### Acronyms and Abbreviations

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<th>Definition</th>
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<tr>
<td>AAA</td>
<td>Analytical and advisory activities</td>
<td>GAO</td>
<td>U.S. Government Accountability Office</td>
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<tr>
<td>ARPP</td>
<td>Annual Review of Portfolio Performance</td>
<td>IAD</td>
<td>Internal Audit Department</td>
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<tr>
<td>BP</td>
<td>Bank Procedure</td>
<td>ICFR</td>
<td>Internal Controls over Financial Reporting</td>
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<tr>
<td>BPM</td>
<td>Business Process Module</td>
<td>IDA</td>
<td>International Development Association</td>
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<tr>
<td>CAS</td>
<td>Country Assistance Strategy</td>
<td>IEG</td>
<td>Independent Evaluation Group</td>
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<tr>
<td>CF AA</td>
<td>Country Financial Accountability Assessment</td>
<td>IL</td>
<td>Investment lending</td>
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<tr>
<td>CGAC</td>
<td>Country Governance and Anti-Corruption</td>
<td>INT</td>
<td>Department of Institutional Integrity</td>
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<tr>
<td>CODE</td>
<td>Committee on Development Effectiveness</td>
<td>IRMF</td>
<td>Integrated Risk Management Framework</td>
</tr>
<tr>
<td>COSO</td>
<td>Committee of Sponsoring Organizations (established by the Treadway Commission)</td>
<td>ISR</td>
<td>Implementation Status (and Results) Report</td>
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<tr>
<td>CPAR</td>
<td>Country Procurement Assessment Report</td>
<td>IT</td>
<td>Information technology</td>
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<tr>
<td>CSR</td>
<td>Controller, Strategy, and Resource Management</td>
<td>KPI</td>
<td>Key Performance Indicator</td>
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<tr>
<td>DPL</td>
<td>Development Policy Loan</td>
<td>LEG</td>
<td>Legal Department</td>
</tr>
<tr>
<td>DIR</td>
<td>Detailed Implementation Review</td>
<td>N/A</td>
<td>Not applicable</td>
</tr>
<tr>
<td>ECDM</td>
<td>Enterprise Content and Document Management</td>
<td>OP</td>
<td>Operational Policy</td>
</tr>
<tr>
<td>ELCQ</td>
<td>Entity-Level Controls Questionnaire</td>
<td>OPCS</td>
<td>Operations Policy and Country Services</td>
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<tr>
<td>EPR</td>
<td>Evaluated pass rate</td>
<td>PR</td>
<td>Procurement processes</td>
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<tr>
<td>ESW</td>
<td>Economic and sector work</td>
<td>PRIMA</td>
<td>Portfolio and Risk Management System</td>
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<tr>
<td>F&amp;C</td>
<td>Fraud and corruption</td>
<td>QAG</td>
<td>Quality Assurance Group</td>
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<tr>
<td>FM</td>
<td>Financial management</td>
<td>QSA</td>
<td>Quality of Supervision Assessment</td>
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<tr>
<td>FR</td>
<td>Fiduciary Review</td>
<td>SPC</td>
<td>Strategy and Performance Contract</td>
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<td>GAC</td>
<td>Governance and Anti-Corruption Council</td>
<td>SPR</td>
<td>Simple pass rate</td>
</tr>
<tr>
<td>TTL</td>
<td>Task Team Leader</td>
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- **Cheryl Gray**
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- **Nils Fostvedt**
  Task Manager
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Preface

Bank management, in its IDA14 Replenishment Report, committed to “carrying out an independent comprehensive assessment of IDA’s control framework, including internal controls over IDA operations and compliance with its charter and policies.” Each part of this review was to be done in three phases: the first phase would be a self-assessment by management, the second a review by the Internal Audit Department (IAD) and report on management’s self-assessment, and the third an Independent Evaluation Group (IEG) independent evaluation of both management and IAD work. Part IA of the review was completed in late 2006 (IEG report dated October 18, 2006) and Part IB was completed in mid-2007 (IEG report dated June 30, 2007). In the present report, IEG evaluates management’s assessment and IAD’s review, which were provided at the completion of Part II. The report incorporates the results of the Part II entity-level assessment with the earlier results from Parts IA and IB, and thus covers the full COSO (Committee of Sponsoring Organizations) framework.

The basis for IEG’s current evaluation consisted of management’s report on its Part II assessment (attachment 1); all the underlying materials that management generated in its entity-level questionnaires, follow-up discussions, and other analysis; and the IAD report (attachment 2).

This report was prepared by Ian Hume, under the task management of Nils Fostvedt and the overall guidance of Cheryl Gray and Vinod Thomas, with the assistance of a core consultant team that included Dexter Peach (strategic advisor, formerly Assistant Comptroller General for planning and reporting, U.S. Government Accountability Office), James Campbell and Rosemary Jellish (consultants, both former Assistant Directors of the Government Accountability Office). Jed Shilling, Hiran Herat, and Domenico Lombardi assisted the core team on selected topics.

An international Advisory Panel reviewed the final drafts of IEG’s reports at the end of both Part I and Part II. The Panel members were all former Auditors General, Patrick Barrett (Australia), Vijay Shunglu (India), and Bjarne Mork-Eidem (Norway). The panel statement at the end of Part II is shown in volume I.
The organization of this report has had to accommodate a number of requirements: To evaluate the considerable amount of work carried out under the current Part II by both management and IAD; to summarize and comment on the key findings and conclusions presented by both management and IAD in their work; and to present IEG’s integrated evaluation of IDA’s controls framework, reflecting both the completion of Part II (the entity levels control review) and the earlier findings from Parts IB and A (transactions level review) shown in volumes 4 and 5, respectively. This integrated evaluation thus draws on materials from three separate parties (management, IAD and IEG itself), and from a total of three reports. To this end, the review also involved sifting through a very substantial volume of material and background information, the use of standardized evaluative templates created for this work, and the generation of a very substantial statistical data set.

In order to structure the presentation of all this material, the report has been presented in five volumes, as follows:

- **Volume I** presents a synthesis of IEG’s overall evaluation of the integrated internal controls framework, drawing on both Parts I and II, together with a summary of the conclusions of the independent Advisory Panel to this evaluation (with their report attached in full in Volume I). It also contains the key findings and conclusions of both management’s Assessment and the IAD Opinion and Review; their full reports are also attached in Volume III. Finally, Volume I presents IEG’s overall conclusions and recommendations from this evaluation.

- **Volume II** contains, in addition to a final Statistical Annex, five annexes that place on record the more detailed analyses that were conducted. They are essentially reference sources, containing data and analysis which provide the underpinning for the findings and conclusions reflected in Volume I. The annexes are divided into two sections:
  - **Section I** (Annexes A and B) deals with the review of the entity level controls (i.e., the subject of Part II of the overall review). Annex A addresses approach and method, while Annex B provides the detailed analysis of the results from
management’s questionnaire, the Entity Level Controls Questionnaire (ELCQ).

- **Section II** (Annexes C, D and E) deals with the integration of findings from Part I and Part II, to form the basis for the overall evaluation of the integrated framework of controls that was discussed in Volume I. Annex C deals with content that was not completed during Part I (scope limitations and resolving identified deficiencies); Annex D provides the detailed basis for the judgment that a material weakness exists in controls over F&C; and Annex E gives the analytical basis for IEG’s composite evaluation of the integrated controls framework.

- **Volume III** contains two attachments: Attachment I is management’s report on the overall exercise and on the current Part II, and Attachment II is IAD’s report on Part II.

- **Volume IV** contains the earlier report on Part IB of the review: on the completion of Part I incorporating compliance testing of key controls.

- **Volume V** contains the first report on Part IA of the review: on process mapping and effectiveness of control design.
## Key Technical Terms

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<tr>
<td><strong>Audit Standards</strong></td>
<td>Criteria established by recognized accounting and audit bodies (in this case COSO and the Accounting Standards 2 (AS2)) for conducting audits and reviews of internal controls that offer a basis for providing assurance that controls are well designed and working as intended, and for identifying deficiencies, significant deficiencies, and material weaknesses.</td>
</tr>
<tr>
<td><strong>Bottom-up Approach</strong></td>
<td>The approach adopted by management in its assessment did not begin with a top-down, entity-level review, but focused first on business processes at the transactions or operating level. Hence, it has been described as a bottom-up approach.</td>
</tr>
<tr>
<td><strong>Business Process Modules (BPMs)</strong></td>
<td>Management chose to conduct this review of internal controls by identifying the main business processes in which IDA is engaged on a daily basis in the course of its operations. There were 35 procedures in all, covering IDA allocation; the Country Assistance Strategy (CAS) process; the main lending products (Specific Investment Loans, or SILs, and Development Policy Loans, or DPLs); and the fiduciary, contractual, safeguards, and quality assurance processes that support lending. Each process was mapped and described as separate business process modules, each containing the key internal controls that are the subject of the review.</td>
</tr>
<tr>
<td><strong>Business Process Template</strong></td>
<td>A standardized assessment questionnaire and rating system used by IEG to provide quality ratings of management’s method and approach in identifying, describing, and mapping the business processes, and of its method in assessing the effectiveness of control design and of control operation.</td>
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| **COSO Integrated Framework**             | A framework of management principles (COSO components) in an organization that, when collectively operating as intended, will provide reasonable assurance as to the attainment of three key organizational goals (COSO objectives): reliable financial reporting, operational effectiveness and efficiency, and compliance with laws and regulations (in IDA’s case, with its charter and internal policies and procedures). The COSO components are: Control Environment, Risk Assessment, Control Activities, Monitoring and Learning, Information and Communications.  
| **Deficiencies, Significant Deficiencies, Material Weaknesses** | Design flaws, omissions, or noncompliant operation of controls, discovered in the course of a controls review, denoting an ascending order of seriousness. The precise criteria by which the three categories of materiality are distinguished are explained in Annex B |
of the Part IA Report. However, in the case of operational as against financial reporting, there are no such clear yardsticks by which to measure the materiality of a given weakness or set of weaknesses. Some judgment is required. The criteria to be used as a guide in making the needed judgments are those outlined in Annex B of the Part IA report.

Entity-Level Controls

Entity level controls refer to those internal controls applicable to the entity as a whole (i.e. “high level” controls). As such, appropriate entity level controls established and supported by management are a critical ingredient in creating an effective control environment. Examples of entity level controls include creating effective systems and processes for performance management (performance measurement and results), human resource management (hiring, performance evaluation, and training), and ethics (code of conduct and ethics regulation). Examples also include the creation of control units with responsibilities that cut across the organization and exist for the purpose of monitoring the effective achievement of objectives and/or implementation of internal controls such as IEG, IAD, QAG, INT and others.

Entity-Level Controls Questionnaire (ELCQ)

A questionnaire designed by management to be answered by managers throughout the operating units in the Bank, with questions aimed at soliciting opinions from managers about the effectiveness of controls. Where questions received “yes” responses the presumption is that the control in question was seen to be working, and where “no” or qualified responses were given, there was presumed to be a weakness in the control.

Entity-Level Template

A standardized questionnaire and rating system used by IEG to evaluate and give quality ratings to both management’s approach and method in its assessment of the entity-level controls framework, and to evaluate the strengths and weaknesses of the framework, as viewed across the five COSO components.

Evaluated Pass Rate (EPR)

An ELCQ question about a given control could be answered “yes” by some managers while being answered “no” by some others. The EPR is the number of questions deemed to have been answered “yes” on balance, taking into account also the number, type and reasons for the “no” responses given for the same question, as a percentage of the total number of questions. Since IEG and management used different criteria for making these judgments, the EPRs calculated by each party were different.

Evaluation Panels

In applying its Business Process Template, IEG assembled panels of 3-4 people, including controls specialists, and with experts in the particular discipline covered by the given BPM. The panels arrived at consensus judgments on the ratings that should be applied to each section of the module, according to their evaluation of the materials presented by management.

Exceptions

Non-compliances deemed to be of a less serious or material nature than deficiencies.
Exceptions/Deficiency Rates: The number of exceptions/deficiencies found during the Part IB testing of key controls, divided by the number of control steps in the sample.

Internal Controls: Controls, individually or collectively, are structured means within an organization to enable it to achieve its business objectives while addressing risk. Control instruments include the control framework (in IDA’s case, the COSO framework), organizational checks and balances, published policies, and required procedures, among others.

Integrated Internal Controls Framework: The combined system of key controls contained in the transactions-level business processes and the entity level controls that provide for governance of the organization as a whole.

Key Control: A gateway and decision point, involving key units and IDA staff, in a given business process module, through which a business transaction being processed must pass. It is the effectiveness in design of these controls and the subsequent testing of the effectiveness of their operation that is at the center of this review.

Non-compliances: Controls or control steps found during testing to be not operating in conformity with the design of the control. The concept of non-compliance includes both exceptions and deficiencies.

Process Map: The flow chart that graphically depicts all steps in a business process module.

Review: The term used to refer to the entire process of this study. Management conducted an assessment, the Internal Audit Department (IAD) conducted a review and opinion, and IEG conducted an evaluation. When referring to all three processes as an entity, the term used is “review.”

Risk Focal Points: In the adaptation of the COSO framework by the Bank and IDA to meet their own needs, management has defined and added to the framework four key points of risk that face the mission of the Bank Group and are especially relevant to IDA. These are: Strategy Effectiveness, Operational Efficiency, Financial Soundness, and Stakeholder Support.

Simple Pass Rates (SPR): The number of “yes” responses received for each category of responses in the Entity-Level Controls Questionnaire, divided by the total number of responses. The SPR therefore gives a direct measure of what the ELCQ results show regarding the effectiveness of controls; hence it directly reflects the perceptions of the managers responding to the questionnaire.
Walkthrough  
An interactive interview and review of process documentation conducted by management with relevant teams of IDA staff knowledgeable in a particular business process and its associated controls, with a view to verifying that controls are designed in the way described and operate as intended.
IEG Evaluation Summary

IDA stakeholders want to be assured that IDA complies with its Articles and policies, and that the funds they provide for development purposes are used as intended and have measurable results. It is a key purpose of IDA’s control system to provide such assurance. Hence, the Board of Executive Directors requested a full assessment of the system by the Independent Evaluation Group (IEG), through an assessment by IDA management and a review by the Internal Audit Department. The assessment is the first of its kind not only for the Bank but also for all international financial organizations.

In this concluding step in the exercise, IEG finds that, with some important qualifications, IDA’s internal controls framework operates to a high standard overall, giving reasonable assurance that the controls operate effectively. The weaknesses are concentrated mainly in the areas of fiduciary controls and the related lack of a specific focus on controls at the transactions level against fraud and corruption in operations supported by IDA. With regard to the management assessment, IEG finds its approach and method as transparent, well documented, and comprehensive.

The analysis indicates several remedial actions. First, controls over possible fraud and corruption in IDA operations should be addressed on a broad front, starting with risk management processes and country assistance strategies, and including the development and deployment of specific additional instruments directed at fraud and corruption issues at the level of programs and projects. Second, the implementation of remedies for the other control deficiencies should be closely monitored. Management has recognized the need for such remedies, and many are contained in the Governance and Anti-corruption (GAC) program currently being implemented (including some still under preparation). These remedies appear to address the key issues but they are not yet sufficiently operative to be tested and, if effective, thereby lessen the materiality of the controls weaknesses identified. IEG thus believes it would be premature to conclude that F&C risks have been successfully resolved under the current IDA controls framework.

Approach and Method

During the IDA14 Replenishment process, in response to shareholder concerns, World Bank management committed to have carried out (by IEG) “an independent comprehensive assessment of IDA’s internal control framework, including internal controls over IDA operations and compliance with its charter and policies.” In the process agreed with the Board, management would assess the controls, the Internal
Audit Department (IAD) would then review the assessment, and IEG would conduct an independent evaluation of both the management and IAD reports.

Management used the COSO (Committee of Sponsoring Organizations of the Treadway Commission) framework as the basis for its assessment. It divided its study into two parts, Part I dealing with compliance issues within business transactions, and Part II dealing with efficiency and effectiveness issues within IDA entity-level controls. Part IA of the review was completed in late 2006 and Part IB in mid 2007.

This report presents IEG’s evaluation of the effectiveness of IDA’s integrated internal controls framework. The evaluation covers both methods and findings, taking Parts I and II together.

IEG has evaluated management’s approach and method as transparent, well documented, and comprehensive, though it would have been preferable to have examined the entity-level controls before the transactions level controls—in other words, for Part II to have preceded Part I, because this would have enabled a more prioritized, risk-based focus to the transactions level assessment.

**Key Findings of Part II**

Evidence presented by management for both the entity- and transactions-level controls gives reasonable assurance—except for weaknesses identified in certain parts of the overall framework—that controls operate effectively. With these exceptions, the controls framework provides Senior Management and the Board with reasonable assurance that the three COSO objectives are being achieved: Reliable financial reporting, compliance with policies and procedures, and the efficiency and effectiveness of operations. Evidence of controls effectiveness at the entity level (based on questionnaire results) includes pass rates ranging from 92 percent to 95 percent, depending on the method. The earlier evidence at the transactions level includes a pass rate of 93 percent (document-based testing of key controls).

Management, IAD, and IEG all found that, while the overall framework is robust, there are weaknesses that are concentrated in a few key areas. The three parties generally agree on the nature of the deficiencies uncovered, but there are somewhat different judgments as to their materiality: IEG found one material weakness and six significant deficiencies. Management found significant deficiencies in five areas but no material weakness. IAD found that a material weakness will arise if a combination of significant deficiencies in fiduciary controls, entity-level controls, controls over fraud and corruption, and information technology (IT) controls are not remedied in timely manner.

**Evaluating Controls Under COSO.** IEG evaluated the overall effectiveness of the entity-level controls framework under COSO, and compared the relative strengths of controls within each of the five COSO components, using the audit standards agreed for the review. The overall rating is satisfactory with qualifications, and this rating was given equally to controls within all five components.
**Material Weakness.** Evidence emerged during the review that suggested that there are significant risks of fraud and corruption (F&C) impinging on IDA’s lending operations, not fully matched by appropriate controls. There has been progress in building the Bank’s global anti-F&C agenda. However, both the specific tools to address F&C issues at the transactions level in IL and heightened efforts to support the building of client country systems that can protect IDA funds from F&C in DPL/PRSC-type lending (i.e., budget support) have been put in place only recently, and their effectiveness cannot yet be tested. These weaknesses are reinforced by significant deficiencies found in other related controls: in risk management, project financial management, and procurement. Since the risk of fraud and corruption by local beneficiaries, contractors, and other stakeholders can result in diversion of funds that, in the worst case, can impair IDA’s mission, IEG considers this weakness to be a material weakness.

EG stresses that this finding is based on the risk of F&C rather than any clear measure of the extent to which F&C may have actually occurred in operations supported by IDA financing. It should also be kept in mind that weak governance is a widespread problem and a fundamental dimension of the development challenge, and the risk of misuse of funds exists not only for IDA but also for its development partners. The challenge, which IDA is now addressing, is to bring it more into the open and match it with risk management controls.

**Significant Deficiencies.** At the conclusion of this final part of the evaluation, IEG found six significant deficiencies: (i) a need to maintain the currency of the Bank’s Operational Policies and Bank Procedures (OP/BPs); (ii) a need for improved systems of document retention and accessibility; (iii) generic weaknesses in controls over financial management and procurement processes (Part I); (iv) a need for improved management oversight of project processing and supervision, coupled with improved staff incentive structures and performance accountability; (v) a need to improve risk management, including inserting specific F&C risk factors into the Risk Scan, and in integrating risk treatment from the entity level to the activity level; (vi) a need for greater IT security in some areas.

**Other Deficiencies.** During the two parts of the review a total of over 160 deficiencies of various kinds were identified. These are numerous but relatively minor weaknesses, which neither individually nor collectively rise above the level of minor deficiencies. Most of these have now been remedied, or their remedies are in progress.

**IAD Review and Opinion.** IAD noted the significant deficiencies and other issues uncovered by the assessment in Parts I and II, and based on its review, expressed the opinion that management’s assessment and qualified conclusions as to the effectiveness of IDA’s internal controls review were fairly stated. However, it pointed to the identified significant deficiencies relating to fiduciary controls, entity-level controls, IT controls, and fraud and corruption controls, which in combination could create vulnerabilities which, if not remediated in a timely manner, could lead to a material weakness. IEG is unclear about the meaning of this, since if any weakness or deficiency has been identified, it should be considered to exist until mitigating measures have been introduced and proven to be effective.
Accomplishments of the review: This was the first review of this kind for any multilateral financial institution. It has thus broken new ground both in creating methodologies (controls mapping and testing, the ELCQ, the IEG templates) and in building strong factual knowledge about the Bank’s internal controls framework. The corpus of materials emanating from the review provides a solid basis for mounting similar reviews in the future and for other analytical exercises. The review has also led to an acceleration in the developing of new controls for good governance within its client countries, and specifically within IDA operations.

Advisory Panel

IEG was assisted by a senior international Advisory Panel. It concluded that the evaluation of IDA’s controls has been a comprehensive, timely and responsible initiative, and that the approaches and specific tools have been consistent with what the Panel would expect from an independent evaluation. The Panel agreed with the IEG finding of one material weakness and endorsed the reasoning underlying the finding, as it did for the six significant deficiencies. The Panel expressed the view that for an organization as significant and complex as the Bank, such findings would not be uncommon for a first review, and it concluded that the outcome of the overall Review reflects a high level of effectiveness compared to results in other organizations of similar size and complexity but with less international involvement.

Recommendations

Based on its evaluation, IEG makes the following recommendations to IDA management:

(a) Address on a broad front the controls needed to ensure that F&C practices in IDA client countries and among participating stakeholders do not impinge on IDA’s mission. Actions could include:

- Accelerate implementation of the ongoing Governance and Anti-Corruption (GAC) program, and devote additional attention and resources to building an organizational culture and incentive structure in which the risks of F&C are explicitly and cost-effectively addressed in the management of IDA’s operations. While Management has correctly observed that such awareness has been spreading, including through the follow-up to the Volcker report, the systematic integration of this awareness into daily operations still has some way to go and needs to be given sustained emphasis going forward.

- Develop and deploy specific F&C related instruments into the Bank’s Risk Scan processes, CASs, lending and project designs, and ISRs. Remedies have already been initiated as part of the GAC initiative and the Volcker Report, and INT has recently become involved in helping to design toolkits to address F&C at various levels of the lending cycle, although it is too early to judge the impact of these initiatives. It is also important to link country-based risk assessments through the Risk Scan to specific tools to address lending risks in both IL and DPL/PRSC type lending.
• Continue the ongoing reforms of FM and PR processes (launched in response to the findings of this review) and link them closely to the F&C agenda. These are key elements in the Bank’s fiduciary and governance systems but evidence from the review suggests that new toolkits (such as those being developed under the “GAC in Projects” program) need to be deployed, made operative and later tested for effectiveness.

• Intensify IDA support to strengthen clients’ fiduciary and governance systems, recognizing that this is a principal means to guard against F&C and to ensure the effective use of IDA resources (and the only means to do so in the case of budget support operations such as PRSCs). In the case of DPL/PRSC operations, special emphasis needs to be given to developing tools that could attach, for example, to the Letter of Development Policy and to CFAA requirements, to raise the attention to systemic F&C issues at the country level.

• Make arrangements for testing the operating effectiveness of these and other new controls at some appropriate time in the future, since the material weakness and other identified deficiencies will be deemed to persist until this has been done.

(b) Closely monitor the implementation of remedies for control deficiencies, including:

• The measures currently in progress to update the OP/BPs. These also need to be extended to key areas (AAA, F&C) not yet covered or where new policies are being developed.

• A mechanism to ensure the future currency of OP/BPs. There has been progress in bringing the body of OP/BPs into conformity with overall Bank and IDA policies and strategic goals, and IEG has therefore downgraded the weakness uncovered in this area during Part I from a potential material weakness to a significant deficiency.

• Improved documentation retention and accessibility and a user-friendly documentation management system. In its Part IB report IEG had already downgraded the materiality of this issue from a potential material weakness to a significant deficiency. However, the needed IT systems are not yet in place and the Enterprise Content and Document Management (ECDM) system of which they will be a part should be developed as a matter of priority.

• Mechanisms to correct and monitor the several IT systems deficiencies identified. These include password management, business continuity and change management, and need for tighter control over IT access privileges for staff who rotate into new positions.

• Measures to address the about 100 identified other as yet unresolved deficiencies. Remedies for many of these are already in progress, but specific monitoring is needed given the wide front and many areas in which remedial actions are needed.
Chairmen’s Summary: Committee on
Development Effectiveness (CODE) and the
Audit Committee of the Board of Executive
Directors

Review of International Development Association (IDA) Internal Controls: An Evaluation of Management’s Assessment and the Internal Auditing Department (IAD) Review
Report on the Completion of Part II and Draft Management Response


2. **Background.** In its IDA14 Replenishment Report, Management committed to an independent comprehensive assessment by IEG of IDA’s control framework, including the internal controls over IDA operations and compliance with its charter and policies. An earlier Audit Committee and CODE discussion of the review had concluded that consistent with the undertaking made under IDA 14, it should be limited to IDA and not be extended to other Bank Group entities. The scope of work and the findings of earlier parts of the review were discussed during prior Committee meetings. The approach agreed with the Committees entailed a Management self-assessment, IAD review, and an independent evaluation of both by IEG. Part I (the transaction-level controls) identified specific issues with outdated OP/BPs, document retention and accessibility, and some fiduciary controls. In response, Management initiated corrective measures, enabling some of the issues to be remedied before the completion of Part II of the review. Members and Management also agreed that the findings could help accelerate efforts to modernize and simplify the control framework.

3. **Overall conclusions.** Members expressed satisfaction with the work of IEG, IAD, and Management on this first review of its kind among multilateral institutions, which provided a comprehensive assessment of IDA’s internal controls utilizing the COSO internal controls framework. IEG’s evaluation concluded that IDA’s internal controls framework operates to a high standard overall, with some important qualifications. IEG, IAD and Management emphasized their consensus on the issues
identified and the direction of the corrective actions needed to address them. Members discussed findings and recommendations of the review and underscored the importance of a comprehensive plan of corrective actions, including: (i) timely implementation of management’s plan of corrective actions (described in Management’s Report and summarized in Management’s Response); (ii) strengthening specific fiduciary controls and enhancing controls for managing the risk of fraud and corruption in IDA-supported operations as a matter of priority; (iii) providing periodic updates to the Board on progress made in implementing the corrective action plan; and (iv) consistency with other institutional initiatives.

The Main Issues Discussed Included

4. **Findings of the Review.** IEG, IAD and Management stated their broad agreement on the findings of the review and the issues identified, with some differences as to characterization of these issues. Members discussed the concerns identified by IEG and IAD related to controls for managing the risk of fraud and corruption in IDA-supported operations, which were assessed as a “material weakness” by IEG, and a “significant deficiency” by IAD and Management. IAD explained the reasons for its conclusion of significant deficiencies which if not addressed in a timely manner and monitored on an ongoing basis could in totality represent a material weakness. In discussing this difference, Management indicated that, in contrast to controls relating to financial reporting, in the context of operational controls there is not as clear a standard by which to measure the materiality of a given weakness, it being a matter of judgment. Management also expressed the view that IEG’s findings in this area reflect the situation that prevailed when IEG did its fact-finding a year ago and do not fully reflect recent corrective actions. IEG noted that many recent corrective actions are at an early stage, and results cannot yet be evaluated. IEG indicated that its assessment of material weakness relates to risks of fraud and corruption, rather than their extent, in operations supported by IDA.

5. **Enhancing controls for managing the risk of fraud and corruption in IDA-supported operations.** Members emphasized the importance of strong proactive actions by Management to enhance controls for managing the risk of fraud and corruption in IDA-supported operations. Management confirmed its commitment to mainstreaming governance and anticorruption efforts into its development work by tackling the anti-corruption agenda at all levels and implementing broad-based actions to strengthen the Bank’s controls over the fraud and corruption risks in operations, as outlined in the five-point plan of corrective actions included in its Management Response. Management also confirmed that its action plan and follow-up actions would be embedded in and fully consistent with the Governance and Anti-Corruption framework and the work of the Institutional Integrity Vice Presidency.

6. **Remedying specific fiduciary controls.** Members underscored the urgency of remedying the specific fiduciary controls that did not pass compliance testing during Part IB as a matter of priority. Management agreed to give priority to remedying the specific fiduciary controls in question and involving IAD in verifying progress made.

7. **Follow-up actions.** Members urged timely implementation and monitoring of the management action plan and sought clarification of the accountability for the
retesting of controls. Management confirmed its commitment to correct the issues identified through timely implementation of effective remedial actions outlined in its action plan. Management also emphasized its agreement with IEG and IAD on the importance of effective monitoring and reporting on the progress achieved, with specific responsibilities for monitoring and retesting of the control framework to be worked out going forward and with the first progress report to the Board prior to the IDA15 Mid-Term Review. Management noted that it is creating an Implementation Oversight Panel (IOP) to oversee implementation of the corrective actions.

Abdulrahman Almofadhi, Chairman, Audit Committee
Giovanni Majnoni, Chairman, CODE
Summary of Management’s Response

Background

1. Pursuant to an undertaking made under IDA 14, management, IAD and IEG carried out a comprehensive assessment of internal controls over IDA’s operations. The assessment has been conducted in the context of the internal control framework developed by the Commission of Sponsoring Organizations of the Treadway Commission (COSO), adapted to fit the unique nature and operations of IDA. It has been carried out in three tiers: Management self-assessment; Internal Auditing Department (IAD) review; and an independent evaluation of both by the Independent Evaluation Group (IEG). Management appreciates the close cooperation with IAD and IEG throughout this important exercise and welcomes the valuable IAD review and IEG evaluation of management’s assessment. The results of this work present an opportunity to accelerate measures to enhance IDA’s internal controls and maximize IDA’s efficiency and effectiveness.

2. This was the first of its kind review, not only for the Bank, but for all international organizations. As noted by IEG, it has broken new ground in creating new methodologies, allowed the Bank and IDA to take an important lead in assessment of its internal controls, and helped accelerate the development of new and improved controls to enhance Bank’s and IDA’s operations.

Results

3. While as noted by IEG the results of this review demonstrate a high level of effectiveness compared to results in other organizations of similar size and complexity, IDA is always looking to improve its performance and management sees this as a real opportunity to maximize IDA’s efficiency and effectiveness generally and in combating fraud and corruption in particular. Management therefore has moved swiftly in formulating and beginning the implementation of a robust program of corrective measures to address issues identified and strengthen IDA’s controls, with most actions in process and many expected to be completed by June 2009. These actions will strengthen and refocus IDA’s internal controls to better address governance and anti-corruption issues, enhance risk identification and management at transaction and entity-levels, and improve effectiveness and efficiency of investment lending, the Bank’s primary lending instrument.

4. Management is pleased to note that at the end of this intensive effort, IEG, IAD and management agree on overall conclusions, findings and the appropriateness of the remedial actions proposed by management. As noted by IEG, with some noteworthy qualifications, IDA’s internal control framework operates to a high standard overall and provides Senior Management and the Board with reasonable assurance that the three COSO objectives are being achieved: Reliable financial reporting, compliance with policies and procedures, and the efficiency and effectiveness of operations. As IEG has pointed out, according to the testing results, evidence of controls effectiveness ranges
from 92 percent to 95 percent at the entity level assessed during Part II, and 93 percent at the transaction-level (reflecting document-based testing of key controls) assessed during Part I. IAD also found reasonable assurance that IDA’s financial statements are being prepared reliably, and that IDA complies with the relevant provisions of its Articles of Agreement and operational policies and procedures, taking into account the exceptions identified as significant deficiencies by management.

5. **IEG, IAD and management are also in broad agreement, with some differences as to degree, on the issues uncovered.** As summarized in table C.2 included in Volume II of IEG’s final Report, IEG, IAD and management agree on the four significant deficiencies relating to: (i) policies and procedures governing investment lending (IL); (ii) risk management and accountability at project and entity levels; (iii) financial management and procurement oversight in projects; (iv) Information Technology (IT) and Analytic and Advisory Activities (AAA) controls. In addition, IEG, IAD and management identified an issue with design and integration of controls for management of fraud and corruption (F&C) risk in operations, with management and IAD classifying the issues identified as a “significant deficiency”, and IEG classifying them as a “material weakness.” In addressing these issues, management has taken due note of the recommendations set out in paragraph 4.10 of the IEG report, and has incorporated these recommendations in the management action program discussed in this Management Response.

6. **The Bank is firmly committed to mainstreaming governance and anticorruption efforts into its development work.** To this end, management is actively tackling the anti-corruption agenda at all levels, as evidenced by: (i) the swift and decisive actions it has taken over the past 6-12 months in response to the Volcker Panel Report, the India DIR and in implementing the GAC strategy; (ii) the remedies invoked to address F&C issues in operations; and (iii) the detailed and candid coverage of fraud and corruption risks in Bank documents (including CASs and PADs). Key among improvements already in place are the actions associated with the Bank’s implementation of 16 of 18 recommendations made by the Volcker Panel. These include: the creation of an Independent Advisory Board to protect the independence and strengthen the accountability of INT; enhancement of INTs’ advisory services and support to the regions in guarding against F&C risks through INT’s Preventive Services Unit; the increase in INT staffing; greater focus on review and management of high-risk cases; and stepping-up of staff training on managing F&C risks. Management acknowledges that more needs to be done to strengthen the Bank’s efforts in this area, and is committed to implementing broad–based actions to strengthen the Bank’s controls over the F&C risks in operations. Given the actions already in place, however (including the measures added over the past 6-12 months), management believes that the remaining issues are at a level of a “significant deficiency” rather than a “material weakness.”

7. **In this regard, IEG’s finding of a “material weakness” needs to be viewed in the context of the following factors.** First, as IEG pointed out in paragraph 2.19 of its final report, a finding of one “material weakness (together with some significant deficiencies) should overall be considered a quite respectable outcome for the first (and very detailed) exercise of its kind for IDA.” Second, as explained by IEG, “in the case of
operational as against financial reporting there are *no... clear yardsticks by which to measure the materiality of a given weakness* or set of weaknesses.” Third, as IEG explained, “weak governance and F&C risks are part of the challenge of development in many IDA countries and F&C risks affect the work of all donors, not just IDA.” Fourth, IEG’s findings in this area are *a snapshot of a review period that ended a year ago*, and therefore they do not capture/evaluate the *improvements introduced in the F&C area in the past 6-12 months*. Finally, it is important to note that IEG found *management’s assessment to be “transparent, well documented and comprehensive”*. (Emphasis added throughout this paragraph.)

**Follow-up Action**

8. Management is in full agreement that *timely and effective remedial action is needed* to address all of the issues identified. It also *agrees with IEG that controls over the risk of possible fraud and corruption in IDA-supported operations should be addressed on a “broad front” and that implementation of all the remedial actions should be closely monitored*. To this end, management has adopted and begun implementation of a *detailed and comprehensive 5 point action plan, with many actions to be completed by June 2009*. These actions will:

- **Improve investment lending** by rationalizing IL policies, processes and controls, strengthening supervision, and focusing resources on high risk projects;

- Enhance the Bank’s risk management tools, incentives, and accountability to *ensure better management and timely reporting of risks at project and entity level*;

- Integrate enhanced management of the F&C risk into operations through implementation of the *GAC strategy at country and project levels*, continued *integration of INT work, enhanced training*, and “smart project design”;

- **Tighten financial management and procurement controls** to incorporate risk management and fraud and corruption issues and *remedy as soon as possible the 10 (out of 50 tested) fiduciary controls* that did not pass compliance testing during Part I;

- **Strengthen role of IT** in risk management and improve processes and controls for AAA.

9. To ensure effective monitoring and reporting on the progress achieved, management is creating an **Implementation Oversight Panel** (IOP) to monitor, oversee and report to the President and the Board on implementation of these corrective actions.
Statement from the Advisory Panel

1. Background

The External Advisory Panel (the Panel), involving the same membership, conducted a review in Washington from 5-9 March 2007 of the IEG Report on the Completion of Part 1A (dated October 16, 2006) and Preliminary Draft IEG Report on the Completion of Part 1B of the above Review. As well, the Panel provided comments on IEG’s thoughts on Part 2 of the Review. The Panel members subsequently received a copy of IEG’s Report on the Completion of Part 1: Incorporating Compliance Testing of Key Controls (Part 1B), including its Conclusions and Recommendations (Chapter 5). The Panel’s Statement was included as Attachment 3.

The Panel was asked to reconvene in Washington from 21-25 April 2008 to provide input on key elements of analysis and conclusions that will form the basis for IEG’s final report to the Bank Board on the overall Review. As an indication to the Panel of matters to be covered, the IEG provided the following list of Principal Discussion Points for the technical interchange between the IEG Team and the Panel:

- The Questionnaire Approach
- Aggregating the Questionnaire Data
- Use of Non-Questionnaire sources
- Integrating Transactions and Entity Level Reviews
- Extent of Revealed Weaknesses
- Material Weakness
- Future Reviews

The Panel was also provided with a Draft of IEG’s Report on the “Review of IDA Internal Controls: An Evaluation of Management’s Assessment and the IAD Review.” As well, the Panel was given a copy of the Management Scoping Paper and was advised that IEG had not seen Management’s final report nor had the Team received anything from IAD. However, the Panel received a copy of IEG's Final Report (Volumes 1 and 2), Management’s Assessment Report, and the IAD Report on its Review and Opinion in mid October last. The Panel's final report also reflects its consideration of those reports.

2. Approach Taken by the Panel

In preparing for the April discussions, the Panel familiarized themselves again with the Part 1 reports, the COSO (Committee of Sponsoring Organizations of the Treadway Commission) Integrated Framework, and the draft IEG final report. We structured our participation in discussions with the IEG Team, Senior Management, the Management
Project Management teams (PMT), Auditor General and the Internal Audit Department (IAD) PMT, and the Chair of the Audit Committee to broadly cover:

- The Approaches taken to Part II of the Review
- Indications of likely Conclusions by the Participants on Parts I and II of the Review and their Integration
- Identified issues from IEG Draft Report for discussion and any Observations
- IEG Draft Report Conclusions and Recommendations
- Panel Suggestions for Consideration
- Panel's Overall Preliminary Observations and Conclusions

The Panel's final assessment was undertaken through e-mail contact with the IEG team and with each other based on documentation provided, as noted earlier.

3. Discussion of Issues

First, we would like to reiterate an observation we made in our 2007 Statement. The strength of the approach in Part II of the Review is the top level strategic focus reflecting decisions made about the application of the overall integrated COSO risk management framework and associated entity-level controls within the governance arrangements that reflect both “tone at the top” and the authority and accountability that is assigned to the Review and any agreed outcomes. These issues are important to recognize in evaluating and concluding on the Integrated Controls Framework arising from both Parts I and II of the Review.

In relation to controls, the Panel stresses the importance of a sound governing framework supported by a robust enterprise risk management (ERM) approach. This goes further than the earlier model framework adopted by IDA on which the entity level Questionnaire used in the assessment activities was based, but is consistent with it. As the COSO documentation indicates, ERM is geared to achieving an entity’s objectives in four categories:

- Strategic: high-level goals, aligned with and supporting its mission;
- Operations: Effective and efficient use of its resources;
- Reporting: Reliability of reporting;
- Compliance: Compliance with applicable laws and regulations;

Internal control is therefore seen as an integral part of enterprise risk management. The process is a means to an end, not an end in itself. It is carried out by people. It can be expected to provide reasonable, not absolute, assurance to an entity’s management and Board. The focus of ERM, in particular, and on internal control, is an integration of inter-related components, setting of strategic and operational priorities, and achieving appropriate balance between competing imperatives, such as control and performance. These requirements are central to good governance and management of an entity with the associated accountability for performance (results) and an increased emphasis on implementation (that is, making sure it happens). As such, an enhanced COSO framework would help build on the learning associated with the IDA Internal Controls Review.
3.1 PANEL ASSESSMENT OF THE REVIEW PROCESSES

The Panel was again impressed by the professionalism, competence, understanding, and commitment of the IEG people involved in the evaluation. The approaches taken were consistent with what the Panel would expect from an independent evaluator. Not surprisingly, the evaluation approaches and the specific tools IEG used in its evaluation were based on the type of analysis that management conducted during its assessments. For Part II, the Entity Level Template used to rate management’s questionnaire-based approach, its assessment of implementation within IDA of each of the five COSO components¹, and the assessment of controls relating to efficiency and effectiveness was assessed as reasonable.

The Panel thought that reflecting IEG’s Template-based ratings in a statistical “diamond” format (Chart A.2) is a simple, useful way of illustrating the relative effectiveness of controls within each of the five COSO components. While questionnaire-based surveys of the kind used by Management have limitations that IEG recognizes, the Panel was satisfied that the latter were largely ameliorated by several non-questionnaire sources of information obtained by Management (including participation by IEG) and by the IEG itself from interviews with selected Bank units and other studies commissioned by IEG and by the Bank, for example the Volcker Report on the Department of Institutional Integrity (INT).

The Panel accepted that the perceptions of managers, who completed Management’s questionnaire as to the effectiveness of controls, were adjusted by IEG judgments based on all sources of evidence (see Box A.3). Those judgments did not seem unreasonable to the Panel (see Chart A.3). The Panel cannot “second guess” the actual judgments made but is supportive of the approach to “standardize” the responses to reasonable confidence levels.

On the issue of aggregating questionnaire data, the Panel recognizes the practicality of modifying some responses in the four-point scale used. Once judgments have been made about the allocation of responses to the scale, the Panel accepts their aggregation is a reasonable basis on which to make indicative assessments. This also recognizes the manner and level at which the Unit managers responded and the fact that the responses are their perceptions. Interpretation of the aggregate responses, including attaching some different weighting to the perceived importance/knowledge, is an added complication. The simple point is that if there were reservations about the capacity of participating Units to respond, they should not have been included in the exercise, or at least made aware they were not expected to answer questions unrelated to their responsibilities or experiences. The Panel also notes the relatively “conservative” nature of IEG’s use of the data and judgments made, as noted above. It supports the IEG comment that warns the results should not be “over-interpreted” and that they are “indicative.”

The Panel considered that the IEG Evaluation Approach and methodology were well articulated and succinctly explained. This comment particularly applies to Annexes A

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¹. Control Environment, Risk Assessment, Control Activities, Monitoring and Information and Communication.
and B which provide the analytical basis for IEG’s evaluation of IDA’s entity-level controls. Reference has already been made to the COSO “Diamond” Figure 2, which will also be useful as a reference point for future reviews. We also considered Figure B3 in Annex B showing the distribution of “No” responses by Organizational Group has important implications for the Review. The Panel refers again to Figure B2 showing the ranking of COSO components by effectiveness of entity level controls, using a composite IEG rating index, as a very useful outcome of the Review. This Chart also reflects the significant interrelationship between Parts 1 and 2 of the Review and the value of presenting an integrated view of findings from both Parts. The Panel also considered the linkages between Activity/Unit and Entity level findings for each of the five COSO components were well illustrated and should assist both greater integration and understanding at all levels of the organization.

3.2 PANEL ASSESSMENT OF MAIN ISSUES

Support for risk management and related controls has to be seen to come from the very top of any organization. This usually is part of the governance framework that provides strategic direction and decides on the appropriate balance between sometimes-conflicting objectives of control and performance (results). Importantly, it also conveys the requirement for accountability in these respects. The Panel did not see any evidence of a coordinated approach to identifying and prioritizing identified risks nor of an organization-wide view of the major risks that needed to be dealt with. It was suggested that this might have been due to the structured “silo-type” approach to dealing with identified risks. The presentation of an integrated approach as part of the final report on the Review may encourage consideration of an enterprise-wide risk management framework to facilitate governance and management. The Internal Audit Department indicated that it already used this framework (eight components)\(^2\) in planning for its audit program each year and for examination of Trust Funds.

In the Panel’s experience, for an organization as significant and complex as the World Bank, it would be common to find one material weakness and six significant operational management deficiencies in Internal Controls. Admittedly, they would more likely be in the information and communications systems areas. As well, there is generally little criticism from stakeholders when such findings are accompanied by remedial action and explanation. Effective implementation as part of clear associated accountability is essential. It is also relevant that this is the first major review of controls in the history of the Bank. However, while the Panel was cognizant of, for example, the need to examine many of the deficiencies identified in Part I of the review in the context of Part II, it remains of the view that timely interim, or final action, was highly desirable to resolve as many of such deficiencies as possible by the time the Review is completed.

The panel was quite impressed by IEG’s treatment of the material weakness in the internal controls to prevent fraud and corruption (F&C) in Annex D to its report. This is clearly a subject of much sensitivity to the Bank. Besides having an impact on the effectiveness of achieving its objectives, F&C issues involve a considerable reputation

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risk, involving at least a potential loss of confidence by its various stakeholders, internal and external. While it is not possible, nor indeed cost effective, to provide absolute assurance in this area, there are considerable “public interest” concerns in this area that need to be kept in mind. In the public sector, these would be an integral part of any audit going well beyond financial statement issues. There would be no question about the responsibility to be open and transparent in reporting the weakness, its ramifications, and corrective action being taken.

The Panel understands the need to put this finding in perspective without understating its seriousness but, at the same time, not risking unwarranted apprehension about the Bank’s operations and any over-reaction by the media or other parties that would be prejudicial to the interests of all concerned. It could be argued that, even if all the criteria agreed by Management, IAD, and IEG for the Review³ to determine material weakness were in evidence, as concluded by IEG, action taken since discovery would now have changed that situation. The Panel agrees that, unless there is clear evidence that the remedies set out in Figure D.1 of Annex D in IEG's final report have been put in place and are working effectively, it would not be prudent to draw such a conclusion. The Panel notes the IAD observation in its final report that “any conclusion on the adequacy and effectiveness of key fiduciary controls to ensure use of funds for intended purposes would be premature until remediation plans have been implemented and verified as effective.” Therefore, the Panel agrees with the IEG finding of one material weakness. The Panel also notes the IAD opinion that “unless recommended corrective actions are implemented in a timely manner and effectively monitored on an ongoing basis, the identified significant deficiencies relating to fiduciary controls, entity level controls, IT controls and fraud and corruption controls, in combination, could represent a material weakness.”

The Panel also was satisfied that there is sufficient evidence to justify the grading of the six significant deficiencies identified by IEG. (See Annex E; setting out its composite evaluation of the Internal Controls Framework). The Panel draws particular attention to Annex C of the IEG's final report. The Panel earlier expressed general reservations about operational management oversight and risk management implementation. However, the Panel draws attention to some particular concerns about the non-observance of well-designed controls, deficiencies in procurement mechanisms and the need for improved IT security. Such deficiencies can markedly affect basic business processes and on stakeholder confidence.

The Panel supports the development of the “Deficiency Tracker” as it is clearly necessary to provide assurance to all concerned that the identified deficiencies are being dealt with effectively and in a timely manner. The Panel also supports the need for clear accountability, for example by sign-off, by the responsible managers that there has been effective implementation.

Deficiencies identified may be indicative of broader issues to be addressed such as changing culture; document management; systems access; improving management

³. Published in Annex B to the Report on Part 1A. See also Annex 3 (page 35) reproduced in Box D1 (Annex A) in IEG’s final report.
oversight in project preparation; understanding risk management and the role of
controls, including the relationship between transaction and entity type controls;
effectively using sound controls that are already in place; developing user-friendly risk
management tools; ensuring values and ethics are embedded in business processes and
outputs and in performance management, including results being achieved;
accountability for regular reviews; and facilitation of learning, personal awareness and
support. As mentioned earlier, the last mentioned is a recognition that people effect
Internal Control. Financial Management, Purchasing, Business Continuity Planning, and
Disaster Recovery systems and related controls are of fundamental business importance
and need ongoing attention. This, in turn, requires specific attention to people, and their
performance, management.

4. Panel Suggestions for Consideration

The foregoing paragraph started to indicate some suggestions for consideration as part
of addressing identified deficiencies. As well, the Panel stressed earlier the importance
of a sound governance framework supported by a robust enterprise risk management
approach consistent with the latest COSO developments. There are now a number of
Better Practice Guides available that give practical advice on the development and
maintenance of different kinds of governance frameworks, on the basis that it is not a
“one size fits all” consideration. The same comment applies to the latest developments
in risk management and compliance. There would be benefit at least in reviewing the
application of standards, particularly world standards, to the Bank’s/IDA’s
environment such as the ISO31000 standard “Risk management - Principles and
Guidelines on implementation.”

The Panel notes that questionnaire results indicate that the Bank has well articulated risk
assessment procedures. We agree that it is a critical link component in the COSO
framework and further note, for example, that the Bank’s risk scan omitted the Fraud
and Corruption risk. Therefore, it is important risk identification and assessment are
done well. In the Panel’s experience, organizations often struggle with adequately
assessing their risks at both the transaction and entity levels, particularly when there is
lack of guidance and of suitable tools. There is also often a lack of appreciation that risk
assessment is an ongoing task, not simply because the business environment is
constantly changing. The concern is not just about process but in ensuring that those
responsible have the capacity and support to properly assess risk and remain vigilant.

The Panel was asked whether it has a view as to the frequency and possible form of
future reviews. We agree that the entire Review is likely to have made a substantial
contribution to the Bank’s knowledge of its internal controls system and the important
role of risk management. As the IEG noted, an annual review with the scope of the
present Review would seem to be impractical even with the learning that has occurred.
While supportive of the IEG recommendation for follow-up, more selective reviews to
be undertaken periodically, perhaps every two or three years, consideration could also
be given to a planned set of rolling reviews, say, over a three year period, aimed at a
similar coverage with an overall evaluation at the end of the period. We would envisage
that any such reviews would be complemented by work undertaken by IAD in its
annual audit program. The IEG view that all such reviews should, as a matter of course, cover both IBRD and IDA would seem logical.

Where the questionnaire approach is used in future reviews, the Panel agrees with IEG that it is essential for those involved to know whether the questionnaire is asking for perceptions about the design or operation of the controls when testing the controls in the future, both at the entity and the transactions levels. It is also important for the questionnaire approach to be supported by “walkthroughs” of the kind conducted in Part I of the Review and to involve IEG if it is to perform a similar role in the future.

Finally, the Panel raises the question of adherence to timetables, perhaps as more of an issue of planning and commitment, including timely information and involvement of all participants. While there are many planning methodologies to choose from, the Panel commends the use of at least the principles of critical path analysis aimed at keeping the review on track and focused on the outcomes to be achieved while minimizing the frustration, cost, and impact on the capacities and effectiveness of the various participants.

5. Panel Observations on IEG’s Overall Conclusions/Recommendations on Parts I and II of the Review

The Panel draws attention to its earlier observations and suggestions relating to the IEG specific conclusions and recommendations. The Panel agrees with the IEG overall finding that its evaluation provides a solid and reliable basis on which to draw the conclusion that there is reasonable assurance that the compliance aspect of Internal Controls for the business processes are working as intended, with some notable exceptions, described as a material weakness and a number of significant deficiencies. The latter need to be put into perspective given the coverage and the first-time nature of the overall Review.

The Panel has made some relatively minor observations on the IEG recommendations to Management that they regarded as being of the highest priority. However, it supports those recommendations as being balanced and appropriate, based on a thorough and comprehensive evaluation. The Panel also agrees, based on its experience, that the outcome of the overall Review reflects a high level of effectiveness compared to results in other organizations of similar size and complexity but with less international involvement. This perception would be reinforced by a clear and timely commitment including reporting back to stakeholders, to overcome the identified deficiencies and improve the effectiveness of internal controls within both the COSO and governance frameworks.

6. Panel’s Observations and Conclusions on the Overall Review

In the Panel’s view, the Review of IDA Controls is a comprehensive, timely, and responsible initiative. It has been undertaken at a time when governance arrangements and public concern about accounting and accountability controls and corporate performance has been at its highest for many years. The result should be of great
satisfaction and source of confidence going forward for the Board, Management and other stakeholders.

While the Panel had most exposure to the IEG team and its professional competence and commitment, we were also similarly impressed with other senior personnel in Management and IAD. In particular, we were very grateful for their openness and cooperation. These observations are made because they explain a lot about the quality of the overall review. As always is the case, the challenge is now the successful implementation of the Review’s Findings and Recommendations, as accepted by the Board. A similar professional commitment will be required.

Patrick Barrett        Bjarne Mork-Eidem        Vijay Shunglu
1. Origins of the Review, Status after Completion of Parts I and II

Purpose of the Report

1.1 This report contains IEG’s evaluation of IDA’s internal controls framework. The report reflects the results of IEG’s evaluation of entity-level controls, conducted as Part II of the overall review, but it also integrates all findings from Part I. Hence, it is a comprehensive evaluation of the whole framework. The report is about IDA, but since IDA is managed by the Bank and governed by Bank controls, the report may refer in some places to the Bank in a generic sense.

1.2 Controls are tools to manage and mitigate risks. The focus of this report is therefore on internal controls, including the identification of weaknesses where they may exist. However, it is not within the scope of this report to identify the detailed remedial mechanisms, nor to address any underlying institutional issues.

Background and Recapitulation

1.3 IEG has conducted its evaluation in accordance with the planned approach that was endorsed by Audit Committee and the Committee on Development Effectiveness in 2006. The overall purpose of IEG’s evaluation has been to offer an independent conclusion to the Board as to the effectiveness of IDA’s controls over compliance with its charter and relevant policies and procedures. This did not encompass an evaluation of the quality or development effectiveness of such policies.

1.4 The Board agreed that the review would involve three parties: management would undertake a self-assessment, the Internal Audit Department (IAD) would provide a review and opinion on management’s assessment, and IEG would undertake an independent evaluation of both management’s and IAD reports.

1.5 Management and IEG agreed that the review would be conducted using the framework of the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Bank and IDA adopted the COSO framework as guiding principles for corporate governance in 1995. Since 1997, management has issued an annual re-
port (shared with the Board since 2000) reflecting the extent to which
the Bank has adapted to these operating principles. Until now the
COSO framework has been applied and adapted in the Bank mainly
for financial reporting, where the Bank has attained a standard that
permitted external auditors to give an attestation not only on the ex-
ternal financial reporting but also on the internal assessment that un-
derlay the external financial reports.

1.6 Management discussed its most recent assessment of financial
reporting controls with the Audit Committee of the Board on October
31, 2007. At that time, the external auditors also presented their Man-
agement Letter on the controls, and their attestation over manage-
ment’s assessment of the internal controls over external financial re-
porting. This report incorporates the results of these assessments
where appropriate, and IEG has verified that the external auditor pre-
sented both the Management Letter and its attestation.

PHASING OF THE REVIEW

1.7 Given the annual assessment of internal controls over financial
reporting, management and IEG agreed that this review would not
need to include this area within its scope (apart from IEG’s verifi-
cations, mentioned above). Management also decided and informed
the Board that the review would be conducted in two parts: Part I
would deal with controls over compliance with IDA’s charter and its in-
ternal policies and procedures, the transaction-level controls; Part II
would focus on controls over the efficiency and effectiveness of IDA oper-

Box 1. Phases, Content and Timing of the Review


Part I — Compliance with IDA’s Articles and Policies (transactions-level controls): This part was split into two steps:

A. Identified and mapped the Business Process Modules (BPMs) and key controls in each process. Management reviewed the design effectiveness of the business processes and recommended remedial actions (IEG report completed October 2006.)

B. Management tested a sample of products and transactions for weaknesses in the operating effectiveness of the key controls and recommended remedies (IEG report completed June 2007.)

Part II — Controls over Efficiency and Effectiveness of Operations (entity-level controls): Management assessed whether the existing internal control framework, including corporate governance and entity-level controls, provides reasonable assurance that IDA’s operations are carried out efficiently and effectively, focusing also on the processes and controls identified in Part I. The content of Part II is the substance of the present report.
ations, the entity-level controls under the COSO framework.

1.8 To better manage the reporting of its progress to the Board, management decided to divide Part I into two stages (Part IA and Part IB), each dealing with distinct components of the assessment of the internal controls. How the overall review has been divided, and what topics are covered in each part, including Part II—the subject of the present report—is described in Box 1.

Status of the Review at the End of Part I

1.9 IEG completed two reports under Part I. The first (October 2006) covered Part IA. In May 2007, management delivered to IEG its Part IB and overall Part I assessment, and IAD delivered its review. IEG completed its evaluation of both management’s assessment and the IAD review in its report on Part I sent to the Audit Committee in late June 2007. Some key findings of the Part IB report included the following:

- Despite starting with a transactions-level assessment, the BPM approach was well focused, transparent, detailed and empirically based, with measurable outcomes;
- Controls testing in Part IB was found satisfactory, robust, and credible;
- Controls at the transactions level complied with required policies and procedures at a rate exceeding the 90th percentile;
- Results provide a reasonable level of assurance that the compliance aspect of internal controls for BPMs is working as intended, with some exceptions;
- The principal exceptions included a potential material weakness relating to OP/BPs which were not current with changes in the Bank, together with a significant deficiency in fiduciary controls.

1.10 Following the conclusion of its Part I evaluation IEG made a number of recommendations in its Part IB report, which served as a basis to ensure continuity and comprehensiveness between the two components of the review. These are summarized in Box 2.

1.11 **Advisory Panel**: As part of its evaluation, IEG was assisted by an international Advisory Panel, which visited Washington in early March 2007. The panel prepared a statement that was supportive of the approach, method, and conclusions reached to that point in the review. A copy of the statement is appended to the report of June 22, 2007.
Box 2. IEG Recommendations at the Conclusion of Part I

Completion of the Entity-Level Assessment (Part II): The challenge for Part II would be to redress the scope deficiencies in Part I and to draw linkages between actual findings from the transactions-level assessment and the COSO framework elements at the entity level. IEG recommended that the following topics be the subject of specific focus in Part II:

- **Controls and Project Processing:** Design flaws were less important than non-observance of controls in Part I, which suggests there is a need for greater management oversight (i.e. improvement in the control environment)

- **Potential Material Weaknesses:**
  - *Documentation Retention and Accessibility:* This significant deficiency suggests the need to draw links with both the Control Environment and the Information and Communications component at the entity level, where improved information technology (IT) systems would be part of the solution.
  - *Dated OP/BPs:* This potential material weakness was an essential element of the Control Activities component, which it would be well to accelerate and complete (as much as possible) in time for the completion of Part II.

- **Managing the Risk Framework and Extending COSO:** As IEG recommended on Part IA, management should consider extending the COSO framework by adding a fourth objective (strategy – high-level goals) and three new components (objective setting, event identification, and risk response). This suggestion was also made by the Advisory Panel.

- **Efficiency and Effectiveness:** As the overall review would move from the transactions level to the entity level, and from compliance to effectiveness and efficiency, a challenge in Part II would be to build on the results from Part I, linking these to IDA’s Monitoring and Learning activities (including the Quality Assurance Group and IEG), in order to provide the element of effectiveness and efficiency testing that was lacking in Part I, and was needed before conclusions could be drawn regarding the overall effectiveness of IDA’s internal controls.

Part II: Assessing Entity-Level Controls

**THE DEFINITION OF ENTITY-LEVEL CONTROLS**

1.12 Entity level controls refer to those internal controls applicable to the entity as a whole (i.e. “high level” controls). These controls include to the structure, practices, and culture of the organization (so-called “high level” controls) which, supported by management, establish an effective Control Environment. The entity-level controls refer to those elements of the five COSO components of internal control that have an overarching or pervasive effect on an agency.

1.13 Examples of entity-level controls include:

- systems and processes for performance management (performance measurement and results);
human resource management (hiring, job descriptions, performance evaluation, and training);
ethics (code of conduct and ethics regulation);
control units (including both regional and sector operating line units as well as cross-cutting central control and monitoring units) with responsibilities that cut across the organization and exist for the purpose of monitoring the effective achievement of objectives and/or implementation of internal controls (for IDA, such as IEG, IAD, the Quality Assurance Group, and Department of Institutional Integrity).

In addressing its assessment of entity-level controls in Part II, management adopted a two-pronged approach that focused on key control units as the basis, and used a questionnaire to corroborate results.

Key Responding Units (Control Units): As it had done in Part I by mapping business processes to represent IDA operations, in Part II management mapped the key units in the Bank most related to its operating processes and hence part of its entity level controls framework. These were the units which were sent the ELCQ (para. 1.16) and responded to it. In all there were 31 units, including Managing Directors and the Chief Financial Officer (CFO), the operating Regions and Networks, nine central control units, and nine other service units. The units are listed in Box A.1 in Annex A, Volume II. Where relevant, the units were also linked to the respective components in the COSO framework. Management mapped the mandate and main responsibilities and role of each unit in the internal control framework; reviewed the primary products and outputs from each unit in the recent past against their respective mission goals; reviewed the processes in place for follow up on recommendations for action by management; and identified some gaps and overlaps in the overall framework.

The Entity-Level Questionnaire (ELCQ): Management designed a questionnaire (based on source information from the public accounting profession and from the U.S Government Accountability Office, or GAO, adapted to the IDA review), to be used to give additional evidence in its analysis of key control units. The ELCQ was sent to managers in all the units identified in the framework. The questionnaire was similar to, and in some cases used the same questions as the questionnaire used annually in the assessment of Internal Controls over Financial Reporting (ICFR), but the ELCQ focused mainly on operational issues and controls over efficiency and effectiveness, issues not routinely covered in the ICFR.

The ELCQ was organized around the five COSO components, and had a sixth section on anti-fraud programs and controls. Each COSO component contains a number of sub-topics which define key control units are structure (key control units), practices, and culture, as exercised through the COSO framework.

Management identified 31 responding units.

ELCQ design was based on GAO and other accounting industry principles; it was partly linked to the annual ICFR and was sent to all 31 controls units.

The Entity-level controls are structure (key control units), practices, and culture, as exercised through the COSO framework.
aspects of the controls framework which are intended to govern management and staff practices in that particular area. For example, the *Control Environment* component is divided into management commitment to excellence (“Tone at the Top”), emphasis on ethical behavior, organizational structure, HR policies, and procedures. Using the GAO Manual as a guide management devised a set of questions for each sub-component designed to solicit responses from managers as to how they saw the controls operating in practice in each area.

1.18 IAD and IEG were shown a draft of the ELCQ and were given the chance to comment on it before it was distributed to managers. Management conducted detailed exchanges with a number of responding units to verify and clarify the responses.

**THE INTERNAL CONTROLS FRAMEWORK UNDER COSO**

1.19 The approach taken in the review has treated the transactions-level controls and the entity-level controls separately, the former being addressed in Part I and the latter in Part II. In reality the internal controls framework is integrated and consists of both these levels of controls, and it is further integrated with the overlay of management principles that constitutes the COSO framework. Management’s assessment was organized around the COSO framework, most particularly in dealing with the entity-level controls. The COSO framework, as used by IDA, was described in the two previous IEG reports, but a summary is repeated for easy reference in Box 3.

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**Box 3. The COSO Framework**

Elements in sound governance: For all public companies and other operating entities COSO postulates the key objectives of sound governance and the means to ensure they are attained.

**The COSO Objectives:**

Sound governance requires the attainment of:

- Reliable financial reporting
- Compliance with laws and regulations
- Effectiveness and efficiency of operations

To minimize risk of misstatements in external reporting
In IDA’s case, compliance with its charter and internal policies and procedures
Being aware of the extent that a company or organization is achieving objectives of efficient and effective operations

**The COSO Components**

Aspects of corporate management to ensure attainment of corporate objectives:
The Review Becomes Comprehensive

1.20 The completion of Part II brings the overall review to a stage where, with both transactions- and entity-level controls assessed and tested, it is now possible to reach conclusions regarding the effectiveness of the overall controls framework under COSO. Volume II of this report gives an account of the elements that went into completing Parts I and II. The review has now become comprehensive in the following respects:

- The entire framework of controls has now been assessed—at both the transactions and entity levels—which means that conclusions can be drawn regarding how transactions controls and framework controls interact, and whether any conclusions drawn during Part I might need to be reconsidered in light of their assessment within the whole controls framework.
- Effectiveness of controls under COSO requires that the assessment examine the degree of attainment of all three COSO objectives. IEG confirms that the assessment of controls over financial reporting was conducted by the external auditors. The
With the completion of Parts I and II, the Review has now covered the entire controls framework; all COSO objectives, all COSO components, and all scope limitations have been addressed; definitive conclusions are now possible. Financial reporting was conducted by the external auditors. The present part of the review has addressed the remaining two COSO objectives. With the completion of Part II this means that all three objectives have been assessed.

- Completion of the entity-level review in Part II focused on all five COSO components, whereas Part I focused mainly on only two (Risk Assessment and Control Activities). The COSO framework suggests that, for reasonable assurance that controls are operating effectively, all five components should be present in the assessment.

- In Part I there were scope limitations (omission of some business process modules; postponement of the assessment of information technology [IT] controls, fraud and corruption, and the decentralized field offices), which implied that the controls framework being assessed was somewhat incomplete, thus preventing clear conclusions regarding overall effectiveness. These remaining components have now all been assessed.

- In the same vein, the discovery during Part I of a number of issues, exceptions, and deficiencies that arose during the transactions-level assessment meant that these needed to be further assessed for the review to be complete and comprehensive. Some were addressed during Part I, several remained to be addressed during Part II. This has now been done (although the resolution of a number of these issues is still in progress).

In short, management’s decision to conduct the review in stages always implied that final conclusions would have to wait until the full framework and entity-level controls had also been assessed. That has now been accomplished. The balance of this report lays out how IEG has evaluated the controls framework as whole, also taking into account the reports from management and IAD. In doing so it gives a brief account of IEG’s method and approach in making its evaluation, which is then followed by a summary of the main findings and conclusions.


2. The IEG Evaluation

IEG’s Approach and Tools

2.1 IEG has performed the role of an independent evaluator, consistent with the initial agreements reached with the Board and management. To this end, IEG has made its own analysis of the effectiveness of IDA’s internal controls, while also using management’s assessment reports and the IAD reviews as primary references. The elements that went into the evaluation are the following:

- Independent analysis of basic materials supplied by management and IAD, including the mapping and survey of key control units, the results from the ELCQ, certain background papers commissioned by management (and others by IEG itself), external articles from the auditing profession, and Bank reports on related topics;
- Extensive interviews with many of the key control units comprising the entity-level controls framework;
- Critical review of the final reports from management and IAD;
- Application of IEG-designed templates to evaluate the design and effectiveness of controls at both transactions and entity levels, as the basis for quantified rating of controls quality;
- The expertise of IEG’s audit-experienced core consulting team, which has kept IEG in close contact with developments in the internal controls profession, regarding COSO itself, and with relevant sources, such as the requirements of the Sarbanes-Oxley legislation, accounting standards (AS2 and 5) and other implementing standards that are recognized as benchmarks for such reviews.

A summary of the approaches IEG used in its evaluation is in Annex E.

2.2 For its evaluation of internal controls over financial reporting, IEG relied upon reports issued by management and the external auditors. IEG examined the results of these reviews for FY 2006 and 2007, including management’s report and the external auditors’ Management Letter for both years, and conducted follow-up work on deficiencies noted and actions taken as a result of the reviews.
Evaluating IDA’s Internal Controls Framework

APPRAOCH AND METHOD

2.3 Since management undertook the self-assessment, it also determined the approach and method for the review, in consultation with IAD and IEG. IEG has conducted a thorough evaluation of management’s approach and method in both Parts I and II. These were also given detailed ratings using the IEG templates. With a few caveats mentioned below, IEG has found the approach for the review methodologically sound.

2.4 IEG had commented in its earlier reports on certain shortcomings it observed in the approach adopted, mainly relating to scope limitations and the fact that management started with the transactions rather than the entity-level assessment. Following completion of Part II this sequencing issue has become largely moot because the entity-level controls have now been assessed, and the earlier scope limitations have also been satisfactorily addressed.

2.5 Management’s use of the questionnaire approach in Part II was appropriate; this is a common method for such reviews. However, a question with this method is whether it may introduce some biases into the results. There is some evidence that operating managers were less likely to see fault with internal controls than managers in the central control and monitoring units (see paragraph 11 and Figures B.3 (a) and (b) in Annex B), with 75 percent of all negative ELCQ responses (indicating controls were failing) coming from managers in central control units. Given their responsibilities and perspective on the institution, it should not be surprising that the central control units are more aware of possible control weaknesses. The remaining 25 percent of “no” responses from operating managers is not a trivial number, however, and suggests that substantial candor was present in this segment of the ELCQ.

2.6 In Annex A (Box A.2) IEG raises some more technical observations on the questionnaire approach, mainly to do with the focus of responses between individual units and the Bank as a whole. However, IEG concludes that none of these observations have caused any significant distortions in the overall results of the review. Also, the ELCQ was but one among a number of other sources of evidence consulted by IDA management, including detailed interviews. Its approach was thus essentially two-pronged, with these other sources of evidence being used to corroborate the findings from the ELCQ.

EFFECTIVENESS OF ENTITY-LEVEL CONTROLS: CALCULATED ELCQ PASS RATES

2.7 As one measure of the effectiveness of entity level controls IEG used the responses from the ELCQ to construct “pass rates” i.e. the fre-
frequency with which managers gave positive responses to questions in the ELCQ, implying that they thought the controls related to the questions were operating effectively. IEG defined the aggregate number of positive responses divided by the total number of individual responses as a simple pass rate (SPR) which showed the average extent to which managers gave positive responses to questions about the effectiveness of the entity level controls. The ELCQ response data showed that, defined in this way, the simple pass rate was in the 95th percentile. This is similar to the 93 percent pass rate for key transactions-level controls more objectively observed (based on documented evidence, not questionnaire responses) during Part I. Annex B gives a more detailed account of these results.

2.8 The question was also addressed whether controls in some parts of the COSO framework might have been systematically weaker than in other parts. The simple pass rates (see Figure 1) showed that there were indeed some differences between COSO components but these were not particularly significant. The pass rates for controls effectiveness were above the 90th percentile in the case of each component, though responses relating to both the Control Environment and to Information and Communication appeared to receive somewhat fewer positive responses than the average.

Figure 1. Simple Pass Rates by COSO Component

2.9 However, the simple pass rate concept provides rather too simple a picture, because within each individual question there were both positive and negative responses, and managers responded differently to given questions. Since the questions were designed to test the effec-
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The IEG Evaluation

tiveness of the controls, a more accurate aggregate count or pass rate would be given by showing how many individual questions out of the total 157 could be deemed to have been responded to positively on balance (i.e. constructing a net balance between positive and negative responses to each question). This approach was defined by IEG as an evaluated pass rate (EPR) because it requires a judgment for each question to balance out the positive and negative responses.

2.10 Judgments to determine the EPR were based both on the number of individual responses of each type (positive and negative), and also on the origin and nature of the responses: i.e. which Bank units made negative responses; how close were they to the subject matter of the given control being addressed; and what evidence or reasoning did they offer to explain their responses. As is described in more detail in Annex B (see paras. 6-7) management and IEG used different criteria to make these judgments and arrived at slightly different results. Management found an EPR of around 96% while IEG, using slightly stricter criteria, found an EPR of 92 percent. Both findings, therefore, were in the 90th percentile and suggested, again, that perceptions from the ELCQ results supported a broad conclusion that the controls framework operated effectively overall.

2.11 Another statistic from the ELCQ results supported the finding that managers saw controls as being generally effective: A majority of the individual questions received no negative responses at all. Out of a total of 157 questions only 70 (43%) had any negative responses and of these more than two-thirds had only one or two negative responses. IEG posited the standard that where three or more negative responses were given to a question it was a signal of possible deficiency in the control being addressed. Out of the total of 157 questions only 18 contained three or more negative responses, which shows how, by this measure, the controls weaknesses appeared to be concentrated in a relatively few areas.

2.12 The analysis was then conducted on these 18 questions, being the areas where most negative responses had been given in the ELCQ, while also consulting evidence from sources other than the ELCQ. From this process emerged the identification of major weaknesses and other deficiencies in the controls framework, ending finally in a composite evaluation of the overall framework. An account of the several building blocks that were used to compile the composite evaluation is given in Volume II in the following annexes: Annex A (Analysis and Evaluation of Management’s Approach and Method in Part II); Annex B (Analysis and Evaluation of ELCQ Results); Annex C (The Deficiency Tracker Consolidating Weaknesses Found in Parts I and II); Annex D (Factors Combining to Form a Material Weakness); Annex E (IEG’s Composite Rating of the Internal Controls Framework).
THE COMPOSITE EVALUATION

2.13 In making its overall evaluation IEG used these different analytical building blocks: it consulted all sources of evidence available; it closely reviewed management’s assessment and the IAD Review; and it applied its own template rating system to give a composite rating of the effectiveness of the overall controls framework. Taking all factors into account (pass rates, other evidence, identified weaknesses) and using the language of its template rating system (see Annex E in Volume II), IEG rates IDA’s controls framework as satisfactory with qualifications, a finding which is consistent with management’s qualified assurance and also with IAD’s conclusion that management’s assessment is fairly stated, but qualified by a number of deficiencies described in its review. However, as described below, IEG concluded that there was one material weakness and six significant deficiencies. This was close but not identical to the findings of management and IAD, because of somewhat different judgments regarding the materiality of some of the findings.

2.14 IEG’s composite rating also included a rating of controls effectiveness within each COSO component, since it is not excluded that controls weaknesses may occur to different degrees in the five components. IEG chose to present the results of this composite, component-based evaluation in the form of a statistical “diamond” shown in Figure 2 below.

Figure 2. IEG’s Evaluation of the Effectiveness of IDA’s Internal Controls Framework

2.15 The figure shows a graph with one arm for each COSO component. The effectiveness of controls within each component was
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THE IEG EVALUATION

Controls weaknesses were found to similar degree in all COSO components

rated on a scale of 1 to 4. Had all five COSO components been evaluated as fully satisfactory (rating 1), each arm of the polygon would have been positioned at the outer perimeter of the diamond. As it happens the evidence shows that the controls within each of the five components were equally rated (at “2”) which therefore equates to satisfactory with qualifications, which equates to the composite rating of the framework as a whole.

2.16 While this depiction accurately expresses IEG’s overall finding, as a statistical aggregate it also masks some important features of the assessment. One is that, as shown in the analysis in Annexes A and B, the more serious weaknesses in controls, even though cutting across COSO components, were concentrated in a relatively few areas in the controls framework. Generally, the framework operates effectively, except for these weaknesses. In the same way, IEG’s ratings of 2 for the controls within each component, while valid overall, hide the fact that many individual control items were rated 1 or fully satisfactory. Out of a total of 74 individual items rated, 43 (58 percent) received a rating of 1.

2.17 The source of the qualifications are the one material weakness and six significant deficiencies that were uncovered during the review. These findings result from IEG’s own analysis but also take account of the similar (though not identical) findings arrived at by both management and IAD. The basis for the findings is contained in Volume II (Annexes B, C, and D). The management and IAD findings are summarized in Chapter 3. What follows is a description of the material weakness and significant deficiencies that IEG has identified.

Material Weaknesses and Significant Deficiencies

MATERIAL WEAKNESS

2.18 Fraud and corruption (F&C) risks are widely assumed to exist in many countries, and this evaluation has shown that the Bank’s traditional internal controls to ensure that F&C does not impinge on IDA projects have not always been effective. Based on the evidence brought to light in the present review, and the agreed criteria underlying the review (see Box 4 below) IEG concludes that the weakness in the existing framework of controls addressing F&C issues are such as to rise to the level of a material weakness. While commitment to integrity has always been and remains a central feature in the Bank, there are also aspects of the culture that have resisted dealing openly with the potential for F&C at the local level in Bank and IDA operations. These facts have been well recognized by the Bank and more specific F&C related controls are now being introduced as part of management’s GAC Implementation Program and in other ways, e.g. in implementing the recommendations of the Volcker Report. However,
until these new measures are fully operative and effective it would be premature (from the view of both process and substance) to conclude that the F&C issues have been successfully resolved under the current IDA controls framework.

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<tr>
<th>MATERIALITY CRITERIA</th>
<th>SPECIFIC EVIDENCE FOUND</th>
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<tr>
<td>• Impair the achievement of IDA’s objectives</td>
<td>• Evidence from INT DIRs and FRs in five countries show F&amp;C indicators which suggest funds may have been diverted from the purposes intended; evidence of actual F&amp;C has also been found in some of these cases</td>
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<td>• INT DIRs/FRs show that F&amp;C indicators appeared in all six studied countries, suggesting actual F&amp;C may not be rare but may occur in many countries</td>
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<tr>
<td>• Violate requirements of IDA’s charters or other contractual agreements</td>
<td>• IDA’s Articles require that IDA operations be governed by its policies and procedures</td>
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<td>• INT DIR evidence (India, Kenya) shows that F&amp;C indicators have been found even when Bank procedures have been correctly followed</td>
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<tr>
<td>• Significantly weaken safeguards against waste, loss, or unauthorized use of funds, property, or assets</td>
<td>• In IL operations evidence from Part I showed significant deficiencies in IL fiduciary controls and absence of F&amp;C controls</td>
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<td></td>
<td>• In DPL/PRSC operations procurement controls do not apply, so F&amp;C has to be addressed through IDA FM and Loan Administration controls and through country systems which are often weak or non-existent</td>
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<td>• Involve conflicts of interest, involve systemic problems in country assistance, partnerships and project lending, or require the attention of Senior Management, the Board as well as the awareness of external stakeholders</td>
<td>• Bank culture, management priorities, staff incentives and HR practices have not given priority to safeguarding against F&amp;C in Bank/IDA operations</td>
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<tr>
<td></td>
<td>• Evidence from Part I (fiduciary weaknesses) and Part II (entity level incentives) shows a gap between progress in building a global Bank agenda against F&amp;C and establishing tools to make the agenda operational; more is needed from Senior Management in linking the global perspective to daily operations and to internal systems in client countries</td>
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2.19 It is important to emphasize key aspects of the context for this finding: First, the finding is based not on evidence of the occurrence of actual F&C (though there is evidence that some F&C has actually occurred) but rather on the fact that there is evident risk of F&C occurring in a significant number of IDA countries. Second, weak governance and F&C risks are part of the challenge of development in many IDA countries and F&C risks affect the work of all donors, not just IDA. Third, this is the first evaluation of its kind for any IFI, which places the Bank out front within the development community. Fourth, the finding of a single material weakness (together with some significant deficiencies) should overall be considered a quite respectable outcome from the first (and very detailed) exercise of its kind for IDA.

2.20 A full accounting of the factors that supports the IEG judgment of a material weakness is presented in Annex D. As explained in the Annex, the evaluation revealed that substantial progress has been made by the Bank over the past decade in building a global strategy to combat F&C, and a number of important steps have been taken to build entity level mechanisms to pursue an anti-corruption agenda in client countries. However, the specific tools needed to translate global goals into transactions level controls have been missing or have only recently been put in place (and so in many cases are not yet fully operative), while some are currently being developed. It should also be emphasized that addressing governance and F&C issues requires country systems to be improved as much as it needs improved internal controls within the Bank. This is so in investment lending, where the Bank is moving towards increased reliance on these local systems, but the Bank also provides general budget support through PRSCs (which are controlled entirely by local systems). Dealing with weak governance, including F&C in operations supported by IDA, is a fundamental dimension of the development challenge.

2.21 To elaborate further on the evidence summarized in Box 4, the key findings underlying the material weakness included the following:

- **Inadequate Tools to Address F&C**: The Bank has until recently had few if any specific tools to supplement its existing controls systems to address F&C at all stages in the lending cycle. Specifically, tools have been lacking to diagnose F&C risks systematically in the Country Assistance Strategy (CAS) process and to address it systematically in project design and appraisal documents. The Implementation Status Report (ISR) lacks F&C indicators, and F&C issues are not treated systematically in Implementation Completion Reports. The Bank’s generic fiduciary and other controls have historically been assumed to be adequate protection against F&C in projects, an assumption that
has been called into question by recent evidence. Furthermore, the question of how best to support clients in building country systems to address F&C – which is critical in ensuring appropriate use of general budget support – has not been fully addressed (although efforts have increased substantially in recent years).

- **Weaknesses in Generic Fiduciary Controls**: Part I of this review showed that the noncompliance rates among some fiduciary processes were higher than the average. Management, IAD, and IEG agreed that this should itself be considered a significant deficiency (see Annex D, para. 19).

- **Absence of F&C in Risk Management**: The Risk Scan does not include routine assessment of country fraud and corruption risk, even though it is widely known that IDA deals with countries where those problems are endemic.

- **Control Environment Factors**: The ELCQ results suggested that HR policies and incentives, job descriptions, and management behavior regarding the treatment of ethical issues in IDA operations are insufficiently geared to emphasizing the need to explicitly address F&C issues in routine IDA operational work.

2.22 Taken overall and measured against the specific criteria by which to judge materiality, as shown in Box 4, the evidence that there is significant risk of actual F&C occurring (whether or not it has actually been widespread) suggests the need for offsetting controls. However, specific tools are lacking in the Bank’s armory of controls to address F&C in Bank/IDA strategy and risk management, as well as in its operations cycle (both DPL and IL lending). These weaknesses are reinforced by deficiencies in some of the key fiduciary elements of the existing controls system, and in cultural and incentive structures which all combine to convince IEG that a material weakness exists.

2.23 **Identifying Remedies**: Given the composite nature of the material weakness IEG proposes that the remedies would also need to be multifaceted. This fact has been very well recognized by management (and by IAD) and is reflected in the wide range of GAC program components currently being implemented or prepared. In the schematic shown in Figure 3 below, IEG displays the key elements it regards as contributing to the weakness and shows the types of remedies that could be applied at the entity level and in the business processes across the project cycle. IEG highlights the following elements:
- **Remedy generic deficiencies** in existing controls and install appropriate tools to combat F&C within Bank/IDA operations. The objective should not be to attempt to eradicate all risk of F&C with stifling controls, but to have a risk-based, prioritized approach to explicitly address F&C issues in IDA operations, with the aim of understanding, signaling a focus on and reducing the risk of F&C. The costs/benefits and feasibility of such new controls need to be kept in mind, but what is being suggested here relates closely to the work already being done to address identified weaknesses in controls to address F&C under the GAC initiative (and the response to the Volcker Report). IEG believes what it is suggesting in this report could probably be accomplished with only minor additions to what is already underway. Also, the new risk management framework adopted by COSO should provide additional guiding principles in managing F&C risks and selecting risk priorities to be pursued going forward (see also para 2.28, bullet five below).

- **Address country systems and harmonize with other donors,** to be sure that those remedies internal to the Bank and IDA are matched by efforts to enhance the scope and capacity for country fiduciary and governance systems within the client countries themselves, working also with other donors and participating partners. This would be the appropriate approach to address F&C in budget support operations and to achieve longer-term development objectives more broadly. The remedies being proposed here should not be taken to suggest that IEG is advocating more “ring fencing” of IDA projects (apart from the already agreed need to strengthen fiduciary controls). On the contrary, as more emphasis and reliance is being placed on country systems (particularly for PRSC type lending), the remedies should rather be seen as simply ensuring that country systems themselves also focus on F&C issues, in parallel with the Bank’s efforts in this area.
2.24 These IEG findings and suggested remedies, therefore, echo and make explicit what the Bank itself has already recognized and is acting to correct.

2.25 For the material weakness to be resolved, such new controls would have also to be tested as being effective, which leads to the question how such effectiveness could be measured. In the first stage it would be progress enough (as is already underway) if explicit controls until recently absent were to be put in place in the key areas of the operations cycle outlined in Figure 3 below, and, as a second step, to demonstrate their effectiveness. It is in not the scope of this study to go beyond that, but it could be envisaged that the combined efforts to apply explicit tools aimed at focusing on F&C will themselves lead to an accumulating data base which will become a part of the Bank’s routine operations monitoring.

**SIGNIFICANT DEFICIENCIES**

2.26 The six significant deficiencies that IEG has identified (including those identified during Part I) are as follows:

- **Lack of currency of OP/BPs:** In light of progress made in updating OP/BPs that were in need of reform, IEG judges this weakness to rise to no more than a significant deficiency.
- **Timely accessibility to operational documents:** In light of the findings from the testing completed in Part IB, IEG concluded that the availability of documentation was substantially im-
proved compared to the previous round of testing and that this issue no longer rose to the level of a material weakness.

- **Weaknesses in FM and PR processes:** Testing of key controls during Part I showed that these fiduciary modules were among those with the highest rates of noncompliance, in part because of regional variations in process. This is a significant deficiency, which has also contributed to the material weakness described above. Management is in process of mounting an action program to remedy these deficiencies.

- **Need for improved management oversight:** Evidence from various sources (Part I findings, the ELCQ results, IAD country audits, the INT India DIR) suggests a lack of adequate management oversight of project processing, and most particularly, project supervision, which has been a significant factor contributing to the weakness of controls in IDA’s operations.

- **Need for improved risk management:** The need to extend the COSO framework to introduce two more risk-oriented components was identified in Part I. In line with current COSO developments, several additions were suggested: a fourth COSO objective, Strategy — High-level Goals Aligning with Supporting Mission; and three new components: Objective Setting, Event Identification, and Risk Response. Part II notes the failure to include an F&C risk element in the Risk Scan, in the CAS, and in project design and supervision processes, which all contribute to the identified material weakness concerning F&C.

- **Need for improved IT security:** The Bank’s current routines concerning managers’ SAP access privileges, and their amendment when staff rotate, may leave open the possibility of lengthy periods when segregation of duties is breached, when staff reassign but carry with them access privileges from their previous positions. This could raise the risk of fraud. Related findings have been reported by IAD and the external auditor (during the ICFR review). There are also issues relating to password sharing and improved IT systems for decentralization, and ensuring business continuity in light of natural or other disasters, as was brought to light in both the ICFR and the ELCQ results.

**EVALUATION OF CONTROLS OVER EFFICIENCY AND EFFECTIVENESS**

2.27 Management concluded that its assessment “gave reasonable assurance to Senior Management and the Executive Directors that they are made aware, in a timely fashion, of the extent to which IDA is moving toward effective and efficient use of its resources in meeting its operational objectives” (Management’s Assessment report paragraph 15). The basis for this statement was as follows:
• Findings in Part I that showed reasonable assurance that IDA operations were conducted in compliance with its policies and procedures, that IDA resources were used for the purposes intended, and that scope was identified for certain streamlining of controls over IL operations; and
• Descriptions during Part II of the various budgetary processes (which contain efficiency indicators and incentives) and monitoring mechanisms by the Bank’s central control units, which ensure that Senior Management and the Board are kept informed of trends in efficiency and effectiveness.

2.28 IEG concurs, as management asserts, that Bank Senior Management is kept informed of the progress and performance in the annual budget cycle. Key tools include the annual budget process (and quarterly QBR processes), the Quality Assurance Group (QAG) Annual Review of Portfolio Performance (ARPP), and the IEG Annual Review of Development Effectiveness and Annual Report on Operations Evaluation (now a combined document). It is also clear, as management says, that the Board is kept current on efficiency and effectiveness outcomes.

2.29 However, in IEG’s view, management did not go far enough in its treatment of controls over efficiency and effectiveness in its Part II assessment, in two respects:

• A focus on the controls over efficiency and effectiveness is a necessary but insufficient condition for sound judgment on this question. While IEG agrees with management that there are extensive controls in the Bank’s budgeting and monitoring systems to ensure that Senior Management is informed, the effectiveness of those controls cannot be judged without some reference to outcomes. For its part, IEG consulted a number of efficiency indicators (FY04-FY08; see Table SA.5 in the Statistical Appendix). All four lending-related efficiency indicators trended positively in each year (except in FY08), but completion costs of economic and sector work (ESW) and technical assistance (TA) have risen in recent years. While trends may not offer complete clarity, IEG is satisfied that Bank staff pursue the operational objectives of IDA with due regard to efficiency and effectiveness requirements.
• Management assembled a significant body of information during its Part II assessment that described ways in which the effectiveness of IDA’s operations is measured and priorities are selected and presented to Senior Management and the Board each year. This information could have been used for a more substantive statement.
CONCLUDING OBSERVATIONS

2.30  This exercise has been a major undertaking for IDA, and IEG acknowledges the commitment that management made to completing both parts of the review. The exercise has contributed substantially to the Bank’s knowledge of its internal controls systems and has heightened controls consciousness among managers and the staff, and corrective actions already underway will strengthen controls and better ensure that IDA’s business objectives are being attained. The combination of mapping the 35 transactions-level business process modules (and their rigorous testing), together with the COSO-framed questionnaire in Part II, has provided the Bank with powerful new knowledge about its internal controls system and how the Bank has adapted to the COSO principles. There were other benefits as well: the mapping has provided a strong basis for further work to streamline operations for greater efficiency, and the framework now established offers a benchmark against which future reviews can be conducted.

2.31  IEG acknowledges the thorough reviews by IAD and the insights that were offered from its auditor’s perspective on how controls should be designed and operated. A good deal of useful evidence for the review was also obtained from IAD’s ongoing work program, not done as part of this review but whose findings have been usefully applied.

2.32  Summary: IEG makes a number of observations and draws several conclusions from all of the foregoing analysis, as follows:

- The controls framework as a whole operates at a high level of effectiveness, but there are controls weaknesses in some areas.
- At both entity and transactions levels more serious weaknesses (noncompliance with controls) were not widespread, but were found to be concentrated around a relatively few areas in the framework.
- Weaknesses were found in both the design of controls and in the nonobservance of well-designed controls. At the entity-level, control design was the dominant source of weakness. At the transactions level, most noncompliance arose from nonobservance of existing controls, not from control design, though some need for the latter was also shown.
- Observing the incidence of controls weaknesses at the entity level within the COSO components, IEG found that there were differences within each component, but that overall weaknesses were also cross-cutting and interrelated, so effectiveness ratings were the same for all components and rated *satisfactory with qualifications*.
- With regard to specific controls weaknesses, IEG found one material weakness in the controls over fraud and corruption in
operations supported by IDA funding, being a composite of several factors. It also found six significant deficiencies, three of which were identified in Part I and three which were added after evaluating entity-level controls in Part II.

**Future Evaluations of IDA Internal Controls**

2.33 At the direction of the Board, management conducted this assessment as a one-time exercise. An outside review organization has earlier recommended that internal control assessments be conducted annually. Future assessments would be able to build on the substantial body of knowledge and analysis that is now available, but an annual review with the scope of the present review would be impractical. However, IEG recommends that more selective reviews be undertaken periodically, perhaps every two to three years. All such reviews should cover both IBRD and IDA.

2.34 IEG recommended in its Part IB report that IDA should consider the value of adopting a policy requiring: (1) ongoing monitoring and reporting on internal controls in the course of operations for all three COSO objectives; and (2) developing a policy on separate evaluations and reporting on special topics. Such a policy could delineate criteria for determining when separate monitoring would be initiated and when IDA would rely upon its ongoing monitoring efforts (IEG, IAD, Department of Institutional Integrity [INT], Quality Assurance Group [QAG]) for assurance as to the effectiveness of internal controls. The COSO framework provides potentially useful guidance for determining when the types of monitoring are appropriate, such as when there has been significant organizational change.

1. As provided in AS5, which was used as a source of guiding principles for this review, IEG relied on the results of the work completed by management and external auditors for evidence supporting the assessment of control over financial reporting. In making this decision, IEG considered the combination of management’s work and that of the independent public accounting firm to offer a high degree of competence and objectivity for evidence on the effectiveness of internal controls over financial reporting, enabling IEG to make full use of that work for its evaluation.

2. The ELCQ contained 157 individual questions. The questionnaire was sent to 31 units in the Bank, so in aggregate there were potentially 4,867 individual responses to the questions (31 x 157). Since some questions were not answered by all units, and some were not applicable to all units, the actual number of effectively possible responses was 4,149. Of this total 3,673 were positive, 177 were negative, and a number were answered ambiguously, giving a simple pass rate of slightly over 95%. See Annex B, para. 5.
3. The ratings were based on a combination of all forms of evidence available to IEG. This included all management materials, including the ELCQ, interviews by IEG with Bank units, all background papers and other external information, and the final reports from management and IAD. Hence, the ratings are a composite of all materials and reflect IEG’s judgment on the overall effectiveness of controls within the framework.

4. INT has conducted several Detailed Implementation Reviews and Fiduciary Reviews (DIRs and FRs, which examine the presence of F&C Indicators in IDA lending operations, including India (07). Some of the reviews were undertaken at INT’s initiative, while the others were initiated by the Regions. The IEG team examined all the reviews, which all showed evidence of F&C indicators, and some of actual F&C. The most recent DIR (on the health sector in India) became public in December 2007, and the key findings were presented to the Board in January 2008. See Annex D para. 14 (Volume II page 40) for types of findings that emerged from these reviews. The Volcker report on INT also contained relevant evidence.

5. Thus the US Treasury was found to have eight material weaknesses in 2005, reduced to four by 2008 (see Statement of Assurance, included in its 2008 Performance and Accountability Report); and USAID was found to have four material weaknesses in 2007 (see USAID FY08 Performance and Accountability Report (PAR). Visit Treasury web site: http://www.treas.gov/offices/management/dcfo/accountability-reports/2008-par.shtml and USAID: http://www.usaid.gov/policy/afr08/

6. Downgraded from potential material weakness in Part I.

7. This was judged by IEG to be a potential material weakness in Part IB, and is now downgraded to a significant deficiency.

8. Treated as part of material weakness in controls over F&C.


10. See IEG Part I report, para. 4.7, final bullet, p. 42.
3. Summary of Management’s Assessment and the IAD Review

Management’s Assessment

3.1 Management’s final assessment report is in Attachment 1. The main objective for management’s review was to assess IDA’s internal controls framework and to ascertain whether the framework gives Senior Management and the Board reasonable assurance that IDA’s operations are in compliance with its policies and procedures and that its resources are used with due regard for efficiency and effectiveness.

3.2 Management’s Overall Assessment:1 “Under the COSO internal controls framework, Management is responsible for establishing and maintaining an effective internal control system. IDA’s management has assessed internal control over IDA’s operations, and based on this assessment, and reflecting the work undertaken by management and attested to by the external auditor during the FY07 ICFR process, management is of the view that the internal controls system over IDA’s operations is adequate to provide reasonable assurance to Senior Management and the Executive Directors, that:

- IDA’s published financial statements are being prepared reliably;
- IDA carries out its operations in compliance with the relevant provisions of its Articles of Agreement and operational policies and procedures, including provisions relating to the use of funds for intended purposes; and
- They are made aware, in a timely manner, of the extent to which IDA is moving toward effective and efficient use of its resources in meeting its operational objectives.”2

3.3 Management goes on to say that, integrating its findings from both Part I and Part II,3 it has identified a number of significant deficiencies that require remedial actions—and effective monitoring of their implementation—in order to strengthen the internal control system over IDA operations. These significant deficiencies fall into five categories, for each of which management also recommended monitorable remedial actions, to be reported on in a progress report to be issued in time for the IDA 15 mid-term review. These are all paraphrased in the paragraphs which follow.

Evaluation Essentials

- Management states that the controls give adequate assurance that IDA’s resources are used efficiently and effectively and in compliance with its policies, but finds significant deficiencies in five areas
- IAD states that management’s qualified assessment is fairly stated; IAD finds a group of significant deficiencies, including in controls over F&C, which could become a material weakness if not soon corrected

Management’s assessment concludes that, with some exceptions, IDA’s internal controls provide adequate assurance that the three COSO objectives are being attained

Management found significant deficiencies in five major areas
<table>
<thead>
<tr>
<th><strong>IEG finds</strong></th>
<th><strong>3.4 IEG Observation:</strong> IEG takes the above statements by management as assurance to IDA stakeholders that, except for certain weaknesses identified in parts of the internal controls framework, the framework provides reasonable assurance that IDA’s operations are in compliance with its policies and procedures and are conducted with due regard for efficiency and effectiveness. Following its own evaluation of the effectiveness of the controls framework, which included confirmation that management’s approach and method were sound, and taking account also of IAD’s conclusion that management’s assurance was well stated, IEG believes that management’s assurance, with the stated significant deficiencies, is justified. However, IEG goes further than both management and IAD regarding the weaknesses of controls over prevention of fraud and corruption in IDA operations, judging it to be a material weakness.</th>
</tr>
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</table>
| **management’s assurance justified, but IEG finds one material weakness in addition to six significant deficiencies** | **I: Issues Relating to the Current Policy and Procedural Framework for Investment Lending**

*Process inefficiencies, including a lack of focus on key risks and controls during preparation/design and supervision stages of investment lending projects*

| 3.5 Management points to the findings arising out of the transactions-level assessment in Part I, which revealed a number of inefficiencies in the processes governing investment loans (ILs), which are duplicative, rigid, “one size fits all,” and are not risk-based or responsive to different country situations. |
|---|---|
| **Recommended Remedies:** Management has prepared a statement containing a new risk-based investment lending (IL) policy framework, which will be shared with the Board (by FY09-Q3) and which contains the following principles: |
| --- | --- |
| • Rationalize and prioritize key controls governing IL. |
| • Facilitate appropriate differentiation of processes and requirements based on risk. |
| • Set appropriate additional controls, resources, and reviews for higher risk operations/environments; maximize efficiency and effectiveness of each control through rationalization and workflow automation. |
| • Strengthen risk identification and monitoring during supervision by, among other things, clarifying roles, responsibility and accountability between IDA and borrowers within the institution. |
| **3.6 IEG Observations:** IEG agrees with these findings and considers the remedies appropriate. |
Reforming the outdated and complex policy framework for investment lending

3.8 During Part I of the review management found that the controls framework governing IL operations is complex – multiple OP/BPs applied to ILs, the framework is over-regulated, and a number of OP/BPs have not been updated to reflect changes in the Bank and its client situations. During Part II, management found further that “the current status of OP/BPs does not have a material impact on compliance and operations objectives of IDA” because there have been mitigating measures taken that “fill in” the gaps with interim decrees and other measures. Management attributes the failure to keep current with OP/BPs mainly to their “prescriptive and micro style approach,” which will be improved once the new controls framework, based more on “core principles and key controls” 4 (described below) is in place.

3.9 **Recommended Remedies:** Management has launched a two-phase program to reform IL processes: Phase I to deal with immediate streamlining issues (completion by FY09Q4); Phase II to deal with a complete realignment of the IL framework, described below (completion by FY10Q2). A concept note on IL reform, which reflects the findings of this review, was discussed with the OVPs on October 20 and with the Board in November-December 2008. The new framework will:

- Reflect the main principles governing IL;
- Replace the current “one-size-fits-all” requirements with a risk-based approach to IL due diligence, processing, and design options; and
- Replace the rigid “ring-fenced” project model with a flexible menu of design and funds flow options to better meet development and funding needs of IDA’s varied clients.

3.10 **IEG Observations:** IEG agrees with management’s findings regarding the status of OP/BPs. However, based on management’s observation in Part I that noncompliance is frequently traced to non-observance of OP/BPs, IEG stresses that ensuring observance and compliance with policies (that is, management oversight) may be as important as maintaining the currency of OP/BP content. Regarding the proposed remedies, IEG considers them appropriate but warns that in seeking more flexibility and moving away from “one-size-fits-all” project preparation approaches the Bank should not lose at least a minimum degree of standardization in the PAD.

**Risk identification and reporting, information sharing**

3.11 Management found weakness in the timeliness and scope in reporting of risks generally, and in the context of project supervision
in particular. As evidence for this, management cited the results from questionnaires (both ICFR and ELCQ) and from the Risk Opportunity Workshops (ROW), as well as data from QAG, IAD, and IEG reviews.

3.12 **Recommended Remedies:** Management calls for an improvement in staff incentives and accountability, as part of an effort to improve the use and application of the ISR tool and process. It points to management action already underway, which includes:

- Issuance of a “Quick Reference Guide on Results and Results Terminology” to help task teams preparing ISRs in preparing results-focused ISRs against which to monitor project progress;
- Modification of the project realism index in April 2007, benchmarked against IEG evaluations of project outcomes at exit; and
- ISR reviews by every Region, to ensure adequate baselines, and to review quality and realism.

3.13 **IEG Observations:** IEG agrees with these findings and considers the remedies appropriate.

**Need to address diffused accountability and compliance**

3.14 Management finds, mainly from its ICFR and ELCQ results, that the links between performance and accountability are not as strong as they could be: accountability, compliance, and internal control responsibilities are not adequately reflected in performance management tools such as OPE or promotion criteria. Accountability issues were also identified as part of the Volcker report and the India DIR.

3.15 **Recommended Remedies:** Management is to conduct a corporate accountability review that will focus on assessing:

- Existing oversight arrangements to identify shortfalls in quality, including the roles and methods of central control units (QAG, IEG, INT, IAD, and Regional Quality Teams);
- Existing accountability arrangements for operations, including mechanisms to detect operational shortfalls, launching an e-module for ISRs (FY08Q4) and ensuring regular reviews of ISRs by regions, with guidance from OPCRX, and several measures to enhance performance management, including the HRS initiated Performance Management Working Group and the HR Insight web site to improve transparency of HRS data.

3.16 **IEG Observations:** IEG agrees with these findings, including the diffusion of management accountability and weak reflection of accountability and compliance in performance management tools. Evi-
dence from different sources (the ELCQ: IAD country audits; QAG assessments; and INT DIR studies) all point to the fact accountabilities seem to be diffused by the matrix management system, and this is likely to contribute its own element of weakness to other controls deficiencies. Also, in evaluating the proposed remedies, IEG would remind management that the ELCQ results suggest that a significant issue with the Bank’s Monitoring and Learning component is that operational management often does not take timely actions to respond to recommendations from the central monitoring units (IAD, QAG, IEG, and INT). More fundamentally, these issues may reflect deeper weaknesses in the Bank’s internal governance structures.

**Timely accessibility of operational documents primarily relating to investment lending operations**

3.17 Difficulties with accessing key operational documents was a major finding that emerged from the testing processes in Parts IA and IB, to such an extent that IEG classified this issues as a potential material weakness. Even though improvements were evident by the time of testing in Part IB (there was a 93 percent success rate in accessing documents), it was evident that significant issues remained. The entity-level assessment in Part II showed that aspects of both the Control Environment and Information and Communication (principally the IT solutions required to support IDA’s operations) needed attention to resolve these issues (as mentioned also by the IEG in its Part IB report).

3.18 **Recommended Remedies:** In FY07 the Bank established a task force, including ISG, to build a new system of automated key controls for IDA’s primary operational tools (CAS, Development Policy Lending [DPL], investment lending). The initial work has focused on IL as the main instrument, will be closely coordinated with the general review of IL controls (to be in effect by FY10Q2), and will be part of the Enterprise Content Data Management (ECDM) effort.

3.19 **IEG Observations:** IEG agrees with management’s findings and its formulation of the issues, which coincide with IEG’s own earlier observations. IEG also considers the remedies appropriate. As described in Chapter 2 (para. 2.24), IEG has downgraded this issue from a potential material weakness to a significant deficiency.

**II: Issues Relating to Fraud and Corruption**

*Need for better integration of fraud and corruption (F&C) issues (including lessons learned from precedents and INT work) into daily operations*
CHAPTER 3
SUMMARY OF MANAGEMENT’S ASSESSMENT AND THE IAD REVIEW

3.20 Management points to the leadership role the Bank has played in addressing the fraud and corruption agenda (acknowledged also in the Volcker Report), and distinguishes three phases, as follows:

- **Phase 1**: Setting out the **intellectual case** that good governance and an attack on corruption must be key parts of efforts to sustain economic growth and reduce poverty.
- **Phase 2**: Formulating an appropriate **anti-corruption strategy** and its adoption by Senior Management and the Board.
- **Phase 3**: Moving into the **implementation of the strategy**, the phase management explains the Bank and IDA have now entered. Using lessons learned, including from the work of INT, much remains to be done to integrate specific F&C tools into daily operations, particularly in countries where corruption is known to be endemic: in risk management, program and project design, and project supervision and evaluation.

3.21 **Recommended Remedies**: Management cites the response it gave to the Volcker report and recommendations as the main thrust of its action program to address F&C issues. Recognizing the need to mainstream good practices across the entire Bank, management also makes a number of specific recommendations for actions:

- Clarify responsibilities and accountabilities in addressing fraud and corruption, including adoption of a new INT strategy by end 2008.
- Introduce improved tools and processes (by November 2008) in order to create a more effective risk management framework to help prevent, deter, detect, and address fraud and corruption through “smart” project design and more effective and more appropriately resourced project supervision (progress to be reported on as part of the overall GAC Implementation Report, discussed at the Board October 21, 2008).
- Expand staff skills and broadening behavioral change in order to mainstream good practices across all of the Bank Group’s work (progress was reported on as part of the overall GAC Implementation Report).
- Review staff incentives (performance reviews, promotions, rewards, and visibility) to ensure that they are aligned with the anti-corruption agenda (an MD-chaired GAC Governance Council has been created and this issue is being discussed at that level).
- Mainstream lessons learned from precedents and INT work through, among other things, forming a consulting unit within INT for non-investigative purposes. The INT consulting unit has been created and core materials are expected from them on this topic by end September 2008.
• Prepare and monitor (with the support of Operations Policy and Country Services [OPCS]) specific action plans for following up on INT reports (a small team for the follow-up on post-INT report action plans is proposed to be established in OPCS with effect from FY 2009).

3.22 **IEG Observations:** IEG agrees with management’s formulation of its role in the area of combating F&C, and it agrees also with the broad findings that weaknesses in the Bank’s specific tools in this area suggest the urgent need to mainstream anti-F&C practices throughout the Bank. IEG also considers appropriate the remedial steps management is taking in this area, including those it committed to in response the Volcker Report. However, as described in Chapter 2 (para. 2.18-2.27 and in more detail in Annex D), IEG has concluded that the weaknesses in this area rise to the level of a *material weakness* in IDA’s internal control framework, rather than the significant deficiency found by management. This judgment is based inter alia on the current absence of specific anti-F&C tools in IDA’s controls framework coupled with the risk of IDA’s mission impairment that this implies. IEG fully recognizes the urgent and comprehensive set of remedial actions management has launched. However, where a material weakness (or any other deficiency) has been identified it must stand until all remedies are completed and found to be in operation and effective, which is not yet the case.

III: Issues Relating to Procurement (PR) and Financial Management (FM)

*Strengthening quality and accountability arrangements for procurement*

3.23 During Part I, management found that quality assurance processes for PR are in place and that the regional variances that existed were in line with the decentralized Bank, but it also identified two principal areas where controls need to be strengthened, and which, when combined with findings uncovered during Part I, it regards as rising to the level of a significant deficiency:

- To ensure consistent follow-up on PR issues by the task teams, including the need for better integration of PR staff in task teams and clarification of accountabilities for procurement issues and decisions;

- To ensure consistency in implementation of post-reviews;

3.24 **Recommended Remedies:** OPCS will set up a working group, by November 2008, that will be responsible for developing the following:
• Mechanisms for early and full integration of PR staff in the project teams and of PR tasks during the project cycle,
• Clarifications regarding the sharing of responsibility for key PR decisions at preparation and implementation stages between TTL and PR staff and Sector Manager and RPM, including mechanisms to resolve disagreements and raise awareness of TTLs/sector managers;
• a Procurement Certification system for this that would increase awareness and importance given to procurement work
• Guidance and criteria for assigning PR ratings for the ISR, and mandatory recording of revisions to such rating by sector staff
• Updating of OP/BP 11.0 Procurement (by end October 2008), and revising the PAD Procurement Annex (by December 2008) to include specific fraud and corruption provisions in addition to mainstreaming the risk-based PR assessment tool developed by SAR in 2004-5 (to be piloted by early 2009).
• Reviewing the roles of the Procurement Sector Board (PSDB) and OPCPR, to expand its ability to guide the regions and standardize regional practices and to provide guidance on risk assessment, including F&C risk, and improved post review monitoring (by December 2008).
• Developing a protocol with INT to systematically address fraud red flags.

3.25 IEG Observations: IEG agrees with management’s findings and formulation of the issues regarding PR and other fiduciary weaknesses and, as it did in Part I, has found in its evaluation that these weaknesses remain a significant deficiency. IEG takes particular note of the accountability uncertainties that derive from the Bank’s matrix management system and which were featured in the India DIR as an important factor relating to F&C (and which IEG regards as one factor contributing to the material weakness in this whole area). IEG considers management’s suggested remedies appropriate.

Issues relating to financial management

3.26 For FM, management finds that quality assurance (QA) arrangements have been put in place, but that the regional QA arrangements and documentation are “inconsistent and do not fully comply with the FM Practices manual (FMPM).” While some differences may be justified, there is a need for consistency across the Bank. Management cites three sets of issues:

• In some Regions, it was not possible to verify regular financial management specialist (FMS) review of audit reports because Audit Report Compliance Systems (ARCS) data entry was considerably out of date.
• There are inconsistent quality arrangements for the documentation of FM supervision work, including supervision planning, supervision reporting, and follow-up on FM action items. Quality arrangements to support the filing of FM documents are also inconsistent, making it difficult to validate that FM work has been done.
• There are inconsistencies between regions in timing of FM quality interventions on risky projects and gaps in oversight practices.

3.27 **Recommended Remedies:** Actions are already underway under the FM Sector Board to strengthen quality arrangements, including a Joint Evaluation by the Controller (CSR) and Operations Policy and Country Services (OPCS) of Network Quality Arrangements (FY09), implementation of Portfolio and Risk Management (FY09), and a review and update of the FMPM (by August 2008). Management also proposes that:

• Regions will consolidate and update their quality arrangements (by August 2008).
• Regions will update the ARCS for earlier years, and the FSB will monitor to be sure this has been done and that in future the data are entered in timely fashion. The Sector Board will develop and communicate good FM practices, pending the development of the ECDM system (by September 2008).

3.28 **IEG Observations:** IEG agrees with management’s identified findings and considers the proposed remedies reasonable and appropriate. In both PR and FM, however, IEG would have suggested giving more recognition to the question of how to support the development of country systems, which is key to both F&C control and IDA effectiveness over the medium term.

IV: Issues Relating to Risk Aggregation

*Potential gaps in risk coverage*

3.29 Despite important review and evaluation work carried out by the Bank’s central control units, there are gaps in risk coverage and IDA lacks a system for aggregating and prioritizing risk.

3.30 **Recommended Remedies:** Management intends to move toward an annual Integrated Risk Report (to be in place by FY10) which is intended to (a) describe overall risks facing the institution, (b) set out actions to address them, (c) assess potential gaps and overlaps, (d) develop a dashboard of risk findings from the various assessment activities, and (e) over time assess the adequacy of the processes in
place. Management also intends to conduct more specific reviews of central control units roles in the integration of risks and in providing checks and balances, and is suggesting a broad review of QAG by January 2009.

3.31 **IEG Observations:** IEG agrees with management’s findings and points to the observation IEG made in its Part IB report to the effect that the identified risks facing IDA had not been aggregated, prioritized, and differentiated. IEG considers the proposed remedies appropriate in general, but more information is needed on the scope and purpose of the QAG review.

**V: Other Significant Deficiencies**

*Processes and controls for analytical and advisory activities*

3.32 Following the request made by IEG in its Part IB report, supported by a similar request from the Audit Committee, management during Part II mapped processes and controls for analytical and advisory activities (AAA) and tested these for a selection of sample tasks, in the same way they had done for other BPMs in Part I. The actual tasks were all for ESW, which represents 80 percent of AAA expenditures. The tests revealed a 75 percent pass rate. However, many of the non-compliances were trivial—almost half were due to simple differences in dates between actual meeting dates and those recorded in the SAP, so the substantive pass rate is certainly higher than 75 percent.

3.33 **Recommended Remedies:** Management has already launched a broad review of AAA processes, controls, and monitoring to address both these deficiencies and some other issues revealed by recent QAG reviews (mainly concerned with the monitoring of AAA). Management expects to complete this review and present the findings to the Board by late FY09.

3.34 **IEG Observations:** IEG notes the successful conclusion of the AAA process mapping and testing, and it evaluates both management’s approach and its findings as being relevant and credible, and considers the proposed remedies appropriate, while noting that a recent IEG evaluation had found that the Bank needed to take the results tracking framework for ESW (and TA) much more seriously. However, IEG sees the main controls weakness here as relating to unstated or unclear policies (i.e. OP/BPs needing amendment) so it sees these as part of the overall weakness in OP/BPs, and does not regard this weakness as rising to the level of a significant deficiency in itself.
Information technology controls relating to password sharing and Infrastructure Change Management

3.35 Management states that the FY07 ICFR process identified three significant deficiencies: sharing of passwords for access into the SAP; issues (scope of access and monitoring) relating to access to privileged accounts; and the need to ensure consistency in application of controls over Infrastructure Change Management.

3.36 **Recommended Remedies:** Management has recommended actions to:

- Address the password sharing issue.
- Strengthen controls around information security to limit privileged access to system applications and to monitor changes made by staff using such privileged IT systems access.
- Strengthen controls around Infrastructure Change Management.

3.37 **IEG Observations:** IEG notes management’s findings from the ICFR and notes also its recommended remedial actions. IEG has not identified these three significant deficiencies in its evaluation since it did not review the ICFR questionnaire in detail. However, the results of the ELCQ also showed that access privilege issues were arising from the fact that the Bank system for managing privileged access for staff who rotate to other positions is not sufficiently fine tuned. This could make fraud easier and was therefore found by IEG, along with other IT issues, to be a significant deficiency.\(^7\)

**Resolving Issues Outstanding at the End of Part I**

3.38 At the completion of Part I, a number of issues remained to be addressed and resolved during Part II. Among these were some scope limitations: three BPMs—ESW, Debt Sustainability Analysis (DSA), and Safeguards (Corporate Risk List)—which had not been mapped and tested; there were other items on which further testing was needed—the large number of N/As, one further DPL, and CASs from other regions; and there were items that had been postponed to Part II—IT, field offices, and fraud and corruption; finally, a large number of miscellaneous deficiencies remained unresolved.

3.39 These various outstanding items have now been assessed, reviewed by IAD, and evaluated by IEG. For the sake of review completeness, a summary account of the results is given in Annex C.

**Monitoring Arrangements**

3.40 Management intends to implement the above remedial actions over the next 18-24 months and report to Senior Management and the
Executive Directors on the progress of their implementation and results achieved. OPCS and CSR will take the primary responsibility for such periodic monitoring and reporting. The first progress report to be prepared and discussed with the Executive Directors in the early fall of 2009, in time for the IDA 15 mid-term review. **IEG Observation:** These arrangements are welcome but management must ensure that the remedies program covers all deficiencies identified (over 100 in total) whose remedies may be in progress but are not yet operative.

**IEG Observations on the Overall Assessment Report**

3.41 Management’s assessment report was subjected to an extensive IEG review, including evaluation ratings for approach and method, findings, and conclusions. The approach and method, as described in Chapter 2, was rated *fully satisfactory*, but with some suggestions for improvements. IEG rates the overall assessment as *satisfactory with qualifications*. The assessment was made by COSO components, and IEG rates the assessment of the *Control Environment* and *Control Activities* as *fully satisfactory* with the assessment of *Risk Assessment, Monitoring and Learning, and Information and Communications* rated as *satisfactory with qualifications*. The qualifications stemmed mainly from the fact that, by conducting the entity-level review after rather than before the transactions-level review, management missed an opportunity to prioritize some areas (particularly regarding risk assessment relating to fraud and corruption), where controls needed to be strengthened.

3.42 In viewing the entire package of management’s findings IEG can confirm that IEG identified no significant deficiencies that management did not also identify. This commonality of findings is significant because IEG did not base its findings on management’s final report. Rather, IEG’s findings were made on the basis of a review and analysis of the raw results of the ELCQ responses, and the other materials provided to IEG. IEG’s analysis is therefore independent of management’s report. IEG also applied a statistical analysis of the ELCQ responses to support its findings, something management chose not to do.

3.43 Notwithstanding the broad commonality of findings, there are also some differences between management and IEG findings, most particularly in two areas:

- **Material Weakness:** IEG found that the deficiencies in controls over detection and prevention of F&C rose to the level of a material weakness, which affects its evaluation of the state of the overall controls framework. However, this does not imply that IDA’s financial reporting has been misstated, because this material weakness is over operational not financial reporting. This issue is further elaborated in Chapter 2 and Annex D.
Organizing the Findings: Management grouped its findings of deficiencies around key areas, and grouped many of them around processes tied to IL business processes, F&C, FM and PR, and others; IEG tended to stay with the framework of the COSO components, but it also used a conglomerate grouping when describing the material weakness; while grouped differently, the commonality of coverage of the findings remained.

The IAD Review and Opinion

3.44 IAD’s final report “IAD Review of Management’s Assessment of IDA’s Internal Controls: Part II,” is in Attachment 2.

OVERALL OBJECTIVE

3.45 IAD’s overall objective in the review was to: “review the basis of management's assessment, and express an opinion on whether it is fairly stated based on the criteria established in Internal Control – Integrated Framework issued by COSO.”

SCOPE, APPROACH, AND METHOD

3.46 Part I: Assessment of Business Process Controls: In its Part IB report IEG gave a full account of the scope, approach, and method adopted by IAD in its Part I review and opinion on management’s assessment of the transactions-level key controls, as well as of the key results. The highlights of this approach were as follows:

- Review of high-level process flow charts and accuracy of management’s mapping of key processes;
- Attendance at workshops/review sessions to verify effectiveness of design of key controls;
- Application of its deficiency tracker to identified weaknesses in controls design;
- Review of sampling and methods of testing for operation of key controls;
- Review and critical validation of management test results (it issued 32 transmittals containing observations to management);
- Used related results of IAD work conducted for other purposes, where relevant to the controls review.

3.47 Part II: The Entity-Level Controls Review: With regard to the scope of its review and opinion in Part II, IAD described this as covering five areas:

- “overarching control framework for IDA, including all aspects of corporate governance and entity-level controls;
- efficiency and effectiveness of IDA’s operations;
• information technology (IT) controls;
• fraud and corruption controls; and
• other outstanding items carried over from Part I, including (i) quality assurance arrangements for procurement and financial management in IDA’s operations (ii) three additional processes relating to Safeguards Corporate Risk, IDA’s Grant Allocation and Debt Sustainability, and Economic and Sector Work (iii) QAG’s Quality of Supervision Assessment, and (iv) additional testing of CAS and DPL modules.”

IAD’s Approach and Method

3.48 IAD’s approach to its Part II review consisted of four segments of work: (a) review of basic instruments; (b) review and verification of management’s testing results; (c) use of other ongoing IAD audits and other reports; and (d) review of management’s assessment report.

3.49 Review of Basic Instruments: As part of the process of reviewing and commenting on management’s approach before the start of the assessment, IAD reviewed both the Part II Scoping Memorandum and the draft pre-issue ELCQ, it commented on each and followed up on the comments.

3.50 Review and Verification of Results: IAD conducted a thorough review of the output from the instruments used in management’s assessment, covering:

• Workshops/Review Sessions: IAD attended walkthrough sessions to validate process documentation for key controls in four business modules not covered during Part I (ESW/AAA, Safeguards and Corporate Risk, Grant Allocation, and Debt Sustainability).

• Revised Process Documentation: IAD reviewed the revised process documentation that arose out of the workshop/walkthrough sessions.

• Management Test Results: IAD reviewed the test results for Part II, including the documentary evidence supporting management’s conclusions.

• Transmittals for Communicating Entity-Level Review Results: IAD issued seven transmittals communicating preliminary results from the responses to management’s ELCQ.

3.51 Use of Other, Ongoing IAD Audits: In its review report, IAD mentions 20 audit reports from which it drew evidence for the IDA controls review. These included 12 country program or other audits of Bank or IDA activities in a range of countries; an audit of Bank Identity and Access Management; audit of key Bank IT and wireless telephone systems; an audit of the Bank’s COSO process; and audits of
the Integrated Risk Management Framework and the Quality Assurance Group. **IEG Observation:** With regard to the country program audits (most of which were also reviewed by IEG) the Bank-wide learning would have been more pronounced had the main findings been organized and analyzed by IAD into a synthesis report where common themes and their materiality could have been identified. Such a report was prepared in September 2008.

3.52 **Draft Management Assessment:** IAD reviewed the draft report and supporting annexes and provided preliminary comments with regard to the candor of management’s conclusions and consistency with the objectives and results of the assessment. Management reformulated its overall conclusions to address some of IAD’s preliminary comments, and additional comments were also made in July 2008.

**SUMMARY OF IAD RESULTS AND FINDINGS**

3.53 IAD presented its findings in the form of a general observation, several specific observations, and a concluding statement.

3.54 **General Observation:** The IAD general observation is as follows: “As noted in IAD’s Part IA and Part IB reports, this IDA assessment is the first comprehensive internal exercise undertaken by management to review its operational/compliance internal control framework. Furthermore, it appears to be unique in the multilateral development banking environment, and to our knowledge, in the broader international financial institution community. While the effort underlying the commitment was clearly underestimated at the outset, substantial commensurate benefits are anticipated: its results will provide a compelling baseline to identify opportunities for streamlining IDA’s (and concurrently IBRD’s) operations and internal controls while significantly improving consistency and efficiency.”

3.55 **IEG Observation:** IEG agrees with this general statement and has itself commented on the fact that this is a first-in-history review of internal controls, whose accumulated body of knowledge and mapped processes will be of great value going forward.

3.56 **Specific Observations:** The principal content of IAD’s findings is contained in specific observations it makes in five areas:

1. **Adequacy and Effectiveness of Key Fiduciary Controls:** IAD concurs with management that the findings of Parts I and II regarding controls over procurement and financial management processes collectively constitute a significant deficiency. However, IAD disagrees with management’s broader conclusion that, despite this significant deficiency, key controls in
IDA’s fiduciary processes still give assurance that IDA’s resources are used for the purposes intended, saying that management’s assertion is inadequately supported, for three reasons: management did not sufficiently examine the underlying quality (that is, outcomes) of the fiduciary controls; there were inappropriate regional variances in FM and PR processes; and some transactions key controls were found to need redesign.

IEG Observation: IEG agrees with the finding of a significant deficiency in this area, it also takes note of IAD’s reasons for this finding and notes management’s remedial actions that are underway.

2. **Entity-Level Controls:** IAD concurs with management that weaknesses in five areas of the entity-level controls which each individually rise to the level of a significant deficiency: outdated policy framework for IL, need to integrate F&C into daily operations, inadequate mechanisms for risk aggregation, issues relating to AAA, and need for controls over information systems. IAD suggests that there are also other aspects that should be added to this list, including governance and accountability for Integrated Risk Management; oversight of operational risk; and QAG assessments. IEG Observation: IEG notes that IAD concurs with management’s assessment as to the significant deficiency at the entity level, and that IAD suggests other issues should also be considered, but notes also that IAD implies that the individual materiality of these issues remains at the level of a significant deficiency.

3. **Controls Over Efficiency and Effectiveness of Operations:** IAD concurs with management’s conclusion relating to efficiency and effectiveness of operations, but states that in its opinion “several opportunities exist for enhancing effectiveness and efficiency of IDA’s operations, including:”9 the need for more reliable and candid ISR reporting; IEG outcome ratings in Africa in recent years have shown steady declines; and opportunities identified for streamlining could significantly improve the efficiency of IDA operations; and HR practices (skill mix and performance management) need improvement. IEG Observations: IEG agrees with the areas highlighted by IAD where improved efficiencies and effectiveness may be achieved. IEG believed that examining “controls over E&E” was the necessary condition of the review, but to be fully sufficient at least some reference also to E&E outcomes would be helpful. At the same time, IEG does not consider the IDA controls review the appropriate occasion for a full examination of E&E outcomes, which would be a major undertaking on its own.

4. **Information Technology Controls:** IAD refers to management’s FY07 ICFR, which found significant deficiencies in
password management, information security rationalization, and change management controls. IAD also mentions certain significant deficiencies that it found in IAD audits covering business continuity, IT governance and strategy, and wireless security controls. IAD concurs with management that weaknesses in the controls in these areas constitute a significant deficiency. **IEG Observation:** These findings are noted and IEG concurs with their materiality. In addition, from its own analysis of the ELCQ results IEG finds that a lack of effective controls over data access privileges when staff rotate to other positions is part of a significant deficiency in IT controls, along with other deficiencies found.

5. **Fraud and Corruption Controls:** IAD states that issues relating to F&C collectively constitute a significant deficiency, while pointing out that such deficiencies in these controls create vulnerabilities to F&C in countries where systemic corruption is not adequately addressed during program and project design. IAD also states that the identified significant deficiencies relating to fiduciary controls, entity-level controls, IT controls, and F&C controls, in combination could represent a material weakness unless remedied in a timely manner and effectively monitored on an ongoing basis. **IEG Observation:** IEG is of the view, based on the audit criteria agreed for this review, that the deficiencies in this group of controls rise to the level of a material weakness unless remedied in a timely manner and effectively monitored on an ongoing basis. IEG is of the view, therefore, that the IAD conclusion implies a material weakness but does not, as IEG suggests it should do, explicitly state this.

3.57 **Status of IAD’s Part I Recommendations and Issues:** IAD refers to a total of 13 issues that were deferred or otherwise left open at the end of Part I (including from Part IA), and explains that, with one exception (relating to treatment of trust funds), remedies are in process of being implemented. **IEG Observations:** IEG considers this is an accurate accounting of the outstanding issues, and does not see grounds for finding any significant weaknesses in these areas of deferred treatment. Regarding trust funds, management had noted at the end of Part I that these had been dealt with separately, including as part of the ICFR process.

3.58 **Overall Conclusion:** IAD concludes that, subject to certain stated exceptions, management’s assessment is fairly stated that the internal control system over IDA’s operations is adequate to provide reasonable assurance to Senior Management and the Executive Directors that IDA’s financial statements are reliable; that IDA carries out its operations in compliance with its Articles, policies, and proce-
dures; and that management is made aware in a timely manner that IDA’s operations are carried out effectively and efficiently.

3.59 Regarding the mentioned exceptions (significant deficiencies in fiduciary controls, entity-level controls, IT controls, and F&C controls) IAD indicates that these could constitute a “material weakness unless remedied in a timely manner” because there is a “reasonable possibility that internal control failures may not be prevented.”

3.60 **IEG Observation:** IEG notes the finding that IAD regards management’s assessment as fairly stated, but subject to certain exceptions. IEG arrives at a similar assessment. However, IEG comes to different findings in relation to the precise treatment of the exceptions, in two respects:

- **Material Weakness:** IEG has concluded that a material weakness already exists in the controls over F&C (contributed to by weaknesses in other associated controls); IAD has found a similar nexus of associated controls (all of which IEG has also identified as deficiencies or significant deficiencies) but has concluded that this creates vulnerabilities to F&C and other issues which collectively could lead to a material weakness if not remedied in a timely manner.

- **Efficiency and Effectiveness:** IEG observes that process controls at the entity level are designed not only to inform Senior Management (and the Board) of the extent of efficiency and effectiveness of IDA operations, but they also contain specific incentive mechanisms to encourage operational managers to conduct their operations with due regard for efficiency and effectiveness, so IEG regards the spirit of the Scoping memorandum on this topic to have been achieved in management’s Part II assessment.

**NOTES**


2. In its final report, management distinguishes between the financial reporting and compliance objectives, which are largely under IDA’s internal control, and the operational objective of efficiency and effectiveness, which cannot be entirely under IDA’s control, so the degree of assurance that can be provided by the internal controls is less absolute than with the former two objectives.

3. As well as from the FY07 ICFR where relevant.

4. All excerpts from Management’s Assessment, para. 24 (Attachment 1).

5. Management’s Assessment, para. 41.

7. The issue is occasioned mainly by staff rotations. If a staff member has access (that is, a password) to a classified database tied to his/her function in one position, this access should end when the member rotates to another position because the segregation of duties principle may be breached if the access continues. At present HR reviews rotations of this kind only periodically, so access may continue for some time in a member’s new position, allowing continued entry to a database that should not be authorized. There needs to be a system that ends such access on the same day as rotation occurs.


4. Summary of Key Findings, Lessons, and Recommendations

Overall Summary of Findings

4.1 In its final assessment report, management provides an assurance, which states that the internal controls framework governing IDA operations has been shown to have been designed and to operate in a way that gives adequate assurance that it is in compliance with IDA’s charter and internal policies and procedures, and that it ensures the efficiency and effectiveness of IDA’s operations.

4.2 Management also states that it found significant deficiencies in five areas of the controls framework governing IDA operations, as well as a number of other deficiencies, all of which are well elaborated.

4.3 In its final review report, IAD provides an opinion that, following its extensive and detailed review of management’s assessment, including its general approach, methods, results, and conclusions, management’s assurance has been fairly stated, but subject to certain exceptions. IAD broadly concurs with management’s findings regarding a number of significant deficiencies, but, unlike management, regards the combination of the deficiencies of controls over fiduciary, entity-level, IT, and fraud and corruption issues will result in a material weakness unless effectively addressed in a timely fashion.

4.4 IAD also makes a number of specific observations about weaknesses over fiduciary controls and entity level controls (need for policies and procedures reform, integration of F&C into operations, improved risk aggregation and treatment of AAA, among others). IAD also questions whether management’s treatment of efficiency and effectiveness was adequate (citing declining IEG performance ratings for the portfolio in Africa) and gives a reminder of certain significant deficiencies that were uncovered during the ICFR on IT controls.

4.5 **IEG’s Evaluation:** In concluding its own evaluation (based on the extensive analysis described in the annexes contained in Volume II) IEG arrived at the following conclusions:
• **Approach and Method:** IEG rated the approach and methods used by management *fully satisfactory* but with some observations relating to certain improvements that could have been made to the questionnaire design. However, these would not have significantly affected the results. IEG also finds IAD’s approach and method satisfactory. To this extent, IEG finds both management’s and the IAD’s approach and outcomes credible and transparent.

• **Results and Conclusions:** IEG concludes that IDA’s internal controls framework operates to a high standard overall, except, as management and IAD also find, it contains some weaknesses. IEG’s evaluation is therefore qualified in a way broadly similar to management’s assurance, except that IEG believes the materiality of one set of weaknesses—in fraud and corruption—rises to the level of a material weakness. It also finds six additional significant deficiencies. Consistent with these findings, IEG rated the overall quality (strength and effectiveness) of the controls framework as *satisfactory with qualifications*.

4.6 The detailed analysis that underlies these IEG findings is described in the annexes in Volume II. The detailed justification for the finding of a material weakness in the area of prevention of fraud and corruption is given in Annex D. There is a high degree of commonality in the findings of management, IAD, and IEG as to individual weaknesses. However, these weaknesses have been presented and grouped somewhat differently in each case, as was described in Chapters 2 and 3. IEG believes that deficiencies can be grouped, but this should be done only where they are related, where they reinforce each other, and/or where needed remedies are common to all deficiencies in a group. IEG has applied this principle to its analysis and in its finding of a material weakness in controls over F&C, where multiple deficiencies are cited but where their linkages are clearly described.

**Lessons Arising from the Review**

4.7 **Benefits of the Review:** IEG regards this entire review as a substantial contribution to IDA’s knowledge of its internal controls system. Whereas IDA has, since adopting the COSO framework a decade ago, achieved conformity with COSO standards with regard to its financial reporting—including obtaining an attestation from the external auditor on the effectiveness of its internal controls over external financial reporting—it has lagged behind in achieving these standards with regard to the *compliance* and *efficiency and effectiveness* objectives of COSO. Completion of this review has redressed this imbalance in IDA’s reporting standards, subject to the weaknesses that have been identified and whose remedies are part of the recommendations of this review.
4.8 It is important to put these findings in a broader perspective. For an agency as complex as IDA and the Bank—with global reach over multi-faceted program content and diverse clients—and for a first-in-history controls review, the outcome of IEG’s review, with one material weakness and five significant deficiencies, is by most standards quite reasonable. The statement of the external panel expresses similar sentiments.

4.9 Implications for IEG: IEG has undertaken this major evaluation at the request of the Board. For the exercise, there has been clear additionality and mutual learning from the involvement of management, IAD, and IEG. Going forward IEG would assume that follow-up work would best be undertaken by management itself, reporting directly to the Board through the Audit Committee. IEG will reflect carefully on the main findings of this evaluation, and in particular the issues related to fraud and corruption in IDA operations, and how these issues would be appropriately addressed in IEG's evaluation program. An evaluation of the GAC currently planned for FY11 should report, inter alia, on the implementation through that vehicle of the current recommendations. In addition, IEG will review how best to incorporate F&C issues in its project evaluations, taking into account the division of labor with INT.

Recommendations

4.10 Based on its evaluation, IEG recommends the following to IDA management:

(a) Address on a broad front the controls needed to ensure that F&C practices in IDA client countries and among participating stakeholders do not impinge on IDA’s mission through possible Fraud and Corruption in IDA operations. Actions could include:

- Accelerate implementation of the ongoing Governance and Anti-Corruption (GAC) program, and devote additional attention and resources to building an organization- al culture and incentive structure in which the risks of F&C are explicitly and cost-effectively addressed in the management of IDA’s operations. While Management has correctly observed that such awareness has been spreading, including through the follow-up to the Volcker report, the systematic integration of this awareness into daily operations still has some way to go and needs to be given sustained emphasis going forward.

- Develop and deploy specific F&C related instruments into the Bank’s Risk Scan processes, CASs, lending and project designs, and ISRs. Remedies have already been initiated as part of the GAC initiative and the Volcker Report, and
INT has recently become involved in helping to design toolkits to address F&C at various levels of the lending cycle, although it is too early to judge the impact of these initiatives. It is also important to link country-based risk assessments through the Risk Scan to specific tools to address lending risks in both IL and DPL/PRSC type lending.

- **Continue the ongoing reforms of FM and PR processes (launched in response to the findings of this review) and link them closely to the F&C agenda.** These are key elements in the Bank’s fiduciary and governance systems but evidence from the review that new toolkits such as those being developed under the “GAC In Projects” program need to be deployed, made operative and later tested for effectiveness.

- **Intensify IDA support to strengthen clients’ fiduciary and governance systems,** recognizing that this is a principal means to guard against F&C and to ensure the effective use of IDA resources (and the only means to do so in the case of budget support operations such as PRSCs). In the case of DPL/PRSC operations special emphasis needs to be given to developing tools that could attach, for example, to the Letter of Development Policy and to CFAA requirements, to raise the attention to systemic F&C issues at the country level.

- **Make arrangements for testing the operating effectiveness of these new controls at some appropriate time in the future,** since the material weakness and other identified deficiencies will be deemed to persist until this has been done.

(b) **Closely monitor the implementation of remedies for control deficiencies, including:**

- **The measures currently in progress to update the OP/BPs.** These also need to be extended to key areas (AAA, F&C) not yet covered or where new policies are being developed.

- **A mechanism to ensure the future currency of OP/BPs.** There has been progress in bringing the body of OP/BPs into conformity with overall Bank and IDA policies and strategic goals, and IEG has therefore downgraded the weakness uncovered in this area during Part I from a potential material weakness to a significant deficiency.

- **Improved documentation retention and accessibility and a user-friendly documentation management system.** In its Part IB report IEG had already downgraded the materiality of this issue from a potential material weakness to a significant deficiency. However, the needed IT systems are not yet in place and the Enterprise Content and Document Man-
agement (ECDM) system of which they will be a part should be developed as a matter of priority.

- **Mechanisms to correct and monitor the several IT systems deficiencies identified.** These included password management, business continuity and change management, and need for tighter control over IT access privileges for staff who rotate into new positions.

- **Measures to address the about 100 identified other as yet unresolved deficiencies.** Remedies for many of these are already in progress, but specific monitoring is needed given the wide front and many areas in which remedial actions are needed.
Annex: Management Response
REVIEW OF IDA INTERNAL CONTROLS: 
AN IEG EVALUATION OF MANAGEMENT’S ASSESSMENT AND 
THE IAD REVIEW: REPORT ON THE COMPLETION OF 
PART II 

MANAGEMENT RESPONSE 
AND UPDATED SUMMARY OF MANAGEMENT’S OVERALL 
ASSESSMENT 

OPCS AND CSR 

February 24, 2009
### ABBREVIATIONS AND ACRONYMS

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>AAA</td>
<td>Analytic and Advisory Activities</td>
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<tr>
<td>ARCS</td>
<td>Audit Report Compliance System</td>
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<td>AS2</td>
<td>PCAOB’s Auditing Standard No. 2, <em>An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements</em></td>
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<td>BP</td>
<td>Bank Procedure</td>
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<td>CAS</td>
<td>Country Assistance Strategy</td>
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<td>CGAC</td>
<td>Country Governance and Anti-Corruption</td>
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<td>CFM</td>
<td>Country Financial Accountability Assessment</td>
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<td>CFO</td>
<td>Chief Financial Officer</td>
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<td>CFP</td>
<td>Concessional Finance and Global Partnerships</td>
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<td>CODE</td>
<td>Committee on Development Effectiveness</td>
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<td>COSO</td>
<td>Commission of Sponsoring Organizations of the Treadway Commission</td>
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<tr>
<td>CPAR</td>
<td>Country Procurement Assessment Report/Review</td>
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<td>CSR</td>
<td>Controller's, Strategy, &amp; Resource Management</td>
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<td>DIR</td>
<td>Detailed Implementation Review</td>
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<td>DPL</td>
<td>Development Policy Lending</td>
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<td>EAP</td>
<td>East Asia and Pacific Region</td>
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<td>ECA</td>
<td>Europe and Central Asia Region</td>
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<td>Enterprise Content and Document Management</td>
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<td>Entity Level Control</td>
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REVIEW OF IDA INTERNAL CONTROLS: AN IEG EVALUATION OF MANAGEMENT’S ASSESSMENT AND THE IAD REVIEW: REPORT ON THE COMPLETION OF PART II

I. Overview and Follow-Up Management Action

1. **Background.** As reflected in the IDA 14 Replenishment Report management committed to carry out an independent comprehensive assessment of its control framework including internal controls over IDA operations and compliance with its charter and policies, and making such assessment available to the public after its disclosure has been approved by IDA’s Executive Directors. The assessment has been conducted in the context of the internal control framework developed by the Commission of Sponsoring Organizations of the Treadway Commission (COSO), adapted to fit the unique nature and operations of IDA. It has been carried out in three tiers: Management self-assessment; Internal Auditing Department (IAD) review; and an independent evaluation of both by the Independent Evaluation Group (IEG). The assessment has been divided into two parts: Part I, which focused on design and operating effectiveness of controls over IDA operations at the transaction level; and Part II, which focused on (a) entity-level controls, (b) outstanding transaction-level controls deferred from Part I, and (c) the operations objective of COSO.

2. **Benefits of this exercise.** In management’s view, this has been a very important and highly useful exercise. It enabled management to take a comprehensive and holistic look at internal control system over IDA’s operations, focusing on management and business processes conducted at transaction and entity levels across IDA. It also allowed management to assess mechanisms in place to monitor and adjust these processes to respond to identified risks and support IDA’s strategy and priorities as they evolve in response to client needs. As noted by IEG, by undertaking this “first of its kind” assessment of internal controls not only for IDA but also for all international financial organizations, “the Bank and IDA have taken an important lead in assessment of internal control” (emphasis added). Being the first of its kind, this unprecedented assessment was much more time and resource consuming than originally anticipated at all levels and for all assessment participants (management, IAD and IEG). As noted by IEG, however, the time and effort spent by management has resulted in development and application of a “transparent, well documented, and comprehensive” approach to this

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1 See, Report from the Executive Directors of the International Development Association to the Board of Governors, Additions to IDA Resources: Fourteenth Replenishment, Working Together to Achieve the Millennium Development Goals, (approved by the Executive Directors of IDA on March 10, 2005), paragraph 39, under the Disclosure bullet.

2 COSO published a report in 1992, “Internal Controls – Integrated Framework,” which is widely referred to by leading financial institutions in the United States and is also seen as a model in many other parts of the world. IDA adopted the COSO framework as its controls methodology in 1995. The framework is an all encompassing process which covers all aspects of internal control of an organization’s operation. It considers not only the evaluation of formal controls, but also informal controls, such as ethics, trust, communication, organization behavior and leadership, and incorporates “top-down” as well as “bottom-up” analysis.
exercise, thus breaking “new ground both in creating methodologies … and in building strong factual knowledge about the Bank’s internal controls framework.”

3. **Management’s conclusion and findings.** Under the COSO internal controls framework, management is responsible for establishing and maintaining an effective internal control system. Management has assessed internal control over IDA’s operations, and based on this assessment, and reflecting the work undertaken by management, and attested to by the external auditor, during the FY07 ICFR process, management is of the view that the internal control system over IDA’s operations is adequate to provide reasonable assurance to Senior Management and the Executive Directors that:

- IDA’s published financial statements are being prepared reliably;
- IDA carries out its operations in compliance with the relevant provisions of its Articles of Agreement and operational policies and procedures including provisions relating to the use of funds for intended purposes; and
- they are made aware, in a timely manner, of the extent to which IDA is moving toward effective and efficient use of its resources in meeting its operational objectives.

As part of its assessment, however, management identified a number of significant deficiencies which require remedial actions—and effective monitoring of their implementation—in order to strengthen the internal control system over IDA’s operations. These significant deficiencies, described in more detail in Part III below, fall into five main categories: (i) the framework governing investment lending (IL); (ii) risk management and accountability at the entity and project levels; (iii) integration of controls for managing fraud and corruption risk in operations; (iv) oversight of Procurement (PR) and Financial Management (FM) work related to IDA-financed projects; and (v) the role of IT in risk management and issues relating to processes and controls over AAA.

4. **Agreement on overall conclusion and follow-up to this review.** Management is pleased to note that at the end of this intensive effort, IEG and IAD have concurred with management’s overall conclusion and findings. As stated by IEG: “evidence presented by management for both the entity- and transactions-level controls gives reasonable assurance—except for weaknesses identified in certain parts of the overall framework—that controls operate effectively… [and subject to identified exceptions] provide Senior Management and the Board with reasonable assurance that the three COSO objectives are being achieved: Reliable financial reporting, compliance with policies and procedures, and the efficiency and effectiveness of operations.” As a result, IEG concluded that, “with some important qualifications, IDA’s internal controls framework operates to a high standard overall, giving reasonable assurance that the controls operate effectively” (emphasis added). Management is also pleased that the senior international Advisory Panel assembled by IEG in connection with this review has opined that the results of this review demonstrate a high level of effectiveness compared to results in other organizations.

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of similar size and complexity but with less international involvement⁴ (emphasis added).

5. **Management, IAD and IEG also agreed on the nature of the issues uncovered and on remedial actions needed to address them**, including IEG’s recommendation that **controls over the risk of possible fraud and corruption in IDA-supported operations should be addressed on a “broad front” and that implementation of the remedial actions should be closely monitored.** Management formulated and began implementation of a comprehensive program of such remedial actions, as described in management’s report and Part III of this Management Response. The key areas being addressed by this program are summarized below and in the five-point action plan set out in Annex 1 to this Management Response:

- **IL reform**, expected to: (a) improve IL instrument efficiency and effectiveness; (b) rationalize and strengthen control framework for IL by adopting a risk-based model to appraisal and supervision of IL operations; and (c) eliminate current backlog of outdated OPs and BPs by creating a principles-based umbrella policy for IL operations.

- **Strengthen risk management capacity, incentives, and accountability at the project and entity levels** by: (a) ensuring appropriate delineation and exercise of responsibilities and accountabilities at management and staff levels, including consequences for failure to report serious issues; (b) aligning incentives and management support and oversight to ensure more timely risk identification, reporting and information-sharing within the task team and between management and staff; (c) launching an annual Integrated Risk Report that would identify overall risks facing the institution, units responsible for managing said risks, including potential gaps and overlaps, and areas needing strengthening; and (d) using the review of QAG to inform a broader review of gaps and overlaps among the existing control units.

- **Better design and integration of controls for managing fraud and corruption risk** into preparation and supervision/monitoring of IDA-supported operations, expected to strengthen the Bank’s ability to detect, deter and address, in partnership with country counterparts, issues of fraud and corruption and form part of the GAC Implementation Plan, discussed with the Board in September 2007⁵ and follow-up actions to the Volcker Panel Report, issued in September 2007,⁶ and the INT’s Report on the Detailed Implementation Review of the India Health Sector (the “India DIR Report”), issued in December 2007.⁷


• **Tighten fiduciary controls and strengthen quality arrangements in the PR and FM areas**, by: (a) enhancing regional and overall monitoring of quality arrangements in the PR and FM areas; (b) raising awareness and achieving better integration of fiduciary staff in task teams, and re-clarifying accountabilities within the task team for PR and fiduciary issues generally and oversight of contract management in particular, including more consistent implementation of PR post-reviews; (c) updating relevant policy and guidelines and mainstreaming risk-based assessment tools, and (d) improving IT systems and data bases function and usage to support FM and PR work.

• **IT strengthening and improvement of AAA processes and controls**, expected to: (a) address password and access issues; (b) improve compliance monitoring through automation of operational processes starting with IL; (c) address current issues with filing and accessibility of operational documents, and (d) simplify and rationalize processes and systems for the wide scope of AAA activities and strengthen compliance with this new improved framework.

6. Management believes that implementation of the agreed remedial actions will make a substantive and critical contribution toward enhancing internal controls over IDA’s and Bank’s operations by strengthening and refocusing internal controls to better address governance and anti-corruption issues, enhance risk identification and management at transaction and entity-levels, and improve effectiveness and efficiency of investment lending, the Bank’s primary lending instrument. Management is committed to implementing the remedial actions swiftly and effectively.

7. **Monitoring and reporting on implementation progress.** Management also shares IAD’s and IEG’s views on the importance of timely implementation and effective and focused monitoring of these actions. To aid with this effort, the President will be establishing in March, 2009 an Implementation Oversight Panel (IOP) to monitor and periodically report to the President and the Board on the implementation progress achieved. Management expects that the first implementation progress report of the IOP would be discussed with the Board in early fall of 2009 prior to the IDA 15 mid-term review.

II. Methodology and Differences with IAD and IEG

8. Throughout this assessment management followed the COSO definition of internal control, namely, a *process* affected by an entity’s board of directors, management and other

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Response), and Independent Panel Review of the World Bank Group Department of Institutional Integrity, September 13, 2007 (the “Volcker Panel Report”), paragraph 140.


8 The IOP would be co-chaired by an outside party, the CFO, and VP OPCS, with VP CSR, VP EXT, VP LEG, VP CFP, and VP ISG as members, and central control groups (IAD, IEG, and INT) as observers.
personnel, designed to provide reasonable assurance regarding the achievement of objectives in three COSO categories: financial reporting, compliance and operations. Management (as did IAD and IEG) also applied the definitions and terminology developed under COSO to identify the seriousness of the issues uncovered during its review, ranging in ascending order from “deficiencies, to significant deficiencies, to material weaknesses.” This has proved challenging when assessing the compliance and operations objectives since at present no precise definitions of these terms exist beyond the area of financial reporting, for which they were developed. Therefore, as explained by IEG, when applying these terms “in the case of operational as against financial reporting, there are no such clear yardsticks by which to measure the materiality of a given weakness or set of weaknesses,” requiring each reviewer to exercise “some judgment” (emphasis added).

In applying these definitions to the issues uncovered by management, while all three parties agreed on the nature, scope, and the ultimate characterization of most of the issues identified, there was some variation with respect to certain issues: management classified each of the issues identified as a “significant deficiency;” IAD agreed, but noted that these deficiencies, in combination, “could represent a material weakness … unless remediated in a timely manner and effectively monitored” (emphasis added); and IEG classified issues relating to integration of fraud and corruption controls as a “material weakness” (emphasis added). Regardless of the ultimate characterization of the issues uncovered, management, IAD and IEG are in agreement that a timely and effective implementation of the remedial actions identified by management will address these issues and strengthen the efficiency and effectiveness of internal controls over IDA’s operations. Management began implementation of these actions and is fully committed to a swift and effective completion of the entire program, including dedication of the resources needed to support it, and to monitoring and reporting on the results achieved through the Implementation Oversight Panel.

In assessing the differences between management, IAD, and IEG in characterizing the issues identified, it is important to view these differences in the context of (i) a very limited experience with reviews of this nature, (ii) the rather nascent and somewhat subjective standards

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9 Under the relevant financial reporting standards (AS2), a material weakness is defined as “a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.” A significant deficiency, on the other hand, is defined as “a control deficiency, or a combination of control deficiencies, that adversely affects the company's ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the company's annual or interim financial statements that is more than inconsequential will not be prevented or detected.”

10 As the IEG Report pointed out in paragraph 2.19: “It is important to emphasize key aspects of the context for this finding: First, the finding is based not on evidence of the occurrence of actual F&C (though there is evidence that some F&C has actually occurred) but rather on the fact that there is evident risk of F&C occurring in a significant number of IDA countries. Second, weak governance and F&C risks are part of the challenge of development in many IDA countries and F&C risks affect the work of all donors, not just IDA. Third, this is the first evaluation of its kind for any IFI, which places the Bank out front within the development community. Fourth, the finding of a single material weakness (together with some significant deficiencies) should overall be considered a quite respectable outcome from the first (and very detailed) exercise of its kind for IDA.” (emphasis added)
when expanding the COSO methodology beyond financial reporting, including the definitions used and the timeframe on which the final conclusion is based, and (iii) the focus placed by IAD and IEG on results relating to fiduciary controls. In terms of comparative experience, as noted by the senior international Advisory Panel assembled by IEG, the results of this review demonstrate a high level of effectiveness of IDA’s internal controls compared to results in other organizations of similar size and complexity but with less international involvement (with a finding of one material weakness and several significant deficiencies being quite common for the first review of this nature). On the applicable standards beyond the area of financial reporting and the time-frame used for the review, it is important to note that IEG’s finding of a material weakness relating to controls over F&C risk in operations reflects a snapshot of the controls in place as of 12 months ago, when most of the diagnostic work was completed, and does not take into account the substantive changes implemented by management in response to the Volcker Panel Report and the India DIR, which have been factored into management’s opinion.

11. During Part I of this exercise, management identified and tested controls in fiduciary areas (including FM, PR and disbursements) and found that 10 out of 50 controls did not pass compliance testing. To address this issue, management is undertaking a concerted effort to improve the specific fiduciary controls in question in order to enable a remapping and retesting of their operating effectiveness as soon as possible. Management also plans at the same time to achieve substantial progress regarding the strengthening of specific controls for managing F&C risks in operations. It is discussing with IAD and IEG a detailed program for assessing these controls, including a methodology for retesting and reporting the results and any related evaluation findings to the IOP, Senior Management and the Board.

III. Management’s Assessment, Findings and Recommendations

12. This section sets out management’s overall assessment regarding the effectiveness of the current internal control framework over IDA’s operations, followed by more detailed findings of significant deficiencies identified by management and recommended actions to address them.

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11 For example, similar comprehensive reviews conducted in the US using the COSO (Committee of Sponsoring Organizations of the Treadway Commission) framework have identified several material weaknesses in the internal controls of the agencies reviewed, e.g. 8 material weaknesses in the internal controls of US Treasury in 2004, reduced to 4 by 2008, and 4 material weaknesses in USAID in 2007 (2 financial and 2 operational). See US Treasury FY 2008 Performance and Accountability Report; and USAID FY08 Performance and Accountability Report (PAR). Visit Treasury web site: http://www.treas.gov/offices/management/dcfo/accountability-reports/2008-par.shtml and USAID: http://www.usaid.gov/policy/afr08/.

12 During Part I of this exercise management identified and tested 50 controls in fiduciary area (including FM, PR and disbursements). Ten out of the 50 controls tested (or 20%) did not pass compliance testing. A list and description of these 10 controls is attached hereto in Annex 2 and is included in Annex 1, Attachment 2 to the Management Report on Its Review of Internal Controls, Part IB, see Attachment I, Review of IDA Internal Controls: An Evaluation of Management’s Assessment and the IAD Review: Report on the Completion of Part I: Incorporating Compliance Testing of Key Controls (Part IB), AC2007-0044, June 22, 2007.

13 This Section III of this Response substantively reflects the text included in Section III of, and the Attachment to the Management Overall Assessment, set out in Attachment I, Volume III of the IEG
A. MANAGEMENT’S OVERALL ASSESSMENT

13. Under the COSO internal controls framework, management is responsible for establishing and maintaining an effective internal control system. IDA’s management has assessed internal control over IDA’s operations, and based on this assessment, and reflecting the work undertaken by management, and attested to by the external auditor, during the FY07 ICFR process, management is of the view that the internal control system over IDA’s operations is adequate to provide reasonable assurance to Senior Management and the Executive Directors that:

- IDA’s published financial statements are being prepared reliably;
- IDA carries out its operations in compliance with the relevant provisions of its Articles of Agreement and operational policies and procedures, including the provisions relating to the use of funds for intended purposes; and
- they are made aware, in a timely manner, of the extent to which IDA is moving toward effective and efficient use of its resources in meeting its operational objectives.

14. As part of its assessment, however, management has identified a number of significant deficiencies which require remedial actions—and effective monitoring of their implementation—in order to strengthen the internal control system over IDA’s operations. These significant deficiencies fall into five categories as follows:

(a) Issues relating to the current policy and procedural framework for IL:

- Process inefficiencies, including a lack of focus on key risks and controls during preparation/design and supervision stages of IL projects resulting from a non-rationalized “one-size-fits all” requirements irrespective of risk.
- Over-focus on project preparation at the expense of project implementation and supervision.
- Outdated and complex policy framework for IL as reflected in multiple OPs and BPs that apply to IL operations.

(b) Risk management and accountability at the entity and project levels:

- Inadequate emphasis on risk identification, reporting and information-sharing within the task teams and between staff and management during project supervision, including diffused accountability in this area and for operational quality more generally.

Report, revised as needed to ensure consistency between the detailed description of the deficiencies and recommended actions and their summary in the action plan matrix included in Annex 1 to this Response.

o Inadequate mechanisms for risk aggregation and timeliness and consistency in monitoring, identifying (and formulating an appropriate response to) systemic risks.

(c) Issues relating to integration of controls for managing fraud and corruption risk in IDA-supported operations:

o Need for better design and integration of controls for managing fraud and corruption risks (reflecting, inter alia, lessons learned from precedents and INT work) into design/preparation and supervision/monitoring of IDA-supported operations.

(d) Issues relating to PR and FM:

o Need to strengthen controls in place to ensure consistent follow-up on PR issues by the task teams, including the need for better integration of PR staff in task teams and clarification of accountabilities for procurement issues and decisions.

o Inconsistent implementation of PR post-reviews.

o Inconsistency in quality arrangements for the documentation of FM supervision and some inconsistency in quality arrangements for oversight and monitoring of FM supervision.

(e) Controls Over IT and AAA:

o Need to strengthen Information Technology (IT) controls relating to password sharing in SAP, privileged access, and Infrastructure Change Management.

o Need to improve timely accessibility of operational documents primarily relating to IL operations.

o Need to review and rationalize processes and controls relating to AAA work.

15. A summary of each of the above significant deficiencies identified by management together with recommended remedial actions are set out below.

B. FINDINGS AND RECOMMENDATIONS

1. IL Reform to Improve IL Efficiency, Effectiveness and Controls

a. Rationalizing IL processes and strengthening controls

16. Transaction-level work conducted by management in Part I (including identification, mapping and testing of IL processes and controls), has identified significant inefficiencies in the current processes and controls that apply to IL, especially during preparation stages (from concept to approval). As reflected in management’s Part I report, IL is currently hampered by inefficient and often duplicative processes and reviews, applied in a “one-size-fits-all” manner, irrespective of the level of risk, borrower capacity, track record, and similar factors. The absence of a risk-based approach to IL processes and controls undermines efficiency and effectiveness of these controls by over-regulating low risk projects while diverting resources and management attention from addressing higher risk situations. Attention to proper risk identification and results monitoring during project supervision is diverted by excessive focus on preparation/appraisal stages. Such
focus also contributes to increased project preparation/appraisal costs and delays in bringing projects to the Board for its consideration and approval.

17. **Recommended action.** In response to these and related findings of this assessment, management has launched a comprehensive effort to reform the investment lending instrument. The proposed reform will also build on and reflect other developments, including the Middle Income Countries (MIC) and Fragile States strategies, the GAC strategy, and the findings of the Volcker Panel Report and the India DIR.\(^\text{15}\) A concept note on IL reform, which reflects the findings of this review, was discussed with the OVPs in November 2008 and with the Board in February 2009. Integration of a risk-based model into the control framework governing IL is a key aspect of the rationalization of IL processes and controls. The principles of the new IL policy and the new risk-based control framework for IL are expected to:

- rationalize and prioritize key controls governing IL;
- facilitate appropriate differentiation of processes and requirements based on risk;
- set appropriate additional controls, resources, and reviews for higher risk operations/environments;
- maximize efficiency and effectiveness of each control through rationalization and work-flow automation; and
- strengthen risk identification and monitoring during supervision by, among other things, clarifying roles, responsibility and accountability between IDA and borrowers and within the institution.

18. Management expects to complete the first phase of IL reform, which will address the process and control issues during all stages (including more timely risk identification and reporting during supervision, clarification of roles, responsibilities and accountability within the task team, as well as better integration of fraud and corruption issues in project appraisal and supervision) in June 2009.

**b. Reforming IL policies**

19. During Part I of the assessment, management identified that various OPs/BPs have not been keeping pace with the changes needed and/or introduced on the ground. As the main fiduciary policies (including OP/BP 12.00 related to disbursements and 10.02 related to FM) were issued in March 2007 and major instrument policies (including OP/BP 8.60 related to DPLs and OP/BP 8.00, related to emergency lending) are in place, this issue primarily affects OPs and BPs that apply to appraisal and supervision of IL. Consistent with the scoping memo for Part II, management has assessed (a) how the proposed reform and consolidation of IL policies will help address this issue; and (b) how the current processes for policy revisions could be made more efficient so as to facilitate more timely updates of OPs and BPs.

\(^\text{15}\) See footnote 5, 6 and 7 for references to the GAC Implementation Plan, the Volcker Panel Report and India DIR.
20. Based on these assessments, management is of the view that the proposed reform of IL policies will address most of the outstanding policy updates issues. While this work is important from the Control Activities and Information and Communication points of view, the entity-level review conducted during Part II, including information from the ELC Questionnaires, confirmed that the current status of OPs and BPs does not have a material impact on compliance and operations objectives of IDA as a result of compensatory measures adopted to “fill in” the gaps created by the outdated OPs and BPs. These mitigating measures include issuance of Operational Memoranda and central and corporate guidance to staff. Based on management’s identification and mapping of the current process for policy revisions, management believes that the current backlog in OP/BP updates is due to the prescriptive and micro style and approach to OP/BP drafting and content rather than the process for introducing policy changes that require OP/BP revisions. The principles-based approach to preparation of new OPs and BPs reflected in the more recent policy reforms, which focuses the OP and BP statements on core principles and key controls rather than detailed rules and procedures characteristic of the older statements, should help minimize any future backlogs in OP/BP updates.

21. **Recommended action.** During Part I, IL was identified as the most over-regulated Bank instrument and is subject to approximately 30 of the Bank’s operational policies and procedures, many of which are misaligned with the current practice and evolution of the IL instrument. To address this shortcoming, which is the source of much inefficiency surrounding the current IL instrument, the IL reform effort will focus on consolidating and rationalizing the policies and procedures governing IL by creating a single principles-based “umbrella” policy for IL that would govern IL projects from preparation through completion. Reflecting lessons learned, including findings of this internal control review, the new IL policy would:

- replace the rigid “ring-fenced” IL project model with a flexible menu of design, funds flow and financing options to better meet development and funding needs of IDA’s varied clients;
- replace the current “one-size-fits-all” requirements with a risk-based approach to selection of IL design options and associated due diligence, processing, and monitoring requirements; and
- reflect main principles governing redesigned IL instrument in a new principles-based umbrella policy governing IL from “identification to exit.”

22. Management expects to make a proposal for policy consolidation during the second phase of IL reform, following the completion of (a) Phase I that would address preparation/appraisal process inefficiencies and significant deficiencies in supervision as a matter of priority, and (b) broad consultations inside and outside the Bank to ensure that the new IL model meets and reflects the needs and expectations of the Bank’s clients, partners and shareholders. This second and final stage of IL reform is expected to be completed in June 2010.

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16 These include: OP/BP 6.00 related to expenditure eligibility, OP/BP 10.02 related to financial management, OP/BP 12.00 related to disbursement, OP/BP 13.20 related to additional financing and OP/BP 8.00 related to rapid response to crises and emergencies.
2. **Strengthen Risk Management Capacity, Incentives and Accountability at Project and Institutional Levels**

   a. **Risk identification and reporting at the project-level**

23. Management’s assessment of entity-level controls has found an issue with timeliness and scope in reporting of risks generally, and in the context of project supervision in particular. Sources for this finding include management’s assessment of responses to the ICFR and ELC Questionnaires, a review of the Risk and Opportunity Workshop (ROW) results, and findings reflected in recent outputs/reports of several central control units, including IAD, QAG and IEG. Given that timely and accurate reporting on risks and project implementation issues is essential to ensure that appropriate and timely decisions and actions are taken to address risks and improve outcomes, this issue merits prompt management attention to formulate and implement an effective remedial action.

24. **Recommended action.** This finding has pointed to the need to strengthen incentives, including: (a) staff incentives and accountability; (b) management tools and accountability; and, (c) resource reallocation mechanisms. These will promote open and timely identification and reporting of risks. Some management actions are already underway to improve candor and realism in implementation supervision reporting in response, at least in part, to IAD’s, QAG’s and IEG’s findings. These include:

   - completion of a cross-regional review of ISRs by OPCRX and its input into the Focus on Results—“IDA 14 Results Measurement System and Directions for IDA 15”;
   - preparation and dissemination of important reference documents, including the launching of an e-learning module in FY08 Q4 to assist teams in preparing and updating ISRs;
   - regular reviews of ISRs by the regions, with guidance from OPCRX, including a guidance on Maintaining a Results Focus in ISRs; and
   - preparation by each Region of specific guidance for ISR reviews to ensure adequate baselines, and to review quality and realism.

25. In addition, as part of the first phase of IL reform management also expects to introduce in June 2009 measures that would improve timeliness and accuracy of risk identification and information sharing within the task team and between management and staff, including such measures as (i) mechanisms for reallocation of resources to address newly-identified risks; (ii) incentives and management actions to encourage accurate and timely reporting of risks and issues in operations, including project performance; and (iii) a more explicit focus on risk monitoring and reporting in the revised ISR template and requirements.

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17 For example, the OPCS Results Agenda Website includes a Quick Reference Guide on Results in Operations; the IDA RMS Fact Sheet; Maintaining a Results Focus in ISRs; Baselines in ISRs; and Results and Harmonization in Bank Operations (including supervision). In addition, the results terminology is periodically updated and posted on the Website.
b. Accountability and compliance incentives and instruments

26. Management’s assessment of entity-level controls has identified that accountability, compliance and internal control responsibilities are not adequately reflected in performance management tools such as OPEs or promotion criteria. Nor does there seem to be a strong link between performance evaluations and individual accountability: for example, job descriptions and performance evaluations do not usually contain specific references to internal control related duties, responsibilities, and accountability. Concerns about the adequacy of current incentives to promote accountability, compliance and quality were also reflected in several units’ responses to the ELC and ICFR questionnaires. Several responders expressed a concern that individual staff and units are primarily rewarded for specific results such as project delivery to the Board and project disbursements and completion, with less attention being paid to the method or quality of these achievements. Potential issues with accountability arrangements were also reflected in the Volcker Panel Report (referenced in footnote 6) and the India DIR (referenced in footnote 7).

27. Some of these concerns are being addressed by ongoing activities in the accountability and ethics areas, such as emphasis on ethics and controls in the orientation program provided for all new Bank hires and implementation of appropriate disciplinary action in response to departures from approved policies and procedures or violations of the code of conduct pursuant to Staff Rule 8.01. In June 2008 the Bank has issued a strengthened, dedicated whistle-blowing policy and amended the Principles of Staff Employment to enhance its current handling of whistle-blowing reports and claims of whistle-blowing retaliation. The new policy, principle and staff rule puts the Bank Group at the leading edge of whistle-blowing protections amongst international organizations, consistent with the highest standards of good governance and the ongoing efforts of the Bank to safeguard its integrity and effectiveness.

28. Management has long-recognized the challenge of managing performance in the Bank—which is key for promoting individual and professional accountability. This has been emphasized most recently in the Report of the Performance Management Working Group published in July 2007. Prompted by the Report, HRS launched HR Insight, a new website dedicated to sharing HR-related data, information and research with Bank Group staff. Efforts have also been made to exercise more differentiation in the recent SRI awards, to ensure that high performers are rewarded.

29. **Recommended action.** Given the importance of individual and professional accountability to the effectiveness and efficiency of an internal control system, Senior Management is undertaking a corporate review of responsibilities, accountabilities and quality oversight. This review will include several components, including (i) existing oversight and quality assurance arrangements to identify shortfalls in quality, including the roles and methodologies of the institutional mechanisms such as QAG, IEG, Regional Quality teams, (ii) the existing quality and accountability arrangements for operations, including roles and responsibilities within the task team and processes and controls in place to ensure proper oversight, (iii) development by HRS of a comprehensive roadmap/strategy for enhancing performance based on the diagnosis of the root causes of dissatisfaction with current performance management, developed by the Performance Management Working Group, and (iv) continuation of HRS efforts to enhance the HR Insight website to increase further the transparency of HR-related data. Components of this work will be reflected in: the QAG review, expected to be completed in March 2009, the first phase of IL, expected to be completed in June
2009, including in particular the integration and clarification of responsibilities within the task team and strengthening of the supervision model.

c. **Risk aggregation, monitoring and reporting at entity-level**

30. Management has identified that while important review and evaluation work is being carried out throughout the institution by the central control units (including IAD, IEG, INT, QAG, CSR, and the Inspection Panel), risk and control activities remain fragmented, resulting in duplication of effort and potential gaps in risk coverage. IDA also currently lacks a consistent mechanism for aggregating and prioritizing the results of this work. This finding is based on management’s review of the terms of reference, key outputs (including recommendations) of the central control units, assessment of responses to the ELC Questionnaire, and relevant observations set out in the Volcker Panel Report (referenced in footnote 6) and the India DIR (referenced in footnote 7).

31. **Recommended action.** This finding merits strengthening of the existing management tools for integrated risk management. To this end, management (through CSR) intends to move toward an annual Integrated Risk Report intended to: (a) describe overall risks facing the institution; (b) identify units responsible for management and oversight of risks identified; (c) assess potential gaps and overlaps; (d) develop a dashboard of risk findings from the various assessment activities; and (e) over time, assess the quality and consistency of the processes in place.

32. In addition, a more in-depth review of the central control units may be merited, including complementarities in their respective methodologies, terms of reference, outputs and current mechanisms for information-sharing and consolidation of their respective findings and recommendations. In management’s view, such review should:

- identify ways to rationalize and improve effectiveness and efficiency of checks and balances provided by the central control units;

- explore various mechanisms for better risk aggregation and assessment/review rationalization, including mechanisms in place to validate and prioritize key risks for monitoring and testing as well as defining opportunities for improvements to controls and management activities; and

- assess mechanisms for linking systemic risks identified from time to time with objectives, initiatives, and business processes, opportunities for alignment and coordination across the institution.

33. The first Integrated Risk Report is expected to be completed in October 2009 for FY 09. Management is also finalizing a review of QAG, which could inform a broader review of central control units described above.
3. Strengthening Controls for Managing F&C Risk at Country and Project Levels

a. Managing F&C risk: a phased approach

34. IDA’s anti-fraud and corruption strategy can be divided into three phases: Phase I, which focused on setting out the intellectual case that good governance and an attack on corruption must be key parts of efforts to sustain economic growth and alleviate poverty, Phase II, which focused on formulating an appropriate anti-corruption strategy and its adoption by Senior Management and the Board; and Phase III, which focuses on the implementation of the anti-corruption strategy through its integration into the Bank Group’s (including IDA’s) daily operations. Having been the leader in making an intellectual case against corruption (as noted in the Volcker Panel Report discussed below), and having demonstrated the depth and breadth of the management and Board commitment to this agenda through the adoption of the GAC strategy, IDA has actively moved into Phase III of this work.

35. Phase III builds on and reflects: (i) the firm commitment and actions of IDA’s Senior Management, starting with the President, to make its fight against fraud and corruption a core element of IDA’s operations; (ii) diagnostic and assessment work performed or commissioned by management to identify areas where the controls for managing F&C risks need to be strengthened; (iii) ongoing efforts and experience with strengthening country client institutions and systems that are essential for effective and efficient management and utilization of public resources, including safeguarding these resources from fraud and corruption; and (iv) roll-out and implementation of specific actions to strengthen controls and improve effectiveness of IDA’s efforts in managing F&C risks that reflect the work and recommendations flowing from the work under items (i)-(iii). As summarized below, much progress has been achieved in this area particularly over the past 6-12 months, putting the Bank well ahead of other institutions dealing with these complex and challenging issues. Management is committed to deepen and broaden these efforts to: (i) continue building and strengthening mechanisms to monitor and manage F&C risks in IDA-supported operations, including expanded Bank-wide staff (and particularly TTL) training, and (ii) refine and improve F&C controls as more knowledge is gained about the weaknesses that still exist (which needs to be a continuous effort to reflect on lessons learned and a growing body of experience).

b. Recent actions to strengthen controls over F&C risk

36. High-level commitment and actions. As the President stated in his recent address to staff during the Integrity Day on December 3, 2008, the Bank’s commitment to integrity is at the core of all it does. The Bank, at its highest levels, is not just making the case but is actively implementing the anti-corruption agenda, as evidenced by: (i) the swift actions it has taken and specific measures it has put in place over the past 11 months in response to the Volcker Panel Report (discussed below); (ii) Senior Management hands-on approach and involvement in decisions relating to delays or suspension of operations affected by fraud and corruption issues; and (iii) detailed and candid coverage of fraud and corruption risks in Bank documents, including CASs, project documents, and periodic updates by management to the Board on specific actions and progress achieved in this area.

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18 See the Volcker Panel Report, paragraph 140, footnote 6 above.
19 See the GAC Implementation Plan, footnote 5 above.
37. **Diagnostic work.** The Volcker Panel, India DIR, and this IDA internal controls exercise have all served as key diagnostic tools to assess the status of controls over management of F&C risks in operations and recommend areas for improvement. To maximize effectiveness of its implementation efforts, including identification of areas for improvement, in February 2007, the World Bank President, in consultation with the Board, requested an independent panel of experts (the Volcker Panel) to review the operations of INT, the Bank’s central control unit responsible for, among other things, investigating allegations of fraud and corruption in operations financed by IDA and other members of the World Bank Group. The findings and recommendations of the Volcker Panel, as set out in the Volcker Panel Report issued in September 2007, identified that much remained to be done in mainstreaming fraud and corruption issues into IDA’s daily operations and has included 18 specific recommendations to help with this effort. Additional concerns about the effectiveness and robustness of controls over fraud and corruption in Bank-supported operations also were raised in the India DIR, issued by INT in December 2007 (referenced in footnote 7). The issues identified in these reports were consistent with management’s findings resulting from its assessment of entity and transaction level controls. Key among these were findings relating to the need to: (i) better integrate INT and the results of its work into IDA’s operations in order to improve management of F&C risks that may arise in the context of IDA-funded projects; (ii) specifically embed fraud and corruption risk assessment in many of the existing risk assessment processes; (iii) undertake assessment of F&C risks in a specific and systematic way throughout the institution; (iv) address more consistently as part of program and project design at a portfolio and project level, the vulnerabilities to fraud and corruption in countries with systemic corruption; (v) focus on incentives that would lead to consistent monitoring, reporting, and timely response to, implementation risks generally, and fraud and corruption issues in particular during project supervision; and (vi) develop new and/or improve existing tools and methodologies in all areas (project design, supervision and evaluation) using lessons learned, including the work of INT, in order to ensure appropriate flagging and treatment of fraud and corruption issues.

38. **Experience and tools for country-level work.** IDA has much experience with conducting country-level ESW work that helps assess and identify systemic issues that could undermine the country’s development efforts due to weaknesses in the country’s systems, institutions, and internal controls frameworks responsible for management and utilization of public funds. Such work is reflected in fiduciary ESW (in particular CPARs and/or joint fiduciary assessments i.e. combined CPAR/CFAAs which have become the quasi norm in the last 4/5 years), which provides the basis for assessing country systems and defining mitigation measures in DPLs and PRSCs as well as assess fiduciary risks at the country level that is an important input into CASs. In addition, many projects that address public sector management have included PR and FM components, several grants (e.g. IDF) have focused on fiduciary strengthening, and close coordination with other donors as part of the harmonization efforts has helped address the capacity-building issues especially in fiduciary areas. This is monitored by the number of completed CPARs and the various Bank initiatives. Much work is being done to strengthen country systems under the country system pilot in the procurement area, which focuses on assessing, strengthening and building on country’s procurement systems. Similar efforts are also underway in the FM area, as reflected in increasing number of projects relying on a country’s own FM systems and a growing number of DPLs (including PRSCs) that reflect assessments and strengthening measures in the area of public financial management. In this regard, it is also important to note the ongoing PEFA Program (with Phase III agreed with the EU, IMF and other bi-laterals in June 2008), which enhances IDA’s ability to strengthen country systems through the use of a

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20 See the Volcker Panel Report, footnote 6 above.
common results measurement framework and joint fiduciary diagnostic work (including with PREM and Procurement). Finally, strengthening and building country systems in these key areas has been, and increasingly is, an important focus of the Bank’s institution-building, governance and fiduciary support work in its client countries. Indeed, over 50% of DPLs in FY07 (up from an average of 24% in 1990-94) included conditionality on public sector governance, including in the areas of procurement, financial management, and budget transparency. While it is not a new area of emphasis, the importance of this work under the GAC strategy, combined with the work underway to implement the recently approved country systems pilot in procurement area, provide an added emphasis to the Bank’s efforts to strengthen the effectiveness, efficiency, reliability and transparency of control systems and institutions in client countries with the help of all of the Bank’s existing tools and instruments.

39. **Management actions to strengthen controls for managing F&C risks at country and project level.** Over the past 12 months, management has undertaken assertive and concrete actions in response to findings and recommendations made in the context of the primary diagnostic tools, and particularly the Volcker Panel Report, India DIR and this IDA internal controls assessment. The progress and results achieved to date with implementation of the GAC strategy are set out in the recent progress report on GAC implementation, discussed with the Board in October 2008. Moreover, the overlap between the issues raised in the context of the India DIR, management’s actions designed in response to the Volcker Panel Report, and the findings of this IDA internal controls assessment, has greatly contributed to management’s ability to better define and begin implementation of a concrete plan of systemic Bank-wide actions for heightening the Bank’s effectiveness in the governance and anti-corruption area. These actions have included development and roll-out over the past 6-12 months of the following specific tools for better management of the F&C risk at both country and project levels:

1. **Dissemination of lessons learned, including:**
   - distillation of lessons learned from INT work by its Preventive Services Unit (PSU), designed as a tool which could be used for didactic purposes throughout the institution;
   - delivery of Bank-wide learning events by OPCS, SAR, and INT to disseminate lessons learned from India DIR;
   - training seminars conducted by the PSU Bank-wide; and
   - PSU collaboration with specific project teams to help define governance, accountability and anti-corruption plans at the project level.

2. **Strengthening project supervision:**
   - compiling and disseminating good practices for better management of F&C risks, including 3rd party supervision and “smart” disseminating through the work of the “GAC in Projects “network.

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21 Strengthening the World Bank Group Engagement on Governance and Anti-Corruption, October 21, 2008 (the GAC Progress Report).
3. **Specific measures focused on F&C risk management in procurement area:**

- development and roll-out of PR Risk Model/Risk Management Tool that specifically focuses on F&C issues, scheduled for piloting in the spring of 2009, which draws on the F&C red flags identified by INT and the regions;
- deepening of the cooperation between the Procurement Anchor in OPCS and INT, including (i) signing in July 2008 of an INT/OPCPR *Memorandum of Understanding on the Prevention of Fraud and Corruption in Procurement*, which sets out a framework for facilitating a joint approach to preventing F&C in operations; and (ii) agreement on a joint INT/OPCPR work program relating to prevention of F&C in operations; and
- improvement of the procurement complaints data base (in terms of completeness, operations and usage) which is an important source for identifying potential F&C issues.

4. **Specific tools for addressing fraud and corruption at project level:**

- development of GAC in project guidelines by “GAC in Projects” team under the GAC Implementation Plan (these have been discussed with teams across the Bank and are being finalized for issuance in March 2009); and
- development, posting, and ongoing updating of lessons learned and best practices on GAC in projects on the “GAC in Projects” website, supplemented by peer learning and other training events in this area across the Bank.

5. **Strengthening financial audits:**

- development of standard terms of reference to widen financial audits to cover performance issues and procurement.

6. **Enhancing tools for monitoring procurement in the health area, including:**

- specific assessment and Bank-wide discussion of the Bank procurement procedures for pharmaceuticals; and
- enhancing training on managing F&C risks in the health sector through such modules as the session developed and delivered to HD staff during the HD week in the fall of 2008 on “Governance and Accountability: Issues, Diagnostics, and Implementation Tools for Health.”

7. **Strengthening accountability:**

- clarifying and re-enforcing the accountability of managers on all sides of the matrix with respect to their respective areas of responsibility.

40. **Specific actions in response to the Volcker Panel Report.** Management also took swift and proactive actions in response to the recommendations in the Volcker Panel Report, with
actions already implemented on 16 of the 18 recommendations (with the remaining two well underway). These actions have gone a long way to transforming INT from a segregated and rather insular function to a core part of the Bank in its fight against corruption. INT has rapidly moved toward the core of operations, without, however, losing its independence as one of the central control units that forms an essential part of the Bank’s internal control system. Key among these transformative actions are:

- elevation of the INT head to a VP level;
- the establishment of a PSU within INT, which has as its major role the dissemination of the results of INT’s investigative work, and collaboration with operations to build these lessons into project design;
- revision of INT’s disclosure policy relating to its work, thus making its findings and lessons that can be drawn from it much more accessible;
- the establishment of a very close relationship and partnership between INT and the operational complex through, in part, its close partnership with OPCS and the regions;
- inclusion of INT in Bank-wide Senior Management dialogue and reviews through INT participation in Operations Committee reviews and OVP meetings;
- INT assistance to task teams that seek its advice, and increased training and learning on fraud and corruption issues carried out across the Bank in close partnership between INT, OPCS, PREM, and the regions; and
- the establishment of the Independent Advisory Board which is an important tool for confirming and building confidence relating to fairness and effectiveness of INT work.

41. The new INT strategy, which was discussed with the Audit Committee in February 2009, also emphasizes this transformation and charts a road ahead to maintaining and deepening the role of INT as a core part of the Bank while maintaining its independence.

42. **Actions and examples of country-level and project work.** As management also reported in its GAC Implementation Progress Report, discussed with the Board in October 2008 (referenced in footnote 5), much work has been done to mainstream the GAC agenda at the country level. Specifically, 27 countries are now participating in the CGAC program, which allocated specific additional resources of $100,000 per participating country to identify, deepen, systematize and mainstream engagement on governance and anti-corruption at the country level. The CGAC initiative has resulted in development and refinement of systemic diagnostics of governance challenges and reflection of these issues in CAS for several countries. As indicated in Table 1 of the GAC Progress Report, GAC issues were adequately integrated in 64% of CASs discussed with the Board in FY 2007/08, with 32% (a jump from 19% compared to CASs discussed in FY 2006) of the CASs rated “high” in terms of providing a diagnosis of governance conditions and corruption risks. Indeed, engagement on governance and anti-corruption issues has increasingly become a part of the process for CAS design and preparation and its content. In countries where corruption issues have
surfaced in the context of Bank projects, there have been serious and concerted responses at the CAS level. Examples include the CAS update in Kenya, following the DIR for health and education, and the recent Indonesia CAS which has GAC as its centerpiece. Recent examples of CASs that specifically address GAC issues also include the India CAS and the Zambia CAS, which are particularly striking in the candor and depth in how these key issues are addressed. In many other countries which have not yet gone through the CGAC process, GAC issues also feature prominently in the CAS. In addition, issues of governance and fraud and corruption are increasingly permeating project design and are reflected frankly and comprehensively in project documents, including in specific Governance and Accountability Action Plans (GAAP) Annexes (see for example the Water and Sanitation Service Improvement Project in Kenya (P096367); Federal Roads Development Project in Nigeria (P090135); National Vector Born Disease Control and Polio Eradication Support Project in India (P094360); ID-BOS KITA Project in Indonesia (P107661); Second Health Sector Support Program in Cambodia (P102284).

c. **Recommended further actions to strengthen F&C controls**

While the efforts described above have strengthened IDA’s controls for identifying and effectively managing F&C risks in operations, more needs to be done to strengthen the controls for managing F&C risk on a “broad front” in order to “expand staff skills and broaden behavioral change in order to deepen, systematize and mainstream good practices across all of the Bank Group’s work.” To this end, management is committed to implementing additional corrective actions outlined below:

1. **Clarifying responsibilities and accountabilities for addressing F&C through:**
   - adopting of the new INT strategy (discussed with the Audit Committee in February 2009);
   - establishing appropriate protocols of cooperation between INT and the Regions on handling allegations of F&C;
   - reforming processing and supervision of IL operations, including specific focus on addressing F&C risk during project appraisal and supervision, as part of Phase I of IL reform, expected to be completed by FY09-Q4; and
   - reviewing staff incentives (performance reviews, promotions, rewards, and visibility) to ensure that they are aligned with the anti-corruption agenda through discussions at an MD-chaired GAC Governance Council (ongoing).

2. **Deepening, systematizing and mainstreaming tools for better management of F&C risk in operations through the work of the GAC in Projects Working Group, supported by OPCS, including:**
   - development and launch by OPCFM of the GAC Audit and Assurance Toolkit, designed to help task teams enhance the effectiveness of financial audit and provide guidance on other types of audit and assurance engagements that focus on fraud and corruption risks, such as technical and contract audit;

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22  The Volcker Panel Report, page 2, footnote 6 above.
• preparation of specific guidance on managing fraud and corruption risk for inclusion in the current update of the FM Practices Manual;

• preparation of guidance for FMSs by OPCFM on better identification and management of F&C risk through smart project design (to be supported by web-based knowledge sharing tools);

• preparation for issuance in FY09-Q3 of GAC good practices at the project level, entitled “Dealing with Governance and Corruption Risks in Project Lending: Emerging Good Practices” (draft completed and circulated for comment)”, which would: (a) provide task teams with a common conceptual framework for understanding GAC issues; (b) highlight some of the key lessons learned over the past several years and provides examples of emerging good practices at the sector and project level; and (c) indicate areas where further work is required in order to fully support task teams;

• development of a comprehensive training program for task teams that would cover 4 major components of the GAC agenda: (a) the CGAC initiative at the country level; (b) assessing governance and corruption risks at the sector and project level; (c) mitigating project risks through “smart project design” and the development of project-specific Anti-Corruption Action Plans; and (d) the supervision of “high corruption risk” projects;

• completion of an initial stock-taking of AAA and investment lending operations with significant GAC components and its conversion to a searchable database that can be accessed by Task Teams to provide examples of innovative approaches to risk assessment and risk mitigation;

• preparation of “case studies and good practice notes” that illustrate and elaborate on the tools and approaches being developed to improve governance and reduce corruption at the sector and project level (to be delivered through training sessions and disseminated as a publications series and on the new GAC in Projects web portal);

• establishment of a GAC in Projects Peer Learning Network, with a rapidly growing “community of practitioners” that will be supported by the interactive web portal under preparation;

• identification of Practice Leaders at the regional and sector levels and establishment of full-time focal points (EAP and SAR) or “on demand” Advisory Units (ECA and INF); and

• building on the progress achieved in developing and testing “smart” project design and more effective and more appropriately resourced project supervision, which reflect lessons learned, including systemic issues drawn from INT investigations and DIRs and creating a more effective risk management framework to help prevent, deter, detect and address fraud and corruption, which are to be reflected in the new approaches to project design/appraisal and supervision to be developed as part of IL reform.
3. **Other initiatives to strengthen controls for managing F&C risk:**

- preparation and monitoring (with OPCS support) specific action plans for following up on INT reports (a small team for the follow-up on post-INT report action plans has been established in OPCS with effect from FY2009);

- at project-level, inclusion of the F&C risk among categories of risks to be assessed during project appraisal (and reported in the PAD) and monitored and reported on during project supervision (as reflected in the revised ISR template);

- at the entity-level, inclusion of the F&C risk among a list of specific risks facing the institution in the new annual Integrated Risk Report, mentioned in paragraphs 31 and 33 above, which will replace the current Risk Scan, with the first such Report expected in October 2009; and

- implementation of actions in the procurement area focused on addressing the F&C risk in operations (reflected in paragraph 45 below).

4. **Strengthening Procurement and Financial Management**

44. **Procurement.** During Part II management assessed quality arrangements over PR work relating to project appraisal and supervision and has identified the need to strengthen quality arrangements, business processes and adequacy of documentation relating to PR during project preparation/appraisal and supervision stages. This review found that (a) quality assurance arrangements for procurement are in place and are generally sound and (b) the regional variances identified are in line with the high degree of decentralization and broad mandate of the Regional Procurement Managers (RPMs). However, management’s review also identified two issues that need to be addressed: (a) adequacy of controls in place to ensure consistent follow-up on PR issues by the task teams, including the need for better integration of PR staff in task teams and clarification of accountabilities for procurement issues and decisions; and (b) consistency in implementation of post-reviews. In management’s view, these issues, combined with the findings of Part I of this exercise, rise to a level of a significant deficiency in PR area, which requires implementation of monitorable corrective actions.

45. **Recommended action.** To address the issues identified, management recommended a plan of corrective actions, some of which have been implemented already, while others are underway.

**Actions in place:**

1. **Improving controls and quality of complaints data base:**

   - as of FY07, the procurement complaints database has been made a key control and management tool, and enhancements to the database were introduced, including (i) better controls: automatic alerts and reports for pending complaint cases, and required RPM clearance to close cases: (ii) improved and more detailed information: updated pick lists with new attributes (e.g. “nature of complaint” and “resolution of complaint”) and tracking complaints related to late
payments; and (iii) improved database management: strengthening of OPCPR monitoring of complaint follow-up.

2. Strengthening PR/INT cooperation on management of F&C risks in operations:
   - an INT/OPCPR Memorandum of Understanding on the Prevention of Fraud and Corruption in Procurement was signed in July 2008; and
   - a joint INT/OPCPR guide/pamphlet on identification and handling of red flags during the project cycle was issued in December 2008.

3. Strengthening of procurement post reviews:
   - OPCPR in collaboration with the RPMs has developed a single PPR system for (i) centrally filing PPRs uploaded by RPM offices and (ii) rating the findings in terms of procurement systems, procurement procedures, and contract administration against the four risk levels (low, moderate, substantial, high). This system is accessible through the Operations Portal and already being used in several projects. The mandatory roll out is planned after the announcement of the updated PPR/IPR guidance note which is pending the approval by the PSB.

Actions underway:

1. Full Integration of PR staff and tasks in project teams (by December 09):
   - a mechanism for early and full integration of PR staff in the project teams and of PR tasks during the project cycle is being developed;
   - new instructions and guidance are under preparation to ensure full understanding by all staff of the appropriate sharing of responsibility for key PR decisions at preparation and implementation stages between TTL and PR staff and between Sector Manager and RPM;
   - Procurement Certification system is being enhanced with a view to increase awareness and importance given to procurement work; and
   - guidance is being prepared to clarify criteria for assigning PR ratings for the ISR, including a mandatory process to be followed for making any revisions to such rating by sector staff.

2. Updating procurement policy and procedures (by March 2009):
   - update of OP/BP 11.00, Procurement, is being finalized to incorporate, inter alia, risk management, handling of fraud and corruption and the already enhanced complaints handling, as well as to revise the matrix of responsibilities and the various clearance thresholds (expected to be issued in March 2009).

3. Bank-wide roll out of a Procurement Post Reviews module:
   - The module is now being extended to all Regions and will be mandated in FY10. In addition, OPCPR requested the RPMs to identify the outstanding post review actions of the FY07/08 reports that require follow-up. RPMs will be held
accountable to follow-up on unresolved post review findings. RPMs will also provide OPCPR a summary of what they have done to meet this requirement by March 2009.

4. **Bank-wide roll out of PR risk assessment tool and revised templates (FY09 Q3/Q4):**

   - a PR Risk Model/Risk Management Tool that goes beyond the traditional capacity assessment template and aims at defining and tracking risk mitigation measures based on an enhanced risk assessment including inter alia F&C issues has been developed. The tool is being finalized and is scheduled to be piloted in the spring of 2009, in particular under the procurement Use of Country Systems piloting program; it is expected to be made mandatory for Bank-wide use later in 2009; and

   - the PAD Procurement Annex template is being revised as part of the first phase of IL reform to reflect new initiatives, including risk-based procurement assessments that include inter alia fraud and corruption, and to reflect the work on risk-based approach to processing of IL operations.

5. **Strengthening OPCPR/PSB Roles:**

   - Review, by June 2009, the roles of the Procurement Sector Board (PSB) and OPCPR with a view of: (a) expanding them to identify areas that may merit harmonization of regional practices; (b) strengthening the advisory role of the PSB to respond to the Regions’ needs; and (c) monitoring regional fiduciary compliance and quality.

6. **Further improvements to controls and quality of complaints data base:**

   - The Procurement Sector Board has approved a few additional features that will be developed during FY09, including (a) the centralization of the reopening of closed cases; and (b) automated case reporting to INT and follow-up handling.

7. **Strengthening PR/INT cooperation on management of F&C risks in operations:**

   - A joint protocol to provide guidance as to the roles of, and the interactions between, operational staff, regional management and INT regarding the reporting of allegations of fraud and corruption and handling of requests for no-objections and post-investigation will be issued after vetting by the OS panel in March 2009.

46. **Financial Management.** In FM, management found that while Quality Assurance (QA) arrangements have been put in place to oversee FM arrangements for the use of IDA financing, the quality and documentation of regional QA arrangements is inconsistent and does not fully comply with the FM Practices Manual (FMPM), particularly during project implementation. Variations in Regional QA exist, and while many of these make sense, there is a need to ensure consistency in the quality of FM work, as defined in the FMPM. Management’s assessment identified, however, issues in three specific areas meriting remediation: The first issue relates to documentation of review of audited financial statements by an FM specialist and management oversight of Audit Report Compliance Systems (ARCS) data given that in some Regions, it was
not possible to verify regular FMS review of audit reports because ARCS data entry was considerably out of date. The second issues relates to documentation of FM supervision, with some inconstancy in quality arrangements for the documentation of FM supervision work, including supervision planning, supervision reporting, and follow-up on FM action items. Some inconsistencies also exist in quality arrangements to support the filing of FM documents, making it difficult to validate that FM work has been undertaken. The third issues relates to the timing of quality interventions during supervision and identification and monitoring of risky projects, with some inconsistency and gaps in quality arrangements for Regional FM managers’ oversight and monitoring of FM work during project supervision. For example, some Regions do not have adequate systematic monitoring of interim financial reports, which could result in untimely identification of FM issues and/or delayed implementation of corrective actions.

47. **Recommended action.** The FM Sector Board formulated and began implementation of actions needed to strengthen quality arrangements in FM work, which include:

- completion of Phase I of the Joint CSR/OPCS Evaluation process (Phase II has been launched in January 2009);
- adoption of the RAPMAN/PRIMA system by all regions;
- centralized monitoring of the ARCS audit tracking system by OPCFM and a rapid reduction in the number of outstanding audit reports;
- actions to strengthen specific F&C controls in the FM area:
  - issuance in June 2007, of an FM Approach Paper to GAC;
  - establishment of an FM GAC Working Group to support the development of good practices, guidance and training for FM staff;
  - issuance of an Audit and Assurance Toolkit;
  - preparation and circulation to the FM Sector Board of FM Guidance on dealing with fraud and corruption in project design;
  - development of guidance on enhanced project supervision and FM "red flags", supported by web-based tools and guidance, including a database of projects featuring FM anti-corruption features; and
  - delivering training on GAC to the FM community, including the training provided during the 2008 Fiduciary Forum;
- additional actions completed or underway to address deficiencies identified in the FM area including:
  - review and update of the FM Practices Manual, which serves as the main operational guide for FM staff, with the revised FMPM expected to be issued in

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June 2009 (findings of this review will be incorporated into the final methodology for the Joint Evaluation);

- consolidation and updated by the regions of the regional QA arrangements (including QA-related information on regional websites), to be followed by introduction of further updates as necessary;
- aligning the QA arrangements with the issuance of an updated FMPM (exposure draft) in June 2009;
- progress in updating the ARCS by the regions for all actions related to audits that were due in FY05 through FY07 and in clearing backlogs relating to earlier years;
- entry of baseline data by the regions on interim financial reports into PRIMA (completed in October 31, 2008); and
- integration by December 2009 of IT systems tracking project performance in FM with other Bank systems to ensure FM is fully reflected in all assessments of project performance.

5. **Deficiencies in IT and AAA Areas**

   a. **IT issues identified as part of the ICFR exercise**

48. During the ICFR review three significant deficiencies were identified in connection with IT-related issues. The first related to password policy breaches in SAP, as identified by IAD in its FY07 “Identify and Access Management” audit. The audit identified that SAP passwords are widely shared by Bank staff which may have resulted in some unauthorized expenses in the financial statements. The second related to the scope of privileged access and monitoring of activities in privileged accounts which were deemed to need rationalization and strengthening to limit risks of misuse. The third related to change management controls associated with Infrastructure Change Management and the need to ensure consistency of application of these controls.

49. **Recommended action.** In response to these findings, management has recommended and as part of the ICFR program is carrying out corrective actions to (a) address the password sharing issue, (b) strengthen controls around information security to rationalize and further limit privileged access to system applications and monitor changes made by IT staff using such privileged accounts; and (c) strengthen controls around Infrastructure Change Management to ensure that change management controls are applied consistently and exceptions are reviewed and authorized by appropriate authority.

   b. **Timely accessibility of operational documents**

50. During “compliance testing” conducted by management in Part I, management identified a problem with accessibility of operational documents. The documents requested by management to support the processes and controls identified were not easily accessible. Although after an extensive effort management was able to obtain 93% of the documents requested, this exercise identified the need to strengthen document retention practices and improve accessibility of operational documents. During Part II management confirmed that this
issue is indeed linked to both, the **Control Environment** and **Information and Communication** components of COSO at the entity level, as was suggested by IEG in its Part IB report. Consistent with IEG’s preliminary recommendation, the review conducted by management also concluded that improved IT systems to support IDA’s operations would have to be an integral part of the solution to these issues.

51. **Recommended action.** Management has already begun to address the document retention and accessibility issue by setting up a Task Force in FY07 to look at retention, filing and accessibility of operational documents and come up with recommendations for improvement. Working closely with ISG, the Task Force has made a proposal for addressing the issues identified through automation of key controls for IDA’s primary operational tools (CAS, DPL, IL) into the Bank’s documentation system. Under the proposal, this work would commence with automation and integration of IL processes and controls, where most issues with documents accessibility occurred. The work on the automation system will proceed in close coordination with the first phase of IL reform and will be part of the Operations and Knowledge Management Systems Program (OKSP, previously known as the Enterprise Content Data Management (ECDM)). The new system for IL will be piloted in FY09 and is expected to be fully in place by the end of FY10, in close coordination, and forming a part of, the roll-out of IL reform.

c. **AAA processes and compliance**

52. As mentioned in the Scoping Memo for Part II, and following the request of IEG and the Audit Committee to include AAA within the scope of this exercise, during Part II, management (a) identified and mapped current processes that apply to the main AAA product line, Economic and Sector Work (ESW) reports, (b) conducted a walkthrough of the mapped processes, and (c) tested compliance with such controls using a sample of randomly selected ESW reports completed and delivered to clients during FY07, in a process similar to that performed for IL, DPL, and CAS product lines during Part I. The focus on ESW (and for sampling purposes, on ESW reports) was in large part due to the fact that ESW funding has traditionally absorbed the major share of AAA funds and ESW reports account for over 80% of total ESW spending. The process mapping exercise will inform management’s larger-scale review of AAA covering both IBRD and IDA, currently underway.

53. In ESW Reports randomly selected for compliance testing, non-compliance with controls was identified in 25% of control steps involved in the ESW process. It should be noted, however, that roughly half of the instances of non-compliance were due to mismatches between dates recorded in SAP and the actual dates of application of such controls (e.g. the dates of the Concept Review meetings of some of the transactions differed from the dates for such meetings recorded in SAP).

54. **Recommended action.** Management is undertaking a broad review of the processes and controls, including systems and monitoring, that apply to AAA in order to simplify and strengthen them where needed, and ensure they are updated to take into account the wide variety of AAA currently carried out by the Bank. This review will also address the compliance

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24 The sample was drawn from the universe of ESW Reports completed as of September 16, 2007, and whose cost exceeded $100,000. These types of ESW Reports accounted for 90% of ESW Reports completed. ESW as a whole has consumed approximately 67% of the AAA budget.
weaknesses observed, along with other issues that have been raised by IEG and QAG in recent related reviews of AAA. Management expects to complete this review and discuss the recommended changes with CODE in FY10.
# Annex 1. Management 5-Point Action Plan

**Summary of Corrective action**

*(with concordance to more detailed recommendations in Management’s Response)*

<table>
<thead>
<tr>
<th>Problem identified</th>
<th>Timeline</th>
<th>On point</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inefficiencies and gaps in control framework governing investment lending (IL), in particular</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(i) non-rationalized “one-size-fits-all” requirements irrespective of risks,</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(ii) over-focus on project preparation at the expense of implementation, and</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(iii) outdated and complex policy framework</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Diffused management and staff accountability and responsibilities for operational quality.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Inadequate mechanisms for institutional risk identification, monitoring and management.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

| I. Improve efficiency, effectiveness and controls for IL (paras 17, 18, 21 and 22 of Management Response) |
|---------------------------------------------------------------------------------------------------------|---------------|----------|
| 1. Match the demands of the process to the level of risk and focus resources on higher risk projects.     | June 2009     | OPCS     |
| 2. Strengthen IL supervision by increasing resources, support and management oversight of project implementation. | June 2009     | OPCS     |
| 3. Tailor design and financing options under the IL instrument more closely to the needs, capacity and risk profile of clients. | June 2010     | OPCS     |
| 4. Consolidate multiple rules into clear key principles to inform design and processing.                  | June 2010     | OPCS     |

| II. Strengthen risk management capacity, incentives and accountability at the project and institutional levels (paras 24, 25, 27-29, 31, 32, 33 of Management Response) |
|----------------------------------------------------------------------------------------------------------------|---------------|----------|
| At the project level                                                                                       |               |          |
| 5. Review lines of accountability at the management and staff level (including management oversight) to ensure appropriate delineation and exercise of responsibilities and accountability and consequences for failure to report serious issues. | Launch January 2009 to be completed by June 2009 | MDs, RVPs, OPCSs |
| 6. Introduce incentives and greater management support and oversight and communicate to staff expectations to ensure accurate and timely reporting of risks. | June 2009 (as part of IL reform) | OPCS, RVPs |

At the institutional level

<p>| 7. Prepare an annual Integrated Risk Report to: a) describe overall risks facing the institution, (b) identify units responsible for management of risks identified, (c) assess potential gaps and outcomes | First report to be prepared for FY09 (October 2009) | CSR       |</p>
<table>
<thead>
<tr>
<th>Problem identified</th>
<th>Summary of Corrective action (with concordance to more detailed recommendations in Management’s Response)</th>
<th>Timeline</th>
<th>On point</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inadequate integration of fraud and corruption issues (including lessons learned from INT work) into daily operations.</td>
<td>(d) develop a dashboard of risk findings from assessment activities, and (e) over time, assess the quality and consistency of processes in place.</td>
<td>March 2009</td>
<td>OPCS, MDs</td>
</tr>
<tr>
<td>8. Review QAG, to inform a broader assessment of gaps and overlaps among the existing central control units (IEG, IAD, INT, QAG and Inspection Panel).</td>
<td>(paras 36-42 of Management Response set out actions already in place; para 43 sets out recommended further actions summarized below)</td>
<td>June 2009</td>
<td>INT/RVPs</td>
</tr>
<tr>
<td>9. Establish clear responsibilities and accountabilities for addressing fraud and corruption in Bank operations (per new INT strategy).</td>
<td></td>
<td>ongoing</td>
<td>INT/RVPs</td>
</tr>
<tr>
<td>10. Establish appropriate protocols of cooperation between INT and the regions on handling allegations of fraud or corruption.</td>
<td></td>
<td>ongoing</td>
<td>INT/RVPs</td>
</tr>
<tr>
<td>11. Promote good practices across the Bank Group’s work by:</td>
<td></td>
<td>ongoing</td>
<td>INT/OPCS</td>
</tr>
<tr>
<td>• Intensifying staff training;</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Increasing management signals on the importance of this issue</td>
<td></td>
<td>ongoing</td>
<td>INT/OPCS</td>
</tr>
<tr>
<td>• Ensuring staff incentives (OPEs, promotions, rewards and visibility) are aligned with anti-corruption strategies.</td>
<td></td>
<td>ongoing</td>
<td>INT/OPCS</td>
</tr>
<tr>
<td>• Propagating lessons learned, including through preventive services unit within INT.</td>
<td></td>
<td>has begun issuing core materials</td>
<td>INT</td>
</tr>
<tr>
<td>• Issuing guide/pamphlet on identifying and handling red flags relating to fraud and corruption during the project cycle.</td>
<td></td>
<td>done in December 2008</td>
<td>INT/OPCS</td>
</tr>
<tr>
<td>12. Improve tools such as smart project design (drawing on lessons learned), and more effective and more appropriately resourced</td>
<td></td>
<td>in progress (per GAC)</td>
<td>MDs/OPCS/RVPs</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Summary of Corrective action  
(with concordance to more detailed recommendations in Management’s Response)

supervision to help prevent, deter, detect and address fraud and corruption.

13. Prepare and monitor specific action plans for following up on INT reports.


IV. Tighten fiduciary controls  
(paras 45 (for PR) and 47 (for FM) of Management Response)

In financial management (FM):

15. Institute corporate monitoring of quality of FM work in operations.  
Initiated in FY09  
CSR/OPCS

16. Integrate IT systems tracking project performance in FM with other Bank systems to ensure FM is fully reflected in all assessments of project performance.  
December 2009  
OPCS/ISG

17. Ensure that all records relating to quality arrangements for FM work, periodic project audits and financial reports submitted by country clients, are maintained and up to date.  
ongoing  
RVPs/OPCS

In procurement (PR):

18. Ensure more consistent follow-up through, e.g., earlier and fuller integration of procurement staff in project teams, review of procurement certification system, issuance of guidance for assigning procurement ratings, and establishment of clear mechanisms to resolve disagreements between procurement staff and task team leaders and sector managers;  
June 2009 (as part of IL reform)  
OPCS/RVPs

19. Update procurement policy to: (i) incorporate risk management  
March 2009  
OPCS
### Problem identified

<table>
<thead>
<tr>
<th>Problem identified</th>
<th>Timeline</th>
<th>On point</th>
</tr>
</thead>
<tbody>
<tr>
<td>and fraud and corruption issues, (ii) document the already enhanced complaints handling; and (iii) mainstream a risk-based procurement assessment tool.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

### V. Deficiencies in the IT and AAA areas
(paras 49 (IT at entity-level), 51 (IT an project level, and 54 (AAA) of Management response)

<table>
<thead>
<tr>
<th>IT system vulnerability.</th>
<th>Ongoing</th>
<th>ISG/GSD</th>
</tr>
</thead>
<tbody>
<tr>
<td>20. Prevent password sharing; and strengthen controls to further limit privileged access to system applications and to monitor changes to privileged accounts.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Difficulties with timely accessibility to operational documents</th>
<th>June 2010 (as part of IL reform)</th>
<th>OPCS/ISG</th>
</tr>
</thead>
<tbody>
<tr>
<td>21. Improve accessibility of operational documents through automation (commencing with IL) and new electronic filing system.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Mismatch between existing AAA processes and controls and the wide range of AAA work</th>
<th>Complete review and discuss with CODE by June 2010</th>
<th>OPCS</th>
</tr>
</thead>
<tbody>
<tr>
<td>22. Rationalize processes and controls governing AAA to better reflect the wide range of AAA work, address compliance issues identified by IEG and QAG, and improve system support and monitoring.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Annex 2. Control Failures by Process Module

(BASED ON COMPLIANCE TESTING CONDUCTED DURING PART IB)

<table>
<thead>
<tr>
<th>No.</th>
<th>Process Name</th>
<th>Tested</th>
<th>Operating Effectively</th>
<th>Failed</th>
<th>Description of Failed Control</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>IDA Allocation</td>
<td>4</td>
<td>4</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>CAS Products</td>
<td>3</td>
<td>3</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>SIL: Specific Investment Loan</td>
<td>9</td>
<td>9</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Project Changes</td>
<td>1</td>
<td>1</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>DPL: Development Policy Lending</td>
<td>7</td>
<td>7</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Corporate Review (ROC/OC)</td>
<td>1</td>
<td>1</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Contractual Remedies</td>
<td>3</td>
<td>3</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>10</td>
<td>Legal – IL</td>
<td>10</td>
<td>10</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>11</td>
<td>Legal – DPL</td>
<td>8</td>
<td>8</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Financial Management – IL</td>
<td>4</td>
<td>2</td>
<td>2</td>
<td>During FY06, the FM Sector Board issued new guidelines for FM practices in Bank-financed investment operations. We could not verify because of lack of documented evidence, and change in Regional practices, that the review and approval of the FM Assessment and appraisal stage PADS and Financing Agreements by the RMM or appointed delegate occurred. The sample testing, based on date prepared, identified that the majority of FMSRs prepared after November 2005 were not in accordance with the suggested requirements in the FM Guidelines as Regions were transitioning to preparing the FMSRs in accordance with the guidelines. Approx. 40% of the projects reviewed had no documentation evidencing that the risk rating identified by the FM specialist was sent to the TTL for inclusion in the ISR. In one instance we noted the ISR had a different rating from the FMSR - and no explanation was attached.</td>
</tr>
<tr>
<td>13</td>
<td>Financial Management – DPL</td>
<td>2</td>
<td>2</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>No.</td>
<td>Process Name</td>
<td>Tested</td>
<td>Operating Effectively</td>
<td>Failed</td>
<td>Description of Failed Control</td>
</tr>
<tr>
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<td>--------</td>
<td>-----------------------</td>
<td>--------</td>
<td>---------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td>14</td>
<td>Procurement – IL</td>
<td>8</td>
<td>6</td>
<td>2</td>
<td>Issues in preparation of the Form 384 included: (i) a few months delay in preparing the Form 384 after the contract received date; (ii) the 384 not showing the LAS disbursement categories; (iii) the 384 not corresponding to the no objection letter; and (iv) the contract amount recorded in the 384 was lower than that of the bid documents.</td>
</tr>
<tr>
<td>15</td>
<td>Procurement – IL</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>Unable to verify that the procurement post reviews were carried out in accordance with the timing requirements in the most recent procurement supervision plan or PAD in approx. 40% of our sample, due to lack of documentation provided. In one case we also noted a lack of audit evidence to support the post procurement review and the results from it.</td>
</tr>
<tr>
<td>16</td>
<td>Procurement – IL</td>
<td>2</td>
<td>2</td>
<td>-</td>
<td>Audit evidence on file was missing to indicate internal review and communication with the borrower in some cases.</td>
</tr>
<tr>
<td>17</td>
<td>LOA – IL</td>
<td>5</td>
<td>4</td>
<td>1</td>
<td>Loan master data created at the time of credit set-up in LAS, was not consistent with the financing agreement and/or disbursement letter. The majority of issues related to the set-up of prior review and/or SOE thresholds.</td>
</tr>
<tr>
<td>18</td>
<td>LOA – DPL</td>
<td>6</td>
<td>6</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>19</td>
<td>LOA – Application Review</td>
<td>5</td>
<td>5</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>20</td>
<td>LOA – SC or Application Problem</td>
<td>1</td>
<td>1</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>21</td>
<td>LOA – Amendment/Extension</td>
<td>2</td>
<td>2</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>22</td>
<td>LOA – Refund Process</td>
<td>1</td>
<td>1</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>23</td>
<td>LOA – Cancellation Process</td>
<td>2</td>
<td>2</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>24</td>
<td>LOA – Suspensions</td>
<td>6</td>
<td>4</td>
<td>2</td>
<td>Controls surrounding FO approvals of notices related to threat of suspension, suspension, and lifting of suspension were not testable in many cases due to the lack of documentary evidence.</td>
</tr>
<tr>
<td>25</td>
<td>LOA – Closing - Standard</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>Verifiable historical audit trail relating to imposing or lifting of suspensions is not readily available in LAS.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Lack of evidence of Finance Officer clearances – documentation not made available/provided for testing.</td>
</tr>
<tr>
<td>No.</td>
<td>Process Name</td>
<td>Tested</td>
<td>Operating Effectively</td>
<td>Failed</td>
<td>Description of Failed Control</td>
</tr>
<tr>
<td>-----</td>
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<td>--------</td>
<td>-------------------------------</td>
</tr>
<tr>
<td>26</td>
<td>LOA – Closing - Special</td>
<td>2</td>
<td>1</td>
<td>1</td>
<td>Housekeeping of the Credit information in LAS is not always performed in a timely manner.</td>
</tr>
<tr>
<td>27</td>
<td>QAG – Quality at Entry &amp; Supervision</td>
<td>6</td>
<td>6</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>28</td>
<td>Safeguards – IL</td>
<td>3</td>
<td>3</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>30</td>
<td>Debt Reporting</td>
<td>3</td>
<td>3</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>31</td>
<td>CPIA</td>
<td>4</td>
<td>4</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>32</td>
<td>PCPI</td>
<td>3</td>
<td>3</td>
<td>-</td>
<td></td>
</tr>
</tbody>
</table>

Less items not included in testing:

| 29  | Safeguards - Corporate Risk (QACU)   | -      | -                     | -      |                               |

Controls included in testing

<p>| | | | |</p>
<table>
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<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td></td>
<td>115</td>
<td>105</td>
<td>10</td>
</tr>
</tbody>
</table>
Review of IDA Internal Controls
An Evaluation of Management’s Assessment and the IAD Review

Report on the Completion of Part II
Final Report on the Effectiveness of IDA Internal Controls for Assuring Reliable Financial Reporting, Compliance with IDA’s Charter and Policies, and Operating Efficiency and Effectiveness

Volume II
Completing Part II and Integrating Parts I and II

This paper is available upon request from IEG-World Bank.
## Acronyms and Abbreviations

<table>
<thead>
<tr>
<th>AA</th>
<th>Analytical and advisory activities</th>
</tr>
</thead>
<tbody>
<tr>
<td>ARPP</td>
<td>Annual Review of Portfolio Performance</td>
</tr>
<tr>
<td>BP</td>
<td>Bank Procedure</td>
</tr>
<tr>
<td>BPM</td>
<td>Business Process Module</td>
</tr>
<tr>
<td>CAS</td>
<td>Country Assistance Strategy</td>
</tr>
<tr>
<td>CFAA</td>
<td>Country Financial Accountability Assessment</td>
</tr>
<tr>
<td>CGAC</td>
<td>Country Governance and Anti-Corruption</td>
</tr>
<tr>
<td>CODE</td>
<td>Committee on Development Effectiveness</td>
</tr>
<tr>
<td>COSO</td>
<td>Committee of Sponsoring Organizations (established by the Treadway Commission)</td>
</tr>
<tr>
<td>CPAR</td>
<td>Country Procurement Assessment Report</td>
</tr>
<tr>
<td>CSR</td>
<td>Controller, Strategy, and Resource Management</td>
</tr>
<tr>
<td>DIR</td>
<td>Detailed Implementation Review</td>
</tr>
<tr>
<td>DPL</td>
<td>Development Policy Loan</td>
</tr>
<tr>
<td>ECDM</td>
<td>Enterprise Content and Document Management</td>
</tr>
<tr>
<td>ELCQ</td>
<td>Entity-Level Controls Questionnaire</td>
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<tr>
<td>EPR</td>
<td>Evaluated pass rate</td>
</tr>
<tr>
<td>ESW</td>
<td>Economic and sector work</td>
</tr>
<tr>
<td>F&amp;C</td>
<td>Fraud and corruption</td>
</tr>
<tr>
<td>FM</td>
<td>Financial management</td>
</tr>
<tr>
<td>FR</td>
<td>Fiduciary Review</td>
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<tr>
<td>GAC</td>
<td>Governance and Anti-Corruption</td>
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<tr>
<td>GAO</td>
<td>U.S. Government Accountability Office</td>
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<tr>
<td>IAD</td>
<td>Internal Audit Department</td>
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<td>ICFR</td>
<td>Internal Controls over Financial Reporting</td>
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<tr>
<td>IDA</td>
<td>International Development Association</td>
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<td>IEG</td>
<td>Independent Evaluation Group</td>
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<td>IL</td>
<td>Investment lending</td>
</tr>
<tr>
<td>INT</td>
<td>Department of Institutional Integrity</td>
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<tr>
<td>IRMF</td>
<td>Integrated Risk Management Framework</td>
</tr>
<tr>
<td>ISR</td>
<td>Implementation Status (and Results) Report</td>
</tr>
<tr>
<td>IT</td>
<td>Information technology</td>
</tr>
<tr>
<td>KPI</td>
<td>Key Performance Indicator</td>
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<tr>
<td>LEG</td>
<td>Legal Department</td>
</tr>
<tr>
<td>N/A</td>
<td>Not applicable</td>
</tr>
<tr>
<td>OP</td>
<td>Operational Policy</td>
</tr>
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<td>OPCS</td>
<td>Operations Policy and Country Services</td>
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<tr>
<td>PR</td>
<td>Procurement processes</td>
</tr>
<tr>
<td>PRIMA</td>
<td>Portfolio and Risk Management System</td>
</tr>
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<td>RAFMAN</td>
<td>Risk and Portfolio Management System</td>
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<tr>
<td>QAG</td>
<td>Quality Assurance Group</td>
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<tr>
<td>QSA</td>
<td>Quality of Supervision Assessment</td>
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<tr>
<td>SPC</td>
<td>Strategy and Performance Contract</td>
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<tr>
<td>SPR</td>
<td>Simple pass rate</td>
</tr>
<tr>
<td>TTL</td>
<td>Task Team Leader</td>
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About this Volume

Volume I presents the synthesis of IEG’s overall evaluation. By contrast, Volume II gives an account of the evidence, methodology, and underlying analysis that went into arriving at the overall findings shown in Volume I.

Given that management decided to conduct its assessment in two parts (Parts I and II) IEG had to make an evaluation of each part separately, and then had to evaluate both parts as an integrated whole. IEG has already written and issued its two reports evaluating Part I. The present report concerns itself with the evaluation both of Part II and then of the integrated whole. Volume II has therefore been designed into two sections to fulfill those two key purposes, evaluating Part II and then the integrated whole:

Section I provides a record of how the review of the entity level controls was conducted by management (comprising Part II of the overall review) and how IEG evaluated that assessment to arrive at its principal findings, based largely on management’s questionnaire results. The section contains two annexes, dealing separately with method and findings:

**Annex A:** This deals with the type of approach and method that management used in its assessment of entity level controls. IEG conducted a specific evaluation of the approach and method to be sure that the methods were robust and did not lead to biases in findings and conclusions.

**Annex B:** This annex deals with the evidence and findings of management’s entity level assessment, based mainly on the evidence of management’s primary instrument for conducting the entity level controls assessment (i.e. the Entity Level Controls Questionnaire (ELCQ)). The ELCQ was a questionnaire organized around the five COSO components, to be filled out by unit managers across the Bank. From its results, IEG conducted a statistical analysis to establish certain “pass rates” to show how effectively the entity level controls were perceived to be operating. The annex also describes how these results were used to identify certain deficiencies in entity level controls.

Section II provides the basis for consolidating and integrating the results and findings from Part I and Part II, and contains IEG’s composite evaluation of the overall integrated controls framework. Section II contains four annexes:

**Annex C:** This annex begins the integration of Part I and Part II and focuses mainly on controls weaknesses. It deals with certain scope limitations that applied to management’s approach to Part I (which would be weaknesses had they not been
addressed in Part II). It describes compliance issues that were postponed in Part I for
completion during Part II. And it lists all controls weaknesses identified in both parts
of the review: one material weakness, five significant deficiencies, and some 160
deficiencies found overall, and describes how many have been resolved and those
whose remedies are still in progress or still to be acted upon.

Annex D: This annex provides a detailed account of the background, evidence,
criteria, and judgments relating to the IEG finding that there is a material weakness
in the complex of controls that govern IDA’s efforts to ensure against F&C in its
lending operations.

Annex E: This annex contains IEG’s final composite evaluation of the integrated
controls framework as a whole. It is based on all sources of evidence. This includes
taking account of the underlying analysis presented in Annexes A and B (showing
the ELCQ results), it integrates findings from both parts of the review, it considers
other evidence available and it reflects the results of the Template application that
IEG used to rate the effectiveness of the controls system. This is where, based on all
sources of evidence, IEG gives its own independent evaluation of the effectiveness of
the controls framework, as is summarized in Volume I.

Annex F: This contains the Statistical Appendix with data gathered from the entity
level controls review, mainly from the ELCQ.
# Key Technical Terms

<table>
<thead>
<tr>
<th>Term</th>
<th>Definition</th>
</tr>
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<tbody>
<tr>
<td><strong>Audit Standards</strong></td>
<td>Criteria established by recognized accounting and audit bodies (in this case COSO and Accounting Standards 2 [AS2]) for conducting audits and reviews of internal controls that offer a basis for providing assurance that controls are well designed and working as intended, and for identifying deficiencies, significant deficiencies, and material weaknesses.</td>
</tr>
<tr>
<td><strong>Bottom-up Approach</strong></td>
<td>The approach adopted by management in its assessment did not begin with a top-down, entity-level review, but focused first on business processes at the transactions or operating level. Hence, it has been described as a bottom-up approach.</td>
</tr>
<tr>
<td><strong>Business Process Modules (BPMs)</strong></td>
<td>Management chose to conduct this review of internal controls by identifying the main business processes in which IDA is engaged on a daily basis in the course of its operations. There were 35 procedures in all, covering IDA allocation; the Country Assistance Strategy (CAS) process; the main lending products (Specific Investment Loans, or SILs, and Development Policy Loans, or DPLs); and the fiduciary, contractual, safeguards, and quality assurance processes that support lending. Each process was mapped and described as separate business process modules, each containing the key internal controls that are the subject of the review.</td>
</tr>
<tr>
<td><strong>Business Process Template</strong></td>
<td>A standardized assessment questionnaire and rating system used by IEG to provide quality ratings of management’s method and approach in identifying, describing, and mapping the business processes, and of its method in assessing the effectiveness of control design and of control operation.</td>
</tr>
<tr>
<td><strong>COSO Integrated Framework (“Internal Controls-Integrated Framework”)</strong></td>
<td>A framework of management principles (COSO components) in an organization that, when collectively operating as intended, will provide reasonable assurance as to the attainment of three key organizational goals (COSO objectives): reliable financial reporting, operational effectiveness and efficiency, and compliance with laws and regulations (in IDA’s case, with its charter and internal policies and procedures). The COSO components are: Control Environment, Risk Assessment, Control Activities, Monitoring and Learning, Information and Communications.</td>
</tr>
<tr>
<td><strong>Deficiencies, Significant Deficiencies, Material Weaknesses</strong></td>
<td>Design flaws, omissions, or noncompliant operation of controls, discovered in the course of a controls review, denoting an ascending order of seriousness. The precise criteria by which the three categories of materiality are distinguished are explained in Annex B of the Part IA Report. However, in the case of operational as against</td>
</tr>
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</table>
financial reporting, there are no such clear yardsticks by which to measure the materiality of a given weakness or set of weaknesses. Some judgment is required. The criteria to be used as a guide in making the needed judgments are those outlined in Annex B of the Part IA report.

Entity-Level Controls

Entity level controls refer to those internal controls applicable to the entity as a whole (i.e., “high level” controls). As such, appropriate entity level controls established and supported by management are a critical ingredient in creating an effective control environment. Examples of entity level controls include creating effective systems and processes for performance management (performance measurement and results), human resource management (hiring, performance evaluation, and training), and ethics (code of conduct and ethics regulation). Examples also include the creation of control units with responsibilities that cut across the organization and exist for the purpose of monitoring the effective achievement of objectives and/or implementation of internal controls such as IEG, IAD, QAG, INT and others.

Entity-Level Controls Questionnaire (ELCQ)

A questionnaire designed by management to be answered by managers throughout the operating units in the Bank, with questions aimed at soliciting opinions from managers about the effectiveness of controls. Where questions received “yes” responses the presumption is that the control in question was seen to be working, and where “no” or qualified responses were given, there was presumed to be a weakness in the control.

Entity-Level Template

A standardized questionnaire and rating system used by IEG to evaluate and give quality ratings to both management’s approach and method in its assessment of the entity-level controls framework, and to evaluate the strengths and weaknesses of the framework, as viewed across the five COSO components.

Evaluated Pass Rate (EPR)

An ELCQ question about a given control could be answered “yes” by some managers while being answered “no” by some others. The EPR is the number of questions deemed to have been answered “yes” on balance, taking into account also the number, type and reasons for the “no” responses given for the same question, as a percentage of the total number of questions. Since IEG and management used different criteria for making these judgments, the EPRs calculated by each party were different.

Evaluation Panels

In applying its Business Process Template, IEG assembled panels of 3-4 people, including controls specialists, and with experts in the particular discipline covered by the given BPM. The panels arrived at consensus judgments on the ratings that should be applied to each section of the module, according to their evaluation of the materials presented by management.

Exceptions

Non-compliances deemed to be of a less serious or material nature than deficiencies.

Exceptions/Deficiency Rates

The number of exceptions/deficiencies found during the Part IB testing of key controls, divided by the number of control steps in the
**Internal Controls**

Controls, individually or collectively, are structured means within an organization to enable it to achieve its business objectives while addressing risk. Control instruments include the control framework (in IDA’s case, the COSO framework), organizational checks and balances, published policies, and required procedures, among others.

**Integrated Internal Controls Framework**

The combined system of key controls contained in the *transactions-level* business processes and the *entity level* controls that provide for governance of the organization as a whole.

**Key Control**

A gateway and decision point, involving key units and IDA staff, in a given business process module, through which a business transaction being processed must pass. It is the effectiveness in design of these controls and the subsequent testing of the effectiveness of their operation that is at the center of this review.

**Non-compliances**

Controls or control steps found during testing to be not operating in conformity with the design of the control. The concept of non-compliance includes both exceptions and deficiencies.

**Process Map**

The flow chart that graphically depicts all steps in a business process module.

**Review**

The term used to refer to the entire process of this study. Management conducted an assessment, the Internal Audit Department (IAD) conducted a review and opinion, and IEG conducted an evaluation. When referring to all three processes as an entity, the term used is “review.”

**Risk Focal Points**

In the adaptation of the COSO framework by the Bank and IDA to meet their own needs, management has defined and added to the framework four key points of risk that face the mission of the Bank Group and are especially relevant to IDA. These are: Strategy Effectiveness, Operational Efficiency, Financial Soundness, and Stakeholder Support.

**Simple Pass Rates (SPR)**

The number of “yes” responses received for each category of responses in the Entity-Level Controls Questionnaire, divided by the total number of responses. The SPR therefore gives a direct measure of what the ELCQ results show regarding the effectiveness of controls; hence it directly reflects the perceptions of the managers responding to the questionnaire.

**Walkthrough**

An interactive interview and review of process documentation conducted by management with relevant teams of IDA staff knowledgeable in a particular business process and its associated controls, with a view to verifying that controls are designed in the way described and operate as intended.

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SECTION I

Entity-Level Controls Review (Concluding Part II)
Preamble to Section I

IEG recognizes that the Bank and IDA have clear missions and are generally well structured and equipped to pursue them. IDA’s general mission statement stems from its Articles and it has a set of policies and procedures to guide its pursuit of strategic objectives related to that mission. It also shares in the Bank’s organization and operational matrix management structure (Regions and Networks).

As the world leader among development finance institutions it is presumed to have excellent, professional management and staff as well as a control environment that assumes integrity, ethical values, discipline, and human resource policies and practices to support the pursuit of its operations.

IDA has explicit mechanisms and routine processes to assess various types of risk that must be faced in pursuing its goals. To match and manage these risks, IDA shares in the Bank’s policies and procedures and has a structured budget and resource allocation system. That system aims to ensure that resources are deployed with due regard for efficiency and in accordance with IDA’s strategic goals. IDA’s Board receives quarterly updates on those resource deployments. IDA has its own allocation model to deploy the resources that donors provide on the IDA replenishment cycle.

In recent years, the Bank has strengthened its capability for monitoring various aspects of its activities, including with the creation of new units such as the Quality Assurance Group (QAG), Department of Institutional Integrity (INT), and Inspection Panel (IP) and new areas of focus, including those covered by IEG.

Finally, as a major knowledge institution the Bank has modern information and communications systems connecting a worldwide network of field offices with headquarters and a wide range of audiences for its activities.

The purpose of the review has been to document, verify, and test IDA’s controls mechanisms and processes, and to identify areas where controls may not always be working as intended, or where new controls may be needed. It is in this light, therefore, that IEG has viewed the output from management’s assessment.
Annex A: Analysis and Evaluation of Management’s Approach and Method in Part II

Introduction

1. This annex deals with the type of approach and method that management used in its assessment of entity level controls. IEG conducted a specific evaluation of the approach and method to be sure that the methods were robust and did not lead to biases in findings and conclusions.

2. The main tools management used in its assessment were questionnaires and analysis of various reports, papers, and documents, specifically it:

   • Mapped all Bank operational and central control and monitoring units and linked them to the COSO components to define the entity-level controls framework;
   • Administered two questionnaires for the Bank’s operating, service and control units:
     - The annual Internal Controls over Financial Reporting (ICFR) questionnaire (routinely used for financial reporting), was used as a background reference;
     - A new Entity-Level Controls Questionnaire (ELCQ) was designed especially for the IDA review, focusing on operational (not financial) reporting issues at the entity level;
   • Interviewed unit staff to gather more detailed information about their questionnaire responses;
   • Prepared analytical papers on such special topics as the budget process, and the role of the Board;
   • Reviewed the results of analytical and evaluative work conducted over the years by central control units as part of their ongoing work programs, including investigative-oriented reports and Internal Audit Department (IAD) audit reports.

Mapping the Bank Units Comprising the Entity-Level Controls

3. Management identified 31 Bank units (shown in Box A.1) whose roles and functions contribute to the entity-level controls framework. The Board of Executive Directors was not included as management did not intend to have the Board respond to the questionnaire, and the Board’s role was handled in a separate process. Management’s assessment of the entity-level controls examined the mandate and terms of reference of each of these units (or groups of units) as well as recent outputs from their ongoing work programs. The findings were used to assess their respective contributions to IDA meeting the COSO principles and to
establish where weaknesses might exist in the exercise of their internal controls function. Management also sent these 31 units the ELCQ. IEG agrees that these units embody the functions that constitute the entity-level controls system over IDA operations.

<table>
<thead>
<tr>
<th>Three Senior Management Units</th>
<th>Six Regions</th>
<th>Four Networks</th>
<th>Nine Central Control Units</th>
<th>Nine Other Units</th>
</tr>
</thead>
<tbody>
<tr>
<td>2 Managing Directors (MDD and MDW)*, and the Chief Financial Officer</td>
<td>Africa (AFR), East Asia and the Pacific (EAP), Europe and Central Asia (ECA), Latin America and the Caribbean (LCR), Middle East and North Africa (MNA), and South Asia (SAR)</td>
<td>Human Development (HDN), Finance and Private Sector Development (FPD), Poverty Reduction and Economic Management (PRM), Social Development (SDN)</td>
<td>Controller, Strategy and Resource Management (CSR), Quality Assurance Group (QAG), Independent Evaluation Group (IEG), Internal Auditing Department (IAD), Concessional Finance and Global Partnerships (CFP), Ethics and Business Conduct (EBC), Operations Policy and Country Services (OPC), Institutional Integrity Department (INT), Inspection Panel (IP)</td>
<td>Treasury (TRE), External Affairs (EXT), Human Resources (HRS), Information Services Group (ISG), General Services Department (GSD), Development Economics (DEC), Legal (LEG), Corporate Secretariat (SEC), World Bank Institute (WBI)</td>
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*Graeme Wheeler and Juan Jose Daboub. A third Managing Director, Ngozi Okonjo-Iweala, joined the Bank only in late 2007 and therefore was not included among the respondents.

The Entity-Level Controls Questionnaire

4. **Questionnaire Design:** The ELCQ was used to deepen the evidence from management’s own Bank unit assessment based on the mapping review. IEG was asked to comment on the draft questionnaire during the design phase before it was distributed to the Bank units. Once the questionnaires were completed, IEG made a more comprehensive evaluation of its effectiveness, finding it to be appropriately organized—with questions arranged in groups under each COSO component—and with questions that were generally well focused on the key issues in each area. Through this organization, the questionnaire was able to deliver results that were easily aggregated into COSO topic areas.

5. The questionnaire contained 157 questions. Based on the population of the 31 Bank units, this would give a total of 4,867 potential responses. However, a number of questions did not apply to all units, so the effective universe was 4,149 potential responses. (This total included 79 questions that were asked to units, but which they decided were not applicable to them.) IEG notes that some of the questions that were not asked of all the monitoring units possibly could have been asked, particularly of INT, and might in that case have yielded useful information.
6. There are also some issues with the questionnaire approach beyond the appropriateness of its design. First, questionnaires record perceptions of managers, not hard facts. Second, there can be issues of candor, and respondents may have shown some degree of bias, because they are often “owners” of the controls and processes being examined. Finally, even if candid, managers may miss certain realities because they may focus on their units more than on the institution as a whole (as in one important case with question 68 relating to the quality and currency of Operational Policies/Bank Procedures [OP/BPs]).

7. These issues are typical for most questionnaire approaches. In this case, management’s assessment did not rely solely on the evidence provided by the questionnaire. Also, such questionnaires are commonly used in controls reviews in the professional auditing industry. On balance, therefore, IEG is satisfied that the questionnaire approach was useful and revealed relevant and actionable information. Moreover, in IEG’s follow-up interviews with a number of the respondents it became evident that they had treated the questionnaire seriously, senior staff answered the questions after careful thought and discussion within each responding unit, and the process was itself a learning experience for some units.

8. In any future surveys of this kind IEG would suggest some refinements:

- Be more explicit as to whether respondents should speak about their units, or about the institution, and what should be the basis of their responses, i.e. relevant experience and observations in their current areas of responsibility or also from previous positions or opinions of others.
- Distinguish more clearly those questions that are searching for responses about controls design and those that are about the operation within the particular work unit of controls.
- Eliminate overlaps between questions, and reformulate questions that were presented in the form of multiple questions when respondents might have given different responses had the questions been asked individually.

Other (Non-ELCQ) Evidence Used in Evaluating Entity-Level Controls

9. Consultation with Bank units: The management team interviewed a number of senior managers who had completed the questionnaire in order to gain a more in-depth view of their responses and what lay behind them, particularly in areas where ELCQ responses suggested possible control weaknesses. These discussions also often went beyond the questionnaire itself to discuss aspects of internal controls more generally, which frequently added significant value to what the questionnaire responses had covered.

10. Analysis of control units’ reports: Among the Bank units that management had mapped to the organizational structure of entity-level controls, the central control units were considered pivotal, specifically in the entity-level monitoring and control functions. Management produced an internal paper that summarized recent work and findings conducted by these units (EBC, CSRRM [Resource Management], CSRSI [Corporate Strategy and Integrated Risk Management], CTR, OPCFM [Financial Management], QAG, IAD, INT, IEG, IPN). This work provided the basis to assess the effectiveness of these units in their
contribution to entity-level controls and in providing feedback, including recommendations for controls improvement, to the Board of Executive Directors and Senior Management. IEG Observations: Management’s summary document on the central control units gave ample evidence of the breadth and depth of information provided on an annual basis by these units, which was useful to corroborate and give context to the questionnaire response data.

11. **Review of Board of Executive Directors’ role in the control framework:** This paper, written jointly by Legal and the Secretary’s Departments (LEG/SECBO), described the roles and responsibilities of the Board of Executive Directors. The Board was not subjected to a review and examination and it was not asked to respond to the ELCQ. Management did, however, take due note of the major Board oversight functions and the Board contribution to the Control Environment of the COSO framework.

12. **Analysis of the Bank’s budgeting processes:** Management commissioned a background paper that described the regular annual budget processes. It highlighted their significance for translating strategic goals from the Medium-Term Financing Strategy (MTFS) into unit operations programs (through the Strategy and Performance Contract, or SPC, and monitored in the Quarterly Business Review, or QBR). It also highlighted the attention given to operational efficiency, in the form of budgetary allocations linked to previous performance, and including specific efficiency incentive measures such as the efficiency or “productivity” tax. **IEG Observation:** IEG commissioned its own working paper on this topic, which gave very similar insights. IEG also gathered specific efficiency indicators (see Table SA.6 in the Statistical Appendix), which it used as a reference point to show the type of information that Senior Management is provided on a routine basis.

13. **Other evidence gathered:** Management also used reports and recommendations stemming from parallel but unrelated studies, such as the Volcker Report on the role of INT, the Detailed Implementation Review (DIR) on the India Health Sector recently completed by INT, and some of the work being undertaken on fraud and corruption issues under the Governance and Anti-Corruption (GAC) initiative. IEG has also drawn on these sources.

14. In addition to reviewing summary documents and analytical papers prepared by management and conducting its own interviews, IEG also independently selected and reviewed certain central control unit reports that were directly relevant to the IDA controls review, namely:

- **IAD audits of country operations in field offices:** IEG reviewed 12 of 21 IAD audit reports (from FY07 to Q1 FY08) relating to IDA-only countries which had been earlier reviewed by management. Of the 12, only one was rated satisfactory, 11 were rated needs improvement. Management’s review of the full 21 showed ratings of 5 satisfactory, 14 needs improvement and 1 was unsatisfactory (and one was not rated). (Of the country cases rated less than satisfactory the dominant area in which deficiencies were identified was in project supervision, and specifically in the area of financial management (FM) and procurement (PR). In one case, administration of the field office budget was unsatisfactory.) **IEG Observation:** This raises an issue regarding controls over supervision of FM and PR, and corroborates the Part I finding that the fiduciary Business Process Modules (BPMs) were among those with the highest rates of noncompliance.
• **QAG Reports on Project Supervision (QSA 7):** QAG reported that supervision had improved—the share of projects with unsatisfactory supervision (moderately unsatisfactory, unsatisfactory, and highly unsatisfactory) was only 5 percent as of 2007. However, only 50 percent of the projects were rated satisfactory or higher; and QAG reported that Implementation Status Reports (ISRs) understated the riskiness of the portfolio and that more projects needed special attention and possibly more resources. The QAG report pointed out a need to focus on development effectiveness outcomes; a need for improved quality of data to support clear key performance indicators (KPIs) and enable teams to address threats to achievement of development objectives (DOs); a need for improved sector management oversight; a need for quality supervisions skills, particularly better support to local staff in fiduciary, social, and environment matters; a need to expand budgets for supervision; and a need for more candor in ISRs. **IEG Observation:** QSA 7 reflects improvements in supervision quality over some past years but in some key areas (candor, need for more budget resources) weaknesses may reinforce controls deficiencies found in other areas (lack of controls or lack of observance of controls over fraud and corruption in particular).

• **INT Detailed Implementation Reviews:** IEG reviewed all DIRs/FRs completed by INT, including the recent DIR on the health sector in India. These reports provide detailed examinations of the implementation of Bank and IDA projects, including through forensic audits. The results shed light on the susceptibility of IDA projects to fraudulent activity and raise issues related to the supervision of projects, since, as in the case of the India DIR they have identified indicators of fraud and corruption in all six sets of projects studied. From the perspective of the IDA controls review, the questions raised by these studies are: (a) which Bank controls (policies, procedures) were breached such that fraud and corruption could have occurred and not been detected in a timely manner? and (b) How widespread might such practices be in other sectors and countries? **IEG Observation:** The evidence emerging from DIRs/FRs has contributed to conclusions reached in this review that controls in place have not reasonably mitigated fraud and corruption risk at several levels of the Bank’s operations processes, which IEG has judged to be a material weakness in the control system.

15. **Background papers commissioned by IEG:** In addition to the several papers presented as relevant evidence for the entity-level controls review, IEG also commissioned four background papers on the following topics:

• **Budgetary Process and Efficiency Measurements:** The paper describes the Bank’s mechanism for setting strategic goals, translating these into VPU and working-level goals, allocating resources through the annual MTSF paper, and the monitoring of progress on goals through the associated SPC and QBRs. It also describes the specific efficiency goals and incentive mechanisms, including the shift to dollar budgeting and the efficiency tax recently introduced. **IEG Observation:** The Bank has an articulated budget mechanism and a regular high-level review cycle that monitors quarterly progress, and the budget contains efficiency incentives.

• **Development Effectiveness of IDA:** The paper draws heavily on IEG reports on annual reviews of development effectiveness (ARDEs) for the past several years, and tracks
achievements in IDA effectiveness since 1990. The paper offers a clear account of
IEG’s role as one of the Bank’s chief entity-level units concerned with measuring and
tracking development effectiveness, and it contains selected evidence of actual
outcomes, which is relevant to the overall extent to which the controls over IDA
operations can be credited with being effective. IEG Observation: The Bank has a
well-defined mechanism through IEG for tracking operational effectiveness. This is
reported on an annual basis in a way that keeps management and other stakeholders
well informed.

• **Review of Operations Evaluation (AROEs):** The paper reviews IEG’s Annual Report on
Operations Evaluation (AROE) from 1997 through 2006 to provide an overview of
the evolution of the Bank’s systems to manage for development effectiveness and on
IEG’s effectiveness over this period. The AROEs covered several themes, including
lending, analytical and advisory activities (AAA) and economic and sector work
(ESW), country focus and the Country Assistance Strategy (CAS), and sector
strategies, trust funds and partnerships, and corporate performance evaluation. The
AROEs also contain self-evaluations by IEG of its own effectiveness, and the
background paper presents survey data on the perceptions of the operating staff as
to the timeliness and quality of IEG products. IEG Observation: The AROEs have
provided a regular and transparent account of the Bank’s evaluation effectiveness.
IEG has now merged the separate AROE into the ARDE discussing issues
concerning Bank operations evaluation and development effectiveness in a single
annual report. The key analytical and reporting aspects of the ARDEs will be
maintained but in a more streamlined reporting format.

• **Results-Based Management:** The paper describes the Bank’s significant progress on the
adoption of a results agenda and the mainstreaming of the Monterey, Marrakesh,
and Paris initiatives. Most CASs have now adopted a results-based approach
(RBCAS), and the Results Measurement System (RMS) is being used by IDA, which
is somewhat ahead of the IBRD in this respect. There is, however, more to be done,
as was also confirmed by the questionnaire. Areas where improvements are needed
include:

* Extending key performance indicators (KPIs) to the individual level;
* Extending the Results Monitoring Learning System Bank-wide;
* Improvement of the results links from projects to sectors to country outcomes;
* More systematic definition of project development objectives in AAA and
  tracking of impacts;
* A shift in managerial emphasis from the current high level of attention to
  performance measurement (data generation) toward more focus on performance
  management (i.e. usage, effective implementation).

IEG Observation: The Bank has made a good start in introducing results measurement
systems and is engaged, alongside other international financial institutions, in
implementing a results-based agenda. However, the instruments have yet to be fully
developed at the operations level.
16. In summary, management conducted its assessment of entity-level controls by identifying, mapping, and surveying the work output from the units in the Bank that contribute to the entity-level controls framework. It used two questionnaires (ICFR and the ELCQ), but principally the latter, which was designed for the purpose, to corroborate and deepen its findings. Using this two-pronged approach, management assembled a significant body of information, consisting of a compendium of reports on the work outputs of the central control units in the Bank, supplemented by a number of background and other papers, including the Volcker Report on INT, IAD audit reports, and reports from QAG and IEG.

17. **IEG’s Evaluation:** IEG used its Entity-Level Template to rate the quality of management’s approach to assessment. The question IEG posed was: *Were there any aspects in management’s approach and method in assessing the entity-level controls framework that would give rise to significant doubts as to the validity of the results of that assessment?* IEG concluded that this was not the case, and it rated the method overall *fully satisfactory*, but with some suggestions for future improvements in the questionnaire design. Overall, management’s approach was sound and its methods and tools were useful and responsive, and IEG finds them not to be the cause of significant doubt as to the results obtained. Questionnaires of this kind are commonly used in the auditing profession as tools to examine entity-level controls.

18. **Template ratings:** Ratings were applied to two separate aspects of management’s approach, with the results as shown in Box A.2. The observations and suggestions made to improve the questionnaire referred to those few areas of possible ambiguity in the questionnaire, as discussed in paras. 4-7. The rating for both the Design of Assessment Instruments and for the Use of Data from the Questionnaire and Other Sources was *fully satisfactory*. 
**Box A.2. Summary of IEG’s Evaluation of Management’s Approach and Method in Its Entity-Level Assessment**

### Approach/Instrument Evaluated by IEG

**Questionnaire Design:**
- Blank form draft: commented on scope, content, responsiveness to COSO components and linkages to transactions level
- Integration of Part II questionnaire with ICFR questionnaire
- Suggested inversion of one question

**Questionnaire Response Matrix:**
- Raised issue of candor in questionnaire responses, and consistency between unit and Bank perspectives
- Reviewed the matrix format summarizing responses
- Confirmed that the universe of Bank units responding was appropriate
- Clarified consistency of matrix summary and questionnaire responses

**Interviews:**
- IEG did not attend management interview sessions
- Conducted its own selected interviews

**Overall Method:**
- Applied IEG Entity-Level Template to rate different aspects of management’s approach in assessing each COSO component
- IEG used these ratings to confirm its own evaluation of the quality and strength of the entity-level controls framework
- **Key Qualifications:** Few details on links between entity and transactions levels; treatment of efficiency and effectiveness made no reference to outcomes

### IEG Evaluation

- Despite some shortcomings — cases of overlap, unit/institutional focus, some multiple questions — the questionnaire is found to be a useful instrument for this review.

- Matrix found to be comprehensive, consistent, and transparent tool to present aggregated response data. Grouping of units could have been aligned more closely to COSO.

- Management interviews provided clarifications of answers and not corroboration and verification that controls were effective, but use of other data sources allowed supportable conclusions to be drawn.

### IEG Ratings of Management Approach

<table>
<thead>
<tr>
<th>Overall rating</th>
<th>Design of assessment instruments</th>
<th>Use of data</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>1</td>
<td>1</td>
</tr>
</tbody>
</table>

**Rating Scale**
- 1 = Fully satisfactory
- 2 = Satisfactory with qualifications
- 3 = Moderately satisfactory
- 4 = Unsatisfactory

**CONCLUSION**

IEG concludes that management’s method and approach provides a credible, transparent, and robust basis for the assessment and evaluation of entity-level controls. IEG rates management’s overall approach **fully satisfactory**, but with some observations relating to improvements that could be made in questionnaire design.
Annex A

1. These DIRs/FRs were not randomly generated, but were initiated where F&C problems were perceived to exist. Two cases were initiated by INT, the remaining four were initiated at the request of the regions.
Annex B: Analysis and Evaluation of the ELCQ Results

Introduction

1. This annex deals with the **evidence and findings** of management’s entity level assessment, based mainly on the evidence of management’s primary instrument for conducting the entity level controls assessment (i.e. the Entity Level Controls Questionnaire (ELCQ)). The ELCQ was a questionnaire organized around the five COSO components, to be filled out by unit managers across the Bank. From its results, IEG conducted a statistical analysis to establish certain “pass rates” to show how effectively the entity level controls were perceived to be operating. This annex also describes how these results were used to identify certain deficiencies in entity level controls.

2. One advantage of the questionnaire method was that it provided an extensive database of responses, reflecting managers’ perceptions across the full spread of relevant Bank units. IEG conducted an extensive statistical analysis of the data. It examined the aggregate *positive* responses as a means of establishing the extent to which controls were seen to be working well. It also looked at the incidence, nature, and frequency of *negative responses* to identify areas where control weaknesses appeared to exist. From this analysis, IEG was able to compile an initial list of deficiencies in the entity-level controls. In corroboration with evidence from other sources, and after integrating all the findings from Part I and Part II, it formed the basis for IEG’s evaluation of the effectiveness of the overall integrated internal controls framework, which is the subject of Section II and Annex C.

3. The present annex summarizes the statistical analysis of the ELCQ results (both positive and negative responses) and summarizes, by COSO components, the negative responses and how these have been used to identify controls deficiencies.

Statistical Analysis of ELCQ Responses

4. Given the nature of the questionnaire approach, and the potential (even if minor) for some degree of bias in the results, IEG used three approaches to analyzing the results of the ELCQ: it started by using a *simple pass rate*, then moved to establishing an *evaluated pass rate*, (both of these based on ELCQ results only) and then it undertook a full rating and *composite evaluation* of results using all forms of evidence, including the ELCQ, but also using evidence from other sources. This third step is dealt with in detail in Annex E.

5. **Simple Pass Rate**: The simple pass rate measures the aggregate number of “yes” responses received from all questions in the ELCQ, as a percentage of the total number of
individual responses received. What this measures, therefore, is the frequency of positive responses out of total responses, and gives a very general reflection of the perception of managers on the overall effectiveness of the controls system. The results from the ELCQ show that there were 3,673 positive responses in aggregate out of a total of 3,850 responses. This calculates to a simple pass rate of 95 percent and indicates that managers perceive that entity-level controls operate with a high degree of effectiveness. This pass rate compares to a simple pass rate of 93 percent for the compliance of key controls in the business processes at the transactions level. Since management organized the ELCQ around the five COSO components, the question was also addressed of whether effectiveness of controls might be different across the five COSO components. The SPRs were therefore calculated and shown in Figure B.1 below. The differences were not marked (from 92 percent for Control Environment to 99 percent for Monitoring and Learning) and all results were above the 90th percentile.

![Figure B.1. Simple Pass Rates by COSO Component](image)

Source: IEG calculations based on Table SA.1 in the Statistical Appendix.

6. **Evaluated Pass Rate:** The ELCQ questions were each designed to shed light on whether managers saw a particular control as working effectively (in which case they would answer “yes” to the question), or whether they saw weaknesses or other issues (in which case they would answer “no” or with some qualification. Many questions received both “yes” and “no” or other responses, because managers differed in their view of the controls, depending on their respective perspectives. Therefore, in order to decide whether a given question had been answered overall and on balance positively or negatively, a judgment had to be made. This judgment was based on the number of “yes” and “no” responses, the origin of the “no” responses in terms of which units saw problems (and how close they were to the given control in question), and the evidence and reasoning given for
the negative responses. The pass rate that was calculated using this approach was therefore referred to as an evaluated pass rate (EPR).

7. The ELCQ contained 157 questions in all. Consistent with a simple pass rate of 95 percent, most of these (87 out of the total of 157 questions) received no negative responses at all. However, where a question received some negatives or “no” responses, the question becomes when to make the judgment that that question has, on balance, overall been answered “no” because of either the number of “no’s” or the importance of the “no” response either in terms of who gave the response, and/or the nature and materiality of the reasons behind the response. It was a judgment call to make these determinations, and management and IEG used somewhat different criteria in making their respective judgments. As shown in Box B.1, management concluded that fully 150 out of 157 questions had received “yes” responses (an EPR of 96 percent), while IEG concluded that 144 questions had been positive, an EPR of 92 percent.

### Box B.1. The Evaluated Pass Rate

<table>
<thead>
<tr>
<th>Concepts underlying management and IEG assignment of results</th>
</tr>
</thead>
<tbody>
<tr>
<td>Based on questions and other data: Total number of questions (out of 157 questions) deemed to have received positive responses overall.</td>
</tr>
<tr>
<td>Judgments were based on the number of units responding “no” (or ambiguously) to a given question as well as the nature and materiality of the responses (as contained in the ELCQ narrative). Management and IEG used somewhat different criteria in making their judgments and came to different conclusions regarding the categorization of questions. Management had a two-part classification (“yes” or “no”), while IEG had a four-part classification: Either “yes” or “no” or “Yes, but” (responses were positive but with significant qualifications) or “No, but” (responses were negative responses and/or negative comments judged to override the overall ‘yes’ rating by management.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Overall rating</th>
<th>Yes</th>
<th>Yes, but</th>
<th>No, but</th>
<th>No</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management</td>
<td>150</td>
<td>0</td>
<td>0</td>
<td>7</td>
<td>157</td>
</tr>
<tr>
<td>IEG</td>
<td>103</td>
<td>41</td>
<td>9</td>
<td>4</td>
<td>157</td>
</tr>
</tbody>
</table>

*Source: IEG calculations based on Table SA.1 in the Statistical Appendix*

### Evaluating Entity-Level Controls Using the Evaluated Pass Rate

8. The outcomes shown in Box B.1 reflect how management and IEG would respectively rate the effectiveness of the Bank’s entity-level controls if only ELCQ data were used in the form of an evaluated pass rate, without looking further at the negative responses and without consulting other evidence. IEG used these results by taking the classifications shown in the Box and transforming them into the same four-part rating system IEG used in its Templates. (“Yes” was rated “1”; “No” was rated “4”; and the two intermediate responses were “2” and “3” respectively.) This was done for the different categories across all COSO components and the results were then tabulated into a statistical “diamond” to
depict how each component would be rated compared to the others. The results are shown in Figure B.2. It shows that IEG has consistently rated the effectiveness of controls in each component less positively than has management, though not by a significant margin. Management’s approach to the EPR resulted in an overall IEG rating of “1.1” (almost fully satisfactory); IEG’s approach gave a rating of “1.5” which was midway between fully satisfactory and satisfactory with qualifications.

Figure B.2. Effectiveness of Controls Based on Evaluated Pass Rates: Management versus IEG Interpretations

<table>
<thead>
<tr>
<th>Component</th>
<th>Management Rating</th>
<th>IEG Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control Environment</td>
<td>1.1</td>
<td>1.5</td>
</tr>
<tr>
<td>Risk Assessment</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Information and Communication</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Monitoring and Learning</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Control Activities</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

9. These ratings are of interest only as an interim indicator. The entity-level framework cannot be fully evaluated without a closer examination of the specific controls weaknesses that have been identified. A first pointer as to where these weaknesses occurred was given by the number of negative responses in the ELCQ for each component of the COSO framework. The following section describes the analysis of these negative responses.

Analyzing the Negative Responses

10. Clearly, all responses to the ELCQ questions are important. However, since the controls review has the purpose to assess effectiveness of controls and to identify weaknesses, priority has been afforded to the negative responses—i.e. the residual 5-8 percent out of the 92-95 percent pass rates—because they signal possible weak spots in the
framework. Further, in making the judgments that underlay the EPRs, it was useful to view the incidence and nature of the “no” responses, to better gauge their importance in given cases, by asking the following questions:

- **Which Bank units gave “no” responses?** One interesting perspective is to know in which Bank units these “no” responses originated. Did they come mainly from operational units or central, entity-level control units?
- **Types of controls issues:** IEG also examined what type of controls issues were being addressed—whether issues of control design or control operation—a factor that will affect what type of remedy may be sought in the case of controls weakness.
- **Were “no” responses widespread among questions or concentrated in a few?** This may reveal whether many controls had some minor weaknesses (one or two managers saw weaknesses) in some areas, or rather a few controls were widely seen not to be working adequately.
- **Identifying potential deficiencies:** Not every “no” response can be taken to show that a deficiency exists. IEG has sifted through all “no” responses and compiled a list where it thinks deficiencies do exist, based also on the concentration of “no” responses.
- **Implications for the COSO framework:** Are controls in all COSO components present within the framework with equal effect, or are controls in some components weaker than others?

11. **Which Bank units gave “no” responses?** This question is important because not all units will have the same perspective on all the issues raised by questions in the questionnaire. IEG posed the following hypothesis: The central control units, senior management, and the other service units have an institutional perspective as part of their function and are more likely than are the operating units to see fault with controls.

12. The data in the charts below clearly uphold this hypothesis. Figure B.3 A, which gives the absolute number of “no” responses, shows that the control units had 66 out of a total of 177 negative responses, but when combined with the other central units the total was 132, or 75 percent of the total. The hypothesis is equally upheld when looking at the negative response rates, which eliminates any bias in the data resulting from the fact that the unit groups are of different sizes, so larger groups may be expected to have a larger absolute number of negative responses. Figure B.3 B shows that both senior management and the central control units have negative response rates substantially higher than the average.

13. The data from these charts is useful in pointing to a related issue regarding the questionnaire method—whether this would have introduced a bias in the results because responding managers may have been less than candid in giving their responses. As shown in the charts, the operating units together had a negative response rate below the average. However, managers in these units did comprise some 25 percent of all negative responses, which is not a trivial number and which suggests that a lack of candor may not have been a significant issue overall, a finding that was also corroborated by the interviews that IEG conducted with 14 responding units within the Bank.
ANNEX B
ANALYSIS AND EVALUATION OF THE ELCQ RESULTS

Figure B.3. Negative Response Rates by Organizational Units

A.

B.

Source: Management Results Matrix. In B, the numerator is the number of “no” responses in each group, and the denominator is the total number of effective questions asked each group (i.e., excluding those not applicable to some units).
14. **Type of control issue: control design or control operation?** When respondents to the questionnaire give a negative response, signifying that they believe a control is not operating effectively, it makes a difference to know whether it is the design of the control or the operation of the control that is being questioned. In the first case, the necessary remedy would be to put in place a new or improved control design; in the second case, the necessary remedy would be more effective enforcement of the existing control, for example, by heightened management supervision of a given process. Some direct testing of entity-level controls to determine the effectiveness of both their design and operation could have improved the results of the review and the basis for conclusions reached. Knowing whether the questionnaire is seeking perceptions about the design or operation of the controls could be helpful when developing plans for testing controls in the future, both at the entity and transaction levels.

15. IEG analyzed the negative responses and found that most (about 60 percent) were questioning the design—or the absence—of the control rather than its operation. The pattern was also similarly found across all COSO components. (See also Table SA.5) in the Statistical Appendix.)

16. **Are “no” responses widespread or concentrated in a few areas?** If negative responses were widely dispersed across all questions, but with only one or two “no” responses per question, it might be difficult to conclude that deficiencies existed. By contrast, if some questions had many “no” responses, this would suggest that there was a common view that a weakness existed in a given control.

17. IEG has analyzed the dispersion of the “no” responses across all questions. It found, as shown in Table B.1, that out of 157 questions, only 70 questions had any negative responses; 87 questions had nothing but positive responses. Of the 70 questions with negative responses, 52 had only one or two “no” responses, while 10 questions had between three and five “no” responses and 8 questions had more than five “no” responses. The table also shows that no less than 60 percent of all negative responses were found in the areas touched on by these 18 questions. In the section that follows, IEG uses this finding as a guide in pointing to where the more serious controls weaknesses may have been identified.

<table>
<thead>
<tr>
<th>Table B.1. Distribution of “No” Responses by Frequency</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>TOTAL</strong></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Total number of questions asked</td>
</tr>
<tr>
<td>Total number of questions with at least one “no” response</td>
</tr>
<tr>
<td>% distribution by frequency</td>
</tr>
<tr>
<td>Total number of “no” responses</td>
</tr>
<tr>
<td>% distribution</td>
</tr>
</tbody>
</table>

Source: IEG calculations based on management results data.

18. IEG’s statistical analysis of the ELCQ results has provided useful insights into the overall perceptions of managers in the Bank regarding the effectiveness of entity-level controls. It has also offered confirmation that the identified weaknesses in the questionnaire
ANNEX B
ANALYSIS AND EVALUATION OF THE ELCQ RESULTS

approach have not caused any significant distortions in the results. Further, the collection of “no” responses which are contained in the ELCQ results matrix has provided a basis to identify specific control weaknesses and to judge their materiality.

Identifying Deficiencies from the ELCQ Responses

19. This last section of Annex B contains a detailed record of how IEG used the ELCQ results to identify controls deficiencies in each of the five COSO components. For this purpose, the existence of any question that received three or more negative responses was presumed to indicate that the underlying control might not be operating as intended. For this analysis IEG conducted a very detailed examination of all questions in the ELCQ that received three or more negative responses, together with the reasons given for the “no” responses and the types of units giving the responses. This analysis was cross-checked with the judgments made in compiling the EPRs for each question (as described in Box B.1). In each case a specific deficiency was identified as being uncovered by these responses, and that deficiency was recorded.

20. From the 18 questions containing three or more “no” responses, IEG extracted a summary of what it believes are 25 potential deficiencies suggested by these responses. (Some responses covered more than one issue.) These potential deficiencies are listed by COSO components, because it is useful when considering remedies for deficiencies to know in which part of the framework remedies are needed and what type of actions may be called for. However, the controls framework works in an integrated way, and some controls deficiencies involve issues that cut across more than a single COSO component. The listing of potential deficiencies is given in Box B.2 below.

21. IEG’s evaluation of the entity-level controls, based on the pass rates reflected in the ELCQ results, shows that entity-level controls appear to operate at an effectiveness level above the 92nd percentile, but are accompanied by 25 identified deficiencies. These apparent weaknesses were concentrated in a few areas, but were found in all COSO components. The concentration is evident from the fact that out of 157 ELCQ questions there were only 18 in which three or more negative responses were received, a criterion that IEG used to identify a potential deficiency. These findings were integrated with those from Part I, and consolidated in a “Deficiency Tracker.” A detailed account of how this was done is given in Annex C in Section II.
<table>
<thead>
<tr>
<th>Control Environment</th>
<th>Management and Ethical Behavior:</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Link from Monitoring component</strong></td>
<td>• Staff fear reprisal for reporting infringements.</td>
</tr>
<tr>
<td></td>
<td>• Reported improprieties are not being acted on, resolved in timely manner.</td>
</tr>
<tr>
<td></td>
<td>• Need wider reporting of disciplinary actions.</td>
</tr>
<tr>
<td></td>
<td>• Management oversight over project processing and supervision could focus more on controls issues.</td>
</tr>
<tr>
<td></td>
<td>• Management often slow to respond to QAG, IEG, INT, and IAD recommendations**</td>
</tr>
<tr>
<td></td>
<td><strong>HR Policies:</strong></td>
</tr>
<tr>
<td></td>
<td>• Lack of links to ethics in OPE.</td>
</tr>
<tr>
<td></td>
<td>• Staff incentives too small to influence behavior, not linked to project performance.</td>
</tr>
<tr>
<td></td>
<td>• HR needs to address skill mix, staff qualifications.</td>
</tr>
<tr>
<td></td>
<td>• Job descriptions should emphasize internal controls.</td>
</tr>
<tr>
<td></td>
<td>• Lack of routine review of access privileges.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Risk Assessment</th>
<th>Risk Management:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Risk management less developed than risk assessment.</td>
</tr>
<tr>
<td></td>
<td>• Risk Scan not integrated into strategic objectives.</td>
</tr>
<tr>
<td></td>
<td>• Weak links between strategic objectives and resources.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Risk Assessment</th>
<th>Fraud Risk:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Risk of fraud and corruption not fully factored.</td>
</tr>
<tr>
<td></td>
<td>• Project-level risk not fully factored.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Control Activities</th>
<th>Performance Measurement:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Key performance indicators (KPIs) not fully developed at individual level.</td>
</tr>
<tr>
<td></td>
<td>• Segregation of duties at times threatened by lack of procurement qualifications in local staff dealing with PR in field offices.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Monitoring</th>
<th>Performance Measurement:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Volcker Report findings (now being acted upon) suggest deficiencies in INT structure and function.</td>
</tr>
<tr>
<td></td>
<td>• Monitoring systems do not all have specific instruments to ensure that operational management takes action on recommendations.</td>
</tr>
<tr>
<td></td>
<td>• Information requirements of monitoring units sometimes excessive, and overlapping.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Information and Communication</th>
<th>Information Systems:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Low information technology user satisfaction and poor data quality in some IT systems.</td>
</tr>
<tr>
<td></td>
<td>• No formal mechanism for identifying emerging IT needs.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Information and Communication</th>
<th>Communicating on Fraud and Corruption:</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>• Need for improved training on detecting fraud and corruption.</td>
</tr>
<tr>
<td></td>
<td>• Senior management needs to communicate consistent message on ethical values, fraud, and corruption.</td>
</tr>
<tr>
<td></td>
<td>• Disaster recovery and business continuity plans not consistent across all regions.</td>
</tr>
</tbody>
</table>

*Source: IEG extracts from management questionnaire data.*
SECTION II
The Integrated Internal Controls Framework
(Combining Parts I and II)
Preamble to Section II

The objective of the overall review is to evaluate the effectiveness of the internal controls framework, which includes the key controls in the business processes at the transactions level and the entity-level controls that form the COSO framework. Having completed Parts I and II it remains to integrate the findings of both parts to provide the overall evaluation.

Management has concluded that the internal controls framework has been shown to operate in a way that—except for certain identified weaknesses—gives adequate assurance that IDA’s operations are compliant with its policies and procedures, and are conducted with due regard to efficiency and effectiveness. In similar fashion, IEG rates the quality (the effectiveness) of the controls framework as *satisfactory with qualifications*, reflecting evidence that at both the transaction and the entity-levels pass rates were above the 90th percentile, but there were a number of identified weaknesses in the framework.

This final segment of the report summarizes all the weaknesses identified (in a Deficiency Tracker; Annex C), and shows how IEG arrived at its final rating of the overall controls framework, including the material weakness (Annex D) and final overall rating (Annex E).
Annex C: Integrating Parts I and II: Scope Limitations and Control Deficiencies

1. This annex begins the integration of Part I and Part II and focuses mainly on controls weaknesses. It deals with certain scope limitations that applied to management’s approach to Part I (which would be weaknesses in management’s assessment had they not been addressed in Part II). It describes compliance issues that were postponed in Part I for completion during Part II. And it lists all controls weaknesses identified in both parts of the review: one material weakness, five significant deficiencies, and some 160 deficiencies found overall, and describes how many have been resolved and those whose remedies are still in progress or still to be acted upon.

2. Because the IDA Internal Control Review was conducted in three parts, Part IA, IB, and II, this annex summarizes the status of issues relating to (1) limitations on the scope of management’s work that was reported by IEG after Part I of the review, and (2) weaknesses in internal controls, which are categorized as material weakness, significant deficiency, or deficiency, that have been surfaced by management, IAD, and IEG in the whole review (both Parts I and II).

Scope Limitation Issues Addressed

3. In its Part IB report, IEG had recommended that management do additional mapping and testing of certain processes and key controls to better support its conclusions. In addition, at that time management had postponed some work on the effectiveness of compliance controls at the transaction level from Part I to Part II.

4. As detailed below, work completed by management in Part II has addressed the scope limitations noted by IEG at the end of Part I.

Additional Control Testing Completed

5. In response to IEG’s recommendations, management in Part II mapped and tested four additional IDA business processes that it had not assessed in Part I. The additional work did not disclose any control deficiencies in three of the four processes. However, testing of AAA/ESW controls revealed a significant deficiency that management has included in its Part II report and listed in its Deficiency Tracker, along with plans for remedial action.
ANNEX C
INTEGRATING PARTS I AND II: SCOPE LIMITATIONS AND CONTROL DEFICIENCIES

AAA/ESW

6. In Part II, management added a new business process module (No. 33, ESW Reports), prepared a process map, and identified four key controls in the processes. However, there is no OP/BP policy for ESW/AAA; rather, the process map and key controls were taken from an “ESW Template for Processing Guidelines.” (We discuss later in this annex that the absence of formal ESW/AAA policy, coupled with other policy-related issues, is a significant deficiency requiring remedial action.) Management performed tests for six ESW reports from four regions to determine whether the four key controls were working. Management found noncompliance for three of the four controls and concluded that achieving the control objectives relating to ESW may be at risk. The deficiencies related primarily to insufficient evidence that required steps, including a formal review at the concept and decision meeting stages, were being performed. In addition, in some cases the dates recorded in SAP indicating that certain key steps were performed did not agree with the dates in supporting documentation. In documenting the ESW deficiency, management also cited weaknesses reported by QAG in coding and tracking of AAA outputs and in the managerial oversight of the AAA program.

DEBT SUSTAINABILITY ANALYSIS

7. In Part I, management limited its compliance testing to debt reporting and did not include a review of how country debt data were analyzed and used within the Bank for resource allocation and lending decisions. To address this limitation, management added in Part II a new business process module (No. 34 Debt Sustainability Analysis), prepared a process map, selected eight countries for review, and performed tests to determine if required documentation was available for the three key controls identified. The additional review revealed only one exception (evidence of the Regional PREM Director’s clearance of the analysis for one country was not available), and management concluded that the controls reasonably assure that IDA objectives for debt sustainability analysis are being achieved.

IDA CREDIT/GRANT MIX

8. In Part I, management assessed the FRM allocation processes except for determining if IDA countries’ financing terms were based on the “balanced perspectives of independent Bank entities (PREM and FRM) and feedback from regional management.” In Part II, management mapped the credit/grant mix process, and tested compliance with the one key control identified (finalize the “traffic lights,” or credit/grant mix) for 10 countries. Management found no exceptions and concluded IDA objectives were being achieved.

SAFEGUARD RISK OVERSIGHT

9. In Part I, management concluded that this process (No. 29 – Safeguards – Corporate Risk [QACU]) was deficient because it was not documented and therefore could not be mapped and tested. Since that time, and after IEG’s recommendation (No. 4 in the Part IB report), the process has been documented and management then mapped the process and tested the one key control identified (QACU and Region meet to discuss portfolio and/or individual projects) for a sample of 11 projects/countries. Management found no exceptions and concluded that the IDA objective (to ensure that projects with high safeguards risks
receive adequate corporate oversight and support in addressing the risk) was being achieved.

**OTHER TRANSACTIONS TESTING COMPLETED**

10. During its Part II work, management also expanded the scope of its testing in two other areas:

- **QAG – Quality at Entry and Supervision.** During Part II, management arranged with IAD to include testing of the QAG QSA 7 process as part of IAD’s planned audit of QAG. Management selected the sample of projects, and IAD performed the testing. All of the eight projects selected and tested were found to be compliant with the six key controls identified, and management concluded that the IDA objective of assuring quality of supervision was being achieved. However, other work performed by IAD in Part II on entity-level controls led to different conclusions about the effectiveness of QAG as a central control unit. (See Table C.2.)

- **CAS, Development Policy Lending (DPL), and Corporate Review Processes.** In Part I, IEG noted that in some cases, Management had limited its testing to three or four of the Regions and questioned the adequacy of the coverage for judging compliance with the key controls identified. To address this limitation, in Part II management added a region (MNA) for testing CAS products (Business Process Module No. 4) and a region (SAR) for DPL testing (BPM No. 7). Management also tested the controls for Corporate Review (BPM No. 8) for these additional regions. Management found no exceptions in any of the three processes, and its conclusions from Part I remained the same.

**Compliance Issues Postponed to Part II**

11. During Part II, management addressed several areas that had been postponed from Part I—namely, IT system controls, transaction controls in use at the field office level, and controls relating to fraud and corruption.

**INFORMATION TECHNOLOGY CONTROLS**

12. During Part II, management determined that the IT testing it had done as part of the ICFR was adequate for the IDA 14 internal control assessment and did not do any further testing. However, several systems excluded from the ICFR work are used or planned for use in IDA operations. Because some of the systems were not fully implemented, they could not be tested during Part II, and management plans to test them when they become operational. IEG agrees that the effectiveness of IT controls in systems such as RAPMAN-PRIMA² and the procurements complaints database still need to be tested.

**FIELD OFFICE CONTROLS**

13. During Part II, rather than conducting on-site field office work, management elected to rely on the work of IAD’s audits of internal controls over decentralized operations at the field offices. IAD had not synthesized and reported in summary form the results of its numerous audits at country offices but has now done so. Consequently, any systemic weaknesses that may have existed and their underlying causes could not be readily identified and addressed by
management. Therefore, for this review, management summarized the results of IAD audits at country offices during fiscal year 2007 and the first quarter of fiscal year 2008. Of the 21 audits completed during this period, IAD rated the operations in one report unsatisfactory, 14 as needs improvement, five as satisfactory, and one report did not have a rating. Management noted three areas of weaknesses in the audit reports as Table C.1 shows.

Table C.1. Weaknesses Identified in Twenty-One IAD Country-Level Audit Reports Issued July 2006 through December 2007

<table>
<thead>
<tr>
<th>Area of Weakness</th>
<th>Country Office Reports Where the Weaknesses Were Found</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Number of Reports</td>
</tr>
<tr>
<td>Project supervision, especially project supervision reporting</td>
<td>15</td>
</tr>
<tr>
<td>Procurement process and controls</td>
<td>14</td>
</tr>
<tr>
<td>Financial management process and controls</td>
<td>9</td>
</tr>
</tbody>
</table>

14. The results of IAD’s audits are consistent with the results of other work done in Part I and Part II of the review, IEG has reported significant deficiencies in all three of the areas indicated in Table C.1. However, it should be noted that the institutional learning from the findings of these audits would have been greater had they been analyzed earlier by IAD in a synthesis report, where common themes and their materiality could have been identified.

FRAUD AND CORRUPTION

15. Management agreed that in Part II it would more specifically address issues of fraud and corruption. In its Entity-Level Control Questionnaire (ELCQ), management added a set of questions dealing specifically with fraud and corruption, which IEG has analyzed along with all other results of the ELCQ and has presented the results in Annexes B and D of this report. In addition, during Part II management identified those of the processes (mapped in Part I) that had tested key controls that would help in preventing or detecting instances of fraud and corruption.

Internal Control Weaknesses

16. IEG reported at the completion of Part I that the conclusions reached on the strength or weakness of the transactions controls were tentative and needed to be validated based on additional transaction testing to be done in Part II and the results of the Part II entity-level review. Final conclusions could not be reached after Part I because weaknesses found in the transaction-level controls could be either mitigated or magnified by the Part II findings.

17. At the end of Part I, IEG had concluded there were one potential material weakness, two significant deficiencies, and three other categories of deficiencies that did not rise to the level of a significant deficiency. After completing Part II, the status of the Part I findings is as shown in Box C.1.
Box C.1. Part I Findings Subject to Review and Modification in Light of Part II Findings

<table>
<thead>
<tr>
<th>Material weaknesses</th>
<th>Significant deficiencies</th>
<th>Status after Part II findings</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of currency of OP/BPs*</td>
<td>Timely accessibility of operational documents</td>
<td>Remains an issue, but based on improvements noted during Part II, the potential material weakness was downgraded to a significant deficiency</td>
</tr>
<tr>
<td>* Potential material weakness</td>
<td>Regional variance in dealing with FM and procurement procedures</td>
<td>Remains unchanged, pending development of new IT programs</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Findings from IAD audits, India and the other DIRs, contribute to an overall material weakness in controls over fraud and corruption</td>
</tr>
</tbody>
</table>

**Status of Other Deficiencies Noted in Part I**

| Need for improved general management oversight of project processing and supervision | Combined evidence from Part I, from IAD audits, from several Part II responses, from QAG ISR rating, from India DIR suggests still a deficiency |
| Need for improved procedures for placing projects on the Corporate Risk List       | New structuring of POCQC procedures, documentation and review procedures, suggests downgrading to “resolved” |
| Need to extend COSO framework to improve risk management                           | Part II reveals imbalance between risk assessment and risk management; suggests upgrading to significant deficiency |

**OVERALL STATUS**

18. During the overall IDA internal control review, a total of 175 individual deficiency issues were recorded in a Deficiency Tracker, including those first identified by management, IAD, or IEG. The status of the deficiencies was as shown in Figure C.1. Of these individual deficiency issues, many have been combined to determine whether they rise to the level of material weakness or significant deficiency.

**Figure C.1. Status of Deficiencies as of September 2008**

19. The 69 deficiencies in the “resolved” category were initially identified as deficiencies but were later disposed of with no remedial action taken or required, often after additional information was obtained or, in some cases, after further testing of key controls was completed. Management has taken remedial action on 25 of the individual deficiency issues and implementation of new or revised policies, procedures, or other controls to address these deficiencies was underway (as this report was completed) and, in some cases they may have
been completed but verification that the action has corrected the underlying weaknesses remains to be done. For the remaining 81 deficiencies, management has developed plans and schedules to strengthen the processes and controls but has not begun implementing the changes.

20. Although each of the deficiencies is recorded in the Deficiency Tracker, management decided—and IEG agreed—that many of the deficiencies represented similar or recurring kinds of weaknesses and could be grouped together for reporting and remedial action purposes. Management, IAD, and IEG each made judgments about the level of control risk associated with the deficiencies and classified each as a material weakness, significant deficiency, or deficiency. Management reported five significant deficiencies and IAD reported six significant deficiencies and four issues that require further consideration. IAD further opined that the significant deficiencies relating to fiduciary controls, entity-level controls, IT controls, and fraud and corruption controls, in combination, will become a material weakness if not corrected. Based on the overall results, IEG is reporting one material weakness, six significant deficiencies, and 22 deficiencies. Table C.2 summarizes these issues by management, IAD, and IEG.

### Table C.2. Summary of Material Weaknesses and Significant Deficiencies Reported by Management, IAD, and IEG

<table>
<thead>
<tr>
<th>Category</th>
<th>Level of deficiency reported by</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Management</td>
</tr>
<tr>
<td>Fraud and corruption</td>
<td>SD</td>
</tr>
<tr>
<td>Policy and procedural framework for investment lending</td>
<td>SD</td>
</tr>
<tr>
<td>- Lack of focus on key risks and controls</td>
<td></td>
</tr>
<tr>
<td>- Policy framework, outdated OP/BPs</td>
<td></td>
</tr>
<tr>
<td>- Project supervision and diffuse accountability</td>
<td></td>
</tr>
<tr>
<td>- Document retention and accessibility</td>
<td></td>
</tr>
<tr>
<td>Procurement and financial management</td>
<td>SD</td>
</tr>
<tr>
<td>- Consistency of regional quality arrangements*</td>
<td></td>
</tr>
<tr>
<td>- Lack of clarity in accountability*</td>
<td></td>
</tr>
<tr>
<td>Identification of systemic risk</td>
<td>SD</td>
</tr>
<tr>
<td>Other issues</td>
<td>SD</td>
</tr>
<tr>
<td>- AAA</td>
<td></td>
</tr>
<tr>
<td>- IT controls</td>
<td></td>
</tr>
<tr>
<td><strong>TOTALS</strong></td>
<td><strong>5 SDs</strong></td>
</tr>
</tbody>
</table>

**Number of Deficiencies (note 4)**  22

Legend: MW - Material weakness; SD - Significant deficiency

* These issues are part of an overall SD but are not SDs in themselves.

Note 1: IEG did not identify the identification of systemic risks as a separate SD, but rather included these issues as part of the SD relating to lack of focus on key risks and controls identified above.

Note 2: IEG does not regard AAA as a separate SD because IEG considers the deficiency to be a part of the broader SD listed above relating to a lack of up-to-date OP/BPs. AAA does not have policy guidance in an OP/BP that requires specific steps of a kind that could be viewed as a key control to ensure AAA performance and quality. Rather, the guidance is in the ESW Template for Processing Guidelines rather than a required policy.

Note 3: IAD concluded that the SDs related to fiduciary controls, entity-level controls, IT controls, and fraud and corruption controls, in combination, represent a potential material weakness. IAD also stated that four issues—governance issues, governance and accountability for integrated risk management, oversight of operational risk, and QAG assessment—require further consideration. In addition, IAD stated that management’s conclusion with regard to effectiveness and efficiency of operations is inconsistent with the original objective.

Note 4: Numerous individual deficiencies requiring remedial action were identified and are not detailed above but they are all listed in the...
Deficiency Tracker. Many are sub-issues of the above issues and they include the 22 new issues uncovered during Part II (see para. 25).

21. Management should take action to fix these internal control weaknesses with target dates for the actions to be completed. Following completion of the actions taken, management should then test to determine whether the actions taken have indeed resulted in controls that are working to prevent these internal control weaknesses. Once controls over an issue have been implemented and tested and found to be working, this issue can be considered closed.

MATERIAL WEAKNESS

22. IEG found (as detailed in Annex D) that there was a weakness in controls over the detection and prevention of fraud and corruption (F&C) in the Bank’s overall operations cycle management, a weakness which, because of the risks that diversion of funds could impair IDA’s mission, is deemed to rise to the level of a material weakness. There were two broad causes for the appearance of this weakness: first, a group of factors, including some deficiencies in the Bank’s generic financial management and procurement controls, a lack of clarity as to the priority of combating unethical practices in Bank operations, and some deficiencies in project supervision and management oversight; and second, the absence of any specific tools to combat F&C in the Bank’s lending management processes.

SIGNIFICANT DEFICIENCIES

23. What follows in paragraphs 23-30 is a record of the various significant deficiencies and deficiencies that have been uncovered in both Part I and II. There is some degree of overlap in this presentation, which is difficult to avoid, but the merit of the section is that it does provide a complete record in a single place. In all, at the conclusion of both Parts I and II of its evaluation, in addition to the material weakness described above and in Annex D, IEG found six significant deficiencies:

1. The need to maintain the currency of the OP/BPs (downgraded from potential material weakness in Part I);
2. The need for improved systems of document retention and accessibility (also downgraded from potential material weakness in Part IA);
3. Generic weaknesses in controls over FM and PR processes (identified in Part I) (this also contributes to the material weakness related to fraud and corruption);
4. A need for improved management oversight of project processing and (most particularly) project supervision;
5. A need to improve risk management, including inserting specific F&C risk factors into the Risk Scan, and in moving risk treatment from the entity level to the activity level;
6. A lack of a rapid review of electronic systems access privileges required by staff re-assignments; and a need for enhanced information security and better change management relating to the Bank’s automated systems.

DEFICIENCIES

24. IEG found that at the end of Part II, besides the material weakness and significant deficiencies listed above, 22 deficiencies were identified in addition to those identified in
Part I. The status of Part I deficiencies that were carried forward from Part I is discussed below, following the discussion of Part II deficiencies.

Part II Deficiencies

25. Following are 22 deficiencies identified by IEG during Part II, listed by primary COSO component where they were identified or where they should be addressed. Many of these contribute to the material weakness and significant deficiencies identified above.

Control Environment

1. **Emphasis on Ethical Values:** The importance of integrity and ethical values is not well reflected in staff’s performance evaluation. There is a lack of specific mention of ethics in the OPE, where this issue is left to the discretion of the managers’ practice.

2. **Anti-Fraud Programs and Controls:** Concern has been expressed that staff fear reprisal for reporting infringements and unethical behavior. This deficiency is being addressed by the new whistleblower mechanism.

3. **Resolution of Improprieties:** Reported improprieties are not followed up on and resolved in a timely manner (identified in the Information and Communications component).

4. **Staff Incentive Systems:** Incentives do not link to ethical behavior, and several respondents stated that the incentives are too small to influence behavior. There are no real links in the incentive system between staff rewards and project performance.

5. **Reporting of Disciplinary Actions:** Actions against outside parties (such as procurement debarment) are frequently and widely reported, but disciplinary actions against Bank staff are reported much less if at all. Management has accepted a recommendation of the Volcker report to correct this.

6. **HR Policies and Skills Mix and Staff Qualifications:** Cases occur on occasion—decentralized procurement in field offices was cited—where less than fully qualified staff members have had to make decisions beyond their level of competence. Maintaining an adequate skills mix for the Bank was identified by the 2006 Risk Scan as one of two high-priority strategic risks (identified in the Control Activities component).

7. **Job Descriptions:** The fact that job descriptions do not sufficiently define internal controls responsibilities appears as a weakness in the entity-level assignment of responsibilities which may have contributed to the non-compliance with some key controls uncovered during the Part I transaction-level review.

8. **Separate Evaluations:** QAG, IEG, INT, and IAD all find that management often fails to take timely actions to follow up on audit, investigatory, and evaluation findings (identified in the Monitoring component).

Risk Assessment

9. **Risk Assessment and Risk Management:** IDA has well-articulated risk assessment processes, but is less well structured in risk management (this contributes to the risk management significant deficiency listed above).

10. **Risk and Strategic Objectives:** Management may not always give sufficient attention to integrating the findings of the Risk Scan process with strategic objectives.
contained in the Strategy and Performance Contract (SPC) (this also contributes to the risk management significant deficiency listed above).

11. **Fraud and Corruption Risk**: Given the corruption that is endemic to the environment in many Bank and IDA client countries, the Bank may not be placing sufficient attention on the fraud and corruption risk in its strategic planning (this contributes to the fraud and corruption material weakness discussed above).

12. **Project Level Risk**: In its review of projects, QAG finds risk assessment at the project level to be improved but more needs to be done. During the transactions level evaluation IEG found that at the business process-level risks were not differentiated as to type, magnitude, and probability of occurrence.

13. **Links between Strategic Objectives and Resources**: Resource allocations are sometimes not closely enough linked to emerging strategic objectives, resulting in a lack of clarity whether certain objectives can be met. Management acknowledges that more flexibility could be helpful in redeploying resources to emerging priorities.

**Control Activities**

14. **Performance Indicators**: The ELCQ raised questions about whether the Key Performance Indicators (KPIs) were also being applied at activity and individual levels, and whether performance measurement was functioning as intended.

15. **Segregation of Duties**: In some cases—mostly in smaller field offices—there has been a breakdown in the segregation of duties principle because there were too few qualified staff to share these duties.

**Monitoring**

16. **The Volcker Report and INT**: The 18 recommendations relating to the structure, reporting lines, and modus operandi of INT have been accepted by management and are being acted upon.

17. **Recommendation Follow-up**: Monitoring systems do not all have specific instruments to ensure operational management takes action on recommendation.

**Information and Communication**

18. **IT User Satisfaction**: There is a lack of user satisfaction with IT systems such as SAP and IRIS and it is often difficult to get consistent aggregated numbers in the Bank’s aggregate reporting processes because of information gaps, including in client countries.

19. **Identifying new IT Needs**: There is no formal mechanism for identifying emerging IT needs.

20. **F&C Training**: There is a need for improved training on detecting fraud and corruption.

21. **Communicating Ethical Values**: There is a need for senior management to communicate a consistent message on ethical values, fraud, and corruption.

22. **Disaster Recovery**: The Bank’s disaster recovery system and business continuity plan is not consistently applied across all regions; it needs to be updated and requires external expertise to broaden it beyond just IT.
PART I SIGNIFICANT DEFICIENCIES AND DEFICIENCIES

26. The significant deficiencies (and potential material weaknesses) identified by management, IAD, and IEG in Part I were:

1. The inability to provide timely access to documents—considered a potential material weakness by IEG in Part IA.
2. The extent of variances in regional implementation of institutionally endorsed financial management and procurement guidelines.
3. The status of OPs and BPs—considered a potential material weakness by IEG.

27. These significant deficiencies are included in the significant deficiencies resulting from the completion of Part II, above.

28. Deficiencies tracked by management at the end of Part I, and agreed to by IAD and IEG were:

1. The need to streamline investment lending operations
2. The disparity in corporate review between investment lending and development policy lending
3. The lack of timely updates to the Loan Administration System
4. The inconsistency and lack of follow-up in clearing review comments
5. The need for improved controls over the safeguards Corporate Risk List
6. Noncompliance of IDA countries with quarterly debt reporting requirements.

29. Of the above six deficiencies, the need for improved controls over the Safeguards Corporate Risk List has been addressed, as indicated above in the additional work management performed in addressing module 29. The improved controls were implemented and management tested them and found no exceptions. The other five continue to be deficiencies that management has action plans to address, generally included as sub-issues under Part II deficiencies, although about half of the sub-issues supporting these deficiencies have been addressed and actions are in progress.

30. In addition to the above three significant deficiencies from Part I (which were aggregated from 32 individual issues in the deficiency tracker) and the six deficiencies (which were aggregated from 19 issues), 11 other issues and exceptions were included at the end of Part I in management’s tracker. These other issues related to allocation procedures (2 issues), project changes (2 issues), QAG (4 issues), refunds (1 issue), and safeguards (2 issues). At the end of Part II, of the 62 deficiency issues from Part I, 27 issues were closed or have actions in progress, 32 were included as sub-issues of Part II issues, and three were included as open issues from Part I.

PART I EFFECTIVENESS AND EFFICIENCY CONTROLS ISSUES

31. At the end of Part I, management had set aside 44 issues related to controls over effectiveness and efficiency to be addressed during Part II. Of these, 19 issues have actions in progress to address them, 21 issues have been included in the Deficiency Tracker as sub-issues of the 20 Part II efficiency and effectiveness controls issues with action plans to address them, and one was included as an open issue from Part I.
32. Thus, management’s Deficiency Tracker at the end of Part II has 24 issues, 20 from Part II, including sub-issues from Part I, and four carried over from Part I (three compliance issues and one effectiveness and efficiency issue).

Annex C

1. IEG regards this deficiency to be a part of the overall significant deficiency relating to areas of the OP/BPs which are in need of updating or formulation, and does not count it as a separate significant deficiency.

Annex D: Factors Combining to Form a Material Weakness

Introduction

1. This annex provides a detailed account of the background, evidence, criteria, and judgments relating to the IEG conclusion that weaknesses in the complex of controls that govern IDA’s efforts to ensure against F&C in its lending operations rise to the level of a material weakness. Management has itself identified the same set of weaknesses, but has concluded that their materiality represent a significant deficiency (as does IAD), which is being addressed by several initiatives now underway. There is therefore agreement on the nature of the weaknesses, but a difference in judgment as to their materiality. IEG sees the risk of F&C in the context of IDA operations as a fundamental dimension of the development challenge, but believes it would be premature (from both process and substance points of view) to conclude that F&C risks have been successfully tackled under the current IDA controls framework.

2. As background, it is important to bear in mind that for the past decade or more the Bank and IDA have taken the lead and have been actively engaged in addressing issues of governance including the potential negative impact of fraud and corruption on the development programs in its client countries. As is well described in the management assessment, and as is summarized in the following section of this annex, these initiatives have been robust and visible, they have included both global and country level focus, and have involved the development within the Bank Group of new entity level mechanisms to address F&C issues on a broad front, including the possibility of F&C affecting projects and programs supported by Bank and IDA funds. What has been brought to light by this internal controls review is that these mechanisms require further strengthening, and in particular that additional, specific transactions level controls to detect and prevent F&C in IDA operations are needed. Management has vigorously responded to this finding and, as described in its report, is engaged in developing new systems and practices, though it will necessarily take some time for these systems to be implemented and to become fully operative.

3. This annex provides the detailed rationale for the identified material weakness. It divides into four sections: Section I credits the Bank for recent major fraud and corruption (F&C) initiatives but points out that the internal controls to make these effective are not yet in place. Section II summarizes evidence of deficiencies in the existing controls that further detract from the F&C agenda. Section III argues that the combination of these two sets of weaknesses constitutes a material weakness. Section IV suggests the types of remedies but these should be read as indicative, since the scope of IEG’s evaluation precludes detailed prescriptions for corrective action.
I. The Bank’s Fraud and Corruption Initiatives: The Need for New and Innovative Approaches to Control

4. Since President James Wolfensohn decided in October 1996 to place corruption openly on the Bank’s agenda, sound governance and a focus on corruption in its client countries have been made an increasingly explicit part of the Bank’s, and thus IDA’s, program. The key elements of its efforts to confront F&C issues in its operations have included the following:

- **High-level speeches:** Successive Presidents of the Bank have made statements to the global audience, as well as to the staff, about the importance of combating F&C because of its debilitating impact on the development agenda, and emphasizing the Bank’s commitment to integrity as being at the core of all that it does.

- **Major Reports:** Since the time of President Wolfensohn’s speech to the 1996 Annual Meetings, governance and accountability have been on the agenda of the World Bank Group. Main reports included the 1997 Helping Countries Combat Corruption: The Role of the World Bank; the 1997 World Development Report, the State in a Changing World; and the 2000 strategy paper, Reforming Public Institutions and Strengthening Governance.

- **Analytical Programs:** Several country reports have been written for local stakeholders (government at all levels, civil society, and academia) to draw attention to F&C issues in a range of countries, raise awareness and suggest remedies. Many of these programs identified lessons and experiences also at the country level.

- **Establishing INT:** Set up as an investigatory unit in 2001, INT has become a key element of the Bank’s F&C monitoring and investigation system; it has now conducted six F&C focused studies: Three Detailed Implementation Reviews (DIRs) (India, Kenya and a narrower DIR on Vietnam) and three Fiduciary Reviews (FRs) (Indonesia, Cambodia and Vietnam). All studies showed significant evidence of F&C indicators. INT is a key element in the Bank’s anti-fraud and corruption program, and, following the outcome of the Volcker Report which reviewed its modus operandi, management has completed actions on 16 out of the 18 recommended steps to improve its operational effectiveness.

5. **Launching the Governance and Anti-Corruption (GAC) initiative and Strategy:** As a global initiative to heighten awareness, and develop the tools needed to combat F&C in Bank and IDA, operations management launched the GAC program in late 2006. Its presentation Strengthening World Bank Group Engagement on Governance and Anti-Corruption lays out a number of principles and concepts as guidance to the measures the Bank needs to adopt in building its portfolio of instruments that need to be developed in tackling the program. In March 2007, the Board of Executive Directors endorsed a new GAC strategy, which calls for the Bank Group to step up the inclusion of appropriate fraud and corruption diagnostic and mitigation measures in CASs and lending. The GAC also recommends better dissemination of INT findings and emerging good practice and more explicit training and sensitization of task teams in how to spot “red flag” indicators of fraud and corruption. In August 2007, Operations Policy and Country Services (OPCS) circulated for discussion a draft plan to articulate concrete steps to implement that strategy, and this was discussed at the Board on October 21, 2008. In addition, the FY 2007 COSO report identifies specific
actions to improve entity-level controls and anti-fraud programs and controls, including a new Code of Professional Ethics for Bank staff and training for staff on internal controls. The report also identified additional remedial actions including the need for central units to work better together on risk identification, responses to risks, and information sharing and the need to strengthen high-level risk management; including reporting key findings periodically and systematically to Senior Management.

6. **Sound initiatives, still lacking specific tools:** There is no question that the general awareness of F&C issues has been raised significantly both within the Bank and in its client community, as has the consciousness of the staff that the Bank is determined to confront this issue. Global statements from the Bank, specific country studies, and the investigations completed by INT have also all helped to send a message of the Bank’s seriousness in this area.

7. Viewed from the perspective of the internal controls review, IEG observes that initiatives to translate this awareness into adequate specific tools to assist the staff in tackling F&C issues in their ongoing operations are being implemented under the GAC initiative, but are still in early stages. In its investigation of the India health sector projects (released in 2007) INT observes gaps (that is, missing tools to combat F&C in Bank operations or internal controls specifically adapted to F&C issues) at all key levels: at the entity level, at the country/activity level, and at the project level. The GAC program has called for the development of such tools, and some regions have responded to the INT DIR findings with action plans specifically geared to addressing F&C issues. However, specific Bank-wide F&C controls that are needed in several key areas to make this agenda effective are not yet in place, as summarized in paras. 9 and 10.

8. **Risk Assessment:** At present F&C risk is addressed in the Bank’s annual management assessments of internal controls over financial reporting (ICFR). However, the ICFR process relates only to financial reporting and this does not address issues relating to possible F&C within Bank/IDA lending operations.

9. There are also other areas where F&C risks need to be more explicitly addressed, including:

- **Risk Scan:** The Bank’s annual Risk Scan, which addresses a broad range of risks, has not specifically targeted F&C risk. F&C risk was not included among the 40 items contained in the Bank’s annual Risk Scan (RS) process, though this is now to be done under a revised risk management regime under development.

- **Risk Opportunity Workshops:** CSR, which administers the annual Risk Opportunity Workshops, has confirmed to IEG that fraud risk assessment is not undertaken in a specific systematic manner. Given the endemic F&C environment in many countries in which the Bank and IDA operate, this is a significant omission.

- **INT Comments:** In a meeting with IEG, INT emphasized that the Bank Group in general needs to develop a better understanding of the specific risks as relating to its instruments, country engagements, sector efforts, and projects and it also plans to continue its support of operational risk assessment.
10. Outside of risk assessments, the treatment of F&C considerations has often been sparse, although it has now begun to be addressed better in several important documents and processes:

- **Country/ Sector Strategy:** The CAS and Sector Strategy processes have not systematically and seriously addressed fraud and corruption risk at the country level. Management is now trying to change this, and under the CGAC being undertaken as part of the GAC initiative it should become routine for a CAS to contain a section on country governance, which would often include F&C issues. The CAS is clearly an instrument which could take the lead in setting the stage for F&C risk assessment, as a backdrop to addressing transaction level F&C risks in the projects of a given country.

- **Project Design:** The PAD has historically had no requirement to address a project’s risk of F&C as part of the routine project preparation, and project design does not consider F&C issues specifically and systematically. In some of its reports INT has cited project design as one weakness in addressing F&C risk. However, the GAC progress Report1 has described efforts to improve the attention to F&C issues in project work, also while trying to ensure that such work does not focus exclusively on fiduciary issues alone.

- **Project Supervision:** The ISR has until now not contained any F&C section and no requirement to reflect F&C issues in any existing components (for example among the reported risk flags). By the same token, Task Team Leaders (TTLs) have not been given toolkits or training to address these issues explicitly. These elements are in the process of being addressed under the “GAC in Projects” program, but their scope and eventual effectiveness remain to be verified.

- **Fiduciary Processes:** Existing FM and PR guidelines were not specifically designed to address F&C risk, or prevent the occurrence of F&C, although if properly applied they should implicitly do so. In particular, the Bank’s Procurement Guidelines were designed to ensure equity and economy, and there is no explicit F&C prevention in these guidelines. Some recent INT findings in Bank projects showed that F&C indicators were found even though Bank procurement procedures had been correctly followed, suggesting further that, even where normal procurement procedures are followed, there is a need for more explicit adaptation—either of new and specific F&C related controls, and/or improved application of controls by project staff—to combat fraud in procurement processes.

- **Country systems:** Part of IDA lending is disbursed in the form of general budget support (DPLs/DPCs/PRSCs). These resources enter the general budgets of borrowing countries, and the country’s control systems apply. To meet both fiduciary/control and development goals it is important for the Bank to provide support to the development of those country systems, as it has been doing in a number of ways, including through the Country Financial Accountability Assessment (CFAAA) and Country Procurement Assessment Report (CPAR) processes. There remains a need to give attention to the specific safeguards against F&C in these operations, in addition to those measures being taken in the case of ILs.

11. Programs to pursue broadly the combat of fraud and corruption in IDA operations cannot succeed at the operations level without the serious introduction of new and
innovative approaches to F&C of the kind mentioned above, and which are found in many aspects of the GAC initiative already underway. Specific F&C toolkits need to be devised and locked on to the Bank’s controls architecture adapted to needs at each level.

II. Deficiencies in Existing Controls

12. There is evidence from various sources consulted by IEG during Part II that suggests strongly that F&C risk has not been adequately addressed by the existing controls framework. This evidence includes the following: evidence from the ELCQ pointing to some deficiencies in entity-level controls; the DIR/FR studies completed by INT since 2000 which show significant indicators of F&C in a number of sets of Bank projects; the Volcker report, which recommended that INT restructure and reform its role; evidence from QAG assessments and country program audits by IAD suggesting the need to strengthen project supervision; and evidence on significant deficiencies in FM and PR uncovered during the transactions-level testing during Part I of the review. The following paragraphs outline the relevance of this evidence to the F&C agenda and suggest how each part may have contributed to the overall material weakness.

13. **Evidence from ELCQ—entity-level deficiencies:** In the responses to the questionnaire there was evidence of weaknesses in relation to addressing F&C risk in four areas: a below-average simple pass rate (SPR) in responses to questions in the F&C section overall; two elements within the Bank’s Control Environment—tone at the top, and certain aspects of HR policies; and factors related to risk assessment.

- **Simple pass rate:** The responses to questions in the section of the questionnaire dealing with Anti-fraud Programs and Controls achieved a SPR of 92 percent, 3 points lower than the questionnaire average of 95 percent. This is not overly significant but may reflect concerns among respondents that F&C controls are an issue. These concerns related to whistleblower mechanisms and ethical conduct (Q8), F&C risk assessment (Q18), and ethics-related training (Q32). INT was a lead respondent questioning whether sufficient training against F&C is available, and stressing that no “systemic” F&C risk assessment tools are in place, either Bank-wide or in the Regions.

- **Tone at the top:** Respondents to the ELCQ acknowledged that Senior Management of the Bank has spoken clearly (for the past decade) on the need to combat F&C, and this has been reinforced by successive presidents. However, some questionnaire responses (by INT in particular) suggested that there is still fear among some staff that seeking out F&C issues in projects and reporting on observed improprieties may lead to reprisals from their managers, and managerial signals and behavior are not always consistent with these messages. Overall, mixed messages and ambivalence are still considered prevalent.

- **HR policies and staff incentives:** Questionnaire responses suggested that there is a cluster of HR-related issues that create disincentives, or do not specifically reward the adoption of an F&C agenda. For example, as stated in the responses, there are no explicit links to ethical behavior and no focus on F&C issues in the OPE criteria. Staff are rewarded more for delivery than for behavior and are not encouraged to focus on F&C in Bank projects and other operations – further evidence of mixed explicit or implicit messages to staff on this issue. Staff performance ratings are not linked to
project performance. Training on the skills needed to detect F&C is in place, but it needs to be deepened and widened (See BoxB.3 in Annex B).

- **Risk assessment:** A number of questions in the Risk Assessment segment of the questionnaire addressed issues relating to F&C. Most units responded in the positive to the question whether the Bank considers fraud as part of its enterprise risk assessment (Question 15). However, INT and others took it as a “serious omission” that the Bank’s Risk Scan omitted F&C risk. Other questions were mostly indirect and not explicitly geared to F&C. For example, Question 57 asked whether IDA considers risks arising from external as well as internal causes, INT referred in its response to the fact that many countries had low capacity to deal with corruption. Question 58 asked whether the Bank learned from past failures and INT stated that IDA did not always do so. The questionnaire responses tended to support the finding that risk assessment of F&C is not strongly integrated into overall risk assessment.

14. **Evidence from INT: F&C risk is significant — did controls fail?** The critical evidence that has emerged is from several DIRs/FRs that have been completed by INT since 2000, all of which have involved IDA countries, and all of which revealed significant indicators of F&C in the reviewed projects. This evidence has included indicators of collusion on bidding, over-pricing of bids, bidding with fictitious entities, delivery of substandard civil works or equipment supplies, and the paying of bribes to officials. Variations in the patterns of these indicators have appeared in all the countries examined in the DIRs. IEG makes the following observations regarding these findings:

- Finding indicators of F&C does not constitute proof that F&C has in fact occurred. However, INT states that there appears to be a correlation between F&C and actual occurrence of the latter and cites subsequent convictions, debarments, and other enforcement actions from some DIRs to support this relationship, including the fact that criminal investigations are ongoing in 13 bribery cases in India.
- In India, IEG observes that the DIR has led to quick and significant reforms by government agencies in areas where indicators of irregularities have been found, suggesting there has been substance to the concerns raised.
- The types of F&C that may have occurred—collusion, over-pricing, under-delivery, bribery—all imply that there may have been a diversion of IDA funds from the purposes intended in the given projects. If this has occurred to a significant extent, this would then imply impairment of the IDA mission, since IDA funds would have been used for purposes not in compliance with intended objectives, policies, and procedures, and would thereby also impair the efficiency and effectiveness of IDA operations.
- Such occurrences, if true, would not be inconsistent with nor would they have been brought to light by the Bank’s annual, unqualified financial reporting and auditing process because the latter considers financial reporting rather than the Bank’s operations.

15. The presence of widespread indicators of F&C, whether proven to be actual or not, do constitute evidence of a significant **risk** of F&C. The question is, therefore, which internal controls over Bank operations may not have operated effectively—or have been absent—so that these occurrences were not prevented? Part of the answer to this question is to be found
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in the fact that the specific controls and approaches that were described as being needed in paras. 9 and 10 are in fact missing or are only now being put in place. A second part of the answer also lies in some of the deficiencies that have been found in other parts of the controls framework, brought to light by the questionnaire and the other sources of evidence, as described below.

16. **Evidence from the Volcker report — role and function of INT:** The Volcker Panel observed that the importance of the Bank’s internal anticorruption effort extends well beyond the immediate fiduciary concerns, and that the Bank’s support for national efforts to improve governance must be at least an equal part of its own efforts to deal with corruption in programs that it supports with its own funds. Ignoring the issue, or, more subtly, tacitly supporting superficial government efforts where there is little political commitment, would conspire against aid effectiveness and the welfare of a country’s poor. The Panel further commented that attention to risk assessment and risk abatement strategies must run right through the organization, drawing on expertise in procurement, disbursement practices, and institutional analysis.

17. Against this background, the Panel found that since its inception INT has provided useful information on the presence of F&C risk and the modalities of potential F&C in Bank projects. In some aspects of the way INT has functioned in the past, however, the dissemination of this knowledge has been less than it might have been, and this may have hindered the learning that should have followed from these findings. A review of the role and modus operandi of INT was published (the Volcker Panel Report) in September 2007 in which 18 recommendations were made to restructure and reform the way INT works. The recommended reforms have already been accepted by management and are under implementation. Most of the Panel’s recommendations are designed to improve the flow of information and communication among various operating and central control units in the Bank. IEG acknowledges that management’s response to the report has been swift and appropriate. However, in the strict application of audit standards the deficiencies that the report identified must continue to be regarded as deficiencies until their remedies have been shown to be fully operative and effective.

18. **Evidence from QAG — project supervision issues (QSA7):** As was described in para. 5, project supervision is a critical element in the Bank’s F&C agenda, because it is the process by which the Bank tracks the performance of projects being implemented by the borrowers. Taken overall, the evidence of the QAG assessment from QSA7 (FY05-06) showed that there has been a general improvement in supervision quality compared to QSA6 (FY03 and 04): QSA 7 showed 95 percent moderately satisfactory or better compared to 90 percent in QSA6. These results show a welcome improvement in supervision where performance in the past had been a weaker link in the Bank’s operations. However, within this improving envelope, QAG itself notes “significant scope for further improvement” and two specific quality dimensions relevant to the F&C agenda which were assessed to be among the weakest:

- **Candor and quality of ISR:** This was rated at least 10 percent lower than all other quality dimensions (85 percent moderately satisfactory or better) and in terms of satisfactory or better has declined (from 49 percent in QSA 6 to 35 percent in QSA 7). This suggests that ISRs quite often still do not fully reflect project realities, a
weakness that would need to be addressed. If the ISR is to have a new F&C toolkit appended to it (as suggested in para. 10 above) this would be of little avail if the ISRs should not to be taken sufficiently seriously by TTLs and reviewing managers.

- **Supervision budgets:** QSA 7 shows that among the items rated among the lowest quality dimensions (78 percent moderately satisfactory or better) was the adequacy of supervision budget, where 20 percent of projects were assessed as having budgets deemed too low. If project supervision will need to carry an increased burden in the fight against F&C, this is going to require more staff time and therefore greater resourcing of supervision budgets.

19. **Evidence from Part I—significant deficiencies in financial management and procurement:** Where there is a risk of fraudulent and corrupt activities it is generally in relation to the procurement of goods and services and the disbursement of funds to suppliers and others implementing Bank projects. The Bank’s FM and PR controls, therefore, are its fiduciary front line. In fact, during the testing of key controls over the FM and PR business processes during Part I management, IAD, and IEG all concluded that the quite high rates of non-compliance in these modules were such as to constitute a significant deficiency. Also, information gathered revealed two control weaknesses relating to IDA’s handling of procurement complaints. First, there was no control to ensure that all complaints were entered into the complaints database. Having all complaints in the database is the first step in ensuring that all complaints are handled appropriately, such as by being referred to the INT and/or considered for potential noncompliance with IDA procurement policies. Second, there was no control to ensure that reports from the complaints database are followed up for all complaints, because there are no regular reports produced from the database. Because of these weaknesses, the monitoring control that complaints themselves provide to IDA may not function as effectively as it should and problems in procurements may go unaddressed. Subsequent to IEG’s Part I report, INT issued the DIR report on the health sector in India, which revealed numerous indications of F&C in IDA projects and according to INT, the source of these indications in many cases was procurements complaints received by the recipient country government and/or by IDA. Until IDA strengthens the procurement complaint handling process, it runs the risk that detectable F&C will not be caught and dealt with in a timely manner.

20. **IAD Country Audits:** As was described in paragraph 14 in Annex A, the evidence from a number of IAD country audits that showed some deficiencies in controls over FM and procurement processes in country programs was also relevant, and added support to the finding of generic controls deficiencies.

**III. A Material Weakness in Controls over F&C**

21. **Summary:** The preceding two sections described a number of internal controls deficiencies—and one significant deficiency from Part I (in FM and PR) which would affect IDA’s and the Bank’s ability to address F&C risk, and thereby assist in the fight against fraud and corruption in its operations. In IEG’s judgment, except for the controls over FM and PR, none of the other weaknesses identified would, on their own, rise above the level of a significant deficiency. The question is whether the combined impact of these various deficiencies would constitute a significant deficiency or material weakness. In examining
this question, IEG was influenced by the extent of the F&C risk, and by the fact that controls did not match this risk.

22. **F&C risks are higher than expected:** Until the establishment of INT and the launching of the Bank’s F&C agenda, there was no systematic examination of whether fraud and corruption was occurring in operations supported by IDA. The evidence brought to light by recent DIR and related studies shows that, indeed, the risk of F&C is significant. In view of the development environment in which IDA is working in many countries, this risk may therefore likely apply to a considerable number of client countries and thus constitutes a potential risk of impairment of IDA’s mission, if not adequately addressed. If F&C actually does occur, this could therefore involve diversion of funds on a significant scale across a number of countries, which would impair IDA’s mission, breach compliance with IDA policies, and put IDA’s reputation at risk. However, IEG emphasizes that its conclusion of a material weakness in controls over F&C is based on the evident risk, and not on any evidence of widespread actual F&C.

23. **Are F&C risks matched by F&C controls?** The essence of an internal controls system is that it identifies priority risk and makes sure that controls are in place to match the risks. As the two earlier sections have described, IEG finds that this is not the case, in two key respects:

- As argued above, improving the effectiveness in operation of the existing controls over FM and PR is a necessary condition of addressing F&C risk. However, this would not be sufficient without also adding new approaches to explicitly combat F&C risk.
- Controls to adequately match F&C risks in Bank-financed projects need to be set in place not just in the fiduciary processes but at all key stages of the project cycle: country strategy, project inception, project design, and project supervision. Specific F&C toolkits need to be designed to do this. As an extension of this also, the governance and fiduciary systems within the countries themselves (on which the Bank and IDA may place increasing reliance in the future) as well as those used by other donors and partners must also be strengthened to match these new controls within the Bank and IDA, since internal Bank controls will not alone be sufficient to effectively combat F&C.

24. **How to judge the materiality of these deficiencies?** In making its evaluation and deciding that the weaknesses amount to a material weakness IEG was guided by the agreed standards by which to judge materiality (see Box D.1 below), which were agreed at the beginning of this review. The materiality of the deficiencies in controls over the FM and PR processes has already been declared in Part I to be a significant deficiency. No mitigations were found for this during Part II. Further, several other deficiencies have been identified whose impact would tend to reinforce the weakness in the controls framework in combating F&C. It is, therefore, difficult to avoid the conclusion that, overall, the materiality of this weakness appears greater now than it did at the completion of Part I, and that, if not addressed, could potentially impair the IDA mission.
Box D.1 Standards and Evidence Which Led to a Finding of a Material Weakness

At the start of this review management, IAD and IEG agreed on the standards that were to be followed in determining the materiality of any controls weaknesses that were uncovered during the review. These were presented in Annex B to IEG’s report on Part IA. Identified deficiencies could be significant deficiencies or material weaknesses depending on whether one or all of the materiality criteria cited below are present.

<table>
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<tr>
<th>MATERIALITY CRITERIA</th>
<th>SPECIFIC EVIDENCE FOUND</th>
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<tr>
<td>• Impair the achievement of IDA’s objectives</td>
<td>• Evidence from INT DIRs and FRs in five countries show F&amp;C indicators which suggest funds may have been diverted from the purposes intended; evidence of actual F&amp;C has also been found in some of these cases</td>
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<td>• INT DIRs/FRs show that F&amp;C indicators appeared in all six studied countries, suggesting actual F&amp;C may not be rare but may occur in many countries</td>
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<tr>
<td>• Violate requirements of IDA’s charters or other contractual agreements</td>
<td>• IDA’s Articles require that IDA operations be governed by its policies and procedures</td>
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<td>• INT DIR evidence (India, Kenya) shows that F&amp;C indicators have been found even when Bank procedures have been correctly followed</td>
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<tr>
<td>• Significantly weaken safeguards against waste, loss, or unauthorized use of funds, property, or assets</td>
<td>• In IL operations evidence from Part I showed significant deficiencies in IL fiduciary controls and absence of F&amp;C controls</td>
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<tr>
<td></td>
<td>• In DPL/PRSC operations procurement controls do not apply, so F&amp;C has to be addressed through IDA FM and Loan Administration controls and through country systems which bare often weak or non-existent</td>
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<tr>
<td>• Involve conflicts of interest, involve systemic problems in country assistance, partnerships and project lending, or require the attention of Senior Management, the Board as well as the awareness of external stakeholders</td>
<td>• Bank culture, management priorities, staff incentives and HR practices have not given priority to safeguarding against F&amp;C in Bank/IDA operations</td>
</tr>
<tr>
<td></td>
<td>• Evidence from Part I (fiduciary weaknesses) and Part II (entity level incentives) shows a gap between progress in building a global Bank agenda against F&amp;C and establishing tools to make the agenda operational; more is needed from Senior Management in linking the global perspective to daily operations and to internal systems in client countries</td>
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25. It needs to be emphasized that the audit standards themselves do not dictate the circumstances or criteria by which a distinction is to be made between a significant deficiency and a material weakness. The generic criteria are clearly stated (as shown in Box D.1), but it remains to some extent a judgment call when to designate a particular deficiency
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a material weakness (and in the present review management, IAD, and IEG, while agreeing on the types of weaknesses, all came to slightly different judgments as to materiality).

26. **Conclusions:** IEG concludes that a *material weakness* exists in the internal transaction-level controls framework to meet the risks that local beneficiaries, participating suppliers and other stakeholders in IDA projects do not subvert the objectives of IDA lending operations through fraud and corruption. Based on the technical criteria agreed for this review IEG finds that, to varying degrees, *all* of the attributes listed in Box C.1 are present. This weakness does not arise from a single-point control that is badly designed or is not observed, nor does it relate solely to the Bank’s fiduciary processes (though the latter are centrally involved). The weakness rather derives from a combination of some inadequate assumptions regarding the prevalence or importance of F&C in Bank operations, which emanate from a certain lack of entity-level awareness and propagation (now in the process of being addressed), and - until the introduction of new controls including some now being put in place - a corresponding absence of specific controls to combat F&C in IDA operations and their related country systems, all of this exacerbated by some generic deficiencies in existing controls.

IV. Summary and Suggested Remedies

27. **Suggestions as to remedies:** Given the composite nature of the material weakness IEG proposes that the remedies would also need to be multifaceted. This fact has been well recognized by management (and by IAD) and is reflected in the wide range of GAC program components currently being implemented or prepared. In the schematic shown in Figure D.1, IEG displays the key elements it regards as contributing to the weakness and shows the types of remedies that could be applied at the entity level and in the business processes across the project cycle. IEG highlights the following elements:

a. **Tone at the top:** By providing the clear and consistent messages from Senior Management emphasizing that adherence to controls to prevent F&C is an explicit part of IDA’s mission, managers would encourage staff to integrate this focus into their ongoing operations at all levels, matching incentives for internal ethical behavior with enhanced external awareness of and vigilance over the potential for F&C to occur.

b. **Match culture with tools:** Developing specific tools to focus on F&C risk at the entity, country, and project levels—and specifically by providing F&C tools in the CAS, PAD, the ISR, and support for country systems—which will also reinforce the cultural factor at the level of the operating staff.

c. **Tilt in favor of supervision:** Provide more emphasis on project supervision as a key element of an F&C agenda. Adopt TTL training and other F&C tools. Where necessary, shift in budget allocations from loan preparation to loan supervision.

d. **Learn from INT findings:** In line with the recommendations currently being worked on by management in its response to the Volcker report, provide greater dissemination of INT findings in ways which will ensure that experience across the Bank leads to improved learning on F&C issues in IDA operations.

e. **Update FM and PR guidelines:** In addition to seeing to some generic FM and procurement controls issues (identified during Part I), there should also be a focus
on linking these to the F&C measures to be introduced into project supervision to ensure that controls are tightened in both areas.

28. **Remedies Already Underway:** Many of the suggested elements that IEG is suggesting seem to be contained in the work currently being implemented or planned under management’s response to the identified control weaknesses: under the GAC initiative; in the management response to the Volcker Report on the working of INT, and in some of the recently initiated INT outreach and training work. The management plans and actions as part of these initiatives seem appropriate and aimed at priority aspects of the controls weaknesses. At the same time, most of these initiatives are quite recent, dating from the completion of the Volcker Report or from the early findings of this review. Many of them are therefore not yet fully operative. IEG therefore believes it would be premature (from both process and substance points of view) to conclude that F&C risks have been successfully tackled under the current IDA controls framework. By this token, while these remedies can be recognized as being well suited to the risks they address, under the COSO criteria which have governed this review, the remedies cannot yet be taken to have removed the material weakness that IEG identified.²

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2. Under the COSO concept of reporting on internal control system effectiveness, if one or more material weaknesses exist (which would preclude a statement that the criteria for system effectiveness are met), a description of the material weaknesses should be included in the report until
such time that “management has determined that the new or revised controls were operating effectively.” Relevant auditing standards (AS5 and its predecessor, AS2) similarly state that any material weakness existing as of the date of the report must be disclosed.
Annex E: IEG Composite Evaluation of the Internal Controls Framework

Description of Approach

1. This annex contains IEG’s final composite evaluation of the integrated controls framework as a whole. It is based on all sources of evidence. This includes taking account of the underlying analysis presented in Annexes A and B (showing the ELCQ results), it integrates findings from both parts of the review, it considers other evidence available and it reflects the results of the Template application that IEG used to rate the effectiveness of the controls system. This is where, based on all sources of evidence, IEG gives its own independent evaluation of the effectiveness of the controls framework, as is summarized in Volume I.

2. IEG’s overall evaluation started with a thorough review of the basic method that management used in its assessment approach, and found that it was sound and was not itself the cause of any serious doubts about the results obtained. IEG also reviewed management’s mapping and role assessment of the Bank units that comprise the entity-level controls framework, and it conducted an extensive analysis of the data that management presented in the form of the ELCQ responses. Together these analyses enabled IEG to formulate its evaluation of the effectiveness of IDA’s entity-level controls, and therefore to complete Part II of the review. Taking the step of integrating the findings from Parts I and II, the question was also asked whether deficiencies identified during Part I would need to be revisited and possibly revised in the light of findings that emerged after completing Part II. Consulting all forms of evidence available for the review, including evidence (such as recent DIR reports from INT) not directly related to the review, IEG was able to formulate its evaluation and provide a final overall quality rating for the effectiveness of IDA’s internal controls framework.

Rating the Effectiveness of IDA’s Controls

3. The Entity-Level Template, details of which are given below in paras. 6-16, was the principal tool IEG used to rate the overall controls framework. The template contained a set of key questions regarding the effectiveness of controls within each COSO component, in light of all the evidence assembled. This included the evidence of a material weakness and six significant deficiencies that IEG has identified by the end of Part II, together with all the evidence of compliance from Part I and of entity-level controls pass rates in Part II. Once completed, the template provided a rating for controls effectiveness within each COSO component. These were then mapped onto a statistical “diamond,” as shown in Figure E.1.
4. The effectiveness of controls within each component was rated on a scale of 1 (fully satisfactory) to 4 (unsatisfactory). The figure shows the quality ratings for controls within each COSO component as one arm in the diamond. Had controls been evaluated as fully satisfactory without qualifications in all cases (rating 1), each arm of the polygon would lie at the outer perimeter. In actuality, after examining all the evidence, IEG found a material weakness and six significant deficiencies in the controls framework (see below). It found further that that these weaknesses cut across several or all components in the COSO framework. As a result, using the IEG rating template, even though the controls within each COSO component were rated separately, the result was that each one was rated satisfactory with qualifications. Hence, the results line in the figure lies symmetrically along the rating line 2.

5. This depiction accurately expresses IEG’s overall finding, but as a statistical aggregate, it also masks some important features that need to be highlighted. One is that, as the analyses in Annexes A and B show, the more serious weaknesses in controls—even though the cut across COSO components—were concentrated in a relatively few areas in the controls framework. Apart from these weaknesses, the framework operates effectively. In the same way, IEG’s 2 ratings for the controls within each component, while valid overall, hide the fact that many individual control items were rated 1 or fully satisfactory. Out of 74 items rated, 43 (58 percent) were rated 1. (See Statistical Appendix Table SA.7.)

6. The finding of satisfactory with qualifications is similar to management’s findings that the controls framework offers “adequate assurance to Senior Management, except for
certain deficiencies.” The evidence that the framework is “satisfactory or adequate” was supported by the pass rates calculated in both Parts I and II, which were above the 90th percentile—a 93 percent pass rate measured by compliance at the transactions level (in Part I), and 92-95 percent pass rate measured by ELCQ responses at the entity level (in Part II). Regarding evidence for the “qualifications” or the “except for” aspects of the controls, these are evident in the one material weakness and six significant deficiencies that were uncovered during the review.

Using the IEG Template to Rate the Controls Framework

7. In completing its evaluation IEG used a combination of analytical tools, including the statistical analysis of the ELCQ data, review of management’s evidentiary materials and its final report, interviews with most central control units in the Bank, reviews of various background papers, and a review of the IAD final report. In addition, IEG used two especially designed templates to combine the evidence from all these sources and methods to derive a single rating for the overall quality (effectiveness) of the controls in question. Two templates were used because the needs of Part I and Part II were different:

- In Part I IEG used the Business Process Template, which was designed to standardize IEG’s analysis and rating of each of the 30 Business Process Modules (BPMs) that management mapped and tested during its transactions-level assessment in Part I. Hence, the template was applied 30 times, once to each BPM. The results were reported in IEG’s Part IB report.
- In Part II IEG used the Entity-Level Template to rate management’s and IAD’s approaches and results in their review of the entity-level controls. This template was used also to generate IEG’s overall ratings of the controls effectiveness in the integrated framework as a whole. The Entity-Level Template was used four times, as described below.

8. Content: Each template has three main elements:

- A set of standardized questions aimed to provide IEG with a rigorous approach to evaluating management and IAD approaches and results.
- The rating system was designed to provide a standard metric with which to rate the results of IEG evaluation.
- A topic structure organized the questions and ratings by topics, permitting the template to be used four times to rate the following aspects of the evaluation:
  1. Evaluation of Management’s Approach and Method;
  2. Evaluation of IAD’s Review and Opinion;
  3. Evaluation of content by COSO components (that is, IEG’s final overall rating of the effectiveness of IDA’s internal controls framework); and
  4. Evaluation of the Treatment of Controls over Efficiency and Effectiveness.

9. The rating system: The templates used a four-part rating system the language of which was built around the degree of certainty that could be assumed as to whether or not controls were working as intended. In making its ratings, IEG assembled a panel consisting
of its core consulting team and selected senior retired Bank staff. A summary of the four-part system and the language describing the ratings is in Box E.1.

<table>
<thead>
<tr>
<th>Box E.1. The Four-Part Rating System</th>
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<tbody>
<tr>
<td><strong>Rating</strong></td>
</tr>
<tr>
<td>Fully satisfactory</td>
</tr>
<tr>
<td>Numerical equivalent: 1</td>
</tr>
<tr>
<td>Satisfactory with qualifications</td>
</tr>
<tr>
<td>Numerical equivalent: 2</td>
</tr>
<tr>
<td>Moderately satisfactory</td>
</tr>
<tr>
<td>Numerical equivalent: 3</td>
</tr>
<tr>
<td>Unsatisfactory</td>
</tr>
<tr>
<td>Numerical equivalent: 4</td>
</tr>
<tr>
<td>Not applicable (NA)</td>
</tr>
</tbody>
</table>

*As defined by the Public Company Accounting Oversight Board, Audit Standards 2 and 5.

Application of the Entity-Level Template: Summary of Results

10. **Ratings of Approach and Method:** As described above, the IEG template was used to evaluate four separate aspects of the overall review, the first of which dealt with management’s approach and method in completing its assessment of entity-level controls in Part II. The template contained two sets of questions in this segment, the first dealing with the design of assessment instruments (principally the ELCQ), the second with the use of data from the ELCQ and other sources. The results of the analysis are shown in Table E.1. IEG finds that the design of the assessment instruments was satisfactory, but with certain qualifications related mainly to the clarity of the ELCQ. Regarding the use of data from the ELCQ and other sources, IEG finds management’s approach fully satisfactory.

<table>
<thead>
<tr>
<th>Table E.1. Ratings from the Template IEG Ratings of Management’s Assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Rating of Approach and Method</strong></td>
</tr>
<tr>
<td>Design of Assessment Instruments</td>
</tr>
<tr>
<td>Use of Data from ELCQ and Other Sources</td>
</tr>
<tr>
<td><strong>OVERALL RATING:</strong></td>
</tr>
</tbody>
</table>

11. **The IAD Review and Opinion:** In the case of the IAD Review and Opinion, the template had questions focused on four areas: Scope of Work, Criteria and Standards, Documentation and Evidence, and Quality of Conclusions. The questions were used as a
guide to evaluating the IAD review and opinion, but the applicability of the template was far less appropriate than in the case of its application to management’s assessment, because of the far fewer data points in the IAD review. Regarding the approach and method used in its Part II review, IAD was systematic in reviewing all management assessment materials and it made extensive use of ongoing IAD audits where relevant. IEG rated this approach *fully satisfactory*. With regard to the findings and the quality of conclusions, IEG identified similar weaknesses in controls, and notes that IAD found management’s qualified assurance to be fairly stated. However, IEG came to different conclusions as to the materiality of the weaknesses in controls over fraud and corruption.

12. **Rating the Effectiveness of the Overall Controls Framework:** In rating the effectiveness of the controls framework the IEG panel was guided by evidence from all sources. This included its review of all of management’s materials, the results from the ELCQ, and the IEG analysis conducted from the data revealed by the ELCQ responses, as well as other sources. It included consideration of the list of deficiencies IEG had compiled and the factors that combined to create a material weakness in IDA’s controls over fraud and corruption in its lending operations. As the template was organized around the five COSO components, following the way management had organized its assessment, the final ratings of controls effectiveness were also given for each component separately. They were then aggregated to give an overall rating for the whole framework.

13. As shown in Table E.2, IEG rated the effectiveness of controls in the framework as *satisfactory with qualifications* (rating 2), based on the material weakness and five significant deficiencies that had been identified. Also, since there were deficiencies in each of the COSO components, though they were rated separately, each component was also rated as having controls that were *satisfactory with qualifications* (rating 2). (It should be noted that controls effectiveness within each COSO component were evaluated and rated separately, based on the findings within each component. The fact that all ratings emerged as 2 is coincidental, but reflects deficiencies found in each component).

<table>
<thead>
<tr>
<th>COSO Components</th>
<th>CE</th>
<th>RA</th>
<th>CA</th>
<th>ML</th>
<th>IC</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effectiveness of Controls</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td>Overall Rating</td>
<td>2</td>
<td></td>
<td></td>
<td></td>
<td>Satisfactory with Qualifications</td>
</tr>
</tbody>
</table>

CE = Control Environment; RA = Risk Assessment; CA = Control Activities; ML = Monitoring and Learning; IC = Information and Communications

14. **Rating Management’s Assessment of Controls over Efficiency and Effectiveness of IDA’s Operations:** Management’s ratings of the controls over efficiency and effectiveness were built around the extent to which management had identified efficiency and effectiveness as key objectives in IDA operations, and then had also identified the full range of tracking systems and processes that the Bank has to keep management informed of the performance in each case. IEG noted that management did not give an account of actual performance of IDA in each area, but simply noted that controls were in place and were regularly operating in a way that ensured that Senior Management is well informed on a timely basis. IEG regards this as a necessary requirement and an acceptable approach to an
internal controls review. Accordingly, it rated management’s treatment as fully satisfactory in each case as summarized in Table E.3. However, IEG is also of the view that to give a sufficient account of controls over efficiency and effectiveness, at least some reference to indicators of efficiency and effectiveness outcomes is also relevant, and would be helpful. IEG made such references in its own evaluation. However, a full examination of efficiency and effectiveness outcomes, of a kind that IAD implied could have been attempted, is not, in IEG’s view, part of the scope of this review.

Table E.3. Rating Management’s Assessment of Controls over Efficiency and Effectiveness of IDA’s Operations

<table>
<thead>
<tr>
<th>Controls over Effectiveness of IDA Operations</th>
<th>1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effectiveness identified as key objective</td>
<td>1</td>
</tr>
<tr>
<td>Full range of effectiveness tracking systems identified</td>
<td>1</td>
</tr>
<tr>
<td>Controls over Efficiency of IDA Operations</td>
<td></td>
</tr>
<tr>
<td>Efficiency identified as key objective</td>
<td>1</td>
</tr>
<tr>
<td>Full range of efficiency tracking systems identified</td>
<td>1</td>
</tr>
</tbody>
</table>

15. **Behind the Overall Ratings**: IEG has used exacting standards in its rating approach. This meant that in any given category, where one or more items may have received a rating less than 1 IEG tended to rate the overall item at less than 1, even though most items in a category may have been rated 1. This is evident in Figure E.2, which shows — for the rating of management’s assessment — data for the distribution of individual ratings across all categories. It is clear that ratings of 1 dominate. Out of 74 ratings, 43 (58 percent) were a rating of 1. Equally, more serious negative ratings (3 and 4) comprised no more than 10 percent of the total. Overall, therefore, the ratings of 2 (satisfactory with qualifications) that IEG gave to the all components tends to mask the frequent extent to which it also gave fully satisfactory ratings to many individual items and seriously negative ratings to only a few.

Figure E.2. Distribution of Template Ratings
16. **Items Rated “Moderately Satisfactory” or Less:** In eight cases, IEG gave individual ratings of *moderately satisfactory* or less to aspects of management’s assessment. The template questions for these items are shown in Box E.2. Most of these lower category ratings were given in relation to different aspects of risk assessment.

<table>
<thead>
<tr>
<th>Box E.2. Questions Which Led to IEG Ratings of Moderately Satisfactory or Less on COSO Components</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>RISK ASSESSMENT</strong></td>
</tr>
<tr>
<td>To what extent did management address the issue of whether results-based vehicles (CASs, PADs, ISR s) reduced misallocation risks?</td>
</tr>
<tr>
<td><strong>Rating:</strong> 3</td>
</tr>
<tr>
<td>Rate the extent to which management’s assessment gave a fair and penetrating account of the effectiveness of both the design and effective operation of the Bank’s Integrated Risk Management Framework (IRMF).</td>
</tr>
<tr>
<td><strong>Rating:</strong> 3</td>
</tr>
<tr>
<td>Rate the extent to which management’s assessment showed how risk assessment mechanisms in the Bank and IDA differentiated between high level and major risk, and lower level and less serious risk factors.</td>
</tr>
<tr>
<td><strong>Rating:</strong> 4</td>
</tr>
<tr>
<td>Rate the extent to which management’s assessment systematically addressed the Risk Focal Points: Strategic Effectiveness; Operational Efficiency; Financial Soundness; Stakeholder Support.</td>
</tr>
<tr>
<td><strong>Rating:</strong> 4</td>
</tr>
<tr>
<td><strong>CONTROL ACTIVITIES</strong></td>
</tr>
<tr>
<td>Where weaknesses were found, to what extent were these clearly distinguished between weaknesses in design (that is, flaws in the published procedures themselves) as against operation (which reflects noncompliance with established procedures), and were remedies suggested in each case that would be feasible to implement?</td>
</tr>
<tr>
<td><strong>Rating:</strong> 3</td>
</tr>
<tr>
<td><strong>MONITORING AND LEARNING</strong></td>
</tr>
<tr>
<td>Rate the extent to which management’s review of the cluster of controls also touched on the monitoring of country outcomes, and IDA’s contribution to country outcomes, as undertaken to be done as part of the Monterey, Paris, and Marrakesh Consensus dealing with Results Measurement.</td>
</tr>
<tr>
<td><strong>Rating:</strong> 3</td>
</tr>
<tr>
<td><strong>INFORMATION AND COMMUNICATION</strong></td>
</tr>
<tr>
<td>Rate the extent to which the management assessment threw light on whether information flows within the units are easy and open, and there are ways in which information critical to IDA controls can be communicated upstream within the organization.</td>
</tr>
<tr>
<td><strong>Rating:</strong> 4</td>
</tr>
</tbody>
</table>
Annex F: Statistical Appendix

Table SA.1. Classification of Management's Questionnaire Responses (Based on Evaluated Pass Rates)

<table>
<thead>
<tr>
<th>Distribution of Questions by Category of Responses</th>
<th>IEG Count by Four Categories</th>
<th>Management Count by Two Categories</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Yes</td>
<td>Yes, but</td>
</tr>
<tr>
<td>Rating Numbers</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Control Environment</td>
<td>27</td>
<td>9</td>
</tr>
<tr>
<td>A. Integrity, ethics behavior</td>
<td>5</td>
<td>2</td>
</tr>
<tr>
<td>B. Control Consciousness, Style</td>
<td>11</td>
<td>3</td>
</tr>
<tr>
<td>C. Commitment to Competence</td>
<td>2</td>
<td>1</td>
</tr>
<tr>
<td>D. Org Structure, Auth, Respblty.</td>
<td>3</td>
<td>2</td>
</tr>
<tr>
<td>E. HR and Policies</td>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>Risk Assessment</td>
<td>22</td>
<td>11</td>
</tr>
<tr>
<td>Control Activities</td>
<td>11</td>
<td>7</td>
</tr>
<tr>
<td>Monitoring</td>
<td>26</td>
<td>4</td>
</tr>
<tr>
<td>Info. And Communications</td>
<td>17</td>
<td>10</td>
</tr>
<tr>
<td>Information</td>
<td>8</td>
<td>4</td>
</tr>
<tr>
<td>Communications</td>
<td>9</td>
<td>6</td>
</tr>
<tr>
<td>Totals And Overall Rating</td>
<td>103</td>
<td>41</td>
</tr>
</tbody>
</table>

Methodology: IEG classified the responses to the ELCO according to its judgments on category of response.

Overall ratings calculated using average category ratings weighted by numbers in each category.

Source: Management results matrix
**Table SA.2. The Distribution of "No" Responses by Frequency and COSO Components**

<table>
<thead>
<tr>
<th>Frequency</th>
<th>1 to 2</th>
<th>3 to 5</th>
<th>&gt;5</th>
<th>Totals</th>
<th>% Distr.</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Control Environment</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>A. Integrity, ethics behavior</td>
<td>12</td>
<td>4</td>
<td>4</td>
<td>20</td>
<td>38</td>
</tr>
<tr>
<td>B. Control Consciousness, Style</td>
<td>5</td>
<td>6</td>
<td>1</td>
<td>12</td>
<td>22</td>
</tr>
<tr>
<td>C. Commitment to Competence</td>
<td>0</td>
<td>0</td>
<td>1</td>
<td>1</td>
<td>7</td>
</tr>
<tr>
<td>D. Org Structure, Auth, Respblty.</td>
<td>2</td>
<td>2</td>
<td>1</td>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td>E. HR and Policies</td>
<td>2</td>
<td>3</td>
<td>1</td>
<td>6</td>
<td>11</td>
</tr>
<tr>
<td><strong>Risk Assessment</strong></td>
<td>16</td>
<td>23</td>
<td>2</td>
<td>18</td>
<td>31</td>
</tr>
<tr>
<td><strong>Control Activities</strong></td>
<td>12</td>
<td>17</td>
<td>3</td>
<td>15</td>
<td>26</td>
</tr>
<tr>
<td><strong>Monitoring</strong></td>
<td>2</td>
<td>2</td>
<td>0</td>
<td>2</td>
<td>2</td>
</tr>
<tr>
<td><strong>Info. And Communications</strong></td>
<td>8</td>
<td>13</td>
<td>2</td>
<td>15</td>
<td>31</td>
</tr>
<tr>
<td>Information</td>
<td>4</td>
<td>9</td>
<td>2</td>
<td>9</td>
<td>15</td>
</tr>
<tr>
<td>Communications</td>
<td>4</td>
<td>4</td>
<td>0</td>
<td>4</td>
<td>7</td>
</tr>
<tr>
<td><strong>Totals</strong></td>
<td>50</td>
<td>69</td>
<td>11</td>
<td>67</td>
<td>100</td>
</tr>
<tr>
<td><strong>%Distribution</strong></td>
<td>100</td>
<td>39</td>
<td>24</td>
<td>37</td>
<td></td>
</tr>
</tbody>
</table>

Source: Management results matrix.
### Table SA.3. Percentage Distribution of Questions by Category of Responses*

<table>
<thead>
<tr>
<th>Category</th>
<th>Yes</th>
<th>Yes, but</th>
<th>Yes, but No</th>
<th>No</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Overall</strong></td>
<td>70</td>
<td>23</td>
<td>4</td>
<td>2</td>
<td>100</td>
</tr>
<tr>
<td><strong>Control Environment</strong></td>
<td>65</td>
<td>23</td>
<td>10</td>
<td>3</td>
<td>100</td>
</tr>
<tr>
<td>A. Integrity, ethics behavior</td>
<td>44</td>
<td>22</td>
<td>22</td>
<td>11</td>
<td>100</td>
</tr>
<tr>
<td>B. Control Consciousness, Style</td>
<td>79</td>
<td>21</td>
<td>0</td>
<td>0</td>
<td>100</td>
</tr>
<tr>
<td>C. Commitment to Competence</td>
<td>67</td>
<td>33</td>
<td>0</td>
<td>0</td>
<td>100</td>
</tr>
<tr>
<td>D. Org Structure, Auth, Respbsy.</td>
<td>50</td>
<td>33</td>
<td>17</td>
<td>0</td>
<td>100</td>
</tr>
<tr>
<td>E. HR and Policies</td>
<td>75</td>
<td>13</td>
<td>13</td>
<td>0</td>
<td>100</td>
</tr>
<tr>
<td><strong>Risk Assessment</strong></td>
<td>76</td>
<td>24</td>
<td>0</td>
<td>0</td>
<td>100</td>
</tr>
<tr>
<td><strong>Control Activities</strong></td>
<td>58</td>
<td>37</td>
<td>5</td>
<td>0</td>
<td>100</td>
</tr>
<tr>
<td><strong>Monitoring</strong></td>
<td>87</td>
<td>13</td>
<td></td>
<td></td>
<td>100</td>
</tr>
<tr>
<td><strong>Info. And Communications</strong></td>
<td>63</td>
<td>26</td>
<td>4</td>
<td>7</td>
<td>100</td>
</tr>
<tr>
<td>Information</td>
<td>62</td>
<td>31</td>
<td>8</td>
<td>0</td>
<td>100</td>
</tr>
<tr>
<td>Communications</td>
<td>64</td>
<td>21</td>
<td>0</td>
<td>14</td>
<td>100</td>
</tr>
</tbody>
</table>

Methodology: IEG classified responses to the ELCQ according to its judgment on category of response

*Source: Management results matrix.

*Data do not include questions on anti fraud programs and controls
### Table SA.4. Distribution of “No” Responses by COSO Components

<table>
<thead>
<tr>
<th>OVERALL</th>
<th>Control Environment</th>
<th>Risk Assessment</th>
<th>Control Activities</th>
<th>Monitoring and Learning</th>
<th>Information and Communication</th>
</tr>
</thead>
<tbody>
<tr>
<td>177</td>
<td>66</td>
<td>31</td>
<td>26</td>
<td>2</td>
<td>52</td>
</tr>
<tr>
<td>% Distribution (177=100)</td>
<td>37</td>
<td>18</td>
<td>15</td>
<td>1</td>
<td>29</td>
</tr>
</tbody>
</table>

#### 3-5 “NO” RESPONSES PER QUESTION

| Number of Questions (8) | 3  | 1  | 2  | 0  | 2  |
| Number of “NOs” (33)    | 13 | 5  | 6  | 0  | 9  |

#### >5 “NO” RESPONSES PER QUESTION

| Number of Questions (6) | 3  | 0  | 0  | 0  | 3  |
| Number of “NOs” (52)    | 29 |    |    |    | 23 |

Source: Management results matrix. Data include “no” responses for Anti-Fraud Programs and Controls, within each COSO component.
### Table SA.5. Negative Responses by Type of Controls Issue: Control Design or Control Operation

<table>
<thead>
<tr>
<th>Allocation by Category</th>
<th>Design</th>
<th>Operation</th>
<th>Total</th>
<th>Percentages</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Design</td>
<td>Operation</td>
</tr>
<tr>
<td>Control Environment I</td>
<td>24</td>
<td>17</td>
<td>41</td>
<td>59%</td>
<td>41%</td>
</tr>
<tr>
<td>Risk Assessment II</td>
<td>20</td>
<td>9</td>
<td>29</td>
<td>69%</td>
<td>31%</td>
</tr>
<tr>
<td>Control Activities III</td>
<td>12</td>
<td>8</td>
<td>20</td>
<td>60%</td>
<td>40%</td>
</tr>
<tr>
<td>Monitoring and Learning IV</td>
<td>17</td>
<td>13</td>
<td>30</td>
<td>57%</td>
<td>43%</td>
</tr>
<tr>
<td>Information and Communications V</td>
<td>16</td>
<td>11</td>
<td>27</td>
<td>59%</td>
<td>41%</td>
</tr>
<tr>
<td>Fraud &amp; Corruption VI</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Totals</td>
<td>89</td>
<td>58</td>
<td>147</td>
<td>61%</td>
<td>39%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Distribution of Ratings</th>
<th>Design</th>
<th>Operation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Y</td>
<td>Y/B</td>
</tr>
<tr>
<td>Control Environment I</td>
<td>16</td>
<td>4</td>
</tr>
<tr>
<td>Risk Assessment II</td>
<td>13</td>
<td>7</td>
</tr>
<tr>
<td>Control Activities III</td>
<td>6</td>
<td>3</td>
</tr>
<tr>
<td>Monitoring and Learning IV</td>
<td>14</td>
<td>3</td>
</tr>
<tr>
<td>Information and Communications V</td>
<td>11</td>
<td>3</td>
</tr>
<tr>
<td>Fraud &amp; Corruption VI</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Totals</td>
<td>60</td>
<td>20</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Percentage of Ratings by Category</th>
<th>Design</th>
<th>Operation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Y</td>
<td>Y/B</td>
</tr>
<tr>
<td>Control Environment I</td>
<td>67%</td>
<td>17%</td>
</tr>
<tr>
<td>Risk Assessment II</td>
<td>65%</td>
<td>35%</td>
</tr>
<tr>
<td>Control Activities III</td>
<td>50%</td>
<td>25%</td>
</tr>
<tr>
<td>Monitoring and Learning IV</td>
<td>82%</td>
<td>18%</td>
</tr>
<tr>
<td>Information and Communications V</td>
<td>69%</td>
<td>19%</td>
</tr>
<tr>
<td>Fraud &amp; Corruption VI</td>
<td>69%</td>
<td>19%</td>
</tr>
<tr>
<td>Totals</td>
<td>67%</td>
<td>22%</td>
</tr>
</tbody>
</table>

*Source:* IEG Calculations based on Management’s Results matrix
Table SA.6. Portfolio Efficiency Indicators

<table>
<thead>
<tr>
<th></th>
<th>AFR</th>
<th>SAR</th>
<th>All Regions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Lending Preparation Time (average months)</strong> /1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q4FY04</td>
<td>17</td>
<td>13</td>
<td>16</td>
</tr>
<tr>
<td>Q4FY05</td>
<td>19</td>
<td>13</td>
<td>16</td>
</tr>
<tr>
<td>Q4FY06</td>
<td>14</td>
<td>17</td>
<td>15</td>
</tr>
<tr>
<td>Q4FY07</td>
<td>15</td>
<td>15</td>
<td>14</td>
</tr>
<tr>
<td>Q1FY08</td>
<td>17</td>
<td>24</td>
<td>17</td>
</tr>
<tr>
<td><strong>Cost of Dropped Projects ($'000)</strong> /1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q4FY04</td>
<td>8,523</td>
<td>1,339</td>
<td>26,130</td>
</tr>
<tr>
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Source: Quarterly Reports to the Board, FY07 Quarter 4 and FY08 Quarter 1
Table SA.7. Distribution of Entity Level Template Ratings

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Review of IDA Internal Controls
An Evaluation of Management’s Assessment and the IAD Review

Volume III
Report on the Completion of Part II
Final Report on the Effectiveness of IDA Internal Controls for Assuring Reliable Financial Reporting, Compliance with IDA’s Charter and Policies, and Operating Efficiency and Effectiveness

Attachments

This paper is available upon request from IEG-World Bank.

2009
The World Bank
Washington, D.C.
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Attachment 1
Management’s Overall Assessment
THE WORLD BANK

IDA: INTERNAL CONTROLS REVIEW:

MANAGEMENT ASSESSMENT FY08

OPCS AND CSR

December 2008
### Abbreviations and Acronyms

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THE WORLD BANK
IDA: INTERNAL CONTROLS REVIEW: MANAGEMENT ASSESSMENT FY08

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ANNEXES

Annex A: Entity Level Controls
Annex B. Supplemental Report on Transaction-Level Controls
Annex C: Entity Level Controls and Efficiency and Effectiveness of Internal Controls Scoping Memorandum, FY08
Executive Summary

1. As set out by the Commission of Sponsoring Organizations of the Treadway Commission (COSO), under the COSO internal controls framework, Management is responsible for establishing and maintaining an effective internal control system. IDA’s management has assessed internal control over IDA’s operations, and based on this assessment, and reflecting the work undertaken by management, and attested to by the external auditor, during the FY07 ICFR process, management is of the view that the internal control system over IDA’s operations is adequate to provide reasonable assurance to Senior Management and the Executive Directors that:

- IDA’s published financial statements are being prepared reliably;
- IDA carries out its operations in compliance with the relevant provisions of its Articles of Agreement and operational policies and procedures including provisions relating to the use of funds for intended purposes; and,
- They are made aware, in a timely manner, of the extent to which IDA is moving toward effective and efficient use of its resources in meeting its operational objectives.

2. Significant deficiencies. As part of its assessment, however, management has identified a number of significant deficiencies which require remedial actions—and effective monitoring of their implementation—in order to strengthen the internal control system over IDA’s operations. These significant deficiencies, described below, fall into five categories: (a) Investment Lending (IL) framework; (b) controls for managing fraud and corruption risk that may be associated with IDA-supported operations; (c) oversight of Procurement (PR) and Financial Management (FM) work related to IDA-financed projects; (d) identification of systemic risks; and (e) Analytic and Advisory Activities (AAA) and Information Technology (IT) issues:

(a) Issues relating to the current policy and procedural framework for IL:

- Process inefficiencies, including a lack of focus on key risks and controls during preparation/design and supervision stages of IL projects.
- Outdated and complex policy framework for IL as reflected in multiple OPs and BPs that apply to IL operations.
- Risk identification and reporting with an emphasis on information-sharing within the task teams and between staff and management during project supervision, including diffused accountability in such areas.
- Timely accessibility of operational documents primarily relating to IL operations.

---

(b) Issues relating to Integration of Controls for Managing Fraud and Corruption Risk in IDA-supported operations:

- Need for better design and integration of controls for managing fraud and corruption risks (reflecting, inter alia, lessons learned from precedents and INT work) into design/preparation and supervision/monitoring of IDA-supported operations.

(c) Issues relating to PR and FM:

- Adequacy of controls in place to ensure consistent follow-up on PR issues by the task teams, including the need for better integration of PR staff in task teams and clarification of accountabilities for procurement issues and decisions.
- Inconsistent implementation of PR post-reviews.
- Inconsistency in quality arrangements for the documentation of FM supervision and some inconsistency in quality arrangements for oversight and monitoring of FM supervision.

(d) Issues relating to identification of systemic risks

- Inadequate mechanisms for risk aggregation and timeliness and consistency in monitoring, identifying (and formulating an appropriate response to) systemic risks.

(e) Other Issues:

- AAA processes and controls.
- IT controls relating to password sharing in SAP, privileged access, and Infrastructure Change Management.

3. Management has formulated specific recommendations to address the above significant deficiencies through monitorable actions. Several of these actions are already in place; others are underway and management is committed to implementing them over the next 12-18 months and reporting to Senior Management and the Executive Directors on the results achieved, including through periodic progress reports (with the first one being prepared in the early fall of 2009 in time for the IDA 15 mid-term review). The recommended actions fall within six areas:

- **IL reform**, expected to: (a) improve IL instrument efficiency and effectiveness, (b) rationalize and strengthen control framework for IL by adopting a risk-based model to appraisal and supervision of IL operations, (c) eliminate current backlog of outdated OPs and BPs by creating a principles-based umbrella policy for IL operations; and (d) align incentives and accountabilities to facilitate more timely risk identification, reporting and information-sharing within the task team and between management and staff.

- **Better design and integration of controls for managing fraud and corruption risks** into design/preparation and supervision/monitoring of IDA-supported operations, expected to strengthen the Bank’s ability to detect, deter and address, in partnership with country counterparts, issues of fraud and corruption and form part of the GAC implementation plan and follow-up actions to the Volcker Panel Report and the India DIR Report.
• *Strengthening quality arrangements in the PR and FM areas,* by raising awareness and achieving better integration of fiduciary staff in task teams and re-clarifying accountabilities within the task team for fiduciary issues generally and oversight of contract management in particular; and strengthening regional and overall monitoring of quality arrangements in the PR and FM areas, particularly during project supervision.

• *Review and improvement of mechanisms for identification of entity-wide risks,* including management’s review of QAG and adoption of an annual Integrated Risk Report.

• *IT strengthening,* expected to address password and access issues, improve compliance monitoring through automation of operational processes starting with IL, and address current issues with filing and accessibility of operational documents.

• *Improving AAA work* by simplifying and rationalizing processes and systems for the wide scope of AAA activities and strengthening compliance with this new improved framework.
I. Introduction

1. Background. As reflected in the IDA 14 Replenishment Report, Management committed to carry out, during the period of IDA 14, an independent comprehensive assessment of its control framework including internal controls over IDA operations and compliance with its charter and policies, and making such assessment available to the public after its disclosure has been approved by IDA’s Executive Directors. The assessment has been conducted in the context of the internal control framework developed by COSO, adapted to fit the unique nature and operations of IDA. It has been carried out in three tiers: Management self-assessment; Independent Audit Department (IAD) review; and an independent evaluation of both by the Independent Evaluation Group (IEG). The assessment has been divided into two parts: Part I, which focused on design and operating effectiveness of controls over IDA operations at the transaction level; and Part II, which focused on (a) entity-level controls, (b) outstanding transaction-level controls deferred from Part I, and (c) the operations objective of COSO. The final IEG report on the results of the assessment is expected to be disclosed by IEG after it is discussed with the Audit Committee (AC) and Committee on Development Effectiveness (CODE), following in this regard usual practice relating to disclosure of IEG reports.

2. Benefits of this exercise. In management’s view, this has been an important and useful exercise. It enabled management for the first time to take a comprehensive look at internal control system over IDA’s operations, focusing on management and business processes conducted at transaction and entity levels across IDA. It also allowed management to assess mechanisms in place to monitor and adjust these processes to respond to identified risks and support IDA’s strategy and priorities as they evolve in response to client needs. Being the first of its kind, this assessment was much more time and resource consuming than originally anticipated at all levels and for all assessment participants (management, IAD and IEG). Building on the extensive experience and comprehensive tools and methodologies developed in the context of this assessment, management expects to mainstream a periodic assessment of internal control over IDA and Bank operations into its ongoing corporate monitoring and control functions. Further, periodic assessment of internal control will become an integral and important part of the ongoing corporate monitoring and control functions.

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1 See, Report from the Executive Directors of the International Development Association to the Board of Governors, Additions to IDA Resources: Fourteenth Replenishment, Working Together to Achieve the Millennium Development Goals, (approved by the Executive Directors of IDA on March 10, 2005), paragraph 39, under the Disclosure bullet.

2 COSO published a report in 1992, “Internal Controls – Integrated Framework,” which is widely referred to by leading financial institutions in the United States and is also seen as a model in many other parts of the world. IDA adopted the COSO framework as its controls methodology in 1995. The framework is an all encompassing process which covers all aspects of internal control of an organization’s operation. It considers not only the evaluation of formal controls, but also informal controls, such as ethics, trust, communication, organization behavior and leadership, and incorporates “top-down” as well as “bottom-up” analysis.
3. **Objective and structure of this report.** This report sets out management’s overall assessment, together with findings and recommendations, regarding the effectiveness of the current internal control framework over IDA’s operations. It builds on and reflects management’s assessment of effectiveness of internal control over the three objectives categories within the COSO integrated controls framework, namely: reliability of financial reporting, compliance with laws and regulations, and effectiveness and efficiency of operations. Management’s assessment, findings and recommendations relating to:

- the first objective — reliability of IDA’s financial reporting — reflects the work undertaken by management and attested to by the external auditor during the FY07 ICFR process.
- the second objective — compliance with applicable laws and regulations — reflects management’s assessment of compliance at the transaction-level (the focus of Part I, as supplemented with additional transaction-level work completed during Part II) and at the entity-level (conducted as part of the assessment of the entity-level controls during Part II).
- the third objective — effectiveness and efficiency of IDA’s operations — was the focus of entity-level work conducted during Part II and builds and reflects Part I findings relating to efficiency and effectiveness at the transaction-level.

4. Following this introduction, Section II of the report sets out a summary of scope and methodology followed by management in conducting its assessment. Section III sets out management’s overall assessment regarding the effectiveness of the current internal control framework over IDA’s operations, followed by a discussion of significant deficiencies identified by management and recommended actions to address them.

   Annexes provide additional information: **Annex A** contains *Management’s Assessment of Entity-Level Controls over IDA’s Operations*, conducted during Part II of this exercise; **Annex B** sets out *Management’s Supplemental Report on Transaction-Level Controls*, which reflects management’s assessment of quality arrangements over financial management and procurement work in the context of IDA operations, mapping of AAA processes and an assessment of compliance with these processes, and supplemental work on several other modules, including the safeguards risk management process, and IDA allocation model; **Annex C** sets out the scoping memorandum for Part II of this assessment.

## II. Scope and Methodology Summary

5. Throughout this assessment, and in preparing this final report, management followed the COSO definition of internal control, namely, a process affected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in three COSO categories: financial reporting, compliance and operations. Management assessed internal controls related to these three objectives categories against different expectations, an approach that was consistent with COSO. In the context of financial reporting and compliance objectives, which are primarily within IDA’s own control, management assessed whether IDA’s internal control system can be expected to provide

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3 Please note that this overall management report reflects findings and recommendations that combine both transaction-level and entity-level work. As such, while it builds on the recommendations reflected on Annexes A and B, some of these recommendations have been prioritized and updated to reflect subsequent actions which are now in place.
reasonable assurance that IDA’s financial reporting is reliable and that IDA carries out its operations in compliance with its charter and operational policies. In the context of operations objective, however, which is not always within an entity’s control, management assessed whether the internal control system in place provides a “reasonable assurance only that management and, in its oversight role, the Board, are made aware, in a timely manner, of the extent to which IDA is moving toward its operations objectives.” It is important to note that this distinction was not reflected in management’s Scoping Memorandum for Part II, which set the operations objective in terms of “assessing whether internal controls over IDA operations provide reasonable assurance to senior management and the Board that IDA’s operations are carried out efficiently and effectively.” Management determined the need for this revision upon a closer review of the COSO report which it used to guide its entity-level work. As explained in the COSO Report, since the operations objective is not always within the entity’s control, the internal control system cannot provide an “absolute reasonable assurance” in this area the way it is expected to do with respect to financial reporting and compliance components; instead, all the internal control system can provide with respect to operational objective is a "reasonable assurance... that management and, in its oversight role, the Board, are made aware, in a timely manner, of the extent to which an entity is moving towards its operations objectives." This is especially important for IDA, given the many factors outside IDA’s control that may and often do affect the development outcomes and effectiveness of IDA’s operations. Since this review is likely to become a precedent and set standards for similar work inside and outside IDA for assessing operations objectives against the COSO methodology, it is all the more important to ensure that efficiency and effectiveness of operations is measure against realistic rather than absolute expectations, in line with the COSO approach.

6. Following is a summary of the scope and methodology followed by management in assessing each of the three objectives against these expectations.

1. Reliability of financial reporting relating to IDA’s operations

7. Since 1997, Management has annually asserted and received attestations from the external auditor that it maintains an effective system of internal controls over external financial reporting for both IBRD (International Bank of Reconstruction and Development) and IDA. The work undertaken by management, and attested to by the external auditor, during the FY07 ICFR process is described in the annexes to Management’s assertion and the external auditor’s attestation for FY07.

2. Compliance with applicable laws and regulations

8. The corporate entities for which the COSO framework was developed are subject to specific laws and regulations in their respective jurisdictions. IDA’s status as an international organization with immunities and privileges makes this COSO category not directly applicable. However, in addition to its charter (i.e. its Articles of Agreement) IDA has a body of internally generated policies and procedures with which it needs to comply. Management has therefore interpreted compliance with laws and regulations to mean compliance with IDA’s (a) Articles of Agreement, and (b) operational policies and procedures.

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9. Management’s assessment of IDA’s compliance with relevant provisions of its Articles of Agreement and operational policies and procedures was carried out in two parts. During Part I management focused on transaction-level controls relating to compliance with (a) provisions of the IDA Articles of Agreement, as interpreted from time to time by IDA’s Executive Directors, relating to the management of IDA’s lending operations, including provisions relating to the use of funds for intended purposes; and (b) internal operational policies and procedures relating to the management of IDA’s lending operations. The results of this assessment are set out in management’s Part IB report. During Part II, management also assessed entity-level controls relevant to compliance with the Articles of Agreement and operational policies and procedures linking these to the transaction-level controls relating to compliance identified and assessed under Part I (as supplemented by the additional transaction-level work completed during Part II and set out in Annex B to this report).

10. Detailed methodology and scope for carrying out the compliance assessment at the entity-level is set out in Management’s Part II Report (attached as Annex A). The tools utilized in carrying out this assessment include: (a) preparation and assessment of entity-level questionnaire (the “ELC questionnaire”) answered by all vice presidents and stand-alone directors, and managing directors as of September 2007; (b) review and assessment of the terms of reference, key outputs (including main recommendations in the most recent reports) of IDA’s central control groups, including documentation and review of the current budget process; (c) review of IDA’s general computer controls related to its information technology; (d) review of decentralized operations using IAD’s country office program audits; and (e) assessment of the Board’s function. In accordance with document sharing process adopted under Part I, all documentation and testing results relating to the above were provided to IAD and IEG for their review and evaluation, respectively.

11. Management believes that the sequencing of the compliance assessment, which commenced with the “bottom-up” approach during Part I to assess compliance at the transaction-level, was necessary in light of the nature of the commitment made under IDA 14, namely to specifically review compliance with applicable charter provisions and policies in place. By focusing during Part I on transaction-level controls relevant to compliance with IDA charter and policies, management was able to identify and test key management and business processes that apply to IDA’s lending operations and bring out the crucial details of operational compliance and any issues that affect operational efficiency and effectiveness (like inefficiencies of current “one-size-fits-all” processes for IL projects and tools in place to assess progress and effectiveness of operations. The more conventional approach of commencing this work with entity-level controls may have been less time and resource-consuming. However, in management’s view the overall results of management’s assessment show that this alternative methodology would not have yielded the same depth, specificity and relevance of findings and actionable recommendations as was made possible through the sequencing of assessment work undertaken and the methodology adopted by management.

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3. Effectiveness and efficiency of IDA’s operations

12. Part II of management’s assessment has focused on whether internal controls over IDA operations provide reasonable assurance to Senior Management and the Board that they are made aware, in a timely manner, of the extent to which IDA is moving toward effective and efficient use of its resources in meeting its operational objectives. The transaction-level assessment under Part I yielded important findings that had a significant bearing on, and were reflected in, the overall assessment of internal controls over effectiveness and efficiency of operations. The findings and recommendations of this assessment, and the detailed methodology and scope for carrying it out, are set out in management’s Part II report (attached as Annex A).

13. In summary, the main tools utilized by management in carrying out an assessment of entity-level controls relating to efficiency and effectiveness of operations included:

- preparation and assessment of the ELC Questionnaire that addressed the five COSO components (control environment, risk assessment, control activities, information and communication, and monitoring and evaluation) as well as anti-fraud and corruption controls;
- assessment of the Board’s function;
- review and assessment of the terms of reference, key outputs (including the main recommendations) of the central control units, including documentation and review of the current budget process;
- review of decentralized operations;
- review of application and general computer controls related to information technology;
- documentation and review of the current processes for identification, formulation, approval and implementation of policy revisions needed to reflect changes in IDA’s strategy, priorities, operational model, and identified risks; and
- integration of findings relating to effectiveness and efficiency from transaction-level work conducted under Part I, and particularly findings regarding inefficiency of current

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6 As explained in paragraph 5, this represents a revision from the formulation of this objective in management’s Part II Scoping Memorandum and aligns it more closely with the COSO standard for this objective.

7 Consistent with the Scoping Memorandum for Part II, management has conducted a review of the role of the Board of Executive Directors (the “Board”), its procedures, and decision-making tools. The results of this review are set out in management’s report on the role of the Board (included as the Attachment to Annex A of this report), which summarizes: (a) the primary control functions of the Board (consistent with its responsibilities under IDA’s Articles of Agreement, as interpreted through various decisions, legal opinions and other means); (b) the main tools, structures and other means for carrying out these functions (including a summary relating to the Board’s committees and their respective roles and functions, types of meetings and other means for deliberation and decision-making; types of Board documents and disclosure regime that applies to the main ones); (c) rules of conduct that apply to Executive Directors and their staff; and (d) more specific information regarding the function/role of the Audit Committee, which has the primary mandate for assisting the Board in overseeing IDA’s financial condition, risk management and assessment processes, the adequacy of governance and controls, and reporting and accounting policies and procedures. The Board under the auspices of COGAM is currently looking into broader internal governance issues relating to the role and operations of the Board. While management expects that this review would result in important findings and possible recommendations for improvement in various areas of Board operations, it does not expect the review to identify major gaps or weaknesses in the Board’s function. Management is therefore of the view that COGAM’s review is unlikely to have a material negative impact on management’s current assessment that the Board is functioning properly and is providing the appropriate governance and oversight of IDA’s operations.

8 See paragraph 42.
processes governing IL operations and work done under Part I to identify and review current processes and tools in place\(^9\) to monitor and report to senior management and the Board at various stages on progress of projects and programs supported by IDA toward achieving the agreed outcomes (both at the project level and at the country level).

### III. Management’s Assessment, Findings and Recommendations

14. This section sets out management’s overall assessment regarding the effectiveness of the current internal control framework over IDA’s operations, followed by more detailed findings of significant deficiencies identified by management and recommended actions to address them.

#### A. MANAGEMENT’S OVERALL ASSESSMENT

15. Under the COSO internal controls framework,\(^10\) Management is responsible for establishing and maintaining an effective internal control system. IDA’s management has assessed internal control over IDA’s operations, and based on this assessment, and reflecting the work undertaken by management, and attested to by the external auditor, during the FY07 ICFR process, management is of the view that the internal control system over IDA’s operations is adequate to provide reasonable assurance to Senior Management and the Executive Directors that:

- IDA’s published financial statements are being prepared reliably;
- IDA carries out its operations in compliance with the relevant provisions of its Articles of Agreement and operational policies and procedures, including the provisions relating to the use of funds for intended purposes; and,
- They are made aware, in a timely manner, of the extent to which IDA is moving toward effective and efficient use of its resources in meeting its operational objectives.

16. As part of its assessment, however, management has identified a number of significant deficiencies which require remedial actions—and effective monitoring of their implementation—in order to strengthen the internal control system over IDA’s operations. These significant deficiencies, described below, fall into five categories: (a) IL framework; (b) fraud and corruption; (c) PR and FM work, (d) identification of systemic risks; and (e) AAA and IT issues:

(a) **Issues relating to the current policy and procedural framework for IL:**

- Process inefficiencies, including a lack of focus on key risks and controls during preparation/design and supervision stages of IL projects.
- Outdated and complex policy framework for IL as reflected in multiple OPs and BPs that apply to IL operations.

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\(^9\) These include: progress reports on implementation IL and DPL operations (ISRs) and CAS progress reports, and project, DPL and CAS completion reports, as well as IEG evaluation of each ICR, CAS completion reports as well as country and thematic evaluations.

o Risk identification and reporting with an emphasis on information-sharing within the task teams and between staff and management during project supervision, including diffused accountability in such areas.

o Timely accessibility of operational documents primarily relating to IL operations.

(b) Issues relating to Controls for Managing Fraud and Corruption Risk in IDA-supported operations:

o Need for better design and integration of controls for managing fraud and corruption risks (reflecting, inter alia, lessons learned from precedents and INT work) into design/preparation and supervision/monitoring of IDA-supported.

(c) Issues relating to PR and FM

o Adequacy of controls in place to ensure consistent follow-up on PR issues by the task teams, including the need for better integration of PR staff in task teams and clarification of accountabilities for procurement issues and decisions

o Inconsistent implementation of PR post-reviews; and

o Inconsistency in quality arrangements for the documentation of FM supervision and some inconsistency in quality arrangements for oversight and monitoring of FM supervision.

(d) Issues relating to identification of systemic risks

o Inadequate mechanisms for risk aggregation and timeliness and consistency in monitoring, identifying (and formulating an appropriate response to) systemic risks.

(e) Other Issues:

o AAA processes and controls.

o Information Technology (IT) controls relating to password sharing in SAP, privileged access, and Infrastructure Change Management.

17. A summary of each of the above significant deficiencies identified by management together with recommended remedial actions are set out below.

B. FINDINGS AND RECOMMENDATIONS

1. Improving the IL framework

   a. Rationalizing IL processes and strengthening controls

18. Transaction-level work conducted by management in Part I (including identification, mapping and testing of IL processes and controls), has identified significant inefficiencies in the current processes and controls that apply to IL, especially during preparation stages (from concept to approval). As reflected in management’s Part I report, IL is currently hampered by inefficient and often duplicative processes and reviews, often applied in a “one-size-fits-all” manner, irrespective of the level of risk, borrower capacity, track record, and similar factors. The absence of a risk-based approach to IL processes and controls undermines efficiency and effectiveness of these controls by over-regulating low risk projects while diverting resources and
management attention from addressing higher risk situations. Attention to proper risk identification and results monitoring during project supervision is diverted by excessive focus on preparation/appraisal stages. Such focus also contributes to increased project preparation/appraisal costs and delays in bringing projects to the Board for its consideration and approval.

19. **Recommended action.** In response to these and related findings of this assessment, management has launched a comprehensive effort to reform the investment lending instrument. An early concept for the proposed reform was shared informally with the Executive Directors in May 2007 through a technical briefing and a revised action plan has been prepared to reflect the results of this internal control review and reflect other developments, including the Middle Income Countries (MIC) and Fragile States strategies, the GAC strategy, findings of the Volcker Panel Report and the India DIR. A concept note on IL reform, which reflects the findings of this review, is scheduled to be discussed with the OVPs on October 20 and with the Board in January 2009. Integration of a risk-based model into the control framework governing IL is a key aspect of the rationalization of IL processes and controls. The principles of the new IL policy and the new risk-based control framework for IL are expected to:

- rationalize and prioritize key controls governing IL;
- facilitate appropriate differentiation of processes and requirements based on risk;
- set appropriate additional controls, resources, and reviews for higher risk operations/environments; and
- maximize efficiency and effectiveness of each control through rationalization and workflow automation
- strengthen risk identification and monitoring during supervision by, among other things, clarifying roles, responsibility and accountability between IDA and borrowers and within the institution.

20. Management expects to complete the first phase of IL reform, which will address the process and control issues during all stages (including more timely risk identification and reporting during supervision, clarification of roles, responsibilities and accountability within the task team, as well as better integration of fraud and corruption issues in project appraisal and supervision) in FY09-Q4.

**b. Reforming IL policies**

21. During Part I of the assessment, management identified that various OPs/BPs have not been keeping pace with the changes needed and/or introduced on the ground. As the main fiduciary policies (including OP/BP 12.00 related to disbursements and 10.02 related to FM) were issued in March 2007 and major instrument policies (including OP/BP 8.60 related to DPLs and OP/BP 8.00, related to emergency lending) are in place, this issue primarily affects OPs and BPs that apply to appraisal and supervision of IL. Consistent with the scoping memo

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12 As noted in paragraph 39, work is underway to update OP/BP 11.00, Procurement.
for Part II, management has assessed (a) how the proposed reform and consolidation of IL policies will help address this issue; and (b) how the current processes for policy revisions could be made more efficient so as to facilitate more timely updates of OPs and BPs.

22. Based on these assessments, management is of the view that the proposed reform of IL policies will address most of the outstanding policy updates issues. While this work is important from the Control Activities and Information and Communication points of view, the entity-level review conducted during Part II, including information from the ELC Questionnaires,13 confirmed that the current status of OPs and BPs does not have a material impact on compliance and operations objectives of IDA as a result of compensatory measures adopted to “fill in” the gaps created by the outdated OPs and BPs. These mitigating measures include issuance of Operational Memoranda and central and corporate guidance to staff. Based on management’s identification and mapping of the current process for policy revisions, management believes that the current backlog in OP/BP updates is due to the prescriptive and micro style and approach to OP/BP drafting and content rather than the process for introducing policy changes that require OP/BP revisions. The principles-based approach to preparation of new OPs and BPs reflected in the more recent policy reforms,14 which focuses the OP and BP statements on core principles and key controls rather than detailed rules and procedures characteristic of the older statements, should help minimize any future backlogs in OP/BP updates.

23. **Recommended action.** During Part I, IL was identified as the most over-regulated Bank instrument and is subject to approximately 30 of the Bank’s operational policies and procedures, many of which are misaligned with the current practice and evolution of the IL instrument. To address this shortcoming, which is the source of much inefficiency surrounding the current IL instrument, the IL reform effort will focus on consolidating and rationalizing the policies and procedures governing IL by creating a single principles-based “umbrella” policy for IL that would govern IL projects from preparation through completion. Reflecting lessons learned, including findings of this internal control review, the new IL policy would:

- replace the rigid “ring-fenced” IL project model with a flexible menu of design, funds flow and financing options to better meet development and funding needs of IDA’s varied clients;
- replace the current “one-size-fits-all” requirements with a risk-based approach to selection of IL design options and associated due diligence, processing, and monitoring requirements.
- reflect main principles governing redesigned IL instrument in a new principles-based umbrella policy governing IL from “identification” to exit.

24. Management expects to make a proposal for policy consolidation during the second phase of IL reform, following the completion of (a) Phase I that would address preparation/appraisal process inefficiencies and significant deficiencies in supervision as a matter of priority, and (b) broad consultations inside and outside the Bank to ensure that the

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13 During the ELC Questionnaire process only OPCS identified OP/BP status as an issue.
14 These include: OP/BP 6.00 related to expenditure eligibility, OP/BP 10.02 related to financial management, OP/BP 12.00 related to disbursement, OP/BP 13.20 related to additional financing and OP/BP 8.00 related to rapid response to crises and emergencies.
new IL model meets and reflects the needs and expectations of the Bank’s clients, partners and shareholders. This second and final stage of IL reform is expected to be completed in FY10-Q4.

c. Risk identification and reporting and better information sharing

25. Management’s assessment of entity-level controls has found an issue with timeliness and scope in reporting of risks generally, and in the context of project supervision in particular. Sources for this finding include management’s assessment of responses to the ICFR and ELC Questionnaires, a review of the Risk and Opportunity Workshop (ROW) results, and findings reflected in recent outputs/reports of several central control units, including IAD, QAG and IEG. Given that timely and accurate reporting on risks and project implementation issues is essential to ensure that appropriate and timely decisions and actions are taken to address risks and improve outcomes, this issue merits prompt management attention to formulate and implement an effective remedial action.

26. **Recommended action.** This finding has pointed to the need to strengthen incentives, including: (a) staff incentives and accountability; (b) management tools and accountability; and, (c) resource reallocation mechanisms. These will promote open and timely identification and reporting of risks. Some management actions are already underway to improve candor and realism in implementation supervision reporting in response, at least in part, to IAD’s, QAG’s and IEG’s findings. These include:

- a cross-regional review of ISRs by OPCRX was conducted as input into the Focus on Results—“IDA 14 Results Measurement System and Directions for IDA 15.”
- preparation and dissemination of important reference documents, including the launching of an e-learning module in FY08 Q4 to assist teams in preparing and updating ISRs;
- regular reviews of ISRs by the regions, with guidance from OPCRX, including guidance on Maintaining a Results Focus in ISRs; and
- preparation by each Region of specific guidance for ISR reviews to ensure adequate baselines, and to review quality and realism.

27. In addition, as part of IL reform management also expects to introduce measures that would improve timeliness and accuracy of risk identification and information sharing within the task team and between management and staff, including such measures as (i) mechanisms for reallocation of resources to address newly-identified risks; and (ii) incentives and management actions to encourage accurate and timely reporting of risks and issues in operations, including project performance.

d. Incentives and instruments to foster accountability and compliance

28. Management’s assessment of entity-level controls has identified that accountability, compliance and internal control responsibilities are not adequately reflected in performance.

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15 For example, the OPCS Results Agenda Website includes a Quick Reference Guide on Results in Operations; the IDA RMS Fact Sheet; Maintaining a Results Focus in ISRs; Baselines in ISRs; and Results and Harmonization in Bank Operations (including supervision). In addition, the results terminology is periodically updated and posted on the Website.
management tools such as OPEs or promotion criteria. Nor does there seem to be a strong link between performance evaluations and individual accountability: for example, job descriptions and performance evaluations do not usually contain specific references to internal control related duties, responsibilities, and accountability. Concerns about the adequacy of current incentives to promote accountability, compliance and quality were also reflected in several units’ responses to the ELC and ICFR questionnaires. Several responders expressed a concern that individual staff and units are primarily rewarded for specific results such as project delivery to the Board and project disbursements and completion, with less attention being paid to the method or quality of these achievements. Potential issues with accountability arrangements were also reflected in the Volcker Panel Report (referenced in footnote 15) and the India DIR (referenced in footnote 10).

29. Some of these concerns are being addressed by ongoing activities in the accountability and ethics areas, such as emphasis on ethics and controls in the orientation program provided for all new Bank hires and implementation of appropriate disciplinary action in response to departures from approved policies and procedures or violations of the code of conduct pursuant to Staff Rule 8.01. In June 2008 the Bank has issued a strengthened, dedicated whistle-blowing policy and amended the Principles of Staff Employment to enhance its current handling of whistle-blowing reports and claims of whistle-blowing retaliation. The new policy, principle and staff rule puts the Bank Group at the leading edge of whistle-blowing protections amongst international organizations, consistent with the highest standards of good governance and the on-going efforts of the Bank to safeguard its integrity and effectiveness.

30. Management has long-recognized the challenge of managing performance in the Bank— which is key for promoting individual and professional accountability. This has been emphasized most recently in the Report of the Performance Management Working Group published in July 2007. Prompted by the Report, HRS launched HR Insight, a new website dedicated to sharing HR-related data, information and research with Bank Group staff. Efforts have also been made to exercise more differentiation in the recent SRI awards, to ensure that high performers are rewarded.

31. **Recommended action.** Given the importance of individual and professional accountability to the effectiveness and efficiency of an internal control system, senior management is undertaking a corporate review of responsibilities, accountabilities and quality oversight. This review will include several components, including (i) existing oversight and quality assurance arrangements to identify shortfalls in quality, including the roles and methodologies of the institutional mechanisms such as QAG, IEG, Regional Quality teams, (ii) the existing quality and accountability arrangements for operations, including roles and responsibilities within the task team and processes and controls in place to ensure proper oversight, (iii) development by HRS of a comprehensive roadmap/strategy for enhancing performance based on the diagnosis of the root causes of dissatisfaction with current performance management, developed by the Performance Management Working Group, and (iv) continuation of HRS efforts to enhance the HR Insight website to increase further the transparency of HR-related data. Components of this work will be reflected in: the QAG review, expected to be completed by January 15, the first phase of IL, expected to be completed in FY09-Q4, including in particular the integration and clarification of responsibilities within the task team and strengthening of the supervision model.
e. Timely accessibility of operational documents

32. During “compliance testing” conducted by management in Part I, management identified a problem with accessibility of operational documents. The documents requested by management to support the processes and controls identified were not easily accessible. Although after an extensive effort management was able to obtain 93% of the documents requested, this exercise identified the need to strengthen document retention practices and improve accessibility of operational documents. During Part II management confirmed that this issue is indeed linked to both, the Control Environment and Information and Communication components of COSO at the entity level, as was suggested by IEG in its Part IB report. Consistent with IEG’s preliminary recommendation, the review conducted by management also concluded that improved IT systems to support IDA’s operations would have to be an integral part of the solution to these issues.

33. **Recommended action.** Management has already begun to address the document retention and accessibility issue by setting up a Task Force in FY07 to look at retention, filing and accessibility of operational documents and come up with recommendations for improvement. Working closely with ISG, the Task Force has made a proposal for addressing the issues identified through automation of key controls for IDA’s primary operational tools (CAS, DPL, IL) into the Bank’s documentation system. Under the proposal, this work would commence with automation and integration of IL processes and controls, where most issues with documents accessibility occurred. The work on the automation system will proceed in close coordination with the first phase of IL reform and will be part of the Operations and Knowledge Management Systems Program (OKSP, previously known as the Enterprise Content Data Management (ECDM)). The new system for IL will be piloted in FY09 and is expected to be fully in place by the end of FY10, in close coordination, and forming a part of, the roll-out of IL reform.

2. Better integration of controls for managing fraud and corruption risks into design and supervision of Bank-supported operations

34. IDA’s anti-fraud and corruption strategy can be divided into three phases: Phase I, which focused on setting out the intellectual case that good governance and an attack on corruption must be key parts of efforts to sustain economic growth and alleviate poverty, Phase II, which focused on formulating an appropriate anti-corruption strategy and its adoption by Senior Management and the Board; and Phase III, which focuses on the implementation of the anti-corruption strategy through its integration into the Bank Group’s (including IDA’s) daily operations. Having been the leader in making an intellectual case against corruption (as noted in the Volcker Panel Report discussed below), and having demonstrated the depth and

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breadth of the management and Board commitment to this agenda through the adoption of the GAC strategy, IDA has actively moved into Phase III of this work.

35. Phase III builds on and reflects: (i) the firm commitment and actions of IDA’s senior management, starting with the President, to make its fight against fraud and corruption a core element of IDA’s operations; (ii) diagnostic and assessment work performed or commissioned by management to identify areas where the controls for managing F&C risks need to be strengthened; (iii) ongoing efforts and experience with strengthening country client institutions and systems that are essential for effective and efficient management and utilization of public resources, including safeguarding these resources from fraud and corruption; and (iv) roll-out and implementation of specific actions to strengthen controls and improve effectiveness of IDA’s efforts in managing F&C risks that reflect the work and recommendations flowing from the work under items (i)-(iii). As summarized in the Attachment to this report, much progress has been achieved in this area particularly over the past 6-12 months, putting the Bank well ahead of other institutions dealing with these complex and challenging issues. Management is committed to deepen and broaden these efforts to: (i) continue building and strengthening mechanisms to monitor and manage F&C risks in IDA-supported operations, including expanded Bank-wide staff (and particularly TTL) training, and (ii) refine and improve F&C controls as more knowledge is gained about the weaknesses that still exist (which needs to be a continuous effort to reflect on lessons learned and a growing body of experience).

36. **Recommended action.** While the efforts described above have strengthened IDA’s controls for identifying and effectively managing F&C risks in operations, more needs to be done to “expand staff skills and broaden behavioral change in order to deepen, systematize and mainstream good practices across all of the Bank Group’s work.” To this end, management is committed to implementing additional corrective actions outlined below:

37. Clarifying responsibilities and accountabilities for addressing fraud and corruption through:

- Adoption of the new INT strategy (expected to be discussed with the Audit Committee in early calendar 2009).
- Establishing appropriate protocols of cooperation between INT and the Regions on handling allegations of F&C.
- Reform of processing and supervision of IL operations as part of Phase I of IL reform, expected to be completed by FY09-Q4;
- Expanding staff skills and broadening behavioral change in order to deepen, systematize and mainstream good practices across all of the Bank Group’s work by introducing improved tools (including training) and processes for identifying and managing F&C risks through:
  - Developing and mainstreaming improved tools for managing F&C risks in project design and supervision stages through the work being carried out by the GAC in Projects Working Group, supported by OPCS, which is undertaking a substantial

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work program aimed at improving quality and consistency in approaches to fraud and corruption risk mitigation at the project level. The main elements of this work, that are well underway, include:

- GAC Audit and Assurance Toolkit, launched by OPCFM, which is designed to help task teams enhance the effectiveness of financial audit and provide guidance on other types of audit and assurance engagements that focus on fraud and corruption risks, such as technical and contract audit.

- The updates under preparation to the FM Practices Manual which will incorporate guidance on fraud and corruption.

- Preparation of guidance for FMSs by OPCFM on how to better identify and manage corruption risks through smart project design (to be supported by web-based knowledge sharing tools).

- To support the mainstreaming of the GAC agenda at the sector and project levels, preparation of an OPCS paper on GAC good practices at the project level “Dealing with Governance and Corruption Risks in Project Lending: Emerging Good Practices” (draft completed and circulated for comment). The paper would: (a) provide Task Teams with a common conceptual framework for understanding GAC issues; (b) highlight some of the key lessons learned over the past several years and provides examples of emerging good practices at the sector and project level; and (c) indicate areas where further work is required in order to fully support Task Teams in this relatively new area of emphasis. The final paper is expected to be issued by the end of Q3 FY09.

- A Training Program for Task Teams is being developed, with two pilots already conducted, and plans to roll this out in FY 2010. The curriculum covers the 4 major components of the GAC agenda: (a) the CGAC initiative at the country level; (b) assessing governance and corruption risks at the sector and project level; (c) mitigating project risks through “Smart Project Design” and the development of project-specific Anti-Corruption Action Plans; and (d) the supervision of high corruption risk projects.

- An initial stock-taking of AAA and investment lending operations with significant GAC components has been completed, and is being converted to a searchable database that can be accessed by Task Teams to provide examples of innovative approaches to risk assessment and risk mitigation.

- Work is underway on “case studies and good practice notes” that illustrate and elaborate on the tools and approaches (see below) that are being developed to improve governance and reduce corruption at the sector and project level. These will be disseminated through an on-going program of brown bag lunches. They will also be available as a publications series and on the new GAC in Projects web portal.

- A GAC in Projects Peer Learning Network has been established, with a rapidly growing “community of practitioners” that will be supported by the interactive web portal noted above. Practice Leaders are also being identified at the regional and sector level, and several units have established either full-time focal points (EAP and SAR) or “on demand” Advisory Units (ECA and INF).
Building on the progress achieved in developing and testing “smart” project design and more effective and more appropriately resourced project supervision, which reflect lessons learned, including systemic issues drawn from INT investigations and DIRs and create a more effective risk management framework to help prevent, deter, detect and address fraud and corruption, which are to be reflected in the new approaches to project design/appraisal and supervision to be developed as part of IL reform.

- Reviewing staff incentives (performance reviews, promotions, rewards, and visibility) to ensure that they are aligned with the anti-corruption agenda through discussions at an MD-chaired GAC Governance Council (ongoing).
- Preparing and monitoring (with OPCS support) specific action plans for following up on INT reports (a small team for the follow-up on post-INT report action plans is proposed to be established in OPCS with effect from FY2009 and a new position has been advertised by OPCS).
- At the entity-level, specifically including F&C risk among the risks facing the institution in the new Annual Integrated Risk Report, mentioned in paragraphs 43 and 45 below, which will replace the current Risk Scan tool.
- Specific actions in the procurement area to address fraud and corruption (reflected in paragraph 39 below).


38. **Procurement.** During Part II management assessed quality arrangements over PR work relating to project appraisal and supervision and has identified the need to strengthen quality arrangements, business processes and adequacy of documentation relating to PR during project preparation/appraisal and supervision stages. This review found that (a) quality assurance arrangements for procurement are in place and are generally sound and (b) the regional variances identified are in line with the high degree of decentralization and broad mandate of the Regional Procurement Managers (RPMs). However, management’s review also identified two issues that need to be addressed: (a) adequacy of controls in place to ensure consistent follow-up on PR issues by the task teams, including the need for better integration of PR staff in task teams and clarification of accountabilities for procurement issues and decisions; and (b) consistency in implementation of post-reviews. In management’s view, these issues, combined with the findings of Part I of this exercise, rise to a level of a significant deficiency in PR area, which requires implementation of monitorable corrective actions. Several corrective actions recommended by management in response to deficiencies indentified under Part I of this review have already been implemented. These include:

39. **Recommended action.** To address the issues identified, management recommended a plan of corrective actions, some of which have been implemented already, while others are underway.

**Actions in place:**

- Improving controls and quality of complaints data base:
Starting in FY07, the procurement complaints database has been made a key control and management tool, and enhancements to the database include automatic alerts to remind RPMs of pending cases, to seek RPM clearance when closing cases, and to track complaints related to late payments. OPCPR monitoring of complaint follow-up has been strengthened.

- Strengthening PR/INT cooperation on management of F&C risks:
  - In July 2008 a Memorandum of Understanding was signed between OPCPR and INT on the prevention of Fraud and Corruption in Procurement.
  - In December 2008 a joint INT/OPCPR guidance note on identification and handling of red flags during the project cycle was issued.

**Actions underway:**

- Full Integration of PR staff and tasks in project teams:
  - Develop mechanisms for early and full integration of PR staff in the project teams and of PR tasks during the project cycle
  - Clarify the sharing of responsibility for key PR decisions at preparation and implementation stages between TTL and PR staff and Sector Manager and RPM, including mechanisms to resolve disagreements and raise awareness of TTLs/sector managers
  - Enhance a Procurement Certification system that would increase awareness and importance given to procurement work
  - Develop guidance and criteria for assigning PR ratings for the ISR, and mandatory recording of revisions to such rating by sector staff.

- Updating procurement policy and procedures:
  - Update of OP/BP 11.00, *Procurement*, is being finalized to incorporate, *inter alia*, risk management and fraud and corruption issues, and to document the already enhanced complaints handling (expected to be issued in January 2009)

- Bank-wide roll out of PR risk assessment tool:
  - Finalize a PR Risk Model/Risk Management Tool that specifically focuses on F&C issues is for piloting in the spring of 2009. (It will be used under the country systems pilot first and will be made mandatory for Bank-wide use later in 2009.)
  - Revise templates for the PAD Procurement Annex in light of new initiatives, including risk-based procurement assessments that include a focus on fraud and corruption and to reflect the work on risk-based approach to processing of IL operations as part of the first phase of IL reform (to be completed by June 2009)

- Strengthening OPCPR/PSB Roles:
  - Review, by March 2009, the roles of the Procurement Sector Board (PSB) and OPCPR with a view of: (a) expanding it to identify areas that may merit harmonization of
regional practices; (b) strengthening the advisory role of the PSB to respond to the Regions’ needs; and (c) monitoring regional fiduciary compliance and quality, including post review.

40. **Financial Management.** In FM, Management found that while Quality Assurance (QA) arrangements have been put in place to oversee FM arrangements for the use of IDA financing, the quality and documentation of regional QA arrangements is inconsistent and does not fully comply with the FM Practices Manual (FMPM), particularly during project implementation. Variations in Regional QA exist, and while many of these make sense, there is a need to ensure consistency in the quality of FM work, as defined in the FMPM. Management’s assessment identified issues in three areas: (a) Documentation of review of audited financial statements by an FM specialist and management oversight of Audit Report Compliance Systems (ARCS) data—in some Regions, it was not possible to verify regular FMS review of audit reports because ARCS data entry was considerably out of date; (b) Documentation of FM supervision—there are inconsistent quality arrangements for the documentation of FM supervision work, including supervision planning, supervision reporting, and follow-up on FM action items. Quality arrangements to support the filing of FM documents are also inconsistent, making it difficult to validate that FM work has been undertaken; (c) Timing of quality interventions during supervision and identification and monitoring of risky projects—there are inconsistencies and gaps in quality arrangements for Regional FM managers’ oversight and monitoring of FM work during project supervision. In some Regions, there is no systematic monitoring of interim financial reports. This could result in FM issues not being identified and corrective actions not being taken on a timely basis.

41. **Recommended action.** The FM Sector Board already has actions underway to strengthen quality arrangements, including:

- Completion of Phase I of the Joint CSR/OPCS Evaluation process (Phase II will be launched in January 2009).
- Adoption of the RAPMAN/PRIMA system by all regions.
- Centralized monitoring of the ARCS audit tracking system by OPCFM and a rapid reduction in the number of outstanding audit reports.
- The FM Sector Board also took the following actions to strengthen specific F&C controls in the FM area:
  - Issuance in June 2007, of an FM Approach Paper to GAC,19
  - Establishment of an FM GAC Working Group to support the development of good practices, guidance and training for FM staff
  - Issuance of an Audit and Assurance Toolkit
  - Draft FM Guidance on dealing with fraud and corruption in project design has been circulated to the FM Sector Board.
  - Work is underway to develop similar guidance on enhanced project supervision and FM "red flags", supported by web-based tools and guidance, including a database of projects featuring FM anti-corruption features.

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o Training on GAC was provided to all FM staff at the 2008 Fiduciary Forum and further training is envisaged.

• Additional actions that are underway to address deficiencies identified in the FM area include:
  o Review and update of the FM Practices Manual, which serves as the main operational guide for FM staff, with the revised FMPM expected to be issued in June 2009. (Findings of this review will be incorporated into the final methodology for the Joint Evaluation).
  o Regions have consolidated and updated their QA arrangements (including QA-related information on their websites), and will introduce further updates as necessary, including to align these arrangements with the issuance of an updated FMPM next June 2009.
  o Considerable progress has been achieved in most regions in updating the ARCS for all actions related to audits that were due in FY05 through FY07 and in clearing backlogs relating to earlier years. In addition, Regions have largely completed entry of baseline data on interim financial reports into PRIMA by October 31, 2008.
  o Pending the establishment of the institutional Enterprise Content and Document Management system, the FMSB will develop and communicate good practices and additional guidance to staff by December 31, 2008.

4. Risk aggregation

42. Management has identified that while important review and evaluation work is being carried out throughout the institution by the central control units (including IAD, IEG, INT, QAG, CSR, and the Inspection Panel), risk and control activities remain fragmented, resulting in duplication of effort and potential gaps in risk coverage. IDA also currently lacks a consistent mechanism for aggregating and prioritizing the results of this work. This finding is based on management’s review of the terms of reference, key outputs (including recommendations) of the central control units, assessment of responses to the ELC Questionnaire, and relevant observations set out in the Volcker Panel Report and the India Detailed Implementation Review (DIR).

43. **Recommended action.** This finding merits strengthening of the existing management tools for integrated risk management. To this end, management (through CSR) intends to move toward an annual Integrated Risk Report intended to (a) describe overall risks facing the institution, (b) identify units responsible for management and oversight of risks identified, and (c) assess potential gaps and overlaps, and (d) develop a dashboard of risk findings from the various assessment activities, and (e) over time, assess the quality and consistency of the processes in place.

44. In addition, a more in-depth review of the central control units may be merited, including complementarities in their respective methodologies, terms of reference, outputs and current mechanisms for information-sharing and consolidation of their respective findings and recommendations. In management’s view, such review should:
  • Identify ways to rationalize and improve effectiveness and efficiency of checks and balances provided by the central control units,
• explore various mechanisms for better risk aggregation and assessment/review rationalization, including mechanisms in place to validate and prioritize key risks for monitoring and testing as well as defining opportunities for improvements to controls and management activities.
• assess mechanisms for linking systemic risks identified from time to time with objectives, initiatives, and business processes, opportunities for alignment and coordination across the institution.

45. The Integrated Risk Report is expected to be completed by FY10. Management is also currently conducting a review of QAG, but believes that a broader review described above would also be merited. The review is expected to be completed by January 15, 2009. Management would welcome the views and guidance of the Audit Committee relating to such broader review.

5. **Other significant deficiencies**

   a. **AAA processes and compliance**

46. As mentioned in the Scoping Memo for Part II, and following the request of IEG and the Audit Committee to include AAA within the scope of this exercise, during Part II, Management (a) identified and mapped current processes that apply to the main AAA product line, Economic and Sector Work (ESW) reports, (b) conducted a walkthrough of the mapped processes, and (c) tested compliance with such controls using a sample of randomly selected ESW reports completed and delivered to clients during FY07, in a process similar to that performed for IL, DPL, and CAS product lines during Part I. The focus on ESW (and for sampling purposes, on ESW reports) was in large part due to the fact that ESW funding has traditionally absorbed the major share of AAA funds and ESW reports account for over 80% of total ESW spending. The process mapping exercise will inform management’s larger-scale review of AAA covering both IBRD and IDA, currently underway.

47. In ESW Reports randomly selected for compliance testing, non-compliance with controls was identified in 25% of control steps involved in the ESW process. It should be noted, however, that roughly half of the instances of non-compliance were due to mismatches between dates recorded in SAP and the actual dates of application of such controls (e.g. the dates of the Concept Review meetings of some of the transactions differed from the dates for such meetings recorded in SAP).

48. **Recommended action.** Management is undertaking a broad review of the processes and controls, including systems and monitoring, that apply to AAA in order to simplify and strengthen them where needed, and ensure they are updated to take into account the wide variety of AAA currently carried out by the Bank. This review will also address the compliance weaknesses observed, along with other issues that have been raised by IEG and QAG in recent

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20 The sample was drawn from the universe of ESW Reports completed as of September 16, 2007, and whose cost exceeded $100,000. These types of ESW Reports accounted for 90% of ESW Reports completed. ESW as a whole has consumed approximately 67% of the AAA budget.
related reviews of AAA. Management expects to complete this review and discuss the
recommended changes with CODE in FY10.

b. IT-related issues identified as part of the ICFR exercise

During the ICFR review three significant deficiencies were identified in connections with IT-related issues. The first related to password policy breaches in SAP, as identified by IAD in its FY07 “Identify and Access Management” audit. The audit identified that SAP passwords are widely shared by Bank staff which may have resulted in some unauthorized expenses in the financial statements. The second related to the scope of privileged access and monitoring of activities in privileged accounts which were deemed to need rationalization and strengthening to limit risks of misuse. The third related to change management controls associated with Infrastructure Change Management and the need to ensure consistency of application of these controls.

50. **Recommended action.** In response to these findings, Management has recommended and as part of the ICFR program is carrying out corrective actions to (a) address the password sharing issue, (b) strengthen controls around Information Security to rationalize and further limit privileged access to system applications and monitor changes made by IT staff using such privileged accounts; and (c) strengthen controls around Infrastructure Change Management to ensure that change management controls are applied consistently and exceptions are reviewed and authorized by appropriate authority.

C. MONITORING ARRANGEMENTS

51. Management intends to implement the above remedial actions over the next 18-24 months and report to Senior Management and the Executive Directors on the progress of their implementation and results achieved. OPCS and CSR will take the primary responsibility for such periodic monitoring and reporting, with the first progress report to be prepared and discussed with the Executive Directors in the early fall of 2009, in time for the IDA 15 mid-term review.
Attachment to Management’s Report

Fraud and Corruption: Summary of Actions Implemented

1. **High-level commitment and actions.** As the President stated in his recent address to staff during the Integrity Day on December 3, 2008, the Bank’s commitment to integrity is at the core of all it does. The Bank, at its highest levels, is not just making the case but is actively implementing the anti-corruption agenda, as evidenced by: (i) the swift actions it has taken and specific measures it has put in place over the past 11 months in response to the Volcker Panel Report (discussed below), (ii) senior management hands-on approach and involvement in decisions relating to delays or suspension of operations affected by fraud and corruption issues; (iii) detailed and candid coverage of fraud and corruption risks in Bank documents, including CASs, project documents, and periodic updates by management to the Board on specific actions and progress achieved in this area (as well as remaining challenges).

2. **Diagnostic work.** The Volcker Panel, India DIR, and this IDA internal controls exercise have all served as key diagnostic tools to assess the status of controls over management of F&C risks in operations and recommend areas for improvement. To maximize effectiveness of its implementation efforts, including identification of areas for improvement, in February 2007,21 the World Bank President, in consultation with the Board, requested an independent panel of experts (the Volcker Panel) to review the operations of INT, the Bank’s central control unit responsible for, among other things, investigating allegations of fraud and corruption in operations financed by IDA and other members of the World Bank Group. The findings and recommendations of the Volcker Panel, as set out in the Volcker Panel Report issued in September 2007, identified that much remained to be done in mainstreaming fraud and corruption issues into IDA’s daily operations and has included 18 specific recommendations to help with this effort. Additional concerns about the effectiveness and robustness of controls over fraud and corruption in Bank-supported operations also were raised in INT’s Report on the Detailed Implementation Review of the India Health Sector (the “India DIR Report”), issued by INT in December 2007. The issues identified in these reports were consistent with management’s findings resulting from its assessment of entity and transaction level controls. Key among these were findings relating to the need to: (i) better integrate INT and the results of its work into IDA’s operations in order to improve management of F&C risks that may arise in the context of IDA-funded projects; (ii) specifically embed fraud and corruption risk assessment in many of the existing risk assessment processes; (iii) undertake assessment of F&C risks in a specific and systematic way throughout the institution; (iv) address more consistently as part of program and project design at a portfolio and project level, the vulnerabilities to fraud and corruption in countries with systemic corruption; (v) focus on incentives that would lead to consistent monitoring, reporting, and timely response to, implementation risks generally, and fraud and corruption issues in particular during project supervision; and (vi) develop new and/or improve existing tools and methodologies in all areas (project design, supervision and evaluation) using lessons learned, including the work of INT, in order to ensure appropriate flagging and treatment of fraud and corruption issues.

3. **Experience and tools for country-level work.** IDA has much experience with conducting country-level ESW work that helps assess and identify systemic issues that could undermine the country’s development efforts due to weaknesses in the country’s systems, institutions, and
internal controls frameworks responsible for management and utilization of public funds. Such work is reflected in fiduciary ESW (in particular CPARs and/or joint fiduciary assessments i.e. combined CPAR/CFAAs which have become the quasi norm in the last 4/5 years), which provide the basis for assessing country systems and defining mitigation measures in DPLs and PRSCs as well as assess fiduciary risks at the country level that is an important input into CASs. In addition, many projects that address public sector management have included PR and FM components, several grants (e.g. IDF) have focused on fiduciary strengthening, and close coordination with other donors as part of the harmonization efforts has helped address the capacity-building issues especially in fiduciary areas. This is monitored by the number of completed CPARs and the various Bank initiatives. In addition, much work is being done to strengthen country systems under the country system pilot in the procurement area, which focuses on assessing, strengthening and building on country’s procurement systems. It is also important to acknowledge the efforts in the FM area both as part of increasing number of projects that can rely on country’s own FM systems and as a key focus of actions that underlie assessments and strengthening measures addressed in an increasing number of DPLs and PRSCs. Strengthening and building country systems in these key areas has been and increasingly is an important focus of the Bank’s institution-building, governance and fiduciary support work in its client countries. Indeed, over 50% of DPLs in FY07 (up from an average of 24% in 1990-94) included conditionality on public sector governance, including in the areas of procurement, financial management, and budget transparency. While it is not a new area of emphasis, the importance of this work under the GAC strategy, combined with the work underway to implement the recently approved country systems pilot in procurement area, provide an added emphasis to the Bank’s efforts to strengthen the effectiveness, efficiency, reliability and transparency of control systems and institutions in client countries with the help of all of Bank’s existing tools and instruments. In addition, Bank FM Policies permit the use of country systems when these are assessed as being appropriate i.e. the challenge for the FM Sector is to accelerate the use of country systems when circumstances permit (presently estimated at 62% of disbursements - Monitoring Survey 2008, Paris Declaration). The 2007 FM Sector Approach to Governance and Anti-corruption identified country systems as one of the key areas of focus for FM work, identifying in particular the need to strengthen key institutions of accountability, including government internal audit functions, supreme audit institutions and legislative oversight committees. The Bank’s engagement with these institutions has been stepped-up. For example, a Global Partnership Agreement between the International Organization of Supreme Audit Institutions (INTOSAI) and Donors is under preparation. Guidance is also being prepared to help FM staff in assessing the adequacy of country FM systems for use in Bank supported operations. Moreover, the ongoing PEFA Program, Phase III of which was agreed with the EU, IMF and other bilaterals in June 2008, enhances IDA’s ability to strengthen country systems through the use of a common results measurement framework and joint fiduciary diagnostic work (including with PREM and Procurement).

4. **Management actions to strengthen controls for managing F&C risks at country and project level.** Over the past 12 months, management has undertaken proactive and concrete actions in response to findings and recommendations made in the context of the primary diagnostic tools, and particularly the Volcker Panel Report, India DIR and this IDA internal controls assessment. Much work has been done at the country level as well as part of management’s implementation of the GAC strategy. As reported in the recent GAC progress report on implementation of actions in response to the India DIR, discussed with the Board in
October 2008\textsuperscript{22}, the overlap between the issues raised in the context of the India DIR, management’s actions designed in response to the Volcker Panel Report, and the findings of this IDA internal controls assessment, has greatly contributed to management’s ability to define a concrete plan of systemic Bank-wide actions for heightening the Bank’s effectiveness in the governance and anti-corruption area, including specific tools for addressing the relevant issues. These include specific actions in the following key areas:

- **Dissemination of lessons learned**, through (i) distillation of lessons learned from INT work by its Preventive Services Unit (PSU), designed as a tool which could be used for didactic purposes throughout the institution; (ii) at least 30 discussions and learning events carried out throughout the Bank by OPCS, SAR, and INT to disseminate lessons learned from India DIR; and (iii) training seminars carried out by the PSU and its collaboration with specific project teams to help them define their governance, accountability and anti-corruption plans at the project level.

- **Strengthening project supervision** through compilation and dissemination via the “GAC in Projects” network of good practice in such areas as 3\textsuperscript{rd} party supervision and “smart” supervision.

- **Specific measures in procurement area:**
  o Development and roll-out of PR Risk Model/Risk Management Tool that specifically focuses on F&C issues, to be piloted in the spring of 2009. It will be used under the country systems pilot first and will be made mandatory for Bank-wide use later this year. The F&C module of the risk-management tool that will become part of the system in the spring of 2009 draws from the red flags identified by INT and the regions.

  o Deepening of the cooperation between the Procurement Anchor in OPCS and INT: A Memorandum of Understanding between OPCPR and INT on the prevention of Fraud and Corruption in Procurement was signed by VP OPCS and VP INT on July 28, 2008. It presents a framework to facilitate a joint approach in preventing F&C and lays down the areas of cooperation between INT and OPCPR. In addition, a joint work program relating to preventing F&C was agreed to by both units. (Due to confidentiality of information in the INT databases, it was agreed that OPCPR will not have access to the INT data base, but INT will be given access to OPCPRs complaints database on an as need basis.)

  o As described in paragraph 8 below, much work has been done to improve the completeness, operation and usage of the complaints data base which is an important source for identifying potential F&C issues.

  o OP/BP 11.00 has been revised and discussed extensively at the Procurement Sector Board; it is expected to be issued by the end of January 2009. OPCPR is also conducting an overall review of the guidance and other tools/ information on its website including all the guidance notes issued and will update them as necessary and at a minimum to be in line with OP/BP 11.00.

\textsuperscript{22} Strengthening the World Bank Group Engagement on Governance and Anti-Corruption, October 21, 2008 (the GAC Progress Report)
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- **Specific tools for addressing fraud and corruption at project level**, have included: (i) the development of GAC in project guidelines by “GAC in Projects” team under the GAC Implementation Plan (these have been discussed with teams across the Bank and are being finalized for issuance this month); (ii) lessons learned and best practices on GAC in projects are available (and being constantly updated and posted) on the GAC in Projects’ website, supplemented by peer learning and other training events in this area across the Bank.

- **Strengthening financial audits** through development of standard terms of reference to widen financial audits to cover performance issues and procurement. These have been issued in draft form and will be available in December for task teams interested in pursuing this more detailed type of audit. These new approaches will be disseminated via the Financial Management Sector Board.

- In the health specific area, an assessment of Bank procurement procedures for pharmaceuticals is now complete and internal discussions are underway. A component of the recent HD week (fall 2008) was dedicated to “Governance and Accountability: Issues, Diagnostics, and Implementation Tools for Health”.

- **Strengthening accountability**: The Bank is also taking action to re-enforce the accountability of managers on all sides of the matrix with respect to their respective areas of responsibility.

5. **Specific actions in response to the Volcker Panel Report**. Management also took swift and proactive actions in response to the recommendations in the Volcker Panel Report (Management’s Response is referenced in footnote 15 to this Report), with actions already implemented on 16 of the 18 recommendations (with the remaining two well underway). These actions have gone a long way to transforming INT from a segregated and rather insular function to a core part of the Bank in its fight against corruption. INT has rapidly moved toward the core of operations, without, however, losing its independence as one of the central control units that forms an essential part of the Bank’s internal control system. Key among these transformative actions are:

- elevation of the INT head to a VP level
- the establishment of a PSU within INT, which has as its major role the dissemination of the results of INT’s investigative work, and collaboration with operations to build these lessons into project design
- revision of INT’s disclosure policy relating to its work, thus making its findings and lessons that can be drawn from it much more accessible;
- the establishment of a very close relationship and partnership between INT and the operational complex through, in part, its close partnership with OPCS and the regions;
- inclusion of INT in Bank-wide senior management dialogue and reviews through INT participation in Operations Committee reviews and OVP meetings
- INT assistance to task teams that seek its advice, and increased training and learning on fraud and corruption issues carried out across the Bank in close partnership between INT, OPCS, PREM, and the regions
- the establishment of the Independent Advisory Board which is an important tool for confirming and building confidence relating to fairness and effectiveness of INT work.
6. The new INT strategy, to be discussed with the Audit Committee in January 2009, also emphasizes this transformation and charts a road ahead to maintaining and deepening the role of INT as a core part of the Bank while maintaining its independence.

7. **Actions and examples of country-level and project work.** As management also reported in its GAC Implementation Progress Report, discussed with the Board in October 2008 (see footnote 2), much work has been done to mainstream the GAC agenda at the country level. Specifically, 27 countries are now participating in the CGAC program, which allocated specific additional resources of $100,000 per participating country to identify, deepen, systematize and mainstream engagement on governance and anti-corruption at the country level. The CGAC initiative has resulted in development and refinement of systemic diagnostics of governance challenges and reflection of these issues in CAS for several countries. As indicated in Table 1 of the GAC Progress Report, GAC issues were adequately integrated in 64% of CASs discussed with the Board in FY 2007/08, with 32% (a jump from 19% compared to CASs discussed in FY 2006) of the CASs rated “high” in terms of providing a diagnosis of governance conditions and corruption risks. Indeed, engagement on governance and anti-corruption issues has increasingly become a part of the process for CAS design and preparation and its content. In countries where corruption issues have surfaced in the context of Bank projects, there have been serious and concerted responses at the CAS level. Examples include the CAS update in Kenya, following the DIR for health and education, and the recent Indonesia CAS which has GAC as its centerpiece. Recent examples of CASs that specifically address GAC issues also include the India CAS and the Zambia CAS, which are particularly striking in the candor and depth in how these key issues are addressed. In many other countries which have not yet gone through the C-GAC process, GAC issues also feature prominently in the CAS. In addition, issues of governance and fraud and corruption are increasingly permeating project design and are reflected frankly and comprehensively in project documents, including in specific Governance and Accountability Action Plans (GAAP) Annexes (see for example the Water and Sanitation Service Improvement Project in Kenya (P096367); Federal Roads Development Project in Nigeria (P090135); National Vector Born Disease Control and Polio Eradication Support Project in India (P094360); ID-BOS KITA Project in Indonesia (P107661); Second Health Sector Support Program in Cambodia (P102284)).

8. **Specific actions to strengthen and enhance operation and controls relating to the procurement complaints data base.** Improvements and enhancements have been made to the Bank’s complaints system, which now has enhanced controls relating to complaints entry into the data base and the tracking of follow-up actions. The procurement complaints database has been made a key control and management tool starting in FY07. Since then, OPCPR has been monitoring quality of data and documentation entered in the system and has followed up with the RPMs on its analysis and findings. In addition, enhancements have been made to Web-based Complaint Application on a continuous basis and with full support of the Procurement Sector Board. Specific improvements include: a distinction between complaints related to prior versus post review contacts; facilitation of end-users monitoring of complaints and complaints analysis, through expanded export capacity of the system to Excel sheets; revision of drop-down lists to better reflect the nature of complaints and to allow detection of trends; revision of drop-down lists on the resolution of the complaints (e.g. misprocurement, cancelation) for more accuracy in definition and analysis; automatic reminders to staff to seek RPM clearance when closing complaint cases in the system; automatic alerts to remind TTL, PS/PAS and RPMs of
long pending cases; automatic monthly reports to RPMs on the cases pending longer than 75 business days; and automatic alerts if complaints are pending on projects that are about to close. OPCPR has also strengthened monitoring of complaints follow-up by (i) tracking complaints related to late payments directly with the regions, and (ii) preparing and providing quarterly/semi-annual monitoring reports to procurement senior management.
THE WORLD BANK

IDA: INTERNAL CONTROLS REVIEW:

MANAGEMENT ASSESSMENT FY08

PART II REPORT

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ANNEX A: ENTITY LEVEL CONTROLS

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Executive Summary

1. As set out by the Commission of Sponsoring Organizations of the Treadway Commission (COSO), under the COSO internal controls framework, Management is responsible for establishing and maintaining an effective internal control system. In line with the Scoping Memo of its assessment of internal controls over the International Development Association’s (IDA) operations and compliance with its charter and policies, during Part II, Management focused on: (i) entity-level controls, (ii) outstanding transaction-level controls deferred from Part I, and (iii) whether the internal control framework over IDA operations provides Senior Management and the Board reasonable assurance that they are made aware, in a timely manner, of the extent to which IDA is moving toward effective and efficient use of its resources in meeting its operational objectives.

2. As a result of this work, and work conducted during Part I, Management concludes that entity level controls combined with transaction level controls are adequate to provide reasonable assurance to Senior Management and the Board that:

- IDA’s published financial statements are being prepared reliably;
- IDA carries out its operations in compliance with the relevant provisions of its Articles of Agreement and operational policies and procedures; and,
- They are made aware, in a timely manner, of the extent to which IDA is moving toward effective and efficient use of its resources in meeting its operational objectives.

3. While the Bank’s control environment, risk assessment, control activities, monitoring, and information and communication components of its internal controls framework (as defined under COSO), are deemed to be overall positive, the review pointed up several areas of opportunity for enhancing and strengthening these areas as follows:

A. Control Environment

- Raise staff awareness about appropriate behavior, including providing unit specific voluntary training by staff from the Office of Ethics and Business Conduct (EBC) and online training on ethics issues;
- Strengthen emphasis on ethics and internal controls in HR tools, such as job descriptions and performance evaluations, and review incentives to encourage staff to identify and report corruption-related activities;

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2 Details for the rationale for the assessment can be found in the “Report from the Executive Directors of the International Development Association to the Board of Governors, Additions to IDA Resources: Fourteenth Replenishment, Working Together to Achieve the Millennium Development Goals,” (approved by the Executive Directors of IDA on March 10, 2005), paragraph 39, under the Disclosure bullet.
3 Management’s work on supplemental transaction-level controls deferred from Part I are covered in a separate report, Annex B.
ANNEX A: ENTITY LEVEL CONTROLS

- More systematic feedback from the Department of Institutional Integrity (INT) to Management needed regarding underlying control deficiencies to facilitate real-time adjustments to project implementation;
- To deter inappropriate and improper behavior, consider measures to communicate, on a case-by-case basis, some instances of such behavior;
- Strengthen the linkage between performance evaluation and individual accountability;
- Improve the alignment of staffing levels and skills mix to changing client needs, shifts in demand, new practices, and emerging corporate needs;
- Improve incentives to staff to work across sectors or to address inter-sectoral issues, and strengthen linkages of such incentives to the achievement of the goals of the institution;
- Review areas where the work of central control units could benefit from greater coordination, rationalization and aggregation, and those activities, created to address specific problems, that are not closed in a timely manner, as these may lead to “mission creep”;
- Follow-up on staff survey results (e.g., staff dissatisfaction over rewards for job performance, feedback to strengthen OPE process, etc.); and,
- Note that the Board has identified issues relating to the Board’s internal governance and has commenced a review to strengthen its controls.4

B. Risk Assessment

- Assess mechanisms for linking systemic risks identified from time to time with objectives, initiatives, and business processes, opportunities for alignment and coordination across the institution
- Consolidate risk identification processes and analyses prepared by various units, including the review of reputational and political risks, and identify ways to rationalize and improve effectiveness and efficiency of checks and balances provided by the central control units;
- Introduce measures that would improve timeliness and accuracy of risk identification and information sharing within the task team and between management and staff;
- Explore various mechanisms for better risk aggregation and assessment/ review rationalization, including mechanisms in place to validate and prioritize key risks for monitoring and testing as well as defining opportunities for improvements to controls and management activities; and
- Better sensitization of staff and Management to risks to information security posed by password policy breaches.

C. Control Activities

- Review policies and procedures to determine if they can be made less burdensome, including looking at controls over the administrative budget;
- Review oversight of AAA processes, as well as scope for OPCS, CSR, and ISG to work together more efficiently;
- Review controls relating to decentralized procurement; and
- Mainstream and integrate fraud and corruption issues into daily operations (as set out in Management’s Response to the Volcker Panel Report).

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4 See “Report to the Board from COGAM green sheet,” July 11, 2007 meeting.
D. Monitoring

- Issues identified were similar to those in control environment and risk assessment sections above.

E. Information and Communication

- Improve data systems to reduce manual intervention and facilitate recovery of consistent aggregated numbers by business units, and their reporting on these to Senior Management and the Board;
- Include in the rationalization of central control units a review of the similarities of information each one gathers or requests from business units, whether these need to be separately collected from business units each time, and how improvements could be made in the timeliness of the transfer of information from business units to central control units;
- Improve user-friendliness of systems and technology links to decentralized offices; and
- Strengthen compliance of business units to unit level business continuity plans.

4. The above conclusions, identified areas for improvement, and recommendations are based on work undertaken throughout the assessment, with particular emphasis on Part II. In this regard, the scope of Management’s work and details of assessment activities undertaken during Part II, including its approach to each activity and methodologies followed to complete such work, as well as specific findings overall (organized by COSO component, to facilitate its review work), are described in the sections that follow.
ANNEX A: ENTITY LEVEL CONTROLS

I. Scope

A. COSO Control Framework

5. As it has throughout this assessment, during Part II management followed the Commission of Sponsoring Organizations of the Treadway Commission (COSO) definition of internal control,5 namely, a process affected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the three COSO categories of financial reporting, compliance and operations. Management assessed internal controls related to these three objectives against different expectations, an approach that was consistent with COSO. In the context of the financial reporting and compliance objectives, which are primarily within IDA’s own control, management assessed whether IDA’s internal control system can be expected to provide reasonable assurance that IDA’s financial reporting is reliable and that IDA carries out its operations in compliance with its charter and operational policies. In the context of the operations objective, however, which is not always within an entity’s control, management assessed whether the internal control system in place provides “reasonable assurance only that management and, in its oversight role, the Board, are made aware, in a timely manner, of the extent to which IDA is moving toward its operations objectives.”6 It is important to note that the distinction between the operations and the compliance and financial reporting objectives was not reflected in the Part II Scoping memo, which set the operations objective in terms of “assessing whether internal controls over IDA operations provide reasonable assurance to senior management and the Board that IDA’s operations are carried out efficiently and effectively”. Management determined the need for this revision upon a closer review of the COSO report which it used to guide its entity-level work relating to this objective. As explained in the COSO Report, since the operational objective is not always within the entity’s control, all the internal control system can provide is a “reasonable assurance ... that management and, in its oversight role, the Board, are made aware, in a timely manner, of the extent to which an entity is moving towards its operations objectives.”6 This is especially important for IDA, given the many factors outside IDA’s control that may and often do affect the development impact and effectiveness of IDA’s operations. Since this review is likely to become a precedent and set standards for similar work inside and outside IDA, it is important to set a realistic standard for the operations objective in line with the COSO approach. The following is a summary of the scope and methodology followed by management in assessing each of the three objectives against these expectations.


6. Since 1997, management has annually asserted and received attestations from the external auditor that it maintains an effective system of internal controls over external financial reporting for both IBRD (International Bank of Reconstruction and Development) and IDA. The work undertaken by management, and attested to by the external auditor, during the FY07 Internal Controls over Financial Reporting (ICFR) process is described in the annexes to management’s assertion and the external auditor’s attestation for FY07.

C. Compliance with Applicable Laws and Regulations

7. The corporate entities for which the COSO framework was developed are subject to specific laws and regulations in their respective jurisdictions. IDA’s status as an international organization with immunities and privileges makes this COSO category not directly applicable. However, in addition to its charter (i.e. its Articles of Agreement) IDA has a body of internally generated policies and procedures with which it needs to comply. Management has therefore interpreted compliance with laws and regulations to mean compliance with IDA’s (i) Articles of Agreement, and (ii) operational policies and procedures.

8. Management’s assessment of IDA’s compliance with relevant provisions of its Articles of Agreement and operational policies and procedures was carried out in two parts. During Part I management focused on transaction-level controls relating to compliance with (i) provisions of the IDA Articles of Agreement, as interpreted from time to time by IDA’s Executive Directors, relating to the management of IDA’s lending operations, including provisions relating to the use of funds for intended purposes; and (ii) internal operational policies and procedures relating to the management of IDA’s lending operations. The results of this assessment are set out in management’s Part IB report. During Part II, management assessed entity-level controls relevant to compliance with the Articles of Agreement and operational policies and procedures linking these to the transaction-level controls relating to compliance identified and assessed under Part I (as supplemented by the additional transaction-level work completed during Part II and set out in Annex B to the overall report).

D. Effectiveness and Efficiency of IDA’s Operations

9. Part II of management’s assessment has focused on whether internal controls over IDA operations provide reasonable assurance to Senior Management and the Executive Directors that they are made aware, in a timely manner, of the extent to which IDA is moving toward effective and efficient use of its resources in meeting its operational objectives. The transaction-level assessment under Part I yielded important findings that had a significant bearing on, and were reflected in, the overall assessment of internal control over effectiveness and efficiency of operations. The findings and recommendations of this assessment, and the detailed methodology are set out in the Methodology section of this report.

10. In summary, the main tools utilized by management in carrying out an assessment of entity-level controls relating to efficiency and effectiveness of operations included:

- assessment of the Board’s function;
- preparation and assessment of the ELC Questionnaire (ELCQ) that addressed the five COSO components (control environment, risk assessment, control activities, information and communication, and monitoring and evaluation) as well as anti-fraud and corruption controls;

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7 As explained in paragraph 5, this represents a revision from the formulation of this objective in management’s Part II Scoping memo and aligns it more closely with the COSO standard for this objective.

8 A paper prepared by LEG and SECBO on the Board’s Role, Procedures, and Decision-Making is the Attachment to this Annex.
ANNEX A: ENTITY LEVEL CONTROLS

- review and assessment of the terms of reference, key outputs (including the main recommendations) of the central control units, including documentation and review of the current budget process;
- review of decentralized operations;
- review of application and general computer controls related to information technology;
- documentation and review of the current processes for identification, formulation, approval and implementation of policy revisions needed to reflect changes in IDA’s strategy, priorities, operational model, and identified risks, and
- integration of findings relating to effectiveness and efficiency from transaction-level work conducted under Part I, and particularly findings regarding inefficiency of current processes governing IL operations and work done under Part I to identify and review current processes and tools in place to monitor and report to senior management and the Board at various stages on progress of projects and programs supported by IDA toward achieving the agreed outcomes (both at the project level and at the country level).

II. METHODOLOGY

11. During Part II Management conducted six major reviews that helped Management determine how IDA entity-level controls are functioning, and whether and where there are areas for improvement. Specifically, these were: (a) an examination of the role of the Executive Directors in IDA’s Internal Control Framework, (b) a review of responses to the Entity Level Controls Questionnaire (ELCQ) filled out by all senior managers at the unit level, (c) an analysis of the role of Central Control Units, (d) a recapitulation of the Budget Process used to allocate resources in support of objectives, (e) a review of the operation of controls in Country Offices, and (vi) a review of controls exercised through Information Technology (IT) systems. In addition to using these tools, Management also reviewed key findings from the most recent annual reports from Central Control Units, the Volker Panel Report and Management’s Response to this Report, the India Detailed Implementation Review (India DIR) and Management’s Response, the Staff Survey of 2007, the Risk and Opportunity Workshops (ROWs) and the most recent Risk Scan run by CSR to supplement findings from the above.

A. Assessment Activities

1. Examination of the role of the Executive Directors in IDA’s internal control framework

12. Consistent with the scoping memo for Part II, management has conducted a review of the role of the Board of Executive Directors (the “Board”), its procedures, and decision-making tools. The Legal Vice Presidency (LEG) and the Corporate Secretariat (SEC) were responsible

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9 These include: progress reports on implementation IL and DPL operations (ISRs) and CAS progress reports, and completion project, DPL and CAS completion reports, as well as IEG evaluation of each ICR, CAS completion reports as well as country and thematic evaluations.

10 See paragraphs 13-19 for a brief description of the ELCQ and the methodology used to review responses received from unit-level managers.

11 See footnote 16 to the Report.

12 See footnote 11 to the Report.
ANNEX A: ENTITY LEVEL CONTROLS

for preparing the document (the “LEG/SECBO Note”, the Attachment to this Annex), which summarizes: (a) the primary control functions of the Board (consistent with its responsibilities under IDA’s Articles of Agreement, as interpreted through various decisions, legal opinions and other means); (b) the main tools, structures and other means for carrying out these functions (including a summary relating to the Board’s committees and their respective roles and functions, types of meetings and other means for deliberation and decision-making; types of Board documents and disclosure regime that applies to the main ones); (c) rules of conduct that apply to Executive Directors and their staff; and (d) more specific information regarding the function/role of the Audit Committee, which has the primary mandate for assisting the Board in overseeing IDA’s financial condition, risk management and assessment processes, the adequacy of governance and controls, and reporting and accounting policies and procedures.

The Board under the auspices of COGAM is currently looking into broader governance issues relating to the role of the Board. While management expects that this review would result in important findings and possible recommendations for improvement in various areas of Board operations, it does not expect the review to identify major gaps or weaknesses in the Board’s function. Management is therefore of the view that COGAM’s review is unlikely to have a material negative impact on management’s current assessment that the Board is functioning properly and is providing the appropriate governance and oversight of IDA’s operations.

2. Review of responses to the ELCQ

13. Background: Questionnaire design. Management developed the ELCQ as its main tool in assessing entity-level controls. The ELCQ was based on the COSO Questionnaire used by IDA’s Controller in conducting the annual ICFR exercise. In developing its ELCQ, Management supplemented and expanded the COSO Questionnaire, drawing on information from the public accounting profession and the U.S. Government Accountability Office (GAO).

14. ELCQ coverage. Consistent with its overall approach, the ELCQ was divided into sections that corresponded with the five COSO components of internal control: control environment, risk assessment or fraud risk assessment, control activities, monitoring, and information and communication. The five sections contained a total of 145 questions (one question, #56 was broken down into 3 sub-questions (a, b, c)) designed to facilitate Management’s assessment of the Bank’s entity-level controls. These were later supplemented by 12 additional questions that focused specifically on the area of anti-fraud and corruption.

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13 The work on LEG/SECBO Report was prepared and coordinated by Dirk Mathiesson, Manager (SECBO) and Natalie Lichtenstein, Assistant General Counsel (LEG) with assistance from Elisabeth Marmolo, Senior Board Operations Officer (SECBO) and Alex Iorio, Lead Counsel (LEG).

14 The Note prepared contained specific descriptions: for example, with respect to operational policy and strategy, the Board sees, inter alia, policy and sector papers; operational policies; country assistance strategy documents; poverty reduction strategy papers and joint IDA-IMF staff advisory notes; general operations (that is, credits, guarantees, and IDA grants). In addition the Note said the Board carries out monitoring and evaluation activities, including reviews by an independent evaluation group (IEG), an Inspection Panel (with respect to certain issues raised by third-parties); and it has a policy on disclosure of information to external parties. Finally, the LEG/SECBO Note pointed out that the rules and practices of the Executive Directors have been continually revised and updated, generally through the mechanism of a Board review of procedures. The most recent review was in the 2005 Report entitled Board Effectiveness: Making Board Decision-making Processes More Efficient.

15 COSO published a report in 1994, “Internal Controls – Integrated Framework,” Executive Summary. The report is widely referred to by leading financial institutions in the United States and is also seen as a model in many other parts of the world. IDA adopted the COSO framework as its controls methodology in 1995.
brining the total of questions to which responses were sought to 157.16 The questions covered topics suggested in the COSO paper intended to facilitate evaluation exercises.17

15. **ELCQ launch.** The ELCQ was launched at a meeting of the Operations Vice Presidents (OVPs) that was co-chaired by the two operations Managing Directors (MDs) Graeme Paul Wheeler (MDW) and Juan Jose Daboub (MDD). The ELCQ was sent to the managers responsible for department-level functions at the Senior Management level: Managing Directors, Vice-Presidents, and Heads of the Quality Assurance Group (QAG), Internal Auditing Department (IAD), Department of Institutional Integrity (INT), General Services Department (GSD), Inspection Panel, and IEG. OPCVP, CSRVP and the project team18 briefed managers on the context, process, method, and timelines of the questionnaire process. They asked respondents to apply informed judgment in filling out the questionnaire, while selecting one of three responses to each question: “yes,” “no,” or “not applicable (N/A),” except for 16 questions (Q95-Q110), which only IEG, QAG, and OPCS were asked to answer. They also asked participants to substantiate their responses by describing, commenting on, or providing tangible examples of unit or institutional-level actions, practices, or outputs that showed how the issue was addressed, or to record what they observed regarding any problems or gaps.

16. **Review of responses.** In reviewing responses to the ELCQ, including those that were subject to updates by unit managers,19 the project team took a phased and analytical approach: the team summarized individual questions within each component, analyzed them, and then prepared overall summaries for each COSO component. In preparing both the question-by-question summaries and the overall component summaries, the team included relevant responses from the ICFR process. In reviewing the responses, the team considered whether responses were given from a unit perspective, from the perspective of the institution as a whole, or both. Responses were also classified according to whether they positively reinforced any control(s) referred to in such questions, or whether they reflected control weaknesses. The team then accumulated responses signaling weaknesses or gaps to consider whether IDA’s objectives in a given area were negatively affected. The review process outlined above is explained in further detail in the next few paragraphs.

17. The team conducted follow-on interviews with representatives of individual units that responded to the questionnaire to (a) spot-check Management’s responses to the questionnaire; (b) obtain additional inputs and insights on issues that the project team had identified as needing clarification; and (c) gather any additional information that was not captured in the questionnaire responses. The project team also used these interviews to obtain clarifications on

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16 Early in the process, the project team had realized that the limited number of antifraud- and anticorruption-related questions would not provide sufficient information to allow the project team to form conclusions in this area. Consequently, 12 supplemental questions were added and were attached to a reminder about the deadline; a later deadline was set for the additional set of questions. This brought the total number of questions to 157.


18 The team, led by Galina Mikhlin-Oliver (OPCS) and Yanni Liakakis (CSR), included Rui Manuel Coutinho and Anna Pinto Hebert (OPCS), and David Mead (consultant, OPCS).

19 Following one-on-one interviews or email exchanges with the project team, the senior managers in the following units updated their responses: MDW, Africa, IAD (twice), INT, IEG, GSD and QAG. These updates were important to the project team objective of accumulating relevant and pertinent information.
positions/ responses that were markedly different from those provided by other units; in this effort they sought a better understanding of whether Management as a whole considered entity-level controls to be in place, and whether “outlier” positions were voiced from sources that were closer to the practice of entity-level controls (such as those exercised by central control groups) and thus had a bigger impact on these controls than others. Interviews conducted:

- Africa and South Asia management representatives (these Regions represent the substantial portion of IDA lending)
- IAD (twice), IEG, and INT management representatives (these units are key central control units), and
- HRS management representatives (this unit is a major FAC unit whose activities directly affect staff)

18. Using all the information gathered, the team summarized each question. They applied professional judgment to (a) weigh the importance and source of caveats to capture them in the summaries, (b) substantiate “glass half-full” or “glass half-empty” responses, as applicable, and (c) identify areas in need of improvement. The team then prepared summaries by COSO component based on response received with conclusions on entity-level controls based on the key criteria specified by COSO. As the project team drafted its overall summaries, the team accounted for responses specific to the following units:

- **IEG**: IEG gave “N/A” responses to questions on areas that IEG has not evaluated, since its unique professional standards require that its opinions be based on evaluations.
- **SAR**: SAR intended its “In principle …” responses to be interpreted as positive, with the caveat that while controls or actions referred to in the questions are in place, Management actions or processes in these areas need strengthening. For example, its response to Q#115, “Are desired internal control actions followed up on to implementation?” SAR management responded, “In principle. Through follow up by IAD, QAG and others.” During a one-on-one interview, the manager confirmed that SAR management believes this area indeed needs more monitoring.
- **INT**: Responses that contained both “yes” and “no” statements differentiated INT’s opinions on how half of the response applied to INT as a unit, and how the other half applied to the Bank as an institution.
- **IAD**: Responses that had “?” marks meant that it was unclear to IAD whether its response would be “yes” or “no” for the institution.

19. **Iterative Process.** As might be expected in such a complex exercise, issues and topics surfaced unevenly and at various points throughout the review process. The team also found that the preliminary concepts, components, and criteria it developed from initial data evolved over the course of the review, or as more information was gathered. Consequently several phases were revisited as information and analysis evolved, or as gaps in the information being collected became apparent.

3. **Analysis of central control units and their role in IDA’s internal controls framework**

20. Based on a definition of what constitutes a central entity level control unit in COSO (discussed and agreed with IAD and IEG), namely “A central control unit is an oversight/monitoring unit that performs ex-ante (guidance setting and review of process design) and/or ex-post activities (monitoring/ reviews/ audits) independent of the business
ANNEX A: ENTITY LEVEL CONTROLS

unit being reviewed, to assess the quality and compliance as well as the efficiency and effectiveness of IDA business units’ activities and processes,” Management identified ten central control units and classified these under the following three categories:

Management Activity
Office of Ethics and Business Conduct (EBC)

Management Oversight
Controller’s group (CTR); Controller’s, Strategy and Resource Management Department (CSRRM); Corporate Strategy and Integrated Risk Management (CSRSI); Operations Policy and Country Services (OPCS); Quality Assurance Group (QAG)

Independent Oversight
(i) Reporting to Senior Management and Audit Committee:
Department of Institutional Integrity (INT); Internal Auditing Department (IAD);
(ii) Independent of Management: Independent Evaluations Group (IEG); and the Inspection Panel (IPN).

21. For each control unit, the oversight authority was identified based on the organization chart of the World Bank, information on its website or in its reports or by asking the unit itself. Terms of Reference (TORs) and key reports prepared by each control unit were obtained (the most recent available, which was November 2007 in most cases), as well as the primary audience for each report identified.

22. Each report was reviewed to identify the main areas of coverage and objectives of the report, the main observations, findings and recommendations made and the response by Management to such findings or recommendations, if any.

23. Clarifications and follow-up were sought from staff in the control unit where deemed necessary, usually as part of the OPCS/CTR follow-up interviews/drill-downs on the ELCQ (specifically in meetings with CTR, IAD, INT, and IEG). A matrix setting out the work performed above for each central control unit was also sent to the relevant unit for review and the matrix was updated to reflect the input received.

24. Management mapped each central control unit by COSO component and examined any potential linkages, gaps, overlaps between the roles and outputs of the groups in question and any other issues.

4. Recapitulation of the Budget Process used to Allocate Resources in Support of Objectives

25. In undertaking a recapitulation of the Budget Process, Management noted that while all business units are responsible for ensuring the efficient use of IDA resources in their day-to-day activities, the Controllers, Strategy, and Resource Management department (CSRRM or CRM for short) is the central control unit tasked with ensuring the appropriateness of inputs to enable the Bank through its various business units to achieve the desired outcome. Management found this is achieved through the annual budget allocation process and monitored using the Quarterly Business Review (QBR) process.
26. With CRM’s assistance and existing descriptions and documentation of the budget process, Management analyzed the entity level FY08 budget process carried out in FY07. All key documents were identified and reviewed to ascertain how the budget process allocated resources in support of the corporate and business unit strategies. Management verified that evaluation criteria including benchmarks, historical trends, internal and external comparators, and other knowledge available to the central staff have been rigorously applied to the budget process. This process was then verified with CRM staff.

27. Because of changes in Senior Management in late FY07, the FY08 budget process deviated in significant respects from the planned process: e.g., the FY08 Budget was approved in absence of a multi-year resource framework, allocations to VPUs were significantly delayed resulting in the country-level detailed plans being delayed into FY08, and major components such as the Governance and Anti-Corruption (GAC) agenda were being defined well into FY08. Management noted where these delayed steps had a significant impact during its review. Finally, since the FY09 budget process is already underway with a different approach to objective setting, it is expected that some of the FY08 objectives will be revised during the current year.

28. In undertaking this recapitulation of the Budget Process, Management noted that it recently reviewed with the Board the current state of the budget process and its proposed action plan to make the process even more effective and transparent in the future. Details on this effort were described in the Board paper: “Improving the Planning, Budgeting and Performance Management Process,” dated October 9, 2007, incorporated into this review by reference. Management’s review therefore focused on describing the FY08 budget planning process from a COSO perspective, and specifically on the entity level processes to allocate resources in support of corporate and business unit strategies and not on the related sub-entity unit specific level processes. With regard to the latter, Management noted at the outset that the budget process was heavily country-driven and that the controls surrounding the Country Assistance Strategies (CASs) have been reviewed and assessed during Part I.

5. Integrating Part I findings relating to efficiency and effectiveness

29. While Part I focused on assessing a compliance objective at the transaction level, it also included a review of processes and tools that have a direct bearing on and/or are used to monitor efficiency and effectiveness of IDA’s operations. These include: (a) review of processes underlying IDA operations and a finding regarding their inefficiency and the need for introduction of a risk-based approach as a basis for their rationalization, and (b) review of current processes and tools in place to monitor and report to senior management and the Board at various stages on progress of projects and programs supported by IDA toward achieving the agreed outcomes (both at the project level and at the country level). These tools and processes

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20 Staffing plans are not part of the budget process (or this review), although they are monitored independently. Management also did not review how Trust Funds are allocated to complement the Bank’s budget in achieving objectives. It is important to note, however, that Management has recently developed, and the Board has approved, a new framework for the management of Trust Funds which envisages integration of budgetary and BETF (Bank Executed Trust Fund) resources; in this regard, information on BETF is now included in all budget related reports as a first step.

21 CRM staff consulted included Grant Cameron, Adviser, CRM; Marie H.R. Bakker, Manager, CRM and Glenn Miles, Director, CRM.
include instruments for reporting progress (ISRs and CAS Progress Reports), self-evaluation at completion of CASs and projects (the ICRs and CAS completion reports), independent evaluation of all completion reports by IEG as well as thematic/sector, country, and instrument evaluations by IEG. We have also examined IAD and QAG reports that are relevant to the question of monitoring and reporting, including in particular the recent IAD audit of supervision reporting that focused on project ISRs.

6. Fraud and corruption

30. Upon IAD’s recommendation, during Part II, Management: (a) assessed controls over fraud and corruption at the entity-level through the ELCQ, including controls to ensure that issues identified by fraud\(^{22}\) and corruption investigations are adequately addressed; and (b) linked, as appropriate, the entity-level fraud and corruption controls identified to the process or transaction-level controls designed to prevent or detect fraud and corruption. As a result of this work, Management developed a listing of specific fraud and anti-corruption controls that have been identified at the transactional as well as entity levels. In performing its assessment, Management considered the findings contained in the Volcker Panel Report relating to fraud and corruption controls specifically and the impact of these findings on the entity-level controls more generally.

7. Review of the operation of controls in country offices

31. IEG recommended and Management agreed that decentralized operations were an increasingly important part of IDA’s operational model and, therefore, should be included in the scope of the overall assessment. To this end, the application of internal controls over IDA operations at the Country Office (CO) level have been reflected in the work completed to date at the transaction level as follows:

- During the review of internal control over financial reporting (ICFR), Management confirmed and the external auditor attested that: (i) all significant disbursement and procurement transactions include those from COs and are captured in the Bank’s systems and tested from headquarters; and (ii) all disbursement approvals are performed in headquarters and all related controls have been tested in headquarters.
- During Part I of the IDA Internal Control Review, the document sample used to perform compliance testing of processes and key controls that apply to the Country Assistance Strategy (CAS), Investment Lending (IL), and Development Policy Lending (DPLs) specifically included transactions (operations) that were task-managed from COs and/or documents that were initiated, prepared and/or reviewed in COs; and
- During Part II, Management:
  - Included specific questions in the ELCQ related to country offices in order to assess whether and how the application of the COSO components of IDA’s internal controls framework extends to these offices; and

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\(^{22}\) Management followed the definition of “fraud” in SAS 99: “...an intentional act that results in a material misstatement in the financial statements that is the subject of an audit. Two types of misstatements are relevant to the auditor’s consideration of fraud – misstatements arising from fraudulent financial reporting, and misstatements arising from misappropriation of assets.”
32. At the conclusion of these reviews, Management found three main areas needing improvement:

- Areas of project supervision, especially project supervision reporting
- Processes and controls in the Procurement; and
- Processes and controls over the Financial Management (FM).

33. These issues are consistent with those identified during the compliance testing and quality reviews of the Procurement and FM processes (please see Annex B for details).

8. Review of controls exercised through information technology (IT) systems

34. During Part II, Management assessed the key IT controls supporting IDA operations. This assessment included all major IT systems used by Bank staff in performing activities related to IDA. The majority of these systems were reviewed during the FY07 ICFR.

a. Integrated systems reviewed

35. In order to ensure that all IT controls related to key processes have been reviewed, Management identified the entire population of integrated IT systems and individual databases used by business units to support IDA’s operations together with the specific business process, the supporting underlying system applications and the applicable underlying technology or software being used. These applications were further reviewed against the objectives of: (a) application systems implementation and maintenance; (b) information systems security; (c) information systems operations; (d) systems software support; (e) network support; (f) database implementation and maintenance; and (g) transaction level controls.

36. These objectives were reviewed and associated controls tested for all the identified key IT systems during the FY07 ICFR review to assess whether such internal controls are adequate to ensure their operating effectiveness. During this review no material weaknesses were identified. However, certain processes surrounding password policy breaches, information security rationalization and monitoring of changes, and change management controls were identified as significant deficiencies requiring Management’s attention.

b. Non-integrated systems identified and reviewed

37. During Part I Management found that many of the process controls that apply to IDA operations at the transaction-level (and particularly to the processes of CAS, IL and DPL) are not automated or do not otherwise entail consistent IT support. The linkage between this finding and the issue of document accessibility identified in Part I have led to the establishment of a working group to look into automation of work flow documentation and controls. Since this relates to future work, there is little that can be assessed during Part II. The one area where limited automated controls were introduced relates to the IT controls relating to supervision reporting through the Implementation Status and Results Report (ISR).
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38. In addition to the integrated IT systems and their related controls reviewed during the ICFR, Management identified the processes that required a certain level of system technology, and assessed their impact on internal controls. Management found that the following processes/systems were either not yet operational or fully integrated systems or were not being consistently updated by Regional staff:

- ISR;
- RAPMAN-PRIMA – the regional integrated FM Portfolio & Risk Management Application for monitoring critical aspects of FM project performance and portfolio management tool;
- Audit Reports Compliance Database (ARCS) – the tool monitoring Bank-wide audit compliance; tracking project audit reports due, timeliness, qualifications etc; and audit compliance data is an important indicator of Project FM performance; and
- Procurement Complaints Database – the Regions’ system for logging procurement-related complaints as well as for tracking pending complaints etc.

39. Management believes that all of the above systems warrant further review and/or redesign in order to be assessed as entity-wide processes and reviewed for their design and operating effectiveness. Management has included the issues related to these systems as deficiencies arising from Part II and included them in the final deficiency tracker shared with IEG and IAD, with appropriate action plans.

9. Response to recommendations for Part II Work in the IEG Part IB Evaluation Report

40. In developing the tools above and in considering findings from other reviews, Management also considered recommendations contained in the IEG Evaluation Report on Part IB. To address these issues, as suggested by IEG, Management tied its findings in these areas to COSO components as follows:

- To address non-compliance occurrences in transaction-level controls that were found during Part IB, and to determine whether these were mitigated, Management linked entity-level controls review work during Part II, which included (i) its reviews of responses to the ELCQ, (ii) the analysis of Central Control Units, (iii) the examination of the role of Executive Directors, and (iv) the review of Country Offices to the non-compliance occurrences. In particular, Management captured its findings in the overall summary on the Control Environment at the entity level, where greater management oversight may be called for.

- To address the significant deficiency found regarding document retention and accessibility, Management linked recommendations from a special Task Force that was put together to examine this area, to controls captured in both the Control Environment and Information and Communications areas at the entity level, where improved IT systems may be part of the solution.

- To address the potential material weakness identified in Part I regarding dated Operational Policies (OP)/Bank Procedures (BP), Management linked process mapping work and its

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24 See paragraphs 41-49 for details.
recommendations to improve operations policy updating to controls related to *Control Activities* at the entity level, as they are an essential element of the *Control Activities* component.

- To provide the element of effectiveness and efficiency that was not fully captured in Part I work, Management linked (i) its review of responses to the ELCQ, (ii) its analysis of Central Control Units, (iii) the recapitulation of the Budget process, (iv) a review of controls operating in decentralized operations (in Country Offices), and (iv) additional transactions controls mapping and compliance testing to *Control Environment* and *Monitoring* controls at the entity level, and added resulting analysis from these various pieces to results from Part I.
III. Findings

Entity Level Controls by COSO Component

41. The following represents the key IDA entity level controls/processes identified and assessed by Management during the Entity Level Control Review part of the IDA internal control review. The Entity Level controls have been organized by the five COSO components which also include findings relating to anti-fraud and anti-corruption activities.

A. Control Environment

42. Control Environment provides an atmosphere in which people conduct their activities and carry out their control responsibilities. It sets the tone of the organization, influencing the control consciousness of the staff. It is the foundation for all the other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values and competence of the entity’s staff; management’s philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its staff; and the attention and direction provided by the Board of Executive Directors.

43. These controls/processes/activities help review the tone of the organization and represent the foundation for all other components of internal control. Based on our review of the control environment questionnaire responses, the Bank’s control environment is deemed to be overall a positive one. The review pointed up several areas of opportunity for enhancing and strengthening the control environment, and Management will include them in its overall action plan to strengthen its organizational controls. The Control Environment can be broken down into several distinct parts:

44. Integrity, ethical values, and behavior of key executives. In assessing this part, Management considered responses to the Entity-Level Questionnaire (ELCQ); the Office of Ethics and Business Conduct (EBC) Annual Report 2007; ROWs; the ICFR Questionnaire; the Volcker Panel Report (VR) and Management’s Response to the VR; and the Staff Survey (2005, 2007).

(a) Standards of professional conduct have been codified in the Bank’s Staff Manual and are communicated to staff prior to joining the Bank. New staff are required to sign-off on their understanding of Principle 3 upon reading it as an attachment to the Appointment Letter prior to joining the Bank. A mandatory induction course includes specific sessions addressing the code of conduct and ethical behavior. The Bank’s Code of Professional Ethics (the Code) is currently in the final stages of revision and is expected to be approved by the President shortly. The Bank has ongoing efforts to raise staff awareness about appropriate behavior including providing unit specific voluntary training utilizing EBC staff and online training on ethics issues. The available Ethics training clearly identifies unacceptable behaviors and the penalties that result from infractions. It remains the responsibility of individual staff to understand and uphold the Bank’s ethical standards.
(b) Although Management’s commitment to integrity and ethical behavior is communicated effectively in words, and the Staff Survey (2007) results indicated 81% of staff believe their managers act with honesty and integrity, a few Respondents felt that in deeds it has been less clear [IAD, EBC]. In light of the recent ethics-related situation involving the former President, staff and managers have raised questions (for instance, in their postings on internal communication sites and in their communications to EBC) that this area requires considerable strengthening [EBC, HRS]. A positive outcome is an increased emphasis on ethics training, as an increasing numbers of managers are seeking advice from EBC and are requesting ethics training for their staff.  

(c) Rewards can foster an appropriate ethical tone when given to staff members who accomplish objectives while respecting established policies, procedures and controls. However, because the rewards available to Bank staff (salary increases, spot awards, promotions, and assignments) are limited, they are not considered to have a significant impact in promoting ethical behavior among staff [MDD, EAP, EBC, INT, EXT, HRS]. Although some emphasis is now being placed on behaviors, there is no systematic review of behavior. Far greater recognition is given to results in annual performance evaluations. Management has no reason to believe that the current system systematically rewards the circumvention of established policies.

(d) Management acts to remove or reduce incentives or temptations that might prompt staff to engage in dishonest, illegal or unethical acts by amending and changing internal policies, processes and procedures when required and strengthening controls. However, this area would specifically benefit from more systematic feedback from INT to Management regarding the underlying control deficiencies supporting their findings in order to enable Management to identify systemic issues and correct incentives for misconduct as well as focus attention to these issues by all Bank units. Program integrity requires far more than the effective functioning of INT.

(e) There is also a well-defined and broadly understood process in place to handling employee claims and concerns in a relatively timely manner (always depending on the type of claim or concern). However, the results of reviews/investigations and findings of subsequent misconduct are not always communicated in a Some of these concerns are being addressed by ongoing activities in the accountability and ethics areas, such as emphasis on ethics and controls in the orientation program provided for all new Bank hires and

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25 EBC has identified that the number of staff cases seeking advice on ethical dilemmas and conflicts of interest has increased 77% from FY05 to FY06.

26 In ROWs, staff across the Bank report that they feel individual staff and units are primarily rewarded for specific results such as project delivery to the Board and project completion with less attention paid to the method or quality of these achievements. As an example, INT investigations have identified instances where deficiencies in projects did not negatively impact the staff involved. In their submissions to the ICFR ELCQ, EBC and INT reiterated their concerns that individual staff and units are primarily rewarded for specific results such as project delivery to the Board and project completion with less attention being paid to the method or quality of these achievements.

27 Some issues may take longer given the need to ensure due diligence in the investigation process.
implementation of appropriate disciplinary action in response to departures from approved policies and procedures or violations of the code of conduct pursuant to Staff Rule 8.01. In addition, the Bank has recently amended the Principles of Staff Employment to enhance its current handling of whistle-blowing reports and claims of whistle-blowing retaliation. The new principle and staff rule puts the Bank Group at the leading edge of whistle-blowing protections amongst international organizations, consistent with the highest standards of good governance and the on-going efforts of the Bank to safeguard its integrity and effectiveness. consistent manner, as the need for confidentiality and privacy typically guide the extent to which the specifics of improper behavior are communicated to staff. Disciplinary actions undertaken in response to improper behavior have not in detail been communicated widely (usually limited to staff on a “need to know” basis and senior management) except in very high profile cases. This may result in a sense that the concerns have not been really resolved or that Management does not care to discipline offenders.

45. **Management’s control consciousness and operating style.** In assessing this part, Management reviewed the responses to the ELCQ.

(a) Management endorses the use of performance-based management, which is the key principle VPs use in managing their business units. There have been significant efforts to incorporate performance-based management into planning and monitoring practices with some units using performance-based management in the measurement of annual results through Results Agreements between managers and the VP, and in the OPE discussions.

(b) In the Regions, at the level of the SMUs and CMUs, the Regional Management Team chaired by the Regional VP regularly discusses key performance indicators, including strategic staffing, deliverables and budgets, as well as strategic priorities and program implementation.

(c) At the Staff level, performance management is provided through the OPE process, SRI and promotion decisions. However, the implementation is impacted by HR policies and procedures, which could benefit from a stronger linkage between performance evaluations and individual accountability: for example, job descriptions and performance evaluations do not contain specific references to internal control related duties, responsibilities, and accountability. Although these are sometimes addressed in the individual OPE depending on the staff work program, references tend to be general for most non-managerial positions.

(d) Management recognizes that emphasizing the importance of integrity and ethical values in the performance evaluation process is subject to the abilities of each manager. Although controls are viewed by Senior Management as the

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28 On the broader issue, that is not just confined to internal controls, the Staff Survey 2007 found that assessments on rewards, performance management and career opportunities continue to be persistently weak, with high levels of dissatisfaction over objectivity and transparency.
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responsibility of line managers, line managers vary in their abilities to discharge their control responsibilities. As with all policies related to staff compensation, performance evaluation and promotion, constant monitoring and feedback is required to strengthen them. However, the implementation of this feedback is again subject to the abilities of each manager. For these and other related reasons, the primary focus of the HR Renewal process currently underway is on strengthening performance management in the Bank.

46. **Management’s commitment to competence and adequacy of resources.** In assessing this part Management reviewed the responses to the ELCQ.

- Management is committed to recruiting and maintaining competence (excellence) in staff. However, there is some concern that the current staff levels and skills mix needs to be better aligned with changing client needs and shift in demand. In this connection, it was noted that changes in skills mix in order to meet changing client needs are not easily implemented and continuous effort is required to adapt skills mix to respond to business needs. Staffing levels and skill mix are reviewed and plans adjusted at least annually, and on a quarterly basis in some units. The majority of Respondents to the ELCQ described their departmental staffing levels as appropriate. Several noted that decentralization and time differences impose additional burdens on staff. [AFR, PRM, IAD, CFP, HRS, LEG]. Two control units [JAD, INT] responded that they do not have sufficient resources to complete their work, or in INT’s case to fully deliver on its mandate.

47. **Board of Directors.** In assessing this part, Management reviewed the Paper prepared by LEG/SECBO on the Board’s Role, Procedures and Decision Making, the FY07 COSO Report and ROWs.

   (a) As part of this Part II Entity-Level Control assessment, Management identified the primary functions of the Board, particularly as they relate to “tone at the top,” ethics and culture, and with respect to IDA’s overall internal control framework.

   (b) The Bank has a unique governance structure with a full-time sitting Board. Management is aware that the Board has identified issues relating to its internal governance and has commenced a review to strengthen its controls. In light of ongoing work by the Board in related areas, Management did not go beyond identification of the Board’s primary functions. The paper prepared by LEG/SECBO contained specific descriptions: for example, with respect to operational policy and strategy, the Board sees, inter alia, policy and sector papers; operational policies; country assistance strategy documents; poverty

29 To be reviewed during HR Reform.
30 See Attachment to this Annex, "Board’s Role, Procedures, and Decision Making."
31 See, Report to the Board from the COGAM green sheet, July 11, 2007 meeting.
32 As stated in page 5 of “Management’s Scoping Memorandum, Part II” (Annex C to the Report), Management has noted that a Sub-Group on Governance (SOG) was established by COGAM “to examine issues directly related to the recent leadership crisis, and broader issues of potential risk in other areas of the bank’s governance arrangements,” from Report to the Board from the COGAM green sheet, July 11, 2007 meeting.
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reduction strategy papers and joint IDA-IMF staff advisory notes; general operations (that is, credits, guarantees, and IDA grants). In addition the paper pointed out that the Board carries out monitoring and evaluation activities, including reviews by an independent evaluation group (IEG), an Inspection Panel (with respect to certain issues raised by third-parties); and it has a policy on disclosure of information to external parties. Finally, the LEG/SECBO paper pointed out that the rules and practices of the Executive Directors have been continually revised and updated, generally through the mechanism of a Board review of procedures. The most recent review was in the 2005 Report entitled Board Effectiveness: Making Board Decision-making Processes More Efficient.

(c) A review of the items set out in (a) and (b) above were sufficient, in Management’s view, to provide reasonable assurance overall that the policies and procedures of the Board of Executive Directors are adequate to provide reasonable assurance that the Board is properly functioning and is providing the appropriate governance and oversight of IDA’s operations; with the qualification that Management’s conclusion may need to be revisited after the internal review by COGAM and SOG has been completed, and their findings have been reviewed and analyzed.

48. **Organizational structure and assignment of authority and responsibility.** In assessing this part, Management reviewed the responses to the ELCQ; the Paper prepared by LEG/SECBO on the Board’s Role, Procedures and Decision Making; ROW’s; Risk Scan; the Volcker Panel Report and Management’s Response; and the matrix of the responsibilities of the Control Units.

(a) Key areas of authority and responsibility have been defined and communicated throughout the organization and appropriate and clear internal reporting relationships have been established. The arrival of a new President and appointment of a third Managing Director (MD), together with the realigning of MD responsibilities will require further review in the next year to see whether the role of a MD role will be one of advisor or manager. Decision-making is clearly linked to assignment of authority, and the level of escalation for decision-making is clear with individuals being held accountable by their direct supervisor for decisions. There are several checks in the system including peer reviews, cross matrix management and procedures for adding value and input throughout the process. However, some staff feel accountability can be diffused by the number of reviews and the difficulty in holding staff accountable for projects which have long completion times and may have been assigned to multiple TTLs and managers.

(b) Although most ELCQ Respondents stated that internal reporting relationships were clear, the review of the control units showed some concern that the matrix in the Regions was not functioning as well as it could: Sector Managers say the Country Management Unit is client government driven rather than what will truly enhance development in the country, while Country Managers say that the sectors are protecting their own agendas and staff rather than focusing on the Country Assistance Strategy. The budget process within the matrix is time
consuming. Finally, the ARDE indicated that achieving results in a given sector may require removal of constraints in other sectors, that is, IDA’s matrix management structure does not provide sufficient incentives to work across sectors or to address inter-sectoral issues.

(c) The Terms of Reference and Reports of the Control Units [IAD, INT, QAG, IEG, and CSR] indicated a mission creep and potential overlap of such units.

(d) With respect to decentralized operations, the majority of Respondents believe they are adequately supervised and monitored. However (i) AFR responded that IAD Reports during the last year suggest that oversight in country offices tends to be weaker than in Washington, and (ii) INT investigations and outside reviews and audits have found deficiencies in supervision and monitoring of decentralized operations, with procurement an area of particular concern.

49. **Human resource policies and practices.** In assessing this part, Management reviewed the responses to the ELCQ; ROWs; Risk Scan; and 2005 and 2007 Staff Survey.

(a) The Bank has comprehensive policies in place that focus on assuring that the best candidate is selected for a given position, and that candidates for promotions are approved by both their internal managers as well as external managers to reduce any potential bias. Compensation, promotion, and rotation policies are based on achievement and performance through annual performance evaluations and management reviews. INT noted that within the Bank promotion is not closely linked to project performance or outcomes but to project approvals. Management also noted that during the recent Staff Survey (2007), their were high levels of dissatisfaction over objectivity and transparency, with only a third of Staff perceiving that they are rewarded according to their job performance. With respect to an ELCQ question on candor and constructiveness of job performance counseling, the only respondent to say “no”, was an MD who commented that career counseling is an institutional weakness, and managers are typically reluctant to take decisive action vis-à-vis poor performers. [MDD]

(b) Several ELCQ Respondents [EAP, ECA, HDN, IAD, HRS] pointed out that the importance of integrity and ethical values are not explicitly identified in the OPE. Although these values are not a systematic element of the Bank’s formal evaluation processes, the importance of personal integrity and ethical values is implied in the behavioral assessment categories of the OPE: client orientation, drive for results, teamwork, learning and knowledge sharing, sets high standards for self and commits to organizational goals. As noted earlier, the emphasis of the importance of these values is subject to the abilities of each manager and is highly dependent on the reviewer’s personal and cultural views on the importance of integrity and ethical values.

(c) At the end of 2006, there were two risks that the Risk Scan rated as high: (i) staff skills and mix, and (ii) resource deployment. Highly restrictive HR policies contribute to the skill mix issues and inability to deploy staff to priority activities.
These concerns seem to be borne out by the results of the 2007 Staff Survey, as Staff assessments of career opportunities continue to be persistently weak.

(d) Management has long-recognized the challenge of managing performance in the Bank—which is key for promoting individual and professional accountability. This has been emphasized most recently in the Report of the Performance Management Working Group published in July 2007. Prompted by the Report, HRS launched HR Insight, a new website dedicated to sharing HR-related data, information and research with Bank Group staff. Efforts have also been made to exercise more differentiation in the recent SRI awards, to ensure that high performers are rewarded. HRS will also develop a comprehensive roadmap/strategy for enhancing performance based on the diagnosis of the root causes of dissatisfaction with current performance management, developed by the Performance Management Working Group, and continue its efforts to enhance the HR Insight website to increase further the transparency of HR-related data.

50. Fraud and corruption. In assessing this part, Management reviewed the responses to the ELCQ; INT’s Annual Report (FY2007); the Volcker Panel Report; Management’s Response to the Volcker Panel Report; the draft Whistleblower Policy; and Staff Rule 8.01.

(a) The control environment questions focused on mechanisms in place to report and follow up on allegations of fraud and corruption. Most units responded that IDA has good overall communication channels/mechanisms in place for reporting fraud and corruption matters to the appropriate/responsible parts of the Bank (INT, IAD, EBC) through hotline, staff/manager relations, and other means.33

(b) Some ELCQ Respondents mentioned that a gap exists in the absence of a revised Whistleblower Policy and emphasized the need to put it in place quickly to alleviate Staff’s fear of reprisals.34 However, INT noted that the incentive structure within the Bank does not reward the identification of lapses in procedures and ethical standards, and that there should be awards to Regional Staff who identify and report corruption. Instead, INT believes that staff fear retaliation by managers.

(c) Nevertheless, some confusion remains among staff regarding what to report to whom, that is, the line manager, VPs, IAD, INT, or EBC. Management’s message regarding the importance of ethics and proper behavior is weakened partly as a result of confidentiality and the resulting lack of factual information on the outcome of reported issues.35 This may be evidenced by the lack of disciplinary information on staff misconduct cases from HRSVP. Finally, as noted earlier, concerns relating to decentralized operations have been raised by IAD and INT regarding lack of rigor and quality arrangements in the oversight by Washington of fiduciary (primarily procurement and financial management) activities.

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33 Staff Rule 8.01 was cited as a source for “what to report and to whom.”
34 More information with respect to the Whistleblower Policy is set out in paragraph 81 under the Information and Communication component.
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(d) Some of these concerns are being addressed by ongoing activities in the accountability and ethics areas, such as emphasis on ethics and controls in the orientation program provided for all new Bank hires and implementation of appropriate disciplinary action in response to departures from approved policies and procedures or violations of the code of conduct pursuant to Staff Rule 8.01. In addition, the Bank has recently amended the Principles of Staff Employment to enhance its current handling of whistle-blowing reports and claims of whistle-blowing retaliation. The new principle and staff rule puts the Bank Group at the leading edge of whistle-blowing protections amongst international organizations, consistent with the highest standards of good governance and the on-going efforts of the Bank to safeguard its integrity and effectiveness.

B. Risk Assessment

51. Every entity faces a variety of risk from external and internal sources that must be assessed. A precondition to risk assessment is the establishment of objectives, linked at different levels and internally consistent. The risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed. Because economic, industry, regulatory and operating condition will continue to change, mechanisms are needed to identify and deal with the special risks associated with change.

52. The following controls/processes ensure the identification and analysis of relevant risks to the achievement of IDA’s operations objectives.

53. **Entity-level objectives are established, communicated and monitored.** In assessing this part, Management reviewed the responses to the ELCQ, the Budget Process, and review of tools for monitoring progress, quality and evaluating development impact at exit during Part I.

(a) Many responses to the ELCQ mentioned the Medium-Term Strategy and Finance (MTSF) paper, the Budget Document, and the President’s speech at the Annual Meetings as vehicles used to communicate to staff the priorities and directions for the coming year. In accordance with the Bank’s strategy, each Region sets its own strategy, mission objectives, and goals, reflecting Regional characteristics and the needs of member countries. The Board reviews these strategies. Each VPU prepares a Strategy and Performance Contract (SPC) outlining its objectives and strategies, and, in principle, updates it every quarter. The achievement of the objectives is monitored by the VPUs themselves (using measurable outcome indicators) as well as through such mechanisms as the Quarterly Business Reviews (QBRs). CASs and Country Partnership Strategy (CPS) exercises update strategic plans at the country level and feed into Regions’ annual SPCs. Management periodically reviews the above plans: annually for the MTSF, quarterly for the SPCs via the QBR process, and every 3-4 years for the CAS. Feedback to Management relating to Staff’s understanding of objectives is provided through different channels, including staff surveys, ROW workshops and formal OC meetings related to CASs. Although

35 An example are the Six Strategic Themes announced by the President in the Fall of 2007.
feedback is received through several channels, some units mentioned the need for more regular feedback from staff [EAP, HDN, AFR, IEG].

(b) Respondents noted that the alignment between entity-wide and unit-wide objectives is broadly adequate. Senior Management regularly discusses the different strategic documents, and efforts to align strategic plans with entity-wide objectives are evident at different levels of the institution: MTSF, Sector Strategy Implementation Updates (SSIUs), SPCs, CASs. Respondents also pointed out that progress was being made on strengthening the links between resource allocation and institutional objectives through the SPC process. Respondents pointed out that activities are linked directly or indirectly to corporate objectives through unit plans that contain key performance indicators (KPIs). The level of detail increases from the entity level (MTSF and Budget Document) to the unit level (SPCs) and the country level (WPAs). Indicators and work programs are periodically updated and analyzed through the QBRs and SPCs. Some units [PREM, SDN, HDN, WBI] stated that in some cases resources available to achieve objectives are not adequate, that the link between strategy and resources is sometimes elusive [LEG], and that the budget could be better linked to results [MDD]. A few areas are perceived to be not well linked to entity-wide goals [AFR, LAC]. It was also mentioned that some activities, created at a given point in time to address specific problems, may not be closed in a timely manner, leading to “mission creep”, and the need for further progress in results measurement [INT, MDD].

(c) During Part I management identified processes and tools in place to monitor and report to senior management and the Board at various stages progress of projects and programs supported by IDA toward achieving the agreed outcomes (both at the project level and at the country level). These tools and processes include instruments for reporting progress (ISRs and CAS Progress Reports), self-evaluation at completion of CASs and projects (the ICRs and CAS completion reports), independent evaluation of all completion reports by IEG as well as thematic/sector, country, and instrument evaluations by IEG. Management has also examined IAD and QAG reports that are relevant to the question of monitoring and reporting on progress and outcomes, including in particular the recent IAD audit of supervision reporting that focused on project ISRs. This review identified that the processes, instruments and controls in place, including the robust independent evaluation of outcomes by IEG, are generally working well. The review also agreed with the IAD findings, however, that improvements are needed in the progress reporting area by revising the form and use of the ISR.

54. **Management has established mechanisms for identification of risks, and evaluates and mitigates risks appropriately.** In assessing this part, Management reviewed responses to the ELCO; the Budget Process; ROWs; Risk Scan; and the CAS and individual project review processes.

(a) The Bank has in place several mechanisms to assess risks at the entity-level (Risk Scan; ROW workshops) and transaction-level (CAS, lending operations). These
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are discussed by Management, including Senior Management, at various times throughout the year. Many ELCQ Respondents mentioned the annual Risk Scan, which covers 40 different categories of risk, as a key tool for risk assessment, and noted as well, the role played by operational reviews. Risk identification also takes place through COSO workshops, Risk Scans, and planning discussions at the Senior and VPU Management levels covering various types of risk. At the instrument level, risk identification is an explicit and central element of the CAS and lending operations review processes. For investment lending a risk identification worksheet is applied. However, it was noted also that the Risk Scan is prepared in different ways across units, and that may lead to inconsistencies [HDN]. The need for better capacity to assess political risk was suggested, as well as the need for more attention to implementing mitigating measures [WBI].

(b) The review of control units pointed out that there is (i) no systemic process to consolidate the various risk identification processes and analyses that are prepared by various units throughout the organization, including a lack of a coherent process for consolidation and identification of key entity-wide/systemic risks and their review and discussion with Senior Management and the Board, and (ii) a need for a more systemic review of and better capacity for assessing reputational and political risks.

(c) There is scope for improvement on risk assessment and feedback/incorporation into project design. Under-reporting of risks is a major issue identified by QAG as it reduces the reliability of portfolio performance indicators. QAG notes that such indicators are no longer as meaningful for tracking and managing portfolio performance because of frequent failure in the ISRs to trigger risk flags. The lack of candor in ISRs is especially troubling as Management relies heavily on the indicators of projects at risk, the fact that they may be flawed and systematically understate risk raises a concern about assertions on the effectiveness of IDA’s operations.

(d) Finally, with respect to risk mitigation, it is interesting to note that while robust information security was among the lowest rated risks in Risk Scan, an IAD audit identified IT issues over information security and infrastructure change management, combined with password policy breaches in SAP by Bank staff, as serious risks that were deemed in aggregate by the Peer committee to constitute a significant deficiency (ICFR). This huge difference in risk perception between IAD and other parts of the Bank points to the need for better sensitization of staff and Management to these risks.

55. Management has implemented mechanisms to anticipate, identify, and react to changes. In assessing this part, Management reviewed responses to the ELCQ, the Budget Process, ICFR, ROWs, and Risk Scan.

36 For example, panelists in the QSA 7 sample identified more than three times more risk flags on projects than were signaled by ISRs.
(a) Attention is given to risk factors when the institution considers entering a new business line or to create a new product. The Board is highly involved in the process and is also kept abreast of budgetary trends in the course of the year and of the impact of key external events at the global and the country level. The risk that Staff skills mix do not match new practices and emerging corporate needs was mentioned [SDN]. With respect to timeliness, one MD mentioned the need to improve how quickly developing risks are brought to Senior Management’s attention [MDD].

(b) However, the ICFR raised the point that the central units could work better together on risk identification and response to risks and information sharing. IDA could strengthen its high-level risk management, by periodically and systematically reporting top level finding to Senior Management.

(c) In addition, INT expressed concerns (which also related to their responses under the Control Activities section of the ELCQ) about whether institutional goals were correct or followed, responding, for example: “The Bank reviews performance measures; the Bank does not always completely validate the propriety and integrity of these measures...the Bank’s business model has inherent limitations”. Management has also identified these issues as part of its ongoing review of the efficiency and effectiveness of the budgeting processes. Along with a number of other issues, they are included in the Management Action Plan which was presented to the Board in October 2007, in the Budget Committee paper “Improving the Planning, Budgeting, and Performance Management Process” (BC2007-0015). Progress on implementing the Action Plan is reported to the Budget Committee through the Quarterly Business Reviews.

56. **Fraud and corruption.** In assessing this part, Management reviewed the responses to the ELCQ; INT’s Annual Report FY2007 the VR, and Management’s Response to the VR.

(a) In the area of fraud risk assessment, VPs agree that they consider and assess the potential for fraud and corruption as part of their enterprise-wide Risk Scan. In addition, ROWs, IAD audits, and unit-specific risk scan exercises were frequently cited as the primary tools used to assess these issues at the business unit levels.

(b) Most VPs believe that unit-level controls in the fraud and corruption area are effective, citing: (i) unit-level controls put in place by RM teams; (ii) controls embedded in SAP; (iii) institution-wide initiatives and assessments, including ROW; (iv) the Quarterly Business Reviews; (v) Risk Scan Exercises; (vi) Letters of Representation (LOR); (vii) random audits conducted by IAD, external auditors; and (viii) the on-going Quality Assurance Reviews conducted by ACT. However, INT responded in the ELCQ that “The incentive structure within the Bank does not reward the identification of lapses in procedures and ethical standards. There should be awards to regional staff who identify and report corruption; instead, many staff fear retaliation by managers.”

(c) As noted, Management’s individual risk assessment processes include assessment of fraud and corruption risks, however, two control units [CSR, INT]
highlighted that a systemic entity-wide aggregation of the assessed fraud risks is lacking. Finally, IAD stated that systematic risk assessments form part of its own annual risk assessment, and INT stated that they are not aware of any systematic fraud risk assessments in regional operations.

C. Control Activities

57. The policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity’s objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.

58. These controls/processes and policies and procedures help ensure the Management directives are carried out. Control Activities occur throughout the organization, and include a range of activities. Thus, the ELCQ sought information on each of the activities noted above. Overall responses were positive concerning the Control Activities being carried out.

59. **Operational practices followed and processes adequately documented.** In assessing this part, Management reviewed the responses to the ELCQ; ROWs; the results of the 2005 and 2007 Staff Survey; the VR and Management’s Response to the VR.

(a) Overall, Respondents said, operational practices are being followed and processes have been adequately documented, and that Management and staff understand and follow the policies, written or practiced, as identified in various policies and manuals, including the Operational Manual, which contains Operational Policies (OPs) and Bank Procedures (BPs); the Administrative Manual; the Staff Manual; and various other manuals and guidelines. Although most Respondents to the ELCQ stated that the policies and procedures are clear and adequate, IAD noted that Bank-wide OPs/BPs need updating. IEG had stated in the Part IB Report that it believed out-dated OPs/BPs were a potential material weakness. OPCS has reviewed the process by which OP/BPs are updated, and management is of the view that the proposed IL reform will address most of the outstanding policy updates issues. Management, notes that as the main fiduciary policies (including OP/BP 12.00 on disbursements and 10.02 on FM) were issued in March 2007 and major instrument policies (including OP/BP 8.60 on DPLs and OP/BP 8.00, on emergency lending) are in place, this issue primarily affects OPs and BPs that apply to appraisal and supervision of IL. Based on management’s identification and mapping of the current process for policy revisions, management believes that the primary source for the current backlog in OP/BP updates is the micro style and approach to OP/BP drafting and content rather than the process for introducing policy changes that require OP/BP revisions. The principles-based approach to preparation of new OPs and BPs reflected in the more recent policy reforms, which focuses the OP and BP statements on core principles and key controls rather than the process for introducing policy changes that require OP/BP revisions.

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37 These include: OP/BP 6.00 re expenditure eligibility, OP/BP 10.02 re financial management, OP/BP 12.00 re disbursement, OP/BP 13.20 re additional financing and OP/BP 8.00 re rapid response to crises and emergencies.
than detailed rules and procedures characteristic of the older statements, should help to minimize any future backlogs in OP/BP updates.

(b) Overall, however, there is some feeling that the policies and procedures are burdensome: for example, the ROWs highlight staff frustration with the burdensome nature of policies/procedures given the benefits. Further, staff feel that the cost/benefit ratio of controls over the administrative budget is very high. The staff’s perception is that (i) HRS and procurement have a knee jerk approach to controls rather than a service orientation; (ii) clearance requirements in operations are excessive, with too much review leading to delays in AAA and lending; and (iii) the costs imposed by multiple ex post review groups, such as, CSR, IEG, QAG, IAD, INT, and IP, are too high. Information gathered as part of the ROW exercises conducted by CTR provides valuable staff perspectives that complement more top-down work such as the Risk Scan. The fact that staff find policies burdensome and costs of controls exceeding the benefits is worrisome in its implications for the likelihood of compliance with Bank policies. Management needs to understand better whether this reflects a lack of understanding of the nature of controls. At the least, there is scope for better coordination across the control units.

(c) In the Part IB Report, QAG noted that policies and procedures concerning AAA would benefit from review and updating. Management is undertaking a broad review of the processes and controls, including systems and monitoring, that apply to AAA in order to simplify and strengthen them where needed, and ensure they are updated to take into account the wide variety of AAA currently carried out by the Bank. This review will also address the compliance weaknesses observed, along with other issues that have been raised by QAG in recent related reviews of AAA. Management expects to complete this review and discuss the recommended changes with the Board by late FY09.

(d) Finally, in its response to the ELCQ, INT expressed some concerns arising from its transaction-level investigations, especially as it refers to decentralized procurement.

60. Management has clear objectives in terms of operating goals. In assessing this part, Management reviewed the responses to the ELCQ; ROWs; the results of the 2005 and 2007 Staff Survey; the VR and Management’s Response to the VR.

- Respondents to the ELCQ said that, in general, appropriate indicators exist and are being monitored to (a) see if entity objectives are being met, (b) identify trends, and (c) prevent surprises. Some of this control activity and monitoring takes place through Quarterly Business Reviews (QBRs) and Key Performance Indicators (KPIs): for example, the KPIs in the Strategic Performance Contracts (SPCs) are linked to strategic objectives and

38 There is a need for tighter oversight of AAA process (work in progress, slippages, delays in delivering policy notes, coding, reporting and dropped projects) by Regional and Network managers. There is also scope for OPCS, CSR, and ISG to work together with operations staff to resolve underlying problems for sustained systemic improvement.
operational goals for each business unit, including targets for KPIs. The KPIs are updated routinely. Some Respondents replied that, to strengthen the links to the institution’s mission, goals, and objectives for the current fiscal year the process would benefit from an institution wide validation of VPU-identified KPIs in terms of appropriateness and realism to institutional goals or priorities. Respondents also noted that no specific incentives are tied to the achievement of KPIs, and incentives for achieving goals in the organization are limited. Most Respondents noted, however, that Management expects the KPIs to be achieved in compliance with policies and procedures in an ethical manner. On the issue of meeting objectives and following through, INT expressed concerns about whether Management is learning and absorbing lessons, observing that some controls are being avoided at the transaction/project level.

61. **Duties are adequately segregated.** In assessing this part, Management reviewed the responses to the ELCQ; various IAD Reviews; the ICFR Results; and the COSO Report.

- Respondents generally agreed that duties are adequately segregated across the organization. Two Regions [EAP, LCR] pointed out that although segregation of duties is hard to achieve in small units, but they have identified the issue, and are monitoring it closely in their smaller units.

62. **Policies are in place to control access to computer programs and data files.** In assessing this part, Management reviewed the responses to the ELCQ; various IAD Reviews; the ICFR Results; and the COSO Report; and the Audit Committee Green Sheets.

- Policies are in place to control access to computer programs and data files. ISG continually monitors access, and IAD periodically conducts audits. IDA’s external auditor annually reviews controls related to IDA’s financial systems. Recently IAD identified that managers’ overriding of approval controls by sharing passwords had seriously affected access control effectiveness. In response, Management prepared an action plan, which has been discussed with both IAD and the AC, to strengthen the appropriate controls and prevent further overriding or intervention. The Part IB Report and other related ICFR work identified other deficiencies, and to address these deficiencies, Management has prepared action plans, discussed them with the external auditor, IAD and the AC, and is in the process of implementing the actions during FY08.

63. **Fraud and corruption.** In assessing this part, Management reviewed the responses to the ELCQ; various IAD Reviews; the COSO Report; INT’s Annual Report FY2007; the VR, and Management’s Response to the VR.

- Most units believe that IDA has implemented adequate controls in the areas associated with high risk of fraud and corruption, including through the annual COSO exercise, IAD work, and transaction-level controls in SAP. In the context of projects, reviews and arrangements established to address higher risks are seen as examples of dealing with fraud and corruption risks. QAG, however, noted that the risk of fraud is not assessed systematically in lending operations. IAD cited improvements underway in this area due to the GAC initiative and INT work. An MD [MDD] noted that there have been improvements in the past 12-24 months in the general strengthening of internal controls at regional levels in response to the GAC strategy and INT work. However the MD also believes that staff are still not well-informed about fraud and corruption indicators and how they can be brought to light. Finally, INT limited its response to controls in the context
of lending operations, and expressed a concern regarding the extent to which vulnerabilities to systemic fraud and corruption and/or INT’s findings are reflected in individual operations.

D. Monitoring

64. *Internal control systems need to be monitored* – a process that assesses the quality of the system’s performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with serious matters reported to top management and the board.

65. Monitoring controls/processes/activities assess the quality of IDA’s internal control system’s performance over time.

66. *Internal communications are effective in providing feedback to Management on whether controls are operating effectively.* In assessing this part, Management reviewed the responses to the ELCQ; QAG Reports (QEA, QSA, ARPP); IAD Audit Reports (e.g. Supervision Reporting Audit); IEG Reports; and IDA Internal Controls Part I findings.

- Numerous ongoing monitoring procedures are built into the Bank’s normal, recurring operational activities. These ongoing procedures include operating reports; communications from external parties; an appropriate organizational structure and supervisory activities; data recorded by information systems compared with physical assets; and recommendations of the internal and external auditors. Overall internal communications are effective in providing feedback to Management on whether controls are operating effectively. These internal communications include feedback through the QBR process and through SPC, coupled with self-monitoring through CAS midterm reviews, mandatory annual project implementation status and results (ISR) reports, and implementation completion (ICR) reports at the conclusion of each operation. However, there is a need to review and improve the level of candor generally, and in the area of risk identification in particular, in project documents and monitoring reports (including PADs and ISRs). In this regard, one MD [MDD] noted that Staff in general may be reluctant to report problems, fearing that it reflects badly on their performance, while another respondent [INT] noted that it was aware of some cases of retaliation against staff for reporting problems.

67. *There are regular self-assessment exercises in the Bank.* In assessing this part, Management reviewed the responses to the ELCQ; QAG Reports (QEA, QSA, ARPP); ICFR; ROWs; Risk Scan; and IDA Internal Controls Part I findings.

- Annual self-assessment exercises review internal controls related to financial statements (ICFR), control environment (ROWs), entity level risks (Risk Scan), and the annual budget process. Operational staff also self-assess performance under all CAS’s and individual operations (including AAA activities) through completion reports. In addition, the Letter
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of Representation that is signed by each Vice President brings an awareness of the issues being monitored.

68. **Management is responsive to internal and external recommendations.** In assessing this part, Management reviewed the responses to the ELCQ; QAG Action Plans; IAD quarterly reports to AC; IEG Management Action Records to CODE; the IP Annual Report, and the External Auditor’s Management Letter.

(a) Processes and procedures are in place to monitor progress of actions agreed to remedy deficiencies identified, or to introduce needed improvements, in response to recommendations made through internal and external reviews and evaluations. Primary among these are: (i) QAG’s regular assessments of the quality of projects entering the portfolio and during supervision, including reviewing the procurement, financial management and safeguards aspects, and then provides recommendations to Management. These assessments are carried out at both project and portfolio levels; (ii) IAD’s annual audits/reviews of both financial and operational processes/activities, which set out recommendations for improvement to governance and internal controls; (iii) IEG’s program and project evaluations which focus on development effectiveness -- specifically whether programs and projects were able to achieve their development objectives; (iv) external auditor’s annual management letter which identifies internal control deficiencies arising during their audit of IDA’s financial statements and their review of ICFR, and (v) the Inspection Panel (IP) reviews and reports on complaints by potentially affected external parties related to Bank adherence to its operational policies in projects it supports.

(b) QAG, IAD, IEG and the IP all follow evaluation standards of external organizations. These four units, together with the external auditor, have direct access to Senior Management and the Board. Their recommendations are closely monitored, and Management attempts to respond to the evaluators’ recommendations in a timely manner. However, some evaluators expressed concerns about actions taken by Management in response to their recommendations: for example, (a) IAD noted that Management ‘usually’ takes adequate and timely actions,39 and (b) IEG noted that the extent and timeliness of Management responses to their recommendations varies.

(c) As stated above, processes and procedures are in place to monitor progress of agreed actions to remedy deficiencies, however, during the review it was noted that there is not a process, or unit, in the institution to consolidate all internal control related recommendations, irrespective of the evaluator/auditor, and to review such recommendations for (i) internal consistency; (ii) consistency in management’s responses; and (iii) identification of control related patterns.

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39 With respect to IAD itself, its quarterly update reports to the AC follow up on recommendations for audits rated unsatisfactory.
69. **Internal audit’s scope, responsibilities, and audit plans are appropriate for the organization.** In assessing this part, Management reviewed the responses to the ELCQ; IAD’s FY07 and FY08 Work Programs; and IAD’s TORs.

- IAD’s responsibilities are described in its Terms of Reference. The revised TOR has been sent to the President for his review and approval. In the meantime, IAD is using the Audit Committee’s TOR as a proxy. In addition IAD’s FY07 and FY08 work programs have been approved by the President and discussed with the Audit Committee.

70. **Internal audit adheres to professional standards, such as those issued by the Institute of Internal Auditors (IIA).** In assessing this part, Management reviewed the responses to the ELCQ; and IIA peer review report of IAD’s activities.

- IAD undergoes periodic peer review by the IIA, the last one of which was completed in FY06.

71. **Fraud and corruption.** In assessing this part, Management reviewed the responses to the ELCQ; INT’s Annual Report FY2007; and VR and Management’s Response to the Volcker Panel Report.

- With respect to fraud and corruption, INT expressed concerns in areas covering both “ongoing monitoring activities” and “separate evaluations”, stating that although INT is good at catching violations over the years, Management supervision has not increased materially in this timeframe.\(^{40}\)

**E. Information & Communication**

72. Pertinent information must be identified, captured and communicated in a form and timeframe that enable people to carry out their responsibilities. Information systems (computerized, manual, or a combination) produce reports, containing operational, financial and compliance-related information that make it possible to run and control IDA’s business. They deal not only with internally generated data, but also information about external events, activities and conditions to inform business decision-making and external reporting. Effective communication also must occur in a broader sense, flowing down, across and up the institution. All personnel must: (i) receive a clear message from top management that control responsibilities must be taken seriously; (ii) understand their own role in the internal control system, as well as how individual activities relate to the work of others; and (iii) have a means of communicating significant information upstream. In addition, there needs to be effective communication with external parties such as shareholders, donors, borrowers, suppliers and regulators.

73. These controls/processes/activities help ensure the identification, capture and communication of pertinent information in a form and timeframe that enables staff and management to carry out their respective responsibilities.

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\(^{40}\) The example INT cited was that travel claim-related cases continue to show inadequate controls by reviewing managers.
1. Information

74. **Operational reporting and related applications and information systems are reliable.** In assessing this part, Management reviewed the responses to the ELCQ; the ICFR Questionnaire; the Business Warehouse; the QAG ARPP Report; the IEG ARDE Report; and the President’s brief to the Board.

   (a) The Bank’s information systems are reliable. Management uses an array of information systems (both computerized and manual), which enable Management to (i) prepare accurate and timely operational reporting, (ii) obtain relevant information from external and internal sources for operational reporting systems, and (iii) have information available on a timely basis. Systems as Business Warehouse (BW), SAP, the Operations Portal, e-Consult, and e-Trust Funds produce reports containing the operational, financial, and compliance-related information that make it possible to run and control IDA’s business. In addition, the Board has access to the ED portal and an electronic distribution system that features full archival retrieval of a wide range of information. The Board also receives special briefings when they request further information from Senior Management or Regions on specific topics or operations.

   (b) However, electronic information systems are sometimes inadequate to suit the needs of operational units that are decentralized. As with centralized units, the decentralized operational units are responsible for recording, collecting, analyzing, preparing reports and papers and distributing information to Senior Management and the Board. In these cases, much more manual intervention and accumulation of data is required in order to provide reliable and consistent aggregated reports to Senior Management and the Board.

   (c) Broader than just the decentralized units, however, is the fact that it is often difficult to get consistent aggregated numbers (for example, on Bank-supported deliverables or budgetary allocations to specific priorities, information from all sources of funds). This difficulty may result from internal and external information gaps [MDD, AFR, ECA, FPD]. At times, obtaining necessary information requires manual intervention or merging reports for Bank Budget (BB) and Trust Funds (TF) and data manipulation, which may impair the integrity of the data being reported. One unit said there may be “too much information to digest,” and suggested “targeting reports to the type of VPU (Regions/Networks/FACs).” [FPD] As a result the above observations may point to an efficiency issue, although there are no obvious overlaps in the information provided, as they question whether so many units need to collect similar information. While another unit observed that SAP does not capture delivery of DEC products such as publications (e.g. working papers, special studies, journal articles, books, conferences). [DEC]

75. **Appropriate and necessary information is obtained from, and provided to, Management.** In assessing this part, Management reviewed the responses to the ELCQ; the ICFR Questionnaire; the Business Warehouse; ROWs; the QAG ARPP Report; the IEG ARDE Report; QBRs; 2005 and 2007 Staff Survey, and the President’s Brief to the Board.
Information capture for monitoring purposes occurs at the unit, corporate, and Board levels. At the VP-level, mechanisms include Regional portfolio and deliverables reports, while Senior Management-level reporting mechanisms include the Quarterly Business Review (QBR) and the President’s Brief. These reports provide periodic operational and budget information to Senior Management and may annex performance memoranda from individual VPU, providing more detailed information about VPU performance and internal/external issues, the execution of VPU work programs, and progress in meeting VPU objectives. External information is provided to Senior Management and operations units by EXT and by the Country Management Unit staff, and is also gathered for special purposes: for example, for activities related to Treasury’s asset management, Treasury’s performance system compares actual portfolio returns with pre-established benchmarks.

With respect to job functions, the recent Staff Surveys results showed that Staff felt they had adequate information to do their jobs (84% said yes in 2005; 82% said yes in 2007). Likewise, ROW results show Staff feel they can easily access such information.

76. **Information is gathered from and disseminated to the appropriate people on a timely basis.** In assessing this part, Management reviewed the responses to the ELCO; the ICFR Questionnaire; the Business Warehouse; the QAG ARPP Report; the IEG ARDE Report; QBRs; and the President’s Brief to the Board.

(a) Staff and managers, both in Washington and in decentralized offices, have appropriate access to financial and operational information in institutional systems such as SAP and BW. User satisfaction with systems varies across the institution, and some units/staff report more work is needed to improve the user-friendliness of systems [AFR, SAR, OPCS, QAG, HDN, SDN, LEG, WBI] and ease-of-access to reports, as well as to improve technology links to some decentralized offices.

(b) The controls units review also noted that there could be improvements in the timeliness of the transfer of information.

77. **There is a process for identifying and responding to the changing information and communication needs.** In assessing this part, Management reviewed the responses to the ELCO; the ICFR Questionnaire; QBRs; IPC (Information Policy Council) and ISC (Information Security Committee) TORs; and the President’s brief to the Board.

(a) Management support for the development of necessary information systems is shown by the commitment of appropriate resources. The Board monitors resource priorities, including those related to information systems as part of the process of presenting to the Board of Governors an audit of accounts, and administrative budget, and an annual report on the Bank’s operations and policies as well as other matters at the Annual Meetings.

(b) Identifying changing information and communication needs resides with the individual VPU. During FY07, a new governing committee, the Information
Policy Council (IPC), was established to ensure development or updates of information systems are based on a strategic plan linked to the overall strategy. The IPC includes members of Operations, Finance, Corporate, and Administration management teams. The fact that it is relatively new means that some business units may be either unaware or dissatisfied with the mechanism.\[41\]

(c) Changing client needs can be communicated through several channels, including feedback, comments, or complaints from external parties which are encouraged through consultations and during project preparation, as well as through CAS inputs from governments, civil society organizations, the private sector, NGOs, and donors.

78. **Business continuity.** In assessing this part, Management reviewed the responses to the ELCQ; the ICFR Questionnaire; QBRs; IPC (Information Policy Council) and ISC (Information Security Committee) TORs; and the President’s brief to the Board.

- Management has a policy for timely recovery of business functions, systems, processes and data captured in an institutional Business Continuity Plan (BCP) which mandates periodic testing and updates, and ISG performs such work according to policy, however, not all business units in HQ or in decentralized offices regularly test or update unit-level BCPs on a periodic basis.

2. **Communications**

79. **Management communicates staffs' duties and control responsibilities in an effective manner.** In assessing this part, Management reviewed the responses to the ELCQ; HRS Job Descriptions; the Operations Manual; Procurement Policies and guidance; the FM Practices Manual; the Administrative Manual; Training Courses; ROWs; Kiosk announcements and desk-to-desk memos.

(a) Management has many tools in which various staff duties and responsibilities related to internal control are described, including, but not limited to: generic job descriptions (HRS and Business Units); operations manual (where BPs set out clearance responsibilities); procurement policies and guidance (where staff involved with operational procurement have responsibilities set out); FM practices manual (where FM staff have responsibilities set out); Administrative manual statements (which among other things sets out staff duties and responsibilities, including those for administrative expenses). However, issues have been identified including the lack of specific internal control responsibilities within the generic job descriptions by Business Units; delays in updating OPs/BPs which may mean that they do not necessarily reflect current process and responsibilities related to internal controls; adequacy of documentation relating to operations generally, including Procurement, during project

\[41\] Some of the dissatisfaction was reflected in the ELCQ responses of three units, who basically responded that “emerging information needs are flagged by different operational units of the Bank and not necessarily pursued/discussed in a systematized manner” [MDD, LEG, HRS]. In addition, two units reported that “specific needs of Country Offices, especially those resulting from increased decentralization, have not yet been fully met.” [AFR, EAP]
preparation/appraisal and supervision stages; and, lack of clear communication and information, including guidance, to support procurement work.

(b) Management uses the opportunities provided by bringing staff together in training sessions and self-assessments (ROWs and ICFR) to discuss staff responsibilities related to internal control and to obtain feedback and discuss instances of control failures. As noted above, in the 2005 Staff Survey 84% of Staff said they had adequate information to do their jobs, while 82% responded similarly in the 2007 Staff Survey.

(c) Management communicates with and updates staff via Kiosk announcements and desk-to-desk emails when new members of management are hired/appointed, units undergo major reorganization, changes are made to the systemic internal controls (e.g., the issue of password sharing), and control-related information is needed to be passed on throughout the organization (e.g. summary of INT findings).

80. **Channels of communication for staff to report suspected improprieties have been established.** In assessing this part, Management reviewed the responses to the ELCQ, and the Staff Manual.

- Multiple channels exist for reporting suspected improprieties, including: line management; the EBC and its Ethics Helpline for assistance with conflicts of interest or ethical dilemmas; Human Resource Officers (both in HRS and VPU); the Bank’s Conflict Resolution System (e.g., Ombuds Office, Mediation Services); INT; and the Staff Association. Staff are informed about the process for formal complaint of harassment, discrimination or other inappropriate behaviors in Staff Rule 8.01. There remains some confusion among staff regarding what to report and to whom, as well as concerns about the gap that exists in the absence of a revised whistleblower policy.42

81. **A "whistle-blowing" program has been established, and Management's reaction is monitored as it relates to operational matters.** In assessing this part, Management reviewed the responses to the ELCQ; ROWs; the Draft Whistleblower policy; the VR, and Management’s Response to the VR.

- The Bank has had whistle-blower protections for some time. However, these require strengthening to provide staff with confidence that they can report alleged violations/improprieties without fear of retaliation. A revised whistle-blower policy has been prepared by Management, reviewed with the Board’s Audit and Personnel Committees and is currently being circulated for public comment. Management will consider the feedback received from this final round of comment and proceed to obtain the necessary approvals for implementation of a new whistle-blower policy as soon as possible.43 Responses to the ELCQ and anecdotal information from ROWs provide some

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42 INT expressed concerns about fear of retaliation and lack of reward to those who identify and report corruption. Since the submission of the ELCQ, the Board has adopted a strengthened Whistleblower Policy.

43 IAD has pointed out that the revised policy, in its view, falls short as it does not offer protection against reprisals for allegations of misconduct against Board members and the President. In June 2008, after the submission of the ELCQ, the Board adopted a strengthened Whistleblower Policy.
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observations about Staff concerns: specifically, some Staff, particularly transaction processors and RM Staff, feared that they would be identified by their managers if they reported improper conduct and circumvention of controls. Other Respondents indicated concerns that not all responses to allegations have been investigated in a timely manner.\textsuperscript{44}

82. \textbf{Management's communication across and outside the organization reflects an attitude toward sound internal controls.} In assessing this part, Management reviewed the responses to the ELCQ; ROWs; the IBRD/IDA Annual Report; the 2005 and 2007 Staff Survey; and Kiosk announcements.

(a) Communication across the organization is adequate and the completeness and timeliness of information is sufficient to enable people to carry out responsibilities effectively. 2007 Staff survey results show that staff feel they have adequate information to do their jobs (82\% said yes). ROW results also show Staff feel they can easily access such information. In addition, Management uses Kiosk announcements, broadcast e-mails, and other alerts to disseminate critical information throughout the Bank.

(b) The Bank has issued in its annual reports for IBRD and IDA and its financial statements and opinion on the adequacy of internal control over financial reporting, and it has disclosed the respective unqualified opinions of its external auditor. IDA’s assessment of its internal control over financial reporting is based on the most comprehensive practices.

(c) Communication with, and feedback from, external parties, including country office contact details are widely distributed. The external web is widely used by regions, and the network of Public Information Centers (PICs) acts as a public gateway and feedback mechanism for the Bank. Various systems are used to track key communications when received by the Bank, including, Encorr, Client Connections, e-Consult, the EXT network trust fund advisory committees, and partnership meetings. Timely and appropriate follow-up action by management to communications received from clients and other external parties.

(d) The mechanisms described above are used to ensure follow-up to such communication. In addition: (a) at the regional level, the EXT office is in charge of overall external communications and draws on the sectoral/CMU units as needed; and (b) at the country level, each country office has its own strategic communications strategy that aims to reach all key counterparts with the latest Bank information and updates on Bank business. Regions conduct routine operational procedures and outreach programs, regular consultation and dialogue with key stakeholders, especially civil society groups, including those critical of the Bank.

(e) As set out above, the Bank has recently amended the Principles of Staff Employment to enhance its current handling of whistle-blowing reports and claims of whistle-blowing retaliation. The new principle and staff rule puts the Bank Group at the leading edge of whistle-blowing protections amongst international organizations.

\textsuperscript{44} EBC was uncertain whether managers or HR managers had taken appropriate follow-up actions in some cases.
ANNEX A: ENTITY LEVEL CONTROLS

consistent with the highest standards of good governance and the on-going efforts of the Bank to safeguard its integrity and effectiveness.

83. **Fraud and corruption.** In assessing this part, Management reviewed the responses to the ELCQ; INT’s FY2007 Annual Report; the VR and Management’s Response to the VR; and the ICFR Questionnaire.

- Most responders to the ELCQ agreed that IDA’s commitment to preventing fraud and corruption is clearly communicated to staff through the GAC papers, internal communications, as well as in annual COSO workshops. Sanctions reform, the existence of INT, and Volcker Panel Report were also cited as sources of heightened focus on this area. Most ELCQ Respondents believed that there was sufficient communication and increasingly more relevant training in this area. Additional information was also provided through the ICFR questionnaire related to increased emphasis, commencing in FY07, on online and in person ethics training made available through the Knowledge and Learning Board and EBC. However, an MD noted that evidence is lacking that practical knowledge in this area is widespread [MDD], and another unit has pointed out that as there is a need to raise awareness in this area (citing the Volcker Panel Report in support of its view) [LEG].

F. Fraud and Corruption Controls

84. Management observed that COSO added to its framework a component for reviewing fraud controls. This was added to specifically address the final rules adopted by the Securities and Exchange Commission (SEC), under the US Sarbanes-Oxley Act. Within this framework, fraud was defined in SAS 99 as:

“...an intentional act that results in a material misstatement in the financial statements that is the subject of an audit. Two types of misstatements are relevant to the auditor’s consideration of fraud – misstatements arising from fraudulent financial reporting, and misstatements arising from misappropriation of assets.”

85. Moreover, Management found that, as noted above, while Anti-fraud Programs and Controls are not currently a specific stand-alone component of COSO, in the IDA controls framework they are embedded in the other five components.

86. Consistent with the above, Management noted the Bank’s fraud risk assessment is performed, in conjunction with the internal control evaluation for financial reporting, at the entity and significant account/process levels. Furthermore, these individual risk assessments are performed based upon Management’s overall knowledge of controls in place, new activities, products and ventures, and historical fraud.

87. As noted previously (Fraud and Corruption section in “Methodology”), the ELCQ was the primary tool used by Management to assess fraud and corruption controls. Overall, responses to the ELCQ were positive, with a notable exception of INT’s responses. INT has responded to most questions from a transaction/project viewpoint rather than a
corporate/institutional perspective and has noted its concern with how fraud and corruption issues are addressed at the project level. Other units worth noting include: IAD, which placed a question mark and responded “unclear for the institution” on many of the questions posed; AFR, which responded “N/A” to many questions on the basis of the current content of its regional risk scan, which does not specifically cover fraud and corruption issues; IEG, which also responded “N/A” to majority of questions given that it has not evaluated the areas being covered; and HR which gave little substantiation for its responses.

The two questions to which several units responded in the negative include: (i) the effectiveness IDA’s whistleblower programs (Q8), and (ii) whether the fraud risk assessment is performed in a systemic manner (Q18). On the effectiveness of the whistleblower program, MDD, CFO, CSR, IAD, EXT and LEG have pointed to the need to adopt a new whistleblower policy to clarify and strengthen the protections to staff against reprisals. On the systemic fraud risk assessment, CFO, CSR, and QAG have suggested that while much is done to identify, assess and mitigate fraud risk at the transaction and corporate levels, the existing assessment tools need to be strengthened to ensure a more systemic approach to the fraud issue. INT, IAD and IEG have replied “N/A” for different reasons: INT has noted that it launches investigations after it receives allegations and is unaware of any “systematic” fraud risk assessments in regional operations; IAD responded with a questions mark and commented that it is “unclear for the institution”; and IEG explained that it has not evaluated the IDA’s fraud risk assessment activities.

1. Control Environment relating to Fraud and Corruption Issues

Questions in this area focused on mechanisms in place to report and follow-up on allegations of fraud and corruption. Overall, most units opined that IDA has good communication channels/mechanisms in place for reporting fraud and corruption matters to appropriate/responsible parts of the Bank (primarily INT) through hotline, staff/manager communications, and through various channels that fall under the Conflict Resolution System. Staff Rule 8.01 was also cited as an important source forclarifying staff responsibilities and options on what to report to whom in the area of fraud and corruption. Some concerns were expressed regarding a gap that exists in the absence of a revised whistle-blower policy (LEG, EXT, CSR, CFO, MDD, IAD), which would hopefully be addressed under the new policy (a draft is posted on the Bank’s external web-cite with comments sought by February 22, 2008).45 Some concerns were also expressed regarding remaining confusion among some staff on what to report to whom and worries about potential reprisals. Questions were also raised regarding lack of information on follow-up actions due to confidentiality issues, which undermines staff confidence in effectiveness of the system.

2. Fraud Risk Assessment

Most responders agreed that IDA considers potential for fraud and corruption as part of its enterprise-wide risk-scan, with COSO, IAD audits, and unit-specific risk scan exercises cited most frequently as the primary tools. Most responders also believe that we have effective unit-level controls in the fraud and corruption (F&C) area, with the following control sources/tools cited in support of this view: (i) unit-level controls put in place by the Resource Management

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45 In June 2008, after the submission of the ELCQ, the Board adopted a strengthened Whistleblower Policy.
(RM) teams; (ii) controls embedded in SAP; (iii) institution-wide initiatives and assessments (including Risk and Opportunity Workshops (ROW), COSO Workshops, the Quarterly Business Reviews (QBRs), Risk Scan Exercises, Letters of Representation (LOR)); (iv) IAD audits; (v) external auditors; and (vi) the ongoing Quality Assurance Reviews conducted by ACT. There was some disagreement, however, on whether a fraud risk assessment is performed in a systematic way. While most responders believe that such assessments are indeed performed in a systematic way, CSR, CFO and QAG have responded “no” to this question. In support of this answer, they pointed out that while much is being done to identify, assess and mitigate fraud risk at the transaction and corporate levels (with CSR noting that fraud risk assessments are embedded in the overall risk assessment processes), the existing assessment tools need to be strengthened to ensure a more systemic approach to the fraud issue. INT has stated that from transaction-level perspective, they are not aware of any systemic fraud risk assessments in regional operations. IAD also noted that it is “unclear” on whether a systemic fraud risk assessment is conducted at the institutional level though it confirmed that fraud risk assessments form part of its annual risk assessment. (HR answered several questions in this area in the negative but cross referenced its reasons to an earlier question, which it has answered in the positive, so this was treated as a transcription error).

3. Control Activities

91. Most units believe that IDA has indeed implemented adequate controls in the areas associated with high fraud and corruption risk, including through the annual COSO exercise, IAD work, and transaction-level controls in SAP. In the context of projects, reviews and arrangements established to address higher risks are seen as examples of dealing appropriate with fraud and corruption risks. IAD cites improvements underway in this area due to the GAC initiative and INT work. INT limited its response to controls in the context of lending operations, and stated that based on its findings it believes that IDA does not adequately address the vulnerabilities in its lending programs in countries with systemic corruption and still does not make real-time adjustments to project implementation based on INT findings. QAG has noted that the risk of fraud is not assessed systematically in lending operations. MDD also responded that while there have been improvements in the past 12-24 months in general strengthening of internal controls at regional levels in response to the GAC strategy and INT work, staff are still not well-informed about the fraud and corruption indicators and how they can be brought to light.

4. Information and Communication

92. Most responders agreed that IDA’s commitment to preventing fraud and corruption is clearly communicated to staff through the GAC papers, internal communications, as well as in annual COSO workshops. Sanctions reform, the existence of INT, and Volcker Panel Report were also cited as sources of heightened focus on this area. Most also believe that there is sufficient communication and increasingly more relevant training in this area. Additional information was also provided through the ICFR questionnaires related to increased emphasis commencing in FY07 on online and in person ethics training made available through the Knowledge and Learning Board and EBC. MDD noted that evidence is lacking that practical knowledge in this area is widespread and LEG has pointed out that as there is a need to raise awareness in this area (citing the Volcker Panel Report in support of this view).
Annex A: Attachment: Board’s Role, Procedures and Decision-Making

93. This Memorandum describes the role of the Board in the control system of the International Development Association (IDA) as part of an overall review of internal controls over IDA operations. As consistent with the terms of reference for the review, this memorandum sets out the primary control functions of IDA’s Executive Directors within the context of its legal framework and current practice. It also examines the main documentation, processes and tools available to the Board in its decision-making. Lastly it describes the recently revised Code of Conduct for Board Officials and Ethics Committee procedures.

A. The Board’s Primary Control Functions—the Legal Framework

94. IDA’s Articles of Agreement (the Articles) provide that “[t]he Association shall have a Board of Governors, Executive Directors, a President and such other officers and staff to perform such duties as the Association may determine.”2 The Articles also vest all powers of the Association in the Board of Governors and permit the Board of Governors to delegate its powers to the Executive Directors except those specifically reserved to the Governors.3 The Board of Governors delegated its non-reserved powers to the Executive Directors, while limiting the Executive Directors from taking any action pursuant to that delegation “which is inconsistent with any action taken by the Board of Governors.”4

95. The basic provisions of the Articles on the role of the Executive Directors read as follows:

“The Executive Directors shall be responsible for the conduct of the general operations of the Association, and for this purpose, shall exercise all the powers given to them by this Agreement or delegated to them by the Board of Governors.”5

96. Furthermore, the Articles require that “[the Executive Directors] shall meet as often as the business of the Association may require.”6

97. The Articles also contain provisions regarding the relationship between the Executive Directors and the President:

“The President of the Bank shall be ex officio President of the Association. The President shall be the Chairman of the Executive Directors of the Association but shall have no vote except a deciding vote in case of an equal division. […] The President shall be chief of the operating staff of the Association. Under the direction of the Executive Directors he shall conduct the ordinary business of

2 Article VI, Section 1.
3 Article VI, Section 2(a) and (c).
4 By-Laws, Section 5.
5 Article VI, Section 4(a).
6 Article VI, Section 4(f).
the Association and under their general control shall be responsible for the organization, appointment and dismissal of the officers and staff.”

98. **History.** The above-quoted provisions of the IDA Articles are similar to those of the International Bank for Reconstruction and Development (the Bank). A brief examination of the latter’s drafting history can help shed little light on how Board/Management relations have evolved in the two agencies. The drafting history of the provisions of the Bank’s Articles related to the Executive Directors and the President is very sparse. At the Bretton Woods Conference, the relevant provisions of the Articles of Agreement of the International Monetary Fund (IMF) were discussed first and very little time was left to discuss the provisions of the Bank’s Articles. The provisions of the original IMF Articles were incorporated in the Bank Articles with few changes.

99. The Bank’s first President, Eugene Meyer, took office in June 1946. He resigned in December of the same year. Among the reasons for his departure, the frustration of being a person with responsibility but no authority has been highlighted. His successor, Mr. McCloy, accepted the post only after an understanding was reached with the Executive Directors as to their working relationship. This was embodied in the June 4, 1947 “Memorandum with Regard to Organization and Loan Procedure” (the 1947 Memorandum). The 1947 Memorandum was revised through 1956 on points of detail, but paragraphs 1 and 2, which establish the basic understanding of the relationship between the Executive Directors and the President, have remained unchanged. The arrangements provide:

“1. The Executive Directors are responsible for the decision of all matters of policy in connection with the operations of the Bank, including the approval of loans.”

“2. The management is responsible for developing recommendations on all matters of policy requiring decision by the Executive Directors. Whenever, in connection with the operations of the Bank [and the Association], decision of a question of policy becomes necessary, the President will submit such question to the Executive Directors with the recommendation of the management as to the action to be taken.”

The same arrangements have been followed for IDA, including Board approval of IDA financing (credits, IDA grants and guarantees).

**B. Board control functions—documentation, processes and instruments**

100. Within the broad legal and historical context outlined above, this section discusses more specifically the various Board functions, as well as the processes and instruments available to the Board in carrying out those functions. A summary of the main Board decisions in Table format is also provided in Annex 1 for ease of reference.

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7 Article VI, Section 5(a) and (b).
ANNEX A: ENTITY LEVEL CONTROLS

1. Operational policy, strategy and instruments

101. Policy and sector papers. In accordance with the 1947 Memorandum, the Executive Directors are responsible for decisions on policy matters, while the Management is responsible for preparation and submission of recommendations to them. Thus, where a policy paper or a sector paper presents a new policy for the Association or a change in previously approved policy, the Board’s approval of the policy or policy change is required. The Management is responsible for the implementation of the Association’s policy.

102. Various Board committees on Board procedures have, over time, commented upon the format of policy papers considered by the Board. Most recently, the Board Effectiveness paper provided that all Board policy papers should (i) contain a two-page Memorandum of the President or Executive Summary identifying all key issues to be addressed by the Board; (ii) present options and reasons for recommendations or conclusions; (iii) outline previous decisions and the relevant legal background; and (iv) set out cost implications. Earlier, the Toure Report had emphasized that policy papers should be concise and focused and include “a clear statement of the Management’s recommendations and the reasons for these.” The Board, in adopting the Toure Report, followed previous Boards in reconfirming the use of a “chairman’s summing-up” for policy and sector discussions. When the chairman’s summing up was introduced in 1988, it was intended “to be used by the Executive Directors to inform their authorities and by the staff for guidance on policy matters.”

103. Sector policy reviews were recommended by the Naim Report, to take stock of experience and provide new policy directions where needed. In 1995, the Board accepted the recommendation of the 1995 Review and adopted Management’s proposal for a standard five year period between formal sector reviews. Currently, Sector Strategy Papers (SSP) are considered by the Board, and where sector policies or policy changes are proposed, the Board’s approval of the policy content of the paper or any policy change is requested, based on Management’s recommendations. In addition, Management prepares periodic reviews of sector strategy implementation, which are consolidated in the annual Sector Strategy Implementation Update (SSIU) for the information of the Executive Directors.

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12 Id. at paragraph 50.
14 “Report of the Ad Hoc Committee on Board Procedures,” as approved by the Executive Directors on August 4, 1992, incorporating R92-103; R92-103/1; R92-103/2 [Naim Report], paragraph 53 (c).
16 See also, “Enhancing the Board’s Focus on Implementation and Results on the Ground,” R97-5, January 14, 1997, paragraph 2. The Bank’s Disclosure Policy provides that the Chairman’s Concluding Remarks on a Sector Strategy Paper (SSP) are publicly available, unless the Executive Directors decide otherwise, while the Chairman’s Concluding Remarks on other policy and strategy issues may be made publicly available by decision of the Executive Directors. “World Bank Policy on Disclosure of Information,” September 2002 [Disclosure Policy], paragraphs 14 and 66. For SSPs, the summary issued is more frequently referred to as the Chairman’s Summing-Up.
104. **Operational policies.** In the implementation of the World Bank’s operational policies, Management currently issues two types of documents: Operational Policy (OP) statements and statements of Bank Procedure (BP). These apply to both Bank and IDA operations unless otherwise stated. OP statements, as well as Management’s proposed amendments and deviations from them, should be consistent with the Association’s Articles of Agreement, as interpreted by the Board, and with Board-approved policies. Deviations from Board-approved policy content are brought to the Board for consideration.\(^\text{17}\)

105. **Country Assistance Strategy (CAS).** The CAS for a particular country describes the Bank Group’s strategy based on an assessment of the country’s own strategies and priorities, and indicates the level and composition of assistance to be provided based on the strategy and country’s portfolio performance. The CAS is the result of discussions between Management and the country’s authorities, but it is not a commitment on the part of the Bank Group or the country to a specific lending program.

106. The Executive Directors discuss the CAS, but do not approve, reject or endorse this presentation of the Management’s strategy for lending and other activities to support the particular member country.\(^\text{18}\) Management is expected to take into account the views expressed by Board members, as summarized by the Chairman in the Concluding Remarks, in developing a country’s lending program and in the formulation of future CAS.\(^\text{19}\)

107. The specific operations for that country are presented to the Executive Directors for approval, as described in paragraphs 16-20 below. Where an operation deviates significantly from the agreed CAS framework, the Memorandum of the President (or President’s Report) should explain why.\(^\text{20}\)

108. **Poverty Reduction Strategy Paper (PRSP) and Joint IDA-IMF Staff Advisory Note (JSAN).** PRSPs, introduced in 1999 for IDA countries,\(^\text{21}\) describe a country’s macroeconomic, structural and social policies and programs to promote growth and reduce poverty, as well as associated external financing needs. PRSPs are country-driven and provide the basis for assistance from the Bank/IDA and the IMF, as well as debt relief under the Heavily Indebted Poor Countries (HIPC) Initiative.\(^\text{22}\) PRSPs and PRSP progress reports are country-owned documents, and are not approved by the Executive Directors.\(^\text{23}\) The accompanying JSAN provides the staffs’ views of the country’s strategy to promote growth and reduce poverty, and provides the staffs’ advice on key priorities for strengthening the strategy and promoting its effective implementation. Directors are asked whether they agree with the staffs’ conclusions on (a) areas in which further analysis or adjustments are needed, (b) measures for improving PRS

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\(^\text{18}\) The Chairman’s Concluding Remarks for a Country Assistance Strategy (CAS) discussion are publicly available except when the CAS itself is not disclosed. Disclosure Policy, supra note 16, paragraph 9.

\(^\text{19}\) 1995 Review, supra note 15, paragraphs 11-12.

\(^\text{20}\) Bank Procedures (BP) 2.11, Country Assistance Strategies, paragraph 14. Such a project is not eligible for presentation under streamlined procedures. For discussion on streamlined procedures, see paragraph 19 below.

\(^\text{21}\) The discussion here of Poverty Reduction Strategy Papers (PRSPs) also includes Interim PRSPs (known as I-PRSPs).

\(^\text{22}\) Countries seeking assistance under the HIPC Initiative should have a PRSP or I-PRSP in place. “Poverty Reduction Strategy Papers: Operational Issues,” R99-241, December 10, 1999 [PRSP Paper], paragraph 51.

implementation, (c) implementation risks and measures to address them, especially the risks relating to debt-sustainability.24

109. **Operations (credits, guarantees, and IDA grants).**25 The Articles authorize the Association to “provide financing to further development in the less-developed areas of the world” subject to conditions set out in the Articles.26 These conditions include, among others that (i) except in special circumstances, financing be for specific projects; (ii) alternative financing at reasonable terms be not available to the borrower from private sources; and (iii) proceeds from financing be used “only for the purposes for which the financing was provided, with due attention to considerations of economy, efficiency and competitive international trade and without regard to political or other non-economic influences or considerations.”27

110. The Articles state that financing by the Association shall take the form of loans, unless the funding is specifically authorized for other types of financing, such as grants and guarantees. The Articles do not specify which organ exercises the power to make loans. Since the Association’s inception, approval of loans has been deemed as part of the function of the Executive Directors28 as consistent with the 1947 Memorandum. IDA financings are presented to the Executive Directors for approval at formal meetings.29

111. The Executive Directors have authorized the delegation of loan approval authority to the President only in very limited circumstances.30 Since 1975, the Executive Directors have delegated to the President the authority to approve advances from the Project Preparation Facility,31 through a tacit interpretation of the Articles.32 In 1997, the Executive Directors further delegated loan approval authority to the President in connection with the introduction of Learning and Innovation Loans (LILs) and Adaptable Program Loans (APLs). LILs are loans of $5 million or less financing small, experimental, risky and/or time-sensitive projects in order to pilot promising initiatives or experiment with an approach prior to larger-scale interventions. APLs are used in a series of loans to provide phased support for an agreed phased long-term development program. The President was authorized to approve LILs, subject to a seven-day

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24 The Chairman’s Summing-Up of such a PRSP discussion is publicly available. Disclosure Policy, supra note 16, paragraph 12.

25 “Operations” as used here includes IDA financing, whether in the form of credits or, where authorized, on a grant basis. This includes IDA 13 Grants, as well as HIPC and Post Conflict Grants made under the authority of earlier replenishments. For a discussion of IDA’s grant-making authorities, see “IDA Grants to Countries in Arrears,” Ko-Yung Tung, April 2, 2002, in Selected Legal Advice of the General Counsel 1999-2002, OM2002-0123, December 11, 2002, [Selected Legal Advice] at page 125.

26 Article V, Section 1.

27 Article V, Section 1 (b), (c) and (g).


29 See paragraph 30 below.

30 The President has further delegated that authority to the Regional Vice Presidents (RVPs).

31 “Assistance in Project Preparation,” R75-224, November 17, 1975, approved by the Executive Directors December 16, 1975 (M75-52, December 22, 1975). Advances from the Project Preparation Facility are refinanced as part of the subsequent loan, or, if there is no loan, repaid over a fixed period. OP 8.10, “Project Preparation Facility,” February 2002, paragraphs 5-8.

period for Executive Directors to pose questions and provide comments. For APLs, the first APL for a program would be approved by the Executive Directors under the streamlined procedure if no significant issues are involved. The President is authorized to approve follow-on APLs in principle, subject to a ten-day period for Executive Directors to request a Board discussion. If at least three Executive Directors request a meeting to discuss such a follow-on APL, the loan is scheduled for Board consideration and approval; otherwise, Management’s approval takes effect at the end of the ten-day period. In practice, Board discussion of follow-on APLs has been requested and taken place.

112. Procedures have been in use since 1973 for Board consideration of more routine operations without discussion by the Executive Directors to allow the Board to spend more time discussing general policies and assistance strategies for individual countries. These “streamlined procedures” were further revised in 1992 and, more recently, in 2005, when the Board Effectiveness paper introduced streamlining of first phase APLs raising no policy, fiduciary or operational issues. It is expected, however, that at least one operation for a country will be considered under regular procedures within about a year of its CAS discussion, even if all operations meet these criteria for streamlined procedures. When an operation has been scheduled for consideration under streamlined procedures, Executive Directors may nevertheless request a general discussion or raise an issue at the meeting by giving three days’ advance notice to the Corporate Secretariat.

113. Guarantees are presented to the Executive Directors for approval under regular procedure rather than streamlined procedures. The Board approves the parameters and terms and conditions under which a guarantee may be given by the Association, normally before negotiations have been completed. Consequently, if the negotiations result in any substantial changes in the terms of the guarantee from those approved by the Board, the guarantee is resubmitted for Board approval of the changes. Thus far, no guarantees have required resubmission for Board approval after negotiations.

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33 Adaptable Lending Paper, supra note 32, paragraphs 44-48, 97 and 108. The Paper specified, in paragraph 48, that the President’s authority would be exercised by the RVPs, under the oversight of the Managing Director for Operations.
34 Board Effectiveness Paper, supra note 10, paragraph 64.
35 Adaptable Lending Paper, supra note 32, paragraphs 72, 97 and 108, as amended. Minutes of Meeting of Executive Directors on September 4, 1997, M97-56, IDA/M97-55, September 26, 1997, paragraph 3(i) (a) and (b). The Paper also specified, in paragraph 72, that the President’s authority would be exercised by the RVPs, under the oversight of the Managing Director for Operations.
36 The “special procedure” for approving routine lending operations was introduced in 1973. “Review of Board Procedures,” R73-225, September 13, 1973, as approved by the Executive Directors in Executive Session on October 16, 1973 (XM73-2/1, October 25, 1973, paragraph 4(e)). This was revised to the “streamlined procedure” in 1992. See Naim Report, supra note 14, paragraph 31.
37 Board Effectiveness Paper, supra note 10, paragraph 64.
38 “Implementation of the Report of the Ad Hoc Committee on Board Procedures,” R92-178, October 7, 1992, approved by the Executive Directors on October 20, 1992 (M92-72, November 10, 1992) [Implementation Memorandum], paragraph 8; BP 10.00, Annex K, paragraph 2.
40 BP 14.25, paragraph 24. In such a case, signing of the legal documents would take place after final Board approval.
ANNEX A: ENTITY LEVEL CONTROLS

114. **Partnerships.** The Articles do not specifically refer to the responsibility for IDA’s partnerships with other entities. The Articles do, however, require Board of Governors’ approval for some IDA partnerships. Certain types of cooperation with other international organizations fall within the Board of Governors’ non-delegable power to “make arrangements to cooperate with other international organizations (other than informal arrangements of a temporary and administrative character).”41 IDA practice has been that Board of Governors’ approval has been sought for cooperation arrangements between the Association and other public international organizations that are formal in nature, general in scope, and indefinite in duration.42 Board of Governors’ approval has not been required for arrangements with public international organizations whose primary purpose is not cooperation, that are informal or ad hoc, that are for a limited duration, or that are administrative, as opposed to institutional or operational in character.43

115. Many other aspects of partnerships fall outside these reserved powers. Executive Directors approve the policy framework for the engagement of the Association in partnerships, while Management has the responsibility for approving individual partnership arrangements, based on the criteria contained in this policy framework. Executive Directors' approval is also needed in those cases where the President proposes to serve as a director of an entity established in respect of activities resulting from the partnership.

116. **Trust Funds.** IDA often acts as administrator or trustee of trust funds, with funds from bilateral, multilateral and other donors. In administering such trust funds, IDA must be guided by its purposes as set out in the Articles.44

117. Approval of IDA administration of trust funds has been sought from the Executive Directors where the trust fund is funded by transfers from the Bank’s net income or surplus, in conjunction with the Bank process for the approval from the Bank’s Board of Governors of the allocation of income or surplus. Executive Directors' approval is also required where the trust fund would provide assistance for entities not included in the IDA membership.45 Finally, where a trust fund presents novel or significant issues. Management has also sought the approval of the Executive Directors.

118. **Grants.**46 IDA financing on a grant basis (such as IDA 13 and 14 Grants, IDA Post Conflict Grants and IDA HIPC Grants) requires Board approval, as outlined in paragraph 17 above. Grants from IDA-administered trust funds are not IDA’s own financing and do not require Board approval unless the trust fund documents specify otherwise.

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41 Article VI, Section 2 (c) (v).
42 “Legal Note on Cooperative Arrangements with Other International Organizations,” Vice President and General Counsel, February 12, 2001, paragraph 4, in Selected Legal Advice, supra note 25, at page 27. The Legal Note also provides illustrations of cooperative arrangements that were sent to the Bank Governors for approval.
43 Id.
45 The determination that IDA administration of a trust fund benefiting territories outside its membership benefits the members as a whole has been requested from the Executive Directors, who, as per Article X(a), have the power to interpret the Articles of Agreement.
119. **Monitoring and Evaluation.** The Board has broad oversight on whether IDA’s operational results are met. The **Independent Evaluation Group** (IEG) is an independent unit within the World Bank Group, which reports directly to the Boards of the Bank and IDA.\(^\text{47}\) Under the oversight of the Board Committee on Development Effectiveness (CODE),\(^\text{48}\) IEG is headed by a Director General, Evaluation (DGO), who is appointed by the Board for a renewable five-year term. IEG independently evaluates IDA strategies, programs, projects and corporate activities with a view to identifying the contribution of the Association to a country’s overall development. The goals of evaluation are to learn from experience, to provide an objective basis for assessing the results of the Association’s work, and to provide accountability in the achievement of its objectives. It also improves the Association’s work by identifying and disseminating the lessons learned from experience and by framing recommendations drawn from evaluation findings. IEG’s programs and budget are reviewed by CODE and approved by the Executive Directors. IEG evaluation findings are reported directly to the Board and shared with the public under Board-approved disclosure policies.

120. **Inspection Panel.** Operational policies aim at ensuring effectiveness, but also transparency and fairness as the Bank and IDA carry out their work. On September 22, 1993, Executive Directors of the IBRD and IDA established the **Inspection Panel**\(^\text{49}\) with the primary purpose of addressing the concerns of the people who may be affected by World Bank’s projects and to ensure that the Bank and the Association adhere to their operational policies and procedures during the design, preparation and implementation phases of projects. The Inspection Panel reports directly to the Board and consists of three members who are appointed by the Board for non-renewable periods of five years. Members are selected on the basis of their ability to deal thoroughly and fairly with the requests brought to them, their integrity and independence from the bank Management, and their exposure to developmental issues and living conditions in developing countries.

121. The Panel can receive requests for inspection by an affected party in the territory of the borrower which is not a single individual, or by a representative of such party, whose rights or interests have been or are likely to be directly and materially affected as a result of a failure of IDA to follow its operational policies. In view of the institutional responsibilities of Executive Directors in the observance by IDA of its operational policies and procedures, an Executive Director may in special cases of serious alleged violations of such policies and procedures ask the Panel for an investigation. The Executive Directors, acting as a Board, may at any time instruct the Panel to conduct an investigation.

122. Before a request for inspection is heard, the Panel satisfies itself that the alleged violation is of a serious character and that Management, having dealt with the subject matter of the request, has failed to demonstrate that it has followed, or is taking adequate steps to follow policies and procedures. The Panel’s report on an inspection considers all relevant facts, and concludes with the Panel’s findings on whether IDA has complied with all relevant policies and procedures.

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48 Id. See also “Standing Committees,” Resolution Nos. 06-0010, IDA 06-0007, IFC 06-0067, October 20, 2006 [Standing Committee Resolution], paragraph 3(a).

procedures. In response to the Panel’s findings, Management submits to the Executive Directors for their consideration a report indicating its recommendations within six weeks from receiving the Panel’s findings. All decisions of the Panel on procedural matters, its recommendations to the Executive Directors on whether to proceed with the investigation of a request, and its reports, are reached by consensus and, in the absence of a consensus, the majority and minority views are stated. Both the request for Inspection and the Inspection Panel Report and management response are made publicly available after consideration by the Executive Directors. An annual report on the Panel’s activities is also provided to the Executive Directors and published.

123. Disclosure. Under its 2002 information disclosure policy,\textsuperscript{50} IDA makes a considerable amount of operational information available to the public, ranging from project and policy documents to strategy and evaluation documents. On March 8, 2005, the Board approved a number of revisions to the policy on the disclosure of information.\textsuperscript{51} The 2005 policy revisions aimed at improving and enhancing the Bank’s record on information disclosure. These changes reaffirm the commitment of the Bank and IDA to ensuring increased transparency about their activities. Notably, the 2005 revisions included a provision for disclosure of Board minutes.

2. Finance and administration

124. Financial Statements. Executive Directors review and approve the Association’s financial statements. As per Article VI Section 11, the Association publishes a report containing an audited statement of its accounts annually and circulates summary statements of its financial position to members at intervals of three months or less.

125. Net Income. The Articles provide that the Board of Governors determines from time to time the disposition of the Association’s net income, if any.\textsuperscript{52} To date, no such disposition has been made.

126. Risk Management. A new framework for provisioning against probable losses in IDA’s portfolio of development credits and guarantees, a requirement under US GAAP, has been approved by the Board on December 11, 2007.\textsuperscript{53} The new framework is based on the IBRD’s LLP framework, while reflecting IDA’s specific financial structure and portfolio characteristics including the concessional nature of IDA’s lending activities.

127. Strategic Planning and Administrative Budget. Every year, Management prepares a Medium-Term Strategy and Finance (MTSF) paper, which presents the Executive Directors with an integrated picture of the World Bank’s strategic priorities, income and expenditure, including a comprehensive overview of IDA’s financial outlook. The MTSF draws from extensive management discussions as well as consultations on these matters between management and the Board. The review of the MTSF precedes, and provides a context to, the annual approval of the World Bank’s administrative budget by the Executive Directors.

\textsuperscript{50} Disclosure Policy, supra note 16.
\textsuperscript{52} Article VI, Section 12.
128. **Managerial Appointments.** The appointment of the Bank’s officers and staff is among the direct responsibilities of the President, subject to the general control of the Board.\(^{54}\) The “general control” to be exercised by the Executive Directors related to staff appointments has customarily been confined to advance notice of proposed senior level staff appointments.\(^{55}\) The practice of informal discussion of proposed senior level staff appointments was first formalized in 1973 when the President and the Executive Directors agreed that the President would send the qualifications of proposed senior management appointees to the Executive Directors for comment five days in advance of appointment (for Department Directors, the period was 24 hours). During the advance period, the President proposed that:

> “any Executive Director may provide me with comments he may wish to make regarding the appointment or extension. Should any Executive Director so desire, I will convene an executive session of the Board to discuss the matter before taking any further action.”\(^{56}\)

129. These practices have remained in place, with modifications in positions covered and timing approved by the Executive Directors in 1999.\(^{57}\) The current, modified procedure requires that Management provide three working days’ advance notice to the Board of (a) appointment to all managerial positions graded GI and above, regardless of title; (b) appointment of all Country Directors, regardless of grade; and (c) reassignment of any manager graded GI and above or of any Country Director to a newly created position or to a position of Vice President or above.

130. Certain senior positions require greater involvement by the Board. The Director-General, Evaluation (head of the Independent Evaluation Group), the members of the IBRD/IDA Inspection Panel and the judges of the World Bank Group Administrative Tribunal are each appointed by the Board on the nomination of the President. While the Auditor General, Group General Counsel and Corporate Secretary are all staff positions, appointed by the President, provision has been made for Board involvement in the appointment process (exercised by the Audit Committee in the case of the Auditor General).\(^{58}\)

### 3. Board procedures and instruments

131. Board procedures and decision-making have evolved over time as the Executive Directors and Management have agreed on the applicable rules. The rules and practices have been continually revised and updated, generally through the mechanism of a Board review of procedures. The most recent review was a 2005 Report entitled *Board Effectiveness: Making Board Decision-making Processes More Efficient* (Board Effectiveness).\(^{59}\) Previous reviews include the 2000

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\(^{54}\) IDA Article VI, Section 5 (b). In practice, IBRD officers generally serve in the same capacity for IDA.


\(^{57}\) “Advance Notice on Managerial Appointments,” R99-33, March 5, 1999.

\(^{58}\) These arrangements are described in paragraphs 9-14 of the 2007 Legal Memorandum, *supra* note 55.

ANNEX A: ENTITY LEVEL CONTROLS


132. The Executive Directors conduct their business in several different formats, depending on the matter under consideration and the action to be taken. The Executive Directors meet in both formal and informal meetings. Technical briefings are held for Executive Directors and those in their offices. The Executive Directors also meet as the Committee of the Whole, in the Steering Committee and in Board Committees. These formats are described below.

133. Under the Articles,\textsuperscript{64} the President serves as Chairman of the Board for all meetings of the Board. Under the Board’s Rules of Procedure for meetings, a Managing Director designated by the President acts as Chairman in his absence.\textsuperscript{65} However, when a meeting is convened to consider the President’s appointment or terms and conditions of service, or “under such other exceptional circumstances in which the President shall have determined that it would be “inappropriate” either for him or for a Managing Director to act as Chairman, an Executive Director selected by the Executive Directors acts as Chairman.\textsuperscript{66}

134. **Formal Meetings.** Where the Executive Directors are called upon to take decisions for the Association, a formal meeting of the Board is the appropriate forum. For routine operational and administrative decisions, approval is sought without meeting, i.e., by circulation of a proposal on a no objection basis.

135. Items submitted for approval on an absence-of-objection (AOB) basis include amendments and waivers to projects as well as some policy items that, as a result of discussion in Board committees and/or formal or informal meetings, are considered ready for approval without further discussion by the full Board. The 2005 Board Effectiveness paper clarified that any Executive Director may request Board discussion of an AOB item and that, if a Director wishes to be recorded as abstaining on or opposing an item without requesting Board discussion, the minutes which record the approval of the item will also record such abstention or opposition.\textsuperscript{67}

136. **Informal Meetings.** Informal Meetings are convened in order to provide a forum for exchange of views and for sharing information on matters of interest to the Executive Directors,

\textsuperscript{60} Toure Report, supra note 11.
\textsuperscript{61} 1995 Review, supra note 15.
\textsuperscript{62} Naim Report, supra note 14.
\textsuperscript{63} 1988 Report, supra note 13.
\textsuperscript{64} Article VI, Section 5(a).
\textsuperscript{65} Rules of Procedure for Meetings of the Executive Directors [Rules of Procedure], Section 2(f).
\textsuperscript{66} Id. Where the occasion is not a formal Board meeting, the Toure Report indicates that – in the President’s absence -- Committee of the Whole discussions are chaired by the responsible MD and informal meetings by an MD or VP. Technical Briefings may be conducted by an MD, VP, department director or senior staff. Toure Report, supra note 11, at note 6, page 26. Note that the Executive Directors are not, strictly speaking, taking formal action as the Board on these latter occasions.
\textsuperscript{67} Board Effectiveness Paper, supra note 10, paragraph 71.
often prior to the submission of a specific recommendation for Board approval. Decisions cannot be taken in informal meetings of the Executive Directors.

137. Formal and informal meetings are open to attendance by Executive Directors, their Alternates, the President and members of the staff designated by him, and such other persons as the Board may invite. Attendance is limited when the Board meets in executive session, to no more than three persons from each office, consisting of the Executive Director, Alternate Executive Director and one Temporary Alternate, and in restricted executive sessions, to one person per office.

138. Technical Briefings. Technical Briefings are convened in order to inform interested Executive Directors and their staff of work in progress on a particular subject. Attendance at Technical Briefings is considered optional and the legal provisions summarized above do not specifically apply to them. Whether particular policy papers are to be considered in Informal Meetings or Technical Briefings in advance of a formal discussion is arranged by Management in close consultation with the Executive Directors’ Steering Committee (discussed in paragraph 46 below). An Executive Director’s request for a Technical Briefing should be supported by at least five other Executive Directors. Technical Briefings scheduled at the request of Management should not exceed two per month.

139. Committee of the Whole. The Executive Directors may also meet as the Committee of the Whole, a committee made up of all Executive Directors. As is the case with Board committees generally, the role of the Committee of the Whole is limited to making recommendations or exchanging views on matters of interest to the Board. No decision binding on the Bank may be taken in these meetings. If required, the Board can take up the same issue for decision in a subsequent formal meeting. Traditionally, the Committee of the Whole has been used as a forum in which to hold preliminary discussions of issues before they were taken up by the Board. The Committee of the Whole is also the forum in which the Executive Directors act as a preparatory body for the work of the Development Committee.

140. Executive and Restricted Executive Sessions. These sessions are used when, in light of the sensitive and confidential nature of matters to be discussed, it is considered desirable to restrict attendance to Board meetings. Generally, these sessions are used for country confidential, market sensitive, personnel-related matters, and INT issues. Attendance to Executive Sessions is limited to three persons from each Executive Directors’ Office and at restricted executive sessions to one person per office.

68 “Types of Board Meetings,” Memorandum to Executive Directors and Alternates from the Corporate Secretary, March 3, 1998. Prior to 1998, the Board also held Board Seminars, which were intended as informal gatherings used to explain a selected topic to the Executive Directors and to obtain their views, frequently in advance of a formal Board discussion.
69 Rules of Procedure, supra note 65, Section 2(d).
70 Toure Report, supra note 11, paragraph xxiv (iii).
71 Id.
72 Naim Report, supra note 14, paragraphs 16 and 53(a).
73 Board Effectiveness Paper, supra note 10, paragraph 77.
141. **Steering Committee.** The Executive Directors also meet in the Executive Directors’ Steering Committee, which is not a formally constituted committee of the Board. Its nature and functions are described in the Toure Report, as follows:

142. “[The Steering Committee is] an informal advisory body, whose functions include reviewing, with the assistance of the Secretary and Management, all matters relating to the scheduling and composition of the Executive Directors’ Work Program and other areas of interest related to the conduct of the Board’s business. Traditionally, the Steering Committee consists of the Dean, Co-Dean and the committee chairs. However, all Executive Directors are encouraged to attend Steering Committee meetings.”

4. **Board committees**

143. The Executive Directors are empowered under the Bank’s Articles to “appoint such committees as they deem advisable,” and committee membership is not limited to Executive Directors. Board Committees also cover IDA matters. Board committees have no decision-making power (except with regard to procedural or administrative matters) and committees do not vote on substantive issues. Instead, each committee submits reports and recommendations to the full Board. In case members of committees take different positions, the committee would report all views and indicate the degree of support received by each. The Board does not delegate decision-making power to the committees, because the weighted voting system under which Board decisions are taken only works if all Executive Directors participate in the decision.

144. Currently, there are five standing committees established by the Board: the Audit Committee, the Budget Committee, the Committee on Development Effectiveness (CODE), the Committee on Governance and Executive Directors’ Administrative Matters (COGAM), and the Personnel Committee. Rules of procedure for the standing committees have been established by the Board. These rules include that committee decisions on procedural and administrative matters are taken by simple majority of those present, and that committee reports to the Board indicate majority and minority views. Committee meetings are open to any Executive Director or authorized representative, “except in highly exceptional circumstances when the committee decides for stated reasons to go into closed session” and committee documents are circulated to all Executive Directors unless the committee directs otherwise. While these rules do not legally apply to the ad hoc committees and working groups that the Board establishes from time to time, the same principles are generally applied by reference.

145. The **Audit Committee** has a mandate to assist the Board in overseeing the World Bank Group’s financial condition, risk management and assessment processes, the adequacy of governance and controls, and reporting and accounting policies and procedures. This mandate includes, in particular, responsibilities relating to (i) the integrity of financial statements (IBRD, IDA, IFC, MIGA and trust funds), (ii) the External Auditor (appointment, qualifications, independence and performance), (iii) the Internal Audit Department, (iv) the system of internal controls regarding finance, accounting and ethics (including mechanisms for dealing with and

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74 Toure Report, supra note 11, paragraph 24.
75 Article V, Section 4(i).
76 Standing Committee Resolution, supra note 48, at paragraph 7.
minimizing fraud and corruption), (v) significant financial and reputational risks (for IBRD, IDA, IFC, MIGA and trust funds), and (vi) the effectiveness and integrity of financial policies in such areas as trust fund administration, procurement procedures and financial management, especially portfolio concentration, capital adequacy, the allocation of net income, and provisions for loss.

146. The **Budget Committee** considers certain aspects of Bank, IFC and MIGA business processes, administrative policies, standards and budget issues which have a significant impact on the cost effectiveness of their operations. The Committee regularly reviews the institutions' budgets for the coming fiscal year, as well as making midyear and retrospective reviews.

147. The mandate of **CODE** is to monitor and assess the Bank Groups' effectiveness in fulfilling its development mandate. The committee reviews the work of the Independent Evaluation Group for the World Bank Group, Management's Responses thereon, and select reports from Management to satisfy itself that the operations evaluation and self-evaluation activities are adequate and efficient. The committee also prepares for Board consideration select operations evaluations, draft strategies and policies, other high-priority development effectiveness issues, and monitors the implementation of Board decisions to ensure that the overall objective of poverty reduction is being served.

148. **COGAM** considers issues of governance and administrative policy relating to the Executive Directors and Alternates and their staff referred to it by the Board, or on the Committee's own initiative, and makes recommendations to the Board. The Committee coordinates many of its recommendations with a similar committee established by the IMF Executive Board. In making its recommendations, the Committee tries to maintain a balance between the organizational and administrative objectives of the institution and the unique circumstances faced by the Executive Directors and Alternates in discharging their dual responsibilities.

149. The **Personnel Committee** is responsible for keeping under continuing review and, where appropriate, advising the Executive Directors on staff compensation and other significant personnel policy issues including strategic staffing, diversity and conflict resolution.

C. Ethics

150. A new Code of Conduct (COC) for Board Officials was adopted by the Executive Directors with effect as of November 1, 2007. It applies to Executive Directors and their Alternates, Senior Advisors and Advisors—collectively designated as “Board Officials”—, as well as the President of the Association. It sets forth principles and ethical standards for Board Officials in connection with, or having a bearing upon, their status and responsibilities in the organization, with a view to reinforcing ethical standards by “setting the tone at the top” and modernizing the ethics framework to reflect best practice. In general terms, the COC prescribes that Board Officials shall carry out their responsibilities as prescribed in the Articles of Agreement, the By-Laws, and other related documents, to the best of their ability and judgment. It stresses that Board Officials should maintain the highest standards of integrity in their personal and professional conduct and should observe principles of good governance. The Code also mandates that Board Officials shall hold the interests of the Bank Group paramount
over personal interests, and shall avoid conduct that could bring the Bank Group into disrepute or create the appearance of impropriety. It includes several specific provisions on conflict of interest, for which it adopts a more inclusive definition, and financial disclosure.

151. The Ethics Committee considers all matters relating to the interpretation or application of the COC, including requests for guidance concerning conflicts of interest, annual disclosures, or other ethical aspects of conduct in respect of Board Officials, and allegations of misconduct by Board Officials.

152. The Ethics Committee consists of five Executive Directors. They are appointed by the Executive Directors on the nomination of the Chairman of the Board following informal consultation with the Executive Directors, and in particular with the Dean. Membership of the Ethics Committee should reflect the economic, cultural, and geographic diversity of the Bank Group’s member countries. The Dean and Co-Dean are not eligible to serve as Committee Members. Specific procedures for the Ethics Committee are set out in the COC.
## Annex A: Attachment – Board Decision-Making

### 1. Institutional Issues

<table>
<thead>
<tr>
<th>Major Decisions</th>
<th>Sources</th>
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<tbody>
<tr>
<td>IBRD President <em>ex officio</em> President of IDA</td>
<td>Article VI, Section 5(a)</td>
</tr>
<tr>
<td>Issue formal interpretations of Association’s Articles of Agreements and propose amendments</td>
<td>IDA Articles IX(a) and X(a)</td>
</tr>
<tr>
<td>Approve Association’s Annual Report</td>
<td>Article VI, Section II</td>
</tr>
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1 Sources are not comprehensive.

### 2. Operational Policy, Strategy and Instruments

<table>
<thead>
<tr>
<th>Major Discussions/Decisions</th>
<th>Sources</th>
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<tbody>
<tr>
<td>• Approve Policy Papers for the general operations of the Bank and grant any waivers thereto</td>
<td>Memorandum with Regard to Organization and Loan Procedure (Jun. 4, 1947); IDA Article VI, Section 2(h)</td>
</tr>
<tr>
<td>Discuss Country Assistance Strategies, Poverty Reduction Strategy Papers and Joint Staff Assessment Notes, and the related progress reports</td>
<td>Memorandum with Regard to Organization and Loan Procedure (June 4, 1947); Review of Board Procedures (R73-225; September 13, 1973); Mainstreaming of Guarantees as an Operational Tool of the World Bank (R94-145; July 14, 1994)</td>
</tr>
<tr>
<td>Approve specific financing operations (Credits, Guarantees and Grants), either through streamlined or regular procedures</td>
<td>A Framework for Managing Global Programs and Partnerships (R2001-2; January 9, 2001)</td>
</tr>
<tr>
<td>Recommend cooperative arrangements with other international organizations for Governors approval</td>
<td>Article VI, Section 2(b)(v)</td>
</tr>
<tr>
<td>Approve individual partnership arrangements requiring the involvement of the President</td>
<td>Article I</td>
</tr>
<tr>
<td>Approve Trust Funds providing assistance outside membership; or raising novel or significant issues; or when required in the respective instruments</td>
<td>Board Resolution No. IDA 93-10</td>
</tr>
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</table>
### 3. Treasury, Finance, and Administration

<table>
<thead>
<tr>
<th>Major Discussions/Decisions</th>
<th>Sources</th>
</tr>
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<tbody>
<tr>
<td>Discuss the Treasury Quarterly Reports</td>
<td></td>
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<tr>
<td>Review and Submit Bank’s financial statements to Governors</td>
<td>IDA By-Laws, Section 8</td>
</tr>
<tr>
<td>Set policy to ensure that Bank’s staff is of highest efficiency and technical competence and of wide geographical basis</td>
<td>Article VI, Section 5(d)</td>
</tr>
<tr>
<td>Approve annual budget</td>
<td>IDA By-Laws, Section 8</td>
</tr>
<tr>
<td>Call meetings of the Board of Governors and/or request Governors’ mail vote</td>
<td>IDA Article VI, Section 2(d) and (g)</td>
</tr>
<tr>
<td>Exercise general control over staff appointments, which are the responsibility of the President</td>
<td>IDA Article VI, Section 5 (b)</td>
</tr>
<tr>
<td>Receive advance notice of senior level appointments</td>
<td>Advance Notice of Senior Level Appointments (R73-146/1, July 3, 1973); Advance Notice on Managerial Appointments (R99-33, March 5, 1999)</td>
</tr>
<tr>
<td>Appoint Director General, Evaluation, members of the Inspection Panel and judges of the Administrative Tribunal (on nomination by President)</td>
<td>DGO Mandate, R2005-0226, October 27, 2005; Board Resolution No. IDA 93-10; Statute of Administrative Tribunal</td>
</tr>
<tr>
<td>Involved in selection process of Auditor General, Group General Counsel and Corporate Secretary (appointed by President)</td>
<td>2007 Legal Memorandum</td>
</tr>
</tbody>
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THE WORLD BANK

IDA: INTERNAL CONTROLS REVIEW:

MANAGEMENT ASSESSMENT FY08

ANNEX B. SUPPLEMENTAL REPORT ON TRANSACTION-LEVEL CONTROLS
ANNEX B. SUPPLEMENTAL REPORT ON TRANSACTION-LEVEL CONTROLS

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IDA: INTERNAL CONTROLS REVIEW
MANAGEMENT’S SUPPLEMENTAL REPORT ON TRANSACTION-LEVEL CONTROLS IN IDA’S INTERNAL CONTROL FRAMEWORK

Executive Summary

1. As set out in paragraphs 12-33 of Management’s Scoping Memo for Part II¹ (the “Scoping Memo”), in response to the recommendations of the Internal Auditing Department (IAD) and the Independent Evaluation Group (IEG) in their respective Part IB reports and discussion of Part IB work at the Audit Committee on July 16, 2007, during Part II Management has carried out the following supplemental work relating to transaction-level controls that included:

- assessments of the:
  - Analytic Advisory Activities (AAA) processes and controls, and compliance with these processes and controls;
  - Process for updating Operational Policy (OP) and Bank Procedures (BP)
  - Safeguards corporate risk management process;
  - IDA Credit/Grant Mix Determination;
  - IDA allocation process; and,
  - Quality Assurance Group’s (QAG) Quality of Supervision (QSA) 7 process;

- reviews of quality arrangements supporting financial management (FM) and procurement (PR) work in the context of IDA operations;
- identification of fraud and corruption controls at the transactions level; and,
- additional testing of Country Assistance Strategy (CAS) and Development Policy Loan (DPL) processes.

2. The results of this supplemental work have confirmed conclusions reached by Management under Part IB that the design and operational effectiveness of identified processes and associated key controls (including the additional processes and controls mapped and tested during Part II, listed below) are adequate to ensure compliance with IDA’s polices and procedures that funds are used for the purposes intended. In particular, during Part II, as part of compliance testing of transaction-level processes and controls, Management found 100% controls compliance in randomly selected transactions in: (i) the safeguards corporate risk management process, (ii) the process related to IDA Credit / Grant Mix Determination, (iii) IDA allocation process, (iv) Quality Assurance Group’s (QAG) Quality of Supervision (QSA) 7, and (v) additional CASs and DPLs.

3. The supplemental work also confirmed the significant deficiencies relating to:

- Timely accessibility of relevant documents;

¹ See Annex C to the Report for details.
ANNEX B: SUPPLEMENTAL REPORT ON TRANSACTION-LEVEL CONTROLS

- Regional variances in financial management and procurement guidelines
- Not keeping pace with needed updates to OPs and BPs, particularly in the area of investment lending.

4. In addition, the Part II “drilldown” of fiduciary controls in the areas of PR and FM identified the following additional significant deficiencies:

- Adequacy of controls in place to ensure consistent follow-up on PR issues by the task teams, including the need for better integration of PR staff in task teams and clarification of accountabilities for procurement issues and decisions.
- Inconsistent implementation of PR post-reviews; and
- Inconsistency in quality arrangements for the documentation of FM supervision and some inconsistency in quality arrangements for oversight and monitoring of FM supervision.

5. Finally, the supplemental work also identified a significant deficiency in the AAA area in the need to simplify and rationalize processes and systems, taking into account the wide scope of AAA activities.

I. Introduction and Background

6. Background. As reflected in the IDA 14 Replenishment Report Management committed to carry out, during the period of IDA 14, an independent comprehensive assessment of its control framework including internal controls over IDA operations and compliance with its charter and policies, and making such assessment available to the public after its disclosure has been approved by IDA’s Executive Directors. The assessment has been conducted in the context of the internal control framework developed by COSO, adapted to fit the unique nature and operations of IDA. It has been carried out in three tiers: Management self-assessment; Independent Audit Department (IAD) review; and an independent evaluation of both by the Independent Evaluation Group (IEG). The assessment has

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2 See, Report from the Executive Directors of the International Development Association to the Board of Governors, Additions to IDA Resources: Fourteenth Replenishment, Working Together to Achieve the Millennium Development Goals, (approved by the Executive Directors of IDA on March 10, 2005), paragraph 39, under the Disclosure bullet.

3 COSO published a report in 1992, “Internal Controls – Integrated Framework,” which is widely referred to by leading financial institutions in the United States and is also seen as a model in many other parts of the world. IDA adopted the COSO framework as its controls methodology in 1995. The framework is an all encompassing process which covers all aspects of internal control of an organization’s operation. It considers not only the evaluation of formal controls, but also informal controls, such as ethics, trust, communication, organization behavior and leadership, and incorporates “top-down” as well as “bottom-up” analysis.
been divided into two parts: Part I, which focused on design and operating effectiveness of controls over IDA operations at the transaction level; and Part II, which focused on (i) entity-level controls, (ii) outstanding transaction-level controls deferred from Part I, and (iii) the operations objective of COSO.

7. **Objective and structure of this report.** This report reflects Management’s assessment of compliance at the transaction-level, building on work performed during Part I and supplemented by transaction-level work completed during Part II. In addition, Management’s work on transaction-level controls conducted during Parts I and II, as these relate to the third COSO objective, effectiveness and efficiency of IDA’s operations, are also reflected in the overall summary, IDA 14 Internal Controls Review.

8. Following this introduction, Section II of this report sets out the scope and methodology followed by Management in conducting supplementary work on transaction level controls during Part II. Section III sets out the results of Management’s assessment of transaction level controls, followed by a discussion of significant deficiencies identified by Management and recommended actions to address them. In accordance with document sharing process adopted under Part I, all documentation and testing results relating to the above were provided to IAD and IEG for their review and evaluation, respectively.

II. SCOPE and Methodology Summary

A. Scope

9. Throughout this assessment, Management followed the COSO definition of internal control, namely, a process affected by an entity’s board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in three COSO categories: financial reporting, compliance and operations. Management assessed internal controls related to these three objectives categories against different expectations, an approach that was consistent with COSO. In the context of the compliance objective, Management assessed whether IDA’s internal control system can be expected to provide reasonable assurance that IDA carries out its operations in compliance with its charter and operational policies. Following is a summary of the scope and methodology followed by management in assessing the compliance objective against such expectations:

10. The corporate entities for which the COSO framework was developed are subject to specific laws and regulations in their respective jurisdictions. IDA’s status as an international organization with immunities and privileges makes this COSO

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4 The work done for the two other COSO objectives, financial reporting and efficiency and effectiveness of controls over operations, along with the assessment of entity-level controls, are covered in Annex A to the Report.
category not directly applicable. However, in addition to its charter (i.e. its Articles of Agreement) IDA has a body of internally generated policies and procedures with which it needs to comply. Management has therefore interpreted compliance with laws and regulations to mean compliance with IDA’s (i) Articles of Agreement, and (ii) operational policies and procedures.

11. Management’s assessment of IDA’s compliance with relevant provisions of its Articles of Agreement and operational policies and procedures was carried out in two parts. During Part I Management focused on transaction-level controls relating to compliance with (i) provisions of the IDA Articles of Agreement, as interpreted from time to time by IDA’s Executive Directors, relating to the management of IDA’s lending operations; and (ii) internal operational policies and procedures relating to the management of IDA’s lending operations. Management supplemented this work during Part II with additional work related to transaction-level controls associated with processes that were not covered during Part I, as well as a “drilldown” in the FM and PR areas.

12. In Management’s view, the overall results of its assessment show that the above methodology, made possible through the sequencing of assessment work undertaken and the methodology adopted by management, has yielded depth, specificity and relevance of findings and actionable recommendations.

13. In particular, to supplement Part I work, and in line with the Scoping Memo, the objectives of supplemental compliance testing work performed by Management during Part II were:

- **for FM and PR** to: (i) drill down on rationale for, and significance of, the regional variances in implementation of FM and PR guidelines identified in Part IB; and (ii) review the quality aspects that have been put in place in each region to support reviews and inputs of FM\(^5\) and PR relating to appraisal and supervision of projects;
- **for AAA** to: (i) map out the process of the main AAA product line, Economic and Sector Work (ESW) report; (ii) conduct a walkthrough; and (iii) test compliance of documents of ESW reports completed during FY2006-2007 that were randomly selected for this purpose, following the process similar to that performed for IL, DPL, and CAS product lines during Part I;
- **for OP/BP updates**: review and document the current processes underlying policy revision and update current status of OP/BP updates since completion of Part IB; and
- **for other modules**: complete the documentation, walkthroughs and testing for additional processes, namely: (i) safeguards corporate risk management process; (ii) IDA Credit/Grant Mix Determination; (iii) IDA allocation process; and (iv) QAG’s Quality of Supervision (QSA) 7 process;

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\(^5\) In the area of FM, this included a review of issues relating to project audits, including audit TORs, audit review process and follow-up, as well as the relationship between the audits and SOE reviews.
• for anti-fraud and anti-corruption controls at the transaction level: identify links of transaction-level controls documented during Part I to entity-level anti-fraud and anti-corruption controls; and

• for CAS/DPL to expand the Part IB testing sample with additional transactions from regions not represented in these two processes.

14. Management’s findings relating to each of these objectives are set out in Section III of this Report.

B. Methodology

1. Financial Management and Procurement

15. Two separate review teams assembled by Management undertook a “drill-down” of FM and PR issues examining (a) the significance and appropriateness of variances in Regional implementation of FM and PR guidelines, and (b) the quality aspects supporting specialist inputs, defined for purposes of this review as Regional quality assurance (QA) arrangements. The separate reviews covered the following five areas:

- QA arrangements and business procedures;
- adequacy of resources;
- projects under preparation;
- projects during implementation; and
- documentation and communication.

16. The reviews did not evaluate the quality of FM and PR work. While these were closely related, a review of quality itself in these areas was beyond the scope of the reviews. Specifically, the “drilldowns” on FM and PR included: (i) a review of findings and recommendations of the QAG Quality of Supervision (QSA 7) assessment as it related to the areas of FM and PR; (ii) a review and incorporation, as appropriate, of IAD findings reflected in its recent fiduciary and project supervision audits; (iii) the development of separate questionnaires related to FM and PR that were filled out by the respective anchors and regional managers, (iv) a review of appropriate documentation from (and interviews with) anchor and regional FM and PR managers and specialists that supported responses to the questionnaires (these also helped the review teams determine whether follow-up of action plans described in Procurement reviews and FM assessments are done and identify current Quality review processes conducted on a portfolio-wide basis at the regional level); and (v) confirmation of procedures for the Management review of IL process from regional managers, particularly as they relate to risk assessment in the areas of FM and PR. The FM “drilldown” and resulting report was done in partnership with the FM anchor. The PR “drilldown” was similarly done in

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7 Management consulted with IAD during the development stage of the questionnaires and incorporated its comments in the final drafts of the questionnaires prior to distribution to respondents.
partnership with the PR anchor, however, the PR anchor took the lead in finalizing the PR report, given the uniqueness and complexity of the PR area. As per the document sharing process applied in Part I, all documentation and testing results were provided to IAD and IEG for their review.

2. Analytic and Advisory Activities

17. During Part II, Management (i) identified and mapped current processes and controls that apply to the main AAA product line, Economic and Sector Work (ESW), (ii) conducted a walkthrough of the mapped processes and controls, and (iii) tested compliance with such controls by a sample of randomly selected ESW reports completed and delivered to clients during FY07, in a process similar to that performed for IL, DPL, and CAS product lines during Part I. The focus on ESW (and for sampling purposes, on ESW reports) was in large part due to the fact that ESW funding has traditionally absorbed the major share of AAA funds and ESW reports account for over 80% of total ESW spending. In accordance with document sharing process adopted under Part I, all documentation and testing results relating to the above were provided to IAD and IEG for their review and evaluation, respectively.

3. OP/BP Updates

18. During Part I, Management identified that some OPs/BPs were not keeping pace with the changes needed and/or introduced on the ground, especially in the area of investment lending (IL). During Part II, Management therefore undertook to review and document the current processes underlying policy revision and make recommendations on how these processes could be made more efficient to facilitate more timely updates of operational policies and Bank procedures. In addition, in its Scoping Memo for Part II, Management noted that with the main fiduciary policies (including OP/BP 12.00 re disbursements and 10.02 re FM) issued in March 2007 and major instrument policies (including OP/BP 8.60 re DPLs and OP/BP 8.00, re emergency lending) in place, the issue of outdated OPs and BPs primarily affects the statements governing the appraisal and supervision of IL operations, i.e., OP/BP 10.00 and 13.05 and related statements. To this end, management has prepared a revised table of OP/BPs that have a direct bearing on IDA’s operations which shows the status of OP/BPs that were recently updated and flags those that still need to be updated/revised. Since most of these govern IL, during Part II, Management also assessed how the proposed reform and consolidation of IL policies will help address the issue of outdated OP/BPs.

19. The identification and documentation of processes underlying policy revision was led by OPCS in close consultation with LEG and assistance from the CSR mapping team. The process documentation was based on the experience with policy

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8 The sample was drawn from the universe of ESW Reports completed as of September 16, 2007, and whose cost exceeded $100,000. These types of ESW Reports accounted for 90% of ESW Reports completed. ESW as a whole has consumed approximately 67% of the AAA budget.
revisions of all types that took place over the past 4 years under OPCS leadership either as a sponsor for the needed policy revisions or as a coordinator of policy revisions sponsored/owned by other units. Examples of policy revisions sponsored by OPCS include: OP/BP 6.00, Expenditure Eligibility, OP/BP 13.20, Additional Financing, OP/BP 8.00, Rapid Response to Crises and Emergencies; examples of policy revisions sponsored by other units and coordinated by OPCS include: OP/BP 12.00, Disbursement, and OP/BP 14.40, Trust Funds. The processes underlying these policy reforms were identified and mapped using the same methodology as has been employed in mapping processes and key controls underlying transaction-level work performed during Part I. An “informal” walkthrough of these process flow charts was conducted with IEG and IAD. During this “walk-through” various questions were discussed and clarified. The final flow-charts that reflect the walkthrough were shared with IAD and IEG.

C. Other Modules:

1. Safeguards Corporate Risk Oversight

20. During Part II, Management (i) revised documentation for the Safeguards Risk Oversight (SRO) process Module # 29 to reflect the new guidance,9 (ii) performed a walkthrough of the process when a project is flagged as having high corporate safeguard risk requiring enhanced oversight, and how a project is determined to no longer need enhanced oversight, and (iii) tested compliance of documents for projects currently subjected to the process and projects removed from the process during the most recent SRO review. The documents were randomly selected for this purpose. In accordance with document sharing process adopted under Part I, all documentation and testing results relating to the above were provided to IAD and IEG for their review and evaluation, respectively.

2. IDA 14 Grant Allocation Process: IDA Credit/Grant Mix Determination

21. Management also (i) identified and mapped the IDA Credit/Grant Mix Determination (Module #35) process, (ii) conducted a walkthrough of the mapped process.

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9 During Part I, the quality assurance and compliance unit responsible for review of safeguards (OPCQC) stated that the screening process for possible inclusion of projects onto the safeguards corporate risk list was based on close consultations between OPCQC and regional staff to determine potential risks and appropriate measures to address them, including potential inclusion on the corporate safeguards risk list. These consultations took place in different ways and on different cycles, depending on the project management system used in each region. Since this was originally designed as a management advisory system rather than as a specific control mechanism, the results of the screening and the subsequent decision to include or remove projects from the list were not recorded in a standardized manner. As a result, Management was unable to perform compliance testing on Module # 29 Safeguards – Corporate Risk List during Part IB. Management has taken steps to standardize the approach used by OPCQC and the regions in screening and tracking projects on the safeguards corporate risk list and provided guidance to the regions on this matter. This work was the subject of Management’s assessment in this area during Part II.
process, and (iii) tested compliance of documents of IDA-eligible countries in the FY07 IDA allocation that were randomly selected for this purpose. In accordance with document sharing process adopted under Part I, all documentation and testing results relating to the above were provided to IAD and IEG for their review and evaluation, respectively.

3. **IDA 14 Grant Allocation Process: Debt Sustainability Analysis (DSA)**

22. FY08 was the first year in which country eligibility for IDA grants has been mostly based on DSAs\textsuperscript{10}. With the understanding that these processes are still being fine-tuned, Management has mapped out the processes under the Debt Sustainability Framework, following the same methodology and framework used for testing Modules during Part I. Management has: (i) identified and mapped the Debt Sustainability Analysis (Module #34) process (ii) conducted a walkthrough of the mapped process, and (iii) tested compliance of documents of DSAs completed during FY08 that were randomly selected for this purpose.\textsuperscript{11} As per the document sharing process applied in Part I, all documentation and testing results were provided to IAD and IEG for their review.

4. **QAG Quality of Supervision Assessment (QSA)**

23. During Part I, Management documented and validated the Quality at Entry Assessment (QEA) process based on the recently completed QEAs. In the Scoping Memo, Management agreed with IAD and IEG that the QSA 7 process would be tested for design and operating effectiveness during Part II. IAD conducted compliance testing on behalf of Management of documents completed for QSA 7 randomly selected for the purpose. As per the document sharing process applied in Part I, all documentation and testing results were provided to IAD and IEG for their review.

\textsuperscript{10} During Part I, Management did not review the processes relating to the broader debt sustainability analyses required under IDA 14, including the grant allocation framework based on a country’s risk of debt distress. These new processes were in a very early stage of implementation during the testing period under review (July 1, 2005 – February, 28, 2006). More specifically, the forward-looking DSAs required for gauging a country’s risk of debt distress were not widely available. As agreed with the IDA Deputies, Management relied on a "static" method based on a country’s current debt situation as a temporary mechanism. In addition, confirmation from the IDA Deputies that eligibility for IDA grants would continue to be based on such new processes only took place in November 2006, as part of the IDA14 Mid-Term Review discussions – Debt Dynamics and Financing Terms: A Forward-Looking Approach To IDA Grant Eligibility.

\textsuperscript{11} FY08 samples were chosen, as the DSA process was formalized with the issuance of *Staff Guidance Note on the Application of the Joint Bank-Fund Debt Sustainability Framework for Low-Income Countries* (May 3, 2007).
5. Tagging of Anti-Fraud and Corruption controls to all transaction level processes

24. Following-up on an IAD recommendation, Management has reviewed the processes and transaction-level controls identified during Part I work and has linked, or “tagged”, each process or control to an entity-level anti-fraud and corruption control identified during Part II work. In accordance with document sharing process adopted under Part I, all documentation and testing results relating to the above were provided to IAD and IEG for their review and evaluation, respectively.

6. Additional testing of CAS and DPL modules

25. In its Part IB evaluation, IEG noted its concern over Management’s sampling methodology for the CAS and DPL modules that were tested for compliance with applicable policies and procedures. In order to address IEG’s concerns, Management undertook additional, targeted tests of these two modules during Part II, specifically including one CAS and one DPL from regions that did not have CAS and DPL transactions in the cohort of transactions that were randomly selected from the available pool of transactions during Part IB. Management tested compliance of documents from additional CAS and DPL samples from regions not represented in the initial testing.

III. SUMMARY of Issues and Recommended Actions

A. Financial Management

26. The review found the following:

1. Quality assurance arrangements and business procedures

- All Regions have QA arrangements that have been documented and disseminated to staff.
- Regional QA arrangements have not been validated by the Financial Management Sector Board (FMSB).
- It is difficult to ascertain in some Regions if QA arrangements for projects under implementation are completely in compliance with the Financial Management Practices Manual (FMPM).
- There is a range of supplementary guidance for FM staff.
- The information on some Region-specific websites is not current.

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12 During Part IB compliance testing, all relevant transactions from all regions were subject to the random selection process. The expanded testing of CAS and DPL controls during Part II ensured at least one representative transaction from regions in the combined Part IB and Part II CAS and DPL cohorts.
2. Adequacy of resources

- Regions report that they have the budgetary resources to fulfill their current fiduciary functions, and are able to plan and staff the FM function adequately.

3. Projects under preparation

- QA arrangements are operating effectively. Variances among Regions appear to be reasonable and generally responsive to the Region’s organizational structure and geographic and other constraints.

4. Projects during implementation

- Some Regions are not in full compliance with the QA arrangements that govern projects under implementation, and remediation is under way.
- Some gaps in the FM Network QA arrangements are not addressed in the Regional QA arrangements.
- Some QA aspects of management oversight during implementation are not operating effectively in some Regions.
- Many of the Regional variances in QA arrangements for projects under implementation make sense; however, in some Regions these variances represent risks and possible control gaps.

5. Documentation and communication

- While filing of FM documents has improved, there are issues surrounding the documentation of FM work.
- Besides using IRIS for filing and Region-specific websites for providing technical information, Regions maintain a number of different document repositories.
27. **Recommended action.** The FMSB already has actions under way to strengthen quality arrangements, including: (i) the CSR/OPCS Joint Evaluation of FM Network Quality Arrangements, which is beginning in FY09; (ii) implementation of PRIMA and full integration with other Bank systems and decision making processes, also in FY09; and (iii) review and update of the FMPM scheduled for completion during 2008. Management will incorporate findings from this review into the final methodology for the Joint Evaluation. Findings are also being taken into consideration in the update of the FMPM.

28. To address specific issues identified in the FM area, Management proposes the following actions:

- Regions will consolidate and update their QA arrangements (including QA-related information on their websites) by September 30, 2008. If necessary, these will be further updated and aligned with the FMPM, with support from OPCFM, immediately after the FMPM update is completed.
- Regions will update ARCS for all actions related to audits due in FY05 through FY07 by June 30, 2008. Regions with outstanding actions related to earlier years, will clear these backlogs by September 30, 2008. In addition, Regions will complete entry of baseline data on interim financial reports into PRIMA by October 31, 2008. The FMSB will monitor PRIMA and ARCS to ensure that the backlog is cleared and that, in future, data are entered regularly and promptly.
- Pending the establishment of the institutional Enterprise Content and Document Management system, the FMSB will develop and communicate good practices and additional guidance to staff by December 31, 2008.

B. **Procurement**

29. The review found the following:

- quality assurance arrangements for procurement are in place and are generally sound, and
- the regional variances identified are in line with the high degree of decentralization and broad mandate of the Regional Procurement Managers (RPMs).

However, management’s review also identified two issues that need to be addressed:

- adequacy of controls in place to ensure consistent follow-up on PR issues by the task teams, including the need for better integration of PR staff in task teams and clarification of accountabilities for procurement issues and decisions; and
- consistency in implementation of post-reviews.

30. In management’s view, these issues, combined with the findings of Part I of this exercise, rise to a level of a significant deficiency in PR area.

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13 This action has been completed, with the exception of Indonesia, and FM staff is working with the Region to resolve data entry issues specific to Indonesia.
31. Management proposes to address these issues through a set of monitorable actions as follows:

(a) Earlier and fuller integration of PR staff/tasks in all stages of project cycle, clarification of roles and accountabilities for PR matters within the task team:
   o Actions already completed:
     ♦ Starting in FY07, the procurement complaints database has been made a key control and management tool, and enhancements to the database include automatic alerts to remind RPMs of pending cases, to seek RPM clearance when closing cases, and to track complaints related to late payments. OPCPR monitoring of complaint follow-up has been strengthened.
     ♦ OPCPR has implemented an Anti-Money Laundering system and provides assistance on due diligence to the Regions who receive AML alerts thus preventing contract awards to firms on the UN/US/UK terrorist lists.
   o Actions planned:
     ♦ Full Integration of Procurement Staff and Tasks in Project Teams:
       ➢ OPCS will set up a working group by November 2008 to review the sharing of responsibilities between sector teams and procurement teams, for key procurement decisions at preparation and implementation stage, in particular reinstatement of requirement for RPM to clear PAD, TTL responsibility for document management and ISR ratings, and active monitoring of post review findings.
       ➢ OPCPR will support OPCS in the development of a Procurement Certification system specifically targeted for TTLs that would increase TTL awareness and importance given to procurement work, such system expected to be developed by December 2008 and rolled out during FY09.
     ♦ Strengthening OPCPR/PSB Roles
       ➢ PSB will review the potential benefits of strengthening and expanding the roles of the PSB and OPCPR to include identifying best regional practice and areas where it would be appropriate for regional variances of quality arrangements to be harmonized by December 2008.
     ♦ Fraud, Corruption and Governance
       ➢ In addition to developing a clear protocol between INT and the Procurement Network by October 2008, to dispose of complaints alleging Fraud and Corruption and handle cases where red flags have been identified, OPCPR will undertake a systematic review of any regional initiatives, including those in SARVP resulting from the India DIR of procurement in India’s health sector, on an ongoing basis (i) to address fraud and corruption and enhance governance and accountability during the project cycle, including
how to deal with red flags of corruption, and (ii) to develop measures as deemed appropriate.

- **Updating Procurement Policy and Procedural Framework and Policy Review**
  - OPCPR is updating OP/BP 11.00 Procurement by October 2008, to clarify responsibilities, update processes and procedures, and to reflect the enhanced complaint handling system. This exercise offers an opportunity to assess variances in regional practices and procedures falling below the threshold for the current policy exceptions mechanism, and to incorporate best practice into the policy and procedural framework.
  - OPCPR will review and update existing instructions (e.g. SWAp approaches) and identify new initiatives that need to be addressed (e.g. PPP, framework contracts, involvement of UN agencies, decentralized procurement).
  - OPCPR will update the existing template for the PAD Procurement Annex taking into account new initiatives, including risk-based procurement assessments with a focus on fraud and corruption by the end of 2008.
  - OPCPR will carry out a review of the preparation and use of Procurement Plans by the end of 2008.

- **Bank-wide Roll-out of Procurement Risk Assessment Tool**
  - The rollout of a dynamic Procurement Risk Assessment tool is expected to improve risk identification and monitoring in the PR area. This risk-based procurement assessment tool which was developed in SAR in 2004-05 and is in use in that Region has been further developed for Bank-wide use. The system is currently being mainstreamed by SAR/OPCPR and is expected to be available online in January 2009. It is mandated for use under the UCS proposal and expected to be mandated for Bank-wide use during FY09.

(b) Improving consistency of post-review implementation:

- **Actions already completed:**
  - A pilot automated post review system was launched in April 2008 to centralize the capture of all post review reports, including data, findings, and recommendations.

- **Actions planned:**
  - A post-review template to be used by all Regions is being developed by OPCPR and expected to be in place by the end of 2008. The template will ensure a harmonized approach to procurement post reviews and more consistent feedback into the ISR and Procurement Risk Assessment tool.
  - The date of the last post review and the status of implementing the mitigating actions will be recorded in the ISR beginning during FY09.
In parallel, a systems solution is being developed to track findings from PPRs and IPRs, expected to be put in place during FY09.

C. Analytic and Advisory Activities

32. Testing results showed an aggregate pass rate of 75%, measured as the total number of control steps in the sampled ESW reports found to be compliant. Most instances of non-compliances were random, isolated cases of failure to observe control requirements by those processing the ESW reports. It should be noted, however, that for roughly half of the non-compliance instances, controls were in fact observed, but because there were mismatches between dates recorded in SAP and the actual dates related to such controls (e.g. the dates of the Concept Review meetings of some of the transactions differed from the dates for such meetings recorded in SAP) Management recorded these as non-compliant.

33. Recommended action. Management is undertaking a broad review of the processes and controls, including systems and monitoring, that apply to AAA in order to simplify and strengthen them where needed, and ensure they are updated to take into account the wide variety of AAA currently carried out by the Bank. This review will also address the compliance weaknesses observed, along with other issues that have been raised by QAG in recent related reviews of AAA. Management expects to complete this review and discuss the recommended changes with the Board by late FY09.

D. OP/BP Updates

34. Management’s review and documentation of the current processes underlying policy revision have identified that the current processes appropriately differentiate between revisions that constitute policy changes that require approval of the Executive Directors as part of their policy setting and oversight responsibilities, and “housekeeping” changes in policy statements and procedures that fall within the responsibility of management.

35. While the process for initiating, preparing and endorsing policy changes that require approval of the Executive Directors are involved and time-consuming, management is of the view that the current process is appropriate for this level of change given the importance and impact of such changes on the control and operational framework of IDA. The process for introducing minor or “housekeeping” changes approved by management are much less involved and, at least in theory, can be done quickly and efficiently. As a result, management believes that the current backlog in OP/BP updates is not associated with the process for policy revisions as designed. Instead, the current backlog in policy updates stems from the prescriptive approach to policy and procedural statements (OPs and BPs) drafting and content, characteristic of the older policies. In such policy statements, policy “proper” could only be revised with the approval of the Board, and was often commingled with operating procedures and guidelines which require more frequent and timely management-approved changes. As a consequence, rather than making the minor changes as needed, such changes have tended to
accumulate and be absorbed in the much more involved and less frequent efforts of a major reform or change to the relevant policies. The principles-based approach reflected in the more recent policy reforms\textsuperscript{14}, which focuses the OP and BP statements on \textit{core principles and key controls}, rather than detailed rules and procedures characteristic of the older statements, should help minimize any future backlogs in OP/BP updates.

36. \textbf{Recommended action.} During Part I, IL was identified as the most over-regulated Bank instrument and is subject to approximately 30 of the Bank’s operational policies and procedures, many of which are misaligned with the current practice and evolution of the IL instrument. This has contributed to the current lag on updating of OPs/BPs that apply to IL. To address this shortcoming, which has contributed to much inefficiency surrounding the current IL instrument, the IL reform effort will focus on consolidating and rationalizing the policies and procedures governing IL by creating a single principles-based “umbrella” policy for IL that would govern IL projects from preparation through completion. Reflecting lessons learned, including findings of this internal control review, the new IL policy would:

- reflect main principles governing IL;
- replace the current “one-size-fits-all” requirements with a risk-based approach to IL due diligence, processing, and design options; and
- replace the rigid “ring-fenced” project model with a flexible menu of design and funds flow options to better meet development and funding needs of IDA’s varied clients.

37. Management expects to make a proposal for policy consolidation during the second phase of IL reform, following the completion of (i) Phase I that would address preparation/appraisal process inefficiencies and significant deficiencies in supervision as a matter of priority, and (ii) broad consultations inside and outside the Bank to ensure that the new IL model meets and reflects the needs and expectations of the Bank’s clients, partners and shareholders. This second and final stage of IL reform is expected to be completed in FY10-Q2.

E. Other Modules

1. \textit{Safeguards Corporate Risk Oversight}

38. On the basis of the (i) revised documentation, (ii) walkthroughs, and (iii) compliance testing, Management has confirmed that the safeguard corporate risk oversight process was functioning as designed.

\textsuperscript{14} These include: OP/BP 6.00 related to expenditure eligibility, OP/BP 10.02 related to financial management, OP/BP 12.00 related to disbursement, OP/BP 13.20 related to additional financing and OP/BP 8.00 related to rapid response to crises and emergencies.
2. IDA 14 Grant Allocation Process: IDA Credit/Grant Mix Determination

39. No exceptions were found in the compliance testing and the process is deemed to be functioning as designed.

3. IDA 14 Grant Allocation Process: Debt Sustainability Analysis (DSA)

40. The compliance testing identified an exception in one of controls of one of the transactions tested which occurred prior to the release of guidelines on the processing of these transactions. Specifically, one of the transactions tested was missing an email showing approval of the relevant sector manager early during the process. This exception was not considered to be significant because this occurred prior to the release of relevant guidelines, and management found approvals by higher level managers in the succeeding stages of the process for this sample. Based on overall results of compliance testing for this module, management found the process to be functioning as designed.

4. QAG Quality of Supervision Assessment (QSA)

41. IAD found no exceptions to Management’s control attributes in the testing, and Management deemed the process to be functioning as designed.

5. Tagging of Anti-Fraud and Corruption controls to all transaction level processes

42. The results of this work have informed management’s entity-level assessment of fraud and corruption component. In accordance with document sharing process adopted under Part I, all documentation and testing results relating to the foregoing were provided to IAD and IEG for their review and evaluation, respectively.

6. Additional testing of CAS and DPL modules

43. On the basis of Part IB compliance testing, and compliance testing of additional CAS and DPL samples from regions not represented in the Part IB compliance testing, management has confirmed that both the CAS and DPL processes to be functioning as designed.
THE WORLD BANK

IDA 14 INTERNAL CONTROLS REVIEW:

MANAGEMENT ASSESSMENT FY08

ANNEX C.
ENTITY LEVEL CONTROLS AND EFFICIENCY AND EFFECTIVENESS OF INTERNAL CONTROLS SCOPING MEMORANDUM, FY08
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I. Background

1. Management is conducting a comprehensive assessment of internal controls over the International Development Association’s (IDA) operations and compliance with its charter and policies, which will be evaluated independently by IEG in response to the request of IDA Deputies reflected in the IDA 14 Replenishment Report.\(^1\)

2. The assessment has been divided into two parts: Part I, which focused on design and operating effectiveness of controls over IDA operations at the transaction level; and Part II, which focuses on (i) entity-level controls, (ii) outstanding transaction-level controls deferred from Part I, and (iii) whether the internal control framework over IDA operations provides Senior Management and the Board reasonable assurance that they understand the extent to which IDA operations’ objectives are being achieved. The assessment is being carried out in three tiers (Management self-assessment, Internal Audit Department (IAD) review, and the Independent Evaluation Group (IEG) evaluation of both) in the context of the internal control framework developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO),\(^2\) adapted to fit the unique nature of IDA’s operational work. IEG expects to disclose its final report and other material after the Audit Committee (AC) and any Board discussions of the Part II report, following in this regard its usual practice.

3. To date, IEG has completed its evaluation of Part I of the assessment conducted by Management and the review carried out by IAD. As under Part I, during Part II, Management will closely consult with IAD and IEG on scope and methodology. As discussed with the AC, Management expects to complete Part II of its self-assessment by December 15, 2007.

II. SCOPE

A. COSO Control Framework

4. Consistent with the COSO definition of internal controls as a process that is designed to provide reasonable assurances\(^3\), Management will assess whether the

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\(^1\) See, Report from the Executive Directors of the International Development Association to the Board of Governors, Additions to IDA Resources: Fourteenth Replenishment, Working Together to Achieve the Millennium Development Goals, (approved by the Executive Directors of IDA on March 10, 2005), paragraph 39, under the Disclosure bullet.

\(^2\) COSO published a report in 1992, “Internal Controls – Integrated Framework,” which is widely referred to by leading financial institutions in the United States and is also seen as a model in many other parts of the world. IDA adopted the COSO framework as its controls methodology in 1995. The framework is an all-encompassing process which covers all aspects of internal control of an organization’s operation. It considers not only the evaluation of formal controls, but also informal controls, such as ethics, trust, communication, organization behavior and leadership, and incorporates “top-down” as well as “bottom-up” analysis.

\(^3\) As it is currently published in its website: http://www.coso.org/publications/executive_summary_integrated_framework.htm
internal control framework is adequate to provide reasonable assurances to Senior Management and the Board in the three categories identified in the COSO framework, namely:

- **Reliability of financial reporting relating to IDA’s operations** – i.e., do the internal controls over IDA operations provide reasonable assurance to Senior Management and the Board that the published financial statements are being prepared reliably?
  
  - Since 1997, Management has annually asserted and received attestations from the external auditor that it maintains an adequate system of internal controls over external financial reporting for both IBRD (International Bank of Reconstruction and Development) and IDA.

- **Compliance with applicable laws and regulations in IDA’s operations** – i.e., do the internal controls over IDA operations provide reasonable assurance to Senior Management and the Board that “laws and regulations” governing IDA’s operations (i.e., (i) financial reporting regulations, (ii) IDA’s Articles of Agreement, and (iii) the Bank’s operational policies and procedures) are being complied with?
  
  - Financial reporting regulations, as required by the financial markets, are reviewed, documented, evaluated, and attested to by external auditors as part of the work performed for Management’s assertion of internal control over financial reporting.
  
  - Part I of the assessment focused on transaction-level controls relating to compliance with:
    
    - Provisions of the Articles, as interpreted from time to time by IDA’s Executive Directors, relating to the management of IDA’s lending operations; and
    
    - Internal operational policies and procedures relating to the management of IDA’s lending operations.
  
  - In addition, Part II will assess entity-level controls relevant to compliance with the Articles and operational policies and procedures and draw any relevant linkages between such controls and transaction-level controls relating to compliance that were assessed under Part I.

- **Effectiveness and efficiency of IDA’s operations** – i.e., do the internal controls over IDA operations provide reasonable assurance to Senior Management and the Board that they understand the extent to which IDA operations’ objectives are being achieved?
  
  - As discussed more fully in the next section, Part II of the assessment will examine whether the internal controls at the entity and transaction levels are effective in providing Senior Management and the Board reasonable assurance that they have the information from which they can understand the extent to which IDA operations’ objectives are achieved.

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III. ASSESSMENT Activities

A. Entity-Level Controls

5. As part of its initial Work Plan Management identified the control groups that form part of the internal controls framework over IDA’s operations and the specific control activities carried out by each such group. During Part II Management will map each such group to the COSO categories relating to “compliance” and “efficiency and effectiveness.” Such mapping will include the identification of (i) each group’s main responsibilities and role in the internal control framework over IDA operations; (ii) the primary products/outputs of each group relating to its role; and (iii) linkages between the roles and outputs of the groups in question. Such mapping will be corroborated by the information that would derive from the results of the entity level Questionnaire prepared by Management.

6. It is Management’s understanding that IAD, as part of its ongoing review activities, has initiated a preliminary review of the Bank’s entity-level controls. During Part II, Management will discuss the preliminary list of entity-level controls it identified with IAD to ensure consistency.

7. The entity level Questionnaire (see Attachment 1), developed based on source information available from the public accounting profession and the U.S. Government Accountability Office (GAO), has been adapted to meet the objectives of the IDA14 Internal Controls assessment. Questions relating to entity-level controls and antifraud programs and controls have been aligned with the five COSO components, namely (i) control environment, (ii) risk assessment or fraud risk assessment, (iii) control activities, (iv) monitoring, and (v) information and communication. It will be completed by all Bank units at the Senior Management level (Managing Directors, Vice-presidents, and Heads of stand-alone Departments -- the Quality Assurance Group (QAG), IAD, Department of Institutional Integrity (INT), Inspection Panel and IEG). Finance, Administration, and some Central VPs and Departments (Treasury, CFP, ISG, CSR, HRS, GSD, IAD, INT, and EBC) have already completed the Questionnaire and follow-up process, per the schedule of the Bank’s annual Internal Control over Financial Reporting (ICFR) exercise. The Questionnaire was distributed to all other units in July.

8. The Questionnaire covers the following areas, as identified by individual COSO components:

- **Control Environment**: sets the tone of an organization and is the foundation for all other components of internal control.
  - Integrity, ethical values, and behavior of key executives
  - Management’s control consciousness and operating style
  - Management’s commitment to competence

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5 See attachment 2 of the Work Plan discussed with the AC and the Committee on Development Effectiveness (CODE) on August 17, 2005 (AC2005-0092).
ANNEX C: ENTITY LEVEL CONTROLS AND EFFICIENCY AND EFFECTIVENESS OF INTERNAL CONTROLS SCOPING MEMORANDUM, FY08

- Organizational structure and assignment of authority and responsibility
- Human resource policies and practices

• Risk Assessment: the identification and analysis of relevant risks to the achievement of IDA operation objectives.
- Entity-level objectives are established, communicated and monitored
- Management has established mechanisms for identification of risks
- Management evaluates and mitigates risks appropriately
- Management has implemented mechanisms to anticipate, identify, and react to changes

• Control Activities: policies and procedures that help ensure the Management directives are carried out.
- Operational practices followed and processes adequately documented
- Management has clear objectives in terms of operating goals
- Duties are adequately segregated
- Policies are in place to control access to computer programs and data files

• Monitoring: a process that assesses the quality of the internal control system’s performance over time.
- Management is responsive to internal and external recommendations
- Internal audit’s scope, responsibilities, and audit plans are appropriate for the company
- Internal audit adheres to professional standards, such as those issued by the institute of internal auditors
- Internal communications are effective in providing feedback to Management on whether controls are operating effectively
- There are regular self-assessment exercises in the Bank

• Information & Communication: identifying, capturing and communicating pertinent information in a form and timeframe that enables staff to carry out their responsibilities.
- Operational reporting and related applications and information systems are reliable
- Appropriate and necessary information is obtained from, and provided to, Management
- Information is gathered from and disseminated to the appropriate people on a timely basis
o There is a process for identifying and responding to the changing information and communication needs

o Management communicates employees' duties and control responsibilities in an effective manner

o A "whistle-blowing" program has been established, and Management's reaction is monitored as it relates to operational matters

o Management's communication across and outside the company reflects an attitude toward sound internal controls

9. The Questionnaire is designed to solicit corroboration for answers provided by each respondent. The responses will be assessed as follows:

- Review of responses and supporting underlying documentation;
- Inquiries, either verbally through interviews or in writing or both, to drill-down where appropriate; and,
- Observations and analysis.

10. In addition to the mapping of entity-level controls and compilation, analysis and drill-down of the Questionnaire results, Management will also review the results of other corporate review activities – including, the Risk and Opportunity Workshop, the Letters of Representation exercise, and relevant IAD reports.

11. As part of this assessment, Management will also identify the primary functions of the Board, particularly as these relate to the COSO components of the “Control Environment” and “Information and Communication” (including “tone at the top,” ethics, culture) with respect to IDA’s overall internal control framework. Management notes that, during a meeting in April 2007, the Board requested its Committee on Governance and Executive Director’s Administrative Matters (COGAM) to make recommendations to the Board on issues of internal governance. In addition, Management has noted that a Sub-Group on Governance (SOG) was established by COGAM “to examine issues directly related to the recent leadership crisis, and broader issues of potential risk in other areas of the bank’s governance arrangements.” Management also understands that the SOG intends to present a document to the Board for its consideration by the Fall 2007 Development Committee meeting regarding some of the issues it will be reviewing. In light of this ongoing work, Management will not go beyond identification of the Board’s primary function. However, Management will review the issues to be reviewed by SOG prior to finalizing its Part II Report to determine their potential impact, if any, Management’s conclusions.

B. Issues Deferred to Part II

12. Analytic and Advisory Activities (AAA). During Part II, Management will (i) map out the process of the main AAA product line, Economic and Sector Work (ESW) reports, (ii) conduct a walkthrough, and (iii) test compliance of documents of ESW

6 See Report to the Board from the COGAM greensheet of the meeting of July 11, 2007.
reports completed during FY2006-2007 that were randomly selected for this purpose, in a process similar to that performed for IL, DPL, and CAS product lines during Part I. The focus on ESW is based on the fact that ESW funding has traditionally absorbed the major share of AAA funds – for example, in FY2007, ESW accounted for 68% of the AAA budget of IDA and IDA-IBRD blend countries. Therefore, Management believes that the mapping and testing of the ESW process during Part II, Management will (i) help verify findings and recommendations of QAG relating to AAA activities overall and (ii) inform preparatory work underway in planning a larger-scale review of AAA in both IBRD and IDA. This work should also address some of the scope concerns expressed by IEG and IAD.

13. **Country Offices.** IEG has recommended that the assessment include country offices. Management agrees that country offices are an increasingly important part of IDA’s operational model. To this end, the application of internal controls over IDA operations at the country office level has been reflected in the work done to date at the transaction level and will be reflected in the entity level work for Part II. Specifically:

- During Part I, the document sample used to perform compliance testing of processes and key controls that apply to CAS, IL, and DPLs specifically included transactions (operations) that were task-managed from country offices and/or documents that were initiated, prepared and/or reviewed in country offices;
- During the ICFR, Management confirmed and the external auditor attested that: (i) all significant disbursement and procurement transactions include those from country offices, and are captured in the Bank’s systems and tested from headquarters; and (ii) all disbursement approvals are performed in headquarters, and all related controls have been tested in headquarters.
- The entity level Questionnaire distributed under Part II includes specific questions related to country offices in order to assess whether and how the application of the COSO components of IDA’s internal controls framework extends to these offices; and
- During Part II, Management will also review IAD’s FY2007 audits of country operations and take them into account in assessing the application/compliance with internal controls at the country-office level.

14. **Information Technology (IT).** As previously stated by Management, Part II will assess IT controls supporting IDA operations. In order to ensure that all IT controls related to key processes have been reviewed, Management has prepared an assessment matrix listing IDA operations business processes, the supporting underlying system applications, and the applicable underlying technology or software being used (see Attachment 2). These applications have been reviewed against the following objectives:

- Application systems implementation & maintenance
- Information systems security
- Information systems operations
- Systems software support
- Network support
- Database implementation & maintenance
15. As identified in the matrix, these objectives have been reviewed and associated controls have been tested during ICFR to assess whether such internal controls are adequate to ensure their operating effectiveness. Identified deficiencies have been described and evaluated as part of the ICFR assessment. There were no material weaknesses identified. However, during the ICFR review the following three IT-related issues were deemed to rise to the level of “Significant Deficiency”:

- Strengthening controls to prevent password policy breaches in SAP and other financial applications impacting financial reporting, by bank staff. This is in response to a finding by IAD, based on an audit of “Identify and Access Management” in FY07, which identified that SAP passwords are widely shared by Bank staff which may result in some unauthorized expenses in the financial statements;
- Strengthening controls around Information Security to rationalize and further limit privileged access to system applications and monitor changes made by IT staff using such privileged accounts; and
- Strengthening controls around Infrastructure Change Management to ensure that change management controls are applied consistently and exceptions are reviewed and authorized by appropriate authority.

16. During Part II, the actions implemented to mitigate these risks will be reviewed and assessed by Management.

17. In addition, during Part I Management found that many of the process controls that apply to IDA operations at the transaction-level (and particularly to the processes of CAS, IL and DPL) are not automated or otherwise entail consistent IT support. The linkage between this finding and the issue of document accessibility identified in Part I have led to the establishment of an expert panel to look into automation of work flow documentation and controls. Since this relates to future work, there is little that can be assessed during Part II. Management proposes to share with IAD and IEG the concept for developing automated workflow for IL and would welcome comments from IAD and IEG on this proposal. The one area where limited automated controls were introduced relates to the IT controls relating to supervision reporting through the Interim Status and Results Report (ISR). During Part II Management will coordinate with IAD to assess whether a review and assessment of these limited IT controls relating to the ISR will be necessary.

18. Finally, Management will continue to discuss with IAD any additional issues related to IT systems that may need to be reviewed and included during the Part II review.

19. **Fraud and Corruption.** An addition to the COSO framework that was specifically addressed within the final rules adopted by the Securities and Exchange Commission (SEC) under the US Sarbanes-Oxley Act was to ensure that the entity specifically reviews its fraud controls. Fraud is defined in SAS 99 as:
“...an intentional act that results in a material misstatement in the financial statements that is the subject of an audit. Two types of misstatements are relevant to the auditor’s consideration of fraud – misstatements arising from fraudulent financial reporting, and misstatements arising from misappropriation of assets.”

20. Consistent with the above, the Bank’s fraud risk assessment is performed, in conjunction with the internal control evaluation for financial reporting, at the entity and significant account/process levels. These individual risk assessments are performed based upon Management’s overall knowledge of controls in place, new activities, products and ventures, and historical fraud.

21. In addition, following IAD’s recommendation, during Part II, Management will: (i) assess controls over fraud and corruption at the entity-level, including controls to ensure that issues identified by fraud and corruption investigations are adequately addressed; and (ii) link, as appropriate, the entity-level fraud and corruption controls identified to the process or transaction-level controls designed to prevent or detect fraud and corruption. As a result of this work, Management will provide a listing of specific fraud and anti-corruption controls that have been identified at the transactional as well as entity levels. In performing its assessment, Management will also take into careful consideration the findings contained in the Volcker Panel Report relating to fraud and corruption controls specifically and the impact of these findings on the entity-level controls more generally.

C. Follow-up of Exceptions Cited in Part IB

22. Timely accessibility of relevant documents. As stated in paragraph 16 above, Management established an expert panel to look into automation of work flow documentation and controls. The panel was composed of representatives of all the regions, the Information Solutions Group (ISG), Controllers, Strategy and Resource Management (CSR) and Operations Policy and Country Services (OPCS). Draft recommendations concerning new workflow authorization and system-based new document retention requirements have been circulated to key parties in the operations community and will be vetted with Senior Management. These will be mapped into the new document retention system, and then piloted in one key process (investment lending (IL)). As stated in paragraph 16 above, Management proposes to share with IAD and IEG the concept for developing automated workflow for IL and would welcome comments from IAD and IEG on this proposal.

23. Follow-on work to assess: (i) the significance and appropriateness of variances in regional implementation of financial management (FM) and procurement guidelines, and (ii) quality aspects supporting specialist inputs. During Part II, Management will:

- Drill down on rationale for, and significance of, the regional variances in implementation of FM and procurement guidelines identified in Part IB; and
• Review the quality aspects that have been put in place in each region to support reviews and inputs of FM, procurement, and safeguards specialists relating to appraisal and supervision of projects.

24. In performing this work, Management will (i) review findings and recommendations of the QAG Quality of Supervision (QSA-7) assessment as it relates to the areas of FM, procurement and safeguards; (ii) review and use as appropriate IAD findings reflected in its recent fiduciary and project supervision audits; (iii) collect appropriate documentation from and interview anchor and regional FM, procurement and safeguards managers and specialists to determine whether follow-up of action plans described in Procurement reviews and FM assessments are done and to identify current Quality review processes conducted on a portfolio-wide basis at the regional level; and (iv) review new procedures for Management review of IL, particularly as they relate to risk assessment in the areas of FM, procurement and safeguards.

25. **Not keeping pace with the needed updates to OPs/BPs, particularly in the area of IL** During Part I, Management identified that some OPs/BPs were not keeping pace with the changes needed and/or introduced on the ground. With the main fiduciary policies (including OP/BP 12.00 re disbursements and 10.02 re FM) issued in March 2007 and major instrument policies (including OP/BP 8.60 re DPLs and OP/BP 8.00, re emergency lending) in place, this issue primarily affects the umbrella OPs/BPs on appraisal and supervision of IL, i.e., OP/BP 10.00 and 13.05.

26. During Part II, Management will assess how the proposed reform and consolidation of IL policies will help address this issue. Management will also assess how the current processes for policy revisions could be made more efficient so as to facilitate more timely updates of operational policies and Bank procedures.

1. **Status of all pending deficiencies/exceptions from Part I**

27. During Part IA Management, IAD, and IEG identified specific issues with the documentation and design effectiveness of some key controls identified. These were combined and listed in a deficiency tracker that Management shared with IAD and IEG. At the end of Part I, Management reviewed all of these issues with IAD and IEG and resolved, where possible. During Part II Management will (i) drill down on transaction level control issues unresolved and entity level control issues deferred to Part II, and (ii) update IAD and IEG on the application of mitigating measures of issues where these had been identified. During Management’s review of Part II, open items/deficiencies identified by Management, IAD and IEG during Part I will be reviewed as to whether Management has resolved or remediated them as appropriate. Issues of efficiency and effectiveness will be tied into the specific areas being reviewed in Part II. As stated in its Part IB report, any unresolved issues/deficiencies that still remain unremediated at the end of Part II will be reviewed and evaluated by Management for their impact, individually and in aggregate, on IDA’s internal control framework over IDA operations.

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7 In the area of FM, this will include the review of issues relating to project audits, including audit TORs, audit review process and follow-up, as well as the relationship between the audits and SOE reviews.
2. Assessments of Modules to be Completed During Part II

28. Safeguards Corporate Risk List. During Management’s walkthrough processes the quality assurance and compliance unit responsible for review of safeguards (OPCQC) stated that the screening process for possible inclusion of projects onto the safeguards corporate risk list is based on close consultations between OPCQC and regional staff to determine potential risks and appropriate measures to address them, including potential inclusion on the corporate safeguards risk list. These consultations take place in different ways and on different cycles, depending on the project management system used in each region. Since this was originally designed as a management advisory system rather than as a specific control mechanism, the results of the screening and the subsequent decision to include or remove projects from the list were not recorded in a standardized manner. As a result, Management was unable to perform compliance testing on Module # 29 Safeguards – Corporate Risk List during Part IB.

29. Management has taken steps to standardize the approach used by OPCQC and the regions in screening and tracking projects on the safeguards corporate risk list and has provided guidance to the regions on this matter. During Part II, Management will revise documentation for module 29 to reflect the new guidance, perform a walkthrough of the process for being included on the list and being removed from the list. In addition, if sufficient data has been accumulated in order to test the application of the controls then an appropriate sample will be selected and tested by Management. As per the document sharing process applied in Part I, all documentation and testing results will be provided to IAD and IEG for their review.

30. Debt Sustainability Analysis. During Part I, Management did not review the processes relating to the broader debt sustainability analyses required under IDA 14, including the grant allocation framework based on countries' risk of debt distress8. These new processes were in a very early stage of implementation during the testing period under review (July 1, 2005 – February, 28, 2006). More specifically, the forward-looking debt sustainability analyses (DSAs) required for gauging countries' risk of debt distress were not widely available. As agreed with the IDA Deputies, Management relied on a "static" method based on countries' current debt situation as a temporary mechanism. In addition, confirmation from the IDA Deputies that eligibility for IDA grants would continue to be based on such new processes only took place in November 2006, as part of the IDA14 Mid-Term Review discussions. As such, FY08 is the first year in which country eligibility for IDA grants has been mostly based on DSAs. With the understanding that these processes are still being fine-tuned, Management will map out the processes under the Debt Sustainability Framework. In addition, Management will review the paper being drafted for IDA Deputies on this topic to draw out any

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8 Management distinguishes: (i) the Debt Sustainability Framework (DSF) itself, which is a joint IMF-World Bank venture, and which provides guidelines and methodology for the debt sustainability analyses (DSAs); from, (ii) the IDA14 grants framework, which applies the DSF to establish countries' eligibility for grants. In the Bank, the DSF and the DSAs are under the purview of PREM’s Economic Policy and Debt Department (PRMED), while the IDA14 grants framework is under the purview of FRM.
preliminary conclusions and observations regarding the Debt Sustainability Analysis (DSA) tool that is part of the DSF.

31. **QAG Quality of Supervision Assessment.** During Part I, Management documented and validated the QEA process based on the recently completed QEA. It also agreed with IAD and IEG that during Part II, the QSA 7 process would be tested for design and operating effectiveness. In addition, as with all other work wherein IAD audits have been carried out, Management will take note of IAD’s findings and recommendations regarding QAG’s QSA process provided these are made available to Management before its Part II Report is finalized.

32. Management was informed that one part of the QAG assessment process was a quality assessment of fiduciary controls. As stated in paragraph 21, in order to substantiate any information gathered in the follow-up activities during Part II relating to fiduciary areas, the results in such areas of QSA 7 will also be reviewed, using an appropriate sample selected by Management. All documentation and testing results will be provided to IAD and IEG for their review. Action plans will be created for issues found, and will be tracked on the deficiency tracker, which will identify responsible units and staff and completion dates. In addition, as mentioned above, Management will take note of IAD’s findings and recommendations in these areas.

33. **Additional testing of CAS and DPL modules.** In its Part IB evaluation, IEG reported its concern over Management’s sampling methodology for the CAS and DPL modules that were tested for compliance with applicable policies and procedures. In order to address such concerns, Management agreed to conduct additional, targeted tests of these modules during Part II, specifically including one CAS and one DPL from regions whose CAS and DPL transactions were not tested (due to the limited pool of such transactions coming from such regions). As was done in Part I, Management will share its testing results with IAD and IEG.

IV. PART II Report

34. As was done during Part I, any deficiencies identified during Management’s assessment of Part II (including any that may remain unresolved from Part I after the follow-up work during Part II) will be placed on a summary deficiency tracker which will: (i) identify each deficiency, (ii) assess the deficiency type, (iii) assess mitigating controls over each deficiency, (iv) assess the potential financial impact of each deficiency as well as its impact from a non-financial perspective, and (v) set out Management’s proposed corrective action (remediation). Descriptions of any significant deficiencies or material weaknesses identified through its assessment will be set out in Management’s report, together with the respective remediation plans to address them. Management’s report will also summarize the findings and recommendations flowing from its assessment under Part II as well as its overall assessment. In particular, the report will set out Management’s views as to whether the internal control framework over IDA’s operations provides a reasonable assurance to Senior Management and the Board that:
• the published financial statements are being prepared reliably,
• “laws and regulations” governing IDA’s operations (i.e., (i) financial reporting regulations, (ii) IDA’s Articles of Agreement, and (iii) the Bank’s operational policies and procedures) are being complied with, and
• they understand the extent to which IDA operations’ objectives are being achieved.

35. The report will be presented to the Steering Committee put together by Management for this exercise (which includes the heads of the following vice-presidential units: Operations Policy and Country Services, Controller’s Strategy and Resource Management, Concessional Finance and Global Partnerships, and Legal) for its endorsement prior to its submission to Senior Management, IAD, and IEG.

A. Timing of the Assessment

36. Management expects all responses on the Questionnaire to be turned in by mid-September 2007. Follow-up discussions are expected to be completed by mid-October 2007. A draft Management assessment will be shared with IAD and IEG in early December 2007. Management expects its assessment on Part II and the entire IDA internal control review will be completed by December 15, 2007. As Management proceeds with its assessment, it will keep IAD and IEG regularly informed on its work progress.

B. Internal Management Structure

37. The Part II assessment will continue to be led by the Offices of the Vice President CSR, and the Vice President, OPCS, with support roles for Concessional Finance and Global Partnerships (CFP) and Legal (LEG). The high-level Steering Committee comprised of the Vice Presidents of the four aforementioned VPUs with the inclusion of IAD and IEG Management as observers will continue to manage the implementation of this process, while the Project Management Team consisting of senior staff of these units will continue to implement the detailed work program.

C. Attestation Standard to be Used

38. As was described at the beginning of the IDA review, there are currently no existing prescribed guidelines or standards that organizations can follow that are specifically related to assessing and supporting the issuance of an assertion regarding the adequacy of internal controls over compliance with laws and regulations and operational efficiency and effectiveness. As such, Management will continue to use the same concepts as defined in the Auditing Standard No. 5 (AS5) issued by the PCAOB on May 24, 2007, An Audit of Internal Control That Is Integrated with An Audit of Financial Statements, together with recently issued guidance from the U.S. Securities and Exchange Commission (SEC) Regarding Management’s Report on Internal Control Over Financial Reporting as much as possible in performing its review.

39. Management believes that continuing to applying the concepts (as revised) that have been defined by standard setters for assessing internal controls over financial
reporting provides the level of comprehensiveness, rigor and standardization required in its self-assessment of internal controls.
Attachment 2
The IAD Review and Opinion
Mr. Jeffrey S. Gutman, Vice President & Head of Network, OPCVP
Mr. Fayezul H. Choudhury, Vice President & Controller, CSRVP

Report on a Review of
Management’s IDA 14 Internal Controls Review FY08 Assessment

Please find attached the final report for the above-mentioned review which was circulated earlier in draft form.

At this time, we would like to convey our sincere appreciation to management and staff for the courtesy extended to the audit team. If we can be of further assistance, please do not hesitate to contact us.

[Signature]
Carman L. Lapointe
Auditor General
Internal Auditing Department

Attachment
cc: Messrs./Mme. Zoellick (EXC); Daboub (MDD); Okenjo-Iweala (MDO);
    Wheeler (MDW); La Via (CFO); Le Houerou (CFPVP);
    Thomas (IEGDG); Gray (IEGWB)
    KPMG
Review of
Management's IDA 14 Internal Controls Review FY08 Assessment

IAD Report No. IBRD FY09-18
December 19, 2008
Confidential
IAD Review of Management’s IDA 14 Internal Controls Review FY08 Assessment

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IAD Review of IDA 14 Internal Controls Review - Management Assessment

I. Background

As part of its FY09 work program, the Internal Auditing Department (IAD) has completed a review of "The World Bank IDA 14 Internal Controls Review – Management Assessment" (hereinafter referred to as Management’s Assessment) of IDA’s internal control framework including governance and entity-level controls. Management’s assessment was undertaken with a view to providing reasonable assurance to senior management and the Board that:

(i) IDA’s operations are in compliance with its charter and policies; and
(ii) IDA’s operations are carried out effectively and efficiently.

This assessment comprises the last of a three-part assessment in response to management’s commitment1 “to carry out an independent comprehensive assessment of IDA’s control framework including internal controls over IDA operations and compliance with its charter and policies”:

• Part IA assessed the design effectiveness of key controls currently in place to ensure compliance with the relevant Articles provisions and policies governing IDA’s operations;
• Part IB assessed the operating effectiveness of, or compliance with, the controls identified in Part IA; and,
• Part II assessed the efficiency and effectiveness of IDA’s operations, including governance and entity-level controls, as well as other outstanding items carried over from Part I.

II. Objective, Scope and Approach

In accordance with our Terms of Reference, IAD’s objective was to review the basis of management’s assessment, and express an opinion on whether it is fairly stated based on the criteria established in Internal Control – Integrated Framework issued by COSO.

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1 Management’s commitment was outlined in the IDA Fourteenth Replenishment report, approved by the Executive Directors of IDA in March 2005, which identified a monitorable action, targeted for CY05, the product of which was an ‘OED Assessment’.
ATTACHMENT 2: THE IAD REVIEW AND OPINION

IAD Review of Management’s IDA 14
Internal Controls Review FY08 Assessment

IAD’s review under Part II examined management’s assessment relating to the following:

- overarching control framework for IDA, including all aspects of corporate governance and entity-level controls;
- efficiency and effectiveness of IDA’s operations;
- information technology (IT) controls;
- fraud and corruption controls; and
- other outstanding items carried over from Part I, including (i) quality assurance arrangements for procurement and financial management in IDA’s operations (ii) three additional processes relating to Safeguards Corporate Risk, IDA’s Grant Allocation and Debt Sustainability, and Economic and Sector Work (iii) QAG’s Quality of Supervision Assessment, and (iv) additional testing of CAS and DPL modules.

IAD’s review of management’s Part II assessment was conducted during July 2007 – October 2008. As agreed with management, IAD applied relevant concepts of Auditing Standard 2 (AS2)\(^2\), appropriately tailored for operational compliance controls.

IAD specifically performed the following:

- **Management Part II Scoping Memoranda:** IAD reviewed drafts of management’s Part II scoping memorandum received on July 24, 2007, August 9, September 16, September 18 and September 25, 2007. IAD provided specific comments on July 27 and August 21, 2007.

- **Management Questionnaires:** IAD reviewed management’s questionnaires for assessing entity-level controls and quality assurance arrangements for procurement and financial management, provided specific comments, and followed up on all comments.

- **Workshops/Review Sessions:** IAD attended process walkthrough sessions convened by management for three additional processes added in Part II (Safeguards Corporate Risk, IDA’s Grant Allocation and Debt Sustainability, and Economic and Sector Work) to validate process documentation, including flowcharts and narrative descriptions provided by management of key controls.

- **Revised Process Documentation:** IAD reviewed the revised process documentation reflecting required changes identified in workshops/review sessions.

\(^2\) Auditing Standard No. 2: An Audit of Internal Control over Financial Reporting Performed in Conjunction with Audit of Financial Statements (AS2) issued by the Public Company Accounting Oversight Board (PCAOB).

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ATTACHMENT 2: THE IAD REVIEW AND OPINION

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• **Management Test Results**: IAD reviewed test results for Part II, provided by management between December 17, 2007 and August 4, 2008, including the documentary evidence supporting management’s conclusions.

• **Related IAD Audit Work**: IAD reviewed relevant results of independent internal audit projects to assess consistency with and reasonableness of management’s test results and conclusions, including the current status of remedial actions to address deficiencies identified in these audits. See Annex A for details.

• **Transmittals for Communicating Entity-Level Review Results**: IAD issued seven transmittals in March 2008 communicating preliminary review results related to management’s validation of business unit responses to the entity-level controls questionnaire.

• **Draft Management Assessment**: IAD reviewed the draft report and supporting annexes received on May 19 and June 3, 2008 and provided preliminary comments on June 18, 2008 with respect to the candor of management’s conclusions and consistency with the objectives and results of management’s assessment. IAD met with the IDA Controls Review Project Management Team, the Heads of the Procurement and Financial Management Sector Boards, and with staff from the respective anchors to discuss IAD’s comments. Management reformulated its overall conclusion to address some of IAD’s preliminary comments. IAD provided additional comments on July 29, 2008. IAD shared a preliminary version of its draft report on Aug 12, 2008 and subsequently met with management to discuss IAD’s comments. Management provided a revised version of its draft report and supporting annexes to IAD on October 8, 2008, taking into account several earlier IAD comments.

III. Management's Overall Conclusion

Management is of the view that the internal control system over IDA’s operations is adequate to provide reasonable assurance to senior management and the executive directors that:

• IDA’s published financial statements are being prepared reliably;
• IDA carries out its operations in compliance with the relevant provisions of its Articles of Agreement and operational policies and procedures; and,
• They are being made aware, in a timely manner, of the extent to which IDA is moving towards effective and efficient use of its resources in meeting its operational objectives.
IV. IAD’s Opinion on Management’s Overall Conclusion

In our opinion, management’s assessment is fairly stated, taking into account the exceptions identified as significant deficiencies by management. However, in IAD’s opinion, the identified significant deficiencies relating to fiduciary controls, entity-level controls, IT controls, and fraud and corruption controls, in combination, could represent a material weakness, such that there is a reasonable possibility that internal control failures may not be prevented or detected in a timely manner to ensure IDA’s ability to meet its internal control objectives, unless remediated in a timely manner and effectively monitored on an ongoing basis.

V. General Observation

As noted in IAD’s Part IA and Part IB reports, this IDA assessment is the first comprehensive internal exercise undertaken by management to review its operational/compliance internal control framework. Furthermore, it appears to be unique in the multilateral development banking environment, and to our knowledge, in the broader international financial institution community. While the effort underlying the commitment was clearly underestimated at the outset, substantial commensurate benefits are anticipated: its results will provide a compelling baseline to identify opportunities for streamlining IDA’s (and concurrently IBRD’s) operations and internal controls while significantly improving consistency and efficiency.

VI. Specific Observations

1. Adequacy and Effectiveness of Key Fiduciary Controls

The results of compliance testing in Part IB indicated that approximately 21% of the key fiduciary controls did not operate effectively. Management’s Part II review of fiduciary controls has identified inconsistencies in regional quality arrangements for procurement and financial management, especially during project supervision, as well as the need to strengthen overall monitoring of quality.

While management has concluded that these deficiencies collectively constitute a significant deficiency in IDA’s system of internal control, it has nevertheless concluded that key controls are adequate to ensure compliance with IDA’s policies and procedures to ensure that funds are used for the purposes intended.

IAD concurs with management that the findings of Parts I and II on procurement and financial management collectively constitute a significant deficiency; however, in our opinion, management’s conclusion that the design and operating effectiveness of key
controls are adequate to ensure use of funds for intended purposes, is not adequately supported and is inconsistent with results of management’s Part I & Part II assessments and with IAD’s independent audit results, for the following reasons:

- **Underlying Quality of Procurement and Financial Management Input:** Management’s assessment of procurement and financial management under Part II did not cover the quality of the underlying input. As indicated in IAD’s Part IB Report, an assessment of the underlying quality of procurement and financial management input is required in order to conclude on the operating effectiveness of these key fiduciary controls. Furthermore, independent IAD audits of country operations have shown that controls in financial management and procurement have not consistently operated effectively.

- ** Appropriateness of Regional Variances:** Gaps in oversight and/or quality assurance arrangements do not permit a determination of whether regional variances appropriately constitute compliance with policies, procedures and guidance. Management acknowledges that the appropriateness of regional variances should be assessed over time based on evaluations of the actual quality of fiduciary work.

- **Transactional Level Key Controls:** Part II testing indicated a need to redefine some transactional level key controls for procurement and financial management. Management is implementing comprehensive action plans to remediate deficiencies in these areas, many of which impact the design and/or operating effectiveness of controls identified as key controls in Part I.

As a result, in our opinion, any conclusion on the adequacy and effectiveness of key fiduciary controls to ensure use of funds for intended purposes would be premature until remediation plans have been implemented and verified as effective.

2. **Entity-Level Controls**

Management has concluded that there are significant deficiencies in IDA’s entity-level controls, specifically:

- issues relating to the current policy and procedural framework for investment lending;
- need for better integration of fraud and corruption issues into daily operations;
- inadequate mechanisms for risk aggregation and timeliness and consistency in monitoring, identifying and formulating an appropriate response to systemic risks;
- issues relating to AAA processes and controls; and,
ATTACHMENT 2: THE IAD REVIEW AND OPINION

IAD Review of Management's IDA 14
Internal Controls Review FY08 Assessment

- controls over information systems relating to password sharing, privileged access, and infrastructure change management.

IAD concurs with management's assessment that there are significant deficiencies in IDA's entity-level controls. However, in our opinion, the following issues related to entity-level controls require further consideration:

Governance Issues: The COGAM Working Group Report on Internal Governance Outline July 3, 2008 identified governance issues that merit further attention and noted that the resolution of these issues would be critical for stronger internal governance and greater accountability. In our opinion, the identified opportunities for improvement relating to internal governance could also improve significantly the efficiency of IDA's operations.

Issues from IAD Audits: A number of independent IAD audits have highlighted the following issues relating to entity-level controls:

- Governance and Accountability for Integrated Risk Management: There is no institutional accountability for effective implementation of Integrated Risk Management. The most important steps in the adopted process, relating to risk response, remediation and enhancement, do not occur in the absence of systematic follow-up. The lack of effective implementation has serious implications for efficiency and accountability.

Management has initiated a comprehensive review to move towards an annual Integrated Risk Report by the end of FY09, that (i) describes the overall risks facing the organization (ii) inventories the various risk assessment activities (iii) identifies potential gaps and overlaps (iv) develops a dashboard of risk findings from various risk assessments, and (v) assesses the quality and consistency of the processes in place.

- Oversight of Operational Risks: Representations relating to business process management are neither adequately supported nor monitored at the institutional level. Consequently, issue resolution for business process and operational risks at the institutional level is weak. The primary issue relating to oversight over the process leading to the assignment of clear accountabilities for business process risk management at the Bank will likely require senior management review and decision.

To the extent that IAD's comments fall within the purview of Controller's, CSRV has already initiated work to address the issues raised. Management plans to create a new integrated risk and control assessment tool that will combine elements of the existing Risk Scan and ROW tools and provide a more robust basis for VPU's to support representations on risk and controls.

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- **QAG Assessments**: Significant or pervasive deficiencies exist in QAG’s Quality-at-Entry Assessments and Quality of Supervision Assessments, affecting the achievement of QAG’s business objectives of providing staff and managers with credible, real-time feedback on quality. Transparency of the processes and lack of objectivity of input have contributed to reporting of success rates that are neither consistent with reality nor representative of the operations portfolio overall.

Senior Management has launched a review of QAG that will consider QAG’s role in relationship to other groups in the Bank and the overall institutional structure and arrangements for meeting key operational needs in tracking quality and providing essential and timely information to management. Based on the recommendations of this review, final decisions on next steps will be decided by senior management.

3. **Efficiency and Effectiveness of Operations**

Management concluded that the internal control system over IDA’s operations is adequate to provide reasonable assurance to senior management and the Board that they are being made aware in a timely manner of the extent to which IDA is moving toward effective and efficient use of resources in meeting its operational objectives.

However, as acknowledged by management, this conclusion with respect to efficiency and effectiveness\(^3\) of operations differed from the original objective reflected in the Part II scoping memorandum, namely, ‘do the internal controls over IDA operations provide reasonable assurance to senior management and the Board that IDA’s operations are carried out efficiently and effectively’. Management has noted that this revision was necessitated, given the many factors outside IDA’s control that may and often do affect the development impact and effectiveness of IDA’s operations.

IAD concurs with management’s conclusion relating to efficiency and effectiveness of operations. However, in our opinion, several opportunities exist for enhancing effectiveness and efficiency of IDA’s operations, including the following:

- **Reporting of Project Performance**: Quality and reliability of information in Implementation Status Reports on projects remain an issue. Management has acknowledged that lack of candor in reporting project risks diminishes the effectiveness of the current system of indicators in tracking portfolio performance, and reduces the likelihood that management will initiate timely corrective actions.

\(^3\) For the purposes of this assessment, *efficiency* has been defined as ‘appropriate level of input to enable the business units to achieve the desired outcome;’ *effectiveness* has been defined as ‘correct things are done and desired outcomes are being achieved.”
ATTACHMENT 2: THE IAD REVIEW AND OPINION

Independent IAD reports have also concluded that significant deficiencies exist in the reliability of ratings on project performance. Management, as part of the first phase of Investment Lending Reform, intends to comprehensively address the issues relating to supervision reporting including more precise, candid, and timely reporting of risks and progress towards results.

- **IEG Outcome Ratings:** The percentage of projects with "satisfactory" outcome ratings for Africa, which is primarily IDA, as determined independently by IEG, has declined significantly\(^4\) from 72.2 in FY05 to 65.3 in FY06 and to 56.7 in FY07. In our opinion, given that *effectiveness* is defined for the purpose of this assessment as 'correct things are done and desired outcomes are being achieved', the significant control deficiencies in IDA operations identified in this assessment and in independent IAD reports are likely interfering with achievement of outcomes. Management has indicated that this issue has been extensively discussed with the Board, including the formulation of appropriate remedial actions.

- **Streamlining of Transactional Key Controls:** Opportunities identified during this assessment for streamlining of transactional key controls for procurement and financial management could result in significantly improved efficiency of IDA operations.

- **HR Practices:** Results of recent Bank-wide Risk Scans and the 2007 Staff Survey indicated concerns relating to staff skills and mix as well as resource deployment and performance management. HRSVP will develop a comprehensive roadmap/strategy for enhancing performance management and will continue its efforts to enhance the sharing and transparency of HR-related data.

4. **Information Technology Controls**

Management has stated that no material weaknesses were identified during the review of key IT systems during the FY07 Internal Controls over Financial Reporting (ICFR) review. However, certain processes surrounding password policy breaches, information security rationalization and monitoring of changes, and change management controls were identified by management as significant deficiencies requiring attention. In addition, several significant deficiencies in this area identified independently by IAD\(^5\) are currently being addressed, including issues relating to IT governance and strategy, business continuity management, information security management, and wireless security controls.

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\(^4\) Refer to Bank's Quarterly Business Review, Q3 of FY08.
\(^5\) Refer to IAD Report "IBRD FY08-33: Summary of Key Information Technology Issues reported by IAD during FY06-FY08".
IAD Review of Management’s IDA 14
Internal Controls Review FY08 Assessment

IAD concurs with management’s assessment that issues relating to IT controls collectively constitute a significant deficiency.

5. Fraud and Corruption Controls

Management has identified specific key controls designed to prevent/detect fraud and corruption. However, significant deficiencies in these controls create vulnerabilities to fraud and corruption in countries where systemic corruption is not adequately addressed during program and project design.

In our opinion, these deficiencies are now being adequately addressed through the Bank-wide roll out of the procurement risk assessment tool, ongoing work on the Governance and Anti-Corruption (GAC) agenda, and management’s response to the India Detailed Implementation Review (DIR).

IAD concurs with management’s assessment that issues relating to fraud and corruption collectively constitute a significant deficiency.

VII. Status of IAD’s Part I Recommendations and Issues

Part IA

- Four IAD recommendations from Part IA are being currently actioned by management, (See Annex B); Eleven issues from IAD’s Part IA Deficiency Tracker remain open at the end of Part II and are being currently addressed by management. (See Annex C).

Part IB

- IAD’s observations relating to (i) auditing arrangements and (ii) the review of OP/BP 14.10 on debt reporting are being addressed by management; Six open issues from IAD’s Part IB transmittals are being actioned by management. (See Annex D).

[Signatures]

Pechiamj Murugan
Auditor-in-Charge

Thomas Ho Quei Hum
Audit Manager

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## Annex A
Related IAD Audit Reports Issued From FY07

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<th>Report Name</th>
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<td>FY07-38</td>
<td>Audit of Bank Activities in Pakistan</td>
<td>Mar 29, 2007</td>
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<td>FY07-49</td>
<td>Audit of the Process for Reporting project Implementation Progress</td>
<td>Apr 11, 2007</td>
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<td>FY07-46</td>
<td>Audit of Bank Activities in Cambodia</td>
<td>May 29, 2007</td>
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<td>FY07-54</td>
<td>Audit of Bank Identity and Access Management</td>
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<td>FY07-59</td>
<td>Audit of Bank Activities in the Kyrgyz Republic</td>
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<td>Audit of Bank Activities in Cameroon</td>
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<td>Audit of Bank Activities in Kenya</td>
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<td>FY08-24</td>
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<td>Audit of WBG Business Continuity Management</td>
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<td>Audit of Bank Activities in Ghana</td>
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<td>FY08-31</td>
<td>Audit of the Security and Controls over the Bank Wireless Network</td>
<td>May 12, 2008</td>
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<td>FY08-33</td>
<td>Summary of Key Information Technology Issues Reported by IAD during FY06-FY08</td>
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<td>Audit of the Quality Assurance Group</td>
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## Annex B

**Status of IAD Part IA Recommendations**

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<th>Issue</th>
<th>IAD Position at the end of Part II</th>
<th>Management Response/Action Plan</th>
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<tbody>
<tr>
<td>IDA Processes selected</td>
<td>Trust funds were excluded from the review; rationalization appears necessary to reconcile management's interpreted scope with the original commitment.</td>
<td>Open: Management noted at the end of Part I that the approach followed proved to be preferable given the intensity, scope of work required and the real time limitations of what could be done in a resource constrained environment.</td>
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<tr>
<td>IT Controls</td>
<td>Certain automated controls in operations have not been examined.</td>
<td>Under implementation: These were not covered specifically as these areas were already identified as requiring further review and are being addressed currently by management.</td>
</tr>
<tr>
<td>Fraud and Corruption Controls</td>
<td>Management should explicitly identify and assess fraud and corruption related controls.</td>
<td>Under implementation: Management's recommendations on actions needed to mainstream and integrate fraud and corruption issues into daily operations are set out in its response to the Volcker report.</td>
</tr>
<tr>
<td>Update of operational policies and procedures</td>
<td>Operational policies and procedures must be up to date with actual practices.</td>
<td>Under implementation: Updating and streamlining of policy framework governing investment lending is under way. Updates are also planned for operational policies and procedures relating to procurement and the FM Manual.</td>
</tr>
<tr>
<td>Document Retention and Accessibility</td>
<td>Timely accessibility of operational documents primarily relating to IL operations.</td>
<td>Under implementation: This is currently being implemented as part of the Enterprise Content Data Management (ECDM) effort.</td>
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Annex C  
Status of Items from IAD's Part IA Deficiency Tracker

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<th>Resolved: No Further Action Required (2)</th>
<th>Actioned and Closed During Part I (3)</th>
<th>To Be Actioned After Part I (4)</th>
<th>Deferred to Part II (5)</th>
<th>Open After Part I (6) = (4) + (5)</th>
<th>Actioned (7)</th>
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# Annex D

## Status of IAD Part IB Transmittals

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<tr>
<th>Process</th>
<th>Transmittals (1)</th>
<th>Issues (2)</th>
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6 Management's assessment did not include an analysis of compliance at the transaction level. Management had indicated that Part IB testing was not designed to assess compliance of a single given operation or product with all the applicable (key) controls throughout the project cycle.

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INTERNAL AUDITING...

Internal Auditing helps the World Bank Group achieve its mission by:

- Providing objective assurance and advice that add value;
- Influencing change that enhances risk management, control, and governance; and
- Improving accountability for results.
Review of IDA Internal Controls

An Evaluation of Management’s Assessment
and the IAD Review

Volume IV

Report on the Completion of Part I
Incorporating Compliance Testing of Key Controls (Part IB)

This paper is available upon request from IEG-World Bank.

The World Bank
Washington, D.C.
<table>
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<th>Acronym</th>
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Attachments

Attachment 1. Management Report on its Review of Internal Controls
Attachment 2. IAD’s Review of Management’s Assessment
Attachment 3. Statement of the External Advisory Panel
Key Technical Terms

**Internal Controls:** Controls, individually or in collective fashion, are structured means within an organization to enable it to achieve its business objectives while addressing risk. Control instruments include the control framework (in IDA’s case, the COSO (Committee of Sponsoring Organizations of the Treadway Commission) framework), organizational checks and balances, published policies, and required procedures, among others.

**COSO Integrated Framework:** A framework of management principles (“COSO components”) in an organization that, when collectively operating as intended, will ensure the attainment of three key organizational goals (“COSO objectives”): reliable financial reporting; operational effectiveness and efficiency; and compliance with laws and regulations (in IDA’s case, with its charter and internal policies and procedures). The COSO components are: Control Environment, Risk Assessment, Control Activities, Monitoring and Learning, Information and Communications.

**Risk Focal Points:** In the adaptation of the COSO framework by the Bank and IDA to meet their own needs, management has defined and added to the framework four key points of risk that face the mission of the Bank Group and are especially relevant to IDA. These are: Strategy Effectiveness; Operational Efficiency; Financial Soundness; and Stakeholder Support.

**Audit Standards:** Criteria established by recognized accounting and audit bodies for conducting audits and reviews of internal controls that offer a basis for providing assurance that controls are well designed and working as intended, and for identifying deficiencies, significant deficiencies, and material weaknesses.

**Business Process Modules (BPMs):** Management chose to conduct this review of internal controls by identifying the main business processes in which IDA is engaged on a daily basis in the course of its operations. These processes, 32 in all, covering IDA allocation; the Country Assistance Strategy (CAS) process; the main lending products (Specific Investment Loans or SILs and Development Policy Loans or DPLs); and the fiduciary, contractual, safeguards, and quality assurance processes that support lending, were each mapped and described as separate business process modules, each containing the key internal controls that are the subject of the review.

**Process Map:** The flow chart that graphically depicts all steps in a business process module.

**Key Control:** A gateway and decision point, involving key units and IDA staff, in a given business process module, through which a business transaction being processed must pass. It is the effectiveness in design of
these controls and the subsequent testing of the effectiveness of their operation that is at the center of this review.

**Business Process Template:** A standardized assessment questionnaire and rating system used by IEG to provide quality ratings of management’s method and approach in identifying, describing, and mapping the business processes, and of its method in assessing the effectiveness of control design and of control operation.

**Evaluation Panels:** In applying its Business Process Template, IEG assembled 3-4 person panels, including both controls specialists, and with experts in the particular discipline covered by the given BPM. The panels arrived at consensus judgments on the ratings that should be applied to each section of the module, according to their evaluation of the materials presented by management.

**Entity-Level Controls:** The control framework that governs an organization at its aggregate level, emanating from central management down to the operating or business process level. In IDA’s case, the reference is to the elements of the COSO framework. Doing a controls review that started with an examination of entity-level controls could be described as a “top-down” approach.

**Bottom-up Approach:** The approach adopted by management in its assessment did not begin with a top-down, entity-level review, but focused first on business processes at the transactions or operating level. Hence, it has been described as a bottom-up approach.

**Walk-through:** An interactive interview and review of process documentation conducted by management with relevant teams of IDA staff knowledgeable in a particular business process and its associated controls, with a view to verifying that controls are designed in the way described and operate as intended.

**Deficiencies, Significant Deficiencies, Material Weaknesses:** Design flaws, omissions, or noncompliant operation of controls, discovered in the course of a controls review, denoting an ascending order of seriousness. The precise criteria by which the three categories of materiality are distinguished are explained in annex B of the Part IA Report.

**NonCompliances:** Controls or control steps found, during testing, to be not operating in conformity with the design of the control. Noncompliances include both exceptions and deficiencies (see below).

**Exceptions:** Noncompliances deemed to be of a less serious or material nature than deficiencies.

**Exceptions/Deficiency Rates:** The number of exceptions/deficiencies found during the Part IB testing of key controls, divided by the number of control steps in the sample.
In the IDA14 Replenishment Report Bank management committed to carrying out an independent comprehensive assessment of IDA’s control framework, including internal controls over IDA operations and compliance with its charter and policies. Each part of this review was to be done in a three-phase approach: the first phase would be a self assessment by management, to be followed by an Internal Audit Department (IAD) review and report on management’s self assessment, and an IEG independent evaluation of both management and IAD work. Part IA of the review was completed in the fall of 2006 (IEG report dated October 18, 2006). The present report contains IEG’s evaluation of the assessment made by management and the review provided by IAD at the completion of Part I, incorporating the results of the testing done in Part IB.

The basis for the work done by IEG in the current evaluation included the report prepared by management detailing its assessment (attachment 1); access to all the underlying materials that management generated in its process based descriptions, definitions of controls, and the documentation of its testing of controls operation; and the report presented by IAD (attachment 2).

Under the task management of Nils Fostvedt, this report was prepared by Ian Hume, with the assistance of a core consultant team, including Dexter Peach (strategic advisor, formerly assistant comptroller general for planning and reporting, U.S. Government Accountability Office (GAO)), James Campbell and Rosemary Jellish (consultants, both former assistant directors, GAO) and Rachid Laajaj. The core team was assisted on selected topics by Jed Shilling, Tribhuwan Narain, David Goldberg, and Mohammed Farhandi.
Evaluation Summary

Review of IDA Internal Controls: An Evaluation of Management’s Assessment and the IAD Review

This report has its origins in a commitment that IDA management made as part of the IDA14 Replenishment process, in which it undertook “to carry out an independent, comprehensive assessment of IDA’s internal control framework, including internal controls over IDA operations and compliance with its charter and policies.” Management proposed, and the Board agreed, that Management would make an assessment of the controls, to be followed by an IAD review of the assessment and an IEG independent evaluation of both the management and IAD reports.

Management conducted its assessment within the COSO (Committee of Sponsoring Organizations of the Treadway Commission) integrated controls framework, and divided its study into two parts: Part I dealt with compliance issues, and was focused on controls at the level of 30 (later increased to 32) business processes. These were identified as representing IDA allocation; Country Assistance Strategy (CAS) and IDA lending products; supporting contractual, fiduciary and safeguard processes; and quality assurance. Part II will deal with issues of operational efficiency and effectiveness, and will include an examination of entity-level controls, within the full COSO framework.

Management’s decision to start the review with a bottom-up approach was different to what would be most often done for such reviews. While management presented reasons for this decision it also unavoidably incurred certain scope limitations, including the need to postpone final conclusions regarding the effectiveness of controls until Part II and the entity-level review have also been completed.

Management subsequently divided Part I of the assessment into two stages: Part IA, completed in October 2006, covered management’s approach and method in identifying and mapping the business processes that represent IDA operations and assessed the effectiveness of the design of controls within these processes. Part IB, the subject of the present report, and which concludes Part I, deals with the testing of how these controls actually operate, compared with their design. Part II is intended for completion by Management at the end of calendar 2007, with the full IEG evaluation then expected in early 2008.

This report contains IEG’s evaluation of the work completed by both management and IAD in their respective assessments and review of Part I, incorporating the testing done in Part IB.

IEG conducted its evaluation using a combination of approaches, including reviewing all management and IAD materials and test results, using an IEG-created template to evaluate the quality of Management’s approach to, and method of, testing, and of the IAD review.
Summary

Findings: Approach and Method
Management decided that the best way to track the use of IDA resources was to focus its assessment at the transactions level on business processes. Management used 32 Business Process Modules (BPMs) to represent IDA operations; 29 of these were subjected to testing.

Overall, management tested 115 key controls across 466 control steps. This represents significant progress in developing an understanding of IDA’s internal controls at the transactions level, and the test results matrices reveal an unprecedented view of these controls in operation.

Findings: Controls Testing
IEG evaluated management’s testing approach and method as being satisfactory, robust, and credible, but with some qualifications relating mainly to sampling methods.

Management presented its testing results in the form of an aggregate pass rate of 93 percent, measured as the total number of control steps in the sampled projects found to be compliant. On this basis, it concluded that IDA processes and controls, and their associated fiduciary, contractual, and safeguards “umbrella” processes were adequate with some exceptions.

IEG found that most noncompliances occurred in random fashion, as isolated cases of failure to observe control requirements by those processing projects. Of the 466 control steps, only 6 percent had concentrations of control failures (of three or more failures in a given control). This means that, in terms of remedies, the need for supervision by management may be more important than the need for re-design of controls.

At the end of Part I, management has identified three significant deficiencies (timely accessibility of relevant documents; variances in regional application of certain financial and procurement procedures; and failure to keep pace with needed updates of the Operational Policy/Bank Procedures (OP/BPs)). Given the importance of the latter issue—as the yardstick for compliance—and given its pervasiveness, IEG regards it to be a potential material weakness, though a final determination will be made once Part II has been completed.

Management also elaborated on how 126 internal control issues raised in Part IA, including those raised by IAD and IEG, have been addressed and disposed of, in some cases by deferring them to Part II. Management could not test the process dealing with safeguards and Corporate Risk list, because testable guidelines did not exist.

Noting the significant deficiencies and other issue uncovered by the assessment in Part IB and its own review, and subject to the work still to be done in Part II, IAD expressed the opinion that management’s qualified conclusions regarding the compliance phase of the controls review was “fairly stated”.

IEG’s evaluation considered a number of alternative “pass rates” but confirmed management’s assessment results which showed that controls at the transactions level were in compliance with required policy and procedures at a rate exceeding the 90th percentile level.

Overall, IEG finds that this result provides a reasonable level of assurance that the compliance aspect of internal controls for the business processes are working as intended, with some notable exceptions. These exceptions relate to the potential material weakness and significant deficiencies identified, and the work still to be done in Part II, which will assess the operational effectiveness and efficiency of internal controls and IDA entity-level controls.

The overall accomplishments of Part I include:

Satisfactory mapping and verification of design effectiveness of 31 out of the 32 principal business processes

Establishing of a credible method for testing key controls and processes
Conducting compliance testing to assess the overall operational effectiveness of the key controls in the business processes.

Taking remedial actions on the majority of transaction control issues surfaced to date.

Review of entity-level controls is to be completed in Part II.

Advisory Panel

As part of its evaluation, IEG obtained the services of an international Advisory Panel, which visited Washington in early March. The Panel prepared a statement that is supportive of the approach, method, and conclusions reached after the work done so far. A copy of the statement is appended to this report.

Summary

Except for the qualifications and deficiencies noted in this report, some of which are significant, and subject to the outcome of the planned follow-on work, the internal controls included in the scope of the work completed to date provided reasonable demonstration that relevant IDA policies and procedures were being followed in IDA’s daily lending transactions. Where deficiencies have been noted, management is undertaking remedial actions to address them.

Recommendations

IEG makes six sets of recommendations, as follows:

Completion of the Entity-Level Assessment (Part II): The challenge for Part II will be to redress the scope deficiencies in Part I and to draw linkages between actual findings from the transactions-level assessment and the COSO framework elements at the entity level. IEG recommends that the following topics be the subject of specific focus in completing Part II:

- **Controls and Project Processing**: More frequent noncompliance in project processing, not controls flaws, suggests a need to link to the Control Environment at the entity level, where greater management oversight may be called for.

- **Documentation Retention and Accessibility**: This significant deficiency suggests the need to draw links with both the Control Environment and the Information and Communications component at the entity level, where improved IT systems will be part of the solution.

- **Dated OP/BPs**: This potential material weakness is an essential element of the Control Activities component, which it would be well to accelerate and complete (as much as possible) in time for the completion of Part II;

- **Managing the Risk Framework and Extending COSO**: As IEG recommended on Part IA, management should consider extending the COSO framework by adding a fourth objective (strategy—high level goals) and three new components (objective setting, event identification and risk response). This suggestion was also made by the Advisory Panel.

- **Efficiency and Effectiveness**: As the overall review moves from the transactions level to the entity level, and from compliance to effectiveness and efficiency, a challenge in Part II will be to build on the results from Part I linking these to IDA’s Monitoring and Learning activities (including the Quality Assurance Group (QAG) and IEG), in order to provide the element of effectiveness and efficiency testing that was lacking in Part I, and is needed before final conclusions can be drawn regarding the overall effectiveness of IDA’s internal controls.

Part I Issues Deferred to Part II: A number of issues have been deferred to Part II, in addition to those such as information technology (IT) controls, field offices, fraud, and corruption, which management had
stated at the outset would be dealt with in Part II. The notable additions, which IEG is recommending be given special focus during completion of Part II, are: assessing the IDA Analytical and advisory activities (AAA) products (economic and sector work (ESW) and technical assistance); and the 44 issues remaining from the 126 identified process issues from Part IA, issues identified in Part IB that are deferred, and progress on the management action plans developed during Part I.

**Remedies for Problem Modules:** Part I revealed a number of modules with more prevalent controls failure, including the fiduciary modules highlighted by IAD in its report: Core Specific Investment Loans or SILs; Financial Management in SILs; Procurement SILs; Procurement Complaints; Loan Management SILs; Loan Suspensions; and Loan Closings. These become clear candidates for review and, where relevant, remedies, and management has recognized this in its report.

**Safeguards and Corporate Risk:** Management is addressing this issue, which concerns the fact that procedures for placing projects on the Risk List are not standardized and documented. However, given the sensitive nature of this topic and the potential risks to the reputation of IDA at stake in managing the Corporate Risk List, IEG recommends that management consider supporting the strengthening of this monitoring device by the introduction of specific controls, standardized across all regions, to more fully integrate these processes into the internal control system.

**Testing Inoperative Control Steps:** In Part IB a number of control steps were not actually tested, because these were often conditional control steps, not applicable in the actual sample of projects tested. Most of these control steps may rarely be needed, but IEG does recommend that management should make a selected, targeted sample to test some of these control steps. This should be done on a risk-weighted basis, in cases where it is deemed important to have the evidence from testing.

**Streamlining:** The process mapping and controls identification (and testing) has been one of the important contributions management has made as part of its transactions-level assessment. IEG believes there is merit in systemizing these materials, giving them widespread visibility within the Bank and IDA, and possibly incorporating them as part of the revised and updated corpus of OP/BPs. These materials could also be invaluable tools in the effort to simplify and streamline Bank/IDA processes.
1. Background and Status After Completion of Part IA

Background, Recapitulation and Present Status

1.1 In the IDA14 Replenishment Report,1 Bank management “has committed to carry out an independent comprehensive assessment of its control framework including controls over IDA operations and compliance with its charter and policies” (para. 39 of that document). Table 3 annex B of the document stipulated that this assessment should be undertaken by the Independent Evaluation Group (IEG, formerly Operations Evaluation Department or OED). That document has been approved by the Executive Directors.

1.2 Management subsequently confirmed that the review was to be conducted within the context of the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework,2 though it was to deal with only two of the COSO objectives: compliance with IDA’s charter, policies, and procedures and the efficiency and effectiveness of IDA operations. The objective of assuring reliable financial reporting is already routinely dealt with in the Bank Group’s annual financial reporting cycle. IEG has verified these procedures and has no issue with the exclusion during this review.

1.3 Management decided that it would divide its assessment into two parts (I and II). Part I was to deal with internal controls over IDA’s compliance with its charter and internal policies and procedures, and Part II with internal controls over IDA’s operational efficiency and effectiveness. Each part was to have three phases: first, a management assessment of internal controls; second, an Internal Audit Department (IAD) review of management’s assessment; and third, IEG’s independent evaluation of both the assessment and the review.

1.4 Following certain delays in completion of Part I, and to better manage the reporting of its progress to the Board, management decided to divide Part I into two stages (Part IA and Part IB), each dealing with distinct components of the assessment of the internal controls. How the overall review has been divided, and what topics are covered in each part, is described in Box 1.
Box 1. Stages in the Study of IDA Internal Controls

Management has divided its assessment into the following parts:

**Part I—Compliance with IDA’s Articles and Policies:** This part, conducted at the transactions level, has been split into (A) the identification of key business processes and controls and assessment of the design effectiveness of the identified key controls and (B) the assessment of the operating effectiveness of the identified key controls through compliance testing.

A. This portion of the overall assessment identified and mapped the Business Process Modules (BPMs) and the key controls in each process. Then management reviewed the design effectiveness of the business processes and key controls involved to identify any deficiencies in the design of the key controls. Management recommended remedial actions to address the design deficiencies.

B. Management has conducted tests on a representative sample of products/transactions to determine whether the key controls were applied to the sample items as designed. Management has thus assessed and determined whether there are significant deficiencies or material weaknesses in the operating effectiveness of the key controls, and, where this has been found, management has recommended measures to address these deficiencies.

**Part II—Efficiency and Effectiveness of Operations:** Management plans to assess whether the existing internal control framework, including corporate governance and entity-level controls, provides reasonable assurance that IDA’s operations are carried out efficiently and effectively, focusing on the processes and controls identified in Part I. In Part II, management also plans to address the other scope limitations in Part I, such as information technology controls and the Bank’s operations in the decentralized field offices.

1.5 The work on all three phases of Part IA (Management Assessment, IAD Review, IEG Evaluation) was completed in the fall of 2006, and IEG sent its report to the Audit Committee (AC) of the Board on October 18, 2006, for a meeting that was held on October 30, 2006. The principal subject matter of Part IA was the assessment of the quality of process mapping and of the design effectiveness of key controls in the business processes that constitute and provide internal controls over IDA operations. The main conclusions that emerged from the AC meeting were the following:

- The progress made during the completion of Part IA was acknowledged;
- The Committee was only partially satisfied with the scope and methodology of Management’s Part IA assessment, and was concerned at the omission of analytical and advisory activities (AAA);
- The Committee expressed surprise at the differences of view regarding scope and method, and called for a more definitive
The subject of the present report is the (Part IB) testing of the operation of the key controls to verify that in practice they work as designed, the resolution of some issues outstanding from Part IA, and the deferment of some issues to Part II. Completing Part I both concludes the assessment of controls at the transactions level, and completes the assessment of internal controls over compliance, the second COSO objective. As background to the controls testing in Part IB, Annex A provides a summary of the main findings, conclusions and pending issues at the completion of Part IA.

Scope and Method for the IEG Evaluation of Part I

1.7 **Objective of the IEG Evaluation:** Consistent with the mandate that the Board has given to IEG, its objective is to provide an independent evaluation of both management assessment and the IAD review, covering scope, method and approach, findings, and the quality of conclusions drawn by both parties. In addition to evaluating—and rating where appropriate—the work of the other two parties, IEG is also to draw its own conclusions regarding the evident state of IDA’s internal controls over compliance with its articles and internal policies and procedures.

1.8 Ultimately, the anticipated outcome of the review (Parts I and II) will be a judgment of whether the IDA internal control framework, as designed and as found to be operating, provides reasonable assurance that objectives relating to accurate financial reporting, compliance with IDA charters and related policies and procedures, and efficient and effective operations are being achieved.

1.9 **Completion of Part IB Completes the Whole of Part I -- Compliance Testing:** The significance of completing the testing of controls in Part IB is threefold. First, it brings to a close the scope limitation that had applied to Part IA, where a judgment on the effectiveness of the design of key controls could not be made until the operation of the controls had been tested. Second, it brings to completion management’s assessment of IDA’s internal controls over compliance with its charter and internal policies and procedures, so far as this can be done without reference to efficiency and effective-
ness issues and the other issues (decentralization, information technology (IT) issues) to be addressed in Part II. And third, it will conclude the transactions level (bottom-up) portion of the assessment, which now awaits linkage to the entity-level (top-down) phase of the review, which will be completed during Part II.

1.10 In its evaluation approach, IEG has therefore maintained a focus on both the testing elements pertaining to Part IB itself and on the broader issues that are marked by the completion of Part IB: how to evaluate the testing process itself; what conclusions can be drawn regarding the completion of the compliance phase of the review; and what linkages can be said to have been established to the entity-level issues that will follow in Part II.

1.11 Evaluation Methods: The basic materials available to IEG in making its evaluation were: a report from management on its assessment and a report from IAD on its review of management’s assessment; methodological documents (sampling criteria, testing plan); raw data from management’s testing, in the form of results sheets and summary findings and conclusions for each module tested; various review sheets and working tools from IAD; and a data room that housed the documentation collected to match each control step tested. A summary of both management and IAD reports, giving an account of the approach, method and findings and conclusions, is presented in the two chapters that follow. The approach and methods of each of the reviewing parties in addressing their respective tasks were explained in the Part IA report, and these have not changed.

1.12 A summary of the key elements that constituted the respective tasks of IEG, management, and IAD is contained in Box 2.

<table>
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<th>Box 2. Summary of the Key Elements in the Approach and Methods of Management, IAD and IEG in Completing the Work in Part IB</th>
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<tr>
<td><strong>MANAGEMENT</strong></td>
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<tr>
<td><strong>Test Operation of Controls</strong></td>
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<tr>
<td>Design controls test plan</td>
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<tr>
<td>Define sampling method</td>
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<tr>
<td>Conduct testing</td>
</tr>
<tr>
<td>Tabulate Findings</td>
</tr>
<tr>
<td>Test results matrix</td>
</tr>
<tr>
<td><strong>Form Conclusions</strong></td>
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<tr>
<td>Statement and Recommendations</td>
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1.13 As it did for Part IA, IEG has applied a combination of methods in making its evaluation of Part IB:

- IEG reviewed all methodological materials presented by management, including those describing the sampling method for projects whose processes were to be the subject of the controls’ testing, as well as the management report on Part IB (shown in attachment 1).
- IEG attended a series of management briefing meetings held during the conduct of Part IB, in which the sampling methods and the actual process of testing were described.
- Using the template that IEG had created for this purpose (described in annex D), it evaluated and rated the quality of management’s approach and methods of testing for each of the 29 Business Process Modules (BPMs) that were tested.
- IEG conducted a statistical analysis of management’s test results (that is, revealed noncompliances, by control steps, key controls, and modules) as a basis for evaluating the overall noncompliance rates revealed by the tests. Analysis was completed to identify the different types of noncompliance and to show project- and control-related concentrations of noncompliance. Noncompliance was also examined on a broadly risk-weighted basis in an effort to establish whether controls have operated more or less effectively in higher-risk modules.
- IEG evaluated all materials presented by IAD during the course of its review for soundness of method, findings, and quality of conclusions. This included those dealing with methodological and sampling issues, together with the report written by IAD on the overall completion of Part IB (shown in attachment 2).
- With regard to the issues and potential deficiencies that were outstanding from Part IA (see para. 8 in annex A), IEG participated in meetings with both Management and IAD that sorted these issues, resolved some, sent some for testing during Part IB, and identified those that were to be dealt with during the completion of Part II.

1.14 The completion of Part IB constitutes the end of the compliance portion of the internal controls review and marks the completion of the transactions-level phase. IEG has therefore given some attention to how this phase should be linked to the entity-level assessment that will be conducted in Part II. To this end IEG has used its template to discern the degree to which management’s assessment has drawn links between individual key controls within the BPMs and the five COSO components, whose effective operation will constitute the main framework of enquiry under Part II.
1.15 **Advance Summary of Findings:** Using the evaluation methods just described, IEG has completed its evaluation of management’s assessment and the IAD review of Part IB. Its complete evaluation is presented in chapter 4. The key overall conclusions reached by management, IAD and IEG can be summarized as follows:

- **At the completion Part I,** IEG concludes that it has been able to achieve the objective of its evaluation as laid out in para. 1.7 above, by evaluating both management’s assessment and the IAD review and arriving at a qualified conclusion. IEG found the approach and method used by management in its controls testing to be concrete, robust, and credible, and it found the review by IAD to be comprehensive and rigorous.

- **On the basis of its own assessment,** which showed a 93% compliance rate over all control steps tested, management came to the conclusion that both the design and the evidence of operation of IDA’s controls over compliance with its charter and internal policies and procedures were adequate with certain exceptions to ensure that IDA funds were used for the purposes intended. The exceptions related to the three significant deficiencies it identified and the need to further review fiduciary controls in the areas of financial management, procurement, and safeguards (Corporate Risk) during Part II.

- **In its report,** IAD emphasized certain methodological issues relating to management’s testing program, and it focused on the less positive results generated by pass rate concepts that differed from the one used by management. On balance, and subject to the work that has still to be performed, IAD stated that, in its opinion, Management’s qualified conclusions were fairly stated.

- **In making its overall evaluation,** IEG believes that management correctly qualified its conclusion regarding the evidence of compliance with processes and controls. IEG believes the need for management to qualify its conclusion should relate more to the number of deficiencies revealed by its assessment, including several significant deficiencies (one of which IEG still considers a potential material weaknesses).

- **Management, IEG, and IAD have together identified three significant deficiencies,** one of which IEG considers to be a potential material weakness, and six deficiencies identified by Management. Where deficiencies have been noted, management is undertaking remedial actions.

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**NOTES**

1. See “Report from the Executive Directors of the International Development Association to the Board of Governors, Additions to the IDA Resources: Fourteenth Replenishment, Working together to Achieve the Millennium Development Goals” (approved by the Executive Directors of IDA on March 10, 2005).


4. There were a total of 32 modules developed by management, but three were not tested: Module 2 (Country Performance and Institutions Assessment [CPIA]) and Module 3 (Post-Conflict Performance Indicators [PCPI]) are sub-processes of the Allocation Module (Module 1), which was fully tested and IEG saw no major reason to test them separately. Module 29 (Corporate Risk—OPCQC/ QACU) was not tested because the Bank has different regional practices (mostly undocumented) whereby high-risk projects are placed on the Corporate Risk List, and these were basically not testable. Both Management and IEG regard this as a deficiency that needs to be addressed (see Management report para 18 E).
2. Management’s Assessment

Introduction

2.1 Management’s report at the conclusion of its assessment of Part I (including Part IB) is attached as attachment 1. What follows is a summary description of the major topics covered, each accompanied by IEG observations on key aspects of the assessment. However, IEG’s overall evaluation, also taking into account IAD’s review, is contained in chapter 4.

2.2 This chapter describes some changes that were made by management in the basic universe of modules and controls to be tested. It discusses management’s method and approach in conducting the compliance testing, summarizes management’s main findings from the testing, and describes management’s main conclusions in completing not just Part IB but Part I as a whole.

2.3 Some Adjustments to the Module Base: As a result of the exchange of views that took place during the completion of Part IA, management has made adjustments to some modules.¹ Further, the Debt Sustainability BPM (now renamed Debt Reporting) which was still being mapped and assessed at the time of Part IA, has now been finished, and has been subjected to the same set of walkthrough and controls testing as the other modules. In addition, responding to comments made during Part IA by IEG and IAD, management has added two new modules, one dealing with the Post-Conflict Performance Indicators (PCPI) and the other with the Country Performance and Institutional Assessment (CPIA) processes. As a result, the number of modules has now grown to 32.² Responding to comments made principally by IEG, management has also begun work on mapping and locating key controls in a BPM representing AAA work, which will be completed in time to be assessed and evaluated during the completion of Part II.

2.4 IEG Comment: IEG views the addition of these modules to be useful and appropriate. However, the Debt Reporting Module should be extended to contain a growth, export, and debt management analysis to assess the debt sustainability of the relevant countries. This aside, these additions mean that, with exception of the AAA products (to be added during Part II), the BPMs now give an adequate representation of the universe of IDA operations.

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Evaluation Essentials

- The testing and sampling methods used for Management’s assessment were generally acceptable.
- The Testing Plan ensured transparency in the testing of each control step.
- Management’s qualified conclusion is appropriate.
- The deficiencies identified are the right ones and appear to be concentrated in fiduciary and safeguard processes.
- Management has taken action on issues and recommendations made in the earlier analysis by IAD and IEG.
Issues of Approach and Method for Part IB Testing

2.5 **Key Elements in Management’s Approach and Method:**
Other than the cases mentioned in para. 2.3 above, the universe of BPMs and their internal controls to be tested were identified and defined in part IA. The key elements of method that were different or additional in Part IB included the sampling methods, the Testing Plan, and the actual testing process.

2.6 **Sampling (Lending Products):** The essence of management’s sampling method was, first, to separate the allocation and other non-lending processes from the main lending operations (SIL, DPL), with the latter chosen from a universe of projects approved or made effective between July 2005, and February 2006. For these lending operations, the project universe was sorted by region; the projects were sorted by approval date. The regional sample size was fed into the random sequence generator (www.random.org), and from this random sample, the number of projects established separately by management as being required (i.e. 15 SILs and 7 DPLs) was identified.

2.7 According to management, “the required number of projects to be selected for testing of Investment Lending operations was determined by management to be 15 each for pre-supervision and supervision activities. This provided a sample size equivalent to the median between the applicable audit requirements applied by IDA’s external auditor…..used for the review of internal controls related to financial reporting for Weekly and Monthly frequency of activity.” For the sample SIL projects, two groups of 15 were needed, because it would have been impractical to follow the same projects throughout their lives, a span of several years. So, two groups were selected: one set from project inception to Board approval; and a second set from effectiveness to completion. From the 15 SILs, 10 were core SIL operations and 5 were other investment lending operations (responding to the IEG request made in Part IA, to test non core SILs as part of the sample).

2.8 **IEG Comment:** IEG finds the sampling methods and the resulting sample sizes to be generally acceptable. However, there were some modules in which not all the projects chosen by the random sample technique exhibited the business process being tested (for example, loan suspensions, or loan cancellations), so the active sample was smaller than the chosen sample. IEG observed that in the DPL sample, not all regions were represented, and management accordingly has undertaken to conduct an additional test with at least one DPL from a region not in the original sample. In those future tests where the sample size would be small by the nature of the case (that is, rarely operated controls), IEG would recommend, where feasible,
expanding the sample sizes (or make targeted samples) to ensure all regions are represented.\textsuperscript{5} IEG also notes that the sample period did not cover the full operational year, so it missed the year-end “bunching” season, which is when project processing is under most stress.

2.9 **Sampling (non-Lending):** The allocation and programming processes were treated separately from the lending operations, since these did not involve individual projects. The IDA allocation process required no project sampling, since this is a unique annual event in itself, but front loading was tested in two countries. Similarly, for the debt sustainability, PCPI, and CPIA modules, several countries were tested through these processes. For CAS processes, five country cases were chosen. QAG processes occur on an annual cycle, and samples were collected by management during the Part IA walk-through process, and the same was intended in the case of the Quality Assurance Compliance Unit (OPCQC, formerly QACU) and the Corporate Risk List (though in the end testing was found not to be possible, because criteria used by the regions have not been standardized and documented).

2.10 **IEG Comment:** IEG agrees with the different approaches followed in the case of these non-project modules, though it observes that in the case of the CAS processes the sampling was not really random. At IEG’s request, management is conducting an additional test on one other CAS cycle.

2.11 **Controls’ Audit and Testing Plan:** In 2006, under Part IA, Management conducted a very detailed examination of each key control in each module, to identify the actual, documentable control steps that constitute the key controls. This inventory became the Testing Plan, which was a description of each testing step management’s Project Management Team (PMT) used to verify the operation of the key control. This provided the basis for the call for documentation, during Part IB, from the Bank’s operating departments to test the actual working of each control.

2.12 **IEG Comment:** The Testing Plan was a useful addition to the BPM materials, and made transparent exactly what was being tested at each control step.

2.13 **Documentation of Controls Steps — The Testing Process:** This differed from the walk-through processes that were conducted in Part IA to verify the accuracy of mapping and effectiveness of control design. In testing for the operation of controls, management requested departments to supply the relevant documentation for each of the sampled projects, for each control step or attribute in each key control. (In the case of the non lending processes, management asked the respective Bank units responsible for executing
2.14 **IEG Comment:** This method appears to have worked well, and the documentation for each step is contained in one or more binders for each module, stored in a data room that IEG has visited and where it has inspected several binders, on a self-selected basis. IEG inspected binders for six business process modules (SIL project cycle, DPL project cycle, Financial Management SIL, Procurement Complaints, Application Review, and Safeguards SIL) and looked at documentation related to two to four projects in each module. IEG found that the binders displayed the relevant documentation of the controls tested and it found that the management team staff were very knowledgeable in explaining the meaning of the documentation that showed the operation of the controls.

2.15 This concludes the summary description of management’s approach and methods used in Part IB; what follows is an account of the results of management’s testing, and the major findings that emerged.6

### Summary of Major Findings

2.16 **Management’s Overall Assessment:** In presenting its findings and conclusions on the completion of Part IB, management provided an overall summary of its assessment (paras. 17 and 18), which states as its view that “the design and operational effectiveness of identified processes and associated key controls are adequate to ensure compliance with IDA’s policies and procedures that funds are used for the purposes intended, except for” three significant deficiencies and the need to further review the fiduciary controls in Part II.

2.17 **IEG Observation:** IEG believes that management correctly qualified its conclusion regarding the evidence of compliance with processes and controls because of the number of deficiencies revealed by its assessment, including several significant deficiencies (one of which IEG still considers a potential material weaknesses).

2.18 **Testing for Operating Effectiveness of Key Controls:** Management tested 115 key controls in 29 modules. Many key controls have several control steps, or (management’s term) “attributes.” Thus, the full test of a control often involved testing several individual steps or attributes. Since there were 466 individual control steps and 115 key controls, the average control had around four control steps, with a range from 1 to 15. (In annex B IEG provides a detailed description of management’s testing approach and method.)
2.19 **Summary of Results and Management Conclusions:** Each module was tested by documenting the processing of a number of sample projects—with samples varying from 30 projects for some modules, to 3 to 5 or fewer for others (345 projects in total). The total number of control steps tested (including the N/As) was 3706, or 3603 net of not applicables. From this total, management found 246 noncompliances, —that is, control steps where the control failed— a failure rate of 7 percent. *(IEG Note: It should be stressed that this “failure rate” does not mean that 7 percent of all tested projects “failed.” The rate is an aggregate measure, across all projects tested, of the gross number of control steps that were not complied with, as a percentage of the total number of control steps tested (for example, 246/3603). Further, as part of its assessment, management found that about half of all noncompliances were, in its judgment, “exceptions” rather than “deficiencies.” Exceptions were less serious cases of noncompliance, frequently involving other mitigating controls, which therefore offset the negative impact of their failure. IEG examined management’s criteria in making these distinctions, module by module, and found them to be justified.)*

2.20 Management took these findings—based on the 93 percent pass rate—as the overall salient feature of its testing program. On this basis it drew the following conclusions:7 *(The following list appears in para. 24, page 9 of management’s report)*

- The performance-based allocation model is being implemented in a manner that directs scarce IDA resources in support of priority development activities in the poorest eligible member countries.
- The complementary use of the three primary instruments for carrying out IDA operations (CAS, ILs and DPL), and evidence relating to the application of the processes and controls that apply to them (from identification to completion), confirm that:
  - IDA financing is being provided in support of development priorities and is focused on matters that appropriately fall within IDA’s mandate; and
  - Consistent with the provisions of IDA’s Articles of Agreement, IDA financing is made available for specific projects as well as other “special circumstances” operations, where appropriate.”

2.21 Management also goes on to say, in the same paragraph, that the test results show that the “umbrella processes”8 and associated fiduciary, contractual, safeguards, and other processes are adhered to as well as that the procurement provisions and controls also ensure compliance with OP/BP11.00 and the Bank Guidelines: Procurement under IBRD Loans and IDA Credits and Guidelines: Selection and Em-
Deficiencies appear to be concentrated in the fiduciary, contractual, and safeguards processes.

Deficiencies Identified During Part IB

2.23 **Significant Deficiencies:** Management identifies three significant deficiencies, as follows:

- **Timely Accessibility of Relevant Documents:** Management explains that while it found a 93 percent overall pass rate in its controls testing, the lack of timely access to relevant documents remained the most common source of noncompliance. Management has already instituted a remedial program, and recommendations are due to be issued by June 30, 2007.

- **Variances in Regional Implementation of Institutionally Endorsed Financial Management and Procurement Guidelines:** The testing revealed that financial and procurement review processes were not always implemented in accordance with the most recent guidance issued by the appropriate sector boards. Management has called for the boards to review the relevant documentation, and for a harmonization of Implementation Status and Result (ISR) Report reporting across the regions, together with improvements in the procurement complaints database.
Not Keeping Pace with Needed Updates of the OP/BPs: As identified during Part IA, management repeats that this is a significant deficiency, but argues that it does not rise to the level of a material weakness because interim procedures have been issued where gaps have been identified in the OP/BPs. It outlines a 24-month program to address this issue, with recommendations to be issued by end-2007, and management will review this issue as part of its entity level assessment in Part II.

2.24 IEG Observations: IEG agrees that all three issues were rightly identified by management. It also agrees that the issue of documentation accessibility (revising its opinion stated in Part IA) can now be treated as a significant deficiency, along with the issue of regional variances. However, given the centrality of OP/BPs as a pillar of policy compliance, IEG retains its earlier opinion that the OP/BPs issue remains a potential material weakness, to be revisited during Part II. Also, IEG notes the tests conducted by management also revealed variation in implementation in institutionally endorsed guidelines with regard to safeguard processes as well as financial and procurement review processes.

2.25 Exceptions and Deficiencies: From a longer list of a number of exceptions and deficiencies identified during Part IB, management highlights the following six:

- **Streamlining of Investment Lending Operations**: Management's assessment identified that existing processes and documentary requirements are inefficient and onerous. For example, the presupervision phase of a SIL comprises 20 controls and 95 attributes. Streamlining recommendations will be made following further review of these issues during Part II.
- **Frequency of Corporate Reviews of ILs**: The disparity was noted between the frequency of ILs and DPLs being sent for corporate review, and Operations Policy and Country Services (OPCS) has already issued a new *Guidance Note* to address this issue.
- **Credit Information Update and Loan Department Clearance Processes**: Testing revealed certain weaknesses in the processes for updating the Loan Administration System (LAS) and documenting the clearance processes, including: LAS set up requirements were not fully implemented; Loan Department (LOA) approvals of notices of loan suspensions were sometimes not filed, and not all suspension notices were sent to LOA for clearance; and a historical trail of non-payment related suspensions were not maintained in the LAS because of system limitations. These will be issues addressed in a new system to be im-
implemented by the third quarter of FY08, and these new controls are to be periodically tested by the Controllers.

- **Providing Clearances from Reviewers:** Management discovered a number of cases where clearance of project documentation had been given, conditional on certain changes being made. However, there was often no follow-up by reviewers to ensure the changes were in fact made, and there was sometimes confusion between Task Team Leaders (TTLs) and reviewers as to whose responsibility this was. Management is reviewing the need for further guidance on this issue.

- **Procedures Related to Safeguards Corporate Risk List:** Management discovered that the existing procedures for OPCQC to determine the inclusion of high-risk projects on the Corporate Risk List were drafted as an advisory system, not a control. Therefore, regions were often found to differ in their application of these processes, and this lack of a standard template meant there was no basis for the testing of this business process module (Module 29). Management is redressing this deficiency by setting up a standardized system, and it will attempt to test Module 29 under the new system (if sufficient data has accumulated) during Part II.

- **Debt Reporting Process:** Management’s review found that borrowing countries, which are required by OP/BP 14.10 to report quarterly and annually on their external debt, were complying with the annual requirement, but not the quarterly requirement. Management did not review the process relating to the broader debt sustainability analyses required under IDA 14, including the grant allocation framework based on the level of debt distress.

2.26 **IEG Observations:** IEG observes that these issues have been correctly identified by management as deficiencies to be highlighted, and these accord with its own review of management’s results. In the case of the procedures for corporate risk review, IEG is not aware of any evidence suggesting that these issues have not been properly managed. However, given the sensitive nature of the Corporate Risk List and the implications it carries, IEG believes that management’s remedial actions should also include a standardized approach to these processes across all regions. IEG has also pointed out that debt sustainability analysis is an important element of the IDA allocation process and needs to be further developed. It should be noted, however, that management has begun, and in many instances completed, significant steps toward remedying not only these issues but the full array of issues and deficiencies identified by the three reviewing parties to date.
Resolving Outstanding Issues from Part IA

2.27 Management saw it as a second objective of the testing in Part IB to resolve the issues that had been raised during Part IA, by management’s own work, and by the IAD review and IEG evaluation of management’s assessment.

2.28 **Addressing Issues Raised by IAD**: Management listed eight issues that had been raised by IAD during Part IA, and described the actions it had taken to address them, as summarized below:

- **Issue 1: IDA Processes Selected.** Management justified the transactions-based first stage of the overall review as being dictated by the unprecedented nature of the review, time limitations, and the fact that the prime focus of the mandate given to management was to assess the extent to which IDA resources were being used for the purposes intended. *IEG commented extensively on management’s approach in Part IA.*

- **Issue 2: Information Technology Controls.** Management has always maintained that it would address the IT controls as part of the entity-level assessment to be done in Part II, but IAD had suggested that some computer controls were also relevant to the transactions-level assessment. Management has undertaken to document all IT systems impacting operations with automated compliance controls and report on them in its Part II report. *IEG accepts management’s explanation as reasonable.*

- **Issue 3: Fraud and Corruption Controls.** Management responded to IAD’s claim that fraud and corruption should have been explicitly addressed at the transactions level by pointing out that this is inherent in the nature of the controls tested for country governance (CAS process), and also in the fiduciary and other aspects of testing project controls. Also, management identified fiduciary controls (such as separation of duties for loan applications and withdrawals within LOA) that have been specifically designed to prevent fraud and corruption. Management will use the results of the Bank’s Internal Control Over Financial Reporting (ICFR) as an input to its entity-level assessment of these issues in Part II. *IEG accepts management’s explanation as being reasonable.*

- **Issue 4: Outdated Operational Policies (OPs) and Bank Procedures (BPs).** Management explains that a program to update and streamline the OP/BPs for investment operations is underway, and will be completed within 24 months, and that the results of the present controls review at the end of Part II is likely to be an important input to that program. *IEG had also raised a similar point; however, pending completion of Part II, IEG still regards this issue as a potential material weakness.*
Management also took actions to deal with IEG's earlier recommendations.

- **Issue 5: Categorization and Remediation of Deficiencies.** Management explains that it has evaluated the magnitude of the control deficiencies identified by itself, or by IAD or IEG, and it has shared these evaluations with both IAD and IEG.

- **Issue 6: Document Retention and Accessibility.** Management repeated the explanation it gave of its own assessment of this issue: that it regards this as less an issue of compliance than as an issue of ensuring adequate accessibility to relevant documentation. *IEG agrees with this explanation, but notes that (as explained in chapter 4) this issue remains a significant deficiency.*

- **Issue 7: Assessment of Entity-Level Controls.** The review of entity-level controls will be carried out during Part II. Management has consulted closely on the scope of the activities to be included in this review with IAD and IEG. *IEG accepts management's explanation for deferring review of these controls to Part II.*

- **Issue 8: Walk-throughs of Process Documentation.** Based on discussions with IAD, management believes that the compliance-testing methodology that included testing individual credits through all the controls in a procedure had alleviated IAD's concerns about the design effectiveness by the completion of Part IB, and do not believe this is an issue any longer. *IEG accepts this explanation, and shares the view that this is no longer an issue.*

2.29 **Addressing IEG Recommendations:** Management dealt with each of the six recommendations made by IEG in its Part IA report, as follows:

- **Recommendation 1: Confirm the Validity of the Business Process Mapping Cluster.** IEG had raised two issues under this heading. The first deals with the fact that the BPM for SILs may not fully represent the controls relating to all ILs. IEG suggested that during Part IB, management include a range of ILs in addition to the SILs in the sample, and management did this. The second issue was the exclusion of AAA products from the cluster. Management explained that the exclusion was consistent with its focus and main objective of assessing the internal controls in place for ensuring how borrowers use IDA resources. During Part II management will review the AAA activities to determine if the key controls for the majority of these activities are consistent and can be easily documented and tested. *IEG explained its position in Part IA: that the review is examining controls over IDA operations (all operations, not just lending), but it believes that management's undertaking to examine the AAA issues during Part II can settle this issue (especially since many AAA aspects relate to efficiency and effectiveness).*

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Recommendation 2: OP/BP Status: Management repeats the same explanations made in the case of the similar point raised by IAD.

Recommendation 3: Complete the Remaining Stages of the IDA Review. Management repeats the explanation given in the case of the same point raised by IAD.

Recommendation 4: Resolve Issues and Potential Deficiencies with IAD. The potential issues identified by Management during its assessment and by IAD’s review have been evaluated to determine their impact on IDA’s internal controls and the remedial actions, if any, that may be required to mitigate risks. Management’s listing of the identified deficiencies and their resolution has been shared with IAD and IEG. IEG comments on these issues in more detail in the sections that follow.

Recommendation 5: Manage the Risk Framework. In response to IEG’s Part IA recommendation, management will review the COSO Enterprise Risk Management framework in the second half of FY 07, for potential strengthening and/or adaptation into COSO of the Bank’s (including IDA) existing Integrated Risk Management Framework. This decision is not expected to impact Part II of the review. IEG accepts this explanation as adequately addressing its concern.

Recommendation 6: Mainstream Internal Controls Reviews. Management will commence discussions with the Audit Committee to consider the value to the Board and shareholders of adopting a process for periodic or ongoing monitoring and reporting on internal controls, in addition to the review of internal control over financial reporting. IEG regards this as a positive step and encourages serious consideration of its recommendation.

2.30 Addressing other specific issues raised in Part IA: During Part IA, management, IAD, and IEG raised a total of 126 other issues. Management reported that 45 of these were resolved, 44 were deferred to Part II, and 37 were included with other issues raised in Part IB.

2.31 This concludes the summary of management’s assessment. Further details of management’s work and the conclusions drawn from the completion of Part IB can be found in the management report itself, at Attachment 1.

NOTES

1. A principal example: QAG processes were added into the core SIL process map.

2. As explained in paragraph 1.13iii above (and footnote 5 in Chapter 1) management only tested 29 of the modules.
3. The Testing Plan was a listing of steps the project management team took to evaluate the components of each key control, with a view to verifying that each control step operated as designed.

4. The applicable audit standard is described in Annex 3 to the Management report (attachment 1): *Standard No.2 (AS2), An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*, issued by the U.S. Public Company Accounting Oversight Board (PCAOB) in response to the provision of Article 404 of the Sarbanes-Oxley Act. As explained in the Part IA Report (see annex B), management has chosen to use concepts similar to AS2 (though not the standard itself) as guiding standards for the present review. Management made the choice of a sample size of 15 based on general guidance in paragraph 105 of AS2 that manual controls that operate more frequently should have more operations of the control tested. Other guidance in AS2, such as that controls that are relatively more important should be tested more extensively — for example, by evaluating whether the judgments made were appropriate and adequately supported, may be used in Part II.

5. IEG also recognizes that in the cases where rarely used controls are to be tested, often these may have to be individually targeted, so the strict principle of random selection may not be achievable.

6. A segment of management’s report also deals with a number of the issues that had arisen during Part IA (all of which have either been mentioned in chapter 1, or are dealt with in chapter 4). These include: Management’s methodology; treatment of IT controls; fraud and corruption issues; the need for improved OP/BPs; documentation issues; walk-through concepts; extending the content of the BPM cluster; treatment of risk; and the resolution of issues uncovered during Part IA.

7. Management makes clear in its report that this pass rate does not imply that 93 percent of all projects were broadly compliant, because the rate is calculated as a broad aggregate on the overall incidence of noncompliance, compared with the total number of tested control steps, not by individual projects.


9. The Corporate Risk List is a document compiled to record the most highly sensitive projects, from a safeguards risk perspective, to allow senior management to internally monitor progress in maintaining their safeguards provisions. At present, therefore, it is really only a monitoring device, and not strictly a control mechanism.
3. The IAD Review

Introduction

3.1 IEG has evaluated the report presented by IAD at the conclusion of its review of management’s Part IB assessment, which is included as Attachment 2. What follows is a summary description of the major topics covered in the IAD review, each accompanied by IEG observations on key aspects of the assessment. However, IEG’s overall evaluation is contained in chapter 4.

3.2 Objectives of the Review: IAD describes the objectives of its Part IB review, as laid out in its Terms of Reference,1 as follows: “IAD’s objective was to review the basis of management's assessment and express an opinion on whether Management’s assessment of the effectiveness of internal controls over IDA operations is fairly stated based on the criteria established in Internal Control—Integrated Framework issued by COSO.”2 IAD emphasizes that Part IB relates to assessing and reviewing “the operating effectiveness of key controls currently in place to ensure compliance with the relevant Articles provisions and policies governing IDA’s operations.”3

Approach and Method

3.3 IAD provided a description of the approach and method it would adopt in conducting its review of Part I (Part IA and Part IB) in its 2006 Terms of Reference which were issued prior to the start of its Part IA review. (See also the summary contained in Box 2, above). In its Part IB report IAD defined the scope of its review and described the IDA processes that management had excluded from its assessment. This was followed by a description of the various review activities that constituted its overall method and approach.

3.4 Scope Limitations: IAD explained that it conducted a review of 31 of the 32 BPMs that Management had presented for assessment, which included the 2 newly added submodules of the IDA Allocation Process Module.4 The excluded module was the Safeguards Corporate Risk module which management had been unable to test.
3.5 IAD explained that its review did not include several areas that management had deemed outside the scope of the review, including:

- The overarching control framework (governance and effectiveness and efficiency);
- Specific processes deemed by management to be outside the scope of this assessment: Economic and sector work (ESW), Report on Observance of Standards and Codes (ROSC), Independent Evaluation Group (IEG) processes, Internal Auditing Department (IAD) processes, Annual Report on Portfolio Performance (ARPP), the Inspection Panel, the Department of Institutional Integrity (INT), and the Results Assessment Framework of IDA;
- Certain OPs and BPs excluded by Management, as outlined in its Part IA report; and,
- Compliance controls embedded in automated applications used in IDA operations.

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<thead>
<tr>
<th>Box 3. Listing of Review Activities Performed by IAD in Part IB</th>
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<tr>
<td><strong>Management Test Plans:</strong> IAD reviewed management’s test plans for assessing the operating effectiveness of the key controls identified for the in-scope processes.</td>
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<tr>
<td><strong>Management Sampling Methodology:</strong> IAD reviewed the sampling methodology note provided by management, provided specific comments, and followed up with management on all comments.</td>
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<tr>
<td><strong>Workshops/Review Sessions:</strong> IAD attended process walk-through sessions convened by Management for the three processes added in Part IB, to validate process flow charts and narrative descriptions of individual key controls provided by management, challenging, seeking clarification, and identifying potential deficiencies as appropriate.</td>
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<tr>
<td><strong>Revised Process Documentation:</strong> IAD reviewed revised process documentation incorporating changes identified in the three additional workshops/review sessions, and based on testing in Part IB.</td>
</tr>
<tr>
<td><strong>Management Test Results and Supporting Documentation:</strong> IAD reviewed and validated the test results, including the documentary evidence supporting process-level conclusions, and management’s methodology for determining compliance rates and identifying exceptions and deficiencies.</td>
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<tr>
<td><strong>Transmittals for Communicating IAD’s Review Results:</strong> IAD issued 32 transmittals to communicate review results and to solicit management responses. Issues covered adequacy of testing and sampling as well as process-specific issues.</td>
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<tr>
<td><strong>Management Drafts:</strong> IAD reviewed drafts of management’s report and provided specific comments.</td>
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<tr>
<td><strong>Significance of Deficiencies Identified in Part IA:</strong> IAD reviewed management’s evaluation of the significance of deficiencies identified by management, IAD, and IEG during Part IA.</td>
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<tr>
<td><strong>Representation of Compliance Rates:</strong> IAD reviewed the consistency of test results with the candor of the representation of those results by Management in their draft report.</td>
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<tr>
<td><strong>Consideration of Related IAD Audit Work:</strong> IAD reviewed relevant results of independent internal audit projects to assess consistency with and reasonableness of management’s test results and conclusions.</td>
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3.6 **Approach:** The IAD report states that, as agreed with management, IAD has applied the Audit Standards 2 (AS2) concepts to its review of Part IB. The report also describes the 10 sets of activities it performed in completing its Part IB review. These are summarized in Box 3.

3.7 **IEG Observations:** IEG observes that IAD’s approach and method for this review have been rigorous, very detailed, and comprehensive. The IAD Transmittals instrument provides for an open and clear statement of issues as these were identified, and this was followed, module by module, by extensive discussions between IAD and management as a means to resolve outstanding issues. IEG believes that these methods, in their focus and detail, were particularly well suited to a review of the specifics of management’s transactions level assessment approach.

### Major Findings

3.8 IAD summarizes its findings by first making a general observation; it then continues by listing and reviewing a series of specific observations that arose during Part IB or were outstanding from Part IA; and it ends by making an overall conclusion.

3.9 **General Observation:** The report mentions that not only was this assessment of IDA controls a first of its kind within the Bank, but is unique among the multilateral international financial institutions (IFIs). Commenting on the overall review, the report states:

> While the effort underlying the commitment was clearly underestimated at the outset, substantial commensurate benefits are anticipated: its results will provide a compelling baseline to identify opportunities for streamlining IDA’s (and concurrently IBRD’s) operations and internal controls while significantly improving consistency and efficiency. (page 4)

3.10 **IEG Observation:** IEG agrees with this vision of the overall review of IDA controls, which has indeed been more taxing than initially envisaged, but which should bring significant benefits to the organization in improved knowledge, more focused controls, and an improved basis for streamlining.

3.11 **Summary of Specific Observations:** The report highlights 7 specific observations that IAD regards as the significant findings that have emerged from its review, including some issues outstanding from Part IA. These are summarized with IEG’s observations in paras 3.12-3.27.
3.12 **Observation 1: Key Fiduciary Control Compliance Rate.** IAD states that of the 115 key controls, 29 are key controls related to the fiduciary processes (procurement, financial management, loan management) “as being most critical to ensuring that IDA funds are used for the purposes intended.” (page 5). IAD points out that 21 percent of these key fiduciary controls do not operate effectively, according to management’s results, and it further states that management has concluded that significant deficiencies exist in the procurement and financial management processes.

3.13 **IEG Observations:** IEG does not share the view that the three fiduciary processes, while obviously important, are the “most critical” in ensuring the intended use of IDA resources. IDA allocation, the CAS process, and the two lending vehicles (SIL/DPL) are the main drivers of IDA operations. The fiduciary processes—together with legal and safeguard processes (not mentioned by IAD)—are supporting processes. IEG did not calculate separate compliance rates for these fiduciary process key controls, but, as part of its overall key controls and other compliance analysis, it found (see Table B-7 in Annex B) that the fiduciary processes were among those with the most concentrations of control failures, and they represent the most important qualification to management’s overall aggregate pass rate. Management also observed this fact, so all parties are in agreement that this is an area where attention is needed.

3.14 **Observation 2: Representation of Compliance Rates.** IAD reviewed the way in which management had represented the compliance rates found in its Part IB testing. Its report notes that management’s testing was not designed to assess compliance of a single project with all applicable controls and points out that the interdependence of key controls is “particularly critical in IDA processes during the supervision phase.”

3.15 **IEG Observation:** IEG agrees with this judgment. IEG undertook an extensive examination of the various pass rate concepts presented by management, IAD and IEG itself (see Annex B paras. 10 and 11). While different pass rates may be used to suggest different outcomes, and while the treatment of controls that were inoperative during these may be an issue for the future (see annex B para 6) IEG is of the view that IAD has correctly confirmed that the overall pass rates presented by management give a fair representation of the general state of compliance of IDA’s internal controls.

3.16 **Observation 3: Operating Effectiveness of the Key Controls within Fiduciary Processes.** IAD states that although “management has verified that documentary evidence exists to support the operation of key fiduciary controls, the quality of the underlying special-
ist input...has not been examined.” (page 5). IAD also cites ISR evidence from other IAD audits that supports the finding that fiduciary controls “do not consistently operate effectively.”

3.17 **IEG Observation**: IEG believes these aspects of operating compliance would be appropriate for review in Part II of the review, along with the effectiveness and efficiency aspects of the controls. But it is important also to acknowledge that Management has addressed certain qualitative aspects of control effectiveness in Part I. Management reported a significant deficiency relating to variances in regional implementation of institutionally endorsed financial management and procurement guidelines and has called for the appropriate sector boards to review the relevant documentation. It also reported a deficiency in providing clearances from reviewers based on the discovery that in number of cases where clearance of project documentation had been given, conditional on certain changes being made but there was often no follow-up by reviewers to ensure the changes were in fact made, and there was sometimes confusion between TTLs and reviewers as to whose responsibility this was. Management is reviewing the need for further guidance on this issue. IEG would also point out that when examining the quality of controls, it should be recognized that the Bank already has well-established quality monitoring units and processes (including those of QAG, IAD, IEG) that examine both projects and programs, and it will be the proper subject of Part II to examine the efficiency and effectiveness aspects of the present review, also using the work of these units.

3.18 **Observation 4: Statement of Expenditure (SOE) Reviews and Audit Arrangements**: IAD states that it regards SOE reviews as critical to ensuring eligibility of expenditures, but management did not include such reviews in its testing, because these reviews are not mandatory where auditing arrangements are considered adequate. Noting that management will be covering audit practices during Part II, IAD asks if SOEs will also be covered.

3.19 **IEG Observations**: SOEs are an important disbursement tool which should be subjected to periodic controls but, as Management explains, it is not mandatory that these be checked, if audit procedures are acceptable. Therefore, it is not clear why IAD did not suggest that the Part IB assessment would have been better conducted had it tested audit processes (which is the primary control function), rather than argue that an SOE review should have been conducted. However, IEG also notes that Management intends to examine audit practices during Part II.
3.20 Observation 5: Debt Reporting Process: IAD points to some inconsistencies between Management’s testing results and statements regarding full compliance with OP/BP 14.10 on External Debt Reporting. Management acknowledges that compliance may not be complete, but asserts that debt reporting control objectives were being achieved. IAD also points to other issues not covered by management’s testing— the debt sustainability analysis needed in some countries and the free rider risk to IDA that arises in some cases — that were not tested by management.

3.21 IEG Observations: IEG has also raised this matter in its own evaluation, but regards the lack of any debt sustainability analysis in the process module to be the most important missing element.

3.22 Observation 6: Status of Issues from IAD’s Part IB Transmittals. IAD commented on management’s testing methods by sending comments on the test plans (44 specific comments). Of these, 40 have been actioned or resolved with management, and the remaining 4 have been deferred to Part II. IAD also sent comments on management’s test results in the form of Transmittals, of which it sent 32 in all, with a total of 58 issues. Of these, 45 have been resolved, 12 were deferred to Part II and one remains open.

3.23 IEG Observations: IEG observes that the number of issues identified, and the fact that almost all issues have been either resolved or deferred to Part II, is a reflection of the thoroughness of IAD’s approach, and the substantial interaction with management that this involved.

3.24 Observation 7: Status of Recommendations and Potential Deficiencies from Part IA. IAD points out that of the eight recommendations it made to management in Part IA, six are still outstanding and open. Since IEG had also taken a position on all of these issues, it makes sense to summarize these in a common table, which is shown in Box 4. IAD also states that it found 59 potential documentation and design deficiencies in Part IA, of which 18 remain open, many because OP/BPs require updating.

3.25 IEG Observations: IEG notes that the six “open” recommendations all relate to matters that are to be addressed or are in process of being remedied. They do not signify disagreement at this stage between the reviewing parties, and these issues will all be addressed during Part II. Regarding the 18 open issues awaiting reform of the OP/BPs, IEG takes this as one piece of evidence (among others) that the OP/BP issue is a potential material weakness.
IAD’s Conclusions

3.26 In making its concluding remarks at the end of its review report, IAD states:

In our opinion, subject to the outcome of the assessment of entity-level controls and other relevant outstanding assessments to be completed in Part II, Management’s view that the design and operational effectiveness of identified processes and associated key controls are adequate to provide reasonable assurance of compliance with IDA’s policies and procedures to ensure the use of funds for the purposes intended is fairly stated, taking into account the exceptions noted by Management.

Box 4. Scorecard and Status of IAD Issues and Recommendations From Part IA

<table>
<thead>
<tr>
<th>IAD ISSUE</th>
<th>IEG POSITION</th>
<th>STATUS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. IDA Processes</td>
<td>IEG agrees there are scope limitations in management’s approach, but has made its evaluation contingent on these limitations being addressed before the review is completed.</td>
<td>X</td>
</tr>
<tr>
<td>Selected</td>
<td>Management was given no mandate to introduce scope limitations</td>
<td></td>
</tr>
<tr>
<td>2. IT Controls</td>
<td>IEG accepts management’s position that these will be assessed in Part II, with a return to assessing transactions processes where these may be specifically required.</td>
<td>X</td>
</tr>
<tr>
<td>These should have been assessed at the transactions level</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3. Fraud and Corruption Controls</td>
<td>General remedies for significant deficiencies would cover fraud and corruption but the latter do not require additional remedies.</td>
<td>X</td>
</tr>
<tr>
<td>These should have been tested explicitly in Part I</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4. Outdated OP/BPs</td>
<td>IEG regards the status of OP/BPs as a potential Material Weakness</td>
<td>X</td>
</tr>
<tr>
<td>These are key elements in compliance</td>
<td></td>
<td></td>
</tr>
<tr>
<td>5. Categorization of Deficiencies</td>
<td>Management has satisfactorily resolved these issues, with appropriate interactions with IAD and IEG.</td>
<td>X</td>
</tr>
<tr>
<td>Management to decide materiality</td>
<td></td>
<td></td>
</tr>
<tr>
<td>6. Documentation Retention and Accessibility</td>
<td>All parties agree this is a significant deficiency but IEG questions IAD view that this is a “design deficiency.” For IEG failure to retain or access documents appears to be largely an operating failure, not a design failure. However, there may be cases where OP/BPs need to state that retention should be maintained.</td>
<td>X</td>
</tr>
<tr>
<td>7. Assessment of Entity Level Controls</td>
<td>Broad scope of Part II is to be reviewed with all three parties.</td>
<td>X</td>
</tr>
<tr>
<td>8. Walk-through of Process Documentation</td>
<td>After extensive debate, this issue has now been closed.</td>
<td>X</td>
</tr>
</tbody>
</table>
3.27 **IEG’s Summary Observations:** IEG takes note of the detailed and systematic approach to the review outlined by IAD, and notes also the extensive review activities that IAD performed in completing its work on Part IB. In IEG’s opinion, the method and approach taken by IAD in its review was appropriate, suitably rigorous, and was generally well explained. IEG notes the range of issues that have emerged as the findings of this process, and a number of these are shared by IEG as findings it has come to in its own evaluation. Most importantly: IEG takes note that IAD has stated its opinion that, subject to the number of important issues that remain to be addressed in Part II, the conclusion arrived at by management that IDA’s internal controls were found to be operating in adequate compliance with its policies and procedures, was fairly stated, taking into account the exceptions noted by management.

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**NOTES**

1. *Terms of Reference for a Review of Management’s Assessment of Internal Controls over IDA Operations*, IAD, May 16, 2006, issued as a memorandum to the Vice Presidents of CTR and OPCS, which IAD also sent to AC and CODE.

2. IAD Report page 1.


4. IEG excluded the two submodules from its count since it viewed them as part of the parent module, so it has stated that 29 modules were tested, whereas IAD has kept these within the testing sample, therefore speaking of 31 modules.
4. The IEG Evaluation

4.1 Introduction: The work on Part I has now been completed by both management and IAD. Their two reports are attached. This allows IEG to make its overall evaluation of the completion of Part I, which dealt with compliance with IDA’s articles and internal policies and procedures (COSO objective 2), and which was tackled by management in a bottom-up, process-level approach. The evaluation will incorporate the results of the controls compliance testing that was completed by management as Part IB. Surveying all the material that has been generated during Part I, by both Management and IAD, IEG has organized its evaluation around the following five main topics:

- Management’s Approach and Method
- Internal Controls at the Transactions Level
- Material Weaknesses and Significant Deficiencies
- Other Process Issues Uncovered in Parts IA and IB
- Overall Evaluation

Management’s Approach and Method

4.2 Scope Limitations: IEG’s Part IA report commented that Management’s decision to open the overall review with a transactions-level assessment was contrary to the normal approach to such reviews, and, coupled with the phasing of the review, led inevitably to a number of scope limitations. As a result, until the entity-level controls have been assessed and reviewed (in Part II), it will not be possible to make definitive conclusions regarding the overall quality of the internal controls framework. It is also possible that some conclusions made during Part I regarding the quality of the transactions-level controls may need to be revisited once Part II has been completed. That said, there has clearly been significant progress made in the completion of Part I, as described below.

4.3 Representing IDA Operations—the Cluster of BPMs: Both IEG and IAD had raised issues relating to certain business processes that were excluded from the cluster of 30 BPMs used to represent IDA operations in Part IA (AAA products; non-SIL Investment Loan products). Management has responded to these observations: it tested non-SIL operations in Part IB, it is preparing a BPM for
AAA for testing in Part II, and it has extended the cluster of BPMs to 32, by adding modules to capture the CPIA and PCPI processes. Management also completed the BPM on Debt Reporting. However, in IEG’s opinion that module as now described needs to be extended to include some controls on the assessment of debt sustainability (for example, encompassing country growth and export prognosis, and government debt management policies). With this qualification, and with the note that it remains important that AAA products are assessed during Part II, IEG is satisfied that the cluster of BPMs as now constituted gives a fully adequate representation of the processes underlying IDA operations.

<table>
<thead>
<tr>
<th>The Debt Reporting module needs to be extended to include some controls for the assessment of debt sustainability</th>
</tr>
</thead>
</table>

### 4.4 Mapping and Design Effectiveness of Key Controls:
IEG has already acknowledged the major contribution to the Bank’s knowledge of its controls system from the mapping of the Business Process Modules, now 32 in number. IEG used the rating template that it created for this purpose to rate management’s mapping methods. (Rating scale: 1-4 with 1 = *highly satisfactory*). Based on this scale, IEG rated management’s mapping and assessment of design effectiveness at 2.5 (that is, *satisfactory* with some qualifications).

### 4.5 Testing Methods for Compliance:
As to the methods for testing the controls, IEG is also satisfied that management’s approach is credible, transparent, and concrete, as described in chapter 2. To understand management’s testing methods, Box 5 presents a depiction of the different elements involved. (More detail is presented in annex B).

### 4.6 IEG Ratings of Management’s Testing Methods:
As it did in Part IA, for management’s approach to process mapping and controls design, IEG systematically rated management’s approach and method in the testing of controls. On the basis of the questions contained in the IEG Business Process Template, the testing method for each module was rated, and aggregated into an overall average for all 29 modules. This average rating was 2.4 overall.

### 4.7 The overall rating, as summarized in Table 1, was comprised of ratings for individual components, as follows: for testing methods per se, a rating of 2.1—very close to being *fully satisfactory*; for sampling methods and quality of conclusions a ratings of 2.4; and for presentation of results a rating of 2.7—close to being *satisfactory with qualifications*. The rating for sampling was mainly the product of small sample sizes in a number of cases, which were often further diluted by the presence of nonoperative controls in the specific random projects chosen in the sample. In the case of presentation of results, the main reason for slightly lower ratings was that descriptions of the findings were not always written clearly and unambiguously. However, taken overall, IEG regards the testing methods to be credible and robust for
the purposes of the review. The overall rating of 2.4 implies that management’s general approach to the testing process was rated *satisfactory* but with some qualifications. Annex D presents more details of the rating process.

**Table 1. Summary of IEG Ratings of Management’s Approach and Part IB Testing Methods**

<table>
<thead>
<tr>
<th>Function Rated</th>
<th>Rating</th>
<th>Function Rated</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Choosing the Sample</td>
<td>2.4</td>
<td>Testing Results</td>
<td>2.7</td>
</tr>
<tr>
<td>Testing Methods</td>
<td>2.1</td>
<td>Quality of Conclusions</td>
<td>2.4</td>
</tr>
</tbody>
</table>

**Rating System:** 1 = Highly Satisfactory; 2 = Satisfactory; 3 = Satisfactory with Qualification; 4 = Less than Satisfactory; N/A = Not Applicable

4.8 **Overall Evaluation of Management’s Method and Approach:** IEG finds management’s approach and method for the compliance testing to have been generally *transparent*, in the sense of being easy to follow; it was *concrete*, in the sense of being based on very specific and documented control steps; it was broadly *comprehensive*, in the sense of not leaving out any key controls within the universe of IDA operations contained in the 32 BPMs; it was generally *conclusive*, in the sense of leaving little doubt whether controls were working or not working as designed; it was *durable*, in the sense of providing an information platform which can be used again in the future, including as a basis for comparison; and it was helpful from the perspective of the *COSO framework*, in the sense that it provides at least the beginning of a basis to draw links between controls deficiencies observed at the process level and what may be broader causes at the entity level. The building blocks of Management’s approach are depicted in Box 5.

**Internal Controls at the Transactions Level**

4.9 **How Effective are IDA’s Controls?** Matters relating to management’s approach and method have their place in this evaluation. However, in the end, the central question to be answered is: *what are the status and effectiveness of the internal controls that govern IDA operations, as revealed by management’s test results?*

4.10 IEG observes, as stated in chapter 2 that, based on the aggregate “pass rates” presented by management the evidence suggests that IDA’s controls have been shown to operate generally as designed. However, there are several possible aggregate pass rates and their results differ. Also, any aggregate measure must be complemented by other, disaggregated evidence that shows where con-

Based on aggregate “pass rates” IDA’s controls have been shown to operate generally as designed, but disaggregated analysis is also needed.
controls have clearly not operated as intended. IEG has conducted a systematic analysis of management’s results (shown in annex B),

Box 5. Depiction of Management’s Testing Method

The model test in the table shows (hypothetically) the BPM for a procurement process, which has three key controls, with between two and four control steps or “attributes” (A, B, C, etc). The process is being tested with four sample projects. In all, therefore, the process involves 32 individually tested control steps or “cells.” In some cases (e.g., Control 2C), the control was not applicable in two of the four cases, so these are marked “N/A”.

<table>
<thead>
<tr>
<th>SAMPLE PROJECTS</th>
<th>CONTROL 1</th>
<th>CONTROL 2</th>
<th>CONTROL 3</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>A</td>
<td>B</td>
<td>C</td>
</tr>
<tr>
<td>Project W</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Project X</td>
<td></td>
<td></td>
<td>N/A</td>
</tr>
<tr>
<td>Project Y</td>
<td></td>
<td></td>
<td>N/A</td>
</tr>
<tr>
<td>Project Z</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Legend:  xxxxxxx  Noncompliance.

Management tested each step by asking the relevant operational units to present documents to show that the actions were taken by the staff at each control step. Where the document is presented, the control step is deemed fulfilled; where not, or where the document may have been inaccurate, or shows the action was not timely, or was not in conformity with the design of the control, management labeled this a noncompliance.

Management’s Pass Rate (Aggregate Count): For the purposes of calculation the “N/As” have been excluded from both the numerator and denominator. In this model case the results show five noncompliances. Out of a total of 32 control steps (management’s method of calculating the pass rate), this would signify a pass rate of 83 percent. When, in the actual tests, the pass rates were averaged across all 29 modules that were tested, Management calculated its overall pass rate as 93 percent.

Alternative Pass Rate: An alternative concept of pass rate (IAD suggested this be considered) is to establish how many sample projects passed through the tested controls with a full pass on all control steps. In this model, only one project (Project Z) would have achieved this, a pass rate of only 25 percent.

Concentrations: IEG has posited the notion that certain “concentrations” of control noncompliance have been found. IEG suggests that this can be said to have occurred when there is a sequence of three or more noncompliances, in either of the following two ways:

- Controls-Related Concentrations (“Vertical Cut”): When three or more noncompliances are found in any one control step (that is, viewed vertically, as in Control 2B in the model above), which shows that several projects failed to comply with that control, suggesting there is a problem with the control design; and/or

- Projects-Related Concentrations (“Horizontal Cut”): When three or more noncompliances are found in any one of the sample projects being tested (viewed horizontally, as in Project W in the model, where Controls 2A, B, and D were found to be noncompliant), suggesting that, in the processing of that project, there was laxity in complying with some controls.

In using concentrations some bias against large, complicated processes is introduced, since, for example, a process with many control steps is more likely to have a concentration of three or more noncompliances than a process with few control steps.
and in the following sections presents its evaluation of the various elements that entered into its overall judgment: the different aggregate pass rates; a more disaggregated view of the results data, showing where controls failures were concentrated; the principal reasons for controls failure; statements regarding material weaknesses and significant deficiencies; and other controls issues that have arisen as a result of management’s assessment, IAD’s review, and IEG’s evaluation.

**Reading Management’s Test Results**

4.11 *Aggregate “Pass Rates”*: In addition to the aggregate pass rate of 93 percent presented by Management, which was based on the number of control steps that passed the tests without noncompliance, four other concepts have been applied. Management also used a concept based on key controls (pass rate 91 percent), IEG suggested using business process modules at risk as a measure (pass rate 76 percent), and — in the working discussions — both IEG and IAD suggested alternative 100 percent compliance concepts, one based on control steps (pass rate 71 percent) and one on sampled projects (pass rate 64 percent). Since this is a review of IDA’s internal controls, IEG believes that the most appropriate pass rate indicators are those based on control steps and key controls. A full description of these different concepts and their respective pass rates is given in Annex B, and summarized in Table B.1.

4.12 *Summary: What do the “Pass Rates” Convey?* Of the different pass rates presented in annex B, IEG favors the aggregate pass rates based on control steps (93 percent) and on key controls (91 percent) because these most closely conform to the nature of the controls assessment being undertaken. Since no other IFIs have completed controls reviews of this kind, there are no benchmarks for comparison, though within the Bank itself these rates are within the range found in quality assurance measurements of Bank products, for example by QAG. IEG therefore expresses the judgment that, in its opinion, these pass rates demonstrate with a reasonable level of confidence that management is justified in stating that, at the transactions level, and subject to the qualifications already mentioned, controls have operated to an adequate level of compliance.

4.13 Considering the complexity of IDA, the fact that this was a first of its kind review, and considering also the rigorous nature of the controls testing, IEG finds it is not surprising that some failure rate was observed. Also, management has indicated that about half of the noncompliances were less material “exceptions”, not “deficiencies”. IEG is of the view that — subject to the other qualifications mentioned — this is an acceptable outcome.
Disaggregating the Test Results: If the aggregate pass rates suggest that controls have been found to operate in a generally adequate fashion, it is also important to view the results below the aggregate, and to focus on those cases where controls clearly did not operate as designed. In this regard, it is important that control failures appear to have occurred as much in scattered fashion, reflecting no particular pattern, being isolated cases of failure to observe control requirements during the processing of projects, as in concentrations. As shown on Figure 1 below, noncompliances occurring in concentrations — where three or more failures occurred in a given control or a given project — accounted for slightly less than half of all noncompliances. (See also Box 5). The presence of concentrations is important, because they suggest areas of more intense control failure, and also whether these were design-related, or project-related failures. As Management found, IAD emphasized and IEG has also shown (see Table B-2 in Annex B), some of the concentrations of control failures occurred in the fiduciary processes, which is a concern, because the essential function of these processes is to add fiduciary discipline.

Figure 1. Distribution of Control Steps with and Without Noncompliances

- **Individual Control Steps**
  - "Vertical": 29% Less than 100%, 71% 100% Compliance
- **Individual Sampled Projects**
  - "Horizontal": 36% Less than 100%, 64% 100% Compliance

% Distribution of projects/controls according to their number of non compliances

- **Number of Non-Compliances per Cut**
  - Clear (0): Controls Cut, Projects Cut
  - Random (1 - 2): Controls Cut, Projects Cut
  - Concentrated (3 or >): Controls Cut, Projects Cut

* Random Occurrences: Control steps or projects with 1-2 noncompliances; Concentrations: Control steps or projects with 3 or more noncompliances
4.15 From the analysis conducted in Annex B (summarized in Figure 1 and Table 2), IEG also observes that most control failures appear to have been the result of flaws in project processing, rather than control design problems. Of all the 246 noncompliances observed, these fell about evenly between apparently random occurrences (129) and concentrations (117), but fewer projects than controls achieved 100 percent compliance. These results suggest that in seeking remedies for failures, the need for management oversight of project processing may be greater than the need to re-design controls, though clearly both may be needed.

<table>
<thead>
<tr>
<th>Total N-Cs</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>&gt;5</th>
</tr>
</thead>
<tbody>
<tr>
<td>246</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Controls</td>
<td>85</td>
<td>44</td>
<td>45</td>
<td>16</td>
<td>20</td>
<td>36</td>
</tr>
<tr>
<td>Projects</td>
<td>67</td>
<td>46</td>
<td>57</td>
<td>32</td>
<td>25</td>
<td>18</td>
</tr>
<tr>
<td>% Random</td>
<td>129</td>
<td>52</td>
<td>48</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Concentrations</td>
<td>117</td>
<td>46</td>
<td>54</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: IEG Calculations from Management test results data.

4.16 *Are IDA controls stronger where risks are greater?* IEG made an attempt to answer this question, based on a relatively crude methodology, which it developed during Part IA. (See Annex B, para. 18). The results tend to suggest that noncompliance rates (averaged across modules and samples, to remove the effects of different sized modules in the sample) have been somewhat higher in that group of modules judged by IEG to carry the most risk for IDA. (See Figure 2) This is consistent with the other findings already described, which showed that the core SIL and several of the fiduciary modules (all of which are in the higher-risk group), were where the main concentrations of control failures were shown to occur.

4.17 It should be stated, however, that IEG regards this analysis as more indicative than substantive at this stage, and that it represents only a first attempt at making an analysis of control failures linked to business processes differentiated by risk. Such an approach is best done during a review of entity-level controls, so IEG is suggesting that a risk-based approach to the controls assessment should be possible as a component in the completion of Part II.
Material Weaknesses and Significant Deficiencies

4.18 In its summary of outcomes at the completion of Part IA, IEG considered that the issues of documentation retention and accessibility and the state of the OP/BPs were both potential material weaknesses. Management took issue with this view, as expressed in its footnote to the Part IA report. IEG used the word “potential” material weakness, because at the stage of the review then reached, there was not sufficient evidence to make a conclusive determination. This was particularly so in the case of the documentation issue, which was to be tested in Part IB. Now that Part I has been completed, IEG is ready to return to this issue.

4.19 Documentation Retention and Accessibility: In light of the findings from the testing in Part IB, IEG concludes that the retrieval of documentation was substantially improved compared with the preliminary round of testing (attempted in Part IA, but abandoned), and therefore concludes that this issue no longer rises to the level of a material weakness. However, as evidenced in the testing results, failure to find or access documents remains a significant cause of noncompliance (see Figure 3) and management has initiated a remedial program (to be completed by end June 2007). In management’s report, this issue has been stated to be a significant deficiency. IEG agrees with this assessment.

4.20 Status and Currency of the OP/BPs: Since IEG made its assertion in Part IA, management has compiled an inventory of OP/BPs, showing the dates of their last revision, which allows a
somewhat more considered judgment on the extent of their possible out-datedness. Management has also made progress in updating some OP/BPs in a program that is due to be completed by end-2007. But IEG also observed the important part played by OP/BPs deficiencies in a number of noncompliant control steps, which were revealed in the Part IB testing process (for example, there is no requirement for a procurement complaints database; there are no structured verification procedures for OPCQC compliance). On balance, at this stage IEG prefers to retain its view that this issue remains a potential material weakness. This issue will be revisited during the completion of Part II, when a final determination will be made.

![Figure 3: Reasons for Noncompliance](image)

<table>
<thead>
<tr>
<th></th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deficiencies</td>
<td>43%</td>
</tr>
<tr>
<td>Other Reasons</td>
<td>57%</td>
</tr>
</tbody>
</table>

* “Other Reasons” include: Inaccuracies in documentation; failure to document in timely manner; failure of Borrowers to deliver documents, failure of staff and borrowers to act on issues.

Source: IEG calculations from Management Data

4.21 In summary, therefore, management has found three significant deficiencies. IAD agrees with Management’s position on these, and IEG has found one of them to be a potential material weakness and the other two to be significant deficiencies.

**Other Process Issues Uncovered in Parts IA and IB**

4.22 At the completion of Part IA management, IAD, and IEG together had uncovered 126 process issues of various kinds that had arisen during the review of controls’ mapping and design effectiveness. In itself, this number of issues is a reflection of the thoroughness of the overall review. IEG discusses in Annex C how these issues were reviewed, assessed, and disposed of, and explains that 44 out of the 126 have been deferred to be addressed during Part II, and 37 were to be addressed under the testing in Part IB. By the
conclusion of Part IB, 25 other issues had been identified, for a total of 62 in all. Annex C describes how management applied explicit criteria to these issues, collectively and individually, and assessed that none were material weaknesses, three were significant deficiencies, and six were deficiencies. As described elsewhere in this report, IAD and IEG were in general agreement with these judgments, but IEG regards the major issue of the status of OP/BPs to be a potential material weakness. However, as described in annex B, management has nevertheless given a full accounting and disposal of all the issues uncovered during Part I by all three reviewing parties. One exception was the fact that IAD recommended an alternative pass rate methodology, based on individual projects, about which management reported that its approach was not designed to address pass rates of individual projects.

Figure 4. Linkages between Key Controls and the COSO Components

Source: Management results data, see Statistical Appendix Table SA.11.

4.23 **Links to the COSO Components:** Management had explained at the start of Part I that during its assessment of compliance at the transactions level, it would be focusing mainly on two of the five COSO components: *Control Activities* and *Risk Assessment*. During the compilation of its process maps and key control designs, management listed which COSO component was linked to each key control, but did not aggregate these linkages as part of its Part IA report.

4.24 IEG did make such an aggregation which is shown in Table SA.11 in the Statistical Appendix. The linkages are summarized in Figure 4. It is clear that the major linkage of the key controls has
been to the Control Activities component and (to a much lesser extent) to the Risk Assessment component. This would be expected in a compliance assessment at the transactions level, where controls are linked to individual risks and the policies (OP/BPs) addressing those risks. The OP/BPs are the critical element of the Control Activities component. IEG takes note of these linkages and expects to return to this topic when all COSO components are addressed during the Part II assessment and evaluation.

The IEG Advisory Panel

4.25 As is common practice for its major evaluations, IEG drew on the services of an international advisory panel of experts to review and comment on its work at the conclusion of Part I. The Panel consisted of three distinguished former Auditor-Generals, from Australia (Mr. Patrick Barrett), India (Mr. Vijay Shunglu), and Norway (Mr. Bjarne Mørk-Eidem). The Panel visited Washington in early March 2007, reviewed the key materials and contents of the Part IA report as well as this draft Part I report, and met with management, the IAD review team, and the chairman of the Audit Committee. The Panel has written a brief statement, which is contained in attachment 3, and is excerpted below:

- The Panel understands the pragmatic approach taken for Part I, while recognizing that final conclusions will be made on the review after the completion of Part II. In fact it may be necessary to vary some of the conclusions of Part I as the result of the work on Part II.
- The strength of the approach in Part II is the top level strategic focus reflecting decisions made about the application of the overall integrated COSO risk management framework and associated entity-wide controls within the governance arrangements that reflect both ‘tone at the top’ and the authority and accountability which is assigned to the review and any agreed outcomes. The necessary leadership is reinforced by both top down and bottom up approaches with the resultant commitment at all levels of the organization.
- The Panel notes some concerns that were expressed (during Part IA), particularly by IAD, about a lack of documentation…. The Panel agrees that documentation is a common problem across both the private and public sectors and is generally being given a higher priority both to facilitate decision-making and to enhance accountability.
- The Panel supports the use of suitable standards against which accomplishment/performance can sensibly be assessed. In the Panel’s view, this is what makes Part II of the review so important in building on the extensive investment in Part I.
The latter has been largely about compliance or conformance, the former is now a challenge to focus more on what is to be achieved both efficiently and effectively.

- The Panel observes that there are different skills required for financial statement, assurance and performance audits. The Auditor General, not surprisingly, has a strong focus on the former and the related controls and risk factors. The Panel accepts that IAD may also have some capacity to undertake reviews of administrative effectiveness. While noting the issue of ‘independence’ in reporting in the relationships with the President and the Board which gave IEG the review role in this exercise, the Panel also notes that Part II may well involve issues of policy effectiveness which are more within the province and scope as well as the competence of IEG.

- The Panel is impressed by the professional approach and commitment of the three major parties to the review — Management, IAD and IEG. Considerable effort and resources have been dedicated to the task. The Panel is not in a position to conclude on the cost/benefit of what has been done to date. However, it notes the paucity of available information on similar exercises elsewhere in areas where many organizations are dealing with demands for better controls, greater assurance, and better outcomes — whether more cost effective programs or more shareholder value. There has been a greater focus on governance frameworks and on associated organization culture that reflects high level values and an ethical approach with greater transparency and associated accountability.

NOTES

1. 1 = highly satisfactory; 2 = satisfactory; 3 = satisfactory with qualification; 4= less than satisfactory.

2. The qualifications regarding the comprehensiveness of the review were the following: 3 of the 32 BPMs were not tested (although two were subprocesses of the overall allocation process that did not have key controls), some individual control steps that were not applicable to the specific projects in the sample were not tested, and AAA products are to be addressed during Part II.


4. For reasons related to the joint availability of the panelists, their visit to Washington had to be timed somewhat before all the materials were ready in final form. However, this did not detract from the materiality of their conclusions.
5. Conclusions and Recommendations

5.1 IEG concludes that, subject to a number of qualifications, the substantial body of work carried out in the completion of Part I, in its breadth, penetration, and specificity of results, can indeed provide general confirmation that internal controls at the transactions level are operating generally as intended. IEG has concluded that Part I has uncovered one potential material weakness and two significant deficiencies, and all three are already being addressed by management. Poorly operating controls in some individual processes have been identified and are also being addressed. For an agency of the size and complexity of IDA, the scale of these revealed weaknesses, deficiencies, and noncompliances—averaging at less than one non-compliant control step per project tested—would appear to IEG to be within an acceptable level of tolerance.

5.2 **Concluding Evidence:** As the key elements of evidence to support this conclusion, IEG would point to the following:

- Management made substantial progress in Part IA by mapping and verifying the effectiveness of design controls at the level of business processes.
- In Part IA, both IAD and IEG observed certain deficiencies in the extent to which the cluster of 30 BPMs fully captured all IDA operations. Management corrected for this by expanding its testing sample for investment lending in Part IB, and it will examine AAA products and processes during Part II.
- Management completed its compliance testing in Part IB in a convincing, detailed, and concrete manner. The results are highly transparent and can be verified or questioned. By its own methodology, management has achieved a stated pass rate of 93 percent, which lies within the range of acceptability achieved in other Bank quality reviews, such as QAG assessments of Bank and IDA operational products. This general pass rate has also been broadly supported by calculations of alternative pass rate concepts.
- IEG finds that the revealed noncompliances appear to result more from laxity in controls processing than from flawed control designs. This would imply that enhanced management
oversight is needed more than redesign of control steps, though some of the latter is certainly also needed, and some streamlining can also likely be achieved;

- Part I has uncovered one potential material weakness and two significant deficiencies. For an agency as complex as the Bank, and for a historic first detailed review of internal controls processes, this would seem a benign outcome. Part IA had also led to some 126 specific process issues, but most of these were resolved during Part IB, or appropriately deferred for assessment during Part II, since they involved efficiency and effectiveness issues. Part IB disclosed 68 specific issues that are currently being addressed by management, 43 carried forward from Part IA and 24 issues arising in the testing;

- IEG sees the findings in Part I regarding the origins of controls failure as giving important guideposts to the work to be done in Part II, whether in terms of the need for enhanced management oversight over project processing, the possible streamlining of processing controls, or the need to redesign certain controls.

5.3 **Qualifications to Be Considered**: The affirmative conclusion described above is subject to some qualifications:

- Within the COSO framework, definitive conclusions regarding the effectiveness of internal controls at the transaction level cannot be made in isolation from the framework as a whole. Any assurance must be based on a verification that all elements of the control framework (all five COSO components) are present. As was made clear in the Part IA report, management’s transactions level approach to Part I did not encompass all COSO elements (see figure 4, para. 23 in chapter 4).

- Definitive conclusions in the form of a general assurance will therefore have to await the completion of the entity-level controls during Part II. It is also possible (as the Advisory Panel also pointed out) that it may be necessary to revisit some conclusions made during Part I after completing Part II. The affirmative conclusions drawn above simply imply that Part I has been successfully accomplished as the first step in a two-step process.

- Management has itself made a qualified statement, saying it concluded that controls were adequate with some qualifications, and it has not given a general assurance, saying only that evidence has been amassed that is consistent with, and could provide the basis for, such an assurance in due course.

- IAD has issued an opinion that management’s qualified conclusion at this stage is fairly stated.
5.4 **Recommendations**: IEG makes recommendations for six sets of actions to be taken, as described in the following paragraphs.

5.5 **Recommendation 1—Completion of the Entity-Level Assessment in Part II**: Clearly, the overriding need now is for the expeditious and effective completion of the review of internal controls at the entity level. The challenge will be to address those findings from Part I that suggest linkages to entity level issues, within the COSO framework, including the following:

- **Controls and Project Processing**: The finding that noncompliances have seemed to arise somewhat more through lapses in project processing, rather than through controls flaws, offers an important insight: it suggests that enhanced management oversight may be needed as the remedy for this, and thus suggests the need for a linkage to the Control Environment at the entity-level, where “tone at the top” and governance may need to be emphasized.

- **Documentation Retention and Accessibility**: This significant deficiency, which has arisen at least in part as a result of the migration from manual to electronic systems, suggests a link needs to be made with both the Control Environment (management oversight) and the Information and Communications component at the entity level where improved IT systems will be part of the solution.

- **Dated OP/BPs**: This is an essential element of the Control Activities component. As revealed in Part I, this remains a potential material weakness, whose remedial program has already been launched. It would be well to accelerate and complete this to the extent possible in time for the completion of Part II. Having a current and well-maintained body of policy documents is a bedrock element of the entity-level control system, and also serves both compliance and efficiency and effectiveness objectives at the transactions level.

- **Risk Management and Extending the COSO Framework**: One of the findings that emerged from Part I is that management did not treat risk issues in this review in a way that allowed risk differentiation and prioritization. This was partly the result of not having had the benefit of a prior entity-level assessment, where risk differentiation could have been made, allowing a risk-based controls assessment to be completed. This should be done during Part II. IEG already recommended in Part IA that management consider extending the COSO framework to enhance the focus on risk by adding a fourth COSO objective (Strategy – high level goals aligning with supporting mission) and three new components (Objective Setting, Event Identification and Risk Response – see Part IA report, page 41).

- **Efficiency and Effectiveness Evaluation**: One of the characteristics of the approaches in Part I was the more or less exclusive focus on
compliance issues, while all issues of efficiency and effectiveness were deferred until Part II. As the overall review moves from the transactions level to the entity level, and from compliance to effectiveness and efficiency, the challenge in Part II will be to build on the results from Part I, linking these to IDA’s Monitoring and Learning activities (including QAG and IEG), in order to provide the element of effectiveness and efficiency testing that was lacking in Part I, and which is needed before final conclusions can be drawn regarding the overall effectiveness of IDA’s internal controls.

5.6 Recommendation 2—Issues Deferred to Part II: A number of issues have been deferred to Part II, in addition to those concerning IT controls, field offices, fraud, and corruption, which management stated at the outset would be dealt with in Part II. The notable additions, which need to be given due attention during Part II, are:

- **AAA and Other Knowledge Products:** In Part IA, IEG and IAD had regarded these as significant omissions from the cluster of BPMs representing IDA operations, and management agreed that these would be addressed during Part II.
- **Debt Sustainability:** IEG believes that the Debt Reporting Module (Module 30) needs to be further elaborated, beyond debt data collection, to encompass growth, export and other dimensions, to underpin the sustainability analysis of the module.
- **Other Unresolved Process Issues:** These are the 44 issues still unresolved from Part IA, which were part of the 126 additional process issues uncovered by management, IAD and IEG in Part IA, but thought to relate to efficiency and effectiveness issues, and were therefore deferred to Part II and the other issues from Part IB that relate to efficiency and effectiveness and thus were deferred to Part II.

5.7 Recommendation 3—Remedies for Problem Modules: The test results emerging from Part I show that many noncompliant control step tests were randomly and quite widely spread among all modules. However, they also showed that there were some concentrations around seven modules in particular (see table B.7 in annex B): Core SILs; FM SIL; Procurement SIL; Procurement Complaints; Loan Management SILs; Loan Suspensions; and Loan Closings. Noncompliance in these modules also occurred for a combination of project processing and controls-related reasons. These concentrations of control failures—where there may be issues of control design, not just processing laxity—therefore become clear candidates for management review and, where relevant, remedies.

5.8 Recommendation 4—Safeguards and Corporate Risk: Management is addressing this issue and will attempt to seek evidence to test Module 29. However, given the sensitive nature of this topic,
and the potential risks to the reputation of IDA at stake in managing the Corporate Risk List, IEG recommends that management consider whether this monitoring device should not be supported by the introduction of specific controls, standardized across all regions, to more fully integrate this process into the internal control system.

5.9 **Recommendation 5—Testing Control Steps which were Inoperative in Part IB:** A significant number of control steps in the sample of projects in Part IB were not actually tested, because these were often conditional control steps, not applicable in the actual sample of projects tested. IAD has raised this issue as a detraction from management’s overall pass rate. Most of these control steps may rarely be needed and may therefore be of less importance, but IEG does recommend that management should make a selected, targeted sample to test some of these control steps, in cases where it is deemed important to have the evidence from testing.

5.10 **Recommendation 6—Streamlining:** IEG believes there is institutional merit in systematizing the process maps and related testing information, giving them widespread visibility within the organization, and possibly incorporating them as part of the revised and updated corpus of OP/BPs. These could have clear applications in the Bank’s ongoing effort to streamline project processes.

5.11 This concludes IEG’s evaluation of Part I. While much has been accomplished in this phase of the review, and a major investment of time and resources has been made, it is necessary to repeat that, under the principles of the COSO framework, definitive conclusions on the health of the internal controls system governing IDA’s operations will have to wait until the framework issues have been assessed, and matched to the transactions issues so far analyzed. Only then will the real return on this major investment be forthcoming.

1 While the Core SIL had a relatively high rate of noncompliances, the bulk of these were less serious noncompliances (exceptions rather than deficiencies). This could be an indication of the need for streamlining these processes more than tightening of controls, consistent with the Part IA finding that many staff complained of SIL processing requirements as unduly complex and onerous.
Annex A
Recapitulation of Main Findings and Summary of Conclusions from Part IA

1. This annex provides a summary of the key findings and conclusions that emerged from completion of Part IA. The four principal topic areas covered during that Part were: issues relating to approach and method; actual findings from the assessment of business process mapping and design effectiveness; major conclusions; and issues still pending at the completion of Part IA.

2. **Issues Relating to Approach and Method:** Management decided to start its assessment by tracking internal controls at the level of individual business processes (a bottom-up approach), rather than by first examining entity-level controls (a top-down approach). With this phasing of the review the entity-level issues would be examined in Part II. IEG was of the view (shared by IAD) that it would have been better to start with a top-down approach, but agreed that management’s approach did permit progress in several areas. However, IEG also raised some caveats concerning scope limitations and some omissions from the business processes assessed, as discussed in the following paragraphs.

3. **Evident Progress:** Management had made a credible linkage between IDA’s Articles, its internal policies and procedures, and the individual business processes as a basis to test internal controls. The mapping of the business processes has made a major contribution to understanding the Bank’s system of internal controls; the mapping was generally of a high quality, with some notable qualifications; and the walk-through processes of verifying the design of controls was rigorous, comprehensive, transparent, and documented, with a few qualifications, to a high standard. The ensuing business process maps, now part of the Bank’s internal controls architecture, can be used again in similar reviews and may also prove to be useful instruments in designing more streamlined and efficient control measures going forward.

4. **Scope Limitations:** Both the bottom-up approach and the phasing of management’s approach led to certain inescapable scope limitations of the assessment made in Part IA. These included:

   - The transactions-level BPM-based assessment dealt mainly with only two of the five COSO components, which rendered it essentially incomplete as an assessment of the controls framework.¹
   - The separation of compliance from efficiency and effectiveness issues was difficult to sustain in some cases.
   - The partial treatment under COSO necessarily implied that definitive conclusions about the overall state of internal controls would have to be postponed until completion of the entity-level review in Part II.
Postponing to Part II other systemic issues—the assessment of fraud and corruption controls and IT controls and the examination of decentralized field offices—also meant that definitive conclusions on the overall controls framework would have to await completion of the second part of the review.

5. **Omissions from the Business Processes**: Two principal omissions were noted from the 30 business process modules (BPMs) that management had chosen to represent IDA operations. One was the exclusion of any analytical and advisory activities (AAA) products, which are important since “IDA operations” should be taken to mean both lending and nonlending operations. The second omission stemmed from an assumption made that the internal controls that governed core Specific Investment Loan (SIL) operations could be taken to represent all investment lending (IL) operations (including Sector-wide Adjustment Programs [SWAPS], Emergency Recovery Loans [ERLs] and others). This assumption needed to be tested, because core SILs account for no more than 60% of all investment lending, and if other IL operations were not fully the same, this could comprise a significant gap in the extent to which the BPM cluster fully represented IDA lending operations.

6. **The Main Findings from Part IA**: The main finding from Part IA was that, using its bottom-up approach, management had made satisfactory progress in defining, locating and assessing key internal controls at the level of some 30 individual business processes. As a result of the combined processes of verifying the integrity of the mapping processes and assessing the design effectiveness of the key controls, module by module, management had also revealed a number of deficiencies and potential weaknesses; the following were seen to be salient:

- **Potential Material Weaknesses**: IEG found that in two areas the preliminary results from Part IA suggested that potential material weaknesses had been uncovered. One was in the state of the Bank’s OPs/BPs, which in a number of cases had not kept pace with and had not been updated to reflect the structural and other changes in the Bank Group. A second related to difficulties with retention of and accessibility to documentation needed to verify the effective operation of key controls (a finding that emerged from the preliminary testing of controls conducted during Part IA, and whose problems led to restructuring of this segment of the review into Parts IA and IB).

- **Other Deficiencies and Issues**: In addition to the two major findings mentioned above, management also identified three other apparent deficiencies: the policy framework for processing SILs was seen as too complex and cumbersome; project processing requirements were seen as onerous and inefficient; and there appeared to be a disparity in the Corporate Review frequency between SILs and DPLs. In addition, IEG and IAD identified other issues that needed clarification of their nature and significance. (These consisted of a variety of controls issues. Some required actions that did not seem to be mandated, some pertained to a lack of clarity in control design, and others involved weaknesses of some descriptions in the documentation. These were described in more detail in annex C of the Part IA Report).

7. **Major Conclusions**: IEG arrived at a mixed conclusion regarding the outcome of Part IA. It saw that important contributions had been made to the Bank’s knowledge of its internal controls, and a major addition had been made to the Bank’s documented business processes. Satisfactory progress had also been made in identifying and defining the key controls that governed IDA business processes at the transactions level and, as described above, manage-
ment’s assessment did lead to the uncovering of a number of revealed deficiencies. At the same time, as already described, there were some notable weaknesses implicit in Management’s approach, stemming from the scope limitations mentioned above, and the phasing of the overall review.

8. **Issues Pending at the Completion of Part IA:** On completion of Part IA, some issues had been postponed for treatment during Part II, and others remained to be resolved during Part IB:

   - **Scope Limitations:** The following issues were postponed until Part II: The full treatment of all COSO components; efficiency and effectiveness issues; addressing fraud and corruption; IT and Bank decentralization; and addressing the exclusion of AAA products from the BPM cluster. Also, IEG had asked that the issue of whether core SILs adequately represented all investment lending be tested in Part IB, by also testing controls in some noncore SIL operations by adding some SWAPs, ERLs, and other ILs to the overall sample to be tested.
   - **Potential Material Weaknesses:** Management has already responded to both the documentation retention and the OP/BP’s issue by initiating further examination of both issues and by launching remedial efforts. The documentation issue has been the central topic of focus during Part IB, because it is precisely the testing of controls (by tracking documentation) that was the substance of Part IB, and the evidence now in hand (in comparison with that obtained during the preliminary testing during Part IA) has provided the basis for a much firmer conclusion to be drawn, as is in this report. Management has stated that the bulk of the issues relating to the OP/BP’s will be dealt with during the completion of Part II.
   - **Resolution of Other Identified Issues and Deficiencies:** Management undertook to address the issues and potential deficiencies described in para. 6 as part of the work to be completed during Part IB, with the following objectives: to clarify their nature as controls issues or other types of issues; to establish their materiality and propose remedial actions; to resolve these issues where possible; for those that required testing or other verification, to include these as part of the Part IB testing process; and to postpone issues to Part II that related more to entity-level controls or to efficiency and effectiveness objectives.

**NOTES**

1. Part I focused mainly on the **Control Activities** and **Risk Assessment** components, and very little, if at all on the remaining three: **Control Environment**; **Monitoring and Learning**; and **Information and Communications**.

2. Management itself had identified these issues, though it did not share the view that they were potential material weaknesses.
Annex B
Summary of the IEG Analysis of Results from Management’s Compliance Testing of Key Controls in Part IB

1. This annex describes the statistical analysis conducted by IEG on the Part IB test results presented by management. It opens with a detailed description of the specific method used by management in conducting its tests, and it then portrays the main findings that emerged from the analysis.

2. Many of the terms used in this review are new to the Bank, since this is the first review of this kind of internal controls. To assist readers in understanding the precise nature of the methods and processes used by management in its assessment, IEG has constructed a set of Management materials, simplified for illustration, which duplicate those used by management in its actual testing. Table B.1 provides brief descriptions of the key elements that entered into the testing process.

<table>
<thead>
<tr>
<th>Table B.1. Key Elements in Testing Internal Controls at the Transactions Level</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Business process module (BPM)</strong></td>
</tr>
<tr>
<td><strong>Key control</strong></td>
</tr>
<tr>
<td><strong>Control steps/attributes</strong></td>
</tr>
</tbody>
</table>

Description of Management’s Testing Method

3. From the 32 modules contained in the process maps, management conducted controls testing on 29, and it was this number that formed the basis for the IEG analysis. To show how management conducted its testing, IEG has constructed a prototype from an actual module (Module 15, Procurement Complaints, see figure B.2 below), from which the elements involved in the testing can be explained.
## ANNEX B
### SUMMARY OF IEG ANALYSIS OF RESULTS FROM MANAGEMENT’S COMPLIANCE TESTING

Table B.2. Prototype Depiction of Module 15—Procurement Complaints

<table>
<thead>
<tr>
<th>Region</th>
<th>Control</th>
<th>A</th>
<th>B</th>
<th>C</th>
<th>D</th>
</tr>
</thead>
<tbody>
<tr>
<td>LCR</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>SAR</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>AFR</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>EAP</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
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<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>SAR</td>
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<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
</tbody>
</table>

Legend: LCR = Latin America and Caribbean; SAR = South Asia; AFR = Africa; EAP = Easy Asia and Pacific; ECA = Europe and Central Asia

**Key Control**: Go, No-Go gateway through which all projects must be processed. Key Controls are the essential elements of the internal controls of IDA business processes at the transactions level. Key Controls have steps Control Steps or Attributes.

- **1A**: Key Control with one Control Step or Attribute
- **2A**: Control Step with 5 Attributes or control steps
- **N/A**: Control Step/Attribute which could have applied but were not applicable in the case of this sample project. Many control steps/Attributes are conditional on project requirements, and can be quite rare: e.g. Control 2A5 requires the “entry of the date of the OPRC review, if required”. In none of the ten sampled projects was there an OPRC review.

<table>
<thead>
<tr>
<th>Control</th>
<th>Number of Steps</th>
<th>Required</th>
<th>Passed</th>
<th>Failed</th>
<th>% Passed</th>
<th>Overall</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control 1—Refer Complaint to INT</td>
<td>1A</td>
<td>1</td>
<td>1</td>
<td>0</td>
<td>100%</td>
<td>PASSED</td>
</tr>
<tr>
<td>Control 2—Determine Validity of Complaint</td>
<td>2A</td>
<td>10</td>
<td>10</td>
<td>0</td>
<td>100%</td>
<td>FAILED</td>
</tr>
<tr>
<td>2A2</td>
<td>10</td>
<td>10</td>
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</tr>
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<td>2A3</td>
<td>10</td>
<td>9</td>
<td>1</td>
<td>90%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2A4</td>
<td>4</td>
<td>4</td>
<td>0</td>
<td>100%</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2A5</td>
<td>2B</td>
<td>10</td>
<td>4</td>
<td>6</td>
<td>40%</td>
<td></td>
</tr>
<tr>
<td>2C1</td>
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<td>3</td>
<td>70%</td>
<td></td>
<td></td>
</tr>
<tr>
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<td>2</td>
<td>80%</td>
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</tr>
<tr>
<td>2C3</td>
<td>10</td>
<td>7</td>
<td>3</td>
<td>70%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Total: 75 steps, 60 passed, 15 failed, 80% overall.
ANNEX B
SUMMARY OF IEG ANALYSIS OF RESULTS FROM MANAGEMENT’S COMPLIANCE TESTING

tributes”), which represent the actions to be taken by various parties to fulfill the requirements of the key control. Control 1 has only 1 control step or attribute (control step A), whereas Control 2, which has control steps A (5 attributes), B, C (3 attributes), and D (2 attributes) has 11 attributes in all. The table also shows that, in this module, there were 10 projects selected in the testing sample. (The number of projects sampled varied from module to module, because some modules tested controls that were more esoteric and did not apply to all projects). This means that in the case of this module (Module 15), with 10 projects and 12 attributes, there were 120 attributes or cells to be tested in all, although 9 attributes and 75 cells were tested because the other three attributes and 45 cells did not apply in the sampled projects. (Note: Control 1 applied to only one country, because Honduras was the only case in which the complaint was referred to INT.)

5. **Not Applicable Control Steps/Attributes (N/A in the Table):** Since the internal controls framework provides for all eventualities in the processing of projects, quite frequently some control steps are conditional on requirements that may not apply to all projects. For example, in Module 15 shown in Table B.2, there were four control steps shown partly or fully as N/A. In the first two (Control Steps 2A4 and 2A5) the dates were required of the Regional Procurement Manager (RPM) and OPRC reviews, if these were applicable in the specific case. As the table shows, there were only four cases in which RPM reviews were held, and none which required OPRC review. Control C1 covers cases of non-ICB (international competitive bidding) procurement, and this applied to none of the projects in the sample. Control C3 covered cases that required OPRC review, which did not apply in any of the cases. For a general description of the implications of these “not applicable” controls, see Box B.1.

6. **IEG Note:** Where control steps are rarely needed, IEG does not see the need for possible retesting at this stage, but this should be considered selectively going forward, in cases where such controls would be seen as of particular importance to risk management.

7. **“Passing” the Controls test:** The testing was done by management asking the relevant operational departments to present the documentation that showed that each control step had been taken as required by the design of the control. Where the documentation was shown, and was complete and accurate, that control step was marked with a certain color code to show that the control step was compliant, or, where it was not compliant, it was marked as an exception or deficiency (see below). Management also used the results to make a judgment over whether each key control had “passed” or failed, based on how many and which control steps within each control had failed. This is explained in more detailed in the following section, where the actual results are shown.

8. **NonCompliance, Exceptions, and Deficiencies:** Where management found that a control step was not documented, or was documented inaccurately, or later than required by the design of the control, or for some other reason did not conform to the control step as designed, it was labeled noncompliant. Management distinguished between two forms of noncompliance: There were cases in which controls, while not being adhered to, were mitigated by other controls, which made their noncompliance less serious in terms of jeopardizing the business process. Management labeled these as “exceptions.” Those noncompliant controls that were not so mitigated were labeled “deficiencies”, and were seen as somewhat more material than the exceptions, though management regarded both as clearly noncompliant. Table B.2 distinguishes both forms of noncompliance, and it also shows the cases (which occurred fairly fre-
quently) where individual controls steps did not apply (N/A in the figure) to the specific project in the sample.

9. **Testing Period:** Management chose projects for its testing sample, all of which were active in the respective elements being tested during the period between July 2005, and February 2006. Choosing this window had certain implications, one being that it did not cover a full fiscal year cycle and, therefore, did not cover the so-called “bunching” season. Given that processing errors may occur more frequently during the high-pressure bunching season at the end of each fiscal year (i.e. April-June), it is possible that this may have biased the findings somewhat in a positive direction.

<table>
<thead>
<tr>
<th>Box B.1: Reading the Results “Vertically” for a Controls Approach, and “Horizontally” for a Projects Approach</th>
</tr>
</thead>
</table>
| **The Controls Approach (“Vertical Cut”):** The controls approach views the matrix vertically, to count the number of “passes” or “fails” at each control or control step. In Module 15, for any given control step, since there were 10 sample projects, 10 passes were required for a 100 percent pass rate, fewer if there were any N/As. One pass rate concept is to ask how many controls were without any fails: in Module 15, four (Control 1, and control steps 2A1, 2A2, and 2A4) were 100 percent compliant, a 44 percent pass rate, by this concept.

- Management used an average of the pass rates across all control steps taken vertically (12 in Table B.2). If a given control step had 2 out of 10 failures, this would be a pass rate of 80%. In the case of Module 15, the overall pass rate, measured in this way was 80 percent; using a similar method across all 29 modules, Management’s pass rate was 93 percent.

- Management emphasized that the pass rate in this example does not mean that 80 percent of all tested projects in this example passed the test without noncompliance. It only means that the aggregate count of total noncompliance in the module as a whole was 20 percent out of the total number of control steps tested.

**The Projects Approach (“Horizontal Cut”):** The projects view is to take each sample project and view it horizontally, counting the number of passes and fails. In this approach a pass rate could be based on how many projects achieved a 100 percent pass rate. In Module 15 this was 3 out of 10 projects (Montenegro, Madagascar, and Vietnam), a pass rate of 30 percent. IEG regards this as a legitimate approach, but it tends to suggest that it is the projects that are being tested, whereas it is really the controls which are the subject of the tests.

NOTES: The horizontal cut views each project in a given module. Some projects were used in more than one module in the testing. IEG has regarded these as separate projects, since the “horizontal” cut views them across a different set of controls in each module.

IEG also points out that, in calculating pass rates the control steps marked N/A were excluded in both numerator and denominator.

**Concentrations:** IEG has posited the notion that certain “concentrations” of control noncompliance have been found. IEG suggests that this can be said to have occurred when there is a sequence of three or more noncompliances, in either of the following two ways (Note that these concentrations are more likely to occur in BPMs with more control steps and/or more projects):

- **Controls-Related Concentrations (Vertical Cut):** When three or more noncompliances are found in any one control step (i.e., viewed vertically, as in Control 2B in the model above); and/or

- **Projects-Related Concentrations (Horizontal Cut):** When three or more noncompliances are found in any one of the sample projects being tested (viewed horizontally, as in the Honduras project above, where Controls 2B, 2D1 and 2D2 were found to be non-compliant).
Reading the Test Results

10. **Aggregate Pass Rates:** One purpose of the review was to find a basis to provide an overall assurance to management concerning IDA’s internal controls. In this regard, Management has presented two overall indicators of the testing results (based respectively on the control attributes and on key controls). During the working level discussions, IEG and IAD have suggested two additional concepts (based on full compliance rates), and IEG also presents a fifth indicator based on business process modules. These concepts are presented below:²

    a. **Control Attributes:** As discussed above, each control has one or more control steps, which has been tested for a number of projects. Each test of a control step for a project gives rise to a control cell (as per Table B.2). Management tested a total of 115 key controls with a total of 466 control steps, across a total of 345 sampled projects,³ for a total of 3603 control steps (tested control step cells, excluding those not applicable). For its control attribute measurement, management calculated the aggregate number across all modules of the attributes that showed noncompliances as a percentage of the total number of attributes. Management found (and IEG has verified) a total of 246 noncompliances, giving an overall pass rate of 93 percent.

    b. **Key Controls:** Management examined all control steps in the controls, and where these were found to have any noncompliances in any attributes, a judgment was made as to whether that meant that the control in question was or was not working. These judgments were based primarily on whether the noncompliances were exceptions or deficiencies, as explained in Table B.2 and para. 8 above. IEG reviewed each of these judgments, and found them to be appropriate. Using management’s results for each module, IEG has calculated that under this concept 91 percent of all controls were judged by Management to have passed (meaning with no deficiencies).

    c. **Business Process Modules:** Using the Key Controls measurement described above, IEG finds that aggregating the failed controls by BPMs may also be useful, since this will allow judgments as to which major IDA processes may have been placed at risk by the failure to comply with controls. Management also implicitly used this approach in identifying the modules where it observed that the most serious problems had arisen. As shown in Table B.3, 22 out of the 29 modules were judged by management to have passed and 7 to have failed or been at risk (in the sense that at least 1 control was judged to have failed). This outcome was checked and verified by IEG.

    d. **Tests with Full Compliance Rate (Controls):** IEG also counted how many control steps passed the tests without any failures (i.e. with 100 percent compliance). It found that of the total 466 control steps, 71 percent passed the tests without any noncompliances.

    e. **Tests with Full Compliance Rate (Projects):** IAD had also suggested a pass rate concept based on viewing the number of sampled projects that passed the tests with no noncompliances. IEG calculated this result and found that of the total of 345 sampled projects, 64 percent were tested at 100 percent compliance.
Table B.3. Aggregate Pass Rate Concepts: Summary of Results

<table>
<thead>
<tr>
<th>Pass Rate Concept</th>
<th>Total Units Tested</th>
<th>Passed</th>
<th>Failed</th>
<th>% Pass Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control Steps</td>
<td>3603</td>
<td>3357</td>
<td>246</td>
<td>93</td>
</tr>
<tr>
<td>Key Controls</td>
<td>115</td>
<td>105</td>
<td>10</td>
<td>91</td>
</tr>
<tr>
<td>Business Process</td>
<td>29</td>
<td>22</td>
<td>7</td>
<td>76</td>
</tr>
<tr>
<td>Full Compliance</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Controls Cut</td>
<td>466</td>
<td>331</td>
<td>135</td>
<td>71</td>
</tr>
<tr>
<td>Projects Cut</td>
<td>345</td>
<td>221</td>
<td>124</td>
<td>64</td>
</tr>
</tbody>
</table>

11. **Summary: What Do the Pass Rates Convey?** This analysis (summarized in table B.3 above) has shown that different indicators convey different signals as to the overall effectiveness of IDA’s controls. IEG could find no established criteria in the controls literature by which to judge whether any of these pass rates fall within a range of acceptability. However, in IEG’s opinion, management’s aggregate controls steps pass rate of 93%, as with the key controls concept with a pass rate of 91 percent, would seem to provide a quite satisfactory level of assurance, at the transactions level, that controls have operated generally as intended. Consider this: while the 7 percent fail rate may sound significant, it does not mean that 7 percent of all projects tested failed. It is an aggregate indicator measuring the rate of observed noncompliances. Since there were 345 projects in the testing sample, and 246 observed noncompliances, this means less than one noncompliance per project.

12. Also in a positive light, the full compliance pass rate presented in Table B.3 shows that of all controls tested nearly three-quarters (71 percent) tested with no noncompliances, the same was true for nearly two-thirds (64 percent) of all projects tested. Given the random nature of how noncompliances occur, these are quite high “perfect score” results.

13. While these aggregate indicators are a source of comfort, and while it is true that control failures have occurred more on a random pattern (see Table 2 in Chapter 4), the results also show that there are certain concentrations of control failure which have to be acknowledged and addressed. These concentrations are significant because, contrary to the generally adequate operation of controls, they suggest areas of control weakness. Also, the concentrations have occurred in the fiduciary processes (see Table B.4 below), whose principal function is to ensure tight controls over resource use. This is an issue of concern, which management itself has recognized, and which must be seen as a significant qualification to Management’s overall 93 percent aggregate pass rate.

**Differentiating the Noncompliance Data**

14. **Patterns, Causes and Concentrations in Noncompliance:** IEG conducted additional analysis of the test results data to explore five sets of questions: what patterns and concentrations of noncompliances were apparent; what were the principal reasons for noncompliance—lack of documentation or other reasons; what patterns emerged as to control failures between types of units, or responsible officers in the Bank; what appeared to be the business modules with the most prevalent patterns of noncompliance; and what can be said about whether the
test results showed that controls appear to be weaker or stronger in areas of greater risk to IDA.

Table B.4: Summary of Management’s Results for Key Controls in Seven Most Problematic Business Processes

<table>
<thead>
<tr>
<th>Key Control</th>
<th>Number</th>
<th>Title</th>
<th>Total Tested</th>
<th>Passed</th>
<th>Failed</th>
</tr>
</thead>
<tbody>
<tr>
<td>12 FM-SIL</td>
<td>4</td>
<td>2</td>
<td></td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>14 Procurement—SIL</td>
<td>8</td>
<td>6</td>
<td></td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>15 Procurement Complaints</td>
<td>2</td>
<td>1</td>
<td></td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>17 Loan Management—SIL</td>
<td>5</td>
<td>4</td>
<td></td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>24 Loan Management—Suspensions</td>
<td>6</td>
<td>4</td>
<td></td>
<td>2</td>
<td></td>
</tr>
<tr>
<td>25 Loan Closing: Standard Procedures</td>
<td>2</td>
<td>1</td>
<td></td>
<td>1</td>
<td></td>
</tr>
<tr>
<td>26 Loan Closing: Special Procedures</td>
<td>2</td>
<td>1</td>
<td></td>
<td>1</td>
<td></td>
</tr>
</tbody>
</table>

Total Key Controls 29 19 10

Percentages of Controls Passed and Failed 100.0% 65.5% 34.5%

15. **Project Processing versus Control Design:** Based on the criteria for “concentrations” described in Box B.1 above, IEG constructed Table B.5 which provides a view of the overall pattern of noncompliances as they occurred across both projects and controls. Overall, out of the 246 noncompliances these have been split roughly evenly between those 129 which have occurred in randomly scattered pattern (one or two, but less than three per control) and the remaining 117 which have occurred in concentrated noncompliances (three or more failures). These are shown in Table B.5 below. Scattered or randomly occurring noncompliances do not necessarily signify problems with specific control steps – because, being random, they suggest only that slips have occurred in project processing on a widespread, or scattered basis. These random occurrences have arisen in many more control steps (23% of the total) than have concentrated noncompliances (only 6% of the total), but they still only signify that project processing, not controls issues have been the problem. Controls issues (design or operation) arise only where there are concentrations of control step failures, with three or more noncompliances occurring in a given control step. On balance, therefore, project processing laxity has been more widespread, specific control design or operation issues more focused on a fewer number of specific controls.

Table B.5: Distribution of Noncompliances by Control Steps and by Projects.

<table>
<thead>
<tr>
<th></th>
<th>Totals</th>
<th>Clear (0)</th>
<th>Random (1-2)</th>
<th>Concentrated (3 or &gt;)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Control Steps</td>
<td>466</td>
<td>331</td>
<td>107</td>
<td>28</td>
</tr>
<tr>
<td>Projects</td>
<td>345</td>
<td>221</td>
<td>90</td>
<td>34</td>
</tr>
</tbody>
</table>

% Distribution

<table>
<thead>
<tr>
<th></th>
<th>Control Steps</th>
<th>Projects</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td></td>
<td>71</td>
<td>64</td>
</tr>
<tr>
<td></td>
<td>23</td>
<td>26</td>
</tr>
<tr>
<td></td>
<td>6</td>
<td>10</td>
</tr>
</tbody>
</table>
16. These results suggest that where remedies are sought these may lie more with management oversight and the Control Environment (management attention to excellence, tone at the top, discipline and accountability) than in the need to revisit the design of specific controls, though the latter is also needed in certain cases, as is discussed below.

17. **Documentation versus other factors:** Table B.6 shows that a lack of documentation remains the cause of noncompliance in more than half the cases tested. The “other reasons” for noncompliance included inaccuracies in documentation, documentation that was filed late, borrowers who failed to deliver documents, and staff that did not act on required control step. IEG regards it as important that a significant portion of the total noncompliances were the result of a failure to find adequate documentation for the controls steps. This relates to the important issue that arose during Part IA, where IEG found that document retention and accessibility in the Bank was a potential material weakness. Now, with the data available from the Part IB testing, IEG has revisited this issue, and observes that the picture is clearly less dire than initially thought.

### Table B.6. Reasons for Noncompliance

<table>
<thead>
<tr>
<th></th>
<th>Lack of Documentation</th>
<th>Other Reasons</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deficiencies/Exceptions</td>
<td>57</td>
<td>43</td>
</tr>
</tbody>
</table>

Source: IEG calculations from management data

18. **Key Responsibilities for Controls Observance:** Consistent with the finding described above, that project processing seems to generally outweigh control design problems as a source of noncompliance, it would be expected that the operations officers most involved with the processing of projects would be those most likely to be linked to cases where noncompliance was found. The evidence in Figure B.1 below clearly bears this out. Task Team Leaders (TTLs) and Financial Officers (FOs) were those most frequently associated with controls that were not complied with (around 35 percent each of all cases). Country Directors were also involved in close to 10 percent of all noncompliances.

![Figure B.1: Responsibilities for non-compliances](image)

TTL = task team leader; CD = country director; FO= financial officer; SM = sector manager; Leg = country lawyer; FMS = financial manager; RSC= regional safeguards coordinator.
19. **Which Processes are More Problematic?** IEG used the concentration analysis also to identify the business processes that appeared to be the most problematic in the sense of having the highest concentrations of both project and controls-related noncompliances. Table B.7 shows the key modules where concentrations of both types were evident. It also lists the modules that management found to be the most problematic (shown in Table B.4 above). IEG agrees with Management in all but one case (Module 5, Core SIL). IEG finds this module to be problematic in that it had a large number of noncompliances (35) (and significant concentrations), though this was a relatively small percentage, because of the large number of control steps in the module. Management points out, and IEG agrees, that many of these noncompliances were “exceptions” rather than “deficiencies”.

<table>
<thead>
<tr>
<th>MODULES</th>
<th>5</th>
<th>12</th>
<th>14</th>
<th>15</th>
<th>17</th>
<th>24</th>
<th>25</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>IEG</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Total noncompliances</td>
<td>35</td>
<td>41</td>
<td>23</td>
<td>15</td>
<td>28</td>
<td>20</td>
<td>11</td>
</tr>
<tr>
<td>As % of Control Steps (cells) in the Module</td>
<td>6</td>
<td>17</td>
<td>5</td>
<td>20</td>
<td>11</td>
<td>33</td>
<td>23</td>
</tr>
<tr>
<td>Concentrations Controls Projects</td>
<td>5</td>
<td>6</td>
<td>2</td>
<td>3</td>
<td>3</td>
<td>3</td>
<td>3</td>
</tr>
</tbody>
</table>

Source: Management test results data, see also Table B.2 above.

20. IEG regards these findings as significant in several respects:
   
a. The results echo the walk-through findings in Part IA, where processing requirements of SILs were seen by the staff to be onerous and cumbersome (and, apparently, are not being fully adhered to); some specific controls in Module 5 may need to be revisited as a candidate for streamlining as much as for tightening of controls.
   
b. Test results showed some significant procurement issues (Module 14)—mainly with post-procurement reviews not being timely, and contract details not being sent in timely fashion to LOA. Management also highlighted these issues in its summary (see para. 17 ii of the Management Report)
   
c. Certain areas of loan management and project closing are in need of possible revision and procedural tightening, specifically those relating to LAS set-ups with thresholds for pre- and post review, and retroactive financing cases. Two controls steps in Module 17 (Loan Management SILs) had almost 100 percent failure rates.

21. **Are Controls Stronger where IDA Risks are Greater?** IEG has taken a first step in differentiating risks among different modules, then comparing the incidence of noncompliance
between the different risk-grouped modules. The risk-grouping was actually done during Part IA, based on a relatively crude methodology,\(^4\) (the results of which are shown in Table SA.12 in the Statistical Appendix to the present report.) In calculating the non-compliant rates by risk group, there is a need to standardize by group size, because Group 1 (higher risk) has both many more control steps and more sample projects than the other two groups. It would follow that most noncompliances would occur in Group 1, as was the case, shown in Table B.8. To offset the sample size issue, IEG calculated the noncompliance rate for each of the three risk groups. As column 6 in the table shows, the average noncompliance rate was slightly higher in Group 1 (7.0 percent), the higher risk group, than in the other two groups (6.4 percent and 6.7 percent respectively). This suggests that the controls appear not to have worked as well in the modules in the higher-risk group. However, given the relative crudeness of this analysis, more work is needed in the area of matching controls strengths and compliance with some form of more rigorous differentiated risk analysis.

<table>
<thead>
<tr>
<th>Risk groups</th>
<th>Modules</th>
<th>Attributes</th>
<th>A/M</th>
<th>Controls Intensity</th>
<th>Noncompliances</th>
<th>Average Noncompliance Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>Group 1</td>
<td>12</td>
<td>272</td>
<td>23</td>
<td>1.44</td>
<td>168</td>
<td>68 7.0</td>
</tr>
<tr>
<td>Group 2</td>
<td>10</td>
<td>146</td>
<td>15</td>
<td>0.94</td>
<td>58</td>
<td>24 6.4</td>
</tr>
<tr>
<td>Group 3</td>
<td>7</td>
<td>48</td>
<td>7</td>
<td>0.44</td>
<td>20</td>
<td>8 6.7</td>
</tr>
<tr>
<td>TOTAL</td>
<td>29</td>
<td>466</td>
<td>16</td>
<td>1.00</td>
<td>246</td>
<td>100 6.8</td>
</tr>
</tbody>
</table>

* Risk groupings as given in the Part IA report, Statistical Appendix, Table G-7, page 78, reproduced in this report in the Statistical Appendix, Table SA.12 page 79: Group 1 = higher-risk; Group 2 = medium-risk; Group 3 = lower-risk

Notes:
1. Modules grouped by Risk Group (see table SA.12 Statistical Appendix).
2. Attributes = Control Steps
3. A/M = Average attributes per module (2/1)
4. Controls Intensity = A/M expressed as percentage of the average
5. Noncompliances in absolute numbers and by % share in each group.
6. ANC % = Average noncompliance Rates

Summary

22. In summary, this IEG analysis has revealed some interesting insights into the testing results that were presented by management. IEG broadly agrees with management’s analysis of its pass rate and believes this is a reasonably satisfactory outcome, given the complexity of the Bank and that this is a first-of-its kind review. This overall result is also broadly corroborated by the calculated alternative pass rates. Different perspectives were offered on the patterns and concentrations that were found in the noncompliance rates: IEG found that project processing was evidently a greater cause of noncompliance than was any problem with individual controls design; and documentation retention is a major cause of noncompliance, though it has improved considerably compared with the early findings in Part IA. As expected, it was the officers such as TTLs and FOs that were most frequently involved in cases where controls were not fully observed. IEG made a simple first attempt at risk differentiation, and found that there was some evidence that higher rates of noncompliance correlated with
the higher-risk business processes. However, with the crudeness of the methodology used, IEG would take these results as no more than an indication that more thorough analysis is needed, which should be done in Part II.

NOTES

1. Management found itself unable to test Module 29 (Safeguards OPCQC) because of problems locating adequate data. Different regions use different clearance procedures, and there is apparently no Bank-wide codification for these processes. It also did not test Modules 2 and 3, because these were essentially once-a-year technical subprocesses of the IDA Allocation model (which was tested). So the total number of modules tested was 29. IEG takes no issue with the latter two cases, but believes that lack of a codified process for OPCQC is a deficiency and should be addressed.

2. General Note: All concepts calculate a pass rate that excludes—as is reasonable—the N/A from both the numerator and, as applicable, to the denominator.

3. The number of unique projects in the sample was smaller, because the same projects were in some cases used to test different controls. Where this happened, IEG regards these as separate projects.

4. Modules were grouped according to (i) the degree to which the business processes they contain involve mainstream allocation and lending operations and major financial and reputational risk is thus involved; (ii) the size of the processes; and (ii) their frequency.
Annex C
Summary Account of the Disposition of All Reported Internal Control Issues Uncovered During Part I

1. This annex provides a summary account of all the issues reported by management, IAD, and IEG during Part IA and Part IB of the IDA14 framework review, including their status or disposition as of May 15, 2007, and highlights the significance the issues using agreed upon terms for their classification as material weaknesses, significant deficiencies, or deficiencies. Included also is summary information on the actions taken or planned by management to address the deficiencies.

2. During Part IA of the review, management, IAD, and IEG identified a total of 126 issues involving a broad range of items that required resolution and closure, attention in Part IB of the review, or deferral to Part II. Management reported the status or disposition of the 126 issues in para. 32-34 of its IB report, which are recapped in table C.1.

<table>
<thead>
<tr>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Addressed in Part IB</td>
<td>37</td>
</tr>
<tr>
<td>Deferred to Part II</td>
<td>44</td>
</tr>
<tr>
<td>Resolved and closed</td>
<td>40</td>
</tr>
<tr>
<td>Review documentation updated</td>
<td>5</td>
</tr>
<tr>
<td>Total</td>
<td>126</td>
</tr>
</tbody>
</table>

3. We have tracked all IEG issues raised in Part IA and agree with the treatment of these issues as shown by management in its report. In addition, we compared the issues reported in the Part IA report with those being formally tracked to their resolution or implementation, and agreement has been reached on the items that require attention and thus should be formally tracked by management, IAD, and IEG.

4. As indicated in the table C.1 above, of the 126 Part IA issues, 37 have been addressed in Part IB. Along with these 37 issues, management and IAD identified in Part IB an additional 25 issues for a total of 62, which provided the starting point for an aggregation and for judgments to be made as to the deficiencies, significant deficiencies, or material weaknesses arising from all of Part I. 1
Definitions and Criteria

5. Management’s report, which is included as attachment 1 to this report, describes the methodology used for assessing the results of the work completed to date in terms of deficiencies, significant deficiencies, and material weaknesses. Definitions of these terms and the criteria for categorizing the review results are also included in management’s annex 3. The precise criteria for distinguishing the three categories of materiality are explained in annex B of IEG’s Part IA Report.

The Aggregation Process

6. The identification, assessment, and reporting of results in the three categories referred to above involve an iterative, building-block approach. The process started in Part IA (control design) and continued in Part IB (control operation) with the identification of specific issues and exceptions for the overall purpose of assessing the design and operating effectiveness of 115 key controls in 32 separate IDA business processes.

7. Management has systematically tracked and reported on the issues and exceptions surfaced by its own work, as well as that of IAD and IEG, from the start of the review in Part IA through the conclusion of Part IB. Management did not classify any of the issues and exceptions identified during Part IA as deficiencies, significant deficiencies, or material weaknesses. Instead, management made this classification after completing Part IB, as shown in Figure C.1.

Material Weaknesses

8. Management did not report any material weaknesses in the work performed during Part I. However, IEG reported at the conclusion of Part IA that there were two potential material weaknesses: documentation retention and accessibility, and the status of OPs and BPs. As explained in the main text, IEG has revised its view on the documentation issue, and now agrees that it constitutes a significant deficiency (see below). However, it has retained its view that the status of OP/BPs remains a potential material weakness.
Significant Deficiencies

9. In its report (para. 25 A-C) management identified three significant deficiencies:

- The inability to provide timely access to documents. (This is a revised formulation of what was earlier labeled a documentation retention and accessibility issue, framed after an improved documentation record and a 93 percent pass rate during the Part IB testing.)
- Variances in regional implementation of institutionally endorsed financial management and procurement guidelines.
- The status of OPs and BPs. This is the same issue mentioned above that IEG previously reported as a potential material weakness.

10. In summary, therefore, the judgments made respectively by management, IAD, and IEG regarding material weaknesses and significant deficiencies are as shown in table C.2.

<table>
<thead>
<tr>
<th></th>
<th>Potential Material Weakness</th>
<th>Significant Deficiency</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management</td>
<td>0</td>
<td>3</td>
</tr>
<tr>
<td>IAD</td>
<td>(See note)</td>
<td>(See note)</td>
</tr>
<tr>
<td>IEG</td>
<td>1</td>
<td>2</td>
</tr>
</tbody>
</table>

Note: IAD reported deficiencies but did not classify them as Potential Material Weakness or Significant Deficiency.

Deficiencies

11. In addition to the significant deficiencies described above, management identified in its report (para. 26) six deficiencies that merit a closer investigation to assess causes and impact and identify appropriate remedial actions, which generally were in the following areas:

- Need to streamline IL operations
- Disparity in corporate review between IL and DPL
- Lack of timely updates to the LAS
- Inconsistency and lack of follow-up in clearing review comments
- Need for improved controls over the safeguards Corporate Risk List
- Non-compliance of IDA countries with quarterly debt reporting requirements and plans to assess debt sustainability in Part II.

Issues and Exceptions

12. As stated in its report (para. 27), management provided IEG and IAD detailed information on the total 62 issues and exceptions, together with management’s response and action for each. For each of these 62 items listed, management provided information that included:

- The business process module or modules in which the items were noted.
- A description of the issue, exception, or deficiency
An evaluation of the significance of each of the items listed that considered whether the issue, exception, or deficiency would meet one of more of the following conditions:

- Impair achievement of IDA’s objectives?
- Violate IDA’s charter or contractual agreements?
- Weaken safeguards—waste, loss unauthorized use of funds, property or assets?
- Conflicts of interest?
- Systemic problems in country assistance partnerships and project lending?
- Require attention of senior management, the Board, or external stakeholders?

13. The above questions are the same as those listed in annex B, page 48, of IEG’s report on Part IA, which are measures to be used as guides by each of the three groups in determining whether identified internal control deficiencies in compliance constitute significant deficiencies or material weaknesses. Based on answers to the above questions and its judgment of the significance of the items listed, management indicated on the listing whether it believed any of the items, alone or in combination with other items on the list, could constitute a deficiency or significant deficiency. Management did not indicate that any one or combination of the items listed would constitute a material weakness.

14. Two ways of considering the issues and exceptions are by the way they were aggregated into the significant deficiencies and deficiencies included in management’s report and by the IDA business processes where they were found. First, the issues and exceptions can be summarized according to whether they were judged to be significant deficiencies, deficiencies, and issues/exceptions being reported and tracked by management until corrected and whether they were identified in Part IA (control design issues) or Part IB (control operation issues revealed by testing), as shown in Table C.3.
Table C.3. Issues and Exceptions as Aggregated and Tracked by Management

<table>
<thead>
<tr>
<th>Issue</th>
<th>Number of Issues in Deficiency Tracker</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
</tr>
<tr>
<td>Significant Deficiencies</td>
<td></td>
</tr>
<tr>
<td>1. The inability to provide timely access to documents</td>
<td>3</td>
</tr>
<tr>
<td>2. The extent of variances in regional implementation of institutionally endorsed financial management and procurement guidelines</td>
<td>19</td>
</tr>
<tr>
<td>3. The status of OPs and BPs. This is the same issue mentioned above that IEG previously reported as a potential material weakness</td>
<td>10</td>
</tr>
<tr>
<td>Deficiencies</td>
<td></td>
</tr>
<tr>
<td>1. The need to streamline IL operations</td>
<td>2</td>
</tr>
<tr>
<td>2. The disparity in corporate review between IL and DPL</td>
<td>1</td>
</tr>
<tr>
<td>3. The lack of timely updates to the LAS</td>
<td>7</td>
</tr>
<tr>
<td>4. The inconsistency and lack of follow-up in clearing review comments</td>
<td>5</td>
</tr>
<tr>
<td>5. The need for improved controls over the safeguards Corporate Risk List</td>
<td>2</td>
</tr>
<tr>
<td>6. Non-compliance of IDA countries with quarterly debt reporting requirements</td>
<td>2</td>
</tr>
<tr>
<td>Other Issues and Exceptions in Management’s Tracker</td>
<td></td>
</tr>
<tr>
<td>1. Allocation procedures</td>
<td>2</td>
</tr>
<tr>
<td>2. Project changes</td>
<td>2</td>
</tr>
<tr>
<td>3. QAG</td>
<td>4</td>
</tr>
<tr>
<td>4. Refunds</td>
<td>1</td>
</tr>
<tr>
<td>5. Safeguards</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>62</td>
</tr>
</tbody>
</table>
15. Second, the issues and exceptions can be viewed by IDA business process—where among the IDA business processes were the issues and exceptions found? Of the 32 processes, management reported no issues or exceptions for 12. As can be seen from Table C.4, two of the remaining 20 business processes accounted for 36.8 percent. Financial Management-SIL (11.8 percent) and Procurement-SIL (25 percent). (See Table C.4.)

Table C.4. Distribution of Issues and Exceptions by Business Process

<table>
<thead>
<tr>
<th>Business Process</th>
<th>Issue and Exceptions</th>
<th>Number</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>FRM Allocation—Main</td>
<td></td>
<td>2</td>
<td>2.9</td>
</tr>
<tr>
<td>SIL—Product Cycle</td>
<td></td>
<td>4</td>
<td>5.9</td>
</tr>
<tr>
<td>DPL—Project Cycle</td>
<td></td>
<td>3</td>
<td>4.4</td>
</tr>
<tr>
<td>Corporate Review (ROC/OC)</td>
<td></td>
<td>2</td>
<td>2.9</td>
</tr>
<tr>
<td>Contractual Remedies</td>
<td></td>
<td>1</td>
<td>1.5</td>
</tr>
<tr>
<td>FM—Specific Investment Loans</td>
<td></td>
<td>8</td>
<td>11.8</td>
</tr>
<tr>
<td>SIL—Procurement Regime</td>
<td></td>
<td>17</td>
<td>25.0</td>
</tr>
<tr>
<td>Procurement Complaints</td>
<td></td>
<td>4</td>
<td>5.9</td>
</tr>
<tr>
<td>Procurement Noncompliance</td>
<td></td>
<td>1</td>
<td>1.5</td>
</tr>
<tr>
<td>Loan Management—SIL</td>
<td></td>
<td>3</td>
<td>4.4</td>
</tr>
<tr>
<td>Amendments &amp; Extensions</td>
<td></td>
<td>1</td>
<td>1.5</td>
</tr>
<tr>
<td>Refund Process</td>
<td></td>
<td>2</td>
<td>2.9</td>
</tr>
<tr>
<td>Cancellation Process</td>
<td></td>
<td>1</td>
<td>1.5</td>
</tr>
<tr>
<td>Loan Mgmt Suspensions</td>
<td></td>
<td>4</td>
<td>5.9</td>
</tr>
<tr>
<td>Loan Closing (Standard Procedures)</td>
<td></td>
<td>3</td>
<td>4.4</td>
</tr>
<tr>
<td>Loan Closing (Special Procedures)</td>
<td></td>
<td>1</td>
<td>1.5</td>
</tr>
<tr>
<td>QAQ: QEA and QSA</td>
<td></td>
<td>4</td>
<td>5.9</td>
</tr>
<tr>
<td>Safeguards—SIL</td>
<td></td>
<td>3</td>
<td>4.4</td>
</tr>
<tr>
<td>Safeguards—Corporate Risk (QACU)</td>
<td></td>
<td>2</td>
<td>2.9</td>
</tr>
<tr>
<td>Debt Reporting</td>
<td></td>
<td>2</td>
<td>2.9</td>
</tr>
</tbody>
</table>

Total (See note)                        | 68                   | 100    |

Note —The total number of issues/exceptions does not equal to 62 because some were found in more than one process.

16. Management plans to update IAD and IEG as to the status of the identified actions for all of the items in the Tracker at the completion of Part II and plans to include their status in its final report.
Management's Actions to Address Deficiencies

17. Management provided IEG with information from its Tracker on the actions taken or planned to address the deficiencies and issues that had surfaced in Part I, as summarized in Table C.5 below.

Table C.5. Status of Issues and Exceptions as of May 15, 2007

<table>
<thead>
<tr>
<th>Status</th>
<th>Number</th>
</tr>
</thead>
<tbody>
<tr>
<td>Action taken</td>
<td>7</td>
</tr>
<tr>
<td>Action planned or underway</td>
<td>33</td>
</tr>
<tr>
<td>Deferred to Part II</td>
<td>11</td>
</tr>
<tr>
<td>No action planned by management</td>
<td>11</td>
</tr>
<tr>
<td>Total</td>
<td>62</td>
</tr>
</tbody>
</table>

18. In the cases where no action was taken or planned as of May 15, 2007, management indicated in the Tracker that clarification of the matter had been obtained or for other reasons management stated that it would not be taking action. Examples of completed actions as described in the Tracker follow:

- Management took steps to standardize the approach used by OPCQC and the regions in screening and tracking projects on the safeguards corporate risk list and also provided related guidance to the regions.

- The Executive Directors approved on July 18, 2006, Management's proposed revisions reflected in updates to BP 13.05, Project Supervision, covering Restructuring and Other Project changes. The revisions dealt with a potential deficiency by clarifying the roles and responsibilities of regional staff and Management, including the CDs, RVPs, and the Board. Management also provided staff with accompanying guidelines for documenting certain project changes as they are first identified by team leaders and country directors.

- On March 25, 2007, OPCS issued a new Guidance Note on Management Review of Investment Operations intended to put in place appropriate measures to ensure that the level of management review that applies (including criteria for corporate review) is aligned with the level of risks involved in specific investment operations.

The Tracker information provides a valuable source of data on areas of IDA operations requiring attention. The information has been jointly developed and shared by the three review groups and thus has eliminated the time and expense of maintaining three separate and potentially conflicting sets of data. As the review moves to Phase II and final, overall reporting, Management intends to address some additional elements in the Tracker which could help in pinpointing responsibility and tracking deficiencies to their final disposition, such as identifying (1) the specific management unit within the bank responsible for evaluating the matters disclosed and taking corrective action where it is called for, (2) milestones and/or anticipated completion dates for implementing the changes needed and being acted on, and (3) target dates
ANNEX C
SUMMARY ACCOUNT OF THE DISPOSITION OF ALL REPORTED INTERNAL CONTROL ISSUES

for follow-up to ensure corrective actions have been fully implemented or appropriately resolved and thus can be dropped from the Tracker.

NOTE

1 IAD also identified a methodological issue with Management’s pass rate which is still open.
Annex D
A Description of the Quality Rating Process Used by IEG in Evaluating the Approach and Methods in Management’s Assessment and the IAD
Review of Part I

Introduction

1. In designing its evaluation, IEG saw the need to create a standardized framework of questions to be asked of the different segments of work that would constitute management’s assessment and the IAD review: the approach and methods that management would use in its process mapping and verification of the design effectiveness of key controls; the methods it would use for sampling and testing those controls; the clarity and robustness of the results achieved in the testing; and the quality of conclusions that management arrived at in completing its assessment; and a parallel application of the review methods, results, and conclusions arrived at by IAD.

2. Standardization was seen as important, for various reasons: there were initially 30 (later 32) different BPMs contained in management’s representation of IDA’s business processes, and it would be important for IEG to apply a uniform set of questions, based on pre-established criteria, so that each module would be evaluated by IEG against a common standard. By creating a standard template of questions, a platform would also be created on which similar future evaluations could rely, and which could provide the basis for comparisons over time.

3. Since management had divided its assessment into two major parts, this gave an additional reason to create a framework to capture issues at two levels: at the level of business transactions (Part I of the review), and then a quite different set of issues to be captured in the entity-level assessment to be conducted in Part II. IEG therefore created two separate (but linked) templates of questions. The first dealt with IDA business processes, the second with the COSO framework. This annex describes the content and application of the first of the templates (The Business Process Template), which IEG has applied in Part I. The COSO Framework Template will be used and described in the IEG report to be written on completion of Part II.
The Business Process Template

4. IEG formulated the template using 56 questions, organized around the different segments of the work described above. The questions were formulated following research conducted by IEG of questions used in similar reviews in other agencies, including the U.S. GAO, but IEG made its own adaptation of the questions to suit the case of IDA. Table D.1 provides a listing of the main categories of the questions, six for the management assessment and four for the IAD review.

<table>
<thead>
<tr>
<th>Question Categories</th>
<th>Number of Questions</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>FOR MANAGEMENT’S ASSESSMENT</strong></td>
<td></td>
</tr>
<tr>
<td>1. Strategic Relevance and Importance</td>
<td>5</td>
</tr>
<tr>
<td>2. Mapping the Business Process</td>
<td>11</td>
</tr>
<tr>
<td>3. Assessment of Control design</td>
<td>10</td>
</tr>
<tr>
<td>4. Testing of Control Compliance</td>
<td>12</td>
</tr>
<tr>
<td>5. Linkage to COSO Framework</td>
<td>6</td>
</tr>
<tr>
<td>6. Quality of Conclusions</td>
<td>4</td>
</tr>
<tr>
<td>SubTotal</td>
<td>48</td>
</tr>
<tr>
<td><strong>FOR THE IAD REVIEW</strong></td>
<td></td>
</tr>
<tr>
<td>1. Scope of Work</td>
<td>1</td>
</tr>
<tr>
<td>2. Criteria and Standards</td>
<td>1</td>
</tr>
<tr>
<td>3. Documentation and Evidence</td>
<td>4</td>
</tr>
<tr>
<td>4. Quality of Conclusions</td>
<td>2</td>
</tr>
<tr>
<td>SubTotal</td>
<td>8</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>56</td>
</tr>
</tbody>
</table>

The Rating System

5. The template also contains a rating system. This was based on criteria that were built around the degree of certainty with which management’s assessment (and the IAD review) could be said to have shown that the methods used were such as to show clearly (or otherwise) that controls were well mapped, designed, tested and so forth. As shown in Box D.1, the system uses a four-part rating system, ranging from highly satisfactory (1) to less than satisfactory (4). Its purpose was to reduce qualitative judgments about different processes to quantified indicators, which would assist in making summary overall judgments.

<table>
<thead>
<tr>
<th>Box D.1. Elements of the 4-Part Rating System</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Rating (numerical equivalent)</strong></td>
</tr>
<tr>
<td>Highly Satisfactory (HS) (1)</td>
</tr>
<tr>
<td>Satisfactory (S) (2)</td>
</tr>
</tbody>
</table>
**ANNEX D**

**DESCRIPTION OF THE QUALITY RATING PROCESS USED BY IEG**

<table>
<thead>
<tr>
<th>Rating</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Satisfactory with Qualification (3)</td>
<td>Uncertainty as to whether the assessment/review showed that controls in the process element are well designed, operate effectively, without deficiencies etc.</td>
</tr>
<tr>
<td>Less than Satisfactory (4)</td>
<td>Clear evidence that the assessment/review did NOT show that controls in the process element are well designed, operate effectively, etc.; OR failed to uncover the presence of deficiencies or weaknesses</td>
</tr>
<tr>
<td>Not Applicable (NA)</td>
<td>Not Applicable</td>
</tr>
</tbody>
</table>

### The Evaluation and Rating Process

6. IEG assembled evaluation panels, consisting of its core team of external consultants, together with a selected number of other experts with significant experience in the Bank (e.g., lending operations, legal, procurement, financial and loan management, safeguards). The panels examined the materials presented to IEG by management for each of the Modules, they applied the template to the findings of the different segments of the assessment, and came to a consensus on the rating to be given to the process referred to by each question. Given that management had divided Part I into two parts (IA and IB), the panels used the template twice, applying Questions 1-3 in the session dealing with Part IA, and questions 4-6 for Part IB.

### Overall Results

7. A summary of the results that were achieved by this process have been given in the main text of the report (table 1) and in the Statistical Appendix (tables SA.1 to SA.5). The summaries describe the fact that an overall rating of 2.5 was given for the outcome of Part IA (process mapping and control design) and 2.4 for Part IB (compliance testing). This implied that for both Parts IA and IB, IEG found management’s approach and methods to be generally satisfactory, but with some qualifications.

### More Detailed Breakdown of Results

8. IEG regarded this tool as adding significant value to its evaluation. Part of this value was in distilling the evaluation into an overall rating. However, possibly even more valuable were the insights that the Template provided at the level of individual modules, where the template questions often led to a searching examination of Management’s processes and results. In this vein, it is instructive to look in more detail at what were the major factors that detracted from the overall rating being (2) — fully satisfactory.

9. An overall summary of the distribution of quality ratings—for both Part IA and IB—is shown in Table D.2. It shows that almost two-thirds of the ratings for all categories were at “2”, i.e. were fully satisfactory, while some 26 to 29 percent were rated at “3”, meaning that processes were seen as satisfactory with qualification. IEG emphasizes that this rating is still above the line, but that some factor or process (very often descriptive materials, rather than substantive deficiencies) could have been better presented, or improved upon in some way. The table also shows that IEG was quite stringent in its ratings, giving ratings of “1” (Highly Satisfactory) to no more than 2 percent of all processes covered in the questions. Against this, ratings of Less than Satisfactory accounted for 7 to 8 percent of the total.
Table D.2. Distribution of IEG Quality Ratings

<table>
<thead>
<tr>
<th>All Modules</th>
<th>Distribution by Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>1</td>
</tr>
<tr>
<td>PART IA (Management)</td>
<td>15</td>
</tr>
<tr>
<td>Distribution by No.</td>
<td></td>
</tr>
<tr>
<td>Distribution by Percentage</td>
<td>2%</td>
</tr>
<tr>
<td>PART IB (Management)</td>
<td>4</td>
</tr>
<tr>
<td>Distribution by No.</td>
<td></td>
</tr>
<tr>
<td>Distribution by Percentage</td>
<td>1%</td>
</tr>
<tr>
<td>PART I OVERALL (IAD)</td>
<td>0</td>
</tr>
</tbody>
</table>

Some Highlighted Features

10. The template was used as a tool to evaluate Management and IAD’s approach and methods. The template ratings are a comment on whether the results management achieved can be taken to be credible, given the methods that were used. In general, the IEG ratings suggest that the methods were indeed credible and satisfactory, but there were also some qualifications. Most of these were of the nature of descriptions which could have been improved, but others, such as the treatment of risk, were of more operational significance.

11. Process Example—Module 28 SIL Safeguards: To illustrate how the template uncovered some useful insights, in the evaluation of the SIL Safeguards module, the evaluation panel had initially rated most elements in the Template at “4” i.e. less than satisfactory. This arose mainly from a lack of clarity as to how management had drawn the process map, and what precise processes had underpinned the clearance of the two key controls. On account of the low rating IEG sought a meeting with management, and asked for an examination of the actual documentation on each step in the key controls, which was contained in the Data Room. Following this meeting, it was clear to IEG that the processes had, in fact, been correctly followed, but that the (Part IB) test results materials presented to IEG had not been sufficiently explicit. This interchange was a learning experience for both sides, and the ratings were amended, though they reflected the fact that this lack of clarity had occurred.

12. Overall, IEG regards the template to have been a useful addition to its arsenal of evaluative tools. Its questions appeared relevant to the different categories of process examined, and the rating results provide a fair, if rigorous, indication of the quality of management and IAD approaches to Part I of the review. Management’s assessment was rated separately for Part IA and Part IB; IAD was rated for Part I overall (see Table D.2 above). IEG is currently refining its version of the COSO Framework template, which will be used in Part II to evaluate management’s assessment and the IAD review of Part II.
## Table SA.1. Summary of IEG Ratings of Management’s Part IB Approach and Testing Methods

<table>
<thead>
<tr>
<th>Function Rated (By Template Question Numbers)</th>
<th>Rating</th>
<th>Function Rated (By Template Question Numbers)</th>
<th>Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>Choosing the Sample (4.01)</td>
<td>2.37</td>
<td>Testing Methods (4.02)</td>
<td>2.07</td>
</tr>
<tr>
<td>4.01a</td>
<td>2.19</td>
<td>4.02a</td>
<td>2.07</td>
</tr>
<tr>
<td>4.01b</td>
<td>2.59</td>
<td>4.02b</td>
<td>2.00</td>
</tr>
<tr>
<td>Testing Results (4.03)</td>
<td>2.68</td>
<td>Quality of Conclusions (6.00)</td>
<td>2.43</td>
</tr>
<tr>
<td>4.03a</td>
<td>2.79</td>
<td>6.01a</td>
<td>2.21</td>
</tr>
<tr>
<td>4.03b</td>
<td>2.36</td>
<td>6.01b</td>
<td>2.57</td>
</tr>
<tr>
<td>4.03c</td>
<td>2.48</td>
<td>6.01c</td>
<td>2.35</td>
</tr>
<tr>
<td>4.03d</td>
<td>3.00</td>
<td>6.01d</td>
<td>2.95</td>
</tr>
<tr>
<td>4.03e</td>
<td>2.40</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Rating System:** 1 = highly satisfactory; 2 = satisfactory; 3 = satisfactory with qualification; 4 = less than satisfactory; N/A = not applicable.

## Table SA.2. Summary of Quality Ratings of Management’s Assessment of the Design Effectiveness of Key Controls (Part IA)

<table>
<thead>
<tr>
<th>Quality Dimensions</th>
<th>Overall</th>
<th>Average Ratings</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>R1</td>
<td>R2</td>
</tr>
<tr>
<td>Mapping the Business Process</td>
<td>2.38</td>
<td></td>
</tr>
<tr>
<td>Origin, Method, and Criteria</td>
<td>2.51</td>
<td>2.58</td>
</tr>
<tr>
<td>Accuracy and Completeness</td>
<td>2.50</td>
<td>2.31</td>
</tr>
<tr>
<td>Identification of Key Controls</td>
<td>2.19</td>
<td>2.38</td>
</tr>
<tr>
<td>Assessment of Control Design</td>
<td>2.62</td>
<td></td>
</tr>
<tr>
<td>Identifying Process Risks</td>
<td>2.81</td>
<td>2.46</td>
</tr>
<tr>
<td>Matching Risks with Process Design</td>
<td>2.31</td>
<td>2.35</td>
</tr>
<tr>
<td>Overall Average Rating</td>
<td>2.45</td>
<td>2.42</td>
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</table>

**Rating Scale:** 1 = highly satisfactory; 2 = satisfactory; 3 = satisfactory with qualification; 4 = less than satisfactory.
### Table SA.3. Summary of Quality Ratings of Management’s Assessment of the Design Effectiveness of Key Controls by Distribution of Ratings (Part IA)

<table>
<thead>
<tr>
<th></th>
<th>Distribution by Rating</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>Mean</td>
</tr>
<tr>
<td>Mapping the Business Process</td>
<td>2.38</td>
</tr>
<tr>
<td>Origin, Method, and Criteria</td>
<td>2.31</td>
</tr>
<tr>
<td>Clarity of IDA Operational Objective?</td>
<td>2.58</td>
</tr>
<tr>
<td>Clarity of method and criteria?</td>
<td>2.00</td>
</tr>
<tr>
<td>BPM established under Bank BP or OP?</td>
<td>2.19</td>
</tr>
<tr>
<td>Management sought input in process area?</td>
<td>2.12</td>
</tr>
<tr>
<td>Accuracy and Completeness</td>
<td>2.50</td>
</tr>
<tr>
<td>Process has been clearly titled?</td>
<td>2.31</td>
</tr>
<tr>
<td>Risks to BPM clearly stated?</td>
<td>2.73</td>
</tr>
<tr>
<td>Ownership of process clearly designated?</td>
<td>2.00</td>
</tr>
<tr>
<td>Management sought input in process?</td>
<td>2.42</td>
</tr>
<tr>
<td>Identification of Key Controls</td>
<td>2.19</td>
</tr>
<tr>
<td>Clear definition of key controls?</td>
<td>2.38</td>
</tr>
<tr>
<td>Relevance of mapped BPM controls?</td>
<td>2.04</td>
</tr>
<tr>
<td>Differentiation between controls for financial reporting and other COSO objectives?</td>
<td>2.62</td>
</tr>
<tr>
<td>Assessment of Control Design</td>
<td>2.62</td>
</tr>
<tr>
<td>Identifying Process Risks</td>
<td>2.46</td>
</tr>
<tr>
<td>Clear identification of risks that the control points are designed to alleviate?</td>
<td>2.46</td>
</tr>
<tr>
<td>Risks have been categorized (fin/op/rep) and analyzed?</td>
<td>4.00</td>
</tr>
<tr>
<td>Management documentation relates to the policies and procedures of controls and risks?</td>
<td>2.31</td>
</tr>
<tr>
<td>Management consulted with the most authoritative sources?</td>
<td>2.15</td>
</tr>
<tr>
<td>Matching Risks with Process Design</td>
<td>2.31</td>
</tr>
<tr>
<td>Management adequately matched the design with the risks?</td>
<td>2.35</td>
</tr>
<tr>
<td>i. Built in checks and balances</td>
<td>2.81</td>
</tr>
<tr>
<td>ii. Involved specialized staff</td>
<td>2.15</td>
</tr>
<tr>
<td>iii. Involved appropriate operational units and mgmt levels?</td>
<td>2.08</td>
</tr>
<tr>
<td>Design process is known by relevant staff?</td>
<td>2.08</td>
</tr>
<tr>
<td>Mgmt. has shown that controls extend to cover external risks?</td>
<td>2.44</td>
</tr>
</tbody>
</table>

Rating Scale: 1 = highly satisfactory; 2 = satisfactory; 3 = satisfactory with qualification; 4 = less than satisfactory.

Note: Modules 1-3 and Modules 25 & 26 were assessed together; therefore maximum number of observations is 26 rather than 29.
Table SA.4. Summary of Quality Ratings of Management’s Assessment of the Control Compliance of Key Controls by Distribution of Ratings (Part IB)

<table>
<thead>
<tr>
<th>Category</th>
<th>Distribution by Rating</th>
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<th>3</th>
<th>4</th>
<th>N</th>
</tr>
</thead>
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<tr>
<td><strong>Testing of Control Compliance</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Clear, well-explained sampling methodology?</td>
<td></td>
<td>2.19</td>
<td>0</td>
<td>85</td>
<td>11</td>
<td>4</td>
<td>27</td>
</tr>
<tr>
<td>Criteria give a credible, comprehensive sample?</td>
<td></td>
<td>2.59</td>
<td>0</td>
<td>56</td>
<td>30</td>
<td>15</td>
<td>27</td>
</tr>
<tr>
<td>Geared to highest risk processes?</td>
<td></td>
<td>2.00</td>
<td>0</td>
<td>100</td>
<td>0</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td><strong>Choosing the Sample to be Tested</strong></td>
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<td>2.37</td>
<td>0</td>
<td>67</td>
<td>30</td>
<td>4</td>
<td>27</td>
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<tr>
<td><strong>Testing Methods</strong></td>
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<td>0</td>
<td>96</td>
<td>0</td>
<td>4</td>
<td>28</td>
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<tr>
<td>Well-explained, explicit testing methodology, followed consistently?</td>
<td></td>
<td>2.07</td>
<td>4</td>
<td>89</td>
<td>4</td>
<td>4</td>
<td>28</td>
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<tr>
<td>Where methods were different, were differences justified?</td>
<td></td>
<td>2.00</td>
<td>0</td>
<td>100</td>
<td>0</td>
<td>0</td>
<td>2</td>
</tr>
<tr>
<td><strong>Testing Results</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Were results robust, credible, unambiguous?</td>
<td></td>
<td>2.79</td>
<td>4</td>
<td>32</td>
<td>46</td>
<td>18</td>
<td>28</td>
</tr>
<tr>
<td>Where control weaknesses were revealed, was it clearly stated whether due to compliance or control design?</td>
<td></td>
<td>2.36</td>
<td>0</td>
<td>68</td>
<td>27</td>
<td>5</td>
<td>22</td>
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<tr>
<td>Where control weaknesses, did tests identify origin and did findings lend themselves to seeking remedies among relevant units?</td>
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<td>2.48</td>
<td>10</td>
<td>43</td>
<td>38</td>
<td>10</td>
<td>21</td>
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<tr>
<td>Where control weaknesses, was additional work done to determine how widespread, cause, consequences?</td>
<td></td>
<td>3.00</td>
<td>0</td>
<td>22</td>
<td>56</td>
<td>22</td>
<td>18</td>
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<tr>
<td><strong>Quality of Conclusions</strong></td>
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<td>2.43</td>
<td>0</td>
<td>64</td>
<td>29</td>
<td>7</td>
<td>14</td>
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<tr>
<td>Is there a conclusion that is clear, concrete, and concise?</td>
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<td>0</td>
<td>79</td>
<td>21</td>
<td>0</td>
<td>28</td>
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<tr>
<td>Does the conclusion reflect the findings?</td>
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<td>2.57</td>
<td>0</td>
<td>46</td>
<td>50</td>
<td>4</td>
<td>28</td>
</tr>
<tr>
<td>Were exceptions adequately identified as exceptions or deficiencies?</td>
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<td>0</td>
<td>65</td>
<td>35</td>
<td>0</td>
<td>23</td>
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<tr>
<td>Were there proposals for remedial action, if relevant?</td>
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<td>0</td>
<td>32</td>
<td>42</td>
<td>26</td>
<td>19</td>
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</tbody>
</table>

Rating Scale: 1 = highly satisfactory; 2 = satisfactory; 3 = satisfactory with qualification; 4 = less than satisfactory.

Note: Modules 1-3 and Modules 25 & 26 were assessed together; also, module 29 was not completed; therefore maximum number of observations is 28. (This table includes modules 30, 31, and 32.)
<table>
<thead>
<tr>
<th>Business Function</th>
<th>Mapping the Business Process</th>
<th>Assessing Control Design</th>
<th>Overall Average</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Origin, Method &amp; Criteria</td>
<td>ID of Key Controls</td>
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<td>Programming &amp; Allocation</td>
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<td>2.50 2.50 3.00</td>
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<tr>
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<td>2.25 2.00 2.00 2.50 2.75 2.75 2.25</td>
<td>2.36</td>
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</tr>
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<td>Legal</td>
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<td>Safeguards</td>
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</tbody>
</table>

Rating Scale: 1 = Highly Satisfactory; 2 = Satisfactory; 3 = Satisfactory with Qualification; 4 = Less than Satisfactory; N/A - Not Applicable.
Table SA.6. Projects-Related Concentrations
(Projects with at least three noncompliances)

<table>
<thead>
<tr>
<th>Country</th>
<th>Module</th>
<th>No. of Exceptions</th>
<th>Non compliance rate (%)</th>
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<tbody>
<tr>
<td>Nicaragua Frontloading</td>
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<td>3</td>
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<tr>
<td>Gambia</td>
<td>5</td>
<td>5</td>
<td>17.2</td>
</tr>
<tr>
<td>Burkina Faso</td>
<td>5</td>
<td>3</td>
<td>10.3</td>
</tr>
<tr>
<td>Mongolia</td>
<td>5</td>
<td>4</td>
<td>28.6</td>
</tr>
<tr>
<td>Yemen</td>
<td>5</td>
<td>4</td>
<td>28.6</td>
</tr>
<tr>
<td>Mali</td>
<td>7</td>
<td>4</td>
<td>11.8</td>
</tr>
<tr>
<td>Timor-Leste</td>
<td>7</td>
<td>3</td>
<td>9.1</td>
</tr>
<tr>
<td>Honduras</td>
<td>7</td>
<td>3</td>
<td>8.8</td>
</tr>
<tr>
<td>São Tomé &amp; Príncipe</td>
<td>9</td>
<td>5</td>
<td>25.0</td>
</tr>
<tr>
<td>Djibouti</td>
<td>9</td>
<td>4</td>
<td>20.0</td>
</tr>
<tr>
<td>Haiti</td>
<td>10</td>
<td>3</td>
<td>15.8</td>
</tr>
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<td>Vietnam</td>
<td>12</td>
<td>3</td>
<td>30.0</td>
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<td>Gambia</td>
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<td>45.5</td>
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<tr>
<td>Serbia-Montenegro</td>
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<td>3</td>
<td>37.5</td>
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<td>India</td>
<td>12</td>
<td>3</td>
<td>42.9</td>
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<td>Bangladesh</td>
<td>12</td>
<td>3</td>
<td>33.3</td>
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<td>Mongolia</td>
<td>14</td>
<td>4</td>
<td>23.5</td>
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<tr>
<td>Bangladesh</td>
<td>14</td>
<td>8</td>
<td>47.1</td>
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<td>Honduras</td>
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<td>3</td>
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<td>China</td>
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<td>4</td>
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<td>India</td>
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<td>3</td>
<td>42.9</td>
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<td>Mozambique</td>
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<td>Vietnam</td>
<td>17</td>
<td>3</td>
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<tr>
<td>Tajikistan</td>
<td>17</td>
<td>3</td>
<td>15.8</td>
</tr>
<tr>
<td>Yemen, Republic of</td>
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<td>5</td>
<td>25.0</td>
</tr>
<tr>
<td>Africa</td>
<td>17</td>
<td>3</td>
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<td>Timor-Leste</td>
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<td>27.3</td>
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<td>São Tomé &amp; Príncipe</td>
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TOTAL NONCOMPLIANCE     132
### Table SA.7. Summary of Sample Projects with Three or More Noncompliances

<table>
<thead>
<tr>
<th>Module</th>
<th>Number of Noncompliances</th>
<th>PROJECTS</th>
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<td>1 Allocation</td>
<td>Nicaragua Frontloading</td>
<td>X</td>
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<td>5 Core SIL</td>
<td>Burkina Faso</td>
<td>X</td>
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<td>Yemen</td>
<td></td>
</tr>
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<td></td>
<td>Mongolia</td>
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</tr>
<tr>
<td></td>
<td>Gambia</td>
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</tr>
<tr>
<td>7 Core DPL</td>
<td>Mali</td>
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<tr>
<td></td>
<td>Timor Leste</td>
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</tr>
<tr>
<td></td>
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</tr>
<tr>
<td>9 Contractual Remedies</td>
<td>Soã Tomé &amp; Principe</td>
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</tr>
<tr>
<td></td>
<td>Djibouti</td>
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<td>10 SIL Legal Regime</td>
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<tr>
<td>12 FM SIL</td>
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<td></td>
<td>Bangladesh</td>
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<td>15 Procurement Complaints</td>
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<tr>
<td></td>
<td>India</td>
<td></td>
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<tr>
<td>17 Loan Management SIL</td>
<td>Mozambique</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Vietnam</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Tajikistan</td>
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<td>Yemen</td>
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<td></td>
<td>Africa Regional</td>
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<td>18 Loan Management DPL</td>
<td>Timor Leste</td>
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<tr>
<td>24 Loan Management Suspensions</td>
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<td></td>
<td>Guinea Bissau</td>
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<td>Pakistan</td>
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</table>

Source: IEG calculations from management test results data.
### Table SA.8. Controls-Related Concentrations
(Control Steps with at least three non compliances)

<table>
<thead>
<tr>
<th>Module</th>
<th>Control</th>
<th>Letter</th>
<th>Number</th>
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<th>Non compliance rate(%)</th>
</tr>
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<tbody>
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<td>C</td>
<td>5</td>
<td>5</td>
<td>33.3</td>
</tr>
<tr>
<td>5</td>
<td>4</td>
<td>E</td>
<td></td>
<td>4</td>
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</tr>
<tr>
<td>5</td>
<td>5</td>
<td>C</td>
<td></td>
<td>3</td>
<td>23.1</td>
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<tr>
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<tr>
<td>5</td>
<td>6</td>
<td>A</td>
<td>2</td>
<td>4</td>
<td>26.7</td>
</tr>
<tr>
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<td>3</td>
<td>B</td>
<td>6</td>
<td>3</td>
<td>42.9</td>
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<tr>
<td>9</td>
<td>1</td>
<td>B</td>
<td>(ii)2</td>
<td>3</td>
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<td>D</td>
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<td>2</td>
<td>3</td>
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<td>1</td>
<td>3</td>
<td>37.5</td>
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<td>4</td>
<td>A</td>
<td>9</td>
<td>6</td>
<td>75.0</td>
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<tr>
<td>17</td>
<td>4</td>
<td>A</td>
<td>10</td>
<td>10</td>
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<tr>
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<td>3</td>
<td>75.0</td>
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<td>24</td>
<td>2</td>
<td>B</td>
<td></td>
<td>4</td>
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<tr>
<td>25</td>
<td>2</td>
<td>B</td>
<td></td>
<td>3</td>
<td>25.0</td>
</tr>
</tbody>
</table>

**TOTAL NONCOMPLIANCEs** 117

*Source: Management results data*
Table SA.9. Summary of Controls with Three or More NonCompliant Control Steps

<table>
<thead>
<tr>
<th>Module # and Title</th>
<th>Specific Control</th>
<th>Number of NonCompliant Control Steps</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>3</td>
</tr>
<tr>
<td>5  Core SIL</td>
<td>Control 4C5</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Control 4E</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Control 5C</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Control 6A1</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Control 6A2</td>
<td></td>
</tr>
<tr>
<td>7  Core DPL</td>
<td>Control 3B6</td>
<td></td>
</tr>
<tr>
<td>9  Contractual Remedies</td>
<td>Control 1B(ii)2</td>
<td></td>
</tr>
<tr>
<td>12 FM SIL</td>
<td>Control 2D</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Control 3A1</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Control 3A3</td>
<td></td>
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<td></td>
<td>Control 4A1</td>
<td></td>
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<td></td>
<td>Control 4A7</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Control 5A</td>
<td></td>
</tr>
<tr>
<td>15 Procurement Complaints</td>
<td>Control 2B</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Control 2C2</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Control 2D2</td>
<td></td>
</tr>
<tr>
<td>14 Procurement SIL</td>
<td>Control 74</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Control 8A</td>
<td></td>
</tr>
<tr>
<td>17 Loan Management SIL</td>
<td>Control 4A1</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Control 4A9</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Control 4A10</td>
<td></td>
</tr>
<tr>
<td>19 LM Application Review</td>
<td>Control 5A2</td>
<td></td>
</tr>
<tr>
<td>24 LM Suspensions</td>
<td>Control 1A</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Control IB</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Control 2B</td>
<td></td>
</tr>
<tr>
<td>25 LM Loan Closing</td>
<td>Control IA</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Control IB</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Control 2B</td>
<td></td>
</tr>
</tbody>
</table>

Source: IEG calculations from management’s test results
Table SA.10. Analysis of the Incidence of Noncompliance by Projects and by Control Steps

**Summary of Controls with Three or More NonCompliant Control Steps “Vertical Cut”**

<table>
<thead>
<tr>
<th>Number of Modules</th>
<th>Number of Controls Steps</th>
<th>Incidence of Noncompliance</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>28</td>
<td>3</td>
</tr>
<tr>
<td></td>
<td></td>
<td>4</td>
</tr>
<tr>
<td></td>
<td></td>
<td>5 or &gt;</td>
</tr>
</tbody>
</table>

Number of Noncompliances: 117
Percent of Total Noncompliances: 48

**Summary of Sample Projects with Three or More Noncompliances “Horizontal Cut”**

<table>
<thead>
<tr>
<th>No. of Modules</th>
<th>No. of Projects</th>
<th>Number of Noncompliant Control Steps</th>
</tr>
</thead>
<tbody>
<tr>
<td>12</td>
<td>34</td>
<td>3</td>
</tr>
<tr>
<td></td>
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<td>4</td>
</tr>
<tr>
<td></td>
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<td>5 or &gt;</td>
</tr>
</tbody>
</table>

Number of Noncompliances: 132
Percent of Total Noncompliances: 54

Source: IEG calculations from Management test results

Table SA.11. Links Identified by Management between Key Controls and the Five COSO Components, shown by Business Function

<table>
<thead>
<tr>
<th>Module Function</th>
<th>No. BPMs</th>
<th>Control Environment</th>
<th>Risk Assessment</th>
<th>Control Activities</th>
<th>Monitoring &amp; Learning</th>
<th>Information &amp; Communication</th>
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</thead>
<tbody>
<tr>
<td><strong>Programming and Lending Products</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internal Programming &amp; Allocation</td>
<td>4</td>
<td>1</td>
<td>7</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Lending Products</td>
<td>4</td>
<td>6</td>
<td>15</td>
<td>2</td>
<td>1</td>
<td></td>
</tr>
<tr>
<td><strong>Fiduciary Services Related to Lending</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial Management</td>
<td>2</td>
<td>13</td>
<td>2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loan Administration</td>
<td>10</td>
<td>32</td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Legal</td>
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<td>22</td>
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<td>19</td>
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<td></td>
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<td>Safeguards</td>
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<td>3</td>
<td>3</td>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Quality Assurance</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>QAG Processes</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DISTRIBUTION OF COSO LINKS</td>
<td>29</td>
<td>11</td>
<td>118</td>
<td>7</td>
<td>1</td>
<td></td>
</tr>
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</table>

Source: IEG calculations from Management test results
### Table SA.12. Distribution of BPMs According to Strategic Relevance and Risk Ranking

<table>
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<tr>
<th>Risk Categories*</th>
<th>Number Distribution</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>14</td>
</tr>
<tr>
<td>2</td>
<td>8</td>
</tr>
<tr>
<td>3</td>
<td>7</td>
</tr>
</tbody>
</table>

- IDA, FRM, & Post-Conflict Allocation
- CAS Products
- SIL—Project Cycle
- DPL—Project Cycle
- Contractual Remedies
- SIL—Legal Regime
- DPL—Legal Regime
- FM—SIL
- FM—DPL
- SIL—Procurement
- Procurement Complaints
- Safeguards—SIL
- Corporate Review (ROC/OC)
- Procurement Noncompliance
- Loan Management—SIL
- Loan Management—DPL
- LOA—Application Review
- LOA—Suspensions
- QAG—QAE and QSA
- Safeguards—OPCQC
- Project Changes
- LOA—Special Commitment
- LOA—Amendment or Extension
- LOA—Refund Process
- LOA—Cancellation Process
- LOA—Closings (Standard & Special)

#### Average Quality Rating for Business Process Mapping

<table>
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<tr>
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<th>1</th>
<th>2</th>
<th>3</th>
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<tbody>
<tr>
<td>Average</td>
<td>2.25</td>
<td>2.50</td>
<td>2.50</td>
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</tbody>
</table>

#### Average Quality Rating for Testing Methods and Results

*STRATEGIC RELEVANCE AND RISK RANKING

1 = Highly relevant, critical; heavy weight in management; major risks; high frequency of occurrence

2 = Relevant, but not critical; average weight in management; some risk; average frequency

3 = Relevant but not critical; moderate weight; moderate or minor risk; infrequent
International Development Association

Management Report on Its Review of Internal Controls

Part IB

Prepared by:
Operations Policy and Country Services Vice Presidency
Controllers, Strategy and Resource Management Vice Presidency
May 29, 2007
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## ACRONYMS

<table>
<thead>
<tr>
<th>Acronym</th>
<th>Full Form</th>
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<tr>
<td>AAA</td>
<td>Analytical and Advisory Activities</td>
</tr>
<tr>
<td>ACTKD</td>
<td>Accounting Department – Knowledge Dissemination Unit</td>
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<tr>
<td>ACTRC</td>
<td>Accounting Department – Operational Risk and Controls Unit</td>
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<tr>
<td>APL</td>
<td>Adaptable Program Loan</td>
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<tr>
<td>BPs</td>
<td>Bank Procedures – a component of the Bank’s Operational Manual</td>
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<td>CAS</td>
<td>Country Assistance Strategy</td>
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<td>COSO</td>
<td>Committee of Sponsoring Organizations – issued an internal control framework</td>
</tr>
<tr>
<td>CPIA</td>
<td>Country Policy and Institutional Assessment</td>
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<td>CSR</td>
<td>Controllers, Strategy and Resource Management Vice Presidency</td>
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<tr>
<td>DEC</td>
<td>Development Economics Vice Presidency</td>
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<td>DPL</td>
<td>Development Policy Loan</td>
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<td>Emergency Recovery Loan</td>
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<tr>
<td>FIL</td>
<td>Financial Intermediary Loan</td>
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<tr>
<td>FRM</td>
<td>Resource Mobilization Department</td>
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<td>GCC</td>
<td>General Computer Controls</td>
</tr>
<tr>
<td>IAD</td>
<td>Internal Auditing Department</td>
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<td>ICFR</td>
<td>Internal Control over Financial Reporting</td>
</tr>
<tr>
<td>IEG</td>
<td>Independent Evaluation Group</td>
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<tr>
<td>IL</td>
<td>Investment Lending operations</td>
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<tr>
<td>IRIS</td>
<td>One of the document retention systems used by the Bank</td>
</tr>
<tr>
<td>ISG</td>
<td>Information Solutions Group</td>
</tr>
<tr>
<td>ISR</td>
<td>Implementation Status and Results report</td>
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<tr>
<td>IT</td>
<td>Information Technology</td>
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<td>LAS</td>
<td>Loan Administration System</td>
</tr>
<tr>
<td>LIL</td>
<td>Learning and Innovation Loan</td>
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<tr>
<td>LOA</td>
<td>Loan Department</td>
</tr>
<tr>
<td>OPCIL</td>
<td>OPCS – Investment Lending Unit</td>
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<tr>
<td>OPCS</td>
<td>Operational Policy and Country Services Vice Presidency</td>
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<tr>
<td>OPCQC</td>
<td>OPCS - Quality Assurance and Compliance Unit</td>
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<td>OPs</td>
<td>Operational Policies – a component of the Bank’s Operational Manual</td>
</tr>
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<td>PAD</td>
<td>Project Appraisal Document</td>
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<td>PCPI</td>
<td>Post Conflict Performance Indicators</td>
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<tr>
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<td>QAG</td>
<td>Quality Assurance Group</td>
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<td>QSA</td>
<td>Quality at Supervision Assessment</td>
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<td>Specific Investment Loan</td>
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<td>Sector Investment and Maintenance Loan</td>
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<tr>
<td>SWAp</td>
<td>Sector Wide Approach lending operation</td>
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<tr>
<td>TA</td>
<td>Technical Assistance operation</td>
</tr>
<tr>
<td>TTL</td>
<td>Task Team Leader</td>
</tr>
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I. EXECUTIVE SUMMARY

1. As reflected in the IDA 14 Replenishment Report\(^1\) Management committed to carry out, during the period of IDA 14, an independent comprehensive assessment of its control framework including internal controls over IDA operations and compliance with its charter and policies, and making such assessment available to the public after its disclosure has been approved by IDA’s Executive Directors.

2. In October 2006, Management completed the report on its review and findings relating to Part IA, which examined and identified internal controls that apply to IDA operations at the transaction level and assessed their design effectiveness. The report containing Management’s assessment of the design effectiveness of these controls was included as an Annex to the Independent Evaluation Group’s (IEG) Report, Review of IDA Internal Controls – An Evaluation of Management’s Assessment and the IAD Review, October 18, 2006, AC2006-0099 (the “October 2006 IEG Report”), discussed with the Audit Committee on October 30, 2006.

3. Building on the results and findings of Part IA, during Part IB Management has tested the compliance with 29 business processes and 115\(^2\) controls in a sample of documents related to Country Assistance Strategies (CAS), Investment Lending operations (IL) and Development Policy Lending operations (DPL) that were processed through various points in the project cycle during the period under review, i.e. July 1, 2005 to February 28, 2006. As explained in Annex 2, the sampling and testing methodology used by Management did not expand the testing sample – either to see if the frequency of an identified deficiency can be reduced by expansion of a sample size or to verify that effectiveness of a given control in a small sample can be confirmed through a larger sample. The following table summarizes the testing results of the key controls:

<table>
<thead>
<tr>
<th>Activity</th>
<th>Total</th>
<th>Passed</th>
<th>Failed</th>
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<tbody>
<tr>
<td>Fiduciary</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>Financial Management</td>
<td>6</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>Procurement</td>
<td>10</td>
<td>7</td>
<td>3</td>
</tr>
<tr>
<td>Disbursements</td>
<td>13</td>
<td>12</td>
<td>1</td>
</tr>
<tr>
<td>Sub-total</td>
<td>29</td>
<td>23</td>
<td>6</td>
</tr>
<tr>
<td>Non-fiduciary</td>
<td>86</td>
<td>82</td>
<td>4</td>
</tr>
<tr>
<td><strong>Total Controls tested in Part IB</strong></td>
<td><strong>115</strong></td>
<td><strong>105</strong></td>
<td><strong>10</strong></td>
</tr>
</tbody>
</table>

---

1 See, Report from the Executive Directors of the International Development Association to the Board of Governors, Additions to IDA Resources: Fourteenth Replenishment, Working Together to Achieve the Millennium Development Goals, (approved by the Executive Directors of IDA on March 10, 2005), paragraph 39, under the Disclosure bullet.

2 As reflected in Table 2 of the report, during the performance of the testing steps, Management was not able to test 7 of the 122 controls identified as key during Part IA, thus testing only 115 of the 122 such controls. Three of these key controls were duplicated in other modules, two key controls were deemed to have design issues that precluded testing and two key controls had attributes of a conditional nature which did not occur in the sample selected.

3 Financial management and disbursement controls include fiduciary controls for investment and development policy lending operations.

4 The financial management and procurement controls that management deemed to have failed relate to investment lending operations only.
4 The impact of the deficiencies and exceptions identified by Management in Part IB is described in detail in paragraphs 25 and 26 of this report. During Part II of this exercise, Management will conduct a “drill down” into the causes and impacts of these exceptions and deficiencies so as to permit an accurate assessment of the operating effectiveness of the key controls where such exceptions and deficiencies were identified and recommend appropriate remedial action.

5. With the completion of Parts IA and IB of Management’s review, Management is of the view that the design and operational effectiveness of identified processes and associated key controls are adequate to ensure compliance with IDA’s polices and procedures that funds are used for the purposes intended, except for:

(i) **the following significant deficiencies (described in more detail in paragraph 25 and defined in Annex 3)**
   
   - Timely accessibility of relevant documents
   - Relevance of regional variances in financial management and procurement guidelines
   - Not keeping pace with needed updates to OPs and BPs, particularly in the area of investment lending; and

(ii) the need to further review the fiduciary controls in the areas of financial management, procurement and safeguards of investment operations by examining the quality aspects supporting the specialists’ inputs.

6. Finally, the testing and evaluation performed under Part IB was aimed at resolving, where possible, the issues and potential deficiencies identified during Part IA by the Internal Auditing Department’s (IAD) review of Management’s Part IA activities, and IEG’s evaluation of Management’s work, as reflected in the October 2006 IEG Report. Management resolved many of these issues. Please refer to the report for further discussion and details.
II. INTRODUCTION AND BACKGROUND

7. In October 2006, Management completed the report on its review and findings relating to Part IA, which examined and identified internal controls that apply to IDA operations at the transaction level and assessed their design effectiveness. The report containing Management’s assessment of the design effectiveness of these controls, was included as an Annex to the October 2006 IEG Report, discussed with the Audit Committee on October 30, 2006. As set out in the said report, Management has carried out this work by: (a) identifying (i) the key instruments through which IDA carries out its operations (namely, CAS, IL and DPL), and (ii) the policies that govern each such instrument; and (b) mapping business processes and associated controls put in place to operationalize such policies and procedures.

8. Management’s assessment was based on its review of documentation and information relating to the said policies, procedures and related processes, supplemented by extensive consultations with the “sponsors” of the policies, procedures, and processes identified. In addition, to confirm the accuracy of the mapped processes and associated controls, verify how they operate in practice, and help assess the design effectiveness of key controls within these processes, Management conducted extensive walkthroughs with owners/implementers of each such process, that included detailed questions and requests for additional information and clarifications to verify the accuracy and design effectiveness of each such process and associated controls. Building on this work and findings, during Part IB Management assessed the operating effectiveness of the processes and associated controls identified and verified during Part IA. This was done by testing the level of compliance with the said processes and associated controls using a mixture of random and targeted (for steps that did not occur frequently) samples of transactional documents relating to the three main instruments (CAS, IL and DPL) which were subject to the said processes and controls during the period under review, July 1, 2005, to February 28, 2006.

9. This report sets out Management’s assessment relating to operating effectiveness of the transaction-level key controls identified in Part IA as controls designed to ensure compliance with the relevant Articles’ provisions and policies governing IDA’s operations. Specifically, the objectives of the compliance testing work performed by Management during Part IB were to: (i) assess the operating effectiveness of the key controls identified during Part IA by testing the level of actual compliance with these controls and their attributes (control steps) as evidenced by relevant transaction-level and other documents provided by the regions and other relevant departments; (ii) resolve issues and potential deficiencies identified by Management’s activities during Part IA, IAD’s review of these activities, and IEG’s evaluation of Management’s work; and (iii) complete the documentation, walkthroughs and testing for three additional processes, namely, Debt Reporting, Country Policy & Institutional Assessment, and Post-Conflict Performance Indicators. Management’s findings relating to each of these three objectives are set out in Part IV of this Report.
10. It is Management’s understanding that any opinion delivered by IAD and IEG following Part IB may be subject to the outcome of the efficiency and effectiveness assessment that would be conducted in Part II.
III. METHODOLOGY

11. Management is conducting the assessment of IDA’s internal controls in the context of the COSO\(^5\) internal control framework. IDA adopted the COSO framework as its controls methodology in 1995. This framework is widely used by leading financial institutions in the United States and is also seen as a model in many other parts of the world. The COSO framework is an all encompassing process which covers all aspects of internal control of an organization’s operation. It considers not only the evaluation of formal controls, but also informal controls, such as ethics, trust, communication, organization behavior and leadership, and incorporates “top-down” as well as “bottom-up” analysis. Based on the COSO framework, as well as the structure for the annual review of the Internal Controls over Financial Reporting (ICFR) Management assesses the organization’s internal controls, and an independent third party verifies such assessment.

12. As a result of the nature of the commitment made under IDA 14, namely to review compliance with applicable charter provisions and policies in place, Management focused Part I of its assessment on transaction-level controls in order to bring out the crucial details of operational compliance. As noted by IAD and IEG in their respective reports on Part IA, an alternative and a more conventional approach would have been to commence this work with entity-level, rather than transaction-level, controls. Management believes, however, that focusing on transaction-level controls first was called for by the very formulation of the IDA 14 commitment which very much focused on operational or transaction-level compliance. This approach has allowed for a systematic, detailed, and manageable analysis of the transaction-level controls that apply to IDA operations and has facilitated the development of specific and actionable findings that affect the core of IDA’s operations. As explained in paragraph 9 above, as part of this exercise, Management verified the content and design of individual processes and controls mapped by walkthroughs with owners/implementers of each such process. In this regard it is important to note that the financial reporting model, where walkthroughs are usually applied to a transaction sequence from beginning-to-end, required modifications to reflect the substantively and qualitatively different business model that applies to IDA’s operations. Specifically, given that the duration of the “project cycle” (from concept to completion) for the primary instruments tested (CAS, IL, and DPL) lasts between 3-7 years, and the diversity and the wide range of owners/implementers involved in each stage and different aspects of the project cycle, the financial reporting-type “beginning-to-end” walkthroughs was not feasible during the review period.

13. Building on the results and findings of Part IA, which identified 30 business processes (plus 2 sub-processes of Financial Resource Management (FRM) included under Module # 1 – IDA Allocation) and 122 controls and approximately 550 related specific controls attributes that evidence and/or bear upon compliance with the said controls that apply to the three instruments and associated products through which IDA carries out its

\(^5\) COSO stands for the Committee of Sponsoring Organizations of the Treadway Commission, which published a report in 1992 titled “Internal Controls – Integrated Framework.”
operations. During Part IB Management tested the compliance with 29% of these 30 business processes and 115 controls in a sample of documents related to CAS, ILs and DPLs that were processed through various points in the project cycle under the mapped processes during the period under review, i.e. July 1, 2005 to February 28, 2006. Table 2 below reconciles the number of controls and attributes identified in Part IA and those tested in Part IB. For a detailed listing of control and attribute counts by process module please see Annex 1, Attachment 2.

Table 2 – Reconciliation of Controls and Attributes

<table>
<thead>
<tr>
<th>Controls</th>
<th>Attributes</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Identified in Part IA and through additional documentation performed in Part IB</strong></td>
<td>122</td>
</tr>
<tr>
<td>Less items not included in testing:</td>
<td></td>
</tr>
<tr>
<td>Duplicate controls/attributes performed in two or more modules</td>
<td>(3)</td>
</tr>
<tr>
<td>Controls/attributes not tested due to design issues</td>
<td>(2)</td>
</tr>
<tr>
<td><strong>Controls/attributes included in testing</strong></td>
<td>117</td>
</tr>
<tr>
<td>Controls not tested due to attributes not occurring in sample</td>
<td>(2)</td>
</tr>
<tr>
<td>Attributes, embedded in tested controls, not tested due to the attributes not occurring in sample</td>
<td>–</td>
</tr>
<tr>
<td><strong>Controls tested in Part IB</strong></td>
<td>115</td>
</tr>
</tbody>
</table>

14. As noted in paragraph 12 and given the duration of the project cycle that applies to each instrument (particularly ILs which take an average of 7 years from identification to completion), it was not possible to test compliance of a single operation or product such as a CAS, IL or DPL, with each of the processes identified. Instead, compliance with individual processes and associated controls that apply to a particular stage or stages of a project cycle was tested against a sample of operations or products that were identified to have gone through the stage or stages in question during the period under review. As such, the compliance testing performed during Part IB was intended to assess the operating effectiveness of specific controls identified as key to each process. It was not designed or implemented to assess compliance of a given single operation or product with all the applicable controls throughout the “project cycle”.

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6 Process # 29 Safeguards – Corporate Risk (QACU) was deemed to be deficient during Part IA and was therefore not testable during Part IB. Management has identified this for further follow-up during Part II.
15. Recognizing that the key controls embedded in the processes identified represent the end-result of a series of events or “attributes” that bear on the operation of each such control, Management’s compliance testing focused not just on the operation of the key controls but also on evidence of compliance with the specific control attributes. As part of its methodology Management defined a “specific control attribute” as a specific step necessary to achieve the objectives of the key control. While recognizing that some attributes are more critical than others, but having no precedent to guide this assessment, Management elected to subject all identified control attributes to the testing methodology, in order to better substantiate its conclusions. Management’s methodology is set out in more detail in Annex 1.

16. During Part IB Management also evaluated issues that remained unresolved at the conclusion of the testing for Part IA, including: (i) determination of significance and material impact of any of the issues (actual or potential) identified during Part IA by Management, IAD and/or IEG on IDA’s internal controls; and (ii) identification of appropriate remedial actions, if any, to mitigate related risks in order to fully assess their impact. As explained in the findings section of this report, with respect to some of the issues identified during Part IB, the ultimate conclusion on the operating effectiveness of certain key controls (e.g., in the areas of financial management and procurement reviews) requires additional work to "drill down" into the qualitative aspects associated with these processes. These aspects consist of review of the action plans and recommendations arising from financial management and procurement reviews and their subsequent implementation and resolution by the task team leader or borrower as appropriate. This additional evaluation will be conducted together with the issues accumulated relating to efficiency and effectiveness during the last stage of this evaluation, namely the Efficiency and Effectiveness Assessment under Part II.

IV. SUMMARY RESULTS OF MANAGEMENT’S ASSESSMENT

17. With the conclusion of Parts IA and IB of Management’s review, Management is of the view that the design and operational effectiveness of identified processes and associated key controls are adequate to ensure compliance with IDA’s policies and procedures that funds are used for the purposes intended, except for:

- the following significant deficiencies (described in more detail in paragraph 25)
  - Timely accessibility of relevant documents
  - Relevance of regional variances in financial and procurement guidelines
  - Not keeping pace with needed updates to Operational Policies (Ops) and Bank Procedures (BPs), particularly in the area of investment lending; and

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7 As explained in Annex 2, the sampling and testing methodology used by Management did not expand the testing sample – either to see if the frequency of an identified deficiency can be reduced by expansion of a sample size or to verify that effectiveness of a given control in a small sample can be confirmed through a larger sample.
(ii) the need to further review the fiduciary controls in the areas of financial
management, procurement and safeguards of investment operations by
examining the quality aspects supporting the specialists’ inputs.

18. The efficiency and effectiveness of the current policy and procedural framework will
be carefully and strategically reviewed during Part II of this review. The examination of
the quality aspects supporting the specialists’ inputs (identified in paragraph 17(ii) above)
during Part II will not review the specialists’ conclusions/ratings but rather will focus on
whether the required monitoring, follow-up, implementation and resolution of identified
issues were carried out. In addition, Management will review whether documentation
exists to support the specialists’ conclusion. Also, Management will document and review
the controls of the current Quality of Supervision Assessment (QSA-7) being undertaken by
the Quality Assurance Group (QAG) during Part II. Management expects that the results of
the overall review including the specific work on effectiveness and efficiencies during Part
II, will provide tangible support for a strategic approach to the needed rationalization of the
policy and procedural framework that governs IDA’s operations.

V. MANAGEMENT’S FINDINGS AND RECOMMENDATIONS

A. Operating Effectiveness of Key Controls

19. Management’s compliance testing under Part IB was undertaken to enable
Management to assess the operating effectiveness of the internal controls associated with
IDA’s operations at the transaction level, where daily decisions are made which have a
direct impact on the use of IDA resources. As identified by Management in Table 2 above,
during the performance of the testing steps, Management did not test 7 controls identified
as key during Part IA: three of these key controls were duplicated in other modules; two
key controls were deemed to have design issues that precluded testing; and two key
controls had attributes of a conditional nature which did not occur in the sample selected.
Please see Annex 1 for a specific example and a listing of the modules that these 7 controls
related to. Management therefore tested compliance of 115 key controls identified and it
believes that not testing the 4 non-duplicated controls does not impact its conclusion.
In addition, due to the sampling methodology applied by Management and the desire to test
the same project sample for as many of the control attributes as possible, Management was
only able to test 466 of the specific control attributes as 74 attributes did not occur in the
samples selected due to a control step, whether conditional or not, not having the
preconditions required for the specific test attribute to occur, please see Annex 1 for a
specific example and Annex 1, Attachment 1 for details by module.

20. The control attributes typically represent the inputs and outputs generated each time
a key control is performed. For example, in the Loan Department (LOA) IL process, key
control 1 has been defined as the LOA Finance Officer clearing the Negotiations Package
(prior to negotiations). The Negotiations Package includes the following documents (which
Management has treated as individual attributes): (i) draft Project Appraisal Document
ATTACHMENT 1

21. Based on data made available by the regions and other relevant departments responsible for implementation of specific processes (e.g., Development Economics (DEC), Resource Mobilization Department (FRM)) Management was able to locate and review about 93% of all the documents required to test compliance with the relevant processes and associated controls identified during Part IA. The thousands of pages of documentation were organized by the Project Management Team into 63 binders. These binders contain the evidence supporting the test results for the specific control attributes and key controls associated with each process tested. These binders, and Management’s analysis and testing of the documentary evidence, were shared with IAD and IEG. This extensive and rigorous process for accumulating, collating and reviewing these documents and testing for the control attributes, while extremely time and labor intensive, was a very valuable undertaking that has already provided important empirical evidence for the needed rationalization and streamlining of the current processes and associated controls especially in the area of investment lending.

22. The results of compliance testing using these documents and applying the methodology described in Annex 1 indicate that the vast majority of attributes operated effectively and that no exceptions were noted in approximately 93% of the tests performed. However, as noted earlier, the compliance testing performed during Part IB was intended to assess the operating effectiveness of specific individual controls identified as key to each process. It was not designed or implemented to assess compliance of a single given operation or product with all the applicable controls throughout the “project cycle.” Therefore, stating that 93% of the tests passed does not mean that 93% of the projects, processes and products are fully compliant with all policies and procedures that govern such project or product. Instead, Management believes that the compliance testing produced evidence that the vast majority of the specific controls identified are being complied with and are operating as designed.

23. The results have shown, however, several deficiencies or exceptions with respect to operation of specific controls, particularly in the areas of document accessibility, financial management, procurement, safeguards and loan administration. Of the 115 tested key controls mentioned above, Management found 10 (or approximately 9%) of these key controls failed to mitigate the risks associated with the specific control. Management considers that 29 of the 115 key controls are fiduciary controls that ensure funds are used for the purposes intended. Of the 10 failed controls, 6 are fiduciary controls (approximately 21% of fiduciary controls were deemed to have failed by Management). The breakdown of the 29 fiduciary controls (and failures in parenthesis) are in the following activities: Financial management – 6 controls (2 failures); Procurement – 10 controls (3 failures); and Loan disbursement processes – 13 controls (1 failure). The impact of these failures has been recognized as a significant deficiency and discussed in paragraph 25B below and included
in Management’s deficiency tracker provided to IAD and IEG. For details of the key control failures see *Annex 1, Attachment 2 – Control Failures by Process Module*. Additional, non-fiduciary deficiencies and exceptions are described in more detail in paragraphs 25 and 26 below. During Part II of this exercise, Management will conduct a “drill down” into the causes and impacts of these exceptions and deficiencies so as to permit an accurate assessment of the operating effectiveness of the key controls where such exceptions and deficiencies were identified and recommend appropriate remedial action.

24. Based on these results, and subject to exceptions and deficiencies noted in paragraphs 25 and 26 compliance testing carried out during Part IB provides substantive evidence that:

- The performance-based allocation model is being implemented in a manner that directs scarce IDA resources in support of priority development activities in the poorest eligible member countries.

- The complementary use of the three primary instruments for carrying out IDA operations (i.e., CAS, IL and DPL), and evidence relating to the application of the processes and controls that apply to them (from identification to completion), confirm that:
  - IDA financing is being provided in support of developmental priorities and is focused on matters that appropriately fall within IDA’s mandate; and
  - consistent with the provisions of IDA’s Articles of Agreement, IDA financing is made available for specific projects as well as other “special circumstances” operations, where appropriate.

- The documentation relating to the implementation of both the umbrella and specific (e.g., fiduciary, contractual, safeguards) processes and associated controls that apply to CAS, IL and DPL through all stages of the “project cycle” (from identification to completion) evidenced compliance with the key IDA policies and procedures adopted to ensure that IDA funds are used for the purposes intended.

- The documentation relating to implementation of specific processes and associated controls applicable to procurement evidenced compliance with IDA’s procurement policies, as reflected in OP/BP 11.00 and *Guidelines: Procurement under IBRD Loans and IDA Credits* and *Guidelines: Selection and Employment of Consultants by World Bank Borrowers* and meet the objective of using IDA resources to finance goods, works and services that were procured with due regard for economy and efficiency, except for some deficiencies and exceptions noted in paragraph 25B.

B. Deficiencies Identified During Part IB

25. As a result of Management’s Part IA review certain issues were identified and included in Management’s report. The compliance testing during Part IB shed more light on the issues identified during Part IA and also identified other issues which merit either correction and/or a further drill down during Part II to identify causes and impacts and
recommend appropriate remedial actions. The following significant deficiencies have been identified by Management at the completion of Part I, and include issues already raised in its Part IA report. For a definition of a deficiency, significant deficiency, or material weakness please see Annex 3.

A. Timely accessibility of relevant documents. While after an extensive effort Management was able to obtain approximately 93% of the documentation required to support the processes and controls identified under Part IA, these documents were not easily accessible and Management therefore had difficulties in obtaining such documents in a timely manner. A careful look into the causes of delays with the availability of documents during Part IB identified an issue with respect to consistency of workflow authorization, and accessibility of documents relating to IDA’s operations, both of which merit serious examination and improvement. Given that 93% of the documents requested were ultimately produced, Management believes that the issue is one of documents accessibility, rather than existence or retention. While this indeed constitutes a deficiency that needs to be addressed through a time-bound plan of actions, it does not rise to the level of a material weakness in the internal controls system. Management has already commenced addressing this issue by setting up an expert panel to look at workflow authorization, retention, filing and accessibility of operational documents and come up with recommendations for improvements. These recommendations are expected to be issued by June 30, 2007. The panel is composed of representatives of all the regions, the Information Solutions Group (ISG), Controllers, Strategy and Resource Management (CSR) and Operations Policy and Country Services (OPCS). The panel’s recommendations will be vetted with Senior Management and piloted in one or two key processes before they are mainstreamed to cover all operations. To achieve maximum efficiency and effectiveness, the new workflow authorization and system-based new document retention requirements should be mainstreamed only after the main processes that apply to IDA operations have been rationalized and streamlined following the conclusion and recommendations of Part II of this assessment.

B. Variances in regional implementation of institutionally endorsed financial management and procurement guidelines. Management identified that financial management and procurement review processes were not always being performed in accordance with the most recent guidance issued by the appropriate sector board. Specifically, guidelines relating to financial management assessments and supervision reviews and procurement reviews need to be reviewed to ascertain whether these variances are appropriate.

To address these issues, the relevant sector boards will:

(i) review the documentation requirements necessary to provide evidence of appropriate senior level reviews and clearances, and request the regions to follow the documentation requirements on a consistent basis;

(ii) perform a periodic qualitative review of the various supervision processes and output reports to ensure quality of the fiduciary
work is consistent across IDA’s portfolio and adequate supporting documentation exists for decisions taken during supervision. In particular, the procedures for documenting and communicating the financial management and procurement specialists’ recommended ratings in the Implementation Status and Results (ISR) report should be harmonized across the regions and subject to periodic quality reviews; and

(iii) enhance documentation processes of procurement complaints to strengthen effectiveness, and review the centralized complaints database to ensure consistency across the regions in responding in a timely manner to complaints and logging of resolutions.

C. Not keeping pace with the needed updates to OPs/BPs, particularly in the area of investment lending. Management has also identified that various OPs/BPs are not keeping pace with the changes needed and/or introduced on the ground. Management, IAD and IEG have flagged this issue in their findings during Part IA and IEG stated that this may be a potential material weakness. As part of Management’s assessment of the effectiveness and efficiency of IDA’s internal control framework, Management intends to look at the current processes underlying policy revision to determine how the policy revision process could be made more efficient so as to facilitate more timely updates of operational policies and Bank procedures. Recommendations for improvement are expected to be issued by December 31, 2007. From the work performed during Part I, Management believes that due to compensatory measures adopted to “fill in” the gaps in the current OPs/BPs, including issuance of Operational Memoranda and interim guidance to staff in areas where gaps have been identified, this does not constitute a material weakness. However, this is only a preliminary conclusion since Management’s ability to fully assess the significance or materiality of the impact of this issue on IDA’s internal control framework will require additional consideration and review during the entity-level review and other activities to be performed during Part II. As part of Management’s review of the OP/BP update process, a table (see Annex 4) has been prepared listing all OPs/BPs that have a direct bearing on IDA’s operations and included in this review, with a summary of update status for each.

26. In addition to the significant deficiencies described above, as part of the detailed review of key controls, process flows (i.e., “walkthroughs”) and compliance testing performed with respect to the individual business processes, Management has identified a number of exceptions and deficiencies in certain areas that merit a closer investigation to assess causes and impact and identify appropriate remedial actions. These include:

A. Streamlining of Investment Lending operations. Management’s assessment identified that existing processes and documentary requirements are inefficient and onerous. For example, the compliance tests performed on the modules documenting the pre-supervision activities of SILs (including Legal, financial management, procurement, safeguards and Loan Department activities) – from project concept through Board approval – comprise approximately 20 controls with 95 control attributes. There is a great need to rationalize and streamline the
existing processes and controls so at to make them more effective and efficient in addressing the key risks. During Part II, Management will look at this issue in a more comprehensive fashion with a view of proposing specific recommendations for such rationalization and streamlining.

B. Frequency of corporate reviews of Investment Lending products. The assessment also identified a disparity in the frequency of corporate reviews of IL and DPL operations, with all DPLs being subject to such review but relatively few ILs. To address this issue, on March 25, 2007, OPCS issued a new Guidance Note on Management Review of Investment Operations, intended to put in place appropriate measures to ensure that the level of management review that applies (including criteria for corporate review) is aligned with the level of risks involved in specific investment operations.

C. Credit information update and Loan Department clearance processes. Results of Management’s testing identified weaknesses in the LOA’s processes in updating the loan administration system (LAS) on a timely basis and documenting clearances provided. Processes requiring attention include ensuring that:

(i) credit master data is created at the time of credit set-up in the LAS, and that the information is consistent with the financing agreement and disbursement letter, especially in the set-up of thresholds for prior review and statement of expenditures. All relevant LOA staff will be reminded to complete all the set-up steps in LAS; and

(ii) (a) controls surrounding the LOA Finance Officers’ approvals of notices related to suspensions were not able to be tested as the approvals were not available. Finance Officers will be reminded to file approvals in IRIS. In addition, operations sector Directors will be asked to remind task team leaders (TTLs) that all draft suspension notices should be sent to LOA clearance; the final suspension notice should be sent to LOA for action, and

(b) historical audit trails relating to imposing and lifting of suspensions for reasons other than credit repayment by the Borrower (e.g. non-payment related) is not readily available in LAS due to system limitations. The Controller will ask the team responsible for implementing the LAS replacement to include this feature in the new system. This new system (iLAP) is expected to become operational in the third quarter of FY08.

CSR management will perform periodic testing of these key controls to ensure they are operating as designed.

D. Providing clearances from reviewers. During Management’s walkthrough and testing processes, many instances were identified of required clearances being provided by reviewers to the TTL with conditional or “subject to” comments. Some of the reviewers follow up on whether their comments were taken into consideration, while others stated that it was the responsibility of the TTL to ensure these comments were incorporated in their final document. To address this inconsistency Management will review the need for clearer guidance on the
division of responsibilities between reviewers and the TTL in ensuring that all relevant comments are reflected in the final documents and/or relevant actions.

E. Procedures related to the Safeguards Corporate Risk List. During Management’s walkthrough process the quality assurance and compliance unit responsible for review of safeguards (OPCQC) stated that the screening process for possible inclusion of projects onto the safeguards corporate risk list is based on close consultations between OPCQC and regional staff to determine potential risks and appropriate measures to address them, including potential inclusion on the corporate safeguards risk list. These consultations take place in different ways and on different cycles, depending on the project management system used in each region. Since this was originally designed as a management advisory system rather than as a specific control mechanism, the results of the screening and the subsequent decision to include or remove projects from the list are not recorded in a standardized manner. As a result, management was unable to perform compliance testing on Module # 29 Safeguards – Corporate Risk List during Part IB. Following the findings of Part IA, Management has taken steps to standardize the approach used by OPCQC and the regions in screening and tracking projects on the safeguards corporate risk list and has provided guidance to the regions on this matter. During Part II, Management will revise documentation for module 29 to reflect the new guidance and assess whether sufficient data has been accumulated in order to test its application.

F. Debt Reporting Process. Pursuant to OP/BP 14.10, IDA borrowing countries are required to provide IDA with quarterly and annual reports on their external debt. Management’s review verified compliance with the annual reporting requirement, but identified lack of compliance and IDA follow-up relating to quarterly reports. While Management believes that control objectives related to Debt Reporting were achieved despite the issue with quarterly reports, management will review OP/BP 14.10 with the view to eliminate the current divergence between the OP/BP requirements and the process as it is performed in practice.

During Part IB testing Management did not review the process relating to the broader debt sustainability analyses required under IDA 14, including the grant allocation framework based on the level of debt distress. Since these new processes were adopted in July 2006 they fell outside the testing period under review (July 1, 2005 – February, 28, 2006). During Part II Management will document the Process put in place since July 2006 and will test its operating effectiveness provided the process has been applied.

27. In addition to the above, as part of the compliance phase of Part I, Management identified minor issues/exceptions/deficiencies in the processes reviewed and has developed corrective actions to address them. These have been shared with IAD and IEG. Management will update IAD and IEG as to the status of the identified actions at the completion of Part II and will include their status in its final report.

C. Issues Identified and Recommendations Made During Part IA
28. The second objective of the testing and evaluation performed under Part IB was aimed at resolving, where possible, the issues and potential deficiencies identified during Part IA by (i) Management as a result of its own activities, (ii) IAD’s review of these activities, and (iii) IEG’s evaluation of Management’s work, as reflected in the October 2006 IEG Report. As set out below, Management was able to resolve many of these issues.

Addressing Issues Raised by IAD

29. The following section describes the key issues identified by IAD as a result of their review of Management’s activities in Part IA together with the recommendations provided by IEG as part of their evaluation of Management’s activities and IAD’s issues from Part IA.

30. The following is a synopsis of the key issues identified by IAD and Management’s response.

Issue 1: IDA processes selected (Management’s Methodology)

Management Action: The methodology applied by management to rationalize its approach to review compliance with the fiduciary aspects of lending operations in IDA’s charter (the work performed in Parts IA and IB) has been described in paragraphs 13 to 24 of Management’s Report on its Review of IDA Internal Controls - Part IA, included as Attachment 1 to the October 2006 IEG Report. This methodology has been described in the Revised Work Plan that was shared with IEG, and IAD and discussed with the Audit Committee on July 17, 2006.

The initial focus on process and transaction-level controls under the methodology applied makes it difficult to provide an overall definitive conclusion on the effectiveness and efficiency of internal controls over IDA’s operations at this stage. However, Management believes that the staged approach to this exercise was necessary in light of the unprecedented nature of this assessment, the intensity and scope of work required, as well as its primary objective of assessing the existing controls for ensuring that IDA funds are used for the purposes intended. Given the trade-offs, in a resource constrained environment and real time-limitations on what could be done, the approach followed proved to be preferable as the findings, and related action plans adopted to address issues identified, are likely to be the major themes of the entire assessment.

Issue 2: Information Technology (IT) controls.

Management Action: Management believes that IT controls must be included in its review of IDA’s internal control framework. Management has indicated from the beginning of this review that IT controls would be reviewed during Part II. Management will identify all relevant key IT systems impacting the operations with automated compliance controls and document them accordingly. Management believes that few of its current documented processes will be impacted by such review based on the relatively low level of automation associated with most of these processes; however, should review of IT controls under Part II identify the need
where it will be necessary to re-work any of the existing documentation and compliance testing, Management will do so accordingly and report on its findings during Part II.

Management will conduct a form of review of General Computer Controls (GCC) during Part II.

**Issue 3: Fraud and corruption controls.**

*Management Action:* The view that key controls to prevent fraud and corruption should have been specifically identified and assessed by Management takes a narrow view of the control framework needed to ensure that “funds are used for the purposes intended”. Since fraud and corruption are a key cause of misuse of funds, prevention and detection of fraud and corruption have to be embedded and indeed be one of the key aspects of the control framework in place to ensure that funds are used for the purposes intended.

At the country level, systemic issues of fraud and corruption and the associated risks are addressed as part of the strategic country dialogue relating to areas of governance, public expenditures and institutional weaknesses, all of which are assessed and reflected as appropriate in the CAS. At the project level, fraud and corruption issues are addressed as part of the review and appraisal processes and are also assessed as part of the fiduciary aspects of project preparation, appraisal, and supervision activities, together with all the fiduciary controls documented as part of the assessment.

Management has identified and documented key fiduciary controls which also mitigate the risks associated with fraud and corruption (e.g. LOA’s segregation of duties in review and approval of withdrawal applications, procurement prior reviews and post reviews, country financial assessments, financial management risk ratings, etc.). In addition to work already performed during Part I, Management will use the results of the Bank’s fraud and anti-corruption controls program used for the review of the ICFR process, to support its review of the fraud and corruption controls on an IDA entity-wide basis.

**Issue 4: Outdated Operational Policies (OPs) and Bank Procedures (BPs).**

*Management Action:* This point is similar to that raised by IEG (recommendation 2). Updating and streamlining operational policies and procedures governing investment lending operations is the primary focus of the final stage of the modernization agenda which is expected to be completed within the next 18 to 24 months. As part of this process Management has prepared a table (see *Annex 4*) of all OPs/BPs that have a direct bearing on IDA’s operations and included in this review, with a summary of update status for each. This table has been shared with IAD and IEG. It is expected that the results of this evaluation, including the efficiency and effectiveness review to be carried out under Part II would form and important input into this work.
Issue 5: Categorization and remediation of deficiencies.

Management Action: Management has evaluated the magnitude of any control deficiency (either raised by IAD, IEG or management), together with findings of non-compliance during the operational effectiveness testing and shared its evaluation with IAD and IEG. The key findings are summarized paragraphs 25 and 26 of this report.

Issue 6: Document retention and accessibility.

Management Action: Management has commenced its review of the issues identified to date by setting up an expert panel to look at document retention, filing and accessibility of operational documents and develop recommendations for improvements. In light of the business units’ ability to provide full documentation during the walkthroughs performed during Part IA, and the high level of documentation obtained as part of the compliance testing in Part IB, the issue appears to be not one of compliance but rather of ensuring the appropriate documentation is easily and readily available to support the various processes and decisions reached.

Issue 7: Assessment of entity-level controls.

Management Action: The review of entity-level controls will be carried out during Part II. Management will closely consult on the scope of the activities to be included in this review with IAD and IEG by the end of May 2007. It is expected that the review of entity-level controls will include tone at the top, assignment of authority and responsibility, appropriate policies and procedures and various entity-wide programs.

Issue 8: Walkthroughs of process documentation.

Management Action: Based on discussions with IAD, Management believes that the compliance testing methodology which included testing individual credits through all the controls in a procedure have alleviated IAD’s concerns about the design effectiveness by the completion of Part IB. We do not believe this is an issue any longer.

Addressing IEG Recommendations

31. The following is a synopsis of the recommendations made by IEG and Management’s response.

Recommendation 1: Confirm the validity of the Business Process Mapping cluster.

Management Action: In order to confirm that all investment lending operations have the same key controls as Specific Investment Loan (SIL) operations, during Part IB Management included in its compliance testing sample investment loans other than SILs (4 IDA grants, 2 Sector Wide Approaches (SWAp), 2 Adaptable Program Loans (APL), 2 Technical Assistance (TA), 2 Emergency Recovery Loans (ERL) and 1 Sector
Investment and Maintenance Loans (SIML) operations were added to the test samples. These were reviewed to ensure that the processes and key controls followed for these types of instruments were consistent with those documented for SILs (excluding the special nuances of each product, where applicable). The results of this testing indicated that the majority of controls were the same for all IL products and compliance was consistent across all products. The results have been made available to IAD and IEG as part of the testing.

Management’s decision to exclude Analytical and Advisory Activities (AAA) and other Knowledge Products in Part I of this exercise was consistent with its focus and main objective of assessing the internal controls in place for ensuring how borrowers use IDA resources for the purposes intended. Management will review the AAA activities to determine if the key controls for the majority of these activities are consistent and can be easily documented and tested during Part II.

Recommendation 2: OP/BP status.

*Management Action:* This point is similar to that raised by IAD (issue 4). Updating and streamlining operational policies and procedures governing investment lending operations is the primary focus of the final stage of the modernization agenda which is expected to be completed within the next 18 to 24 months. As part of this process Management prepared a list of all OPs/BPs that have a direct bearing on IDA’s operations and included in this review, with a summary of update status for each, see *Annex 4*. This list has been shared with IAD and IEG. As stated above, it is expected that the results of this evaluation, including the efficiency and effectiveness review to be carried out under Part II would be an important input into this work.

Recommendation 3: Complete the remaining stages of the IDA Review.

*Management Action:* With the issuance of this report, Management has completed its assessment of the first part of the review of IDA’s internal controls. The testing results for 28 of the 29 modules reviewed were delivered to IAD in separate groups during the period from January 25 through February 9. The last module was delivered to IAD on March 1, 2007. IEG began receiving the modules upon completion of IAD’s review.

Management will commence Part II immediately upon issuance of this report. During this part Management will assess whether the overall control framework over IDA’s operations, including corporate governance, entity-level controls and IT controls, is effective and efficient to provide reasonable assurance to Senior Management and the Board that IDA’s operations are carried out in a manner that complies with the provisions of IDA’s charter and internal operational policies. Management will closely consult with IAD and IEG on the methodology and scope of this work by the end of May 2007 so that work can commence and be completed by end-2007.

Recommendation 4: Resolve issues and potential deficiencies with IAD.
Management Action: In completing Part IB, the potential issues identified by Management during its assessment and by IAD’s review have been evaluated to determine their impact on IDA’s internal controls and the remedial actions, if any, that may be required to mitigate risks. Management’s listing of the identified deficiencies and their resolution has been shared with IAD and IEG.

Issues of efficiency and effectiveness accumulated from Parts IA and IB will be reviewed and evaluated during Part II.

Recommendation 5: Manage the risk framework.

Management Action: During the second half of FY07 Management will review the COSO Enterprise Risk Management framework for potential strengthening and or adaptation of the Bank’s (including IDA) existing Integrated Risk Management Framework. This decision is not expected to impact Part II of the review.

Recommendation 6: Mainstream internal controls reviews.

Management Action: During the second half of FY07 Management will commence discussions with the Audit Committee to consider the value to the Board and Shareholders of adopting a process for periodic or ongoing monitoring and reporting on internal controls in addition to the review of internal control over financial reporting.

Addressing Specific Issues Identified During Part IA by Management, IAD and IEG

32. During Part IA Management, IAD and IEG identified specific issues with the documentation and design effectiveness of the identified key controls. Management reviewed all of these issues with IAD and IEG and resolved them as appropriate or in the case of the 41 control design issues indicated in the table below, evaluated the magnitude of the issues and categorized them as deficiencies, significant deficiencies or material weaknesses. Those issues that have been deemed to be issues of efficiency and effectiveness have been carried forward to Part II and will be categorized as part of that process. It should be noted that there is some overlap in the issues identified by the three groups, so the actual total number is less than the simple sums shown in the table below.

33. The following table indicates the preliminary work performed by management in grouping all these issues by type.
<table>
<thead>
<tr>
<th>Description</th>
<th>Issues Identified During Part IA By</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Management</td>
</tr>
<tr>
<td>Total</td>
<td>56</td>
</tr>
<tr>
<td>Issues resolved and closed</td>
<td>(4)</td>
</tr>
<tr>
<td>Documentation updated</td>
<td>-</td>
</tr>
<tr>
<td>Efficiency &amp; Effectiveness</td>
<td>(36)</td>
</tr>
<tr>
<td>Control design issues for evaluation during Part IB</td>
<td></td>
</tr>
</tbody>
</table>

*Control Design issues defined as:*
- By-pass existing control: 1 2 - 3
- Improperly designed control: 11 8 3 22
- Regional variance: 3 - - 3
- OP/BP update required: 1 8 - 9

<table>
<thead>
<tr>
<th>Description</th>
<th>Issues Identified During Part IB</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>16 18 3 37</td>
</tr>
</tbody>
</table>

34. The above table depicts the 126 issues documented by Management, IAD, and IEG during Part IA and is broken out between two levels of categorization:

- The first level categorizes issues not by content, but by how they were tagged for resolution:
  - (a) issues resolved and closed required additional information and clarification on the process. The Project Management Team (PMT) followed up with the respective process owners to gather additional information that would satisfy IAD and IEG’s inquiries;
  - (b) documentation issues were addressed via updates to the PMT’s working papers (process flows and key control sheets); and
  - (c) issues of efficiency and effectiveness would be addressed in Part II; and
- The second level categorizes the remaining 37 issues by type of control design flaw as identified in the table. As already discussed, these issues have been reviewed and evaluated by Management as to their impact, individually and in aggregate, on IDA’s objectives.

D. Completing Work on the Processing Relating to Debt Reporting, Country Policy and Institutional Assessment and Post-Conflict Performance Indicators

35. The documentation and compliance testing of key controls for the Debt Reporting, Country Policy and Institutional Assessment and Post-Conflict Performance Indicators modules # 30, 31 and 32 respectively, was completed during Part IB. The results of the work performed have been incorporated into the overall Part IB findings and results that have been shared with IAD and IEG.
Attachment Annexes
1. Under the methodology outlined below, Management began its compliance testing effort on November 21, 2006, by requesting documentation for the sampled items from the Business Units. The compliance testing was completed on March 1, 2007.

Collection of sample documentation

2. For each sample chosen per Management’s Sampling Methodology, which has been shared with IAD and IEG, Management requested documentation from appropriate parties throughout the institution in Washington and Country Offices using standardized documentation lists generated from the Testing Plans (also referred to as Audit Programs). The Testing Plans specify the controls and control attributes to be tested for each process module together with the specific testing methods used. See Attachment 1 for a complete count of controls identified, controls tested, and attributes tested for each process module. An OPCS Investment Lending (OPCIL) Operations Officer collected all documentation held within the regional operations departments while two CSR Business Development Officers (from the ACTKD unit) collected documentation for all other areas, including Loan Management and the other remaining centralized processes. See Attachment 3 for the complete breakdown of documentation collection responsibilities.

3. As documentation was received from the various departments, it was organized by sample and by project or by module, depending upon the process for which it was collected. See Attachment 3 for a complete breakdown. This documentation was reviewed and tagged by the staff that collected the documentation in preparation for testing.

Testing

4. Testing of the documentation collected began on January 14, 2007. Testing was performed by a Management auditing team consisting of the following qualified accountants from CSR’s Operational Risk and Control (ACTRC) unit:

- Manager
- Senior Accounting Officer
- Senior Financial Officer/Operational Risk
- Financial Officer

5. Following the Testing Plan for each process module, the auditors worked with the staff that collected the documentation to review the documentation and determine whether the requirements of each test attribute for each key control had been met in the performance of the process for the given sample set. The audit team used a Testing Results Matrix
(“matrix”) for each process module to capture the result of each test performed for each sampled activity. The matrix contains columns corresponding to the Testing Plan tests to be performed, and rows corresponding to the samples chosen for testing.

6. In the course of testing, an auditor may have identified changes required within the Testing Plan. These changes, whether due to redundant steps, lack of clarity or any other reason, were reviewed and cleared with the Manager of ACTRC prior to being put into effect. Any changes made to the Testing Plan were highlighted within the plan for future reference by IAD and IEG reviewers against the original Testing Plans which had been distributed to, and reviewed by IAD and IEG prior to the start of Management’s testing process.

7. For each test that passed, the corresponding cell in the matrix was colored green. For tests that failed initially, the audit team worked with the appropriate Business Unit to determine if additional documentation could be made available or if explanations could be provided to validate the exception. If explanations were provided which were deemed as validating an exception, the explanation and any supporting documentation was filed with the other documentary evidence within the corresponding binder. Any comments useful for reviewers relating to a passed test were footnoted on the matrix. If no documentation could be made available and/or no valid explanation could be provided for the exception, then the test was noted as failing using a red color in the corresponding matrix cell. Where possible, the reasons for failures were also footnoted on the matrix. If a control step, whether conditional or not, did not have the preconditions required for the specific test attribute in the selected sample to occur, it was identified as not applicable “N/A”. In certain instances, the reasons for the step being defined as not applicable were footnoted on the matrix. The following example of this has been extracted from the Investment Lending (IL) project supervision process:

Specific Risk Identified
Credits are allowed to proceed to signing without signing requirements per IDA policy having been met by the borrower and authorized by appropriate parties in IDA.

Specific Control to Mitigate Identified Risk
Control 5 – Country Director’s signature of Financing Agreement confirming that the appropriate IDA policies have been complied with.

Conditional Control Attribute to be Tested
Attribute D – If IDA’s signing requirements have not been met, review evidence to verify that the following 5 steps took place.

This conditional step was not tested for any of the 15 IL operations selected in Management’s sample as all of the signing requirements were met within the original timeframe. Therefore these 5 specific control attributes have all been identified as N/A in the Testing Results Matrix.
Evaluating the Results

8. After all tests were performed and failed tests were identified, the audit team reviewed the reasons for each failed test to determine if the failure represented a minor exception or a deficiency. If the auditor determined that the failure represented a minor exception, the rationale was footnoted on the matrix and the corresponding cell in the matrix was changed to the color pink. If the failure was deemed to represent a deficiency, the color in the matrix remained red.

9. The audit team then created a Summary Sheet for each process module, containing the overall percentage of tests passing for each key control within the process and the evaluation of the exceptions and/or deficiencies identified. The evaluation of exceptions or deficiencies includes a discussion of the reasons for the failure as well as an evaluation of the impact of the specific failure on the objectives of the process. In addition, the Summary Sheet contains the auditor’s overall assessment as to the ability of the testing results to provide Management with reasonable assurance that the objectives of the process are being met, taking into consideration the sum of the reasons for all exceptions and deficiencies found and the specific objectives of the process.

10. Certain processes’ test results did not provide reasonable assurance to Management in the opinion of the concerned auditor. For these process modules, the results of testing and the evaluation of the extent of improvement needed within the process were reviewed with and cleared by the Deputy Controller and Director of Accounting.

Distribution to IAD and IEG

11. For each completed process module, IAD and IEG were provided with a documentation package which included the following documents:

- Summary Sheet
- Testing Results Matrix
- Final Audit Program
- Process Coversheet with Objective
- Process Flow Chart
- Process Key Control Sheets

12. The supporting documentary evidence for each process module or sample project was then made available for review by IAD and IEG in office set aside by the Controller. See Attachment 3 for a complete listing of Management’s testing auditor responsibilities and delivery dates for each process module to IAD for their review. IEG will review at their discretion, as part of their work in supporting their Part IB report.
## Control and Attribute Counts by Process Module

<table>
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<th>#</th>
<th>Process Name</th>
<th>Controls</th>
<th>Attributes</th>
</tr>
</thead>
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</tr>
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<td>1</td>
<td>IDA Allocation</td>
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<td>–</td>
</tr>
<tr>
<td>2</td>
<td>IDA Allocation Model</td>
<td></td>
<td></td>
</tr>
<tr>
<td>3</td>
<td>IDA Post-Conflict Allocation</td>
<td></td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>CAS Products</td>
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<td>–</td>
</tr>
<tr>
<td>5</td>
<td>SIL: Specific Investment Loan</td>
<td>9</td>
<td>–</td>
</tr>
<tr>
<td>6</td>
<td>Project Changes</td>
<td>1</td>
<td>–</td>
</tr>
<tr>
<td>7</td>
<td>DPL: Development Policy Lending</td>
<td>8</td>
<td>(1)²</td>
</tr>
<tr>
<td>8</td>
<td>Corporate Review (ROC/OC)</td>
<td>2</td>
<td>–</td>
</tr>
<tr>
<td>9</td>
<td>Contractual Remedies</td>
<td>3</td>
<td>–</td>
</tr>
<tr>
<td>10</td>
<td>Legal – IL</td>
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<td>(1)⁴</td>
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<tr>
<td>11</td>
<td>Legal – DPL</td>
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<td>(1)¹</td>
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<td>Financial Management – IL</td>
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</tr>
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<td>Procurement – Non-Compliance</td>
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<td>LOA – IL</td>
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<td>LOA – DPL</td>
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<td>–</td>
</tr>
<tr>
<td>19</td>
<td>LOA – Application Review</td>
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<td>LOA – SC or Application Problem</td>
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<td>LOA – Amendment/Extension</td>
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<td>LOA – Refund Process</td>
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<td>LOA – Cancellation Process</td>
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<td>LOA – Suspensions</td>
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<td>LOA – Closing - Standard</td>
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<td>–</td>
</tr>
<tr>
<td>26</td>
<td>LOA – Closing - Special</td>
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<td>–</td>
</tr>
<tr>
<td>27</td>
<td>QAG – Quality at Entry &amp; Supervision</td>
<td>6</td>
<td>–</td>
</tr>
</tbody>
</table>

1. These two sub-processes were initially recorded as separate processes. After discussion with CFP management they were deemed to be sub-processes of the IDA allocation process and were consequently integrated into process number 1. We have not revised the numbering scheme. There are 28 processes that have been selected by Management for documentation.

2. One control, and its four associated attributes, was tested as part of the Project Changes (#6) and Contractual Remedies (#9) modules.

3. One control, and its one associated attribute, was identified as a design issue during Part IA and was not tested.

4. One control, and its three associated attributes, was tested as part of the Contractual Remedies (#9) module.

5. One control, and its two associated attributes, was determined not to be a control during the operational effectiveness testing.

6. One control, and its one associated attribute, was not testable as no DPL sample required FM clearance for conditions of tranche disbursement.

7. One control, and its nine associated attributes, was not testable as no evidence of disagreement within the task team was identified that would require the control of escalating disagreements to sector and procurement managers to kick in.
<table>
<thead>
<tr>
<th>#</th>
<th>Process Name</th>
<th>Controls</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th>Attributes</th>
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<td>Tested</td>
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<td>Not</td>
<td>Tested</td>
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<td>28</td>
<td>Safeguards - IL</td>
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<td>-</td>
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<td>11</td>
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<td>-</td>
<td>-</td>
<td>11</td>
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<td>30</td>
<td>Debt Reporting</td>
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<td>-</td>
<td>3</td>
<td>8</td>
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<td>-</td>
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<td>(4)</td>
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<td>(7)</td>
<td>(77)</td>
<td>466</td>
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<td></td>
<td>Less items not included in testing:</td>
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<td>Safeguards - Corporate Risk (QACU)¹</td>
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<td>(7)</td>
<td>7</td>
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<tr>
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<td>Controls not tested due to design issue</td>
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<td>-</td>
<td>2</td>
<td>-</td>
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<td>-</td>
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<td>115</td>
<td>540</td>
<td>-</td>
<td>74</td>
<td>466</td>
<td></td>
</tr>
</tbody>
</table>

¹ Deemed deficient during Part 1A. Not testable during Part 1B, will be followed-up during Part II.
## Control Failures by Process Module

<table>
<thead>
<tr>
<th>#</th>
<th>Process Name</th>
<th>Tested</th>
<th>Operating Effectively</th>
<th>Failed</th>
<th>Description of Failed Control</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>IDA Allocation</td>
<td>4</td>
<td>4</td>
<td>–</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>CAS Products</td>
<td>3</td>
<td>3</td>
<td>–</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>SIL: Specific Investment Loan</td>
<td>9</td>
<td>9</td>
<td>–</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Project Changes</td>
<td>1</td>
<td>1</td>
<td>–</td>
<td></td>
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<tr>
<td>7</td>
<td>DPL: Development Policy Lending</td>
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<tr>
<td>8</td>
<td>Corporate Review (ROC/OC)</td>
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<td>9</td>
<td>Contractual Remedies</td>
<td>3</td>
<td>3</td>
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</tr>
<tr>
<td>10</td>
<td>Legal – IL</td>
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<td></td>
</tr>
<tr>
<td>11</td>
<td>Legal – DPL</td>
<td>8</td>
<td>8</td>
<td>–</td>
<td></td>
</tr>
<tr>
<td>12</td>
<td>Financial Management – IL</td>
<td>4</td>
<td>2</td>
<td>2</td>
<td>During FY06, the FM Sector Board issued new guidelines for FM practices in Bank-financed investment operations. We could not verify because of lack of documented evidence, and change in Regional practices, that the review and approval of the FM Assessment and appraisal stage PADs and Financing Agreements by the RMFM or appointed delegate occurred. The sample testing, based on date prepared, identified that the majority of FMSRs prepared after November 2005 were not in accordance with the suggested requirements in the FM Guidelines as Regions were transitioning to preparing the FMSRs in accordance with the guidelines. Approx. 40% of the projects reviewed had no documentation evidencing that the risk rating identified by the FM specialist was sent to the TTL for inclusion in the ISR. In one instance we noted the ISR had a different rating from the FMSR - and no explanation was attached.</td>
</tr>
<tr>
<td>13</td>
<td>Financial Management – DPL</td>
<td>2</td>
<td>2</td>
<td>–</td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>Procurement – IL</td>
<td>8</td>
<td>6</td>
<td>2</td>
<td>Issues in preparation of the Form 384 included: (i) a few months delay in preparing the Form 384 after the contract received date; (ii) the 384 not showing the LAS disbursement categories; (iii) the 384 not corresponding to the no objection letter; and (iv) the contract amount recorded in the 384 was lower than that of the bid documents. Unable to verify that the procurement post reviews were carried out in</td>
</tr>
</tbody>
</table>
accordance with the timing requirements in the most recent procurement supervision plan or PAD in approx. 40% of our sample, due to lack of documentation provided. In one case we also noted a lack of audit evidence to support the post procurement review and the results from it.

<table>
<thead>
<tr>
<th></th>
<th>Procurement – Complaints</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>15</td>
<td></td>
<td>2</td>
<td>1</td>
</tr>
</tbody>
</table>

Audit evidence on file was missing to indicate internal review and communication with the borrower in some cases.

<table>
<thead>
<tr>
<th></th>
<th>Procurement – Non-Compliance</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>16</td>
<td></td>
<td>2</td>
<td>2</td>
</tr>
</tbody>
</table>

Loan master data created at the time of credit set-up in LAS, was not consistent with the financing agreement and/or disbursement letter. The majority of issues related to the set-up of prior review and/or SOE thresholds.

<table>
<thead>
<tr>
<th></th>
<th>LOA – IL</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>17</td>
<td></td>
<td>5</td>
<td>4</td>
</tr>
</tbody>
</table>

Controls surrounding FO approvals of notices related to threat of suspension, suspension, and lifting of suspension were not testable in many cases due to the lack of documentary evidence.

Verifiable historical audit trail relating to imposing or lifting of suspensions is not readily available in LAS.

<table>
<thead>
<tr>
<th></th>
<th>LOA – DPL</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>18</td>
<td></td>
<td>6</td>
<td>6</td>
</tr>
</tbody>
</table>

Lack of evidence of Finance Officer clearances – documentation not made available/provided for testing.

<table>
<thead>
<tr>
<th></th>
<th>LOA – Closing - Standard</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>25</td>
<td></td>
<td>2</td>
<td>1</td>
</tr>
</tbody>
</table>

Housekeeping of the Credit information in LAS is not always performed in a timely manner.

<table>
<thead>
<tr>
<th></th>
<th>LOA – Closing - Special</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>26</td>
<td></td>
<td>2</td>
<td>1</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>QAG = Quality at Entry &amp; Supervision</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>27</td>
<td></td>
<td>6</td>
<td>6</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Safeguards – IL</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>28</td>
<td></td>
<td>3</td>
<td>3</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Debt Reporting</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>29</td>
<td></td>
<td>3</td>
<td>3</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>CPIA</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>30</td>
<td></td>
<td>4</td>
<td>4</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>PCPI</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>31</td>
<td></td>
<td>3</td>
<td>3</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Less items not included in testing: Safeguards - Corporate Risk (QACU)</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>32</td>
<td></td>
<td>-</td>
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</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Controls included in testing</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>33</td>
<td></td>
<td>115</td>
<td>105</td>
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</table>
## Testing Process by Module

<table>
<thead>
<tr>
<th>#</th>
<th>Process Name</th>
<th>Document Collection</th>
<th>Binder Organized By</th>
<th>Auditor</th>
<th>Delivered to IAD</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>IDA Allocation</td>
<td>CSR Module</td>
<td>SAO</td>
<td>31-Jan-07</td>
<td></td>
</tr>
<tr>
<td>4</td>
<td>CAS Products</td>
<td>OPCS Project</td>
<td>Mgr</td>
<td>1-Feb-07</td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>SIL: Specific Investment Loan</td>
<td>OPCS Project</td>
<td>Mgr</td>
<td>26-Jan-07</td>
<td></td>
</tr>
<tr>
<td>6</td>
<td>Project Changes</td>
<td>OPCS Module</td>
<td>FO</td>
<td>9-Feb-07</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>DPL: Development Policy Lending</td>
<td>OPCS Project</td>
<td>Mgr</td>
<td>31-Jan-07</td>
<td></td>
</tr>
<tr>
<td>8</td>
<td>Corporate Review (ROC/OC)</td>
<td>OPCS Project</td>
<td>Mgr</td>
<td>31-Jan-07</td>
<td></td>
</tr>
<tr>
<td>9</td>
<td>Contractual Remedies</td>
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<tr>
<td>10</td>
<td>Legal - IL</td>
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<td>11</td>
<td>Legal - DPL</td>
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<tr>
<td>12</td>
<td>Financial Management – IL</td>
<td>OPCS Project</td>
<td>Mgr</td>
<td>9-Feb-07</td>
<td></td>
</tr>
<tr>
<td>13</td>
<td>Financial Management – DPL</td>
<td>OPCS Project</td>
<td>Mgr</td>
<td>7-Feb-07</td>
<td></td>
</tr>
<tr>
<td>14</td>
<td>Procurement – IL</td>
<td>OPCS Project</td>
<td>SFO</td>
<td>9-Feb-07</td>
<td></td>
</tr>
<tr>
<td>15</td>
<td>Procurement – Complaints</td>
<td>CSR Module</td>
<td>SFO</td>
<td>9-Feb-07</td>
<td></td>
</tr>
<tr>
<td>16</td>
<td>Procurement – Non-Compliance</td>
<td>OPCS Module</td>
<td>SFO</td>
<td>9-Feb-07</td>
<td></td>
</tr>
<tr>
<td>17</td>
<td>LOA – IL</td>
<td>CSR Module</td>
<td>SAO</td>
<td>2-Feb-07</td>
<td></td>
</tr>
<tr>
<td>18</td>
<td>LOA – DPL</td>
<td>CSR Module</td>
<td>SAO</td>
<td>31-Jan-07</td>
<td></td>
</tr>
<tr>
<td>19</td>
<td>LOA – Application Review</td>
<td>CSR Module</td>
<td>Mgr</td>
<td>26-Jan-07</td>
<td></td>
</tr>
<tr>
<td>20</td>
<td>LOA – SC or Application Problem</td>
<td>CSR Module</td>
<td>SAO</td>
<td>25-Jan-07</td>
<td></td>
</tr>
<tr>
<td>21</td>
<td>LOA – Amendment/Extension</td>
<td>CSR Module</td>
<td>FO</td>
<td>25-Jan-07</td>
<td></td>
</tr>
<tr>
<td>22</td>
<td>LOA – Refund Process</td>
<td>CSR Module</td>
<td>SAO</td>
<td>1-Feb-07</td>
<td></td>
</tr>
<tr>
<td>23</td>
<td>LOA – Cancellation Process</td>
<td>CSR Module</td>
<td>SAO</td>
<td>25-Jan-07</td>
<td></td>
</tr>
<tr>
<td>24</td>
<td>LOA – Suspensions</td>
<td>CSR Module</td>
<td>SAO</td>
<td>31-Jan-07</td>
<td></td>
</tr>
<tr>
<td>25</td>
<td>LOA – Closing - Standard</td>
<td>CSR Module</td>
<td>SAO</td>
<td>30-Jan-07</td>
<td></td>
</tr>
<tr>
<td>26</td>
<td>LOA – Closing - Special</td>
<td>CSR Module</td>
<td>SAO</td>
<td>26-Jan-07</td>
<td></td>
</tr>
<tr>
<td>27</td>
<td>QAG – Quality at Entry &amp; Supervision</td>
<td>CSR Module</td>
<td>FO</td>
<td>25-Jan-07</td>
<td></td>
</tr>
<tr>
<td>28</td>
<td>Safeguards – IL</td>
<td>OPCS Project</td>
<td>Mgr</td>
<td>6-Feb-07</td>
<td></td>
</tr>
<tr>
<td>29</td>
<td>Safeguards - Corporate Risk (QACU)</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
<td></td>
</tr>
<tr>
<td>30</td>
<td>Debt Reporting</td>
<td>CSR Module</td>
<td>SAO</td>
<td>1-Feb-07</td>
<td></td>
</tr>
<tr>
<td>31</td>
<td>CPIA</td>
<td>CSR Module</td>
<td>SAO</td>
<td>6-Feb-07</td>
<td></td>
</tr>
<tr>
<td>32</td>
<td>PCPI</td>
<td>CSR Module</td>
<td>SAO</td>
<td>31-Jan-07</td>
<td></td>
</tr>
</tbody>
</table>

**Auditor Legend:**

- Mgr - Manager
- SAO - Senior Accounting Officer
- SFO - Senior Financial Officer
- FO - Financial Officer
Annex 2: IDA Internal Control Review
Compliance Testing – Sampling Methodology

OVERVIEW

1. To perform compliance testing on the control activities within all documented process modules for Part I of Management’s review of IDA internal controls, sampling was required for both projects/operations as well as several processes with activities performed outside of the project/operation cycle. This document describes Management’s methodology for all required samples including:
   - Core Investment Lending (IL) and Development Policy Lending (DPL) operations
   - Country Assistance Strategy (CAS) products
   - Other non-lending processes

SAMPLE SELECTION OF IL AND DPL OPERATIONS

2. The methodology for selecting projects/operations for IDA Internal Control Review compliance testing is outlined below for the primary sample of Specific Investment Loan (SIL) and DPL products as well as for additional IL types with lower lending volumes than the SIL product.

A Core IL Operations Sample

3. Based on the universe identified for IL operations (see the sections on SIL and additional IL operations below), the required number of projects to be selected for testing of Investment Lending operations was determined by Management to be 15 each for pre-supervision and supervision activities. This provided a sample size equivalent to the median between the applicable audit requirements applied by IDA’s external auditor used for the review of internal controls related to financial reporting for Weekly and Monthly frequency of activity.

4. Management randomly selected 10 projects for the SIL product (10 projects for pre-supervision activities and 10 different projects for supervision activities) from the SIL Sample Universe as described below. An additional 5 projects, for both pre-supervision and supervision, of other IL operations were selected randomly from the IL Sample Universe as described below to provide the required sample size of 15 for all IL operations.

5. Selection of the pre-supervision and supervision projects for IL operations was performed on the basis of approval date. Projects approved during FY06 formed the pre-supervision sample universe for each operation. Projects approved prior to FY06 formed the supervision universe for each operation. This enabled Management to ensure as far as possible that the operational control activities being tested would have occurred during the testing timeframe for this exercise – July 1, 2005 to February 28, 2006.
**SIL Operations – Identifying the Universe**

Starting Project Universe: Downloaded all projects from the Operations Portal on March 8, 2006.

Remove all projects where: (i) status is non-Active; (ii) projects are non-IBRD/IDA; (iii) IDA Commitment amount is Zero; (iv) not a Development Policy Loan or Specific Investment Loan that was approved since January 1, 2001; and all DPL, PRSC, Sector Adjustment Loan, Structural Adjustment Loan.

Projects constituting the SIL sample universe for Management’s assessment

<table>
<thead>
<tr>
<th># Projects</th>
</tr>
</thead>
<tbody>
<tr>
<td>14,776</td>
</tr>
<tr>
<td>(14,369)</td>
</tr>
</tbody>
</table>

SIL sample selected for testing: 20 operations (10 pre-supervision and 10 supervision)

**Additional IL Operations – Identifying the Universe**

Starting Project Universe: Downloaded all Non-SIL investment lending projects from the Operations Portal on November 16, 2006.

Remove all projects where: (i) status is non-Active; (ii) projects are non-IBRD/IDA; (iii) IDA Commitment amount is Zero; (iv) all projects that were approved after FY06

Projects constituting the Additional IL sample universe for Management’s assessment

<table>
<thead>
<tr>
<th># Projects</th>
</tr>
</thead>
<tbody>
<tr>
<td>4,060</td>
</tr>
<tr>
<td>(3,770)</td>
</tr>
</tbody>
</table>

The additional IL operations were further broken down by the following types and 5 individual samples were selected from the more numerous types below:

<table>
<thead>
<tr>
<th># Projects</th>
<th>Sample</th>
</tr>
</thead>
<tbody>
<tr>
<td>APL</td>
<td>119</td>
</tr>
<tr>
<td>TA</td>
<td>73</td>
</tr>
<tr>
<td>ERL</td>
<td>50</td>
</tr>
<tr>
<td>SIML</td>
<td>23</td>
</tr>
<tr>
<td>LIL</td>
<td>17</td>
</tr>
<tr>
<td>FIL</td>
<td>8</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
</tbody>
</table>

6. Please see *Attachment 1* for a listing of the selected SIL and additional IL operations included in Management’s testing process.
B. Core DPL Operations Sample

7. Management documented the procedures associated with the current policy regime for DPL operations under the revised OP/BP 8.60, issued in August 2004. Compliance testing for these procedures focused on operations governed by this current policy regime during the timeframe for testing in this exercise, July 1, 2005 through February 28, 2006. However, DPL operations with a Concept Review date of August 9, 2004, or earlier are not required to comply with the new OP/BP 8.60. These operations continued to be governed by the previous policy regime under OD 8.60.

8. Management conducted a review of all 21 DPL operations that met the following criteria:
   a. Active during the testing timeframe and approved in FY05 but processed under the new policy OP/BP 8.60; or
   b. Approved during the testing timeframe, including those that also then closed during the testing timeframe.

9. Management used random and targeted sampling in selecting the 7 DPL operations, or 33% of the total universe, for testing purposes. Please see Attachment 1 for a listing of the selected DPL operations included in Management’s testing process.

SAMPLE SELECTION OF COUNTRY ASSISTANCE STRATEGY OPERATIONS

10. Management identified 13 IDA country assistance strategy (CAS) products with a Board Date within the testing timeframe for this exercise. Management decided that a sample of 5 CAS products, representing 38% of the total universe, was acceptable for testing. The sample for the CAS process was judgmentally selected by the Regions after OPCS requested that the Regions identify CAS products developed during the testing time frame. Management collected documentation for the 5 CAS products during its Inception-to-Completion walkthroughs, and relied on the documentation collected for these CAS products for its testing.

11. The sample of CASs tested by Management included 2 CASs in ECA, 2 CASs in SAR and one CAS in the AFR region.

SAMPLE PROJECTS SELECTED FOR OTHER MODULES

12. Not all modules were able to be fully covered by Management’s sampling methodology used for selecting test samples for the IL, DPL and CAS products. Specifically, the following modules required targeted sampling based on specific sample universes:

   1: IDA Allocation
   8: Corporate Review
   15: Procurement Complaints
   16: Procurement Noncompliance
   19: LOA Application Review
ANNEX 2

20. LOA Special Commitment or Application Problem
21. LOA Amendments
22. LOA Refunds
23. LOA Cancellations
24. LOA Suspensions
25. LOA Closing – Standard Procedures
26. LOA Closing – Special Procedures
27. QAG - Quality at Entry Assessment (EA) and,
   - Quality at Supervision Assessment (QSA)
30. Debt Reporting
31. Country Policy and Institutional Assessment (CPIA)
32. Post Conflict Performance Indicators (PCPI)

13. These modules are either entirely independent, or have processes that are not part, of
the project cycle for IL or DPL products, and occur either once per year or random time
cycles depending on their conditionalities. For each of these modules, Management
requested documentation for any/all occurrences of the activity using the Core IL/DPL
sample within the testing timeframe.

14. If results provided at least 5 samples of each activity, Management tested these
samples and considered this an adequate sample for activities that are not deemed to be
occurring on a daily basis. If results did not provide 5 samples of each activity, Management
considered whether additional targeted/judgmental sampling was required to indicate a
key control or specific control attribute was operating adequately. Where additional
samples were deemed to be necessary, Management relied upon available system reports or
other search methods to identify occurrences of the activity. Such methods, where used,
were specifically documented to enable re-performance and validation.

15. The individual sampling methodologies for each of these modules, together with those
of the IL, DPL and CAS products have been provided to IAD and IEG by Management.
IDA Internal Control Review
Compliance Testing – Sampling Methodology
Listing of Operations Selected for Core Investment Lending (IL) and Development Policy Lending (DPL) Testing

Sample of IL Operations Selected for Testing of Pre-Supervision Controls

<table>
<thead>
<tr>
<th>Type</th>
<th>Region</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>SIL</td>
<td>AFR</td>
<td>Mozambique</td>
</tr>
<tr>
<td>SIL</td>
<td>AFR</td>
<td>Mozambique</td>
</tr>
<tr>
<td>APL</td>
<td>AFR</td>
<td>Africa</td>
</tr>
<tr>
<td>APL</td>
<td>AFR</td>
<td>Gambia</td>
</tr>
<tr>
<td>SIML</td>
<td>AFR</td>
<td>Burkina Faso</td>
</tr>
<tr>
<td>SIL</td>
<td>EAP</td>
<td>Vietnam</td>
</tr>
<tr>
<td>TA</td>
<td>EAP</td>
<td>Mongolia</td>
</tr>
<tr>
<td>ERL</td>
<td>EAP</td>
<td>Lao PDR</td>
</tr>
<tr>
<td>SIL</td>
<td>ECA</td>
<td>Tajikistan</td>
</tr>
<tr>
<td>SIL</td>
<td>ECA</td>
<td>Georgia</td>
</tr>
<tr>
<td>SIL</td>
<td>LCR</td>
<td>Haiti</td>
</tr>
<tr>
<td>SIL</td>
<td>MNA</td>
<td>Yemen</td>
</tr>
<tr>
<td>SIL</td>
<td>SAR</td>
<td>Sri Lanka</td>
</tr>
<tr>
<td>SIL</td>
<td>SAR</td>
<td>Pakistan</td>
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</table>
### Sample of IL Operations Selected for Testing of Supervision Controls

<table>
<thead>
<tr>
<th>Type</th>
<th>Region</th>
<th>Country</th>
</tr>
</thead>
<tbody>
<tr>
<td>SIL</td>
<td>AFR</td>
<td>Rwanda</td>
</tr>
<tr>
<td>SIL</td>
<td>AFR</td>
<td>Mozambique</td>
</tr>
<tr>
<td>SIL</td>
<td>AFR</td>
<td>Africa</td>
</tr>
<tr>
<td>APL</td>
<td>AFR</td>
<td>Ethiopia</td>
</tr>
<tr>
<td>APL</td>
<td>AFR</td>
<td>Rwanda</td>
</tr>
<tr>
<td>SIL</td>
<td>EAP</td>
<td>Mongolia</td>
</tr>
<tr>
<td>SIL</td>
<td>EAP</td>
<td>Lao PDR</td>
</tr>
<tr>
<td>SIL</td>
<td>ECA</td>
<td>Serbia and Montenegro</td>
</tr>
<tr>
<td>SIL</td>
<td>ECA</td>
<td>Serbia and Montenegro</td>
</tr>
<tr>
<td>SIL</td>
<td>LCR</td>
<td>Honduras</td>
</tr>
<tr>
<td>TA</td>
<td>LCR</td>
<td>Guyana</td>
</tr>
<tr>
<td>SIL</td>
<td>MNA</td>
<td>Yemen</td>
</tr>
<tr>
<td>SIL</td>
<td>SAR</td>
<td>India</td>
</tr>
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<td>ERL</td>
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<td>India</td>
</tr>
<tr>
<td>SIML</td>
<td>SAR</td>
<td>Bangladesh</td>
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</table>
Sample of DPL Operations Selected for Testing of Controls

<table>
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<th>Type</th>
<th>Region</th>
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</tr>
</thead>
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<td>DPL</td>
<td>AFR</td>
<td>Mozambique</td>
</tr>
<tr>
<td>DPL</td>
<td>AFR</td>
<td>Uganda</td>
</tr>
<tr>
<td>DPL</td>
<td>AFR</td>
<td>Mali</td>
</tr>
<tr>
<td>DPL</td>
<td>AFR</td>
<td>Cameroon</td>
</tr>
<tr>
<td>DPL</td>
<td>EAP</td>
<td>Timor-Leste</td>
</tr>
<tr>
<td>DPL</td>
<td>ECA</td>
<td>Armenia</td>
</tr>
<tr>
<td>DPL</td>
<td>LCR</td>
<td>Honduras</td>
</tr>
</tbody>
</table>

Summary of Sample Operations by Region

Listed below are the total number of IL (by type) and DPL operations sampled for each of IDA’s operational regions:

<table>
<thead>
<tr>
<th>Product</th>
<th>AFR</th>
<th>EAP</th>
<th>ECA</th>
<th>LCR</th>
<th>MNA</th>
<th>SAR</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>SIL</td>
<td>6</td>
<td>3</td>
<td>4</td>
<td>2</td>
<td>2</td>
<td>3</td>
<td>20</td>
</tr>
<tr>
<td>APL</td>
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<td>4</td>
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</table>
1. The Bank is performing its assessment of internal controls over external financial reporting using existing auditing standards on attestation of internal controls over financial reporting as prescribed by generally accepted auditing standards. In performing its review of compliance with IDA’s charter and applicable internal policies and procedures, Management has used the same concepts as those defined in the Auditing Standard No. 2 (AS2) An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements, issued by the U.S. Public Company Accounting Oversight Board (PCAOB) as much as possible.

2. Management believes that applying the concepts that have been defined by audit standard setters for assessing internal controls over financial reporting will provide the level of comprehensiveness, rigor and consistency required in its self-assessment of internal controls and compliance with IDA’s charter and applicable internal policies and procedures.

3. During Management’s review items that represent deficiencies and which may or may not require remediation were discovered. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance on a timely basis.

- A deficiency in design exists when (a) a control necessary to meet the control objective is missing, or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective is not always met.
- A deficiency in operation exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively.

4. Control deficiencies are classified as one of the following: (i) an internal control deficiency; (ii) a significant deficiency\(^\text{16}\); or (iii) a material weakness\(^\text{17}\). The classification of the deficiency is based upon the likelihood of occurrence/noncompliance and/or the significance of noncompliance.

\(^{16}\) AS2 defines a significant deficiency as a control deficiency, or a combination of control deficiencies, that adversely affects the company’s ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles such that there is more than remote likelihood that a misstatement of the company’s annual or interim financial statements that is more than inconsequential will not be prevented or detected.

\(^{17}\) AS2 defines a material weakness as a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.
5. Conclusions about what constitutes a material weakness over compliance or operations are judgmental, more so than in the case of material weaknesses in financial reporting. Therefore, the definition of material weakness has been adapted from the context of the financial reporting definition, with its reliance on materiality in relation to the financial statements, to one using more judgment as to whether the operations and compliance objectives of internal control are met. To guide financial auditors in making these judgments, AS2 identifies examples of attributes the auditor should consider in evaluating identified internal control deficiencies to determine whether the deficiencies, individually or in combination, are significant deficiencies or material weaknesses. Management, IAD and IEG have agreed that clearly defined measures be established for judging operational materiality. These measures have been used as guides by each of the three groups in determining whether identified internal control deficiencies in compliance constitute significant deficiencies or material weaknesses. Identified deficiencies could be significant deficiencies or material weaknesses where the control deficiencies have attributes that could:

- impair the achievement of IDA’s objectives;
- violate requirements of IDA’s charters or other contractual agreements;
- significantly weaken safeguards against waste, loss, or unauthorized use of funds, property, or assets;
- involve conflicts of interest;
- involve systemic problems in country assistance, partnerships and project lending; and
- require the attention of Senior Management, the Board as well as the awareness of external stakeholders.

6. All deficiencies identified during Management’s assessment have been recorded on a summary deficiency schedule. This deficiency schedule outlines Management’s assessment of the deficiency (type of deficiency), any mitigating controls over the deficiency, the potential financial impact, if any, the impact from a non-financial perspective, and management’s determination of how to address the deficiency, i.e. corrective action (remediation). A control deficiency or combination of control deficiencies that, in management’s judgment, represent significant deficiencies in the design or operation of internal control that could adversely affect the organization’s ability to meet its internal control objectives is a “Significant Deficiency”. A significant deficiency or a combination of significant deficiencies that Management determines to be significant enough to be reported outside IDA shall be considered a “Material Weakness”.

7. Management’s report on Part IB includes its assessment of the overall deficiencies and a determination on the impact these deficiencies have individually and in total on the internal controls over IDA’s compliance with its charter and applicable internal policies and procedures. This report includes: (i) Management’s assessment of IDA’s compliance with its charter and applicable internal policies and procedures; and (ii) a description of any significant deficiencies or material weaknesses identified through its assessment, together with their respective remediation plan.
## Annex 4: IDA Internal Control Review
### OP/BP Status of Updates

### Volume I: Strategies and Products

#### Country Focus

- **2.11 - Country Assistance Strategies**
  - BP
  - Latest Revision: June, 2005
  - In Pipeline to be Updated: Possibly in the next 6 months, if determined that changes needed to reflect the GAC action plan

#### Business Products and Instruments

- **8.60 - Development Policy Lending**
  - OP
    - Latest Revision: August, 2004
  - BP
    - Latest Revision: August, 2004
  - In Pipeline to be Updated: No

- **10.00 - Investment Lending: Identification to Board Presentation**
  - OP
    - Latest Revision: June, 1994
    - Latest Revisions:
      - Annex C-Operational Plan Contents: January, 1994
      - Annex D-Outline for a Staff Appraisal Report: January, 1994
      - Annex D1-Outline for Preparing the "Loan and Project Summary": January, 1994
      - Annex D2-Standard Disbursement Profiles: January, 1994
      - Annex E-Outline for a Memorandum and Recommendation of the President: January, 1994
      - Annex F-Sample Notice of Invitation to Negotiate: January, 1994
      - Annex G-Telex of Invitation to Negotiate: January, 1994
      - Annex I-Loan/Credit/GEF Grant Cover Sheet: January, 1994
      - Annex J-Conditions of Board Presentation: January, 1994
  - BP
    - Latest Revision: June, 1994
    - In Pipeline to be Updated: Yes, a proposal for modernization, consolidation and rationalization of this OP/BP is expected to be presented to the EDs in the next 18 to 24 months to reflect lessons learned from experience and reflect recommendations of IDA internal controls review.
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<td></td>
<td>Annex A-Dam Safety Reports: Content and Timing</td>
<td>October, 2001</td>
</tr>
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</table>

**Fiduciary**

| ➢ 10.02 – Financial Management | | | |
| OP | March, 2007 | Revised OP/BP 10.02 effective March 22, 2007 |
| BP | March, 2007 | |
| | Annex B-Sample Telexes: Accounting; Financial Reporting; and Auditing | March, 2007 |
| | Annex C-Audit Reports Compliance System | March, 2007 |

| ➢ 11.00 – Procurement | | |
| OP | July, 2001 | Yes. OP and BP to be revised in the next 18 months to reflect lessons learned and recommendations of the internal controls review. |
| BP | July, 2001 | |
| | Annex A-The World Bank Procurement Function | October, 2002 |

| ➢ 12.00 – Disbursement | | |
| OP | March, 2007 | Revised OP/BP 12.00 effective March 22, 2007 |
| BP | March, 2007 | |

| ➢ 12.20 - Special Accounts | | |
| OP | May, 1994 | Has been replaced by revised OP 12.00 on March 22, 2007. |
| | Annex B-Subaccounts and Second-Generation Special Accounts | January, 1994 |
| BP | May, 1994 | Has been replaced by revised BP 12.00 on March 22, 2007. |

| ➢ 12.30 - Statements of Expenditure | | |
| OP | September, 1993 | Has been replaced by revised OP/BP 12.00 on March 22, 2007. |
| BP | August, 1993 | |
## Financial

- **12.10 - Retroactive Financing**
  - OP: July, 2002
  - Latest Revision: July, 2002
  - In Pipeline to be Updated: Has been replaced by an OP Memo on expenditure eligibility for projects in countries without approved country financing parameters on March 27, 2007.

## Management

- **13.05 - Project Supervision**
  - OP: July, 2001
  - BP: July, 2001
  - Latest Revision: July, 2001
  - In Pipeline to be Updated: Yes, OP and BP to be revised in the next 18 to 24 months to reflect lessons learned and recommendations of the internal controls review.

## Contractual

- **3.10 - Financial Terms and Conditions of IBRD Loans, IBRD Hedging Products, and IDA Credits**
  - OP: June, 2003
  - Latest Revision: June, 2003
  - In Pipeline to be Updated: Updated at least 2-3 times a year.
  - BP: June, 2003
  - Latest Revision: June, 2003
  - In Pipeline to be Updated: Updated at least 2-3 times a year.

- **7.00 - Lending Operations: Choice of Borrower and Contractual Agreements**
  - OP: February, 2001
  - Latest Revision: February, 2001
  - In Pipeline to be Updated: No.

- **13.00 - Signing of Legal Documents and Effectiveness of Loans and Credit**
  - OP: February, 2002
  - Latest Revision: February, 2002
  - In Pipeline to be Updated: Possibly, if changes needed based on results of IDA internal controls review.
  - BP: February, 2002
  - Latest Revision: February, 2002
  - In Pipeline to be Updated: Same as above re OP.

- **13.30 - Closing Dates**
  - OP: February, 2002
  - Latest Revision: February, 2002
  - In Pipeline to be Updated: Possibly, if changes needed based on results of IDA internal controls review.
  - BP: February, 2002
  - Latest Revision: February, 2002
  - In Pipeline to be Updated: Same as above re OP.
### 13.40 - Suspension of Disbursements

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<td>February, 1996</td>
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- Annex A-Sample Notice to the Borrower for a Suspension Unrelated to Payment
- Annex B-Sample Notice to the Executive Directors for a Suspension Unrelated to Payment
- Annex C-Sample Notice of Cancellation Sent to the Borrower
- Annex D-Sample Notice of Cancellation Sent to the Executive Directors
- Annex E-Sample Notice to the Borrower for Lifting a Suspension
- Annex F-Sample Notice Sent to the Executive Directors for Lifting a Suspension Unrelated to Payment
- Annex G-Sample Notice to the Borrower When Payment Is 30 Days Overdue
- Annex H-Sample Notice of Impending Suspension Sent to the Borrower When Payment Is 45 Days Overdue
- Annex I-Sample Notice of Suspension Sent to the Borrower When Payment Is 60 Days Overdue
- Annex J-Sample Notice of Suspension Sent to the Executive Directors for a Payment-Related Suspension
- Annex K-Sample Notice to the Executive Directors for Lifting a Payment-Related Suspension

### 13.50 – Cancellations

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<td></td>
<td>August, 2002</td>
<td>Possibly, if changes needed based on results of IDA internal controls review</td>
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<td></td>
<td>August, 2002</td>
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## 14.10 - External Debt Reporting and Financial Statements

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<tr>
<td>Annex B1 - Countries Subject to IDA's Non-Concessional Borrowing Policy</td>
<td>August, 2006</td>
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<tr>
<td>Annex C - Sample Letter of Representations regarding a Borrower's/Project Entity's Financial Condition</td>
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June 7, 2007

Mr. Faezul H. Choudhury, Vice President & Controller, CSRVP
Mr. Jeffrey S. Gutman, Vice President & Head of Network, OPCVP

Report on a Review of Management’s Assessment of the
Operating Effectiveness of Internal Controls over IDA Operations and Compliance
with its Charter and Policies

Please find enclosed the above-mentioned report which represents the outcome of
our review on Management’s Assessment of IDA’s Internal Controls Review: Part IB.

[Signature]
Carman Lapointe-Young
Auditor General
Internal Auditing Department

Attachments

cc: Messrs. Wheeler (MDW); Daboub (MDD); La Via (CFO); Le Houerou (CFPVP);
Thomas (IEGDO)

Deloitte & Touche LLP
Review of Management’s Assessment of the Operating Effectiveness of Internal Controls over IDA Operations and Compliance with its Charter and Policies (Part IB)

Background

As part of its work program, Internal Auditing Department (IAD) has completed a review of “Management’s assessment relating to the operating effectiveness of key controls currently in place to ensure compliance with the relevant Articles’ provisions and policies governing IDA’s operations”.

This assessment comprises the second of a three-part assessment in response to Management’s commitment to carry out an independent comprehensive assessment of IDA’s control framework including internal controls over IDA operations and compliance with its charter and policies:

- Part IA assessed the design effectiveness of key controls currently in place to ensure compliance with the relevant Articles’ provisions and policies governing IDA’s operations;
- Part IB assessed the operating effectiveness of, or compliance with, the controls identified in Part IA; and,
- Part II will assess the efficiency and effectiveness, including corporate governance and entity-level controls.

Objective

In accordance with our Terms of Reference, IAD’s objective was to review the basis of Management’s assessment and express an opinion on whether Management’s assessment of the effectiveness of internal controls over IDA operations is fairly stated based on the criteria established in Internal Control – Integrated Framework issued by COSO.

---

1 Management’s commitment was outlined in the IDA Fourteenth Replenishment report, approved by the Executive Directors of IDA in March 2005, which identified a monitorable action, targeted for CY05, the product of which was an ‘OED Assessment’.
Part IB of IDA Internal Controls Review
- Compliance with Charter and Policies

Scope

IAD’s review under Part IB examined Management’s assessment relating to the operating
effectiveness of the transactional level key controls designed and placed in operation to
ensure compliance with the relevant Articles’ provisions and policies governing IDA’s
operations. Thirty-one (31) documented processes (including 2 sub-processes relating to
Financial Resource Mobilization (FRM)) of the thirty-two (32) processes2 deemed in-
scope by Management were reviewed. The review also included an examination of the
to extent to which issues and potential deficiencies identified during Part IA had been
resolved.

IAD’s review did not include the following areas excluded by Management under Parts
IA and/or IB:

- The overarching control framework for IDA including all aspects of corporate
governance and entity level controls as well as efficiency and effectiveness of
operations;

- Specific processes deemed out of scope by Management for this assessment, namely
Economic Sector Work (ESW), Report on Observance of Standards and Codes
(ROSC), Independent Evaluation Group (IEG) Processes, IAD Processes, Annual
Report on Portfolio Performance (ARPP), the Inspection Panel, the Department of
Institutional Integrity (INT), and the Results Assessment Framework of IDA;

- Certain Operational Policies (OPs) and Bank Procedures (BPs) excluded by
Management, as outlined in its Part IA report; and,

- Compliance controls embedded in automated applications used in IDA operations.

IAD’s review of Management’s Part IB assessment was conducted during the period from

Approach

As agreed with Management, IAD applied relevant concepts of Auditing Standard 2
(AS2)3, appropriately tailored for operational compliance controls.

---

2 Management added three processes in Part IB to the twenty nine (29) documented processes that were already in
scope for Part IA: (i) Country Policy and Institutional Assessment (CPIA) (ii) Post Conflict Performance
Indicators (PCPI) and (iii) Debt Reporting. However, the process relating to Safeguards - Corporate List was not
tested by management and hence was not reviewed by IAD.

3 Auditing Standard No. 2: An Audit of Internal Control over Financial Reporting Performed in Conjunction with
An Audit of Financial Statements (AS2) issued by the Public Company Accounting Oversight Board (PCAOB)
IAD specifically performed the following:

- **Management Test Plans:** IAD reviewed Management's test plans for assessing the operating effectiveness of the key controls identified for the in-scope processes, provided specific comments, and followed up with Management on all comments.

- **Management Sampling Methodology:** IAD reviewed the sampling methodology note provided by Management, provided specific comments, and followed up with Management on all comments.

- **Workshops/Review Sessions:** IAD attended process walkthrough sessions convened by Management for the three processes added in Part IB, namely, the processes relating to Country Policy and Institutional Assessment (CPIA), Post Conflict Performance Indicators (PCPI), and Debt Reporting, to validate process flow charts and narrative descriptions of individual key controls provided by Management, challenging, seeking clarification and identifying potential deficiencies as appropriate.

- **Revised Process Documentation:** IAD reviewed revised process documentation incorporating changes identified in the three additional workshops/review sessions, and based on testing in Part IB.

- **Management Test Results and Supporting Documentation:** The test results for the in-scope processes were provided by management to IAD between January 25, 2007 and March 1, 2007. IAD reviewed and validated the test results provided by Management for each process, including the documentary evidence supporting process level conclusions, and Management's methodology for determining compliance rates and identifying exceptions and deficiencies.

- **Transmittals for Communicating IAD's Review Results:** IAD issued thirty-two (32) transmittals between February 9, 2007 and March 19, 2007, to communicate review results and to solicit Management responses. Transmittals communicated unresolved issues surrounding adequacy of testing and sampling as well as process-specific issues.

- **Management Drafts:** IAD reviewed drafts of Management's report received on March 1, April 11, May 8, and May 11, 2007, and provided specific comments as our review of test results permitted, including the review of final Management responses to IAD transmittals received on April 26, 2007.
Part IB of IDA Internal Controls Review
- Compliance with Charter and Policies

- **Significance of Deficiencies Identified in Part IA:** IAD reviewed Management’s evaluation, received on April 11, 2007, of the significance of deficiencies identified by Management, IAD and IEG during Part IA.

- **Representation of Compliance Rates:** IAD reviewed the consistency and candor of the presentation of test results in Management’s draft reports with the objectives and results of Management’s tests. IAD then confirmed that Management’s final report appropriately represented the results of the testing, including an appropriate focus on key controls related to fiduciary processes.

- **Consideration of Related IAD Audit Work:** IAD reviewed relevant results of independent internal audit projects to assess consistency with and reasonableness of Management’s test results and conclusions.

Specifically, the results of the following IAD audit projects were used in IAD’s review of Management’s test results:

- IBRD FY07-14: Report on an Audit of Bank Activities in Benin;
- IBRD FY07-22: Report on an Audit of Bank Activities in Lesotho;
- IBRD FY07-26: Report on an Audit of the Africa Region;
- IBRD FY07-35: Report on an Audit of Bank Activities in Brazil;
- IBRD FY07-40: Report on an Audit of the Process for Reporting Project Implementation Progress;
- IBRD FY07-38: Report on an Audit of Bank Activities in Pakistan; and,
- IBRD FY07-41: Report on an Audit of Bank Activities in West Bank and Gaza.

**General Observation**

As observed in IAD’s report on Part IA of this review dated October 13, 2006, this IDA assessment is the first comprehensive internal exercise undertaken by Management to review an operational/compliance internal control framework. Furthermore, it appears to be unique in the multilateral development banking environment, and to our knowledge, in the broader international financial institution community. While the effort underlying the commitment was clearly underestimated at the outset, substantial commensurate benefits are anticipated: its results will provide a compelling baseline to identify opportunities for streamlining IDA’s (and concurrently IBRD’s) operations and internal controls while significantly improving consistency and efficiency.
Specific Observations

1. **Management Testing Results for Key Fiduciary Controls**: Of the 115 key controls documented and tested by Management, IAD considers the 29 key controls related to the fiduciary processes (Procurement, Financial Management, and Loan Management and Disbursements), as being most critical to ensuring that IDA funds are used for purposes intended. Management's testing results for Part IB have indicated that approximately 21% of these key fiduciary controls do not operate effectively. Management has further concluded that significant deficiencies exist in the procurement and financial management processes.

2. **Analysis of Compliance Rate at the Transaction Level**: A system of internal control is generally designed such that key controls in a process are interdependent; that is, each key control assumes that the prior and subsequent key controls within a transaction also operate effectively. This is particularly critical in IDA processes during the project supervision phase.

   Management has stated in its report that Part IB testing was not designed to assess compliance of a single given operation or product with all the applicable (key) controls throughout the project cycle.

3. **Operating Effectiveness of Key Fiduciary Controls**: While Management has verified that documentary evidence exists to support the operation of key fiduciary controls, the quality of the underlying specialist input, including procurement, financial management and safeguards aspects of supervision, and the appropriateness of the resulting ratings, has not yet been examined.

   Recent audits conducted by IAD have concluded that such controls do not consistently operate effectively. Further testing is required to ensure that follow-up action has been taken to correct weaknesses identified by specialists prior to concluding that these key fiduciary controls operate effectively.

   Management has stated in its report that further review is required of the fiduciary controls in the areas of financial management and procurement, as well as key controls related to safeguards of investment operations. This will be accomplished by examining the related quality aspects and follow-up actions in Part II.

4. **Statement of Expenditure (SOE) Reviews and Auditing Arrangements**: Management's testing did not cover SOE reviews (and supporting documentation to verify the eligibility of expenditures), or audit policies and practices for Bank projects including appropriateness of scope, periodicity of audits, auditing standards and the Audit Report Compliance System (ARCS).
Part IB of IDA Internal Controls Review
- Compliance with Charter and Policies

In IAD’s opinion, SOE reviews, either directly by Bank staff or indirectly through appropriate audit arrangements, are critical to ensure that funds are used for intended purposes.

Management has stated that audit practices and SOE reviews will be covered in Part II, along with the further review of fiduciary controls (See specific observation #3 above).

5. **Debt Reporting Process**: Management’s test results indicating a hundred percent (100%) compliance rate for the Debt Reporting process is inconsistent with recent Board Papers indicating the need for improved compliance in aspects not covered by testing.

Management has acknowledged the divergence between the OP/BP and the process as it is performed in practice, concluding that control objectives relating to Debt Reporting were nevertheless being achieved. Management will review OP/BP 14.10 with a view to eliminate the divergence between policy requirements and the process as it is performed in practice.

Further, the processes relating to the broader debt sustainability analysis required for IDA, including the grant allocation framework based on the level of debt distress, was not covered during Part IB, as the policy approval fell outside the testing period under review. Management has stated that the debt sustainability process will be documented and tested during Part II.

6. **Status of Review Results for Part IB**: IAD provided forty-four (44) specific comments on Management test plans related to the testing of operating effectiveness of key controls at the transaction level. Of these, forty (40) have either been actioned or resolved with Management; the remaining four (4) have been deferred to Part II.

In addition, IAD identified fifty-eight (58) issues during its review of results of Management’s testing. Of these, forty-five (45) have either been actioned or resolved with Management; twelve (12) have been deferred to Part II; one (1) remains outstanding.

See Annex A for details.
Part IB of IDA Internal Controls Review
- Compliance with Charter and Policies

Status of Part IA Recommendations and Potential Deficiencies

Six of the eight IAD recommendations in Part IA remain open. The current status is attached as Annex B.

During Part IA, IAD identified fifty-nine (59) potential documentation and design deficiencies. Eighteen (18) remain open; while five (5) have been deferred to Part II. The current status is attached as Annex C.

Overall Conclusion

In our opinion, subject to the outcome of the assessment of entity-level controls and other relevant outstanding assessments to be completed in Part II, Management’s view that the design and operational effectiveness of identified processes and associated key controls are adequate to provide reasonable assurance of compliance with IDA’s policies and procedures to ensure the use of funds for the purposes intended, is fairly stated, taking into account the exceptions noted by Management.

[Signatures]

Pachiaraj Murugan
Auditor-in-Charge

Thomas Ho Quen Hum
Audit Manager
## Annex A

### Status of IAD Comments to Management Test Plans

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4 Management’s assessment did not include an analysis of compliance at the transaction level. Management has indicated that Part IB testing was not designed to assess compliance of a single given operation or product with all the applicable (key) controls throughout the project cycle.

Report No. IBRD FY07-49  CONFIDENTIAL  June 7, 2007

Assurance and advice that bring Our Dream closer
Annex B

Status of IAD’s Part IA Issues and Recommendations

1. IDA Processes Selected: Management’s methodology does not adequately rationalize its intention to limit the scope of the review, as outlined in the IDA Control Review Methodology Note dated July 6, 2006 to determining compliance with fiduciary aspects of lending operations in IDA’s charter, as the basis for deciding which IDA processes were relevant to the assessment. Management further limited its scope to processes applicable to Specific Investment Lending (SILs) and Development Policy Lending (DPLs) as the two lending instruments representing most of the value and volume, and which were deemed to be a representative proxy for other lending operations. Certain other IDA products, trust funds and grants that do not utilize IDA resources, and other miscellaneous operations outlined in the Articles were also excluded. We are not aware of any intended scope limitations of the commitment for a comprehensive assessment. By scrapping out certain of IDA’s operations, a selective rather than a comprehensive “bottom-up” approach has resulted. Rationalization appears necessary to reconcile management’s interpreted scope with that described in the original commitment.

Management Response: The methodology applied by management to rationalize its approach to review compliance with the fiduciary aspects of lending operations in IDA’s charter (the work performed in Parts IA and IB) has been described in paragraphs 13 to 24 of Management’s Report on Its Review of IDA Internal Controls - Part IA, included as Attachment 1 to the October 2006 EEG Report. This methodology has been described in the Revised Work Plan that was shared with EEG, and IAD and discussed with the Audit Committee on July 17, 2006.

The initial focus on process and transaction-level controls under the methodology applied makes it difficult to provide an overall definitive conclusion on the effectiveness and efficiency of internal controls over IDA’s operations at this stage. However, Management believes that the staged approach to this exercise was necessary in light of the unprecedented nature of this assessment, the intensity and scope of work required, as well as its primary objective of assessing the existing controls for ensuring that IDA funds are used for the purposes intended. Given the trade-offs, in a resource constrained environment and real time limitations on what could be done, the approach followed proved to be preferable to the findings, and related action plans adopted to address issues identified, are likely to be the major themes of the entire assessment.

Current Status: OPEN.

To address IAD’s concern that only two lending instruments were sampled during Part IA, Management added other types of investment lending products to its sample in Part IB covering Adaptable Program Loans (APLs), Technical Assistance (TA), Emergency Recovery Loan (ERL) and Sector Investment and Maintenance Loan (SIML). However IAD’s concern that a selective “bottom-up” approach was used, still remains.

2. Information Technology (IT) Controls: Work has not yet been undertaken to identify significant compliance controls embedded in automated applications. The separate assessment of Internal Controls over Financial Reporting (ICFR) was not designed nor intended to cover operations compliance controls, automated or manual. To include the assessment of automated compliance controls embedded in applications along with General Computer Controls (GCC) as part of the entity-level controls review in Part II will require re-work in the areas of documentation, confirmation, and testing to assess design and operating effectiveness of process/transaction level controls. In order to reliably conclude its Part I assessment of process/transaction level controls, management will necessarily be required to carry out its assurance of key IT Controls together with Part IB.
Part IB of IDA Internal Controls Review
- Compliance with Charter and Policies

Management Response in Part IB: Management believes that IT controls must be included in its review of IDA's internal control framework. Management has indicated from the beginning of this review that IT controls would be reviewed during Part II. Management will identify all relevant key IT systems impacting the operations with automated compliance controls and document them accordingly. Management believes that few of its current documented processes will be impacted by such review based on the relatively low level of automation associated with most of these processes; however, it should review IT controls under Part II identify the need where it will be necessary to re-work any of the existing documentation and compliance testing. Management will do so accordingly and report on its findings during Part II.

Although performing a review of General Computer Controls (GCC) is not a requirement under COSO, Management intends to conduct a form of this review during Part II.

Current Status: OPEN. Deferred to Part II.

3. Fraud and Corruption Controls: Management should identify and assess key controls to prevent and detect fraud and corruption at the process/transaction level.

Management Response in Part IB:

The view that key controls to prevent fraud and corruption should have been specifically identified and assessed by Management takes a narrow view of the control framework needed to ensure that "funds are used for the purposes intended". Since fraud and corruption are a key cause of misuse of funds, prevention and detection of fraud and corruption have to be embedded and indeed be one of the key aspects of the control framework in place to ensure that funds are used for the purposes intended.

At the country level, systemic issues of fraud and corruption and the associated risks are addressed as part of the strategic country dialogue relating to areas of governance, public expenditures and institutional weaknesses, all of which are assessed and reflected as appropriate in the CAS. At the project level, fraud and corruption issues are addressed as part of the review and appraisal processes and are also assessed as part of the fiduciary aspects of project preparation, appraisal, and supervision activities, together with all the fiduciary controls documented as part of the assessment.

Management has identified and documented key fiduciary controls which also mitigate the risks associated with fraud and corruption (e.g. LOA's segregation of duties in review and approval of withdrawal applications, procurement prior reviews and post reviews, country financial assessments, FM risk ratings, etc.). In addition to work already performed during Part I, Management will use the results of the Bank's fraud and anti-corruption controls program used for the review of the Internal Control over Financial Reporting (ICFR) process, to support its review of the fraud and corruption controls on an IDA entity-wide basis.

Current Status: OPEN. Significant deficiencies have been identified in the fiduciary controls relating to procurement and financial management processes. Since these are key processes for the prevention and detection of fraud and corruption, management's conclusion that fraud and corruption controls have been specifically identified and tested and that they operate effectively at the transaction level will be subject to the outcome of further review of the qualitative aspects of these review processes in Part II.

4. Outdated Operational Policies (OPs) and Bank Procedures (BPs): One objective of the assessment by Management related to the design effectiveness of key controls is to ensure compliance with policies and procedures governing IDA's operations. Management has acknowledged in its report that OPs and BPs
PART IB OF IDA INTERNAL CONTROLS REVIEW
- COMPLIANCE WITH CHARTER AND POLICIES

have not kept pace with changing business practices. In principle, absent processes to ensure that policies are current, appropriately approved, and consistently communicated in accordance with business needs, providing reasonable assurance that controls are designed effectively to ensure compliance with such policies would not be meaningful, even if current practices appear adequate to meet business needs. Management has committed to review current processes to facilitate more frequent and timely updating of operational policies and procedures. Management has also committed to review the appropriateness of regional variances in their implementation.

Management Response in Part IB: This point is similar to that raised by IEG (recommendation 2). Updating and streamlining operational policies and procedures governing investment lending operations is the primary focus of the final stage of the modernization agenda which is expected to be completed within the next 24 months. As part of this process, Management has prepared a table (see Annex 4) of all OPs/BPs that have a direct bearing on IDA’s operations and included in this review, with a summary of update status for each. This table has been shared with IAD and IEG. It is expected that the results of this evaluation, including the efficiency and effectiveness review to be carried out under Part II, would form an important input into this work.

Current Status: OPEN.

5. CATEGORIZATION AND REMEDIATION OF DEFICIENCIES: Analysis has not yet been carried out under Part IA of management’s assessment to determine whether identified deficiencies pose, in the aggregate if not individually, significant or material risks to the attainment of the control objectives to which they relate. In our view, in the absence of such determination, management has no sound basis upon which to conclude whether controls are effectively designed.

Management Response in Part IB: Management has evaluated the magnitude of any control deficiency (either raised by IAD, IEG or management), together with findings of non-compliance during the operational effectiveness testing and shared its evaluation with IAD and IEG. The key findings are summarized in this report.

Current Status: CLOSED.

6. DOCUMENT RETENTION AND ACCESSIBILITY: Management acknowledged significant difficulties in obtaining timely access to relevant documents for compliance testing, which led to the segregation of assessments of control design effectiveness from operating effectiveness. In our view and experience, this represents a significant control design deficiency. Management has committed to address the document retention and accessibility issue immediately.

Management Response in Part IB: Management has commenced its review of the issues identified to date by setting up an expert panel to look at document retention, filing and accessibility of operational documents and develop recommendations for improvements. In light of the business units’ ability to provide full documentation during the walkthroughs performed during Part IA, and the high level of documentation obtained as part of the compliance testing in Part IB, the issue appears to be not one of compliance but rather of ensuring that the appropriate documentation is easily and readily available to support the various processes and decisions reached.

Current Status: OPEN.
7. Assessment of Entity-level Controls: Management has indicated that the review of entity-level controls, including tone at the top, the assignment of authority and responsibility, appropriate policies and procedures, and company-wide programs, will be carried out under Part II of the assessment. The effectiveness of entity-level controls should have been assessed prior to undertaking any assessment of controls at the process or transaction level, since controls at the organizational level often have a pervasive impact on controls at the process, transaction or application level. Therefore, any management conclusions on control effectiveness as a result of Part I assessments will need to be reconsidered once entity-level controls have been examined.

The review of entity-level controls, including tone at the top, the assignment of authority and responsibility, appropriate policies and procedures, and company-wide programs, will be carried out by Management under Part II of the assessment.

Management Response in Part IB: The review of entity-level controls will be carried out during Part II. Management will agree the scope of the activities to be included in this review with IAD and IEG by the end of May 2007. It is expected that the review of entity-level controls will include tone at the top, assignment of authority and responsibility, appropriate policies and procedures and various entity-wide programs.

Current Status: OPEN. Deferred to Part II.

8. Walkthroughs of Process Documentation: Management’s assessment of design effectiveness of internal controls under Part IA of the review included walkthroughs of process documentation for three (3) of the twenty-nine (29) documented in-scope processes (CASs, SILs and DPLs) from inception to completion. The workshops/review sessions for the other twenty-six (26) documented in-scope processes do not meet the criteria for walkthroughs outlined in AS 2.

In our view, end-to-end process walkthroughs of all in-scope processes should have been conducted prior to management concluding on design effectiveness of internal controls, but in any case will need to be carried out by management prior to (or concurrently with) compliance testing in Part IB.

Management Response in Part IB: Based on discussions with IAD, Management believes that the compliance testing methodology which included testing individual credits through all the controls in a procedure have alleviated IAD’s concerns about the design effectiveness by the completion of Part IB. We do not believe this is an issue any longer.

Current Status: CLOSED. Management’s compliance testing in Part IB met the requirements of valid walkthroughs for the other twenty-six (26) processes that were not covered in Part IA.
Annex C
Current Status of Part IA Deficiencies Identified by IAD

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STATEMENT BY THE EXTERNAL ADVISORY PANEL TO THE INDEPENDENT EVALUATION GROUP (IEG) IN RELATION TO THEIR REVIEW OF IDA CONTROLS

1. Terms of Reference.

The Terms of Reference for Panel members referred to IEG’s conduct of an independent evaluation of the self assessment being completed by management (the Controller’s Department) and the subsequent review to be conducted by the Internal Audit Department (IAD).

Panel members were to be provided with a selected set of materials as background reading to familiarize themselves with the nature of overall task. As well, once the IEG evaluation study reached the stage at which its findings were incorporated in a draft report. Panel members working individually, were expected to review the draft report and participate in a Panel discussion to be held in Washington, DC. That discussion would involve the IEG evaluation project team and selected members of IEG management.

The major purpose for involving the Panel was to have to provide an independent opinion on the IEG evaluation approach and findings directly to the Board of IDA. This it would do in a Letter of Comment. It would be a relatively brief statement, focusing on highlighted issues, but would not be constrained in any way from making observations on any aspects of the overall review it may deem relevant, whether these may pertain to the overall review itself, or to the part that was played by IEG in making its evaluations.

2. Timing and Coverage of the Panel’s Review

The Panel conducted its review in the five days from 5-9 March 2007 in Washington, DC. The review covered mainly the almost completed Part I: Processes and controls applicable to the fiduciary aspects of IDA (The Compliance Assessment) which had been divided into two parts—Part IA: Process Mapping and Design Effectiveness; and Part IB: Testing of Controls Operation. The Panel reviewed and discussed the IEG Report on the Completion of Part IA (dated October 16, 2006) and the Preliminary Draft IEG Report on the Completion of Part IB. As well, the Panel provided comments on IEG’s Thoughts on Part II of the IAD Internal Control Assessment. The Panel had access to the draft Management report on its Review of Internal Controls—Part IB. The Panel did not benefit from sight of the IAD Part IB report, since this was not yet ready for release.

3. Working Papers and Documents

The Panel was provided with a range of papers and documents for information as well as to enhance its understanding and comprehension of the issues and the approaches, methodologies and techniques used. A full set of these documents as well as working papers with comments and cross references to the former have been given to IEG.
4. Related Background

The Panel’s attention was drawn to the then United States General Accounting Office Report to Congressional Committees (June 2003) entitled “World Bank Group—Important Steps taken on Internal Control but additional assessments should be made”. In that report, at least two relevant observations were made for this review as follows (Page 3):

‘Bank Group management does not include an assertion on internal control over operations and compliance with key provisions of its bank charters and policies, and it has not asked the external auditor to give an opinion on those internal controls.’

And,

‘The Bank Group’s external financial statement audits do not, and are not intended to, provide specific assurance about the internal control over the Bank Group’s operations and whether the funds are spent for their intended purposes. Given the inherent users in the Bank’s activities, additional assurance on these other categories of internal control—operations and compliance—would provide an added level of assurance to the Bank Group and its member countries that funds were used for their ‘intended purposes’.

In the IDA14 Replenishment Report approved by the Executive Directors of IDA on March 10, 2005, Bank management ‘committed to carry out an independent comprehensive assessment of its control framework including controls over IDA objectives and compliance with its charter and policies’ (Page 39). The interpretation of this commitment and its impact on the nature and direction of the review have been, and will continue to be, of central importance to a successful outcome.

In a report entitled ‘Integrated Risk Management Framework and Implementation’ as requested by Executive Directors during a joint Audit Committee and CODE meeting on May 15, 2002, it was stated that:

‘Development effectiveness is the central management challenge for the Bank. It requires a focus not just on getting the best results from ongoing activities but also on choosing the right activities and scale to engage in-taking appropriate risks’ (Page 1).

The report goes on to say that:

“The Board faces a wide range of increasingly complex risks. Sound risk management—to meet the dual requirement of development effectiveness and resource mobilization—must be comprehensive. To ensure that opportunities are not missed and the full range of risks is considered, it helps to organize risk management around four focal areas: strategic effectiveness, operational efficiency, stakeholder support, and financial soundness’ (Page 1).
Finally,

‘But it is also crucial to take into account the interactions among the different types of risks. So these four focal areas have to be treated only as an organizing principle, as part of a whole,’ (Page 1).

The Panel also noted the ‘IBRD and IDA FY06 COSO year-end report’ prepared by the Controllers, Strategy and Resource Management Vice Presidency of October 11, 2006 and comments on the Risk and Opportunity Workshops providing the:

‘ability to take the institution’s pulse’ on the control environment and other aspects of risk management and to ensure their findings become an integral part of the IRM effort on risk awareness and measurement (Page 19).

This observation has implications that go well beyond financial reporting controls. It also reflects the interrelationship between risk and control and the requirement for cost/benefit assessments.

5. **Panel Observations.**

The Panel was impressed by the professionalism, competence, understanding and commitment of the IEG personnel involved in the evaluation. We also met with the Auditor General and two other senior IAD staff on two occasions as well as with a senior group of management personnel. These were full and frank discussions. We also had an opportunity to meet with the Chair of the Audit Committee. Details of the meetings are included in the Working Papers.

The Panel notes that there were different views on the so-called bottom up approach to Part I as opposed to a top down approach starting with entity level controls. In emphasizing, for Part I, the fiduciary aspects of IDA controls, and while keeping within the COSO framework, Management decided to approach its assessment by focusing on the business processes that IDA performs on a daily basis in the execution of its operations. The Panel understands the pragmatic approach taken for Part I while recognizing that final conclusions will be made on the review after the completion of Part II. In fact it may be necessary to vary some of the conclusions of Part I as the result of the work on Part II.

The strength of the approach in Part II is the top level strategic focus reflecting decisions made about the application of the overall integrated COSO risk management framework and associated entity-wide controls within the governance arrangements that reflect both ‘tone at the top’ and the authority and accountability which is assigned to the review and any agreed outcomes. The necessary leadership is reinforced by both top down and bottom up approaches with the resultant commitment at all levels of the organization.

Any initiatives taken should reflect the culture of the organization, in particular by strong values and ethics. Identified risks and associated controls can be better integrated in a cohesive, consistent and transparent manner which should result in better understanding
and commitment to the framework throughout the Bank. That is, controls and risk treatments should be coincidental business process and entity levels and mutually reinforcing.

The Panel notes the extent and value of work done on Part I which is in the final stages of completion. What it has done is to provide information about business processes and operation that was not readily available in the past. This has led to better understanding of the business and provides a useful basis for future analysis and strategic decision making. Some concerns were expressed, particularly by IAD, about a lack of documentation. The Panel also notes the views that, in most cases, documentation was available but difficult to discover/access. In that respect, it strongly supports the Management initiative on Enterprise Content Management to improve documentation, link directly with work flows and automate. The Panel agrees that documentation is a common problem across both the private and public sectors and is generally being given a higher priority both to facilitate decision-making and to enhance accountability.

The Panel supports the use of suitable standards against which accomplishment/performance can sensibly be assessed. This is a discipline that all such reviews should involve and is an essential element of quality assurance. The Panel notes the Management’s comment, that “The audit standards to be used define the degree of rigor in controls assessment and testing”. Management indicated that it used a set of standards based on concepts which are contained in the United States Audit Standard 2 (AS2) criteria. These standards are as directed by the Sarbanes-Oxley legislation (SOX) and were designed to strengthen financial reporting under the COSO framework. The standards agreed by the Management, IAD and IEG in assessing deficiencies, significant deficiencies, and material weaknesses are appended as Attachment 2 to the Approach Paper submitted to the Audit Committee on July 12, 2006.

The Panel also notes the differences of view between Management and IAD about the use of concept of “walkthroughs” under the above standard. The IEG has broadly crafted the management approach as meeting the intentions of the standard. However, this is an issue that is still to be resolved between Management and IAD. The Panel supports the requirements for an evidential trail which can be provided in alternative ways, for example by informed expert comment. But what this does raise is the question of the use of such standards as a guide for exercises of this kind or as a prescriptive element of the review. The Panel would be inclined to the notion of a Guide. The Panel also supports the use of the INTOSAI Guidelines for Internal Control Standards for the Public Sector as suggested in the paper ‘Thoughts on Part II of the IDA Internal Control Assessment’ given the nature and constituency of the Bank with both its public and private sector profiles.

Another common issue for both the private and public sectors is achieving a suitable balance between conformance and performance imperatives as a central element of good governance. Put simply, the challenge is to provide both adequate assurance and achieve required results. They are not alternatives and sound risk management frameworks assist those in charge of governance to decide on an appropriate balance at specific points in time and over time. In the Panel’s view, this is what makes Part II of the review so important in building on the extensive investment in Part I. The latter has been largely about compliance
or conformance, the former is now a challenge to focus more on what is to be achieved both efficiently and effectively.

The Panel observes that there are different skills required for financial statement, assurance and performance audits. The Auditor General, not surprisingly, has a strong focus on the former and the related controls and risk factors. The Panel accepts that IAD may also have some capacity to undertake reviews of administrative effectiveness. While noting the issue of ‘independence’ in reporting in the relationships with the President and the Board which gave IEG the review role in this exercise, the Panel also notes that Part II may well involve issues of policy effectiveness which are more within the province and scope as well as the competence of IEG.

The Panel understands the problems that can arise with apparently overlapping functions and responsibilities and the need for open, as well as close, consultation and cooperation to achieve required outcomes. Indeed, this was reflected in a degree of frustration in the Audit Committee last year which all parties are determined will not be repeated. This is not a matter of achieving agreement at the expense of informed debate on the issues but rather ensuring that respective roles are recognized as well as the contributions made, facts are agreed and differences of opinion are clarified so that informed decisions can be made. This requires mutual trust, respect and cooperation in a genuine ‘partnership’ to achieve the best results for the organization.

The above issues are important for the timely achievement of Part II. As noted earlier, Part I is in the final stages of completion with a focus on the testing in Part IB. This work is necessary as part of good quality assurance and has been important element of the learning process. While there remain some matters of detail to be resolved which reflect on the confidence in the statistical sampling methodology and interpretation of a number of the elements of the business processes, the Panel notes IEG’s view that the approach may well have wider benefits for future understanding of the various interrelationships and structures of those processes and their resulting efficiency and effectiveness, including risk assessments and controls. The Panel notes that Management, IAD and IEG will meet to resolve and clarify some issues and concerns in the process. Moreover, there is confidence that the Board will receive considerable assurance that the processes and controls put in place are largely working as intended. Part II will provide an opportunity to make improvements in the existing arrangements but also, hopefully, provide insights which could result in different approaches and achieve better results.

In discussions with Management the Panel understood that there will be some changes and enhancements to their Draft Report on Part IB (of February 28, 2007). The Panel was encouraged by the response and a more helpful report should result. While the IEG Report on the completion of Part IB is still work-in-progress, the structure and content are supported. Timing is a factor. As noted earlier, there are issues and queries to be resolved between the main parties—Management, IAD and IEG. Management stressed that Part IB is an ‘interim assessment’. The Auditor General may not give an opinion on Part IB but more likely will opine on whether Management has done sufficient work to justify their conclusions and whether their report is fairly stated. It is probably fair to say that, at this
date, there is a greater distance to travel for agreement between IAD and Management than between Management and IEG.

6. Overall Conclusions

The Panel is impressed by the professional approach and commitment of the three major parties to the review – Management, IAD and IEG. Considerable effort and resources have been dedicated to the task. The Panel is not in a position to conclude on the cost/benefit of what has been done to date. However, it notes the paucity of available information on similar exercises elsewhere in areas where many organizations are dealing with demands for better controls, greater assurance, and better outcomes — whether more cost effective programs or more shareholder value. There has been a greater focus on governance frameworks and on associated organization culture that reflects high level values and an ethical approach with greater transparency and associated accountability.

The Panel strongly supports adherence to the COSO Integrated Risk Management framework. This requires considerable ongoing support from the top of the Bank and commitment at all levels of the organization. The Panel also notes the initiatives taken over a number of years in relation to that framework, particularly in the area of controls for financial reporting and the Bank’s financial statements. These are not covered in the reviews basically because there has not been any adverse audit opinion expressed on them, as the Panel understands. Nevertheless, they are an important part of the integrated framework which is increasingly covering both non-financial as well as financial information. In particular, the Panel notes the growing importance of Information Management and Communication controls in the ever increasing technological era and the associated risks which have often added to management complexity as well as facilitating organizational effectiveness.

The Panel wishes all parties well in what is now likely to be the more complex part of the reviews. Hopefully, the efforts to date will facilitate the conduct of Part II but timing will continue to be a challenge, particularly if it is considered that the result should be available for Replenishment 15 discussions early in 2008. The issue of timing is also important for any effective conversion to be made between business process controls reviewed in Part I and entity controls in Part II. The nature of Part II is likely to demand considerable time and commitment of many Senior Executives and Board members. A number of clear milestones need to be established and the risks to the timetable managed accordingly. Greater emphasis will need to be placed on cooperation and timely information exchange as well as on key decision points. Issues about priority will need to be addressed at the outset. No doubt Part II will be facilitated by the insights and lessons learned, from Part I. An early sharing of these across the key participants would facilitate a successful outcome.

Patrick Barrett  
Bjarne Mørk-Eidem  
Vijay Shunglu
Review of IDA Internal Controls

An Evaluation of Management’s Assessment and the IAD Review

Volume V

Report on the Completion of Part IA
Process Mapping and Effectiveness of Control Design

This paper is available upon request from IEG-World Bank.
<table>
<thead>
<tr>
<th>Acronyms and Abbreviations</th>
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<tr>
<td>AAA Analytical and Advisory Activities</td>
<td>IRMF Integrated Risk Management Framework</td>
</tr>
<tr>
<td>AC Audit Committee</td>
<td>ISR(R) Implementation Status (and Results) Report</td>
</tr>
<tr>
<td>ACS Administrative and Client Support Network</td>
<td>IT Information Technology</td>
</tr>
<tr>
<td>AICPA American Institute of Certified Public Accountants</td>
<td>NGO Non-Governmental Organization</td>
</tr>
<tr>
<td>ARDE Annual Review of Development Effectiveness</td>
<td>OED Operations Evaluations Department</td>
</tr>
<tr>
<td>ARPP Annual Review of Portfolio Performance</td>
<td>OM Operational Memorandum</td>
</tr>
<tr>
<td>AS2 Audit Standard No. 2</td>
<td>OP Operational Policy</td>
</tr>
<tr>
<td>BP Bank Procedure</td>
<td>OPCS Operations Policy and Country Services</td>
</tr>
<tr>
<td>BPM Business Process Module</td>
<td>PAS Procurement Accredited Specialist</td>
</tr>
<tr>
<td>CAS Country Assistance Strategy</td>
<td>PCAOB Public Company Accounting Oversight Board</td>
</tr>
<tr>
<td>CDS Control Detail Sheet</td>
<td>PCPI Post Conflict Performance Indicators</td>
</tr>
<tr>
<td>CODE Committee on Development Effectiveness</td>
<td>PMT Project Management Team</td>
</tr>
<tr>
<td>COSO Committee on Sponsoring Organizations, of the Treadway Commission</td>
<td>PO Process Overview</td>
</tr>
<tr>
<td>CPIA Country Policy and Institutional Assessment</td>
<td>PPF Project Preparation Facility</td>
</tr>
<tr>
<td>CTR Controller’s</td>
<td>PS Procurement Specialist</td>
</tr>
<tr>
<td>DEC Development Economics and Chief Economist</td>
<td>SME Subject Matter Experts</td>
</tr>
<tr>
<td>DPL Development Policy Loan</td>
<td>QAG Quality Assurance Group</td>
</tr>
<tr>
<td>ESW Economic and Sector Work</td>
<td>QEA Quality at Entry Assessment</td>
</tr>
<tr>
<td>GPN General Procurement Notice</td>
<td>QSA Quality of Supervision Assessment</td>
</tr>
<tr>
<td>FM Financial Management</td>
<td>RMCP Vice President, Resource Mobilization and Co-financing</td>
</tr>
<tr>
<td>FMA Fiduciary Monitoring Agent</td>
<td>RMFM Regional Manager, Financial Management</td>
</tr>
<tr>
<td>IAD Internal Audit Department</td>
<td>ROC Regional Operations Committee</td>
</tr>
<tr>
<td>ICR Implementation Completion Report</td>
<td>ROW Risk Opportunity Workshop</td>
</tr>
<tr>
<td>IDA International Development Association</td>
<td>SIL Specific Investment Loan</td>
</tr>
<tr>
<td>IEG Independent Evaluation Group (formerly OED)</td>
<td>SOX Sarbanes-Oxley Legislation</td>
</tr>
<tr>
<td>IL Investment Lending</td>
<td>SSS Transition Support Strategy</td>
</tr>
<tr>
<td></td>
<td>TTL Task Team Leader</td>
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<tr>
<td></td>
<td>RS Risk Scan</td>
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<td></td>
<td>VAA VPU Access Administrator</td>
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<td></td>
<td>VPU Vice Presidential Unit</td>
</tr>
<tr>
<td></td>
<td>WBI World Bank Institute</td>
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Key Technical Terms

**Internal Controls:** Controls, individually or in collective fashion, are structured means within an organization to enable it to achieve its business objectives, while addressing risk. Control instruments include the control framework (in IDA’s case, the COSO framework), organizational checks and balances, published policies and required procedures, among others.

**COSO Integrated Framework:** A framework of management principles (“COSO components”) in an organization which, when collectively operating as intended, will ensure the attainment of three key organization goals (“COSO objectives”), namely: reliable financial reporting; operational effectiveness and efficiency; and compliance with laws and regulations, (or in IDA’s case with its charter and internal policies and procedures). The COSO components are: Control Environment; Risk Assessment; Control Activities; Monitoring and Learning; Information and Communications.

**Risk Focal Points:** In the way the Management of the Bank and IDA have adapted the COSO framework to their own needs, four key points of risk which face the mission of the Bank Group—and are especially relevant to IDA—have been defined and added to the COSO framework, namely: Strategy Effectiveness; Operational Efficiency; Financial Soundness; and Stakeholder Support.

**Audit Standards:** Criteria established by recognized accounting and audit bodies, which, in the course of reviews of internal controls systems, enable the definition of deficiencies, significant deficiencies, and material weaknesses that may be revealed in those systems.

**Business Process Modules (BPMs):** Management chose to conduct this review of internal controls by identifying the main business processes in which IDA is engaged on a daily basis in the course of its operations. These processes, 30 in all, covering IDA allocation, the CAS process, the main lending products (SILs and DPLs), and the fiduciary, contractual, safeguards and quality assurance processes that support lending, were each mapped and described as separate business process modules, each containing the key internal controls that are the subject of the review.

**Process Map:** The flow chart that graphically depicts all steps in a business process module.
**Key Control**: A gateway and decision point, involving key units and IDA staff, in a given business process module, through which a business transaction being processed must pass. It is the effectiveness in design of these controls and the subsequent testing of the effectiveness of their operation that is at the center of this review.

**Business Process Template**: A standardized questionnaire and rating system used by IEG to provide quality ratings of Management’s method and approach in identifying, describing and mapping the business processes, and its method in assessing control design effectiveness and effectiveness of control operation.

**Evaluation Panels**: In applying its Business Process Template, IEG assembled 3-4 person panels, including specialists in the particular discipline covered by the given BPM. The panels arrived at consensus judgments on what should be the ratings applied to each section of the module, according to their evaluation of the materials presented by Management.

**Entity Level Controls**: This refers to the control framework that governs an organization at its aggregate level, emanating from central management down to the operating or business process level. In IDA’s case, the reference is to the elements of the COSO framework. Doing a controls review that started with an examination of entity-level controls, could be described as a “top down” approach.

**Bottom up Approach**: The approach adopted by Management in its assessment did not begin with a “top-down” entity-level review, but focused first on business processes at the operating level. Hence, it has been described as a “bottom-up” approach.

**Walkthrough**: An inter-active interview and review of process documentation conducted by Management with relevant teams of IDA staff knowledgeable in a particular business process and its associated controls, with a view to verifying that controls are designed in the way described, and operate in the way intended.

**Deficiencies, Significant Deficiencies, Material Weaknesses**: Design flaws, omissions, or non-compliant operation of controls, discovered in the course of a controls review, denoting ascending order of seriousness. The precise criteria by which the three categories of materiality are distinguished are explained in Annex B.
Preface

In the IDA 14 Replenishment Report Bank management committed to carry out an independent comprehensive assessment of IDA’s control framework including internal controls over IDA operations and compliance with its charter and policies. Each part of this review is to be done in a three-phase approach: the first phase would be a self-assessment by Management, to be followed by an Internal Audit Department (IAD) review and report on management’s self assessment, and an IEG independent evaluation of management and IAD work. This report contains IEG’s evaluation of the work done by management, and reviewed by IAD, for Part IA of the overall review.

The basis for the work done by IEG in its evaluation included: the report prepared by Management reflecting its assessment (Attachment 1); access to all the underlying materials that Management generated in its process based descriptions, definitions of controls and its “walk-through” testing of control design effectiveness; and the report presented by IAD (Attachment 2).

Under the task management of Nils Fostvedt, this report was prepared by Ian Hume, with the assistance of a core consultant team, including: Dexter Peach (Strategic Advisor, formerly Assistant Controller General for Planning and Reporting, GAO), James Campbell and Rosemary Jellish (Consultants, both former Assistant Directors, GAO) and Barbara Yale. The core team was assisted, in selected topics, by: Jed Shilling, Tribhuwan Narain, David Goldberg, and Mohammed Farhandi.
Review of IDA Internal Controls: An Evaluation of Management’s Assessment and the IAD Review

This report has its origins in a commitment that IDA Management made as part of the IDA 14 Replenishment process, in which it undertook “to carry out an independent, comprehensive assessment of IDA’s internal control framework, including internal controls over IDA operations and compliance with its charter and policies.” Management proposed, and the Board agreed, that Management would make an assessment of the controls, to be followed by an IAD review of the assessment and an IEG independent evaluation of both Management and IAD reports.

Management decided that it would conduct its assessment within the COSO integrated controls framework, but it would divide its study into two parts: Part I would deal with compliance issues, and be focused on controls at the level of 30 business processes, identified as representing IDA allocation, CAS and IDA lending products, supporting contractual, fiduciary and safeguard processes, and quality assurance; Part II would deal with issues of operational efficiency and effectiveness, and would include an examination of entity-level controls, within the full COSO framework.

Management subsequently divided Part I of the assessment into two stages: Part IA, recently completed and the subject of the present report, covers Management’s approach and method in identifying and mapping the business processes that represent IDA operations, and assesses the effectiveness of the design of controls within these processes; Part IB, to be completed early in 2007, will deal with the testing of how these controls actually operate, compared to their design. Part II is intended for completion by Management at the end of calendar 2007, with the full IEG evaluation expected in early 2008.

This IEG report contains the evaluation made by IEG of the work completed by both Management and IAD in their respective assessments and review of Part IA. IEG conducted its evaluation using a combination of approaches:

- Verifying the legal, methodological, and operational basis for the approach taken in the Management assessment;
- Reviewing Management’s findings and conclusions;
- Participating as observers in a selection of Management’s “walkthroughs” (verification interviews with knowledgeable Bank staff, concerning the actual design and working of key controls in the business processes);
- Creating an evaluation tool (a standardized template), which generated a quality data base, enabling IEG’s analysis and evaluation of Management’s method in identifying and building the process maps and descriptive materials, and in conducting its assessment of the effectiveness of control design;
- Within the context of COSO, making an evaluation of the scope limitations inherent in Management’s approach, and their impact on the quality of conclusions that can be drawn at this stage of the review.

Findings

Management decided the best way to track the use of IDA resources, was to focus its assessment at the transactions level on business processes. Doing so, it provided a rigorous, transparent and concrete
method for addressing internal controls, which was applied thoroughly and well documented. The assessment resulted in the production of 30 business process maps, accompanied by detailed description for each module and its key controls. Overall, the assessment resulted in the amassing of over 700 pages of evidentiary documentation, and in identifying a significant number of potential deficiencies. This represents progress in developing an understanding of IDA’s internal controls at the transactions level.

As evidence of this progress IEG would cite the following:

• As a basis to test for compliance, Management has made a credible linkage between the IDA Articles, the Bank’s policies and procedures, and the business processes identified to represent IDA operations;
• The mapped Business Process Modules have provided a concrete and transparent means of identifying, assessing and testing key controls;
• Management’s methods of mapping and assessing the BPMs were rated by IEG to be of a generally satisfactory quality, though with some notable qualifications relating to the treatment of risk, and the need to improve some of the descriptive materials;
• Management’s “walkthrough” method of verifying the accuracy of the selected business processes and testing the design effectiveness of their key controls was rigorous, comprehensive, transparent, and documented to a satisfactory standard, with some qualifications.

Management asserts that its approach gave a representative picture of IDA transactions processes, and that controls for the IDA allocation process as well as other controls over various aspects of IDA lending are appropriately designed to suggest that IDA resources are allocated and used in accordance with the IDA articles, and internal policies and procedures. It also documents that the approach succeeded in uncovering a significant number of specific controls-related issues. Of these, Management highlighted five it considered to be most serious:

• Difficulties with retention of and accessibility to documentation needed to verify the operation of key internal controls;
• Problems in keeping current the IDA OPs and BPs, which have not kept pace with the pace of change within the Bank Group;
• The policy framework for SILs being seen as too complex and cumbersome;
• Existing processes and documentary requirements for projects is seen by staff as onerous and inefficient;
• A disparity in the frequency with which DPLs (always) and SILs (seldom) are sent for Corporate Review, instead of Decision Meeting processing.

An evaluation of controls within the COSO framework requires that all its components be examined. Since this has not yet been done, is too early to make definitive conclusions on the state of the overall framework. However, from the deficiencies so far revealed, IEG considers that the issues highlighted by Management related to documentation retention, and the state of OPs/BPs are areas of potential material weakness. Management has initiated remedial programs in both these areas, and a firmer basis to draw conclusions about their materiality will be in place once testing has been completed in Part IB. IEG has also had to take account of the trade-offs and implications of process-based, bottom-up method chosen by Management for its assessment, and the scope limitations this has implied. From this perspective, notwithstanding the progress made, IEG found notable weaknesses in Management’s approach:

• Because conclusions on controls within COSO cannot be made piecemeal, but only within the framework as a whole, staging and dividing the study has effectively postponed the ability to make definitive conclusions on the outcomes of each stage of the review until the overall (Part II) assessment has been completed.
• Even the staging of the study between Part IA and Part IB makes conclusions on control design (Part IA) difficult until Part IB has been completed, because final judgments on design effectiveness cannot be made until the operation of the control has also been tested.
• Separating compliance and efficiency and effectiveness is really not possible in practice: many business processes and their associated controls are as much to do with compliance as with efficiency and effectiveness, and these are best treated together rather than in sequence. To illustrate, although management has focused its efforts to date on assessing compli-
ance, most of the potential issues it has identified are related to efficiency and effectiveness.

- Other scope limitations flowing from the delineation of the study—in particular the decision to deal with IT systems and field offices in Part II, have yet further limited the conclusions that can be drawn in Part I, especially given IDA’s increasing decentralization, and the growing importance of IT in maintaining the integrity of central controls.

- In taking 30 business process modules to represent the totality of IDA operations, Management has given a good representation of lending operations and the associated fiduciary processes; however, it has chosen to exclude AAA and other Knowledge Products, which IEG regards as a significant omission.

- In principle, it is possible that by completing the entity-level review during Part II, and addressing the postponed parts of the framework, Management will be able to mitigate these deficiencies in approach by linking results from the various parts together, to provide an overall statement. However, this will depend on there being no changes in any basic parameters: controls will be assessed at different points in time, and policies, procedures, systems, organization structures may change during this period.

IEG therefore arrives at a mixed conclusion on completion of this stage of the study: satisfactory progress has been made in defining, locating and assessing key internal controls at the transactional level, and the results have revealed a number of deficiencies and possible weaknesses in the underlying controls; on the other hand, the general approach and scope limitations applying to this stage of the assessment prevent any positive assertions being made now regarding the effective operation of the overall system of controls.

IAD was also positive in its findings of what Management had contributed to the Bank Group’s knowledge of its internal controls systems, and the new information provided at the process level, stating that it provided a compelling baseline to streamline operations and improve efficiency going forward. IAD identified eight key issues which it drew to Management’s attention: The exclusion of certain processes from the IDA processes selected; the fact that IT controls were not examined during Part I; the absence of fraud and corruption controls in the scope for Part I; outdated OPs and BPs; the need to categorize and take remedies for deficiencies; the issue of documentation retention and accessibility; the assessment of entity level controls; and issues relating to walkthroughs.

With the exception of the emphasis given to fraud and corruption and walkthroughs, all of these issues are also raised by IEG, with similar emphasis, and are covered in IEG’s overall evaluation. With regard to fraud and corruption, IEG believes that they (a) should be examined as part of the entity-level controls, and (b) were implicitly handled by Management in its process level approach. IEG agrees with IAD that more explicit mention of fraud and corruption issues could have been made in Management’s process-level assessment. With regard to walkthroughs, Management and IAD have applied differing concepts of the term. In addition to these highlighted issues, IAD has also indicated that it has found a number of other deficiencies (55 in all). While these have been listed by broad type, IAD has not yet categorized these as to their materiality (i.e. seriousness of their possible impact on risk mitigation).

Recommendations

Given the interim nature of the work so far completed and the limited conclusions that can be drawn from it in relation to the overall system issues, IEG’s recommendations are focused on the issues to be dealt with in completing the remaining phases of the review, and on the broader control framework issues that may emerge going forward. In this context, IEG makes six recommendations to Management (including one also to IAD), as follows:

- Confirming the Validity of the BPM Cluster: Management has argued, but has not conclusively demonstrated, that the core SIL prototype module in the cluster of BPMs can be used as a proxy for all investment type lending, because all ILs have the same controls as SILs. This proposition should be tested, and this could be done during Part IB. (para 2.18).

- Reform of the OPs/BPs: IEG considers this topic an area of potential material weakness, whose remedy Management should treat as a priority. IEG notes that Management has a stated strategy to address the problem, both
to streamline and to update the OPs/BPs. (para 2.37).

- Completing the Remaining Stages: IEG recommends that preparation for the Part II stage should begin promptly upon completion of Part I. It would seem useful to precede this work with a work plan (which could be discussed with the Board), that could benefit from consultations between Management, IAD, and IEG, much as the Audit Standards were discussed under Part I. Part II should preferably be completed expeditiously, also because if it should be delayed, the controls parameters that were tested during Part I may have changed, and there may be difficulties in integrating the two parts of the assessment. (para 2.24).

- Resolving Specific Issues and Potential Deficiencies (Management and IAD): It is important that the several deficiencies uncovered by both Management’s assessment and IAD review, as listed and described in Annex C, be addressed during completion of Part IB. While some of these issues relate to lack of clarity in documentation, others to efficiency and effectiveness of controls, others are potential deficiencies in controls. It is the seriousness of the latter group—the materiality of their potential impact on risk mitigation—that must be addressed before conclusions can be drawn on the state of the overall control framework. (paras 2.41, 2.44 and 3.3, third bullet).

- Managing the Risk Framework and Extending COSO: IEG believes the Integrated Risk Management Framework will need to be broadened to focus also on compliance and operations reporting, and in this context, the Bank may also consider adopting the recently extended version of COSO which provides for the addition of a new fourth objective (strategy—high level goals, aligning with supporting mission) and three new components to the existing five components of COSO: objective setting, event identification and risk response. (para 1.7 and Annex A paras 4-6)

- Mainstreaming Internal Controls Reviews: IDA should begin considering the value of adopting a policy requiring: (1) ongoing monitoring and reporting on internal controls in the course of operations for all three COSO objectives; and (2) separate evaluations and reporting as necessary.

**Attachments to the Executive Summary:**
Given the relative complexity of this three-part review and the technical, detailed nature of the issues examined and the findings arrived at, IEG has provided tabular summaries of both the approach and method of Management, IAD and IEG respectively (Box 1 and 2 below, extracted from Chapter 1), and of the main findings and positions taken on the key issues (Box 3, extracted from Chapter 4, paragraph 4.6).
### Box 1. Key Components in the Management Assessment, IAD Review, and IEG Evaluation (Part I)

<table>
<thead>
<tr>
<th>Management Assessment</th>
<th>IAD Review</th>
<th>IEG Evaluation</th>
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<tbody>
<tr>
<td><strong>Define Approach and Method</strong></td>
<td>Review Assumptions, Criteria, Methodology</td>
<td>Establish Framework/Tools</td>
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<tr>
<td>Business Process Based</td>
<td>Criteria for Inclusion/Exclusion</td>
<td>The COSO Framework</td>
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<tr>
<td>Fiduciary Focus</td>
<td>Review process</td>
<td>Business Process Template</td>
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<tr>
<td>Partial COSO</td>
<td>Test Methodology</td>
<td>COSO Template</td>
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<tr>
<td>Other Scope Limitations</td>
<td></td>
<td>Implications of Scope Limitations</td>
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<td><strong>Identify BPMs, Key Controls</strong></td>
<td>Review Use of BPMs</td>
<td>Review Use of BPMs</td>
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<tr>
<td>4 Umbrella Areas</td>
<td>Criteria for Selection</td>
<td>Criteria for Selection</td>
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<tr>
<td>30 BPMs</td>
<td>Definition of Key Controls</td>
<td>Definition of Key Controls</td>
</tr>
<tr>
<td>114 Key Controls</td>
<td>Review of Process</td>
<td>Review of Process</td>
</tr>
<tr>
<td><strong>Verify Mapping, Assessed Design of Key Controls</strong></td>
<td>Review of Management Assessment</td>
<td>Evaluate Individual BPMs</td>
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<td>Match Risks with Key Controls</td>
<td>Attend Walkthroughs</td>
<td>Rank for Significance and Risk</td>
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<tr>
<td>Conduct Walkthroughs</td>
<td>Review Assessment of Process and Design</td>
<td>Provide Quality Ratings for Documentation and Mapping</td>
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<tr>
<td>Assessment of Design Effectiveness</td>
<td>Effectiveness</td>
<td>Assessment of Design Effectiveness</td>
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<tr>
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<td>Apply Deficiency Tracker</td>
<td>Attend Selected Walkthroughs</td>
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**Conclusions for Part IA**
- Qualified Assurance
- Opinion Postponed

**Part IB**
- **Test Operation of Controls**
  - Conduct Audit of Controls
  - Define Sampling Method
  - Conduct Testing
- **Tabulate Findings**
  - Test Results Matrix

**Conclusions for Part IB**
- Evaluate Quality of Controls Tests
  - Provide Quality Ratings for: Testing of Key Control Compliance
  - Linkage to COSO Framework
  - Conduct Independent Analysis of Management Exceptions data

**Form Conclusions**
- **Statement of Assurance**
- Make Recommendations
  - Unqualified Opinion or Modified Report
  - Overall Evaluation, Recommendations

**Notes:** BPMs – Business Process Modules
### Box 2. Overall Timeline for Completion of IDA 14 Assessment

<table>
<thead>
<tr>
<th></th>
<th>Part IA</th>
<th>Part IB</th>
<th>Part II</th>
</tr>
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<tbody>
<tr>
<td>Management Report</td>
<td>Aug 06*</td>
<td>Dec 06</td>
<td>Sep 07</td>
</tr>
<tr>
<td>IAD Report</td>
<td>Sept 06*</td>
<td>Jan 07</td>
<td>Nov 07</td>
</tr>
<tr>
<td>IEG Report</td>
<td>Oct 06</td>
<td>March 07</td>
<td>Jan 08</td>
</tr>
</tbody>
</table>

*Source:* Based on the Management paper to the Audit Committee and current estimates. * These reports were actually completed in early October 2006.

### Box 3. Summary of Principal Issues Identified by Management, IAD, and IEG

<table>
<thead>
<tr>
<th>Issues relating to approach and method</th>
<th>Management</th>
<th>IAD</th>
<th>IEG</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A: Framework Issues</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Bottom-up versus Top-down</td>
<td>Better start Top-down</td>
<td>Better start Top-down</td>
<td></td>
</tr>
<tr>
<td>2. Staging and Dividing the Assessment</td>
<td>Postpones Conclusions</td>
<td>Postpones Conclusions</td>
<td></td>
</tr>
<tr>
<td>3. Dealing only partially with COSO components</td>
<td>-</td>
<td>Postpones Conclusions</td>
<td></td>
</tr>
<tr>
<td>4. Scope Limitations</td>
<td>IT to be assessed in Part IB</td>
<td>Optional; IT is part of Entity Level controls</td>
<td></td>
</tr>
</tbody>
</table>

| **B: Process Level Issues:**          |            |     |     |
| 1. Definition of Objectives, Compliance| -         |     | Acceptable |
| 2. From Articles to Key Policies and Procedures | - |     | Acceptable |
| 3. Linking OPs/BPs                    | Explanations offered | - | Only 50% linked to BPMs |
| 4. Identifying BPMs                    | -         |     | Acceptable |
| 5. Quality of BPM mapping              | -         |     | Satisfactory, some qualifications |
| 5. The Cluster as Representing IDA Operations | Issue: Excluded Processes | a. Lending: Test ILs b. Excluded AAA/KP |

<table>
<thead>
<tr>
<th>Issues relating to results: major controls issues</th>
<th>Management</th>
<th>IAD</th>
<th>IEG</th>
</tr>
</thead>
</table>

**Highlighted Controls Issues**

**By Management**

1. Document Retention and Accessibility

<table>
<thead>
<tr>
<th></th>
<th>Highlighted Deficiency</th>
<th>Highlighted Deficiency</th>
<th>Potential Material Weakness</th>
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<table>
<thead>
<tr>
<th>Box 3 (continued)</th>
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<th></th>
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</thead>
<tbody>
<tr>
<td><strong>2. Current Status of OPs/BPs:</strong></td>
<td><strong>Highlighted</strong></td>
<td><strong>Potential</strong></td>
</tr>
<tr>
<td>a. OPs/BPs outdated, often not current</td>
<td><strong>Deficiency</strong></td>
<td><strong>Material</strong></td>
</tr>
<tr>
<td>b. Complex, disjointed policy framework</td>
<td><strong>Highlighted</strong></td>
<td><strong>Weakness</strong></td>
</tr>
<tr>
<td>c. Onerous, inefficient processes</td>
<td><strong>Deficiency</strong></td>
<td></td>
</tr>
<tr>
<td><strong>3. Disparity in Corporate Review SILs and DPLs.</strong></td>
<td><strong>Highlighted</strong></td>
<td><strong>Highlighted</strong></td>
</tr>
<tr>
<td><strong>By IAD (3)</strong></td>
<td><strong>Highlighted</strong></td>
<td><strong>Highlighted</strong></td>
</tr>
<tr>
<td>1. Outdated OPs/BPs</td>
<td><strong>Highlighted</strong></td>
<td><strong>Highlighted</strong></td>
</tr>
<tr>
<td><strong>2. Definition of Walkthrough</strong></td>
<td><strong>Disputed</strong></td>
<td><strong>Management</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>Consistent</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>with AS2 concepts</strong></td>
</tr>
<tr>
<td><strong>3. Fraud and Corruption Controls</strong></td>
<td><strong>Should be assessed at process level</strong></td>
<td><strong>Start with</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>Entity level controls; could have been more explicitly treated</strong></td>
</tr>
<tr>
<td><strong>By IEG (4)</strong></td>
<td></td>
<td><strong>Highlighted</strong></td>
</tr>
<tr>
<td>(i) No control over “subject to” disbursement changes; (ii) no assurance all refunds received; (iii) No mechanism to assure country safeguard documents redone if necessary; (iv) No Bank-wide log for procurement complaints</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Issues relating to Results: Documentation and potential control Deficiencies.</strong></td>
<td><strong>Highlighted</strong></td>
<td><strong>Materiality</strong></td>
</tr>
<tr>
<td></td>
<td><strong>Additional Issues</strong></td>
<td><strong>should be established during Part IB</strong></td>
</tr>
<tr>
<td></td>
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</tbody>
</table>
1. Background and Description of Approaches

Origins of the Study

1.1 In the IDA14 Replenishment Report, Bank Management “has committed to carry out an independent comprehensive assessment of its control framework including internal controls over IDA operations and compliance with its charter and policies” (paragraph 39 of that document). Annex B Table 3 of the document stipulated that this assessment should be undertaken by the Independent Evaluation Group (IEG, formerly OED). That document has been approved by the Executive Directors.

1.2 This Review of IDA’s controls was discussed briefly at a Board meeting in May 2005. At that time, Management reiterated that—consistent with the practice that is being followed under the Bank’s COSO-based control framework—there should first be a self-assessment of the controls system, with a role for IAD, leading up to the IEG evaluation. IEG confirmed that it was prepared to take on the requested evaluation if the Board should so wish. As this was not in the IEG work program, there would need to be a non-fungible addition to the IEG budget for this purpose.

1.3 Management has since confirmed that the Review will be conducted in two parts (I and II). Part I will deal with internal controls over IDA’s compliance with its charter and internal policies and procedures; and Part II with internal controls over IDA’s operational effectiveness and efficiency. Each part will have three phases: first a Management assessment of internal controls; second, an IAD review of Management’s assessment; and third, IEG’s independent evaluation of both the assessment and the review. Following certain delays that Management encountered in completing the first part (on compliance), it decided further to divide this part into two stages (Part IA and Part IB), as described in Box 4.

1.4 The present report covers only that portion of the study to be completed under Part IA. It therefore deals with the assessment of internal controls over compliance, to the stage of examining the identification and mapping of business processes, and the assessment of the...
design effectiveness of key controls within these processes. It will be a prelude to the assessment of the operating effectiveness of these controls, which is to be completed during the next stage (Part IB). Part II will then follow.

Box 4. Stages in the Study of IDA Internal Controls

Management has divided its assessment into the following parts:

Part I—Compliance with IDA’s Articles and Policies-- This part has been split into (A) the identification of key business processes and controls and assessing the design effectiveness of the identified key controls; and (B) assessment of the operating effectiveness of the identified key controls through compliance testing.

A. This portion of the overall assessment identified and mapped the Business Process Modules (BPMs) and the key controls contained in each process. Then management reviewed the design effectiveness of the business processes and key controls involved to determine whether any significant deficiencies in the design of the key controls were identified. Management recommended remedial actions to address the design deficiencies.

B. Management intends to test a representative sample of products/transactions to determine whether the key controls were applied to the sample items as designed. Management could then determine whether there are significant deficiencies or material weaknesses in the operating effectiveness of the key controls and, if so, recommend measures for addressing any such deficiencies.

Part II—Efficiency and Effectiveness of Operations—Management plans to assess whether the existing internal control framework, including corporate governance and entity level controls, provides reasonable assurance that IDA’s operations are carried out efficiently and effectively, focusing on the processes and controls identified in Part I. In Part II management also plans to address the other scope limitations in Part I, such as information technology controls and the Bank’s operations in the decentralized field offices.

The COSO Perspective

1.5 The World Bank adopted the COSO internal control framework in 1995. COSO defines internal control as a process, effected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Reliability of financial reporting—relating to preparation of published financial statements;
- Compliance with applicable laws and regulations—relating to compliance with applicable legal and regulatory framework,
which in the case of IDA is taken to mean its charter and policies; and
• Effectiveness and efficiency of operations—relating to effective and efficient use of resources in meeting business objectives.

Figure 1. The COSO Framework: Components, Objectives, and Risk Factors

1.6 To meet the three objectives, the COSO framework has five interrelated components that define the minimum level of quality acceptable for internal control and provide the basis against which internal control is to be evaluated. These internal control components, which apply to all aspects of an organization’s operations, include the control environment, risk assessment, control activities, monitoring and learning, and information and communication. All five components must be present and effective in order for management to have reasonable assurance that risks are managed to ensure the achievement of the organization’s objectives. Management is responsible for developing the detailed policies, procedures, and practices to fit the organization’s operations and to ensure that they are built into and are an integral part of its operations, by conducting ongoing monitoring and, as needed, separate evaluations of internal controls.

1.7 A direct relationship exists between the three categories of objectives—what the entity is striving to achieve—and components—the management dimensions the entity needs to achieve the objectives. These are depicted graphically in Figure 1, and are more fully described in Annex A. COSO is a dynamic framework which is being adapted continuously to changes in the global situation. Recent emphasis in adapting COSO has been focused on better management of risk, and in 2004 COSO itself added a new strategic objective to the ex-
isting three objectives (financial reporting, operations and compliance) and three new components to the existing five shown in the figure above: objective setting; event identification; and risk response. This expanded framework has not yet been adopted by the Bank.

1.8 Given that the Bank has, for a number of years, assessed the internal controls over its financial reporting, and has had the external auditor attest to the quality of the assessment, the present review does not deal with financial reporting, but focuses on the remaining two COSO objectives, namely compliance and operations.

**Integrating the COSO Framework into Bank Operations**

1.9 The Bank’s Management has, since 1997, written internal, annual year-end reports on the status of the adaptation to COSO. IEG’s Annual Report on Operations Evaluation (AROE) reports for 2000-2001 and 2002 addressed development effectiveness issues from the perspective of the COSO framework. The 2002 report noted the profound changes that had taken place in the Bank’s control environment: new controls structures had been put in place and “a new culture has taken root with respect to risk management,” but risk aversion appeared to have become a feature, and the report foresaw a need for what later became the Bank’s integrated risk management framework (IRMF). Under Control Activities, it saw the need for an accelerated conversion and updating of the Bank’s policies and procedures, and under Monitoring it called for improved methods of evaluating Economic and Sector Work (ESW), grants and partnerships. In the Information and Communication component it reported the major progress transforming the Bank as a Knowledge Bank, which had enabled rapid transfer of information on guidelines and best practice, and reported on the roles to be played by Development Economics Department and the World Bank Institute.

1.10 These themes are a relevant prelude to the present controls review. Being focused on development effectiveness, they preface the overall COSO-based approach that IEG is taking in the review, and the 2002 AROE stated the need for further developing the control environment quite clearly: “… the drive to become a Knowledge Bank has engendered new initiatives and new processes, for which both the control environment and the evaluation framework have yet to be well defined.”

**IEG’s Approach to its Evaluation**

1.11 **IEG Objective:** The objectives of the IEG evaluation for this Part IA Report must be viewed in light of the objectives of the overall review. IEG’s role in the overall review is to provide an independent
evaluation to determine whether Management and IAD have provided a reasonable basis for judging whether internal controls over IDA compliance and operations are in place and working; whether any material weaknesses and other deficiencies have been identified; and, as necessary, whether internal control corrective action plans are being implemented. Within that context, and for the purposes of producing a report on the status of work completed during Part IA of the review, IEG has aimed to:

- evaluate implications of scope limitations and management’s phased approach;
- evaluate management’s method for and completion of the mapping of business processes;
- evaluate Management’s assessment of control design; and
- evaluate IAD’s approach to its work and its conclusions.

1.12 **IEG Scope:** IEG’s overall evaluation of both the management assessment and the IAD review offers an independent conclusion to the Board as to the degree of assurance with which the assessment and opinion presented respectively in the final reports by Management and IAD can be taken to be fairly stated, in terms of their giving reasonable assurance (or other conclusion) that IDA’s controls over compliance with its charter and relevant policies and procedures are effective.

1.13 IEG took the COSO framework and the audit standards consistent with that framework as the starting point for its evaluation. It assumed that the judgments regarding the effectiveness of the internal IDA controls over compliance and operations had to be made against criteria contained in the COSO framework as a whole. At the same time, IEG recognized that management took an approach in Part I that has certain scope limitations. These limitations will have a bearing on the quality of assertions that can be made at this stage to the management and Board of IDA.

1.14 IEG notes that the key scope limitations in Part I are: the postponement to Part II of issues relating to entity-level controls; consideration of only two out of the five COSO components; the treatment of compliance only, and not efficiency and effectiveness of operations; and the postponement to Part II of the treatment of decentralized locations and IT systems. As described in Chapter 2 and summarized in Chapter 4, IEG has evaluated the implications of these postponements in making its judgments on the overall quality of the management assessment and on the conclusions that can be made at this stage of the exercise.
1.15 **Audit Standards:** Management had stated in its preparatory working papers that it intended to use audit standards similar to those used for its financial reporting (namely the general concepts of AS2 standard developed under the Sarbanes-Oxley legislation), since these would provide due rigor and standardization. IEG believed that this raised the question of whether it was indeed appropriate to use the same standards for compliance and operations reporting as for financial reporting, because the nature of the issues would be different. IEG therefore conducted significant research into this question. It was concluded that similar standards could be used, but that for compliance and operations reporting, assessing the materiality of deficiencies required more judgmental decision than for financial reporting. After consultations with both Management and IAD, agreement was reached both on the fact that all three parties would use the same standards, and on the precise definition for each. A description of the latter is given in Annex B.

1.16 **IEG Evaluation Method:** IEG has applied four principal methods in making its evaluation:

- It critically reviewed the available reports from management and IAD.
- It conducted an independent analysis of the raw data generated by Management’s assessment. This analysis addressed the quality and effectiveness of design of the underlying internal controls.
- IEG assembled evaluation panels for the purpose of rating each step in the assessment and review processes. The panels used an evaluation tool designed by IEG for this purpose, called a Business Process Template, which contained a series of standard questions on Management’s method of mapping and assessment of design of each business process module. This generated a data stream on the quality of Management’s method and approach to mapping and controls assessment.
- IEG has reserved the option to conduct its own tests of the design effectiveness of selected key controls, as a means of obtaining verification independent from the results obtained by Management. This was found to be not necessary during Part IA. However, IEG did interview staff in selected units, including some that are involved in entity level controls, to gain a better understanding of the overall processes and controls that affect the business process modules included in Management’s assessment.

1.17 **Advisory Panel:** As is now normal for many of IEG’s major evaluations, a senior Advisory Panel will be invited to review and comment on the IEG evaluation report and will be requested to share its comments also with CODE and the Audit Committee (AC). The mem-
bers of the panel for this evaluation are former Auditors-General, from India, Norway, and Australia, respectively. However, the services of the Panel will be invoked only when IEG has completed its draft evaluation report on Part IB.

**Summary of Approaches: Management Assessment and the IAD Review**

1.18 A description of the approach taken by Management to its assessment, and the key findings arrived at, is contained in Chapter 2, and a copy of the Management report is in Attachment 1. A description is given in Chapter 3 for the method, approach and findings of the IAD review, and a copy of the IAD report is appended at Attachment 2. Box 5 and Box 6 summarize the three approaches and the current timetable.

<table>
<thead>
<tr>
<th>Box 5. Key Components in the Management Assessment, IAD Review, and IEG Evaluation (Part I)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Management Assessment</strong></td>
</tr>
<tr>
<td>Define Approach and Method</td>
</tr>
<tr>
<td>Business Process Based</td>
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<tr>
<td>Fiduciary Focus</td>
</tr>
<tr>
<td>Partial COSO</td>
</tr>
<tr>
<td>Other Scope Limitations</td>
</tr>
<tr>
<td>Identify BPMs, Key Controls</td>
</tr>
<tr>
<td>4 Umbrella Areas</td>
</tr>
<tr>
<td>30 BPMs</td>
</tr>
<tr>
<td>114 Key Controls</td>
</tr>
<tr>
<td>Verify Mapping, Assessed Design of Key Controls</td>
</tr>
<tr>
<td>Match Risks with Key Controls</td>
</tr>
<tr>
<td>Conduct Walkthroughs</td>
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<tr>
<td>Assessment of Design Effectiveness</td>
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<td></td>
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<tr>
<td>Conclusions for Part IA</td>
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<td>Qualified Assurance</td>
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CHAPTER 1
BACKGROUND AND DESCRIPTION OF APPROACHES

Box 5 (continued)

<table>
<thead>
<tr>
<th>Part IB</th>
<th>Evaluate Quality of Controls Tests</th>
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<tbody>
<tr>
<td>Test Operation of Controls</td>
<td>Review Testing of Controls</td>
</tr>
<tr>
<td>Conduct Audit of Controls</td>
<td>Review test Methodology</td>
</tr>
<tr>
<td>Define Sampling Method</td>
<td>Review Process for Documenting Results</td>
</tr>
<tr>
<td>Conduct Testing</td>
<td>Assess Process to Detect Fraud</td>
</tr>
<tr>
<td>Tabulate Findings</td>
<td>Review Deficiencies, Criteria</td>
</tr>
<tr>
<td>Test Results Matrix</td>
<td></td>
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</tbody>
</table>

Form Conclusions

<table>
<thead>
<tr>
<th>Statement of Assurance</th>
<th>Unqualified Opinion or Modified Report</th>
</tr>
</thead>
<tbody>
<tr>
<td>Make Recommendations</td>
<td>Overall Evaluation, Recommendations</td>
</tr>
</tbody>
</table>

Notes: BPMs—Business Process Modules

Box 6. Overall Timeline for Completion of IDA 14 Assessment

<table>
<thead>
<tr>
<th></th>
<th>Part IA</th>
<th>Part IB</th>
<th>Part II</th>
</tr>
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<tbody>
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<td>Management Report</td>
<td>Aug 06*</td>
<td>Dec 06</td>
<td>Sep 07</td>
</tr>
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<td>Jan 08</td>
</tr>
</tbody>
</table>

Source: Based on the Management paper to the Audit Committee and current estimates. * These reports were actually completed in early October 2006.

NOTES

1. See “Report from the Executive Directors of the International Development Association to the Board of Governors, Additions to the IDA Resources: Fourteenth Replenishment, Working Together to Achieve the Millennium Development Goals” (approved by the Executive Directors of IDA on March 10, 2005).

2. The May 12 2005 discussion of IEG-WB’s FY06-08 work program and FY06 budget.


4. This representation of the COSO framework is what is currently in use in the Bank and IDA, showing also the Risk Focal Points, which have been added to the framework, following adoption by the Bank of the Integrated Risk Management Framework (IRMF) in 2002. For a fuller explanation, see Annex A.

5. IEG has verified that in recent years (2002-2005) the Bank published the management assessment report and the auditor’s attestation report in the Annual Report, Volume 2, Financial Statements. This includes a transmittal letter, management’s discussion and analysis (covering just IBRD), IBRD financial
statements and internal control reports, and IDA financial statements and internal control reports.


7. The AROEs for 2003 and 2004 also covered specific individual topics within the framework, namely monitoring and evaluation.


9. In management’s approach the focus was mainly on Risk Assessment (at the unit level) and Control Activities, and there was no direct focus on the other three components (Control Environment, Monitoring and Learning, and Information and Communications), which are postponed until Part II.

10. Auditing Standard No. 2 (AS2) An Audit of Internal Control over Financial Reporting Performed in Conjunction with An Audit of Financial Statements, was issued by the U.S. Public Company Accounting Oversight Board (PCAOB) to respond to the provisions of Section 404 of the Sarbanes-Oxley legislation as much as possible.

11. As set down in the Approach Paper, IEG might consider commissioning its own testing, if and when: (i) A general random selected testing of controls seems warranted; (ii) Certain controls were found not to have been tested; and (iii) Testing that was done may be deemed inadequate, for example because of sampling deficiencies or other flaws in approach.

12. To discuss entity-level control issues, the IEG team had separate meetings with Bank units dealing with: IDA allocation (FRM); the Integrated Risk Management Framework (SFRSI); issues of fraud and corruption detection (INT); quality assurance (QAG); and safeguards (QACU).
2. Management’s Assessment

2.1 This chapter divides into two parts: the first part (paras 2.2-2.11) gives a descriptive synopsis of Management’s approach and method; the second part (from para 2.12) contains IEG’s evaluation of the assessment. Management’s report is in Attachment 1.

Background and Objective

2.2 Management intended to conduct the review of IDA internal controls within the context of the COSO framework, but would focus in this phase of the study only on the assessment of internal controls over compliance. The report states that the COSO framework includes both “top-down” and “bottom-up” analysis. Management determined that Part I of the study would be “more valuable if carried out following a bottom-up approach,” in order to best track directly the use of IDA resources. Accordingly, the report describes how Management has identified, described and mapped a collection of the key business processes that it used to represent the principal operations activities of IDA, which will be used both to assess compliance in Part I, and to lay a “solid foundation” for the examination of institutional efficiency and effectiveness to be undertaken in Part II. 1

2.3 Management’s objective was to provide an assessment of whether the internal control framework over IDA’s operations provides reasonable assurance to Senior Management and the Board that such operations are carried out in a manner that complies with the provisions of the IDA charter and internal policies governing IDA’s operations, including the mechanisms in place to ensure that funds are disbursed for the intended purposes.

Management’s Method: From the IDA Charter to Policies to Business Processes

2.4 Defining “Compliance” for IDA: Management chose to redefine the meaning of “compliance” in IDA’s case.2 Under COSO, compliance generally implies compliance with local laws and regulations. In IDA’s case, as “an international organization established by international treaty with privileges and immunities” Management suggested instead that compliance should be measured against the
2.5 Accordingly, Management states in its report that “any compliance assessment of internal controls over IDA’s operations must therefore go through a four-step process:

1. identifying key provisions of the IDA Articles that govern IDA’s operations;
2. identifying main policies that were adopted by IDA to ensure that IDA’s operations are carried out consistently with these provisions;
3. identifying the manner in which these policies are intended to be carried out by cataloguing the business processes and key controls put in place to ensure compliance with the identified policies and assessing the “design effectiveness” of these processes and key controls; and
4. assessing compliance with the business process and key controls by testing a sample of transactions.” (The subject of Part IB).

2.6 Key Policies and Instruments: Based on this concept of compliance, Management sought to establish clear links between the IDA Articles, related policies and procedures, and the actual business processes whose internal controls would be the subject of assessment and testing. The specific hierarchy of these steps is given in summary form in Box 7. It shows how the provisions of the Articles link to specific policies and procedures and the related operational instruments. It shows that the approach stemmed from eight specific provisions of Article V of the IDA Articles, covering allocation and use of IDA resources. From over 100 published policies and procedures, Management made a selection of those that related to the allocation of IDA resources and the three key instruments governing IDA operations—country assistance strategies, and the two main forms of lending—Specific Investment Loans (SILs) and Development Policy Loans (DPLs)—citing the four “umbrella” statements in these “flagship” policies and procedures. Having identified these primary operational instruments, Management then also addressed the need to take account of the fiduciary, contractual and safeguards aspects of IDA lending, adding the relevant policy provisions in each of these areas.
Box 7. Building Blocks in Management’s Approach

### IDA Articles

**Article V—Operations**
- Concessional Resources to Less Developed Areas
- Financing High Priority Development
- Specific Projects and Special Circumstances Lending
- Lender of Last Resort
- Use of Funds for Purposes Intended
- Due Regard for Economy and Efficiency
- Non-political interference
- Linking Disbursements to Expenditures incurred

### Policies and Procedures

From >100 OPs and BPs Management Focused on

**Three Primary Instruments:**
- Country Assistance Strategy (CAS)
- Investment Lending Operations (IL)
- Development Policy Lending (DPL)

**“Flagship” OPs and BPs**
The Flagships Contain four “Umbrella Statements,” namely:
- Umbrella Statement governing financial terms of and eligibility for IDA financing
- Umbrella Statement governing Country Assistance Strategies
- Umbrella Statements governing Investment Lending
- Umbrella Statement governing Development Policy Lending

**Specific Policies for Fiduciary, Contractual and Safeguards Aspects**
All lending instruments are accompanied by supporting policies and procedures covering:
- Financial management of projects
- Disbursement aspects
- Procurement aspects
- Contractual/Legal and Loan Administration aspects
- Safeguard aspects
- Quality Assurance

### 30 Business Process Modules

*Source: Management Report*

2.7 **The Business Process Modules (BPMs):** Based on this hierarchy of policies and procedures, Management identified 30 Business Process Modules (BPMs) which it saw as representing “the relevant business processes currently in place which staff are expected to use as guidance and best practice when working on IDA operations.” The modules covered the “umbrella” business functions, (allocation, CAS and lending instruments) plus the supporting fiduciary and other aspects and quality assurance. The material for each BPM included descriptions, process flow maps, and specifically defined and located...
key controls. It is these controls whose design and operating effectiveness are the central subject matter of the review. A listing of the BPMs, broadly organized by business function, is given in Box 8.

### Box 8. Management's List of 30 Business Process Modules (Listed by Business Function*)

<table>
<thead>
<tr>
<th>“UMBRELLA” PROCESSES (8 Modules)</th>
<th>FIDUCIARY PROCESSES (21 Modules)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FRM IDA Allocation</td>
<td>LEGAL</td>
</tr>
<tr>
<td>(IDA Allocation Model)</td>
<td>SIL Legal Regime</td>
</tr>
<tr>
<td>(Post-Conflict Allocation)</td>
<td>DPL Legal Regime</td>
</tr>
<tr>
<td>Debt Sustainability Analysis</td>
<td>Project Changes</td>
</tr>
<tr>
<td>CAS Products</td>
<td>Contractual Remedies</td>
</tr>
<tr>
<td>SIL Project Cycle</td>
<td></td>
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<tr>
<td>DPL Project Cycle</td>
<td></td>
</tr>
<tr>
<td>Corporate Review (ROC/OC)</td>
<td></td>
</tr>
<tr>
<td><strong>QUALITY ASSURANCE (1 Module)</strong></td>
<td>FINANCIAL MANAGEMENT</td>
</tr>
<tr>
<td>QAG Processes QEA QSA</td>
<td>SIL</td>
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<td></td>
<td>DPL</td>
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<td></td>
<td>PROCUREMENT</td>
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<td></td>
<td>SIL Procurement Regime</td>
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<td>Procurement Complaints</td>
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<td></td>
<td>Procurement Non-Compliance</td>
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<tr>
<td><strong>LOAN ADMINISTRATION</strong></td>
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<td>Loan Administration SIL</td>
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<td>Loan Administration DPL</td>
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<td>Loan Application Review</td>
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<td>Special Commitment</td>
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<td>Amendment or Extension</td>
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<td>Refund Process</td>
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<td>Loan Cancellation Process</td>
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<td>Loan Suspension Process</td>
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<tr>
<td>Loan Closing (Standard)</td>
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<tr>
<td>Loan Closing (Special Procedure)</td>
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<tr>
<td><strong>SAFEGUARDS</strong></td>
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<tr>
<td>Safeguards SIL</td>
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<tr>
<td>Safeguards Corporate Risk (QACU)</td>
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</tr>
</tbody>
</table>

*Source: Management listing, organized across business function by IEG.*

Some processes were excluded

2.8 Management also explicitly excluded a number of business process modules (10 in total) either because they were deemed not to have direct bearing on lending, or for other reasons, as shown in Box 9. More details on these exclusions are given in Annex E.
Box 9. Business Process Modules Excluded from Compliance Assessment

<table>
<thead>
<tr>
<th>Exclusion By Management’s Resolution That the Process Does Not Have Critical Bearing on Current Assessment Objective</th>
<th>Exclusion Based on Determination of No Input to IDA Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Country Policy and Institutional Assessment (CPIA)</td>
<td>• Procurement DPL (Procurement is minor in DPLs)</td>
</tr>
<tr>
<td>• Post-Conflict Performance Indicators (PCPI)</td>
<td>• IEG Process</td>
</tr>
<tr>
<td>• Project Preparation Facility (PPF)</td>
<td>• IAD Process</td>
</tr>
<tr>
<td>• Loan Management—PPF Refinancing</td>
<td>• AAA Products</td>
</tr>
<tr>
<td>• Annual Report on Portfolio Performance (ARPP)</td>
<td></td>
</tr>
<tr>
<td>• Inspection Panel</td>
<td></td>
</tr>
</tbody>
</table>

Source: Management Methodology Note (working level paper)

2.9 Management has provided a graphic depiction of the full scope of its assessment, show in Figure 2. It depicts the project cycle for SILs and DPLs as the central element, which is linked to the CAS process, to IDA allocation, and to the associated fiduciary, legal, safeguards and quality assurance processes. These are the essential processes which Management has captured in the 30 BPMs described above, and which Management has taken to represent the totality of IDA operations.

2.10 The Concept of “Design Effectiveness”: While Management has identified the business processes as the vehicles which deliver the various IDA business objectives, it also makes clear that the key controls within them (114 in all) are critical to the review of internal controls and the forthcoming testing for compliance. As stated in the standards, Management has distinguished between control design and a control operation. To be fully effective, a control must not only be well designed, it must also operate as designed, i.e. staff must respect its provisions in the execution of transactions. In Part IA Management has assessed the design effectiveness of these 114 controls under the following definition:

“whether the system of such internal controls is both comprehensive as well as suitably designed to prevent or detect on a timely basis, material issues of non-compliance or significant control deficiencies.”

The model requires that controls both be well designed and operate as designed to be effective.
Figure 2. Overview Scope Map of Management’s Assessment

Source: Management working materials
2.11 Management explained in its report that its working teams conducted their assessment of the design effectiveness of these controls through a combination of observation, examination of documentary evidence and verification of control design. The output from this process was a series of fully mapped BPMs and accompanying descriptive documentation, namely: for each business process module, a Process Overview (PO); and for each key control, a Control Detail Sheet (CDS). An example of a process flow chart—i.e. the graphic mapping of the flow of a transaction through the management system—together with descriptive materials showing the content of a sample Process Overview and a typical Control Detail Sheet, are also shown in Annex D.

**IEG’s Evaluation of Management’s Approach and Method**

2.12 The foregoing comprises IEG’s synopsis of Management’s approach. The remainder of Chapter 2 contains IEG’s evaluation of Management’s approach (paragraphs 2.14 - 2.26) and of Management’s main findings (paragraphs 2.27-2.45).

2.13 Management made a number of key choices related to its approach and method, the most important of which are summarized below and accompanied by IEG’s findings and conclusions. In particular, choices on basic approach and other scope limitations significantly limit conclusions about the adequacy of internal controls that can be drawn at this stage of management’s work.

2.14 **Objectives of the Compliance Assessment:** IEG finds the objective of the assessment as stated in para 2.3 above to be reasonably stated, appropriate, clear and complete.

2.15 **The Definition of Compliance:** IEG agrees that an adaptation of the definition of compliance was necessary in IDA’s case, and finds reasonable Management’s rationale and decision to use compliance with the IDA charter, internal policies and procedures. IEG examined the legal theory underlying this issue and found that very generalized reference to “laws and regulations” does not in the case of a special institution such as IDA provide any guidance as to which laws and regulations are determinate and may give rise to ambiguity as to the role of local law. In the circumstances, it was preferable to refer specifically to the Articles, the lending (or financial) agreements including the General Conditions, and IDA Policies and Procedures, as constituting the governing “laws and regulations” for IDA transactions.¹

2.16 **From the IDA Articles to Policies to BPMs:** Management also correctly located the benchmark for the compliance elements as being the appropriate provisions of the IDA Articles, and the relevant Bank Operational Policies and Bank Procedures (OPs and BPs). Both spe-
specific Article provisions and the published OPs/BPs were used as the basis to decide which operational instruments and business processes would best represent the panoply of IDA operations. IEG does find the method of developing the 30 business process modules to be logical, transparent, and generally convincing. However, IEG does have comments regarding the possible lack of completeness of the universe of BPMs, as discussed in paragraph 2.18 below.

2.17 Are the Bank’s OPs and BPs an Apt Expression of the Bank’s Policies and Procedures? IEG finds that in each business process module, each control has been linked to one or more specific OPs/BPs, and/or risk statement from the IRMF. However, there are two issues that have been identified regarding OPs/BPs:

- The fact that the reform of OP/BP has seriously lagged the pace of change in the Bank Group is acknowledged by Management, and is widely known already;
- What was uncovered by IEG during its evaluation, is that there appear to be a significant number of OPs/BPs — some 50% — which were not directly linked by Management to any key controls or business processes. Management has given a satisfactory explanation for those OPs/BPs not linked to specific BPMs, to the effect that: (1) they relate to trust funds and grants, not financed by IDA resources; (2) they apply to other lending products, not SILs; (3) they govern guarantees, which are a very small portion of the IDA portfolio; (4) they govern topics that feed into the processes that were mapped (e.g. economic evaluation of investment operations; co-financing); or (5) they relate to contractual or other issues that are addressed in the processes that were mapped.

2.18 Does the Cluster of BPMs Adequately Represent the Universe of IDA Operations? IEG conducted an analysis of the cluster against some key criteria: What portion of IDA’s operating budget did the cluster account for? What product lines? Where processes were excluded from the cluster, did this create gaps in measuring compliance? The content of this analysis is shown in Annex E. IEG concludes that the cluster is broadly representative of IDA’s lending operations (which covers 78% of IDA’s overall operational expenditure). However, by using only SILs to represent all investment lending, Management needs to verify its claim that all other investment loan products have the same controls as SILs (see Annex E paragraph 6). Also, the cluster is essentially lending and fiduciary in focus, suggesting that IDA operations are simply IDA lending operations. The cluster omits all Knowledge Products, specifically Analytical and Advisory Activities (AAA), all of which have direct relevance to compliance. As argued in Annex E, AAA has a direct bearing on the quality of IDA lending, as well as accounting for about 22% of the IDA budget (almost the same as lending
preparation—24%). This is therefore a significant gap in coverage. Management will not be in a position to report on whether internal controls are achieving the business objectives involved until these additional IDA functions and activities are assessed.

2.19 **The Quality of Management’s methods in BPM Mapping and Assessing design Effectiveness:** IEG conducted a systematic quality evaluation of the methods used in Management’s mapping of the BPMs and assessment of control design. This involved assembling evaluation panels, consisting of 3-4 specialist consultants, who used an evaluation tool created by IEG (the Business Process Template) to give quality ratings to the process of mapping and assessing each of the business process modules. The questions in the Template tested (i) Management’s method for completeness and accuracy of BPM mapping, and (ii) clarity in Management’s assessment of the effectiveness of their controls design. Details of the content of the Template and rating system are provided in Annex F. Ratings ranged from Highly Satisfactory (1), to Satisfactory (2), Satisfactory with Qualification (3) and Less than Satisfactory (4). The evidence on which the ratings were based came from Management’s process maps, the accompanying descriptive materials, other working materials Management made available, and the “walkthroughs” i.e. verification interviews between Management and operations staff, many of which IEG panel members attended as observers.

2.20 **Rating Results:** IEG found that the quality of Management’s mapping and assessment of design effectiveness were of a generally satisfactory standard, but there were also a number of areas with room for improvement. Taking all questions in the Template together, the IEG panels rated 66% of all dimensions as Satisfactory or better (with 93% as Satisfactory with Qualification or better). The average rating across all dimensions was 2.5 (midway between fully satisfactory (rating 2) and satisfactory with qualification (rating 3). More detailed data on the ratings can be found in the Statistical Appendix at Annex G.

2.21 Generally the accuracy and completeness of the process mapping received high ratings. The principal reason why other ratings were not higher overall was the prevalence, in the descriptive materials for some modules, of descriptions of control objectives and specific risks that were more process-oriented than operational in focus. In addition, in most descriptions of key controls there was a systematic failure to categorize specific risks by type of risk and to analyze the risk importance in terms of likelihood of occurrence and impact.

2.22 **Treatment of Risk:** The principal shortcoming affecting the ratings for method and approach was that Management did not attempt in any modules to categorize risks by type or priority (this question was rated 4 in all modules). IEG cannot conclude from this
alone that this failure may have impaired Management’s assessment of control design effectiveness, but prioritizing risks should be an essential part of designing internal controls systems, with due regard for economy and efficiency. Also, risks may be more readily prioritized from an entity-level perspective than within individual business processes. This is an added example of where a top-down approach to the study would have been preferable, and foresees the need for greater attention to risk focus at the organization level.

2.23 Relative Significance and Risk Ranking of BPMs: IEG used its rating process also to rank the modules into groups, according to their strategic importance and risk potential. This was measured by their centrality as a management tool, the magnitude of financial risk incurred in each process, and the frequency of occurrence. While this involved subjective judgments, it was thought useful as a means of grouping the modules into high, medium and lower risk categories, to separate out the principal modules and those that were more secondary. The IEG panels ranked 14 modules in the principal category, 8 into medium risk and 7 lower risk. (See Annex G Table G.7).

2.24 The Overall Approach: Staging the Assessment, Adopting a Bottom-up Approach, Separating Compliance from Efficiency and Effectiveness: IEG recognizes the rationale for choosing the bottom up approach—to more directly track the allocation and use of IDA resources. IEG also acknowledges the contribution this has made, in the identification and mapping of the relevant processes, which has provided a vision of IDA operations, and a level of detail not hitherto available. The platform of these maps should be very useful going forward both as a source of future tracking of internal controls, and as a means of identifying areas which have scope for streamlining to bring economies and efficiencies. At the same time, the choice of this approach (which runs contrary to standard industry recommendations) has created trade-offs which have serious implications for both its Management’s assessment, as well as the IAD review and the present IEG evaluation, of which IEG would emphasize the following:

- Because conclusions on controls within COSO cannot be made piecemeal, but only within the framework as a whole, staging and dividing the study has effectively postponed the ability to make definitive conclusions on the outcomes of each stage of the review until the overall (Part II) assessment has been completed, i.e. until end 2007, or later.
- Also the staging of the study between Part IA and Part IB makes conclusions on control design (Part IA) difficult until Part IB has been completed, because final judgments on design effectiveness cannot be made until the operation of the controls has also been tested.
• Separating compliance and efficiency and effectiveness is really not possible in practice: many business processes and their associated controls are as much to do with compliance as with efficiency and effectiveness, and these are best treated together rather than in sequence. To illustrate, although management has focused its efforts to date on assessing compliance, most of the potential issues it has identified are related to efficiency and effectiveness.

• Other scope limitations flowing from the delineation of the study—in particular the decision to deal with IT systems and field offices in Part II, have yet further limited the conclusions that can be drawn in Part I, especially given IDA’s increasing decentralization, and the growing importance of IT in maintaining the integrity of central controls.

• In principle, it is possible that by completing the entity-level review during Part II, and addressing the postponed parts of the framework, Management will be able to mitigate these deficiencies in approach by linking results from the various parts together, to provide an overall statement. However, this will depend on there being no changes in any basic parameters: controls will be assessed at different points in time, and policies, procedures, systems, organization structures may change during this period.

2.25 **A Note on Scope Limitations:** It was stated early in this report that IEG would be evaluating the implications of the various scope limitations that Management, by intent, or by implication, has imposed on this first part of the study: the separation of COSO objectives, the staging of the parts of the study, the postponement of the treatment of entity-level controls, and the examination of IT systems and decentralized locations. The impact these limitations have had on the outcome of the assessment and evaluation so far have been itemized in much of the foregoing analysis. No separate evaluation of the implications of these limitations is therefore needed here.

2.26 **Summary Evaluation of Management’s Methods:** In summary, IEG recognizes the underlying reasons why Management decided to adopt a process-based approach, to divide the study into stages, and to impose other scope limitations. However, in considering the trade-offs that this gave rise to, IEG comes to a mixed conclusion on the approach overall, finding both strong points and some problem areas:

• **Strong Points:** IEG finds that the following key elements of the approach have all contributed positively to the assessment: the definition of the objective of the assessment; the re-definition of compliance as it applies to IDA; the identification of the relevant provisions of the IDA Articles; and the related links to policies and procedures, as the basis to build a cluster of rep-
representative business process modules; and the actual mapping and description of the modules, which formed the bases for testing.

- **Problem Areas:** IEG observes several issues: issues with the quality of OPs/BPs; that the chosen cluster of BPMs represents well IDA lending products, but excludes AAA and other Knowledge Products—a significant omission; the combination of factors stemming from the bottom-up, three-stage division of the study over time, with a separation of COSO elements. All of the latter oblige the postponement of definitive conclusions on the earlier stages of the study, until the overall review has been completed.

**Management’s Main Findings and Conclusions: IEG Comment and Evaluation**

2.27 The main findings from Management’s Part IA assessment, in terms of specific issues relating to controls design and operation, will be discussed under three headings:

- Management’s broad conclusions on what it has achieved in the review so far;
- The main highlighted deficiencies, which Management sees as the most important weaknesses so far revealed;
- A listing of a number of additional issues, which Management regards as notable but less significant. The materiality of these is still to be established by Management, and many may not rise to the level of significant deficiencies or material weaknesses under the agreed audit standards described in Annex B.

2.28 What follows is a summary of these main findings, and conclusions, accompanied by a comment and evaluation from IEG, case by case.

**Management’s Broad Conclusions**

2.29 Management found that its assessment approach, unprecedented in the Bank Group, was such as to “capture a representative picture of the control environment over IDA’s operations at the transaction level” and that it had contributed information which would be useful for strategic and rationalization decisions regarding IDA operations going forward. The examination of the key policies and procedures that govern IDA operations and the mapping and review of the key business processes and associated controls that enable compliance with these policies confirmed in its view that the processes and controls that apply to the four primary instruments for carrying out IDA operations (i.e. Allocation mechanism, CAS, IL and DPL) have been designed to verify that scarce IDA resources are made available to
support priority development activities in the poorest eligible member countries.

2.30 **IEG Comment:** IEG states that it cannot at this stage make an affirmative statement regarding IDA controls over allocations and use of funds, but it agrees that the transaction-level mapping of business processes and the definition of key controls has contributed valuable information not hitherto available and it agrees that this could serve IDA well going forward, by providing a useful platform for future control tracking and reviews, and also for identifying areas where streamlining may be possible.

** MANAGEMENT’S HIGHLIGHTED DEFICIENCIES **
*(PARAGRAPH 26 OF ITS REPORT)*

2.31 **Deficiency 1:** Management stated in its Report that it “had difficulties with obtaining timely access to relevant documents that are needed to carry out the compliance testing portion of the assessment” and it went on to explain that while external auditors confirm that many institutions transiting from manual to electronic filing systems have similar retention and accessibility problems, Management regards this as a serious issue, and has consequently commissioned a Task Force to address this issue and present solutions within six months.

2.32 **IEG Comment:** Document retrieval has clearly become a major issue, and is an area of potential material weakness. For now, IEG takes note of Management’s straightforward recognition of the issue, its diagnosis, and the suggested remedial action plan. IEG suggests that this problem may have broader roots than Management has described. No doubt the transition to an electronic Bank is a (possibly the) central issue; but this has also been accompanied in the past decade by an ensuing cultural shift in the roles of staff (e.g. in the interaction between Task Team Leaders (TTLs) and support staff), as well as by the major decentralization of the Bank in the past decade. Since the present Part I stage of the study has explicitly excluded examination of IT and field offices, this, also, could have affected these results. Finally, while Management’s bottom-up approach successfully demonstrated the severity of this problem, a top-down approach might have given the whole exercise more visibility with line managers and this could possibly have strengthened unit cooperation and facilitated the rigorous process-level demand for documentation, that is required for the process-based method.

2.33 It is too early at this stage of the review to make definitive conclusions, but **IEG believes that the document retention issue is an area of potential material weakness**, and takes note of the fact that Management has already mounted a high-level remedial effort.
2.34 Deficiency 2: Management has identified the fact “that the OPs and BPs included in the Operational Manual are not keeping pace with the changes on the ground that are being introduced from time to time.” It gave as examples BP10.00 on processing investment lending from identification to Board approval, which is in need of urgent update, the 12.00 series governing disbursements, and OP/BP10.02 on financial management. Management goes on to state that “As part of Management’s assessment of the effectiveness and efficiency of IDA’s internal control framework, Management intends to look at the current processes underlying the policy revision to determine if they need to be revised to facilitate more efficient and timely updating of operational policies and procedures.”

2.35 Deficiency 3: Management states that “the policy framework governing IL operations is too complex and disjointed, making it hard for staff to identify all the policies with which they are expected to comply when working on IL operations” and it explains that it is actively working on rationalizing and consolidating the OPs/BPs governing investment lending.

2.36 Deficiency 4: Management states that its assessment showed that many staff find the existing processes and documentary requirements very onerous and inefficient, and that “Management intends to issue in the next few months standard updated operational templates to be used by staff in documenting various steps in the IL and DPL processes.”

2.37 IEG Comment: IEG observes that there are issues relating to overall status and quality of the OPs, BPs and processes governing project preparation. IEG also observes that this issue is not new, and has been referred to in earlier IEG studies. From the perspective of internal controls, the issue may be more serious than Management has stated. If the quality of the OPs/BPs is poor, in terms of the fact they have not all been amended to take account of change in the Bank Group, this could call into question whether they provide a valid benchmark for compliance testing. Other agencies facing a similar situation have sometimes decided to postpone compliance testing until the policies have been reformed. In the case of IDA, Management faces a decision: whether to proceed with the assessment with the present OPs/BPs, and perhaps settle for a qualified assertion at the end, or whether to postpone the assessment of compliance, until the OPs/BPs have been brought current. IEG believes a postponement may be impractical, and argues elsewhere (see paragraph 4.5 third bullet) that completion of Part II needs to be timely.

2.38 While it is too early in the review to make definitive conclusions, IEG believes that the status of the OPs/BPs is a second area of potential material weakness but notes that Management has stated that it has a reform program, consisting of both streamlining and updating components. IEG believes this program should be treated as a high priority, even accelerated.
2.39 **Deficiency 5:** Management stated that its assessment had found a “disparity in the frequency of corporate reviews of SIL and DPL operations, with all DPLs being subject to such review and relatively few SILs. ... Management is examining whether there is a need to review criteria for submitting investment lending operations that raise special risks or issues to the corporate review process.”

2.40 **IEG Comment:** IEG agrees that management should review its criteria and make revisions as necessary to ensure operations with special risks are subject to corporate review.

**MANAGEMENT’S LIST OF ADDITIONAL ISSUES**

2.41 In addition to the five high-level findings identified in Management’s report and discussed above, Management provided IEG with a list (not appended to its report) of additional potential issues relating to internal control design effectiveness. The issues require additional work to substantiate the findings and determine their significance and the remedial actions, if any, that may be required to mitigate risks. This work is to be made as part of the follow-on Part 1B stage focusing on the operational effectiveness of the controls. At that time, IEG anticipates that Management will determine which of these issues, or combination of issues, may rise to the level of a deficiency, significant deficiency, or material weakness, as defined by the agreed standards described in Annex B.

2.42 In summarizing its detailed list of potential control issues, Management identified areas that merit a closer look in its follow-on work, as follows:

- “Several existing policies and procedures need to be updated or enhanced or, in some instances, additional guidance needs to be introduced.
- Certain system capabilities or system-related controls need to be better aligned with the process requirements.
- Timeliness of processes related to managing individual credits should be improved.
- Variances in regional implementation of institutionally endorsed guidelines need to be reviewed to ascertain whether these variances are appropriate.
- Certain procurement processes and controls require enhancements to strengthen effectiveness.
- Processes surrounding SILs with regard to project changes or contractual remedies need to be strengthened.
- Clarification should be issued to require staff, which provide conditional clearances or feedback on project documents, follow up to ensure that their comments have been incorporated, as appropriate.”

**Other issues were identified but their materiality has not yet been established**
2.43 Annex C provides additional information on internal control issues identified to date, including specific examples to illustrate the character of the (i) several potential internal control issues or deficiencies identified by Management, (ii) additional issues identified by IEG as potential internal control deficiencies; and (iii) noted deficiencies identified by IEG in the materials submitted by Management as part of its Part IA assessment.

**Findings from IEG’s Analysis**

2.44 IEG conducted its own independent analysis of Management’s assessment, both by examining Management’s materials and by attending selected “walkthroughs” as observers. The analysis revealed a number of additional issues to those that Management had identified, some of which related to controls issues, others to deficiencies in Management’s materials, mapping and descriptions. In both cases, more details are given in Annex C:

**ISSUES RELATED TO CONTROLS**

- In the modules dealing with disbursements and loan amendments (Modules 19 and 21) IEG found that Task Team Leaders are afforded much flexibility in the OPs that govern IDA, which permit them to make changes in a project disbursement category amount, on the understanding this will be documented later, but IEG could not find a control which ensured this would take place. Also, IEG could find no mechanism whereby a TTL could inform the Loan Department to place a hold on disbursements, if she/he had uncertainty that funds were being disbursed for the purposes intended.

- In the refunds and loan closing modules (Modules 22, 25, 26) IEG learned that the Loan Department has no mechanism to ensure that balances remaining in special accounts (greater than 1% of loan amount) and due for refund to IDA are eventually received.

- In the safeguards module for a SIL (Module 28) IEG found that, if certain safeguard documents to be prepared by the country in the preparation phase are inadequate, there is no mechanism in the process for it to be sent back to be redone.

- In the procurement complaints module (Module 15) IEG found that there is no control to ensure that all complaints are entered into the complaints database. Also, there is no control to ensure that reports from the complaints database are followed up on and that all complaints are handled appropriately.

2.45 **Summary Evaluation of Revealed Deficiencies:** In IEG’s opinion, these issues taken individually are deficiencies. Whether, individually or in combination, they would rise to the level of significant
deficiencies or material weaknesses would best be judged as part of the totality of the revealed deficiencies, including those uncovered by both Management and IAD, and this should be deferred until at least the completion of the controls testing to be done in Part IB. Failure to establish the materiality of these deficiencies by then would interfere with the ability to make affirmative conclusions on the effectiveness of the overall internal controls framework.

**ISSUES RELATED TO MANAGEMENT’S DESCRIPTIVE MATERIALS AND MAPPING**

2.46 IEG also noted certain imperfections in Management’s descriptive materials, of which the following are highlight examples (more details are given in Annex C):

- In the description of specific risks linked to key controls, Management did not categorize these risks as to type (e.g., financial, operational, or reputational) or analyze the risks in terms of likelihood of occurrence or impact; (para 2.21)
- The DPL module did not address the potential impact on IDA’s reputation and the country if the DPL objectives are not accomplished;
- Loan management modules did not mention the area of repayment and amortization risks;
- In some BPM process maps, the sections of the main lending processes subject to QAG assessments (Quality of Supervision Assessment; Quality at Entry Assessment) had no links to show where these QAG interventions would be made.
- The CAS module omitted to show links to the portfolio/pipeline review, to AAA, including CEM and PRSP, and did not show the inputs of the Sector Networks;

2.47 These comments complete IEG’s evaluation of Management’s assessment of the present stage. Chapter 3 deals with the IAD review, while Chapter 4 presents IEG conclusions and recommendations.

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1. Quotes from page 2 of Management’s Report.
2. Ibid page 2.
3. At the time of completing this report, Module 30, on Debt Sustainability Analysis, was still being completed, so the assessment and IEG evaluation were effectively conducted on 29 modules. IEG assumes that Module 30 remains part of the universe going forward. Further, Management regards the IDA Allocation Model and the Post Conflict Allocation as sub-processes to the main Allocation module, so by some counts Management refers to 27 modules.

1. The Bank and IDA are affiliated multi-national development agencies each with its own jurisprudential personality established through international treaty by Articles of Agreement between the member countries. Article VIII
Section 10 of IDA’s Articles of Agreement requires that “Each member take action necessary in its own territories for the purpose of making effective in terms of its own law the principles set forth in the Articles of Agreement and shall inform the Association of the detailed action which it has taken.” This principle is carried forward from the Articles into the IDA lending agreements (which incorporate the General Conditions) and which stipulate that in case of conflict the member/borrower cannot raise the local law as a justification for failure to implement the conditions set forth in the lending agreements. It is not the legal duty of IDA to monitor the compliance by the borrower with all its own laws and regulations. However, IDA has to be assured that the conditions it needs for a successful project are spelled out in the lending agreements and will be implemented notwithstanding conflict with local law. For this purpose, IDA requires (as a standard condition of effectiveness) a legal opinion satisfactory to IDA confirming that the provisions of the lending agreement are valid and binding on the borrower.

2. Management comment: Management’s decision to focus this exercise on IDA lending products and not specifically focus on AAA and other Knowledge Products was consistent with the main objective of assessing the internal controls in place for ensuring how borrowers use IDA resources for the purposes intended. The fact that a large percentage of administrative budget is spent on AAA does not in and of itself suggest the connection between AAA and lending where IDA controls under review would apply.

3. Take, for example, Module 9, Contractual Remedies. The Process Overview describes the objective of the process as: “Ensure contractual remedies are applied when necessary…..” Though not wrong, it sounds as if the objective of the process is the process, and the explanation carries little of the operationally substantive facts that: IDA assistance is always contingent on fulfillment of project agreements and other covenants. This implies a need for sanction and remedies where agreements are broken, or covenants not met….etc, so that when the occasion arises, there is a structured process to seek remedies and sanctions….etc., and this is the purpose of Module 9.

4. Management comment: IEG’s criticism of the Management’s approach of dividing the assessment into two parts and focusing the first part on transaction-level controls has to be taken in the context of the unprecedented nature of this assessment, the intensity and scope of work required as well as its primary objective of assessing the existing controls for ensuring that IDA funds are used for the purposes intended. As has been discussed with CODE and the Audit Committee in November 2005 and July 2006, the review of IDA’s Internal Controls, to date, has required a massive amount of work on Management side, involving the identification and categorization of the relevant policies and a rigorous review of 30 business processes that are key to IDA operations and resulting in 700 pages of documentation. We believe that everyone (IEG, IAD and Management) is in agreement that the work performed represents a landmark step in the understanding and evaluation of IDA’s control framework and is unique in the development community. The work performed to date is particularly useful precisely because of the methodology utilized. In recognition of the practical difficulties of undertaking one comprehensive study, Management has in effect identified three phases: in the first (Part IA), which is the subject of this report, Management has sought to ensure that procedures embed key controls to assure compliance with policies; in the second (Part IB), Management will assess whether these procedures are complied with in practice; and in the third (Part II), Management will assess whether the mechanisms in place to monitor that IDA op-
erations are efficient and effective are adequate. Management believes that this methodology allows for a systematic and manageable analysis, and the development of specific and actionable findings. While Management agrees with IEG that the methodology applied makes it difficult for IEG to provide an overall definitive conclusion at this stage, given the trade-offs, in a resource constrained environment and real time-limitations on what could be done, the approach followed proved to be preferable as the findings, and related action plans are likely to be the major themes of the entire assessment. In this regard, it is important to note that IEG has confirmed that “The mapped Business Process Modules have provided a concrete and transparent means of identifying, assessing and testing key controls” (para 4.3 (ii), emphasis supplied) and found that “Management’s approach has yielded concrete results in revealing deficiencies and potential weaknesses” (para 4.3 (v)). Management is committed to complete the next phases of this exercise, namely Part IB relating to assessment of operation effectiveness of the controls identified and Part II relating to the overall efficiency and effectiveness. However, it is important to note that while these parts are expected to refine Management’s findings and conclusions, given the nature of conclusions to date and the rigor of the work performed, it is reasonable to expect that the nature of the conclusions under Part IB and II will be the same as the important findings and conclusions which resulted from the work carried out under Part IA.

5. An entity-level review would have allowed a prior assessment of how well the COSO framework is being observed as a whole, it might have suggested priority areas of risk, and it would have informed the operating units in the Bank of the impending review, and given them time to prepare for the business process tests. IEG can find few if any precedents for major internal control reviews which have not started at the entity level. AS2 (see annex 2) states that “it may be appropriate for the auditor to test and evaluate the design effectiveness of company-level controls first.” The Policy Statement issued by the PCAOB after the first year of experience with AS2 states that “this Policy Statement expresses the Board’s view that, to properly plan and perform an effective audit under Auditing Standard No. 2, auditors should … use a top-down approach and that “Auditing Standard No. 2 was designed to be applied from the top down.”

6. Management’s statement that this type of review is without precedent is true for the Bank and IDA, but there are some precedents for this in other agencies. The United States federal government agencies have been making such assessments under the Federal Managers’ Financial Integrity Act (FMFIA) since its passage in 1982. For example, the United States Department of the Treasury, in its Fiscal Year 2005 Performance and Accountability Report (page 23), stated that “As a result of our evaluations, Treasury can provide reasonable assurance that the objectives of the Federal Managers’ Financial Integrity Act have been achieved, except for the remaining material weaknesses…” (which were listed). Treasury went on to list the management control objectives under FMFIA among which included “to ensure that programs achieve their intended results, resources are used consistent with overall mission, programs and resources are free from waste, fraud and mismanagement, and laws and regulations are followed.”

7. **Management comment:** The IEG report states that IEG regards the issues identified by Management relating to documents retention as a “potential material weakness.” Management questions the validity of IEG’s use of the term “potential material weakness” given the speculative nature associated
with any “potential” material weaknesses. The outcome of any prospective work is by definition unknown. Therefore, Management believes that it would be more prudent at this stage not to guess or prejudge what the possible outcome might be but rather limit any conclusions to the factual statements and specify that as part of the follow on phases this issue would be looked at so as to assess both the seriousness of any problem and how best to address it.

8. See, for example, the AROE for 2002.

9. **Management comment:** The IEG report states that IEG regards the status of some OPs and BPs as “potential material weakness.” As with the issues relating to document retention, Management questions the validity of IEG’s use of the term “potential material weakness” relating to OP/BP status given the speculative nature associated with any “potential” material weaknesses. In addition, Management believes that while the current status of some OPs and BPs may have a negative impact on the efficiency and transaction costs of processes and key controls associated with such OPs and BPs, it does not constitute an actual or potential material weakness relating to compliance. In this regard, it is also important to note that the policy reform effort underway as part of the modernization agenda has been focused on simplifying and streamlining the existing policies and procedures, not in addressing weaknesses or gaps in the current statements. Most notable examples of these types of policy reforms are the reform of OP/BP 8.60, governing Development Policy Lending, reform of policy on expenditure eligibility (OP/BP 6.00), and the policy on additional financing for investment lending (OP/BP 13.20). Recognizing this, as part of the modernization agenda, Management discussed with the Board that other updates of policies relating to investment lending would proceed only after progress was made on modernizing non-policy aspects of investment lending and not in parallel. It also has been long recognized by Management and the Board that the current processes for preparation, review, consultation, approval and issuance of revised policies are extremely time and resource consuming, often resulting in a lag between the time when a need for a given policy update is identified and the final approval and issuance of the revised or updated policy. To reflect this, and ensure that this issue is properly addressed as part of this exercise, in paragraph 26 C of its Findings and Recommendations, Management suggests that “As part of Management’s assessment of the effectiveness and efficiency of IDA’s internal controls framework, Management intends to look at the current processes underlying policy revision to determine if they need to be revised to facilitate a more efficient and timely updating of operational policies and procedures.” Management believes that this is indeed an important efficiency issue that should be addressed under Part II of this exercise.
3. The IAD Review and Report

Context for IEG’s Review of IAD’s Work

3.1 This chapter contains a description of IAD’s objectives, scope and approach to its review (paragraphs 3.2-3.3), and a summary (paragraphs 3.4 and 3.5) of the main observations that IAD has recorded in its report. In the latter section, where appropriate, IEG comments on and evaluates IAD’s main findings. The complete IAD report is in Attachment II.

IAD’s Objective

3.2 IAD’s Terms of Reference stated as its objective in reviewing Management’s assessment of internal controls to express an opinion on whether the assessment of internal controls over IDA operations, relating to their compliance with the IDA charter and its internal policies and procedures, has been fairly stated, based on the criteria established in the COSO framework. As a result of Management’s decision to divide its assessment into Part I—internal controls over compliance—and Part II—internal controls over operational effectiveness and efficiency—and subsequently to divide Part I into Parts IA and IB, IAD had to develop a more specific scope and approach for Part IA. IAD has also concluded that its opinion would have to await completion of Part IB.

IAD’s Scope and Approach for Part IA

3.3 Similar to IEG, IAD noted a number of scope limitations in Management’s work, including the deferral of entity-level controls and internal controls over efficiency and effectiveness of operations, processes excluded by Management, and deferral of the evaluation of information technology controls. Using relevant concepts from AS2 tailored for compliance and operational controls, IAD performed the following work.

- **Process Documentation**: IAD reviewed high level process flowcharts, descriptive materials of processes and control objectives, risks and key controls provided by Management. IAD...
reviewed whether key controls identified by management appeared adequate to satisfy control objectives, and identified potentially missing key controls.

- **Workshops/Review Sessions:** IAD observed workshops/review sessions conducted by Management with subject matter experts to review the design effectiveness of key controls as identified and documented by Management, challenging, seeking clarification and identifying potential deficiencies as appropriate.

- **Revised Process Documentation:** IAD reviewed revised process descriptions incorporating changes identified in the workshops/review sessions, and potential control issues identified by Management.

- **Deficiency Tracker:** IAD provided Management with a list of 59 potential deficiencies in documentation and/or design identified during its review, four of which also were included in Management’s list of potential deficiencies.

- **Process Walkthroughs:** IAD attended process walkthrough sessions convened by Management with operating personnel responsible for three processes (Country Assistance Strategy, Investment Lending and Development Policy Lending) to confirm the operation of process controls (for at least one transaction for each process) from inception to completion, as documented in the workshops/review sessions.

- **Management’s Report:** IAD reviewed drafts of Management’s report and provided comments as appropriate.

### IAD’s General Observation and Key Issues

3.4 **General observation:** Overall, IEG and IAD raised many of the same issues as a result of their work. IAD commented positively on the comprehensive and unique nature of Management’s assessment within the multilateral development banking community and stated that it could provide a compelling baseline for identifying opportunities to streamline operations and internal controls and improve efficiency and consistency.

3.5 **Key Issues:** IAD identified eight key issues during its review of Part IA of Management’s assessment. Each of the key issues is summarized briefly below along with IEG’s observations.

- **IDA processes selected:** IAD raised questions about Management’s decision to exclude certain processes in determining compliance with fiduciary aspects of IDA’s lending operations, as well as limiting its scope to processes applicable to SILs and DPLs. IEG’s evaluation also raised a number of concerns about IDA processes excluded from Management’s as-
assessment (particularly knowledge products) and using SILs alone to represent all investment lending. (para 2.8 and Annex E, paras 7-9)

- **Information technology (IT) controls**: IAD commented on Management’s plan to defer assessment of IT controls to Part II as part of assessing entity-level controls and took the position that key IT controls need to be assessed in Part IB to reach reliable conclusions. IEG’s work also identified the deferral of IT controls to Part II as a significant scope limitation, which limits conclusions that can be drawn from Management’s assessment on Part I. (2.24)

- **Fraud and corruption controls**: IAD commented that Management had not identified and documented controls focused on mitigating risks associated with fraud and corruption at the process level. IAD also noted that Management had not assessed the adequacy of other controls to satisfy such objectives, such as ensuring that control implications identified during fraud and corruption investigations are adequately addressed. In IEG’s view, controls over fraud and corruption should first be addressed at the entity-wide level, which would include controls to assure that issues identified during fraud and corruption investigations are adequately addressed. Work on fraud and corruption controls at the entity-wide level could then inform the need to assess key controls at the process level important to preventing or detecting fraud and corruption. IEG also observes that the controls assessments completed by Management implicitly also dealt with fraud and corruption prevention issues, but agrees with IAD that this could have been made more explicit.

- **Outdated OPs and BPs**: IAD notes “absent processes to ensure that policies are current, controls to ensure compliance with such policies would not be meaningful, even if current practices meet business needs.” IAD recognizes that Management has committed to review the process for updating the OPs and BPs and to examine the appropriateness of regional variances in implementation. IEG’s work identifies this as a significant issue raised by Management’s assessment that IEG believes is an area of potential material weakness, and recommends that Management’s reform work be treated as a priority.

- **Categorization and Remediation of Deficiencies**: IAD states that Management’s assessment in Part I A has yet to determine whether identified deficiencies pose, in the aggregate if not individually, significant or material risks to the attainment of control objectives. IEG’s work also identified this issue and IEG agrees with IAD on the need for Management to evaluate in Part IB the significance of the deficiencies identified by
Management’s assessment and the additional deficiencies identified by IAD and IEG (para 2.45).

- **Document Retention and Accessibility:** IAD takes note of Management’s significant difficulties in obtaining timely access to relevant documents for compliance testing and concludes that in IAD’s experience this represents a significant control design deficiency. While Management has agreed to address this issue, IEG concludes that this is clearly a major issue that could reach the level of material weakness. In particular, IEG notes the potential relationship between the document retention issue and the major decentralization of the Bank in the past decade and the role of information technology in document retention (para 2.32).

- **Assessment of Entity-level Controls:** IAD comments on the decision to defer the assessment of entity-level controls to Part II and notes that Management’s conclusions on control effectiveness as a result of Part I will need to be reconsidered once entity-level controls have been examined. IEG identifies the decision to delay assessment of entity-level controls to Part II as a major scope limitation and finds that Management’s decision to employ a bottom-up approach to assess controls as contrasted to a top-down approach, starting with entity-level controls, runs contrary to standard industry recommendations.

- **Walkthrough of Process Documentation:** IAD states that “Management’s assessment of design effectiveness of internal controls under Part IA of the review included walkthroughs of process documentation for three of the 29 documented in-scope processes (CAS, SILs and DPLs) from inception to completion.” IEG disagrees with IAD’s definition of walkthrough, in this context, and regards most of the 29 in-scope processes to have been subjected by Management to a walkthrough process essentially similar (as modified to suit the nature of IDA operations) to that described in the AS2 text summary of the concept.

- **Completion of Remaining Stages:** IAD “strongly recommends reconsidering the relative cost-benefit of continuing immediately with the remaining issues of the assessment versus continuing after addressing significant deficiencies identified in Part IA” (PAGE 7, IAD report). IEG has considered this option, but regards a postponement as unnecessary and impractical and believes, on the contrary (as argued in paras 2.24 and 4.7), that the remaining stages should be completed expeditiously.

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**NOTES**

1. IEG had a very limited period of time to review IAD’s report, so these observations are to be taken as reflecting IEG’s evaluation at this stage of its analysis. IEG will be broadening its evaluation in the light of further work to be completed during Part IB and beyond.
2. Terms of Reference for a Review of Management’s Assessment of Internal Controls over IDA Operations, IAD, May 16, 2006, issued as a memorandum to the Vice Presidents of CTR and OPCS, which IAD also sent to AC and CODE.

3. IAD and Management have used different applications of the term “Walk-through.” They also have differing views on the extent of work to be completed under this process. IEG has used the term (as described on page iv) to signify the process by which Management has verified process mapping and design effectiveness, without denoting acceptable quality of the work completed.

4. Economic and Sector Work (ESW), Report on Observance of Standards (ROSC) Independent Evaluation Group (IEG) and Internal Audit Department (IAD) processes, among others. (see Box 6 on page 15).
4. Conclusions and Recommendations

4.1 This final chapter presents IEG’s main conclusions from its evaluation of the work completed so far. The chapter provides a broad overview, a summary of the concluding evaluation of both Management’s assessment and the IAD review, and it concludes with a set of IEG recommendations going forward.

Overall IEG Evaluation

4.2 IEG recognizes the reasons why Management adopted the process-based and phased approach, and acknowledges its merits. But considering also the scope limitations this necessarily implied, IEG arrives at a mixed conclusion on the completion of this first stage of the study: At the Transactions Level: robust progress has been made in defining, locating and assessing key internal controls, and the results from this approach have revealed a number of deficiencies and possible weaknesses in the underlying controls; At the Controls Framework Level the general approach and scope limitations applying to this stage of the assessment prevent positive assertions being made now regarding the effective operation of the overall system of controls.

4.3 At the transactions level progress can be measured in the following ways:

- As a basis to test for compliance, Management has made a credible linkage between the IDA Articles, the Bank’s policies and procedures, and the business processes identified to represent IDA operations;
- The mapped Business Process Modules have provided a concrete and transparent means of identifying, assessing and testing key controls;
- Management’s methods of mapping and assessing the BPMs have been of a generally satisfactory quality, though with some notable qualifications relating to the treatment of risk, and the need to improve some of the descriptive materials.
- Management’s “walkthrough” method of verifying the accuracy of the selected business processes and testing the design effectiveness of their key controls was rigorous, comprehensive, transparent, and documented to a largely satisfactory
standard, consistent with general concepts of AS2; (some further walkthroughs may still be needed);

- Management’s approach has yielded concrete results in revealing deficiencies and potential weaknesses: Management uncovered two deficiencies (which IEG regards as potential material weaknesses—document retention; imprecise and un-reformed OPs/BPs), as well as one other potential significant deficiency; in addition, Management compiled a list of some other issues whose materiality is to be examined and assessed in the next stages of the study. Also, on the basis of their review of Management’s work, both IAD and IEG have added to this list, with IAD identifying 55 issues (35 documentation issues; 20 potential control deficiencies), and IEG identifying four control deficiencies, and six areas of imperfection in the descriptive materials and process maps.

4.4 At the Level of the Controls Framework, the weaknesses stemming from the inevitable trade-offs and scope limitations inherent in Management’s chosen approach can be summarized as follows:

- Conclusions on controls within COSO cannot be made piece-meal, so staging and dividing the study has effectively postponed the ability to make definitive conclusions on the outcomes of each stage of the review until the overall (Part II) assessment has been completed, i.e. until end 2007, or later.
- Even the staging of the study between Part IA and Part IB makes conclusions on control design (Part IA) difficult until Part IB has been completed.
- Separating compliance and efficiency and effectiveness is really not possible in practice: many business processes and their associated controls are as much to do with compliance as with efficiency and effectiveness, and these are best treated together rather than in sequence.
- Other scope limitations flowing from the delineation of the study—in particular the decision to deal with IT systems and field offices in Part II, have yet further limited the conclusions that can be drawn in Part I.

4.5 By completing the entity-level review during Part II, and addressing the postponed parts of the framework, Management should be able to mitigate these deficiencies in approach by linking results from the various parts together, to provide an overall statement. However, this will depend on there being no changes in any basic parameters: controls will be assessed at different points in time, and policies, procedures, systems, organization structures may change during this period.
4.6 Summary of Key Observations by the Reviewing Parties: This three-phase assessment, review and evaluation has given rise to a complex combination of descriptions of method, summary of findings, and evaluative observations. As an aid to provide a simplified summary of the main issues that have been identified by Management, IAD and IEG, Box 7 below provides a tabulation of issues. It separates issues relating to approach and method from those relating to the results of Management’s assessment at the conclusion of Part IA. It shows that there is a considerable commonality between IEG’s findings and the observations that IAD has made on issues raised by Management’s approach and method. It also shows areas in which IEG has made observations where IAD has not commented, (e.g. process issues; quality of Management’s BPM mapping) and cases of disagreement (e.g. over the definition of walkthrough). IAD has, through the walkthrough process been able to identify 55 additional issues (documentation and control issues) to be further examined for their nature and materiality. Taken overall, IEG finds the coverage of issues for this stage of the review to be robust and wide-ranging.

<p>| Box 10. Summary of Principal Issues Identified by Management, IAD, and IEG |
|---------------------------------|-----------------|-----|-----|</p>
<table>
<thead>
<tr>
<th>Issues relating to approach and method</th>
<th>Management</th>
<th>IAD</th>
<th>IEG</th>
</tr>
</thead>
<tbody>
<tr>
<td>A: Framework Issues</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Bottom-up versus Top-down</td>
<td>Better start Top-down</td>
<td>Better start Top-down</td>
<td></td>
</tr>
<tr>
<td>2. Staging and Dividing the Assessment</td>
<td>Postpones Conclusions</td>
<td>Postpones Conclusions</td>
<td></td>
</tr>
<tr>
<td>3. Dealing only partially with COSO components</td>
<td>-</td>
<td>Postpones Conclusions</td>
<td></td>
</tr>
<tr>
<td>4. Scope Limitations</td>
<td>IT to be assessed in Part IB</td>
<td>Optional; IT is part of Entity Level controls</td>
<td></td>
</tr>
<tr>
<td>---------------------------------</td>
<td>-----------</td>
<td>-----</td>
<td>-----</td>
</tr>
<tr>
<td>B: Process Level Issues:</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Definition of Objectives, Compliance</td>
<td>-</td>
<td>Acceptable</td>
<td></td>
</tr>
<tr>
<td>2. From Articles to Key Policies and Procedures</td>
<td>-</td>
<td>Acceptable</td>
<td></td>
</tr>
<tr>
<td>3. Linking OPs/BPs</td>
<td>Explanations offered</td>
<td>-</td>
<td>Only 50% linked to BPMs</td>
</tr>
<tr>
<td>4. Identifying BPMs</td>
<td>-</td>
<td>Acceptable</td>
<td></td>
</tr>
<tr>
<td>5. Quality of BPM mapping</td>
<td>-</td>
<td>Satisfactory, some qualifications</td>
<td></td>
</tr>
<tr>
<td>5. The Cluster as Representing IDA Operations</td>
<td>Issue: Excluded Processes</td>
<td>a. Lending: Test ILs b. Excluded AAA/KP</td>
<td></td>
</tr>
<tr>
<td>---------------------------------</td>
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</tbody>
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Continued
### Box 10 (continued)

<table>
<thead>
<tr>
<th>Issues relating to results: major controls issues</th>
<th></th>
</tr>
</thead>
</table>

#### Highlighted Controls Issues

**By Management**

<table>
<thead>
<tr>
<th>1. Document Retention and Accessibility</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highlighted Deficiency</td>
</tr>
</tbody>
</table>

2. Current Status of OPs/BPs:

   a. OPs/BPs outdated, often not current
   b. Complex, disjointed policy framework
   c. Onerous, inefficient processes

3. Disparity in Corporate Review SILs and DPLs.

   Highlighted | -- | Highlighted

**By IAD (3)**

<table>
<thead>
<tr>
<th>1. Outdated OPs/BPs</th>
</tr>
</thead>
<tbody>
<tr>
<td>Highlighted</td>
</tr>
</tbody>
</table>

2. Definition of Walkthrough

<table>
<thead>
<tr>
<th>Disputed</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management Consistent with AS2 concepts</td>
</tr>
</tbody>
</table>

3. Fraud and Corruption Controls

<table>
<thead>
<tr>
<th>Should be assessed at process level</th>
</tr>
</thead>
<tbody>
<tr>
<td>Start with Entity level controls; could have been more explicitly treated</td>
</tr>
</tbody>
</table>

**By IEG (4)**

(i) No control over “subject to” disbursement changes;
(ii) no assurance all refunds received;
(iii) No mechanism to assure country safeguard documents redone if necessary;
(iv) No Bank-wide log for procurement complaints

| Highlighted |

### Issues relating to Results: Documentation and potential control Deficiencies.

| Highlighted Additional Issues | 55 Identified; Materiality not yet established | Materiality should be established during Part IB |

#### 4.7 Recommendations for Next Steps:

IEG’s recommendations are focused on the issues to be dealt with in completing the remaining phases of the review, and on the broader control framework issues that may emerge going forward. Note is taken of the fact that Management has identified the documentation retention and accessibility
as a weakness and has already launched a remedial effort. In this context, IEG makes six recommendations to Management, (including one also to IAD), as follows:

- **Confirming the Validity of the BPM Cluster:** Management has argued, but has not conclusively demonstrated, that the core SIL prototype module in the cluster of BPMs can be used as a proxy for all investment type lending, because all ILs have the same controls as SILs. This proposition should be tested, and this could be done during Part IB. (para 2.18)

- **Reform of the OPs/BPs:** IEG considers this topic an area of potential material weakness, whose remedy Management should treat as a priority. IEG notes that Management has a stated strategy to address the problem, both to streamline and to update the OPs/BPs. (para 2.37).

- **Completing the Remaining stages:** IEG recommends that preparation for the Part II stage should begin promptly upon completion of Part I. It would seem useful to precede this work with a work plan (which could be discussed with the Board), which could benefit from consultations between Management, IAD, and IEG, much as the Audit Standards were discussed under Part I. Part II should preferably be completed expeditiously, also because if it should be delayed, the controls parameters that were tested during Part I may have changed, and there may be difficulties integrating the two parts. (para 2.24).

- **Resolving Specific Issues and Potential Deficiencies (Management and IAD):** It is important that the several deficiencies uncovered by both Management’s assessment and IAD review, as listed and described in Annex C, be addressed during completion of Part IB. While some of these issues relate to lack of clarity in documentation, others to efficiency and effectiveness of controls, others are potential deficiencies in controls. It is the seriousness of the latter group—the materiality of their potential impact on risk mitigation—that must be addressed before conclusions can be drawn on the state of the overall control framework. Management and IAD should work on this together. (paras 2.41, 2.44 and 3.3, third bullet).

- **Managing the Risk Framework and Extending COSO:** IEG believes the Integrated Risk Management Framework will need to be broadened to focus also on compliance and operations reporting, and in this context, the Bank may also consider adopting the recently extended version of COSO which provides for the addition of a new fourth objective (strategy—high level goals, aligning with supporting mission) and three new components to the existing five components of COSO: objective setting, event identification and risk response. (para 1.7 and Annex A paras 4-6).
• **Mainstreaming Internal Controls Reviews:** IDA should begin considering the value of adopting a policy requiring: (1) ongoing monitoring and reporting on internal controls in the course of operations for all three COSO objectives; and (2) separate evaluations and reporting as necessary.

4.8 **Postscript:** A Summary of Key Steps to be Taken in Preparing for and Completing Part IB:

- **Content:** Testing (or re-testing) key controls operation (Box 1, page 2)
- **Identified Deficiencies:** Management, in consultation with IAD and IEG, to categorize, and establish materiality of deficiencies identified during Part IA (paras 2.41; 2.46; 3.5; 4.7; and Annex C)
- **Verify Validity of ILs in BPM Cluster:** To show that SILs represent all ILs, test a range of investment lending products (para 2.18 and Annex E)
- **Explicitly Address Fraud and Corruption Issues:** Management to itemize controls where fraud issues are relevant, indicate mitigating controls (para 3.5 and Box 7)
- **Assessment of IT Controls (Optional):** IAD has recommended assessment during Part IB; IEG agrees this is a scope limitation, but could be dealt with as an entity-level control, during Part II. (para 2.24 and para 3.5)
- **Advisory Panel:** IEG will be convening an Advisory Panel of international experts to give an opinion on its evaluation of Part IA and Part IB. (para 1.17)
Annex A. The COSO Framework

1. Figure A1 below conceptually integrates the COSO objectives and components and the Bank’s own integrated risk management focal points. COSO defines internal control as a process, effected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

   - Reliability of financial reporting—relating to preparation of published financial statements;
   - Compliance with applicable laws and regulations—relating to compliance with applicable legal and regulatory framework, which in the case of IDA is taken to mean its charter and policies; and
   - Effectiveness and efficiency of operations—relating to effective and efficient use of resources in meeting business objectives.

2. To meet the above objectives of internal control COSO describes the following components of internal control. All five components must be present and functioning effectively to conclude that internal control is effective over any of the three objectives.
Annex A
The COSO Framework

- **Control Environment.** The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include: the integrity, ethical values, and competence of the people; management’s philosophy and operating style (tone at the top); the way management assigns authority and responsibility and organizes and develops its people; and the attention and direction provided by the board of directors.

- **Risk Assessment.** The Bank defines risk as anything that hinders the ethical achievement of sustainable business objectives and results. This includes failure to exploit opportunities and to maintain organizational relevance. Every organization faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is establishment of business objectives that are internally consistent and aligned with an organization’s strategy and mission. Risk assessment is the identification and analysis of those risks that potentially jeopardize the achievement of business objectives. Risk assessment forms a basis for determining how risks should be managed, and as the Bank operates in a complex and rapidly changing environment, it is critical that risk assessment and risk mitigation are rigorous and ongoing processes.

- **Control Activities.** Control activities are the policies and procedures that help ensure that management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the objectives. Control activities occur throughout the organization, at all levels, and in all functions. They include a range of activities such as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets, and segregation of duties. In terms of the Bank’s operations, control activities can include key processes such as supervision of projects, and regional portfolio risk reviews.

- **Monitoring and Learning.** Internal control systems need to be monitored—a process that assesses the quality of the system’s performance over time. This is accomplished through ongoing monitoring activities and separate evaluation. Ongoing monitoring occurs in the course of business operations. It includes regular management and supervisory activities and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported “upstream,” with serious matters reported to top management and the board of directors.

- **Information and Communication.** Pertinent information must be identified, captured, and communicated in a form and timeframe that enables people to carry out their responsibilities. Information systems produce reports containing operational, financial, and compliance-related information that make it possible to run and control the business. They deal not only with internally generated data, but also with information about external events and activities and conditions necessary for informed decision-making and external reporting. Effective communication must also occur in a broader sense, flowing down, across, and from the bottom upward in the organization. In a healthy control environment, communications are open and when a business objective is in jeopardy “bad news” flows rapidly so that corrective action can be taken in a timely manner. All personnel must receive a clear message from top management that control re-
responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream. There also needs to be effective communication with external parties such as suppliers, regulators, shareholders, borrowers, donors, and interested parties such as Non-Governmental Organizations (NGOs).

3. The Bank faces a wide range of increasingly complex risks. Sound risk management must be comprehensive to meet the dual requirement of development effectiveness and resource mobilization. To ensure that opportunities are not missed and the full range of risks is considered, the Bank has organized its risk management around the following four focal points.

- **Strategic effectiveness.** Success in this area means setting and maintaining the Bank’s strategic direction on a course that leads to enhancing development effectiveness and reducing poverty. It involves making sure that strategic choices and follow-up decisions are not only in response to immediate challenges but also aim to maintain the Bank’s relevance and its role as a leading development institution. Four main dimensions are included in strategic effectiveness: selectivity, execution of strategy, agility, and governance.

- **Operational efficiency.** This is relevant to virtually all parts of the Bank’s internal operations. It is about “doing things right” in all areas, from country work to central services, from HR to finance, etc. Operational efficiency requires operating and managerial standards as well as implementation and control mechanisms that ensure reliable, high-quality, and cost-effective performance. Five main dimensions are included in operational efficiency: human resources, fiduciary performance, safeguard quality and performance, operational performance, and information technology.

- **Stakeholder support.** The support of a wide range of stakeholders is key to the Bank’s pursuit of its mission. Building political will and constituencies entails close cooperation among all branches of government, NGOs, people affected by Bank projects, private firms, Bank staff, media, and others. The point is not to please everyone, but to ensure that the perspective of all relevant stakeholders has been duly taken into account in Bank decisions. Two main dimensions are included in stakeholder support: member governments and other stakeholders.

- **Financial Soundness.** The Bank has to ensure that its financial policies and practices (for investment, borrowing, and lending decisions) provide sustained access to low-cost assistance for its borrowing members, consistent with its mission and strategy. Three major sources of threats to financial soundness are country (sovereign) credit risk, market risk, and liquidity (funding) risk.

**Recent Developments in COSO**

4. While the Bank has taken a number of initiatives to develop an integrated risk management framework (as is referenced in several places in the text of this report), there are still some questions as to how effectively the integrated framework is operating and how it will develop going forward. IEG believes it worthwhile to draw attention to some of the changes that COSO has recently introduced, as a pointer for further exten-
sions of the Bank’s own efforts in this area. In 2004 COSO itself published a paper entitled *Enterprise Risk Management – Integrated Framework*, which includes consideration of risk appetite, strategy, and decisions; new opportunities; and deployment of capital—elements which are directly parallel to those the Bank has already introduced into its own Integrated Risk Management Framework (IRMF). To emphasize the need to focus on the entity’s mission the new framework also adds a fourth objective to the earlier three objectives of operations, compliance and financial reporting: *Strategic – high-level goals, aligning with supporting mission*

5. Lastly, the new COSO framework expands its components from the existing five to eight, now encompassing the following:

- Internal Environment—management sets tone for organization, defines how risk is viewed and addressed
- Objective Setting—Objectives must exist to identify events, internal and external, that may affect their achievement
- Event Identification—Internal and external events identified that create risks and/or opportunities
- Risk Assessment—likelihood and impact of risk assessed
- Risk Response—management selects risk responses
- Controls Activities—policies and procedures established for risk response
- Information and Communication—information flows up, down, and across the organization
- Monitoring—Ongoing monitoring and periodic, in-depth evaluations.

6. As described above, the COSO framework is a dynamic framework, which has been adapted to the Bank and IDA, and which its originators are also constantly adapting to global developments. As the Bank enters into the next phase of its controls review, in which the COSO framework will be center stage, it may consider making similar additional adaptations to those recently suggested by COSO itself. These are intended to sharpen the focus on risk issues, and risk is what lies at the center of all internal control systems.

**NOTES**


2. As described in Chapter 2 (para 2.4) there was a need to adapt the normal meaning of compliance under COSO to the case of IDA, since the latter is an international agency under its own legal charter, not subject to local laws in the way would be a domestic commercial organization.

3. COSO, September 2004
Annex B. Standards Agreed by Management, IAD and IEG to be used in Assessing Deficiencies, Significant Deficiencies and Material Weaknesses

IEG conducted considerable research into the question of what audit standards would be appropriate to govern this review of IDA controls. The issue was: Management had proposed that it would use virtually the same standards as those that it used for its assessments of internal controls over financial reporting, whereas this review was to be concerned with operational and compliance reporting, where the issues would be different. Following this research, and extensive discussions that were held between Management, IAD and IEG, it was agreed that a common standard would be used by all three parties, and what follows explains this process and the content of the standards.

1. The Bank is currently performing its assessment of internal controls over external financial reporting using existing auditing standards on attestation of internal controls over financial reporting as prescribed by generally accepted auditing standards. In performing its review of compliance with IDA’s charter and applicable internal policies and procedures, Management plans to use the same concepts as those defined in the Auditing Standard No. 2 (AS2) An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements, issued by the U.S. Public Company Accounting Oversight Board (PCAOB) in response to the provisions of Section 404 of the Sarbanes-Oxley legislation as much as possible.

2. Management believes that applying the concepts that have been defined by audit standard setters for assessing internal controls over financial reporting will provide the level of comprehensiveness, rigor and consistency required in its self-assessment of internal controls over compliance with IDA’s charter and applicable internal policies and procedures.

3. During our work it is anticipated that Management will discover items that represent deficiencies and which may or may not require remediation. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance on a timely basis.

- A deficiency in design exists when (a) a control necessary to meet the control objective is missing, or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective is not always met.
A deficiency in operation exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively.

4. Control deficiencies are classified as one of the following: (i) an internal control deficiency; (ii) a significant deficiency; or (iii) a material weakness. The classification of the deficiency is based upon the likelihood of occurrence/noncompliance and/or the significance of noncompliance.

5. Conclusions about what constitutes a material weakness over compliance or operations are judgmental, more so than in the case of material weaknesses in financial reporting. Therefore, the definition of material weakness needs to be adapted from the context of the financial reporting definition, with its reliance on materiality in relation to the financial statements, to one using more judgment as to whether the operations and compliance objectives of internal control are met. To guide financial auditors in making these judgments, AS2 identifies examples of attributes the auditor should consider in evaluating identified internal control deficiencies to determine whether the deficiencies, individually or in combination, are significant deficiencies or material weaknesses. Management, IAD and IEG have agreed that clearly defined measures be established for judging operational materiality. These measures will be used as guides by each of the three groups in determining whether identified internal control deficiencies in compliance constitute significant deficiencies or material weaknesses. Identified deficiencies could be significant deficiencies or material weaknesses where the control deficiencies have attributes that could:

- impair the achievement of IDA’s objectives,
- violate requirements of IDA’s charters or other contractual agreements,
- significantly weaken safeguards against waste, loss, or unauthorized use of funds, property, or assets,
- involve conflicts of interest,
- involve systemic problems in country assistance, partnerships and project lending, or
- require the attention of Senior Management, the Board as well as the awareness of external stakeholders.

6. All deficiencies identified during Management’s assessment will be placed on a summary deficiency schedule. The deficiency schedule will outline Management’s assessment of the deficiency (type of deficiency), any mitigating controls over the deficiency, the potential financial impact, if any, the impact from a non-financial perspective, and management’s determination of how to address the deficiency, i.e. corrective action (remediation). A control deficiency or combination of control deficiencies that, in management’s judgment, represent significant deficiencies in the design or operation of internal control that could adversely affect the organization’s ability to meet its internal control objectives is a “Significant Deficiency.” A significant deficiency or a combination of significant deficiencies that Management determines to be significant enough to be reported outside IDA shall be considered a “Material Weakness.”

7. Management (i.e. Controllers (CTRVP) and Operations Policy and Country Services (OPCVP)) will prepare a report assessing the overall deficiencies and make a de-
termination on the impact the deficiencies have individually and in total on the internal controls over IDA’s compliance with its charter and applicable internal policies and procedures. This report which will include: (i) Management’s assessment of IDA’s compliance with its charter and applicable internal policies and procedures; and (ii) a description of any significant deficiencies or material weaknesses identified through its assessment, together with their respective remediation plan.
Annex C. Illustration of Potential Internal Control Design Weaknesses

Findings from Management’s Assessment, the IAD Review, and the IEG Evaluation

1. In its report, Management highlighted five high-level findings where potential deficiencies and weaknesses had been revealed, as follows: (1) difficulties experienced by Management during its assessment in obtaining timely access to relevant documents, (2) changes introduced on the ground that are not consistent with policies and procedures, (3) the difficulty staff is having in identifying which policies they must comply with, (4) confirmation that many staff find the existing processes and documentation requirements very onerous and inefficient, and (5) a disparity between SIL and DPL operations in the extent to which corporate reviews are initiated.

2. In addition to the above five main findings, Management identified and provided IEG a list of “potential issues” identified during its Part 1A compliance assessment work. IAD also identified and is tracking “deficiencies” based on its review of all modules as of September 20, 2006. IAD provided its list of deficiencies to Management and IEG. IAD stressed to Management the importance of evaluating and classifying (based on their level of significance) all of the deficiencies identified by both IAD and Management in order to substantiate the findings in later work and to draw conclusions.

3. IAD provided management and IEG with a list, taken from its Deficiency Tracker, of potential additional deficiencies in Management’s documentation of process flows for key controls and/or design gaps in key controls without adequate mitigating controls. The list identifies several which relate to process documentation, others to design gaps, and a few to both process documentation and design gaps. IAD noted that, for each of the deficiencies, it had recommended that Management revise the process documentation and, where appropriate, clearly indicate how the associated risks are mitigated.

4. During its evaluation, IEG examined the narrative descriptions and flow charts of IDA business processes, including key internal controls, provided by Management. IEG representatives also attended meetings arranged by Management and observed its process of assessing the design of key internal controls. In addition, IEG reviewed the lists of potential issues and deficiencies provided by Management and IAD. IEG notes that Management is to do further work on these issues to establish whether the issues, or combination of issues, may rise to the level of a deficiency, significant deficiency, or material weakness, as defined by the agreed standards described in Annex B.
5. What follows are some examples of the main issues that IEG considers to merit attention:

- Potential internal control issues or deficiencies identified by Management and/or IAD;
- Additional issues identified by IEG as potential internal control issues;
- Issues identified by IEG as deficiencies in the materials submitted by Management as part of its Part IA assessment.

A. Potential Control Issues Identified by Management and IAD

IDA RESOURCE ALLOCATION MODEL (MODULE 1)

6. The IDA resource allocation model is a management tool used as part of a process for providing financing, in line with IDA’s Articles of Agreement, for purposes that are of high development priority in the less-developed areas of the world that are within the Association’s membership. Management identified and assessed three business processes (of the 30 in total) and three key controls over IDA resource allocations. One of the key controls assessed was the need for the validation by the FRM Manager of all assumptions and conditions used in running the allocation model, such as whether proper allocations are made for large blend countries (e.g. India, Pakistan, and Indonesia); maximum allocations are not exceeded; and allocations for post-conflict countries are proper.

7. Information developed by Management indicates two potential issues exist relating to the above-mentioned internal control over IDA resource allocations. First, the FRM Manager’s validation of the allocations does not consider inputs to the allocation process but rather is based only on the outputs from the allocation model. As a result, Management cannot be assured from the validation process that the assumptions and other conditions or factors going into the model are valid. Second, responsibility for running the allocation model is assigned to a single individual, an FRM Management Information Specialist. While this may assure control over access to the model and what changes are made, a deficiency may exist relating to reliance on a single person for such an important step. This person should have a back-up person who is also knowledgeable about the model in case the primary person is unable to run the model.

8. IAD identified additional deficiencies relating to Management’s process documentation and key controls for the FRM resource allocation processes. For example, Management did not identify any key controls for the IDA Post Conflict Allocation process and had not linked the process to OP/BP 2.30, Development Cooperation and Conflict. IAD said the post conflict allocation model would operate in conjunction with the underlying principles of OP/BP 2.30 and recommended that Management include this OP/BP in the assessment.

CORE INVESTMENT LOAN PROCESS (MODULE 5)

9. This highly important business process module involves all aspects of developing and executing the project cycle for a Specific Investment Loan (SIL) and includes nine key controls.
10. Based on the information it gathered, Management noted that in certain instances reviewing officials in the loan department, procurement, financial management, or legal may approve loan documents but include, with their approvals, “subject to” comments. The comments require certain actions to be taken before the documents are processed to their final stages. However, procedures did not provide for the reviewing officials to follow-up on their “subject to” comments to ensure that relevant documents included changes suggested or that the comments were in some way appropriately addressed. In addition, procedures allowed certain project changes to be initiated between the TTL and the borrower that could have legal and/or disbursement implications but the changes did receive appropriate legal and/or loan department review and authorizations.

**PROCUREMENT MANAGEMENT (MODULE 14)**

11. The procurement regime for a SIL is covered in this process, including nine controls to ensure disbursement of IDA funds to suppliers of goods and services in accordance with Bank procurement guidelines, to achieve equity and efficiency in procurement practice, and to take account of local capabilities in executing contractual awards and monitoring in accordance with Bank guidelines.

12. Based on information gathered, Management identified several potential control issues including these five: (1) there could be a potential conflict of interest when a Task Team Leader (TTL) is also a procurement accredited staff (PAS) and thus performs many of the procurement functions on his or her own without an appropriate segregation of duties; (2) when the TTL and procurement staff are nationals of the project country there is a potential for collusion and conflict of interest; (3) prior review may not be taking place as designed by IDA policy if implementing agencies structure contract packages in such a way as to avoid it (e.g., splitting large contracts into multiple smaller ones solely to avoid prior review requirements, or amending a contract after award to an amount that would have required prior review); (4) staff completing the form 384, which authorizes disbursement on contracts that required prior review may not be appropriately knowledgeable or accredited to do this (sometimes TTLs request other staff to do it, and some staff who had the authorization in the past and no longer have it may not have been removed from the list of authorized users), and appropriate staff do not review the forms; and (5) contracts are selected for post review subjectively by TTLs or procurement staff, which leaves the process open to potential manipulation.

13. IAD identified numerous documentation and/or potential control design deficiencies relating to procurement management. As one example, Management did not identify as a key control the mandatory step prescribed in BP11.00, *Procurement*, that the PS or PAS clear a General Procurement Notice issued by the borrower. IAD said this step is critical for ensuring timely and transparent notification of bidding opportunities. IAD recommended that Management designate the required clearance step as a key control.

**LOAN AMENDMENTS (MODULE 21)**

14. The amendment module describes the review of the Loan Department staff when TTLs submit proposed amendments to IDA credit agreements that affect the disbursements schedule. The objective of the review is to ensure that amendment documentation is consistent with IDA policies. Management identified two key controls in the amendment process.
15. The Loan Department has no control, such as a log of amendments requested, to ensure that all amendments requested are acted on. Thus, some amendments that are requested to the Loan Department may not be processed and approved, and the original disbursement schedule may not meet the needs of the borrower.

**QUALITY ASSURANCE GROUP (MODULE 27)**

16. Activities of the Quality Assurance Group could be viewed as an entity-wide monitoring control within the Bank. Its importance as a control rests largely on the impact QAG results can have both on the management of individual IDA projects and on operations across the Bank. QAG serves as a corollary check on the quality of the work performed by line employees at the entry (QEA) and supervision (QSA) phases of the lending cycle. The results of QAG work are communicated both during the assessment process and also at the end in individual and “synthesis” QAG reports.

17. Management identified a potential issue in that it found no control to ensure QAG recommendations are implemented. The descriptions in Management’s documentation do not sufficiently address how recommendations and other QAG results are to be used to effect improvements in IDA operations. Specifically, the synthesis phase of the narrative and mapping do not adequately explain how recommendations are to be acted on, tracked, and disposed of.

18. IAD identified a potential control deficiency relating to the selection of QAG panel members. Management had identified the risk of individuals serving on the panels who may not be independent and objective vis-à-vis the project they are assessing. Management had not identified a key control to address this risk. IAD recommended that Management identify and assess a key control to ensure QAG panelists are independent and objective relative to the project being assessed.

**B. Potential Control Issues Identified by IEG**

19. IEG concurs with the issues that were identified by Management as potential control deficiencies and has discussed these with Management. IEG agrees that they should be examined further and remedial action taken where needed. In addition, IEG highlights the following issues:

**PROCUREMENT COMPLAINTS (MODULE 15)**

20. The procurement complaints module is the process performed by procurement staff and the TTL to manage complaints received from within or outside IDA regarding procurement. The objective of the two controls in the module is to ensure that procurement complaints regarding procurement on SIL projects are addressed and resolved in accordance with IDA policy and that decisions are disseminated to appropriate internal and external parties.

21. Information gathered by Management revealed two potential internal control weaknesses. First, there is no control to ensure that all complaints are entered into the complaints database. Having all complaints in the database is the first step in ensuring that all complaints are handled appropriately, such as by being referred to the Department of Institutional Integrity and considered for potential non-compliance with IDA procure-
ment policies. Second, there is no control to ensure that reports from the complaints database are followed up on to ensure all complaints are handled appropriately, because there are no regular reports produced from the complaints data base. Because of these weaknesses, the monitoring control that complaints themselves provide to IDA may not function as effectively as it should and problems in procurements may go unaddressed.

**Disbursements and Loan Amendments (Modules 19, 21)**

22. These two modules describe the reviews of the Loan Department staff when (1) borrowers submit applications for disbursements on their IDA credits or requests for special commitments or (2) TTLs submit proposed amendments to IDA credit agreements that affect the disbursements schedule. The objectives of the reviews are to ensure that (1) disbursements are made based upon complete, accurate documentation that is properly approved in accordance with the credit’s financial agreement and (2) amendment documentation is consistent with IDA policies. Management identified five key controls in the disbursement process and two in the amendment process.

23. IEG found two potential deficiencies in control design in these two modules:

- The TTL is allowed much flexibility in the Operational Policies that govern the staff’s IDA activities. The TTL may exceed a category amount with the understanding that he or she will input an amendment later. However, IEG could find no control in either module to ensure that the later amendment takes place. Thus a change may be made to an IDA credit disbursement schedule without the appropriate approvals and documentation change.
- IEG did not identify any standard mechanism for a TTL to let Loan Department staff know if he or she has concerns about a project and wants to put a hold on a disbursement. Thus, a disbursement may be made on a credit when the TTL has some reason to believe it should not be made.

**Refunds and Loan Account Closing (Modules 22, 25, 26)**

24. The refund and loan closing modules include activities of the Loan Department staff to process the closing of IDA credits after the final disbursement or to process refunds received by the Bank for funds previously disbursed. The objectives of these activities are to ensure that IDA issues the appropriate notifications to the borrower, that any credit balances are cancelled in the loan system and the credit is officially closed, and that any special accounts with a balance remaining are refunded to IDA. Management identified one key control in the refund process and two key controls in the standard loan closing process and two in the special closing process.

25. IEG learned that the Loan Department does not have any mechanism to ensure that balances remaining in special accounts that should be refunded to IDA are eventually received by the Bank. Loan Department staff notify the borrower with a balance in a special account of payment instructions, but there is no database monitored to ensure all refunds are received. Instead, individual Finance Officers can keep notes of the refunds expected in their portfolios. Management did not recognize this as a deficiency.
SAFEGUARDS (MODULE 28)

26. The safeguards process includes the activities performed by the IDA safeguards personnel for SILs from project identification to completion. The objective of the process is for safeguards personnel to (1) ensure that safeguard aspects of a project are assessed appropriately given the project circumstances and design; (2) for all safeguards policies that are assessed as being triggered within a project, ensure project design and implementation arrangements are adequate to comply with IDA policy and procedures; and (3) monitor safeguards aspects of projects to ensure the arrangements are carried out according to IDA policy and procedures and adjusted as necessary.

27. IEG recognized that there is a gap in the process documented by Management in that if certain safeguards documents in the preparation phase are inadequate (such as the environmental assessment, done by the country), there is no mechanism in the process for it to be sent back to be redone. This is necessary to mitigate the risk Management has identified that client commitment and capacity to implement safeguards may not be sufficient to ensure that the safeguards are implemented. This in turn could result in reputational risk to IDA.

C. IEG Identified Deficiencies in Management’s Documentation

COUNTRY ASSISTANCE STRATEGY (MODULE 4)

28. Management identified and assessed a business process module and three key controls related to the preparation of the country assistance strategy (CAS), the central tool with which Management and the Board review and guide IDA’s support for the country’s development programs. The objective of the process is to ensure alignment of the CAS with associated lending volume, most recently approved Performance Based Allocation, creditworthiness, potential legal issues, and overall CAS quality.

29. Management’s process maps and descriptive materials omitted from the CAS Preparation phase what IEG considers to be key steps and related controls relating to (1) portfolio/pipeline review, (2) Analytical and Advisory Activities including Country Economic Memorandum actions, and (3) the Poverty Reduction Strategy Papers.

30. IEG could also not find in the CAS BPM any reference which explicitly identified the inputs of the Sector Networks into developing the CAS.

CORE DEVELOPMENT POLICY LOAN PROCESS (MODULE 7)

31. This business process module involves all aspects of the cycle for executing a development policy loan (DPL) from identification to completion and includes seven key controls. The objective of the process is to ensure DPL operations are identified, executed, and completed according to IDA policy and procedures with inputs as required and necessary from internal and external parties.

32. Management’s statement of risks does not address the potential impact on IDA’s reputation and the country if the DPL objectives are not accomplished. The limitations of country capacity, structure, etc. that the DPL is intended to fill will continue to exist if DPL activities are not completed or for any reason, do not accomplish the objectives for
which the DPL was approved. IEG considers this a major risk that is not identified in the Management assessment.

**Loan Management (Modules 17 & 18)**

33. The business process modules involving all activities performed by the Loan Department in the preparation of individual SILs and DPLs from project identification through loan effectiveness (for SILs) or supervision (for DPLs) include five key controls in the SIL process and six in the DPL process. The objective of the Loan Department activities is to ensure that each project includes in the financing agreement and the program document the appropriate overall financial structure of the loan including disbursement and repayment arrangements, as required by IDA’s internal policies.

34. However, Management did not consider the risks in the area of repayment and amortization in these modules, which IEG considers to be a major risk area in these activities. Even though repayment terms are standardized in IDA, there should be a place to mention repayment flows as an issue in the loan process flow charts, since there is always some risk involved.

**QAG Processes (Modules 5, 7, 10, 11, 12, 13, 14, 17, 18, 28)**

35. The QAG processes are those that monitor, in real time, assessments of projects which are still active, all key aspects of project quality, including quality at entry (QEA) and during supervision (QSA), in all aspects of the Banks’ tracking and supervision, including all fiduciary, contractual and safeguards aspects.

36. Management correctly identifies and maps these QAG processes in the QAG module (Module 27), but it does not make explicit the QAG interventions in the other individual line operations modules. This does not affect the assessment of the design effectiveness of the controls, but it is a deficiency in the completeness and accuracy of the process flow charts in the modules mentioned, and by omitting these references Management misses an opportunity to emphasize that the QAG assessments cover all aspects of project design and implementation, including the fiduciary, contractual and safeguards.
Annex D. A Typical BPM: Descriptive Material

Extracted from Management BPM Materials

Figure D.1: Sample Process Map for Module 8—Corporate Review of a SIL Operation
Description of Process

These are the activities associated with conducting a corporate review, with the operations committee (OC) or the regional operations committee (ROC), during the identification or preparation phases of an operation or country assistance strategy (CAS).

Objective of the Process

For DPL operations and CAS(s) the corporate review ensures that documents are reviewed by senior management at the corporate level during identification and / or preparation. For SIL projects, the corporate review ensures that higher risk and exceptional projects are reviewed by senior management, though this is not mandatory and can also happen after preparation, if appropriate.

Risks Impacting the Process

General Risk as Defined in the IRMF:

- Choices within countries (2)
- Quality assurance (5)
- Policy / guideline alignment (7)
- Results-oriented culture (12)
- Timely evaluation and disclosure (13)
- Reliable procurement / disbursements (18)
- Safeguards compliance (22)
- Management of projects with complex safeguards issues (23)
- Business process management (24)

Specific Control Risks:

- IDA projects are not focusing enough resources on priority activities within a country. High risk and high profile projects within a country may not receive the appropriate level of management review to ensure management buy-in for the resources required to adequately fund or scale up these projects / operations
- Not enough of a visible layer of review for quality of operations and their fiduciary arrangements. Innovative or new designs may not be reviewed for quality and fiduciary soundness
- Those operations with the highest potential risk and impact both within the institution and within the borrower country may not be given the highest possible visibility and review at the earliest possible stage, relative to IDA’s other ongoing projects and operations. It is of the most importance for these operations that risks and problems be identified early and have had the most senior management visibility
• For high-risk safeguard projects, there may be no opportunity for corporate buy-in, and projects may be rejected because of their high reputation risks
• The business process is made to be too cumbersome for the relative risks and requirements associated with a project / operation. Not every project / operation requires an OC-level review, and if all were tapped to receive one this would result in an unnecessary bottleneck in the process
• **For All**: Lack of coherence between proposed operations and the CAS and sectoral strategies
• **For CAS products**: The mitigation of all aspects of risk associated with choices within countries may not be carried out – IDA’s efforts in individual countries may not be sufficiently concentrated on priority activities where we can have the greatest impact – including through scaling up efforts. Resources may be spread across too many activities instead of adequately funding critical work. IDA’s mix of instruments within countries may not be appropriate.
• **For CAS products**: Activities programmed by IDA are not harmonized with other development partners
• **For DPL and IL**: No consistent application of IDA policy and adherence to IDA guidelines, nor the opportunity for senior management to help resolve policy issues
• **For DPL and IL**: Lack of linkage between proposed operations and targeted results and / or objectives
• **For IL**: No review of project design parameters, implementation plans, and integration of capacity building in an operation

**Mitigating Key Controls Identified**

In order to ensure the above risks are mitigated, the procedure for deciding on if / when and how to hold a corporate review was reviewed by subject matter experts who prepared the attached process flow diagram and identified the following key control steps in the process:

• Decision to hold ROC or OC review meeting
• ROC Review / OC Review
Key Control Detail Sheet

Corporate Review Corporate

Review — Control 1

Project Stage: Identification or Preparation

Key Control Step: ROC or OC?

A. Description:

For Projects/Operations:

Corporate Review level is decided by the Region (Task Team Leader (TTL), Country Director (CD), Regional Vice President (RVP)) in consultation with Operational Policy and Country Services (OPCS). The Operations Committee (OC) Secretary and the Managing Director (MD) are notified of the decision.

The decision is based on the criteria as outlined below, from the online guidelines.

From Guidelines:

- OC review is recommended for operations that:
  - pose high risk for the institution;
  - have a large size or represent a substantial departure from the CAS;
  - are subject to OC review under existing policy and guidance; and
  - facilitate institution-wide learning or adequate sampling to review for quality.

- (i) Risk: An OC review may be appropriate when there are high risks, including:
  - Safeguard Risks and Corporate / Reputational Risks. Operations with critical safeguard and / or reputational risks, as identified through the existing process (whereby Regions flag operations with high safeguard and reputational risks to ESSD/QACU and Senior Management).
  - Operational / Development Effectiveness Risks. Operations with high development effectiveness risks as identified through the existing process (whereby Regions flag operations with high operational or development effectiveness risks to Senior Management).
o **Financial risks.** Operations that entail financial risk or systemic considerations for IDA’s finances (credit loss provisions, capital needs, available net income), as identified by Credit Risk (SFRCR).

o **Anti-Money Laundering (AML) / Combating the Financing of Terrorism (CFT) Related Risks.** Operations that are exposed to high risks of money laundering and terrorism financing.

• **(ii) Size and Departure from the Country Assistance Strategy (CAS).** An OC review of an operation may be appropriate when the operation is large or when the operation diverges significantly from the program laid out in the CAS:

  o **Size of Operation.** Given the potential financial implications for the institution of large operations, the OC should generally review all IDA operations of at least $200 million.

  o **Departure from CAS Lending Program.** While most CAS implementation related issues should be handled at the ROC level, there may be substantial (operation-specific) departures from the CAS (in terms of financing size, instrument, risk or content) that would indicate an OC review. The OC could review certain proposed operations that involve a substantial increase or acceleration in total IDA lending relative to the CAS.

• **(iii) OC review required by existing policy and guidance.** These include special DPLs, and DPLs with a deferred drawdown options (DDO), crisis and post-conflict situations (and guarantees). In addition, the OC reviews operations involving exceptions from operational policy.

• **(iv) Institution-wide learning and sampling to test quality.** The OC reviews credits with new or potentially contentious approaches that are likely to create precedents for other operations in other Regions. In these cases, the OC can bring institution-wide innovation and learning to bear on initial operations. OC review may also be appropriate to ensure that a minimum number of operations in a Region are tested for quality.

**For CAS Products:**

- For CAS products, an OC is recommended for the same criteria stated above for operations pertaining to items (i), pose a high risk to the institution, and if the proposed CAS lending envelope is large.

B. **Control Details:**

  **Objective:** Validity /
  **Existence Type:** Manual,
C. Risks Mitigated / Policies Addressed:

**IRMF Risk(s):**
1. Choices within Countries (IRMF: 2)
2. Quality assurance (IRMF: 5)
3. Timely evaluation and disclosure (IRMF: 13)
4. Reliable procurement/disbursements (IRMF: 18)
5. Management of projects with complex safeguard issues (IRMF: 23)
6. Business process management (IRMF: 24)

**Specific Risk(s):**
1. IDA projects are not focusing enough resources on priority activities within a country.
2. High risk and high profile projects within a country may not receive the appropriate level of management review to ensure management buy-in for the resources required to adequately fund or scale up these projects/operations.
3. Not enough of a visible layer of review for quality of operations and their fiduciary arrangements. Innovative or new designs may not be reviewed for quality and fiduciary soundness.
4. Those operations with the highest potential risk and impact both within the institution and within the borrower country may not be given the highest possible visibility and review at the earliest possible stage, relative to IDA’s other ongoing projects and operations. It is of the most importance for these operations that risks and problems be identified early and have had the most senior management visibility.
5. For high-risk safeguard projects, there may be no opportunity for corporate buy-in, and projects may be rejected because of their high reputation risks.
6. The business process is made to be too cumbersome for the relative risks and requirements associated with a project/operation. Not every project/operation requires an OC-level review, and if all were tapped to receive one this would result in an unnecessary bottleneck in the process.

**Policies:**
1. BP 2.11—Country Assistance Strategies
2. OP/BP 10.00—Investment Lending: Identification to Board Approval
3. OP/BP 8.60—Development Policy Lending

D. **Owner:** Regional Vice President (RVP)

E. **Other Parties:**

Country Director (CD), Task Team Leader (TTL), Operational Policy and Country Services (OPCS), Managing Director (MD), Credit Risk (SFRCR)

F. **Verifiable Evidence:**
   - None required
G. COSO Framework:

This control step contributes directly to the fulfillment of the risk assessment and control activities elements of the COSO framework.
1. AS2 defines a significant deficiency as a control deficiency, or a combination of control deficiencies, that adversely affects the company’s ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles such that there is more than remote likelihood that a misstatement of the company’s annual or interim financial statements that is more than inconsequential will not be prevented or detected.

2. AS2 defines a material weakness as a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

1. By contrast, in its evaluations, IEG’s main recommendations are entered into the Management Action record (MAR) which is updated annually and reported to CODE.
Annex E. Does the Cluster of BPMs Represent the Universe of IDA Controls?

1. Management’s claim that the 30 BPMs it identified “captured a representative picture of the control environment over IDA operations”\(^1\) was independently tested by IEG. The first step was to propose criteria (shown in Box E. 1 below) against which to measure this claim. What follows is the ensuing analysis and conclusions IEG arrived at.

Box E.1. Criteria by which to Evaluate if 30 BPMs Adequately Represent the Universe of IDA Controls

PREMISE: Business processes have the purpose of achieving business objectives; the key controls embodied in the processes have the purpose of addressing the risks which arise in the pursuit of those business objectives. How to judge the adequacy of the cluster?

- Does the cluster provide a measurable basis to assess COSO compliance with internal policies and procedures? Does it adequately link, in aggregate, to the IDA risk focal points under COSO?
- Do the business processes cover all key business objectives?
- Does the cluster comprise a high share of the IDA operating budget?
- Does it cover all major IDA product lines?
- Where modules have been excluded, does this create significant gaps in measuring compliance?

2. Compliance with COSO and Internal Policies and Procedures: In the approach which Management has taken, the cluster has not been built as an expression of entity level controls cascaded down to the operating level; rather, it has been built up from the operating level, as a means of providing the basis for testing the design and operation of mainly fiduciary controls that govern IDA lending. Management has linked each module and its controls to published policies and procedures, but some 50% of the total number of OP/Bps are not linked. However, in the cases where no linkage has been made, Management has given satisfactory explanations (most often because the OP/BPs refer to sub-processes of the main processes covered). To this extent, the cluster broadly conforms to policies and procedures. (para 2.17)

3. Management has also been clear that its focus on COSO during this Part IA stage of the review has been only partial. IEG has checked this against the links shown in the cluster, module by module. The table below shows that, taken individually, the modules have links overwhelmingly to the Control Activities of COSO, in a minor way also to the Risk Assessment, Monitoring and Information and Communications components, but with no link at all to the Control Environment. These results are not surprising, since Management has stated that the links to COSO in this Part I phase are only partial. It does show the need, however, for later stages of the review to build links to the other COSO components.
Annex E
Does the Cluster of BPMs Represent the Universe of IDA Controls?

Table E.1. Stated Links between BPMs and COSO Components
Units Denote One Stated Link per Key Control
(Some controls link to more than one COSO component)

<table>
<thead>
<tr>
<th>Control environment</th>
<th>Risk assessment</th>
<th>Control activities</th>
<th>Monitoring</th>
<th>Information and communications</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>14</td>
<td>109</td>
<td>25</td>
<td>11</td>
</tr>
</tbody>
</table>

Source: Management Business Process Modules, Control Detail Sheet

4. **The BPMs and Business Objectives**: Management’s building block approach, creating a hierarchy from Articles, to policies and procedures, to identifying the key business processes, supported by “umbrella” policy statements, is logical, transparent and convincing. The 30 business processes which were identified between them embody four main business processes: IDA allocation; the CAS process cycle; the two main lending type (SIL and DPL); and the supporting fiduciary, contractual and safeguards processes. However, there is no direct capture of non-lending processes and objectives. While some of these could be subsumed in the CAS process, in fact the treatment of CAS does not make this explicit. The lending product ands heavy fiduciary emphasis in the cluster is evident from Figure E.1 below. It shows how the majority of modules and key control points are located in the fiduciary and contractual support modules (21 out of 30 modules, and 82 out of 114 controls).

Figure E.1. Distribution of BPMs and Controls Across Business Functions

5. **The Share of IDA’s Operating Budget and Product Lines**: If the cluster of BPMs exactly matched the totality of IDA controls, the service costs of the business processes
Does the Cluster of BPMs Represent the Universe of IDA Controls?

captured in the 30 BPMs would account for the total IDA operating budget. In fact, it appears to account for significantly less than the total. From the data in Table E.2 below a broad measure can be made as follows: Lending and supervision (which are the major process in the cluster) account for 58% of the IDA country service spending over the past three years. To this can be added some unknowable portion of the 20% for “Other” expenditure—to cover the overhead costs of the IDA allocation and CAS products processes which are represented in the cluster. If the whole 20% were added, the cluster would represent 78% of the total IDA operating budget, which is a substantial portion. However, the budget share of AAA (22%) is almost the same share as that for lending preparation (24%), so on these grounds alone, it cannot be claimed that the cluster captures “a representative picture” of IDA controls. There are also other reasons (argued in the main text—see para 2.20) why IEG believes it unjustified to have excluded AAA and other non-lending products.

Table E.2: Country Service Costs for IDA Countries 2003-2005

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>3yr Av.%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service Costs for IDA (only) countries</td>
<td>180.7</td>
<td>213.2</td>
<td>219.2</td>
<td>100</td>
</tr>
<tr>
<td>Of which: Project Supervision</td>
<td>62.7</td>
<td>67.0</td>
<td>77.1</td>
<td>34</td>
</tr>
<tr>
<td>Lending</td>
<td>49.7</td>
<td>65.5</td>
<td>59.0</td>
<td>24</td>
</tr>
<tr>
<td>AAA</td>
<td>38.2</td>
<td>48.5</td>
<td>48.7</td>
<td>22</td>
</tr>
<tr>
<td>Other</td>
<td>30.1</td>
<td>32.2</td>
<td>34.4</td>
<td>20</td>
</tr>
</tbody>
</table>

Source: Business Warehouse

6. **Do SILs and DPLs Adequately Represent Lending Operations?** The BPMs that Management has used to represent IDA lending are “core” SILs and DPLs. These are but two of a wider range of lending products, so there is a question whether all lending products are well represented by these two prototypes. IEG reviewed the data for the IDA lending program in recent years. It showed that all adjustment lending is captured under DPLs. The investment lending is shown under SILs and other types of investment lending. The share was 64% for SILs, with other investment loans comprising 36%. Management argues that all lending products—whether IL or DPL—share almost identical processing and controls. In IEG’s opinion this needs to be tested, because while it may be broadly true, there are also variations in lending product type which may be processed somewhat differently through the controls system. This could be done during Part IB. The test samples for lending products could include a range of product types, not just core SILs and DPLs.

Table E.3: Share of IDA Investment and Policy Loans

<table>
<thead>
<tr>
<th>Investment Lending (2005 $m)</th>
<th>5626</th>
<th>3-Yr Av.%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Core SIL</td>
<td>3312</td>
<td>64</td>
</tr>
<tr>
<td>Other Investment Lending</td>
<td>2314</td>
<td>36</td>
</tr>
<tr>
<td>Adjustment Lending (DPL)</td>
<td>2161</td>
<td>100</td>
</tr>
<tr>
<td>TOTAL LENDING</td>
<td>7787</td>
<td></td>
</tr>
</tbody>
</table>

Source: Business Warehouse

7. **Excluded Processes:** Management gives the following reasons for excluding certain processes or product lines from the assessment during this phase of the study:
Annex E
Does the Cluster of BPMs Represent the Universe of IDA Controls?

a. that they do not contribute directly to IDA lending operations; or
b. they are not relevant to this phase of the study, because they relate more to efficiency and effectiveness issues than to compliance.

<table>
<thead>
<tr>
<th>Box E.2. Business Process Modules Excluded from Compliance Assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Exclusion By Management’s Resolution That the Process Does Not Have Critical Bearing on Current Assessment Objective</strong></td>
</tr>
<tr>
<td>• Country Policy and Institutional Assessment (CPIA)</td>
</tr>
<tr>
<td>• Post-Conflict Performance Indicators (PCPI)</td>
</tr>
<tr>
<td>• Project Preparation Facility (PPF)</td>
</tr>
<tr>
<td>• Loan Management –PPF Refinancing</td>
</tr>
<tr>
<td>• Annual Report on Portfolio Performance (ARPP)</td>
</tr>
<tr>
<td>• Inspection Panel</td>
</tr>
<tr>
<td><strong>Exclusion Based on Determination of No Input to IDA Operations</strong></td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Source: Management Methodology Note</td>
</tr>
</tbody>
</table>

8. A summary of the excluded processes, grouped according to the major reasons for their exclusion is given in Box E.2 above. Many of these processes relate to or form part of the Bank’s overall monitoring instruments (ARPP; Inspection Panel; IEG processes; IAD processes), which are more relevant to the entity-level phase of the study, and concern more the efficiency and effectiveness objective than compliance. In this sense, Management’s justification for their exclusion has been clearly stated. Equally, the processes dealing with PPF and procurement DPL are of generally secondary significance, and their exclusion would not create any significant gaps in coverage. In evaluating these exclusions, IEG makes the following observations:

i. Had all processes been subjected to a top-down, entity-level review process to start with, it would have been easier to make a consistent and complete justification for excluding certain processes less relevant to business process controls; as it is QAG processes are also an entity-level control, but these have been included, rather than excluded in this round.

ii. Knowledge products (specifically AAA) should clearly have been included in this compliance part of the study.

iii. Regarding CPIA and PCPI, both are sub-processes of and provide inputs to IDA allocation, and should have been included.

iv. While the Inspection Panel is a key entity-level unit, its activities always concern issues relating to complaints regarding specific non-compliance with (Bank and) IDA policies, so there would seem to be a default case for its having been included rather than excluded from the compliance part of the study.
9. **Scorecard and Conclusions:** How do these various issues tally, and what conclusion do they suggest in answering the main questions: does the cluster well represent the universe of controls governing IDA operations? Based on this analysis, as a representation of IDA allocation and lending processes—which are the bulk of IDA operations—Management’s BPM cluster scores well on most counts and is a credible representation of the full universe of IDA lending. However, in excluding non-lending, Management has taken out of play an important set of product lines that not only rank almost equally with lending preparation costs in the operational budget, but rank alongside lending as an important part of the IDA assistance portfolio.

**NOTES**

2. As part of the working documents Management produced for its assessment, one was under the title “Methodology Note,” which outlined the reasons for these exclusions.
Annex F. Method and Results in Applying the Business Process Template

1. **Introduction to the Business Process Template**: IEG created the Business Process Template especially for this review. Its main purpose was to have an evaluation tool which would contain a standardized set of questions which could be applied uniformly to each evaluated business process module, to critique its content in a systematic way, and to provide ratings as to the quality exhibited.

2. **Rating System**: The Template embodies a four-part rating system which reflects quality ratings from Highly Satisfactory (1), Satisfactory (2), Satisfactory with Qualification (3) to Less than Satisfactory (4) measured as degrees of certainty that Management has achieved in its method and construct of the module, in addressing the following underlying question:

   "What degree of certainty does Management’s Assessment (and IAD’s Review) provide that the business processes are well designed and mapped and that their associated control processes are effectively designed?"

3. The Template was created for use in the IEG evaluation of all stages of the controls review, and it has sections dealing with compliance, operational and entity-level issues. For the present Part IA stage, only a portion of the Template was used, covering three sets of issues: ranking the BPMs according to their strategic importance and magnitude of risk; evaluating the method of building and mapping the BPMs; and evaluating Management’s assessment of the effectiveness of key control design. What follows is a brief summary of the form of questions that the Template contained in each case.

4. **Ranking for Strategic Importance and Risk**: The rankings were from 1 (Highly relevant, critical, heavy weight in management, high risk); 2 (Relevant, medium weight); 3 (Relevant but not critical, low weight, low risk). The questions in the Template on this topic were as follows:

   - Its centrality to the overall IDA-Client relationship?
   - Its weight as a control instrument within the Bank?
   - The Risks that would pertain were the process to be lax?
   - Its frequency of Occurrence?
   - Potential magnitude in Dollars?

5. **Evaluating the Mapping of the BPMs**: IEG viewed the task of evaluating Management’s mapping of the business process modules as having three elements, and the Template that was used as the principal evaluation tool contained questions which explored Management’s methods and criteria in mapping the modules, as follows:
• The method and criteria used in identifying each module: Was the business objective clearly described? Were specific criteria given for choosing the module? Did the process derive from a specific published policy or procedure? Did Management consult the most knowledgeable people in the Bank in constructing the process map?

• The Accuracy and Completeness of the Process map: Was the process clearly titled, in a way which made it clear what business process was being tracked? Were the risks pertaining to the business process clearly stated? Were the units in the Bank which are key to the process clearly identified? Was the process adequately linked to parallel or related sub-processes?

• Identification of the Key Controls: Were the key controls clearly defined? Is it evident why the key control is relevant to the process? Were links made between the COSO objectives and individual controls?

6. **Evaluating Design Effectiveness of Key Controls**: Most of the business process modules had multiple key controls, ranging from two or three to nine or eleven in some cases. Since the purpose of the controls is to address risks that are confronted in the pursuit of the business objective that the process is aimed at, assessing the effectiveness of control design—and the corresponding structure of the Business Process Template—is basically an issue involving two aspects:

• Identifying Process Risks: Were the specific risks identified that the control was intended to mitigate? Were the risks categorized as to type and priority or likelihood? Were the risks derived from published policies and procedures? Were the most authoritative sources consulted?

• Matching Risks with Process Design: In matching risk and controls, were there adequate checks and balances, and were there any gaps? Were specialist staff involved? Does the control oblige involvement of specific units and management authority? Is the design of the control widely known? Does the control relate also to risks external to the process and the Bank? Did Management identify specific weaknesses or deficiencies in the design of the controls?

7. **Summary of results**: A full summary of the ratings data is provided in the Statistical Appendix at Annex G. The table below gives a summary of the results, showing the average ratings achieved for each segment, and a set of selected highlights showing higher and lower quality aspects.

| Table F.1. Management’s Method and Approach to BPM Mapping and Control Design |
|---|---|---|---|---|
| **Selected Average IEG Ratings** | **Distribution By Rating** | **ALL MODULES** |
| | | 1 | 2 | 3 | 4 |
| Distribution by Number | 15 | 450 | 184 | 51 |
| Distribution by Percentage (%) | 2 | 64 | 26 | 7 |
| **Higher Quality** | **Lower Quality** | **Av. Rating** | **Assessment of Control Design:** Average Overall Rating (2.62) |
| **Mapping the Business Process:** Average Overall Rating 2.38 | | Assessment of Control Design: | |
| **Selected Higher Quality Ratings** | | | | |
| Clarity in Method and Criteria | 2.00 | Categorizing Risk by Type and Likelihood | 4.00 |
| Ownership of Process | 2.00 | Matching Design with Risks | 2.81 |
| Relevance of BPM Controls | 2.04 | Risks to BPM clearly stated? | 2.73 |
| Design Process Widely Known | 2.08 | | |
| Coverage of External Risks | 2.08 | | |
8. This Template analysis has shown that Management’s methods in both developing the process flow charts and associated materials, and assessing the effectiveness of control design, has been conducted to a high standard, even though in some cases improvements could be suggested. As the table shows, fully 66% of all ratings were Satisfactory or better, and some 93% were Satisfactory with Qualification or better. Most of the reasons which underlay the areas where qualifications were made referred to descriptions of processes, and categorization and prioritization of risk. Other imperfections in the precision of the documentation included: the CAS module omitting portfolio/pipeline review, AAA, and the inputs of the Sector Networks; the DPL module not addressing potential impact on IDA’s reputation and the country if the DPL objectives are not accomplished; Loan management modules not considering the area of repayment and amortization; and the processes subject to QAG assessments not being shown on the main flow charts.

9. Since this was the first time the Template was used as an evaluation tool its usefulness was also being tested in this process. In the view of the panelists involved in the ratings, the Template was responsive and gave credible, robust results.
Annex G. Statistical Appendix

Table G.1: IDA Operations Data Reflecting Magnitude of Selected Business Process Modules, 2003-2005

Table G.2: Links Identified by Management between Controls and the Five COSO Components, Shown by Business Function

Table G.3: Category and Type of Key Controls, by Audit Objectives, System and Frequency

Table G.4: Summary of Quality Ratings of Management’s Assessment of the Design Effectiveness of Key Controls

Table G.5: Summary of Quality Ratings for Management’s Mapping and Assessment of Design Effectiveness of Key Controls

Table G.6: Distribution of Quality Ratings Across Mapping and Control Design Dimensions

Table G.7: Distribution of BPMs by Strategic Relevance and Risk Ratings

Table G.8: Listing of OPs and BPs Linked by Management to the BPMs
### Table G.1: IDA Operations Data Reflecting Magnitude of Selected Business Process Modules

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Number of Approved IDA Projects</strong></td>
<td>141</td>
<td>158</td>
<td>158</td>
<td>7282.5</td>
<td>9034.6</td>
<td>8559.0</td>
</tr>
<tr>
<td>Of which: Investment Loans</td>
<td>117</td>
<td>135</td>
<td>126</td>
<td>5451.3</td>
<td>7336.6</td>
<td>6258.0</td>
</tr>
<tr>
<td>Adjustment / Dvlp. Policy Loans</td>
<td>24</td>
<td>23</td>
<td>32</td>
<td>1831.2</td>
<td>1698.0</td>
<td>2301.0</td>
</tr>
<tr>
<td>Of which: SILs</td>
<td>66</td>
<td>88</td>
<td>77</td>
<td>3342.2</td>
<td>4992.5</td>
<td>3312.1</td>
</tr>
<tr>
<td>DPLs</td>
<td>0</td>
<td>0</td>
<td>9</td>
<td>0.0</td>
<td>0.0</td>
<td>462.0</td>
</tr>
<tr>
<td><strong>... ... ... Active Loans</strong></td>
<td>753</td>
<td>764</td>
<td>765</td>
<td>34,722.8</td>
<td>37,045.8</td>
<td>36,228.3</td>
</tr>
<tr>
<td><strong>Service Costs for IDA (only) countries</strong></td>
<td>180.7</td>
<td>213.2</td>
<td>219.2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Of which: Project Supervision</td>
<td></td>
<td></td>
<td></td>
<td>62.7</td>
<td>67.0</td>
<td>77.1</td>
</tr>
<tr>
<td>Lending</td>
<td></td>
<td></td>
<td></td>
<td>49.7</td>
<td>65.5</td>
<td>59.0</td>
</tr>
<tr>
<td>ESW</td>
<td>38.2</td>
<td>48.5</td>
<td>48.7</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>IDA Allocations</strong></td>
<td>19</td>
<td>19</td>
<td>16</td>
<td>1235.2</td>
<td>1393.1</td>
<td>662.7</td>
</tr>
<tr>
<td>Subject to Post-Conflict Allocation (projects)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Operations Programming</strong></td>
<td>24 / 4</td>
<td>25 / 6</td>
<td>25 / 3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of CAS (full / TSS)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Number of PRSPs (full)</td>
<td>12</td>
<td>12</td>
<td>8</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cumulative Total (Full)</td>
<td></td>
<td></td>
<td></td>
<td>49</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Interim)</td>
<td></td>
<td></td>
<td></td>
<td>10</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>IDA Countries Without PRSP</strong></td>
<td>22</td>
<td></td>
<td></td>
<td></td>
<td></td>
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</tr>
<tr>
<td><strong>Procurement</strong></td>
<td>45</td>
<td>9</td>
<td>22</td>
<td>61</td>
<td>18</td>
<td>1</td>
</tr>
<tr>
<td>Misprocurement</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Procurement Complaints</td>
<td>448</td>
<td>475</td>
<td>301</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Loan Administration</strong></td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amendments/Extensions</td>
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<td></td>
<td></td>
<td>n.a.</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Refunds</td>
<td>n.a.</td>
<td>n.a.</td>
<td>5127</td>
<td>n.a. 8</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Cancellations</td>
<td>132</td>
<td>120</td>
<td>87</td>
<td>610.6</td>
<td>554.5</td>
<td>605.8</td>
</tr>
<tr>
<td>Loan Closings</td>
<td>137</td>
<td>137</td>
<td>127</td>
<td></td>
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<td></td>
</tr>
<tr>
<td><strong>Safeguards</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Projects subject to Corporate Review</td>
<td>83</td>
<td>101</td>
<td>92</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>QAG Processes</strong></td>
<td>n.a.</td>
<td>124</td>
<td>n.a.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>QEA</td>
<td>n.a.</td>
<td>69</td>
<td>n.a.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Table G.2: Links Identified by Management between Key Controls and the Five COSO Components, shown by Business Function

<table>
<thead>
<tr>
<th>Module Function</th>
<th># BPMs</th>
<th>Control Environment</th>
<th>Risk Assessment</th>
<th>Control Activities</th>
<th>Monitoring &amp; Learning</th>
<th>Information &amp; Communication</th>
</tr>
</thead>
<tbody>
<tr>
<td>Programming and Lending Products</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Internal Programming &amp; Allocation</td>
<td>4</td>
<td>0</td>
<td>1</td>
<td>7</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Lending Products</td>
<td>3</td>
<td>0</td>
<td>8</td>
<td>17</td>
<td>2</td>
<td>8</td>
</tr>
<tr>
<td>Fiduciary Services Related to Lending</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Financial Management</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>8</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Loan Administration</td>
<td>10</td>
<td>0</td>
<td>0</td>
<td>32</td>
<td>4</td>
<td>0</td>
</tr>
<tr>
<td>Legal</td>
<td>4</td>
<td>0</td>
<td>0</td>
<td>24</td>
<td>15</td>
<td>2</td>
</tr>
<tr>
<td>Procurement</td>
<td>3</td>
<td>0</td>
<td>1</td>
<td>13</td>
<td>1</td>
<td>0</td>
</tr>
<tr>
<td>Safeguards</td>
<td>2</td>
<td>0</td>
<td>0</td>
<td>6</td>
<td>0</td>
<td>1</td>
</tr>
<tr>
<td>Quality Assurance</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>QAG Processes</td>
<td>1</td>
<td>0</td>
<td>4</td>
<td>2</td>
<td>3</td>
<td>0</td>
</tr>
<tr>
<td>DISTRIBUTION OF COSO LINKS</td>
<td>29</td>
<td>0</td>
<td>14</td>
<td>109</td>
<td>25</td>
<td>11</td>
</tr>
</tbody>
</table>

### Table G.3: Category and Type of Key Controls by Audit Objective, System, and Frequency

#### Distribution Across All Business Process Modules

<table>
<thead>
<tr>
<th>AUDIT CATEGORY</th>
<th>Type</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
</tr>
</thead>
<tbody>
<tr>
<td>%Incidence</td>
<td>30%</td>
<td>4%</td>
<td>30%</td>
<td>30%</td>
<td>3%</td>
<td>1%</td>
<td>1%</td>
<td></td>
</tr>
</tbody>
</table>

**Description**
1. **Validity/Existence**: All transactions are properly authorized.
2. **Segregation of Duties**: Non-compatible control functions such as cash payment and cash authorization performed independently.
3. **Ownership**: There are documented agreements in place to support the existence of transactions.
4. **Completeness/Accuracy**: All transactions are recorded properly.
5. **Cut-Off**: All transactions are in the correct reporting period.
6. **Valuation**: Loans, borrowings, and investment transactions are valued independently.
7. **Disclosure**: Adequate disclosure is made in the financial statements to comply with international financial reporting standards.

#### TYPE AND SYSTEM

<table>
<thead>
<tr>
<th>Type/System</th>
<th>Manual</th>
<th>Automatic/Systemic</th>
<th>Preventive</th>
<th>Detective</th>
</tr>
</thead>
<tbody>
<tr>
<td>%Incidence</td>
<td>99%</td>
<td>1%</td>
<td>88%</td>
<td>12%</td>
</tr>
</tbody>
</table>

#### FREQUENCY

<table>
<thead>
<tr>
<th>Frequency</th>
<th>Transactions</th>
<th>Yearly</th>
<th>Bi-Yearly</th>
<th>Monthly</th>
<th>Weekly</th>
<th>Daily</th>
</tr>
</thead>
<tbody>
<tr>
<td>%Incidence</td>
<td>91%</td>
<td>4%</td>
<td>2%</td>
<td>0%</td>
<td>0%</td>
<td>3%</td>
</tr>
</tbody>
</table>
**Table G.4: Summary of Average Quality Ratings of Management’s Assessment of the Design Effectiveness of Key Controls**

<table>
<thead>
<tr>
<th>Business Function</th>
<th>Mapping the Business Process</th>
<th>Assessing Control Design</th>
<th>Overall Average</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Overall</td>
<td>Origin, Method &amp; Criteria</td>
<td>Accuracy &amp; Completeness</td>
</tr>
<tr>
<td>Programming &amp; Allocation</td>
<td>2.50</td>
<td>2.00</td>
<td>3.00</td>
</tr>
<tr>
<td>Lending Products</td>
<td>2.33</td>
<td>2.00</td>
<td>2.00</td>
</tr>
<tr>
<td>Legal</td>
<td>2.25</td>
<td>2.25</td>
<td>2.25</td>
</tr>
<tr>
<td>Financial Management</td>
<td>2.00</td>
<td>2.00</td>
<td>2.00</td>
</tr>
<tr>
<td>Procurement</td>
<td>2.00</td>
<td>2.00</td>
<td>2.00</td>
</tr>
<tr>
<td>Loan Administration</td>
<td>2.67</td>
<td>2.67</td>
<td>3.00</td>
</tr>
<tr>
<td>Quality Assurance</td>
<td>3.00</td>
<td>3.00</td>
<td>3.00</td>
</tr>
<tr>
<td>Safeguards</td>
<td>2.00</td>
<td>2.00</td>
<td>2.00</td>
</tr>
</tbody>
</table>

Rating Scale: 1 = Highly Satisfactory; 2 = Satisfactory; 3 = Satisfactory with Qualification; 4 = Less than Satisfactory; N/A — Not Applicable.

---

**Table G.5: Summary of Quality Ratings For Management’s Mapping and Assessment of Design Effectiveness of Key Controls**

<table>
<thead>
<tr>
<th>Quality Dimensions</th>
<th>Average Ratings</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Overall</td>
</tr>
<tr>
<td>Mapping the Business Process</td>
<td>2.38</td>
</tr>
<tr>
<td>Origin, Method, and Criteria</td>
<td>2.31</td>
</tr>
<tr>
<td>Accuracy and Completeness</td>
<td>2.50</td>
</tr>
<tr>
<td>Identification of Key Controls</td>
<td>2.19</td>
</tr>
<tr>
<td>Assessment of Control Design</td>
<td>2.62</td>
</tr>
<tr>
<td>Identifying Process Risks</td>
<td>2.81</td>
</tr>
<tr>
<td>Matching Risks with Process Design</td>
<td>2.31</td>
</tr>
<tr>
<td>Overall Average Rating</td>
<td>2.45</td>
</tr>
</tbody>
</table>

Rating Scale: 1 = Highly Satisfactory; 2 = Satisfactory; 3 = Satisfactory with Qualification; 4 = Less than Satisfactory.
Table G.6: Distribution of Quality Ratings Across Mapping and Control Design Dimensions

<table>
<thead>
<tr>
<th></th>
<th>Distribution by Rating</th>
<th></th>
<th></th>
<th></th>
<th></th>
<th>N</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Mapping the Business Process</strong></td>
<td></td>
<td>Mean</td>
<td>1</td>
<td>2</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td><em>Origin, Method, and Criteria</em></td>
<td></td>
<td>2.31</td>
<td>0%</td>
<td>69%</td>
<td>31%</td>
<td>0%</td>
</tr>
<tr>
<td>Clarity of IDA Operational Objective?</td>
<td></td>
<td>2.58</td>
<td>4%</td>
<td>54%</td>
<td>23%</td>
<td>19%</td>
</tr>
<tr>
<td>Clarity of method and criteria?</td>
<td></td>
<td>2.00</td>
<td>0%</td>
<td>100%</td>
<td>0%</td>
<td>0%</td>
</tr>
<tr>
<td>BPM established under Bank BP or OP?</td>
<td></td>
<td>2.19</td>
<td>12%</td>
<td>62%</td>
<td>23%</td>
<td>4%</td>
</tr>
<tr>
<td>Management sought input in process area?</td>
<td></td>
<td>2.12</td>
<td>0%</td>
<td>88%</td>
<td>12%</td>
<td>0%</td>
</tr>
<tr>
<td><strong>Accuracy and Completeness</strong></td>
<td></td>
<td>2.50</td>
<td>4%</td>
<td>46%</td>
<td>46%</td>
<td>4%</td>
</tr>
<tr>
<td>Process has been clearly titled?</td>
<td></td>
<td>2.31</td>
<td>4%</td>
<td>62%</td>
<td>35%</td>
<td>0%</td>
</tr>
<tr>
<td>Risks to BPM clearly stated?</td>
<td></td>
<td>2.73</td>
<td>4%</td>
<td>38%</td>
<td>38%</td>
<td>19%</td>
</tr>
<tr>
<td>Ownership of Process clearly designated?</td>
<td></td>
<td>2.00</td>
<td>4%</td>
<td>92%</td>
<td>4%</td>
<td>0%</td>
</tr>
<tr>
<td>Management sought input in process?</td>
<td></td>
<td>2.42</td>
<td>12%</td>
<td>50%</td>
<td>23%</td>
<td>15%</td>
</tr>
<tr>
<td><strong>Identification of Key Controls</strong></td>
<td></td>
<td>2.19</td>
<td>0%</td>
<td>81%</td>
<td>19%</td>
<td>0%</td>
</tr>
<tr>
<td>Clear definition of key controls?</td>
<td></td>
<td>2.38</td>
<td>0%</td>
<td>69%</td>
<td>23%</td>
<td>8%</td>
</tr>
<tr>
<td>Relevance of mapped BPM controls?</td>
<td></td>
<td>2.04</td>
<td>0%</td>
<td>96%</td>
<td>4%</td>
<td>0%</td>
</tr>
<tr>
<td>Differentiation between controls for financial reporting and other COSO objectives?</td>
<td></td>
<td>2.62</td>
<td>0%</td>
<td>92%</td>
<td>8%</td>
<td>0%</td>
</tr>
<tr>
<td><strong>Assessment of Control Design</strong></td>
<td></td>
<td>2.62</td>
<td>0%</td>
<td>38%</td>
<td>62%</td>
<td>0%</td>
</tr>
<tr>
<td><em>Identifying Process Risks</em></td>
<td></td>
<td>2.46</td>
<td>0%</td>
<td>23%</td>
<td>73%</td>
<td>4%</td>
</tr>
<tr>
<td>Clear identification of risks that the control points are designed to alleviate?</td>
<td></td>
<td>2.46</td>
<td>8%</td>
<td>38%</td>
<td>54%</td>
<td>0%</td>
</tr>
<tr>
<td>Risks have been categorized (fin/op/rep) and analyzed?</td>
<td></td>
<td>4.00</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>100%</td>
</tr>
<tr>
<td>CTR documentation relates to the policies and procedures of controls and risks?</td>
<td></td>
<td>2.31</td>
<td>0%</td>
<td>73%</td>
<td>23%</td>
<td>4%</td>
</tr>
<tr>
<td>CTR consulted with the most authoritative sources?</td>
<td></td>
<td>2.15</td>
<td>0%</td>
<td>85%</td>
<td>15%</td>
<td>0%</td>
</tr>
<tr>
<td><strong>Matching Risks with Process Design</strong></td>
<td></td>
<td>2.31</td>
<td>0%</td>
<td>69%</td>
<td>31%</td>
<td>0%</td>
</tr>
<tr>
<td>Management adequately matched the design with the risks?</td>
<td></td>
<td>2.35</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>i. Built in checks and balances</td>
<td></td>
<td>2.81</td>
<td>0%</td>
<td>35%</td>
<td>50%</td>
<td>15%</td>
</tr>
<tr>
<td>ii. Involved specialized staff</td>
<td></td>
<td>2.15</td>
<td>0%</td>
<td>85%</td>
<td>15%</td>
<td>0%</td>
</tr>
<tr>
<td>iii. Involved appropriate operational units and mgmt levels?</td>
<td></td>
<td>2.08</td>
<td>0%</td>
<td>92%</td>
<td>8%</td>
<td>0%</td>
</tr>
<tr>
<td>Design process is known by relevant staff?</td>
<td></td>
<td>2.08</td>
<td>8%</td>
<td>81%</td>
<td>8%</td>
<td>4%</td>
</tr>
<tr>
<td>Mgmt. has shown that controls extend to cover external risks?</td>
<td></td>
<td>2.44</td>
<td>0%</td>
<td>56%</td>
<td>44%</td>
<td>0%</td>
</tr>
</tbody>
</table>

Rating Scale: 1 = Highly Satisfactory; 2 = Satisfactory; 3 = Satisfactory with Qualification; 4 = Less than Satisfactory.
Note: Modules 1-3 and Modules 25 & 26 were assessed together; therefore max. number of observations is 26 rather than 29.
### Table G.7: Distribution of BPMs According to Strategic Relevance and Risk Ranking

<table>
<thead>
<tr>
<th>Risk Categories*</th>
<th>1</th>
<th>2</th>
<th>3</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Number Distribution</strong></td>
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<td></td>
</tr>
<tr>
<td>14</td>
<td>14</td>
<td>8</td>
<td>7</td>
</tr>
<tr>
<td>• IDA, FRM, &amp; Post Conflict Allocation</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• CAS Products</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• SIL—Project Cycle</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• DPL—Project Cycle</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Contractual Remedies</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• SIL—Legal Regime</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• DPL—Legal Regime</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• FM—SIL</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• FM—DPL</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• SIL—Procurement</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Procurement Complaints</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Safeguards—SIL</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Corporate Review (ROC/OC)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Procurement Non-Compliance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Loan Management—SIL</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Loan Management—DPL</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• LOA—Application Review</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• LOA—Suspensions</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• QAG—QAE and QSA</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Safeguards—QACU</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Project Changes</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• LOA—Special Commitment</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• LOA—Amendment or Extension</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• LOA—Refund Process</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• LOA—Cancellation Process</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• LOA—Closings (Standard &amp; Special)</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

*STRATEGIC RELEVANCE AND RISK RANKING*

1 = **Highly Relevant, critical**: heavy weight in management; major risks; high frequency of occurrence

2 = **Relevant, but not critical**: average weight in management; some risk; average frequency

3 = **Relevant but not critical**: moderate weight; moderate or minor risk; infrequent;
<table>
<thead>
<tr>
<th>OP / BP #</th>
<th>Operational &amp; Bank Policies</th>
<th>Covered OP/BP</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.00</td>
<td>OP Poverty Reduction</td>
<td></td>
</tr>
<tr>
<td>1.21*</td>
<td>OMS Bank Financing of Recurrent Costs</td>
<td></td>
</tr>
<tr>
<td>2.11</td>
<td>BP Country Assistance Strategies</td>
<td>X</td>
</tr>
<tr>
<td>2.20</td>
<td>OMS Project Appraisal</td>
<td></td>
</tr>
<tr>
<td>2.30</td>
<td>OP/BP Development Cooperation and Conflict</td>
<td></td>
</tr>
<tr>
<td>3.10</td>
<td>OP/BP Financial Terms and Conditions of IBRD Loans, IBRD Hedging Products, and IDA Credits</td>
<td>X</td>
</tr>
<tr>
<td>4.00</td>
<td>OP/BP Use of Borrower Systems to Address Environ and Social Safeguard Issues</td>
<td></td>
</tr>
<tr>
<td>4.01</td>
<td>OP/BP Environmental Assessment</td>
<td>X</td>
</tr>
<tr>
<td>4.02</td>
<td>OP/BP Environmental Action Plans</td>
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<tr>
<td>4.04</td>
<td>OP/BP Natural Habitats</td>
<td>X</td>
</tr>
<tr>
<td>4.07</td>
<td>OP/BP Water Resource Management</td>
<td></td>
</tr>
<tr>
<td>4.09</td>
<td>OP Pest Management</td>
<td>X</td>
</tr>
<tr>
<td>4.10</td>
<td>OP/BP Indigenous Peoples</td>
<td>X</td>
</tr>
<tr>
<td>4.11</td>
<td>OP/BP Physical Cultural Resources</td>
<td>X</td>
</tr>
<tr>
<td>4.12</td>
<td>OP/BP Involuntary Resettlement</td>
<td>X</td>
</tr>
<tr>
<td>4.20</td>
<td>OP/BP Gender and Development</td>
<td></td>
</tr>
<tr>
<td>4.36</td>
<td>OP/BP Forests</td>
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<td>OP/BP Investment Lending: Identification to Board Presentation</td>
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### Listing of OPs and BPs Linked by Management to the BPMs

| 10.02 | OP/BP | Financial Management (OP rev. 4/04) | X |
| 10.04 | OP/BP | Economic Evaluation of Investment Ops | |
| 10.21 | OP/BP | Investment Operations Financed by the MFMP | |
| 10.70 | OD   | Project Monitoring and Evaluation | |
| 11.00 | OP/BP | Procurement (OP rev. 4/04) | X |
| 12.00 | OP/BP | Disbursement | X |
| 12.10 | OP   | Retroactive Financing | X |
| 12.20 | OP/BP | Special Accounts | X |
| 12.30 | OP/BP | Statement of Expenditures | X |
| 13.00 | OP/BP | Signing of Legal Documents and Effectiveness of Loans and Credits | X |
| 13.05 | OP/BP | Project Supervision | X |
| 13.16 | OP/BP | Country Portfolio Performance Reviews | |
| 13.20 | OP/BP | Additional Financing for Investment Lending | X |
| 13.25 | OP/BP | Use of Project Cost Savings (OP rev. 4/04) | X |
| 13.30 | OP/BP | Closing Dates | X |
| 13.40 | OP/BP | Suspension of Disbursements | X |
| 13.50 | OP/BP | Cancellations | X |
| 13.55 | OP/BP | Implementation Completion Reporting | |
| 13.60 | OD   | Dissemination and Utilization of the OED Findings | |
| 14.10 | OP/BP | External Debt Reporting and Financial Statements | X |
| 14.20 | OP/BP | Cofinancing | |
| 14.25 | OP/BP | Guarantees | |
| 14.40 | OP/BP | Trust Funds | |
| 14.70 | GP   | Involving Nongovernmental Organizations in Bank-Supported Activities | |
| 17.30 | BP   | Comunications with Individual EDs | |
| 17.55 | BP   | Inspection Panel | |

**Total References in the 2006 World Bank Operational Manual**

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**Note:** *OPs/BPs and OMS are applied only to project in countries without approved country financing parameters. BP—Bank Procedure, GP—Good Practice, OD—Operational Directive, OMS—Operational Memoranda, and OP—Operational Policy.*
NOTES

1. *Source:* Business Warehouse (BW)
3. *Source:* FRM and BW. Number of Post-Conflict countries by year: FY03 = 11, FY04 = 9, FY05=8.
4. *Source:* BW / OPCS
5. *Source:* OPCS
6. *Source:* Refunds — LOA; Cancellations — BW Loan Information Table; Closings — BW IEG Ratings table 4a1.
7. Of which 80% are SA/UN advance balance refund; other reasons 18%; World Bank error <2%
8. Data being collected, not available in published form
9. QACU and Regional EA Reviews of Safeguards A and B. *Source:* BW — Lending table 4a5
10. *Source:* QAG
Attachment 1:
Management Report on its Review of IDA Controls—Part IA
International Development Association

Management Report on Its Review of Internal Controls

Part IA

Prepared by:
Operations Policy and Country Services Vice Presidency
Controllers, Strategy and Resource Management Vice Presidency
October 6, 2006
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LIST OF ACRONYMS

BP s  Bank Procedures – a component of the Bank’s Operational Manual
CAS  Country Assistance Strategy
CFP  Concessional Finance and Global Partnerships Vice Presidency
COSO  Committee of Sponsoring Organizations – issued an internal control framework
CTR  Controller and Vice President
DPL  Development Policy Lending operations
IL  Investment Lending operations
IAD  Internal Auditing Department
IEG  Independent Evaluation Group
LEG  Legal Vice Presidency
OPCS  Operations Policy and Country Services Vice Presidency
OPs  Operational Policies – a component of the Bank’s Operational Manual
PBA  Performance Based Allocation
PMT  Project Management Team
SIL  Specific Investment Loan
SOX  The Sarbanes-Oxley Act of 2002
PCAOB  Public Company Accounting Oversight Board
INTRODUCTION AND BACKGROUND

1. As reflected in the IDA 14 Replenishment Report\(^1\) Management committed to carry out, during the period of IDA 14, an independent comprehensive assessment of its control framework including internal controls over IDA operations and compliance with its charter and policies, and making such assessment available to the public after its disclosure has been approved by IDA’s Executive Directors. This assessment was originally agreed to be completed by December 2005. However, due to the massive volume of work required, and unprecedented nature of this type of assessment, the original delivery date turned out to be unrealistic.

2. In furtherance of this commitment, Management met with the Board’s Audit Committee and Committee on Development Effectiveness (November 28, 2005) and again with the Audit Committee (July 17, 2006). As explained by Management in these meetings and in the underlying documentation, the comprehensive scope and lack of precedents for this type of assessment have made it necessary to carry out the overall assessment in two parts: Part I, compliance assessment (which in turn has been subdivided, as discussed with the Audit Committee in November, into Part IA, relating to design effectiveness of key controls, and Part IB, relating to operating effectiveness, or compliance with, such controls); and Part II, efficiency and effectiveness assessment. During the compliance assessment (Part I), Management is focusing on whether the existing internal control framework over IDA’s operations provides reasonable assurance that such operations are carried out in a manner that complies with the provisions of IDA’s charter (that is, IDA’s Articles of Agreement - referred to as the “Articles”) and internal policies governing IDA’s operations, with special focus on the mechanisms in place to ensure that funds are disbursed for the intended purposes.

3. This Report on Part IA sets out Management’s assessment relating to the design effectiveness of key controls currently in place to ensure compliance with the relevant Articles’ provisions and policies governing IDA’s operations. It will be followed by a Report containing Management’s assessment of the operating effectiveness of, or compliance with, these controls.

METHODOLOGY

4. Management is conducting the assessment of IDA’s internal controls in the context of the COSO\(^2\) internal control framework. IDA adopted the COSO framework as its controls methodology in 1995. This framework is widely used by leading financial institutions in the United States and is also seen as a model in many other parts of the world. The COSO framework (described in more detail in Management’s Work Plans and in Annex 1) is an all encompassing process which covers all aspects of internal control of an organization’s operation. It considers not only the evaluation of formal controls, but also informal controls, such as ethics, trust, communication, or-

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1 See, Report from the Executive Directors of the International Development Association to the Board of Governors, Additions to IDA Resources: Fourteenth Replenishment, Working Together to Achieve the Millennium Development Goals, (approved by the Executive Directors of IDA on March 10, 2005), para. 39, under the Disclosure bullet.

ganization behavior and leadership, and incorporates “top-down” as well as “bottom-up” analysis. Like all modern control frameworks, the COSO framework requires that: (i) management assess the organization’s internal controls; and (ii) an independent third party verify such assessment.

5. Management determined that Part I of this exercise would be more valuable if carried out following a “bottom up” approach. This exercise involves an unprecedented, comprehensive identification and cataloguing of the key business processes supporting the key internal controls and mechanisms throughout the operational complex of IDA. Management anticipates that this comprehensive mapping will provide a solid foundation for the examination of institutional efficiency and effectiveness to be undertaken in Part II of this exercise. In carrying out the commitment made in the IDA 14 Replenishment Report, Management determined that it should not go into a lengthy, detailed historical analysis of IDA’s policies, but it should provide a timely, clear snapshot of IDA’s operational processes as practiced today.

6. As mentioned in paragraph 4, Management is carrying out its commitment in the context of the COSO framework. This framework rests on three pillars: (i) compliance with applicable laws and regulations; (ii) effectiveness and efficiency; and (iii) internal controls over financial reporting. Management already completed a comprehensive review of internal control over financial reporting in line with industry best practice and has received an attestation from its external auditors on such controls since 1997. Management has initially focused additional efforts on the “compliance pillar”.

**COMPLIANCE WITH APPLICABLE LAWS AND REGULATIONS**

7. As an international organization established by an international treaty with privileges and immunities, IDA differs from the corporate entities for which the COSO framework was developed. As such, this assessment of IDA’s “compliance with laws and regulations” cannot focus on compliance with specific laws and regulations in various jurisdictions. Rather it must focus on whether the existing internal control framework over IDA’s operations provides reasonable assurance that such operations are carried out in a manner that complies with the provisions of the IDA’s Articles and internal policies governing IDA’s operations, including the mechanisms in place to ensure funds are disbursed for the intended purposes.

8. Any compliance assessment of internal controls over IDA’s operations must therefore go through a four-step process of:
   
a) identifying key provisions of the IDA Articles that govern IDA’s operations;

b) identifying main policies that were adopted by IDA to ensure that IDA’s operations are carried out consistently with these provisions;

c) identifying the manner in which these policies are intended to be carried out by cataloguing the business processes and key controls put in place to ensure compliance with the identified policies and assessing the “design effectiveness” of these processes and key controls; and

d) assessing compliance with the business process and key controls by testing a sample of transactions.
9. Management’s assessment relating to the first three steps is set out below. It is to be followed by a separate report relating to the compliance testing portion of the assessment.

**Key Articles’ Provisions Governing IDA’s Operations**

10. Article I states that “the Association shall be guided in all its decisions by the provisions of [Article I]”. These provisions state:

“The purposes of the Association are to promote economic development, increase productivity and thus raise standards of living in the less-developed areas of the world included within the Association’s membership, in particular by providing finance to meet their important developmental requirements on terms which are more flexible and bear less heavily on the balance of payments than those of conventional loans, thereby furthering the developmental objectives of the International Bank of Reconstruction and Development (hereinafter called “the Bank”) and supplementing its activities.”

With these provisions in mind, Management has, for purposes of this exercise, identified the following key provisions set out in Article V, *Operations, Section 1. Use of Resources and Conditions of Financing*, that serve as the foundation for carrying out IDA’s operations.

**Purposes**

*a) Concessional Resources to Less Developed Areas*

“V.1(a) The Association shall provide financing to further development in the less-developed areas of the world included within the Association’s membership.”

*b) Financing High Development Priorities*

“V.1(b) Financing provided by the Association shall be for purposes which in the opinion of the Association are of high developmental priority in the light of the needs of the area or areas concerned…”

**Project Related**

*c) Specific Projects and Special Circumstances Lending*

“V.1(b) Financing provided by the Association .... except in special circumstances, shall be for specific projects.”

*d) Use of Funds for Purposes Intended*

“V.1(g) The Association shall make arrangements to ensure that the proceeds of any financing are used only for the purposes for which the financing was provided…”

*e) Due Regard for Economy and Efficiency*

“V.1(g) The Association shall make arrangements to ensure that the proceeds of any financing are used .... with due attention to considerations of economy, efficiency, and competitive international trade”
f) Linking Disbursements to Expenditures as Incurred

“V.1(h) Funds to be provided under any financing operation shall be made available to the recipient only to meet expenses in connection with the project as they are actually incurred.”

General

h) Non-political Interference

“V.1(g) The Association shall make arrangement to ensure that the proceeds of any financing are used .... without regard to political or other non-economic influences or considerations.”

For the purpose of this exercise, Article V, Operations, Section 2. Form and Terms of Financing, and Section 3. Modifications of Terms of Financing also set out important provisions, including: general financing provisions; economic prospects; acceptable borrower; guarantees; use of currencies; and modifications.

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3 See also Article V, Section 6 which states: “The Association and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighted impartially in order to achieve the purposes stated in this Agreement.”

4 Article V, Section 2 (a) Financing by the Association shall take the form of loans, the Association may, however, provide other financing, either (i) out of funds subscribed pursuant to Article III, Section 1, and funds derived therefrom as principal, interest or other charges, if the authorization for such subscription expressly provides for such financing; or (ii) in special circumstances, out of supplementary resources furnished to the Association, and funds derived therefrom as principal, interest or other charges, if the arrangements under which such resources are furnished expressly authorize such financing.

5 Article V, Section 2 (b) Subject to the foregoing paragraph, the Association may provide financing in such forms and on such terms as it may deem appropriate, having regard to the economic position and prospects of the area or areas concerned and to the nature and requirements of the project.

6 Article V, Section 2 (c) Association may provide financing to a member, the government of a territory included within the Association’s membership, a political subdivision of any of the foregoing, a public, or private entity in the territories of a member or members, or to a public international or regional organization.

7 Article V, Section 2 (d) In the case of a loan to an entity other than a member, the Association may, in its discretion, require a suitable governmental or other guarantee or guarantees.

8 Article V, Section 2 (e) The Association, in special cases, may make foreign exchange available for local expenditures.

9 Article V, Section 3 The Association may, when and to the extent it deems appropriate in the light of all relevant circumstances, including the financial and economic situation and prospects of the member concerned, and on such conditions as it may determine, agree to a relaxation or other modification of the terms on which any of its financing shall have been provided.
11. In identifying the above as the key Articles’ principles governing IDA’s operations, Management has focused on the gravity and impact that these provisions, as interpreted by the Executive Directors, have had on the manner in which IDA’s operations have been conducted since its inception. In practice, other provisions of Article V have had less of an impact on day-to-day operations of IDA and therefore have not been focused on as part of this exercise.¹⁰

12. In order to reflect and comply with the above Articles’ principles, since its inception, IDA operations have been structured and implemented in a manner to ensure that scarce IDA resources were made available to support priority development activities in the poorest eligible member countries. The structure also meant that decisions regarding IDA’s financing would be made without regard to political or other non-economic influences or considerations and that IDA financing would be available for specific projects as well as other “special circumstances” operations. Across all modes of financing, IDA is required to ensure that its funds are used for the purposes intended to meet expenses as they are actually incurred, with due regard for economy and efficiency.

**Main Policies Governing IDA’s Operations**

13. The policy framework governing IDA operations is the primary tool for setting the parameters for conducting IDA’s operations consistent with the above Articles’ principles.

14. The Executive Directors are responsible for interpreting IDA’s Articles and approving IDA’s operational policy framework, based on Management’s proposals. Over the years, to ensure that IDA’s operations are carried out in compliance with the Articles’ principles, while reflecting the evolving model underlying development assistance, the Executive Directors have approved various policies, which comprise the policy framework for IDA’s operations. These policies have been “translated” by Management into Operational Policies (OPs)¹¹ and Bank Procedures (BPs)¹² included in the Bank’s Operational Manual. The OPs and BPs put in place the main parameters and procedures to be followed by staff in conducting IDA’s operations in a manner that has been determined by Management and the Board to comply with the IDA Articles.

15. Currently, the Operational Manual contains over 100 OPs and BPs. (The table of contents of the Operational Manual is set out in *Annex 2.*) In order to determine which OP/BPs are most pertinent to the key Articles’ principles identified above, Management focused on the three primary instruments through which IDA currently conducts its operations:

a) *Country Assistance Strategy* (CAS), which sets out a country’s development priorities and the strategy for IDA support of such priorities over an agreed period of time.

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¹⁰ One exception is Section 1 (d) of Article V, which requires that every IDA financing presented to the Executive Directors for approval be accompanied by a recommendation of a “competent committee”. This requirement is included in the business processes or flows for processing investment lending operations and development policy operations. However, over the years it has lost much of its control efficacy and has limited value in terms of risk mitigation.

¹¹ OPs are short, focused statements that follow from the Articles of Agreement, the general conditions, and policies approved by the Board. OPs establish the parameters for the conduct of operations; they also describe the circumstances under which exceptions to policy are admissible and spell out who authorizes exceptions.

¹² BPs explain how staff carry out the policies set out in the OPs. They spell out the procedures and documentation required to ensure Bankwide consistency and quality.
b) **Investment Lending Operations** (IL), as represented by Specific Investment Loans (SILs), which are the primary tool for providing IDA financing for specific projects within the meaning of IDA’s Articles and to which IDA applies the requisite due diligence throughout the project cycle (from identification to completion) to ensure compliance, inter alia, with the key Articles’ principles.

c) **Development Policy Lending Operations** (DPL), which are the primary tool for providing IDA financing for “special circumstances” operations within the meaning of IDA’s Articles and to which IDA applies the requisite due diligence throughout the project cycle (from identification to completion) to ensure compliance, inter alia, with the key Articles’ principles.

16. Management assessment focused on these three primary instruments, and the policies and procedures that apply to them, as a result of its determination that the three represented a significant portion of IDA operations in terms of the overall numbers and volume of IDA yearly new commitments. In FY05 and FY06 combined, IDA approved a total of 327 operations totaling $17.4 billion. Of these, 263 operations or $12.6 billion were IL operations, 62 and $4.6 billion were DPL operations and 2 were Guarantee operations. Further, of the 263 IL operations, 163 (or 62%) were SIL operations, accounting for $8.0 billion of the $17.4 billion. Overall, DPL and SIL operations accounted for 72% or $12.6 billion of the $17.4 billion. (See Annex 3 for more details). Similar proportions are reflected when looking at the “active” IDA portfolio under implementation.

17. To reflect the above, in identifying key polices governing IDA’s operations, Management focused on “flagship” OP/BPs that are most critical to the three primary instruments and compliance with the key Articles’ principles. These “flagship” OP/BPs include four umbrella statements governing financial terms of and eligibility for IDA financing as well as policies and procedures governing the three primary instruments for carrying out IDA operations, namely:

a) **Umbrella statement governing financial terms of and eligibility for IDA financing**

OP/BP 3.10, *Financial Terms and Conditions of IBRD Loan, IBRD Hedging Products, and IDA Credits*, which sets out the financial terms and conditions of IDA Credits.

b) **Umbrella statement governing CASs**

OP/BP 2.11, *Country Assistance Strategies*, which sets out the key processes that apply to the CAS product from identification through completion.

c) **Umbrella statements governing ILs**

OP/BP 10.00, *Investment Lending: Identification to Board Presentation*, which sets out the parameters for processing investment projects from identification through Board presentation.

OP/BP 13.05, *Project Supervision*, which sets out the parameters for supervision of investment projects under implementation.

d) **Umbrella statement governing DPLs**

OP/BP 8.60, *Development Policy Lending*, which sets out the parameters for processing of DPLs from identification through completion.
18. In addition to these four umbrella statements, the Operational Manual also includes specific policies governing fiduciary, contractual and safeguards requirements and associated procedures to be followed when IDA finances either IL or DPL operations. These specific policies are:

- **Policies and procedures governing financial management aspects (OP/BP 10.02, Financial Management).**

- **Policies and procedures governing disbursement aspects (OP/BP 12.00, Disbursement, 12.20, Special Accounts, OP/BP 12.30, Statements of Expenditure, OP/BP 6.00, Bank Financing (Expenditure Eligibility)).**

- **Policies and procedures governing procurement aspects (OP/BP 11.00, Procurement).**


19. The table of contents of the Operational Manual set out in Annex 2 highlights the OP/BPs that were specifically looked at as part of this assessment. The OPs and BPs that were not specifically mapped by Management as part of this exercise can be classified into the following broad categories:

- **OP/BPs governing various trust funds and grants that do not utilize IDA resources (e.g., OP/BP 8.45; OD 9.01; OP/BP 10.21; OP/BP 14.20; OP/BP 14.40);**

- **Ops/BPs that apply to specific other types of investment lending products (Emergency Recovery Credits (OP/BP 8.50), Financial Intermediary Credits (OP/BP 8.30) and Technical Assistance Credits (OP/BP 8.40)), given that the SIL was deemed to be a representative proxy for all investment lending in terms of volume and main processes;**

- **OP/BP 14.25 governing guarantees, given the very small volume of guarantees in the IDA portfolio;**

- **Thematic and content-specific OP/BPs that feed into the processes that were mapped as part of this exercise, but do not have separate processes and controls to be captured in this phase of this exercise (e.g., OP/BP 1.00, 4.07, OP/BP 4.20, OMS 2.20, OP/BP 10.04; 6.00 (which supersedes OP/BP 6.30, 6.60) OP/BP 11.03); and**

- **OP/BPs relating to specialized contractual and other issues which, when they arise, are addressed as part of the processes and controls that have been mapped (e.g., OP/BP 2.30, OP 7.20, OP/BP 7.30, 7.40, 7.50, 7.60).**
Business Processes and Key Associated Controls that Support Implementation of the Principles and Procedures set out in Identified OP/BPs

20. In assessing how staff comply with the above policies and procedures, Management identified the relevant business processes in place which staff are expected to use as guidance and best practice when working on IDA operations. For the purposes of this exercise, Management, in consultation and agreement with the Internal Auditing Department (IAD) and the Independent Evaluation Group (IEG), focused on the period from July 1, 2005, through March 31, 2006, (the period under review). These business process reviews are the tool that Management has used to document its processes, risks and controls related to the preparation of the financial statements, and this tool is also being used in documenting the controls over IDA’s compliance with its Articles and applicable internal policies and procedures. These business process reviews were performed through a combination of process flows and narratives, and risk assessments. The total number of 27 process overviews (process #30 – Debt Sustainability Analysis has not yet been completed and is not included), and detailed descriptions for 108 key controls when set out in narrative form give rise to a document of about 350 pages. (See Annex 5 for examples of process flow charts.) These process flows and narratives were prepared by the staff of the Project Management Team (PMT), with input from individual subject matter experts of the identified processes in OPCS and other units as required. Management believes that all these identified activities and controls have been accurately reflected.

21. For the purposes of this Report, Management’s assessment of the design effectiveness of controls associated with the business processes identified was focused on addressing whether the system of such internal controls is both comprehensive as well as suitably designed to prevent or detect on a timely basis, material issues of non-compliance or significant control deficiencies. Key controls have been evaluated for their design effectiveness by reviewing the process maps and associated key controls documentation to ensure that internal controls have been suitably designed. The key controls as defined by the PMT and/or the specific subject matter experts within Controller’s and Operations Policy and Country Services (OPCS) have been corroborated by (a) examination of documentary evidence, (b) observation, and/or (c) re-performance. This process has led to the production of detailed flow charts relating to 27 of the 28 main business processes (process #30 – Debt Sustainability Analysis has not yet been completed and is not included) and key associated controls. (The list of the 28 main business processes is set out in Annex 4.)

22. Management’s decision relating to identification and grouping of these 28 main business processes and key controls associated with them mirrors the manner in which Management identified and grouped the policies that apply to the three primary IDA instruments as set out above. Specifically, in support of the four umbrella statements, which govern financial terms of and eligibility for IDA financing as well as the three primary instruments for carrying out IDA operations, Management has identified and mapped, or catalogued, the following four umbrella processes:

a) Processes that apply to IDA allocation\textsuperscript{13} (Nos.1 and 30, See Annex 4).

\textsuperscript{13} Please note that IDA's allocations are carried out in accordance with the IDA Performance Based Allocation System (PBA) -- a set of rules by which IDA allocates its resources to each IDA recipient. With modifications, this has been used since 1977 (IDA 5). The PBA rules and criteria have been adopted over successive IDA replenishments and are contained in the sequence of replenishment reports.
b) Processes that apply to the CAS from identification through completion (No. 4, see *Annex 4*).

c) Processes that apply to SILs from identification through completion (No. 5, see *Annex 4*).

d) Processes that apply to DPLs from identification through completion (No. 7, see *Annex 4*).

23. Consistent with Management’s grouping of the relevant policies as set out above, Management then identified and mapped business processes that support implementation of the specific policies governing fiduciary, contractual and safeguards requirements and associated procedures relating to CAS, SIL and DPL, all of which feed into the four umbrella business processes identified in paragraph 17 above. These include:

a) Processes relating to corporate review with respect to CAS, SIL and DPL (No. 8, see *Annex 4*).

b) Processes relating to implementation of policies and procedures governing financial management aspects (Nos. 12 and 13, relating to OP/BP 10.02, *Financial Management*, see *Annex 4*).


d) Processes relating to implementation of polices and procedures governing procurement aspects (Nos. 14-16, relating to OP/BP 11.00, *Procurement*, see *Annex 4*).


24. In addition to the above, Management also mapped the business processes that apply to the quality assurance function which, while not mandated by any specific policy, has played an important role in reviewing quality aspects of operational work both at appraisal and at supervision stages (No. 27, see *Annex 4*).
Management Findings and Recommendations

25. The design effectiveness assessment captured a representative picture of the control environment over IDA’s operations at the transaction level, where daily decisions are made which have a direct impact on the use of IDA resources. While this turned out to be an extremely involved and labor intensive exercise for which there was little precedent inside or outside the institution, Management found it to be valuable. Management expects that the information gleaned as a result of this exercise will provide tangible support for strategic and rationalization decisions for IDA’s operations going forward.

26. On the basis of the above-described methodical, interactive and thorough exercise of performing a bottom up identification and cataloguing of the processes and associated controls for carrying out IDA’s operations, Management has the findings and recommendations set out below.

A. The examination of the key policies and procedures that govern IDA operations and the mapping and review of the key business processes and associated controls that enable compliance with these policies confirmed that:

- The performance based allocation model is appropriately designed to direct scarce IDA resources in support of priority development activities in the poorest eligible member countries.

- The three primary instruments for carrying out IDA operations (i.e, CAS, SIL and DPL), their complementary use and the processes and controls that apply to them from identification to completion have been appropriately designed to verify that:
  o IDA financing is being provided in support of developmental priorities and is focused on matters that appropriately fall within IDA’s mandate
  o Consistent with the Articles’ provisions, IDA financing is made available for specific projects as well as other “special circumstances” operations where appropriate.

- The umbrella processes and associated controls for processing CAS, SIL and DPL through all stages (from identification to completion) and the specific processes and controls that fall under these umbrella processes (fiduciary, contractual, safeguards, etc.) are appropriately designed to facilitate and verify compliance with the key IDA policies and procedures adopted to ensure that IDA funds are used for the purposes intended to meet expenses as they are actually incurred.

The specific processes and associated controls related to procurement are appropriately designed to facilitate and verify compliance with IDA’s procurement policies, as reflected in OP/ BP 11.00 and Guidelines: Procurement under IBRD Loans and IDA Credits and Guidelines: Selection and Employment of Consultants by World Bank Borrowers and meet the objective of using IDA resources to finance goods, works and services that were procured by the borrower with due regard for economy and efficiency.

B. Management had difficulties with obtaining timely access to relevant documents that are needed to carry out the compliance testing portion of the assessment. This work clearly revealed that there is an issue with respect to document retention and accessibility which merits serious examination and improvement. Although the auditors retained by Management to do compliance testing informed Management that document retention
and accessibility is a common problem in many corporations that have transitioned from manual retention and filing of hard copies of documents to filing and archiving documents electronically, Management intends to address the document retention and accessibility issue immediately by setting up an expert panel to look at retention, filing and accessibility of operational documents and come up with recommendations for improvements within the next six months.

C. Management has also identified that the OPs and BPs included in the Operational Manual are not keeping pace with the changes on the ground that are being introduced from time to time. One example is BP 10.00 on processing investment lending from identification to Board approval, which is in need of urgent update. Other examples in need of updating to reflect current requirements which have been approved by the Board over the past several years include the 12.00 series governing disbursements, and OP/BP 10.02 on financial management. As part of Management's assessment of the effectiveness and efficiency of IDA's internal controls framework, Management intends to look at the current processes underlying policy revision to determine if they need to be revised to facilitate more efficient and timely updating of operational policies and procedures.

D. The policy framework governing IL operations is too complex and disjointed, making it hard for staff to identify all the policies with which they are expected to comply when working on IL operations. Following the example of the recent reform of the DPL policy and procedures (OP/BP 8.60), Management has been actively working on rationalization and consolidation of policies governing IL processing from identification to completion.

E. The assessment confirmed that many staff find the existing processes and documentary requirements very onerous and inefficient. To address this problem, at least in part, Management intends to issue in the next few months standard updated operational templates to be used by staff in documenting various steps in the IL and DPL processes.

F. The assessment identified that there is a disparity in the frequency of corporate reviews of SIL and DPL operations, with all DPLs being subject to such review and relatively few SILs. While some of the heightened scrutiny of the DPLs is consistent with the Articles' provisions relating to “special circumstances” lending, Management is examining whether there is a need to review criteria for submitting Investment Lending operations that raise special risks or issues to the corporate review process.

G. As part of the detail review of key controls and process flows (i.e., “walkthroughs”) performed with respect to the individual business processes, Management has identified a number of areas that merit a closer look. Some of these areas are:

1. Several existing policies and procedures need to be updated or enhanced or, in some instances, additional guidance needs to be introduced.
2. Certain system capabilities or system-related controls need to be better aligned with the process requirements.
3. Timeliness of processes related to managing individual credits should be improved.
4. Variances in regional implementation of institutionally endorsed guidelines need to be reviewed to ascertain whether these variances are appropriate.
5. Certain procurement processes and controls require enhancements to strengthen effectiveness.

6. Processes surrounding SILs with regard to project changes or contractual remedies need to be strengthened.

7. Clarification should be issued to require staff, which provide conditional clearances or feedback on project documents, follow up to ensure that their comments have been incorporated, as appropriate.

Management intends to closely examine these areas as part of the compliance phase of the project and to develop corrective action plans for the findings that require remediation.
ANNEX 1: DISCUSSION OF COSO AND METHODOLOGY USED IN THE ASSESSMENT

1. In performing its review of the compliance with IDA’s Articles and applicable internal policies and procedures, Management has used, as much as possible, the concepts as defined in the Auditing Standard No. 2 (AS2) An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements issued by the U.S. Public Company Accounting Oversight Board (PCAOB) in response to the provisions of Section 404 of the U.S. Sarbanes-Oxley Act of 2002 (SOX legislation). The Bank is currently performing its assessment of internal controls over external financial reporting using existing auditing standards on attestation of internal controls over financial reporting as prescribed by generally accepted auditing standards. Applying these concepts, which have been defined by standard setters for assessing internal controls over financial reporting, provides Management a level of comprehensiveness, rigor and standardization required in its assessment of internal controls and compliance.

2. Under the COSO framework, the effectiveness of an internal control system is measured by its capacity to provide reasonable assurance to Management and the Executive Directors (the Board) regarding the achievement of the Bank’s objectives in the following three areas (pillars):

   - Reliability of financial reporting – relating to preparation of published financial statements;
   - Compliance with applicable laws and regulations – relating to compliance with applicable legal and regulatory framework (charter, policies, etc.); and
   - Effectiveness and efficiency of operations – relating to effective and efficient use of resources.

3. COSO’s categorization allows focusing on separate aspects of internal controls, addressing different needs and taking into account that each area may be the direct responsibility of different organizational units and managers. As briefly summarized below, this categorization also distinguishes between what can be expected from each category of internal control.

4. **Financial Reporting:** Bank/IDA’s primary objective in adopting the COSO framework was to focus on financial reporting, which is the primary focus of the Bank’s external auditor. Since 1997, Management has annually asserted that it maintains an adequate system of internal control over external financial reporting for both IBRD and IDA; and Management has received an attestation to this effect from the external auditor at the end of each fiscal year.¹

¹ The examination of financial reporting under the COSO framework has also enabled the Bank to be well positioned in reviewing the impact of various shareholder nation’s legislation related to corporate governance requirements (i.e. the U.S. Sarbanes-Oxley Act of 2002 (SOX)). SOX is a set of legislative reforms adopted in the United States to strengthen corporate governance and regulatory activities for financial reporting by capital market participants, and the EU 8th Directive (Proposal for a Directive of the European Parliament and the Council on Statutory Audit of Annual and Consolidated Accounts and Amending Council Directives, issued on March 16, 2004) and enhancing its internal controls, where appropriate.
5. **Effectiveness and Efficiency of Operations:** Unlike the areas of financial reporting and compliance with laws and regulations, which largely depend on performance of activities within the organization’s control, effectiveness and efficiency of operations depend on a host of factors that are often outside the organization’s control and over which Bank/IDA staff and management may have little influence. Specifically:

- Internal controls cannot eliminate bad judgment or decisions, nor can they influence external events that may result in a failure to achieve operations’ goals or objectives; and
- With respect to these objectives, the internal control system can provide reasonable assurance only that Management and, in its oversight role, the Board are made aware, in a timely manner, of the extent to which the organization is moving towards meeting the agreed goals or objectives.

6. With the above caveats, as part of this exercise, Management intends to assess whether the existing internal control framework over IDA’s operations provides reasonable assurance that IDA’s operations are carried out efficiently and effectively.

7. The review of internal controls for IDA’s operations are being limited to the areas of “compliance with applicable laws and regulations” and “effectiveness and efficiency of operations” under the COSO framework. Given that the financial reporting controls are assessed annually by Management and verified by the external auditors as part of the annual audit, no additional assessment in this area was believed necessary in the context of the overall internal control assessment.

**Division of Responsibilities**

8. Management’s Assessment of IDA’s Internal Controls – Consistent with the COSO framework requirements Management will assess the key internal controls for IDA operations in the areas of compliance and effectiveness and efficiency of operations. This assessment includes the identification of and compliance with the relevant controls (Parts I(A) and I(B)) and a review and assessment of the efficiency and effectiveness of their design and operation (Part II).

9. The assessment is being led by the Offices of the Vice President and Controller (CTR), and the Vice President, Operational Policy and Country Services (OPCS), with key support roles for Concessional Finance and Global Partnerships (CFP) and Legal (LEG). To manage the implementation of this process, Management has created a high-level Steering Committee comprised of the Vice Presidents of the above four units with the inclusion of the Internal Audit Department (IAD) and the Independent Evaluation Group (IEG) management as observers. The responsibilities of the Steering Committee are to:

- Define the objectives of the assessment in the areas of compliance and efficiency and effectiveness of operations;
- Oversee the implementation of the assessment and coordinate Management’s activities with those of IAD and IEG;
• Review the controls issues identified during the assessment and evaluate whether these issues rise to the level of material weaknesses that would impact Management’s assessment; and

• Review and endorse Management’s assessment and/or report of its review prior to its transmittal to IAD, IEG and the President.

10. To assist the Steering Committee in implementing the detailed work program, a Project Management Team (PMT) consisting of the Directors of Accounting and OPCS’s Country Services Departments and certain senior staff within these units has been established. The responsibilities of the PMT include:

• Preparing the detailed scoping and implementation plan and obtaining its approval by the Steering Committee;

• Bring all the respective units together in the Bank to brief them as to the work program and where their assistance will be required;

• Documenting the risks, processes and related controls associated with ensuring IDA’s funds are being used for the purposes described in the credit agreements;

• Performing the assessment of the design and operational effectiveness of the controls;

• Identifying instances of non-compliance with prescribed controls and related control deficiencies;

• Evaluating whether the identified control deficiencies, individually or in aggregate, have a material impact on Management’s ability to state whether internal controls are adequate over compliance with IDA’s charter and applicable internal policies and procedures; and

• Preparing Management’s assessment and/or report of its review for review and endorsement by the Steering Committee; and

• Liaising with IAD and IEG in the preparation of their respective validation and evaluation.

11. IAD Review of Management’s Assessment – Consistent with IAD’s overall mandate, Management’s assessment of internal controls over IDA’s operations in the areas of compliance (Parts I(A) and I(B)) and efficiency and effectiveness (Part II) will be reviewed by IAD.

12. Overall IEG Evaluation – in order to fulfill Management’s commitment of carrying out an independent assessment of its internal controls over IDA operations, as specified in the IDA 14 Report, IEG will evaluate (i) the work performed and findings identified by Management, in the areas of compliance (Parts I(A) and I(B)) and efficiency and effectiveness (Part II) of the internal controls framework over IDA operations, as well as (ii) IAD’s review of Management’s assessment (including methodology, testing results, and reported findings). Based on these evaluations, IEG would then issue its report. [If the timing permits, IEG would also contribute a section to the report on Part IA, in time for the meeting of the IDA Deputies in late November.]
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The following table represents the IDA lending by type of major lending instrument for the fiscal years 2005 and 2006.

<table>
<thead>
<tr>
<th>Lending Instrument</th>
<th>Approved FY05</th>
<th></th>
<th></th>
<th>Approved FY06</th>
<th></th>
<th></th>
<th>Combined Approvals</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>No.</td>
<td>% of Total</td>
<td>Amt (US$M)</td>
<td>% of Total</td>
<td>No.</td>
<td>% of Total</td>
<td>Amt (US$M)</td>
<td>% of Total</td>
<td>No.</td>
<td>% of Total</td>
</tr>
<tr>
<td>DPL</td>
<td>32</td>
<td>20.0%</td>
<td>2.16</td>
<td>27.3%</td>
<td>30</td>
<td>18.0%</td>
<td>2.42</td>
<td>25.5%</td>
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<tr>
<td>Investment Lending</td>
<td>126</td>
<td>78.8%</td>
<td>5.63</td>
<td>71.0%</td>
<td>137</td>
<td>82.0%</td>
<td>7.02</td>
<td>73.9%</td>
<td>263</td>
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<tr>
<td>SIL</td>
<td>77</td>
<td>48.1%</td>
<td>3.31</td>
<td>41.8%</td>
<td>86</td>
<td>51.5%</td>
<td>4.71</td>
<td>49.5%</td>
<td>163</td>
</tr>
<tr>
<td>Other Investment</td>
<td>49</td>
<td>30.6%</td>
<td>2.31</td>
<td>29.2%</td>
<td>51</td>
<td>30.5%</td>
<td>2.32</td>
<td>24.3%</td>
<td>100</td>
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<tr>
<td>Guarantees</td>
<td>2</td>
<td>1.3%</td>
<td>0.14</td>
<td>1.7%</td>
<td>0</td>
<td>0.0%</td>
<td>0.06</td>
<td>0.6%</td>
<td>2</td>
</tr>
<tr>
<td>Total</td>
<td>160</td>
<td>100.0%</td>
<td>7.92</td>
<td>100.0%</td>
<td>167</td>
<td>100.0%</td>
<td>9.51</td>
<td>100.0%</td>
<td>327</td>
</tr>
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# ANNEX 4: BUSINESS PROCESSES SELECTED FOR REVIEW

<table>
<thead>
<tr>
<th>#</th>
<th>List of IDA Business Processes Reviewed</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>IDA Allocation</td>
</tr>
<tr>
<td></td>
<td>IDA Allocation Model *</td>
</tr>
<tr>
<td></td>
<td>IDA Post Conflict Allocation *</td>
</tr>
<tr>
<td>4</td>
<td>Country Assistance Strategy: preparation and processing of country strategy documents (CAS etc.)</td>
</tr>
<tr>
<td>5</td>
<td>Specific Investment Loan (SIL): project cycle (from identification to completion)</td>
</tr>
<tr>
<td>6</td>
<td>Project Changes: processing project changes during project supervision</td>
</tr>
<tr>
<td>7</td>
<td>Development Policy Lending (DPL): project cycle (from identification to completion)</td>
</tr>
<tr>
<td>8</td>
<td>Corporate Reviews: procedures for regional operations committee/operations committee reviews</td>
</tr>
<tr>
<td>9</td>
<td>Contractual Remedies: application of contractual remedies</td>
</tr>
<tr>
<td>10</td>
<td>Legal – SIL: legal aspects of specific investment loans</td>
</tr>
<tr>
<td>11</td>
<td>Legal – DPL: legal aspects of development policy lending</td>
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<tr>
<td>12</td>
<td>Financial Management – SIL: financial management aspects of specific investment loans</td>
</tr>
<tr>
<td>13</td>
<td>Financial Management – DPL: financial management aspects of development policy lending</td>
</tr>
<tr>
<td>14</td>
<td>Procurement – SIL: procurement aspects of specific investment loans</td>
</tr>
<tr>
<td>15</td>
<td>Procurement Complaints: procurement processes relating to complaints</td>
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<td>16</td>
<td>Procurement Non-compliance: procurement processes relating to non-compliance</td>
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<td>17</td>
<td>Loan Management – SIL: loan management aspects of specific investment loans</td>
</tr>
<tr>
<td>18</td>
<td>Loan Management – DPL: loan management aspects of development policy lending</td>
</tr>
<tr>
<td>19</td>
<td>Loan Management – Application Review: processes relating to application review</td>
</tr>
<tr>
<td>20</td>
<td>Loan Management – Special Commitment or Application Problems: processes relating to special commitment or application problem</td>
</tr>
<tr>
<td>21</td>
<td>Loan Management – Amendments and Notices: processes relating to amendment/extension processing</td>
</tr>
<tr>
<td>22</td>
<td>Loan Management – Refunds: processes relating to refund processing</td>
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<tr>
<td>23</td>
<td>Loan Management – Cancellations: processes relating to cancellation processing</td>
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<tr>
<td>24</td>
<td>Loan Management – Suspensions: processes relating to suspension processing</td>
</tr>
<tr>
<td>25</td>
<td>Loan Management – Loan Account Closing: processes relating to loan account closing - standard procedures</td>
</tr>
<tr>
<td>26</td>
<td>Loan Management – Loan Account Closing: processes relating to loan account closing - special procedures</td>
</tr>
<tr>
<td>27</td>
<td>QAG: quality at entry and supervision</td>
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<tr>
<td>28</td>
<td>Safeguards – SIL: safeguard aspects of specific investment loans</td>
</tr>
<tr>
<td>29</td>
<td>Safeguards – Corporate Risk: safeguard procedures relating to corporate risk (QACU)</td>
</tr>
<tr>
<td>30</td>
<td>Debt Sustainability Analysis: relating to financial management</td>
</tr>
</tbody>
</table>
Attachment 1

* These two sub-processes were initially recorded as separate processes. After discussion with CFP management they were deemed to be sub-processes of the IDA allocation process and were consequently integrated into process number 1. We have not revised the numbering scheme. There are 28 processes that have been selected by Management for documentation.
SAMPLE OF PROCESS FLOW DIAGRAMS
Module 4: Country Assistance Strategy
Module 8: Corporate Review

1. CAS, PD, PAD Ready for Review (Mods 4, 5 & 7)
   - Prepare Documentation Package
     - ROC or OC?
       - ROC
         - Send ROC Invitations with Documentation using Standard Distribution Lists
       - OC
         - Send OC Invitations with Documentation using Standard Distribution Lists

2. ROC Review
   - ROC Input from Sectors / Networks
   - Input from OPCS
   - ROC Review
     - Require OC Review?
       - Yes
         - Circulate Minutes
       - No
         - No

3. OC Review
   - OC Input from Sectors / Networks
   - OPCS Acts as Secretariat
   - Circulate Minutes
     - Update Documentation
     - Circulate Decision Note

4. Pre-Neg. MD Review
   - MD Request Pre-Negotiation Review? (Operations)
     - Yes
       - Pre-Neg. MD Review
     - No
       - Appraisal Complete (Modules 5, 7)

5. Complete Pre-Neg. MD Review
   - Yes
   - No
Attachment 2:
IAD Review of Management’s Assessment
October 13, 2006

Mr. Fayezul H. Choudhury, Controller & Vice President, CTRVP
Mr. James W. Adams, Vice President & Head of Network, OFCVP

Report on a Review of Management’s Assessment of the Design Effectiveness of Internal Controls over IDA Operations and Compliance with its Charter and Policies

Please find enclosed the above-mentioned report which represents the outcome of our review on Management’s Assessment of IDA’s Internal Controls Review: Part IA.

[Signature]
Carman Lapointe Young
Auditor General
Internal Auditing

Attachment

cc: Messrs. Wolfowitz (EOC); Wheeler (MDW); Daboub (MDD); La Via (CFO); Thomas (IEGDG)

Deloitte & Touche, LLP
Review of Management's Assessment of the Design Effectiveness of Internal Controls over IDA Operations and Compliance with its Charter and Policies

Background

As part of its work program, Internal Auditing Department (IAD) has completed a review of “Management's assessment relating to the design effectiveness of key controls currently in place to ensure compliance with the relevant Articles provisions and policies governing IDA's operations”.

This assessment comprises the first Part IA of a three-part assessment envisaged to satisfy Management’s commitment “to carry out an independent comprehensive assessment of IDA's control framework including internal controls over IDA operations and compliance with its charter and policies”. Management’s commitment was outlined in the IDA Fourteenth Replenishment report, approved by the Executive Directors of IDA in March 2005, which identified a monitorable action, targeted for CY05, the product of which was an ‘OED Assessment’.

The balance of Management’s commitment will be met through Part IB: the assessment of the operating effectiveness of, or compliance with, the controls identified in Part IA; and Part II: the assessment of efficiency and effectiveness, including corporate governance and entity-level controls.

Management indicated in its Revised Work Plan that its assessment would be conducted using the control framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Objective

In accordance with our Terms of Reference, IAD’s objective was to review the basis of Management’s assessment and express an opinion on whether Management's assessment of the effectiveness of internal controls over IDA operations is fairly stated based on the criteria established in Internal Control – Integrated Framework issued by COSO.

Management’s assessment, originally outlined as Part A, was to “focus on the compliance portion of the assessment, namely whether the existing internal control framework over IDA’s operations provides reasonable assurance to Senior Management and the Board that such operations are carried out in a

1 See “Report from the Executive Directors of the International Development Association to the Board of Governors, Additions to the IDA Resources: Fourteenth Replenishment, Working Together to Achieve the Millennium Development Goals” (approved by the Executive Directors of IDA on March 10, 2005).
manner that complies with the provisions of the IDA charter and internal policies governing the fiduciary aspects of IDA’s lending operations”2. Part A has since been segregated into two parts (Part IA and Part IB) as outlined above. This segregation resulted from unsuccessful attempts to obtain documentation to test compliance and design effectiveness concurrently, as was originally intended by management.

Scope

IAD’s review examined Management’s assessment relating to the design effectiveness of key controls currently in place to ensure compliance with the relevant Articles provisions and policies governing IDA’s operations. Twenty-nine documented processes of the thirty processes3 deemed in-scope by Management were reviewed, including management’s methodologies for determining in-scope processes and for assessing the design effectiveness of internal controls.

Management’s assessment and IAD’s review covered the period from July 1, 2005 to March 31, 2006.

IAD did not review the following areas excluded by Management under Part IA:

- Overarching control framework for IDA including all aspects of corporate governance and entity level controls as well as efficiency and effectiveness of operations;

- Specific processes deemed out of scope by management for this assessment, namely Economic Sector Work (ESW), Report on Observance of Standards and Codes (ROSC), Independent Evaluation Group (IEG) Processes, Internal Auditing Department (IAD) Processes, Country Policy & Institutional Assessment (CPIA), Post Conflict Performance Indicators (PCPI), Annual Report on Portfolio Performance (ARPP), the Inspection Panel, the Department of Institutional Integrity (INT), and the Results Assessment Framework of IDA;

- Process walkthroughs, from inception to completion, except for 3 processes (Country Assistance Strategy, Investment Lending and Development Policy Lending);

- Operational Policies (OPs) and Bank Procedures (BPs) excluded by management, as outlined in their report; and

- Compliance controls embedded in automated applications used in IDA operations4.


3 Management has not completed the documentation of the process relating to the “Debt Sustainability Framework”. We understand that this will be completed by management along with Part IB of the compliance assessment.

4 IT controls significant for financial reporting purposes were assumed to have been covered under management’s Assessment of Internal Controls over Financial Reporting for FY06.
Approach

A highly compressed time schedule for the review was necessitated by management’s decision to segregate design effectiveness from compliance testing following the unsuccessful attempts by management to carry out this testing concurrently. As a result, IAD’s review, originally scheduled to follow completion of management’s assessment, was carried out simultaneously, with IAD conducting its own work independently and providing frequent and continuous feedback to management.

As agreed with management, IAD applied all relevant concepts of Auditing Standard 2 (AS2)\(^5\) appropriately tailored for auditing operational compliance controls.

IAD reviewed management’s scoping methodology and work plan. For the 29 documented processes (of the 30 in-scope IDA processes), IAD performed the following:

- **Process Documentation:** IAD reviewed high level process flowcharts, narratives of processes and control objectives, risks and key controls provided by management. IAD reviewed whether key controls identified by management appeared adequate to satisfy control objectives, and identified potentially missing key controls.

- **Workshops/Review Sessions:** IAD observed workshops/review sessions conducted with subject matter experts to validate process flow charts and narrative descriptions of individual key controls provided by management, challenging, seeking clarification and identifying potential deficiencies as appropriate.

- **Revised Process Documentation:** IAD reviewed revised process descriptions incorporating changes identified in the workshops/review sessions and potential control issues identified by management.

- **Deficiency Tracker:** IAD provided management with a list of 59 potential deficiencies in documentation and/or design identified during our review, 55 of which were incremental to control issues identified by management. The following table outlines the nature of deficiencies by module.

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\(^5\) Auditing Standard No. 2: An Audit of Internal Control over Financial Reporting Performed in Conjunction with An Audit of Financial Statements (AS2) issued by the Public Company Accounting Oversight Board (PCAOB).
IAD’s Review of Management’s Assessment of IDA Internal Controls: Part IA
Potential Deficiencies Outstanding for Remediation – By Deficiency Type

<table>
<thead>
<tr>
<th>MODULE</th>
<th>Documentation</th>
<th>Design</th>
<th>Total Potential</th>
</tr>
</thead>
<tbody>
<tr>
<td>DPL/SIL</td>
<td>-</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>ROC/OC</td>
<td>1</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>FRM - ALLOCATION</td>
<td>5</td>
<td>1</td>
<td>6</td>
</tr>
<tr>
<td>LOAN MANAGEMENT</td>
<td>9</td>
<td>2</td>
<td>11</td>
</tr>
<tr>
<td>FINANCIAL MANAGEMENT</td>
<td>4</td>
<td>7</td>
<td>11</td>
</tr>
<tr>
<td>PROCUREMENT</td>
<td>15</td>
<td>7</td>
<td>22</td>
</tr>
<tr>
<td>SAFEGUARDS</td>
<td>1</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>QAG</td>
<td>2</td>
<td>-</td>
<td>2</td>
</tr>
<tr>
<td>Deficiencies</td>
<td>37</td>
<td>22</td>
<td>59</td>
</tr>
</tbody>
</table>

- **Process Walkthroughs:** IAD attended process walkthrough sessions convened by management with operating personnel responsible for three processes (Country Assistance Strategy, Investment Lending and Development Policy Lending) to confirm the operation of process controls (for at least one transaction for each process) from inception to completion, as validated in the workshops/review sessions.

- **Management's Report:** IAD reviewed drafts of Management’s report and provided comments as appropriate.

**General Observation**

This IDA assessment is the first comprehensive internal exercise undertaken by management to review an operational/compliance internal control framework. Furthermore, it appears to be unique in the multilateral development banking environment, and to our knowledge, in the broader international financial institution community. The effort underlying the commitment, the magnitude of which was clearly underestimated at the outset, should present substantial commensurate benefits: its results should provide a compelling baseline to identify opportunities for streamlining IDA’s (and concurrently IBRD’s) operations and internal controls while significantly improving consistency and efficiency.

**Key Issues**

The following key issues were identified during our review of Management’s Part IA assessment:

1. **IDA Processes Selected:** Management’s methodology does not adequately rationalize its intention to limit the scope of the review, as outlined in the IDA Control Review Methodology Note dated July 6, 2006, to determining compliance with fiduciary aspects of lending operations in IDA’s charter, as the basis for deciding which IDA processes were relevant to the assessment.
Management further limited its scope to processes applicable to Specific Investment Lending (SILs) and Development Policy Lending (DPLs) as the two lending instruments representing most of the value and volume, and which were deemed to be a representative proxy for other lending operations. Certain other IDA products, trust funds and grants that do not utilize IDA resources, and other miscellaneous operations outlined in the Articles were also excluded. We are not aware of any intended scope limitations of the commitment for a comprehensive assessment.

By scoping out certain of IDA’s operations, a selective rather than a comprehensive “bottom-up” approach has resulted. Rationalization appears necessary to reconcile management’s interpreted scope with that described in the original commitment.

2. **Information Technology (IT) Controls**: Work has not yet been undertaken to identify significant compliance controls embedded in automated applications. The separate *Assessment of Internal Controls over Financial Reporting (ICFR)* was neither designed nor intended to cover operations compliance controls, automated or manual. To include the assessment of automated compliance controls embedded in applications along with General Computer Controls (GCC’s) as part of the entity-level controls review in Part II will require re-work in the areas of documentation, confirmation, and testing to assess design and operating effectiveness of process/transaction level controls.

In order to reliably conclude its Part I assessment of process/transaction level controls, management will necessarily be required to carry out its assessment of key IT controls together with Part IB.

3. **Fraud and Corruption Controls**: Identification and documentation have not been undertaken of fiduciary controls focused specifically on mitigating risks associated with fraud and corruption. Furthermore, an assessment of the adequacy of other identified controls to satisfy these specific objectives has not been carried out in Part IA. This would include controls to prevent and detect fraud and corruption, as well as ensuring that control implications identified during fraud and corruption investigations are adequately addressed.

Management should specifically identify and assess key controls to prevent and detect fraud and corruption at the process/transaction level.

4. **Outdated Operational Policies (OPs) and Bank Procedures (BPs)**: One objective of the assessment by management related to the design effectiveness of the key controls that ensure compliance with policies and procedures governing IDA’s operations. Management has acknowledged in its report that “OPs and BPs … are not keeping pace with the changes on the ground that are being introduced from time to time”.

In principle, absent processes to ensure that policies are current, controls to ensure compliance with such policies would not be meaningful, even if current practices meet business needs.
Management has committed to review current processes to facilitate more efficient and timely updating of OPs and BPs. Management has also committed to review the appropriateness of regional variances in their implementation.

5. **Categorization and Remediation of Deficiencies:** Analysis has not yet been carried out under Part IA of management’s assessment to determine whether identified deficiencies pose, in the aggregate if not individually, significant or material risks to the attainment of the control objectives to which they relate.

In our view, in the absence of such determination, management has no sound basis upon which to conclude whether controls are effectively designed.

Accordingly, it will be important for management to evaluate the significance of identified deficiencies prior to concluding on Part IB.

6. **Document Retention and Accessibility:** Management acknowledged significant difficulties in obtaining timely access to relevant documents for compliance testing, which led to the segregation of assessments of control design effectiveness from operating effectiveness. In our view and experience, the inability to verify compliance with key controls represents a significant control design deficiency.

Management has committed to address the document retention and accessibility issue immediately.

7. **Assessment of Entity-level Controls:** Management has indicated that the review of entity-level controls, including tone at the top, the assignment of authority and responsibility, appropriate policies and procedures, and company-wide programs, will be carried out under Part II of the assessment.

The effectiveness of entity-level controls should have been assessed prior to undertaking any assessment of controls at the process or transaction level, since controls at the organizational level often have a pervasive impact on controls at the process, transaction or application level. Therefore, any management conclusions on control effectiveness as a result of Part I assessments will need to be reconsidered once entity-level controls have been examined.

8. **Walkthroughs of Process Documentation:** Management’s assessment of design effectiveness of internal controls under Part IA of the review included walkthroughs of process documentation for 3 of the 29 documented in-scope processes (CASs, SILs and DPLs) from inception to completion. The workshops/review sessions for the other 26 documented in-scope processes do not meet the criteria for walkthroughs outlined in AS2.

End-to-end process walkthroughs of all in-scope processes should have been conducted prior to management concluding on design effectiveness of internal controls, but in any case will need to be carried out by management prior to (or concurrently with) compliance testing in Part IB to support any conclusion.
Overall Conclusion

IAD committed in our original Terms of Reference to express an opinion at the end of Part A of the review (now Part IB) on whether management's assessment of the effectiveness of internal controls over IDA operations relating to compliance with IDA's charter and applicable policies is fairly stated. Any opinion delivered following Part IB would be subject to the outcome of the assessment of corporate governance and entity level controls in Part II.

However, IAD strongly recommends reconsidering the relative cost-benefit of continuing immediately with the remaining phases of the assessment versus continuing after addressing significant deficiencies identified in Part IA.

Packiaraj Murugan
Auditor-in-Charge

Thomas Ho Quen Hum
Audit Manager