REVIEW OF IDA INTERNAL CONTROLS
An Evaluation of Management’s Assessment and the IAD Review

Volume V
Report on the Completion of Part IA
Process Mapping and Effectiveness of Control Design
THE WORLD BANK GROUP

WORKING FOR A WORLD FREE OF POVERTY

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This paper is available upon request from IEG-World Bank.
### Acronyms and Abbreviations

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<th>Acronym</th>
<th>Description</th>
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<th>Description</th>
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<tr>
<td>AAA</td>
<td>Analytical and Advisory Activities</td>
<td>IRMF</td>
<td>Integrated Risk Management Framework</td>
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<tr>
<td>AC</td>
<td>Audit Committee</td>
<td>ISR(R)</td>
<td>Implementation Status (and Results) Report</td>
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<td>ACS</td>
<td>Administrative and Client Support Network</td>
<td>IT</td>
<td>Information Technology</td>
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<td>AICPA</td>
<td>American Institute of Certified Public Accountants</td>
<td>LOA</td>
<td>Loan Department</td>
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<td>AROE</td>
<td>Annual Review of Operations Evaluation</td>
<td>NGO</td>
<td>Non-Governmental Organization</td>
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<td>ARDE</td>
<td>Annual Review of Development Effectiveness</td>
<td>OD</td>
<td>Operational Directive</td>
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<td>ARPP</td>
<td>Annual Review of Portfolio Performance</td>
<td>OED</td>
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<td>AS2</td>
<td>Audit Standard No. 2</td>
<td>OM</td>
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<td>BP</td>
<td>Bank Procedure</td>
<td>OP</td>
<td>Operational Policy</td>
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<td>BPM</td>
<td>Business Process Module</td>
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<td>CDS</td>
<td>Control Detail Sheet</td>
<td>PAS</td>
<td>Procurement Accredited Specialist</td>
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<td>CODE</td>
<td>Committee on Development Effectiveness</td>
<td>PCAOB</td>
<td>Public Company Accounting Oversight Board</td>
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<td>COSO</td>
<td>Committee of Sponsoring Organizations, of the Treadway Commission</td>
<td>PCPI</td>
<td>Post Conflict Performance Indicators</td>
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<td>CPIA</td>
<td>Country Policy and Institutional Assessment</td>
<td>PMT</td>
<td>Project Management Team</td>
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<td>CTR</td>
<td>Controller’s Directive</td>
<td>PO</td>
<td>Process Overview</td>
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<td>Financial Management</td>
<td>QSA</td>
<td>Quality of Supervision Assessment</td>
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<td>FMA</td>
<td>Fiduciary Monitoring Agent</td>
<td>RMCVP</td>
<td>Vice President, Resource Mobilization and Co-financing</td>
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<td>Internal Audit Department</td>
<td>RMFM</td>
<td>Regional Manager, Financial Management</td>
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<td>ROC</td>
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<td>IDA</td>
<td>International Development Association</td>
<td>ROW</td>
<td>Risk Opportunity Workshop</td>
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<td>Task Team Leader</td>
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<td>Vice Presidential Unit</td>
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<td>IEG</td>
<td>Independent Evaluation Group (formerly OED)</td>
<td>WBI</td>
<td>World Bank Institute</td>
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Key Technical Terms

**Internal Controls**: Controls, individually or in collective fashion, are structured means within an organization to 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.

**COSO Integrated Framework**: A framework of management principles (“COSO components”) in an organization which, when collectively operating as intended, will ensure the attainment of three key organization goals (“COSO objectives”), namely: reliable financial reporting; operational effectiveness and efficiency; and compliance with laws and regulations, (or in IDA’s case with its charter and internal policies and procedures). The COSO components are: Control Environment; Risk Assessment; Control Activities; Monitoring and Learning; Information and Communications.

**Risk Focal Points**: In the way the Management of the Bank and IDA have adapted the COSO framework to their own needs, four key points of risk which face the mission of the Bank Group—and are especially relevant to IDA—have been defined and added to the COSO framework, namely: Strategy Effectiveness; Operational Efficiency; Financial Soundness; and Stakeholder Support.

**Audit Standards**: Criteria established by recognized accounting and audit bodies, which, in the course of reviews of internal controls systems, enable the definition of deficiencies, significant deficiencies, and material weaknesses that may be revealed in those systems.

**Business Process Modules (BPMs)**: Management chose to conduct this review of internal controls by identifying the main business processes in which IDA is engaged on a daily basis in the course of its operations. These processes, 30 in all, covering IDA allocation, the CAS process, the main lending products (SILs and DPLs), and the fiduciary, contractual, safeguards and quality assurance processes that support lending, were each mapped and described as separate business process modules, each containing the key internal controls that are the subject of the review.

**Process Map**: The flow chart that graphically depicts all steps in a business process module.
Key Control: A gateway and decision point, involving key units and IDA staff, in a given business process module, through which a business transaction being processed must pass. It is the effectiveness in design of these controls and the subsequent testing of the effectiveness of their operation that is at the center of this review.

Business Process Template: A standardized questionnaire and rating system used by IEG to provide quality ratings of Management’s method and approach in identifying, describing and mapping the business processes, and its method in assessing control design effectiveness and effectiveness of control operation.

Evaluation Panels: In applying its Business Process Template, IEG assembled 3-4 person panels, including specialists in the particular discipline covered by the given BPM. The panels arrived at consensus judgments on what should be the ratings applied to each section of the module, according to their evaluation of the materials presented by Management.

Entity Level Controls: This refers to the control framework that governs an organization at its aggregate level, emanating from central management down to the operating or business process level. In IDA’s case, the reference is to the elements of the COSO framework. Doing a controls review that started with an examination of entity-level controls, could be described as a “top down” approach.

Bottom up Approach: The approach adopted by Management in its assessment did not begin with a “top-down” entity-level review, but focused first on business processes at the operating level. Hence, it has been described as a “bottom-up” approach.

Walkthrough: An inter-active 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 in the way intended.

Deficiencies, Significant Deficiencies, Material Weaknesses: Design flaws, omissions, or non-compliant operation of controls, discovered in the course of a controls review, denoting ascending order of seriousness. The precise criteria by which the three categories of materiality are distinguished are explained in Annex B.
Preface

In the IDA 14 Replenishment Report Bank management committed to carry out an independent comprehensive assessment of IDA’s control framework including internal controls over IDA operations and compliance with its charter and policies. Each part of this review is to be done in a three-phase approach: the first phase would be a self assessment by Management, to be followed by an Internal Audit Department (IAD) review and report on management’s self assessment, and an IEG independent evaluation of management and IAD work. This report contains IEG’s evaluation of the work done by management, and reviewed by IAD, for Part IA of the overall review.

The basis for the work done by IEG in its evaluation included: the report prepared by Management reflecting its assessment (Attachment 1); access to all the underlying materials that Management generated in its process based descriptions, definitions of controls and its “walk-through” testing of control design effectiveness; and the report presented by IAD (Attachment 2).

Under the task management of Nils Fostvedt, this report was prepared by Ian Hume, with the assistance of a core consultant team, including: Dexter Peach (Strategic Advisor, formerly Assistant Controller General for Planning and Reporting, GAO), James Campbell and Rosemary Jellish (Consultants, both former Assistant Directors, GAO) and Barbara Yale. The core team was assisted, in selected topics, by: Jed Shilling, Tribhuwan Narain, David Goldberg, and Mohammed Farhandi.
Review of IDA Internal Controls: An Evaluation of Management’s Assessment and the IAD Review

This report has its origins in a commitment that IDA Management made as part of the IDA 14 Replenishment process, in which it undertook “to carry out an independent, comprehensive assessment of IDA’s internal control framework, including internal controls over IDA operations and compliance with its charter and policies.” Management proposed, and the Board agreed, that Management would make an assessment of the controls, to be followed by an IAD review of the assessment and an IEG independent evaluation of both Management and IAD reports.

Management decided that it would conduct its assessment within the COSO integrated controls framework, but it would divide its study into two parts: Part I would deal with compliance issues, and be focused on controls at the level of 30 business processes, identified as representing IDA allocation, CAS and IDA lending products, supporting contractual, fiduciary and safeguard processes, and quality assurance; Part II would deal with issues of operational efficiency and effectiveness, and would include an examination of entity-level controls, within the full COSO framework.

Management subsequently divided Part I of the assessment into two stages: Part IA, recently completed and the subject of the present report, covers Management’s approach and method in identifying and mapping the business processes that represent IDA operations, and assesses the effectiveness of the design of controls within these processes; Part IB, to be completed early in 2007, will deal with the testing of how these controls actually operate, compared to their design. Part II is intended for completion by Management at the end of calendar 2007, with the full IEG evaluation expected in early 2008.

This IEG report contains the evaluation made by IEG of the work completed by both Management and IAD in their respective assessments and review of Part IA. IEG conducted its evaluation using a combination of approaches:

- Verifying the legal, methodological, and operational basis for the approach taken in the Management assessment;
- Reviewing Management’s findings and conclusions;
- Participating as observers in a selection of Management’s “walkthroughs” (verification interviews with knowledgeable Bank staff, concerning the actual design and working of key controls in the business processes);
- Creating an evaluation tool (a standardized template), which generated a quality data base, enabling IEG’s analysis and evaluation of Management’s method in identifying and building the process maps and descriptive materials, and in conducting its assessment of the effectiveness of control design;
- Within the context of COSO, making an evaluation of the scope limitations inherent in Management’s approach, and their impact on the quality of conclusions that can be drawn at this stage of the review.

Findings

Management decided the best way to track the use of IDA resources, was to focus its assessment at the transactions level on business processes. Doing so, it provided a rigorous, transparent and concrete
method for addressing internal controls, which was applied thoroughly and well documented. The assessment resulted in the production of 30 business process maps, accompanied by detailed description for each module and its key controls. Overall, the assessment resulted in the amassing of over 700 pages of evidentiary documentation, and in identifying a significant number of potential deficiencies. This represents progress in developing an understanding of IDA’s internal controls at the transactions level.

As evidence of this progress IEG would cite the following:

• As a basis to test for compliance, Management has made a credible linkage between the IDA Articles, the Bank’s policies and procedures, and the business processes identified to represent IDA operations;
• The mapped Business Process Modules have provided a concrete and transparent means of identifying, assessing and testing key controls;
• Management’s methods of mapping and assessing the BPMs were rated by IEG to be of a generally satisfactory quality, though with some notable qualifications relating to the treatment of risk, and the need to improve some of the descriptive materials;
• Management’s “walkthrough” method of verifying the accuracy of the selected business processes and testing the design effectiveness of their key controls was rigorous, comprehensive, transparent, and documented to a satisfactory standard, with some qualifications.

Management asserts that its approach gave a representative picture of IDA transactions processes, and that controls for the IDA allocation process as well as other controls over various aspects of IDA lending are appropriately designed to suggest that IDA resources are allocated and used in accordance with the IDA articles, and internal policies and procedures. It also documents that the approach succeeded in uncovering a significant number of specific controls-related issues. Of these, Management highlighted five it considered to be most serious:

• Difficulties with retention of and accessibility to documentation needed to verify the operation of key internal controls;
• Problems in keeping current the IDA OPs and BPs, which have not kept pace with the pace of change within the Bank Group;

• The policy framework for SILs being seen as too complex and cumbersome;
• Existing processes and documentary requirements for projects is seen by staff as onerous and inefficient;
• A disparity in the frequency with which DPLs (always) and SILs (seldom) are sent for Corporate Review, instead of Decision Meeting processing.

An evaluation of controls within the COSO framework requires that all its components be examined. Since this has not yet been done, is too early to make definitive conclusions on the state of the overall framework. However, from the deficiencies so far revealed, IEG considers that the issues highlighted by Management related to documentation retention, and the state of OPs/BPs are areas of potential material weakness.

Management has initiated remedial programs in both these areas, and a firmer basis to draw conclusions about their materiality will be in place once testing has been completed in Part IB. IEG has also had to take account of the trade-offs and implications of process-based, bottom-up method chosen by Management for its assessment, and the scope limitations this has implied. From this perspective, notwithstanding the progress made, IEG found notable weaknesses in Management’s approach:

• Because conclusions on controls within COSO cannot be made piecemeal, but only within the framework as a whole, staging and dividing the study has effectively postponed the ability to make definitive conclusions on the outcomes of each stage of the review until the overall (Part II) assessment has been completed.
• Even the staging of the study between Part IA and Part IB makes conclusions on control design (Part IA) difficult until Part IB has been completed, because final judgments on design effectiveness cannot be made until the operation of the control has also been tested.
• Separating compliance and efficiency and effectiveness is really not possible in practice: many business processes and their associated controls are as much to do with compliance as with efficiency and effectiveness, and these are best treated together rather than in sequence.

To illustrate, although management has focused its efforts to date on assessing compli-
ance, most of the potential issues it has identified are related to efficiency and effectiveness.

- Other scope limitations flowing from the delineation of the study—in particular the decision to deal with IT systems and field offices in Part II, have yet further limited the conclusions that can be drawn in Part I, especially given IDA’s increasing decentralization, and the growing importance of IT in maintaining the integrity of central controls.

- In taking 30 business process modules to represent the totality of IDA operations, Management has given a good representation of lending operations and the associated fiduciary processes; however, it has chosen to exclude AAA and other Knowledge Products, which IEG regards as a significant omission.

- In principle, it is possible that by completing the entity-level review during Part II, and addressing the postponed parts of the framework, Management will be able to mitigate these deficiencies in approach by linking results from the various parts together, to provide an overall statement. However, this will depend on there being no changes in any basic parameters: controls will be assessed at different points in time, and policies, procedures, systems, organization structures may change during this period.

IEG therefore arrives at a mixed conclusion on completion of this stage of the study: satisfactory progress has been made in defining, locating and assessing key internal controls at the transaction level, and the results have revealed a number of deficiencies and possible weaknesses in the underlying controls; on the other hand, the general approach and scope limitations applying to this stage of the assessment prevent any positive assertions being made now regarding the effective operation of the overall system of controls.

IAD was also positive in its findings of what Management had contributed to the Bank Group’s knowledge of its internal controls systems, and the new information provided at the process level, stating that it provided a compelling baseline to streamline operations and improve efficiency going forward. IAD identified eight key issues which it drew to Management’s attention: The exclusion of certain processes from the IDA processes selected; the fact that IT controls were not examined during Part I; the absence of fraud and corruption controls in the scope for Part I; outdated OPs and BPs; the need to categorize and take remedies for deficiencies; the issue of documentation retention and accessibility; the assessment of entity level controls; and issues relating to walkthroughs.

With the exception of the emphasis given to fraud and corruption and walkthroughs, all of these issues are also raised by IEG, with similar emphasis, and are covered in IEG’s overall evaluation. With regard to fraud and corruption, IEG believes that they (a) should be examined as part of the entity-level controls, and (b) were implicitly handled by Management in its process level approach. IEG agrees with IAD that more explicit mention of fraud and corruption issues could have been made in Management’s process-level assessment. With regard to walkthroughs, Management and IAD have applied differing concepts of the term. In addition to these highlighted issues, IAD has also indicated that it has found a number of other deficiencies (55 in all). While these have been listed by broad type, IAD has not yet categorized these as to their materiality (i.e. seriousness of their possible impact on risk mitigation).

Recommendations

Given the interim nature of the work so far completed and the limited conclusions that can be drawn from it in relation to the overall system issues, IEG’s recommendations are focused on the issues to be dealt with in completing the remaining phases of the review, and on the broader control framework issues that may emerge going forward. In this context, IEG makes six recommendations to Management (including one also to IAD), as follows:

- Confirming the Validity of the BPM Cluster: Management has argued, but has not conclusively demonstrated, that the core SIL prototype module in the cluster of BPMs can be used as a proxy for all investment type lending, because all ILs have the same controls as SILs. This proposition should be tested, and this could be done during Part IB. (para 2.18).

- Reform of the OPs/BPs: IEG considers this topic an area of potential material weakness, whose remedy Management should treat as a priority. IEG notes that Management has a stated strategy to address the problem, both
• Completing the Remaining Stages: IEG recommends that preparation for the Part II stage should begin promptly upon completion of Part I. It would seem useful to precede this work with a work plan (which could be discussed with the Board), that could benefit from consultations between Management, IAD, and IEG, much as the Audit Standards were discussed under Part I. Part II should preferably be completed expeditiously, also because if it should be delayed, the controls parameters that were tested during Part I may have changed, and there may be difficulties in integrating the two parts of the assessment. (para 2.24).

• Resolving Specific Issues and Potential Deficiencies (Management and IAD): It is important that the several deficiencies uncovered by both Management’s assessment and IAD review, as listed and described in Annex C, be addressed during completion of Part IB. While some of these issues relate to lack of clarity in documentation, others to efficiency and effectiveness of controls, others are potential deficiencies in controls. It is the seriousness of the latter group—the materiality of their potential impact on risk mitigation—that must be addressed before conclusions can be drawn on the state of the overall control framework. (paras 2.41,2.44 and 3.3, third bullet).

• Managing the Risk Framework and Extending COSO: IEG believes the Integrated Risk Management Framework will need to be broadened to focus also on compliance and operations reporting, and in this context, the Bank may also consider adopting the recently extended version of COSO which provides for the addition of a new fourth objective (strategy—high level goals, aligning with supporting mission) and three new components to the existing five components of COSO: objective setting, event identification and risk response. (para 1.7 and Annex A paras 4-6)

• Mainstreaming Internal Controls Reviews: IDA should begin considering the value of adopting a policy requiring: (1) ongoing monitoring and reporting on internal controls in the course of operations for all three COSO objectives; and (2) separate evaluations and reporting as necessary.

Attachments to the Executive Summary:
Given the relative complexity of this three-part review and the technical, detailed nature of the issues examined and the findings arrived at, IEG has provided tabular summaries of both the approach and method of Management, IAD and IEG respectively (Box 1 and 2 below, extracted from Chapter 1), and of the main findings and positions taken on the key issues (Box 3, extracted from Chapter 4, paragraph 4.6).
### Box 1. Key Components in the Management Assessment, IAD Review, and IEG Evaluation (Part I)

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<th>Management Assessment</th>
<th>IAD Review Part IA</th>
<th>IEG Evaluation</th>
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<tr>
<td><strong>Define Approach and Method</strong></td>
<td>Review Assumptions, Criteria, Methodology</td>
<td>Establish Framework/Tools</td>
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<td>COSO Template</td>
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<td>Review Use of BPMs</td>
<td>Implications of Scope Limitations</td>
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<td><strong>Identify BPMs, Key Controls</strong></td>
<td>Review process</td>
<td>Review Use of BPMs</td>
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<td>30 BPMs</td>
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<td>114 Key Controls</td>
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<td><strong>Verify Mapping, Assessed Design of Key Controls</strong></td>
<td>Review of Management Assessment</td>
<td>Evaluate Individual BPMs</td>
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<td>Match Risks with Key Controls</td>
<td>Attend Walkthroughs</td>
<td>Rank for Significance and Risk</td>
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<td>Review Assessment of Process and Design</td>
<td>Provide Quality Ratings for Documentation and Mapping</td>
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<td>Apply Deficiency Tracker</td>
<td>Attend Selected Walkthroughs</td>
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<td>Opinion Postponed</td>
<td>Evaluate Quality of Management and IAD Conclusions</td>
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<td>Draw IEG Conclusions</td>
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<td>Implications for Part IB and Part II</td>
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<td><strong>Review Testing of Controls</strong></td>
<td><strong>Evaluate Quality of Controls Tests</strong></td>
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<td>Conduct Audit of Controls</td>
<td>Review test Methodology</td>
<td>Provide Quality Ratings for: Testing of Key Control Compliance</td>
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<td>Define Sampling Method</td>
<td>Review Process for Documenting Results</td>
<td>Linkage to COSO Framework</td>
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<td>Conduct Testing</td>
<td>Assess Process to Detect Fraud</td>
<td>Conduct Independent Analysis of Management Exceptions data</td>
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<tr>
<td><strong>Tabulate Findings</strong></td>
<td>Review Deficiencies, Criteria</td>
<td></td>
</tr>
<tr>
<td>Test Results Matrix</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Form Conclusions</strong></td>
<td><strong>Unqualified Opinion or Modified Report</strong></td>
<td><strong>Overall Evaluation, Recommendations</strong></td>
</tr>
<tr>
<td>Statement of Assurance Make Recommendations</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Notes: BPMs—Business Process Modules</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

**Part IB**

**Evaluate Quality of Controls Tests**

Provide Quality Ratings for: Testing of Key Control Compliance
Linkage to COSO Framework
Conduct Independent Analysis of Management Exceptions data
### Box 2. Overall Timeline for Completion of IDA 14 Assessment

<table>
<thead>
<tr>
<th></th>
<th>Part IA</th>
<th>Part IB</th>
<th>Part II</th>
</tr>
</thead>
<tbody>
<tr>
<td>Management Report</td>
<td>Aug 06*</td>
<td>Dec 06</td>
<td>Sep 07</td>
</tr>
<tr>
<td>IAD Report</td>
<td>Sept 06*</td>
<td>Jan 07</td>
<td>Nov 07</td>
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<tr>
<td>IEG Report</td>
<td>Oct 06</td>
<td>March 07</td>
<td>Jan 08</td>
</tr>
</tbody>
</table>

*These reports were actually completed in early October 2006.*

### Box 3. Summary of Principal Issues Identified by Management, IAD, and IEG

<table>
<thead>
<tr>
<th>Issues relating to approach and method</th>
<th>Management</th>
<th>IAD</th>
<th>IEG</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>A: Framework Issues</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Bottom-up versus Top-down</td>
<td>Better start Top-down</td>
<td>Better start Top-down</td>
<td></td>
</tr>
<tr>
<td>2. Staging and Dividing the Assessment</td>
<td>Postpones Conclusions</td>
<td>Postpones Conclusions</td>
<td></td>
</tr>
<tr>
<td>3. Dealing only partially with COSO components</td>
<td>-</td>
<td>-</td>
<td>Postpones Conclusions</td>
</tr>
<tr>
<td>4. Scope Limitations</td>
<td>IT to be assessed in Part IB</td>
<td>Optional; IT is part of Entity Level controls</td>
<td></td>
</tr>
<tr>
<td><strong>B: Process Level Issues:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Definition of Objectives, Compliance</td>
<td>-</td>
<td>Acceptable</td>
<td></td>
</tr>
<tr>
<td>2. From Articles to Key Policies and Procedures</td>
<td>-</td>
<td>Acceptable</td>
<td></td>
</tr>
<tr>
<td>3. Linking OPs/BPs</td>
<td>Explanations offered</td>
<td>-</td>
<td>Only 50% linked to BPMs</td>
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<tr>
<td>4. Identifying BPMs</td>
<td>-</td>
<td>Acceptable</td>
<td></td>
</tr>
<tr>
<td>5. Quality of BPM mapping</td>
<td>-</td>
<td>Satisfactory, some qualifications</td>
<td></td>
</tr>
<tr>
<td>5. The Cluster as Representing IDA Operations</td>
<td>Issue: Excluded Processes</td>
<td>a. Lending: Test IL</td>
<td>b. Excluded AAA/KP</td>
</tr>
<tr>
<td><strong>Issues relating to results: major controls issues</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Highlighted Controls Issues</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>By Management</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Document Retention and Accessibility</td>
<td>Highlighted Deficiency</td>
<td>Highlighted Deficiency</td>
<td>Potential Material Weakness</td>
</tr>
</tbody>
</table>

Continued→→→→
| Box 3 (continued) | 2. Current Status of OPs/BPs:  
|---|---|---|
| a. OPs/BPs outdated, often not current  
b. Complex, disjointed policy framework  
c. Onerous, inefficient processes | Highlighted Deficiency | Highlighted Deficiency | Potential Material Weakness |
| 3. Disparity in Corporate Review SILs and DPLs. | Highlighted | -- | Highlighted |
| *By IAD (3)*  
1. Outdated OPs/BPs | Highlighted | Highlighted | Highlighted |
| 2. Definition of Walkthrough | Disputed | Management Consistent with AS2 concepts |
| 3. Fraud and Corruption Controls | Should be assessed at process level | Start with Entity level controls; could have been more explicitly treated |
| *By IEG (4)*  
(i) No control over “subject to” disbursement changes; (ii) no assurance all refunds received; (iii) No mechanism to assure country safeguard documents redone if necessary; (iv) No Bank-wide log for procurement complaints | | Highlighted |
| **Issues relating to Results:**  
Documentation and potential control Deficiencies. | Highlighted Additional Issues | 55 Identified; Materiality not yet established | Materiality should be established during Part IB |
1. Background and Description of Approaches

Origins of the Study

1.1 In the IDA14 Replenishment Report, 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” (paragraph 39 of that document). Annex B Table 3 of the document stipulated that this assessment should be undertaken by the Independent Evaluation Group (IEG, formerly OED). That document has been approved by the Executive Directors.

1.2 This Review of IDA’s controls was discussed briefly at a Board meeting in May 2005. At that time, Management reiterated that—consistent with the practice that is being followed under the Bank’s COSO-based control framework—there should first be a self-assessment of the controls system, with a role for 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 non-fungible addition to the IEG budget for this purpose.

1.3 Management has since confirmed that the Review will be conducted in two parts (I and II). Part I will deal with internal controls over IDA’s compliance with its charter and internal policies and procedures; and Part II with internal controls over IDA’s operational effectiveness and efficiency. Each part will have three phases: first a Management assessment of internal controls; second, an IAD review of Management’s assessment; and third, IEG’s independent evaluation of both the assessment and the review. Following certain delays that Management encountered in completing the first part (on compliance), it decided further to divide this part into two stages (Part IA and Part IB), as described in Box 4.

1.4 The present report covers only that portion of the study to be completed under Part IA. It therefore deals with the assessment of internal controls over compliance, to the stage of examining the identification and mapping of business processes, and the assessment of the
design effectiveness of key controls within these processes. It will be a prelude to the assessment of the operating effectiveness of these controls, which is to be completed during the next stage (Part IB). Part II will then follow.

### Box 4. Stages in the Study of IDA Internal Controls

Management has divided its assessment into the following parts:

**Part I** — Compliance with IDA’s Articles and Policies -- This part has been split into (A) the identification of key business processes and controls and assessing the design effectiveness of the identified key controls; and (B) assessment of the operating effectiveness of the identified key controls through compliance testing.

   A. This portion of the overall assessment identified and mapped the Business Process Modules (BPMs) and the key controls contained in each process. Then management reviewed the design effectiveness of the business processes and key controls involved to determine whether any significant deficiencies in the design of the key controls were identified. Management recommended remedial actions to address the design deficiencies.

   B. Management intends to test a representative sample of products/transactions to determine whether the key controls were applied to the sample items as designed. Management could then determine whether there are significant deficiencies or material weaknesses in the operating effectiveness of the key controls and, if so, recommend measures for addressing any such deficiencies.

**Part II** — Efficiency and Effectiveness of Operations — Management plans to assess whether the existing internal control framework, including corporate governance and entity level controls, provides reasonable assurance that IDA’s operations are carried out efficiently and effectively, focusing on the processes and controls identified in Part I. In Part II management also plans to address the other scope limitations in Part I, such as information technology controls and the Bank’s operations in the decentralized field offices.

### The COSO Perspective

1.5 The World Bank adopted the COSO internal control framework in 1995. COSO defines internal control as a process, effected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Reliability of financial reporting — relating to preparation of published financial statements;
- Compliance with applicable laws and regulations — relating to compliance with applicable legal and regulatory framework,
which in the case of IDA is taken to mean its charter and policies; and

- Effectiveness and efficiency of operations—relating to effective and efficient use of resources in meeting business objectives.

### Figure 1. The COSO Framework: Components, Objectives, and Risk Factors

1.6 To meet the three objectives, the COSO framework has five interrelated components that define the minimum level of quality acceptable for internal control and provide the basis against which internal control is to be evaluated. These internal control components, which apply to all aspects of an organization’s operations, include the control environment, risk assessment, control activities, monitoring and learning, and information and communication. All five components must be present and effective in order for management to have reasonable assurance that risks are managed to ensure the achievement of the organization’s objectives. Management is responsible for developing the detailed policies, procedures, and practices to fit the organization’s operations and to ensure that they are built into and are an integral part of its operations, by conducting ongoing monitoring and, as needed, separate evaluations of internal controls.

1.7 A direct relationship exists between the three categories of objectives—what the entity is striving to achieve—and components—the management dimensions the entity needs to achieve the objectives. These are depicted graphically in Figure 1, and are more fully described in Annex A. COSO is a dynamic framework which is being adapted continuously to changes in the global situation. Recent emphasis in adapting COSO has been focused on better management of risk, and in 2004 COSO itself added a new strategic objective to the ex-
existing three objectives (financial reporting, operations and compliance) and three new components to the existing five shown in the figure above: objective setting; event identification; and risk response. This expanded framework has not yet been adopted by the Bank.

1.8 Given that the Bank has, for a number of years, assessed the internal controls over its financial reporting, and has had the external auditor attest to the quality of the assessment, the present review does not deal with financial reporting, but focuses on the remaining two COSO objectives, namely compliance and operations.

**Integrating the COSO Framework into Bank Operations**

1.9 The Bank’s Management has, since 1997, written internal, annual year-end reports on the status of the adaptation to COSO. IEG’s Annual Report on Operations Evaluation (AROE) reports for 2000-2001 and 2002 addressed development effectiveness issues from the perspective of the COSO framework. The 2002 report noted the profound changes that had taken place in the Bank’s control environment: new controls structures had been put in place and “a new culture has taken root with respect to risk management,” but risk aversion appeared to have become a feature, and the report foresaw a need for what later became the Bank’s integrated risk management framework (IRMF). Under Control Activities, it saw the need for an accelerated conversion and updating of the Bank’s policies and procedures, and under Monitoring it called for improved methods of evaluating Economic and Sector Work (ESW), grants and partnerships. In the Information and Communication component it reported the major progress transforming the Bank as a Knowledge Bank, which had enabled rapid transfer of information on guidelines and best practice, and reported on the roles to be played by Development Economics Department and the World Bank Institute.

1.10 These themes are a relevant prelude to the present controls review. Being focused on development effectiveness, they preface the overall COSO-based approach that IEG is taking in the review, and the 2002 AROE stated the need for further developing the control environment quite clearly: “… the drive to become a Knowledge Bank has engendered new initiatives and new processes, for which both the control environment and the evaluation framework have yet to be well defined.”

**IEG’s Approach to its Evaluation**

1.11 **IEG Objective**: The objectives of the IEG evaluation for this Part IA Report must be viewed in light of the objectives of the overall review. IEG’s role in the overall review is to provide an independent
evaluation to determine whether Management and IAD have provided a reasonable basis for judging whether internal controls over IDA compliance and operations are in place and working; whether any material weaknesses and other deficiencies have been identified; and, as necessary, whether internal control corrective action plans are being implemented. Within that context, and for the purposes of producing a report on the status of work completed during Part IA of the review, IEG has aimed to:

- evaluate implications of scope limitations and management’s phased approach;
- evaluate management’s method for and completion of the mapping of business processes;
- evaluate Management’s assessment of control design; and
- evaluate IAD’s approach to its work and its conclusions.

1.12 IEG Scope: IEG’s overall evaluation of both the management assessment and the IAD review offers an independent conclusion to the Board as to the degree of assurance with which the assessment and opinion presented respectively in the final reports by Management and IAD can be taken to be fairly stated, in terms of their giving reasonable assurance (or other conclusion) that IDA’s controls over compliance with its charter and relevant policies and procedures are effective.

1.13 IEG took the COSO framework and the audit standards consistent with that framework as the starting point for its evaluation. It assumed that the judgments regarding the effectiveness of the internal IDA controls over compliance and operations had to be made against criteria contained in the COSO framework as a whole. At the same time, IEG recognized that management took an approach in Part I that has certain scope limitations. These limitations will have a bearing on the quality of assertions that can be made at this stage to the management and Board of IDA.

1.14 IEG notes that the key scope limitations in Part I are: the postponement to Part II of issues relating to entity-level controls; consideration of only two out of the five COSO components; the treatment of compliance only, and not efficiency and effectiveness of operations; and the postponement to Part II of the treatment of decentralized locations and IT systems. As described in Chapter 2 and summarized in Chapter 4, IEG has evaluated the implications of these postponements in making its judgments on the overall quality of the management assessment and on the conclusions that can be made at this stage of the exercise.
1.15 **Audit Standards:** Management had stated in its preparatory working papers that it intended to use audit standards similar to those used for its financial reporting (namely the general concepts of AS2 standard developed under the Sarbanes-Oxley legislation\(^{11}\)), since these would provide due rigor and standardization. IEG believed that this raised the question of whether it was indeed appropriate to use the same standards for compliance and operations reporting as for financial reporting, because the nature of the issues would be different. IEG therefore conducted significant research into this question. It was concluded that similar standards could be used, but that for compliance and operations reporting, assessing the materiality of deficiencies required more judgmental decision than for financial reporting. After consultations with both Management and IAD, agreement was reached both on the fact that all three parties would use the same standards, and on the precise definition for each. A description of the latter is given in Annex B.

1.16 **IEG Evaluation Method:** IEG has applied four principal methods in making its evaluation:

- It critically reviewed the available reports from management and IAD.
- It conducted an independent analysis of the raw data generated by Management’s assessment. This analysis addressed the quality and effectiveness of design of the underlying internal controls.
- IEG assembled evaluation panels for the purpose of rating each step in the assessment and review processes. The panels used an evaluation tool designed by IEG for this purpose, called a Business Process Template, which contained a series of standard questions on Management’s method of mapping and assessment of design of each business process module. This generated a data stream on the quality of Management’s method and approach to mapping and controls assessment.
- IEG has reserved the option to conduct its own tests of the design effectiveness of selected key controls, as a means of obtaining verification independent from the results obtained by Management.\(^{12}\) This was found to be not necessary during Part IA. However, IEG did interview staff in selected units,\(^{13}\) including some that are involved in entity level controls, to gain a better understanding of the overall processes and controls that affect the business process modules included in Management’s assessment.

1.17 **Advisory Panel:** As is now normal for many of IEG’s major evaluations, a senior Advisory Panel will be invited to review and comment on the IEG evaluation report and will be requested to share its comments also with CODE and the Audit Committee (AC). The mem-
bers of the panel for this evaluation are former Auditors-General, from India, Norway, and Australia, respectively. However, the services of the Panel will be invoked only when IEG has completed its draft evaluation report on Part IB.

**Summary of Approaches: Management Assessment and the IAD Review**

1.18 A description of the approach taken by Management to its assessment, and the key findings arrived at, is contained in Chapter 2, and a copy of the Management report is in Attachment 1. A description is given in Chapter 3 for the method, approach and findings of the IAD review, and a copy of the IAD report is appended at Attachment 2. Box 5 and Box 6 summarize the three approaches and the current timetable.

<table>
<thead>
<tr>
<th>Management Assessment</th>
<th>IAD Review</th>
<th>IEG Evaluation</th>
</tr>
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<tbody>
<tr>
<td><strong>Define Approach and Method</strong></td>
<td>Review Assumptions, Criteria, Methodology</td>
<td>Establish Framework/Tools</td>
</tr>
<tr>
<td>Business Process Based</td>
<td>Criteria for Inclusion/Exclusion</td>
<td>The COSO Framework</td>
</tr>
<tr>
<td>Fiduciary Focus</td>
<td>Review process</td>
<td>Business Process Template</td>
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<td>Partial COSO</td>
<td>Test Methodology</td>
<td>COSO Template</td>
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<tr>
<td>Other Scope Limitations</td>
<td><strong>Review Use of BPMs</strong></td>
<td>Implications of Scope Limitations</td>
</tr>
<tr>
<td>Identify BPMs, Key Controls</td>
<td></td>
<td>Review Use of BPMs</td>
</tr>
<tr>
<td>4 Umbrella Areas</td>
<td>Criteria for Selection</td>
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<td>30 BPMs</td>
<td>Definition of Key Controls</td>
<td></td>
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<tr>
<td>114 Key Controls</td>
<td>Review of Process</td>
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<tr>
<td><strong>Verify Mapping, Assessed Design of Key Controls</strong></td>
<td><strong>Review of Management Assessment</strong></td>
<td><strong>Evaluate Individual BPMs</strong></td>
</tr>
<tr>
<td>Match Risks with Key Controls</td>
<td>Attend Walkthroughs</td>
<td>Rank for Significance and Risk</td>
</tr>
<tr>
<td>Conduct Walkthroughs</td>
<td>Review Assessment of Process and Design</td>
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<tr>
<td>Assessment of Design Effectiveness</td>
<td>Effectiveness</td>
<td>Provide Quality Ratings for Documentation and Mapping</td>
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<tr>
<td></td>
<td>Apply Deficiency Tracker</td>
<td>Assessment of Design Effectiveness</td>
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<tr>
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<td>Attend Selected Walkthroughs</td>
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<td><strong>Conclusions for Part IA</strong></td>
<td><strong>Conclusions for Part IA</strong></td>
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<td>Opinion Postponed</td>
<td>Evaluate Quality of Management and IAD Conclusions</td>
</tr>
<tr>
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<td>Draw IEG Conclusions</td>
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</table>

**Implications for Part IB and Part II**


**Box 5 (continued)**

<table>
<thead>
<tr>
<th>Test Operation of Controls</th>
<th>Part IB</th>
<th>Evaluate Quality of Controls Tests</th>
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</thead>
<tbody>
<tr>
<td>Conduct Audit of Controls</td>
<td>Review Testing of Controls</td>
<td>Review test Methodology</td>
</tr>
<tr>
<td>Define Sampling Method</td>
<td>Review Process for Documenting Results</td>
<td>Review Process for Assessing Process to Detect Fraud</td>
</tr>
<tr>
<td>Conduct Testing</td>
<td>Assess Process to Detect Fraud</td>
<td>Review Deficiencies, Criteria</td>
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<td>Evaluate Quality of Controls Tests</td>
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</tbody>
</table>

*Notes: BPMs—Business Process Modules*

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**Box 6. Overall Timeline for Completion of IDA 14 Assessment**

<table>
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<tr>
<th></th>
<th>Part IA</th>
<th>Part IB</th>
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<td>Jan 08</td>
</tr>
</tbody>
</table>

*Source: Based on the Management paper to the Audit Committee and current estimates. * These reports were actually completed in early October 2006.*

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**NOTES**

1. 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).

2. The May 12 2005 discussion of IEG-WB’s FY06-08 work program and FY06 budget.


4. This representation of the COSO framework is what is currently in use in the Bank and IDA, showing also the Risk Focal Points, which have been added to the framework, following adoption by the Bank of the Integrated Risk Management Framework (IRMF) in 2002. For a fuller explanation, see Annex A.

5. IEG has verified that in recent years (2002-2005) the Bank published the management assessment report and the auditor’s attestation report in the Annual Report, Volume 2, Financial Statements. This includes a transmittal letter, management’s discussion and analysis (covering just IBRD), IBRD financial...
statements and internal control reports, and IDA financial statements and internal control reports.


7. The AROEs for 2003 and 2004 also covered specific individual topics within the framework, namely monitoring and evaluation.


9. In management’s approach the focus was mainly on Risk Assessment (at the unit level) and Control Activities, and there was no direct focus on the other three components (Control Environment, Monitoring and Learning, and Information and Communications), which are postponed until Part II.

10. Auditing Standard No. 2 (AS2) An Audit of Internal Control over Financial Reporting Performed in Conjunction with An Audit of Financial Statements, was issued by the U.S. Public Company Accounting Oversight Board (PCAOB) to respond to the provisions of Section 404 of the Sarbanes-Oxley legislation as much as possible.

11. As set down in the Approach Paper, IEG might consider commissioning its own testing, if and when: (i) A general random selected testing of controls seems warranted; (ii) Certain controls were found not to have been tested; and (iii) Testing that was done may be deemed inadequate, for example because of sampling deficiencies or other flaws in approach.

12. To discuss entity-level control issues, the IEG team had separate meetings with Bank units dealing with: IDA allocation (FRM); the Integrated Risk Management Framework (SFRSI); issues of fraud and corruption detection (INT); quality assurance (QAG); and safeguards (QACU).
2. Management’s Assessment

2.1 This chapter divides into two parts: the first part (paras 2.2-2.11) gives a descriptive synopsis of Management’s approach and method; the second part (from para 2.12) contains IEG’s evaluation of the assessment. Management’s report is in Attachment 1.

Background and Objective

2.2 Management intended to conduct the review of IDA internal controls within the context of the COSO framework, but would focus in this phase of the study only on the assessment of internal controls over compliance. The report states that the COSO framework includes both “top-down” and “bottom-up” analysis. Management determined that Part I of the study would be “more valuable if carried out following a bottom-up approach,” in order to best track directly the use of IDA resources. Accordingly, the report describes how Management has identified, described and mapped a collection of the key business processes that it used to represent the principal operations activities of IDA, which will be used both to assess compliance in Part I, and to lay a “solid foundation” for the examination of institutional efficiency and effectiveness to be undertaken in Part II.  

2.3 Management’s objective was to provide an assessment of whether the internal control framework over IDA’s operations provides reasonable assurance to Senior Management and the Board that such operations are carried out in a manner that complies with the provisions of the IDA charter and internal policies governing IDA’s operations, including the mechanisms in place to ensure that funds are disbursed for the intended purposes.

Management’s Method: From the IDA Charter to Policies to Business Processes

2.4 Defining “Compliance” for IDA: Management chose to re-define the meaning of “compliance” in IDA’s case. Under COSO, compliance generally implies compliance with local laws and regulations. In IDA’s case, as “an international organization established by international treaty with privileges and immunities” Management suggested instead that compliance should be measured against the
Compliance was redefined relevant provisions of the charter (IDA Articles) and against IDA’s internal policies and procedures.

2.5 Accordingly, Management states in its report that “any compliance assessment of internal controls over IDA’s operations must therefore go through a four-step process:

1. identifying key provisions of the IDA Articles that govern IDA’s operations;
2. identifying main policies that were adopted by IDA to ensure that IDA’s operations are carried out consistently with these provisions;
3. identifying the manner in which these policies are intended to be carried out by cataloguing the business processes and key controls put in place to ensure compliance with the identified policies and assessing the “design effectiveness” of these processes and key controls; and
4. assessing compliance with the business process and key controls by testing a sample of transactions.” (The subject of Part IB).

2.6 Key Policies and Instruments: Based on this concept of compliance, Management sought to establish clear links between the IDA Articles, related policies and procedures, and the actual business processes whose internal controls would be the subject of assessment and testing. The specific hierarchy of these steps is given in summary form in Box 7. It shows how the provisions of the Articles link to specific policies and procedures and the related operational instruments. It shows that the approach stemmed from eight specific provisions of Article V of the IDA Articles, covering allocation and use of IDA resources. From over 100 published policies and procedures, Management made a selection of those that related to the allocation of IDA resources and the three key instruments governing IDA operations—country assistance strategies, and the two main forms of lending—Specific Investment Loans (SILs) and Development Policy Loans (DPLs)—citing the four “umbrella” statements in these “flagship” policies and procedures. Having identified these primary operational instruments, Management then also addressed the need to take account of the fiduciary, contractual and safeguards aspects of IDA lending, adding the relevant policy provisions in each of these areas.
## Box 7. Building Blocks in Management’s Approach

### IDA Articles

**Article V — Operations**
- Concessional Resources to Less Developed Areas
- Financing High Priority Development
- Specific Projects and Special Circumstances Lending
- Lender of Last Resort
- Use of Funds for Purposes Intended
- Due Regard for Economy and Efficiency
- Non-political interference
- Linking Disbursements to Expenditures incurred

### Policies and Procedures

From >100 OPs and BPs Management Focused on

**Three Primary Instruments:**
- Country Assistance Strategy (CAS)
- Investment Lending Operations (IL)
- Development Policy Lending (DPL)

**“Flagship” OPs and BPs**
The Flagships Contain four “Umbrella Statements,” namely:
- Umbrella Statement governing financial terms of and eligibility for IDA financing
- Umbrella Statement governing Country Assistance Strategies
- Umbrella Statements governing Investment Lending
- Umbrella Statement governing Development Policy Lending

### Specific Policies for Fiduciary, Contractual and Safeguards Aspects

All lending instruments are accompanied by supporting policies and procedures covering:
- Financial management of projects
- Disbursement aspects
- Procurement aspects
- Contractual/Legal and Loan Administration aspects
- Safeguard aspects
- Quality Assurance

### 30 Business Process Modules

*Source: Management Report*

2.7 **The Business Process Modules (BPMs):** Based on this hierarchy of policies and procedures, Management identified 30 Business Process Modules (BPMs) which it saw as representing “the relevant business processes currently in place which staff are expected to use as guidance and best practice when working on IDA operations.” The modules covered the “umbrella” business functions, (allocation, CAS and lending instruments) plus the supporting fiduciary and other aspects and quality assurance. The material for each BPM included descriptions, process flow maps, and specifically defined and located

Thirty Business Process Modules, and their key controls, were identified as representing IDA operations.
key controls. It is these controls whose design and operating effectiveness are the central subject matter of the review. A listing of the BPMs, broadly organized by business function, is given in Box 8.

| Box 8. Management’s List of 30 Business Process Modules (Listed by Business Function*) |
|-----------------------------------|---------------------------------|---------------------------------|
| **“UMBRELLA” PROCESSES**         | **FIDUCIARY PROCESSES**         |
| (8 Modules)                      | (21 Modules)                    |
| FRM IDA Allocation               | LEGAL                           |
| (IDA Allocation Model)           | SIL Legal Regime                |
| (Post-Conflict Allocation)       | DPL Legal Regime                |
| Debt Sustainability Analysis     | Project Changes                 |
| CAS Products                     | Contractual Remedies            |
| SIL Project Cycle                | **QUALITY ASSURANCE**           |
| DPL Project Cycle                | (1 Module)                      |
| Corporate Review (ROC/OC)        | QAG Processes QEA QSA           |
| **FIDUCIARY PROCESSES**          | **QUALITY ASSURANCE**           |
| (21 Modules)                     | (1 Module)                      |
| SIL Procurement Regime           | QAG Processes QEA QSA           |
| Procurement Complaints           | **LEGAL**                       |
| Procurement Non-Compliance       | SIL Legal Regime                |
| **QUALITY ASSURANCE**            | DPL Legal Regime                |
| (1 Module)                       | Project Changes                 |
| **FIDUCIARY PROCESSES**          | Contractual Remedies            |
| (21 Modules)                     | **FINANCIAL MANAGEMENT**        |
| **LEGAL**                        | SIL                             |
| SIL Procurement Regime           | DPL                             |
| Procurement Complaints           | **FINANCIAL MANAGEMENT**        |
| Procurement Non-Compliance       | SIL                             |
| **PROCUREMENT**                  | DPL                             |
| SIL Procurement Regime           | **PROCUREMENT**                 |
| Procurement Complaints           | SIL                             |
| Procurement Non-Compliance       | DPL                             |
| **LOAN ADMINISTRATION**          | **PROCUREMENT**                 |
| Loan Administration SIL          | **LOAN ADMINISTRATION**         |
| Loan Administration DPL          | Loan Administration SIL          |
| Loan Application Review          | Loan Administration DPL         |
| Special Commitment               | Loan Application Review         |
| Amendment or Extension           | Special Commitment              |
| Refund Process                   | Amendment or Extension          |
| Loan Cancellation Process        | Refund Process                  |
| Loan Suspension Process          | Loan Cancellation Process       |
| Loan Closing (Standard)          | Loan Suspension Process         |
| Loan Closing (Special Procedure) | Loan Closing (Standard)         |
| **SAFEGUARDS**                   | Loan Closing (Special Procedure)|
| Safeguards SIL                   | **SAFEGUARDS**                  |
| Safeguards Corporate Risk (QACU) | Safeguards SIL                  |

*Source: Management listing, organized across business function by IEG.*

Some processes were excluded

2.8 Management also explicitly excluded a number of business process modules (10 in total) either because they were deemed not to have direct bearing on lending, or for other reasons, as shown in Box 9. More details on these exclusions are given in Annex E.
Box 9. Business Process Modules Excluded from Compliance Assessment

<table>
<thead>
<tr>
<th>Exclusion By Management’s Resolution That the Process Does Not Have Critical Bearing on Current Assessment Objective</th>
<th>Exclusion Based on Determination of No Input to IDA Operations</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Country Policy and Institutional Assessment (CPIA)</td>
<td>• Procurement DPL (Procurement is minor in DPLs)</td>
</tr>
<tr>
<td>• Post-Conflict Performance Indicators (PCPI)</td>
<td>• IEG Process</td>
</tr>
<tr>
<td>• Project Preparation Facility (PPF)</td>
<td>• IAD Process</td>
</tr>
<tr>
<td>• Loan Management—PPF Refinancing</td>
<td>• AAA Products</td>
</tr>
<tr>
<td>• Annual Report on Portfolio Performance (ARPP)</td>
<td></td>
</tr>
<tr>
<td>• Inspection Panel</td>
<td></td>
</tr>
</tbody>
</table>

Source: Management Methodology Note (working level paper)

2.9 Management has provided a graphic depiction of the full scope of its assessment, show in Figure 2. It depicts the project cycle for SILs and DPLs as the central element, which is linked to the CAS process, to IDA allocation, and to the associated fiduciary, legal, safeguards and quality assurance processes. These are the essential processes which Management has captured in the 30 BPMs described above, and which Management has taken to represent the totality of IDA operations.

2.10 **The Concept of “Design Effectiveness”:** While Management has identified the business processes as the vehicles which deliver the various IDA business objectives, it also makes clear that the key controls within them (114 in all) are critical to the review of internal controls and the forthcoming testing for compliance. As stated in the standards, Management has distinguished between control design and a control operation. To be fully effective, a control must not only be well designed, it must also operate as designed, i.e. staff must respect its provisions in the execution of transactions. In Part IA Management has assessed the design effectiveness of these 114 controls under the following definition:

“whether the system of such internal controls is both comprehensive as well as suitably designed to prevent or detect on a timely basis, material issues of non-compliance or significant control deficiencies.”

The model requires that controls both be well designed and operate as designed to be effective.
Figure 2. Overview Scope Map of Management’s Assessment

Source: Management working materials
2.11 Management explained in its report that its working teams conducted their assessment of the design effectiveness of these controls through a combination of observation, examination of documentary evidence and verification of control design. The output from this process was a series of fully mapped BPMs and accompanying descriptive documentation, namely: for each business process module, a Process Overview (PO); and for each key control, a Control Detail Sheet (CDS). An example of a process flow chart—i.e. the graphic mapping of the flow of a transaction through the management system—together with descriptive materials showing the content of a sample Process Overview and a typical Control Detail Sheet, are also shown in Annex D.

IEG’s Evaluation of Management’s Approach and Method

2.12 The foregoing comprises IEG’s synopsis of Management’s approach. The remainder of Chapter 2 contains IEG’s evaluation of Management’s approach (paragraphs 2.14 -2.26) and of Management’s main findings (paragraphs 2.27-2.45).

2.13 Management made a number of key choices related to its approach and method, the most important of which are summarized below and accompanied by IEG’s findings and conclusions. In particular, choices on basic approach and other scope limitations significantly limit conclusions about the adequacy of internal controls that can be drawn at this stage of management’s work.

2.14 **Objectives of the Compliance Assessment:** IEG finds the objective of the assessment as stated in para 2.3 above to be reasonably stated, appropriate, clear and complete.

2.15 **The Definition of Compliance:** IEG agrees that an adaptation of the definition of compliance was necessary in IDA’s case, and finds reasonable Management’s rationale and decision to use compliance with the IDA charter, internal policies and procedures. IEG examined the legal theory underlying this issue and found that very generalized reference to “laws and regulations” does not in the case of a special institution such as IDA provide any guidance as to which laws and regulations are determinate and may give rise to ambiguity as to the role of local law. In the circumstances, it was preferable to refer specifically to the Articles, the lending (or financial) agreements including the General Conditions, and IDA Policies and Procedures, as constituting the governing “laws and regulations” for IDA transactions.1

2.16 **From the IDA Articles to Policies to BPMs:** Management also correctly located the benchmark for the compliance elements as being the appropriate provisions of the IDA Articles, and the relevant Bank Operational Policies and Bank Procedures (OPs and BPs). Both spe-
cific Article provisions and the published OPs/BPs were used as the basis to decide which operational instruments and business processes would best represent the panoply of IDA operations. IEG does find the method of developing the 30 business process modules to be logical, transparent, and generally convincing. However, IEG does have comments regarding the possible lack of completeness of the universe of BPMs, as discussed in paragraph 2.18 below.

2.17 Are the Bank’s OPs and BPs an Apt Expression of the Bank’s Policies and Procedures? IEG finds that in each business process module, each control has been linked to one or more specific OPs/BPs, and/or risk statement from the IRMF. However, there are two issues that have been identified regarding OPs/BPs:

- The fact that the reform of OP/BP has seriously lagged the pace of change in the Bank Group is acknowledged by Management, and is widely known already;
- What was uncovered by IEG during its evaluation, is that there appear to be a significant number of OPs/BPs — some 50% — which were not directly linked by Management to any key controls or business processes. Management has given a satisfactory explanation for those OPs/BPs not linked to specific BPMs, to the effect that: (1) they relate to trust funds and grants, not financed by IDA resources; (2) they apply to other lending products, not SILs; (3) they govern guarantees, which are a very small portion of the IDA portfolio; (4) they govern topics that feed into the processes that were mapped (e.g. economic evaluation of investment operations; co-financing); or (5) they relate to contractual or other issues that are addressed in the processes that were mapped.

2.18 Does the Cluster of BPMs Adequately Represent the Universe of IDA Operations? IEG conducted an analysis of the cluster against some key criteria: What portion of IDA’s operating budget did the cluster account for? What product lines? Where processes were excluded from the cluster, did this create gaps in measuring compliance? The content of this analysis is shown in Annex E. IEG concludes that the cluster is broadly representative of IDA’s lending operations (which covers 78% of IDA’s overall operational expenditure). However, by using only SILs to represent all investment lending, Management needs to verify its claim that all other investment loan products have the same controls as SILs (see Annex E paragraph 6). Also, the cluster is essentially lending and fiduciary in focus, suggesting that IDA operations are simply IDA lending operations. The cluster omits all Knowledge Products, specifically Analytical and Advisory Activities (AAA), all of which have direct relevance to compliance. As argued in Annex E, AAA has a direct bearing on the quality of IDA lending, as well as accounting for about 22% of the IDA budget (almost the same as lending
preparation—24%). This is therefore a significant gap in coverage. Management will not be in a position to report on whether internal controls are achieving the business objectives involved until these additional IDA functions and activities are assessed.

2.19 The Quality of Management’s methods in BPM Mapping and Assessing design Effectiveness: IEG conducted a systematic quality evaluation of the methods used in Management’s mapping of the BPMs and assessment of control design. This involved assembling evaluation panels, consisting of 3-4 specialist consultants, who used an evaluation tool created by IEG (the Business Process Template) to give quality ratings to the process of mapping and assessing each of the business process modules. The questions in the Template tested (i) Management’s method for completeness and accuracy of BPM mapping, and (ii) clarity in Management’s assessment of the effectiveness of their controls design. Details of the content of the Template and rating system are provided in Annex F. Ratings ranged from Highly Satisfactory (1), to Satisfactory (2), Satisfactory with Qualification (3) and Less than Satisfactory (4). The evidence on which the ratings were based came from Management’s process maps, the accompanying descriptive materials, other working materials Management made available, and the “walkthroughs” i.e. verification interviews between Management and operations staff, many of which IEG panel members attended as observers.

2.20 Rating Results: IEG found that the quality of Management’s mapping and assessment of design effectiveness were of a generally satisfactory standard, but there were also a number of areas with room for improvement. Taking all questions in the Template together, the IEG panels rated 66% of all dimensions as Satisfactory or better (with 93% as Satisfactory with Qualification or better). The average rating across all dimensions was 2.5 (midway between fully satisfactory (rating 2) and satisfactory with qualification (rating 3). More detailed data on the ratings can be found in the Statistical Appendix at Annex G.

2.21 Generally the accuracy and completeness of the process mapping received high ratings. The principal reason why other ratings were not higher overall was the prevalence, in the descriptive materials for some modules, of descriptions of control objectives and specific risks that were more process-oriented than operational in focus. In addition, in most descriptions of key controls there was a systematic failure to categorize specific risks by type of risk and to analyze the risk importance in terms of likelihood of occurrence and impact.

2.22 Treatment of Risk: The principal shortcoming affecting the ratings for method and approach was that Management did not attempt in any modules to categorize risks by type or priority (this question was rated 4 in all modules). IEG cannot conclude from this
alone that this failure may have impaired Management’s assessment of control design effectiveness, but prioritizing risks should be an essential part of designing internal controls systems, with due regard for economy and efficiency. Also, risks may be more readily prioritized from an entity-level perspective than within individual business processes. This is an added example of where a top-down approach to the study would have been preferable, and foresees the need for greater attention to risk focus at the organization level.

2.23 Relative Significance and Risk Ranking of BPMs: IEG used its rating process also to rank the modules into groups, according to their strategic importance and risk potential. This was measured by their centrality as a management tool, the magnitude of financial risk incurred in each process, and the frequency of occurrence. While this involved subjective judgments, it was thought useful as a means of grouping the modules into high, medium and lower risk categories, to separate out the principal modules and those that were more secondary. The IEG panels ranked 14 modules in the principal category, 8 into medium risk and 7 lower risk. (See Annex G Table G.7).

2.24 The Overall Approach: Staging the Assessment, Adopting a Bottom-up Approach, Separating Compliance from Efficiency and Effectiveness: IEG recognizes the rationale for choosing the bottom up approach—to more directly track the allocation and use of IDA resources. IEG also acknowledges the contribution this has made, in the identification and mapping of the relevant processes, which has provided a vision of IDA operations, and a level of detail not hitherto available. The platform of these maps should be very useful going forward both as a source of future tracking of internal controls, and as a means of identifying areas which have scope for streamlining to bring economies and efficiencies. At the same time, the choice of this approach (which runs contrary to standard industry recommendations) has created trade-offs which have serious implications for both its Management’s assessment, as well as the IAD review and the present IEG evaluation, of which IEG would emphasize the following:

- Because conclusions on controls within COSO cannot be made piecemeal, but only within the framework as a whole, staging and dividing the study has effectively postponed the ability to make definitive conclusions on the outcomes of each stage of the review until the overall (Part II) assessment has been completed, i.e. until end 2007, or later.
- Also the staging of the study between Part IA and Part IB makes conclusions on control design (Part IA) difficult until Part IB has been completed, because final judgments on design effectiveness cannot be made until the operation of the controls has also been tested.
Separating compliance and efficiency and effectiveness is really not possible in practice: many business processes and their associated controls are as much to do with compliance as with efficiency and effectiveness, and these are best treated together rather than in sequence. To illustrate, although management has focused its efforts to date on assessing compliance, most of the potential issues it has identified are related to efficiency and effectiveness.

Other scope limitations flowing from the delineation of the study—in particular the decision to deal with IT systems and field offices in Part II, have yet further limited the conclusions that can be drawn in Part I, especially given IDA’s increasing decentralization, and the growing importance of IT in maintaining the integrity of central controls.

In principle, it is possible that by completing the entity-level review during Part II, and addressing the postponed parts of the framework, Management will be able to mitigate these deficiencies in approach by linking results from the various parts together, to provide an overall statement. However, this will depend on there being no changes in any basic parameters: controls will be assessed at different points in time, and policies, procedures, systems, organization structures may change during this period.

A Note on Scope Limitations: It was stated early in this report that IEG would be evaluating the implications of the various scope limitations that Management, by intent, or by implication, has imposed on this first part of the study: the separation of COSO objectives, the staging of the parts of the study, the postponement of the treatment of entity-level controls, and the examination of IT systems and decentralized locations. The impact these limitations have had on the outcome of the assessment and evaluation so far have been itemized in much of the foregoing analysis. No separate evaluation of the implications of these limitations is therefore needed here.

Summary Evaluation of Management’s Methods: In summary, IEG recognizes the underlying reasons why Management decided to adopt a process-based approach, to divide the study into stages, and to impose other scope limitations. However, in considering the trade-offs that this gave rise to, IEG comes to a mixed conclusion on the approach overall, finding both strong points and some problem areas:

- **Strong Points:** IEG finds that the following key elements of the approach have all contributed positively to the assessment: the definition of the objective of the assessment; the re-definition of compliance as it applies to IDA; the identification of the relevant provisions of the IDA Articles; and the related links to policies and procedures, as the basis to build a cluster of rep-
representative business process modules; and the actual mapping and description of the modules, which formed the bases for testing.

- **Problem Areas:** IEG observes several issues: issues with the quality of OPs/BPs; that the chosen cluster of BPMs represents well IDA lending products, but excludes AAA and other Knowledge Products—a significant omission; the combination of factors stemming from the bottom-up, three-stage division of the study over time, with a separation of COSO elements. All of the latter oblige the postponement of definitive conclusions on the earlier stages of the study, until the overall review has been completed.

**Management’s Main Findings and Conclusions: IEG Comment and Evaluation**

2.27 The main findings from Management’s Part IA assessment, in terms of specific issues relating to controls design and operation, will be discussed under three headings:

- Management’s broad conclusions on what it has achieved in the review so far;
- The main highlighted deficiencies, which Management sees as the most important weaknesses so far revealed;
- A listing of a number of additional issues, which Management regards as notable but less significant. The materiality of these is still to be established by Management, and many may not rise to the level of significant deficiencies or material weaknesses under the agreed audit standards described in Annex B.

2.28 What follows is a summary of these main findings, and conclusions, accompanied by a comment and evaluation from IEG, case by case.

**Management’s Broad Conclusions**

2.29 Management found that its assessment approach, unprecedented in the Bank Group, was such as to “capture a representative picture of the control environment over IDA’s operations at the transaction level” and that it had contributed information which would be useful for strategic and rationalization decisions regarding IDA operations going forward. The examination of the key policies and procedures that govern IDA operations and the mapping and review of the key business processes and associated controls that enable compliance with these policies confirmed in its view that the processes and controls that apply to the four primary instruments for carrying out IDA operations (i.e. Allocation mechanism, CAS, IL and DPL) have been designed to verify that scarce IDA resources are made available to
support priority development activities in the poorest eligible member countries.

2.30 IEG Comment: IEG states that it cannot at this stage make an affirmative statement regarding IDA controls over allocations and use of funds, but it agrees that the transaction-level mapping of business processes and the definition of key controls has contributed valuable information not hitherto available and it agrees that this could serve IDA well going forward, by providing a useful platform for future control tracking and reviews, and also for identifying areas where streamlining may be possible.

**MANAGEMENT’S HIGHLIGHTED DEFICIENCIES**
*(PARAGRAPH 26 OF ITS REPORT)*

2.31 Deficiency 1: Management stated in its Report that it “had difficulties with obtaining timely access to relevant documents that are needed to carry out the compliance testing portion of the assessment” and it went on to explain that while external auditors confirm that many institutions transiting from manual to electronic filing systems have similar retention and accessibility problems, Management regards this as a serious issue, and has consequently commissioned a Task Force to address this issue and present solutions within six months.

2.32 IEG Comment: Document retrieval has clearly become a major issue, and is an area of potential material weakness. For now, IEG takes note of Management’s straightforward recognition of the issue, its diagnosis, and the suggested remedial action plan. IEG suggests that this problem may have broader roots than Management has described. No doubt the transition to an electronic Bank is a (possibly the) central issue; but this has also been accompanied in the past decade by an ensuing cultural shift in the roles of staff (e.g. in the interaction between Task Team Leaders (TTLs) and support staff), as well as by the major decentralization of the Bank in the past decade. Since the present Part I stage of the study has explicitly excluded examination of IT and field offices, this, also, could have affected these results. Finally, while Management’s bottom-up approach successfully demonstrated the severity of this problem, a top-down approach might have given the whole exercise more visibility with line managers and this could possibly have strengthened unit cooperation and facilitated the rigorous process-level demand for documentation, that is required for the process-based method.

2.33 It is too early at this stage of the review to make definitive conclusions, but IEG believes that the document retention issue is an area of potential material weakness, and takes note of the fact that Management has already mounted a high-level remedial effort.
Deficiency 2: Management has identified the fact “that the OPs and BPs included in the Operational Manual are not keeping pace with the changes on the ground that are being introduced from time to time.” It gave as examples BP10.00 on processing investment lending from identification to Board approval, which is in need of urgent update, the 12.00 series governing disbursements, and OP/BP10.02 on financial management. Management goes on to state that “As part of Management’s assessment of the effectiveness and efficiency of IDA’s internal control framework, Management intends to look at the current processes underlying the policy revision to determine if they need to be revised to facilitate more efficient and timely updating of operational policies and procedures.”

Deficiency 3: Management states that “the policy framework governing IL operations is too complex and disjointed, making it hard for staff to identify all the policies with which they are expected to comply when working on IL operations” and it explains that it is actively working on rationalizing and consolidating the OPs/BPs governing investment lending.

Deficiency 4: Management states that its assessment showed that many staff find the existing processes and documentary requirements very onerous and inefficient, and that “Management intends to issue in the next few months standard updated operational templates to be used by staff in documenting various steps in the IL and DPL processes.”

IEG Comment: IEG observes that there are issues relating to overall status and quality of the OPs, BPs and processes governing project preparation. IEG also observes that this issue is not new, and has been referred to in earlier IEG studies. From the perspective of internal controls, the issue may be more serious than Management has stated. If the quality of the OPs/BPs is poor, in terms of the fact they have not all been amended to take account of change in the Bank Group, this could call into question whether they provide a valid benchmark for compliance testing. Other agencies facing a similar situation have sometimes decided to postpone compliance testing until the policies have been reformed. In the case of IDA, Management faces a decision: whether to proceed with the assessment with the present OPs/BPs, and perhaps settle for a qualified assertion at the end, or whether to postpone the assessment of compliance, until the OPs/BPs have been brought current. IEG believes a postponement may be impractical, and argues elsewhere (see paragraph 4.5 third bullet) that completion of Part II needs to be timely.

While it is too early in the review to make definitive conclusions, IEG believes that the status of the OPs/BPs is a second area of potential material weakness but notes that Management has stated that it has a reform program, consisting of both streamlining and updating components. IEG believes this program should be treated as a high priority, even accelerated.
2.39  **Deficiency 5:** Management stated that its assessment had found a “disparity in the frequency of corporate reviews of SIL and DPL operations, with all DPLs being subject to such review and relatively few SILs. ... Management is examining whether there is a need to review criteria for submitting investment lending operations that raise special risks or issues to the corporate review process.”

2.40  **IEG Comment:** IEG agrees that management should review its criteria and make revisions as necessary to ensure operations with special risks are subject to corporate review.

**MANAGEMENT’S LIST OF ADDITIONAL ISSUES**

2.41  In addition to the five high-level findings identified in Management’s report and discussed above, Management provided IEG with a list (not appended to its report) of additional potential issues relating to internal control design effectiveness. The issues require additional work to substantiate the findings and determine their significance and the remedial actions, if any, that may be required to mitigate risks. This work is to be made as part of the follow-on Part 1B stage focusing on the operational effectiveness of the controls. At that time, IEG anticipates that Management will determine which of these issues, or combination of issues, may rise to the level of a deficiency, significant deficiency, or material weakness, as defined by the agreed standards described in Annex B.

2.42  In summarizing its detailed list of potential control issues, Management identified areas that merit a closer look in its follow-on work, as follows:

- “Several existing policies and procedures need to be updated or enhanced or, in some instances, additional guidance needs to be introduced.
- Certain system capabilities or system-related controls need to be better aligned with the process requirements.
- Timeliness of processes related to managing individual credits should be improved.
- Variances in regional implementation of institutionally endorsed guidelines need to be reviewed to ascertain whether these variances are appropriate.
- Certain procurement processes and controls require enhancements to strengthen effectiveness.
- Processes surrounding SILs with regard to project changes or contractual remedies need to be strengthened.
- Clarification should be issued to require staff, which provide conditional clearances or feedback on project documents, follow up to ensure that their comments have been incorporated, as appropriate.”
Chapter 2
Management’s Assessment

2.43 Annex C provides additional information on internal control issues identified to date, including specific examples to illustrate the character of the (i) several potential internal control issues or deficiencies identified by Management, (ii) additional issues identified by IEG as potential internal control deficiencies; and (iii) noted deficiencies identified by IEG in the materials submitted by Management as part of its Part IA assessment.

Findings from IEG’s Analysis

2.44 IEG conducted its own independent analysis of Management’s assessment, both by examining Management’s materials and by attending selected “walkthroughs” as observers. The analysis revealed a number of additional issues to those that Management had identified, some of which related to controls issues, others to deficiencies in Management’s materials, mapping and descriptions. In both cases, more details are given in Annex C:

**Issues Related to Controls**

- In the modules dealing with *disbursements and loan amendments* (Modules 19 and 21) IEG found that Task Team Leaders are afforded much flexibility in the OPs that govern IDA, which permit them to make changes in a project disbursement category amount, on the understanding this will be documented later, but IEG could not find a control which ensured this would take place. Also, IEG could find no mechanism whereby a TTL could inform the Loan Department to place a hold on disbursements, if she/he had uncertainty that funds were being disbursed for the purposes intended.

- In the *refunds and loan closing* modules (Modules 22, 25, 26) IEG learned that the Loan Department has no mechanism to ensure that balances remaining in special accounts (greater than 1% of loan amount) and due for refund to IDA are eventually received.

- In the *safeguards module for a SIL* (Module 28) IEG found that, if certain safeguard documents to be prepared by the country in the preparation phase are inadequate, there is no mechanism in the process for it to be sent back to be redone.

- In the *procurement complaints module* (Module 15) IEG found that there is no control to ensure that all complaints are entered into the complaints database. Also, there is no control to ensure that reports from the complaints database are followed up on and that all complaints are handled appropriately.

2.45 *Summary Evaluation of Revealed Deficiencies:* In IEG’s opinion, these issues taken individually are deficiencies. Whether, individually or in combination, they would rise to the level of significant
deficiencies or material weaknesses would best be judged as part of the totality of the revealed deficiencies, including those uncovered by both Management and IAD, and this should be deferred until at least the completion of the controls testing to be done in Part IB. Failure to establish the materiality of these deficiencies by then would interfere with the ability to make affirmative conclusions on the effectiveness of the overall internal controls framework.

**ISSUES RELATED TO MANAGEMENT’S DESCRIPTIVE MATERIALS AND MAPPING**

2.46 IEG also noted certain imperfections in Management’s descriptive materials, of which the following are highlight examples (more details are given in Annex C):

- In the description of specific risks linked to key controls, Management did not categorize these risks as to type (e.g., financial, operational, or reputational) or analyze the risks in terms of likelihood of occurrence or impact; (para 2.21)
- The DPL module did not address the potential impact on IDA’s reputation and the country if the DPL objectives are not accomplished;
- Loan management modules did not mention the area of repayment and amortization risks;
- In some BPM process maps, the sections of the main lending processes subject to QAG assessments (Quality of Supervision Assessment; Quality at Entry Assessment) had no links to show where these QAG interventions would be made.
- The CAS module omitted to show links to the portfolio/pipeline review, to AAA, including CEM and PRSP, and did not show the inputs of the Sector Networks;

2.47 These comments complete IEG’s evaluation of Management’s assessment of the present stage. Chapter 3 deals with the IAD review, while Chapter 4 presents IEG conclusions and recommendations.

1. Quotes from page 2 of Management’s Report.
2. Ibid page 2.
3. At the time of completing this report, Module 30, on Debt Sustainability Analysis, was still being completed, so the assessment and IEG evaluation were effectively conducted on 29 modules. IEG assumes that Module 30 remains part of the universe going forward. Further, Management regards the IDA Allocation Model and the Post Conflict Allocation as sub-processes to the main Allocation module, so by some counts Management refers to 27 modules.

1. The Bank and IDA are affiliated multi-national development agencies each with its own jurisprudential personality established through international treaty by Articles of Agreement between the member countries. Article VIII
Section 10 of IDA’s Articles of Agreement requires that “Each member take action necessary in its own territories for the purpose of making effective in terms of its own law the principles set forth in the Articles of Agreement and shall inform the Association of the detailed action which it has taken.” This principle is carried forward from the Articles into the IDA lending agreements (which incorporate the General Conditions) and which stipulate that in case of conflict the member/borrower cannot raise the local law as a justification for failure to implement the conditions set forth in the lending agreements. It is not the legal duty of IDA to monitor the compliance by the borrower with all its own laws and regulations. However, IDA has to be assured that the conditions it needs for a successful project are spelled out in the lending agreements and will be implemented notwithstanding conflict with local law. For this purpose, IDA requires (as a standard condition of effectiveness) a legal opinion satisfactory to IDA confirming that the provisions of the lending agreement are valid and binding on the borrower.

2. **Management comment:** Management’s decision to focus this exercise on IDA lending products and not specifically focus on AAA and other Knowledge Products was consistent with the main objective of assessing the internal controls in place for ensuring how borrowers use IDA resources for the purposes intended. The fact that a large percentage of administrative budget is spent on AAA does not in and of itself suggest the connection between AAA and lending where IDA controls under review would apply.

3. Take, for example, Module 9, Contractual Remedies. The Process Overview describes the objective of the process as: “Ensure contractual remedies are applied when necessary……” Though not wrong, it sounds as if the objective of the process is the process, and the explanation carries little of the operationally substantive facts that: IDA assistance is always contingent on fulfillment of project agreements and other covenants. This implies a need for sanction and remedies where agreements are broken, or covenants not met….etc, so that when the occasion arises, there is a structured process to seek remedies and sanctions….etc., and this is the purpose of Module 9.

4. **Management comment:** IEG’s criticism of the Management’s approach of dividing the assessment into two parts and focusing the first part on transaction-level controls has to be taken in the context of the unprecedented nature of this assessment, the intensity and scope of work required as well as its primary objective of assessing the existing controls for ensuring that IDA funds are used for the purposes intended. As has been discussed with CODE and the Audit Committee in November 2005 and July 2006, the review of IDA’s Internal Controls, to date, has required a massive amount of work on Management side, involving the identification and categorization of the relevant policies and a rigorous review of 30 business processes that are key to IDA operations and resulting in 700 pages of documentation. We believe that everyone (IEG, IAD and Management) is in agreement that the work performed represents a landmark step in the understanding and evaluation of IDA’s control framework and is unique in the development community. The work performed to date is particularly useful precisely because of the methodology utilized. In recognition of the practical difficulties of undertaking one comprehensive study, Management has in effect identified three phases: in the first (Part IA), which is the subject of this report, Management has sought to ensure that procedures embed key controls to assure compliance with policies; in the second (Part IB), Management will assess whether these procedures are complied with in practice; and in the third (Part II), Management will assess whether the mechanisms in place to monitor that IDA op-
erations are efficient and effective are adequate. Management believes that this methodology allows for a systematic and manageable analysis, and the development of specific and actionable findings. While Management agrees with IEG that the methodology applied makes it difficult for IEG to provide an overall definitive conclusion at this stage, given the trade-offs, in a resource constrained environment and real time-limitations on what could be done, the approach followed proved to be preferable as the findings, and related action plans are likely to be the major themes of the entire assessment. In this regard, it is important to note that IEG has confirmed that “The mapped Business Process Modules have provided a concrete and transparent means of identifying, assessing and testing key controls” (para 4.3 (ii), emphasis supplied) and found that “Management’s approach has yielded concrete results in revealing deficiencies and potential weaknesses” (para 4.3 (v)). Management is committed to complete the next phases of this exercise, namely Part IB relating to assessment of operation effectiveness of the controls identified and Part II relating to the overall efficiency and effectiveness. However, it is important to note that while these parts are expected to refine Management’s findings and conclusions, given the nature of conclusions to date and the rigor of the work performed, it is reasonable to expect that the nature of the conclusions under Part IB and II will be the same as the important findings and conclusions which resulted from the work carried out under Part IA.

5. An entity-level review would have allowed a prior assessment of how well the COSO framework is being observed as a whole, it might have suggested priority areas of risk, and it would have informed the operating units in the Bank of the impending review, and given them time to prepare for the business process tests. IEG can find few if any precedents for major internal control reviews which have not started at the entity level. AS2 (see annex 2) states that “it may be appropriate for the auditor to test and evaluate the design effectiveness of company-level controls first.” The Policy Statement issued by the PCAOB after the first year of experience with AS2 states that “this Policy Statement expresses the Board’s view that, to properly plan and perform an effective audit under Auditing Standard No. 2, auditors should … use a top-down approach and that “Auditing Standard No. 2 was designed to be applied from the top down.”

6. Management’s statement that this type of review is without precedent is true for the Bank and IDA, but there are some precedents for this in other agencies. The United States federal government agencies have been making such assessments under the Federal Managers’ Financial Integrity Act (FMFIA) since its passage in 1982. For example, the United States Department of the Treasury, in its Fiscal Year 2005 Performance and Accountability Report (page 23), stated that “As a result of our evaluations, Treasury can provide reasonable assurance that the objectives of the Federal Managers’ Financial Integrity Act have been achieved, except for the remaining material weaknesses…” (which were listed). Treasury went on to list the management control objectives under FMFIA among which included “to ensure that programs achieve their intended results, resources are used consistent with overall mission, programs and resources are free from waste, fraud and mismanagement, and laws and regulations are followed.”

7. **Management comment:** The IEG report states that IEG regards the issues identified by Management relating to documents retention as a “potential material weakness.” Management questions the validity of IEG’s use of the term “potential material weakness” given the speculative nature associated
with any “potential” material weaknesses. The outcome of any prospective work is by definition unknown. Therefore, Management believes that it would be more prudent at this stage not to guess or prejudge what the possible outcome might be but rather limit any conclusions to the factual statements and specify that as part of the follow on phases this issue would be looked at so as to assess both the seriousness of any problem and how best to address it.

8. See, for example, the AROE for 2002.

9. **Management comment:** The IEG report states that IEG regards the status of some OPs and BPs as “potential material weakness.” As with the issues relating to document retention, Management questions the validity of IEG’s use of the term “potential material weakness” relating to OP/BP status given the speculative nature associated with any “potential” material weaknesses. In addition, Management believes that while the current status of some OPs and BPs may have a negative impact on the efficiency and transaction costs of processes and key controls associated with such OPs and BPs, it does not constitute an actual or potential material weakness relating to compliance. In this regard, it is also important to note that the policy reform effort underway as part of the modernization agenda has been focused on simplifying and streamlining the existing policies and procedures, not in addressing weaknesses or gaps in the current statements. Most notable examples of these types of policy reforms are the reform of OP/BP 8.60, governing Development Policy Lending, reform of policy on expenditure eligibility (OP/BP 6.00), and the policy on additional financing for investment lending (OP/BP 13.20). Recognizing this, as part of the modernization agenda, Management discussed with the Board that other updates of policies relating to investment lending would proceed only after progress was made on modernizing non-policy aspects of investment lending and not in parallel. It also has been long recognized by Management and the Board that the current processes for preparation, review, consultation, approval and issuance of revised policies are extremely time and resource consuming, often resulting in a lag between the time when a need for a given policy update is identified and the final approval and issuance of the revised or updated policy. To reflect this, and ensure that this issue is properly addressed as part of this exercise, in paragraph 26 C of its Findings and Recommendations, Management suggests that “As part of Management’s assessment of the effectiveness and efficiency of IDA’s internal controls framework, Management intends to look at the current processes underlying policy revision to determine if they need to be revised to facilitate a more efficient and timely updating of operational policies and procedures.” Management believes that this is indeed an important efficiency issue that should be addressed under Part II of this exercise.
3. The IAD Review and Report

Context for IEG’s Review of IAD’s Work

3.1 This chapter contains a description of IAD’s objectives, scope and approach to its review (paragraphs 3.2-3.3), and a summary (paragraphs 3.4 and 3.5) of the main observations that IAD has recorded in its report. In the latter section, where appropriate, IEG comments on and evaluates IAD’s main findings. The complete IAD report is in Attachment II.

IAD’s Objective

3.2 IAD’s Terms of Reference stated as its objective in reviewing Management’s assessment of internal controls to express an opinion on whether the assessment of internal controls over IDA operations, relating to their compliance with the IDA charter and its internal policies and procedures, has been fairly stated, based on the criteria established in the COSO framework. As a result of Management’s decision to divide its assessment into Part I—internal controls over compliance—and Part II—internal controls over operational effectiveness and efficiency—and subsequently to divide Part I into Parts IA and IB, IAD had to develop a more specific scope and approach for Part IA. IAD has also concluded that its opinion would have to await completion of Part IB.

IAD’s Scope and Approach for Part IA

3.3 Similar to IEG, IAD noted a number of scope limitations in Management’s work, including the deferral of entity-level controls and internal controls over efficiency and effectiveness of operations, processes excluded by Management, and deferral of the evaluation of information technology controls. Using relevant concepts from AS2 tailored for compliance and operational controls, IAD performed the following work.

- **Process Documentation**: IAD reviewed high level process flowcharts, descriptive materials of processes and control objectives, risks and key controls provided by Management. IAD
reviewed whether key controls identified by management appeared adequate to satisfy control objectives, and identified potentially missing key controls.

- **Workshops/Review Sessions:** IAD observed workshops/review sessions conducted by Management with subject matter experts to review the design effectiveness of key controls as identified and documented by Management, challenging, seeking clarification and identifying potential deficiencies as appropriate.

- **Revised Process Documentation:** IAD reviewed revised process descriptions incorporating changes identified in the workshops/review sessions, and potential control issues identified by Management.

- **Deficiency Tracker:** IAD provided Management with a list of 59 potential deficiencies in documentation and/or design identified during its review, four of which also were included in Management’s list of potential deficiencies.

- **Process Walkthroughs:** IAD attended process walkthrough sessions convened by Management with operating personnel responsible for three processes (Country Assistance Strategy, Investment Lending and Development Policy Lending) to confirm the operation of process controls (for at least one transaction for each process) from inception to completion, as documented in the workshops/review sessions.

- **Management’s Report:** IAD reviewed drafts of Management’s report and provided comments as appropriate.

### IAD’s General Observation and Key Issues

3.4 **General observation:** Overall, IEG and IAD raised many of the same issues as a result of their work. IAD commented positively on the comprehensive and unique nature of Management’s assessment within the multilateral development banking community and stated that it could provide a compelling baseline for identifying opportunities to streamline operations and internal controls and improve efficiency and consistency.

3.5 **Key Issues:** IAD identified eight key issues during its review of Part IA of Management’s assessment. Each of the key issues is summarized briefly below along with IEG’s observations.

- **IDA processes selected:** IAD raised questions about Management’s decision to exclude certain processes in determining compliance with fiduciary aspects of IDA’s lending operations, as well as limiting its scope to processes applicable to SILs and DPLs. IEG’s evaluation also raised a number of concerns about IDA processes excluded from Management’s as-
CHAPTER 3
THE IAD REVIEW AND REPORT

assessment (particularly knowledge products) and using SILs alone to represent all investment lending. (para 2.8 and Annex E, paras 7-9)

- **Information technology (IT) controls:** IAD commented on Management’s plan to defer assessment of IT controls to Part II as part of assessing entity-level controls and took the position that key IT controls need to be assessed in Part IB to reach reliable conclusions. IEG’s work also identified the deferral of IT controls to Part II as a significant scope limitation, which limits conclusions that can be drawn from Management’s assessment on Part I. (2.24)

- **Fraud and corruption controls:** IAD commented that Management had not identified and documented controls focused on mitigating risks associated with fraud and corruption at the process level. IAD also noted that Management had not assessed the adequacy of other controls to satisfy such objectives, such as ensuring that control implications identified during fraud and corruption investigations are adequately addressed. In IEG’s view, controls over fraud and corruption should first be addressed at the entity-wide level, which would include controls to assure that issues identified during fraud and corruption investigations are adequately addressed. Work on fraud and corruption controls at the entity-wide level could then inform the need to assess key controls at the process level important to preventing or detecting fraud and corruption. IEG also observes that the controls assessments completed by Management implicitly also dealt with fraud and corruption prevention issues, but agrees with IAD that this could have been made more explicit.

- **Outdated OPs and BPs:** IAD notes “absent processes to ensure that policies are current, controls to ensure compliance with such policies would not be meaningful, even if current practices meet business needs.” IAD recognizes that Management has committed to review the process for updating the OPs and BPs and to examine the appropriateness of regional variances in implementation. IEG’s work identifies this as a significant issue raised by Management’s assessment that IEG believes is an area of potential material weakness, and recommends that Management’s reform work be treated as a priority.

- **Categorization and Remediation of Deficiencies:** IAD states that Management’s assessment in Part IA has yet to determine whether identified deficiencies pose, in the aggregate if not individually, significant or material risks to the attainment of control objectives. IEG’s work also identified this issue and IEG agrees with IAD on the need for Management to evaluate in Part IB the significance of the deficiencies identified by
Management’s assessment and the additional deficiencies identified by IAD and IEG (para 2.45).

- **Document Retention and Accessibility:** IAD takes note of Management’s significant difficulties in obtaining timely access to relevant documents for compliance testing and concludes that in IAD’s experience this represents a significant control design deficiency. While Management has agreed to address this issue, IEG concludes that this is clearly a major issue that could reach the level of material weakness. In particular, IEG notes the potential relationship between the document retention issue and the major decentralization of the Bank in the past decade and the role of information technology in document retention (para 2.32).

- **Assessment of Entity-level Controls:** IAD comments on the decision to defer the assessment of entity-level controls to Part II and notes that Management’s conclusions on control effectiveness as a result of Part I will need to be reconsidered once entity-level controls have been examined. IEG identifies the decision to delay assessment of entity-level controls to Part II as a major scope limitation and finds that Management’s decision to employ a bottom-up approach to assess controls as contrasted to a top-down approach, starting with entity-level controls, runs contrary to standard industry recommendations.

- **Walkthrough of Process Documentation:** IAD states that “Management’s assessment of design effectiveness of internal controls under Part IA of the review included walkthroughs of process documentation for three of the 29 documented in-scope processes (CAS, SILs and DPLs) from inception to completion.” IEG disagrees with IAD’s definition of walkthrough, in this context, and regards most of the 29 in-scope processes to have been subjected by Management to a walkthrough process essentially similar (as modified to suit the nature of IDA operations) to that described in the AS2 text summary of the concept.

- **Completion of Remaining Stages:** IAD “strongly recommends reconsidering the relative cost-benefit of continuing immediately with the remaining issues of the assessment versus continuing after addressing significant deficiencies identified in Part IA” (PAGE 7, IAD report). IEG has considered this option, but regards a postponement as unnecessary and impractical and believes, on the contrary (as argued in paras 2.24 and 4.7), that the remaining stages should be completed expeditiously.

**NOTES**

1. IEG had a very limited period of time to review IAD’s report, so these observations are to be taken as reflecting IEG’s evaluation at this stage of its analysis. IEG will be broadening its evaluation in the light of further work to be completed during Part IB and beyond.
2. Terms of Reference for a Review of Management’s Assessment of Internal Controls over IDA Operations, IAD, May 16, 2006, issued as a memorandum to the Vice Presidents of CTR and OPCS, which IAD also sent to AC and CODE.

3. IAD and Management have used different applications of the term “Walk-through.” They also have differing views on the extent of work to be completed under this process. IEG has used the term (as described on page iv) to signify the process by which Management has verified process mapping and design effectiveness, without denoting acceptable quality of the work completed.

4. Economic and Sector Work (ESW), Report on Observance of Standards (ROSC) Independent Evaluation Group (IEG) and Internal Audit Department (IAD) processes, among others. (see Box 6 on page 15).
4. Conclusions and Recommendations

4.1 This final chapter presents IEG’s main conclusions from its evaluation of the work completed so far. The chapter provides a broad overview, a summary of the concluding evaluation of both Management’s assessment and the IAD review, and it concludes with a set of IEG recommendations going forward.

Overall IEG Evaluation

4.2 IEG recognizes the reasons why Management adopted the process-based and phased approach, and acknowledges its merits. But considering also the scope limitations this necessarily implied, IEG arrives at a mixed conclusion on the completion of this first stage of the study: At the Transactions Level: robust progress has been made in defining, locating and assessing key internal controls, and the results from this approach have revealed a number of deficiencies and possible weaknesses in the underlying controls; At the Controls Framework Level the general approach and scope limitations applying to this stage of the assessment prevent positive assertions being made now regarding the effective operation of the overall system of controls.

4.3 At the transactions level progress can be measured in the following ways:

- As a basis to test for compliance, Management has made a credible linkage between the IDA Articles, the Bank’s policies and procedures, and the business processes identified to represent IDA operations;
- The mapped Business Process Modules have provided a concrete and transparent means of identifying, assessing and testing key controls;
- Management’s methods of mapping and assessing the BPMs have been of a generally satisfactory quality, though with some notable qualifications relating to the treatment of risk, and the need to improve some of the descriptive materials.
- Management’s “walkthrough” method of verifying the accuracy of the selected business processes and testing the design effectiveness of their key controls was rigorous, comprehensive, transparent, and documented to a largely satisfactory
standard, consistent with general concepts of AS2; (some fur-
ther walkthroughs may still be needed);

- Management’s approach has yielded concrete results in re-
vealing deficiencies and potential weaknesses: Management
uncovered two deficiencies (which IEG regards as potential
material weaknesses—document retention; imprecise and un-
reformed OPs/BPs), as well as one other potential significant
deficiency; in addition, Management compiled a list of some
other issues whose materiality is to be examined and assessed
in the next stages of the study. Also, on the basis of their re-
view of Management’s work, both IAD and IEG have added to
this list, with IAD identifying 55 issues (35 documentation is-
issues; 20 potential control deficiencies), and IEG identifying
four control deficiencies, and six areas of imperfection in the
descriptive materials and process maps.

4.4 At the Level of the Controls Framework, the weaknesses
stemming from the inevitable trade-offs and scope limitations inher-
ent in Management’s chosen approach can be summarized as follows:

- Conclusions on controls within COSO cannot be made piece-
meal, so staging and dividing the study has effectively post-
poned the ability to make definitive conclusions on the out-
comes of each stage of the review until the overall (Part II)
assessment has been completed, i.e. until end 2007, or later.
- Even the staging of the study between Part IA and Part IB
makes conclusions on control design (Part IA) difficult until
Part IB has been completed.
- Separating compliance and efficiency and effectiveness is
really not possible in practice: many business processes and
their associated controls are as much to do with compliance as
with efficiency and effectiveness, and these are best treated to-
gether rather than in sequence.
- Other scope limitations flowing from the delineation of the
study—in particular the decision to deal with IT systems and
field offices in Part II, have yet further limited the conclusions
that can be drawn in Part I.

4.5 By completing the entity-level review during Part II, and ad-
dressing the postponed parts of the framework, Management should
be able to mitigate these deficiencies in approach by linking results
from the various parts together, to provide an overall statement.
However, this will depend on there being no changes in any basic pa-
rameters: controls will be assessed at different points in time, and
policies, procedures, systems, organization structures may change
during this period.
4.6 **Summary of Key Observations by the Reviewing Parties:** This three-phase assessment, review and evaluation has given rise to a complex combination of descriptions of method, summary of findings, and evaluative observations. As an aid to provide a simplified summary of the main issues that have been identified by Management, IAD and IEG, Box 7 below provides a tabulation of issues. It separates issues relating to approach and method from those relating to the results of Management’s assessment at the conclusion of Part IA. It shows that there is a considerable commonality between IEG’s findings and the observations that IAD has made on issues raised by Management’s approach and method. It also shows areas in which IEG has made observations where IAD has not commented, (e.g. process issues; quality of Management’s BPM mapping) and cases of disagreement (e.g. over the definition of walkthrough). IAD has, through the walkthrough process been able to identify 55 additional issues (documentation and control issues) to be further examined for their nature and materiality. Taken overall, IEG finds the coverage of issues for this stage of the review to be robust and wide-ranging.

<table>
<thead>
<tr>
<th>Box 10. Summary of Principal Issues Identified by Management, IAD, and IEG</th>
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<td><strong>B: Process Level Issues:</strong></td>
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<td>1. Definition of Objectives, Compliance</td>
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<td>5. Quality of BPM mapping</td>
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<td>5. The Cluster as Representing IDA Operations</td>
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Continued…
Box 10 (continued)

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<tr>
<th>Issues relating to results: major controls issues</th>
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*Highlighted Controls Issues*

**By Management**

1. Document Retention and Accessibility
   - Highlighted Deficiency
   - Highlighted Deficiency
   - Potential Material Weakness

2. Current Status of OPs/BPs:
   - a. OPs/BPs outdated, often not current
   - b. Complex, disjointed policy framework
   - c. Onerous, inefficient processes
   - Highlighted Deficiency
   - Highlighted Deficiency
   - Potential Material Weakness

3. Disparity in Corporate Review SILs and DPLs.
   - Highlighted
   - --
   - Highlighted

**By IAD (3)**

1. Outdated OPs/BPs
   - Highlighted
   - Highlighted

2. Definition of Walkthrough
   - Disputed
   - Management Consistent with AS2 concepts

3. Fraud and Corruption Controls
   - Should be assessed at process level
   - Start with Entity level controls; could have been more explicitly treated

**By IEG (4)**

(i) No control over “subject to” disbursement changes; (ii) no assurance all refunds received; (iii) No mechanism to assure country safeguard documents redone if necessary; (iv) No Bank-wide log for procurement complaints

**Issues relating to Results: Documentation and potential control Deficiencies.**

- Highlighted Additional Issues
- 55 Identified; Materiality not yet established
- Materiality should be established during Part IB

4.7 **Recommendations for Next Steps:** IEG’s recommendations are focused on the issues to be dealt with in completing the remaining phases of the review, and on the broader control framework issues that may emerge going forward. Note is taken of the fact that Management has identified the documentation retention and accessibility
as a weakness and has already launched a remedial effort. In this context, IEG makes six recommendations to Management, (including one also to IAD), as follows:

- **Confirming the Validity of the BPM Cluster:** Management has argued, but has not conclusively demonstrated, that the core SIL prototype module in the cluster of BPMs can be used as a proxy for all investment type lending, because all ILs have the same controls as SILs. This proposition should be tested, and this could be done during Part IB. (para 2.18)

- **Reform of the OPs/BPs:** IEG considers this topic an area of potential material weakness, whose remedy Management should treat as a priority. IEG notes that Management has a stated strategy to address the problem, both to streamline and to update the OPs/BPs. (para 2.37).

- **Completing the Remaining stages:** IEG recommends that preparation for the Part II stage should begin promptly upon completion of Part I. It would seem useful to precede this work with a work plan (which could be discussed with the Board), which could benefit from consultations between Management, IAD, and IEG, much as the Audit Standards were discussed under Part I. Part II should preferably be completed expeditiously, also because if it should be delayed, the controls parameters that were tested during Part I may have changed, and there may be difficulties integrating the two parts. (para 2.24).

- **Resolving Specific Issues and Potential Deficiencies (Management and IAD):** It is important that the several deficiencies uncovered by both Management’s assessment and IAD review, as listed and described in Annex C, be addressed during completion of Part IB. While some of these issues relate to lack of clarity in documentation, others to efficiency and effectiveness of controls, others are potential deficiencies in controls. It is the seriousness of the latter group—the materiality of their potential impact on risk mitigation—that must be addressed before conclusions can be drawn on the state of the overall control framework. Management and IAD should work on this together. (paras 2.41, 2.44 and 3.3, third bullet).

- **Managing the Risk Framework and Extending COSO:** IEG believes the Integrated Risk Management Framework will need to be broadened to focus also on compliance and operations reporting, and in this context, the Bank may also consider adopting the recently extended version of COSO which provides for the addition of a new fourth objective (strategy—high level goals, aligning with supporting mission) and three new components to the existing five components of COSO: objective setting, event identification and risk response. (para 1.7 and Annex A paras 4-6).
Mainstreaming Internal Controls Reviews: IDA should begin considering the value of adopting a policy requiring: (1) ongoing monitoring and reporting on internal controls in the course of operations for all three COSO objectives; and (2) separate evaluations and reporting as necessary.

4.8 Postscript: A Summary of Key Steps to be Taken in Preparing for and Completing Part IB:

- **Content**: Testing (or re-testing) key controls operation (Box 1, page 2)
- **Identified Deficiencies**: Management, in consultation with IAD and IEG, to categorize, and establish materiality of deficiencies identified during Part IA (paras 2.41; 2.46; 3.5; 4.7; and Annex C)
- **Verify Validity of ILs in BPM Cluster**: To show that SILs represent all ILs, test a range of investment lending products (para 2.18 and Annex E)
- **Explicitly Address Fraud and Corruption Issues**: Management to itemize controls where fraud issues are relevant, indicate mitigating controls (para 3.5 and Box 7)
- **Assessment of IT Controls (Optional)**: IAD has recommended assessment during Part IB; IEG agrees this is a scope limitation, but could be dealt with as an entity-level control, during Part II. (para 2.24 and para 3.5)
- **Advisory Panel**: IEG will be convening an Advisory Panel of international experts to give an opinion on its evaluation of Part IA and Part IB. (para 1.17)
Annex A. The COSO\textsuperscript{1} Framework

1. Figure A1 below conceptually integrates the COSO objectives and components and the Bank’s own integrated risk management focal points. COSO defines internal control as a process, effected by an entity’s board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Reliability of financial reporting—relating to preparation of published financial statements;
- Compliance with applicable laws and regulations—relating to compliance with applicable legal and regulatory framework, which in the case of IDA is taken to mean its charter and policies\textsuperscript{2}; and
- Effectiveness and efficiency of operations—relating to effective and efficient use of resources in meeting business objectives.

**Figure A.1: Relationship of COSO Objectives, Components, and the Bank’s Risk Focal Points**

2. To meet the above objectives of internal control COSO describes the following components of internal control. All five components must be present and functioning effectively to conclude that internal control is effective over any of the three objectives.
Annex A
The COSO Framework

- **Control Environment.** The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include: the integrity, ethical values, and competence of the people; management’s philosophy and operating style (tone at the top); the way management assigns authority and responsibility and organizes and develops its people; and the attention and direction provided by the board of directors.

- **Risk Assessment.** The Bank defines risk as anything that hinders the ethical achievement of sustainable business objectives and results. This includes failure to exploit opportunities and to maintain organizational relevance. (See below.) Every organization faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is establishment of business objectives that are internally consistent and aligned with an organization’s strategy and mission. Risk assessment is the identification and analysis of those risks that potentially jeopardize the achievement of business objectives. Risk assessment forms a basis for determining how risks should be managed, and as the Bank operates in a complex and rapidly changing environment, it is critical that risk assessment and risk mitigation are rigorous and ongoing processes.

- **Control Activities.** Control activities are the policies and procedures that help ensure that management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the objectives. Control activities occur throughout the organization, at all levels, and in all functions. They include a range of activities such as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets, and segregation of duties. In terms of the Bank’s operations, control activities can include key processes such as supervision of projects, and regional portfolio risk reviews.

- **Monitoring and Learning.** Internal control systems need to be monitored—a process that assesses the quality of the system’s performance over time. This is accomplished through ongoing monitoring activities and separate evaluation. Ongoing monitoring occurs in the course of business operations. It includes regular management and supervisory activities and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported “upstream,” with serious matters reported to top management and the board of directors.

- **Information and Communication.** Pertinent information must be identified, captured, and communicated in a form and timeframe that enables people to carry out their responsibilities. Information systems produce reports containing operational, financial, and compliance-related information that make it possible to run and control the business. They deal not only with internally generated data, but also with information about external events and activities and conditions necessary for informed decision-making and external reporting. Effective communication must also occur in a broader sense, flowing down, across, and from the bottom upward in the organization. In a healthy control environment, communications are open and when a business objective is in jeopardy “bad news” flows rapidly so that corrective action can be taken in a timely manner. All personnel must receive a clear message from top management that control re-
responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream. There also needs to be effective communication with external parties such as suppliers, regulators, shareholders, borrowers, donors, and interested parties such as Non-Governmental Organizations (NGOs).

3. The Bank faces a wide range of increasingly complex risks. Sound risk management must be comprehensive to meet the dual requirement of development effectiveness and resource mobilization. To ensure that opportunities are not missed and the full range of risks is considered, the Bank has organized its risk management around the following four focal points.

- **Strategic effectiveness.** Success in this area means setting and maintaining the Bank’s strategic direction on a course that leads to enhancing development effectiveness and reducing poverty. It involves making sure that strategic choices and follow-up decisions are not only in response to immediate challenges but also aim to maintain the Bank’s relevance and its role as a leading development institution. Four main dimensions are included in strategic effectiveness: selectivity, execution of strategy, agility, and governance.

- **Operational efficiency.** This is relevant to virtually all parts of the Bank’s internal operations. It is about “doing things right” in all areas, from country work to central services, from HR to finance, etc. Operational efficiency requires operating and managerial standards as well as implementation and control mechanisms that ensure reliable, high-quality, and cost-effective performance. Five main dimensions are included in operational efficiency: human resources, fiduciary performance, safeguard quality and performance, operational performance, and information technology.

- **Stakeholder support.** The support of a wide range of stakeholders is key to the Bank’s pursuit of its mission. Building political will and constituencies entails close cooperation among all branches of government, NGOs, people affected by Bank projects, private firms, Bank staff, media, and others. The point is not to please everyone, but to ensure that the perspective of all relevant stakeholders has been duly taken into account in Bank decisions. Two main dimensions are included in stakeholder support: member governments and other stakeholders.

- **Financial Soundness.** The Bank has to ensure that its financial policies and practices (for investment, borrowing, and lending decisions) provide sustained access to low-cost assistance for its borrowing members, consistent with its mission and strategy. Three major sources of threats to financial soundness are country (sovereign) credit risk, market risk, and liquidity (funding) risk.

### Recent Developments in COSO

4. While the Bank has taken a number of initiatives to develop an integrated risk management framework (as is referenced in several places in the text of this report), there are still some questions as to how effectively the integrated framework is operating and how it will develop going forward. IEG believes it worthwhile to draw attention to some of the changes that COSO has recently introduced, as a pointer for further exten-
Annex A
The COSO Framework

sions of the Bank’s own efforts in this area. In 2004 COSO itself published a paper entitled Enterprise Risk Management – Integrated Framework, 3 which includes consideration of risk appetite, strategy, and decisions; new opportunities; and deployment of capital—elements which are directly parallel to those the Bank has already introduced into its own Integrated Risk Management Framework (IRMF). To emphasize the need to focus on the entity’s mission the new framework also adds a fourth objective to the earlier three objectives of operations, compliance and financial reporting: Strategic – high-level goals, aligning with supporting mission

5. Lastly, the new COSO framework expands its components from the existing five to eight, now encompassing the following:

- Internal Environment—management sets tone for organization, defines how risk is viewed and addressed
- Objective Setting—Objectives must exist to identify events, internal and external, that may affect their achievement
- Event Identification—Internal and external events identified that create risks and/or opportunities
- Risk Assessment—likelihood and impact of risk assessed
- Risk Response—management selects risk responses
- Controls Activities—policies and procedures established for risk response
- Information and Communication—information flows up, down, and across the organization
- Monitoring—Ongoing monitoring and periodic, in-depth evaluations.

6. As described above, the COSO framework is a dynamic framework, which has been adapted to the Bank and IDA, and which its originators are also constantly adapting to global developments. As the Bank enters into the next phase of its controls review, in which the COSO framework will be center stage, it may consider making similar additional adaptations to those recently suggested by COSO itself. These are intended to sharpen the focus on risk issues, and risk is what lies at the center of all internal control systems.

NOTES
2. As described in Chapter 2 (para 2.4) there was a need to adapt the normal meaning of compliance under COSO to the case of IDA, since the latter is an international agency under its own legal charter, not subject to local laws in the way would be a domestic commercial organization.
3. COSO, September 2004
Annex B. Standards Agreed by Management, IAD and IEG to be used in Assessing Deficiencies, Significant Deficiencies and Material 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.
Annex B
Standards for Assessing Deficiencies and Weaknesses

- 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 (CTRVVP) 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. Illustration of Potential Internal Control Design Weaknesses

Findings from Management’s Assessment, the IAD Review, and the IEG Evaluation

1. In its report, Management highlighted five high-level findings where potential deficiencies and weaknesses had been revealed, as follows: (1) difficulties experienced by Management during its assessment in obtaining timely access to relevant documents, (2) changes introduced on the ground that are not consistent with policies and procedures, (3) the difficulty staff is having in identifying which policies they must comply with, (4) confirmation that many staff find the existing processes and documentation requirements very onerous and inefficient, and (5) a disparity between SIL and DPL operations in the extent to which corporate reviews are initiated.

2. In addition to the above five main findings, Management identified and provided IEG a list of “potential issues” identified during its Part 1A compliance assessment work. IAD also identified and is tracking “deficiencies” based on its review of all modules as of September 20, 2006. IAD provided its list of deficiencies to Management and IEG. IAD stressed to Management the importance of evaluating and classifying (based on their level of significance) all of the deficiencies identified by both IAD and Management in order to substantiate the findings in later work and to draw conclusions.

3. IAD provided management and IEG with a list, taken from its Deficiency Tracker, of potential additional deficiencies in Management’s documentation of process flows for key controls and/or design gaps in key controls without adequate mitigating controls. The list identifies several which relate to process documentation, others to design gaps, and a few to both process documentation and design gaps. IAD noted that, for each of the deficiencies, it had recommended that Management revise the process documentation and, where appropriate, clearly indicate how the associated risks are mitigated.

4. During its evaluation, IEG examined the narrative descriptions and flow charts of IDA business processes, including key internal controls, provided by Management. IEG representatives also attended meetings arranged by Management and observed its process of assessing the design of key internal controls. In addition, IEG reviewed the lists of potential issues and deficiencies provided by Management and IAD. IEG notes that Management is to do further work on these issues to establish whether the issues, or combination of issues, may rise to the level of a deficiency, significant deficiency, or material weakness, as defined by the agreed standards described in Annex B.
5. What follows are some examples of the main issues that IEG considers to merit attention:

- Potential internal control issues or deficiencies identified by Management and/or IAD;
- Additional issues identified by IEG as potential internal control issues;
- Issues identified by IEG as deficiencies in the materials submitted by Management as part of its Part IA assessment.

A. Potential Control Issues Identified by Management and IAD

IDA RESOURCE ALLOCATION MODEL (MODULE 1)

6. The IDA resource allocation model is a management tool used as part of a process for providing financing, in line with IDA’s Articles of Agreement, for purposes that are of high development priority in the less-developed areas of the world that are within the Association’s membership. Management identified and assessed three business processes (of the 30 in total) and three key controls over IDA resource allocations. One of the key controls assessed was the need for the validation by the FRM Manager of all assumptions and conditions used in running the allocation model, such as whether proper allocations are made for large blend countries (e.g. India, Pakistan, and Indonesia); maximum allocations are not exceeded; and allocations for post-conflict countries are proper.

7. Information developed by Management indicates two potential issues exist relating to the above-mentioned internal control over IDA resource allocations. First, the FRM Manager’s validation of the allocations does not consider inputs to the allocation process but rather is based only on the outputs from the allocation model. As a result, Management cannot be assured from the validation process that the assumptions and other conditions or factors going into the model are valid. Second, responsibility for running the allocation model is assigned to a single individual, an FRM Management Information Specialist. While this may assure control over access to the model and what changes are made, a deficiency may exist relating to reliance on a single person for such an important step. This person should have a back-up person who is also knowledgeable about the model in case the primary person is unable to run the model.

8. IAD identified additional deficiencies relating to Management’s process documentation and key controls for the FRM resource allocation processes. For example, Management did not identify any key controls for the IDA Post Conflict Allocation process and had not linked the process to OP/BP 2.30, Development Cooperation and Conflict. IAD said the post conflict allocation model would operate in conjunction with the underlying principles of OP/BP 2.30 and recommended that Management include this OP/BP in the assessment.

CORE INVESTMENT LOAN PROCESS (MODULE 5)

9. This highly important business process module involves all aspects of developing and executing the project cycle for a Specific Investment Loan (SIL) and includes nine key controls.
10. Based on the information it gathered, Management noted that in certain instances reviewing officials in the loan department, procurement, financial management, or legal may approve loan documents but include, with their approvals, “subject to” comments. The comments require certain actions to be taken before the documents are processed to their final stages. However, procedures did not provide for the reviewing officials to follow-up on their “subject to” comments to ensure that relevant documents included changes suggested or that the comments were in some way appropriately addressed. In addition, procedures allowed certain project changes to be initiated between the TTL and the borrower that could have legal and/or disbursement implications but the changes did receive appropriate legal and/or loan department review and authorizations.

**PROCUREMENT MANAGEMENT (MODULE 14)**

11. The procurement regime for a SIL is covered in this process, including nine controls to ensure disbursement of IDA funds to suppliers of goods and services in accordance with Bank procurement guidelines, to achieve equity and efficiency in procurement practice, and to take account of local capabilities in executing contractual awards and monitoring in accordance with Bank guidelines.

12. Based on information gathered, Management identified several potential control issues including these five: (1) there could be a potential conflict of interest when a Task Team Leader (TTL) is also a procurement accredited staff (PAS) and thus performs many of the procurement functions on his or her own without an appropriate segregation of duties; (2) when the TTL and procurement staff are nationals of the project country there is a potential for collusion and conflict of interest; (3) prior review may not be taking place as designed by IDA policy if implementing agencies structure contract packages in such a way as to avoid it (e.g., splitting large contracts into multiple smaller ones solely to avoid prior review requirements, or amending a contract after award to an amount that would have required prior review); (4) staff completing the form 384, which authorizes disbursement on contracts that required prior review may not be appropriately knowledgeable or accredited to do this (sometimes TTLs request other staff to do it, and some staff who had the authorization in the past and no longer have it may not have been removed from the list of authorized users), and appropriate staff do not review the forms; and (5) contracts are selected for post review subjectively by TTLs or procurement staff, which leaves the process open to potential manipulation.

13. IAD identified numerous documentation and/or potential control design deficiencies relating to procurement management. As one example, Management did not identify as a key control the mandatory step prescribed in BP11.00, *Procurement*, that the PS or PAS clear a General Procurement Notice issued by the borrower. IAD said this step is critical for ensuring timely and transparent notification of bidding opportunities. IAD recommended that Management designate the required clearance step as a key control.

**LOAN AMENDMENTS (MODULE 21)**

14. The amendment module describes the review of the Loan Department staff when TTLs submit proposed amendments to IDA credit agreements that affect the disbursements schedule. The objective of the review is to ensure that amendment documentation is consistent with IDA policies. Management identified two key controls in the amendment process.
15. The Loan Department has no control, such as a log of amendments requested, to ensure that all amendments requested are acted on. Thus, some amendments that are requested to the Loan Department may not be processed and approved, and the original disbursement schedule may not meet the needs of the borrower.

**QUALITY ASSURANCE GROUP (MODULE 27)**

16. Activities of the Quality Assurance Group could be viewed as an entity-wide monitoring control within the Bank. Its importance as a control rests largely on the impact QAG results can have both on the management of individual IDA projects and on operations across the Bank. QAG serves as a corollary check on the quality of the work performed by line employees at the entry (QEA) and supervision (QSA) phases of the lending cycle. The results of QAG work are communicated both during the assessment process and also at the end in individual and “synthesis” QAG reports.

17. Management identified a potential issue in that it found no control to ensure QAG recommendations are implemented. The descriptions in Management’s documentation do not sufficiently address how recommendations and other QAG results are to be used to effect improvements in IDA operations. Specifically, the synthesis phase of the narrative and mapping do not adequately explain how recommendations are to be acted on, tracked, and disposed of.

18. IAD identified a potential control deficiency relating to the selection of QAG panel members. Management had identified the risk of individuals serving on the panels who may not be independent and objective vis-à-vis the project they are assessing. Management had not identified a key control to address this risk. IAD recommended that Management identify and assess a key control to ensure QAG panelists are independent and objective relative to the project being assessed.

**B. Potential Control Issues Identified by IEG**

19. IEG concurs with the issues that were identified by Management as potential control deficiencies and has discussed these with Management. IEG agrees that they should be examined further and remedial action taken where needed. In addition, IEG highlights the following issues:

**PROCUREMENT COMPLAINTS (MODULE 15)**

20. The procurement complaints module is the process performed by procurement staff and the TTL to manage complaints received from within or outside IDA regarding procurement. The objective of the two controls in the module is to ensure that procurement complaints regarding procurement on SIL projects are addressed and resolved in accordance with IDA policy and that decisions are disseminated to appropriate internal and external parties.

21. Information gathered by Management revealed two potential internal control weaknesses. First, there is no control to ensure that all complaints are entered into the complaints database. Having all complaints in the database is the first step in ensuring that all complaints are handled appropriately, such as by being referred to the Department of Institutional Integrity and considered for potential non-compliance with IDA procure-
ment policies. Second, there is no control to ensure that reports from the complaints database are followed up on to ensure all complaints are handled appropriately, because there are no regular reports produced from the complaints database. Because of these weaknesses, the monitoring control that complaints themselves provide to IDA may not function as effectively as it should and problems in procurements may go unaddressed.

**Disbursements and Loan Amendments (Modules 19, 21)**

22. These two modules describe the reviews of the Loan Department staff when (1) borrowers submit applications for disbursements on their IDA credits or requests for special commitments or (2) TTLs submit proposed amendments to IDA credit agreements that affect the disbursements schedule. The objectives of the reviews are to ensure that (1) disbursements are made based upon complete, accurate documentation that is properly approved in accordance with the credit’s financial agreement and (2) amendment documentation is consistent with IDA policies. Management identified five key controls in the disbursement process and two in the amendment process.

23. IEG found two potential deficiencies in control design in these two modules:

- The TTL is allowed much flexibility in the Operational Policies that govern the staff’s IDA activities. The TTL may exceed a category amount with the understanding that he or she will input an amendment later. However, IEG could find no control in either module to ensure that the later amendment takes place. Thus a change may be made to an IDA credit disbursement schedule without the appropriate approvals and documentation change.
- IEG did not identify any standard mechanism for a TTL to let Loan Department staff know if he or she has concerns about a project and wants to put a hold on a disbursement. Thus, a disbursement may be made on a credit when the TTL has some reason to believe it should not be made.

**Refunds and Loan Account Closing (Modules 22, 25, 26)**

24. The refund and loan closing modules include activities of the Loan Department staff to process the closing of IDA credits after the final disbursement or to process refunds received by the Bank for funds previously disbursed. The objectives of these activities are to ensure that IDA issues the appropriate notifications to the borrower, that any credit balances are cancelled in the loan system and the credit is officially closed, and that any special accounts with a balance remaining are refunded to IDA. Management identified one key control in the refund process and two key controls in the standard loan closing process and two in the special closing process.

25. IEG learned that the Loan Department does not have any mechanism to ensure that balances remaining in special accounts that should be refunded to IDA are eventually received by the Bank. Loan Department staff notify the borrower with a balance in a special account of payment instructions, but there is no database monitored to ensure all refunds are received. Instead, individual Finance Officers can keep notes of the refunds expected in their portfolios. Management did not recognize this as a deficiency.
SAFEGUARDS (MODULE 28)

26. The safeguards process includes the activities performed by the IDA safeguards personnel for SILs from project identification to completion. The objective of the process is for safeguards personnel to (1) ensure that safeguard aspects of a project are assessed appropriately given the project circumstances and design; (2) for all safeguards policies that are assessed as being triggered within a project, ensure project design and implementation arrangements are adequate to comply with IDA policy and procedures; and (3) monitor safeguards aspects of projects to ensure the arrangements are carried out according to IDA policy and procedures and adjusted as necessary.

27. IEG recognized that there is a gap in the process documented by Management in that if certain safeguards documents in the preparation phase are inadequate (such as the environmental assessment, done by the country), there is no mechanism in the process for it to be sent back to be redone. This is necessary to mitigate the risk Management has identified that client commitment and capacity to implement safeguards may not be sufficient to ensure that the safeguards are implemented. This in turn could result in reputational risk to IDA.

C. IEG Identified Deficiencies in Management’s Documentation

COUNTRY ASSISTANCE STRATEGY (MODULE 4)

28. Management identified and assessed a business process module and three key controls related to the preparation of the country assistance strategy (CAS), the central tool with which Management and the Board review and guide IDA’s support for the country’s development programs. The objective of the process is to ensure alignment of the CAS with associated lending volume, most recently approved Performance Based Allocation, creditworthiness, potential legal issues, and overall CAS quality.

29. Management’s process maps and descriptive materials omitted from the CAS Preparation phase what IEG considers to be key steps and related controls relating to (1) portfolio/pipeline review, (2) Analytical and Advisory Activities including Country Economic Memorandum actions, and (3) the Poverty Reduction Strategy Papers.

30. IEG could also not find in the CAS BPM any reference which explicitly identified the inputs of the Sector Networks into developing the CAS.

CORE DEVELOPMENT POLICY LOAN PROCESS (MODULE 7)

31. This business process module involves all aspects of the cycle for executing a development policy loan (DPL) from identification to completion and includes seven key controls. The objective of the process is to ensure DPL operations are identified, executed, and completed according to IDA policy and procedures with inputs as required and necessary from internal and external parties.

32. Management’s statement of risks does not address the potential impact on IDA’s reputation and the country if the DPL objectives are not accomplished. The limitations of country capacity, structure, etc. that the DPL is intended to fill will continue to exist if DPL activities are not completed or for any reason, do not accomplish the objectives for
Annex C
Illustration of Potential Internal Control Design Weaknesses

which the DPL was approved. IEG considers this a major risk that is not identified in the Management assessment.

**LOAN MANAGEMENT (MODULES 17 & 18)**

33. The business process modules involving all activities performed by the Loan Department in the preparation of individual SILs and DPLs from project identification through loan effectiveness (for SILs) or supervision (for DPLs) include five key controls in the SIL process and six in the DPL process. The objective of the Loan Department activities is to ensure that each project includes in the financing agreement and the program document the appropriate overall financial structure of the loan including disbursement and repayment arrangements, as required by IDA’s internal policies.

34. However, Management did not consider the risks in the area of repayment and amortization in these modules, which IEG considers to be a major risk area in these activities. Even though repayment terms are standardized in IDA, there should be a place to mention repayment flows as an issue in the loan process flow charts, since there is always some risk involved.

**QAG PROCESSES (MODULES 5, 7, 10, 11, 12, 13, 14, 17, 18, 28)**

35. The QAG processes are those that monitor, in real time, assessments of projects which are still active, all key aspects of project quality, including quality at entry (QEA) and during supervision (QSA), in all aspects of the Banks’ tracking and supervision, including all fiduciary, contractual and safeguards aspects.

36. Management correctly identifies and maps these QAG processes in the QAG module (Module 27), but it does not make explicit the QAG interventions in the other individual line operations modules. This does not affect the assessment of the design effectiveness of the controls, but it is a deficiency in the completeness and accuracy of the process flow charts in the modules mentioned, and by omitting these references Management misses an opportunity to emphasize that the QAG assessments cover all aspects of project design and implementation, including the fiduciary, contractual and safeguards.
Annex D. A Typical BPM: Descriptive Material

Extracted from Management BPM Materials

Figure D.1: Sample Process Map for Module 8—Corporate Review of a SIL Operation
Description of Process

These are the activities associated with conducting a corporate review, with the operations committee (OC) or the regional operations committee (ROC), during the identification or preparation phases of an operation or country assistance strategy (CAS).

Objective of the Process

For DPL operations and CAS(s) the corporate review ensures that documents are reviewed by senior management at the corporate level during identification and / or preparation. For SIL projects, the corporate review ensures that higher risk and exceptional projects are reviewed by senior management, though this is not mandatory and can also happen after preparation, if appropriate.

Risks Impacting the Process

General Risk as Defined in the IRMF:
- Choices within countries (2)
- Quality assurance (5)
- Policy / guideline alignment (7)
- Results-oriented culture (12)
- Timely evaluation and disclosure (13)
- Reliable procurement / disbursements (18)
- Safeguards compliance (22)
- Management of projects with complex safeguards issues (23)
- Business process management (24)

Specific Control Risks:
- IDA projects are not focusing enough resources on priority activities within a country. High risk and high profile projects within a country may not receive the appropriate level of management review to ensure management buy-in for the resources required to adequately fund or scale up these projects / operations
- Not enough of a visible layer of review for quality of operations and their fiduciary arrangements. Innovative or new designs may not be reviewed for quality and fiduciary soundness
- Those operations with the highest potential risk and impact both within the institution and within the borrower country may not be given the highest possible visibility and review at the earliest possible stage, relative to IDA’s other ongoing projects and operations. It is of the most importance for these operations that risks and problems be identified early and have had the most senior management visibility
• For high-risk safeguard projects, there may be no opportunity for corporate buy-in, and projects may be rejected because of their high reputation risks
• The business process is made to be too cumbersome for the relative risks and requirements associated with a project / operation. Not every project / operation requires an OC-level review, and if all were tapped to receive one this would result in an unnecessary bottleneck in the process
• For All: Lack of coherence between proposed operations and the CAS and sectoral strategies
• For CAS products: The mitigation of all aspects of risk associated with choices within countries may not be carried out –IDA’s efforts in individual countries may not be sufficiently concentrated on priority activities where we can have the greatest impact – including through scaling up efforts. Resources may be spread across too many activities instead of adequately funding critical work. IDA’s mix of instruments within countries may not be appropriate.
• For CAS products: Activities programmed by IDA are not harmonized with other development partners
• For DPL and IL: No consistent application of IDA policy and adherence to IDA guidelines, nor the opportunity for senior management to help resolve policy issues
• For DPL and IL: Lack of linkage between proposed operations and targeted results and / or objectives
• For IL: No review of project design parameters, implementation plans, and integration of capacity building in an operation

Mitigating Key Controls Identified

In order to ensure the above risks are mitigated, the procedure for deciding on if / when and how to hold a corporate review was reviewed by subject matter experts who prepared the attached process flow diagram and identified the following key control steps in the process:
• Decision to hold ROC or OC review meeting
• ROC Review / OC Review
Key Control Detail Sheet

Corporate Review Corporate

Review — Control 1

Project Stage: Identification or Preparation

Key Control Step: ROC or OC?

A. Description:

For Projects/Operations:

Corporate Review level is decided by the Region (Task Team Leader (TTL), Country Director (CD), Regional Vice President (RVP)) in consultation with Operational Policy and Country Services (OPCS). The Operations Committee (OC) Secretary and the Managing Director (MD) are notified of the decision.

The decision is based on the criteria as outlined below, from the online guidelines.

From Guidelines:

- OC review is recommended for operations that:
  - pose high risk for the institution;
  - have a large size or represent a substantial departure from the CAS;
  - are subject to OC review under existing policy and guidance; and
  - facilitate institution-wide learning or adequate sampling to review for quality.

- (i) Risk: An OC review may be appropriate when there are high risks, including:
  - Safeguard Risks and Corporate / Reputational Risks. Operations with critical safeguard and / or reputational risks, as identified through the existing process (whereby Regions flag operations with high safeguard and reputational risks to ESSD/QACU and Senior Management).
  
  - Operational / Development Effectiveness Risks. Operations with high development effectiveness risks as identified through the existing process (whereby Regions flag operations with high operational or development effectiveness risks to Senior Management).
o **Financial risks.** Operations that entail financial risk or systemic considerations for IDA’s finances (credit loss provisions, capital needs, available net income), as identified by Credit Risk (SFRCR).

o **Anti-Money Laundering (AML) / Combating the Financing of Terrorism (CFT) Related Risks.** Operations that are exposed to high risks of money laundering and terrorism financing.

• (ii) **Size and Departure from the Country Assistance Strategy (CAS).** An OC review of an operation may be appropriate when the operation is large or when the operation diverges significantly from the program laid out in the CAS:

  o **Size of Operation.** Given the potential financial implications for the institution of large operations, the OC should generally review all IDA operations of at least $200 million.

  o **Departure from CAS Lending Program.** While most CAS implementation related issues should be handled at the ROC level, there may be substantial (operation-specific) departures from the CAS (in terms of financing size, instrument, risk or content) that would indicate an OC review. The OC could review certain proposed operations that involve a substantial increase or acceleration in total IDA lending relative to the CAS.

• (iii) **OC review required by existing policy and guidance.** These include special DPLs, and DPLs with a deferred drawdown options (DDO), crisis and post-conflict situations (and guarantees). In addition, the OC reviews operations involving exceptions from operational policy.

• (iv) **Institution-wide learning and sampling to test quality.** The OC reviews credits with new or potentially contentious approaches that are likely to create precedents for other operations in other Regions. In these cases, the OC can bring institution-wide innovation and learning to bear on initial operations. OC review may also be appropriate to ensure that a minimum number of operations in a Region are tested for quality.

  For CAS Products:

    • For CAS products, an OC is recommended for the same criteria stated above for operations pertaining to items (i), pose a high risk to the institution, and if the proposed CAS lending envelope is large.

B. **Control Details:**

  **Objective:** Validity /
  **Existence Type:** Manual,
Preventive Frequency:
Infrequent Transaction

C. Risks Mitigated / Policies Addressed:

IRMF Risk(s):
1. Choices within Countries (IRMF: 2)
2. Quality assurance (IRMF: 5)
3. Timely evaluation and disclosure (IRMF: 13)
4. Reliable procurement/disbursements (IRMF: 18)
5. Management of projects with complex safeguard issues (IRMF: 23)
6. Business process management (IRMF: 24)

Specific Risk(s):
1. IDA projects are not focusing enough resources on priority activities within a country.
2. High risk and high profile projects within a country may not receive the appropriate level of management review to ensure management buy-in for the resources required to adequately fund or scale up these projects/operations
3. Not enough of a visible layer of review for quality of operations and their fiduciary arrangements. Innovative or new designs may not be reviewed for quality and fiduciary soundness
4. Those operations with the highest potential risk and impact both within the institution and within the borrower country may not be given the highest possible visibility and review at the earliest possible stage, relative to IDA’s other ongoing projects and operations. It is of the most importance for these operations that risks and problems be identified early and have had the most senior management visibility
5. For high-risk safeguard projects, there may be no opportunity for corporate buy-in, and projects may be rejected because of their high reputation risks
6. The business process is made to be too cumbersome for the relative risks and requirements associated with a project/operation. Not every project/operation requires an OC-level review, and if all were tapped to receive one this would result in an unnecessary bottleneck in the process

Policies:
1. BP 2.11—Country Assistance Strategies
2. OP/BP 10.00—Investment Lending: Identification to Board Approval
3. OP/BP 8.60—Development Policy Lending

D. Owner: Regional Vice President (RVP)

E. Other Parties:

Country Director (CD), Task Team Leader (TTL), Operational Policy and Country Services (OPCS), Managing Director (MD), Credit Risk (SFRCR)

F. Verifiable Evidence:
• None required
o Minutes of any meetings that may have been held with the OC/ROC Secretary are available for any such meetings that may have taken place

G. COSO Framework:

This control step contributes directly to the fulfillment of the risk assessment and control activities elements of the COSO framework.
NOTES

1. AS2 defines a significant deficiency as a control deficiency, or a combination of control deficiencies, that adversely affects the company’s ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles such that there is more than remote likelihood that a misstatement of the company’s annual or interim financial statements that is more than inconsequential will not be prevented or detected.

2. AS2 defines a material weakness as a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected.

1. By contrast, in its evaluations, IEG’s main recommendations are entered into the Management Action record (MAR) which is updated annually and reported to CODE.
Annex E. Does the Cluster of BPMs Represent the Universe of IDA Controls?

1. Management’s claim that the 30 BPMs it identified “captured a representative picture of the control environment over IDA operations” was independently tested by IEG. The first step was to propose criteria (shown in Box E. 1 below) against which to measure this claim. What follows is the ensuing analysis and conclusions IEG arrived at.

<table>
<thead>
<tr>
<th>Box E.1. Criteria by which to Evaluate if 30 BPMs Adequately Represent the Universe of IDA Controls</th>
</tr>
</thead>
<tbody>
<tr>
<td>PREMISE: Business processes have the purpose of achieving business objectives; the key controls embodied in the processes have the purpose of addressing the risks which arise in the pursuit of those business objectives. How to judge the adequacy of the cluster?</td>
</tr>
<tr>
<td>• Does the cluster provide a measurable basis to assess COSO compliance with internal policies and procedures? Does it adequately link, in aggregate, to the IDA risk focal points under COSO?</td>
</tr>
<tr>
<td>• Do the business processes cover all key business objectives?</td>
</tr>
<tr>
<td>• Does the cluster comprise a high share of the IDA operating budget?</td>
</tr>
<tr>
<td>• Does it cover all major IDA product lines?</td>
</tr>
<tr>
<td>• Where modules have been excluded, does this create significant gaps in measuring compliance?</td>
</tr>
</tbody>
</table>

2. **Compliance with COSO and Internal Policies and Procedures**: In the approach which Management has taken, the cluster has not been built as an expression of entity level controls cascaded down to the operating level; rather, it has been built up from the operating level, as a means of providing the basis for testing the design and operation of mainly fiduciary controls that govern IDA lending. Management has linked each module and its controls to published policies and procedures, but some 50% of the total number of OP/Bps are not linked. However, in the cases where no linkage has been made, Management has given satisfactory explanations (most often because the OP/BPs refer to sub-processes of the main processes covered). To this extent, the cluster broadly conforms to policies and procedures. (para 2.17)

3. Management has also been clear that its focus on COSO during this Part IA stage of the review has been only partial. IEG has checked this against the links shown in the cluster, module by module. The table below shows that, taken individually, the modules have links overwhelmingly to the Control Activities of COSO, in a minor way also to the Risk Assessment, Monitoring and Information and Communications components, but with no link at all to the Control Environment. These results are not surprising, since Management has stated that the links to COSO in this Part I phase are only partial. It does show the need, however, for later stages of the review to build links to the other COSO components.
Annex E
Does the Cluster of BPMs Represent the Universe of IDA Controls?

Table E.1. Stated Links between BPMs and COSO Components

<table>
<thead>
<tr>
<th>Control environment</th>
<th>Risk assessment</th>
<th>Control activities</th>
<th>Monitoring</th>
<th>Information and communications</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>14</td>
<td>109</td>
<td>25</td>
<td>11</td>
</tr>
</tbody>
</table>

Source: Management Business Process Modules, Control Detail Sheet

4. **The BPMs and Business Objectives**: Management’s building block approach, creating a hierarchy from Articles, to policies and procedures, to identifying the key business processes, supported by “umbrella” policy statements, is logical, transparent and convincing. The 30 business processes which were identified between them embody four main business processes: IDA allocation; the CAS process cycle; the two main lending type (SIL and DPL); and the supporting fiduciary, contractual and safeguards processes. However, there is no direct capture of non-lending processes and objectives. While some of these could be subsumed in the CAS process, in fact the treatment of CAS does not make this explicit. The lending product and heavily fiduciary emphasis in the cluster is evident from Figure E.1 below. It shows how the majority of modules and key control points are located in the fiduciary and contractual support modules (21 out of 30 modules, and 82 out of 114 controls).

**Figure E.1. Distribution of BPMs and Controls Across Business Functions**

5. **The Share of IDA’s Operating Budget and Product Lines**: If the cluster of BPMs exactly matched the totality of IDA controls, the service costs of the business processes
Annex E

Does the Cluster of BPMs Represent the Universe of IDA Controls?

...captured in the 30 BPMs would account for the total IDA operating budget. In fact, it appears to account for significantly less than the total. From the data in Table E.2 below a broad measure can be made as follows: Lending and supervision (which are the major process in the cluster) account for 58% of the IDA country service spending over the past three years. To this can be added some unknowable portion of the 20% for “Other” expenditure—to cover the overhead costs of the IDA allocation and CAS products processes which are represented in the cluster. If the whole 20% were added, the cluster would represent 78% of the total IDA operating budget, which is a substantial portion. However, the budget share of AAA (22%) is almost the same share as that for lending preparation (24%), so on these grounds alone, it cannot be claimed that the cluster captures “a representative picture” of IDA controls. There are also other reasons (argued in the main text—see para 2.20) why IEG believes it unjustified to have excluded AAA and other non-lending products.

<table>
<thead>
<tr>
<th>Table E.2: Country Service Costs for IDA Countries 2003-2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>(US$M)</td>
</tr>
<tr>
<td>Service Costs for IDA (only) countries</td>
</tr>
<tr>
<td>Of which: Project Supervision</td>
</tr>
<tr>
<td>Lending</td>
</tr>
<tr>
<td>AAA</td>
</tr>
<tr>
<td>Other</td>
</tr>
</tbody>
</table>

Source: Business Warehouse

6. **Do SILs and DPLs Adequately Represent Lending Operations?** The BPMs that Management has used to represent IDA lending are “core” SILs and DPLs. These are but two of a wider range of lending products, so there is a question whether all lending products are well represented by these two prototypes. IEG reviewed the data for the IDA lending program in recent years. It showed that all adjustment lending is captured under DPLs. The investment lending is shown under SILs and other types of investment lending. The share was 64% for SILs, with other investment loans comprising 36%. Management argues that all lending products—whether IL or DPL—share almost identical processing and controls. In IEG’s opinion this needs to be tested, because while it may be broadly true, there are also variations in lending product type which may be processed somewhat differently through the controls system. This could be done during Part IB. The test samples for lending products could include a range of product types, not just core SILs and DPLs.

<table>
<thead>
<tr>
<th>Table E.3. Share of IDA Investment and Policy Loans</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment Lending (2005 $m)</td>
</tr>
<tr>
<td>Core SIL</td>
</tr>
<tr>
<td>Other Investment Lending</td>
</tr>
<tr>
<td>Adjustment Lending (DPL)</td>
</tr>
<tr>
<td>TOTAL LENDING</td>
</tr>
</tbody>
</table>

Source: Business Warehouse

7. **Excluded Processes:** Management gives the following reasons for excluding certain processes or product lines from the assessment during this phase of the study:2
Annex E

Does the Cluster of BPMs Represent the Universe of IDA Controls?

a. that they do not contribute directly to IDA lending operations; or
b. they are not relevant to this phase of the study, because they relate more to efficiency and effectiveness issues than to compliance.

<table>
<thead>
<tr>
<th>Box E.2. Business Process Modules Excluded from Compliance Assessment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Exclusion By Management’s Resolution That the Process Does Not Have Critical Bearing on Current Assessment Objective</strong></td>
</tr>
<tr>
<td>• Country Policy and Institutional Assessment (CPIA)</td>
</tr>
<tr>
<td>• Post-Conflict Performance Indicators (PCPI)</td>
</tr>
<tr>
<td>• Project Preparation Facility (PPF)</td>
</tr>
<tr>
<td>• Loan Management –PPF Refinancing</td>
</tr>
<tr>
<td>• Annual Report on Portfolio Performance (ARPP)</td>
</tr>
<tr>
<td>• Inspection Panel</td>
</tr>
<tr>
<td><strong>Exclusion Based on Determination of No Input to IDA Operations</strong></td>
</tr>
</tbody>
</table>

*Source: Management Methodology Note*

8. A summary of the excluded processes, grouped according to the major reasons for their exclusion is given in Box E.2 above. Many of these processes relate to or form part of the Bank’s overall monitoring instruments (ARPP; Inspection Panel; IEG processes; IAD processes), which are more relevant to the entity-level phase of the study, and concern more the efficiency and effectiveness objective than compliance. In this sense, Management’s justification for their exclusion has been clearly stated. Equally, the processes dealing with PPF and procurement DPL are of generally secondary significance, and their exclusion would not create any significant gaps in coverage. In evaluating these exclusions, IEG makes the following observations:

i. Had all processes been subjected to a top-down, entity-level review process to start with, it would have been easier to make a consistent and complete justification for excluding certain processes less relevant to business process controls; as it is QAG processes are also an entity-level control, but these have been included, rather than excluded in this round.

ii. Knowledge products (specifically AAA) should clearly have been included in this compliance part of the study.

iii. Regarding CPIA and PCPI, both are sub-processes of and provide inputs to IDA allocation, and should have been included.

iv. While the Inspection Panel is a key entity-level unit, its activities always concern issues relating to complaints regarding specific non-compliance with (Bank and) IDA policies, so there would seem to be a default case for its having been included rather than excluded from the compliance part of the study.
9. **Scorecard and Conclusions:** How do these various issues tally, and what conclusion do they suggest in answering the main questions: does the cluster well represent the universe of controls governing IDA operations? Based on this analysis, as a representation of IDA allocation and lending processes—which are the bulk of IDA operations—Management’s BPM cluster scores well on most counts and is a credible representation of the full universe of IDA lending. However, in excluding non-lending, Management has taken out of play an important set of product lines that not only rank almost equally with lending preparation costs in the operational budget, but rank alongside lending as an important part of the IDA assistance portfolio.

**NOTES**


2. As part of the working documents Management produced for its assessment, one was under the title “Methodology Note,” which outlined the reasons for these exclusions.
Annex F. Method and Results in Applying the Business Process Template

1. **Introduction to the Business Process Template:** IEG created the Business Process Template especially for this review. Its main purpose was to have an evaluation tool which would contain a standardized set of questions which could be applied uniformly to each evaluated business process module, to critique its content in a systematic way, and to provide ratings as to the quality exhibited.

2. **Rating System:** The Template embodies a four-part rating system which reflect quality ratings from Highly Satisfactory (1), Satisfactory (2), Satisfactory with Qualification (3) to Less than Satisfactory (4) measured as degrees of certainty that Management has achieved in its method and construct of the module, in addressing the following underlying question:

   “What degree of certainty does Management’s Assessment (and IAD’s Review) provide that the business processes are well designed and mapped and that their associated control processes are effectively designed?”

3. The Template was created for use in the IEG evaluation of all stages of the controls review, and it has sections dealing with compliance, operational and entity-level issues. For the present Part IA stage, only a portion of the Template was used, covering three sets of issues: ranking the BPMs according to their strategic importance and magnitude of risk; evaluating the method of building and mapping the BPMs; and evaluating Management’s assessment of the effectiveness of key control design. What follows is a brief summary of the form of questions that the Template contained in each case.

4. **Ranking for Strategic Importance and Risk:** The rankings were from 1 (Highly relevant, critical, heavy weight in management, high risk); 2 (Relevant, medium weight); 3 (Relevant but not critical, low weight, low risk). The questions in the Template on this topic were as follows:

   - Its centrality to the overall IDA-Client relationship?
   - Its weight as a control instrument within the Bank?
   - The Risks that would pertain were the process to be lax?
   - Its frequency of Occurrence?
   - Potential magnitude in Dollars?

5. **Evaluating the Mapping of the BPMs:** IEG viewed the task of evaluating Management’s mapping of the business process modules as having three elements, and the Template that was used as the principal evaluation tool contained questions which explored Management’s methods and criteria in mapping the modules, as follows:
Method and Results in Applying the Business Process Template

- The method and criteria used in identifying each module: Was the business objective clearly described? Were specific criteria given for choosing the module? Did the process derive from a specific published policy or procedure? Did Management consult the most knowledgeable people in the Bank in constructing the process map?
- The Accuracy and Completeness of the Process map: Was the process clearly titled, in a way which made it clear what business process was being tracked? Were the risks pertaining to the business process clearly stated? Were the units in the Bank which are key to the process clearly identified? Was the process adequately linked to parallel or related sub-processes?
- Identification of the Key Controls: Were the key controls clearly defined? Is it evident why the key control is relevant to the process? Were links made between the COSO objectives and individual controls?

6. *Evaluating Design Effectiveness of Key Controls:* Most of the business process modules had multiple key controls, ranging from two or three to nine or eleven in some cases. Since the purpose of the controls is to address risks that are confronted in the pursuit of the business objective that the process is aimed at, assessing the effectiveness of control design—and the corresponding structure of the Business Process Template—is basically an issue involving two aspects:

- Identifying Process Risks: Were the specific risks identified that the control was intended to mitigate? Were the risks categorized as to type and priority or likelihood? Were the risks derived from published policies and procedures? Were the most authoritative sources consulted?
- Matching Risks with Process Design: In matching risk and controls, were there adequate checks and balances, and were there any gaps? Were specialist staff involved? Does the control oblige involvement of specific units and management authority? Is the design of the control widely known? Does the control relate also to risks external to the process and the Bank? Did Management identify specific weaknesses or deficiencies in the design of the controls?

7. Summary of results: A full summary of the ratings data is provided in the Statistical Appendix at Annex G. The table below gives a summary of the results, showing the average ratings achieved for each segment, and a set of selected highlights showing higher and lower quality aspects.

**Table F.1. Management’s Method and Approach to BPM Mapping and Control Design**

<table>
<thead>
<tr>
<th>Selected Average IEG Ratings</th>
<th>Distribution By Rating</th>
</tr>
</thead>
<tbody>
<tr>
<td>ALL MODULES</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1</td>
</tr>
<tr>
<td>Distribution by Number</td>
<td>15</td>
</tr>
<tr>
<td>Distribution by Percentage (%)</td>
<td>2</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Higher Quality</th>
<th>Lower Quality</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mapping the Business Process:</td>
<td>Assessment of Control Design:</td>
</tr>
<tr>
<td>(Average Overall Rating 2.38)</td>
<td>Average Overall Rating (2.62)</td>
</tr>
<tr>
<td>Av. Rating</td>
<td>Av. Rating</td>
</tr>
<tr>
<td>Selected Higher Quality Ratings</td>
<td>Selected Lower Quality Ratings</td>
</tr>
<tr>
<td>Clarity in Method and Criteria</td>
<td>Categorizing Risk by Type and Likelihood</td>
</tr>
<tr>
<td>2.00</td>
<td>4.00</td>
</tr>
<tr>
<td>Ownership of Process</td>
<td>Matching Design with Risks</td>
</tr>
<tr>
<td>2.00</td>
<td>2.81</td>
</tr>
<tr>
<td>Relevance of BPM Controls</td>
<td>Risks to BPM clearly stated?</td>
</tr>
<tr>
<td>2.04</td>
<td>2.73</td>
</tr>
<tr>
<td>Design Process Widely Known</td>
<td></td>
</tr>
<tr>
<td>2.08</td>
<td></td>
</tr>
<tr>
<td>Coverage of External Risks</td>
<td></td>
</tr>
<tr>
<td>2.08</td>
<td></td>
</tr>
</tbody>
</table>
Annex F
Method and Results in Applying the Business Process Template

8. This Template analysis has shown that Management’s methods in both developing the process flow charts and associated materials, and assessing the effectiveness of control design, has been conducted to a high standard, even though in some cases improvements could be suggested. As the table shows, fully 66% of all ratings were Satisfactory or better, and some 93% were Satisfactory with Qualification or better. Most of the reasons which underlay the areas where qualifications were made referred to descriptions of processes, and categorization and prioritization of risk. Other imperfections in the precision of the documentation included: the CAS module omitting portfolio/pipeline review, AAA, and the inputs of the Sector Networks; the DPL module not addressing potential impact on IDA’s reputation and the country if the DPL objectives are not accomplished; Loan management modules not considering the area of repayment and amortization; and the processes subject to QAG assessments not being shown on the main flow charts.

9. Since this was the first time the Template was used as an evaluation tool its usefulness was also being tested in this process. In the view of the panelists involved in the ratings, the Template was responsive and gave credible, robust results.
Annex G. Statistical Appendix

TABLE G.1: IDA Operations Data Reflecting Magnitude of Selected Business Process Modules, 2003-2005

TABLE G.2: Links Identified by Management between Controls and the Five COSO Components, Shown by Business Function

TABLE G.3: Category and Type of Key Controls, by Audit Objectives, System and Frequency

TABLE G.4: Summary of Quality Ratings of Management’s Assessment of the Design Effectiveness of Key Controls

TABLE G.5: Summary of Quality Ratings for Management’s Mapping and Assessment of Design Effectiveness of Key Controls

TABLE G.6: Distribution of Quality Ratings Across Mapping and Control Design Dimensions

TABLE G.7: Distribution of BPMs by Strategic Relevance and Risk Ratings

TABLE G.8: Listing of Ops and BPs Linked by Management to the BPMs
### Table G.1: IDA Operations Data Reflecting Magnitude of Selected Business Process Modules

<table>
<thead>
<tr>
<th></th>
<th>Number of Cases</th>
<th>US$ (m)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2003</td>
<td>2004</td>
</tr>
<tr>
<td><strong>Total Number of Approved IDA Projects</strong>¹</td>
<td>141</td>
<td>158</td>
</tr>
<tr>
<td>Of which: Investment Loans</td>
<td>117</td>
<td>135</td>
</tr>
<tr>
<td>Adjustment / Dvlp. Policy Loans</td>
<td>24</td>
<td>23</td>
</tr>
<tr>
<td>Of which: SILs</td>
<td>66</td>
<td>88</td>
</tr>
<tr>
<td>DPLs</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Active Loans</strong></td>
<td>753</td>
<td>764</td>
</tr>
<tr>
<td><strong>Service Costs for IDA (only) countries</strong>²</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Of which: Project Supervision</td>
<td>62.7</td>
<td>67.0</td>
</tr>
<tr>
<td>Lending</td>
<td>49.7</td>
<td>65.5</td>
</tr>
<tr>
<td>ESW</td>
<td>38.2</td>
<td>48.5</td>
</tr>
<tr>
<td><strong>IDA Allocations</strong>³</td>
<td>19</td>
<td>19</td>
</tr>
<tr>
<td>Subject to Post-Conflict Allocation (projects)</td>
<td>19</td>
<td>19</td>
</tr>
<tr>
<td><strong>Operations Programming</strong>⁴</td>
<td>24 / 4</td>
<td>25 / 6</td>
</tr>
<tr>
<td>Number of CAS (full / TSS)</td>
<td>12</td>
<td>12</td>
</tr>
<tr>
<td>Cumulative Total (Full)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(Interim)</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>IDA Countries Without PRSP</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Procurement</strong>⁵</td>
<td>45</td>
<td>9</td>
</tr>
<tr>
<td>Misprocurement</td>
<td>448</td>
<td>475</td>
</tr>
<tr>
<td><strong>Loan Administration</strong>⁶</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Amendments/Extensions</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Refunds</td>
<td>n.a.</td>
<td>n.a.</td>
</tr>
<tr>
<td>Cancellations</td>
<td>132</td>
<td>120</td>
</tr>
<tr>
<td>Loan Closings</td>
<td>137</td>
<td>137</td>
</tr>
<tr>
<td><strong>Safeguards</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Projects subject to Corporate Review⁹</td>
<td>83</td>
<td>101</td>
</tr>
<tr>
<td><strong>QAG Processes</strong>¹⁰¹</td>
<td></td>
<td></td>
</tr>
<tr>
<td>QEA</td>
<td>n.a.</td>
<td>124</td>
</tr>
<tr>
<td>QSA</td>
<td>n.a.</td>
<td>69</td>
</tr>
</tbody>
</table>
### Table G.3: Category and Type of Key Controls by Audit Objective, System, and Frequency

#### Distribution Across All Business Process Modules

<table>
<thead>
<tr>
<th>AUDIT CATEGORY</th>
<th>Type</th>
<th>1</th>
<th>2</th>
<th>3</th>
<th>4</th>
<th>5</th>
<th>6</th>
<th>7</th>
</tr>
</thead>
<tbody>
<tr>
<td>%Incidence</td>
<td>30%</td>
<td>4%</td>
<td>30%</td>
<td>30%</td>
<td>3%</td>
<td>1%</td>
<td>1%</td>
<td></td>
</tr>
</tbody>
</table>

**Description**
1. **Validity/Existence**: All transactions are properly authorized.
2. **Segregation of Duties**: Non-compatible control functions such as cash payment and cash authorization performed independently.
3. **Ownership**: There are documented agreements in place to support the existence of transactions.
4. **Completeness/Accuracy**: All transactions are recorded properly.
5. **Cut-Off**: All transactions are in the correct reporting period.
6. **Valuation**: Loans, borrowings, and investment transactions are valued independently.
7. **Disclosure**: Adequate disclosure is made in the financial statements to comply with international financial reporting standards.

#### Type and System

<table>
<thead>
<tr>
<th>Type/System</th>
<th>Manual</th>
<th>Automatic/Systemic</th>
<th>Preventive</th>
<th>Detective</th>
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<tbody>
<tr>
<td>%Incidence</td>
<td>99%</td>
<td>1%</td>
<td>88%</td>
<td>12%</td>
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</table>

#### Frequency

<table>
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<tr>
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<th>Transactions</th>
<th>Yearly</th>
<th>Bi-Yearly</th>
<th>Monthly</th>
<th>Weekly</th>
<th>Daily</th>
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<tr>
<td>%Incidence</td>
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<td>4%</td>
<td>2%</td>
<td>0%</td>
<td>0%</td>
<td>3%</td>
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### Table G.4: Summary of Average Quality Ratings of Management’s Assessment of the Design Effectiveness of Key Controls

<table>
<thead>
<tr>
<th>Business Function</th>
<th>Mapping the Business Process</th>
<th>Assessing Control Design</th>
<th>Overall Average</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Overall</td>
<td>Origin, Method &amp; Criteria</td>
<td>Accuracy &amp; Completeness</td>
</tr>
<tr>
<td>Programming &amp; Allocation</td>
<td>2.50</td>
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<tr>
<td>Lending Products</td>
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<td>Procurement</td>
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<tr>
<td>Loan Administration</td>
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<td>Quality Assurance</td>
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<tr>
<td>Safeguards</td>
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<td>2.00</td>
<td>2.00</td>
</tr>
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</table>

Rating Scale: 1 = Highly Satisfactory; 2 = Satisfactory; 3 = Satisfactory with Qualification; 4 = Less than Satisfactory; N/A = Not Applicable.

### Table G.5: Summary of Quality Ratings For Management’s Mapping and Assessment of Design Effectiveness of Key Controls

<table>
<thead>
<tr>
<th>Quality Dimensions</th>
<th>Average Ratings</th>
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<td></td>
<td>Overall</td>
</tr>
<tr>
<td>Mapping the Business Process</td>
<td>2.38</td>
</tr>
<tr>
<td>Origin, Method, and Criteria</td>
<td>2.31</td>
</tr>
<tr>
<td>Accuracy and Completeness</td>
<td>2.50</td>
</tr>
<tr>
<td>Identification of Key Controls</td>
<td>2.19</td>
</tr>
<tr>
<td>Assessment of Control Design</td>
<td>2.62</td>
</tr>
<tr>
<td>Identifying Process Risks</td>
<td>2.81</td>
</tr>
<tr>
<td>Matching Risks with Process Design</td>
<td>2.31</td>
</tr>
<tr>
<td>Overall Average Rating</td>
<td>2.45</td>
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Rating Scale: 1 = Highly Satisfactory; 2 = Satisfactory; 3 = Satisfactory with Qualification; 4 = Less than Satisfactory.
<table>
<thead>
<tr>
<th>Mapping the Business Process</th>
<th>Distribution by Rating</th>
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</thead>
<tbody>
<tr>
<td><strong>Origin, Method, and Criteria</strong></td>
<td></td>
</tr>
<tr>
<td>Clarity of IDA Operational Objective?</td>
<td>2.58 4% 54% 23% 19% 26</td>
</tr>
<tr>
<td>Clarity of method and criteria?</td>
<td>2.00 0% 100% 0% 0% 26</td>
</tr>
<tr>
<td>BPM established under Bank BP or OP?</td>
<td>2.19 12% 62% 23% 4% 26</td>
</tr>
<tr>
<td>Management sought input in process area?</td>
<td>2.12 0% 88% 12% 0% 26</td>
</tr>
<tr>
<td><strong>Mapping the Business Process</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Accuracy and Completeness</strong></td>
<td></td>
</tr>
<tr>
<td>Process has been clearly titled?</td>
<td>2.31 4% 62% 35% 0% 26</td>
</tr>
<tr>
<td>Risks to BPM clearly stated?</td>
<td>2.73 4% 38% 38% 19% 26</td>
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<tr>
<td>Ownership of Process clearly designated?</td>
<td>2.00 4% 92% 4% 0% 26</td>
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<tr>
<td>Management sought input in process?</td>
<td>2.42 12% 50% 23% 15% 26</td>
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<tr>
<td><strong>Identification of Key Controls</strong></td>
<td></td>
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<tr>
<td>Clear definition of key controls?</td>
<td>2.38 0% 69% 23% 8% 26</td>
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<tr>
<td>Relevance of mapped BPM controls?</td>
<td>2.04 0% 96% 4% 0% 26</td>
</tr>
<tr>
<td>Differentiation between controls for financial reporting and other COSO objectives?</td>
<td>2.62 0% 92% 8% 0% 25</td>
</tr>
<tr>
<td><strong>Assessment of Control Design</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Identifying Process Risks</strong></td>
<td></td>
</tr>
<tr>
<td>Clear identification of risks that the control points are designed to alleviate?</td>
<td>2.46 8% 38% 54% 0% 26</td>
</tr>
<tr>
<td>Risks have been categorized (fin/op/rep) and analyzed?</td>
<td>4.00 0% 0% 0% 100% 26</td>
</tr>
<tr>
<td>CTR documentation relates to the policies and procedures of controls and risks?</td>
<td>2.31 0% 73% 23% 4% 26</td>
</tr>
<tr>
<td>CTR consulted with the most authoritative sources?</td>
<td>2.15 0% 85% 15% 0% 26</td>
</tr>
<tr>
<td><strong>Matching Risks with Process Design</strong></td>
<td></td>
</tr>
<tr>
<td>Management adequately matched the design with the risks?</td>
<td>2.31 0% 69% 31% 0% 26</td>
</tr>
<tr>
<td>i. Built in checks and balances</td>
<td>2.81 0% 35% 50% 15% 26</td>
</tr>
<tr>
<td>ii. Involved specialized staff</td>
<td>2.15 0% 85% 15% 0% 26</td>
</tr>
<tr>
<td>iii. Involved appropriate operational units and mgmt levels?</td>
<td>2.08 0% 92% 8% 0% 26</td>
</tr>
<tr>
<td>Design process is known by relevant staff?</td>
<td>2.08 8% 81% 8% 4% 26</td>
</tr>
<tr>
<td>Mgmt. has shown that controls extend to cover external risks?</td>
<td>2.44 0% 56% 44% 0% 25</td>
</tr>
</tbody>
</table>

Rating Scale: 1 = Highly Satisfactory; 2 = Satisfactory; 3 = Satisfactory with Qualification; 4 = Less than Satisfactory.
Note: Modules 1-3 and Modules 25 & 26 were assessed together; therefore max. number of observations is 26 rather than 29.

<table>
<thead>
<tr>
<th>All Modules</th>
<th>Distribution by Rating</th>
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<td>1</td>
<td>2</td>
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<tr>
<td>Distribution by No.</td>
<td>15</td>
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<tr>
<td>Distribution by Percentage</td>
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77
**Table G.7: Distribution of BPMs According to Strategic Relevance and Risk Ranking**

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<th>Risk Categories*</th>
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<th>3</th>
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<tr>
<td><strong>Number Distribution</strong></td>
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<td>7</td>
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<tr>
<td>IDA, FRM, &amp; Post Conflict Allocation</td>
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<td></td>
<td></td>
</tr>
<tr>
<td>CAS Products</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>SIL—Project Cycle</td>
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<td></td>
<td></td>
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<tr>
<td>DPL—Project Cycle</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Contractual Remedies</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>SIL—Legal Regime</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>DPL—Legal Regime</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>FM—SIL</td>
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<td></td>
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<tr>
<td>FM—DPL</td>
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<td></td>
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</tr>
<tr>
<td>SIL—Procurement</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Procurement Complaints</td>
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<tr>
<td>Safeguards—SIL</td>
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</tr>
<tr>
<td>Corporate Review (ROC/OC)</td>
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<td>Procurement Non-Compliance</td>
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<td>Loan Management—SIL</td>
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<tr>
<td>Loan Management—DPL</td>
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<tr>
<td>LOA—Application Review</td>
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<tr>
<td>LOA—Suspensions</td>
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<td>QAG—QAE and QSA</td>
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<td>Safeguards—QACU</td>
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<td>Project Changes</td>
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<tr>
<td>LOA—Special Commitment</td>
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<td>LOA—Amendment or Extension</td>
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<td>LOA—Refund Process</td>
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<td></td>
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<td>LOA—Cancellation Process</td>
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<tr>
<td>LOA—Closings (Standard &amp; Special)</td>
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</table>

**Average Quality Rating for Business Process Mapping**

| 2.25 | 2.50 | 2.50 |

* STRATEGIC RELEVANCE AND RISK RANKING

1 = **Highly Relevant, critical**: heavy weight in management; major risks; high frequency of occurrence

2 = **Relevant, but not critical**: average weight in management; Some Risk; average frequency

3 = **Relevant but not critical**: moderate weight; moderate or minor risk; infrequent;
<table>
<thead>
<tr>
<th>OP / BP #</th>
<th>Operational &amp; Bank Policies</th>
<th>Covered OP/BP</th>
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<td>OP Poverty Reduction</td>
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<td>2.11</td>
<td>BP Country Assistance Strategies</td>
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<tr>
<td>2.20</td>
<td>OMS Project Appraisal</td>
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<tr>
<td>2.30</td>
<td>OP/BP Development Cooperation and Conflict</td>
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<tr>
<td>3.10</td>
<td>OP/BP Financial Terms and Conditions of IBRD Loans, IBRD Hedging Products, and IDA Credits</td>
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<tr>
<td>4.00</td>
<td>OP/BP Use of Borrower Systems to Address Environ and Social Safeguard Issues</td>
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<tr>
<td>4.01</td>
<td>OP/BP Environmental Assessment</td>
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<tr>
<td>4.02</td>
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<td>4.04</td>
<td>OP/BP Natural Habitats</td>
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<td>4.09</td>
<td>OP Pest Management</td>
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<tr>
<td>4.10</td>
<td>OP/BP Indigenous Peoples</td>
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<tr>
<td>4.11</td>
<td>OP/BP Physical Cultural Resources</td>
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<td>OP/BP Involuntary Resettlement</td>
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<td>OP/BP Gender and Development</td>
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<td>4.36</td>
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<td>6.60*</td>
<td>OP/BP Financing of Interest during Construction</td>
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<td>OP Lending Operations: Choice of Borrower and Contractual Agreement</td>
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<td>OP/BP Emergency Recovery Assistance</td>
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<td>OP/BP Development Policy Lending</td>
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<td>10.00</td>
<td>OP/BP Investment Lending: Identification to Board Presentation</td>
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### Listing of OPs and BPs Linked by Management to the BPMs

<table>
<thead>
<tr>
<th>Code</th>
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<th>Description</th>
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<td>10.02</td>
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<td>Economic Evaluation of Investment Ops</td>
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<td>11.00</td>
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<td>12.20</td>
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<td>OP/BP</td>
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<td>Signing of Legal Documents and Effectiveness of Loans and Credits</td>
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<td>OP/BP</td>
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<td>Dissemination and Utilization of the OED Findings</td>
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<td>Cofinancing</td>
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<td>OP/BP</td>
<td>Guarantees</td>
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<td>Involving Nongovernmental Organizations in Bank-Supported Activities</td>
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<td>17.30</td>
<td>BP</td>
<td>Communications with Individual EDs</td>
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<td>17.55</td>
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<td>Inspection Panel</td>
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**Total References in the 2006 World Bank Operational Manual**

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<th>Category</th>
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<td>Operational Policies and Bank Procedures (OPs &amp; BPs)</td>
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<td>Operational Directives (ODs)</td>
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**Note:** *OPs/BPs and OMS are applied only to project in countries without approved country financing parameters.*

NOTES

1. Source: Business Warehouse (BW)
2. Source: BW – Direct Costs by Service Report 4.1
3. Source: FRM and BW. Number of Post-Conflict countries by year: FY03 = 11, FY04 = 9, FY05=8.
4. Source: BW / OPCS
5. Source: OPCS
6. Source: Refunds — LOA; Cancellations — BW Loan Information Table; Closings — BW IEG Ratings table 4a1.
7. Of which 80% are SA/UN advance balance refund; other reasons 18%; World Bank error <2%
8. Data being collected, not available in published form
9. QACU and Regional EA Reviews of Safeguards A and B. Source: BW — Lending table 4a5
10. Source: QAG
Attachment 1:
Management Report on its Review of IDA Controls—Part IA
International Development Association

Management Report on Its Review of Internal Controls

Part IA

Prepared by:
Operations Policy and Country Services Vice Presidency
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October 6, 2006

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LIST OF ACRONYMS

BP
BPs      Bank Procedures – a component of the Bank’s Operational Manual
CAS  Country Assistance Strategy
CFP  Concessional Finance and Global Partnerships Vice Presidency
COSO  Committee of Sponsoring Organizations – issued an internal control framework
CTR  Controller and Vice President
DPL  Development Policy Lending operations
IL  Investment Lending operations
IAD  Internal Auditing Department
IEG  Independent Evaluation Group
LEG  Legal Vice Presidency
OPCS   Operations Policy and Country Services Vice Presidency
OPs  Operational Policies – a component of the Bank’s Operational Manual
PBA  Performance Based Allocation
PMT  Project Management Team
SIL  Specific Investment Loan
SOX  The Sarbanes-Oxley Act of 2002
PCAOB  Public Company Accounting Oversight Board
INTRODUCTION AND BACKGROUND

1. As reflected in the IDA 14 Replenishment Report Management committed to carry out, during the period of IDA 14, an independent comprehensive assessment of its control framework including internal controls over IDA operations and compliance with its charter and policies, and making such assessment available to the public after its disclosure has been approved by IDA’s Executive Directors. This assessment was originally agreed to be completed by December 2005. However, due to the massive volume of work required, and unprecedented nature of this type of assessment, the original delivery date turned out to be unrealistic.

2. In furtherance of this commitment, Management met with the Board’s Audit Committee and Committee on Development Effectiveness (November 28, 2005) and again with the Audit Committee (July 17, 2006). As explained by Management in these meetings and in the underlying documentation, the comprehensive scope and lack of precedents for this type of assessment have made it necessary to carry out the overall assessment in two parts: Part I, compliance assessment (which in turn has been subdivided, as discussed with the Audit Committee in November, into Part IA, relating to design effectiveness of key controls, and Part IB, relating to operating effectiveness, or compliance with, such controls); and Part II, efficiency and effectiveness assessment. During the compliance assessment (Part I), Management is focusing on whether the existing internal control framework over IDA’s operations provides reasonable assurance that such operations are carried out in a manner that complies with the provisions of IDA’s charter (that is, IDA’s Articles of Agreement – referred to as the “Articles”) and internal policies governing IDA’s operations, with special focus on the mechanisms in place to ensure that funds are disbursed for the intended purposes.

3. This Report on Part IA sets out Management’s assessment relating to the design effectiveness of key controls currently in place to ensure compliance with the relevant Articles’ provisions and policies governing IDA’s operations. It will be followed by a Report containing Management’s assessment of the operating effectiveness of, or compliance with, these controls.

METHODOLOGY

4. Management is conducting the assessment of IDA’s internal controls in the context of the COSO internal control framework. IDA adopted the COSO framework as its controls methodology in 1995. This framework is widely used by leading financial institutions in the United States and is also seen as a model in many other parts of the world. The COSO framework (described in more detail in Management’s Work Plans and in Annex 1) is an all encompassing process which covers all aspects of internal control of an organization’s operation. It considers not only the evaluation of formal controls, but also informal controls, such as ethics, trust, communication, or-

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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, 2005), para. 39, under the Disclosure bullet.

ganization behavior and leadership, and incorporates “top-down” as well as “bottom-up” analysis. Like all modern control frameworks, the COSO framework requires that: (i) management assess the organization’s internal controls; and (ii) an independent third party verify such assessment.

5. Management determined that Part I of this exercise would be more valuable if carried out following a “bottom up” approach. This exercise involves an unprecedented, comprehensive identification and cataloguing of the key business processes supporting the key internal controls and mechanisms throughout the operational complex of IDA. Management anticipates that this comprehensive mapping will provide a solid foundation for the examination of institutional efficiency and effectiveness to be undertaken in Part II of this exercise. In carrying out the commitment made in the IDA 14 Replenishment Report, Management determined that it should not go into a lengthy, detailed historical analysis of IDA’s policies, but it should provide a timely, clear snapshot of IDA’s operational processes as practiced today.

6. As mentioned in paragraph 4, Management is carrying out its commitment in the context of the COSO framework. This framework rests on three pillars: (i) compliance with applicable laws and regulations; (ii) effectiveness and efficiency; and (iii) internal controls over financial reporting. Management already completed a comprehensive review of internal control over financial reporting in line with industry best practice and has received an attestation from its external auditors on such controls since 1997. Management has initially focused additional efforts on the “compliance pillar”.

**COMPLIANCE WITH APPLICABLE LAWS AND REGULATIONS**

7. As an international organization established by an international treaty with privileges and immunities, IDA differs from the corporate entities for which the COSO framework was developed. As such, this assessment of IDA’s “compliance with laws and regulations” cannot focus on compliance with specific laws and regulations in various jurisdictions. Rather it must focus on whether the existing internal control framework over IDA’s operations provides reasonable assurance that such operations are carried out in a manner that complies with the provisions of the IDA’s Articles and internal policies governing IDA’s operations, including the mechanisms in place to ensure funds are disbursed for the intended purposes.

8. Any compliance assessment of internal controls over IDA’s operations must therefore go through a four-step process of:

   a) identifying key provisions of the IDA Articles that govern IDA’s operations;
   b) identifying main policies that were adopted by IDA to ensure that IDA’s operations are carried out consistently with these provisions;
   c) identifying the manner in which these policies are intended to be carried out by cataloguing the business processes and key controls put in place to ensure compliance with the identified policies and assessing the “design effectiveness” of these processes and key controls; and
   d) assessing compliance with the business process and key controls by testing a sample of transactions.
9. Management’s assessment relating to the first three steps is set out below. It is to be followed by a separate report relating to the compliance testing portion of the assessment.

**Key Articles’ Provisions Governing IDA’s Operations**

10. Article I states that “the Association shall be guided in all its decisions by the provisions of [Article I]”. These provisions state:

“The purposes of the Association are to promote economic development, increase productivity and thus raise standards of living in the less-developed areas of the world included within the Association’s membership, in particular by providing finance to meet their important developmental requirements on terms which are more flexible and bear less heavily on the balance of payments than those of conventional loans, thereby furthering the developmental objectives of the International Bank of Reconstruction and Development (hereinafter called “the Bank”) and supplementing its activities.”

With these provisions in mind, Management has, for purposes of this exercise, identified the following key provisions set out in Article V, Operations, Section 1. Use of Resources and Conditions of Financing, that serve as the foundation for carrying out IDA’s operations.

**Purposes**

a) **Concessional Resources to Less Developed Areas**

“V.1(a) The Association shall provide financing to further development in the less-developed areas of the world included within the Association’s membership.”

b) **Financing High Development Priorities**

“V.1(b) Financing provided by the Association shall be for purposes which in the opinion of the Association are of high developmental priority in the light of the needs of the area or areas concerned…”

**Project Related**

c) **Specific Projects and Special Circumstances Lending**

“V.1(b) Financing provided by the Association .... except in special circumstances, shall be for specific projects.”

d) **Use of Funds for Purposes Intended**

“V.1(g) The Association shall make arrangements to ensure that the proceeds of any financing are used only for the purposes for which the financing was provided…”

e) **Due Regard for Economy and Efficiency**

“V.1(g) The Association shall make arrangements to ensure that the proceeds of any financing are used .... with due attention to considerations of economy, efficiency, and competitive international trade”
f) **Linking Disbursements to Expenditures as Incurred**

“V.1(h) Funds to be provided under any financing operation shall be made available to the recipient only to meet expenses in connection with the project as they are actually incurred.”

General

g) **Lender of Last Resort**

“V.1(c) The Association shall not provide financing if in its opinion such financing is available from private sources on terms which are reasonable for the recipient or could be provided by a loan of the type made by the Bank.”

h) **Non-political Interference**

“V.1(g) The Association shall make arrangement to ensure that the proceeds of any financing are used .... without regard to political or other non-economic influences or considerations.”

For the purpose of this exercise, Article V, *Operations, Section 2. Form and Terms of Financing, and Section 3. Modifications of Terms of Financing* also set out important provisions, including: general financing provisions; economic prospects; acceptable borrower; guarantees; use of currencies; and modifications.

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3 See also Article V, Section 6 which states: “The Association and its officers shall not interfere in the political affairs of any member; nor shall they be influenced in their decisions by the political character of the member or members concerned. Only economic considerations shall be relevant to their decisions, and these considerations shall be weighted impartially in order to achieve the purposes stated in this Agreement.”

4 Article V, Section 2 (a) Financing by the Association shall take the form of loans, the Association may, however, provide other financing, either (i) out of funds subscribed pursuant to Article III, Section 1, and funds derived therefrom as principal, interest or other charges, if the authorization for such subscription expressly provides for such financing; or (ii) in special circumstances, out of supplementary resources furnished to the Association, and funds derived therefrom as principal, interest or other charges, if the arrangements under which such resources are furnished expressly authorize such financing.

5 Article V, Section 2 (b) Subject to the foregoing paragraph, the Association may provide financing in such forms and on such terms as it may deem appropriate, having regard to the economic position and prospects of the area or areas concerned and to the nature and requirements of the project.

6 Article V, Section 2 (c) Association may provide financing to a member, the government of a territory included within the Association’s membership, a political subdivision of any of the foregoing, a public, or private entity in the territories of a member or members, or to a public international or regional organization.

7 Article V, Section 2 (d) In the case of a loan to an entity other than a member, the Association may, in its discretion, require a suitable governmental or other guarantee or guarantees.

8 Article V, Section 2 (e) The Association, in special cases, may make foreign exchange available for local expenditures.

9 Article V, Section 3 The Association may, when and to the extent it deems appropriate in the light of all relevant circumstances, including the financial and economic situation and prospects of the member concerned, and on such conditions as it may determine, agree to a relaxation or other modification of the terms on which any of its financing shall have been provided.
11. In identifying the above as the key Articles’ principles governing IDA’s operations, Management has focused on the gravity and impact that these provisions, as interpreted by the Executive Directors, have had on the manner in which IDA’s operations have been conducted since its inception. In practice, other provisions of Article V have had less of an impact on day-to-day operations of IDA and therefore have not been focused on as part of this exercise.\(^\text{10}\)

12. In order to reflect and comply with the above Articles’ principles, since its inception, IDA operations have been structured and implemented in a manner to ensure that scarce IDA resources were made available to support priority development activities in the poorest eligible member countries. The structure also meant that decisions regarding IDA’s financing would be made without regard to political or other non-economic influences or considerations and that IDA financing would be available for specific projects as well as other “special circumstances” operations. Across all modes of financing, IDA is required to ensure that its funds are used for the purposes intended to meet expenses as they are actually incurred, with due regard for economy and efficiency.

**Main Policies Governing IDA’s Operations**

13. The policy framework governing IDA operations is the primary tool for setting the parameters for conducting IDA’s operations consistent with the above Articles’ principles.

14. The Executive Directors are responsible for interpreting IDA’s Articles and approving IDA’s operational policy framework, based on Management’s proposals. Over the years, to ensure that IDA’s operations are carried out in compliance with the Articles’ principles, while reflecting the evolving model underlying development assistance, the Executive Directors have approved various policies, which comprise the policy framework for IDA’s operations. These policies have been “translated” by Management into Operational Policies (OPs)\(^\text{11}\) and Bank Procedures (BPs)\(^\text{12}\) included in the Bank’s Operational Manual. The OPs and BPs put in place the main parameters and procedures to be followed by staff in conducting IDA’s operations in a manner that has been determined by Management and the Board to comply with the IDA Articles.

15. Currently, the Operational Manual contains over 100 OPs and BPs. (The table of contents of the Operational Manual is set out in *Annex 2*. In order to determine which OP/BPs are most pertinent to the key Articles’ principles identified above, Management focused on the three primary instruments through which IDA currently conducts its operations:

a) **Country Assistance Strategy** (CAS), which sets out a country’s development priorities and the strategy for IDA support of such priorities over an agreed period of time.

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\(\text{10}\) One exception is Section 1 (d) of Article V, which requires that every IDA financing presented to the Executive Directors for approval be accompanied by a recommendation of a “competent committee”. This requirement is included in the business processes or flows for processing investment lending operations and development policy operations. However, over the years it has lost much of its control efficacy and has limited value in terms of risk mitigation.

\(\text{11}\) OPs are short, focused statements that follow from the Articles of Agreement, the general conditions, and policies approved by the Board. OPs establish the parameters for the conduct of operations; they also describe the circumstances under which exceptions to policy are admissible and spell out who authorizes exceptions.

\(\text{12}\) BPs explain how staff carry out the policies set out in the OPs. They spell out the procedures and documentation required to ensure Bankwide consistency and quality.
b) Investment Lending Operations (IL), as represented by Specific Investment Loans (SILs), which are the primary tool for providing IDA financing for specific projects within the meaning of IDA’s Articles and to which IDA applies the requisite due diligence throughout the project cycle (from identification to completion) to ensure compliance, inter alia, with the key Articles’ principles.

c) Development Policy Lending Operations (DPL), which are the primary tool for providing IDA financing for “special circumstances” operations within the meaning of IDA’s Articles and to which IDA applies the requisite due diligence throughout the project cycle (from identification to completion) to ensure compliance, inter alia, with the key Articles’ principles.

16. Management assessment focused on these three primary instruments, and the policies and procedures that apply to them, as a result of its determination that the three represented a significant portion of IDA operations in terms of the overall numbers and volume of IDA yearly new commitments. In FY05 and FY06 combined, IDA approved a total of 327 operations totaling $17.4 billion. Of these, 263 operations or $12.6 billion were IL operations, 62 and $4.6 billion were DPL operations and 2 were Guarantee operations. Further, of the 263 IL operations, 163 (or 62%) were SIL operations, accounting for $8.0 billion of the $17.4 billion. Overall, DPL and SIL operations accounted for 72% or $12.6 billion of the $17.4 billion. (See Annex 3 for more details). Similar proportions are reflected when looking at the “active” IDA portfolio under implementation.

17. To reflect the above, in identifying key policies governing IDA’s operations, Management focused on “flagship” OP/BPs that are most critical to the three primary instruments and compliance with the key Articles’ principles. These “flagship” OP/BPs include four umbrella statements governing financial terms of and eligibility for IDA financing as well as policies and procedures governing the three primary instruments for carrying out IDA operations, namely:

a) Umbrella statement governing financial terms of and eligibility for IDA financing

OP/BP 3.10, Financial Terms and Conditions of IBRD Loan, IBRD Hedging Products, and IDA Credits, which sets out the financial terms and conditions of IDA Credits.

b) Umbrella statement governing CASs

OP/BP 2.11, Country Assistance Strategies, which sets out the key processes that apply to the CAS product from identification through completion.

c) Umbrella statements governing ILs

OP/BP 10.00, Investment Lending: Identification to Board Presentation, which sets out the parameters for processing investment projects from identification through Board presentation.

OP/BP 13.05, Project Supervision, which sets out the parameters for supervision of investment projects under implementation.

d) Umbrella statement governing DPLs

OP/BP 8.60, Development Policy Lending, which sets out the parameters for processing of DPLs from identification through completion.
18. In addition to these four umbrella statements, the Operational Manual also includes specific policies governing fiduciary, contractual and safeguards requirements and associated procedures to be followed when IDA finances either IL or DPL operations. These specific policies are:

a) Policies and procedures governing financial management aspects (OP/BP 10.02, Financial Management).

b) Policies and procedures governing disbursement aspects (OP/BP 12.00, Disbursement, 12.20, Special Accounts, OP/BP 12.30, Statements of Expenditure, OP/BP 6.00, Bank Financing (Expenditure Eligibility)).

c) Policies and procedures governing procurement aspects (OP/BP 11.00, Procurement).


19. The table of contents of the Operational Manual set out in Annex 2 highlights the OP/BPs that were specifically looked at as part of this assessment. The OPs and BPs that were not specifically mapped by Management as part of this exercise can be classified into the following broad categories:

- **OP/BPs governing various trust funds and grants that do not utilize IDA resources** (e.g., OP/BP 8.45; OD 9.01; OP/BP 10.21; OP/BP 14.20; OP/BP 14.40);

- Ops/BPs that apply to specific other types of investment lending products (Emergency Recovery Credits (OP/BP 8.50), Financial Intermediary Credits (OP/BP 8.30) and Technical Assistance Credits (OP/BP 8.40)), given that the SIL was deemed to be a representative proxy for all investment lending in terms of volume and main processes;

- OP/BP 14.25 governing guarantees, given the very small volume of guarantees in the IDA portfolio;

- Thematic and content-specific OP/BPs that feed into the processes that were mapped as part of this exercise, but do not have separate processes and controls to be captured in this phase of this exercise (e.g., OP/BP 1.00, 4.07, OP/BP 4.20, OMS 2.20, OP/BP 10.04; 6.00 (which supersedes OP/BP 6.30, 6.60) OP/BP 11.03); and

- OP/BPs relating to specialized contractual and other issues which, when they arise, are addressed as part of the processes and controls that have been mapped (e.g., OP/BP 2.30, OP 7.20, OP/BP 7.30, 7.40, 7.50, 7.60).
20. In assessing how staff comply with the above policies and procedures, Management identified the relevant business processes in place which staff are expected to use as guidance and best practice when working on IDA operations. For the purposes of this exercise, Management, in consultation and agreement with the Internal Auditing Department (IAD) and the Independent Evaluation Group (IEG), focused on the period from July 1, 2005, through March 31, 2006, (the period under review). These business process reviews are the tool that Management has used to document its processes, risks and controls related to the preparation of the financial statements, and this tool is also being used in documenting the controls over IDA’s compliance with its Articles and applicable internal policies and procedures. These business process reviews were performed through a combination of process flows and narratives, and risk assessments. The total number of 27 process overviews (process #30 – Debt Sustainability Analysis has not yet been completed and is not included), and detailed descriptions for 108 key controls when set out in narrative form give rise to a document of about 350 pages. (See Annex 5 for examples of process flow charts.) These process flows and narratives were prepared by the staff of the Project Management Team (PMT), with input from individual subject matter experts of the identified processes in OPCS and other units as required. Management believes that all these identified activities and controls have been accurately reflected.

21. For the purposes of this Report, Management’s assessment of the design effectiveness of controls associated with the business processes identified was focused on addressing whether the system of such internal controls is both comprehensive as well as suitably designed to prevent or detect on a timely basis, material issues of non-compliance or significant control deficiencies. Key controls have been evaluated for their design effectiveness by reviewing the process maps and associated key controls documentation to ensure that internal controls have been suitably designed. The key controls as defined by the PMT and/or the specific subject matter experts within Controller’s and Operations Policy and Country Services (OPCS) have been corroborated by (a) examination of documentary evidence, (b) observation, and/or (c) re-performance. This process has led to the production of detailed flow charts relating to 27 of the 28 main business processes (process #30 – Debt Sustainability Analysis has not yet been completed and is not included) and key associated controls. (The list of the 28 main business processes is set out in Annex 4.)

22. Management’s decision relating to identification and grouping of these 28 main business processes and key controls associated with them mirrors the manner in which Management identified and grouped the policies that apply to the three primary IDA instruments as set out above. Specifically, in support of the four umbrella statements, which govern financial terms of and eligibility for IDA financing as well as the three primary instruments for carrying out IDA operations, Management has identified and mapped, or catalogued, the following four umbrella processes:

   a) Processes that apply to IDA allocation13 (Nos.1 and 30, See Annex 4).

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13 Please note that IDA's allocations are carried out in accordance with the IDA Performance Based Allocation System (PBA) -- a set of rules by which IDA allocates its resources to each IDA recipient. With modifications, this has been used since 1977 (IDA 5). The PBA rules and criteria have been adopted over successive IDA replenishments and are contained in the sequence of replenishment reports.
b) Processes that apply to the CAS from identification through completion (No. 4, see Annex 4).

c) Processes that apply to SILs from identification through completion (No. 5, see Annex 4).

d) Processes that apply to DPLs from identification through completion (No. 7, see Annex 4).

23. Consistent with Management’s grouping of the relevant policies as set out above, Management then identified and mapped business processes that support implementation of the specific policies governing fiduciary, contractual and safeguards requirements and associated procedures relating to CAS, SIL and DPL, all of which feed into the four umbrella business processes identified in paragraph 17 above. These include:

a) Processes relating to corporate review with respect to CAS, SIL and DPL (No. 8, see Annex 4).

b) Processes relating to implementation of policies and procedures governing financial management aspects (Nos. 12 and 13, relating to OP/BP 10.02, Financial Management, see Annex 4).


d) Processes relating to implementation of policies and procedures governing procurement aspects (Nos. 14-16, relating to OP/BP 11.00, Procurement, see Annex 4).


24. In addition to the above, Management also mapped the business processes that apply to the quality assurance function which, while not mandated by any specific policy, has played an important role in reviewing quality aspects of operational work both at appraisal and at supervision stages (No. 27, see Annex 4).
Management Findings and Recommendations

25. The design effectiveness assessment captured a representative picture of the control environment over IDA’s operations at the transaction level, where daily decisions are made which have a direct impact on the use of IDA resources. While this turned out to be an extremely involved and labor intensive exercise for which there was little precedent inside or outside the institution, Management found it to be valuable. Management expects that the information gleaned as a result of this exercise will provide tangible support for strategic and rationalization decisions for IDA’s operations going forward.

26. On the basis of the above-described methodical, interactive and thorough exercise of performing a bottom up identification and cataloguing of the processes and associated controls for carrying out IDA’s operations, Management has the findings and recommendations set out below.

A. The examination of the key policies and procedures that govern IDA operations and the mapping and review of the key business processes and associated controls that enable compliance with these policies confirmed that:

- The performance based allocation model is appropriately designed to direct scarce IDA resources in support of priority development activities in the poorest eligible member countries.

- The three primary instruments for carrying out IDA operations (i.e, CAS, SIL and DPL), their complementary use and the processes and controls that apply to them from identification to completion have been appropriately designed to verify that:
  - IDA financing is being provided in support of developmental priorities and is focused on matters that appropriately fall within IDA’s mandate
  - Consistent with the Articles’ provisions, IDA financing is made available for specific projects as well as other “special circumstances” operations where appropriate.

- The umbrella processes and associated controls for processing CAS, SIL and DPL through all stages (from identification to completion) and the specific processes and controls that fall under these umbrella processes (fiduciary, contractual, safeguards, etc.) are appropriately designed to facilitate and verify compliance with the key IDA policies and procedures adopted to ensure that IDA funds are used for the purposes intended to meet expenses as they are actually incurred.

The specific processes and associated controls related to procurement are appropriately designed to facilitate and verify compliance with IDA’s procurement policies, as reflected in OP/ BP 11.00 and Guidelines: Procurement under IBRD Loans and IDA Credits and Guidelines: Selection and Employment of Consultants by World Bank Borrowers and meet the objective of using IDA resources to finance goods, works and services that were procured by the borrower with due regard for economy and efficiency.

B. Management had difficulties with obtaining timely access to relevant documents that are needed to carry out the compliance testing portion of the assessment. This work clearly revealed that there is an issue with respect to document retention and accessibility which merits serious examination and improvement. Although the auditors retained by Management to do compliance testing informed Management that document retention
and accessibility is a common problem in many corporations that have transitioned from manual retention and filing of hard copies of documents to filing and archiving documents electronically, Management intends to address the document retention and accessibility issue immediately by setting up an expert panel to look at retention, filing and accessibility of operational documents and come up with recommendations for improvements within the next six months.

C. Management has also identified that the OPs and BPs included in the Operational Manual are not keeping pace with the changes on the ground that are being introduced from time to time. One example is BP 10.00 on processing investment lending from identification to Board approval, which is in need of urgent update. Other examples in need of updating to reflect current requirements which have been approved by the Board over the past several years include the 12.00 series governing disbursements, and OP/BP 10.02 on financial management. As part of Management’s assessment of the effectiveness and efficiency of IDA’s internal controls framework, Management intends to look at the current processes underlying policy revision to determine if they need to be revised to facilitate more efficient and timely updating of operational policies and procedures.

D. The policy framework governing IL operations is too complex and disjointed, making it hard for staff to identify all the policies with which they are expected to comply when working on IL operations. Following the example of the recent reform of the DPL policy and procedures (OP/BP 8.60), Management has been actively working on rationalization and consolidation of policies governing IL processing from identification to completion.

E. The assessment confirmed that many staff find the existing processes and documentary requirements very onerous and inefficient. To address this problem, at least in part, Management intends to issue in the next few months standard updated operational templates to be used by staff in documenting various steps in the IL and DPL processes.

F. The assessment identified that there is a disparity in the frequency of corporate reviews of SIL and DPL operations, with all DPLs being subject to such review and relatively few SILs. While some of the heightened scrutiny of the DPLs is consistent with the Articles’ provisions relating to “special circumstances” lending, Management is examining whether there is a need to review criteria for submitting Investment Lending operations that raise special risks or issues to the corporate review process.

G. As part of the detail review of key controls and process flows (i.e., “walkthroughs”) performed with respect to the individual business processes, Management has identified a number of areas that merit a closer look. Some of these areas are:

1. Several existing policies and procedures need to be updated or enhanced or, in some instances, additional guidance needs to be introduced.
2. Certain system capabilities or system-related controls need to be better aligned with the process requirements.
3. Timeliness of processes related to managing individual credits should be improved.
4. Variances in regional implementation of institutionally endorsed guidelines need to be reviewed to ascertain whether these variances are appropriate.
5. Certain procurement processes and controls require enhancements to strengthen effectiveness.

6. Processes surrounding SILs with regard to project changes or contractual remedies need to be strengthened.

7. Clarification should be issued to require staff, which provide conditional clearances or feedback on project documents, follow up to ensure that their comments have been incorporated, as appropriate.

Management intends to closely examine these areas as part of the compliance phase of the project and to develop corrective action plans for the findings that require remediation.
ANNEX 1: DISCUSSION OF COSO AND METHODOLOGY USED IN THE ASSESSMENT

1. In performing its review of the compliance with IDA’s Articles and applicable internal policies and procedures, Management has used, as much as possible, the concepts as 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 U.S. Sarbanes-Oxley Act of 2002 (SOX legislation). 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. Applying these concepts, which have been defined by standard setters for assessing internal controls over financial reporting, provides Management a level of comprehensiveness, rigor and standardization required in its assessment of internal controls and compliance.

2. Under the COSO framework, the effectiveness of an internal control system is measured by its capacity to provide reasonable assurance to Management and the Executive Directors (the Board) regarding the achievement of the Bank’s objectives in the following three areas (pillars):

   - Reliability of financial reporting – relating to preparation of published financial statements;
   - Compliance with applicable laws and regulations – relating to compliance with applicable legal and regulatory framework (charter, policies, etc.); and
   - Effectiveness and efficiency of operations – relating to effective and efficient use of resources.

3. COSO’s categorization allows focusing on separate aspects of internal controls, addressing different needs and taking into account that each area may be the direct responsibility of different organizational units and managers. As briefly summarized below, this categorization also distinguishes between what can be expected from each category of internal control.

4. Financial Reporting: Bank/IDA’s primary objective in adopting the COSO framework was to focus on financial reporting, which is the primary focus of the Bank’s external auditor. Since 1997, Management has annually asserted that it maintains an adequate system of internal control over external financial reporting for both IBRD and IDA; and Management has received an attestation to this effect from the external auditor at the end of each fiscal year.¹

¹ The examination of financial reporting under the COSO framework has also enabled the Bank to be well positioned in reviewing the impact of various shareholder nation’s legislation related to corporate governance requirements (i.e. the U.S. Sarbanes-Oxley Act of 2002 (SOX)). SOX is a set of legislative reforms adopted in the United States to strengthen corporate governance and regulatory activities for financial reporting by capital market participants, and the EU 8th Directive (Proposal for a Directive of the European Parliament and the Council on Statutory Audit of Annual and Consolidated Accounts and Amending Council Directives, issued on March 16, 2004) and enhancing its internal controls, where appropriate.
5. **Effectiveness and Efficiency of Operations:** Unlike the areas of financial reporting and compliance with laws and regulations, which largely depend on performance of activities within the organization’s control, effectiveness and efficiency of operations depend on a host of factors that are often outside the organization’s control and over which Bank/IDA staff and management may have little influence. Specifically:

- Internal controls cannot eliminate bad judgment or decisions, nor can they influence external events that may result in a failure to achieve operations’ goals or objectives; and
- With respect to these objectives, the internal control system can provide reasonable assurance only that Management and, in its oversight role, the Board are made aware, in a timely manner, of the extent to which the organization is moving towards meeting the agreed goals or objectives.

6. With the above caveats, as part of this exercise, Management intends to assess whether the existing internal control framework over IDA’s operations provides reasonable assurance that IDA’s operations are carried out efficiently and effectively.

7. The review of internal controls for IDA’s operations are being limited to the areas of “compliance with applicable laws and regulations” and “effectiveness and efficiency of operations” under the COSO framework. Given that the financial reporting controls are assessed annually by Management and verified by the external auditors as part of the annual audit, no additional assessment in this area was believed necessary in the context of the overall internal control assessment.

**Division of Responsibilities**

8. Management’s Assessment of IDA’s Internal Controls – Consistent with the COSO framework requirements Management will assess the key internal controls for IDA operations in the areas of compliance and effectiveness and efficiency of operations. This assessment includes the identification of and compliance with the relevant controls (Parts I(A) and I(B)) and a review and assessment of the efficiency and effectiveness of their design and operation (Part II).

9. The assessment is being led by the Offices of the Vice President and Controller (CTR), and the Vice President, Operational Policy and Country Services (OPCS), with key support roles for Concessional Finance and Global Partnerships (CFP) and Legal (LEG). To manage the implementation of this process, Management has created a high-level Steering Committee comprised of the Vice Presidents of the above four units with the inclusion of the Internal Audit Department (IAD) and the Independent Evaluation Group (IEG) management as observers. The responsibilities of the Steering Committee are to:

- Define the objectives of the assessment in the areas of compliance and efficiency and effectiveness of operations;
- Oversee the implementation of the assessment and coordinate Management’s activities with those of IAD and IEG;
- Review the controls issues identified during the assessment and evaluate whether these issues rise to the level of material weaknesses that would impact Management’s assessment; and
- Review and endorse Management’s assessment and/or report of its review prior to its transmittal to IAD, IEG and the President.

10. To assist the Steering Committee in implementing the detailed work program, a Project Management Team (PMT) consisting of the Directors of Accounting and OPCS’s Country Services Departments and certain senior staff within these units has been established. The responsibilities of the PMT include:

- Preparing the detailed scoping and implementation plan and obtaining its approval by the Steering Committee;
- Bring all the respective units together in the Bank to brief them as to the work program and where their assistance will be required;
- Documenting the risks, processes and related controls associated with ensuring IDA’s funds are being used for the purposes described in the credit agreements;
- Performing the assessment of the design and operational effectiveness of the controls;
- Identifying instances of non-compliance with prescribed controls and related control deficiencies;
- Evaluating whether the identified control deficiencies, individually or in aggregate, have a material impact on Management’s ability to state whether internal controls are adequate over compliance with IDA’s charter and applicable internal policies and procedures; and
- Preparing Management’s assessment and/or report of its review for review and endorsement by the Steering Committee; and
- Liaising with IAD and IEG in the preparation of their respective validation and evaluation.

11. IAD Review of Management’s Assessment – Consistent with IAD’s overall mandate, Management’s assessment of internal controls over IDA’s operations in the areas of compliance (Parts I(A) and I(B)) and efficiency and effectiveness (Part II) will be reviewed by IAD.

12. Overall IEG Evaluation – in order to fulfill Management’s commitment of carrying out an independent assessment of its internal controls over IDA operations, as specified in the IDA 14 Report, IEG will evaluate (i) the work performed and findings identified by Management, in the areas of compliance (Parts I(A) and I(B)) and efficiency and effectiveness (Part II) of the internal controls framework over IDA operations, as well as (ii) IAD’s review of Management’s assessment (including methodology, testing results, and reported findings). Based on these evaluations, IEG would then issue its report. [If the timing permits, IEG would also contribute a section to the report on Part IA, in time for the meeting of the IDA Deputies in late November.]
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<td>Procurement Complaints: procurement processes relating to complaints</td>
</tr>
<tr>
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<td>Procurement Non-compliance: procurement processes relating to non-compliance</td>
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<td>Loan Management – SIL: loan management aspects of specific investment loans</td>
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<td>Loan Management – DPL: loan management aspects of development policy lending</td>
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<tr>
<td>19</td>
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</tr>
<tr>
<td>20</td>
<td>Loan Management – Special Commitment or Application Problems: processes relating to special commitment or application problem</td>
</tr>
<tr>
<td>21</td>
<td>Loan Management – Amendments and Notices: processes relating to amendment/extension processing</td>
</tr>
<tr>
<td>22</td>
<td>Loan Management – Refunds: processes relating to refund processing</td>
</tr>
<tr>
<td>23</td>
<td>Loan Management – Cancellations: processes relating to cancellation processing</td>
</tr>
<tr>
<td>24</td>
<td>Loan Management – Suspensions: processes relating to suspension processing</td>
</tr>
<tr>
<td>25</td>
<td>Loan Management – Loan Account Closing: processes relating to loan account closing - standard procedures</td>
</tr>
<tr>
<td>26</td>
<td>Loan Management – Loan Account Closing: processes relating to loan account closing - special procedures</td>
</tr>
<tr>
<td>27</td>
<td>QAG: quality at entry and supervision</td>
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<tr>
<td>30</td>
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</tr>
</tbody>
</table>
These two sub-processes were initially recorded as separate processes. After discussion with CFP management they were deemed to be sub-processes of the IDA allocation process and were consequently integrated into process number 1. We have not revised the numbering scheme. There are 28 processes that have been selected by Management for documentation.
SAMPLE OF PROCESS FLOW DIAGRAMS
Module 4: Country Assistance Strategy
Attachment 2:
IAD Review of Management’s Assessment
October 13, 2006

Mr. Fayezul H. Choudhury, Controller & Vice President, CTRVP
Mr. James W. Adams, Vice President & Head of Network, OP/CVP

Report on a Review of Management's Assessment of the Design
Effectiveness of Internal Controls over IDA Operations and Compliance
with its Charter and Policies

Please find enclosed the above-mentioned report which represents the outcome of
our review on Management’s Assessment of IDA’s Internal Controls Review: Part IA.

[Signature]
Carman Lapointe Young
Auditor General
Internal Auditing

Attachment

cc: Messrs. Wolfowitz (EXC); Wheeler (MDW); Daboub (MDD); Li Via (CFO);
Thomas (IEG/DG)

Deloitte & Touche, LLP
Review of Management's Assessment of the Design Effectiveness of Internal Controls over IDA Operations and Compliance with its Charter and Policies

Background

As part of its work program, Internal Auditing Department (IAD) has completed a review of “Management's assessment relating to the design effectiveness of key controls currently in place to ensure compliance with the relevant Articles provisions and policies governing IDA’s operations”.

This assessment comprises the first Part IA of a three-part assessment envisaged to satisfy Management’s commitment “to carry out an independent comprehensive assessment of IDA’s control framework including internal controls over IDA operations and compliance with its charter and policies”. Management’s commitment was outlined in the IDA Fourteenth Replenishment report1, approved by the Executive Directors of IDA in March 2005, which identified a monitorable action, targeted for CY05, the product of which was an ‘OED Assessment’.

The balance of Management’s commitment will be met through Part IB: the assessment of the operating effectiveness of, or compliance with, the controls identified in Part IA; and Part II: the assessment of efficiency and effectiveness, including corporate governance and entity-level controls.

Management indicated in its Revised Work Plan that its assessment would be conducted using the control framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

Objective

In accordance with our Terms of Reference, IAD’s objective was to review the basis of Management’s assessment and express an opinion on whether Management's assessment of the effectiveness of internal controls over IDA operations is fairly stated based on the criteria established in Internal Control – Integrated Framework issued by COSO.

Management’s assessment, originally outlined as Part A, was to “focus on the compliance portion of the assessment, namely whether the existing internal control framework over IDA’s operations provides reasonable assurance to Senior Management and the Board that such operations are carried out in a

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1 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).
manner that complies with the provisions of the IDA charter and internal policies governing the fiduciary aspects of IDA’s lending operations”2. Part A has since been segregated into two parts (Part IA and Part IB) as outlined above. This segregation resulted from unsuccessful attempts to obtain documentation to test compliance and design effectiveness concurrently, as was originally intended by management.

Scope

IAD’s review examined Management’s assessment relating to the design effectiveness of key controls currently in place to ensure compliance with the relevant Articles provisions and policies governing IDA’s operations. Twenty-nine documented processes of the thirty processes3 deemed in-scope by Management were reviewed, including management’s methodologies for determining in-scope processes and for assessing the design effectiveness of internal controls.

Management’s assessment and IAD’s review covered the period from July 1, 2005 to March 31, 2006.

IAD did not review the following areas excluded by Management under Part IA:

- Overarching control framework for IDA including all aspects of corporate governance and entity level controls as well as efficiency and effectiveness of operations;

- Specific processes deemed out of scope by management for this assessment, namely Economic Sector Work (ESW), Report on Observance of Standards and Codes (ROSC), Independent Evaluation Group (IEG) Processes, Internal Auditing Department (IAD) Processes, Country Policy & Institutional Assessment (CPIA), Post Conflict Performance Indicators (PCPI), Annual Report on Portfolio Performance (ARPP), the Inspection Panel, the Department of Institutional Integrity (INT), and the Results Assessment Framework of IDA;

- Process walkthroughs, from inception to completion, except for 3 processes (Country Assistance Strategy, Investment Lending and Development Policy Lending);

- Operational Policies (OPs) and Bank Procedures (BPs) excluded by management, as outlined in their report; and

- Compliance controls embedded in automated applications used in IDA operations4.

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3 Management has not completed the documentation of the process relating to the “Debt Sustainability Framework”. We understand that this will be completed by management along with Part IB of the compliance assessment.

4 IT controls significant for financial reporting purposes were assumed to have been covered under management’s Assessment of Internal Controls over Financial Reporting for FY06.
Approach

A highly compressed time schedule for the review was necessitated by management’s decision to segregate design effectiveness from compliance testing following the unsuccessful attempts by management to carry out this testing concurrently. As a result, IAD’s review, originally scheduled to follow completion of management’s assessment, was carried out simultaneously, with IAD conducting its own work independently and providing frequent and continuous feedback to management.

As agreed with management, IAD applied all relevant concepts of Auditing Standard 2 (AS2)\(^5\) appropriately tailored for auditing operational compliance controls.

IAD reviewed management’s scoping methodology and work plan. For the 29 documented processes (of the 30 in-scope IDA processes), IAD performed the following:

- **Process Documentation:** IAD reviewed high level process flowcharts, narratives of processes and control objectives, risks and key controls provided by management. IAD reviewed whether key controls identified by management appeared adequate to satisfy control objectives, and identified potentially missing key controls.

- **Workshops/Review Sessions:** IAD observed workshops/review sessions conducted with subject matter experts to validate process flow charts and narrative descriptions of individual key controls provided by management, challenging, seeking clarification and identifying potential deficiencies as appropriate.

- **Revised Process Documentation:** IAD reviewed revised process descriptions incorporating changes identified in the workshops/review sessions and potential control issues identified by management.

- **Deficiency Tracker:** IAD provided management with a list of 59 potential deficiencies in documentation and/or design identified during our review, 55 of which were incremental to control issues identified by management. The following table outlines the nature of deficiencies by module.

\(^5\) Auditing Standard No. 2: An Audit of Internal Control over Financial Reporting Performed in Conjunction with An Audit of Financial Statements (AS2) issued by the Public Company Accounting Oversight Board (PCAOB).
IAD’s Review of Management’s Assessment of IDA Internal Controls: Part IA
Potential Deficiencies Outstanding for Remediation – By Deficiency Type

<table>
<thead>
<tr>
<th>MODULE</th>
<th>Documentation</th>
<th>Design</th>
<th>Total Potential</th>
</tr>
</thead>
<tbody>
<tr>
<td>DPL/SIL</td>
<td>-</td>
<td>3</td>
<td>3</td>
</tr>
<tr>
<td>ROC/OC</td>
<td>1</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>FRM - ALLOCATION</td>
<td>5</td>
<td>1</td>
<td>6</td>
</tr>
<tr>
<td>LOAN MANAGEMENT</td>
<td>9</td>
<td>2</td>
<td>11</td>
</tr>
<tr>
<td>FINANCIAL MANAGEMENT</td>
<td>4</td>
<td>7</td>
<td>11</td>
</tr>
<tr>
<td>PROCUREMENT</td>
<td>15</td>
<td>7</td>
<td>22</td>
</tr>
<tr>
<td>SAFEGUARDS</td>
<td>1</td>
<td>1</td>
<td>2</td>
</tr>
<tr>
<td>QAG</td>
<td>2</td>
<td>-</td>
<td>2</td>
</tr>
<tr>
<td><strong>Total Deficiencies</strong></td>
<td><strong>37</strong></td>
<td><strong>22</strong></td>
<td><strong>59</strong></td>
</tr>
</tbody>
</table>

- **Process Walkthroughs:** IAD attended process walkthrough sessions convened by management with operating personnel responsible for three processes (Country Assistance Strategy, Investment Lending and Development Policy Lending) to confirm the operation of process controls (for at least one transaction for each process) from inception to completion, as validated in the workshops/review sessions.

- **Management's Report:** IAD reviewed drafts of Management’s report and provided comments as appropriate.

**General Observation**

This IDA assessment is the first comprehensive internal exercise undertaken by management to review an operational/compliance internal control framework. Furthermore, it appears to be unique in the multilateral development banking environment, and to our knowledge, in the broader international financial institution community. The effort underlying the commitment, the magnitude of which was clearly underestimated at the outset, should present substantial commensurate benefits: its results should provide a compelling baseline to identify opportunities for streamlining IDA’s (and concurrently IBRD’s) operations and internal controls while significantly improving consistency and efficiency.

**Key Issues**

The following key issues were identified during our review of Management’s Part IA assessment:

1. **IDA Processes Selected:** Management’s methodology does not adequately rationalize its intention to limit the scope of the review, as outlined in the IDA Control Review Methodology Note dated July 6, 2006, to determining compliance with fiduciary aspects of lending operations in IDA’s charter, as the basis for deciding which IDA processes were relevant to the assessment.
Management further limited its scope to processes applicable to Specific Investment Lending (SILs) and Development Policy Lending (DPLs) as the two lending instruments representing most of the value and volume, and which were deemed to be a representative proxy for other lending operations. Certain other IDA products, trust funds and grants that do not utilize IDA resources, and other miscellaneous operations outlined in the Articles were also excluded. We are not aware of any intended scope limitations of the commitment for a comprehensive assessment.

By scoping out certain of IDA’s operations, a selective rather than a comprehensive “bottom-up” approach has resulted. Rationalization appears necessary to reconcile management’s interpreted scope with that described in the original commitment.

2. **Information Technology (IT) Controls**: Work has not yet been undertaken to identify significant compliance controls embedded in automated applications. The separate Assessment of Internal Controls over Financial Reporting (ICFR) was neither designed nor intended to cover operations compliance controls, automated or manual. To include the assessment of automated compliance controls embedded in applications along with General Computer Controls (GCC’s) as part of the entity-level controls review in Part II will require re-work in the areas of documentation, confirmation, and testing to assess design and operating effectiveness of process/transaction level controls.

In order to reliably conclude its Part I assessment of process/transaction level controls, management will necessarily be required to carry out its assessment of key IT controls together with Part IB.

3. **Fraud and Corruption Controls**: Identification and documentation have not been undertaken of fiduciary controls focused specifically on mitigating risks associated with fraud and corruption. Furthermore, an assessment of the adequacy of other identified controls to satisfy these specific objectives has not been carried out in Part IA. This would include controls to prevent and detect fraud and corruption, as well as ensuring that control implications identified during fraud and corruption investigations are adequately addressed.

Management should specifically identify and assess key controls to prevent and detect fraud and corruption at the process/transaction level.

4. **Outdated Operational Policies (OPs) and Bank Procedures (BPs)**: One objective of the assessment by management related to the design effectiveness of the key controls that ensure compliance with policies and procedures governing IDA’s operations. Management has acknowledged in its report that “OPs and BPs … are not keeping pace with the changes on the ground that are being introduced from time to time”.

In principle, absent processes to ensure that policies are current, controls to ensure compliance with such policies would not be meaningful, even if current practices meet business needs.
Management has committed to review current processes to facilitate more efficient and timely updating of OPs and BPs. Management has also committed to review the appropriateness of regional variances in their implementation.

5. **Categorization and Remediation of Deficiencies**: Analysis has not yet been carried out under Part IA of management’s assessment to determine whether identified deficiencies pose, in the aggregate if not individually, significant or material risks to the attainment of the control objectives to which they relate.

In our view, in the absence of such determination, management has no sound basis upon which to conclude whether controls are effectively designed.

Accordingly, it will be important for management to evaluate the significance of identified deficiencies prior to concluding on Part IB.

6. **Document Retention and Accessibility**: Management acknowledged significant difficulties in obtaining timely access to relevant documents for compliance testing, which led to the segregation of assessments of control design effectiveness from operating effectiveness. In our view and experience, the inability to verify compliance with key controls represents a significant control design deficiency.

Management has committed to address the document retention and accessibility issue immediately.

7. **Assessment of Entity-level Controls**: Management has indicated that the review of entity-level controls, including tone at the top, the assignment of authority and responsibility, appropriate policies and procedures, and company-wide programs, will be carried out under Part II of the assessment.

The effectiveness of entity-level controls should have been assessed prior to undertaking any assessment of controls at the process or transaction level, since controls at the organizational level often have a pervasive impact on controls at the process, transaction or application level. Therefore, any management conclusions on control effectiveness as a result of Part I assessments will need to be reconsidered once entity-level controls have been examined.

8. **Walkthroughs of Process Documentation**: Management’s assessment of design effectiveness of internal controls under Part IA of the review included walkthroughs of process documentation for 3 of the 29 documented in-scope processes (CASs, SILs and DPLs) from inception to completion. The workshops/review sessions for the other 26 documented in-scope processes do not meet the criteria for walkthroughs outlined in AS2.

End-to-end process walkthroughs of all in-scope processes should have been conducted prior to management concluding on design effectiveness of internal controls, but in any case will need to be carried out by management prior to (or concurrently with) compliance testing in Part IB to support any conclusion.
Overall Conclusion

IAD committed in our original Terms of Reference to express an opinion at the end of Part A of the review (now Part IB) on whether management's assessment of the effectiveness of internal controls over IDA operations relating to compliance with IDA's charter and applicable policies is fairly stated. Any opinion delivered following Part IB would be subject to the outcome of the assessment of corporate governance and entity level controls in Part II.

However, IAD strongly recommends reconsidering the relative cost-benefit of continuing immediately with the remaining phases of the assessment versus continuing after addressing significant deficiencies identified in Part IA.

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