

**INDEPENDENT EVALUATION GROUP**  
**IDA INTERNAL CONTROLS**  
**IEG EVALUATION OF MANAGEMENT'S REMEDIATION PROGRAM**  
**APPROACH PAPER<sup>1</sup>**

**Introduction**

1. At the time of the IDA14 replenishment the Board agreed, based on a request from the IDA Deputies, to an independent evaluation by IEG of IDA's internal controls. With the agreement of the Board the task was organized through a management self-assessment, a review by the Internal Audit Department (IAD) of this self-assessment, and an evaluation by IEG of both the self-assessment and the review, as well as of the underlying control issues.

2. IEG completed this evaluation in FY09.<sup>2</sup> Management has now requested IEG to provide an evaluation of the implementation of the resulting action program (para 4), along the same principles and methods as for the earlier evaluation of IDA's internal controls. IEG proposes to do so as outlined in this Approach Paper (AP), as a modest one-time extension of the work under the original evaluation.

3. At the conclusion of IEG's evaluation there was broad agreement between management, IAD and IEG on the key identified issues, although some differences of opinion as to materiality. IEG identified one material weakness (MW) in the controls over fraud and corruption (F&C) in operations supported by IDA, and six significant deficiencies (SDs) in controls related to (i) a need to maintain the currency of the Bank's Operational Policies and Bank Procedures (OPs/BPs); (ii) a need for improved document retention and accessibility; (iii) generic weaknesses in controls over financial management and procurement processes (from Part I of the evaluation); (iv) a need for improved management oversight of project processing and supervision, coupled with improved staff incentive structures and performance accountability; (v) a need to improve risk management, including inserting specific F&C risk factors into the Risk Scan, and in integrating risk treatment from the entity level to the activity level; and (vi) a need for greater IT security in some areas.

4. Management prepared and presented to CODE and the Audit Committee (AC) an extensive five-point remediation action program<sup>3</sup> to address the MW and the SDs:

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<sup>1</sup> An earlier version of this Approach Paper was discussed at the Audit Committee on September 23, 2009.

<sup>2</sup> *Review of IDA Internal Controls: An Evaluation of Management's Assessment and the IAD Review.*

<sup>3</sup> Included as an annex of Vol. I of the IEG Report.

- 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 Anti-Corruption (GAC) strategy at country and project levels, continued integration of 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 AAA.
5. Under its current timetable, management expects to complete all of its actions in the program by about end September 2010, including relevant testing of the operating effectiveness of controls related to F&C and other action items.

### Scope and Approach

6. **Purpose:** 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. This is a narrow follow-up activity addressing key earlier findings, and is thus not a re-evaluation of the overall IDA control framework.

7. **Structure of the Exercise:** The current work should largely be structured as was the case for the evaluation itself, with management reporting/self-assessment, appropriate IAD reviews, and an IEG evaluation of both including of any underlying material and with such independent verification work as IAD and/or IEG might find necessary. (In this regard, IAD plans to determine whether management has effectively implemented the corrective actions described in the IDA Internal Controls Assessment five-point action program.)

8. **Methodology:** As was the case for the IDA controls evaluation, the follow-up evaluation will be conducted in the context of the internal control framework developed by the Commission of Sponsoring Organizations of the Treadway Commission (COSO), and using the materiality criteria contained in the Accounting Standards of the PCAOB (AS5). In addressing the MW and the SDs, the following methodological aspects are also important:

- The entire review of IDA controls was *a testing of internal controls and processes, not of operational outcomes*. Any required testing of new controls (such as to combat F&C) should not be undertaken to a higher standard than was applied to the overall

review. Such testing will need to show that controls that were formerly absent are now in place and are being systematically applied in operational practice (and thus not e.g. whether the actual amount of F&C may have declined).

- Where there is a finding of a weakness in controls and its materiality has been established, such finding can be modified only after new or improved controls have been set in place, and only after these have been tested and shown to be effective.

9. **Schedule:** The work under this exercise has a specific and limited scope - to evaluate the implementation of the management action plan. Also, IEG expects there to be close and open communications between management, IAD and IEG, and that IEG will be able to draw to a significant extent on the work planned to be done by IAD. IEG's amount of new work is therefore expected to be quite limited. The binding constraint is likely to be the time it will necessarily take for management to complete the various actions and for these to take hold in such a way that they can reasonably be tested, since the final IEG report should be delivered only when all the forthcoming information is available and the related evaluative activities have reasonably been completed. Management currently expects for its own work to be completed by about end September 2010. On this basis, IEG expects to deliver its final report in the second to third quarter of FY11. Prior to that report, IEG could as needed provide oral progress reports to the AC and/or CODE and to IDA Deputies, as was done at some stages of the controls evaluation itself, but more formal progress reports would not seem warranted.

10. **The Report:** For the controls evaluation the final IEG report included reports from management and IAD, respectively. While the reporting under this implementation exercise might be a bit different, in principle it is currently expected that the final IEG report would contain (i) a concise report by management on the action program and its implementation, (ii) a report from IAD with its conclusions regarding the implementation of the action plan; and (iii) a report from IEG on both reports and the underlying developments concerning the controls related to the identified MW and SDs.

11. **The IEG Team:** IEG's evaluation would be carried out by some of the team members from the earlier controls evaluation, with a core team consisting of Nils Fostvedt (task manager) and Ian Hume.

12. **Advisory Panel:** An expert external advisory panel (three former auditor-generals) provided very useful independent comments on the IEG controls evaluation report. IEG is considering making use of such a panel also for this follow-up evaluation.

13. **Evaluation of the Governance and Anti-Corruption (GAC) Framework:** An IEG evaluation of the GAC framework is scheduled for FY11. The more limited work discussed in this AP will serve as one input among several into that broader evaluation. The relationship between the two evaluations will be discussed in more detail in the AP for the GAC evaluation that will be distributed to CODE in mid FY10.