

EXECUTIVE SUMMARY

FISCAL YEAR 2007: A YEAR OF ACTION IN THE WORLD BANK'S FIGHT AGAINST CORRUPTION

This annual report covers a year in which the World Bank Group undertook several important steps to strengthen its commitment to fighting corruption and to helping improve governance around the globe. It was also a year in which the Bank Group's Department of Institutional Integrity (INT) achieved a number of significant successes in its work to ensure that the Bank Group's limited financial resources are directed to the intended beneficiaries, as enshrined in the institution's Articles of Agreement.

Governance and Anticorruption Strategy

In fiscal year 2007 (FY07), the World Bank Group's Board of Executive Directors unanimously endorsed a new Governance and Anticorruption (GAC) Strategy which aims to heighten the institution's focus on these areas as an integral part of its work to reduce poverty and promote economic growth. The strategy calls for the Bank Group to increase its engagement in governance and anticorruption in three key areas: supporting country efforts; addressing fraud and corruption in Bank Group operations; and building global partnerships. Among the strategy's recommendations, the GAC calls for the Bank Group to step up the inclusion of appropriate fraud and corruption mitigation measures in project design, drawing on lessons from INT investigations regarding effective anticorruption safeguards and due diligence. The GAC also recommends wider dissemination of INT findings and emerging good practices and increased training and sensitization of task teams in how to spot "red flag" indicators of fraud and corruption.

Voluntary Disclosure Program and Sanctions Reform

The Bank Group's Board also approved two other important anticorruption initiatives in FY07, both directed toward private-sector actors that have engaged in fraud and corruption related to Bank-financed projects: a

Voluntary Disclosure Program and a broad new set of reforms to the Bank Group's sanctions regime.

The Voluntary Disclosure Program (VDP) is a proactive anticorruption tool designed to identify corrupt and fraudulent schemes and patterns in Bank Group-financed activities through the voluntary cooperation of participating firms and individuals. Managed by INT, the VDP allows entities who have engaged in past fraud and corruption to avoid administrative sanctions if they disclose all prior wrongdoing and satisfy standardized, non-negotiable terms and conditions. Lessons learned through the program will be applied to mitigate risks more effectively in future Bank Group-supported operations.

The reforms to the Bank Group's sanctions regime, which INT was significantly involved in designing, will help ensure uniform compliance with the highest ethical standards in all aspects of Bank-financed projects across the world. These standards will help level the playing field among companies and individuals involved in Bank Group-supported activities.

These two initiatives, which will greatly increase INT's ability to gain information about corrupt practices as they affect Bank Group activities and help the institution hold wrongdoers accountable, were approved by the Bank Group's Board at a meeting on August 1, 2006. At this session, the Board requested an external review of INT in order to ensure that the Department was operating as effectively as possible. This review, which was completed in September 2007, was conducted by a panel of experts headed by Paul Volcker, former Chairman of the United States Federal Reserve, who led the Independent Inquiry Committee into the United Nations Oil-for-Food Programme.

The Independent Review Panel has reviewed and evaluated several aspects of INT's work, including its mandate, authorities, policies, procedures, practices, independence, reporting lines, and oversight mechanisms. Throughout much of FY07, INT had to devote a significant amount of time and energy preparing for and responding to requests concerning this review.

As the Independent Review Panel's report was issued in fiscal year 2008, and the institution is currently reviewing its recommendations, this report does not reflect the findings of the review.

Sanctions-Related Activities

In fiscal year 2007, the Bank Group implemented a number of important changes to the institution's sanctions procedures that were approved by the Bank Group's Board in fiscal year 2004. One key modification was the replacement of the Bank Group's previous Sanctions Committee—comprised of only Bank Group staff—with a Sanctions Board that includes external parties.

Another was the creation of an "Evaluation and Suspension Officer" position for each of IBRD/IDA, IFC, MIGA and Bank Partial Risk Guarantees, who is to evaluate the evidence presented by INT and decide whether the case against the respondent has been substantiated.¹ The Evaluation and Suspension Officer also has the authority to temporarily suspend a private sector entity in a Sanctions proceeding pending final resolution of the case and to recommend a sanction to be imposed on a respondent, which sanction would become effective if the respondent elects not to contest the allegations against it by appealing to the Sanctions Board. The transition period between the Sanctions Committee and the new sanctioning bodies (consisting of the Sanctions Board and the Evaluation and Suspension Officers) took longer than expected, causing a temporary slowdown in the institution's ability to move sanctions proceedings forward.

Because of the delay in the implementation of the sanctions reform, the Department participated in only one sanctions hearing during the fiscal year, which was held under the previous Sanctions Committee procedures;² once the new sanctions system was in place, INT presented two new cases to the IBRD/IDA Evaluation and Suspension Officer in FY07, involving over 50 respondents.

In FY07, the previous Sanctions Committee provided its recommendation to the President for a final decision on a

significant case that had been heard by the Committee in FY06. On November 3, 2006, the Bank Group declared Lahmeyer International GmbH (Lahmeyer), a German company, ineligible to be awarded Bank-financed contracts for a period of seven years because of corrupt activities in connection with the Lesotho Highlands Water Project (LHWP). The Sanctions Committee recommended that the period of ineligibility may be reduced by four years if the Bank Group determines that the company has met specific compliance conditions and fully cooperated with the Bank Group in disclosing past sanctionable misconduct. This was the first time that the Sanctions Committee provided an incentive for private sector entities to reform their internal compliance process—a result that has been advocated by INT.

Joint IFI Anticorruption Task Force

FY07 was also a year that saw an unprecedented agreement among the International Financial Institutions (IFIs) to harmonize their approaches in investigating fraud and corruption in their lending operations. From FY06 into FY07, an IFI Task Force comprised of representatives of the African Development Bank, Asian Development Bank, European Bank for Reconstruction and Development, European Investment Bank, Inter-American Development Bank, International Monetary Fund, and the World Bank Group worked to develop a common approach to preventing and combating fraud and corruption in the activities and operations of their respective institutions. INT was appointed representative to the Task Force by the World Bank's President.

On September 17, 2006, the IFI Task Force Joint Framework was announced at the World Bank/IMF Annual Meetings in Singapore. This agreement represents a significant step forward, as it allows all IFIs to work according to the same set of standards and procedures. The Joint Framework provides new harmonized definitions of fraudulent and corrupt practices, principles and guidelines for investigations, and the promotion of information exchange across the institutions, among other measures.

¹ A case is "substantiated" when the evidence is *reasonably sufficient* to show that the alleged misconduct was committed; it is "unfounded" when the evidence is *reasonably sufficient* to show that the alleged misconduct did not occur; and it is "unsubstantiated" when the evidence is inconclusive or the allegation is unsupported, vague and ambiguous to warrant review.

² This case resulted in the debarment of two firms in early FY08 by the new Sanctions Board: Nestor Pharmaceuticals Ltd. (Nestor) and Pure Pharma Ltd. (Pure Pharma). Nestor was debarred for a period of three years and Pure Pharma was debarred for one year because of collusive practices in connection with the Bank-financed Reproductive and Child Health Project (RCH I) in India.

As a result of this agreement among the IFIs, the European Bank for Reconstruction and Development (EBRD) in February 2007 took the unprecedented step of debarbing Lahmeyer International based on INT's investigative findings and the World Bank's debarment of the firm. The ineligibility will apply until Lahmeyer has implemented an anticorruption program satisfactory to the EBRD. The EBRD's cross-debarment of Lahmeyer marked the first time a Multilateral Development Bank (MDB) took such mutual enforcement action, a move with the potential to significantly increase the deterrent effect of each MDB's sanctions process.

Detailed Implementation Reviews

Over the fiscal year, INT greatly increased its use of a proactive diagnostic tool called the Detailed Implementation Review, or DIR. The DIR was developed in 2001 to evaluate Bank-financed projects for indicators of fraud and corruption and to assess the robustness of the Bank Group's anticorruption control mechanisms to prevent, detect, and respond to them. Using forensic accounting and investigative techniques, a DIR examines a project's procurement, financial management and implementation processes for indicators of fraud and corruption. Although there are similarities, a DIR is not an INT investigation in the traditional sense.

INT completed two DIRs in FY07, in Kenya and Vietnam, and shared the findings with the Bank Group's Regional management for the respective countries and with the country governments themselves, in order to allow for learning opportunities. In addition to these completed DIRs—twice as many as any other fiscal year—INT undertook a DIR of five projects across the Bank Group's health portfolio in India. This DIR was the most complex and labor-intensive undertaking ever initiated within INT. The India DIR team involved the work of dozens of INT staff, consultants, and subject matter experts. It also involved the collection and detailed review of thousands of project procurement files; hundreds of complaints; and large volumes of Bank Group appraisal documents, audits, and operational reports. In addition, the DIR undertook visits

to more than one hundred field sites across multiple districts in five Indian states. A report with recommendations will be issued in fiscal year 2008.

Lessons Learned and Operational Advice

FY07 saw a marked increase in INT's sharing of "lessons learned" from past investigations, as well as in the provision of operational advice on projects under preparation. INT was asked by Task Teams to review numerous Project Appraisal Documents to assess whether they include appropriate risk mitigation measures. Among the success stories of FY07 is the support INT provided to the development of a risk assessment and mitigation plan for the Colombia La Guajira Water Project. The Task Team had developed a rigorous governance risk assessment and mitigation plan that received strong and explicit support by a wide range of Board members. INT also greatly stepped up the number of workshops and training sessions provided to operational colleagues on "red flags" and risk assessments receiving widely positive reviews from participants.

INT Investigative Activities During Fiscal Year 2007

- In fiscal year 2007, INT closed a total of 301 cases, including both external cases (fraud and corruption in Bank-financed projects) and internal cases (alleged staff misconduct), an increase of 60 cases from FY06;
- The total carryover of open cases into FY08 was 232 cases, a decrease of 62 cases (21 percent) from the carryover into FY07 and the lowest year-end total since FY02;
- INT's External Unit closed 149 cases in FY07, one more than in fiscal year 2006. Of these, 85 were fully investigated; the balance were either referred or closed as Low Priority;
- Of the fully investigated external cases, 33 (39 percent) were found to be substantiated; 44 (52 percent) unsubstantiated; and eight (9 percent) unfounded;

- INT's Internal Unit closed 152 cases—the highest number in four fiscal years and an increase of 63 percent over FY06;
- Of the 152 cases closed, 38 were referred to others in the institution for action and 114 were investigated;
- Of the 114 cases investigated, 51 (45 percent) were found to be substantiated, 38 (33 percent) unsubstantiated, and 25 (22 percent) unfounded;
- As a result of the substantiated investigations, the Human Resources Vice President terminated and/or barred from rehire 22 staff members and imposed other disciplinary measures on 22 additional staff members with sanctions ranging from salary reductions, demotions, and letters of reprimand to training. The number of substantiated cases includes three cases of sexual harassment, wherein the staff members were all terminated for such behavior;
- INT made nine referrals to borrower countries and other donors in FY07, but challenges remain;
- These exceptional numbers were achieved notwithstanding the resources that INT had to devote to the

Independent Review Panel, the India DIR and the collateral issues regarding the leadership crisis in the fourth quarter of this fiscal year.

Conclusion

While FY07 was a noteworthy year in the World Bank's work on governance and anticorruption, it was also a period that presented significant challenges to the institution. During the latter half of the fiscal year, the Bank Group underwent a leadership crisis that was extremely testing for the Bank Group's Board, its management, and its staff. This crisis highlighted the importance of maintaining the highest standards in governance, both within the organization and with our borrowers, in order for the institution to remain credible and viable going forward.

As the World Bank continues to deliver on its mission of helping reduce poverty and foster economic growth, so must the vital work of INT continue. The findings from external and internal investigations, DIRs, and the VDP all clearly point to the fact that an independent and effective investigative office, able to deliver on its mandate without interference, is critically important for the Bank Group's staff, shareholders, and project beneficiaries.