

**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

AAA	Analytic and Advisory Activities	IDA	International Development Association
ARCS	Audit Report Compliance System	IDF	Institutional Development Fund
AS2	PCAOB's Auditing Standard No. 2, <i>An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements</i>	IEG	Independent Evaluation Group
AS5	PCAOB's Auditing Standard No. 5, <i>An Audit of Internal Control Over Financial Reporting That Is Integrated With an Audit of Financial Statements</i>	IFI	International Financial Institution
BP	Bank Procedure	IL	Investment Lending
CAS	Country Assistance Strategy	IMF	International Monetary Fund
CGAC	Country Governance and Anti-Corruption	INT	Department of Institutional Integrity
CFAA	Country Financial Accountability Assessment	IOP	Implementation Oversight Panel
CFO	Chief Financial Officer	ISG	Information Solutions Group
CFP	Concessional Finance and Global Partnerships	ISR	Implementation Status and Results Report
CODE	Committee on Development Effectiveness of the Treadway Commission	IT	Information Technology
COSO	Commission of Sponsoring Organizations of the Treadway Commission	LEG	The Legal Vice Presidency
CPAR	Country Procurement Assessment Report/ Review	MD	Managing Director
CSR	Controller's, Strategy, & Resource Management	MIC	Middle Income Country
DIR	Detailed Implementation Review	OKSP	Operations and Knowledge Management Systems Program
DPL	Development Policy Lending	OP	Operational Policy
EAP	East Asia and Pacific Region	OPCFM	Financial Management Anchor OPCS
ECA	Europe and Central Asia Region	OPCPR	Procurement Policy and Services Group, OPCS
ECDM	Enterprise Content and Document Management	OPCRX	Results Secretariat Unit, OPCS
ELC	Entity Level Control	OPCS	Operations Policy and Country Systems
ESW	Economic and Sector Work	OPE	Overall Performance Evaluation
EU	European Union	OVP	Operational Vice-President
EXT	External Affairs	PAD	Project Appraisal Document
F&C	Fraud and Corruption	PCAOB	Public Company Accounting Oversight Board
FM	Financial Management	PEFA	Public Expenditure and Financial Accountability
FMPM	Financial Management Practices Manual	PR	Procurement
FMS	Financial Management System/ Financial Management Specialist	PREM	Poverty Reduction and Economic Management Network
FY	Fiscal Year	PRIMA	Portfolio and Risk Management
GAAP	Governance and Accountability Action Plans	PRSC	Poverty Assessment Support Credit / Poverty Reduction Support Credit
GAC	Governance and Anti-Corruption	PSB	Procurement Sector Board
GSD	General Service Department	PSU	Prevention Service Unit with INT
HD	Human Development	QA	Quality Assurance
HR	Human Resource	QAG	Quality Assurance Group
HRS	Human Resource Services	RAPMAN	The Financial Management Risk and Portfolio Management Model
IAD	Internal Auditing Department	ROW	Risk and Opportunity Workshop
IBRD	International Bank for Reconstruction and Development	RMS	Results Measurement System
ICFR	Internal Controls over Financial Reporting	RPM	Regional Procurement Manager
		SAP	Systems, Applications, and Products
		SAR	South Asia Region
		SRI	Salary Review Increase
		TTL	Task Team Leader
		US	United States
		USAID	United States Agency for International Development
		VP	Vice-President

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CONTENTS

Summary of Management’s Response iii

I. Overview and Follow-Up Management Action1

II. Methodology and Differences with IAD and IEG.....4

III. Management’s Assessment, Findings and Recommendations.....6

A. Management’s Overall Assessment6

B. Findings and Recommendations8

Annex 1. Management 5-Point Action Plan27

Annex 2. Control Failures by Process Module.....31

**REVIEW OF IDA INTERNAL CONTROLS:
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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.

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 Report¹ 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),² 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 exercise, thus breaking "new ground both in creating methodologies ... and in building strong factual knowledge about the Bank's internal controls framework."

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. **Management’s conclusion and findings.** Under the COSO internal controls framework,³ 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** of similar size and complexity but with less international involvement⁴ (emphasis added).

³ See the COSO report: “*Internal Controls—Integrated Framework*,” July 1994, page 21.

⁴ See the IEG 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*, AC2008-0147/CODE2008-0098, December 29, 2008, (the IEG Report), Volume III, Attachment 3, Statement of the Advisory Panel –Section 5.

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

⁵ Implementation Plan for Strengthening the World Bank Group Engagement on Governance and Anti-Corruption, OPCS September 28, 2007 (the “GAC Implementation Plan”).

⁶ Implementing the Recommendations of the Independent Panel Review of the World Bank Group Department of Institutional Integrity, Report of the Working Group, January 23, 2008 (Management’s Response), and Independent Panel Review of the World Bank Group Department of Institutional Integrity, September 13, 2007 (the “Volcker Panel Report”), paragraph 140.

⁷ Detailed Implementation Review India Health Sector 2006-2007 issued December 19, 2007, Department of Institutional Integrity. (the “India DIR”); and Implementing the Recommendations of the Independent Panel Review of the World Bank Group Department of Institutional Integrity, September 13, 2007, Report of the Working Group January 23, 2008 (Management’s Response to India DIR).

- ***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.***⁸ 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 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

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.

of these terms exist beyond the area of financial reporting, for which they were developed.⁹ 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).

9. 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”***¹⁰ (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.

10. 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 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

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)

first review of this nature).¹¹ 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.¹² 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.¹³

A. Management’s Overall Assessment

13. Under the COSO internal controls framework,¹⁴ 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

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 substantially 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 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.

¹⁴ See the COSO report: *“Internal Controls—Integrated Framework,” July 1994, page 21.*

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.
- 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:

- 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:

- 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.
- 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.

(e) Controls Over IT and AAA:

- Need to strengthen Information Technology (IT) controls relating to password sharing in SAP, privileged access, and Infrastructure Change Management.
- Need to improve timely accessibility of operational documents primarily relating to IL operations.
- 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.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.

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

¹⁵ See footnote 5, 6 and 7 for references to the GAC Implementation Plan, the Volcker Panel Report and India DIR.

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,¹⁶ 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.

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

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.

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,¹⁷ 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.

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

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.

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 controls 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,¹⁸ 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-

¹⁸ See the Volcker Panel Report, paragraph 140, footnote 6 above.

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,¹⁹ 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.

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 2007,²⁰ 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

¹⁹ See the GAC Implementation Plan, footnote 5 above.

²⁰ See the Volcker Panel Report, footnote 6 above.

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 bilaterals in June 2008), which 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). 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 2008.²¹ 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.
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

²¹ Strengthening the World Bank Group Engagement on Governance and Anti-Corruption, October 21, 2008 (the GAC Progress Report).

- 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 Borne 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

43. 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."²² 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;
 - 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

²² The Volcker Panel Report, page 2, footnote 6 above.

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;²³
 - 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 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

²³ Financial Management Sector: Approach to Governance and Anticorruption, Financial Management Sector Board, June 8, 2007.

- o 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.²⁴ 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 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.

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.

ANNEX 1. MANAGEMENT 5-POINT ACTION PLAN

<i>Problem identified</i>	<i>Summary of Corrective action (with concordance to more detailed recommendations in Management's Response)</i>	<i>Timeline</i>	<i>On point</i>
Inefficiencies and gaps in control framework governing investment lending (IL), in particular	I. Improve efficiency, effectiveness and controls for IL (paras 17, 18, 21 and 22 of Management Response)		
(i) non-rationalized “one-size-fits-all” requirements irrespective of risks,	1. Match the demands of the process to the level of risk and focus resources on higher risk projects.	June 2009	OPCS
(ii) over-focus on project preparation at the expense of implementation, and	2. Strengthen IL supervision by increasing resources, support and management oversight of project implementation.	June 2009	OPCS
(iii) outdated and complex policy framework.	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)		
Diffused management and staff accountability and responsibilities for operational quality.	<i>At the project level</i>		
Inadequate mechanisms for institutional risk identification, monitoring and management.	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
	<i>At the institutional level</i>		
	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 overlaps, (d) develop a dashboard of risk findings from assessment activities, and (e) over time, assess the quality and consistency of processes in place	First report to be prepared for FY09 (October 2009)	CSR

<i>Problem identified</i>	<i>Summary of Corrective action (with concordance to more detailed recommendations in Management's Response)</i>	<i>Timeline</i>	<i>On point</i>
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).		March 2009	OPCS, MDs
Inadequate integration of fraud and corruption issues (including lessons learned from INT work) into daily operations.	III. Better integrate fraud and corruption prevention into operations (paras 36- 42 of Management Response set out actions already in place; para 43 sets out recommended further actions summarized below)		
9. Establish clear responsibilities and accountabilities for addressing fraud and corruption in Bank operations (per new INT strategy).		June 2009	INT/RVPs
10. Establish appropriate protocols of cooperation between INT and the regions on handling allegations of fraud or corruption.		ongoing	INT/RVPs
11. Promote good practices across the Bank Group's work by:		ongoing	INT/OPCS
• Intensifying staff training;		ongoing	MDs/OVPs
• Increasing management signals on the importance of this issue		ongoing	INT
• Ensuring staff incentives (OPEs, promotions, rewards and visibility) are aligned with anti-corruption strategies.		ongoing	HR
• Propagating lessons learned, including through preventive services unit within INT.		has begun issuing core materials	INT
• Issuing guide/pamphlet on identifying and handling red flags relating to fraud and corruption during the project cycle.		done in December 2008	INT/OPCS
12. Improve tools such as smart project design (drawing on lessons learned), and more effective and more appropriately resourced supervision to help prevent, deter, detect and address fraud and corruption.		in progress (per GAC progress report)	MDs/OPCS/RVPs
13. Prepare and monitor specific action plans for following up on INT reports.		ongoing (small team created in OPCS)	OPCS/RVPs
14. Issue OPCS Guidance on addressing GAC issues in projects.		March 2009	OPCS

<i>Problem identified</i>	<i>Summary of Corrective action (with concordance to more detailed recommendations in Management's Response)</i>	<i>Timeline</i>	<i>On point</i>
Issues relating to fiduciary controls in the areas of financial management and procurement, particularly during project implementation.	IV. Tighten fiduciary controls (paras 45 (for PR) and 47 (for FM) of Management Response)		
	<i>In financial management (FM):</i>		
	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
	<i>In procurement (PR):</i>		
IT system vulnerability.	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 and fraud and corruption issues, (ii) document the already enhanced complaints handling; and (iii) mainstream a risk-based procurement assessment tool.	March 2009	OPCS
	V. Deficiencies in the IT and AAA areas (paras 49 (IT at entity-level), 51(IT at project level, and 54 (AAA) of Management response)		
	20. Prevent password sharing; and strengthen controls to further limit privileged access to system applications and to monitor changes to privileged accounts.	Ongoing	ISG/GSD

<i>Problem identified</i>	<i>Summary of Corrective action (with concordance to more detailed recommendations in Management's Response)</i>	<i>Timeline</i>	<i>On point</i>
Difficulties with timely accessibility to operational documents.	21. Improve accessibility of operational documents through automation (commencing with IL) and new electronic filing system.	June 2010 (as part of IL reform)	OPCS/ISG
Mismatch between existing AAA processes and controls and the wide range of AAA work.	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.	Complete review and discuss with CODE by June 2010	OPCS

ANNEX 2. CONTROL FAILURES BY PROCESS MODULE
(BASED ON COMPLIANCE TESTING CONDUCTED DURING PART IB)

<i>No.</i>	<i>Process Name</i>	<i>Tested</i>	<i>Operating</i>		<i>Description of Failed Control</i>
			<i>Effectively</i>	<i>Failed</i>	
1	IDA Allocation	4	4	–	
4	CAS Products	3	3	–	
5	SIL: Specific Investment Loan	9	9	–	
6	Project Changes	1	1	–	
7	DPL: Development Policy Lending	7	7	–	
8	Corporate Review (ROC/OC)	1	1	–	
9	Contractual Remedies	3	3	–	
10	Legal – IL	10	10	–	
11	Legal – DPL	8	8	–	
12	Financial Management – IL	4	2	2	<p>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 delegee occurred.</p> <p>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.</p>
13	Financial Management – DPL	2	2	–	
14	Procurement – IL	8	6	2	<p>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.</p> <p>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.</p>
15	Procurement – Complaints	2	1	1	Audit evidence on file was missing to indicate internal review and communication with the borrower in some cases.
16	Procurement – Non-Compliance	2	2	–	
17	LOA – IL	5	4	1	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.

<i>No.</i>	<i>Process Name</i>	<i>Tested</i>	<i>Operating</i>		<i>Description of Failed Control</i>
			<i>Effectively</i>	<i>Failed</i>	
18	LOA – DPL	6	6	–	
19	LOA – Application Review	5	5	–	
20	LOA – SC or Application Problem	1	1	–	
21	LOA – Amendment/Extension	2	2	–	
22	LOA – Refund Process	1	1	–	
23	LOA – Cancellation Process	2	2	–	
24	LOA – Suspensions	6	4	2	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.
25	LOA – Closing - Standard	2	1	1	Lack of evidence of Finance Officer clearances – documentation not made available/provided for testing.
26	LOA – Closing - Special	2	1	1	Housekeeping of the Credit information in LAS is not always performed in a timely manner.
27	QAG – Quality at Entry & Supervision	6	6	–	
28	Safeguards – IL	3	3	–	
30	Debt Reporting	3	3	–	
31	CPIA	4	4	–	
32	PCPI	3	3	–	
		115	105	10	
<i>Less items not included in testing:</i>					
29	Safeguards - Corporate Risk (QACU)	–	–	–	
Controls included in testing		115	105	10	