IMF POLICY PAPER

SAFEGUARDS ASSESSMENT—2019 UPDATE

December 2019

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—2019 Update, prepared by IMF staff and completed on December 4, 2019.

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

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

Electronic copies of IMF Policy Papers
are available to the public from
https://www.imf.org/en/data/imf-finances#sa

International Monetary Fund
Washington, D.C.

INTERNATIONAL MONETARY FUND

SAFEGUARDS ASSESSMENTS—2019 UPDATE

December 4, 2019

EXECUTIVE SUMMARY

Safeguards assessments activity was slightly lower in the past two years than in the 2015–2017 period. 15 assessments were completed during the period May 2017 to April 2019 and a further six were in progress at end-April 2019. This is lower than the 21 assessments completed and five in progress during the previous period from September 2015 to April 2017. This primarily reflects the decrease in new Fund programs with 19 arrangements approved in the current period compared to 24 arrangements in the previous period.

In contrast, monitoring activity intensified during the current period. Monitoring of safeguards developments at central banks is conducted until Fund credit is fully repaid. Although the number of central banks subject to monitoring remained unchanged at just over 60 central banks, there was an increase in safeguards monitoring missions to central banks to follow up on emerging or persistent vulnerabilities. Seven missions were conducted during the current period, compared to three in the previous one.

The risk profile of central banks assessed during the period was relatively high. While external audit has maintained a positive trend with steady improvements at central banks, challenges remain in the other four safeguards pillars, namely, the legal structure and autonomy, financial reporting, internal audit and the system of internal controls. A contributing factor was that more than a quarter of the assessments were either a first-time engagement or an update where the previous engagement was about a decade ago. Experience in such cases is that risk ratings are typically higher owing to the limited exposure with staff on safeguards issues.

There were no cases of misreporting of monetary program data during the current period. Misreporting cases reviewed by the Executive Board during the current period related mainly to breaches of program requirements on external arrears. The ex-ante nature of the assessments continues to proactively identify issues on monetary program data with regard to clarifying definitions and strengthening the compilation procedures.

Safeguards work continues to evolve in line with experience and other developments. Following the 2015 safeguards policy review, assessments have been adapted to provide for closer evaluation of governance arrangements and more comprehensive coverage of risk management functions at central banks. On the latter, consideration is also being given to risks emerging from Fintech initiatives and cybersecurity. In addition, the first-ever fiscal safeguards review was conducted during the period, and safeguards staff has been involved in the Fund's recently adopted framework for enhanced engagement on governance to help assess central bank vulnerabilities.

Approved By
Andrew Tweedie (FIN)

Prepared by George Kabwe, Elie Chamoun, Riaan van Greuning, Mowele Mohlala, and Júlia Cardoso (all FIN).

CONTENTS

INTRODUCTION

1. **Safeguards assessments are a key pillar of the risk management arrangements for IMF lending**. Safeguards assessments aim to mitigate the risks of misuse of Fund resources and misreporting of program monetary data under Fund arrangements (see Annex I for an overview of the safeguards policy). Safeguards assessment reports are confidential and therefore the IMF Executive Board is provided with a periodic report on safeguards activities on a biennial basis, in addition to high-level summaries in member country staff reports on key findings and recommendations.

2. **This update on safeguards activity covers the period May 2017 to end-April 2019 (the period)**. Safeguards assessment work has traditionally involved two main activities: the conduct of assessments following Board approval of a Fund lending arrangement[1]; and monitoring of subsequent developments at central banks for as long as Fund credit remains outstanding. In recent years, outreach activities to help build awareness in safeguards areas where capacity challenges persist have been more prevalent in staff's work, and conducted jointly with other departments in some cases. In addition, with the introduction of the 2018 IMF framework on enhanced engagement with member countries on governance and corruption, staff has seen growing demand to cover central bank governance in this context.

SAFEGUARDS ACTIVITY DURING THE PERIOD

A. Assessments and Monitoring Visits

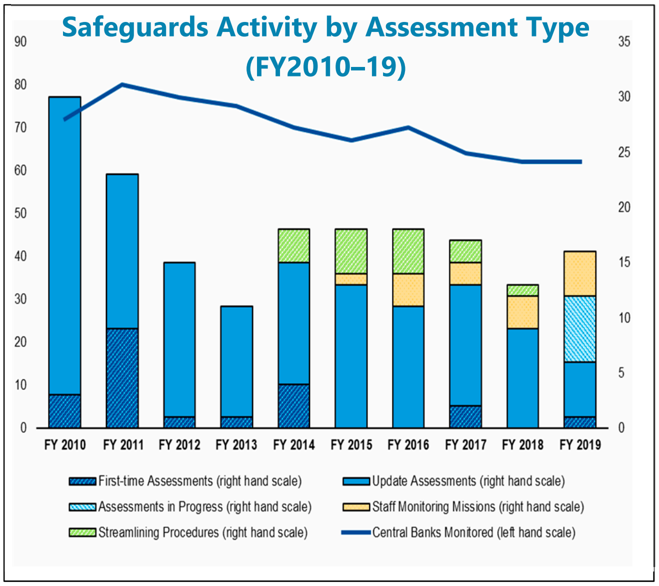
3. **Safeguards assessments activity in the period was slightly lower than in the previous period**.[2] 15 assessments were completed and a further six were in progress at end-April 2019. This is lower than the 21 assessments completed and five in progress during the previous period and primarily reflects the Fund's lending activity which saw a similar decrease in new Fund programs.[3]

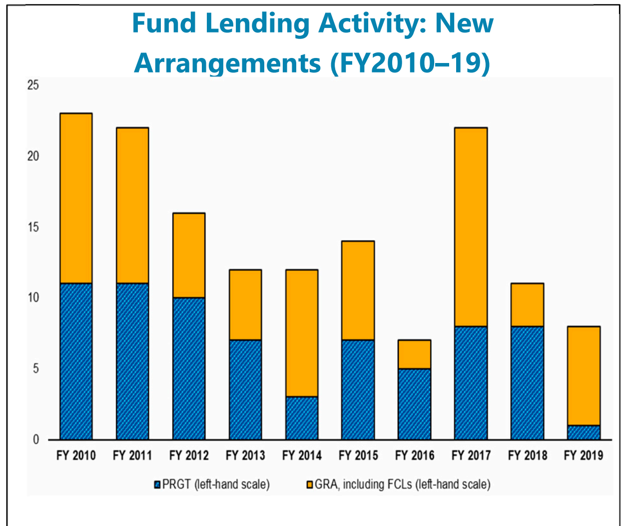
[1] Assessments are also conducted for emergency disbursements under the Rapid Credit Facility (RCF) or the Rapid Financing Instrument (RFI).

[2] The current update period (May 2017 – April 2019) differs from the 2017 update period (September 2015 – April 2017) as the latter was aligned to the 2015 safeguards policy review.

[3] 19 arrangements were approved (10 GRA and nine PRGT) in the current period. In the prior period, 24 arrangements were approved (14 GRA and 10 PRGT). In each of the periods, the approvals included five arrangements for countries that are part of regional central banks. In addition, limited safeguards procedures were performed for two Flexible Credit Line (FCL) arrangements in each of the periods. For member countries with no autonomous national central bank, a periodic assessment of the regional central bank is conducted every four years.

Another relevant factor is the streamlining measures introduced at the 2015 review of the safeguards policy, which resulted in two assessments not being conducted in the period.[4,5]

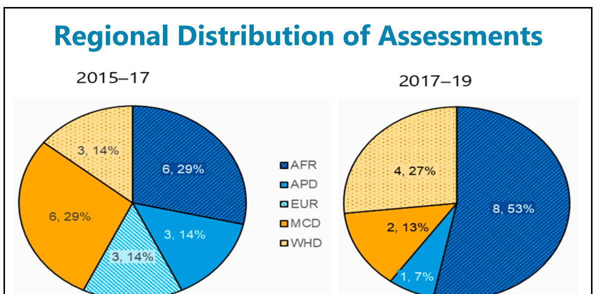




Source: FINSA database

4. **In contrast, monitoring activity intensified during the period.** While the number of central banks under monitoring remained broadly unchanged at 62 at end-April 2019 (63 at end-April 2017), there was an increase in safeguards monitoring missions to central banks. Seven missions were conducted during the period, compared to three in the prior period. This increase in monitoring activity reflects staff's identification of safeguards developments that necessitated closer engagement and follow up with country authorities to ensure that appropriate remedial measures were being taken to properly address emerging vulnerabilities (see Section B).

5. **More than half of the safeguards assessments in the period were conducted in the Africa region.** Africa and the Western Hemisphere regions saw the largest increases in assessments during the current period. No safeguards assessments were conducted in Europe during this period, as there were no new arrangements in the region. The Middle East and Asia regions saw decreased activity, reflecting the Fund's lending activity.



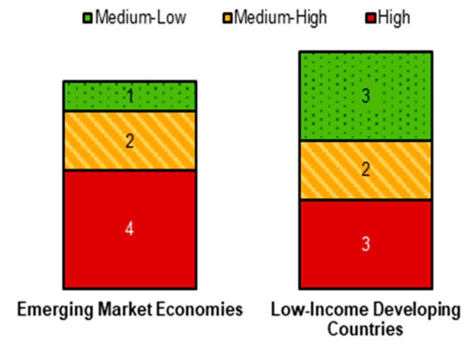
Source: FINSA database.

[4] The streamlining measures discontinued assessments for program augmentations, successor arrangements approved within18 months from the last safeguards assessment, and central banks with a strong track record if the previous assessment was completed within four years of a new program approval for the member country.

[5] One for an augmentation and the second for a successor arrangement within 18 months. In the previous update period, six assessments were not conducted for three augmentations, two successor arrangements, and a central bank with a strong track record.

6. **Member countries assessed during the period were all emerging market and low-income countries.** Eight of the 15 assessments were in low-income countries, and the remaining countries are emerging market economies. There were no significant differences in safeguards risk ratings between the two categories. Almost half had a high-risk rating, while the remaining eight were split evenly between medium-high and medium-low. The lack of capacity, and sub-optimal governance arrangements at central banks were the most frequent drivers of risks identified by the safeguards assessments (see Section C).

Risk Ratings Across Emerging Markets and Low-Income Developing Countries



Source: FINSA database

B. Monitoring Activity

7. **Monitoring missions are tailored to country-specific circumstances and take place when significant safeguards issues remain unresolved, or new risks are identified.** In particular, consideration is given to key factors such as deteriorating changes in the central bank's safeguards framework, emergence of governance issues, and slow implementation of safeguards recommendations. Furthermore, staff's monitoring activity is a key input for update assessments and helps to add depth to the safeguards process.

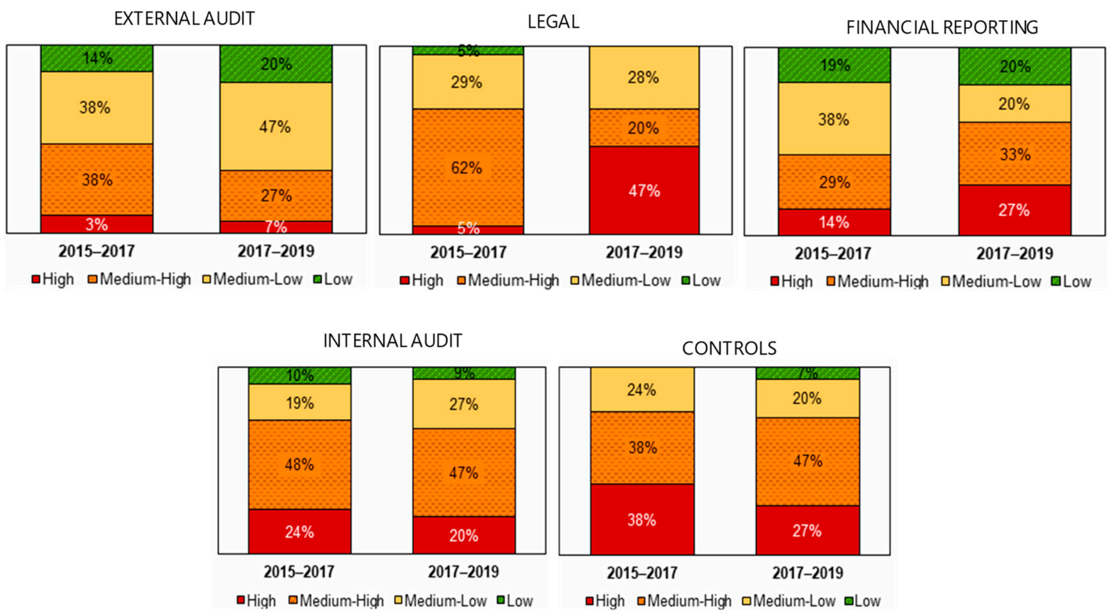
8. **Monitoring missions during the period were triggered by various risk factors and included one special case that required intense engagement.** Monitoring activity during the period encompassed following through on safeguards-related reforms such as legal amendments or transition to IFRS, as well as in certain cases reviving the authorities' commitment to address long outstanding recommendations. However, intensified monitoring was also prompted in a number of cases by other vulnerabilities that emerged across the five safeguards pillars, including: (i) governance gaps occurring during political transitions and resulting in non-operational Boards and suboptimal oversight arrangements; (ii) significant monetary financing of the government in breach of statutory limits or irregular liquidity lending; and (iii) compromised external audit quality as well as weaknesses in controls related to monetary data reporting.[6] Also, staff remain involved, in close collaboration with the area department, in a case concerning a forensic audit that was conducted in response to fraud uncovered in the foreign currency operations at one central bank.

[6] 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 internal controls.

C. Safeguards Findings and Recommendations

9. **The risk profile of central banks assessed during the period was relatively high.**[7] External audit maintained the positive trend observed in the prior period, and a slight improvement was also noted in internal audit. However, some challenges remain in financial reporting, and vulnerabilities increased in legal frameworks (see below). Of the 15 assessments completed, one was a first-time assessment and three were update assessments where the Fund had had no financing arrangements, and thus no safeguards assessment interactions, over the last decade. Experience in these cases has indicated that risk ratings are typically higher owing to the limited exposure to leading practices. The key drivers for the risk ratings and significant findings are discussed below.

Safeguards Findings and Risk Ratings Across the ELRIC Framework



Source: FINSA database.

External Audit

10. **Assessments found generally strong external audit mechanisms.** All central banks assessed during the period had audits conducted by international audit firms. This was the result of generally strong external audit selection and appointment procedures. Relatedly, their audit opinions stated compliance with International Standards on Auditing (ISA). As such, assessments continued to focus on the application of these standards, and on audit quality.

[7] 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) and *Safeguards Assessments - 2017 Update.*

Legal Framework

11. **Legal reforms to strengthen central banks' autonomy and governance arrangements were recommended in nearly all assessments during the period.** As experienced in previous periods, strengthening legislation remains a challenge as it involves a lengthy process and multiple stakeholders. Staff therefore remains closely engaged with the authorities to draft amendments and advance the process, primarily through technical assistance. As noted earlier, the legal structure and autonomy was an area where lack of recent IMF engagement had a particularly significant impact on the observed risk ratings. That said, the period has also seen successful implementation of recommended amendments in seven central bank laws that were enacted. These recommendations were anchored in program conditionality and implementation was facilitated by close staff engagement. In addition, seven central banks have either submitted draft amendments to Cabinet for Parliamentary consideration and enactment, or are in the process of finalizing the amendments.

Financial Reporting

12. **The publication of audited financial statements and increasing adoption of International Financial Reporting Standards (IFRS) continue to strengthen transparency in financial reporting.** Nearly all central banks assessed during the period published their audited financial statements, albeit with delays in some cases. Also, nearly half (seven) of the central banks have IFRS as their accounting framework, and a further six have taken decisions to adopt IFRS and are in the transition process to implementation.

Internal Audit

13. **Modest improvements were observed in internal audit, but capacity constraints remain.** While practices in five assessments were found to be in line with international standards, the overall trend indicates that internal audit functions continue to face challenges with fulfilling their mandates. This is primarily a result of limited capacity in member countries and insufficient allocation of resources that manifested in low staffing levels, lack of professional certifications, training, or audit expertise. Some functions lacked independence, a key attribute for a strong internal audit function. Addressing these gaps requires a commitment at the institution level to oversee progress and allocation of resources to increase capacity.

Internal Controls

14. **Governance arrangements remain a key source of high risks in the internal control environment.** This is particularly true for those central banks that had vacancies on their Boards or ineffective oversight primarily due to insufficient requisite expertise or provisions in the central bank law that need to be strengthened on independent oversight. Additional governance-related risks were manifested in heightened exposures stemming from fiscal dominance in over half of the assessments, frequently due to inadequate legal safeguards or noncompliance with statutory limits. Other factors include weak controls in foreign reserves management, the compilation of program monetary data, and operations related to Emergency Liquidity Assistance (ELA).

15. **The implementation rate of safeguards recommendations improved in the current period** (see Table 1). Recommendations to address significant vulnerabilities in safeguards frameworks are often anchored in program conditionality, thus resulting in a higher implementation rate (80 percent) compared to 57 percent in the previous period. While an improvement in the implementation rate of remaining recommendations was noted, 58 percent compared to 50 percent in the previous period, it remains lower than would be desired.[8] Half of the overdue recommendations relate to measures that address shortfalls in the internal control environment, and in most cases require significant undertakings and greater capacity building, such as establishing a middle office function or operationalizing an ELA framework. Further, reforms on IFRS and legislative amendments were frequently met with delays given the multiple stakeholders involved. Notwithstanding this, the overall implementation rate since inception of the policy remains high at 89 percent for recommendations included under program conditionality and 79 percent for the remainder.

Table 1. Implementation of Safeguards Recommendations

	Program Conditionality *	Other	Total
Recommendations issued during the period	33	190	223
Less: Recommendations not yet due	-8	-29	-37
Sub-total (due recommendations)	25	161	186
Less: Implemented	20	104	124
Overdue	**5**	**57**	**62**
Implementation rate by percentage	**80%**	**65%**	**67%**
Implementation rate by percentage (2017 update period)	**57%**	**50%**	**51%**
Implementation rate by percentage (since inception)	**90%**	**80%**	**81%**

** Program conditionality covers structural benchmarks (SB), prior actions (PA), and commitments in the Letter of Intent (LOI) contained within the Memorandum of Economic and Financial Policies*

Source: FINSA database

16. **Technical assistance (TA) continues to be essential in advancing the implementation of recommendations.** Safeguards staff closely collaborated with counterparts in other departments, particularly in providing technical assistance on legal and governance reforms in line with the sharper focus in this area. TA provided in the period also facilitated the implementation of safeguards recommendations in areas such as IFRS, the compilation and submission of monetary statistics, organizational restructuring, internal audit, and risk management.

[8] In the prior period, several RCF and RFI disbursements were not followed by a program, which would provide additional leverage in following up on outstanding recommendations, including through elevation to program measures if weaknesses are significant. It is worth noting that the safeguards monitoring process involves active follow-up on all outstanding recommendations without distinguishing whether these are under program conditionality or not. By virtue of their nature, however, safeguards-related program measures generate different levels of commitment and tend to yield higher rates of implementation.

D. Misreporting and Mitigation

17. **Mitigating the risks surrounding program monetary data reported to the Fund is a key objective of the safeguards assessments policy.** There were no cases of misreporting of program monetary data during the current period.[9] However, as with the prior review periods, the ex-ante nature of the assessments continues to proactively identify issues with program definitions and the need to strengthen the compilation procedures. Review of the program monetary data compilation procedures and evaluation of the adequacy of control processes are important aspects of this work. Staff also reconciles the key monetary data with information in the audited financial statements or underlying accounting records. This ex-ante work has in at least four cases uncovered issues early, that if unresolved could possibly have led to misreporting. Key recurring themes were as follows:

- *Program data compilation controls*. Weaknesses identified in six assessments include lack of internal coordination and documentation of processes. In two cases, capacity constraints in the internal audit functions triggered the need for verification procedures to be outsourced to external auditors.

- *Technical Memorandum of Understanding (TMU) definitions*. Staff identified eight cases where definitions did not properly capture elements of Net International Reserves (NIR), such as the treatment of non-convertible currencies, non-monetary gold, government and state-owned enterprises' foreign currency deposits, letters of credit, and poor-quality assets. These issues have been addressed through revised definitions in updated TMUs.

- *Off-balance sheet items*. Staff encountered two instances where encumbered foreign assets were not excluded from NIR. These related to guarantees issued on behalf of the government and foreign assets pledged to support a loan facility.

18. **Closer engagement with central banks and collaboration with area departments help mitigate the risk of misreporting.** The ex-ante nature of safeguards work allows inter-departmental discussion on the treatment of complex items. In cases where additional assurances were needed, staff's recommendations included: (i) reviews of monetary data by external or internal auditors at test dates; (ii) establishment of committees from various functions within the central bank to document compilation procedures and review of monetary data; and (iii) clarification of program definitions of the treatment of certain types of assets and liabilities.

E. Evolution Within the Safeguards Framework

19. **The safeguards framework continues to evolve in line with experience and lessons learned.** The assessment of governance arrangements has progressed with the mandate

[9] Misreporting cases reviewed by the Executive Board during the period related mainly to breaches of program requirements on external arrears.

provided in the 2010 and 2015 Board reviews of the safeguards policy.[10] In addition, deeper evaluations of risk management practices are now an integral part of safeguards assessments. Furthermore, proactive engagement with key stakeholders has been embedded in staff's monitoring approach to facilitate recommended legal reforms and secure buy-in and sustained commitment.

Governance

20. **Safeguards assessments have been adapted to provide for closer evaluation of governance arrangements.** The safeguards evaluation of governance is more focused on the assessment of decision-making bodies and independent oversight of central banks. The evaluations aim to assure: (i) the adequacy of checks and balances, and (ii) the effectiveness of key governance bodies such as central bank boards, and audit committees.[11]

Risk Management

21. **A more comprehensive coverage of risk management functions at central banks is now an integral part of safeguards work.** Staff finalized a new approach in 2018 for the assessment of risk management practices, based on a deeper evaluation of their maturity and state of development, and guided by an assessment tool developed internally for this purpose.[12] A modular approach to ascertaining the maturity levels of risk management provides staff with a foundation to tailor safeguards recommendations for a gradual evolution of these practices, taking into account existing capacity at each central bank.[13]

[10] See *Safeguards Assessments—Review of Experience*. As with previous reviews, an external panel of experts provided an independent perspective on the implementation of the policy. The panel's report is available on the Fund's external website.

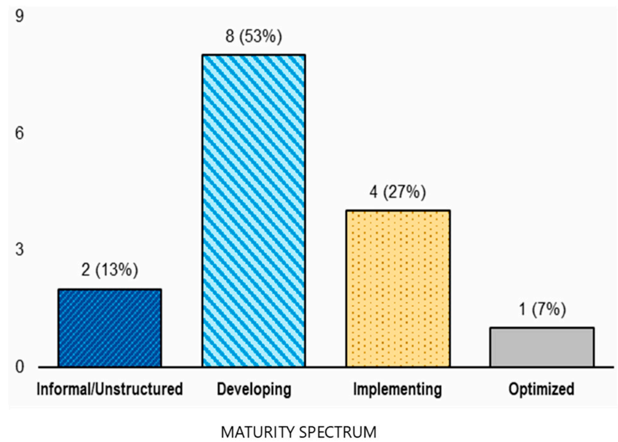
[11] Factors considered include the strength of their mandates, composition, appointment practices, independence and expertise, and operational modalities. The assessments require a pragmatic consideration of the political environments and capacity constraints that may warrant a tailored approach to remedial measures.

[12] The maturity assessment tool helps evaluate the extent to which central banks are implementing risk management in substance. It guides staff in (i) benchmarking risk management practices against the key elements of a full-fledged risk management framework such as strategy, policies, process, governance structure, and monitoring and reporting mechanisms and (ii) ascertaining the current level of maturity and implementation of these elements to determine development needs to progress from an informal to an optimized level. As such, the tool is a matrix combining both the elements of the risk management framework and the attributes of these elements at different maturity levels.

[13] The modular approach combines a periodic checkpoint and a path forward to continue evolving the risk management practices. It fosters simple building blocks for central banks that are in the nascent stages of this work, or that have capacity constraints, while those at the other end of the spectrum with more advanced frameworks benefit from engagement on observations and leading practices in this area.

22. **Central banks are advancing their risk management frameworks**. The majority of assessments during the period indicated that central banks are continuing to develop integrated risk management structures, including establishing dedicated functions for this purpose (see Figure).[14] Of the 15 central banks assessed, only two have not yet formally started on this path. However, risk management functions were found to have areas for improvement in about 50 percent of central banks with respect to governance arrangements, such as separation from internal audit or business areas, strengthening executive management, reporting to an oversight body; and risk management processes, such as establishing risk registers or action plans, enhancing risk reporting and monitoring. Capacity constraints and lack of technical expertise were also identified. Notwithstanding the progress being made, optimized risk management practices remain aspirational for all but one of the central banks assessed and comprehensive coverage of all financial and non-financial risks within one full-fledged framework is a common challenge.

Risk Management Maturity and State of Development



Source: FINSA database.

F. Fiscal Safeguards Review – 2015 Policy Review and Requirements

23. **The first-ever fiscal safeguards review was conducted during the period**. At the 2015 safeguards policy review, the IMF Executive Board endorsed an evaluation framework and risk-based approach to expand staff's assessment beyond central banks, in cases where significant IMF lending resources are directed to budget support.[15] The June 2018 Argentina Stand-By Arrangement met the criteria for a fiscal safeguards review to be conducted and a mission was fielded in October 2018. The fiscal safeguards review identified vulnerabilities in the fiscal area that were considered in the program. These included strengthening modalities in the budget process, improving oversight of entities outside the federal central administration, and increasing the quality of fiscal reports through reconciliation exercises.[16] In addition, the program included a structural benchmark for a treasury single account to be established at the central bank rather than at a state-owned commercial bank.

[14] This figure does not include a comparative to the previous period given the new maturity assessment tool, which was only adopted in this period.

[15] Fiscal safeguards are to be conducted for all arrangements where a member requests exceptional access to Fund resources, with an expectation that a significant proportion, i.e., at least 25 percent, of the funds will be directed to financing of the state budget.

[16] See the second review staff report for Argentina.

24. **The first-time review provided an opportunity for lessons learned to strengthen modalities**. The mission comprised a multi-department team led by FAD, with support from LEG and FIN staff. This facilitated a broader engagement on inter-linkages of underlying issues with respect to legal, control, and audit aspects of the areas covered under the review. Lessons learned will be considered in coordination with FAD and factored into the 2020 safeguards assessment policy review on areas such as scope, modalities, and review process.

G. IMF Enhanced Engagement on Governance

25. **In 2018, the Fund adopted a framework for Enhanced Fund Engagement on Governance.**[17] The framework is designed to enable an assessment of governance vulnerabilities and corruption in six categories of state functions that are most relevant to economic activity. The six areas of governance are: (i) fiscal governance; (ii) financial sector oversight; (iii) central bank governance and operations; (iv) market regulation; (v) rule of law; and (vi) anti-money laundering and combatting the financing of terrorism.

26. **Existing work is being utilized in the enhanced engagement on governance.** This systematic approach relies on information, for the most part, already obtained in the context of existing Fund activities. For the central bank governance and operations category, safeguards assessments are the primary source. However, since not all member countries have been subject to safeguards assessments, coordination is required among staff (area and functional departments) to provide some relevant information under the framework. In this connection, work thus far for safeguards has included participation in:

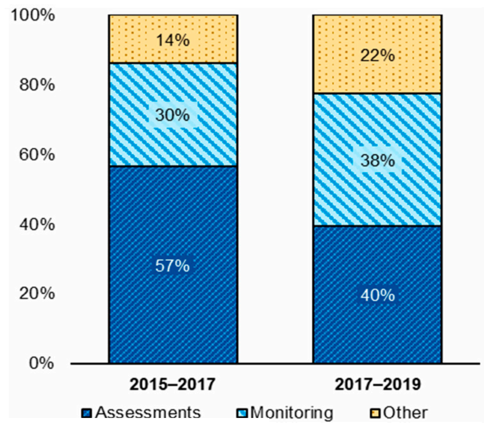
- ***Governance assessments.*** As part of the framework, the Fund has implemented a centralized institutional process, which FIN participates in, to select the countries and areas of governance to be assessed, and to determine the timing of coverage based on the perceived vulnerabilities for each of the six categories.
- ***Brainstorming sessions.*** As the Fund is stepping up efforts to support the implementation of the framework, safeguards staff participate in brainstorming sessions conducted to assist country teams on coverage of governance issues as they prepare policy consultation notes and missions in the context of Article IV and Use of Fund Resources. FIN safeguards staff contribute by providing background on safeguard assessment findings, and by sharing experience to help guide the deliberations on central bank governance.
- ***Ad-hoc requests.*** FIN safeguards staff contributed to an area department initiative to deepen regional cross-country analysis on select governance issues under the new framework, including central bank governance. Other contributions during the period include regular review of policy consultation notes and staff reports to guide area departments' assessments, in particular where resolution of governance vulnerabilities was considered as being critical to program success.

[17] 2018 –*"Review of 1997 Guidance Note on Governance—A Proposed Framework for Enhanced Fund Engagement"*

H. Staff Resources

27. **The safeguards staff complement remains unchanged from the previous period.**[18] While safeguards work continues to focus primarily on assessments and monitoring, staff has seen increased activity in a number of areas. In particular, this includes analytical work on safeguards issues, such as internal audit, risk management, and external audit, which has resulted in the publication of working papers and outreach at various global conferences (see below). Other areas of note are: (i) work on the Fund's new framework for enhanced engagement on governance (see above); and (ii) developing a new database (Safeguards Portal) to further enhance the IT capabilities of safeguards processes, including strengthening the data management of the safeguards findings, and facilitate monitoring activities.[19] The new portal, which was developed in-house with close collaboration between FIN and ITD enables the safeguards team to have enhanced data integration to other relevant Fund financial information.

Staff Time



Source: FINSA database

OUTREACH AND INFORMATION SHARING

A. Analytical Work and Publications

28. **As the policy matures, key elements of the safeguards knowledge database and staff's expertise are being leveraged through analytical work and publications.** During the period, these covered issues related to external audit arrangements at central banks and governance arrangements with a focus on independent oversight and internal audit. As discussed earlier, the issue of capacity development is central to strengthening central bank safeguards frameworks and can help to reduce the risks the Fund faces in its lending operations. In addition, central banks continue to be receptive to any impetus that strengthens their control environment. In this connection, safeguards analytical work has been leveraged as an additional vehicle to share experiences and challenges, and engage with the central banking community on emerging leading practices.

[18] The division comprises management (Division Chief and a deputy), ten professional staff, one research assistant, and two staff assistants. During the period, one staff transferred to another division within the Finance Department and was replaced by an external candidate.

[19] Although the majority of the work put into developing the new Safeguards Portal was done within the current period, the project was only finalized in July 2019.

29. **Staff has published two working papers as part of the initiatives to strengthen awareness and improve communications on safeguards-related issues**.[20,21] The analytical work drew on the broad data from safeguards findings and observations since 2010, and staff's cross-regional experience. The publications have resonated well with the central banking community, and continue to generate interest from various parties as useful and aspirational benchmarking references. In particular, the findings from the working paper on internal audit and oversight have been disseminated at various regional workshops and at the IMF Analytical Corner presentations series during the 2019 Spring meetings.[22]

B. Collaboration with Stakeholders

30. **Collaboration with key stakeholders in the central banking community was broadened.** This period presented two significant developments that expanded engagement with the central banking community. First, the Fund joined the International Operational Risk Working Group (IORWG), expanding the avenues for staff's contribution to debates and advancement in operational risk management and access to leading practices.[23] Second, analytical work published during the period generated substantial interest in safeguards findings and provided a platform for advocacy of leading practices and raising awareness about the policy. Staff maintained participation in periodic and well-established safeguards outreach activities, including the following:

---

[20] *Effectiveness of Internal Audit and Oversight at Central Banks: Safeguards Findings—Trends and Observations* (WP/18/125). Experience under the safeguards policy has shown that while central banks continued to strengthen their safeguards frameworks, vulnerabilities prevailed in the areas of internal audit and oversight by the audit committee (AC). The publication, which covered 111 assessments at 64 central banks, undertakes a detailed review of the safeguards findings to help unravel the underlying causes. In summary, internal audit functions at central banks were found to face three key challenges: (i) limited independence that undermines the mandate of the function; (ii) capacity constraints including skills and relevant professional qualifications; and (iii) inadequate oversight by the Board or Audit Committee. In connection with the latter, and in addition to presenting the key attributes for an effective internal audit and AC, the paper's empirical data finds that strong oversight by a high-performing AC is a key enabler of good governance.

[21] *External Audit Arrangements at Central Banks* (WP/18/199). This publication takes stock of external audit arrangements at central banks. The paper outlines good practices in these areas and provides a summary of actual practices observed based on a review of audited financial statements and central bank legislation (covering 170 central banks). Observations on best practice and audit quality issues are also corroborated by the findings of IMF safeguards assessments. Safeguards experience indicates that, while central banks have improved their external audit mechanisms, the vulnerabilities identified are typically due to: (i) weak capacity and deficient quality control processes for some audit firms; (ii) deficient procedures for the selection and appointment of external auditors; and (iii) oversight by the Audit Committee being either weak or lacking.

[22] Two additional publications on (i) central banks' financial reporting practices and safeguards experience with the implementation of IFRS, and (ii) the risk management frameworks at central banks, are being finalized and will form part of the continued advocacy and outreach to promote sound financial safeguards.

[23] The IORWG comprises 85 central banks and monetary and supervisory authorities and the Bank for International Settlements. The IORWG shares good risk management practices through an annual meeting that is informed by select research conducted by working groups on topical issues. The Office of Risk Management is the Fund's point of liaison with the IORWG and coordinates closely with FIN and MCM.

- **High-level forums on aspects of governance were held in 2019 and 2018 for central banks and their external auditors.**[24] The 2019 forum focused on the legal underpinnings of board oversight, and emphasized the role of financial risk management and implications of developments in FinTech, data analytics, and Artificial Intelligence. The forum discussions highlighted the continuing dispersion in maturity of governance practices across regions.
- **Regional safeguards seminars continue to provide a channel for sharing safeguards experience on topical issues affecting central banks.** Five seminars on safeguards assessments were held during the update period in Kuwait (two), Austria, Mauritius, and Singapore.[25] Central bank participants noted the beneficial impact of the seminars on their understanding of the safeguards policy and interconnections with their work, and the opportunity to network and discuss issues with their peers.
- **Increased engagement with the World Bank's Reserves Advisory and Management Program (RAMP).** Staff were invited to contribute to internal audit (December 2018) and accounting (March 2019 and 2018) workshops organized by the World Bank for central banks that are members of RAMP. These contributions form part of continued outreach efforts on safeguards issues and served as a good opportunity to strengthen ties with the World Bank. The events were well received, and the World Bank has requested staff's continued involvement in similar workshops going forward.
- **Other outreach activities focused on internal audit, risk management, governance, accounting matters, and cybersecurity.** Staff participated in a course on cybersecurity hosted by the National Institute of Standards and Technology (November 2018) and contributed to global and regional conferences hosted by the Central Bank of Turkey (March 2019), the Asian Development Bank (November 2018), Bank of Indonesia (October 2018), European Central Bank (September 2018), Bank for International Settlements (September 2018), and the Banco de Portugal (September 2017). These events provided opportunities to share safeguards experience and enhance peer exchanges in these specialized areas.

31. **Solicitations for staff's expertise and input in an advisory capacity have increased.** Staff continued to be proactively engaged, in close collaboration with other departments within the Fund, in cases that presented safeguards challenges. This is particularly true for those central banks where multi-stage technical assistance programs were being undertaken to support governance and legislative reforms or transition to IFRS. Customized guidance was also provided in cases concerning forensic work and special audits. Safeguards staff's contributions were of an advisory nature and focused on aspects that required substantive expertise and a facilitative role. Key highlights:

[24] Five such events have been held since 2013, two of which were during this period (January 2019 and March 2018). The events continue to be held in collaboration with the Hawkamah Institute for Corporate Governance, a not-for-profit organization based in Dubai.

[25] Almost 150 participants representing over 100 central banks attended the safeguards seminars during the period.

- **Governance matters and legal reforms.** In three cases of governance focused legal reforms, staff participated in legal technical assistance missions to aid the formulation of governance and central bank autonomy provisions. Such engagements involved discussions with the central bank authorities and other stakeholders (i.e., ministries of finance or justice).[26] Staff also joined one area department visit to follow up on a long outstanding safeguards recommendation to amend the central bank law.

- **International Financial Reporting Standards (IFRS).** Staff's efforts focused on advancing the transition to IFRS, including through the development of comprehensive roadmaps, advising on the nature and scope of external auditors' involvement, and engaging accounting regulatory bodies in their role in advancing IFRS in their jurisdictions. Internally, staff worked with area departments to anchor such transitions in program commitments and collaborated with MCM to help prioritize and facilitate technical assistance in some cases.

- **Forensic work.** As part of ongoing safeguards support to area departments under IMF-supported programs, staff was closely involved in work, in three countries, related to forensic audits that resulted from allegations of misappropriation of banknotes and foreign exchange, and concerns regarding the adequacy of capital injections within the financial system for recapitalization and restructuring of certain financial institutions.[27] In all these cases, staff provided input to the terms of reference for the audit and reviewed audit results and remedial action plans. Safeguards staff also assisted in reviewing terms of reference for a special audit (review of financial structure) of one central bank.

C. Reporting to the Board and Sharing of Safeguards Reports

32. **Safeguards reports are confidential, and the Board is informed primarily through country staff reports.** A safeguards-related paragraph continues to be included in staff reports for countries that are under safeguards monitoring, i.e., member countries with outstanding Fund credit or active arrangements. This informs the Board on the status of safeguards recommendations, and key developments in safeguards-related issues, such as enactment of proposed amendments to the central bank law. This enhanced disclosure at Board-level helps to gain traction on challenging cases.

33. **In accordance with the Board decision, safeguards reports can be shared with the World Bank and the European Central Bank (ECB)**.[28] For each request, staff seeks consent

[26] 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.

[27] Liberia 2019 Article IV Consultation (19/169); Mongolia 2019 Article IV Consultation (19/297); Sierra Leone First Review Under the Extended Credit Facility Arrangement (19/217).

[28] 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. The Board has authorized the sharing of the reports with the World Bank and the ECB.

from the relevant central bank prior to sharing the report. In the period under review, 23 reports were shared with the World Bank (17 during the previous period) for their fiduciary assessments related to development policy lending. No requests were received from the ECB in either period.

EMERGING RISKS AND RENEWED PRIORITIES

Governance

34. **In line with the Fund's renewed framework on governance, engagement in this area will continue to be a priority.** Going forward, staff anticipates a growing demand in this institutional effort as the framework continues to mature. However, there are challenges associated with this new activity, including the competing priorities of other safeguards work and resource constraints. In addition, there are data gaps, since the safeguards assessment policy only covers a subset of member countries, i.e., those that have lending arrangements or outstanding Fund credit. There is a need to continue refining the approach to ensure appropriate contribution to, and evenhanded application of the new framework, given that the depth of coverage of a typical safeguards assessment across the membership is not a feasible option.

Financial Risk Management

35. **Additional work is needed to ensure comprehensive coverage of financial risks at central banks.** Central banks continue to make progress in risk management by progressively expanding their coverage of non-financial risks and formalizing an enterprise risk management (ERM) framework. However, financial risk management is often narrowly focused on foreign reserves management and does not encompass the policy-related operations which also expose the central bank to financial risks. Bank-wide risk management frameworks with broader consideration of financial risks at policy and balance sheet levels help safeguard the financial strength of a central bank and the soundness of its policies.

Cybersecurity

36. **The role of central banks in the financial sector increases their exposure to cyber risks**. The use of technology in transactions exposes the financial sector, and central banks, to cyber risks. An active cyber risk management strategy that includes robust business continuity and recovery plans is crucial, and should be embedded in a comprehensive risk management framework. Coverage of this topic in safeguards assessments is in its initial stages. Only a few central banks covered during this period have active management of cyber risks. A more structured coverage in safeguards work of the extent to which cyber risks are adequately addressed as part of central banks' risk management frameworks will need to be developed

---

The latter concerns the national central banks in the European System of Central Banks where the member state received financial assistance jointly from the European Union and the Fund.

going forward. Internal guidance is being developed by staff to inform coverage in assessments, and the related recommendations to address identified vulnerabilities.

Fintech

37. **Rapid advances in digital technology are transforming the financial services landscape, creating opportunities and challenges for central banks.** These innovations, often referred to as "fintech", are changing the way in which financial transactions are conducted, especially given the interlinkages with payment systems.[29] To the extent that central banks are venturing into new technologies, such as digital currencies, safeguards work in risk management will need to ensure that any new risks emerging from Fintech initiatives are being considered.

[29] Different definitions of fintech are used by international bodies and national authorities, and the broad interpretation of fintech is the advances in technology that have the potential to transform the provision of financial services spurring the development of new business models, applications, processes, and innovative products.

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.

Annex II. Assessments and Monitoring Visits Completed During the May 2017 – April 2019 Period

Assessments		
Year	**Countries**	**Total**
2019	Angola, Morocco	2
2018	Argentina, Barbados, BCEAO, The Gambia, Guinea, Malawi, Mauritania, Seychelles	8
2017	BEAC, Ecuador, Jamaica, Mongolia, Sierra Leone	5

Monitoring Visits		
Year	**Countries**	**Total**
2019	Tunisia	*1 in progress*
2018	Ghana, Liberia, Madagascar, Nepal, Sierra Leone	**5**
2017	The Gambia, Guinea	**2**

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

1. **During the period under review, 15 assessments were completed.** This comprises nine assessments conducted in FY2018 (BCEAO, BEAC, Ecuador, Gambia, Guinea, Jamaica, Mongolia, Seychelles, and Sierra Leone), and six assessments completed in FY2019 and listed below. All six assessments in progress at end-FY2019 were subsequently finalized.

Type of Activity	Assessments Completed	Assessments in Progress	Total
FY 2019	6	6	12
First Time	Barbados		1
Update	Angola, Argentina, Malawi, Mauritania, Morocco	Ecuador, Haiti, Honduras, Kenya, São Tomé and Príncipe, Ukraine	11
FY 2018	9	2	11
FY 2017	13	5	18
FY 2016	16	6	22
FY 2015	13	6	19
FY 2014	15	6	21
FY 2013	11	12	23
FY 2012	15	11	26
FY 2011	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).