of the policy, i.e., 2000-2005, most safeguards recommendations called for the establishment of an audit committee. Currently, about 70 percent of banks assessed have an audit committee. Accordingly, the assessments evaluate the effectiveness of such oversight bodies and the above tool supports a consistent methodology.

Risk Management

28. **A phased approach to broadening coverage of risk management frameworks at central banks has been adopted.** As risk management is a relatively new function at many central banks, the first step was to agree on the common elements of an ERM framework to be covered during assessments. The second step was to provide staff with high-level guidance on assessing the maturity level of risk management practices.[15] The last step, which is expected to be completed by end FY2018, is the development of a tool to assess risk management practices in order to make tailored safeguards recommendations.

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[13] In the safeguards context, governance refers to "institutional" as opposed to "policy" governance; the focus is on decision-making bodies and the checks and balances on such bodies.

[14] However, an emerging leading practice is for central banks to move towards collegial decision-making in their governing structures.

[15] Maturity levels are based on assertions of completeness, adequacy, effectiveness and consistency in application of the key components of an integrated framework and are tied to the complexity and riskiness of central bank operations.

Monitoring Framework

29. **The monitoring framework has been reviewed and updated to incorporate streamlining and additional steps in key areas.** The framework continues to be risk-based and classifies central banks into four monitoring intensity categories, i.e., low, medium-low, medium-high, and high. These categories provide for varying levels of engagement depending on the risk profile of the central bank.[16] A new monitoring intensity classification, namely, limited monitoring, was introduced to operationalize the streamlining measures discussed above. For other intensity categories, staff added steps to identify governance developments in a timely way, for example, through periodic communication with audit committees and/or internal audit functions. Further, to gain additional assurance on program monetary data, new steps were added for higher intensity cases. These include continuous monitoring of the adequacy of controls in this area (e.g., through review of periodic internal/external audit reports on data verification).

Broader Engagement on Legal Reforms

30. **Legal reforms are often included in safeguards recommendations and staff increased interactions with key domestic stakeholders, when necessary.** Legal changes normally require the involvement of the ministry of finance and parliamentary approval before amendments can take effect. This can make the process lengthy and sometimes contentious, with different stakeholders having conflicting objectives. Where the need for fundamental legal amendments was identified, staff met with the ministry of finance, with the Governor's consent, to inform them of the background for, and objectives of, the recommended changes to the legal framework. Given that vulnerabilities in central bank legislation relating to autonomy, governance, and oversight practices expose the Fund to increased risks, safeguards recommendations in this regard are often included as part of program measures (nine programs in the period). This is done in close consultation with LEG, who also provide TA on central bank legal frameworks. In such cases, LEG uses the safeguards recommendations as a starting point for its TA.

Fiscal Safeguards

31. **None of the new arrangements during the period met the requirements for a fiscal safeguards review.** Of the 26 new arrangements (excluding FCLs) approved, none constituted

[16] See *Safeguards Assessments—Review of Experience* (2010) for a description of the monitoring framework. For example, for low intensity central banks, monitoring procedures include a review of annual audit results and follow-up on recommendations. Engagement with the authorities and external auditors is on an as-needed basis. In contrast, for high intensity central banks procedures are expanded to require mandatory communications with the central bank and the external auditors, and monitoring missions when necessary.

exceptional access.[17] In addition, the number of budget financing cases decreased since its peak in 2011 (nine cases) to four in the period under review.[18]

32. **The risk-based framework for conducting the fiscal safeguards reviews has been incorporated into the Operational Guidelines**. This reflects the modalities agreed during the 2015 policy review that provide for a high-level evaluation of state treasuries based on existing diagnostics and experience from technical assistance (TA) activities; dedicated missions are envisaged only where such information is not available.[19]

OUTREACH AND INFORMATION SHARING

A. Collaboration with Stakeholders

33. **Staff continued its collaboration with key stakeholders in the central banking community.** Key activities include the regional safeguards seminars, held two-three times a year, and a periodic high-level forum on central bank governance issues. These events provided an opportunity to elevate awareness of good practices in internal auditing at central banks, in line with the 2015 policy review recommendation to increase outreach on internal audit issues.

34. **A third high-level forum for central banks and their external auditors on aspects of governance was held in Dubai.** The two-day event, organized in partnership with the Hawkamah Institute for Corporate Governance, brought together over 90 central bankers and their external auditors from over 49 countries.[20,21] The forum focused on a review of key governance bodies, i.e., central bank boards and audit committees, including their independence, expertise and efficacy in ensuring appropriate "checks and balances". A key objective of the Forum was to explore how central banks are adapting their governance structures and institutional arrangements to provide for greater autonomy and independent oversight of operations. The forum highlighted diverse approaches and different milestones among central

[17] Exceptional access cases peaked in the period from 2010-2012 (three-four per year). In the period under review, one case was under exceptional access; however, it reverted to access within the normal limits once the member's quota increase became effective in 2016.

[18] While fiscal reviews were not required during the period based on the thresholds established by the policy, members were requested to ensure compliance with other safeguards requirements; namely, that (i) the Fund resources be maintained at the central bank pending their use for budget financing; and (ii) the government and the central bank clarify their roles and responsibilities for timely servicing of financial obligations to the Fund in a framework agreement, such as a Memorandum of Understanding.

[19] Relevant diagnostics evaluations include the Public Expenditure and Accountability Framework (PEFA) and Fiscal Transparency Evaluations (launched in 2014).

[20] Hawkamah, a nonprofit organization established in 2006 to promote corporate governance in the Middle East region, is based in Dubai, United Arab Emirates. Hawkamah hosted the event and provided logistical planning and support for the forum.

[21] The audience included eight Governors and Deputy Governors, and 16 board and audit committee members.

banks in strengthening oversight and enablers of good governance, such as internal audit and risk management.

35. **Regional safeguards seminars continue to provide a channel for sharing safeguards experience on topical issues affecting central banks.** Four seminars on safeguards assessments were held during the update period in Kuwait, Austria, South Africa, and Singapore.[22] The seminars provide an opportunity for senior central bank officials to share their experiences and establish contacts with counterparts facing similar issues. External speakers in Kuwait (from the Hawkamah Institute) and Vienna (from De Nederlansche Bank N.V) provided practical insights on governance and internal audit, respectively. In the wake of recent cyberattacks, the South African Reserve Bank and the Monetary Authority of Singapore discussed approaches to combatting cyber threats at the Pretoria and Singapore seminars, respectively.

36. **Seminar material was revamped to reflect current safeguards issues and to incorporate the 2015 policy review proposal for enhanced outreach on internal audit.** Presentations and case studies now include a discussion on autonomy and governance reforms, and the implications of fiscal dominance and the issuing of guarantees. New internal audit case studies were introduced to (i) demonstrate the role of internal audit in providing assurances on the veracity of monetary program data; and (ii) emphasize audit committees' responsibilities to support capacity building and oversee the work of internal audit.

37. **Other outreach activities focused primarily on internal audit matters and interactions with standard-setters.** Staff participated in a course on Operational Risk Management and Internal Audit hosted by FED New York (May 2016) and contributed to a global conference hosted by the Central Bank of Armenia in collaboration with the Institute of Internal Auditors (September 2016). Both events provided a further opportunity to share safeguards experience and enhance peer exchange in these specialized areas. Other initiatives included engagement with the International Public Sector Accounting Standards Board on its consultation paper for accounting treatment of certain financial instruments by central banks, and informal interactions with the International Auditing and Assurance Standards Board on new audit standards and audit quality issues.

B. Reporting to the Board and Sharing of Safeguards Reports

38. **Safeguards reports are confidential, and the Executive Board is informed about safeguards matters mainly through country staff reports.** In response to the 2015 policy review recommendation, safeguards related paragraphs are now placed in the main body of these reports. This applies to cases under safeguards monitoring (i.e., with credit outstanding or current arrangements) and the discussion covers recommendations on legislative amendments, problems in obtaining access to data, and deviations from commitments relating to safeguards recommendations. In four cases, this enhanced disclosure has helped gain traction and improved

[22] A total of 112 participants representing over 80 central banks attended the safeguards seminars.

progress with implementing recommendations as well as the timeliness of monitoring information.

39. **In accordance with the Executive Board decision, safeguards reports can be shared with the World Bank and the European Central Bank (ECB).**[23] In addition, confidential briefings may be provided to the donors. In all instances, staff seeks prior consent from the central bank. In the period under review, 17 reports were shared with the World Bank for their fiduciary assessments related to development policy lending. There were no requests (nor recent assessments) on the national banks from the European System of Central Banks (ESCB).

[23] Given the confidential nature of the assessments, reports may be shared with the authorized international agencies subject to conditions that provide for reciprocity, assurances on confidentiality, and consent of the central bank in question. To date, the Board has authorized the sharing of the reports with the World Bank and the ECB. The latter concerns the national central banks in the ESCB where the member state received financial assistance jointly from the European Union and the Fund.

Annex I. Safeguards Assessment Policy and Applicability

Framework and Modalities

1. **The safeguards assessments policy applies to central banks of member countries seeking financing from the Fund.** Safeguards assessments cover five key areas of governance and control within a central bank, namely: the external audit; legal structure and autonomy; financial reporting; internal audit; and control mechanisms, collectively referred to as the ELRIC framework. A cornerstone of the policy is that central banks of member countries that borrow from the Fund should publish annual financial statements that have been independently audited by external auditors in accordance with International Standards on Auditing. The assessments are conducted independently from program discussions, and although the safeguards recommendations may lead to technical assistance to implement remedial measures, safeguards work remains separate from such activities to maintain the independence of the safeguards function.

2. **The policy requires safeguards assessments to be completed no later than the first review of an arrangement.** Assessments involve a diagnostic review of a central bank's safeguards, by analyzing information provided by the bank and its external auditors using the ELRIC framework. This review is documented in a safeguards report that includes a snapshot of governance and control practices at the central bank, identifies vulnerabilities across the ELRIC areas, and proposes recommendations to address them. Recommendations to address critical safeguards vulnerabilities may also be included in program measures.

3. **All members subject to safeguards assessments continue to be monitored under the safeguards assessments policy for as long as they have credit outstanding to the Fund.**

Applicability

4. **The safeguards assessments policy applies to members seeking financial arrangements with the IMF.** Accordingly, assessments are required for the following arrangements: (i) Stand-By; (ii) Extended Fund Facility; (iii) Extended Credit Facility; (iv) Standby Credit Facility; and the (v) 1-2 year Precautionary and Liquidity Line (PLL). A member requesting a Flexible Credit Line (FCL) arrangement is subject to limited safeguards procedures owing to the rigorous requirements that must be met to qualify for the FCL. The policy applies to new and certain successor arrangements (see below), and arrangements treated as precautionary. Safeguards assessment requirements also apply to disbursements involving liquidity and emergency assistance under the Rapid Credit Facility (RCF), Rapid Financing Instrument (RFI), and a 6-month PLL. A member following a Rights Accumulation Program (RAP), where resources are being committed but no arrangement is in place, would also be subject to an assessment. Safeguards assessments do not apply to financing extended through first credit tranche purchases.

5. **For members of currency unions with no autonomous national central banks, a periodic assessment cycle was established where the assessments are updated every four years.**

6. **Voluntary assessments are encouraged for members that have a Policy Support Instrument or Policy Consultation Instrument in place, or those that are implementing a Staff Monitored Program.**

7. **Based on the streamlining measures introduced in 2015, update assessments are normally not required for:** (i) augmentations of existing arrangements; (ii) successor arrangements where an assessment was completed no more than 18 months prior to the approval of the successor arrangement; or (iii) central banks with a documented strong track record where the previous assessment was completed within the past four years and no substantial issues were identified in the prior assessment or subsequent monitoring.[1]

[1] A central bank is considered to have a strong track record if: (i) recommendations from the previous safeguards assessment have been implemented; (ii) the previous assessment did not identify any substantial issues (i.e., the risk assessment for each of the ELRIC pillars was either low or medium-low); (iii) no substantial political or governance changes, such as overhaul of central bank management, have taken place; and (iv) monitoring activities since the previous assessment have not uncovered any significant adverse developments at the central bank.

Annex II. Assessments Completed During and in Progress at Fiscal Year-End[1]

1. **During the period under review, 21 assessments were completed.** This comprises eight assessments conducted in FY2016 (ECCB, Haiti, Iraq, Kosovo, Kyrgyz Rep., Liberia, Nepal, and Sao Tome and Principe), and 13 assessments completed in FY2017 and listed below. All five assessments in progress at end-FY2017 were subsequently finalized.

Type of Activity	Assessments Completed	Assessments in Progress	Total
First Time Assessments	Suriname Vanuatu		2
Update Assessments	Afghanistan Bosnia & Herzegovina Egypt Guinea Jordan Sri Lanka Moldova Madagascar Mozambique Rwanda Tunisia	Ecuador Jamaica Mongolia Sierra Leone BEAC	16
FY2017	13	5	18
FY2016	11	6	17
FY2015	13	6	19
FY2014	15	6	21
FY2013	11	12	23
FY2012	15	11	26
FY2011	23	9	32

[1] A list of assessments completed since March 2000 (i.e., the policy inception) is available on the Fund's extranet (http://www.imf.org/external/np/tre/safegrds/complete/index.aspx).