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INDEPENDENT EVALUATION GROUP

THE WORLD BANK

IDA INTERNAL CONTROLS

Evaluation of Management's Remediation Program

Report on Management's Implementation and IAD's Review of the Five-Point Action Plan

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2010
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Washington, D.C.

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ISBN-13: 978-1-60244-160-6

World Bank InfoShop
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Printed on Recycled Paper

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Abbreviations and Acronyms

AAA	Analytical and advisory activities
ARCS	Audit Reports Compliance System
BP	Bank Procedure
BPM	Business Process Module
CA	Corrective action
CAS	Country Assistance Strategy
CGAC	Country Governance and Anticorruption
CODE	Committee on Development Effectiveness
COSO	Committee of Sponsoring Organizations (established by the Treadway Commission)
DPL	Development Policy Loan
DIR	Detailed Implementation Review
ELCQ	Entity-Level Controls Questionnaire
ERM	Enterprise Risk Management
F&C	Fraud and corruption
FMPM	Financial Management Practices Manual
FPAP	Five-Point Action Plan
FM	Financial management
FY	Fiscal year
GAC	Governance and Anticorruption
HRS	Human Resources
IAD	Internal Audit Vice-Presidency
ICFR	Internal Controls over Financial Reporting
IDA	International Development Association
IEG	Independent Evaluation Group
IL	Investment lending
INT	Integrity Vice-Presidency
IRMR	Integrated Risk Management Report
IS	Implementation support
ISR	Implementation Status and Results Report
IT	Information technology
MD	Managing director
MLT	Matrix Leadership Team
MW	Material Weakness
OC	Operations Committee
OKSP	Operations and Knowledge Systems Program
OP	Operational Policy
OPCS	Operations Policy and Country Services
ORAF	Operational Risk Assessment Framework
PAD	Project Appraisal Document
PPR	Procurement Post-Review
PR	Procurement
P-RAMS	Procurement Risk Assessment and Management System
PRIMA II	Portfolio and Risk Management II
PRSC	Poverty Reduction Support Credit
QAG	Quality Assurance Group
RBL	Results-Based Lending
SD	Significant Deficiency
VP	Vice-president
VPU	Vice-presidential unit

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Foreword

In late 2008 IEG reported on the major exercise started in 2005 to provide an independent evaluation of IDA's internal controls. That exercise broke new ground within IDA and was the first exercise of its kind among the international development finance institutions. In concluding its report, IEG found that IDA's internal controls framework operated to a high standard overall. But there were also weaknesses, most importantly a material weakness (the only one identified by IEG) concerning the risk of fraud and corruption in operations supported by IDA funding.

In response to that evaluation, World Bank management prepared a Five-Point Action Plan (FPAP) designed to address and remedy the controls weaknesses uncovered by the review. At its request a follow-up exercise was undertaken with the same three-tier approach as for the earlier evaluation: A management report on the more narrow issue of the implementation of the FPAP, an IAD review and opinion, and an IEG evaluation.

The attached report concludes that management has achieved significant progress. IEG concludes that the FPAP was well designed and that the Action Plan has been substantially implemented. IEG also concurs with management's statement that the FPAP has strengthened IDA's internal controls and improved the overall control environment. The effectiveness of these new tools will, however, depend crucially on the extent and manner of their application and the strength of underlying staff and manager incentives to apply them effectively, and this will need to be tested over time.

Based on its extensive analysis, IEG finds that the Material Weakness can now be downgraded to a Significant Deficiency, with the needed follow up as indicated in the report. There has also been substantial progress in addressing all of the six earlier Significant Deficiencies, two of which can now be removed.

Weak governance remains a fundamental development challenge, and the Bank seeks to address this through various channels. This IEG report on internal IDA controls complements a broader IEG evaluation of the Bank's Governance and Anticorruption (GAC) initiative currently underway. While IEG's focused evaluation work on IDA controls now comes to an end, IEG recommends that management adopt a continuous process of monitoring, with selective in-depth reviews and periodic reporting.

Preface

In December 2008 the Independent Evaluation Group (IEG) completed its evaluation of internal controls for operations supported by the International Development Association (IDA). The evaluation had been undertaken as a result of the Board's endorsement of management commitments during the replenishment discussions for IDA14. The evaluation was based on an extensive management self-assessment and review by the Internal Audit Vice-Presidency (IAD).[1] While management, IAD, and IEG broadly agreed on the key issues identified, some differences of opinion arose as to materiality. IEG identified one Material Weakness (MW) in the fraud and corruption (F&C) controls. It also found six Significant Deficiencies (SDs) in other areas of controls, covering the currency of Operational Policies (OPs) and Bank Procedures (BPs), retention and accessibility of operational documents, generic weaknesses in fiduciary controls, management oversight and staff incentives, risk management, and information technology security.

Responding to the final IEG report, Bank management prepared a Five-Point Action Plan (FPAP) to address the identified controls weaknesses with specific remedial actions. Management has now presented a report that summarizes the content and achievements of the FPAP. Management asserts that it has made strong progress in implementing the FPAP and thus in addressing the MW and all of the SDs. Hence, it believes that the MW should no longer apply.

IAD has reviewed implementation of the FPAP in some detail and has issued an opinion on the extent to which the FPAP has addressed the identified controls weaknesses. Both the management and IAD reports are included as attachments to this report.

This report contains IEG's evaluation of the management report, together with IAD's review and opinion, and it examines the present status of the MW and SDs that were identified during the earlier evaluation of IDA's internal controls.

The IEG Team: The evaluation has been carried out under the supervision of Cheryl Gray (Director, IEGWB) by a core group of team members from the earlier controls evaluation consisting of Nils Fostvedt (Task Manager), Ian Hume (Consultant, Lead Author), and Rosemary Jellish (Consultant, Technical Advisor). IEG was assisted in the review of drafts of this report by two external peer reviewers, Dexter Peach and James Campbell, both formerly with the United States Government Accountability Office (GAO) and members of the core team for the earlier Main Evaluation.

Glossary

Audit standards	Criteria established by recognized accounting and audit bodies (in this case COSO and Audit Standard 5) for conducting audits and reviews of internal controls that offer a basis for providing assurance that controls are well designed and working as intended, and for identifying deficiencies, Significant Deficiencies, and Material Weaknesses.
Bottom-up approach	An approach management adopted in its assessment, which focused first on business processes at the transactions or operating level rather than beginning with a top-down, entity-level review.
Business Process Modules (BPMs)	The main business processes in which IDA is engaged in the course of its operations. There were 35 processes in all, covering IDA allocation; the Country Assistance Strategy (CAS) process; the main lending products (Specific Investment Loans, or SILs, and Development Policy Loans, or DPLs); and the fiduciary, contractual, safeguards, and quality assurance processes that support lending. Each business process is separately mapped and contains the key internal controls that are the subject of the review.
Business Process Template	A standardized assessment questionnaire and rating system IEG used to provide quality ratings of management's method and approach in identifying, describing, and mapping business processes, and of its method in assessing the effectiveness of control design and of control operation.
COSO Integrated Framework ("Internal Controls-Integrated Framework")	A framework of management principles (COSO components) in an organization that, when collectively operating as intended, will provide reasonable assurance as to the attainment of three key organizational goals (COSO objectives): reliable financial reporting, operational effectiveness and efficiency, and compliance with laws and regulations (in IDA's case, with its charter and internal policies and procedures). The COSO internal control components are: control environment, risk assessment, control activities, monitoring and learning, information, and communications.[1]
Deficiencies, Significant Deficiencies, Material Weaknesses	Design flaws, omissions, or noncompliant operation of controls discovered in the course of a controls review and denoting an ascending order of seriousness. The precise criteria by which the three categories of materiality are distinguished are explained in Annex B of the Part IA report. However, in operational reporting, unlike in financial reporting, there are no clear yardsticks by which to measure the materiality of a given weakness or set of weaknesses. Some judgment is required. The criteria to be used as a guide in making the needed judgments are those outlined in Annex B of the Part IA report.
Entity-level controls	Internal controls applicable to the entity as a whole (that is, "high-level" controls). Appropriate entity-level controls established and supported by management are critical to creating an *effective control environment.* Examples of entity-level controls include: effective systems and processes for performance management (performance measurement and results), human resource management (hiring, performance evaluation, and training), and ethics (code of conduct and ethics regulation). Examples also include the creation of control units with responsibilities that cut across the organization and exist for the purpose of monitoring the effective achievement of objectives or implementation of internal controls such as IEG, the Internal Audit Vice-Presidency (IAD), Quality Assurance Group (QAG), the Integrity Vice-Presidency (INT), and others.

Entity-Level Controls Questionnaire (ELCQ)	A questionnaire designed by management to be answered by managers in Bank operating units containing questions aimed at soliciting opinions about the effectiveness of controls. Where questions received "yes" responses the control in question was considered to be working, and where "no" or qualified responses were given, a weakness was considered to exist in the control.
Internal controls	Controls, individually or collectively, are structures within an organization that enable it to achieve its business objectives while addressing risk. Control instruments include the control framework (in IDA's case, the COSO framework), organizational checks and balances, published policies, and required procedures, among others.
Integrated Internal Controls Framework	The combined system of key controls contained in the *transactions-level* business processes and the *entity-level controls* that provide for governance of the organization.
Key control	A gateway and decision point in a given business process module through which a business transaction being processed must pass, usually involving key units and IDA staff. Effectiveness in design of these controls and the subsequent testing of the effectiveness of their operation is at the center of this review.
Non-compliances	Controls or control steps found during testing to be not operating in conformity with the design of the control. The concept of non-compliance includes both exceptions and deficiencies.
Process map	The flow chart that graphically depicts all steps in a business process module.
Review	The term used to refer to the entire process of this study. Management conducted an assessment, IAD conducted a review and opinion, and IEG conducted an evaluation. When referring to all three processes as an entity, the term used is "review."
Risk focal points	In adapting the COSO framework to meet its needs, Bank management has defined and added to the framework four key points of risk for the Bank Group's mission that are especially relevant to IDA. These are: strategy effectiveness, operational efficiency, financial soundness, and stakeholder support.
Walkthrough	An interactive interview and review of process documentation conducted by management with relevant teams of IDA staff knowledgeable in a particular business process and its associated controls, with a view to verifying that controls are designed in the way described and operate as intended.

ABOUT THIS REPORT

This specialized review focuses on the internal controls system under the Bank's version of the Committee of Sponsoring Organizations (COSO) internal controls framework. It does not deal with Bank or IDA operations, but it is quite clear that the strength of the underlying controls system is critical to the quality of those operations. The volume of funding that the Bank administers on behalf of IDA has grown sharply in recent years, as part of the Bank Group response to the global financial crisis. Given that certain weaknesses in controls uncovered by the 2008 review related to ensuring that IDA funds are used for the purposes intended, timely correction of those weaknesses was critically important.

The key purpose of this review, and a main point of focus for the IEG evaluation, is to provide IDA stakeholders with assurances that the controls system is robust and that the weaknesses have been effectively remedied. The focus of this report is confined to internal controls issues. It does not seek to evaluate related governance issues from an operational perspective, but IEG is currently engaged in an evaluation of the Governance and Anticorruption (GAC) program on which it will issue a separate report.

In writing this report IEG has faced a number of challenges: How to write a concise report, readable by an audience who may not all have been involved in the almost five year-long review process and who may not be familiar with the original causes and findings of controls weaknesses. Among these are: How to write a report that remains true to the professional requirements of the "controls and auditing" industry, which has a language of its own, while relating the materials to an audience that may not be familiar with that language. How to write a report that builds on the inputs from two other major reports (from management and the Internal Audit Vice-Presidency), neither of which organized the controls deficiencies exactly as had been done by IEG, as well as on an approach and method that IEG defined for itself.

It is likely that some readers may find the report difficult to absorb at a single reading because of its use of terms that are not in daily use in the institution. IEG decided that the best way to balance the conflicting needs was to adopt a three-tier approach: Most technical details are in the two Annexes (A and B); the main story line (still with a significant amount of technical detail) is in chapter 3; and the Evaluation Summary contains the main story line, focuses on results and conclusions, and uses a minimum of detail and technical terminology.

Evaluation Summary

IDA Internal Controls: Evaluation of Management's Remediation Program

IEG completed the last of its three reports for the review of IDA's internal controls in December 2008. Subsequently, and in response, World Bank management prepared a Five-Point Action Plan (FPAP) designed to address and remedy the controls weaknesses uncovered by the review—one Material Weakness and six Significant Deficiencies. Management now states that it has nearly completed the plan by implementing most of the 22 corrective actions, and it has presented a report in which it asserts that the FPAP has successfully remedied the Material Weakness and made significant progress in remediating the Significant Deficiencies.

In parallel, and in keeping with the practice used for the earlier review, the Internal Audit Vice-Presidency (IAD) has reviewed in some detail management's implementation of the FPAP and has issued a report with a generally positive and concurring opinion.

In the present report, IEG evaluates the FPAP implementation against the key findings and recommendations of its earlier internal controls evaluation, assessing and taking account of the IAD review and opinion, and on that basis reassesses the materiality of the identified controls weaknesses. This follow-up activity addresses earlier findings and is not a reevaluation of the overall IDA control framework. IEG concurs with management and IAD that significant progress has been made and finds that the previously identified Material Weakness can now be downgraded to a Significant Deficiency and two of the previously identified Significant Deficiencies can now be dropped.

Management Assessment

The FPAP was so framed because, to address the seven most critical control weaknesses per IEG (five per management and IAD), five steps were needed: improve the efficiency and effectiveness of controls for investment lending; strengthen risk management capacity, incentives, and accountability at the project and institutional levels; better integrate fraud and corruption prevention into operations; tighten fiduciary controls; and strengthen the role of information technology in risk management and improve processes for analytic and advisory activities.

In its assessment of the FPAP implementation, management describes progress in adopting remedies in each of the five areas. It states that IDA internal controls have been significantly strengthened and that the control environment (at both transaction and entity levels) has been fundamentally improved. Out of 22 corrective actions, management finds that 19 have been implemented and the remaining 3 are at an advanced stage of design and testing. The report describes risk-mitigating measures that are in place to offset the remedies that are not yet implemented and operational. It further states that the current status of these three remedies does not represent a significant risk for IDA operations.

IAD Review and Opinion

IAD has closely tracked FPAP implementation progress. In its final report, which incorporates findings from earlier reviews, IAD presents findings and conclusions from a detailed database of actions underlying the 22 corrective actions in the FPAP. This provides an auditable basis to check the validity and operational content of the corrective actions. The report also compiles a detailed record of management testing of certain reformed fiduciary controls that had failed tests during the earlier review.

The IAD report agrees with management that (as of September 2010) 19 out of the 22 corrective actions have been completed and implemented. The basis for this finding is that IAD regards a corrective action to be completed when the action has been designed, tested, and expected to be put into operation by September 30, 2010. The three corrective actions still in progress by this count are: CA 4 (consolidate multiple rules into clear principles to inform design and processing); CA 5 (review lines of accountability at the management and staff levels); and CA 22 (rationalize controls and processes governing analytic and advisory activities, and address compliance issues identified by IEG and the Quality Assurance Group).

IAD's Conclusion. "In IAD's opinion, Management's assertion that IDA internal controls have been significantly strengthened at both the transaction and entity levels is fairly stated. Management has substantially addressed the significant deficiencies identified in the 2008 Review through the implementation of the FPAP. The introduction of new tools and frameworks at the entity and transaction levels satisfactorily address the control weaknesses identified in the 2008 Review. Also, in the fiduciary and IT [information technology] areas, specific controls that were not operating effectively at the time of the 2008 Review have been corrected and are now operating effectively. IAD can give assurance that the design of all the new controls is robust. However, the operating effectiveness of most of these controls can be assessed only after a reasonable period of operation. IAD will cover operating effectiveness in the course of its regular assurance audits."

IEG's Evaluation

The Scope of the FPAP. In its 2008 report IEG described the origins of each weakness, in the case of the Material Weakness also including a chart that indicated the factors involved and their interactions. Management did not organize the remedies in its FPAP to match the matrix of IEG findings, so IEG had to cross-track some remedies from the FPAP back to the earlier IEG analyses. In doing so IEG found that all areas in the matrix of the Material Weakness and six Significant Deficiencies had been directly or indirectly addressed by the FPAP. IEG therefore concludes that the content and scope of the FPAP were broadly appropriate.

Management, in its description of the FPAP design, gave most emphasis to investment lending issues. This is understandable given the weaknesses in fiduciary and other project-level controls found by the review. Both the FPAP and the ongoing Governance and Anticorruption (GAC) implementation program also contain measures to strengthen country systems and address risk in development policy lending, but IEG finds that management could have usefully emphasized these topics more in describing its own program. This issue is important because improved country systems and institutions are needed to bolster controls and governance in Bank projects and programs under all types of lending.

Management's Implementation of the FPAP. Using the criterion that a corrective action must be in operation to be counted as implemented, IEG found that 17 of the 22 actions have been implemented. The difference between the IEG finding and that of management and IAD is not material given the progress so far and does not detract from the fact that the FPAP as a whole has been substantially implemented. Management has stated that it will put all these 5 remaining corrective actions into operation before the end of FY11. Further, IEG conducted a detailed examination of the 9 corrective actions that had several subcomponent actions (of which there were 49 in all) and found that virtually all subcomponents had been implemented.

Given that IEG finds the FPAP to be well designed and that implementation of the action plan has been almost fully completed, it has reconsidered the materiality of the controls weaknesses found in its earlier evaluation.

The Material Weakness. In its earlier evaluation IEG found that no controls explicitly addressed the risks of fraud and corruption in IDA operations. Given the potential for impairment of IDA's mission if such risks were not adequately addressed, IEG deemed this a Material Weakness in the controls system. Eleven factors contributed to this finding, including entity-level (institutional) factors, project-level (transactions) factors, and a lack of integrated risk management, which should link the entity and transactions level controls. For each of the 11 factors this current IEG report provides a detailed account of the nature of each issue found in the 2008 report; the corrective actions that directly or indirectly addressed that issue; the implementation status of the intended remedy; and the possible impact the corrective action could have on the controls in question. The report also offers IEG's conclusion regarding the contribution of the remedies to alleviating or removing the Material Weakness.

IEG arrived at a consolidated conclusion regarding remediation of the Material Weakness by evaluating the combined impact of all remedies together. It is evident that the FPAP was designed to address the three key areas—entity-level factors, linking factors (risk management), and project level (transactions) factors that IEG identified. All have been found to be appropriately designed and substantially implemented, although greater emphasis could usefully have been given to the need to strengthen country systems.

IEG therefore concurs with management's assertion that the FPAP has significantly strengthened IDA's internal controls and improved the overall control environment. Management of institutional risk has been strengthened by a shift to a risk-based approach for investment lending operations, by new processes of quarterly and annual risk reporting to the Board that explicitly address fraud and corruption risk facing the Bank, and by providing support through tools and guidance to address fraud and corruption risk at the project level. The Country GAC (CGAC) has been designed *inter alia* to address fraud and corruption risks at the country level. The effectiveness of these new tools will depend on the extent and the manner of their application, and management will need to test them over time. However, their existence represents an enhancement of the controls to address fraud and corruption risk in IDA operations in a way that responds substantially to the Material Weakness finding. Based on these considerations, IEG finds that the Material Weakness can now be downgraded to a Significant Deficiency.

The three elements still to be implemented in the control environment (definition of responsibilities and accountabilities, management oversight, and human resources policies) are important, and continued attention is needed to the aspects of accountability, management oversight, and human resource policies to ensure adequate staff incentives to address fraud and corruption. Management and staff incentives and behavioral factors were important to the Material Weakness finding. Behavioral factors and incentives will continue to be important in strengthening the controls and addressing the ongoing Significant Deficiency in this critical area, because the effectiveness of the new tools that have been in put in place will ultimately be determined by how they are applied by the operations staff.

The Significant Deficiencies. IEG employed an organizing device similar to that used for the Material Weakness, namely each corrective action relevant to addressing each of the six Significant Deficiencies has been identified, described, and evaluated. In this way IEG has now evaluated the extent to which each Significant Deficiency has been addressed by corrective actions and the extent to which the resulting improvement in controls for some of the Significant Deficiencies (management oversight, fiduciary controls, and risk management processes) may also have contributed to alleviation of the Material Weakness.

Overall Scorecard. Following its analysis of how the FPAP has addressed the Material Weakness and the six Significant Deficiencies, IEG finds that there has been substantial progress in addressing all of the Significant Deficiencies. IEG concludes on this basis that the overall scorecard of remedies has led to the results summarized in the table below: The Material Weakness should be downgraded to a Significant Deficiency, and, of the six original Significant Deficiencies, two (which relate to generic weaknesses in fiduciary controls and certain weaknesses in information technology controls) should be removed and four should remain pending implementation and testing of stated actions. Thus, the result of the FPAP so far has been to move from one Material Weakness and six Significant Deficiencies to five ongoing Significant Deficiencies: controls over fraud and corruption; currency of OP/BPs; retention and accessibility of operational documents; management oversight and staff incentives; and risk management.

Summary of IEG Findings Relating to the Material Weakness and Significant Deficiencies

Control weakness finding	*IEG finding on the status of the MW/SD*	*Actions pending*	*Expected completion date*
Material Weakness:			
In controls to address risk of fraud and corruption (F&C) in IDA operations	Downgraded to Significant Deficiency	Continued testing of key controls	Recommend testing by July 2012
Significant Deficiencies:			
SD 1: Currency of Bank OP/BPs	Remains Significant Deficiency	OP/PB 11.00, OP/BP on reformed investment lending controls, and compliance of analytical and advisory activities (AAA)	June 2011
SD 2: Retention and accessibility of operations documents	Remains Significant Deficiency	Rollout and testing of the Operations and Knowledge Systems Program (OKSP)	Rollout, October 2010, recommend testing by October 2012
SD 3: Generic weaknesses in fiduciary controls	Removed	Fraud and corruption aspects of fiduciary controls to be tested under the Material Weakness cluster	See F&C controls
SD 4: Management oversight and staff incentives	Remains Significant Deficiency	Completion of Matrix Leadership Team (MLT) work on sector managers; continued testing of key controls	Completion, December 2010, recommend testing by December 2012
SD 5: Risk management at Bank and project levels	Remains Significant Deficiency	Testing of operability of new fraud and corruption controls	Recommend testing by July 2012
SD 6: Lack of information technology security in certain areas	Removed	--	

Overall Summary and Recommendations

IEG agrees with management and IAD that the extensive review of internal controls has been a positive experience and has strengthened IDA and the Bank. Management should periodically conduct such reviews, with modifications to fit the circumstances. IEG takes note of the next steps that management described in its report—to emphasize the monitoring of key aspects of the Bank's quality assurance, financial management, and procurement systems and to strengthen still further the Bank's risk management systems—and makes the following recommendations:

On the five Significant Deficiencies:

- **Management should continue to address the remaining five Significant Deficiencies proactively and should revisit their status when significant further improvements have been made or when there are sufficient lessons of experience.**
    - ***Controls to address fraud and corruption in Bank/IDA operations:*** Within two years of the ongoing rollout of the new risk-based investment lending system, management should review experience under the new system. This should include selected and

indicative tests of the operational effectiveness (that is, widespread usage and credible applications) of the new tools to address fraud and corruption risks in Bank operations. It should also include, as IEG recommended in its 2008 report, a parallel review of how country systems have been strengthened to address risks—including fiduciary and fraud and corruption risks—in development policy lending and investment loans that provide significant operations and management financing—both of which may require more in-depth management attention.

- ***Currency of OP/BPs:*** A number of OP/BPs are in various stages of revision. Management should continue or accelerate this progress to improve the currency of the OP/BPs in order to have a body of policy documents to guide staff. In particular, management has almost finalized OP/BP 11.00 on procurement, is developing a framework for new policy guidance on investment lending to conform to the new tools that are being rolled out, and is considering guidance on controls and processes for analytic and advisory activities.
- ***Retention and accessibility of documentation:*** In about two years, management should review experience with the operational use of the Project Portal and WBDocs, with selective and indicative testing of a few key controls to assess their effectiveness in a significant sample of projects processed under the new risk-based investment lending system.
- ***Management oversight and staff incentives:*** The earlier Entity-Level Controls Questionnaire (ELCQ) proved useful for assessing controls-related attitudes and problems Bank managers face. Assuming that management will periodically undertake both internal and external controls reviews, IEG recommends that the ELCQ tool also be applied periodically (every three to four years), suitably updated but with continuity in the questions so as to test the evolution of management and staff attitudes to addressing fraud and corruption risk in Bank operations.
- ***Risk management:*** Management has taken steps to improve risk management, including incorporation of the COSO Enterprise Risk Management into the new integrated risk management framework, adoption of the annual Integrated Risk Management Report (IRMR) and quarterly risk reports to the Board, and establishment of the risk-based approach to investment lending and the accompanying instruments and tools. Over the coming two years, and as part of testing the effectiveness of these tools, management should establish the extent to which the tools have been applied to enhance integrated risk awareness. For example, what trends emerge in the fraud and corruption risks tracked in the IRMR? What is the frequency and quality of treatment of fraud and corruption risks in Country Assistance Strategy papers for high-risk countries, and what links exist between fraud and corruption risks expressed in the Country Assistance Strategies and those expressed in the Operational Risk Assessment Framework and Project Appraisal Document in project design?

On future internal controls reviews:

- **Monitoring of internal controls should be a continuous process.** As part of this process, management should undertake in-depth reviews when continuous monitoring highlights a problem in a particular area. High-risk areas in particular should be reviewed periodically. And when changes occur—new functions are added, reorganizations are completed, or new risks emerge, for example—those new areas should be reviewed. Risks should always be matched by explicit controls. The new Integrated Risk Report should be used to detect and report on new risks as well as on the status of existing controls based on the results of continuous monitoring efforts and any in-depth reviews of controls performed. The results of these periodic reviews should, as appropriate, be shared with the Board and other IDA stakeholders.

Management Response

I. Background

1. In the IDA14 Replenishment Report,[1] Management committed to carry out a comprehensive independent review of internal controls[2] over IDA operations. This exercise broke new ground and was the first of its kind among international development institutions. Each phase of this assessment included three tiers—Management's self-assessment, a review by the Internal Audit Vice Presidency (IAD); and an independent evaluation of both by the Independent Evaluation Group (IEG), reviewed by IEG's International Advisory Panel (IAP). At the completion of the initial 2008 Review,[3] all three parties reached a similar conclusion regarding the overall adequacy of the internal controls over IDA operations, summarized by IEG in the following terms: "with some important qualifications, IDA's internal control framework operates to a high standard overall, giving reasonable assurance that the controls operate effectively." IEG's International Advisory Panel stated that the results of this exercise reflected a high level of effectiveness in IDA, compared to other organizations. The three parties also concurred on the nature of the few deficiencies uncovered by the 2008 Review, although they had somewhat different views as to their materiality. Management then designed and carried out a Five-Point Action Plan (FPAP) to address these deficiencies, which was published in 2009.[4] The implementation of the FPAP has subsequently been evaluated using the same three-tier approach used in the initial review.

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1 See *Report from the Executive Directors of the International Development Association to the Board of Governors, Additions to IDA Resources: Fourteenth Replenishment, Working Together to Achieve the Millennium Development Goals* (approved by the Executive Directors of IDA on March 10, 2006), paragraph 39, under the Disclosure bullet.

2 This review used the rigorous COSO (Committee of Sponsoring Organizations of the Treadway Commission) framework and methodology, which establishes "a common definition of internal controls, standards, and criteria against which companies and organizations can assess their control systems." Control systems encompass all measures to make sure that money is used efficiently and for its intended purpose, including procurement processes, supervision mechanisms and procedures and measures to prevent fraud and corruption.

3 See *Review of IDA Internal Controls: An Evaluation of Management's Assessment and the IAD Review: Report on the Completion of Part II* (AC2008-0147; CODE2008-0098), December 29, 2008, referred to as "the 2008 Review" or "the Review."

4 See *Review of IDA Internal Controls—Management Response and Updated Summary of Management's Overall Assessment* (AC2008-0154/1; CODE2008-0101/1), February 25, 2009.

2. IEG's September 2010 report[5] summarizes IEG's evaluation of the implementation of the FPAP, based on Management's self-evaluation and IAD's review and opinion, both attached to IEG's evaluation, and IEG's own review of facts. It offers IEG's assessment of the completion of the 22 Corrective Actions (CAs) that went into the FPAP and maps these 22 CAs to the definitions of the material weakness (MW) and six significant deficiencies (SDs) that IEG had identified in its original evaluation of IDA's internal controls. As a result of this evaluation, IEG has reached the conclusion that the FPAP "has been substantially implemented … Virtually all multi-component CAs have been implemented, and the CAs still under implementation are in their final stages. There are also credible mitigating factors in place to offset any risks to IDA stemming from the fact that these CAs have not yet been fully implemented. … [T]he FPAP has significantly strengthened IDA's internal controls and improved the overall control environment; …the Material Weakness can now be downgraded to a Significant Deficiency; … Management should continue to address the remaining five Significant Deficiencies proactively and should revisit their status when significant further improvements have been made or when there are sufficient lessons of experience."

II. Management Comments

3. The review of IDA's internal controls has been a value-adding exercise that has strengthened IDA. Management took the findings of the 2008 Review seriously and has considered the review as a timely opportunity to take an in-depth look at the systems of control over IDA operations and improve them further. Through the COSO methodology, IDA Management has improved its knowledge of the standards, systems, protocols, incentives, and behaviors that can help to detect and assess risks affecting the effectiveness of its operations—including those associated with fraud and corruption (F&C)—and, as a result, it is in a much better position to prevent or mitigate such risks going forward. Looking strategically ahead, there is now better awareness throughout the organization—at the entity as well as the transaction level—of the importance of adequate risk identification and management. There is also better awareness of the areas for further improvement, on which actions are already in progress. Overall, over the past four years, collaboration with IEG and IAD on this review has been close, probing and constructive.

4. Management welcomes IEG's conclusion and recommendations. It especially welcomes the downgrading of the Material Weakness on F&C. This represents an acknowledgment of the substantial progress that has been made in strengthening the controls on F&C—including through the implementation of the recommendations of the Volcker panel, the improvement of the operational relevance and follow-up on INT recommendations, the design and implementation of the Governance and Anti-Corruption (GAC) strategy and establishment of the GAC Council and Secretariat, the sanctions reform, and improved fiduciary attention and controls across all Bank instruments and products.

[5] *IDA Internal Controls – Evaluation of Management's Remediation Program – Report on Management's Implementation and IAD's Review of the Five-Point Action Plan* (AC2010-0098), September 14, 2010.

5. Management does have a difference in view concerning the remaining classification of "Significant Deficiencies." Management finds that this classification does not accurately reflect the substantial improvement in IDA's controls that IEG's evaluation found. In other words, taken out of context, the conclusion that there are still "five ongoing Significant Deficiencies" may strike the reader as more negative than what in actual fact is IEG's overall conclusion. However, Management understands the intention of maintaining a metric that—even if lacking the granularity it would prefer—is consistent with the 2008 evaluation, and appreciates the effort made in the IEG report to place this classification in a more informative context, i.e., explaining that there has been "substantial progress in addressing all of the Significant Deficiencies," asserting that "the incomplete corrective actions are all near implementation," and acknowledging the existence of credible mitigating measures for corrective actions that IEG considers to be not yet fully implemented.

6. A slight difference in the assessment of implementation of the corrective actions emerges from differences between the definitions of "implementation" used by Management and IEG. Management states that "the term *implemented* is used to mean that an action has been designed, tested, and expected to be put into operation (process for roll-out initiated) by September 30, 2010."[6] In contrast, in its evaluation, IEG uses the criterion that a corrective action must be actually rolled out (and, implicitly, should have some experience of implementation to demonstrate the operational effectiveness of the action). In addition, Management sees significant overlap—even duplication—between the pending actions listed under the remaining Significant Deficiency on F&C and those under SD5, both of which entail the further monitoring of the implementation effectiveness of new F&C controls already in place. However, these differences in definitions boil down to relatively little differences in the overall favorable conclusion of the evaluation.

7. Finally, as the IEG report indicates, in its design of the FPAP, Management deliberately emphasized investment lending issues, consistent with the findings of the 2008 review. IEG believes that Management "could have usefully emphasized [country systems and country-level instruments] more in describing its own program." Management fully agrees with IEG that country systems and institutions are essential to ensure transparent and effective governance of resources, including those resulting from Bank support. As stated in the Director General's memorandum to the Executive Directors and the President, "weak governance remains a fundamental development challenge, and the Bank seeks to address this through various channels." Evidence of Bank programs and operations that aim to improve countries' ability to address governance and F&C issues is solid and growing, though there is always, of course, room for further improvement. However, Management considered important that the scope of its final report on IDA Internal Controls maintain its close alignment with the core subject of the review and its commitments under the FPAP.

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[6] IAD's definition of an *implemented* action is "an action [that] has been designed and tested, and is expected to be put into operation by September 30, 2010. See *Review of Management's Implementation of the IDA Internal Controls Five-Point Action Plan*, IAD Report No. IBRD FY11-03, September 8, 2010, included as Annex B, Attachment 2 in *IDA Internal Controls – Evaluation of Management's Remediation Program – Report on Management's Implementation and IAD's Review of the Five-Point Action Plan* (AC2010-0098), September 14, 2010.

III. IEG Recommendations

8. Concurring with the final statement in the memorandum of the Director General that "IEG's focused evaluation work on IDA controls now comes to an end," Management considers that the IDA Internal Controls review initiated during the IDA 14 period now comes to an end. As a result of this exercise, the remediation plan has been substantially completed and IDA internal controls have been significantly strengthened. Intense activity and attention to internal controls, including F&C, will continue. Management will ensure timely completion of the pending corrective actions under its FPAP during FY11. It will also continue to seek ways to improve the quality of IDA's internal controls and to adapt them to evolving country and global development conditions and knowledge. Finally, Management is committed to a continuous process of monitoring, informed by the lessons of this review of IDA Internal Controls, with periodic reporting through its regular communications with the Board. This is consistent with the IEG recommendations summarized in the Management Action Record that follows.

IDA Internal Controls: Evaluation of Management's Remediation Program

Management Action Record

	IEG Recommendations	Management Response
1	Management should continue to address the remaining five Significant Deficiencies proactively and should revisit their status when significant further improvements have been made or when there are sufficient lessons of experience.	
1a	***Controls to address fraud and corruption in Bank/IDA operations:*** Within two years of the ongoing rollout of the new risk-based investment lending system, management should review experience under the new system. This should include selected and indicative tests of the operational effectiveness (that is, widespread usage and credible applications) of the new tools to address fraud and corruption risks in Bank operations. It should also include, as IEG recommended in its 2008 report, a parallel review of how country systems have been strengthened to address risks—including fiduciary and fraud and corruption risks—in development policy lending, which may be an area requiring more in-depth management attention.	**Agree** • During FY12, IDA Management will complete an update on the implementation of the Investment Lending Reform, including selected indicators of the operational effectiveness of the new tools to identify and address risks of F&C in the Bank's Investment Lending operations. • Upcoming DPL retrospective reviews will report on efforts to strengthen national fiduciary systems (including F&C) as part of Bank-financed DPLs. • A progress report to the Board on the Use of Country Systems, including updates on the Safeguards and Procurement Pilots, is scheduled for November 2010, with subsequent updates as recommended by the Executive Directors.
1b	***Currency of OP/BPs:*** A number of OP/BPs are in various stages of revision. Management should continue or accelerate this progress to improve the currency of the OP/BPs in order to have a body of policy documents to guide staff. In particular, management has almost finalized OP/BP 11.0 on procurement, is developing a framework for new policy guidance on investment lending to conform to the new tools that are being rolled out, and is considering guidance on controls and processes for analytic and advisory activities.	**Ongoing/Agree** • The Procurement and Consultants Guidelines will be discussed by the Board in October 2010, and finalized shortly thereafter. Any consequential changes to OP/BP 11.00 will then be made, and the final OP/BP will then be submitted to the Board for information. • A final proposal for a consolidated and consistent body of Operational Policies for IL will be completed by end-FY11. There will be consultation with the Executive Directors during the next months. • Phase I of the AAA review—including clarification of product lines and processes, improved guidance to staff, and development of a programmatic AAA product—will be completed by December

	IEG Recommendations	Management Response
		2010, followed by Phase II during the remainder of FY11.
1c	***Retention and accessibility of documentation***: In about two years, management should review experience with the operational use of the Project Portal and WBDocs, with selective and indicative testing of a few key controls to assess their effectiveness in a significant sample of projects processed under the new risk-based investment lending system.	**Agree** A review of the operational effectiveness of the Project Portal and WBDocs will be undertaken before the end of CY2012.
1d	***Management oversight and staff incentives***: The earlier Entity-Level Controls Questionnaire (ELCQ) proved useful for assessing controls-related attitudes and problems Bank managers face. Assuming that management will periodically undertake both internal and external controls reviews, IEG recommends that the ELCQ tool also be applied periodically (every three to four years), suitably updated but with continuity in the questions so as to test the evolution of management and staff attitudes to addressing fraud and corruption risk in Bank operations.	**Ongoing/Agree** • Management already conducts an annual entity-level controls evaluation to support its assertion on internal controls over financial reporting. • From FY12, Management plans to supplement this review every three to four years by conducting an entity-level review of controls focused on Bank operations using an updated entity-level controls questionnaire.
1e	***Risk management:*** Management has taken steps to improve risk management including incorporation of the COSO Enterprise Risk Management into the new integrated risk management framework, adoption of the annual Integrated Risk Management Report (IRMR) and quarterly risk reports to the Board, and establishment of the risk-based approach to investment lending and the accompanying instruments and tools. Over the coming two years, and as part of testing the effectiveness of these tools, management should establish the extent to which the tools have been applied to enhance integrated risk awareness. For example, what trends emerge in the fraud and corruption risks tracked in the IRMR? What is the frequency and quality of treatment of fraud and corruption risks in Country Assistance Strategy papers for high-risk countries, and what links exist between fraud and corruption risks expressed in the Country Assistance Strategies and those	**Ongoing/Agree** • As part of the FY12 IRMR, Management will provide an update of the impact of the new processes and tools in enhancing integrated risk awareness. This update will draw on several sources that will be in place, including: (a) the DPL retrospectives, (b) Annual Reports on FM and Procurement, (c) reports from the INT operational follow-up database, and (d) the Investment lending Reform update.

	IEG Recommendations	Management Response
	expressed in the Operational Risk Assessment Framework and Project Appraisal Document in project design?	
2	***Monitoring of internal controls should be a continuous process.*** As part of this process, management should undertake in-depth reviews when continuous monitoring highlights a problem in a particular area. High-risk areas, in particular, should be reviewed periodically. And when changes occur—new functions are added, reorganizations are completed, or new risks emerge, for example—those new areas should be reviewed. Risks should always be matched by explicit controls. The new Integrated Risk Report should be used to detect and report on new risks as well as on the status of existing controls based on the results of continuous monitoring efforts and any in-depth reviews of controls performed. The results of these periodic reviews should, as appropriate, be shared with the Board and other IDA stakeholders.	**Ongoing/Agree** In coordination with IAD, Management will use the above-mentioned monitoring processes to identify any areas that may require further in-depth review. Focused assessments will be performed as part of the entities' regular work programs and reported through their regular communications with the Board and via the annual IRMR.

Summary of Audit Committee Discussion

The findings of the final evaluation of the review of IDA internal controls, along with the outcome of IAD's review and Management's report on implementation of the Five-Point Action Plan (FPAP) were presented to the Committee by the Independent Evaluation Group (IEG), Internal Auditing (IAD) and Bank/IDA Management. The presentation clarified that the comprehensive review of IDA's internal control system was the first and only such effort undertaken by any international development institution. The internal control systems for IDA were found from the beginning of the exercise to be on the whole functioning well and operating at a high standard, with some significant deficiencies and, as identified in IEG's evaluation, one material weakness that needed to be addressed. Management's response to IEG's original evaluation, embodied in the FPAP, has been quick and effective, though some corrective actions have not yet been fully implemented. Management assured the Committee that IDA's control system has been strengthened through the completion of the review of internal controls and the implementation of a Five-Point Action Plan (FPAP). IEG reported that Management's FPAP had substantially addressed the one material weakness and six significant deficiencies identified in IEG's initial evaluation. The material weakness, related to controls over fraud and corruption, was reclassified as a significant deficiency following corrective action by Management. Of the original list of control weaknesses identified by IEG, corrective action remains to be completed in three areas, as described in IEG's final evaluation report. IEG and IAD noted that some of the corrective actions can at this stage only be evaluated for their design and early stage implementation: the effectiveness of the corrective actions and the system of internal controls will need to be ensured and tested over time. IEG emphasized the importance of monitoring internal controls on an ongoing basis with reporting to the governing body. IEG's evaluation also noted that issues of staff incentives, resources, and accountability will determine the ultimate effectiveness of the internal control framework and will need to be considered carefully in follow-up evaluations. IEG, IAD, and management proposed and the Committee agreed that follow-up and further monitoring would be achieved through the regular work programs of the various entities, primarily the Bank/IDA integrated risk management process and IAD's risk-based program of ongoing audit work. IEG's role in the review of internal controls has now come to an end with the completion of this final evaluation.

The Committee expressed its appreciation for the work of IEG, IAD, and Management in completing the review of internal controls and their presentation of the final reports, and for the oral presentations. In response to questions from the Committee, IEG said it was generally satisfied with the IDA internal control system, with the caveat that some measures, though well-designed, are still being implemented. Members were generally satisfied with the remedial measures put in place in the context of the FPAP, but urged careful ongoing attention to remaining implementation and monitoring. Members sought clarification of the dissemination of the final evaluation results and the communications strategy vis à vis IDA Deputies and the public. Other questions and comments from members and speakers related to: (i) the current assessment of the internal control environment for IDA; (ii) further review of the effectiveness of corrective actions taken; (iii) the linkage between the review of IDA internal controls and ongoing reform initiatives; (iv) how the "soft" or cultural aspects of internal controls can be best addressed; (v) controls over fraud and corruption risk; (vi) budget resources and future internal control efforts; and (vii) the matrix management system.

Introduction

Evaluation Essentials

- IEG reported in 2008 on IDA's internal controls
- Management, in response, has been implementing a Five-Point Action Plan
- This report reviews implementation of the Action Plan
- It also reassesses the Material Weakness and six Significant Deficiencies identified in the IEG evaluation

Background and Recapitulation

1.1 At the time of the IDA14 replenishment, based on a request from the IDA Deputies, the World Bank's Board of Executive Directors agreed to an independent evaluation by IEG of IDA's internal controls. The task was organized to include a management self-assessment, a review of that self-evaluation by the Internal Audit Vice-Presidency (IAD), and an evaluation by IEG of both the self-assessment and the review, as well as of the underlying control issues. IEG completed its evaluation (referred to in this report as the Main Evaluation) in December 2008. Management subsequently requested that IEG evaluate the implementation of its resulting Five-Point Action Plan (FPAP) using the same principles and methods as the Main Evaluation.

1.2 The key milestones for the Main Evaluation were as follows: Management divided its self-assessment into two parts—Part I dealt with transactions-level controls, and Part II examined entity-level controls. Part I was split into two segments, Part IA dealt with the mapping and design of controls, and Part IB covered the testing of the controls for compliance and operational effectiveness. Reports were completed by all three reviewing parties on Part IA in fall 2006 (the IEG report was dated October 18, 2006) and on Part IB in June 2007 (the IEG report was dated June 22). Following this all parties undertook their respective examination of entity-level controls under Part II, and consolidated, comprehensive reports integrating Parts I and II were completed in December 2008 (IEG's five-volume report, including the two previous reports, being sent to the Board in late December and disclosed in April 2009).[1]

1.3 **Status of the Review.** The findings of the final 2008 IEG report gave a substantive picture—the first such picture in the history of the World Bank Group or any international financial institution—of the design and operation of the overall framework of controls that govern IDA operations. It showed the strength of the whole framework, as well as some weaknesses in certain areas, which required remedies to be introduced by management. To this end, management presented in its response to the final IEG report a remediation program (the FPAP). The present report again involves separate reports from each of the reviewing parties and takes stock of the completion of management's implementation of the FPAP.

1.4 **Findings of the Main Evaluation.** The principal finding of IEG's Main Evaluation, a finding that was shared by both management and IAD, was that the overall framework of controls had been designed well and was found to operate at a high level of effectiveness, with some important weaknesses concentrated in a few areas. Based on the extensive empirical testing (in Part IB) of key controls at the transactions level, these were found to be operating at a level in the 93rd percentile of effectiveness, while similar testing at the entity level showed that entity-level controls operated with effectiveness pass rates at the 92nd to 95th percentile, depending on how these were measured. For a global agency as large and complex as the Bank, and given that this was the first such review undertaken in the institution, these results were reassuring.

The principal finding of IEG's earlier report was that the overall framework of controls had been designed well and was operating at a high level of effectiveness, with some important weaknesses concentrated in a few areas

1.5 At the same time, there were a few significant weaknesses in certain parts of the overall controls framework.[2] Management, IAD, and IEG broadly agreed on the location and types of these weaknesses, although with some differences of opinion regarding their materiality. IEG identified one Material Weakness (MW) in the controls to address risk of fraud and corruption (F&C) in operations supported by IDA, and six Significant Deficiencies (SDs) in controls related to:

1. a need to maintain the currency of the Bank's Operational Policies and Bank Procedures (OPs/BPs);
2. a need for improved document retention and accessibility;
3. generic weaknesses in controls over financial management and procurement processes (from Part I of the evaluation);
4. a need for improved management oversight of project processing and supervision, coupled with improved staff incentive structures and performance accountability;
5. a need to improve risk management, including inserting specific F&C risk factors into the Bank's existing tool for assessing entity-level risk (the Risk Scan), and in integrating risk treatment from the entity level to the activity level; and
6. a need for greater information technology (IT) security in some areas.

1.6 The differences in the materiality of controls over F&C risks between management, IAD, and IEG in the 2008 evaluation arose largely from the following different perspectives: IEG judged the weakness in controls to be a Material Weakness because of ***significant risks unmatched by specific controls***; management regarded this to be only a Significant Deficiency, because ***they were in process of installing such controls.*** IAD opined that the identified Significant Deficiencies, in combination, could represent a Material Weakness unless remediated in a timely manner and effectively monitored on an ongoing basis. These differences in perspective were not operationally significant since they all implied that reconsideration of the materiality of the weaknesses in the controls in question would depend on the extent to which new controls would be put in place and would actually be applied operationally.

Management responded to the findings of the Main Evaluation with a Five-Point Action Plan

1.7 **Management's Five-Point Action Plan.** Management responded to this group of findings by preparing an extensive program to address the identified controls weaknesses. In all the program consisted of 22 corrective actions (CAs), grouped into the five areas:[3]

- Improve investment lending by rationalizing policies, processes, and controls; strengthening supervision; and focusing resources on high-risk projects.
- Enhance 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 Governance and Anticorruption (GAC) strategy at country and project levels, continued integration of the work of the Integrity Vice-Presidency (INT), enhanced training, and "smart project design."
- Tighten financial management and procurement controls to incorporate risk management and F&C issues and remedy the fiduciary controls that did not pass compliance testing during Part IB of the controls evaluation.
- Strengthen the role of IT in risk management and improve processes and controls for analytical and advisory activities (AAA).

The purpose of this evaluation is to assess implementation of management's actions and to reassess the materiality of the identified controls weaknesses

Objectives and the Scope of the Present Report

1.8 **Purpose of the Report.** IEG's Approach Paper, endorsed by the Committee on Development Effectiveness (CODE) in October 2009,[4] stated: "The purpose of the evaluation will be to provide a report at the end of the implementation of the action program that would assess the implementation against the key findings and recommendations of the IEG controls evaluation, and on that basis re-assess the materiality of the MW and the six SDs." The Approach Paper also clarified that this would be a narrow follow-up activity addressing key earlier findings, and would thus not be a reevaluation of the overall IDA control framework.

The evaluation focuses only on the controls related to the seven identified controls weaknesses

1.9 **Scope, Approach, and Method:** Barring any unexpected controls-related developments (none actually happened), this report was expected to focus on the set of controls issues related to the seven identified weaknesses. Within this limited focus, the criteria, standards, and rigor of the approach and method would be the same as applied to the earlier review. The analysis would be conducted within the Committee of Sponsoring Organizations (COSO) framework; the auditing standards would remain those used in the review (AS5); and there would be a three-tier reporting approach—management's report on the implementation of the FPAP (together with the underlying material) would be the basis for the analysis; IAD would provide a Review and Opinion; and IEG would provide an overall evaluation of both management and IAD reports and on the related controls issues.

1.10 Management's approach in its report on the implementation of the FPAP is essentially descriptive. It explains the components of the improved controls systems that have been put in place, and their rationales, under the various elements of the FPAP. There is also evidence from testing of new or strengthened controls in financial management and procurement processes that were found to be SDs in Part IB. IAD has been tracking management's implementation of the specific items in the FPAP, including by checking the documentation that records the application of the new controls, and in its final report it provides a related opinion.

1.11 **IEG's Approach and Focus.** The starting point for IEG's evaluation was the matrix of key issues underlying the MW, as shown in Figure 1 (see paragraph 3.11), together with the six SDs that were described in IEG's Main Evaluation. A number of other less important deficiencies in controls also were uncovered by the internal controls review (see Box 1), but these have not been examined in the current report, which focuses on the main controls weakness addressed by the FPAP from three perspectives:

- ***Breadth of scope:*** Taking account of all the areas planned to be covered by management in the FPAP, assessing the degree to which it covered, as designed, all important areas identified as issues for the MW and six SDs.
- ***Completeness and effectiveness of implementation:*** Whether all the remedies introduced have been appropriately designed and to what extent they have been implemented. IEG uses the criterion that a corrective action must be actually rolled out to be considered implemented.
- ***Revisiting the MW and six SDs:*** Whether the measures put in place under the FPAP are in IEG's view sufficient to warrant a

reassessment and possibly a revision of the materiality of the identified weaknesses.

Box 1. Deficiencies of Lesser Importance Uncovered During the Review

Various controls issues were uncovered during parts of the earlier review (Parts IA, IB, and II). In addition to the one Material Weakness and six Significant Deficiencies discussed in this evaluation, many other weaknesses of lesser significance were found and listed in a deficiency tracker (as were the more significant weaknesses). At the end of the review, a total of 175 deficiencies had been identified and placed in the deficiency tracker. Many of them were combined to determine whether they rose to the level of Material Weakness or Significant Deficiency. Of those 175, 69 had been resolved during the review and 25 had actions to resolve them under implementation. Management had actions planned to resolve the remaining 81 deficiencies. The most critical of these actions were summarized in the Five-Point Action Plan. Management should continue to address the other deficiencies, as IEG had recommended in its main report, and IEG does not address these less serious issues in this report.

1.12 **IEG's Method.** The basis for the IEG evaluation has been its analysis of the final reports from management and IAD, which are attached to this report. However, IEG has also examined the control remedies on its own and has deployed a combination of other methods to corroborate this analysis: available findings from other relevant evaluations; reviews of other relevant documents; independent assessments of a number of the specific items under the FPAP; and interviews with selected staff in the operational complex, including to gauge the extent of operational adoption of the new controls. IEG has also drawn on IAD working papers and on the underlying data files maintained by both management and IAD to help check the validity of claims (by both management and IAD) that measures have been adopted.

Although the evaluation is based primarily on the implementation reports produced by management and IAD, IEG has also examined the control remedies on its own to corroborate the analysis

1.13 **Advisory Panel.** A senior external advisory panel (composed of three former auditor-generals) provided very useful independent comments on the 2008 IEG controls evaluation report, and IEG has engaged the same panel for this report. They will meet in late September 2010, and their statement will be contained in Attachment 3 to the disclosed version of this report.

ENDNOTES

2. The Management and IAD Reports

Evaluation Essentials

- Management states that it has undertaken 22 corrective actions
- It reports that IDA internal controls have been strengthened at both transaction and entity levels
- Management asserts that the MW has been alleviated and substantial progress made in dealing with the SDs
- The Internal Audit Vice-Presidency concurs

Management Assessment

2.1 Management's entire report is appended as Attachment 1. The report is in three parts: Introduction; Management's Assessment; and Next Steps. The report contains details of the 22 CAs that constitute the FPAP, and it describes the contribution they have made to addressing the Material Weakness and Significant Deficiencies that had been identified in the internal controls review. In Annex A, IEG summarizes the content and status of each of the 22 CAs. The key aspects, as presented by management, are summarized below, largely through selective extracts from the Executive Summary of the management report, including an overview of the achievements under the FPAP as seen by management, an assertion regarding the overall findings, and an account of next steps.

Management asserts that the IDA internal controls have been "substantially strengthened"

2.2 **Management Assertion.** Management's assertion regarding the overall impact of the FPAP is as follows:

> "Given the overall progress in implementing the actions outlined in the Management Response to the Review of IDA Internal Controls, Management asserts that IDA internal controls have been significantly strengthened at both transaction and entity levels. It is Management's judgment that the issues with the controls for F&C found during the Review have been substantially addressed, in both design and implementation, and no longer constitute a Material Weakness as had been identified by IEG. Substantial progress has also been made in remediating the other significant deficiencies, and mitigating actions are in place for those few actions that require more time for finalization. This assertion has been endorsed by the IOP [Implementation Oversight Panel]."

2.3 **Management's Response.** Management describes the origins of the FPAP as follows:

> "Management took the findings of the 2008 Review seriously and considered the review as a timely opportunity to take an in-depth look at the systems of control over IDA operations

and improve them further. It devised a strong program of remedial actions to address the deficiencies identified by the review, organized around the five areas of significant deficiencies that Management's self-assessment had identified. IAD has used Management's Five-Point Action Plan (FPAP) as the basis for its reviews and Management believes that IEG is also comfortable with the scope of the actions in the FPAP."

2.4 **Progress of Remedial Plan**. Management describes progress in implementing the FPAP as follows:

Management states that it has now largely implemented the corrective actions designed to address the seven identified weaknesses

"In this report, the term *implemented* will be used to mean that an action has been designed, tested, and is expected to be put into operation by September 30, 2010, pursuant to the commitments in Management's FPAP. In cases in which the action has only been recently launched and it is too soon to assess the operating effectiveness, implementation is being closely monitored to confirm the operating effectiveness over time. Of the 22 corrective actions (CAs) included in the FPAP, 19 have been *implemented* or will be *implemented* as of September 30, 2010. The remaining three CAs are at an advanced level of design—some of them already at the testing stage—and are planned to be fully implemented within the current fiscal year. Management has put in place satisfactory risk-mitigating actions until their completion, and considers that the lack of full implementation of these three remaining CAs does not represent a significant risk for IDA operations. The achievements in the implementation of the FPAP can be summarized as follows:

- **Improve efficiency, effectiveness, and controls for investment lending** (CAs 1–4). CAs 1–3 have been implemented. The new risk-based approach embodied in the Operational Risk Assessment Framework (ORAF) allows teams to match project preparation and implementation support to each project's level of risk. The ORAF is used from the earliest stage of project preparation, allowing project design to be more readily adjusted to the client's risk profile and capacities. Management has put in place mechanisms to increase the level of attention to project implementation, to mitigate potential risks to projects' development effectiveness, and has introduced or updated options for timely restructuring of projects as appropriate. Finally, CA 4 is under implementation: Management is in the process of consolidating and integrating the operational policies for investment lending, to further improve the ease and effectiveness of their application.

- **Strengthen risk management capacity, incentives, and accountability at the project and institutional levels** (CAs 5–8). CAs 6–8 have been implemented. Management has approached the incentive issue by setting a clear tone at the top, stressing the importance of a risk-based approach, and providing staff with tools to help them identify and discuss risks together candidly. With respect to risk management, at the corporate level, Management has revised the Integrated Risk Management framework, prepared an annual risk report based on this framework, and has reviewed, rationalized, and started to realign the quality assurance functions. Going forward, Management plans to appoint a World Bank Group Chief Risk Officer. At the project level, the new risk-based approach for investment lending clearly establishes accountabilities for different dimensions of risk, and brings together these perspectives in a comprehensive assessment of the risk to the project's development objectives. CA 5, on the other hand, is still under implementation: At the level of the operational vice presidencies, the Matrix Leadership Team is addressing issues of span of control and ensuring that there is timely learning from best practice in quality assurance and risk management across the Regions. Overall, accountabilities for risk assessment and mitigation are now much clearer and better understood throughout the organization than they were at the time of the 2008 Review, yet Management recognizes that there is room for further improvement.
- **Better integrate the prevention of fraud and corruption (F&C) into operations (CAs 9–14).** These CAs have been fully implemented, and have significantly changed the way the Bank does business. Protocols for cooperation between INT, OPCS [Operations Policy and Country Services], and the Regions have been established; wide-ranging measures have been put in place to promote good practices in preventing F&C and strengthen guidance to staff; tools for "smart" project design, incorporating F&C detection and prevention measures as part of project design, have been created; INT's new Preventive Unit is now actively working with the Regions; and a database to monitor and report on the progress of action plans for following up on INT reports has been created. Along with such important institutional developments as the follow-up on each of the 18 recommendations of the Volcker Report and the reform of the Bank's sanctions system,

these corrective actions represent a substantial strengthening of the Bank's ability to detect and mitigate F&C risks.

- **Tighten fiduciary controls** (CAs 15–19). These CAs have been fully implemented. Controller's and OPCS established a Joint Evaluation Team to determine whether the Bank's financial management quality arrangements are sufficiently robust; at the same time, the Financial Management Sector Board has recorded a visible improvement in specific quality assurance indicators. In Procurement, several tools have been put in place or strengthened to improve the identification, monitoring and management of risks and the timely and substantive interaction and coordination between procurement staff, task teams, and sector managers. Also, OP/BP 11.00, *Procurement*, and the Procurement Guidelines have been updated to better incorporate risk management, enhance complaint handling, and mainstream risk-based procurement assessment. In addition, the 10 procurement, financial management and loans management controls that were assessed as "failed" in 2008 have been retested and found to be operating effectively.
- **Strengthen the role of IT in risk management and improve AAA processes** (CAs 20–22). CAs 20 and 21 have been implemented. Controls have been put in place to prevent password sharing and restrict staff access to privileged information when rights have expired. All staff members had to pass an IT security test, which heightened awareness of IT security risks. The Operations and Knowledge Systems Program (OKSP), a major institutional IT initiative, has established an upgraded Project Portal, Ops 2.0, to implement the risk-based lending process with document retention features, which was launched on July 1, 2010. In addition, a new Bankwide document repository system, WBDocs, which will help to ensure timely processing, archiving, and retrieval of documents associated with Bank business, has been designed and tested and will be made available for staff use, starting with the LCR [Latin America and the Caribbean] Region in late September 2010. The IRIS document storage system will remain in operation in parallel (and has been retrofitted to comply with the new Access to Information requirements) until WBDocs is fully rolled out in all the Regions. CA 22, addressing processes and controls for AAA, is still under implementation: the corporate strategy and governance frameworks have been developed, AAA management protocols are being clarified and simplified,

and recording practices at the unit level have improved demonstrably. A presentation on the new features of the AAA control system will be made to CODE in FY11 Q2."

2.5 **Link to the Bank's Internal Reforms**. Management explains that the FPAP has been integrated into other ongoing Bank reform programs:

"Management has taken the opportunity to embed the remedial actions responding to the 2008 Review in the broader set of internal reforms presented to the Development Committee in the Spring of 2010—that is, investment lending reform, the review of the organization's Matrix, the Knowledge Strategy, and the OKSP. While augmenting the complexity and length of the remediation process, this decision has also strengthened the sustainability and robustness of IDA's overall control framework."

Management's response has also been integrated with other ongoing Bank reform programs

2.6 **Monitoring**. Looking forward, management describes its intentions as follows:

"Starting in FY11, the performance and impact of IDA controls will be monitored through IDA's regular monitoring and reporting systems. These monitoring systems include (a) the realigned portfolio quality assurance system; (b) Financial Management and Procurement annual reports and quality assurance reporting systems; (c) the institutional database for follow-up on Regional action plans in response to INT reviews; (d) the results framework on the Bank's internal reforms; and (e) the new Institutional Risk Management system, which will aggregate risk management reporting at the corporate level. Regular IAD reviews and IEG evaluations of the development effectiveness of IDA's interventions complete this monitoring framework."

The IAD Review and Opinion

2.7 **The IAD Review.** IAD has undertaken a detailed review of management's FPAP. Its report which contains IAD's overall review and opinion, is attached as Attachment 2.

IAD has conducted a detailed review and has verified management actions

2.8 **The Objective.** IAD states the objective of its review as follows: "The objective of IAD's review was to assess Management's overall implementation of Corrective Actions described in its IDA Internal Controls Assessment FPAP."

2.9 **Scope and Approach.** The report states:

"The review comprised two parts: an update on implementation progress and an overall assessment of Management's implementation of the FPAP. The majority of IAD's testing focused on the design of the new controls because these controls have not been in operation long enough for IAD to be able to test their effectiveness in operation.

In reviewing the Corrective Actions, IAD verified that Management's implementation of measures would adequately address the originally identified issues. This work included the following steps:

- obtaining details on the measures being implemented;
- obtaining evidence that measures were implemented;
- assessing how the implemented measures addressed the identified issues by reviewing supporting documents, performing walkthroughs, and interviewing clients; and
- assessing the significance of the overall progress and of risks associated with pending actions.

To assess the overall implementation of Management's FPAP, IAD compared internal controls before and after the remediation and evaluated whether Management's actions addressed the significant deficiencies identified in the 2008 Review."

2.10 The IAD report focuses on the time profile of completing the implementation of the 22 corrective actions and agrees with management that (as of September 2010) 19 out of the 22 CAs have been completed and implemented, the three remaining being CA 4 (consolidate multiple rules into clear principles to inform design and processing); CA 5 (review lines of accountability at the management and staff levels); and CA 22 (rationalize controls and processes governing AAA, address compliance issues identified by IEG and the Quality Assurance Group). IAD also states: "In IAD's view, the residual risks are not significant. For *Corrective action 4*, Management has implemented compensating controls for the short term. *Corrective actions 5 and 22* are substantially implemented, and the remaining measures are scheduled to be in place by June 30, 2011."

IAD concurs with management assessment that 19 out of 22 corrective actions have been completed

2.11 **IAD's Conclusion.** IAD concludes its review report by stating:

"In IAD's opinion, Management's assertion that IDA internal controls have been significantly strengthened at both the transaction and entity levels is fairly stated. Management has substantially addressed the significant deficiencies identified in the 2008 Review through the implementation of the FPAP. The introduction of new tools and frameworks at the entity

IAD concurs with management that new tools and improved control environment substantially addressed the Significant Deficiencies and transaction levels satisfactorily address the control weaknesses identified in the 2008 Review. Also, in the fiduciary and IT areas, specific controls that were not operating effectively at the time of the 2008 Review have been corrected and are now operating effectively. IAD can give assurance that the design of all the new controls is robust. However, the operating effectiveness of most of these controls can be assessed only after a reasonable period of operation; IAD will cover operating effectiveness in the course of its regular assurance audits."

3. IEG's Evaluation

Evaluation Essentials

- The scope and content of the FPAP were broadly appropriate
- The Material Weakness in controls over fraud and corruption in IDA operations can be downgraded to a Significant Deficiency
- There has been significant progress in addressing all six Significant Deficiencies
- Two of the six Significant Deficiencies identified by the IEG evaluation can now be removed
- Ongoing actions are still needed for the now five Significant Deficiencies

Evaluating the Scope of Management's FPAP

3.1 In its final 2008 report IEG stated that the Bank's internal controls system operated at a high standard, with some important exceptions in a few areas (which led to the finding of one MW and six SDs). Where weaknesses were found, a mix of factors was involved, some of them interrelated and many with aspects at both the entity and transactions levels. It was important, therefore, to verify carefully that the remedies contained in the FPAP covered all aspects of the weaknesses and did not miss any contributing factors.

3.2 Accordingly, IEG conducted a detailed matching of proposed remedies with identified weaknesses. Management had organized its remedies somewhat differently from the matrix of IEG findings, so IEG had to cross-track some remedies from the FPAP to the IEG framework. The results of the cross-tracking exercise are in Annex B. IEG could not find any area in the matrix of its identified weaknesses that had not been directly or indirectly addressed by the FPAP. **IEG therefore concludes that the scope and content of the FPAP were broadly appropriate, although the consistency and quality of guidance in some areas should be further reviewed against early implementation experience**. The following paragraphs examine how well the FPAP actions have been implemented as designed.

IEG concludes that the scope and content of the FPAP were broadly appropriate

3.3 Management, in its description of the FPAP design, gave most emphasis to investment lending issues. This is understandable given the weaknesses in fiduciary and other project-level controls found by the review. Both the FPAP and the ongoing Governance and Anticorruption (GAC) implementation program also contain measures to strengthen country systems and address risk in development policy lending, but IEG finds that management could have usefully emphasized these topics more in describing its own program. This issue is important because improved country systems and institutions are needed to bolster controls and governance in projects and programs under all types of lending.

Management's Implementation of the FPAP

3.4 Management indicated in its report that all but 3 of the 22 CAs contained in the FPAP have been implemented, and these 3 will be implemented by the end of FY11. IAD concurs with this finding, based on a criterion that a corrective action is implemented when the action has been designed, tested, and expected to be put into operation by September 30, 2010. IEG has made its own tally of implemented CAs, but using the criterion that a corrective action must be actually rolled out to be considered implemented. **On this basis, IEG finds five CAs not yet implemented**, as shown in Box 3 (CA 4, CA 5, CA 19, CA 21, and CA 22).

IEG finds five corrective actions have not yet been fully implemented

Box 2. Glossary of Acronyms Used in Components of the Five-Point Action Plan

CA	**Corrective action**—Each area requiring a controls remedy was addressed by one or more corrective actions (new controls, measures, or staff practices).
CGAC	**Country Governance and Anticorruption—** A section of the GAC program that emphasizes country-level aspects of combating fraud and corruption, including by having Country Assistance Strategy papers address the issue.
ERM	**Enterprise Risk Management**—The extended risk-based framework under COSO.
FMPM	**Financial Management Practices Manual**—A new publication to assist in the enhanced use of the new financial management monitoring tools.
GAC	**Governance and Anticorruption**—The Bank's initiative to address fraud and corruption in its operations.
IOP	**Implementation Oversight Panel**—An external panel set up to monitor and advise management on its design and implementation of the FPAP.
IRMR	**Integrated Risk Management Report**—A new annual risk report, replacing the Risk Scan.
IS	**Implementation Support**—A new template designed to give enhanced attention and support to the process of project supervision.
ISR	**Implementation Status and Results Report**—Management's main tool for monitoring project supervision, now modified to link into the new tools, including ORAF, P-RAMS, and PRIMA II.
ORAF	**Operational Risk Assessment Framework**—A template of risk-based requirements for all project teams to be addressed during project design, implementation, and closure.
PPR	**Procurement Post Review**—The process that requires contract review after the award of a contract.
P-RAMS	**Procurement Risk Assessment and Management System**—A new template of procurement-related risks that have to be addressed in project design and supervision.
PRIMA II	**Portfolio Risk Management**—A new information technology tool designed to assist in improving the quality of financial management tracking and control.
RBL	**Results-Based Lending**—A framework of results being developed to improve results monitoring under investment lending.

3.5 IEG verified the implementation status of the CAs, together with their design content, using a multilayered process: the process started with a careful review of management's report on the implementation of its program as well as the detailed work undertaken by IAD. In addition, IEG attended a number of briefings on the design and application of new tools for investment lending and on the testing of corrected controls that had previously failed, and demonstrations of new IT instruments and Web sites. The results of this process, covering each of the 22 CAs, are in Annex A.

Nine corrective actions had 49 subcomponents, virtually all of which have been implemented

3.6 The tally of CAs implemented is not as straightforward as simply counting how many of the 22 CAs have been designed and put into action, because some CAs have more than one subcomponent; for example, CA 11 (promoting good practices across the Bank) had 19 subcomponents. Of the 22 CAs IEG found that 13 were single-component actions and 9 had subcomponents. In the 9 CAs with subcomponents there were 49 subcomponents. In making its overall tally IEG conducted a detailed check of all subcomponents and found that virtually all actions have been implemented.

The incomplete corrective actions are all near implementation

3.7 The five CAs that IEG finds are not yet implemented are very close to finalization. In most cases design and pilot testing has been completed and what remains is actual rollout into operation of the new systems and tools. A summary of the CA status is in Box 3.

3.8 The corrective actions not yet completely implemented and the nature of the pending actions are:

- For CA 4 (consolidate rules into new principles for investment lending)—Management has decided to wait until the new IL risk-based system has been used for a period before codifying the rules into operating principles.
- For CA 5 (review accountabilities at manager and staff levels)—Background analytical work on accountabilities of managers in Regions is complete, key issues identified, and preferred options signaled by the MLT, but implementation is still to be completed and MLT work on Networks is in its early stages.
- For CA 19 (procurement policy)—The new OP/BP 11.00 has been written, reviewed by the Board, and posted on the Bank Web site; new Procurement Guidelines under OP/BP 11.00 are being finalized based on the external comments received and are expected to be sent to the Board for a meeting in October 2010.
- For CA 21 (improve accessibility to operational documents)—The Project Portal 2.0 was rolled out in July 2010 and WBDocs will be rolled out by the Regions in the coming months as part of the new Operations Knowledge Systems Program (OKSP).

- For CA 22 (defining controls and compliance for AAA)—Management has committed to a document containing definitions of controls for AAA by the end of FY11.

Box 3. Summary of CAs Implemented and in Progress According to IEG Definition and Methodology

CA	*Implemented*	*In progress*
POINT 1: IMPROVE EFFICIENCY AND EFFECTIVENESS AND CONTROLS FOR INVESTMENT LENDING (IL)		
1	Establish risk-based approach	
2	Strengthen IL implementation support	
3	Tailor IL financing options (and RBL)	
4		Consolidate rules into Principles for IL
POINT II: STRENGTHEN RISK MANAGEMENT AND ACCOUNTABILITY		
5		Review accountabilities at manager and staff levels
6	Improve management oversight and staff incentives	
7	Prepare an annual integrated risk report	
8	Review QAG to inform a broader assessment of gaps and overlaps	
POINT III: BETTER INTEGRATE F&C PREVENTION INTO OPERATIONS		
9	Responsibility/accountability for F&C	
10	Protocols of cooperation between INT and Regions	
11	Promote good practices across the Bank	
12	Improve tools (smart project design)	
13	Operational follow-up on INT reports	
14	OPCS guidelines on GAC in projects	
IV: TIGHTEN FIDUCIARY CONTROLS		
15	FM: Corporate monitoring of quality	
16	IT Systems tracking FM in projects	
17	Up to date FM quality assurance records	
18	PR: Resolve differences between task team leaders, sector managers, and regional procurement managers	
19		Procurement policy
V:STRENGTHEN ROLE OF IT IN RISK MANAGEMENT, AAA PROCESSES		
20	Password security, systems access	
21		Improve accessibility to documents
22		Controls and compliance for AAA
TOTALS:	IMPLEMENTED 17	IN PROGRESS 5

Notes: QAG=Quality Assurance Group; FM = financial management; PR = procurement

3.9 **IEG's finding on the implementation of the FPAP.** Overall, IEG concurs with management that the FPAP has been substantially implemented, considering both the nature of the CAs not yet implemented and their quite advanced stages of implementation. Virtually all multicomponent CAs have been implemented, and the CAs still under implementation are in their final stages. There are also

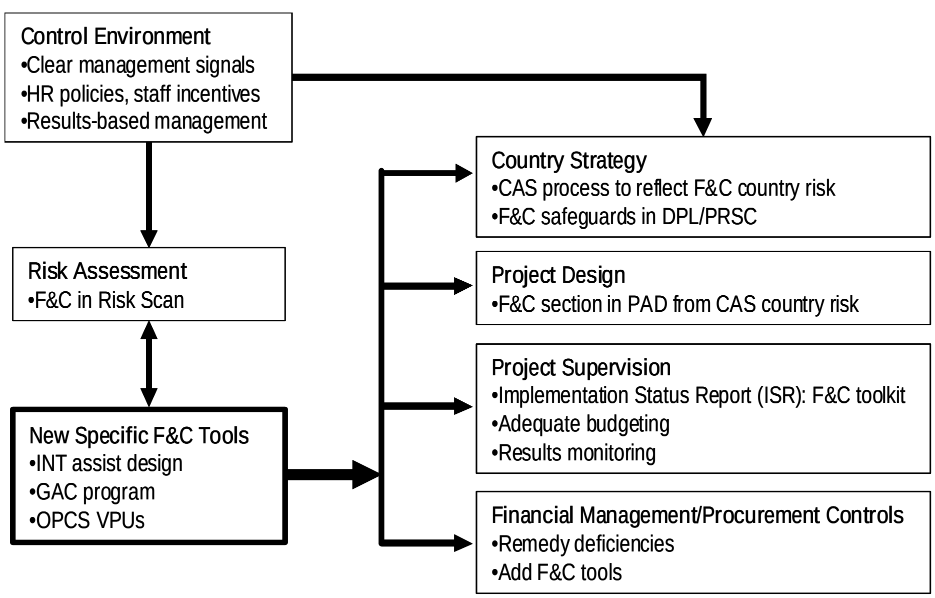
IEG concurs with management that the FPAP has been substantially implemented credible mitigating factors in place that offset any risks to IDA stemming from the fact that these CAs have not yet been fully implemented. This statement is made on the basis of the detailed examination of each of the CAs and the forms of verification described in Annex A.[1]

3.10 **Cross-tracking the FPAP to the MW and SDs.** As mentioned earlier, management organized the remedies in the FPAP somewhat differently from the structure of remedies that IEG had called for in its 2008 report. Management laid out its structure of remedies under five points, as shown in their report (and summarized in Box 3); for its part, with regard to the Material Weakness, IEG displayed the needed remedies in a structure shown in Figure 1.

The Material Weakness

3.11 Evidence from different sources used in the Main Evaluation showed that significant risks of fraud and corruption in IDA operations were not matched by explicit controls to address these risks. IEG found this set of control deficiencies to be a Material Weakness, considering the standards for assessing deficiencies and weaknesses laid out in Annex B to its main report,[2] and considering further that fraud and corruption (F&C) risks have the potential to impair IDA's mission if not corrected.

Figure 1. Remedies to Combat a Material Weakness in Controls over Fraud and Corruption



3.12 **Factors contributing to the Material Weakness.** A controls framework is a highly interactive system, and control weaknesses in one area may affect the strength of controls in other areas. For this reason, IEG highlighted in its Main Evaluation areas where remedies were needed to address the Material Weakness (while also emphasizing the importance of the Significant Deficiencies). This suggested the need for remedies across a broad front, including at the entity and project levels, together with remedies that linked these two. IEG highlighted these concerns by depicting them in a graphic showing the relationship between the various weaknesses and the combined set of remedies that were suggested by IEG's analysis. That graphic is shown in Figure 1.

3.13 As the figure shows, IEG identified three sets of factors that contributed to the MW in the controls needed to better address the risks of F&C in IDA operations, and it suggested remedies to address each set of factors. Certain factors were of central and critical importance to the finding, while others could best be described as contributing factors, as follows:

- **Central factors.** The general absence of specific controls at the level of projects (transactions level) to explicitly address F&C risk; generic weaknesses in the Bank's fiduciary controls (an area that should be central to addressing F&C risk); and Bank risk management processes that did not address F&C risk and did not sufficiently link institutional, country, and project-level F&C risks.
- **Contributing factors.** At the entity level this included the lack of clarity in the "tone at the top" regarding staff's obligations to address F&C risk in projects; weaknesses in management oversight of project processing; HR incentives that did not sufficiently emphasize the need to address F&C risks in projects; and insufficient linkages between staff rewards and project performance.

3.14 The sections that follow assess management progress on the central and contributing factors for each control weakness.

ENTITY-LEVEL ISSUES

Substantial progress has been made regarding controls related to fraud and corruption

3.15 **Control Weakness 1—Need for clear management signals on F&C issues, OPCS, and vice-presidential unit (VPU) oversight** (contributing factor): IEG stated in its 2008 main report: "some questionnaire results (by INT in particular) suggested that there is still fear among some staff that seeking out F&C issues in projects and reporting on observed improprieties may lead to reprisals from managers and managerial signals and behavior are not always consistent with these messages. Overall, mixed messages and ambiguity are still considered prevalent."[3] This controls weakness reflected a broad shortcoming in the "tone at the top" relating to the treatment of F&C risks in Bank operations generally, and the fact that staff received unclear signals on how to act. Many elements of the FPAP will affect the clarity of the signals to staff—including full implementation of the recommendations of the Volcker Report[4] and accelerated implementation of the GAC program—but IEG considers three corrective actions most relevant to addressing this weakness:

- **CA 1—Establish a risk-based approach to IL (Match the demands of the process to the level of risk and focus resources on higher-risk projects):** The key part of this corrective action is the introduction of the ORAF, which makes it mandatory to consider F&C risk in assessing overall project risk. This is intended to make it unambiguous to staff that F&C risks are to be candidly treated as part of project design.
- **CA 9—Establish clear responsibilities and accountabilities for F&C issues:** Accountability for ensuring adequate management of F&C risks at the corporate level is now clearly assigned to a managing director for operations. A GAC Council, chaired by the managing director and attended by vice-presidents (VPs), now meets monthly. Regional VPs are responsible for managing F&C risks at the regional level, and Network VPs are responsible for a progress report "GAC in Sectors" to the GAC Council. Definition of responsibilities and accountabilities for sector managers within the Networks has not been completed and is still in progress.
- **CA 11—Promote good practices across the Bank:** Over the past two years the Bank has stepped up its development and dissemination of materials and training of staff regarding good practices in addressing F&C risks. Many Bank units—the GAC Secretariat, INT, OPCS, and various Sector Boards—shared experiences and offered practical knowledge and advice of immediate use to staff teams. As described in paragraph 31 of management's report (and summarized in Annex A of this report) there are some 19 sub-activities in CA 11 that involve information sharing on financial management, procurement, GAC practices, and other aspects of addressing F&C in Bank projects.

IEG finds that "tone at the top" has improved, but clear signals on addressing F&C risks still need attention

3.16 **IEG finding.** IEG finds that control environment ("tone at the top") issues have been addressed on a broad front. Initiatives include the assignment of responsibility to a managing director, the establishment of the GAC Council, implementation of the Volcker report recommendations, the increased integration of INT work into the Bank's daily operations, and focused attention to GAC at corporate, country, sector, and project levels. For these reasons IEG regards this control weakness to have been substantially addressed and finds that the "tone at the top" has improved, at least in the sense that there is now a more systematic airing of issues relating to F&C risks than before. However, questions remain about the depth of penetration of the institutional and cultural shifts needed to effectively address F&C risks in the Bank, and there are still concerns (expressed in some GAC meeting discussions) about mixed messages to staff in this area. This will need to be further assessed once more time has elapsed.

3.17 **Control Weakness 2—HR policies, staff incentives, management oversight** (contributing factor): IEG stated in its Main Evaluation: "Questionnaire responses suggested that there is a cluster of HR-related issues that create disincentives, or do not specifically reward the adoption of an F&C agenda. For example…there are no explicit links to ethical behavior and no focus on F&C issues in the OPE [Overall Performance Evaluation]. Staff are rewarded more for delivery than for behavior and are not encouraged to focus on F&C in Bank projects and other operations…"[5] Three CAs directly or indirectly focused on this weakness (and are closely linked with Significant Deficiency 4—management oversight and staff incentives—see paragraph 3.47):

- **CA 5—Review responsibilities and accountabilities at management and staff levels**: Management established a Matrix Leadership Team (MLT) and conducted a corporate review of responsibilities and accountabilities for quality oversight within the Regions (already completed) and in the Networks to cover sector managers (ongoing).
- **CA 6—Improve management oversight and staff incentives and communications:** Meetings of the Operations Committee (OC), chaired by managing directors, have emphasized the need for management support and oversight of project processing, with specific reference to enhanced attention and resources for implementation support to projects under supervision. The briefing materials given to IEG (as well as the title of CA 2) speak explicitly of "increasing resources" for project supervision (now called implementation support), but no clear evidence has yet been produced to show (in a zero budget growth environment) that this has actually occurred. In relation to linking staff incentives and project performance and addressing F&C risks, management decided not to institute new personnel incentives. Instead it will emphasize management oversight of the application of the new tools to address F&C risks. Mandatory use of these tools is intended to instill widespread awareness of the need to address F&C risks in Bank operations.
- **CA 11—Promote good practices across the Bank**: The dissemination of guidelines and other learning materials and

INT training on best practices in addressing F&C risks in projects are intended to impress on staff that addressing these risks is a normal part of project design and implementation. Hence, the degree to which the risks are addressed should become part of the normal criteria by which staff performance is assessed and rewarded.

3.18 **IEG finding.** IEG notes that management is not intending to develop specific enhanced staff incentives to induce greater attention to the handing of F&C risks in projects. It is relying instead on greater Operations Committee emphasis on oversight and communications to staff and on improved learning. The Human Resources vice-presidency is pursuing enhanced staff performance evaluation as a long-term project. IEG considers that this control weakness has been partially addressed and alleviated by the various actions being taken to enhance staff awareness and accountability for F&C issues. However, policies and systems are evolving, and it is not clear to what extent staff performance and incentives are fully linked to project outcomes. Staff incentives are also affected by the tone and robustness of Bank-country relationships and the quality of the country dialogue, and there may be tensions between these goals and the ability to address sensitive F&C issues at the country level. INT has offered training to staff in the handling of F&C issues, and its efficacy and value added should be monitored. Given the importance of staff and managerial incentives, IEG places this weakness on a list requiring further management observation over time, also considering that IEG has not removed the Significant Deficiency found in management oversight and staff incentives (see paragraph 3.47).

Efforts have been made to clarify management signals and staff incentives, and Human Resources has an ongoing program to address staff performance, though their efficacy is still untested

3.19 **Control Weakness 3—Results–based management** (contributing factor): This factor was included in the matrix of findings not because it was found to be a control weakness but more as a matter of needed policy improvement: well formed results frameworks can be useful tools to detect if F&C is detracting from the attainment of project development objectives. Three CAs have content directly or indirectly focused on this weakness: CA 2 (strengthen IL supervision by increasing resources, support, and management oversight of project implementation); CA 6 (improve management oversight, staff incentives, and communications); and CA 3 (tailor IL financing options). The latter contains a component to introduce the Results-Based Lending (RBL) instrument, but this is not expected to be implemented until later in FY11. The new emphasis on implementation support as part of investment lending reform, which management stated would involve both enhanced resourcing and increased staff support, is directly parallel to the recommendations made by IEG in its report on the need for greater attention to project supervision overall. This includes the use of improved results frameworks.

RBL is expected to be implemented by end FY 11 and new tools should improve results frameworks

3.20 **IEG finding.** Efforts have been made in recent years to improve the quality of results frameworks in the Project Appraisal Document (PAD) and in Implementation Status Reports (ISRs), and progress on this front is being monitored by IEG as part of its evaluation of GAC. Part of the intention of the new risk-based tools (the ORAF-based PAD and ISR) is to more systematically address risks and measure project results. If the RBL is made operational, this control is likely to be strengthened further. Regarding the enhancing of resource allocations in support of project supervision (implementation support), IEG notes that management has made this an explicit part of the title of the corrective action (CA 2). However, it has not been explained how this is operating in practice, and the concern is that with sharp increases in Bank lending levels and a zero-growth administrative budget, managers may be highly constrained when it comes to realizing this needed reallocation.

However, zero-growth budgeting may constrain increased resource allocation to implementation support

LINKING ISSUES: RISK MANAGEMENT

3.21 **Control Weakness 4—The need to address F&C risk in the Risk Scan** (central factor): IEG stated in its main report: "Most units responded in the positive to the question whether the Bank considers fraud as part of its enterprise risk assessment (Question 15). However, INT and others took it as a serious omission that the Bank's Risk Scan omitted F&C risk."[6] Four CAs address different aspects of this weakness: CA 1 (establish a risk-based approach to IL); CA 5 (review lines of accountability at management and staff level); CA 6 (improve management oversight, staff incentives and communications); and CA 7 (prepare an Annual Risk Management Report). The latter addresses this weakness most directly:

> ***CA 7: Prepare an Annual Integrated Risk Report:*** The Bank has adopted a new risk management framework, combining the Enterprise Risk Management (ERM) from COSO with elements from other sources, as adapted to the Bank and IDA (see Para 23 in the Management Report). The first Annual Integrated Risk Monitoring Report (IRMR) was produced in December 2009. It described what risks the Bank is facing, for the first time including F&C risks at the corporate level, who is managing these risks and how the results are reported. The Board is now receiving quarterly risk reports in addition to the annual report.

3.22 **IEG finding.** The IRMR is an improved entity-level risk management instrument. It now includes questions relating to F&C risk, which it did not previously, and therefore provides a basis to link corporate, country, and project risk, including F&C risk. This was a critical missing element in the Bank's risk management approach at

The IRMR is an improvement over previous entity-level risk management the time of the Main Evaluation. IEG finds that this control weakness, a central factor in the MW finding, has been materially addressed.

3.23 **Control Weakness 5—Country strategy: CAS process to reflect F&C country risk; F&C safeguards in development policy lending** (central factor): It is critically important for the Bank's risk management—and a requirement of the ERM framework under COSO—that risk perceptions in the Bank be harmonized between entity, country, and project levels. The CAS is the critical instrument to achieve this, as it feeds into other tools. To quote: "Specifically, tools have been lacking to diagnose F&C risks systematically in the Country Assistance Strategy (CAS) process and to address it systematically in project design….It should also be emphasized that addressing governance and F&C issues requires that country systems be improved….This is so in investment lending, where the Bank is moving toward increasing reliance on these local systems, but the Bank also provides general budget support through PRSCs (which are controlled entirely by local systems)."[7] Management addresses this weakness as part of the GAC program, where the Country GAC initiative emphasizes the importance of focusing on F&C risk in the CAS. This is also addressed in CA 11:

> ***CA 11: Promoting Good Practices across the Bank:*** One of the many sub-components in CA 11 deals with the issuance of a Guidance Note on the inclusion of an F&C risk section in Country Assistance Strategy papers in high risk countries, and in relevant annexes in high risk projects.

3.24 **IEG finding.** CA 11 supports the goal of strengthening F&C sections in CASs, which addresses one of the central factors in the MW. The extent and efficacy of implementation has not been evaluated in this exercise and will be analyzed in IEG's upcoming evaluation of the GAC program. Though not a central feature of the FPAP, IEG notes that the FPAP states (paragraph 30) that INT and OPCPR will soon (during FY11) survey the effectiveness of country systems' treatment of F&C risks.

Changes in the extent to which CASs address fraud and corruption will be addressed in an upcoming IEG evaluation

PROJECT-LEVEL ISSUES: NEW SPECIFIC F&C TOOLS

3.25 IEG identified at the center of its MW finding a cluster of controls weaknesses—often simply an absence of controls designed to address F&C risks—that constituted a critical shortcoming with potentially serious implications for IDA's mission. To quote its earlier finding: "The presence of widespread indicators of F&C, whether proven to be actual or not—do constitute evidence of a significant risk of F&C. The question is, therefore, which internal controls may not have operated effectively—or have been absent—so that these occurrences were not prevented? Part of the answer to this question is

IEG found a cluster of six controls deficiencies that constituted a Material Weakness to be found in the fact that the specific controls…needed… are in fact missing or are only now being put in place"[8] IEG found in this regard six controls weaknesses as central to the MW finding:

3.26 **Control Weakness 6—The need to have INT contribute to design of F&C tools:** At the time of the Main Evaluation INT was operating within a tightly closed environment, and outreach and dissemination of learning was highly limited.

3.27 **Control Weakness 7—The need to accelerate implementation of the GAC program:** One of the findings of the 2008 Main Evaluation, common to management, IAD, and IEG, was that the Bank had developed an extensive global agenda to address F&C issues in Bank operations, but the translation of that agenda into operational tools and processes was lacking, or not moving fast enough.

3.28 **Control Weakness 8—Project design: need for an F&C section in PAD informed by F&C treatment in the CAS:** In the 2008 report, evidence of the lack of specific tools to address F&C risks in projects included the absence of any requirement to do this in the PAD. Where these issues were addressed at all it was widely assumed that the risks of their occurrence would be addressed routinely by the Bank's existing fiduciary controls, but this assumption was proved false in certain INT Detailed Implementation Review reports.

3.29 **Control Weakness 9—Project supervision: need for a toolkit to address F&C risk in the ISR:** Since the risk of the actual occurrence of F&C is clearly greater during project implementation than during the design and preparation stages, the need is evident for toolkits in the ISR to address risks during implementation.

3.30 **Control Weakness 10—Remedy generic deficiencies in fiduciary controls:** IEG stated in its 2008 report: "improving the effectiveness in operation of the existing controls over FM [financial management] and PR [procurement] is a necessary condition for addressing F&C risk."[9] The generic weaknesses found in the fiduciary controls were deemed by all parties to be a Significant Deficiency, which contributed also to the Material Weakness finding. The remedial actions on these weaknesses are dealt with below as part of the discussion of alleviating the six SDs.

3.31 **Control Weakness 11—Add tools to address F&C risks in PR and FM:** IEG's 2008 report also stated, as part of the same statement quoted above: "However, this would not be sufficient without also adding new approaches to explicitly combat F&C risk." This second aspect of the weaknesses in fiduciary controls derived from the important finding (following Detailed Implementation Reviews conducted by INT) that the assumption that the Bank's traditional fiduciary controls would implicitly also address F&C risk was shown to be unrealistic. Explicit controls were needed to address F&C risks.

3.32 Management's remedial actions do not match these weaknesses point for point, but each of them is addressed within the cluster of five centrally relevant CAs in the FPAP. Of these the two most central are:

- CA 1 (establishing the risk-based approach to IL), which created the ORAF, Procurement Risk Assessment and Management System (P-RAMS), and new ISR tools that now address F&C risk explicitly, including in the area of fiduciary controls.
- CA 12 (improve tools such as smart project design), which requires that F&C issues be addressed in project design and explicitly described in the PAD.
- Other relevant CAs that aim to improve management and staff awareness of F&C issues, accelerate implementation of GAC, and more fully integrate INT work into Bank operations serve to reinforce these central CAs. The relevant CAs are: CA 9 (establish clear responsibilities for F&C issues); CA 10 (establish protocols of cooperation between INT and the Regions); CA 11 (promote good practices across the Bank); and CA 13 (prepare and monitor specific action plans for following up on INT reports).

Management has clarified responsibilities/ accountabilities in Regions and similar clarifications for sector managers are under way

3.33 **IEG finding.** Management has clarified the responsibilities matrix (CA 9) in ways intended to sharpen management oversight of project processing, including over the management of F&C risks. It has attempted to enhance the impact that INT has on the new controls over F&C by more fully and explicitly linking INT with the operations complex (in line with Volcker report recommendations; CA 10), as well as in the form of protocols and memoranda of understanding for procurement. The 19 elements in CA 11, including guidance on F&C in CASs, the PAD, and the ISR, are intended to contribute to improved mainstream awareness of GAC and INT's role in the Bank. CA 12 involves implementation of the "GAC in Projects" initiative, which focuses on the application of tools whose absence during the Main Evaluation (coupled with generic weaknesses in fiduciary controls) were found to be Significant Deficiencies and central contributors to the Material Weakness. The P-RAMS, combined with the ORAF, directly addresses procurement-related F&C risks in projects, as does the GAC Audit and Assurance Toolkit for FM. CA 13, dealing with follow-up to INT reports, will be an additional factor more closely integrating the work of INT with the Bank's operations, and in improving institutional learning. As in other areas being addressed, it is too early to evaluate the effectiveness of many of these

New tools directly address earlier absence of controls, but their effectiveness needs to be tested in time measures as part of this report. The extent to which these new controls are internally consistent and are operating effectively will need to be further examined by management once sufficient time has passed.

IEG'S OVERALL EVALUATION OF THE REMEDIES TO ADDRESS THE MATERIAL WEAKNESS

3.34 IEG has arrived at a consolidated conclusion regarding the remediation of the MW by tracking the remedies for each of the 11 controls areas and by evaluating the combined impact of all remedies together. It is evident that the FPAP was designed to address each of the three key areas—entity-level factors, linking factors (risk management) and project-level factors (transactions)—that IEG had identified and depicted in its chart of suggested remedies. From a strict controls perspective the critical needs were for certain new controls explicitly aimed at addressing F&C risks. Though it may be premature to assess how effectively such controls may operate, the first necessary step is for them to be designed and put in place. In most cases this has been done.

FPAP has strengthened the controls architecture, though implementation challenges remain

3.35 IEG therefore concurs with management's assertion that the FPAP has strengthened IDA's internal controls and improved the overall control environment. Though IEG is separately examining how effective the GAC program has been in operational practice, this report finds that it has made important contributions to the F&C controls architecture. However, this general finding comes with a caveat: important elements of the control environment (definition of responsibilities and accountabilities, management oversight and staff incentives, and HR policies) are among those CAs still not fully implemented. They will strongly influence the effectiveness of the new tools that have been put in place.

The MW regarding controls needed to address the risks of F&C in Bank operations can be downgraded to an SD; removal of the SD will require future testing of operational effectiveness of new controls

3.36 The management of institutional risk has been strengthened in several ways: by a shift to a risk-based approach for IL operations; by new processes of quarterly and annual risk reporting to the Board explicitly addressing F&C risk facing the Bank; by mandating that CASs (at least for high-risk countries) have sections dealing with F&C risk; and by adopting tools to address F&C risk at the project level (the Operational Risk Assessment Framework, the Procurement Risk Management System, the new ISR, the Portfolio and Risk Management system, and Procurement Post-Review system). Together these provide stronger and more concrete controls to address F&C risk than existed when the first review was undertaken.

3.37 The effectiveness of these new tools will depend on the extent and the manner of their application. It would have been premature to evaluate at this time the operation of these new controls, which will need to be tested over time. For the purposes of the present report, their existence alone represents an enhancement in the controls to address F&C risk in Bank/IDA operations in a way that substantially responds to the Material Weakness finding. For this reason, and based on the multiple remedies put in place at all three levels, **IEG finds that the Material Weakness over controls needed to address the risks of F&C in Bank operations can be downgraded to a Significant Deficiency.** The new or amended controls have only recently been put into operation. For the Significant Deficiency to be removed, the effectiveness of the controls will need to be tested by management after some time has elapsed.

The Six Significant Deficiencies

3.38 **Overview and common findings.** At the time of the Main Evaluation, management, IAD, and IEG generally agreed regarding the finding of six Significant Deficiencies, though there were minor differences in how the findings were presented. IEG has employed a similar organizing device to that used in its Material Weakness finding, namely each CA relevant to addressing each of the six SDs has been identified, described, and evaluated. The details of this are in Annex B, Box 2. IEG has evaluated the extent to which each Significant Deficiency has been alleviated by CAs in the FPAP, not only in themselves but also in relation to how in some cases (management oversight, fiduciary controls, and risk management processes) this alleviation may also have contributed to alleviation of the Material Weakness.

All six original SDs are cross-tracked with remedies from the FPAP

SIGNIFICANT DEFICIENCY 1—THE NEED TO MAINTAIN CURRENCY OF BANK OP/BPS

3.39 IEG stated in its 2008 report: "The OPs and BPs included in the Operations Manual are not keeping pace in the changes on the ground that are being introduced from time to time." During Part I IEG had regarded this as a potential Material Weakness, but given progress by the end of Part II it had been downgraded to a Significant Deficiency. Management's principal corrective action to address this weakness has been CA 4 (consolidate multiple rules into clear key principles to inform design and processing for IL), which is one of the actions that management intends to implement by end FY11. Other actions also are relevant to this weakness, including:

- OP/BP 11.00 on procurement, which has been amended (to include requirements to address F&C risk in the Procurement Guidelines) and will go with the Guidelines as background information as the Guidelines await approval, so both may be issued in final form after October 2010;
- A new FM Manual has been produced and a new Guidance Note on GAC and new GAC Portal;

- The retirement of a number of Operational Manual Statements and other decrees that are no longer valid, which address the general point about keeping policy documents current.
- CA 22, which is in progress and is expected in late FY11, aims to formalize Controls and Compliance for AAA.

3.40 **IEG finding.** Some significant progress has been made in this area, both in relation to the key fiduciary policies (both FM and PR) and the GAC Guidelines and Portal, which inform staff regarding the key elements of risk relating to the Significant Deficiency. IEG also notes that management decided to delay production of the OP/BP on reformed IL until the end of the rollout of the new risk-based system. IEG does not take issue with that decision, though it will delay somewhat the opportunity to remove this Significant Deficiency, as will the fact that the new policy to formalize management of AAA (CA 22) is also not yet implemented. **IEG therefore finds that, despite the progress made, this Significant Deficiency should remain until remedies have been further advanced**. Management can revisit this issue once the revised OP/BP 11.00 has been put into full operation, the new OP/BP on IL has been implemented and made operational, and the statement on Controls and Compliance for AAA is implemented.

This SD remains pending further progress on making new OP/BPs operational

OP/BP 11.00 still not fully operative; others still to be written

SIGNIFICANT DEFICIENCY 2—THE NEED FOR IMPROVED DOCUMENT RETENTION AND ACCESSIBILITY

3.41 Following the difficulties that had been encountered in finding materials to complete controls testing in Part IA, IEG had stated in its 2008 report: "[There was] difficulty with obtaining timely access to relevant documents that are needed to carry out the compliance testing."[10] During Part IA IEG had regarded this as a potential Material Weakness, but given progress by the end of Part IB it had been downgraded to a Significant Deficiency. Management's remedial action to address this weakness was CA 21 (improve accessibility of operational documents through automation), which has involved a major extension and improved functionality of the Bank's IT architecture, in the form of the newly developed Operations and Knowledge Systems Program (OKSP). This includes Project Portal 2.0 and its new tool to replace IRIS, WBDocs, as a Bank-wide repository of all documentation, including documentation on projects in the Project Portal. The new system has been designed using the mapping of the Business Process Modules (BPMs) that was developed for the Main Review, but it has been amended to account for the new IL reforms. The OKSP system is fully designed and tested, Project Portal 2.0 was rolled out in July 2010, and WBDocs is awaiting rollout, Region by Region, expected to begin in late September 2010.

This SD remains pending further progress on and testing of the document retention and accessibility issue, which requires full rollout of the OKSP

3.42 **IEG finding.** The creation and adoption of the new OKSP, which incorporates the WBDocs data bank, will provide a seamless documentation system with a rapid search function to replace IRIS as the repository of all project files. The Project Portal's "Go-No-Go" feature will integrate key process controls into the system, and since the system itself will be used as the means of communicating up the management chain, this should ensure its mandatory use. IEG has been given several briefings and demonstrations of the new OKSP and its components, in particular the new Projects Portal. IEG regards this as a major improvement in IT functionality that is highly responsive to the areas of weakness that were found in the Main Evaluation, but the system is not yet rolled out and operational. **IEG therefore finds that this Significant Deficiency should remain until remedies have been further advanced.** Management can revisit this issue once the OKSP is fully adopted, operational, and tested. IEG also notes that the "Go-No-Go" feature of the Project Portal 2.0 has the potential to provide an element of control to prevent the processing of projects up the management chain until all required authorized signatories have signed off. This could add a useful IT supplement to the discipline of the internal controls system.

SIGNIFICANT DEFICIENCY 3—GENERIC WEAKNESSES IN CONTROLS OVER FINANCIAL MANAGEMENT AND PROCUREMENT PROCESSES

3.43 IEG stated in its Main Evaluation: "Testing of key controls during Part I showed that the fiduciary modules were among those with the highest rates of non-compliance, in part because of regional variations in process. This is a Significant Deficiency which has contributed to the Material Weakness."[11] Management addressed this SD with two sets of actions: first, new controls were designed and tested to address the specific generic controls deficiencies (high rates of non-compliance); second, five corrective actions were contained in the FPAP, three dealing with FM and two with PR.

Successful testing of new Fiduciary controls (in both PR and FM) has removed this SD

3.44 **Controls Redesign and Testing.** Management redesigned, enhanced, or eliminated as redundant a total of 10 controls (5 in the loan disbursement process, two in financial management, and three in procurement processes) and, with IAD verifying the process and results, tested all new controls against the same methodology that was used to test compliance in Part IB. All the new controls passed the tests. Details of these specific controls are provided in Annex II of IAD's report (see Attachment 2). This was a central part of addressing the generic weaknesses in fiduciary controls.

3.45 **Corrective Actions under the FPAP.**

(i) In Financial Management:

- ***CA 15—Institute corporate monitoring of FM quality:*** This emphasized the standardization and consolidation of quality assurance procedures for FM across the Regions. The Phase I evaluation has been completed; the Phase II (compliance and quality review) report is being drafted.
- ***CA 16—Integrate FM IT systems tracking project performance:*** This involved the development and adoption by all Regions of the Portfolio and Risk Management System (PRIMA II), a new IT tool for tracking FM performance in projects. PRIMA II integrated existing FM management systems (PRIMA and RAPMAN) used by different Regions into an integrated, consolidated IT system, with improved functionality linking to ORAF and other aspects of the new IL approach.
- ***CA 17—Ensure all records relating to quality arrangements for FM are maintained and up to date:*** This involved updating and clearing the backlog of unreviewed audit reports by the Regions using the Audit Reports Compliance System (ARCS) for all actions related to audits due in FY05 through FY07. New baseline data have been entered and are now monitored quarterly, without backlogs and with sharp declines in the number of unrecorded Interim Unaudited Financial Reports. A new, principles-based FM Manual has been produced and disseminated Bank-wide.

(ii) In Procurement:

- ***CA 18—Ensure more consistent follow through and establish clear mechanisms to resolve disagreements between procurement staff, task teams, and sector managers:*** This is a multicomponent CA involving establishment of a Procurement Complaints Data Base; improved integration of PR staff with project task teams, resolving differences in approach; enhancing the Sector Board and OPCPR role in harmonizing regional practices; and strengthening the Procurement Post-Review Process (PPR), including mandatory entry into IRIS from September 2009. These processes are to be assisted by the new P-RAMS risk assessment tool.
- ***CA 19—Update PR policy to incorporate risk management, enhance complaints handling, and mainstream risk-based PR assessment:*** This involved updating OP/BP 11.00 on procurement to emphasize risk management under the new risk-based approach to IL, handling of F&C risk in procurement, and revisions to the matrix of responsibilities. The action includes a revision of the Procurement Guidelines to include requirements to explicitly address F&C risks in procurement.

3.46 **IEG finding.** The Significant Deficiency in fiduciary controls was discovered during testing in Part IB and was thought to be serious because these controls should be among the strongest in the system. This factor was clearly a central factor to the Material Weakness. The fact that management has now not only redesigned these controls but has also had them successfully tested has resolved this issue directly so **that the Significant Deficiency over the generic weaknesses in fiduciary controls can now be removed**, and the contribution that these deficiencies had made to the Material Weakness has also been alleviated. This finding is strengthened by the other ways in which the FPAP has addressed quality issues in the fiduciary area to improve reporting and tracking of FM in projects, to standardize and harmonize practices across the Regions, and to improve procurement complaints systems through the application of new tools (for example, PRIMA II and the updated ARCS in FM; PPR, P-RAMS, and a new Complaints Data Base in PR.)

The Significant Deficiency regarding generic weaknesses in fiduciary controls can now be removed

3.47 However, a second element in the fiduciary area emerged during Part II of the 2008 Main Evaluation and contributed to the Material Weakness. Like other controls at the project level, the fiduciary controls were found to lack explicit measures to address the risk of F&C in Bank/IDA operations. Management has also addressed this element of the fiduciary controls in several ways. OP/BP 11.00 and the new Procurement Guidelines explicitly address F&C risk; new tools have been introduced (including P-RAMS, the PRIMA II and the Complaints Data Base, and the new PPR, together with the new ISR), all of which will contribute to combating F&C risks in operations. However, these new controls and systems will take time to become fully effective, and these **elements will remain part of the overall Significant Deficiency in F&C controls (that has now been downgraded from a Material Weakness).** Management can revisit this remaining Significant Deficiency as part of addressing the overall assessing the effectiveness of the cluster of new, F&C-related tools.

SIGNIFICANT DEFICIENCY 4—NEED FOR IMPROVED MANAGEMENT OVERSIGHT OF PROJECT PROCESSING AND SUPERVISION, COUPLED WITH IMPROVED STAFF INCENTIVE STRUCTURES AND PERFORMANCE ACCOUNTABILITY

3.48 IEG wrote in its Main Evaluation: "Evidence from various sources (Part I findings, the ELCQ [Entity-Level Controls Questionnaire] results, IAD country audits, the INT India DIR [Detailed Implementation Review]) suggests a lack of adequate management oversight of project processing, and most particularly, project supervision, which has been a significant factor in contributing to the weakness in controls in IDA operations."[12] Management responded to these weaknesses as part of its cluster of CAs dealing with risk management capacity, incentives, and accountability at the project and institutional levels. Two corrective actions dealt with improved management oversight (both at the project level), as follows:

- ***CA 5—Review lines of accountability at the management and staff level:*** Senior management established a Matrix Leadership Team (MLT) and conducted a corporate review of responsibilities and accountabilities for quality oversight within the Regions (already completed) and in the Networks to cover sector managers (still ongoing). Management states that once CA5 is implemented, progress in the application of the new accountabilities will be measured by regular HR monitoring systems, reports to the Board on Matrix Reform and the proposed FY11 reviews of quality assurance in Regions.
- ***CA 6—Introduce incentives and greater management support and oversight, and communicate expectations to staff:*** Meetings of the Operations Committee (OC), chaired by managing directors, have emphasized the need for management support and oversight of project processing, with specific reference to enhanced attention to and implicitly resources for implementation support to projects under supervision, with the intention of ensuring that the ORAF and the new ISR will be applied effectively.

3.49 **IEG finding.** IEG regards the clarification of responsibilities and accountabilities as a necessary condition for improved management oversight. Management has addressed this issue by creating the MLT, which has completed a review and assignment of responsibilities within the Regions. This has not yet been completed for the Networks. However, IEG notes that there has been no specific requirement stipulated to increase resource allocations to implementation support (even though the template on IL reform on which IEG was briefed does explicitly mention the need for greater budget allocations to support the new emphasis on such support).

Measures have been taken to improve management oversight over F&C risks, and staff awareness is being encouraged through high level discussion of F&C issues

3.50 Given the new tools and the risk-based approach to project management now in force, the measures have the potential to assist in more candid discussion of project risks between staff and management, thereby improving the links between staff incentives and project performance. This directly addresses one of the key contributing factors to the Significant Deficiency finding (and indirectly to the Material Weakness), although improved management oversight, by its nature, is an institutional and behavioral aspect of internal control that is closely tied to staff incentives. **The Significant Deficiency in this area of controls should remain until remedies have been further advanced and their efficacy tested**. Management should revisit this issue once the MLT recommendations and the new implementation support template have been in operation for some time.

SIGNIFICANT DEFICIENCY 5—NEED TO IMPROVE RISK MANAGEMENT, INCLUDING INSERTING SPECIFIC F&C RISK FACTORS INTO THE RISK SCAN, AND IN INTEGRATING RISK TREATMENT FROM THE ENTITY LEVEL TO THE ACTIVITY LEVEL

3.51 IEG wrote in its main report: "The need to extend the COSO framework to introduce two more risk-oriented components was identified in Part I…..Part II notes a failure to include an F&C risk element in the Risk Scan, in the CAS, and in project design and supervision processes, which all contribute to the identified Material Weakness concerning F&C."[13] Management, IAD, and IEG all agreed on the nature of this Significant Deficiency. IEG also saw it as a central factor contributing to the Material Weakness, because of the absence of specific tools to link entity, country, and project-level risk, including F&C risk. Management addressed this weakness with a specific corrective action focused on the Bank's earlier Risk Scan.

This SD remains pending further progress

3.52 In addition, the enhancement of risk management in general and more specifically at the country and project levels was also achieved through other factors and other CAs, as follows:

- ***CA 7—Prepare an annual integrated risk report (IRMR):*** In 2009 the Risk Scan was replaced by the first annual Integrated Risk Management Report (IRMR). Its contents included: (a) a description of overall risks facing the institution, (b) identification of units responsible for management and oversight of risks identified, (c) assessment of potential gaps and overlaps, and (d) development of a dashboard of risk findings from the various assessment activities, including—for the first time—an account of F&C risk facing the Bank. Over time the intention is to assess the quality and consistency of the processes in place which underlie the IRMR.
- ***Other Factors and CAs affecting Risk Management:*** The shift of all IL processes onto a risk-based approach (under CAs 1-4) and the development of new risk-based tools such as the ORAF and P-RAMS have created a new context in which risk is being addressed throughout the Bank. Under the GAC program CGAC is supporting more explicit treatment of country-level risks (among them F&C risks) in CASs.

Progress has been made with the new IRMR, but further progress is needed in making new risk management tools operational

3.53 **IEG finding.** IEG observes that management has addressed the two aspects of risk management that had constituted the Significant Deficiency—first, the need to address F&C risks in the Risk Scan; and second, the need for greater integration between entity, country, and project-level treatment of risk. The first aspect has been addressed by replacing the Risk Scan with the annual Integrated Risk Management

Report, with a section explicitly devoted to addressing F&C risk, addresses the first of these issues. The fact that the 2009 IRMR now exists and has this new feature (which ranks F&C risk in Bank operations as the single most highly rated risk area, among all categories) is sufficient grounds to remove this first aspect of SD5. Also, with the rollout of the new project tools, the requirement to explicitly address risk (including risk of F&C) at all levels of the Bank is intended to be mandatory.

This SD remains pending further progress and testing of new tools

3.54 The second aspect—ensuring risk management is integrated at the Bank, country, and project levels—has been addressed by the rollout of the new projects tools to address F&C risk (ORAF, P-RAMS and PRIMA II, and the new ISR), the mandatory use of which is intended to enforce this integration. However, as with the F&C tools for project design and fiduciary controls, it is too early to judge the operational application of these tools, so they need to be tested as part of the overall set of controls to address F&C issues. Therefore, IEG finds that, despite the progress made, **the Significant Deficiency over risk management should remain until remedies have been further advanced**. It is immaterial whether this deficiency is considered a separate Significant Deficiency in the controls over risk management or should now be seen as contributing to the Significant Deficiency that used to be a Material Weakness. But the remedy for one will surely also be a remedy for the other. Management can revisit this Significant Deficiency once these new tools have been in use for some period, the impact of the various aspects of GAC are better understood, and their operational effectiveness can be measured.

SIGNIFICANT DEFICIENCY 6—NEED FOR GREATER IT SECURITY IN SOME AREAS

3.55 IEG stated in its Main Evaluation: "The Bank's current routines concerning managers' SAP access privileges and their amendment when staff rotate, may leave open the possibility of lengthy periods when segregation of duties is breached, when staff reassign but carry with them access privileges from their previous positions….There are also issues relating to password sharing and improved IT systems for decentralization, and ensuring business continuity in light of natural or other disasters, as was brought to light in both the ICFR [Internal Controls over Financial Reporting] and the ELCQ results."[14] Management addressed this Significant Deficiency through a single corrective action under Point 5 of the FPAP (strengthen the role of IT in risk management and improve AAA processes), as follows:

- ***CA 20—Prevent password sharing and strengthen controls to privileged systems:*** This involved monitoring and training by management to reduce the incentives and incidents of password sharing, and by the time of the 2008 ICFR this weakness had been deemed corrected by the external auditors.

Remedies to password sharing and data access during staff rotation have been accomplished, and this SD has been removed

Equally, a new system now governs the rotation of staff with regard to the swiftness with which data access privileges are also changed, so that the loosely managed system found at the time of the Main Evaluation has been remedied.

3.56 **IEG finding.** IEG regards the weaknesses relating to password sharing and control of data access privileges for rotating staff to be now closed and, given also that the external auditors have tested and are satisfied with the outcome of the new controls, **this Significant Deficiency should be removed**.

3.57 **Scorecard for the Material Weakness and six Significant Deficiencies.** Box 4 summarizes IEG's finding for the Material Weakness and each of the Significant Deficiencies. It shows the recommended status following the IEG evaluation, and the pending actions that would be required for management to reconsider the SDs. IEG finds that there has been substantial progress in addressing all of the Significant Deficiencies. IEG has concluded that the Material Weakness should be downgraded to a Significant Deficiency and that two of the six original SDs should be removed. Thus, the result of the FPAP so far has been to move from one MW and six SDs to five SDs, some of which can be reconsidered as soon as the remaining corrective actions are fully in place and have been tested to assure the improved controls are in place and operating as intended.

Box 4. Summary of IEG Findings Relating to the Material Weakness and Six Significant Deficiencies

Control weakness finding	*IEG finding on the status of the MW/SD*	*Actions pending*	*Expected completion date*
Material Weakness:			
In controls to address risk of fraud and corruption (F&C) in IDA operations	Downgraded to Significant Deficiency	Continued testing of key controls	Recommend testing by July 2012
Significant Deficiencies			
SD 1: Currency of Bank OP/BPs	Remains Significant Deficiency	OP/PB 11.00, OP/BP on reformed IL, controls, and compliance of AAA	June 2011
SD 2: Retention and accessibility of operations documents	Remains Significant Deficiency	Rollout and testing of the OKSP	Rollout, October 2010, recommend testing by October 2012
SD 3: Generic weaknesses in fiduciary controls	Removed	F&C aspects of fiduciary controls to be tested under Material Weakness cluster	See F&C controls
SD 4: Management oversight and staff incentives	Remains Significant Deficiency	Completion of MLT work on sector managers; continued testing	Completion, December 2010, recommend testing by December 2012
SD 5: Risk Management at Bank and project levels	Remains Significant Deficiency	Testing of operability of new F&C controls	Recommend testing by July 2012
SD 6: Lack of IT security in certain areas	Removed	--	

ENDNOTES

4. Conclusions and Recommendations

4.1 This report has evaluated the implementation of management's FPAP within the context of the Material Weakness and six Significant Deficiencies identified by the Main Evaluation. IEG has closely reviewed management's own report and the review and opinion produced by IAD. Notwithstanding some minor differences in the way management, IAD, and IEG organized their evidence and findings during the Main Review, the three parties have converged in their findings regarding implementation of the FPAP, and there is broad consensus on the main findings of this report.

4.2 **Design of the FPAP.** IEG concludes that the design of the FPAP has been broadly appropriate in its content and scope and has addressed all areas that the Main Review found were in need of remedies. The consistency and quality of guidance in some areas should be further reviewed against early implementation experience. In the design of FPAP management gave most emphasis to traditional investment lending issues. This is understandable given the weaknesses in fiduciary and other project-level controls found by the Main Review. Both the FPAP and ongoing GAC also contain measures to strengthen country systems and address risk in development policy lending and investment loans that provide large-scale operations and management financing, but management could have usefully emphasized these topics more in describing its program. This issue is important because improved country systems and institutions are needed to bolster controls and governance in projects and programs under all types of lending.

4.3 **Implementation of the FPAP.** Sound design and content of the FPAP alone is not sufficient without effective implementation of the new measures. IEG finds that the FPAP has been substantially implemented as designed, but it is too soon to assess effectiveness. The fact that some corrective actions are still in progress does not detract significantly from the substantive impact of the FPAP. Credible mitigating factors are in place that offset risks to IDA of not yet having fully implemented these CAs.

4.4 **The Material Weakness.** IEG arrived at a consolidated conclusion regarding the remediation of the MW by evaluating the combined impact of all remedies together. It is evident that the FPAP was designed to address each of the three key areas—entity-level factors, linking factors (risk management), and project-level (transactions) factors—that IEG had depicted in its chart of suggested remedies. All have been found to be appropriately designed and substantially implemented, though greater emphasis could have usefully been place on strengthening country systems in support of development policy lending.

4.5 **IEG therefore concurs with management's assertion that the FPAP has strengthened IDA's internal controls and improved the overall control environment.** The evidence for this includes: management of institutional risk has been strengthened in several ways—by a shift to a risk-based approach for IL operations; by new processes of quarterly and annual risk reporting to the Board that explicitly address F&C risk facing the Bank; by supporting CASs (at least for high-risk countries) in addressing F&C risk; and by providing support through tools and guidance to address F&C risk at the projects level. The effectiveness of these new tools will depend on the extent and the manner of their application in practice, and management will need to test them over time. However, their existence itself represents an enhancement in the controls to address F&C risk in Bank/IDA operations in a way that responds substantially to the Material Weakness finding. **Based on these considerations, IEG finds that the Material Weakness can now be downgraded to a Significant Deficiency.**

4.6 The three elements in the control environment that still need to be fully implemented (definition of responsibilities and accountabilities, management oversight, and HR policies) are important aspects of the control environment and need to be fully executed. Management and staff behavioral factors and incentives were important to the Material Weakness finding and will continue to be important to successfully strengthening the controls and addressing the Significant Deficiency in this critical area because the effectiveness of the new tools that have been put in place will ultimately be determined by how they are applied by the operations staff.

4.7 **The Significant Deficiencies.** Based on a cross-tracking of remedies in the FPAP to the six SDs in the Main Evaluation, IEG finds substantial progress in addressing all of the SDs. On this basis, IEG concludes that two of the six Significant Deficiencies in the Main Evaluation (generic weaknesses in fiduciary controls and certain weaknesses in IT controls) should be removed. To the four that remain (the need to maintain currency in OP/BPs; need for improved documentation retention and accessibility; management oversight and staff incentives; and need for improved risk management) a fifth is added, namely the need to address F&C risk at all levels, now downgraded from a Material Weakness.

4.8 **Overall summary and recommendations:** IEG agrees with Bank management and IAD that the extensive review of internal controls has been a positive experience and has strengthened IDA and the Bank. There is a place for management to periodically conduct such reviews, possibly modified as the circumstances dictate. This could include continuous systemic attention together with in-depth monitoring of special topics. IEG takes note of the next steps that management described in its report—to emphasize the monitoring of key aspects of the Bank's quality assurance, FM, and procurement systems and to strengthen still further the Bank's risk management systems. Taking account of these planned next steps IEG makes the following recommendations:

On the five Significant Deficiencies:

- **Management should continue to address the remaining five Significant Deficiencies proactively and should revisit their status when significant further improvements have been made or when there are sufficient lessons of experience.**

    - ***Controls to address fraud and corruption in Bank/IDA operations:*** Within two years of the ongoing rollout of the new risk-based investment lending system, management should review experience under the new system. This should include selected and indicative tests of the operational effectiveness (that is, widespread usage and credible applications) of the new tools to address fraud and corruption risks in Bank operations including through an update of the 2009 QAG benchmarking survey of GAC Elements in Projects. It should also include, as IEG recommended in its 2008 report, a parallel review of how country systems have been strengthened to address risks—including fiduciary and fraud and corruption risks—in development policy lending and investment loans that provide significant operations and management financing—both of which may require more in-depth management attention.
    - ***Currency of OP/BPs:*** A number of OP/BPs are in various stages of revision. Management should continue or accelerate this progress to improve the currency of the OP/BPs in order to have a body of policy documents to guide staff. In particular, management has almost finalized OP/BP 11.00 on procurement, is developing a framework for new policy guidance on investment lending to conform

to the new tools that are being rolled out, and is considering guidance on controls and processes for analytic and advisory activities.

- *Retention and accessibility of documentation:* In about two years, management should review experience with the operational use of the Project Portal and WBDocs, with selective and indicative testing of a few key controls to assess their effectiveness in a significant sample of projects processed under the new risk-based investment lending system.
- *Management oversight and staff incentives:* The earlier Entity-Level Controls Questionnaire (ELCQ) proved useful for assessing controls-related attitudes and problems Bank managers face. Assuming that management will periodically undertake both internal and external controls reviews, IEG recommends that the ELCQ tool also be applied periodically (every three to four years), suitably updated but with continuity in the questions so as to test the evolution of management and staff attitudes to addressing fraud and corruption risk in Bank operations.
- *Risk management:* Management has taken steps to improve risk management, including incorporation of the COSO Enterprise Risk Management into the new integrated risk management framework, adoption of the annual Integrated Risk Management Report (IRMR), and quarterly risk reports to the Board, and establishment of the risk-based approach to investment lending and the accompanying instruments and tools. Over the coming two years, and as part of testing the effectiveness of these tools, management should establish the extent to which the tools have been applied to enhance integrated risk awareness. For example, what trends emerge in the fraud and corruption risks tracked in the IRMR? What is the frequency and quality of treatment of fraud and corruption risks in Country Assistance Strategy papers for high-risk countries, and what links exist between fraud and corruption risks expressed in the Country Assistance Strategies and those expressed in the Operational Risk Assessment Framework and Project Appraisal Document in project design?

On future internal controls reviews:

- **Monitoring of internal controls should be a continuous process.** As part of this process, management should undertake in-depth reviews when continuous monitoring highlights a problem in a particular area. High-risk areas, in particular, should be reviewed periodically. And when changes occur—new functions are added, reorganizations are completed, or new risks emerge, for example—those new areas should be reviewed. Risks should always be matched by explicit controls. The new Integrated Risk Report should be used to detect and report on new risks as well as on the status of existing controls based on the results of continuous monitoring efforts and any in-depth reviews of controls performed. The results of these periodic reviews should, as appropriate, be shared with the Board and other IDA stakeholders.

Annex A: List of Corrective Actions in the Five-Point Action Plan

(Including Results of the IAD Review and IEG Verification)

PROBLEM IDENTIFIED	*CORRECTIVE ACTION IN FPAP*	*STEPS*	*RESULTS OF IAD REVIEW*	*IEG VERIFICATION AND CONCLUSION*
INEFFICIENCIES AND GAPS IN CONTROLS FRAMEWORK GOVERNING INVESTMENT LENDING				
POINT I: Improve efficiency, effectiveness, and controls for investment lending				
(i) non-rationalized "one-size-fits-all" requirements irrespective of risks	CA 1: Match the demands of the process to the level of risk and focus resources on higher-risk projects.	Integrate risk-based model into the control framework governing investment lending.	The Operational Risk Assessment Framework (ORAF) was rolled out Bank wide in July 2010. The ORAF is a standardized risk framework to be used throughout the entire project cycle to identify and track risks and to allocate resources to reflect the level of risk. CA 1: Implemented	IEG reviewed documents and attended briefings on ORAF. IEG also attended live meetings of risk team critiquing two actual projects. Conclusion: ORAF is a responsive instrument to improve risk management; after rollout usage needs to be tested over time.
(ii) over-focus on project preparation at the expense of implementation	CA 2: Strengthen IL supervision by increasing resources, support, and management oversight of project implementation.	Strengthen risk identification and monitoring during supervision by, among other things, clarifying roles, responsibility, and accountability between IDA and borrowers and within the institution.	ORAF is designed to better allocate supervision/implementation resources. Management is also strengthening implementation support oversight through Operations Committee meetings. CA 2: Implemented	IEG attended briefing on IL reform, including implementation support component. IEG reviewed the new Implementation Support Plan (ISP), part of the Project Appraisal Document (PAD) and the new Implementation Status and Results Report (ISR) report format. Conclusion: The new emphasis on implementation support as part of the IL reform, involving both enhanced resourcing and increased staff support, responds to the recommendations made by IEG in its report on the need for greater attention to project supervision overall. This includes the use of improved results frameworks. However, while the design is largely in place, resource availability and effectiveness have not yet been determined.

PROBLEM IDENTIFIED	*CORRECTIVE ACTION IN FPAP*	*STEPS*	*RESULTS OF IAD REVIEW*	*IEG VERIFICATION AND CONCLUSION*
	CA 3: Tailor design and financing operations under the IL instrument more closely to the needs, capacity, and risk profile of clients.	Provide a risk-based approach to selection of IL design options and associated due diligence, processing, and monitoring requirements. Provide a flexible menu of design, funds flow and financing options.	The use of ORAF will facilitate the Bank's tailoring the design of the project more closely to clients' needs, capacity, and risk profile. Regarding the development of the results-based loan, IAD concurs with Management's view that this is not a condition for completion of this corrective action. CA 3: Implemented	As above for ORAF. Conclusion: The new instrument will not be completed by September 2010. Delay in its completion may affect economy and efficiency more than controls compliance, with only indirect effects on the Material Weakness (MW) and Significant Deficiencies (SD).
(iii) outdated and complex policy framework	CA 4: Consolidate multiple rules into clear key principles to inform design and processing.	Create a single principles-based "umbrella" policy for investment lending.	The implementation of this Corrective Action is, by design, still at the planning stage since it is to follow the completion of a review of the IL processes. The actual consolidation of relevant policies, procedures, and guidelines with a consistent and clear hierarchy is not expected by September 2010. Management has started to develop a broad framework for the IL policy consolidation and plans to provide a technical update to the Board in September 2010. CA 4: Under Implementation	Conclusion: IEG observes that some progress has been made in updating Operational Policies (OPs) and Bank Procedures (BPs) and recognizes the mitigating factors. The trend therefore appears to be diminishing the materiality of the deficiency. With completion of this update during FY11, and based on an AS5 definition of an SD as a "reportable condition" IEG would expect this CA to contribute to removing this SD. IEG also urges continuation of updating of OP/BPs. Delay in completion of new IL system policies may affect economy and efficiency more than controls compliance, with only indirect effects on the MW.
DIFFUSED MANAGEMENT AND STAFF ACCOUNTABILITY AND RESPONSIBILITIES FOR OPERATIONAL QUALITY; INADEQUATE MECHANISMS FOR INSTITUTIONAL RISK IDENTIFICATION, MONITORING, AND MANAGEMENT				
POINT II: Strengthen risk management capacity, incentives, and accountability at the project and institutional levels				
Diffused management and staff accountability and responsibilities for operational quality	*At the project level:* CA 5: Review lines of accountability at the management and staff levels.	Review of responsibilities, accountabilities and quality oversight including the following: Existing oversight and quality assurance arrangements, Existing quality and accountability arrangements for operations, Development by Human Resource Services (HRS)	This Corrective Action is largely implemented. Management has evaluated the existing lines of accountability and created a Matrix Leadership Team (MLT) to design and implement measures to address the issues identified. The MLT is expected to complete its work in June 2011. As part of the internal	IEG reviewed documentation and discussed with management. Conclusion: The definition of responsibilities and accountabilities has been accomplished in the Regions but will not be settled in the Networks until completion of the work by the MLT. The goal is to strengthen management

PROBLEM IDENTIFIED	*CORRECTIVE ACTION IN FPAP*	*STEPS*	*RESULTS OF IAD REVIEW*	*IEG VERIFICATION AND CONCLUSION*
		of a comprehensive strategy for enhancing performance, and Continuation of HRS efforts to enhance the Insight Web site.	matrix reform, Management created the MLT at the vice presidential level to bring more clarity to this issue. The Team's work program for FY10-11, which has been discussed with the Board, includes mapping responsibilities in the matrix organizational structure and developing accountability frameworks for Regions, knowledge activities, and Networks. CA 5: Under Implementation	oversight, the effectiveness of which will need to be tested.
	At the project level: CA 6: Introduce incentives and greater management support and oversight and communicate expectations to staff.	Review staff incentives and communicate expectations to staff. Introduce senior management support and oversight in project implementation.	Rather than introduce HR measures, Management approached the incentive issue by setting a clear tone from the top and by providing staff with tools to help them discuss risks candidly. Management review of projects at different levels and the use of ORAF will force staff to analyze risks and allow them to bring issues to Management's attention. CA 6: Implemented	IEG reviewed documentation and discussed with management Conclusion: The OC claims to be giving greater attention to oversight. This is intended to be further strengthened by the increasing emphasis on implementation support, reinforced with the new tools—ORAF, Procurement Risk Assessment and Management System (P-RAMS), and Portfolio and Risk Management II (PRIMA II) system. This has the potential to remove the SD, but effectiveness of ORAF, P-RAMS, and PRIMA II will need to be tested further.
Inadequate mechanisms for institutional risk identification monitoring and management	*At the institutional level:* CA 7: Prepare an annual integrated risk report.	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.	Management completed the first Integrated Risk Monitoring Report, for FY09, in October 2009. The report defined the standard risk taxonomy for the institution and comprehensively analyzed risks facing the Bank, including fraud and corruption. CA 7: Implemented	IEG reviewed the report and interviewed the authors Conclusion: The Integrated Risk Management Report (IRMR) is an improved entity-level risk management instrument; it now explicitly includes questions relating F&C risk and therefore provides a basis to link corporate, country, and project risk, including F&C risk.
	At the institutional level: CA 8: Review the activities	A more in-depth review of the central control units, starting with QAG, since it	The review of QAG was completed and a proposal on realigning the quality	IEG reviewed the realigned quality assurance functions.

PROBLEM IDENTIFIED	*CORRECTIVE ACTION IN FPAP*	*STEPS*	*RESULTS OF IAD REVIEW*	*IEG VERIFICATION AND CONCLUSION*
	of the Quality Assurance Group (QAG), to inform a broader assessment of gaps and overlap.	was under management's control.	assurance functions in operations was implemented in July 2010. The central control units have completed a self-evaluation, and an independent evaluation of the central units will follow later. CA 8: Implemented	IEG attended a management briefing on work done by the Joint Evaluation Team (JET) on financial management (FM) quality in regions. Conclusion: CA 8 relocates the central quality assurance function. It does not have direct relevance to either the SDs or MW.
INADEQUATE INTEGRATION OF FRAUD AND CORRUPTION ISSUES INTO DAILY OPERATIONS				
POINT III. Better integrate fraud and corruption (F&C) prevention into operations:				
Need to better integrate the Integrity Vice-Presidency (INT) and results of its work into IDA operations to improve management of F&C risks.	CA 9: Establish clear responsibilities and accountability for addressing F&C issues.	Adopting new Integrity Vice-Presidency (INT) strategy.	Management adopted the new INT strategy. Completed	IEG reviewed the strategy IEG interviewed INT and discussed interaction between INT and Operational Managers.
		Specific actions in response to Volcker Panel report.	Management implemented specific actions outlined in the Volcker Panel Report. Completed	IEG reviewed the recommendations as implemented IEG interviewed INT
		Clarifying and reinforcing accountability of managers on all sides of the matrix with respect to their areas of responsibility.	Management clarified the accountability of managers at both transactional and institutional levels. The operation of the ORAF will facilitate a cohesive understanding of risks that may lead to F&C. Completed CA 9: Implemented	IEG verified ORAF as above. Conclusion: Clarifying the responsibilities matrix is expected to sharpen INT's impact.
	CA 10: Establish appropriate protocols of cooperation between INT and the Regions.	Establish appropriate protocols of cooperation between INT and the Regions on handling allegations of F&C. Prepare a joint protocol to provide guidance as to the roles of and interactions between operational staff, regional management, and INT regarding the reporting of allegations of F&C and handling requests for no-objections and post-investigations.	Management issued an OPCS/INT protocol on handling suspected and alleged F&C in procurement. Completed	IEG reviewed the protocol and the memorandum of understanding. IEG interviewed OPCPR and operational managers regarding degree of satisfaction with practice so far. Conclusion: More fully and explicitly linking INT with the operations complex (in line with Volcker report recommendations), including in the form of protocols and memoranda of understanding (MOUs), especially in the area of procurement, can enhance effectiveness of new controls over F&C and therefore help alleviate the MW. The design is appropriate, and
		Deepening cooperation between the Procurement Anchor in Operations Policy and Country Services (OPCS) and INT, including INT/OPC Procurement (PR) memorandum of understanding and joint	Management issued a Memorandum of Understanding between OPCS and INT on the prevention of F&C in procurement. Completed CA 10: Implemented	

PROBLEM IDENTIFIED	*CORRECTIVE ACTION IN FPAP*	*STEPS*	*RESULTS OF IAD REVIEW*	*IEG VERIFICATION AND CONCLUSION*
		INT/OPCPR work program.		effectiveness needs to be tested.
	CA 11: Promote good practices across the Bank Group's work.	Distillation of lessons learned from INT work by its Preventive Services Unit (PSU).	The PSU carried out a number of training seminars on lessons learned from INT work. Completed	IEG attended a demo of the operation of the Company Risk Profile Database (CRPD) and the scope of its application.
		Delivery of Bank-wide learning events related to the India Detailed Implementation Review (DIR).	The PSU carried out a number of training seminars on lessons learned from INT work. Completed	IEG reviewed selected training sessions.
		Training seminars by PSU and development of a comprehensive training program for task teams.	The PSU carried out a number of training seminars on lessons learned from INT work. Completed	IEG reviewed selected training sessions. Discussed training approaches, practices, and outcomes of PSU with INT.
		PSU collaboration with specific project teams related to governance, accountability, and anticorruption plans at project level.	The PSU continues to assist project teams in defining governance, accountability, and anticorruption plans at the project level. Completed	IEG interviewed INT and interviewed selected operational managers.
		Issue guidance on inclusion of F&C in Country Assistance Strategies (CASs) in high-risk countries and relevant annexes in high-risk projects.	Management issued guidelines on F&C in CASs. Completed	IEG verified that guidance for CASs includes consideration of F&C. Discussed issue with INT and selected operational managers.
		Reform processing and supervision of IL, including focus on F&C risks and new approaches to design/appraisal and supervision.	The risk-based approach to project preparation and implementation was rolled out in July 2010. The ORAF is expected to encourage staff to highlight F&C risks throughout the lifecycle of every project. Completed	IEG verified contents of IL reform, including ORAF. Attended risk team project critiques.
		Review staff incentives (performance reviews, promotions, rewards, visibility) to ensure alignment with anticorruption agenda through discussions at MD-chaired GAC Council.	Rather than introduce HR measures, Management approached the incentive issue by setting a clear tone from the top and by providing staff with tools to help them discuss risks candidly. Completed	IEG reviewed GAC documentation and attended launch of GAC learning platform. IEG discussed issue with selected operational managers.
		Joint INT/OPCPR guide on identification and handling of red flags in procurement.	Management issued an F&C awareness handbook/pamphlet. Completed	IEG reviewed red flag tool and F&C awareness handbooks. Interviewed OPCPR and selected operational managers.
		Establish FM GAC Working Group to support	Management established an FM GAC Working	IEG reviewed the FM GAC

PROBLEM IDENTIFIED	*CORRECTIVE ACTION IN FPAP*	*STEPS*	*RESULTS OF IAD REVIEW*	*IEG VERIFICATION AND CONCLUSION*
		good practices, guidance, training for FM staff.	Group. Completed	documentation. Attended several OPCFM briefings.
		Deliver training on GAC to FM, including during the 2008 Fiduciary Forum.	Training on GAC was delivered to the FM community. Completed	IEG reviewed training materials on GAC provided to FM staff. Attended FM briefings.
		Develop, post, update lessons learned and best practices on GAC in projects Web site, supplemented by peer learning and other training.	The GAC in Projects website was developed and is updated as new information becomes available. Completed	IEG verified that GAC in projects Web site is available. Discussed issue with operational managers.
		Develop standard terms of reference (TORs) to widen financial audits to cover performance issues and procurement.	Standard terms of reference for audits were developed to include performance issues and procurement. Completed	IEG reviewed the TORs.
		Specific assessment and Bank-wide discussion of Bank procurement procedures for pharmaceuticals.	A study was completed that provided recommendations for more effective responses in Bank health projects. Completed	IEG reviewed the report.
		Enhance training on managing F&C risks in health sector through modules such as that delivered in fall 2008.	The PSU delivered training using the lessons learned from the India DIR. Completed	IEG noted that INT did not provide training material to IAD, but IAD indicated two specific training events by PSU.
		Prepare specific guidance on managing F&C risk for inclusion in the FMPM.	The updated FM Manual for World Bank-Financed Investment Operations includes guidance on managing F&C risks. Completed	IEG reviewed new manual and attended a meeting with FM where it was described.
		Initial stock-taking of analytical and advisory activities (AAA) and IL operations with significant GAC components and conversion to searchable database that can be accessed by task teams to provide examples of innovative approaches to risk assessment and mitigation.	Management developed a searchable database for lending projects with a significant GAC component, and created a new GAC Knowledge and Learning portal that, together with the existing GAC guidance, will provide guidance for AAA. Completed	IEG attended the rollout of the GAC knowledge and learning portal. Discussed portal usage in practice and how it will provide guidance for AAA with selected operational managers.
		Prepare case studies and good practice notes.	Management issued guidance notes on GAC in projects. Completed	IEG noted these are on the Web site. Discussed with operational managers.
		Establish GAC in Projects Peer Learning Network.	Management established a GAC-in-Projects Peer Learning Network. Completed	IEG noted this on the Web site. Discussed usage in practice with operational

PROBLEM IDENTIFIED	*CORRECTIVE ACTION IN FPAP*	*STEPS*	*RESULTS OF IAD REVIEW*	*IEG VERIFICATION AND CONCLUSION*
				managers.
		Identification of practice leaders at regional and sector levels and establish full-time focal points or on demand advisory units.	Practice leaders and focal points were identified and became operational. Completed	IEG reviewed list of names of practice leaders and focal points. Interviewed GAC Secretariat on dissemination of GAC awareness. Discussed usage in practice with operational managers.
			CA 11: Implemented	Conclusion: The many elements in CA 11 should combine to contribute to improved mainstream awareness of GAC and the INT role in the Bank and should contribute to the institutional and cultural shift needed to sharpen the focus on F&C and thereby help to alleviate the MW. The GAC evaluation will look further into the effectiveness of these actions.
	CA 12: Improve tools such as smart project design.	Compile and disseminate good practices for better management of F&C risks, including third-party supervision and smart disseminating through GAC in Projects network.	Management issued GAC guidelines and good practices notes. Completed	IEG reviewed these tools. Discussed GAC awareness and usage issues with operational managers.
		Improve procurement complaints database (completeness, operations, usage).	Management completed improvements to the procurement complaints database. Completed	IEG reviewed IAD's work papers. Discussed the procurement complaints database with OPCPR.
		Project Appraisal Document (PAD) Procurement Annex template is being revised as part of IL reform to reflect new initiatives, including risk-based procurement assessments, including F&C and to reflect risk-based approach to processing IL operations.	The ORAF—which comprises all risks, including F&C—forms part of the PAD. The ORAF was rolled out Bank wide in July 2010. Completed	IEG reviewed PAD Procurement Annex template. Attended meetings discussing the template with both IL reform team and OPCPR.
		At project level, including of F&C risk among categories of risks to be assessed during project appraisal (and reported in PAD) and monitored and reported on during project supervision (as reflected in	The ORAF and the new PAD and revised ISR templates include F & C risks. Completed	IEG reviewed PAD template and new ISR.

PROBLEM IDENTIFIED	*CORRECTIVE ACTION IN FPAP*	*STEPS*	*RESULTS OF IAD REVIEW*	*IEG VERIFICATION AND CONCLUSION*
		revised ISR template).		
		At entity level, include F&C risk among specific risks facing the Bank in the new Annual Integrated Risk Report.	The new Integrated Risk Monitoring Report includes F&C risk in the standard taxonomy of risks facing the Bank. Completed	IEG reviewed new Annual Integrated Risk Report. Attended briefings by OPCSR (Controller, Strategy, and Resource Management).
		Develop and roll out Procurement Risk Model/Risk Management Tool.	The Procurement Risk Assessment and Management System was rolled out in July 2010. Completed	IEG attended a walkthrough of this system. Discussed with OPCPR and operational managers.
		Development of GAC in Project guidelines by GAC in Projects team under GAC implementation plan.	Management issued GAC guidelines and good practices notes. Completed	IEG reviewed guidelines and notes. Attended briefings by OPCFM and GAC personnel.
		Develop and launch by OPCFM the GAC Audit and Assurance Toolkit.	OPCFM developed and launched the GAC Audit and Assurance Toolkit. Completed	IEG reviewed the toolkit. Attended briefing by OPCFM.
		Develop guidance on enhanced project supervision and FM red flags, supported by Web-based tools and guidance, including database of projects with FM anticorruption features.	Management issued guidance on FM Red Flags and developed a GAC-in-projects database. Completed	IEG reviewed these. Attended briefing by OPCFM.
			CA 12: Implemented	Conclusion: CA 12 contains tools that directly address the fiduciary SDs and the MW: The P-RAMS, combined with the ORAF, should directly address procurement-related F&C risks in projects, as should GAC Audit and Assurance Toolkit for FM risks. The absence of tools such as these was a prime factor in determining the MW and will also serve to directly alleviate the SD in fiduciary controls, which themselves contributed to the MW. Further verification of effectiveness will be important in the future.
	CA 13: Prepare and monitor specific action plans for following up on INT reports.	Prepare and monitor (with INT support) specific action plans for following up on INT reports.	Management set up the systems and arrangements for monitoring Regional plans that will follow up on INT reports. CA 13: Implemented	IEG reviewed IAD work papers on this topic and reviewed documents from management, including the first report from the database. IEG interviewed INT and operational managers.

PROBLEM IDENTIFIED	*CORRECTIVE ACTION IN FPAP*	*STEPS*	*RESULTS OF IAD REVIEW*	*IEG VERIFICATION AND CONCLUSION*
				Conclusion: CA 13 should be an additional factor in more closely integrating the work of INT with the Bank's operations, and in increasing institutional learning, and should thereby contribute to the needed institutional and cultural shift to address F&C risk effectively. Continued monitoring will be important.
	CA 14: Issue OPCS guidance on addressing GAC issues in projects.	Prepare and circulate to the FM Sector Board guidance on dealing with F&C in project design.	Management issued FM guidance on dealing with F&C in project preparation. Completed	IEG reviewed these tools. Attended multiple briefings by OPCFM on PRIMA II and links to ORAF. Conclusion: Now completed, this adds an F&C focus to the FM dimension of fiduciary controls and should reinforce the contribution to alleviating the MW. Continued monitoring and verification of effectiveness will be needed.
		Prepare guidance for FMSs by OPCFM on better identification and management of F&C risk through smart project design (with Web-based knowledge sharing tools).	Management issued FM guidance on dealing with F&C in project preparation and developed a GAC-in-projects database. Completed	
		Prepare GAC good practices at the project level.	GAC issued this good practice guidance. Completed	
		Issue an FM Approach Paper to GAC.	Management issued a paper on the FM approach to GAC. Completed CA 14: Implemented	
ISSUES RELATING TO FIDUCIARY CONTROLS IN THE AREAS OF FINANCIAL MANAGEMENT AND PROCUREMENT, PARTICULARLY DURING PROJECT IMPLEMENTATION				
POINT IV: Tighten fiduciary controls				
Fiduciary controls in FM	*In financial management (FM):* CA 15: Institute corporate monitoring of FM quality.	Undertake a Joint CTR/OPCS Evaluation process—review of regional quality assurance arrangements.	Management completed the first phase of the joint CTR/OPCS evaluation, which reviewed Regional quality assurance arrangements and disseminated lessons learned. Completed	IEG reviewed these steps, documentation of the updating of the regional quality assurance arrangements. Attended a meeting where these issues were discussed with OPCFM. Attended a management briefing on the work done by the joint evaluation team on quality assurance in the Regions. Reviewed reports showing the status of the Audit Reports Compliance System (ARCS), in terms of maintaining a reduced backlog of audit reports. Conclusion: FM quality appears to have improved.
		Consolidate and update regional quality assurance arrangement by the Regions.	Regions' consolidation and updating of their quality assurance arrangements is complete. Completed	
		Centralized monitoring of the Audit Report Compliance System (ARCS) by OPCFM, and rapidly reduce number of outstanding audit reports.	The monitoring of ARCS is now centralized at OPCFM. Completed	
		Review and update FM Practices Manual (FMPM)	Management issued the updated FM Manual for	

PROBLEM IDENTIFIED	*CORRECTIVE ACTION IN FPAP*	*STEPS*	*RESULTS OF IAD REVIEW*	*IEG VERIFICATION AND CONCLUSION*
		and align quality assurance arrangements with the updated FMPM.	World Bank-Financed Investment Operations. Completed CA 15: Implemented	IEG notes that FM guidance for development policy lending is to come later. Management could have said more on this topic, as the FPAP fiduciary measures appear to have positively strengthened some country systems, in turn serving to address F&C risk in development policy operations.
	In FM: CA 16: Integrate FM information technology systems tracking project performance	Adopt risk and portfolio management system/portfolio and risk management system by all Regions.	Management required all Regions to use existing FM information systems to systematically record FM project performance. Completed	IEG attended a walkthrough of PRIMA II. Part of this corrective action is to integrate PRIMA II with other Bank systems. In discussions with OPCFM and operational managers IEG checked if integration of PRIMA II with other tools took place. Conclusion: The PRIMA II system should add improved functionality to the tracking of FM processes in Bank projects and by incorporating different regional systems (namely, RAPMAN and PRIMA) should standardize Bank practice. The controls dimension of PRIMA II will depend on its application but should be reinforced by the links between PRIMA II, ORAF, P-RAMs, and new ISR.
		Integrate information technology (IT) systems tracking project performance in FM with other Bank systems to ensure FM is fully reflected in all assessments of project performance.	In July 2010 Management rolled out a new system (the Portfolio and Risk Management system, or PRIMA II) to standardize FM information systems. Completed CA 16: Implemented	
	In FM: CA 17: Ensure that all records relating to quality arrangements for FM are maintained and up to date.	Progress in updating ARCS by the Regions for all actions related to audits due in FY05 to FY07 and clearing earlier backlogs.	Management completed the update of the ARCS database, and all backlogs of audit reports are now cleared. Completed	IEG reviewed documentation of these results and attended a demo of ARCS and PRIMA II. Conclusion: The updating of the ARCS and the creation of PRIMA II should contribute to improved FM tracking and ensuring currency of FM reporting.
		Entry of baseline data by Regions in interim financial reports into portfolio and risk management systems.	The entry of baseline data from interim financial reports into the existing FM systems is now significantly improved and is monitored each quarter. Completed CA 17: Implemented	
Fiduciary controls in procurement	*In procurement (PR):* CA 18: Ensure more consistent follow-through	Improve controls and quality of complaints database.	Management improved controls in the procurement complaints database. Completed	IEG attended meeting with OPCPR where this was discussed. Attended ISG briefing on

PROBLEM IDENTIFIED	*CORRECTIVE ACTION IN FPAP*	*STEPS*	*RESULTS OF IAD REVIEW*	*IEG VERIFICATION AND CONCLUSION*
	and establish clear mechanisms to resolve disagreements.			Operations and Knowledge Systems Program (OKSP), checked how documentation entry and retention will work.
		(a) Mechanism for early and full integration of PR staff in project team, (b) new instructions and guidance on sharing of responsibility for key PR decisions at preparation and implementation stages between task team leader and procurement staff and between sector managers and regional procurement managers, (c) PR certification system enhancement, (d) guidance to clarify criteria for assigning PR ratings for ISR, including mandatory process for revision by sector staff	Under the ORAF each team, including the procurement team, now has responsibility for completion of the ORAF. Hence, the ORAF is an effective tool to encourage increased close collaboration among task team members and to facilitate resolution of different views. Completed	IEG reviewed documentation provided on team integration.
		Review role of 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 advisory role of PSB to respond to Regions' needs, and (c) monitoring regional fiduciary compliance and quality.	Management expanded the role of the Procurement Sector Board to include review of developed tools—such as the procurement post-review system and the procurement risk assessment and management systems—and the OPCPR work program to ensure harmonization within all Regions. Completed	IEG reviewed documentation of this.
		(a) Strengthen Procurement Post Review (PPR) system (b) Bank-wide rollout of a PPR module	Management developed and rolled out Bank wide a centralized procurement post-review system aimed at strengthening procurement post-reviews. Completed	IEG reviewed documentation of this system. Attended demo on PPR by OPCPR.
			CA 18: Implemented	Conclusion: Within the context of the parallel efforts underway, including by the MLT, to clarify responsibilities and accountabilities, and supported by the new ORAF and P-RAMS tools, these PR-related measures should help to clarify roles of team and PR specialists and

PROBLEM IDENTIFIED	*CORRECTIVE ACTION IN FPAP*	*STEPS*	*RESULTS OF IAD REVIEW*	*IEG VERIFICATION AND CONCLUSION*
				contribute to alleviating the fiduciary SDs and thereby also contribute to alleviating the MW. Caveat: monitoring of PPR system not yet in place.
	In PR: CA 19: Update procurement policy to incorporate risk management, enhanced complaints handling and mainstream risk-based procurement assessment.	Update OP/BP 11.00, Procurement, for risk management, handling of F&C and complaints handling and revise matrix of responsibilities and various clearance thresholds	Management has revised OP/BP 11.00 to take into account issues identified during the 2008 Review. Staff are being advised to use the revised policy. CA 19: Implemented	IEG reviewed the OP/BP and the revised procurement guidelines. Attended an Audit Committee meeting where the guidelines were discussed. Conclusion: Completion of the OB/PB should contribute not only to the alleviation of the SD found in fiduciary controls but also the separate SD related to the fact that OP/PBs were in general in need of revision. However, OP/BP 11.00 will be issued when the Board approves the Procurement Guidelines; management is scheduled to submit them to the Board for a meeting in October 2010.
IT SYSTEM VULNERABILITY, DIFFICULTIES IN TIMELY ACCESSIBILITY TO OPERATIONAL DOCUMENTS, MISMATCH BETWEEN AAA TYPES AND PROCESSES				
POINT V: Strengthen role of IT in risk management and improve AAA processes:				
IT system vulnerability	CA 20: Prevent password sharing and strengthen controls to privileged systems.	(a) Address password sharing issue, (b) strengthen controls around information security re privileged access to system applications, and (c) strengthen management change controls.	To address the password-sharing issue, Management implemented a mandatory information security awareness training program, and the Office of Information Security started monitoring potential password-sharing activities. With regard to privileged access and infrastructure change management, controls were strengthened as part of the FY08 Internal Controls for Financial Reporting exercise. CA 20: Implemented	IEG reviewed documentation. Checked that staff rotation mechanisms now included instant blocking of access to privileged data systems. Conclusion: Completion of all components of CA 20 and testing contribute to removal of the SD relating to IT systems. IEG regards the password sharing and data access in cases of staff rotation a closed issue. The SD in the area of the Bank's IT systems has now been addressed.
Difficulties in timely accessibility to operational documents	CA 21: Improve accessibility of operational documents through automation.	Automate and integrate IL processes and controls in close coordination with first phase of IL reform and will be part of Operations and Knowledge Management Systems Program (OKSP).	Automation and integration of IL processes and controls is being done through the OKSP's Operations Portal 2.0 and WBDocs systems. The Bank Project Portal (Ops 2.0) was rolled out in July 2010, and rollout of	IEG attended ISG briefing and demo on OKPS system and Operations Portal 2. Conclusion: The creation and adoption of the new OKSP, which incorporates Ops 2.0 and the WBDocs

PROBLEM IDENTIFIED	*CORRECTIVE ACTION IN FPAP*	*STEPS*	*RESULTS OF IAD REVIEW*	*IEG VERIFICATION AND CONCLUSION*
			WBDocs will be done in phases, beginning in September 2010. CA 21: Implemented	data bank, should provide a seamless documentation system, with a rapid search function, to replace IRIS as the repository of all project files. Its "go-no-go" feature should integrate key process controls into the system, and since the system itself will be used as the means of communicating up the management chain, this should ensure its mandatory usage. Once fully adopted and tested this should serve to remove the SD relating to documentation retention and accessibility. Also, the new OKSP system, once it is in full operation, should provide a substantial enhancement of the IT contribution to the enforcement of internal controls. This should include improved tools for risk management and project tracking. However, WBDocs will begin rollout in September 2010.
Mismatch between AAA types and processes	CA 22: Rationalize processes and controls governing AAA, address compliance issues identified by IEG and QAG, improve system support and monitoring.	Management is undertaking a broad review of the processes and controls, including systems and monitoring, that apply to AAA to simplify and strengthen them and ensure updating. It will also address compliance weaknesses observed in recent related reviews.	This Corrective Action is largely implemented and will be considered completed once the identified measures to rationalize processes and improve controls are discussed by CODE in FY11Q2 and put in place. Management developed a Knowledge Strategy to strengthen governance and accountability for the knowledge portfolio (including AAA) and established the Knowledge and Learning Council to lead the implementation of the strategy. In addition, at the AAA product level, Management improved the reporting and recording of AAA with more discipline across Regions and Networks. However, controls over AAA	IEG reviewed the knowledge strategy document. Conclusion: Implementation of new controls and processes for AAA should help to alleviate the SD of lack of currency of Bank OP/BPs and strengthen governance and accountability of AAA. However, it is expected to be completed later in FY11, and testing for application and effectiveness will be important.

PROBLEM IDENTIFIED	*CORRECTIVE ACTION IN FPAP*	*STEPS*	*RESULTS OF IAD REVIEW*	*IEG VERIFICATION AND CONCLUSION*
			processes have not been fully addressed. Management completed the business process review of AAA, and will recommend measures to the CODE in FY11 Q2, pushing for implementation by December 31, 2010. CA 22: Under implementation	

Annex B: Tracking the Remedies in the FPAP to Components of the Material Weakness

1. Management's Five-Point Action Plan was organized around five functional areas in which remedies were seen to be needed, but these areas did not exactly coincide with the way that IEG had organized its findings relating to the Material Weakness and the six Significant Deficiencies. Therefore, having conducted (in Annex A) a detailed listing of the specific corrective actions that were contained in the FPAP, including IEG's conclusions regarding the likely impact of these actions, these remedies need to be tracked against the controls weakness as identified by IEG in its 2008 report. This annex therefore tracks the specific corrective actions that have been taken against each of the areas IEG had identified as contributing to both the Material Weakness and the six Significant Deficiencies.

The Material Weakness

2. IEG had identified several factors that contributed to the Material Weakness (MW) in the internal controls needed to address the risk of fraud and corruption in the Bank/IDA. These were laid out graphically in a chart in Annex D in its 2008 report. The same chart is repeated in the main text of this report (Figure 1 on page 19). IEG is using this chart as the template to track the specific remedies that have been executed under the FPAP and to organize the material in such a way as to help make a judgment in each case as to the design of the measures and their likely impact on strengthening the controls in each given area. The results of this tracking are in Box B1.

Box B1: Tracking the Corrective Actions and Other Factors Aimed at Alleviating the Material Weakness

<table>
<tr><td colspan="2">ENTITY-LEVEL FACTORS: CONTROL ENVIRONMENT</td></tr>
<tr><td colspan="2">1. Need for clear management signals on F&C issues, OPCS and VPU oversight
(contributing factor)</td></tr>
<tr><td>Corrective actions under the FPAP relevant to this control weakness:
• CA 1 Establish Risk-Based Approach
• CA 5 Review Accountabilities
• CA 6 Improve Management Oversight, staff incentives
• CA 9 Responsibilities/Accountabilities for F&C
• CA 10 Protocols of Cooperation between Regions and INT
• CA 11 Promote Good Practices across the Bank
• CA 13 Operational Follow up on INT Reports
• CA 14 OPCS Guidelines on GAC in Projects

Other factors that contribute to climate of awareness of F&C:
• Completion of all 18 Volcker Report recommendations
• Successive implementation, mainstreaming of the overall GAC agenda</td><td>IEG comments on focus and design of corrective actions, creation of new controls compared to 2007 and likely impact:

Control environment issues have been addressed on a broad front with eight CAs having relevance to heightened awareness of F&C issues in Bank/IDA operations. Highlights include:
• ORAF requires consideration of F&C risk at several levels in a project, country, sector, and implementing agency
• An MD has been made explicitly responsible for the GAC agenda; GAC Council sits monthly; GAC Secretariat has network of “GAC Champions”
• A new INT strategy has been adopted;
• The GAC Council is intended to maintain constancy of management attention to F&C issues and to drive the GAC agenda;
• Regions have established protocols between them and INT on F&C issues;</td></tr>
</table>

	• Operations Committee (OC) meetings focus on need for enhanced management oversight of project preparation and implementation; • MOU signed between INT and OPCPR to develop PR red flags and give training; • Creation of the INT PSU and distillation by the PSU of lessons learned from INT DIRs and other work; Bank-wide learning events held by OPCS to spread learning from INT India DIR; task team training sessions held by PSU Bank-wide; outreach by PSU to project teams, giving advice on governance and F&C issues; • An FIR database of INT reports has been established by OPCS; • Adoption of new F&C tools, which themselves has served to spread awareness that Bank senior management takes F&C as mainstream concern. Caveats: • Network accountabilities under CA 5 to be completed by the MLT not before end of FY11; • Extent to which the needed behavioral shift has actually permeated all levels of Bank staff is not yet clear; • Extent to which the "tone at the top" and messages to staff are consistent is also unclear.
2. HR Policies, staff incentives, management oversight *(contributing factor)*	
Corrective actions under the FPAP relevant to this control weakness: • CA 5 Review Lines of Accountability at Management and Staff Level • CA 6 Improve Management Oversight, staff incentives, communications • CA 11Promote Good Practices across the Bank	IEG comments on focus and design of corrective actions, creation of new controls compared to 2007 and likely impact: All three relevant CAs contain elements that deal with improving staff incentives, clarity of management oversight and communication to staff regarding the treatment of F&C risks. Each CA is aimed at progressing beyond the practices prevalent in 2007. The highlights are: • Under CA 6: OC meetings chaired by MDs to discuss and emphasize oversight and addressing of F&C through ORAF and IS support; • Under CA 11 Review staff incentives to ensure they are aligned with anticorruption agenda, as also discussed in the GAC Council. CA 11 also contains training components (PSU training seminars) to spread awareness of need for and methods to address F&C risks in projects. Caveats: • Development of a comprehensive strategy to enhance staff performance is a long-term project, and the effectiveness of recent management actions has not yet been evaluated by IEG. • The extent to which staff incentives are aligned with GAC is unclear.

<table>
<tr><td colspan="2">3. Results–based management
(contributing factor)</td></tr>
<tr><td>Corrective actions under the FPAP relevant to this control weakness:
• CA 2 Strengthen IL Implementation Support
• CA 6 Improve Management Oversight, staff incentives, communications
Other factors that contribute to improved results management:
• CA 3 Tailor IL Financing Options contains a component to introduce the RBL, but this will not be completed until later in FY11.</td><td>IEG comments on focus and design of corrective actions, creation of new controls compared to 2007 and likely impact:
• CA 2: The new emphasis on implementation support as part of the IL reform, involving both enhanced resourcing and increased staff support, responds to the recommendations made by IEG in its report on the need for greater attention to project supervision overall. This includes the use of improved results frameworks.
• CA 6: CA 6 is meant to address management oversight, contribute to alleviation of the SD, and with ORAF, address F&C risk which before was absent, and thereby contribute to alleviating the MW.
• IEG notes that the RBL, if approved by the Board, will not be operational until later in FY11; results are expected to be improved (including with an F&C component) in the new, ORAF-based PAD and ISR tools.
Caveats:
• Resources for implementation support are uncertain, and improvements in results frameworks have not yet been confirmed by IEG evaluation.</td></tr>
<tr><td colspan="2">RISK ASSESSMENT</td></tr>
<tr><td colspan="2">4. The need to address F&C risk in the Risk Scan
(central factor, linking entity level, country and project level risk)</td></tr>
<tr><td>Corrective actions under the FPAP relevant to this control weakness:
At Project Level:
• CA 1 Establish Risk-Based Approach
• CA 5 Review Lines of Accountability at Management and Staff Level
• CA 6 Improve Management Oversight, staff incentives, communications
At Institutional Level:
• CA 7 Prepare an Annual Integrated Risk Report (IRMR)
Other factors that contribute to improved risk management:
The fact that the entire IL reform involved the introduction of a more risk-based model for managing the project cycle has implied the need for enhanced risk detection and risk management throughout the project cycle.</td><td>IEG comments on focus and design of corrective actions, creation of new controls compared to 2007 and likely impact:
• CA 1: ORAF requires consideration of F&C risk at several levels in a project, linking F&C risk at the levels of country, sector, and implementing agency to the project.
• CA 5: Once fully implemented and operative, CA 5 is expected to tighten management oversight, therefore should, over time, contribute to alleviating the SD in this area, therefore also contribute to alleviating the MW.
• Once fully operational, CA 6 should directly address management oversight, contribute to alleviation of the SD, and with ORAF, address F&C risk (absent previously), and should contribute to alleviating the MW.
• The IRMR is an improved entity level risk management instrument; it now explicitly includes questions relating F&C risk, which was not previously done, therefore provides basis to link corporate, country, and project risk, including F&C risk. Directly addresses the key F&C risk factor and should contribute to alleviating the MW. (The first IRMR was produced in December 2009. Contains the four risk pillars embodied in new ERM, enhanced-risk content of COSO (as recommended be</td></tr>
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<table>
<tr><td></td><td>adopted in the IEG Part I report). Contains specific section on risks of F&C in Bank operations, cites IEG IDA controls report findings and states that 25 out of 32 units ranking F&C in Bank operations as high or substantial. States that of all 36 risk categories the risk of F&C in Bank operations is deemed the highest single risk. Cites progress in mitigation measures.</td></tr>
<tr><td colspan="2">5. Country strategy: CAS process to reflect F&C country risk; F&C safeguards in DPL.
(central factor, linking entity level, country and project level risk)</td></tr>
<tr><td>Corrective actions under the FPAP relevant to this control weakness:

• CA 11 Promote Good Practices across the Bank</td><td>IEG comments on focus and design of corrective actions, creation of new controls compared to 2007 and likely impact:

• CA 11: One of the many subcomponents in CA 11 deals with the issuance of a Guidance Note on the inclusion of an F&C risk section in CASs, at least in high-risk countries, and in relevant annexes in high-risk projects. This addresses one of the key factors in the MW.

Caveats

• The FPAP did not provide many details as to the way in which F&C risks in development policy lending operations would be addressed. No specific CA addresses this issue. However, there are CAs that indirectly or implicitly deal with country risk (CA 11 deals with F&C in the CAS; all CAs dealing with improved FM controls implicitly also deal with improved country systems, as does the CGAC component of the GAC). Paragraph 30 in the FPAP states that INT and OPCPR will soon (during FY11) conduct surveys into the effectiveness of country systems' treatment of F&C risks.</td></tr>
<tr><td colspan="2">NEW SPECIFIC F&C TOOLS</td></tr>
<tr><td colspan="2">6. The need to have INT contribute to design of F&C tools.
7. The need to accelerate implementation of the GAC program.
8. Project Design: F&C section in PAD informed by F&C treatment in the CAS.
9. Project Supervision: Need for F&C toolkit in the ISR
(central factors: absence of F&C tools was key contributor to MW)</td></tr>
<tr><td>Corrective actions under the FPAP relevant to this control weakness:

• CA 1 Establish the risk based approach to IL
• CA 9 Establish clear Responsibilities for addressing F&C issues
• CA 10 Establish appropriate protocols of cooperation between INT and the Regions
• CA 11 Promote Good Practices across the Bank
• CA 12 Improve tools such as Smart Project Design
• CA 13 Prepare and monitor specific action plans for following up on INT reports</td><td>IEG comments on focus and design of corrective actions, creation of new controls compared to 2007 and likely impact:

• CA 1: The risk-based approach to IL created the ORAF, P-RAMS, and new ISR tools now address F&C risk explicitly.
• CA 9: Clarifying the responsibilities matrix is intended to sharpen management oversight, including over F&C.
• CA 10: More fully and explicitly linking INT with the operations complex (in line with Volcker report recommendations), including in the form of protocols and MOUs, especially in the area of procurement, should enhance effectiveness of new controls over F&C, therefore contribute to alleviating the MW.
• CA 11: The many elements (19 in all) in CA 11,</td></tr>
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<table>
<tr><td></td><td>including guidance on F&C in CASs, the PAD, and the ISR, should combine to contribute to improved mainstream awareness of GAC and the INT role in the Bank and contribute to the institutional and cultural shift needed to sharpen the focus on F&C and thereby help to alleviate the MW.
• CA 12: This contains tools that directly address the fiduciary SDs and the MW. The P-RAMS combined with the ORAF should directly address procurement-related F&C risks in projects, as should GAC Audit and Assurance Toolkit for FM risks. Includes introduction of the new PAD and ISR, with an F&C component. The absence of tools such as these were a prime factor in determining the MW and should also serve to directly alleviate the SD in fiduciary controls, which themselves contributed to the MW.
• CA 13: This should be an additional factor bringing the work of INT into closer integration with the Bank's operations, and greater institutional learning, and should thereby contribute to the needed cultural shift in which awareness of F&C risk becomes routine and mainstream.

OVERALL: This combination of CAs most directly addresses those controls weaknesses that were central to the MW. In 2007 specific tools to address F&C were basically absent. With the introduction of new tools such as the Smart Project Design under CA 12, but also the whole package of new F&C-focused tools (CGAC CAS, ORAF, P-RAMS, new ISR) this absence has now been addressed. While the effectiveness of these new tools will need to be tested over time, their existence itself represents an enhancement in the controls to address F&C risk.</td></tr>
<tr><td colspan="2">FINANCIAL MANAGEMENT AND PROCUREMENT CONTROLS</td></tr>
<tr><td colspan="2">10. Remedy generic deficiencies in fiduciary controls
11. Add tools to address F&C risks in PR and FM
(central factors since PR and FM are areas most directly related to F&C risk)</td></tr>
<tr><td>Corrective actions under the FPAP relevant to this control weakness:

In Financial Management:

• CA 14 Issue OPCS Guidance on addressing GAC issues in projects
• CA 15 Institute corporate monitoring of quality.
• CA 16 Integrate FM IT systems tracking project performance.
• CA 17 Ensure all records relating to quality arrangements for FM are maintained and up to date.

In Procurement:

• CA 18 Ensure more consistent follow-through and establish clear mechanisms to resolve disagreements between PR staff, task team and sector managers.
• CA 19 Update PR policy to incorporate risk management, enhance complaints handling and</td><td>IEG comments on focus and design of corrective actions, creation of new controls compared to 2007 and likely impact:

In Financial Management:

• CA 14: Management issued FM Guidance on dealing with F&C in project preparation. This adds an F&C focus to the FM dimension of fiduciary controls (previously absent) and should reinforce the contribution to alleviating the MW.
• CA 15: This emphasized the standardization and consolidation of quality assurance procedures for FM across the regions. Phase I evaluation has been completed; Phase II (compliance and quality review) report is being drafted. IEG notes that FM guidance for development policy lending is to come later. Management could have said more on this topic, because the FPAP fiduciary measures have also already positively strengthened country systems, in</td></tr>
</table>

mainstream risk-based PR assessment. Other factors that contribute to improved fiduciary controls: In addition to the specific CAs mentioned above, management also reviewed the generic weaknesses in FM and PR controls that had been revealed during the Part IB testing. It instituted remedies where needed in some controls (some were also made redundant by IL streamlining), and it conducted a formal testing of the new controls on a sample of projects. The results of these tests—all of which showed the controls passed—are discussed in more detail in Box B2, which deals with the SDs found in fiduciary controls.	turn serving to address F&C risk in development policy-type operations. • CA 16: This involved the development and adoption by all Regions of the Portfolio and Risk Management System (PRIMA II), a new IT tool for tracking FM performance in projects. PRIMA II integrated existing FM management systems (PRIMA and RAPMAN) used by different regions into an integrated, consolidated IT system, with improved functionality linking to ORAF and other aspects of the new IL approach. • CA 17: This involved the updating and clearing the backlog of unreviewed audit reports by the Regions using the ARCS for all actions related to audits due in FY05 to FY07. New baseline data have been entered and are now monitored on a quarterly basis, without backlogs and with sharp declines in the number of unrecorded IFRs. A new, principles-based FM Manual has been produced and disseminated Bank-wide. *In Procurement:* • CA 18: This is a multicomponent CA involving: establishment of a Procurement Complaints Data Base; improved integration of PR staff with project task teams, resolving differences in approach; enhancing the Sector Board and OPCPR role in harmonizing regional practices; and strengthening of the Procurement Post-Review Process (PPR), including mandatory entry in to IRIS from September 2009. • CA 19: This involved updating OP/BP11.00 on Procurement Policy to emphasize risk management under the new risk-based approach to IL, handling of F&C risk in procurement, and revisions to the matrix of responsibilities. The action includes a revision of the Procurement Guidelines, among other things, to include requirements to explicitly address F&C risks in procurement. OVERALL: The main review had found two sets of weaknesses in fiduciary controls that together contributed to the MW finding: one was the generic weakness in both FM and PR controls revealed during the Part IB testing where FM and PR process modules were shown to have the highest rates of non-compliance; the second was the absence in the Bank's fiduciary controls of any specific tools to explicitly address F&C risks. Taken collectively the package of corrective actions (CA 14-19) have addressed the issues of adding an F&C focus to both FM and PR controls; the package contains measures to disseminate awareness among the staff of how the tools are to be worked (FM Sector Board Guidance on dealing with F&C in project design; the new FMPM; OPCS Guidance on GAC in projects; centralized monitoring of the ARCS; issue of PRIMA II). In addition, the successful testing of the newly strengthened FM and PR controls have corrected the generic weaknesses that were found in Part IB, so that collectively these actions are likely to significantly reduce

<table>
<tr><td></td><td>the contribution to the overall MW that derived from deficiencies in the fiduciary controls. However, the new fiduciary controls to address F&C risk (CA 15-19) have only recently been put in place and will remain part of the downgraded SD on F&C until tested.

Caveats:
• Management expects to issue FM guidance for DPL by the end of September 2010.
• The PR policy is not yet issued.</td></tr>
</table>

3. What follows in Box B2 is a similar tabulation of deficiencies and remedies relating to the six Significant Deficiencies. There is significant overlap in the case of a number of the weaknesses and the FPAP remedies. This follows from the composite nature of the IEG finding on the Material Weakness, which had both central and contributing causes, covering a range of often interrelated control points in the project cycle.

Box B2: Tracking the Corrective Actions and Other Factors Aimed at Alleviating the Six Significant Deficiencies

<table>
<tr><td colspan="2">SD 1. NEED TO MAINTAIN CURRENCY OF BANK OP/BPs.
"The OPs and BPs included in the Operations Manual are not keeping pace in the changes on the ground that are being introduced from time to time"
(Management finding as Highlighted Deficiency with IAD concurring. IEG regarded this as potential Material Weakness).[1] After completion of Part II IEG downgraded this to Significant Deficiency[2]</td></tr>
<tr><td>Corrective actions under the FPAP relevant to this control weakness:
• CA 4 Consolidate multiple rules into clear key principles to inform design and processing for IL

IAD Review: The implementation of this Corrective Action is, by design, still at the planning stage since it is to follow the completion of a review of the IL processes. The actual consolidation of relevant policies, procedures, and guidelines with a consistent and clear hierarchy is not expected by September 2010.
• CA 19 PR Policy for Risk Management, Complaints, and risk-based assessment

IAD Review: Management has revised OP/BP 11.00, to take into account issues identified during the 2008 Review. Staff are being advised to use the revised policy.
• CA 22 Controls and Compliance for AAA

IAD Review: This corrective action is largely implemented and will be considered completed once the identified measures to rationalize processes and improve controls are discussed by the CODE in FY11Q2 and put in place.</td><td>IEG comments on focus and design of corrective actions, creation of new controls compared to 2007 and likely impact:
• Management decided to deal with this SD as part of the overall process of IL reform. It also decided to delay a comprehensive updating of the relevant OP/BPs until the IL reform has been implemented and so that the policy principles can be based on observed operational practice.
• A technical update is planned for September 2010 with completion of the new policy scheduled for end FY11. Meanwhile mitigating measures are intended to be the operation of the new, risk-based IL process itself, together with the July 2010 launch of new tools including ORAF, the new ISR, and others.
• IEG observes that some progress has been made in updating OP/BPs—PR with OP/BP11:00 (almost ready to be issued); FM with a new FM Manual; and new OP/BP on Trust Funds and GPPs—and recognizes the mitigating factors. The trend therefore appears to be diminishing the materiality of the deficiency. IEG would expect this SD to be removed when the new policies are in place for ILs, PR, and AAA.</td></tr>
<tr><td colspan="2">SD 2. DOCUMENTATION RETENTION AND ACCESSIBILITY
"(There was) difficulty with obtaining timely access to relevant documents that are needed to carry out the compliance testing"[3]
Management finding in its Part IA report, with IAD concurring this was a Highlighted Deficiency. IEG regarded this as a potential Material Weakness. After completion of Part IB all parties agreed that progress in finding documents downgraded the materiality to a Significant Deficiency[4]</td></tr>
<tr><td>Corrective actions under the FPAP relevant to this</td><td>IEG comments on focus and design of corrective</td></tr>
</table>

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<td>control weakness:

• CA 21 Improve accessibility of operational documents through automation

IAD Review: Automation and integration of IL processes and controls is being done through the OKSP's Operations Portal 2.0 and WBDocs systems. The Bank Project Portal (Ops 2.0) was rolled out in July 2010 and the rollout of WBDocs will be done in phases beginning in September 2010.</td>
<td>actions, creation of new controls compared to 2007 and likely impact:

• The key instrument to address this SD is the development by ISG/OPCS of the OKSP system, which includes the new Project Portal 2.0 and its new tool to replace IRIS, namely the WBDocs, as a Bank-wide repository of all documentation, including those on projects in the Project Portal.
• The creation and adoption of the new OKSP, which incorporates the WBDoc data bank, should provide a seamless documentation system, with a rapid search function, to replace IRIS as the repository of all project files. The Project Portals' "go-no-go" feature should integrate key process controls into the system, and since the system itself will be used as the means of communicating up the management chain, this should ensure its mandatory usage. Once fully adopted, operational and tested this should serve to remove the SD relating to documentation retention and accessibility.</td>
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<tr>
<td colspan="2">SD 3. GENERIC WEAKNESSES IN CONTROLS OVER FINANCIAL MANAGEMENT AND PROCUREMENT PROCESSES
"Testing of key controls during Part I showed that the fiduciary modules were among those with the highest rates of non-compliance, in part because of regional variations in process. This is a Significant Deficiency which has contributed to the Material Weakness"
IEG finding from Part II completion, with management and IAD concurring this was a Significant Deficiency.[5]</td>
</tr>
<tr>
<td>Corrective actions under the FPAP relevant to this control weakness:

In Financial Management:

• CA 15 Institute corporate monitoring of FM quality.
• CA 16 Integrate FM IT systems tracking project performance.
• CA 17 Ensure all records relating to quality arrangements for FM are maintained and up to date.

In Procurement:

• CA 18 Ensure more consistent follow-through and establish clear mechanisms to resolve disagreements between PR staff, task team and sector managers.
• CA 19 Update PR policy to incorporate risk management, enhance complaints handling and mainstream risk-based PR assessment.

Other factors that contribute to improved fiduciary controls:

In addition to the specific CAs mentioned above, management also reviewed the generic weaknesses in FM and PR controls that had been revealed during the Part IB testing. It instituted remedies where needed in some controls (some were also made redundant by IL streamlining), and it conducted a formal testing of the new controls on a sample of projects. The results of these tests—all of which showed the controls passed—are discussed in more detail in Annex II of IAD's report</td>
<td>IEG comments on focus and design of corrective actions, creation of new controls compared to 2007 and likely impact:

• CA 15: This emphasized the standardization and consolidation of quality assurance procedures for FM across the regions. Phase I evaluation has been completed; Phase II (compliance and quality review) report is being drafted.
• CA 16: This involved the development and adoption by all Regions of the Portfolio and Risk Management System (PRIMA II), a new IT tool for tracking FM performance in projects. PRIMA II integrated existing FM management systems (PRIMA and RAPMAN) used by different regions into an integrated, consolidated IT system, with improved functionality linking to ORAF and other aspects of the new IL approach.
• CA 17: This involved the updating and clearing the backlog of unreviewed audit reports by the regions using the ARCS for all actions related to audits due in FY05 to FY07. New baseline data have been entered and are now monitored on a quarterly basis, without backlogs and with sharp declines in the number of unrecorded IFRs. A new, principles-based FM Manual has been produced and disseminated Bank-wide.

In Procurement:

• CA 18: This is a multicomponent CA involving: establishment of a Procurement Complaints Data Base; improved integration of PR staff with project task</td>
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(Attachment 2), which deals with the retesting of the failed fiduciary controls.
IAD Review: CA 15: Management completed the first phase of the joint CTR/OPCS evaluation, which reviewed Regional quality assurance arrangements and disseminated lessons learned. Regions' consolidation and updating of their quality assurance arrangements is complete. The monitoring of the ARCS is now centralized at OPCFM. Management issued the updated FM Manual for World Bank-Financed Investment Operations.

CA 16: Management required all Regions to use existing FM information systems to systematically record FM project performance. In July 2010 Management rolled out a new system (the Portfolio and Risk Management system, or PRIMA II) to standardize FM information systems.
CA 17: Management completed the update of the ARCS database, and all backlogs of audit reports are now cleared. The entry of baseline data from interim financial reports into the existing FM systems is now significantly improved and is monitored each quarter.
CA 18: Management improved controls in the procurement complaints database. Under the ORAF each team, including the procurement team, now has responsibility for completion of the ORAF. Management expanded the role of the Procurement Sector Board. Management developed and rolled out Bank wide a centralized procurement post review system
CA 19: Management has revised OP/BP 11.00 to take into account issues identified during the 2008 Review. Staff are being advised to use the revised policy.

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<td>
teams, resolving differences in approach; enhancing the Sector Board and OPCPR role in harmonizing regional practices; and strengthening of the Procurement Post-Review Process (PPR), including mandatory entry in to IRIS from September 2009.

CA 19: This involved updating OP/BP11.00 on Procurement Policy to emphasize risk management under the new risk-based approach to IL, handling of F&C risk in procurement, and revisions to the matrix of responsibilities. The action includes a revision of the Procurement Guidelines, among other things, to include requirements to explicitly address F&C risks in procurement.

OVERALL: The weaknesses in fiduciary controls, in both FM and PR, that constituted the SD did not relate specifically to F&C but were generic to project processing and resulted from non-compliance in a number of areas. This is one area (described in detail in Annex II of the IAD report) in which new or redesigned controls were put in place, with designs which corrected the failings found in Part IB, and which were then tested across a sample of projects. Since all tests revealed that the new controls passed, IEG regards the SD in this area to be removed. Since these deficiencies had also contributed importantly to the MW, and since new FM and PR tools also contains explicit measures aimed at addressing F&C risks in financial management and procurement, this finding is of significance also in relation to downgrading the materiality of the MW. However, the new fiduciary controls to address F&C risk (CA 15-19) have only recently been put in place and will remain part of the downgraded SD on F&C until tested.
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<td colspan="2">
4. NEED FOR IMPROVED MANAGEMENT OVERSIGHT OF PROJECT PROCESSING AND SUPERVISION (coupled with improved staff incentive structures and performance accountability)
“Evidence from various sources (Part I findings, the ELCQ results, IAD country audits,, the INT India DIR) suggests a lack of adequate management oversight of project processing, and most particularly, project supervision, which has been a significant factor in contributing to the weakness in controls in IDA operations”
IEG finding in its Part II report[6]
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<td>
Corrective actions under the FPAP relevant to this control weakness:

CA 5 Review lines of accountability at the management and staff level
CA 6 Introduce incentives and greater management support and oversight and communicate expectations to staff

IAD Review: CA 5: As part of the internal matrix reform, Management created the MLT at the vice presidential level to bring more clarity to this issue. The Team's work program for FY10-11, which has been discussed with the Board, includes mapping responsibilities in the matrix organizational structure and developing accountability frameworks for Regions, knowledge activities, and Networks.

CA 6: Rather than introduce HR measures,

</td>
<td>
IEG comments on focus and design of corrective actions, creation of new controls compared to 2007 and likely impact:

CA 5 is intended to tighten management oversight and therefore, over time, to contribute to alleviating the SD in this area.
CA 6 is intended to strengthen management oversight. The OC is giving attention to oversight and this is intended to be further strengthened by the increasing emphasis on support for implementation support, reinforced with the new tools (ORAF, P-RAMS, PRIMA II). This has the potential to remove the SD but it will take time to be fully evident across the Bank, and monitoring and verification are needed.
It is unclear to what extent additional resources will be available for implementation support in the current tight budget environment.

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<tr>
<td>Management approached the incentive issue by setting a clear tone from the top and by providing staff with tools to help them discuss risks candidly. Management review of projects at different levels and the use of ORAF will force staff to analyze risks and allow them to bring issues to Management's attention.

Other Factors that Contribute to Improved Management Oversight and Supervision

In addition to the specific CAs mentioned above, CA 1, Establish a risk-based approach, CA 2, Strengthen IL Implementation Support, and CA 12, Improve tools, contribute to this SD.</td>
<td>• Continued efforts are needed to ensure that staff incentives are fully aligned with project outcomes.</td>
</tr>
<tr>
<td colspan="2">SD 5. NEED TO IMPROVE RISK MANAGEMENT
"The need to extend the COSO framework to introduce two more risk-oriented components was identified in Part I…..Part II notes a failure to include an F&C risk element in the Risk Scan, in the CAS, and in project design and supervision processes, which all contribute to the identified Material Weakness concerning F&C"
IEG Finding in its Part II Report[7]</td>
</tr>
<tr>
<td>Corrective actions under the FPAP relevant to this control weakness:

• CA 7 Prepare an annual integrated risk report (IRMR)
• The IRMR is 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

Other factors that contribute to improved risk management:
• The main driving factor for IL reform was to place all project management processes on a risk-based approach, with links to both the CAS and the fiduciary tools (ORAF, P-RAMS, PRIMA II, and new ISR). The intention was to elevate risk consciousness in the Bank at all levels (institution, country, project) and to link the risk processes in all three levels.
• Under the GAC program CGAC is rolling out the need for all CASs to contain more explicit treatment of country-level risks (among them F&C risks).

IAD Review: CA 7: Management completed the first Integrated Risk Monitoring Report for FY09 in October 2009. The report defined the standard risk taxonomy for the institution and comprehensively analyzed risks facing the Bank, including fraud and corruption.</td>
<td>IEG comments on focus and design of corrective actions, creation of new controls compared to 2007 and likely impact:

• The risk management measures contained in CA 7 should be viewed within the context of the fact that the entire package of CAs has been embedded within the reformed IL process, which has been placed on a risk-based approach. This in itself should serve to enhance and mainstream the focus on risk, in ways that were not present in 2007.
• IEG observes that, with the rollout of the new project tools, the need to explicitly address risk at all levels of the Bank should be enhanced and mandatory.
• With specific regard to CA 7, the IRMR is an improved entity-level risk management instrument that provides a basis to link corporate, country, and project risk, in more explicit fashion than was the case in 2007, including F&C risk. IAD regards CA 7 as implemented.
• Viewed against the context of the overall risk-based IL reform and the related new projects tools (ORAF, P-RAMS and PRIMA II, new ISR), which are essentially risk-based by design, IEG regards that the SD in this area should be removed when their use is verified across the Bank.
• Given that the new projects tools by design explicitly and directly address the key F&C risk factors this will add further weight to diminishing the risk-related aspects of the MW.</td>
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<table>
<tr><td colspan="2">SD 6. NEED FOR IMPROVED IT SECURITY
"The Bank's current routines concerning managers' SAP access privileges and their amendment when staff rotate, may leave open the possibility of lengthy periods when segregation of duties is breached, when staff reassign but carry with them access privileges from their previous positions…..There are also issues relating to password sharing and improved IT systems for decentralization, and ensuring business continuity in light of natural or other disasters, as was brought to light in both the ICFR and the ELCQ results"
IEG finding from its Part II Report.[8]</td></tr>
<tr><td>Corrective actions under the FPAP relevant to this control weakness:

Management addresses this SD under Point V of the FPAP: Strengthen the role of IT in risk management and improve AAA processes. Specifically:
• CA 20 Prevent Password Sharing and Strengthen Controls to Privileged Systems

IAD Review: CA 20: To address the password-sharing issue, management implemented a mandatory information security awareness training program, and the Office of Information Security started monitoring potential password-sharing activities. With regard to privileged access and Infrastructure change management, controls were strengthened as part of the FY08 Internal Controls for Financial Reporting exercise.</td><td>IEG comments on focus and design of corrective actions, creation of new controls compared to 2007 and likely impact:

• IEG regards the password sharing and the staff rotation and access privilege issues to be now closed.</td></tr>
</table>

Attachment 1: Management Report

REVIEW OF IDA INTERNAL CONTROLS: REPORT ON THE COMPLETION OF MANAGEMENT'S FIVE-POINT ACTION PLAN

Operations Policy and Country Services (OPCS)

September 2, 2010

ABBREVIATIONS AND ACRONYMS

AAA	Analytic and advisory activities
AFR	Africa Region
BBL	Brown-bag lunch (informal seminar)
BP	Bank Procedures (statement)
CA	Corrective action
CODE	Committee on Development Effectiveness
COSO	Committee of Sponsoring Organizations of the Treadway Commission
CPPO	Chief Procurement Policy Officer
CY	Calendar year
DFGG	Demand for Good Governance
EAP	East Asia and Pacific Region
ECA	Europe and Central Asia Region
F&C	Fraud and corruption
FIR	Final Investigative Report
FM	Financial management
FMPM	Financial Management Practices Manual
FMSB	FM Sector Board
FPAP	Five-Point Action Plan
FY	Fiscal year (World Bank: July 1-June 30)
GAC	Governance and anticorruption
IAD	Internal Audit Vice Presidency
IBRD	International Bank for Reconstruction and Development
ICFR	Internal Controls over Financial Reporting
IDA	International Development Association
IEG	Independent Evaluation Group
IFC	International Finance Corporation
IL	Investment lending
INT	Integrity Vice Presidency
IOP	Implementation Oversight Panel
IRM	Integrated Risk Management
ISR	Implementation Status and Results Report
IT	Information technology
JET	Joint Evaluation Team
LCR	Latin America and the Caribbean Region
MDB	Multilateral development bank
MNA	Middle East and North Africa Region
MoU	Memorandum of Understanding
OP	Operational Policy (statement)
OPCFM	OPCS Financial Management Unit
OPCPR	OPCS Procurement Unit
OPCS	Operations Policy and Country Services
ORAF	Operational Risk Assessment Framework
PCN	Project Concept Note
PFM	Public financial management
PPR	Procurement Post Review
PR	Procurement
P-RAMS	Procurement Risk Assessment and Management System
PRIMA	Portfolio Risk Management (FM)
QA	Quality assurance
QAG	Quality Assurance Group
QALP	Quality of Lending Portfolio
QPRs	Quarterly Progress Reports
RAPMAN	Risk and Portfolio Management System (FM/ECA)
RBL	Results-based loan
SAP	Systems, Applications and Products in Data Processing [Enterprise Software corporation]
SAR	South Asia Region
UN	United Nations

REVIEW OF IDA INTERNAL CONTROLS: REPORT ON THE COMPLETION OF MANAGEMENT'S FIVE-POINT ACTION PLAN

CONTENTS

ANNEXES

FIGURE AND TABLE

REVIEW OF IDA INTERNAL CONTROLS: REPORT ON THE COMPLETION OF MANAGEMENT'S FIVE-POINT ACTION PLAN

EXECUTIVE SUMMARY

1. In the IDA14 Replenishment Report, Management committed to carry out a comprehensive independent assessment of IDA's control framework. This exercise broke new ground and was the first of its kind among international development institutions. Each phase of this assessment included three tiers: Management's self-assessment, a review by the Internal Audit Vice Presidency (IAD), and an independent evaluation of both by the Independent Evaluation Group (IEG). IEG assembled an International Advisory Panel, and Management created an Implementation Oversight Panel (IOP), both including non-Bank members, to serve as oversight bodies to the review. The assessment covered the full range of internal control aspects included in the framework developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The purpose of this document is to describe the work undertaken by IDA Management to respond to the findings of the three-tier IDA controls review (also referred here as "the 2008 Review" or "the Review"), and to inform IDA shareholders of its completion.

2. ***Findings.*** All three parties to the 2008 Review—Management, IAD, and IEG—reached a similar conclusion regarding the overall adequacy of the internal controls over IDA operations. IEG summarized its findings by stating that "with some important qualifications, IDA's internal control framework operates to a high standard overall, giving reasonable assurance that the controls operate effectively." IEG's International Advisory Panel stated that the results of this exercise reflected a high level of effectiveness in IDA, compared to other organizations. The Director-General, Evaluation, acknowledged that the exercise "[broke] new ground within IDA, and [was] the first exercise of its kind among the international development institutions." Management, IAD, and IEG also agreed on the nature of the deficiencies uncovered in five areas: (a) investment lending; (b) risk management; (c) integration of fraud and corruption into operations; (d) financial management and procurement; and (e) information technology processes, and systems for analytic and advisory activities (AAA). The three parties had somewhat different views, however, with respect to the materiality of these deficiencies. Management categorized the issues it found as *significant deficiencies*; IAD concurred with Management's assessment and opined that a combination of *significant deficiencies* could represent a *material weakness* in the absence of timely remediation; and IEG found one *material weakness* in the area of fraud and corruption and six *significant deficiencies*. Also, as part of the review, 32 key IDA processes were mapped and 115 control points were identified and tested along these processes; 10 of these 115 controls, concentrated in the areas of financial management, procurement, and loans management, failed the testing and required correction.

3. ***Management's Response: Five-Point Action Plan.*** Management took the findings of the 2008 Review seriously and considered the review as a timely opportunity to take an in-depth look at the systems of control over IDA operations and improve them further. It devised a strong

program of remedial actions to address the deficiencies identified by the review, organized around the five areas of significant deficiencies that Management's self-assessment had identified. IAD has used Management's Five-Point Action Plan (FPAP) as the basis for its reviews, and Management believes that IEG is also comfortable with the scope of the actions in the FPAP.

4. ***Progress of Remedial Plan***. In this report, the term *implemented* is used to mean that an action has been designed, tested, and is expected to be put into operation by September 30, 2010, pursuant to the commitments in Management's FPAP. In cases in which the action has only been recently launched and it is too soon to assess the operating effectiveness, implementation is being closely monitored to confirm the operating effectiveness over time. Of the 22 corrective actions (CAs) included in the FPAP, 19 have been *implemented* or will be *implemented* as of September 30, 2010. The remaining three CAs are at an advanced level of design—some of them already at the testing stage—and are planned to be fully implemented within the current fiscal year. Management has put in place satisfactory risk-mitigating actions until their completion, and considers that the lack of full implementation of these three remaining CAs does not represent a significant risk for IDA operations. The achievements in the implementation of the FPAP can be summarized as follows:

- ***Improve efficiency, effectiveness, and controls for investment lending*** (CAs 1 – 4). CAs 1 – 3 have been implemented. The new risk-based approach embodied in the Operational Risk Assessment Framework (ORAF) allows teams to match project preparation and implementation support to each project's level of risk. The ORAF is used from the earliest stage of project preparation, allowing project design to be more readily adjusted to the client's risk profile and capacities. Management has put in place mechanisms to increase the level of attention to project implementation, to mitigate potential risks to projects' development effectiveness, and has introduced or updated options for timely restructuring of projects as appropriate. Finally, CA 4 is under implementation: Management is in the process of consolidating and integrating the operational policies for investment lending, to further improve the ease and effectiveness of their application.

- ***Strengthen risk management capacity, incentives, and accountability at the project and institutional levels*** (CAs 5 – 8). CAs 6 – 8 have been implemented. Management has approached the incentive issue by setting a clear tone at the top, stressing the importance of a risk-based approach, and providing staff with tools to help them identify and discuss risks together candidly. With respect to risk management, at the corporate level, Management has revised the Integrated Risk Management framework, prepared an annual risk report based on this framework, and has reviewed, rationalized, and started to realign the quality assurance functions. Going forward, Management plans to appoint a World Bank Group Chief Risk Officer. At the project level, the new risk-based approach for investment lending clearly establishes accountabilities for different dimensions of risk, and brings together these perspectives in a comprehensive assessment of the risk to the project's development objectives. CA 5, on the other hand, is still under implementation: At the level of the operational vice presidencies, the Matrix Leadership Team is addressing issues of span of control and ensuring that there is timely learning from best practice in quality assurance and risk management across the Regions. Overall, accountabilities for risk assessment and mitigation are now much clearer and better understood throughout the organization than they were at the time of the 2008 Review, yet Management recognizes that there is room for further improvement.

- ***Better integrate the prevention of fraud and corruption (F&C) into operations*** (CAs 9 – 14). These CAs have been fully implemented, and have significantly changed the way the Bank does business. Protocols for cooperation between INT, OPCS, and the Regions have been established; wide-ranging measures have been put in place to promote good practices in preventing F&C and strengthen guidance to staff; tools for "smart" project design, incorporating F&C detection and prevention measures as part of project design, have been created; INT's new Preventive Unit is now actively working with the Regions; and a database to monitor and report on the progress of action plans for following up on INT reports has been created. Along with such important institutional developments as the follow-up on each of the 18 recommendations of the Volcker Report and the reform of the Bank's sanctions system, these corrective actions represent a substantial strengthening of the Bank's ability to detect and mitigate F&C risks.

- ***Tighten fiduciary controls*** (CAs 15 – 19). These CAs have been fully implemented. Controller's and OPCS established a Joint Evaluation Team to determine whether the Bank's financial management quality arrangements are sufficiently robust; at the same time, the Financial Management Sector Board has recorded a visible improvement in specific quality assurance indicators. In Procurement, several tools have been put in place or strengthened to improve the identification, monitoring and management of risks and the timely and substantive interaction and coordination between procurement staff, task teams, and sector managers. Also, OP/BP 11.00, *Procurement*, and the Procurement Guidelines have been updated to better incorporate risk management, enhance complaint handling, and mainstream risk-based procurement assessment. In addition, the 10 procurement, financial management, and loans management controls that were assessed as "failed" in 2008 have been retested and found to be operating effectively.

- ***Strengthen the role of IT in risk management and improve AAA processes*** (CAs 20 – 22). CAs 20 and 21 have been implemented. Controls have been put in place to prevent password sharing and restrict staff access to privileged information when rights have expired. All staff members had to pass an IT security test, which heightened awareness of IT security risks. The Operations and Knowledge Systems Program (OKSP), a major institutional IT initiative, has established an upgraded Project Portal, Ops 2.0, to implement the risk-based lending process with document retention features, which was launched on July 1, 2010. In addition, a new Bankwide document repository system, WBDocs, which will help to ensure timely processing, archiving, and retrieval of documents associated with Bank business, has been designed and tested and will be made available for staff use, starting with the LCR Region in late September 2010. The IRIS document storage system will remain in operation in parallel (and has been retrofitted to comply with the new Access to Information requirements) until WBDocs is fully rolled out in all the Regions. CA 22, addressing processes and controls for AAA, is still under implementation: the corporate strategy and governance frameworks have been developed, AAA management protocols are being clarified and simplified, and recording practices at the unit level have improved demonstrably. A presentation on the new features of the AAA control system will be made to CODE in FY11 Q2.

5. ***Management's Assertion***. Given the overall progress in implementing the actions outlined in the Management Response to the Review of IDA Internal Controls, Management asserts that IDA internal controls have been significantly strengthened at both transaction and entity levels. It is Management's judgment that the issues with the controls for F&C found during the Review have been substantially addressed, in both design and implementation, and no longer constitute a material weakness as had been identified by IEG. Substantial progress has also been made in remediating the other significant deficiencies, and mitigating actions are in place for those few actions that require more time for finalization. This assertion has been endorsed by the IOP.

6. ***Link to the Bank's Internal Reforms***. Management has taken the opportunity to embed the remedial actions responding to the 2008 Review in the broader set of internal reforms presented to the Development Committee in the Spring of 2010—that is, investment lending reform, the review of the organization's Matrix, the Knowledge Strategy, and the OKSP. While augmenting the complexity and length of the remediation process, this decision has also strengthened the sustainability and robustness of IDA's overall control framework.

7. ***Monitoring Going Forward***. Starting in FY11, the performance and impact of IDA controls will be monitored through IDA's regular monitoring and reporting systems. These monitoring systems include (a) the realigned portfolio quality assurance system; (b) Financial Management and Procurement annual reports and quality assurance reporting systems; (c) the institutional database for follow-up on Regional action plans in response to INT reviews; (d) the results framework on the Bank's internal reforms; and (e) the new Institutional Risk Management system, which will aggregate risk management reporting at the corporate level. Regular IAD reviews and IEG evaluations of the development effectiveness of IDA's interventions complete this monitoring framework.

REVIEW OF IDA INTERNAL CONTROLS: REPORT ON THE COMPLETION OF MANAGEMENT'S FIVE-POINT ACTION PLAN

I. INTRODUCTION

1. This report presents Management's assessment of the progress in addressing the findings of the 2008 IDA Internal Controls Review.[1] It fulfills the engagement Management made in the Management Response issued to the Audit Committee and CODE on February 2009.[2] In responding to the 2008 Review, Management devised a Five-Point Action Plan (FPAP) consisting of 22 corrective actions (CAs), and this report presents evidence that the CAs have been substantially completed (see Annex A). On the basis of this evidence, Management asserts that IDA internal controls have been significantly strengthened at the transactions and entity levels, with an overall improvement in the control environment.

2. ***The IDA14 Internal Controls Review.*** In the IDA14 Replenishment Report,[3] Management committed to carry out, and make available to the public, a comprehensive independent assessment of IDA's control framework, including internal controls over IDA operations and compliance with its charter and policies. Each phase of this assessment included three tiers: Management's self-assessment, a review by the Internal Audit Vice Presidency (IAD), and an independent evaluation of both by the Independent Evaluation Group (IEG). The assessment covered the full range of internal control aspects included in the framework developed by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)[4]—formal controls as well as issues of communication, organizational behavior, and leadership. IEG assembled an International Advisory Panel, and Management created an Implementation Oversight Panel (IOP), both including non-Bank members, to serve as oversight bodies for the review.

3. ***Overall Findings.*** At the end of an intensive effort stretching from 2005 to 2008, all three parties to the 2008 Review—Management, IAD, and IEG—reached a similar conclusion regarding the overall adequacy of the internal controls over IDA operations. IEG summarized its findings by stating that "with some important qualifications, IDA's internal control framework

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1 See *Review of IDA Internal Controls: An Evaluation of Management's Assessment and the IAD Review: Report on the Completion of Part II* (AC2008-0147; CODE2008-0098), December 29, 2008, referred to in this document as "the Review" or "the 2008 Review."
The Review was made public in April 2009 and can be accessed via IEG's external website at http://web.worldbank.org/external/default/main?noSURL=Y&theSitePK=1324361&piPK=64252979&pagePK=64253958&contentMDK=22142204

2 See *Review of IDA Internal Controls—Management Response and Updated Summary of Management's Overall Assessment* (AC2008-0154/1; CODE2008-0101/1), February 25, 2009, referred to as the "Management Response."

3 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, 2006), paragraph 39, under the Disclosure bullet.

4 In 1992 COSO published a report, *Internal Controls—Integrated Framework,* which IDA adopted in 1995.

operates to a high standard overall, giving reasonable assurance that the controls operate effectively." IEG's International Advisory Panel stated that the results of this exercise reflected a high level of effectiveness in IDA, compared to other organizations.[5] The Director-General, Evaluation, acknowledged that the exercise "[broke] new ground within IDA, and [was] the first exercise of its kind among the international development institutions."

4. ***Issues.*** While IDA's overall control framework was found to be robust, Management, IAD, and IEG also agreed that IDA controls presented some issues, concentrated in a few key areas. The three parties agreed on the nature of these deficiencies, but had somewhat different judgments as to their materiality (see Annex B): Management categorized the weaknesses it found as *significant deficiencies* in five areas; IAD concurred with Management's assessment, and opined that "the identified *significant deficiencies* relating to fiduciary controls, entity-level controls, controls over F&C, and information technology (IT) controls, in combination, could represent a *material weakness*, such as there is a reasonable possibility that internal control failures may not be prevented or detected in a timely manner to ensure IDA's ability to meet its internal control objectives, unless remediated in a timely manner and effectively monitored on an ongoing basis."[6] IEG found a material weakness in the "controls over F&C in operations"[7] but stressed that its finding was "based on the *risk* of F&C rather than any clear measure of the extent to which F&C may have actually occurred in operations supported by IDA financing," and should overall be "considered a quite respectable outcome from the first (and very detailed) exercise of its kind for IDA."[8] Also, as part of the review, 32 key IDA processes were mapped and 115 controls were identified and tested along these processes; 10 of these 115 controls (concentrated in the areas covered by the financial management and procurement units and loan management) failed the testing and required correction.[9]

5. ***Management's Response***. In the Management Response, Management acknowledged the importance and usefulness of the Review for IDA. The exercise enabled Management to take a comprehensive look at the system of controls over IDA operations and assess the mechanisms to monitor these processes, adjust them to respond to emerging risks, and support the evolving needs of IDA clients. As the first of its kind, this assessment consumed more time and resources than any of the assessment participants had originally envisaged; however, it resulted in the design and application of a ground-breaking methodology for control review in a large and complex organization like the Bank, and it also yielded strong factual knowledge about the Bank's controls. In addition, the benefits of the exercise transcend IDA and extend to IBRD, as most of the processes and controls benefited by this exercise apply also to IBRD functions and operations.

6. ***Five-Point Action Plan.*** Management summarized its proposed remedial actions in a Five-Point Action Plan (FPAP) organized around the five significant deficiencies that Management's self-assessment had identified (see Annex A). The Executive Directors supported the FPAP as the framework for assessing Management's progress in addressing the issues

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5 See the 2008 Review, Volume III, Attachment 3, Statement of the Advisory Panel, Section 5.

6 See the 2008 Review, Volume III, Attachment 2.

7 See the 2008 Review, Vol. I, para. 2.32.

8 See the 2008 Review, IEG Evaluation, para. 2.19.

9 See Management Response, Annex 2.

highlighted by the 2008 Review. IAD has used the FPAP as the basis for its reviews, and Management believes IEG is comfortable with the scope of the actions in the FPAP. The self-assessment summarized in section II of this report is, therefore, organized along the five areas of the FPAP.

7. ***FPAP's Link to the Bank's Internal Reforms***. Management has taken the opportunity to embed the remedial actions resulting from the Review in a broader set of internal reforms that it has been carrying out over the past couple of years.[10] This approach has augmented the complexity and the length of the remediation process, but it has also helped the remedial actions take deeper root in IDA's structure and processes, enhancing their sustainability. The following are some of the links between the IDA Controls remedial actions and key internal reforms:

- ***Investment lending reform***. In early 2009, Management launched a comprehensive effort to reform the investment lending (IL) instrument.[11] With an emphasis on improved, comprehensive risk management at the project level and enhanced implementation support, the reform effort explicitly targets many of the key issues identified by the 2008 Review.
- ***Review of the Matrix***. The Matrix Leadership Team has taken up managerial and staff accountability as one of the key issues on its agenda,[12] increasing the visibility of the topic, focusing senior managers' attention on it, helping to set a firm timeframe for its resolution, and establishing a link to related corporate issues such as span of control.
- ***Knowledge Strategy***. The discussion of the Knowledge Strategy resulted in the development of a strategic and governance framework for knowledge products,[13] providing a solid foundation for strengthening practices, processes, and controls for analytic and advisory activities (AAA).
- ***Operations and Knowledge Systems Program (OKSP)***. The OKSP provides a much more robust and sophisticated IT foundation than anticipated by the 2008 Review in two key areas: (a) a comprehensive document repository (WBDocs); and (b) systematic mapping of key controls and their documentation and clearance requirements, which teams need to use for project processing via the web-based Project Portal (Ops 2.0). Thanks to these technological improvements, key IL controls will be monitorable in a more automatic, systematic, and regular fashion than was possible at the time of the 2008 Review.

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10 See *New World, New World Bank Group: (II) the internal Reform Agenda* (SecM2010-0147; IDA/SecM2010-0123; IFC/SecM2010-0030; MIGA/SecM2010-0015), March 22, 2010.

11 See *Investment Lending Reform—Concept Note* (SecM2009-026), January 29, 2009, and subsequent progress reports: *Moving Ahead on Investment Lending Reform: Risk Framework and Implementation Support* (SecM2009-0442, IDA/SecM2009-0499), September 9, 2009, and *Investment Lending Reform—Update* (CODE2010-016), March 31, 2010.

12 See *Towards a More Effective Matrix* (SecM2010-0137), March 10, 2010.

13 See *Transforming the Bank's Knowledge Agenda: A Framework for Action* (SecM2010-0052; IDA/SecM2010-0038; IFCSecM2010-011; MIGASecM2010-0008), February 5, 2010.

II. MANAGEMENT'S ASSESSMENT

8. Given the progress in implementing the actions outlined in the Management Response to the Review of IDA Internal Controls, Management asserts that IDA internal controls have been sufficiently strengthened at both transaction and entity levels. ***It is Management's judgment that the issues with the controls for F&C identified through the Review are substantially addressed, in both design and implementation, and no longer constitute a material weakness as had been identified by IEG. Substantial progress has also been made in remediating the other significant deficiencies, and mitigating actions are in place for those few actions that require more time for finalization.*** This assertion has been endorsed by the IOP. This section describes the progress in implementing[14] the 22 CAs that Management identified as key for addressing the deficiencies identified in the 2008 Review and provides the basis for Management's assertion. This assessment of progress has benefited from IAD's ongoing reviews, from first-hand observation of processes and review of relevant documents, and from discussions with Bank management and staff and with IAD and IEG counterparts.

A. Improve Efficiency, Effectiveness, and Controls for Investment Lending

9. At the core of the IL reform effort is Management's commitment to resolve the issues identified by the 2008 Review: inefficient project processing that did not sufficiently take into account risk (including the risk of F&C) and borrower capacity; sometimes inadequate attention to risk identification and results monitoring during project supervision; and a backlog in updating the complex body of OP/BPs for IL which, while not having a material impact on compliance and development objectives, did result in inefficiency and ambiguity. The four corrective actions under this first point of the FPAP encapsulate Management's approach to addressing these issues.

Corrective Action #1: Match the demands of the process to the level of risks and focus resources on higher-risk projects.

10. This CA has been implemented: the new Operational Risk Assessment Framework (ORAF) satisfies this objective. ORAF provides a comprehensive and systematic approach to the assessment of the risk to a project's development objectives at all stages, from preparation through implementation. It explicitly takes into consideration risks from different sources—project stakeholders, the operating environment (country and sector/institutional), implementing agencies, and the project's own design, social and environmental implications, and delivery quality (see Annex C). Staff are expected to incorporate the risks of F&C, especially at the level of the implementing agency.

11. ***Risk-based Approach.*** At the Project Concept Note (PCN) stage, the Region uses the outcome of the ORAF assessment to decide on the overall level of risk (including fraud and corruption) to the project's development objectives, the timing for the potential emergence of

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14 In this report, the term *implemented* is used to mean that an action has been designed, tested, and expected to be put into operation by September 30, 2010, pursuant to the commitments in Management's FPAP. In cases in which the action has only been recently launched and it is too soon to assess the operating effectiveness, implementation is being closely monitored to confirm the operating effectiveness over time.

these risks, and the possible mitigating actions—and makes a decision on the processing mode on this basis.[15] With this new approach, the demands of the project preparation process can effectively be adjusted to the level of risk to the project's development objectives, and Management and staff attention can in practice be rebalanced to allow increased scrutiny to projects with higher levels of risk.

12. *Timeline.* The design of the ORAF has been completed, and pre-rollout activities were initiated in all Regions during FY10. As of June 30, 2010, 50 new projects had gone through ORAF risk reviews. Starting on July 1, 2010, all projects with a PCN meeting taking place on July 1 or after are being processed according to the risk-based approach. Projects for which the PCN meeting took place before July 1, 2010, are being processed according to the preexisting system. Nevertheless, going forward, Management is committed to ensure that appropriate mechanisms are in place to assess and record the risks to development objectives of projects under implementation. Management is presently exploring ways by which this can be done with the least disruption to the implementation of programs.

Corrective Action #2: Strengthen IL supervision by increasing resources, support, and management oversight of project implementation.

13. This CA has been implemented: Management has put in place a number of measures to enhance implementation support by (a) strengthening emphasis on implementation and supervision support; (b) sharpening the focus on results and capacity building; (c) increasing flexibility for adjusting operations where necessary; and (d) strengthening incentives for and recognition of implementation support efforts. Two key new tools help achieve these objectives: the Implementation Support Plan, part of the documentation for all new projects, which helps to anticipate challenges and issues that may emerge during project implementation; and the new template for the Implementation Status and Results Report (ISR), the key tool for monitoring and reporting on project result and risks during implementation. The new ISR template—designed in FY10 and available in the new Project Portal (Ops 2.0) as of July 1, 2010—allows for better monitoring and reporting of results and risks, easier navigation and accessibility, automatic migration of data from the new PAD template to the ISR (which saves staff time and helps to ensure consistency across documents in the project cycle), and clarity on which are the disclosable sections, according to the new Access to Information policy. Two additional measures already in place provide space and incentive for teams to consider readjusting projects under implementation to improve their development effectiveness and results: new guidelines for project restructuring, which allow for simpler and more appropriate processing of project changes during implementation; and the new approach to IDA cancellation and recommitments. Moreover, in FY10 Management initiated the Implementation Support Operations Committee

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[15] If the risk level at preparation stage is deemed relatively low or can be adequately mitigated, the project may be processed according to "Track 1" (the "express lane"), which involves the Project Appraisal Document (PAD), which has been now revised and simplified, and fewer PAD annexes; four instead of five decisions points (i.e., no Decision Meeting); fewer clearance points; and possibly simplified assessments. If the risk level at preparation stage is deemed relatively high or possible mitigation is limited, the project should be processed according to "Track 2," or "regular" preparation, which involves the use of the Project Appraisal Document with more annexes, and standard preparation and clearances. It should be pointed out, however, that on either track, the principles of the Bank's social, environmental, and fiduciary policies apply to all projects.

(IS-OC) meetings, chaired by the Managing Directors, which focus high-level attention and effort on resolving important implementation issues.[16]

Corrective Action #3: Tailor design and financing options under the IL instrument more closely to the needs, capacity, and risk profile of clients.

14. This CA, which is closely related to the first two CAs, has been implemented. Early consideration of risks during project preparation via the ORAF allows teams to adjust project design to make it more realistic and appropriate to the client's implementation capacity, or to ensure that mitigating actions are in place for risks that can be anticipated. Several examples illustrated the power of this feature during the pre-rollout of the risk-based approach when, with the help of the Bankwide IL Risk Team,[17] project teams were able to introduce significant improvements to project design.[18] The risk-based approach continues through implementation, via the ISR; this allows teams to focus better on risk monitoring and mitigation, and readjust project components or mitigating actions to reflect new knowledge gained with implementation. Other new policies or processes facilitate or provide the incentives and the enabling environment for timely tailoring of projects to country circumstances and needs. For instance, the new Restructuring Guidelines make adaptation to changing circumstances easier and faster. Also, the update of OP/BP 13.20, *Additional Financing*,[19] and the related guidance to staff allow the Bank to provide additional resources in the context of ongoing, well-performing projects to implement additional or expanded activities that would scale up the project's impact, to implement modified project activities in the context of restructuring or address justified unanticipated financing gaps. Together, these measures have allowed teams much more flexibility to customize projects to clients' needs and capacities—within clear parameters for adequate risk management—than was possible at the time of the 2008 Review, improving the chances for achieving higher impact and thus making the best use of scarce development resources.

15. ***Menu of Instruments.*** More broadly, Management has been discussing the Bank's menu of lending instruments with Executive Directors. In January 2010, an informal Board discussion considered the overall menu of Bank instruments. In March 2010, an update on the IL reform

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16 The first IS-OC meeting, held in February 2010, discussed the implications of the rapid increase in lending as a result of the 2008-09 economic crisis; Regions presented their processes for reviewing the portfolio and identifying projects which may require more supervision resources. The second, held in May 2010, dealt with sectors and themes that present specific risks at implementation, specifically operations that involve land issues. The third, held in June 2010, dealt with implementation issues of programmatic investment lending.

17 The IL Risk Team, composed of at least one experienced representative from each Region, under OPCS coordination, provides advice and guidance to task teams; for "Track 2" projects, it reviews at PCN stage; it helps to harmonize risk ratings across the Regions and share lessons across teams; draws lessons from the applications of ORAF; and it will review risk management in ISRs on an ex-post and sample basis.

18 Examples: (a) teams preparing social funds for two different countries (Yemen and Honduras) were put in contact with each other by the IL Risk Team, leading to learning on how to manage stakeholder risk across teams; (b) when the risk to the development objectives of the India National Highways Authority Technical Assistance project was deemed too high at PCN stage, the team was advised to simplify the components and clarify and streamline project design, leading to better risk mitigation and Management comfort with processing the project on "Track 1," while maintaining development objectives; and (c) the team preparing the Panama Metro Water and Sanitation project returned to the client for a discussion on how aspects of the project could be redesigned to reduce the risk.

19 See *Additional Financing: Responding to New Needs* (SecM2009-0025), January 29, 2009.

elicited CODE members' feedback on a new lending option under development (the results-based loan, or RBL), which would provide support for government programs or subprograms, with disbursements linked to progress on monitorable indicators. Feedback received during these discussions and lessons from such operations as sectorwide approaches, output-based lending, and results-based financing (e.g., in the health sector) are being incorporated into the design of the RBL. The concept for the proposed RBL will be scheduled for CODE discussion at the beginning of FY11 Q2.

Corrective Action #4: Consolidate multiple rules into clear key principles to inform design and processing.

16. This CA is under way and will be fully implemented during FY11. During FY10, Management has started to develop a broad framework for the IL policy consolidation, based on a review of each of the relevant OP/BPs to identify the key policy principles and pinpoint duplication and outdated material, and on a scan of approaches to operational policy by IFC and by other multilateral organizations, searching for possible lessons and good practices. This provides a good basis for a discussion of the architecture of the OP/BPs going forward.

17. ***Timing and Mitigating Measures.*** From the outset, Management conceived this CA in sequence with the completion of the design and piloting of the ORAF and enhanced implementation support. Only after developing a solid design and good sense of potential implementation challenges for these crucial components of the IL reform could the needed policy framework be structured. Management is working toward providing a technical update on the OP/BP consolidation in September 2010, and completing the consolidation by end-FY11, after extensive consultation inside and outside the Bank. In the meantime, risks associated with the absence of a consolidated policy framework will be mitigated through the availability of comprehensive guidance to staff on the new risk-based approach and the enhanced implementation support, including via a helpdesk, the new IL website, and directly in the Project Portal (Ops 2.0) as part of the new templates for the ORAF, project concept notes, ISRs, etc.

B. Strengthen Risk Management Capacity, Incentives, and Accountability at the Project and Institutional Levels

18. Events and entity-level surveys preceding the 2008 IDA Controls review[20] revealed room for improvement in identifying, reporting, and addressing operational risks throughout the project cycle, but especially at the supervision stage. Management has taken a number of actions to address this issue not only at the project level, but also in terms of institutional enabling conditions related to institution-wide reform efforts. At both project and institutional levels, these actions aim to clarify accountabilities for risk identification and reporting, strengthen management and staff incentives to acknowledge risk, and improve the mechanisms for monitoring and oversight.

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[20] Relevant sources include, for instance, the Entity Level Control Questionnaire (covering COSO- and F&C-related questions, completed by department-level senior managers during the IDA Controls review, for the identification of perceived entity-level issues); the Detailed Implementation Review of the India Health Sector 2006-2007, issued December 19, 2007, by the Department of Institutional Integrity; and the "Volcker Report," Independent Panel Review of the World Bank Group Department of Institutional Integrity, September 13, 2007.

Corrective Action #5: Review lines of accountability at the management and staff levels.

19. Significant progress has been achieved on this CA with the completion of the Bankwide review of Regional managerial accountability and the establishment of ORAF. In 2009, OPCS coordinated a review of accountability in all Regions to identify possible pressure points and gaps in accountability in the matrix organization. The Matrix Leadership Team discussed these issues during a retreat on June 25, 2010, and concluded that lines of accountability are generally clearly defined and well understood at the project level. The mapping of IL control points that was developed in Part I of the IDA Controls Review[21]—updated to reflect the risk-based approach and the stronger focus on implementation—has helped as one of the organizing principles for the Matrix Leadership Team discussions of accountability at the project level. For instance, after IL reform, key control points during project processing include clear assignment of accountability (and, when needed, clear delegation protocols). These assignments of accountability are "hard-wired," in turn, into the project workflow protocols in the new Project Portal (Ops 2.0). In other words, completion of key control points in project processing in the system requires submission of specific documents and recording of specific clearances by the accountable managers, thereby significantly strengthening checks and balances for accountability through the project cycle. The MLT recognized, however, that there is still room for improvement. At the transaction level, the key issue pending resolution is the broad span of control of sector managers—who are accountable for many of the controls in the IL preparation and implementation process and often oversee substantial numbers of operational staff—particularly in the context of growing portfolios and flat budgets. At the entity level, differences in approaches to delegation across Regions (e.g. to sector leaders vs. country sector coordinators) provide an opportunity for learning across Regions and extension of good practices.

20. ***Timing and Mitigating Actions.*** The Regions' Operations Directors have been tasked with completing a cross-Regional learning exercise on accountability approaches (focusing on quality assurance and risk management functions) by end-CY10. Also by end-CY10, Management will look into solutions to the overly broad span of control of sector managers. In addition, risks are further mitigated by the application of the risk-based approach at the project level and, at the Regional level, by the fact that Regions have developed clearer roles and job descriptions for key operational positions, following up on the 2009 Accountability Review. Once this CA is completed, progress will be measured via regular HR monitoring systems, reports to the Board on the Matrix Reform, and the proposed FY11 IAD reviews of quality assurance in Regions.

Corrective Action #6: At the project level, introduce incentives and greater management support and oversight, and communicate expectations to staff.

21. This CA has been implemented through the establishment of the risk-based approach to project management and the wide communication effort to increase staff awareness of it and readiness to adopt it. Management has approached the incentive issue by setting a clear tone at the top, stressing the importance of a risk-based approach, and providing staff with tools to help

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[21] See the 2008 Review, Volumes IV and V.

them identify and discuss risks together candidly. The use of the risk-based approach throughout the project cycle prompts staff to analyze risks and allows them to bring issues to Management's attention on a timely basis. Management review of projects focuses on risk assessment on at least three levels: the Country Director, the Regional Vice President and, for the higher-risk projects, the Operations Committee chaired by the Managing Director. In addition, the IL Risk Team further helps and encourages teams to take a proactive approach to risk identification and mitigation, and provides a more consistent perspective on risk issues across projects, allowing for Bankwide benchmarking, lesson-sharing, and monitoring. As a result of this multilayered approach, the Bank now benefits from a culture that increasingly recognizes, openly discusses, and proactively manages risk.

22. ***Communications.*** The launch of the risk-based approach, as the mandated approach for all projects with PCN meetings on or after July 1, 2010, was announced through the Bank Kiosk, as well as through a memo from the Managing Directors to all staff. Over the previous six months, Regions had been repeatedly alerted—from the RVP and the Operations and Strategy Directors on down—to be prepared for full ORAF rollout in FY11, and an extensive communications effort had targeted staff globally: 56 Bankwide clinics and seminars (including a webinar for country office staff and sessions for SEC and EDs' advisers) and country visits for dissemination reached over 2,400 managers and staff in FY10. Focal points were established in each Region, and champions were identified in many sector and country units, to embed the communication effort within the teams. In addition, issues briefs have been made available for consistent dissemination of messages. OPCS has also set up a helpdesk and a user-friendly website (which can be reached easily by typing "ilreform" in the Bank's intranet browser) that includes fact sheets, frequently asked questions, relevant documents and templates, and a calendar of ORAF training and other activities.

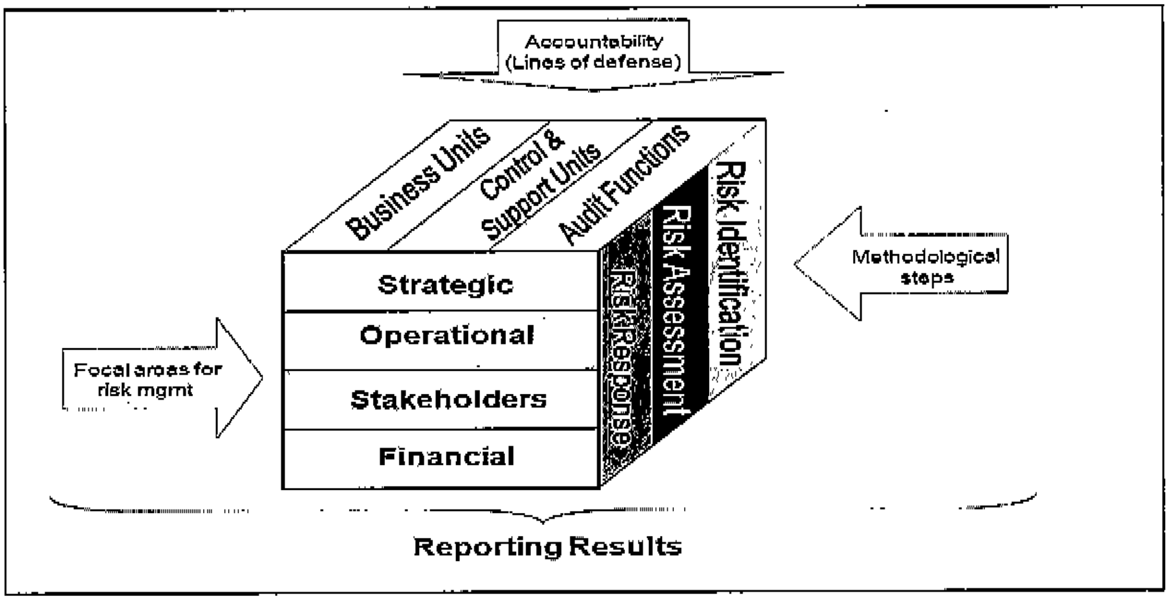
Corrective Action #7: At the institutional level, prepare an annual integrated risk report.

23. This CA has been implemented. As part of the Bank's efforts to improve risk management and establish mechanisms for risk aggregation at the institutional level, Management has reviewed and revised the Integrated Risk Management (IRM) framework by adopting a blended approach, incorporating the COSO Enterprise Risk Management framework as well as other methodologies and standards. Figure 1 depicts this revised IRM framework, illustrating the following:

- ***Risk taxonomy:*** the four focal areas for risk management from the original IRM framework: strategic effectiveness, operational efficiency, stakeholder support, and financial soundness.
- ***Accountability structure:*** the three lines of defense that are accountable for risk management: business units (first line of defense), control and support units (second line of defense), and the audit function (third line of defense).
- ***Methodological steps:*** the three steps through which these risks are monitored and managed: risk identification, risk assessment, and risk response.

- ***Results reporting:*** how the results of all these areas are communicated to senior Management and the Board.

Figure 1. Revised IRM Framework



24. ***Integrated Risk Report.*** As part of this revised framework, the risk taxonomy now takes into consideration "fraud and corruption" as a specific risk category. In addition, a reporting mechanism has been established to provide the Board with both quarterly and annual updates on institutional risks. The first Annual Integrated Risk Monitoring Report described what risks the Bank is facing, who is managing these risks, and how the results are reported. In addition, the report discussed the gaps and overlaps in risk management activities and provided observations about the Bank's risk management in general, drawing from results of the annual institutional risk assessment and such recent institutional reviews as those conducted by the IAD, the IEG, and the Integrity Vice Presidency (INT). While this first report did not seek to evaluate the quality or effectiveness of any particular risk management activity or unit, this will form part of the ongoing work program. Management is also working to develop a risk governance structure for the World Bank Group, including the appointment of a Group Chief Risk Officer.

Corrective Action #8: At the institutional level, review QAG, to inform a broader assessment of gaps and overlaps.

25. This CA has been implemented. In 2009 Management undertook a review of the Bank's quality assurance functions. The review was conducted by a Steering Committee of Bank Operational Directors, responsible for overseeing a team of consultants and synthesizing their work into a set of recommendations for the two Managing Directors for Operations. The consultant review was based on interviews with staff, including five Regional Vice Presidents, and an extensive document review. The review concluded that the Bank's system of quality assurance—involving the Quality Assurance Group (QAG), Regional quality units, and a number of oversight units—had served a useful purpose in addressing the quality decline in Bank operations a decade ago, but that it needed to be revised to be more compatible with the Bank's

current business model, better integrated into the existing quality assurance system, and more comprehensive. The Steering Committee recommended that a reform of the system should involve a full integration of the quality assurance function into the existing system of Regional quality assurance mechanisms to ensure that it would be (a) consistent with the existing managerial accountability for operations, (b) integrated into current quality assurance functions at the regional level, and (c) consistent with the ongoing reform of lending processes and procedures. Based on the Steering Committee's recommendations, it was agreed that the Quality Assessment of Lending Portfolio (QALP) be continued on a biannual basis, that Regional quality units be strengthened to take on the enhanced quality functions, and that OPCS take on the corporate portfolio management and reporting functions previously performed by QAG. As a consequence, the remaining functions of QAG were integrated into OPCS and QAG was dissolved as a separate administrative unit as of July 1, 2010. These actions were endorsed by the Bank's Senior Management in FY10. After Senior Management endorsement, CODE and the Executive Directors were informed of the changes and the realignment of the Bank's quality assurance was announced in May 2010.

C. Better Integrate the Prevention of Fraud and Corruption into Operations

26. The Independent Panel Review of the World Bank Group Department of Institutional Integrity (the "Volcker Report") recognized the Bank's leadership role in making an intellectual case against F&C.[22] The Bank has performed or commissioned substantive diagnostic and assessment work to identify priorities for action to mitigate F&C risks, and the Bank's Executive Directors and Management have demonstrated the breadth and depth of their commitment to the governance and anticorruption (GAC) agenda.[23] Drawing on this increasingly solid foundation of knowledge and Management commitment, the 2008 IDA Controls Review described the range of actions undertaken to strengthen controls over F&C risks in operations: (a) actions in response to the Volcker Panel Report (elevating the INT head to a VP level, establishing a prevention services unit within INT, increasing access to lessons from INT work by initiating a revision of INT's disclosure policy, including INT as a participant in Operations Committee reviews and meetings of the operational vice presidents, and establishing an Independent Advisory Board to confirm and build confidence in the fairness and effectiveness of INT's work); (b) launch of the GAC agenda and, within it, the "GAC in Projects" network, and the provision of guidance to task team leaders; (c) dissemination of good practice lessons, through learning and training events and INT's work with project teams; and (d) specific measures in the procurement and financial management (FM) areas.[24] To supplement these actions, the enabling environment for mitigating F&C risks has been enhanced in the past two years with sanctions reform and establishment of cross-debarment across multilateral development banks (MDBs).

27. ***Attention in the IDA Controls Review.*** Nevertheless, addressing the risk of F&C remained one of the most discussed areas in the 2008 Review, and was deemed to be an area for strengthened attention and further improvement. Management acknowledged the existence of

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22 Volcker Report, *op. cit.*

23 See *Strengthening World Bank Group Engagement on Governance and Anticorruption -- Second-Year Progress Report* (SecM2009-0506; IDASecM2009-0544; IFCSecM2009-0062; MIGASecM2009-0043), October 2, 2009.

24 See Management Response, paras. 36-42.

significant deficiencies in the controls aimed at detecting and addressing F&C risks, particularly in reference to investment lending; IEG's own review elevated these deficiencies to the level of a material weakness. It is important to reiterate that the Review found no evidence of actual F&C affecting Bank projects, but referred only to the ability of the existing controls to identify and mitigate such risks.

28. ***Corporate and Country Framework.*** The 2008 IDA Controls Review yielded a number of F&C-related recommendations, reflected in CAs 9 – 14 of the FPAP—actions that sought to accelerate, deepen, or extend the initiatives begun before 2008, and also to establish new measures to strengthen the implementation of the GAC strategy through better integration into the Bank's daily operations. These actions are linked with, and influenced by, other CAs (especially 15 – 19, addressing fiduciary controls). They are also framed by the continuing corporate anticorruption agenda (including progress in implementing the GAC Strategy, the new cross-debarment protocol with other MDBs, and sanctions reform). And they are complemented by the important developmental role that IDA's country-level work plays in helping client countries strengthen their own systems for mitigating F&C risks.[25]

Corrective Action #9: Establish clear responsibility and accountability for addressing F&C issues.

29. This CA has been implemented. Accountability for ensuring adequate management of risks of F&C at the corporate level is now clearly assigned to one of the Managing Directors for Operations. A Governance and Anticorruption Council, made up of VPs and chaired by the MD, meets monthly to examine different corporate, regional, and sectoral issues, and issues yearly progress reports on the implementation of the Bankwide GAC strategy. Regional vice presidents are responsible for identifying and managing F&C risks at the Regional level, and they meet periodically with INT to review any issues. For sectors, Network Vice Presidents are now responsible for a progress report on "GAC in Sectors" to the GAC Council. Across projects in different Regions, the new IL Risk Team represents a corporate perspective, promoting consistency in risk identification and management. At the individual project level, the new ORAF clearly establishes the need to identify and propose mitigating actions for F&C risks that may have an impact on projects' development objectives, relating to country conditions (accountable manager: country director), sector and institutional conditions (sector manager), and project-specific risks (task team leader, with inputs from safeguard and fiduciary specialists, the lawyer and the disbursements officer). This system has been taking shape over the past couple of years, and it will be further strengthened with the full rollout of the risk-based approach in FY11.

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[25] For instance, the requirement for Country Assistance Strategies for high-risk countries to discuss more systematically how F&C may affect Bank-supported activities, their implementation, and achievement of countries' development objectives. Development policy operations also play an important role in strengthening country institutions.

Corrective Action #10: Establish appropriate protocols of cooperation between INT, OPCS, and the Regions.

30. This CA has been implemented: a number of agreements have been established to ensure systematic cooperation between INT and the Regions, directly or through such OPCS units as Procurement (OPCPR).

- ***Protocol for Handling Suspected and Alleged Fraud and Corruption in Procurement.*** This protocol clarifies the roles of, and the interactions between, operational staff, Regional management, and INT regarding: (a) the reporting of procurement-related allegations of fraud and corruption; (b) the INT case intake, prioritization and investigation process; (c) the review of requests for no-objection for procurement transactions when there has been an allegation of fraud or corruption, and follow-up with borrowers; and (d) the post-investigation process. The protocol, which entails obligations for both procurement and INT staff, was developed and rolled out by OPCPR and INT in November 2009, and is posted on both INT and OPCPR websites. Together with the revamped procurement complaint database, the protocol has helped streamline the processing of allegations of F&C in Bank operations.
- ***INT/OPCS Memorandum of Understanding on Prevention of Fraud and Corruption.*** This MoU, which resulted from the first joint working retreat of INT and OPCPR, in June 2008, was designed to facilitate the two VPUs' joint approach to preventing F&C in Bank-financed procurement by outlining the areas of engagement and coordination between them. Its objective is to strengthen the capacity of the Bank's procurement function to deal with F&C at the corporate, country, implementing agency, and individual contract levels.
- ***Assessments.*** In FY11, INT and OPCPR will pilot enhanced assessments of agencies and country systems from an F&C prevention perspective. In July 2010, the two units reviewed and assessed the progress achieved under the MoU, took stock of the effectiveness of the protocol, and refined their joint work program for the next two FYs.
- ***INT membership in the Bank's Operations Committee (OC).*** INT is now notified of all OC meetings so that they can determine if there are country, sector, or specific project issues on which they may be able to contribute in relation to identification, mitigation or management of F&C risks.

Corrective Action #11: Promote "good practices" across the Bank Group's work.

31. This CA has been implemented. Over the past two years, the Bank stepped up its development and dissemination of materials, and active training to staff, on good practices in addressing F&C risks. Many Bank units—the GAC Secretariat, INT, OPCS, and various Regions or sectors—shared experiences and offered practical knowledge and advice of immediate use to task teams. The new GAC Knowledge and Learning portal collects or provides links to many of the relevant sources and groups, as do the websites of INT, OPCPR, and the

OPCS Financial Management unit (OPCFM). Some examples of activities and specific products:

- ***Regular INT-Region meetings.*** INT meets regularly with each Region's management team to disseminate information that emanates from the complaint reviews and INT investigations. This information is passed on to staff for their use in handling the issues that arise in their day-to-day tasks.

- ***Red Flags in procurement.*** OPCPR and INT have (a) developed and published, in six languages, a leaflet—*The Most Common Red Flags in Procurement*; (b) developed an online ("e-module) Red Flags tool for operational staff (OPCPR website/currently being moved to a new IT platform); (c) finalized the complaint handling protocol; (d) developed a Quick Tip on contractor due diligence; and (e) conducted joint learning events (most recently, sessions at the Fiduciary Forum), all targeted at improving Bank staff's ability to detect and respond to Red Flags. In addition, OPCPR and INT are developing a stand-alone training module on F&C in procurement, elements of which will also be incorporated into procurement training conducted by OPCPR and INT's Flagship Training Course. The module went live on the web on July 15, 2010.

- ***FM GAC Working Group.*** The FM GAC Working Group was established in 2007 to help implement the FM GAC approach and provide guidance to FM staff on good practices. The Working Group, which comprises representatives from each of the Regions and from the Legal Department, the Loan Department, INT, Procurement, and the FM Anchor, is chaired by a Regional manager, and its annual work plan is discussed and agreed by the FMSB. Responding to demand from operational staff, the Working Group has focused more on operational aspects of GAC at the project level than on country-level activities. Major deliverables have been three "good practice" notes (on project design, project implementation, and enhanced audit and assurance); a website with additional guidance and examples, and a "good practices" project database. The Working Group reports to the FMSB and also provides inputs to the FM Annual Report.

- ***Bank procurement procedures for pharmaceuticals.*** The Health, Nutrition, and Population sector took the lead in conducting two studies (with OPCPR input) related to procurement of pharmaceuticals. The first, on bottlenecks in the procurement of health-related goods, identified problem areas in procurement of pharmaceuticals and made recommendations to improve procurement under Bank-financed health projects. The second focused on how the Bank's strategies address supply chain management issues, and how these issues are linked with the procurement of pharmaceuticals. In addition, with support from the Legal Department's Institutional Administration unit, OPCPR led discussions with several UN agencies to streamline procurement in the health sector in general, and pharmaceuticals in particular, when procurement is done through the UN agencies. This resulted in a standard form (template) of agreement for the procurement of health goods and related services, for borrowers to use under Bank-financed projects.

- ***Training and dissemination to staff.*** The FM Working Group organizes learning events—occasional BBLs and, in the past year, seven GAC training events as part of the 2010 Fiduciary Forum, and three half-day GAC training events at Regional retreats around the Forum. OPCPR has overhauled its knowledge and learning strategy to create a comprehensive training program.

- ***"Fundamentals of Operations Procurement,"*** core procurement training for Bank operational staff, has been offered monthly since March 2010 (80 staff have been trained in the first three months). The course, now part of the Operations Core Curriculum, is mandatory for all Bank staff of grades GE+ working in operations. Its objective is to increase staff awareness of the Bank's basic procurement principles, policies, and procedures, its fiduciary responsibilities, and the role of procurement staff on the task team, and to develop basic skills to detect F&C risks. The course includes a module on misprocurement, complaints, and investigations that is delivered jointly with INT. An e-learning format will be ready in FY11.
- ***"Simple Procurement Methods Accreditation,"*** a course now under development, will, among other things, help staff better understand their roles and responsibilities in preventing F&C in procurement.
- ***Monthly procurement clinics*** on various topics help procurement specialists improve their practical skills and competencies, including on issues related to F&C, sanctions, and remedies. Three clinics were delivered in FY10, and 90 staff attended (including by videoconferencing). Materials and presentations are posted on the OPCPR website.
- ***Fiduciary Forum 2010***—which over 600 staff attended—included sessions related to F&C, which were delivered jointly with INT and the Regions.
- ***"Public Procurement Reform Assessment and Dialogue,"*** a new course, will be developed in FY11 to focus on GAC issues in conducting country procurement assessments and carrying out a dialogue with the government.
- ***Other activities.*** OPCPR, as the Procurement Anchor, uses targeted distribution/ communication channels to inform staff of good practices and updates, including on sanctions reform, guidelines, and revisions to standard bidding documents related to cross-debarment, F&C, and the Bank's right to audit. In addition, in each Region the Procurement Manager's office conducts training activities—BBLs, clinics, Regional procurement retreats—that directly or indirectly address F&C, as a form of continuous professional training of Bank's procurement staff.

Corrective Action #12: Improve tools such as smart project design.

32. This CA has been implemented. The GAC Implementation Plan[26] referred to the need for "smart" project design—that is, incorporating in project design mitigating actions and approaches based on early identification of GAC risks and their drivers. Several of the tools that have been introduced facilitate smart project design: (a) the P-RAMS, a control tool aligned with the ORAF framework, which allows staff to identify procurement risks during preparation and follow them throughout the project cycle (discussed in more depth under CA 18); (b) the web-

[26] See *Implementation Plan for Strengthening the World Bank Engagement on Governance and Anti-Corruption* (SecM2007-0360), August 21, 2007.

based "Red Flags" (with versions available for tagging observed procurement and FM-related risks, and guidance to staff on both, as discussed under CA11); (c) guidance to staff such as the GAC in Projects Emerging Good Practices Note and the FM Note on Project Implementation Support; and (d) the Complaints Database, a control tool to help managers maintain, track, and electronically capture information on procurement complaints in Bank-financed projects. In January 2010, a new control feature was introduced in the Complaints Database to ensure that all relevant supporting documents and responses are filed electronically before a complaint can be closed in the database—a change that has enhanced data quality and has been applied in 100 percent of cases closed after January 2010. OPCPR's biannual quality assurance process, implemented in January 2010, was established to add a layer of control to the automated complaint alert process by notifying the Regions of all pending complaint cases over 90 days. Results are shared with the Chief Procurement Policy Officer (CPPO) and the Regional Procurement Managers.

Corrective Action #13: Prepare and monitor specific action plans for following up on INT reports.

33. This CA has been implemented. One of the 18 recommendations included in the Volcker Report was the development of a timely and comprehensive action plan for Regional VPUs to address all issues of remedies, disclosures, referrals, and future prevention related to INT's findings.[27] The Working Group appointed by the President to prepare Management's response to the Volcker report broadly endorsed this recommendation and made OPCS accountable for documenting the action plans, ensuring consistency across Regions, tracking implementation against an explicit timeline, and reporting to Management.[28] In March 2010, OPCS completed the development of an automated monitoring database that supports the reporting on the status of action plans prepared and implemented by the Regions following INT's Final Investigative Reports (FIRs). The database includes protocols for formalization, import, and export of data; capability to develop query-driven, case-profile, and comprehensive reports; and other functions. Work has proceeded in collaboration with INT (which shares a copy of each FIR with OPCS when the FIR is submitted to the President) and the Regions, which have designated focal points for Regional coordination of action plans in response to FIRs. In June 2010 OPCS completed the first status report on the action plans in response to FIRs, covering lessons from the first months of implementation of the database—on consistency of nomenclature across Regions, clarity of governance of the process, data quality, and cross-unit information flows—which OPCS, INT, and the Regions are translating into further improvements of the system.

Corrective Action #14: Issue OPCS guidance on addressing GAC issues in projects.

34. This CA has been implemented. The GAC in Projects Peer Learning Network was created in 2007 as part of the implementation of the GAC Strategy. It is led by OPCS and operates under the authority of the GAC Council. In addition to OPCS members, its membership includes GAC in Projects focal points from each of the Regions; the main sector networks,

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[27] Volcker Report, *op.cit.*, p.18.

[28] See *Implementation of the Recommendations of the Independent Panel Review of the World Bank Group's Department of Institutional Integrity* (SecM2008-0013), January 23, 2008, p. 8.

including Human Development and Sustainable Development; and INT, the World Bank Institute, and the Public Sector Governance Department (GAC Secretariat). The Learning Network's objective is to promote knowledge and learning on dealing with GAC issues at the project level by providing guidance and training and developing a community of practice. The Network has developed an active website and delivered the following main products: (a) Project preparation - Good practices for FM specialists; (b) Guidance to financial management specialists on better identification of F&C risks through "smart" project design; (c) FM approach paper on GAC; and (d) GAC good practices at the project level. Lessons from this work have been widely disseminated through training courses (delivered over the past two years in Washington, India, Kenya, Senegal, Lebanon, Vietnam, and Indonesia); an e-learning version of the training, now available on the website; a community of practice; a BBL series; and a searchable database of good practice projects, linked to the Project Portal and the GAC Knowledge and Learning Portal.

D. Tighten Fiduciary Controls

35. The 2008 Review underscored the need to strengthen fiduciary controls by identifying a number of issues: the need for consistent follow-up on procurement issues by task teams and better integration of procurement staff in those teams; inconsistent implementation of procurement post-reviews; and inconsistent quality arrangements for the documentation of FM supervision. CAs 15 – 19 address these issues. In addition, control testing during the 2008 Review found 10 failed controls, which have now been retested and found to be operating effectively.

Corrective Action #15: In financial management, institute corporate monitoring of quality.

36. This CA has been implemented. The Joint Evaluation Team (JET), sponsored by Controller's and OPCS, was established in 2008 with the mandate to determine whether the quality arrangements for the Bank's FM work are sufficiently robust and are being implemented as designed and in accordance with the 2005 Financial Management Practices Manual (FMPM). The reviews have also facilitated identification of good practice examples and fostered cross-Regional knowledge-sharing. The JET performed desk reviews of FM arrangements in two phases:

- An initial high-level confirmation that the Regions had in place quality assurance arrangements in accordance with the FMPM. This review was supplemented by walk-throughs of actual FM work at a level that was commensurate with the results of the initial high-level confirmation and informed by work of the IDA Internal Controls Review.
- Substantive testing of compliance and of the adequacy of the Regional quality assurance arrangements in practice. Under the supervision of OPCFM representatives, JET selected a random sample of 135 projects across all Regions, covering CY08.

Corrective Action #16: In financial management, integrate IT systems tracking project performance.

37. This CA has been implemented. In the past, the FM Sector used two systems—RAPMAN (in ECA and MNA) and PRIMA (in AFR, EAP, LAC and SAR)—to record and monitor critical compliance aspects of FM work. As of end-July 2010, these systems have been integrated into a single system (PRIMA II) on the Bank's SAP Project Portal and become operative Bankwide; the new system has been upgraded to improve its functionality and streamline its application across Regions. This integration enables improved interfacing with other project management systems. OPCFM carried out this work collaboratively with the Information Solutions Group, which is responsible for maintenance. The integrated and updated system ensures comprehensive recording and monitoring of FM aspects of IL portfolios throughout the project cycle; monitors compliance with quality arrangements (via exception reports); supports quality standards through standardized documentation and archiving of key issues; establishes systemic workflows to ensure timely processing of key FM fiduciary activities; and supports the implementation of a risk-based approach to the allocation of FM resources by helping focus Management attention on high-risk areas. FY10 tasks included (a) system testing by users, with close monitoring and resolution of any issues; (b) gradual data migration from the previously existing systems, with user participation in the verification; and (c) completion of user training for all 170 FM staff.

Corrective Action #17: In financial management, ensure that all records relating to quality arrangements for FM are maintained and up to date.

38. This CA has been implemented. The 2008 Review identified a number of FM issues for correction, and an Action Plan was developed to address them. The FM Sector Board (FMSB) was tasked with monitoring compliance with the agreed actions, and OPCFM agreed to provide quarterly progress reports (QPRs) on the degree of compliance. Regions are continuing their efforts to review audit reports received from borrowers and enter interim financial report (IFR) data in PRIMA for all projects under supervision. The findings of the latest QPR (FY10 Q3) are summarized in Table 1.

Table 1. Summary of FM Actions

Action	*QPR as of Dec. 31, 08*	*QPR as of Dec. 31, 09*	*QPR as of March 31, 2010*
Audit reports received but not reviewed by FM staff	834	9	0
Projects missing data entry information relating to IFRs in PRIMA II (% of total portfolio)	157 (6.7%)	79 (3%)	47 (2%)

39. ***Financial Management Manual.*** The FMSB's Quality and Results Committee led the work of updating the FMPM into a principles-based FM Manual, which became effective on March 1, 2010. The Manual's implications and details were discussed extensively at the

Fiduciary Forum with the more than 600 participants from Procurement, FM, other sectors, and development partners from the public and private sectors.

40. ***Retest of FM Controls.*** In addition, the FMSB led the process of retesting the two failed FM controls identified by the Review. OPCFM worked closely with Controller's in reviewing and updating the failed controls documentation, to better align it with the requirements of the FMPM for IL operations. The FMSB finalized the test plans in July 2009. The retesting, launched in December 2009 by the JET, entailed reviewing the operating effectiveness of the two failed controls, including the adequacy of evidence/documentation. The retesting was later independently validated by IAD. The final retesting results indicated that the two key controls are operating effectively.

Corrective Action #18: In procurement, ensure more consistent follow–through and establish clear mechanisms to resolve disagreements between procurement staff, task teams, and sector managers.

41. This CA has been implemented. Two complementary tools— the Procurement Risk Assessment and Management System (P-RAMS), and the Procurement Post-Review (PPR) system—help to improve the identification, mitigation and management of risks, including those associated with F&C, and ensure timely and substantive coordination between procurement staff, task teams, and sector managers:

- ***P-RAMS***, a control tool updated to align with the ORAF, helps identify, monitor, and manage procurement risks throughout the project cycle. P-RAMS is built on the procurement capacity assessment, extended by consideration of risks at the country, sector, and implementing agency levels. The assessor (a) identifies risks under 11 specific risk factors, (b) prepares a detailed risk mitigation plan for each identified risk, and (c) monitors implementation of the mitigation plan to ensure that the project team addresses all control risks. P-RAMS's outputs will allow project teams to calibrate their supervision efforts to maximize the Bank's ability to address the identified control risks. The tool was piloted Bankwide in late 2009 and rolled out in March 2010, when training was provided to over 60 procurement staff from country offices. To date, over 40 assessments have been completed using P-RAMS. The system is available in the Operations Portal and its use became mandatory on July 1, 2010, to coincide with the release of ORAF. A Guidance Note to staff has also been released by July 1, 2010 to explain how to transfer information between systems, and how to comply with procurement policy requirements when using P-RAMS with the traditional procurement assessments of implementing agencies. In FY11, P-RAMS will be fully integrated with ORAF to facilitate the dialogue on procurement matters within project teams.
- The ***PPR system*** helps managers better monitor and control the implementation of contracts that are subject to the Bank's post-review. Under this new system, staff can upload a PPR report in the Operations Portal and save it in the Bank's centralized electronic document management system. The system includes risk ratings and recommendations based on findings in the report—information that is then used for populating P-RAMS during project supervision. A six-month pilot of the PPR system

in 2009 showed that the system added value by (a) providing a central repository for all PPR reports during project life, and (b) facilitating the identification of procurement risks at the level of the implementing agency. The tool was implemented Bankwide in the Operations Portal as part of the revised post-review procedures introduced in August 2009 and will be integrated into the P-RAMS workflow in FY11.

Corrective Action #19: Update procurement policy to incorporate risk management, enhance complaints handling, and mainstream risk-based procurement assessment.

42. This CA has been implemented: the Guidelines on Procurement, the Guidelines on the Selection and Employment of Consultants, and OP/BP 11.00, *Procurement*, have been revised to take into account issues identified during the 2008 Review, including more explicit reference to F&C risks. There has been wide consultation and dissemination to facilitate implementation, and staff are already being directed to use the revised policy.

- ***OP/BP 11.00*** is an internal policy document providing broad interpretation of specific issues (in particular the application of remedies) and guidance for Bank staff. Annexes to the BP provide staff with specific internal process/review/clearance procedures, including a decision matrix that specifies when and at what level specific decisions are made. Revisions to OP/BP 11.00 were prepared in July 2009, following consultations with staff and Management, to reflect multiple changes since the last update of the OP/BP in 2004. These changes address areas that were not previously covered by the OP/BP—providing for output-based aid operations, public private partnerships, sectorwide approaches, and use of country procurement systems; handling of recipient-executed trust funds; and changes arising from sanctions reform such as early temporary suspension and cross-debarment—and also reflect the recommendations of the IDA Controls Review and the enhanced risk-based approach for procurement reviews, including the revision of clearance thresholds and prior-/post-review maximum thresholds. The revised OP/BP provides links to key related documents, making it easier for staff to supplement information covered in the OP/BP. The Audit Committee had requested that the proposed revisions to OP/BP 11.00 be submitted for information as part of the Board submission of an ongoing revision to the Procurement and Consultant Guidelines (explained below). The revised version of the OP/BP, prepared in collaboration with LEG, reflects the latest revisions of the Procurement and Consultant Guidelines, as well as internal procedures and tools developed by OPCPR and approved by the Procurement Sector Board, such as P-RAMS, and has been posted on the Procurement web for staff use as of mid-August 2010.

- ***Guidelines on Procurement and Guidelines on Selection and Employment of Consultants*** are the primary rules that guide borrowers' handling of procurement under Bank-financed loans, credits, and recipient-executed trust funds. They are incorporated by reference in legal agreements, making them binding on borrowers. In both Guidelines the provisions related to F&C were revised in May 2010—among other reasons, to operationalize the application of the cross-debarment agreement with four other MDBs. A broader revision of the Guidelines has already been presented to the Audit Committee. Consultations on the proposed revisions with internal and external stakeholders (including posting the proposed revisions on external websites, conducting a series of regional videoconferences and events with the industry, and discussing the revisions with the MDBs' Heads of Procurement) were completed by the end of June 2010, and the final proposal is scheduled to be submitted to the Board in October 2010.

43. ***Dissemination and Application.*** The Bank is taking significant actions to ensure wide dissemination and adequate application of the revised OP/BP and Guidelines. Several discussions at the Procurement Sector Board Policy Committee and with the offices of the Regional Procurement Managers preceded the posting of the Guidelines for broader consultation. In the broader consultation, staff were asked to provide suggestions and raise issues that they felt needed to be addressed, and they had the opportunity to comment on the draft before it was submitted to the Audit Committee. Guidance changes will be incorporated into staff training. In addition, the rollout process will involve several forms of communication to staff, including general Kiosk announcements and specific communications to staff and borrowers. The Bank's normal control procedures will ensure appropriate application of the policies by borrowers and Bank staff.

E. Strengthen Role of IT in Risk Management and Improve AAA Processes

44. The 2008 Review also included recommendations associated with IT controls—improving controls to detect and prevent password sharing in SAP and ensure that privileged access to systems was removed for staff leaving a position; improving the timely accessibility of operational documents, primarily those relating to IL operations; and reviewing and rationalizing processes and controls relating to AAA work. CAs 20 – 22 addressed these points.

Corrective Action #20: Prevent password sharing and strengthen controls on privileged systems.

45. This CA has been implemented. The 2007 Internal Controls over Financial Reporting (ICFR) review identified significant deficiencies in IT controls relating to password policy breaches in SAP, excessive privileged access to systems and inconsistent application of change management controls for infrastructure. In response, Management took the following actions: (a) launching communication, staff training and awareness programs to emphasize that sharing of passwords is a violation of Bank's Information Security policy and promote the importance of compliance with change control policies and procedures; (b) requiring all staff to undergo an IT security course and test; (c) rationalizing and limiting access to privileged user accounts; and (d) enhancing monitoring controls to identify and follow up on potential risk areas. These controls were evaluated as part of the 2008 and 2009 ICFR exercises and were deemed to be operating effectively.

Corrective Action #21: Improve accessibility to operational documents through automation.

46. This CA has been implemented. The Operations and Knowledge Systems Program (OKSP), a major IT initiative, has replaced and improved on the earlier Enterprise Content Data Management. The OKSP includes two components of great relevance for the IDA Internal Controls exercise. The first component is an upgraded Project Portal (Ops 2.0), which is envisaged as the single point of entry for project processing and the means for project information sharing between the different parties involved in project management. Its project processing steps are based on the mapping of business processes and control points that were developed at the early stages of the Review and updated to incorporate the IL reform. It is designed to prevent the progress of a document from one stage of processing to the next without the signature of the authorized manager, and to store the documents submitted directly into the institutional repository, thereby helping to ensure compliance with operational controls and timely maintenance and updating of project records. The second component of the OKSP is a new Bankwide document repository system, WBDocs, which will gradually replace IRIS with significantly improved functionality and user-friendliness. With WBDocs, documents will be much easier to file, organize, and retrieve, thus significantly improving the likelihood that staff will file documentation frequently and correctly. WBDocs includes records related to World Bank business, and allows filing directly from an application into the repository (e.g., from the Project Portal, Lotus Notes, or Office suite). It also allows tagging for disclosability according to the new Access to Information policy. The system provides improved access from country offices, and it duplicates country office archives to provide a safety net against country document loss. In retrieving documents, the system allows for web-wide searches or specific searches by Bank staff, project, or product. WBDocs design has been completed, and it will be made available for staff use, starting with the LCR Region, in late September 2010. In October 2010, migration of operational documents from the IRIS system to WBDocs will begin, and both systems (IRIS and WBDocs) will operate in parallel until full migration has been accomplished.

Corrective Action #22: For AAA, rationalize processes and controls, address compliance issues identified by IEG and QAG, and improve system support and monitoring.

47. Good progress has been made in implementing this CA. The broad strategic framework for this CA is provided by the Knowledge Strategy,[29] which aims to improve governance for knowledge products by (a) clarifying the mandate for the Chief Economist Council; (b) setting standards for all knowledge products; (c) tightening quality control; (d) evaluating impact; and (d) improving compliance for storing, accessing, and sharing knowledge. The Knowledge Strategy has also defined a broad governance framework for rationalizing AAA processes—a Knowledge and Learning Council, composed of VPs and chaired by an MD. The implementation of the new Access to Information Policy, with new guidance to staff and IT systems improvements, is reinforcing requirements to file AAA products.

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[29] See *Transforming the Bank's Knowledge Agenda—A Framework for Action* (SecM2010-0052; IDA/SecM2010-0038; IFC/SecM2010-0011; MIGA SecM2010-0008), February 5, 2010.

48. ***Timing and Mitigating Measures***. These and other achievements—simplifying processes and procedures, revising milestones in AAA preparation, developing a "programmatic AAA" product, and better capturing the results of AAA—will be summarized in a presentation to CODE toward the end of CY10, as a step toward finalization of guidance to staff and full rollout later in FY11. Even before the new tools are fully in place, strong signals from Management and changes in staff behaviors are already resulting in measurable improvements in AAA recording, and they mitigate the risks that may arise as this CA is completed.[30] Moreover, the establishment of the new WBDocs document repository, linked to SAP, represents a leap forward in the instrumentality to record AAA and is scheduled to be operational in all Regions by October 2010.

III. NEXT STEPS

49. With the completion of the IDA14 Internal Controls Review, IDA Management has further enhanced its ability to ensure that IDA resources are used for their intended purposes. Through the COSO methodology, IDA Management has improved its knowledge of the standards, systems, protocols, incentives, and behaviors that can help to detect and assess risks affecting the effectiveness of its operations—including those associated with F&C—and, as a result, it is in a much better position to prevent or mitigate such risks going forward. IDA Management can now reiterate the 2008 Review's assessment that IDA has a secure and well-integrated control environment, and that, in an effort lasting almost two years, it has effectively addressed the material weakness identified by IEG and made substantial progress on the significant deficiencies found through the Review. Looking strategically ahead, there is now better awareness throughout the organization—at the entity as well as the transaction level—of the importance of adequate risk identification and management, and of how timely risk assessment can help to prioritize actions and allocate resources for improved effectiveness and sustainability. Overall, this has been a value-adding and positive exercise that has strengthened IDA.

50. ***Mitigating Actions***. With respect to the 2008 Review's recommendations, the areas for improvement remaining at the time of this report are few and well-bounded. Management has put in place adequate mitigating actions, and it assigns urgency to finalizing work on these areas over the next months. First, the consolidation of the policy framework for IL into a principles-based umbrella architecture is under way. Until this work is completed in FY11, comprehensive guidance is available to enable staff to carry out their responsibilities effectively and mitigate risks (see para. 17). Second, measures to improve consistency in the approach to delegation across Regions and to address the issue of the broad span of control for sector managers are expected to be in place by the end of FY11; and in the meantime all Regions have reviewed their accountability frameworks, identified risks, and flagged them to Management and staff (para. 20). Management is also looking into waiver and delegation approaches from a corporate

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[30] Preparation of Activity Completion Summaries for economic and sector work tasks finished in the preceding fiscal year went from 68% and 55% in December 2008, to 83% and 85% in December 2009 for Regions and Networks, respectively. The largest Network, the Sustainable Development Network, reports the following improvements: (a) AAA showing as overdue in SAP fell from 144 at Q1/FY07 to 10 at Q3/FY10; (b) AAA still not closed although delivered to client more than one year before declined from 41 at Q1/FY07 to 8 at Q3/FY10; and (c) in percentage terms, economic and sector work/technical assistance tasks with missing Activity Completion Summaries went from 30% at Q2/FY09 to 5% at Q3/FY10.

perspective. Third, the AAA review has made progress, and changes in staff incentives and behaviors have already brought about improvement in AAA recording practices (see para. 48). Additional improvements will be made in this area to enhance the efficiency and impact of AAA, but their absence until full rollout in the second half of FY11 does not represent a substantial risk to the use of IDA resources for their intended purposes.

51. ***Monitoring***. The improvement of controls for IDA is a dynamic and continuous process that does not end with the completion of the IDA Controls exercise. Starting in FY11, monitoring of the performance and impact of IDA controls will be done through IDA's regular monitoring and reporting systems, which have been enhanced and integrated as a result of the 2008 Review. This comprehensive monitoring system includes the following elements.

- ***Realigned portfolio quality assurance functions.*** This system will build on the portfolio monitoring system originally developed by QAG, incorporating the risk dimension derived directly and automatically from ORAF evaluations throughout the preparation and implementation of the project. These reports will also integrate selected information on performance drawing from different operational systems, including ISR, PRIMA II, P-RAMS, and others. The technology changes introduced by the OKSP will ensure timely capture and processing of, and access to, reports of portfolio quality and performance.
- ***Reporting on quality assurance in financial management and procurement.*** A comprehensive report on progress in the fiduciary areas will be available from the Annual Reports on Financial Management and Procurement, normally discussed with the Audit Committee. Information from the semiannual reviews of the Procurement Complaints System data will be incorporated in the Annual Report on Procurement. On the FM side, Quarterly Progress Reports (QPRs) monitoring Regional FM performance are now shared with Management; going forward, the intention is that key aspects of the QPRs will be appropriately reflected in the FM Annual Report.
- ***Reporting on follow-up on action plans following INT FIRs.*** With the database already in place and functional, specific reports can be prepared on a just-in-time basis. A regular semiannual report will be prepared; the first was prepared in June 2010.
- ***Results framework for the internal reforms.*** A semiannual synthesis report on the progress of all the internal reforms that provide the background for the significant change in IDA's control environment will be consolidated for submission to the Development Committee during Annual and Spring Meetings, beginning with the 2010 Annual Meetings.
- ***New Institutional Risk Management (IRM) System***: As part of setting up an institutional governance framework for risk management, Management plans to establish an IBRD/IDA Risk Management Advisory group to support the soon-to-be appointed Group Chief Risk Officer and the Group Risk Council. Key vice presidencies will be represented on the advisory group. Representatives of this advisory group will be required to report periodically on risk events and risk indicators using the existing institutional risk taxonomy.

52. These reporting tools will be complemented by the assurance reviews in IAD's work program, which follows up on several of the topics addressed by the 2008 Review. Finally, IEG will also complement this suite of monitoring tools with its focused evaluations of the development effectiveness of IDA's work.

ANNEX A. MANAGEMENT FIVE-POINT ACTION PLAN

Problem identified	*Summary of corrective action*	*Status as of September 30, 2010*	*Mitigating measures*
Inefficiencies and gaps in controls framework governing investment lending (IL), in particular (i) Non-rationalized "one-size-fits-all" requirements irrespective of risks, (ii) Over-focus on project preparation at the expense of implementation, and (iii) Outdated and complex policy framework	**I. Improve efficiency, effectiveness and controls for IL**		
	1. Match the demands of the process to the level of risk and focus resources on higher risk projects.	Implemented	n.a.
	2. Strengthen IL supervision by increasing resources, support and management oversight of project implementation.	Implemented	n.a.
	3. Tailor design and financing options under the IL instrument more closely to the needs, capacity and risk profile of clients.	Implemented	n.a.
	4. Consolidate multiple rules into clear key principles to inform design and processing.	Under implementation	Solid body of guidance to staff, including through website, helpdesk.
Diffused management and staff accountability and responsibilities for operational quality. Inadequate mechanisms for institutional risk identification, monitoring and management	**II. Strengthen risk management capacity, incentives and accountability at the project and institutional levels** *At the project level*		
	5. Review lines of accountability at the management and staff level (including management oversight) to ensure appropriate delineation and exercise of responsibilities and accountability and consequences for failure to report serious issues.	Under implementation	ORAF application; Regional reviews of accountability.
	6. Introduce incentives and greater management support and oversight and communicate to staff expectations to ensure accurate and timely reporting of risks.	Implemented	n.a.
	At the institutional level		
	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,	Implemented	n.a.

Problem identified	*Summary of corrective action*	*Status as of September 30, 2010*	*Mitigating measures*
	assess the quality and consistency of processes in place.		
	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).	Implemented	n.a.
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**		
	9. Establish clear responsibilities and accountabilities for addressing fraud and corruption in Bank operations (per new INT strategy).	Implemented	n.a.
	10. Establish appropriate protocols of cooperation between INT and the regions on handling allegations of fraud or corruption.	Implemented	n.a.
	11. Promote good practices across the Bank Group's work by: • Intensifying staff training; • Increasing management signals on the importance of this issue • Ensuring staff incentives (OPEs, promotions, rewards and visibility) are aligned with anti-corruption strategies. • Propagating lessons learned, including through preventive services unit within INT. • Issuing guide/pamphlet on identifying and handling red flags relating to fraud and corruption during the project cycle.	Implemented	n.a.
	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.	Implemented	n.a.
	13. Prepare and monitor specific action plans for following up in INT reports.	Implemented	n.a.
	14. Issues OPCS Guidance on addressing GAC issues in projects.	Implemented	n.a.
Issues relating to fiduciary controls in the areas of financial management and procurement, particularly during project	**IV. Tighten fiduciary controls** ***In financial management (FM)***		
	15. Institute corporate monitoring of quality of FM work in operations.	Implemented	n.a.

Problem identified	*Summary of corrective action*	*Status as of September 30, 2010*	*Mitigating measures*
implementation	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.	Implemented	n.a.
	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.	Implemented	n.a.
	In procurement (PR) 18. Ensure more consistent follow-up through, e.g., earlier and fuller integration of procurement staff in project teams, review of procurement certification system, issuance of guidance for assigning procurement ratings, and establishment of clear mechanisms to resolve disagreements between procurement staff and task team leaders and sector managers.	Implemented	n.a.
	19. Update procurement policy to: (1) incorporate risk management and fraud and corruption issues, (ii) document the already enhanced complaints handling; and (iii) mainstream a risk-based procurement assessment tool.	Implemented	n.a.
	V. Deficiencies in the IT and AAA areas		
IT system vulnerability	20. Prevent password sharing; and strengthen controls to further limit privileged access to system applications and to monitor changes to privileged accounts.	Implemented	n.a.
Difficulties with timely accessibility to operational documents.	21. Improve accessibility of operational documents through automation (commencing with IL) and new electronic filing system.	Implemented	n.a.
Mismatch between existing AAA Processes and controls and the wide range of AAA work	22. For AAA, rationalize processes and controls to better reflect the wide range of AAA work, address compliance issues identified by IEG and QAG, and improve system support and monitoring.	Under implementation	Clear guidance and incentives for timely reporting (already showing in concrete improvements of AAA reporting indicators)

ANNEX B. STANDARDS FOR ASSESSING DEFICIENCIES AND WEAKNESSES

Source: IEG: Review of IDA Internal Controls. Volume V: Report on the Completion of Part IA – Process Mapping and Effectiveness of Control Design Annex B – Standards for Assessing Deficiencies and Weaknesses

IEG conducted considerable research into the question of what audit standards would be appropriate to govern this review of IDA controls. The issue was: Management had proposed that it would use virtually the same standards as those that it used for its assessments of internal controls over financial reporting, whereas this review was to be concerned with operational and compliance reporting, where the issues would be different. Following this research, and extensive discussions that were held between Management, IAD and IEG, it was agreed that a common standard would be used by all three parties, and what follows explains this process and the content of the standards.

1. The Bank is currently performing its assessment of internal controls over external financial reporting using existing auditing standards on attestation of internal controls over financial reporting as prescribed by generally accepted auditing standards. In performing its review of compliance with IDA's charter and applicable internal policies and procedures, Management plans to use the same concepts as those defined in the *Auditing Standard No. 2 (AS2) An Audit of Internal Control Over Financial Reporting Performed in Conjunction with An Audit of Financial Statements,* issued by the U.S. Public Company Accounting Oversight Board (PCAOB) in response to the provisions of Section 404 of the Sarbanes-Oxley legislation as much as possible.

2. Management believes that applying the concepts that have been defined by audit standard setters for assessing internal controls over financial reporting will provide the level of comprehensiveness, rigor and consistency required in its self-assessment of internal controls over compliance with IDA's charter and applicable internal policies and procedures.

3. During our work it is anticipated that Management will discover items that represent deficiencies and which may or may not require remediation. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance on a timely basis.

- A deficiency in design exists when (a) a control necessary to meet the control objective is missing, or (b) an existing control is not properly designed so that, even if the control operates as designed, the control objective is not always met.

- A deficiency in operation exists when a properly designed control does not operate as designed, or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively.

4. Control deficiencies are classified as one of the following: (i) an internal control deficiency; (ii) a significant deficiency; or (iii) a material weakness. The classification of the deficiency is based upon the likelihood of occurrence/noncompliance and/or the significance of noncompliance.

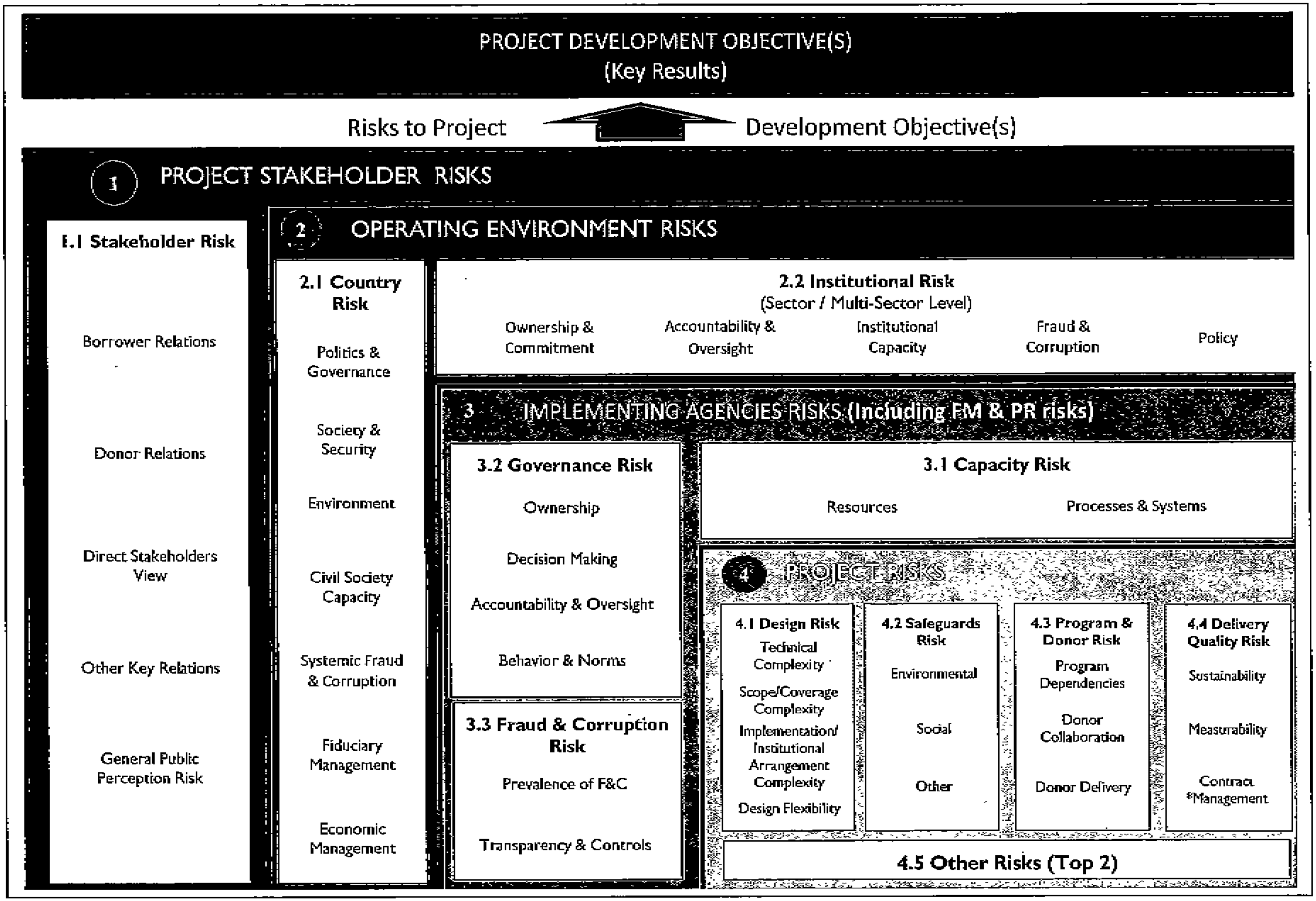
5. Conclusions about what constitutes a material weakness over compliance or operations are judgmental, more so than in the case of material weaknesses in financial reporting. Therefore, the definition of material weakness needs to be adapted from the context of the financial reporting definition, with its reliance on materiality in relation to the financial statements, to one using more judgment as to whether the operations and compliance objectives of internal control are met. To guide financial auditors in making these judgments, AS2 identifies examples of attributes the auditor should consider in evaluating identified internal control deficiencies to determine whether the deficiencies, individually or in combination, are significant deficiencies or material weaknesses. Management, IAD and IEG have agreed that clearly defined measures be established for judging operational materiality. These measures will be used as guides by each of the three groups in determining whether identified internal control deficiencies in compliance constitute significant deficiencies or material weaknesses. Identified deficiencies could be significant deficiencies or material weaknesses where the control deficiencies have attributes that could:

- impair the achievement of IDA's objectives,
- violate requirements of IDA's charters or other contractual agreements,
- significantly weaken safeguards against waste, loss, or unauthorized use of funds, property, or assets,
- involve conflicts of interest,
- involve systemic problems in country assistance, partnerships and project lending, or
- require the attention of Senior Management, the Board as well as the awareness of external stakeholders.

6. All deficiencies identified during Management's assessment will be placed on a summary deficiency schedule. The deficiency schedule will outline Management's assessment of the deficiency (type of deficiency), any mitigating controls over the deficiency, the potential financial impact, if any, the impact from a non-financial perspective, and management's determination of how to address the deficiency, i.e. corrective action (remediation). A control deficiency or combination of control deficiencies that, in management's judgment, represent significant deficiencies in the design or operation of internal control that could adversely affect the organization's ability to meet its internal control objectives is a "Significant Deficiency." A significant deficiency or a combination of significant deficiencies that Management determines to be significant enough to be reported outside IDA shall be considered a "Material Weakness."

7. Management (i.e. Controllers (CTRVP) and Operations Policy and Country Services (OPCVP)) will prepare a report assessing the overall deficiencies and make a de-termination on the impact the deficiencies have individually and in total on the internal controls over IDA's compliance with its charter and applicable internal policies and procedures. This report which will include: (i) Management's assessment of IDA's compliance with its charter and applicable internal policies and procedures; and (ii) a description of any significant deficiencies or material weaknesses identified through its assessment, together with their respective remediation plan.

ANNEX C. OPERATIONAL RISK ASSESSMENT FRAMEWORK (ORAF)



Attachment 2: IAD Report

Review of Management's Implementation of the IDA Internal Controls Five-Point Action Plan

IAD Report No. *IBRD FY11-03*
September 8, 2010

Confidential

THE WORLD BANK

INTERNAL AUDITING
THE WORLD BANK

Review of Management's Implementation of the IDA Internal Controls Five-Point Action Plan

Introduction

At the request of Management, the Internal Audit Vice Presidency (IAD) undertook an advisory review of Management's implementation of its IDA Internal Controls Five-Point Action Plan (FPAP)[1]. IAD carried out the review in three phases: in February and May 2010 it reviewed the interim progress and shared the results with Management, the Independent Evaluation Group (IEG), and the Board's Audit Committee; and this report concludes its review and provides an overall assessment of implementation.

Findings of the Initial IDA Internal Control Review. Mana gement prepared the FPAP in response to the findings of the 2008 IDA Internal Controls Review (also referred to in this report as "the 2008 Review"), which was requested by the Board and conducted between FY06 and FY09. The 2008 Review involved three parties: Management conducted a comprehensive assessment of internal controls over IDA operations and compliance with IDA's charter and policies; IAD conducted an independent review and gave its opinion on Management's self-assessment; and IEG then examined both Management's and IAD's reports, made its own independent evaluation of internal controls over IDA operations, and presented its conclusions and recommendations. In the 2008 Review, Management, IAD, and IEG reached very similar conclusions on the existence of control weaknesses in the following key areas:

- the policy and procedural framework for investment lending (IL);
- risk management and accountability at entity and project levels;
- controls for managing fraud and corruption (F&C) risk in IDA-supported operations;
- procurement and financial management (FM) processes; and
- controls over information technology (IT) and analytic and advisory activities (AAA).

IAD agreed that Management's assessment was fairly stated, taking into account the exceptions that Management had identified as significant deficiencies. However, IAD opined that the five significant deficiencies, in combination, could represent a material weakness unless remediated in a timely manner[2]. IEG concluded that "the weaknesses in the existing framework of controls addressing F&C issues were such as to rise to the level of a material weakness." In addition, the 2008 Review found that 10 key controls related to financial management, procurement, and loan disbursement processes were not operating effectively.

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[1] The FPAP was described in the Independent Evaluation Group's *Review of IDA Internal Controls: An Evaluation of Management's Assessment and the IAD Review*, April 2009.

[2] A material weakness indicates a reasonable possibility that internal control failures may not be prevented or detected in a timely manner to ensure IDA's ability to meet its internal control objectives, unless remedied in a timely manner and effectively monitored on an ongoing basis.

Five-Point Action Plan. IAD, IEG, and the Board accepted Management's FPAP (attached as Annex I to this report) as a comprehensive way forward. The FPAP consisted of 22 Corrective Actions addressing the five areas of control weakness, and each Corrective Action had a set of specific measures. Management set up an Implementation Oversight Panel to monitor and oversee the implementation progress, and to report on it to the President and the Board. IAD and IEG have been observers of the Implementation Oversight Panel.

Management's Assertion on the Implementation of the FPAP. On September 2, 2010, Management completed its assessment of the implementation of the FPAP, concluding that IDA internal controls have been significantly strengthened at both the transaction and entity levels. Management also asserted that the issues relating to controls for F&C identified during the 2008 Review have been substantially addressed, in both design and implementation[3], and no longer constitute the material weakness that IEG had identified. In addition, Management is of the view that substantial progress has been made to remediate the other significant deficiencies, and mitigating actions are in place for those few actions that require more time to finalize.

Objective

The objective of IAD's review was to assess Management's overall implementation of Corrective Actions described in its IDA Internal Controls Assessment FPAP.

Scope and Approach

The review comprised two parts: an update on implementation progress and an overall assessment of Management's implementation of the FPAP. The majority of IAD's testing focused on the design of the new controls because these controls have not been in operation long enough for IAD to be able to test their effectiveness in operation.

In reviewing the Corrective Actions, IAD verified that Management's implementation of measures would adequately address the originally identified issues. This work included the following steps:

- obtaining details on the measures being implemented;
- obtaining evidence that measures were implemented;
- assessing how the implemented measures addressed the identified issues by reviewing supporting documents, performing walkthroughs, and interviewing clients; and
- assessing the significance of the overall progress and of risks associated with pending actions.

To assess the overall implementation of Management's FPAP, IAD compared internal controls

[3] In this report, the term *implemented* is used to mean that an action has been designed and tested, and is expected to be put into operation by September 30, 2010.

before and after the remediation and evaluated whether Management's actions addressed the significant deficiencies identified in the 2008 Review.

Summary of the Review

IAD's Conclusion. In IAD's opinion, Management's assertion that IDA internal controls have been significantly strengthened at both the transaction and entity levels is fairly stated. Management has substantially addressed the significant deficiencies identified in the 2008 Review through the implementation of the FPAP. The introduction of new tools and frameworks at the entity and transaction levels satisfactorily address the control weaknesses identified in the 2008 Review. Also, in the fiduciary and IT areas, specific controls that were not operating effectively at the time of the 2008 Review have been corrected and are now operating effectively. IAD can give assurance that the design of all the new controls is robust. However, the operating effectiveness of most of these controls can be assessed only after a reasonable period of operation. IAD will cover operating effectiveness in the course of its regular assurance audits.

Status of Management's Implementation of the FPAP. Of the 22 Corrective Actions, 19 are expected to be satisfactorily implemented as of September 30, 2010. Three Corrective Actions will not be fully implemented. These corrective actions are to:

- consolidate multiple rules into clear key principles to inform design and processing (*Corrective Action 4*);
- review lines of accountability at the Management and staff levels (*Corrective Action 5*); and
- for AAA, rationalize processes and controls, address compliance issues identified by IEG and the Quality Assurance Group (QAG), and improve system support and monitoring (*Corrective Action 22*).

In IAD's view, the residual risks are not significant. For *Corrective Action 4*, Management has implemented compensating controls for the short term. *Corrective Actions 5 and 22* are substantially implemented, and the remaining measures are scheduled to be in place by June 30, 2011.

Table 1 summarizes the expected implementation status of all Corrective Actions as of September 30, 2010, and Annex III provides a detailed assessment of the Corrective Actions.

Table 1. Implementation Status of Corrective Actions

CA #	*Corrective Action (CA)*	***Status of implementation as of September 30, 2010 (IAD assessment)***
I	**Improve efficiency, effectiveness, and controls for IL**	
1	Match the demands of the process to the level of risk and focus resources on higher-risk projects.	Implemented
2	Strengthen IL supervision by increasing resources, support, and Management oversight of project implementation.	Implemented
3	Tailor the design of projects and financing options under the IL instrument more closely to the needs, capacity, and risk profile of clients.	Implemented
4	Consolidate multiple rules into clear key principles to inform design and processing.	Under implementation
II	**Strengthen risk management capacity, incentives, and accountability at the project and institutional levels**	
5	Review lines of accountability at Management and staff levels.	Under implementation
6	Introduce incentives and greater Management support and oversight and communicate expectations to staff.	Implemented
7	Prepare an annual integrated risk report.	Implemented
8	Review the activities of QAG, to inform a broader assessment of gaps and overlaps.	Implemented
III	**Better integrate F&C prevention into operations**	
9	Establish clear responsibilities and accountability for addressing F&C issues.	Implemented

CA #	*Corrective Action (CA)*	***Status of implementation as of September 30, 2010 (IAD assessment)***
10	Establish appropriate protocols of cooperation between the Integrity Vice Presidency (INT) and the Regions.	Implemented
11	Promote good practices across the Bank Group's work.	Implemented
12	Improve tools such as smart project design.	Implemented
13	Prepare and monitor specific action plans for following up on INT reports.	Implemented
14	Issue OPCS guidance on addressing GAC issues in projects.	Implemented
IV	**Tighten fiduciary controls**	
15	Institute corporate monitoring of FM quality.	Implemented
16	Integrate FM IT systems tracking project performance.	Implemented
17	Ensure that all records relating to quality arrangements for FM are maintained and up to date.	Implemented
18	Ensure more consistent follow-through and establish clear mechanisms to resolve disagreements between procurement staff, task teams, and sector managers.	Implemented
19	Update procurement policy to incorporate risk management, enhance complaints handling, and mainstream risk-based procurement assessment.	Implemented
V	**Strengthen role of IT in risk management and improve AAA processes**	
20	Prevent password sharing and strengthen controls to privileged systems.	Implemented
21	Improve accessibility of operational documents through automation.	Implemented
22	For AAA, rationalize processes and controls, address compliance issues identified by IEG and QAG, and improve system support and monitoring.	Under implementation

IAD's Analysis of the impact of the FPAP on the significant deficiencies identified in the 2008 Review

Management's FPAP was designed to address the significant deficiencies found in the 2008 Review. Each of the five points in the Action Plan corresponded to one of the five significant deficiencies. This section recaps the control weaknesses originally identified as factors for the significant deficiencies, reviews the actions taken by Management under the FPAP, and finally assesses the impact of the Management actions on each significant deficiency from the perspective of both the design effectiveness and the operating effectiveness of the controls.

Point I: Improve efficiency, effectiveness, and controls for IL (*Corrective Actions 1-4*)

Control issues identified. During the 2008 Review, Management identified the following deficiencies in the IL policy and procedural framework:

- process inefficiencies, including a lack of focus on key risks and controls during the preparation/design and supervision stages of IL projects, resulting from "one-size-fits-all" requirements irrespective of risk;
- undue focus on project preparation at the expense of project implementation and supervision; and
- an outdated and complex policy framework for IL as reflected in multiple Operational Policies (OPs) and Bank Procedures (BPs) that apply to IL operations.

Management Actions. In response, Management developed and implemented the ORAF, which will be used throughout the entire cycle of a project to identify and track risks and to allocate resources appropriate to the level of risk. Management also created a central risk team to ensure consistent and effective application of the ORAF throughout the organization. The Implementation Support Plan (ISP) was created, and the Implementation Status and Results (ISR) Report revised, to conform to the new practices and the risk-based approach to project design represented by the ORAF. Additionally, Management is supporting staff in project implementation through Operations Committee (OC) meetings focused on implementation support, in which senior managers discuss challenges and constraints to project supervision and agree on practical solutions. As part of the review of financing options under the IL instrument, Management is designing a results-based loan (RBL) that would provide support for government programs or subprograms, with disbursements linked to progress on monitorable indicators. The concept for the proposed RBL is scheduled to be discussed by CODE in FY11 Q2. IAD does not believe the delay in implementation of this instrument poses immediate risks to existing IDA operations.

Impact and IAD's Assessment. The implementation of the risk-based approach to project preparation and implementation through the ORAF addresses the IL process inefficiencies, and the undue focus on project preparation at the expense of project implementation and supervision. The remaining issue is to address the outdated and complex policy framework by consolidating the relevant IL policies, procedures, and guidelines in a consistent and clear hierarchy. To address this issue in the short term, Management has prepared comprehensive guidance to staff on the new risk-based approach and the enhanced implementation support, including a helpdesk, a new IL website, and an updated Bank Project Portal (Ops 2.0) with new templates for the ORAF, project concept notes, and ISRs. For the long term, Management plans to rationalize, consolidate, and update IL policies by refocusing them on key principles. To date Management has discussed the overall approach for the IL operational policy reform and has begun analyzing existing overlaps and the adequacy of the current IL approach and practices. It plans to present to the Board a technical update on the concept and structure of a single principles-based IL policy in September 2010. We encourage Management to accelerate this review to establish clear consolidated guidance for staff to ensure consistent application of the newly introduced controls and tools in the IL process.

Taking into account all the Corrective Actions that have been implemented and the short-term mitigating measures that are in place for the outstanding Corrective Action, IAD opines that the design of controls is sufficiently robust to address the inefficiencies originally identified in the control framework governing IL.

Point II: Strengthen risk management capacity, incentives, and accountability at the project and institutional levels (*Corrective Actions 5-8*)

Control issues identified. During the 2008 Review, Management identified several deficiencies in risk management and accountability at the entity and project levels: inadequate emphasis on risk identification; insufficient coordination in reporting and information-sharing within task teams and between staff and Management during project supervision; accountability for operational quality diffused among managers and staff; and inadequate mechanisms for risk aggregation and for timeliness and consistency in monitoring, identifying, and formulating appropriate responses to systemic risks.

Management Actions. Management established the risk-based approach to project management through ORAF and started systematic communication on the risk-based approach to operational staff through IL clinics, the IL reform website, and specific guidance. Management approached the incentive issue by setting a clear tone from the top and by providing staff with tools to help them discuss risks candidly. Management also reviewed and revised the Integrated Risk Management framework by adopting the COSO Enterprise Risk Management framework in combination with other methodologies and standards. The first integrated risk report, issued in October 2009, defined the standard risk taxonomy for the institution and comprehensively analyzed risks facing the Bank, including F&C risks that had not been explicitly included in the previous institutional risk framework. Additionally, Management reviewed the activities of QAG in reference to the emerging environment for development assistance, identified possible functional overlaps with other oversight units of the Bank, and decided to discontinue QAG, effective July 1, 2010. The quality assurance work carried out by QAG was integrated into the quality assessment and monitoring functions in OPCS.

Impact and IAD's Assessment. The use of the ORAF promotes a rigorous emphasis on risk identification, reporting, and information-sharing within task teams and between staff and Management during project supervision. The ORAF directs task teams to analyze risks systematically and allows them to bring issues to the attention of Management. In addition, the annual integrated risk monitoring report addresses the issues of risk aggregation, timeliness, and consistency in monitoring, and it seeks to formulate an appropriate response to systemic risks. The FY10 Integrated Risk Monitoring Report discussed the gaps and overlaps in risk management activities and provided observations about the Bank's risk management in general, drawing from results of the annual institutional risk assessment and such recent institutional reviews as those conducted by IAD, IEG, and the Integrity Vice Presidency (INT). The issue of diffused Management and staff accountability and responsibilities for operational quality was partially addressed by the implementation of the ORAF, which defines the roles of various parties during the project cycle and encourages collaboration between country director and country manager, between sector director and sector manager, and within task teams. Accountability at the entity level is still to be clarified in relation to the matrix organizational structure. As part of the internal matrix reform effort, Management created a Matrix Leadership Team at the vice presidential level to bring more clarity to this issue. The Team's work program for FY10-11, which has been discussed with the Board, includes mapping responsibilities in the matrix organizational structure and developing accountability frameworks for Regions, knowledge activities, and Networks.

Considering the Corrective Actions that have been implemented, IAD opines that the design of controls is sufficient to address deficiencies in risk management, and accountability at the project level.

Point III: Better integrate F&C prevention into operations (*Corrective Actions 9-14*)

Control issues identified. The 2008 Review identified the need for better design and integration of controls for managing F&C risks (reflecting, among other things, lessons learned from precedents and INT work) into the design/preparation and supervision/monitoring of IDA-supported operations.

Management Actions. Management established clear responsibilities and accountability for addressing F&C issues by repositioning INT closer to operations; setting a strategically aligned INT strategy; designing and rolling out the ORAF; and implementing the governance and anticorruption (GAC) agenda, which promotes the development of capable and accountable states and institutions that can control corruption.

Management also established appropriate protocols of cooperation between INT and the Regions by issuing an OPCS/INT protocol to handle suspected and alleged F&C in procurement, and by developing a memorandum of understanding between OPCS and INT on the prevention of F&C in procurement. Further, Management has promoted good practices in combating F&C across Bank Group work through staff training and various new guidance documents on F&C.

Management also developed the GAC Audit and Assurance toolkit, enhanced the functionality of the complaints database to more easily and effectively address F&C risks and enhance collaboration with INT, and launched the Procurement Risk Assessment and Management System (P-RAMS) to identify risk and track the implementation and effectiveness of risk mitigation measures. Additionally, Management set up systems and arrangements to better monitor Regional plans and to follow up on INT reports, and issued OPCS guidance for addressing GAC issues in projects.

Impact and IAD's Assessment. These Management actions have contributed to better-designed controls for managing F&C risks, and their better integration into the design/preparation and supervision/monitoring of IDA-supported operations. Since the time of the 2008 Review, explicit F&C controls have been created and instituted at both the project and entity levels.

Taking into account the Corrective Actions that have been implemented, IAD confirms that explicit F&C controls have been incorporated into the design/preparation and supervision/monitoring processes of IDA-supported operations.

Point IV: Tighten fiduciary controls (*Corrective Actions 15-19*)

Control issues identified. The 2008 Review identified the need to strengthen fiduciary controls in project procurement, FM, and disbursement activities. The issues identified included task teams' inconsistent follow-up on procurement issues; inconsistent implementation of procurement post-reviews; inconsistent quality arrangements for the documentation of FM supervision; inconsistent quality arrangements for oversight and monitoring of FM supervision; and failure of 10 key controls related to FM, procurement, and loan disbursement processes.

Management Actions. Management instituted corporate monitoring of FM quality, updated the audit report compliance system (ARCS) database, and cleared all backlogs of project audit report reviews. Management has also improved controls over the procurement complaints database; developed a centralized system to strengthen procurement post-reviews; expanded the roles of the Procurement Sector Board; implemented the ORAF, which encourages closer collaboration among task team members and facilitates resolution of different views; and updated the procurement policy to incorporate risk management, enhance the handling of complaints, and mainstream risk-based procurement assessment. IAD confirmed that the updated procurement policy and related guidelines, which are still to be approved by the Board, address the issues identified in the 2008 Review, and staff have been advised to use the updated policy.

Management has also required all Regions to use the FM information systems to systematically record FM project performance, and it developed a new system (PRIMA II) to standardize FM information systems. With regard to the 10 controls in the disbursement, FM, and procurement areas that failed in the 2008 Review, Management remedied the problems by establishing corporate monitoring of quality, issuing relevant guidance, developing a system for procurement post-reviews, and improving controls in the complaints database.. Annex II provides detailed information on these key controls.

Impact and IAD's Assessment. These Management actions are expected to ensure that task teams provide consistent follow-up on procurement issues, with better integration of procurement staff in task teams and clearer accountabilities for procurement decisions; consistent implementation of procurement post-reviews; and consistency in quality arrangements for documentation of FM supervision and for oversight and monitoring of FM supervision. IAD has reviewed the 10 failed controls and determined that they are now operating effectively.

Given the improvement of the design of controls and remediation of the failed controls in fiduciary activities, IAD opines that fiduciary controls have been strengthened.

Point V: Strengthen role of IT in risk management and improve AAA processes (*Corrective Actions 20-22*)

Control issues identified. During the 2008 Review, Management identified the need to strengthen IT controls relating to password sharing in SAP, privileged access, and infrastructure change management; improve staff's timely accessibility to operational documents related to IL operations; and rationalize processes and controls relating to AAA work.

Management Actions. Management implemented a mandatory information security awareness training program and remedied issues relating to privileged access and infrastructure change management during the FY08 Internal Controls over Financial Reporting (ICFR) exercise, and it is actively monitoring potential password-sharing activities in SAP. Management also introduced the Operations and Knowledge Systems Program (OKSP), a new institutional platform for managing information and documents, to improve the accessibility of operational documents through automation and enhance staff's flexibility and agility in responding to client needs. The OKSP includes two components of great relevance for the IDA internal controls. The first is an upgraded Bank Project Portal (Ops 2.0), which is the single point of entry for project processing and the means for sharing project information among the different parties involved in project management. It includes automated controls to ensure that projects can move to the next stage only after the authorized manager's review and sign-off. Also, it automatically retains key project documents in the institutional repository. This automation will ensure compliance with operational controls and timely maintenance and updating of project records. The second component of the OKSP is a new Bank-wide document repository system, WBDocs, which will gradually replace the Integrated Record and Information Services (IRIS) system and will provide significantly improved functionality and user-friendliness. With WBDocs, documents will be much easier to file, organize, and retrieve, thus significantly improving the likelihood that staff will file documentation correctly and frequently. Full rollout of WBDocs will be done in phases beginning in September 2010.

With respect to AAA, Management has developed a Knowledge Strategy to strengthen the governance and accountability for the knowledge portfolio (including AAA), and has established the Knowledge and Learning Council to lead the implementation of the strategy. In addition, Management has improved the reporting and recording of AAA, with more discipline across Regions and Networks.

Impact and IAD's Assessment. The issue of password sharing and privileged access to system applications was resolved through active monitoring of potential password-sharing activities in SAP and remediation of issues related to privileged access and infrastructure change management during the FY08 ICFR exercise. Implementation of these actions was confirmed by FY09 and FY10 ICFR testing and recent IAD audits. With respect to difficulties with timely accessibility to operational documents, the enhanced Bank Project Portal (Ops 2.0) and WBDocs are adequately designed to address this issue. However, actions to improve controls over AAA processes are still under way. To address this issue, Management has completed the business process review of AAA, and the recommended measures will be presented to CODE in FY11 Q2 and implemented by December 31, 2010.

Taking into account the Corrective Actions already implemented, IAD opines that the design of controls is robust and has strengthened IT controls relating to password sharing in SAP, privileged access, and infrastructure change management, and improved staff's timely accessibility to operational documents. Also, substantial progress continues to be made in remediating the control issues in AAA.

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Management's 5 Point Action Plan (timeline as presented on Sep 23, 2009)

Problem Identified	Corrective Action	Revised Timeline
Inefficiencies and gaps in control framework governing investment lending (IL) (i) non-rationalized "one-size-fits all" requirements irrespective of risks (ii) over-focus on project preparation at the expense of implementation, and (iii) outdated and complex policy framework	**I. Improve efficiency, effectiveness and controls for IL** 1. Match the demands of the process to the level of risk and focus resources on higher risk projects 2. Strengthen IL supervision by increasing resources, support and management oversight of project implementation 3. Tailor design and financing options under the IL instrument more closely to the needs, capacity and risk profile of clients 4. Consolidate multiple rules into clear key principles to inform design and processing	March 2010 March 2010 Sep 2010 Sep 2010
Diffused management and staff accountability and responsibilities for operational quality **Inadequate mechanisms for institutional risk identification monitoring and management**	**II. Strengthen risk management capacity, incentives and accountability at the project and institutional levels** *At the project level:* 5. Review lines of accountability at the management and staff level 6. Introduce incentives and greater management support and oversight and communicate expectations to staff *At the institutional level:* 7. Prepare an annual Integrated Risk Report 8. Review QAG, to inform a broader assessment of gaps and overlaps	Dec 2009 March 2010 Nov 2009 Done
Inadequate integration of fraud and corruption issues in daily operations	**III. Better integrate fraud and corruption prevention into operations** 9. Establish clear responsibilities and accountability for addressing F&C issues 10. Establish appropriate protocols of cooperation between INT and the regions 11. Promote 'good practices' across the Bank Group's work 12. Improve tools such as smart project design 13. Prepare and monitor specific action plans for following up on INT reports 14. Issue OPCS Guidance on addressing GAC issues in projects.	June 2010 Ongoing Ongoing Dec 2009 Ongoing Done
Issues relating to fiduciary controls in the areas of financial management and procurement, particularly during project implementation	**IV. Tighten Fiduciary controls:** *In financial management (FM)* 15. Institute corporate monitoring of quality 16. Integrate IT systems tracking project performance 17. Ensure that all records relating to quality arrangements for FM are maintained and up to date *In procurement* 18. Ensure more consistent follow through and establish clear mechanisms to resolve disagreements between procurement staff, task team & sector managers 19. Update procurement policy to incorporate risk management, enhance complaints handling and mainstream risk-base procurement assessment	Done Dec 2009 Done Oct 2009 July 2009
IT system vulnerability **Difficulties in timely accessibility to operational documents** **Mismatch between AAA types & processes**	**V. Strengthen role of IT in risk management and improve AAA processes :** 20. Prevent password sharing and strengthen controls to privileged systems 21. Improve accessibility of operational documents through automation 22. Rationalize processes and controls governing AAA, address compliance issues identified by IEG and QAG; improve system support and monitoring	Done June 2010 June 2010

Details of IAD Assessment of Failed Controls

Control	***Control failure description***	***Control enhancement and process changes to the initial conditions***	***IAD retesting results***	***Control reference #***
Loan disbursement process				
The Finance Officer (FO) reviews credit set-up data and approves the category schedule in the Loan Accounting System **Purpose:** To ensure appropriate disbursement information is recorded in the disbursement system.	Loan master data created at the time of credit set-up in Loan Accounting System (LAS) was not consistent with the financing agreement and/or disbursement letter. The majority of issues related to the set-up of prior review (PRT) and/or statement of expenditure thresholds (SOE).	Management enhanced controls by issuing guidelines on SOE, PRT, and retroactive financing master data set-up; also, automated retroactive financing controls.	Pass	Module #17, Control #4
The FO reviews and clears the notice threatening suspension **Purpose:** To ensure accurate recording and communication to the borrower.	Controls surrounding FO approvals of notices related to threat of suspension, actual suspension, and/or lifting of suspension were not testable in many cases because of the lack of documentary evidence.	Management enhanced controls by issuing guidance on proper procedures for clearing suspensions and threats of suspensions, and for documenting such actions.	Pass	Module #24, Control #1
The FO enters a note in LAS to record the suspension threat **Purpose:** To ensure that disbursements are not made while suspension is in place.	Verifiable historical audit trail relating to imposing or lifting of suspensions is not readily available in LAS.	Management enhanced controls by issuing guidance on proper procedures for clearing suspensions and threats of suspensions, and for documenting such actions.	Pass	Module #24, Control #2

Control reference # refers to IDA business processes: Modules 17, 24, and 25 relate to the loan management process, Module 12 relates to the financial management process, and Modules 14 and 15 relate to the procurement process.

Control	Control failure description	Control enhancement and process changes to the initial conditions	IAD retesting results	Control reference #
The FO reviews and clears the credit closing notification **Purpose:** To ensure that accurate, complete information is sent to borrower.	Lack of evidence of FO clearances: documentation not made available/provided for testing.	The review and clearance of closing letters were reassigned to loan disbursement management staff working in Regional offices, and are no longer performed by FOs.	Pass	Module #25, Control #1
The FO reviews and finalizes the closing of the disbursement account in the LAS **Purpose:** To ensure that credit is accurately and completely closed.	Housekeeping of the credit information in LAS is not always performed in a timely manner.	This manual control no longer exists; it was eliminated with the adoption of an electronic filing system in the new iLAP system.	Redundant	Module #26, Control #2
Financial Management (FM) Process				

Control reference # refers to IDA business processes: Modules 17, 24, and 25 relate to the loan management process, Module 12 relates to the financial management process, and Modules 14 and 15 relate to the procurement process.

Control	*Control failure description*	*Control enhancement and process changes to the initial conditions*	*IAD retesting results*	*Control reference #*
The Regional Manager, FM (RMFM), or delegate reviews the Project Appraisal Document (PAD) **Purpose:** To ensure that FM aspects of a project entered in the PAD are consistent with and reflect (a) the information gathered for and included in the FM assessment report, and (b) the input provided by FM staff.	Because of lack of documented evidence and changes in Regional practices, it could not be verified that the RMFM's review and approval of the FM assessment and appraisal-stage PADs and Financing Agreement had occurred.	Management instituted corporate monitoring of FM quality and clarified the control processes. These responsibilities are now reflected in the new FM Manual.	Pass	Module #12, Control #3
• ***The RMFM reviews the FM Supervision Report (FMSR)*** • ***The financial management specialist (FMS) reviews FM ratings in the Implementation Status and Results (ISR) Report*** **Purpose:** To ensure that FM aspects of a project are closely monitored for continuing adequacy, risk ratings are updated to reflect current supervision	• Sample testing found that the majority of FMSRs prepared after November 2005 were not in accordance with requirements in the FM guidelines, as Regions were transitioning to preparing the FMSRs in accordance with the guidelines. • Approximately 40% of projects reviewed had no documentation to evidence that risk ratings identified by the FMS were sent to the	Management instituted corporate monitoring of FM quality and issued guidance on quality arrangements as part of the new FM Manual.	Pass	• Module #12, Control #4 • Module #12, Control #5

Control reference # refers to IDA business processes: Modules 17, 24, and 25 relate to the loan management process, Module 12 relates to the financial management process, and Modules 14 and 15 relate to the procurement process.

Control	*Control failure description*	*Control enhancement and process changes to the initial conditions*	*IAD retesting results*	*Control reference #*
findings, and recommendations/action plans for implementation are adequate.	task team leader (TTL) for inclusion in the ISR. In one instance, IAD noted that the ISR had a different rating from the FMSR, and no explanation was attached.			
	Procurement Process			
The TTL reviews Form 384 (information for prior review of contracts) for accuracy and completeness before it is submitted to loan disbursement management **Purpose:** To ensure that contract and disbursement processing are accurate and timely.	Issues in preparation of the Form 384 included (a) a few months' delay in preparing the Form 384 after the date the contract was received; (b) Form 384 not showing the LAS disbursement categories; (c) Form 384 not corresponding to the "no objection" letter; and (d) the contract amount recorded in the Form 384 was lower than that of bid documents.	Management discontinued contract accounting procedures as part of the Bank wide simplification initiative.	Redundant	Module #14, Control #8

Control reference # refers to IDA business processes: Modules 17, 24, and 25 relate to the loan management process, Module 12 relates to the financial management process, and Modules 14 and 15 relate to the procurement process.

Control	*Control failure description*	*Control enhancement and process changes to the initial conditions*	*IAD retesting results*	*Control reference #*
The procurement specialist performs a post-review procurement audit **Purpose:** To ensure that contracts subject to post-review are appropriately procured.	In approximately 40% of our sample, insufficient documentation was provided to allow the testers to verify that procurement reviews were carried out in accordance with timing requirements in the most recent procurement supervision plan or PAD. In one case, testers also noted a lack of audit evidence to support the post-procurement review and the results from it.	Management developed a procurement post-review system in the Operations Portal to improve the Bank's capture of procurement post-review reports and to strengthen reporting of procurement post-review data.	Pass	Module #14, Control #9

Control reference # refers to IDA business processes: Modules 17, 24, and 25 relate to the loan management process, Module 12 relates to the financial management process, and Modules 14 and 15 relate to the procurement process.

Control	*Control failure description*	*Control enhancement and process changes to the initial conditions*	*IAD retesting results*	*Control reference #*
The TTL consults required parties in reviewing a procurement complaint, updates the complaint database, and communicates with the borrower as appropriate **Purpose:** To ensure that the complaint is resolved appropriately, accurately, and in a timely manner; and that any communication sent to borrower is also complete, accurate and timely.	In a few cases, there was no audit evidence on file to indicate that internal review had taken place and its results communicated to the borrower.	Management improved the controls and quality of the procurement complaints database, including implementing a new feature to reinforce filing of key documents before closing a complaint case.	Pass	Module #15, Control #2

Control reference # refers to IDA business processes: Modules 17, 24, and 25 relate to the loan management process, Module 12 relates to the financial management process, and Modules 14 and 15 relate to the procurement process.

Detailed Assessment of Corrective Actions

Corrective Action and corresponding measures in Management Response	*Description*	*Status of implementation*	*Comment*
Point I	**Improve efficiency, effectiveness, and controls for investment lending (IL)**		
Corrective Action 1	**Match demands of the process to the level of risk, and focus resources on higher-risk projects.**	**Implemented**	**This Corrective Action was implemented.**
Measure 1	Integrate a risk-based model into the control framework governing IL.	Completed	The Operational Risk Assessment Framework (ORAF) was rolled out Bank-wide in July 2010. The ORAF is a standardized risk framework to be used throughout the entire project cycle to identify and track risks and to allocate resources to reflect the level of risk.
Corrective Action 2	**Strengthen IL supervision by increasing resources, support, and management oversight of project implementation.**	**Implemented**	**This Corrective Action was implemented.**
Measure 2	Strengthen risk identification and monitoring during supervision by, among other things, clarifying roles, responsibility, and accountability between IDA and	Completed	ORAF is designed to better allocate supervision/implementation resources. Management is also

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Corrective Action and corresponding measures in Management Response	*Description*	*Status of implementation*	*Comment*
	borrowers and within the institution.		strengthening implementation support oversight through Operations Committee meetings.
Corrective Action 3	**Tailor design and financing options under the IL instrument more closely to the needs, capacity, and risk profile of clients**	**Implemented**	**This Corrective Action was implemented.**
Measure 3	• Provide a risk-based approach to selection of IL design options and associated due diligence, processing, and monitoring requirements. • Provide a flexible menu of design, funds flow, and financing options.	Completed	The use of ORAF will facilitate the Bank's tailoring the design of the project more closely to clients' needs, capacity, and risk profile. Regarding the development of the results-based loan, IAD concurs with Management's view that this is not a condition for completion of this corrective action.
Corrective Action 4	**Consolidate multiple rules into clear key principles to inform design and processing**	**Under implementation**	**The implementation of this Corrective Action is, by design, still at the planning stage since it is to follow the completion of a review of the IL processes. The actual consolidation of relevant policies, procedures, and guidelines with a consistent and**

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Corrective Action and corresponding measures in Management Response	*Description*	*Status of implementation*	*Comment*
			clear hierarchy is not expected by September 2010.
Measure 4	Create a single principles-based "umbrella" policy for IL.	In progress	Management has started to develop a broad framework for the IL policy consolidation and plans to provide a technical update to the Board in September 2010.
Point II	**Strengthen risk management capacity, incentives, and accountability at project and institutional levels.**		
Corrective Action 5	**Review lines of accountability at management and staff levels.**	**Under implementation.**	**This Corrective Action is largely implemented. Management has evaluated the existing lines of accountability and created a Matrix Leadership Team (MLT) to design and implement measures to address the issues identified. The MLT is expected to complete its work in June 2011.**
Measure 5	Review of responsibilities, accountabilities, and quality oversight, including: • existing oversight and quality assurance arrangements;	In progress	As part of the internal matrix reform, Management created the MLT at the vice presidential level

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Corrective Action and corresponding measures in Management Response	*Description*	*Status of implementation*	*Comment*
	• existing quality and accountability arrangements for operations; • Development by Human Resource Services (HRS) of a comprehensive roadmap/strategy for enhancing performance; and • Continuation of HRS efforts to enhance the Human Resource (HR) Insight website.		to bring more clarity to this issue. The Team's work program for FY10-11, which has been discussed with the Board, includes mapping responsibilities in the matrix organizational structure and developing accountability frameworks for Regions, knowledge activities, and Networks.
Corrective Action 6	**Introduce incentives and greater management support for and oversight of implementation, and communicate expectations to staff**	**Implemented**	**This Corrective Action was implemented.**
Measure 6	• Review staff incentives and communicate expectations to staff. • Introduce Senior Management support for and oversight of project implementation.	Completed	Rather than introduce HR measures, Management approached the incentive issue by setting a clear tone from the top and by providing staff with tools to help them discuss risks candidly. Management review of projects at different levels and the use of ORAF will force staff to analyze risks and allow them to bring

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Corrective Action and corresponding measures in Management Response	*Description*	*Status of implementation*	*Comment*
			issues to Management's attention.
Corrective Action 7	**Prepare an annual integrated risk report**	**Implemented**	**This Corrective Action was implemented.**
Measure 7	Prepare an annual integrated risk report 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 various assessment activities; and (e) over time, assess the quality and consistency of the processes in place.	Completed	Management completed the first Integrated Risk Monitoring Report, for FY09, in October 2009. The report defined the standard risk taxonomy for the institution and comprehensively analyzed risks facing the Bank, including fraud and corruption.
Corrective Action 8	**Review the activities of the Quality Assurance Group (QAG), to inform a broader assessment of gaps and overlaps**	**Implemented**	**This Corrective Action was implemented.**
Measure 8	Conduct an in-depth review of the central control units, including QAG, to inform a broader assessment of gaps and overlaps.	Completed	The review of QAG was completed and a proposal on realigning the quality assurance functions in operations was implemented in July 2010. The central control units have completed a self-evaluation, and an independent evaluation of the central units will follow later.
Point III	**Better integrate fraud and corruption (F&C) prevention**		

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Corrective Action and corresponding measures in Management Response	*Description*	*Status of implementation*	*Comment*
	into operations		
Corrective Action 9	**Establish clear responsibilities and accountability for addressing F&C issues.**	**Implemented**	**This Corrective Action was implemented.**
Measure 9a	Adopt the new strategy of the Integrity Vice Presidency (INT).	Completed	Management adopted the new INT strategy.
Measure 9b	Implement specific actions in response to the Volcker Panel Report.	Completed	Management implemented specific actions outlined in the Volcker Panel Report.
Measure 9c	Clarify, redefine, and reinforce accountability of managers on all sides of the matrix with respect to individual areas of responsibility.	Completed	Management clarified the accountability of managers at both transactional and institutional levels. The operation of the ORAF will facilitate a cohesive understanding of risks that may lead to F&C.
Corrective Action 10	**Establish appropriate protocols of cooperation between INT and the Regions**	**Implemented**	**This Corrective Action was implemented.**
Measure 10a	• Establish appropriate protocols of cooperation between INT and the Regions to handle allegations of F&C. • Establish a joint protocol to provide guidance on the roles of, and the interactions between, operational staff, Regional management, and INT regarding reporting	Completed	Management issued an OPCS/INT protocol on handling suspected and alleged F&C in procurement.

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Corrective Action and corresponding measures in Management Response	*Description*	*Status of implementation*	*Comment*
	allegations of F&C and handling requests for no-objections and post-investigation.		
Measure 10b	Deepen cooperation between the OPCS Procurement Anchor (OPCPR) and INT, including INT/OPCPR Memorandum of Understanding and joint INT/OPCPR work program.	Completed	Management issued a Memorandum of Understanding between OPCS and INT on the prevention of F&C in procurement.
Corrective Action 11	**Promote good practices across the Bank Group's work**	**Implemented**	**This Corrective Action was implemented.**
Measure 11a	Distill lessons learned from INT work by its Preventive Services Unit (PSU).	Completed	The PSU carried out a number of training seminars on lessons learned from INT work.
Measure 11b	Deliver Bank-wide learning events by OPCS, South Asia Region, and INT to disseminate lessons learned from India DIR.	Completed	
Measure 11c	Conduct Bank-wide training seminars (by the PSU); develop a comprehensive training program for task teams.	Completed	
Measure 11d	Define governance, accountability, and anticorruption plans at the project level.	Completed	The PSU continues to assist project teams in defining governance, accountability, and anticorruption plans at the project level.
Measure 11e	Issue guidance on inclusion of specific paragraphs on F&C in Country Assistance Strategies (CASs) in high-risk countries	Completed	Management issued guidelines on F&C in CASs.

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Corrective Action and corresponding measures in Management Response	*Description*	*Status of implementation*	*Comment*
	and in relevant annexes in high-risk projects.		
Measure 11f	As part of IL reform: • reform processing and supervision of IL operations, including a specific focus on addressing F&C risk during project appraisal and supervision; and • Develop new approaches to project design/appraisal and supervision.	Completed	The risk-based approach to project preparation and implementation was rolled out in July 2010. The ORAF is expected to encourage staff to highlight F&C risks throughout the life cycle of every project.
Measure 11g	Review staff incentives (performance reviews, promotions, rewards, and visibility) to ensure that they are aligned with the anticorruption agenda through discussions at a Managing Director-chaired Governance and Anti-Corruption (GAC) Governance Council.	Completed	Rather than introduce HR measures, Management approached the incentive issue by setting a clear tone from the top and by providing staff with tools to help them discuss risks candidly.
Measure 11h	Issue a joint INT/OPCPR guide/pamphlet on identifying and handling Red Flags during the project cycle.	Completed	Management issued an F&C awareness handbook/pamphlet.
Measure 11i	Establish a Financial Management (FM) GAC Working Group to support the development of good practices, guidance, and training for FM staff.	Completed	Management established an FM GAC Working Group.
Measure 11j	Deliver training on GAC to the FM community, including during the 2008 Fiduciary Forum.	Completed	Training on GAC was delivered to the FM community.
Measure 11k	Develop, post, and regularly update lessons learned and best	Completed	The GAC in Projects website was

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Corrective Action and corresponding measures in Management Response	***Description***	***Status of implementation***	***Comment***
	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.		developed and is updated as new information becomes available.
Measure 11l	Develop standard terms of reference that widen financial audits to cover performance issues and procurement.	Completed	Standard terms of reference for audits were developed to include performance issues and procurement.
Measure 11m	Assess Bank procurement procedures specifically for pharmaceuticals, and discuss Bank-wide.	Completed	A study was completed that provided recommendations for more effective responses in Bank health projects.
Measure 11n	Enhance training on managing F&C risks in the health sector through such modules as the session developed and delivered to Human Development staff during the Human Development week in the fall of 2008 on "Governance and Accountability: Issues, Diagnostics, and Implementation Tools for Health."	Completed	The PSU delivered training using the lessons learned from the India DIR.
Measure 11o	Prepare specific guidance on managing F&C risk and include in the FM Manual.	Completed	The updated FM Manual for World Bank-Financed Investment Operations includes guidance on managing F&C risks.
Measure 11p	Complete an initial stocktaking of AAA and IL operations with significant GAC components, and include the revisions in a searchable database, accessible to task teams, as	Completed	Management developed a searchable database for lending projects with a significant GAC

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Corrective Action and corresponding measures in Management Response	*Description*	*Status of implementation*	*Comment*
	examples of innovative approaches to risk assessment and risk mitigation.		component, and created a new GAC Knowledge and Learning portal that, together with the existing GAC guidance, will provide guidance for AAA.
Measure 11q	Prepare case studies and good practice notes to illustrate and elaborate on the tools and approaches being developed to improve governance and reduce corruption at the sector and project levels.	Completed	Management issued guidance notes on GAC in projects.
Measure 11r	Establish GAC-in-Projects Peer Learning Network.	Completed	Management established a GAC-in-Projects Peer Learning Network.
Measure 11s	Identify Practice Leaders at the regional and sector levels and establish full-time focal points (EAP and SAR) or "on demand" advisory units (ECA and SDN).	Completed	Practice leaders and focal points were identified and became operational.
Corrective Action 12	**Improve tools such as smart project design**	**Implemented**	**This Corrective Action was implemented.**
Measure 12a	Through the GAC in Projects network, compile and disseminate good practices for better management of F&C risks, including third-party supervision and "smart" project design.	Completed	Management issued GAC guidelines and good practices notes.
Measure 12b	Improve the procurement complaints database (in terms of completeness, operations, and usage) thus enhancing this important source for identifying potential F&C issues.	Completed	Management completed improvements to the procurement complaints database.

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Corrective Action and corresponding measures in Management Response	*Description*	*Status of implementation*	*Comment*
Measure 12c	Revise the Project Appraisal Document (PAD*)* Procurement Annex template as part of the first phase of IL reform to reflect new initiatives, including risk-based procurement assessments that cover, among other things, F&C.	Completed	The ORAF—which comprises all risks, including F&C—forms part of the PAD. The ORAF was rolled out Bank-wide in July 2010.
Measure 12d	Include F&C risks among the categories of project-level risks to be assessed at the project appraisal phase (and reported in the PAD) and monitored and reported on during project supervision (as reflected in the revised ISR).	Completed	The ORAF and the new PAD and revised ISR templates include F&C risks.
Measure 12e	In the new annual integrated risk report, include F&C risk among the specific risks facing the institution.	Completed	The new Integrated Risk Monitoring Report includes F&C risk in the standard taxonomy of risks facing the Bank.
Measure 12f	Develop and roll out the Procurement Risk Model/Risk Management Tool.	Completed	The Procurement Risk Assessment and Management System was rolled out in July 2010.
Measure 12g	Develop GAC-in-project guidelines by GAC in Projects team under the GAC Implementation Plan.	Completed	Management issued GAC guidelines and good practices notes.
Measure 12h	Develop and launch the GAC Audit and Assurance Toolkit.	Completed	OPCFM developed and launched the GAC Audit and Assurance Toolkit.
Measure 12i	Develop guidance on enhanced project supervision and FM Red Flags, supported by web-based tools and guidance,	Completed	Management issued guidance on FM Red Flags and developed a

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Corrective Action and corresponding measures in Management Response	*Description*	*Status of implementation*	*Comment*
	including a database of projects featuring FM anticorruption features.		GAC-in-projects database.
Corrective Action 13	**Prepare and monitor specific action plans for following up on INT reports**	**Implemented**	**This Corrective Action was implemented.**
Measure 13	Prepare and monitor (with OPCS support) specific action plans for following up on INT reports.	Completed	Management set up the systems and arrangements for monitoring Regional plans that will follow up on INT reports.
Corrective Action 14	**Issue OPCS guidance on addressing GAC issues in projects**	**Implemented**	**This Corrective Action was implemented.**
Measure 14a	Prepare FM guidance on dealing with F&C in project design, and circulate it to the FM Sector Board.	Completed	Management issued FM guidance on dealing with F&C in project preparation.
Measure 14b	Prepare guidance for FMSs on better identification and management of F&C risk through smart project design (to be supported by web-based knowledge sharing tools).	Completed	Management issued FM guidance on dealing with F&C in project preparation and developed a GAC-in-projects database.
Measure 14c	Prepare guidance on GAC good practices at the project level: "Dealing with Governance and Corruption Risks in Project Lending: Emerging Good Practices."	Completed	GAC issued this good practice guidance.
Measure 14d	Issue a paper on the FM approach to GAC.	Completed	Management issued a paper on the FM approach to GAC.

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Corrective Action and corresponding measures in Management Response	*Description*	*Status of implementation*	*Comment*
Point IV	**Tighten fiduciary controls**		
Corrective Action 15	**Institute corporate monitoring of FM quality**	**Implemented**	**This Corrective Action was implemented.**
Measure 15a	Undertake a joint CTR/OPCS evaluation process.	Completed	Management completed the first phase of the joint CTR/OPCS evaluation, which reviewed Regional quality assurance arrangements and disseminated lessons learned.
Measure 15b	Consolidate and update the Regions' quality assurance arrangements.	Completed	Regions' consolidation and updating of their quality assurance arrangements is complete.
Measure 15c	Centralize monitoring of the Audit Report Compliance System (ARCS) by OPCFM and rapidly reduce the number of outstanding audit reports.	Completed	The monitoring of ARCS is now centralized at OPCFM.
Measure 15d	• Review and update the FM Practices Manual (FMPM). • Align the quality assurance arrangements with the issuance of an updated FMPM.	Completed	Management issued the updated FM Manual for World Bank-Financed Investment Operations.
Corrective Action 16	**Integrate FM IT systems tracking project performance**	**Implemented**	**This Corrective Action was implemented.**
Measure 16a	Adopt the portfolio and risk management system in all Regions.	Completed	Management required all Regions to use existing FM information

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Corrective Action and corresponding measures in Management Response	*Description*	*Status of implementation*	*Comment*
			systems to systematically record FM project performance.
Measure 16b	Integrate IT systems that track project performance in FM with other Bank systems to ensure FM is fully reflected in all assessments of project performance.	Completed	In July 2010 Management rolled out a new system (the Portfolio and Risk Management system, or PRIMA II) to standardize FM information systems.
Corrective Action 17	**Ensure that all records relating to quality arrangements for FM are maintained and up to date**	**Implemented**	**This Corrective Action was implemented.**
Measure 17a	Achieve substantial 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.	Completed	Management completed the update of the ARCS database, and all backlogs of audit reports are now cleared.
Measure 17b	Ensure that Regions enter baseline data from interim financial reports into the portfolio and risk management system.	Completed	The entry of baseline data from interim financial reports into the existing FM systems is now significantly improved and is monitored each quarter.
Corrective Action 18	**Tighten fiduciary controls in procurement: ensure more consistent follow-through and establish clear mechanisms to resolve disagreements between procurement staff, task teams, and sector managers**	**Implemented**	**This Corrective Action was implemented.**

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Corrective Action and corresponding measures in Management Response	*Description*	*Status of implementation*	*Comment*
Measure 18a	• Improve controls and quality of complaints database.	Completed	Management improved controls in the procurement complaints database.
Measure 18b	• Create a mechanism for early and full integration of procurement staff in the project teams and of procurement tasks during the project cycle. • Issue new instructions and guidance on appropriate sharing of responsibility for key procurement decisions at preparation and implementation stages between TTL and procurement staff and between sector manager and Regional procurement manager. • Enhance procurement certification system. • Issue guidance to clarify criteria for assigning procurement ratings for ISRs, including a mandatory process for sector staff to follow in making any revisions to such ratings.	Completed	Under the ORAF, each team, including the procurement team, now has responsibility for completion of the ORAF. Hence, the ORAF is an effective tool to encourage increased close collaboration among task team members and to facilitate resolution of different views.
Measure 18c	Review the roles of the Procurement Sector Board and OPCPR so as to (a) expand them to identify areas that may merit harmonization of Regional practices; (b) strengthen the advisory role of the Procurement Sector Board in responding to the Regions' needs; and (c) monitor Regional fiduciary compliance and quality.	Completed	Management expanded the role of the Procurement Sector Board to include review of developed tools—such as the procurement post-review system and the procurement risk assessment and

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Corrective Action and corresponding measures in Management Response	*Description*	*Status of implementation*	*Comment*
			management systems—and the OPCPR work program to ensure harmonization within all Regions.
Measure 18d	Strengthen procurement post-reviews.	Completed	Management developed and rolled out Bank-wide a centralized procurement post-review system aimed at strengthening procurement post-reviews.
Measure 18e	Roll out a procurement post-review module Bank-wide.	Completed	
Corrective Action 19	**Update procurement policy to incorporate risk management, enhance complaints handling, and mainstream risk-based procurement assessment**	**Implemented**	**This Corrective Action was implemented.**
Measure 19	Update of OP/BP 11.00, *Procurement*, to cover, among other things, risk management, handling of F&C, and the already enhanced complaints handling, and to revise the matrix of responsibilities and the various clearance thresholds.	Completed	Management has revised OP/BP 11.00 to take into account issues identified during the 2008 Review. Staff are being advised to use the revised policy.
Point V	**Strengthen role of IT in risk management and improve AAA processes.**		

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Corrective Action and corresponding measures in Management Response	*Description*	*Status of implementation*	*Comment*
Corrective Action 20	**Prevent password sharing and strengthen controls to privileged systems.**	**Implemented**	**This Corrective Action was implemented.**
Measure 20	• Address the password-sharing issue. • 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. • Strengthen controls around infrastructure change management to ensure that change management controls are applied consistently and exceptions are reviewed and authorized by appropriate authority.	Completed	To address the password-sharing issue, Management implemented a mandatory information security awareness training program, and the Office of Information Security started monitoring potential password-sharing activities. With regard to privileged access and infrastructure change management, controls were strengthened as part of the FY08 Internal Controls for Financial Reporting exercise.
Corrective Action 21	**Improve accessibility of operational documents through automation.**	**Implemented**	**This Corrective Action was implemented.**
Measure 21	Automate and integrate IL processes and controls in close coordination with the first phase of IL reform and as part of the OKSP.	Completed	Automation and integration of IL processes and controls is being done through the OKSP's Operations Portal 2.0 and WBDocs systems. The Bank Project Portal (Ops 2.0) was rolled out in July

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Corrective Action and corresponding measures in Management Response	***Description***	***Status of implementation***	***Comment***
			2010, and rollout of WBDocs will be done in phases, beginning in September 2010.
Corrective Action 22	**Rationalize processes and controls governing AAA; address compliance issues identified by Independent Evaluation Group (IEG) and QAG; improve system support and monitoring.**	**Under implementation**	**This Corrective Action is largely implemented and will be considered completed once the identified measures to rationalize processes and improve controls are discussed by CODE in FY11Q2 and put in place.**
Measure 22	Undertake a broad review of the processes and controls, including systems and monitoring, that apply to AAA, to simplify and strengthen them where needed, and to 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 were raised by IEG and QAG in recent related reviews of AAA.	In progress	Management developed a Knowledge Strategy to strengthen governance and accountability for the knowledge portfolio (including AAA) and established the Knowledge and Learning Council to lead the implementation of the strategy. In addition, at the AAA product level, Management improved the reporting and recording of AAA with more discipline across Regions and

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Corrective Action and corresponding measures in Management Response	*Description*	*Status of implementation*	*Comment*
			Networks. However, controls over AAA processes have not been fully addressed. Management completed the business process review of AAA, and will recommend measures to the CODE in FY11 Q2, pushing for implementation by December 31, 2010.

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Attachment 3: IDA Internal Controls: Comment by the Independent Advisory Panel on the IEG Evaluation of Management's Remediation Program

IDA INTERNAL CONTROLS

COMMENT BY THE INDEPENDENT ADVISORY PANEL ON THE IEG EVALUATION OF MANAGEMENT'S REMEDIATION PROGRAM

KEY MESSAGES

- **In the Panel's view, the IEG has provided a sound, useful and professionally based evaluation of the Implementation of the Five Point Action Plan.**
- **We consider that the IEG has put forward a sound basis for downgrading the Material Weakness to a Significant Deficiency and that only the two Significant Deficiencies relating to generic weaknesses in fiduciary controls and certain weaknesses in information technology controls should now be removed.**
- **The Panel reiterates the importance of recognizing explicitly the integrated nature of both the financial and risk management frameworks and the systems that support them.**
- **As other large organizations have found, it is essential that a position of a Chief Risk Officer and the support it provides are not seen as an alternative to Managers at all levels being responsible for risk identification, assessment and treatment.**
- **We previously stressed the importance of people in the implementation process and ensuring that there is real understanding of what is required strategically and operationally and adequate systems (such as a knowledge based IT system) to inform them and facilitate the learning process. We do so again and strongly support the IAD's intention of reviewing the "softer issues" of the implementation process (that is cultural, people and learning aspects) over the next 12 to 24 months.**
- **We regard the Audit Committee (in conjunction with IAD) to be a key player in the future reviews and accountability for implementation of an effective control and performance framework.**
- **It would be useful for all stakeholders if the results of the remaining implementations would be made generally available, as they have been to date.**
- **In view of the wide-ranging interest in the Overall Review, it would seem desirable to ask the independent evaluator, IEG, given its substantial involvement in the Review from the outset, to report on the remaining implementations at the appropriate time.**
- **In our opinion, the Bank would be well advised to take both a top down and bottom up approach in any future major review of this nature.**

TERMS OF REFERENCE

The Panel was requested to review the key aspects of the IEG evaluation, its scope and basic content, its general approach and method, the framework and audit standards that it used, the adherence to the principles embodied in the COSO Framework, and the findings and judgments of the evaluation and the quality of the report itself.

In short, the Panel was requested to provide an independent opinion on the IEG Evaluation Approach and Findings in a Letter of Comment focusing on the major issues identified.

BACKGROUND

The Panel was pleased to be again asked to provide comment on the IEG Evaluation of the IDA Internal Controls. It is an area of considerable interest and long experience for all of the Panel Members. This aspect of the management of the World Bank is of major importance for its reputation, its performance and for the confidence of all its stakeholders, within and outside the Bank. The Panel gained a good understanding of the focus of the Overall Review of the internal controls governing IDA operations from its involvement in reviewing the earlier IEG Evaluations. We were impressed by the comprehensive and professional approach taken by IEG (and by the Management Group, including Internal Audit) in those evaluations. The Panel supported the IEG conclusions and recommendations, particularly in the remedial action required. As well, the Panel provided a number of observations on the approach taken to the Overall Review at both the strategic and operational levels with an emphasis on sound communication and understanding at all levels of the organization to promote "ownership "of the remediation program and accountability for its implementation.

The Panel also noted the need to recognize explicitly that financial controls and risk management are important not only for assurance but also for performance. Both are concerns of the Governing Body (however it is constituted) and of the Management. This recognition is essential for the success of an integrated approach taken by the COSO Framework adopted. It has been stressed that, under the COSO Framework, objective setting is a pre-condition to internal control. This appreciation is essential so that risks can be clearly identified, assessed and ranked, reflecting the Governing Body's views about " risk appetite ", so that those responsible within the organization can put in place cost effective systems and measures to manage those risks. The effectiveness of internal control can then be assessed by how well the objectives are achieved, and how effectively the risks are addressed. Reflecting this consideration, the Panel had previously noted the advantages for the overall review of a more robust top down as well as a bottom up approach. That said, the Panel was cognizant of the increasing involvement of the Governing Board which should ensure a focus on strategic as well as on operational issues and on the overall performance of the Bank.

In our previous Report, we stressed the need for a "clear and timely commitment (to implementation), including reporting back to stakeholders, to overcome the perceived deficiencies and improve the effectiveness of internal controls within both the COSO and governance frameworks ". This requirement is now reflected in the implementation of Management's Five Point Action Plan and the IAD Review, being the subject of the IEG's current Evaluation and our Comment. Depending on how further implementation is taken forward, there could be concerns about assurance in relation to the remaining Significant Deficiencies.

The Panel also draws attention to its earlier comments about the importance of people in any implementation process. The COSO framework not only considers so-called "hard "financial controls, such as segregation of duties, but also "soft "controls such as the competence and professionalism of staff at all levels. The Panel suggested that this was an important factor to consider in the implementation phase. In particular, staff generally needs to understand the strategic direction for the organization and the commitment of the Governing Body in order to promote "ownership "of the control environment as well as the assurance and performance requirements. In our view, this is essential for the effective operation of any risk management framework, which recognizes strategic guidance from the top level of the organization (in particular, the governing body) but also ensures that the management and accountability for risk identification and assessment lies with those having the direct operational responsibility for achieving the required outcomes.

REVIEW APPROACH

The Panel was provided with an advanced copy of the IEG's Report entitled " IDA Internal Controls: Evaluation of Management's Remediation Program (Report on the Implementation of Management's Five Point Action Plan and the IAD Review)" for examination and review. This provided an opportunity for the Advisory Panel to familiarize themselves with the issues and the evaluation approach. A number of preliminary observations on relevant issues were provided to IEG for later examination. The Panel subsequently met in Washington DC from 25 to 29 September for discussions with IEG, Management and IAD representatives and to prepare its Letter of Comment.

We were given the opportunity to meet with Mr. Abdulrahman Almofadhi, the Chair of the Audit Committee. **The latter was particularly important as we regard the Audit Committee (in conjunction with IAD) to be a key player in the future reviews and accountability for implementation of an effective control and performance framework.** We note that this reflects the important role of the Audit committee in the Governance Framework and that the Management response to the IEG report will be discussed at the meeting of the Audit Committee scheduled for September 29, 2010. At the operational level, Management has an equally important role in both implementation and identification of robust and effective approaches and systems for effective control and performance. The meetings were productive and gave the Panel a sound platform on which to base its conclusions, despite the tight timetable involved.

The Panel regarded this assignment as being in the nature of a Limited Assurance Review (a meta-evaluation). It was therefore cognizant of the INTOSAI Code of Ethics and Auditing Standards (that is, Performance Auditing Standards) in its approach. However, its examination was based solely on the IEG Report and questioning of people in IEG, Management and IAD. That is, we did not undertake any verification of Statements made. Rather, we assessed the adequacy and appropriateness of the approaches and action taken consistent with the COSO Framework and with other better practice that we are familiar with in our auditing experience. We also drew on our own knowledge and experience in both the public and private sectors in assessing better practice in governance and management as part of that assessment.

MAIN ISSUES IDENTIFIED

The immediate issues are relatively straightforward. Has Management's Five Point Action Plan been adequately designed and effectively implemented and, if not, what action is in hand to ensure it will be. The real test will only be possible after a period of experience and review. This is a further issue for consideration. Essentially, we are referring to the 22 Corrective Actions (CAs) covered by the Plan. The IAD regards a Corrective Action completed once its design has been finalized and verified for appropriateness. Management states that " the term " implemented " is used to mean that an action has been designed, tested and expected to be put into operation (process for roll-out initiated) by September 30, 2010 ". Therefore they do not agree with the IEG criterion that a corrective action must be actually rolled out (and, implicitly should have some experience of implementation to demonstrate the operational effectiveness of the action). Not surprisingly, a significant issue is the treatment of the earlier identified Material Weakness (MW) relating to controls over fraud and corruption in projects supported by IDA, about which there was a difference of view between Management and IEG, and of six Significant Deficiencies. Our focus is, of course, mainly on the evaluation and report by IEG.

Looking at the IEG evaluation, an issue is the scope and coverage of the Report. Another consideration, identified by IEG itself, is the clarity and comprehension of the Report. Importantly, for our Review, is the quality of the analytical framework and of the analysis itself, in particular the evaluation approach, its conformance with applicable standards, methodology, analytical techniques and data used to support the analysis and its conclusions and recommendation. Finally, we have given attention to the relationship between the analysis and the IEG's conclusions and recommendations, as well as any caveats entered in relation to particular implementations. An overriding issue is the relationships between IEG and Management and IAD in securing a successful conclusion to the overall Review.

PANEL ASSESSMENT

Scope and Coverage of the IEG Report

In the light of the content and duration of the Overall Review, and in the interest of bringing the Review to a conclusion after five years of considerable effort, the Panel considers that the relatively narrow scope and coverage of the IEG Report is appropriate. Implementation of the Five Point Action Plan is virtually complete. The IAD has stated that "Management has substantially addressed the significant deficiencies identified in the 2008 Review ". The focus is now on ensuring that implementation meets the organization's objectives as required under the COSO framework. The value of the IEG Report is the independent view provided on the action taken by Management to address identified deficiencies and any insights the IEG has on making that implementation more efficient and effective.

The only reservation the Panel continues to have is whether the main focus on operational aspects of specific financial controls has limited the attention to considerations of strategic aspects of the organization's performance, where input from the Governing Body is normally required. Simply put, how well do the operational controls, individually and collectively, contribute to the World Bank's strategic objectives, including its management of risk. These issues would seem to be an essential element of any future reviews of the effectiveness of the control environment, taking the COSO framework as being an important part of the Bank's financial management approach.

The IEG specifically recognized the integration requirement of the COSO framework. This is illustrated in its consolidated conclusion in regard to the remediation of the material weakness by "its evaluation of the combined impact of all remedies together "(page xi). The Five Point Action Plan was designed to address each of three key elements - Entry Level Factors, Linking Factors (Risk Management), and Project Level (transactions) factors that IEG had depicted in its Chart of Suggested Remedies in its earlier Report. The Panel also notes the development of the World Standard for Enterprise Risk Management, referred to in our previous Comment, which similarly stresses the need for an integrated approach to management of risk.

Clarity and comprehension of the Report

The Panel is sympathetic to IEG's concern that the Report be clearly understood "by an audience who may not all have been involved in the about five year-long review process and who may not be familiar with the original causes and findings of control weaknesses." The nature and duration of the Overall Review almost guarantees the presumption about, and acceptance of, the knowledge of the reader of particular concepts, terminology and methodology associated with the Report. It is difficult to avoid the use of at least some technical language and concepts in any review of this nature. In the Panel's view, the approach taken by IEG largely overcomes the problem. It particularly supports the use of Annexes A and B for technical details which the Panel found to be very useful for our own analysis. The Evaluation Summary should similarly be helpful for the wider readership community. Minimal use of abbreviations for the various organization specific and technical terms would have assisted the reader. The Panel considers the explanation and amplification of key technical terms (pages v and vi) would be particularly helpful for a range of readers. As well, the Panel considers the layout of the Report to be quite reader friendly.

IEG's Analysis and Findings

While the scope and coverage of the IEG Report may be narrow, its analyses and findings are well structured and comprehensive. IEG has again taken a highly professional approach to the work. It is consistent with the requirements of performance auditing standards and with best practice in evaluation. The issues are well defined; the methodology and analytical techniques are appropriate for the purpose, and the conclusions and recommendations are clear, succinct and add value. We also note the cooperative and corroborative approach taken with Management and IAD. The Panel was particularly pleased to see the IEG evaluation assess and take account of the IAD Review and Opinion. As noted earlier, the Panel would expect to see the IAD play a key role in reviewing the implementation of the control framework and in any future reviews of that framework.

The comprehensive nature of IEG's analysis is illustrated by its examination of each of the sub-components of nine of the twenty-two corrective actions, which had several sub-components. However, not surprisingly, IEG focused heavily on the area of Material Weakness (MW) and came to a consolidated conclusion of the MW by evaluating the combined impact of all remedies together. This is consistent with the integrated nature of the COSO framework. While the IEG agreed with Management's assertion that the Five Point Action Plan had significantly strengthened IDA's internal controls and improved the overall control environment, the question still remains, in the Panel's view, as to how this action will actually improve overall performance and lead to better outcomes. The Panel accepts that IEG's conclusion is not an unreasonable assumption but reiterates that the "solution " is mainly operationally, not strategically, focused in terms of the organization's objectives. It may mean that the controls in place need to be more attuned to the strategic demands, or indeed, there might be a need for different kinds of controls, including risk management approaches.

The Panel agrees that there is now significant evidence that key controls to address fraud and corruption risks (which were previously absent) have been put in place. Again, there is an issue about the effectiveness of the new tools to address such risks. Moreover, the IEG observation that three elements in the control environment (that is, definition of responsibilities and accountabilities, management oversight and HR policies) are among those corrective actions still in the process of implementation is of some concern. The Panel agrees with the IEG suggestion that the Integrated Risk report be used for future reporting of new risks, status of existing controls, and results of monitoring and in-depth reviews.

The Panel took particular care to examine the IEG analysis of the implementation of required action to deal with the MW and the six Significant Deficiencies. We are in agreement with the analytical basis for comments in Annex B. After detailed discussion of the IEG's verification approach and conclusions in Annex A, and their inter relationship, we were able to satisfy ourselves that the conclusions were properly based.

We consider that the IEG has put forward a sound basis for downgrading the MW to a Significant Deficiency and that only the two Significant Deficiencies relating to generic weaknesses in fiduciary controls and certain weaknesses in information technology controls should now be removed. This leaves five Significant Deficiencies to be treated with appropriate and timely testing to provide the necessary confidence to all stakeholders that they do not constitute a threat to the organization.

We note that there seems to be an expectation that Management will provide assurance that the remaining Significant Deficiencies have been effectively remediated in a timely manner. The IAD Report indicates that the operating effectiveness of most of the controls "can be assessed only after a reasonable period of operation "(page 3). The Report goes on to indicate that "IAD will cover operating effectiveness in the course of its regular assurance audits ". **It would be useful for all stakeholders if the results of the remaining implementations would be made generally available, as they have been to date.**

PANEL CONCLUSIONS AND RECOMMENDATIONS

In the Panel's view, the IEG has provided a sound, useful and professionally based evaluation of the Implementation of the Five Point Action Plan. The IEG has also dealt positively with both the Management's and IAD's Reports. Differences in views will always be a factor to deal with. However, there is considerable agreement among the three Groups on the appropriateness and quality of the Implementation of the Five Point Action Plan. We do not think that IEG is being overly cautious in recommending that five Significant Deficiencies remain even though action is in hand to deal with them. It is also good practice to ensure that regular reviews are scheduled to ascertain whether implementation actually achieves the required outcomes. The issue is more about due process than about semantics.

The Panel is familiar with the implementation of large systems, for example in Defense Departments, where the system has experienced considerable problems in implementation, sufficient to force a re-appraisal of the approach taken. **In view of the wide-ranging interest in the Overall Review, it would seem desirable to ask the independent evaluator, IEG, given its substantial involvement in the Review from the outset, to report on the remaining implementations at the appropriate time.** This would provide assurance to all stakeholders, particularly those who initiated the Review that the remediation actions had been successful and/or that other action is necessary to achieve the required outcomes.

From our experience we would fully support the IEG view that "monitoring of internal controls should be a continuous process ". **As well, we generally support the suggested action and questions to be addressed in relation to the remaining significant deficiencies.** We also reiterate our view that rolling reviews of the areas covered by the Action Plan can be quite cost effective and ensure that both top down (that is, from the Governing Body's strategic perspective) and bottom up (from an operational viewpoint) issues are recognized and understood by all concerned and addressed in a timely fashion.

The Panel reiterates the importance of recognizing explicitly the integrated nature of both the financial and risk management frameworks and the systems that support them. It was also good to see that the "tone at the top" issues in the control environment have been addressed on a broad front. The Panel points to the initiatives taken at senior management and Board levels in relation to action taken on Significant Deficiency 4 in this respect. In particular, the Panel notes Management Plans to appoint a World Bank Group Chief Risk Officer. As well, Management plans to establish an IBRD/IDA Risk Management Advisory Group to support that Office and the Group Risk Council. Key Vice Presidents will be represented on the Advisory group. This will help focus greater attention to the risk management approach at both the strategic and operational levels. **As other large organizations have found, it is essential that a position of a Chief Risk Officer and the support it provides are not seen as an alternative to Managers at all levels being responsible for risk identification, assessment and treatment.** Such a position can provide a useful advisory, coordinating and over sighting capacity and an organization wide view of the risks being confronted by the Bank in a changing environment.

We also draw attention to the considerable progress that has been made on improved document retention and accessibility which will greatly assist the integration requirements and facilitate staff knowledge and understanding so that timely and appropriate action can be taken in all areas of the Bank. The Panel knows from experience that knowledge management systems are not easy to implement but are even more difficult to maintain with appropriate staff input and commitment. Nevertheless, they can be a major contributor to achievement of the Bank's objectives and provide considerable confidence to all stakeholders, internal and external.

We previously stressed the importance of people in the implementation process and ensuring that there is real understanding of what is required strategically and operationally and adequate systems (such as a knowledge based IT system) to inform them and facilitate the learning process. We do so again and strongly support the IAD's intention of reviewing the "softer issues" of the implementation process (that is cultural, people and learning aspects) over the next 12 to 24 months.

In our opinion, the Bank would be well advised to take both a top down and bottom up approach in any future major review of this nature. This would result in better understanding, guidance and support for any changes and specifically recognize integration issues at the outset instead of later in the implementation phase. It would also better establish priorities at both the strategic and operational levels.

NOTE OF APPRECIATION

The Panel again expresses its appreciation for being given the opportunity to be involved with such an important review. In particular, we would like to thank sincerely Cheryl Gray, Nils Fostvedt and Ian Hume for their personal involvement and support and recognize the professionalism and support of the whole IEG team. We would also like to thank Charles McDonough and other senior members of Management and Clare Brady, Auditor-General for making time available to meet with us and for their willingness to share their insights and provide feedback on our views and queries. We were also very grateful that the Chair of the Audit Committee, Mr. Abdulrahman Almofadhi, was able to make time to talk with us. All should be explicitly recognized for the contributions they have made to the overall success of the Review and the Implementation of the Remediation Program to date.

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28 September 2010

Endnotes

[1]*Review of IDA Internal Controls: An Evaluation of Management's Assessment and the IAD Review.*

[1] See World Bank Web site for COSO Framework.

[1] *Review of IDA Internal Controls: An Evaluation of Management's Assessment and the IAD Review.* AC 2008-0147 CODE 2008-0098. December 22, 2008.

[2] The 2008 IEG report states: "Management, IAD, and IEG all found that, while the overall framework is robust, there are weaknesses that are concentrated in a few key areas" IEG Evaluation Summary, page xix.

[3] Nine CAs had a total of 49 subcomponent actions. Therefore, there were 62 individual action items in the FPAP. This count is taken from Annex III of IAD's report (see Attachment 2).

[4] A draft of this Approach Paper had earlier been discussed with the Audit Committee.

[1] "List of Corrective Actions Taken in the FPAP, Including the Results of the IAD Review and IEG Verification."

[2] This annex has been included in Management's Report as Annex B (see Attachment 1).

[3] See Volume II, Annex D, page 42, second bullet regarding tone at the top.

[4] "Independent Panel Review of the World Bank Group Department of Institutional Integrity," September 13, 2007.

[5] See Volume II, Annex D, page 42, paragraph 13 bullets.

[6] See Volume II, Annex D, page 42, paragraph 13 bullets.

[7] See Volume I, paragraphs 2.20 and 2.21, page 16.

[8] See Volume II, Annex D, paragraph 15, page 43.

[9] See Volume II, Annex D, paragraph 23 (first bullet), page 46.

[10] See IEG 2008, Volume V, page 23.

[11] IEG finding from Part II completion, with management and IAD concurring this was a Significant Deficiency.

[12] See IEG 2008, Volume I, page 20, and Volume IV, Evaluation Summary, page xi.

[13] See IEG 2008, Volume I, page 20.

[14] See IEG 2008, Volume I, page 20.

[1] See IEG 2008, Volume V, pages 24 and 40.

[2] See IEG 2008, Volume I, page19.

[3] See IEG 2008, Volume V, page 23.

[4] See IEG 2008, Volume I, page 19.

[5] See IEG 2008, Volume I, page 20.

[6] See IEG 2008, Volume I, page 20, and Volume IV, Evaluation Summary, page xi.

[7] See IEG 2008, Volume I, page 20.

[8] See IEG 2008, Volume I, page 20.