

The IDA Internal Controls Framework

Overall IEG¹ Evaluation of Management's Assessment

Draft Approach Paper

I. Background

1. This draft Approach Paper (AP) is submitted for the information of the Committee on Development Effectiveness (CODE) and the Audit Committee (AC), as background to the joint AC/CODE meeting November 28, 2005. It takes as its starting point the proposed work plan presented by Management last August,² and that will be discussed November 28. Based on the discussions at the AC/CODE meeting the draft AP will be modified, such as by limiting the scope of work only to IDA.

2. In the IDA14 Replenishment Report³ Bank Management “has committed to carry out an independent comprehensive assessment of its control framework including internal controls over IDA operations and compliance with its charter and policies” (para 39 of that document). Annex Table 3 of the document stipulated that this assessment should be undertaken by IEG (the former OED). This document has been approved by the Executive Directors.

3. This assessment of IDA's controls was discussed briefly at the Board last June.⁴ At that time, Management stated that – consistent with the Bank's COSO-based control framework – there should first be a self-assessment with a role for the Internal Audit department (IAD), leading up to the IEG evaluation. IEG confirmed that it was prepared to take on the requested evaluation if the Board should so wish. As this was not in the IEG work program, there would need to be a one-time non-fungible addition to the budget for this purpose.

¹ The Independent Evaluation Group (IEG) is the new name for the Bank's independent evaluation function, following the recent Board approval of the proposed changes to the names of the Bank Group's independent evaluation entities. IEG comprises the independent evaluation entities in the Bank, IFC, and MIGA. All the evaluation work to be done under this draft Approach Paper would be done through IEG-WB – the former Operations Evaluation Department (OED).

² “An Assessment of IDA's Internal Control Framework”, August 17, 2005. (AC2005-0092; CODE2005-0078). That document referred (para 1) to a previous (2003) report by the U.S. General Accountability Office (GAO): “WORLD BANK GROUP – *Important Steps Taken on Internal Control but Additional Assessments Should be Made*”.

³ See “Report from the Executive Directors of the International Development Association to the Board of Governors, Additions to the IDA Resources: Fourteenth Replenishment, Working Together to Achieve the Millennium Development Goals” (approved by the Executive Directors of IDA on March 10, 2005), para 39.

⁴ At the June 12 discussion of IEG-WB's FY06-08 work program and FY06 budget.

II. The Management Self-Assessment

4. In accordance with Management's proposed work plan for this assessment, it intends to conduct the assessment of internal controls in the context of the COSO internal control framework.⁵ As described in the Management work plan, this framework is an all encompassing process which covers all aspects of internal control of an organization's operation. The framework requires that Management assess the organization's internal controls, and that an independent third party verify such assessment. The methodology of Management's self-assessment, the areas to be addressed, and its scope are shown in paras 5-14 of the Management's work plan, including the control groups that form part of the internal controls framework over IDA's operations (Attachment 2 of the Management work plan) and the specific processes to be performed by Management as part of its assessment (Attachment 3 of the work plan).

5. In its work plan, Management commented that internal controls over financial reporting are assessed annually by Management, and the external auditor provides annually a statement of opinion on Management's assertion. Accordingly, it proposed that the current review would not address them, but would focus on the areas of compliance and economy and efficiency. IEG concurs with this approach.

6. The Management work plan states that given the rather compressed timeline for the IDA portion of the assessment (to be able to report relatively quickly back to the IDA Deputies), it would be necessary to carry out the overall assessment in four parts (IEG understands that Management may now suggest to limit this exercise only to IDA)::

- Processes and controls applicable to IDA operations, including linkage of strategy to CAS, project cycle, financial management, procurement activities, and use of budgetary resources. The Management assessment to be completed by April 2006 and validation by IAD of Management's assessment by June 2006.
- Processes and controls applicable to IBRD operations, including linkage of strategy to CAS, project cycle, financial management, procurement activities, and use of budgetary resources. The Management assessment to be completed by March 2007 and validation by IAD of Management's assessment by May 2007.
- Overarching control framework for IDA including all aspects of corporate governance and entity level control. The Management assessment to be completed by December 2007 and validation by IAD of Management's assessment by February 2008.
- Overarching control framework for IBRD including all aspects of corporate governance and entity level control. The Management assessment to be completed by February 2008 and validation by IAD of Management's assessment by April 2008.

7. For each part, there would be three phases:

- First, a Management self-assessment of the internal controls over operations and compliance, thereby providing the basis for a Management statement of assertion

⁵ COSO: Committee of Sponsoring Organizations of the Treadway Commission.

regarding the extent to which controls meet COSO standards and/or identifying any reportable conditions or material weaknesses in controls.

- Second, the Bank's Internal Audit Department (IAD) would review the self-assessment and provide an IAD opinion regarding the correctness of Management's statement of assertion as to the adequacy of internal controls and its identification of reportable conditions and material weaknesses.⁶
- Third, IEG would provide an independent evaluation of the overall process and its effectiveness in assuring the Bank's internal controls over operations and compliance meet COSO standards and/or reporting any reportable conditions and material weaknesses in internal controls.

8. In IEG's view, Management must assess the controls using as criteria the COSO standards.⁷ If Management identifies any control weaknesses, they should address them (reportable conditions and material weaknesses), together with corrective actions. IAD will review Management's assertions and express an opinion on Management's assessment.

III. The IEG Evaluation

9. Key Assumptions: This draft AP focuses primarily, as does the Management work plan, on the processes and controls applicable to IDA operations, and will be limited strictly to those parts if that should be the outcome of the forthcoming AC/CODE meeting. Pending that discussion, this draft AP adopts the same approach as has been set out by Management in its work plan. In particular, this includes in this draft AP:

- Using the COSO integrated internal control framework (para 4).
- That internal controls over financial reporting not be addressed (para 5).
- The proposed four parts (para 6).
- The proposed three-phase process (Management self-assessment, IAD validation, IEG evaluation) for each of the four parts (para 7).
- The involvement of IEG in all of the four parts (even though the IDA14 agreement referred only to IDA).

10. IEG's Work: IEG will provide an overall assessment of IDA's control framework as per Management's commitment in the IDA14 Replenishment Report. IEG – reporting to the Board through CODE and AC - will thus provide an independent evaluation of the overall process used by Management to develop a statement of assertion⁸ as to the adequacy of internal controls and its identification of reportable conditions and material weaknesses of internal controls over operations and compliance, as well as of the work done by IAD to provide an opinion on the

⁶ While IAD is part of Bank management, the proposed work plan sets out the IAD validation as a separate exercise.

⁷ For a discussion of COSO standards, see World Bank, Office of the Controller, *Controls Guide: Implementing a Control Program in Your Unit* (2003).

⁸ IEG will at that time, inter alia, consider whether Management's assertion would need to be qualified due to limited scope of the work carried out until then.

correctness of management's internal controls assertion. IEG will rely on the COSO internal controls framework as criteria in evaluating Management's and IAD's efforts. IEG will also rely on COSO definitions of reportable conditions and material weaknesses in judging the correctness of management reporting on identified control weaknesses. Using these criteria, IEG's work will focus on the efforts of management and IAD and the approaches they use and the documentation they provide to determine whether internal controls over operations and compliance meet the COSO framework and how it worked, including the methodology and scope of Management's self-assessment, any limitations or qualifications to the assertions, the areas that the work addressed, the appropriateness and completeness of the control groups, the specific processes that it performed, and the work of IAD in reviewing and arriving at an opinion on Management's assertion.

11. In carrying out its evaluation, IEG needs to analyze the work done by both Management and by IAD, and to obtain sufficient independent information to reach independent conclusions about their work as required to provide an overall assessment of IDA's control framework. In part due to time constraints, for the first part (processes and controls applicable to IDA operations) IEG does not plan any field work, whether with Bank field offices or with IDA clients/projects. However, IEG's report for this first part will identify any such desirable field work, which could then be undertaken subsequently.

12. IEG was requested to carry out this assessment due to its independence from Management,⁹ reporting directly to the Board. As is its normal practice, IEG will provide its evaluation in the form of a report (or more than one report, as appropriate) directly to the Board (through AC/CODE). IEG will carry out its work under the following planned structure:

- A core IEG task manager, supported by a senior outside consultant, that will report directly to the IEG -WB Director.
- The task manager will supervise a small team of staff and consultants, the latter to be hired from a well-established firm of auditors or other contractors with a similar background. The team will carry out the specific analyses and testing for this exercise, and provide recommendations to the IEG task manager.
- The report(s) will be submitted to the Board by the Director-General, Evaluation (DGE).
- As is now normal for many of IEG's major evaluations, an advisory panel will help guide the work, and will provide comments directly to CODE/AC on the IEG evaluation. The advisors will be selected in their individual capacity.

IV. Duration and Costing

13. Timetables: Management has set out timetables for the overall work in Attachment 4 of its work plan. There are four somewhat overlapping parts with dates identified tentatively by Management for IEG to deliver its findings – taking IEG's work all the way into early FY09. This work plan could be modified based on the outcome of the AC/CODE meeting:

⁹ OED Reach, *Independence of OED*, dated February 24, 2003. OED's independence has since been validated by two external panels.

- Processes and controls applicable to IDA operations: September 2006 (three months after IAD completion).
- Processes and controls applicable to IBRD operations: August 2007 (three months).
- Overarching control framework for IDA: July 2008 (six months).
- Overarching control framework for IBRD: July 2008 (three months).

14. Furthermore, Management has since informed IEG that it is important for Management to present the reports concerning the processes and controls applicable to IDA operations to the first IDA15 Deputies' meeting in September 2006.

15. IEG is not now in a position to confirm these deadlines. As already mentioned, IEG as an independent evaluation entity will not necessarily be limited to what is outlined in the Management paper concerning IEG's role, responsibilities, or timeline(s). Also, the amount of additional review, testing and analysis will depend in part on the quality and timeliness of the work by Management and IAD. Finally, unless we reach agreement to change this, under the normal IEG procedures for interacting with Management and with the Board, all major evaluations are sent to Management for comments, a process for which six weeks are normally allocated (and at times more time is required), and under IEG's disclosure policy that has been approved by the Board, the major reports are disclosed only after they have been discussed by CODE (a minimum of two weeks after report distribution), or after Board discussion in those cases when there is such discussion.

16. The above shows that Management's tentative time tables may be very difficult to meet, and cannot determine the scope of IEG's work. However, IEG will follow as observer the progress of the work being done by Management and by IAD. If this is carried out largely in a modular fashion, it should be possible for IEG to start its work on this first IDA phase well before June 2006 (planned date for the completion of the IAD validation), and perhaps to some extent prior to April 2006 (planned date for the completion of the Management assessment).

17. If CODE/AC members should feel that it would be important for the IEG report on the first phase (IDA processes and controls) to be distributed to IDA donors by a certain date, they might wish to consider whether the IEG report should be shared with the IDA donors at the same time as it would be distributed to CODE/AC.

18. For the first part, following the discussion at CODE/AC on November 28), IEG would move expeditiously with finalizing the AP and recruiting the necessary consultants.

19. Cost: Given the many uncertainties not under IEG's control that are surrounding this multi-year exercise from FY06 and into FY09, it is not possible to prepare a precise budget at this time. However, IEG estimates tentatively that its overall costs (FY06-FY09) will stay within the \$1 million allocated in the FY06 budget for this exercise (whether or not the exercise will be limited only to IDA). It is assumed that funds not used in FY06 will be reallocated in FY07 and later years as necessary. However, at this stage IEG must reserve the possibility to request additional funding later, if this should prove necessary due to additional work requirements.