Musing #2

THE C--------- WORD*

THE WORLD BANK'S EXPOSURE AND HOW TO ADDRESS IT

*Corruption - from the Latin ***com rumptus,***
meaning "jointly broken," or alternatively,
"it takes two to tango"
(song title by Hoffman & Manning, 1952)

CTRVP
November 8, 1995

TABLE OF CONTENTS

FOREWORD

This paper expresses the views of CTRVP -- rather than a Bankwide consensus -- on the issue of corruption and its implications for the World Bank. CTRVP gratefully acknowledges the input and suggestions of staff from across the Bank, in particular: Nimrod Raphaeli, Raghavan Srinivasan (OPR); Michael Stevens (PSP); Graham Joscelyne, Robert Saunders (IAD); Robert Picciotto (OED); Louis Forget, Hans Gruss, Christian Walser (LEG); Katrina Sharkey (EDI); Randolph Andersen, Fayezul Choudhury, Michael Ruddy, George Russell (ACT); Babu John, V.S. Raghavan, Senga Sengamalay (LOA); Richard Lynn, Kabir Ahmed, Miguel Schloss (PBD); Karl Krueger, George West (CTRCS); Ladipo Adamolekun, Stephen Berkman, Colin Lyle, Katherine Marshall (AFR); Francis Colaco, Marianne Haug (EAP); Allan Legg (ECA); and James Wesberry (LAC).

I. PURPOSE AND SCOPE OF PAPER

1. The purpose of this paper is to stress the exposure of the World Bank (IBRD and IDA) to corruption, to take stock of how far the Bank has gone toward heeding its own rallying cry to establish accountability as a means of addressing it, to take stock of what other organizations have done or are undertaking, and to recommend further actions for the Bank to take to minimize its exposure, and in so doing, further optimize its development effectiveness. This paper will not attempt to shed new intellectual or ethical light on the issue of corruption, about which much has been written and more could be learned. Nor will it attempt to quantify the extent to which corruption has directly affected the Bank (i.e., has involved Bank loan funds and/or the Bank's budgetary resources), as this was beyond the terms of reference for this paper. While its recommendations focus mainly on the Bank (IBRD and IDA), they are equally relevant to the Bank Group as a whole (i.e., including IFC and MIGA).

2. For purposes of this paper, corruption is defined as the misuse of position for private gain; more specifically, the use of influence (whether by a politician, supplier or civil servant, or staff member or manager of the World Bank) on account of his or her position, to reap illicit, personal or corporate benefit -- either monetary or in-kind, and whether for himself or herself, or for an entity or person close to him or her. Corruption can take many forms, including bribery, fraud, extortion, embezzlement, falsification, and kickbacks. It typically involves two beneficiaries profiting at the expense of one or more third parties.

II. SUMMARY OF CONCLUSIONS AND RECOMMENDATIONS

3. Corruption compromises the ability of the Bank to carry out its fundamental mission of poverty alleviation and economic development. Corruption also puts the Bank's financial integrity at risk -- in terms of its own assets, those for which it has a fiduciary responsibility, and IBRD loans and IDA credits. And the real victims are the poor, for whom corruption inflates the future debt burden, by an amount far greater than bribes themselves. Hence, corruption jeopardizes the Bank's ability to carry out its mission of poverty alleviation and economic development. With its mission and effectiveness at stake, the Bank must confront the issue in a clear and consistent manner.

4. The Bank has already taken a number of actions to strengthen financial accountability -- in the Regions' project work; in policy setting units within the Bank (CTR, OPR, and MPS); and via EDI training seminars and grant allocations from the Bank's Special Programs in support of capacity building. But more remains to be done. To take the recommended actions, the Bank will need to overcome several major internal attitudinal barriers. These include: (a) the Bank's own inhibitions to discuss corruption, long a taboo subject; (b) a perceived incentive structure that, despite some improvements following the Portfolio Management Task Force Report, to some extent continues to emphasize lending volume (output) at the expense of quality and effectiveness (outcome); (c) a tendency to recognize corruption as merely an ethical or political issue, and not a serious economic development or financial control issue, for the Bank to address accordingly; (d) the legalistic position that to address corruption, unless specifically related to the use of Bank loan funds or at the request of the borrower, constitutes political activity -- prohibited by the Bank's Articles of Agreement; and (e) not giving resource priority to this strategy (including staff with necessary specialized expertise) in the face of declining or stagnant budgets. Unless management is prepared to confront and overcome these barriers, the Bank will remain *com rumptus*, i.e., "jointly broken," and jeopardize its development effectiveness as well as its reputation for financial strength and integrity.

5. Corruption is increasingly a key issue in public debate. The time is ripe for the Bank to take a more coherent and proactive role in this debate. This paper recommends that the Bank take certain steps to address systemic accountability, accountability of suppliers – and their governments -- under Bank projects, accountability of the Bank's borrowers, and accountability of Bank management and staff. These proposed actions (summarized in Table 1) are aimed at (i) galvanizing a concerted, visible, and coordinated effort at the highest levels of management and across the Bank, to address corruption issues affecting the Bank both as a lender and as an employer; (ii) going beyond past exhortations to specific actions; and (iii) linking the Bank's anti-corruption strategy to the Bankwide COSO initiative's emphasis on effectiveness and accountability for financial controls. Over the medium to long term, the cost of taking the proposed actions will be more than offset by more efficient project implementation and real, albeit not easily quantifiable, improvements in the Bank's effectiveness and development impact.

III. THE BANK'S EXPOSURE

A. The Risks

6. The Bank's financial integrity and its associated reputation as a sound financial institution are *sine qua non* to its effectiveness as a lender, and particularly as a lender to developing countries. The potential for corruption puts the Bank's financial integrity at risk on two fronts: (i) the Bank's own assets and those for which it has a fiduciary responsibility (i.e., trust funds); and (ii) IBRD loan and IDA credit funds. The statistical chance is always there that a major scandal could break and damage the Bank's reputation and therefore its effectiveness, at a time when it has come under close scrutiny by its members and severe criticism by some NGOs (albeit often for varying and sometimes self-serving reasons). The inevitable price the Bank and its ultimate clients -- the poor -- would pay in that case is paralysis of the Bank's resource mobilization potential.

B. The Victims

7. Corruption is of deeper concern to the Bank than in the context of its own financial integrity and capacity to raise funds in capital markets and in donor country capitals. Corruption is an impediment to economic development. It therefore goes to the heart of the Bank's raison d'etre. The victims are very often the poor -- viz., diversion of increasingly scarce donor funds and the higher debt burden that results from procurement contracts inflated by an amount highly leveraged relative to the amount of associated bribes. Hence it mortgages future generations with the bills to pay for their forbears' ill-gotten, expensive lifestyle. Corruption damages a country's credibility, is an obstacle to transparency -- a prerequisite for competition – and deters private investment critical to economic growth, even in high-growth developing countries. High transaction costs (financial and/or otherwise, e.g., delays) are often associated with corruption. Social costs can far outweigh the personal benefits, as in the case of violated environmental, public health, and safety standards. And corruption is exacerbating donor fatigue. Corruption therefore compromises the ability of the Bank to carry out its fundamental mission of poverty alleviation and economic development.

Table 1

RECOMMENDED NEXT STEPS

A. Systemic Accountability	B. Accountability of Suppliers And Their Governments	C. Accountability of the Bank's Borrowers	D. Accountability of Bank Staff
(i) Multi-Country Initiatives	(i) Donor Governments	(i) Immediate Actions	(i) Financial Management and Covenant Compliance
(a) Link a multilateral debt initiative (should one materialize) to a coherent and visible anti-corruption strategy of the Bank. (b) Increase Special Programs grant support for international NGOs and professional associations, to develop international standards and best practice guidance for accounting and auditing, and for establishing legal and regulatory frameworks and enforcement capacity.	(a) Together with the IMF and other multilateral development banks, work with the OECD and the European Community to pressure their member countries' repeal of tax deductibility of foreign bribes, and toward universal adoption by member governments of domestic anti-corruption laws. (b) Work with the WTO toward an international convention, making transnational corruption (including bribery) a crime and establishing an international grievance mechanism; limit bid eligibility to firms based in signatory countries.	(a) Require regional sign-off on the adequacy of the project accounting system in place, as a condition for effectiveness for every loan and credit; offset costs by relaxing requirements for project audits (e.g., require more limited reviews rather than full audits), which are of limited value in project management. (b) Include a mandatory review of financial accountability issues relevant to a given project at the key review stages (Initial Executive Project Summary, Final Executive Project Summary and Loan Committee), highlighting outstanding issues flagged in reports of the borrower's Auditor General; have IAD periodically audit these reviews for compliance and effectiveness. (c) Include in all Public Expenditure Reviews (PERs) not only an assessment of (i) the allocation of resources, but (ii) the government's institutional capacity to manage budgets and public expenditures, and (iii) the accounting framework within which government funds are accounted for and controlled; and recommendations on how to address weaknesses. (d) Make Board consideration of new Bank loans to a given borrower contingent on financial covenant compliance under all Bank loans under implementation in that country.	(a) Assemble Regional teams to do in-depth review (including some physical verification) of SOEs for a sample of problem projects, to assess nature and extent of misprocurement. (b) Establish a structured position of Regional Accounting and Auditing Adviser, in the front office of each Regional Vice President and with a dotted line reporting relationship with ACTCO, to serve as a focal point for addressing borrower accountability issues in the Region. (c) Establish a small team of financial, accounting, and procurement specialists in each Regional Technical Department to serve as consultants to task managers; the team would monitor project financial management at entry and thereafter, compliance with financial covenants and procurement guidelines; the team would have a dotted line reporting relationship to the proposed Regional Accounting and Auditing Adviser. (d) Institute more systematic independent *ex post* field SOE reviews (including some physical verification) on a sample basis, under the Bank's direction, whether at the Bank's expense or funded by the borrower; the Bank should contract for this work within a global framework vis-a-vis international accounting firms' worldwide headquarters.

Table 1

RECOMMENDED NEXT STEPS

A. Systemic Accountability	D. Accountability of Suppliers And Their Governments	C. Accountability of the Bank's Borrowers	B. Accountability of Bank Staff
(i) Multi-Country Initiatives (Cont'd)	**(ii) Suppliers**	**(i) Immediate Actions (Cont'd)**	**(i) Financial Management and Covenant Compliance (Cont'd)**
(c) With international NGOs and professional associations, cosponsor conferences, workshops, and EDI seminars for government officials on accounting, auditing, and legal framework and enforcement issues relevant to developing countries. (d) Undertake a major research initiative on corruption (e.g., a WDR) to improve understanding of its dynamics, the implications for economic development, and options for addressing it.	(a) Revise the Bank's procurement guidelines and bidding documents to include a no-bribery pledge, to be signed by a senior official of the bidding firm.	(e) Make it official Bank policy to suspend disbursements if an audit is overdue by more than 90 days. (f) Require that written terms of reference for all audit engagements in connection with Bank-financed projects be submitted to the Bank for no-objection review, prior to the audit engagement. (g) Revise Standard Bidding Documents to remove ambiguity regarding tolerance of bribery.	(e) Establish a cycle of internal audits of supervision reports to check for systematic independent SOE reviews as well as for project audit compliance. (f) Building on the work of the Portfolio Management Task Force, reorient the incentive system to reward outcome rather than output -- e.g., the flagging of accountability issues and enforcement of financial covenants, even if at the expense of commitments and/or disbursements; reflect this shift in Performance Management Process and management contracts.
			(ii) Procurement
			(a) Make random post reviews of procurement contracts the responsibility of field offices (overseen by proposed team in the Regional Technical Departments), and include review of this procedure in IAD field office audits. (b) Address clearly in the Staff Rules the obligations of Bank staff to report known or suspected violations of the Bank's procurement guidelines, and put in place a mechanism for handling these leads.

Table 1

RECOMMENDED NEXT STEPS

A. Systemic Accountability	D. Accountability of Suppliers And Their Governments	C. Accountability of the Bank's Borrowers	B. Accountability of Bank Staff
(ii) Country-Level Initiatives	(ii) Suppliers (Cont'd)	(ii) Longer Term Actions	(iii) Bank Financial Resources
(a) Collaborate with the IMF, other MDBs, and borrowers to include anti-corruption policies in economic and regulatory reform programs. (b) Finance initiatives at the country level -- through the Bank's lending program as well as its Institutional Development Fund -- for building capacity in accounting, auditing, and legal frameworks, based in part on Country Financial Accountability Assessments. (c) Through high level country visits by both the Bank's General Counsel and its Controller, work to raise borrowers' awareness of the importance of institutional development and accounting, auditing, and legal professionalism, to effective governance, poverty alleviation, and economic development. (d) In country dialogue, stress the importance of eliminating incentives that spawn corruption, and of promoting a transparent, competitive investment climate.		(a) Make proper financial management a development objective in its own right and as such, a priority for Bank financing; implement a more aggressive schedule of Country Financial Accountability Assessments (an assessment for each borrower country by the year 2000, and an update every five years), and feed results into CASs, discussions at Consultative Group meetings, and Lending Allocations Reviews. (b) Revise the grievance procedures for allegations of procurement malfeasance under Bank projects, to facilitate recourse to the Bank (e.g., via a hot line or continued use of the Inspection Panel), and clarify these procedures in the Bank's procurement guidelines and Instructions to Bidders. (c) Give prominence to corruption and its impact on economic performance, in the context of policy dialogue and private sector development and financial sector work; encourage borrowers to adopt anti-corruption legislation, put in place enforcement capacity, and promote a transparent, competitive investment climate. (d) Strengthen sanctions for borrowers that have willingly engaged in misprocurement, and/or have not enacted anti-corruption legislation; limit IBRD/IDA lending to countries that have enacted anti-corruption legislation or signed an international convention, on grounds of country performance.	(a) Consider adopting commercial bank practice of having staff members sign an annual "integrity letter" on a retrospective basis, in addition to the prospective statement signed upon appointment to the Bank. (b) Take steps to clarify in the Staff Rules and the Bank's Code of Professional Ethics, that Bank staff are obliged to report, *inter alia*, suspected or known fraud or corruption committed either by Bank staff related to the use of Bank or fiduciary resources, or by borrowers in connection with Bank loans or other services; and establish a mechanism for their doing so. (c) Establish a formal mechanism by which the Ethics Officer makes regular reports to IAD on lessons learned from breaches of Staff Rules and/or the Bank's Code of Professional Ethics, to assess whether preventative measures are needed.

C. The Cynics

8. That being said, why should the Bank bother to confront corruption? After all, some would argue, it is a fact of life, a concomitant of human nature which the Bank cannot purge. In some situations, it may even enhance efficiency and redistribute wealth more equitably. It is subject to different cultural interpretations (although, according to a scholarly treatment of the history of bribes, a form of it -- bribery -- is officially condemned in the laws of every country[1]). As Robert E. Klitgaard writes,

> " 'But who's to say that a given act is really "corrupt"? Maybe it is corrupt in your culture but not in theirs. And might not corruption play a useful role in developing societies? Doesn't it grease the wheels of commerce, build political coalitions, and help organizations overcome red tape? Besides, what can you or anyone else do about corruption? Like sin, it's everywhere. So isn't your topic fatally fraught with arbitrary value judgments, naivete, and futility?'
>
> "Each of these rhetorical questions has a point. Together, they have spawned the definitional debates, functionalist apologies, and moralist and antimoralist polemic that have dominated the literature on corruption. And yet if you are interested in what to do about corruption, the questions may strike you as tangential, even supercilious. It is as if you expressed an interest in reducing poverty and were told that 'poverty' is a relative term, that poverty has its social functions and perhaps its social utility, and that the poor shall always be with you.
>
> "Like illness, corruption will always be with us. But as this sad fact does not keep us from attempting to reduce disease, neither should it paralyze efforts to reduce corruption. Corruption involves questions of degree. Countries and agencies have more and less corruption, and various kinds of illicit behavior are more and less harmful. We can do better in controlling corruption."[2]

D. The Stakes

9. In short, because corruption compromises its ability to carry out its basic mission, the Bank cannot afford to take the passive position that it is a necessary evil. With poverty reduction, economic development, and the donor community's confidence in aid effectiveness at stake, the Bank will be best served if it confronts the issue in a clear and consistent manner and takes advantage of its ability to lead by example and promote best practices, by setting and enforcing rigorous standards for its borrowers and their suppliers under Bank loans, and by taking a balanced view of the root causes of corruption -- including the complicity of developed countries that allow (even encourage) their firms to pay foreign bribes. In confronting the issue of corruption, the Bank should also set and enforce rigorous standards for its own management and staff, since minimizing risk to the Bank from corruption is ultimately their responsibility; in line

---

[1]John T. Noonan, Jr. Bribes (New York: Macmillan, 1984), pg. 702.

[2]Robert E. Klitgaard, Controlling Corruption (Berkeley: University of California Press, 1988).

with the principles underlying the COSO initiative being started across the Bank in FY96,[3] it is not limited to the purview of the Bank's Controller.

IV. THE BANK'S ACTIONS AND INACTIONS

A. Exhortation

10. Six years ago the World Bank exhorted the donor community -- itself included -- to address the issue of corruption:

> "The widespread perception in many countries is that the appropriation of the machinery of government by the elite to serve their own interests is at the root of this crisis of governance. The willingness of the donor community to tolerate impropriety - by failing to insist on scrupulous conduct by their own suppliers, by not ensuring that funds are properly used, by overlooking inadequate accounting and auditing, and by tolerating generally lax procurement procedures - aggravates the malaise. Everyone avowedly deplores the situation and wishes it were otherwise. But it will not be so until accountability is instituted."[4]

B. Actions

11. The Bank has subsequently taken some actions to strengthen financial accountability on the part of borrowers and Bank staff, many of which are summarized below.

(i) Regions

12. The Regions have introduced operations specifically aimed at strengthening the borrower's national accounting and auditing capacity.[5] The Regions are also introducing Country Financial Accountability Assessments in selected countries[6] as recommended in the Financial Reporting and Auditing Task Force (FRAT) Report; they are including the issue of financial

---

[3] "COSO" stands for the "Committee of Sponsoring Organizations of the Treadway Commission." This Committee developed criteria for assessing the adequacy of internal controls for assuring the integrity of financial reporting, efficiency, and effectiveness. The term "COSO" refers to these criteria.

[4] Sub-Saharan Africa: from Crisis to Sustainable Growth (Washington, DC: The World Bank, 1989), pg. 192.

[5] Such operations are under way in Tanzania, Zambia, Uganda, Madagascar, China, Indonesia, Pakistan, Mongolia, Nepal, Bolivia, El Salvador, Venezuela, Mexico and Egypt. Others are planned for Laos PDR, the Philippines, India, and a second operation in Indonesia.

[6] Country Financial Accountability Assessments have been completed for Moldova, Kenya, Malawi, Senegal, Zimbabwe, South Africa, Morocco, Tunisia, and Iran; and are planned for *inter alia* Estonia, Latvia, Lithuania, Ukraine, and Peru.

accountability in Country Portfolio Performance Reviews (CPPRs) and at Consultative Group (CG) meetings; they are creating working groups to resolve auditing problems; and they are engaging local professional accountants at resident missions.

13. With the 1987 reorganization, the number of accounting and auditing specialists and financial analysts in the Regions dropped significantly. And those who remained have typically become task managers, no longer working in their specific area of expertise. To address this problem, the Regions together with the Accounting Department (ACT) are assessing the Regions' skills needs in accounting and auditing as against their current skills inventory, and will develop a remedial action plan, in collaboration with the Accounting, Auditing and Budgeting Staffing Group.

(ii) Africa Region

14. In response to a paper voluntarily written by one of its staff members,[7] which describes various types of corruption associated with past Bank projects, the Africa Region has formed a task force to develop an action program for the Region, in the course of its supervision work, to identify and deal with corrupt practices. The action plan begins with a "SWAT Team" effort during October - December 1995, to review Statements of Expenditure (SOEs)[8] for a sample of 50 problem projects. Depending on the outcome of this initiative, the task force will then consider specific remedial steps to improve borrower compliance with accounting and auditing covenants as well as with procurement guidelines. Further actions will include greater coverage of in-country financial management capacity in Country Assistance Strategies (CASs) and in other nonlending outputs, more emphasis on "quality at entry" in terms of project financial management, and more extensive training of staff as well as an assessment of the Region's staffing requirements in the area of financial management.

(iii) Controllers

15. Within CTR, ACT in 1993 established an advisory service to the Regions and their field offices on issues of borrower accountability; in the spring of 1995, issued to all task managers and many borrowers the Financial Accounting Reporting and Auditing Handbook (FARAH), which stresses the importance of quality of project accounts and internal controls at entry; is drafting an Operational Policy and Bank Procedure to replace Operational Directive 10.60 on Accounting, Financial Reporting and Auditing; is offering training to task managers on the Bank's requirements for project accounts, SOEs, Special Accounts, and audits; is revising the Guidelines for Bank Project Financial Reporting and Auditing; and is making the Bank's financial reporting of trust funds more transparent.

16. CTR's Loan Department (LOA) is rigorously exercising its fiduciary role in portfolio management, by closely monitoring the status of audit compliance in each country in collaboration with task managers, so as to avoid overdue situations; and is training local field staff as well as

---

[7]Stephen A. Berkman, "Corruption and Its Impact on Project Management," April 1995.

[8]When Bank-financed expenditure amounts are small and the associated documentation is voluminous, the Bank reimburses the borrower with loan funds, against a withdrawal application supported by an SOE prepared and certified by the implementing agency and acceptable to the Bank in form and content. Supporting documentation is retained by the borrower or project entity, and made available for inspection and verification by independent auditors and Bank supervision missions. Once the Bank and the borrower agree to the use of SOEs for specified categories or items of expenditure within defined dollar-equivalent limits, all withdrawal applications for such expenditures are to be submitted with SOEs.

staff of borrowers' project implementation units on procedures for withdrawal applications and SOEs, including documentation requirements. LOA is also -- in collaboration with the Internal Audit Department (IAD) and the Borrower Accountability Unit in ACT -- proactively following up on all reports of fraud in connection with Bank loan disbursements. In each known case of misuse of Bank loan funds disbursed in the past two to three years, the Bank has enforced its policy of full repayment of these misused funds. In several instances, these cases were detected and brought to the attention of the Bank by vigilant accountants in project implementation units.

(iv) COSO

17. More broadly, CTR is about to embark on a major effort to strengthen the Bank's internal controls, with the aim of independent attestation using a COSO framework[9] in FY96; and has asked each Vice President and each Chief Administrative Officer or Program Coordinator to sign a letter of representation with respect to (i) the adequacy of internal controls in their VPU, and (ii) their knowledge (either actual or contingent) of fraud or corruption, whether committed by Bank staff or by borrowers in connection with Bank operations.

(v) Legal

18. At the request of the Board, the Senior Vice President and General Counsel of the Bank has issued legal opinions, statements, and memoranda[10] to clarify the meaning of the prohibition of political activities in the Bank's work, as stated in the Bank's Articles of Agreement.[11] The most recent of these papers states:

> "Upon the request of a borrowing member, the Bank may finance projects for purposes of ensuring predictability and stability of the business environment and efficiency of public administration, such as civil service reform, legal and regulatory reform and judicial reform. Through such reforms, the Bank should be able to assist its borrowing countries in their efforts to fight corruption and increase transparency and accountability in public functions [emphasis added]. These aspects of institutional development are directly relevant to the Bank's objective of facilitating investment for productive purposes. Experience has proven their great importance, especially for

---

[9]Attestation by the Bank's external auditor that the Bank's financial reporting meets the criteria set by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission.

[10]Prohibition of Political Activities in the Bank's Work (SecM95-707), July 12, 1995; Issues of "Governance" in Borrowing Members - The Extent of Their Relevance Under the Bank's Articles of Agreement (SecM91-431), April 12, 1991 and (SecM91-131), February 5, 1991; and Prohibition of Political Activities Under the IBRD Articles of Agreement and Its Relevance to the Work of the Executive Directors (SecM87-1409), December 23, 1987.

[11] Per Article IV, Section 10 of the IBRD Articles of Agreement: "The Bank 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 weighed impartially in order to achieve the purposes stated in Article I." The same language is in Article V, Section 6 of the IDA Articles of Agreement.

countries in transition from command to market economies and for private sector development generally."[12]

(vi) Operations Policy

19. The Operations Policy Department (OPR) issued a discussion paper in 1991 entitled Managing Development: The Governance Dimension (SecM91-820), which examined the meaning of governance and its relevance to development, and another report in 1993, Governance: The World Bank's Experience (R93-203), which gave an overview of the Bank's activity in the area of governance. More recently, in January 1995 OPR revised the Bank's procurement guidelines to include language relating to corruption. As in the past, procurement contracts financed under Bank projects are to be reviewed by the Bank either prior to or following signature, depending on the dollar value. Contracts above a given threshold dollar amount (based on, *inter alia*, country performance, and specified in the loan or credit documents) are subject to prior review by the Bank, and if approval is given it is done on a "no objection" basis. Contracts below that threshold are subject to post review by the Bank. The new language regarding corruption in the Bank's procurement guidelines is as follows:

> "[I]f a borrower has awarded a contract after obtaining the Bank's 'no objection,' the Bank will declare misprocurement only if the 'no objection' was issued on the basis of incomplete, inaccurate or misleading information furnished by the borrower, or if it is established, by a decision of a court of law, that the contract was awarded on the basis of corrupt practices."[13]

20. In addition, OPR has introduced a provision in the Bank's "Instructions to Bidders" issued in those countries which have instituted a legal requirement that bidders sign a "no bribery pledge." This new provision calls for bidders, as a condition for eligibility to bid for Bank-financed procurement, to disclose commissions and gratuities paid to local persons or risk disqualification. At OPR's instigation, Country Procurement Assessment Reviews (CPARs) were introduced in 1992 and are to be conducted for every country every four years. As part of these CPARs, the Regions are working with borrowers to align local bidding procedures with the international competitive bidding procedures set out in the Bank's procurement guidelines, in terms of efficiency and transparency.

(vii) Development Training

21. The Economic Development Institute (EDI) conducted a workshop in November 1994 on "Enhancing Transparency and Accountability: Issues and Options," which focused on the economic and social costs of corruption, strategies for combating it, case studies for pursuing anti-corruption programs in Uganda and the Ukraine, and the potential role of EDI and the Bank as a whole in promoting transparency and accountability. Bank and IMF staff accounted for 28 of the 43 participants, six participants were from the two case study countries, and the remaining nine were academics, consultants, or NGO representatives. EDI has also offered a workshop to train developing country journalists, with the goal of promoting transparency and information flow, both of which contribute to an enabling environment for private sector development.

---

[12] Prohibition of Political Activities in the Bank's Work (SecM95-707), July 12, 1995, pg. 25.

[13] Appendix 4, para. 3 of the Bank's procurement guidelines. Standard Bidding Documents (SDBs), mandatory and issued by the Bank, already include provisions regarding undue influence, bribes, etc. See Instruction 28.2 of SDB for Goods; and Instructions 26 and Conditions of Contract 74.1 of SDB for Works.

(viii) Bank Grants

22. The Bank has supported the strengthening of borrowers' accountability through two of its grant programs -- the Institutional Development Fund (IDF) and the Special Grants Program (SGP). Since its inception in FY93, the IDF has been used to fund 24 initiatives, for a total Bank contribution of $6.6 million, spanning 20 countries, to strengthen the accounting and auditing standards, Auditor General function, procurement procedures, and/or judiciary system of the recipient governments. The SGP is funding the development of an international accounting standard for agriculture by the International Accounting Standards Committee (IASC), and is supporting an initiative by the International Organization of Supreme Audit Institutions (INTOSAI) to strengthen SAIs in developing countries through training and information exchange on a regional basis. SGP funding for these two initiatives is expected to total about $1.4 million.

(ix) Human Resource Policies

23. In terms of managers' and staff accountability for abiding by the Bank's own procedures (including the handling of budgetary and trust fund resources), MPS ensures that as a condition of appointment, every new staff member and consultant sign a letter stating that he or she has reviewed and understands the Staff Rule pertaining to "Outside Activities and Interests" as well as the paragraph dealing with the "General Obligations of Staff Members" in the "Principles of Staff Employment." In addition, the Bank's President distributed to all staff on September 20, 1994 a copy of the Bank's Code of Professional Ethics, and beginning in FY93 ACT has required task managers to sign an annual letter of representation regarding use and financial reporting of Bank-executed trust fund resources.

C. Inactions

24. While the above initiatives are worthwhile, they are not sufficient. There continues to be a shortage of operational staff skilled in accounting and auditing, and management does not adequately stress their importance in conveying incentives and motivating staff. The consequences are many, and serious: (i) 37% and 7% of audit reports due in FY95 and FY94, respectively, are currently overdue; (ii) of the FY94 audit reports received, more than 500 (or about 15%) were qualified and in connection with nearly 300, Bank staff reported the possibility of serious accountability issues; (iii) Bank projects are designed without due prior consideration of borrowers' financial management capacity; (iv) the Bank does not adequately consider reports of the Auditors General in its borrower countries when planning a given country's lending program; (v) there is inadequate independent *ex post* review of SOEs; and (vi) there is inadequate attention to performing post reviews of bidding documents for procurement.

25. In addition, the Bank has been reluctant to discuss the issue of corruption openly. Consequently the Bank has not exerted pressure on donor countries to eliminate the tax deductibility of foreign bribes, enjoyed by their corporations doing business abroad. And there is ambiguity surrounding Bank staff's responsibilities for reporting fraud and corruption. Hence the Bank cannot afford to be complacent on the basis of past or ongoing efforts. More remains to be done.

V. ATTITUDINAL BARRIERS

A. Inhibitions

26. There are several major internal attitudinal barriers the Bank must overcome, if it is to give corruption the attention it deserves. One is the Bank's own inhibitions about discussing the issue of corruption openly. These inhibitions stem from uncertainty about what constitutes crossing the line from agnosticism to infringement of political sovereignty; reluctance to rock the boat by confronting client counterparts; and an incentive system that rewards task managers up through Regional Vice Presidents for making loans and disbursing them, in spite of assertions by Bank presidents that the Bank must place quality and effectiveness above lending volume targets in measuring its own performance, and in spite of some progress in this area following the Portfolio Management Task Force Report. Management -- from the country department director level up to senior management -- should therefore resist pressure to lend, which can be exerted by developed as well as developing country member governments. And it must give the right signals to staff to ensure that effectiveness is rewarded. This calls for some fresh thinking in setting performance criteria for operational staff and management (see para. 65 below).

B. Skills Gaps

27. As noted in para. 13 above, the current dearth of qualified accountants and auditors among operational staff in the Bank poses a major constraint to effective monitoring of project financial management and borrower compliance with financial covenants under Bank loans. CTR has flagged this issue before, notably in its FRAT Report. But little action has been taken, ostensibly due to the difficulties with recruiting new staff while cutting budgets, as well as the Bank's disinclination to redeploy resources.

C. Prohibitions

28. The Bank's traditional, somewhat legalistic position vis-a-vis corruption has been a barrier to meaningful action, on the grounds that for the Bank to address corruption in its borrower countries constitutes political activity, unless specifically related to the use of Bank loan funds or at the request of the borrower, and the Bank's Articles prohibit political activities in its work. Bank management should revisit the cost of this position. It should reassess whether this is the proper stance for the Bank to take toward such an impediment to development, and whether there is room to manoeuvre into a more substantive, proactive position -- and one that acknowledges that politics cannot be completely isolated from economics (hence the academic field of "political economy"). In the interim, the Bank is encouraged to work with borrower governments to "fight corruption and increase transparency and accountability in public functions."[14] The Bank must therefore continue to use the tools already at its disposal -- e.g., policy advice, sector work, CASs, country performance ratings in the annual Lending Allocations Review. In the end, the Bank's actions must be driven by corruption's economic impact. Hence, the Bank must be vigilant to ensure that its initiatives to address corruption can be justified on economic grounds -- and clearly they can.

---

[14] Prohibition of Political Activities in the Bank's Work (SecM95-707), July 12, 1995, pg. 25.

VI. NON-BANK INITIATIVES

29. The Bank is not alone in giving increasing priority to accountability as a means of fighting corruption. Some of the efforts by others in this area are described below.

30. Summit of the Americas. Heads of state discussed the issue of corruption at the Summit of the Americas in Miami in December 1994, and included in the resulting Declaration of Principles a section entitled "Combating Corruption," which states *inter alia* that governments will "give priority to strengthening government regulations and procurement, tax collection, the administration of justice and the electoral and legislative processes, utilizing the support of the IDB [the Inter-American Development Bank] and other international financial institutions where appropriate."

31. Inter-American Development Bank. The IDB recently established a State and Civil Society Unit which with the Inter-American Bar Foundation (IABF) is co-sponsoring a regional information exchange on public contracting and procurement, with the aim of establishing national chapters of the IABF to promote anti-corruption legislation and its enforcement. The IDB's State and Civil Society Unit is also planning to conduct a workshop with Latin American NGOs in early 1996, in collaboration with Transparency International (see para. 37 below).

32. USAID. USAID has sponsored two inter-American teleconferences on "The Problems of Fraud and Corruption in Government," the first in 1989 and the second in 1992, with participation by several heads of state, other government officials, the private sector, academics, journalists, professional associations, consultants, and a World Bank representative.

33. United Nations. The UN's Department of Technical Cooperation for Development co-sponsored, together with the Crime Prevention and Criminal Justice Branch of the UN's Vienna office and the Ministry of Foreign Affairs and Ministry of Justice of The Netherlands, an inter-regional workshop at The Hague in 1989 on the problem of corruption in government. Participants included representatives from developing countries in Africa, Asia, the Middle East, Latin America and the Caribbean, as well as from developed countries and NGOs.

34. OECD. The OECD passed a resolution in June 1994 that its member governments would review their respective anti-corruption legislation and toughen their sanctions against foreign bribery (including the elimination of tax deductions for illicit foreign payments). The OECD also held a symposium in March 1995 (attended by two Bank representatives, one of whom was a discussant) on "Corruption and Good Governance." Two outcomes of the symposium were the establishment of a network of international organizations concerned with corruption and of an OECD task force to coordinate OECD efforts on the issue.

35. USAID, the Inter-American Accountancy Association, and the Office of the Auditor General of Nicaragua co-sponsored an inter-American regional seminar in Managua in April 1995 on corruption in Latin America. The discussions focused on the causes of corruption and what reforms governments should implement to address them.

36. NGOs and Professional Associations. There are numerous international and national NGOs and professional associations undertaking institution building initiatives and/or information campaigns to address corruption: the National Republican Institute, the Center for International Private Enterprise, the World Press Institute, the Freedom Forum, the International Consortium on Governmental Financial Management, the Africa Leadership Forum, the Latin American Institute Against Corruption, the Institute of Public Administration, the Inter-American Accountancy

Association, the International Federation of Accountants, INTOSAI, the International Development Law Institute, and Transparency International (TI), to name a few.

37. Transparency International. TI is working to establish national chapters in as many developed as well as developing countries as possible, always at the invitation of the government. The purpose of a national chapter is for TI to work jointly with the government of the country to develop strategies for combating corruption, specifically foreign bribery payments. Recently TI issued its first "Corruption Index," based on seven surveys by risk analysts and business organizations, which ranked 41 countries from least to most corrupt. Established in 1992 by two former Bank staff (Peter Eigen and Frank Vogl), TI has garnered funding from a broad spectrum of bilateral and multilateral aid agencies, private sector firms in developed countries, and the Government of Ecuador. TI sought SGP funding from the Bank in 1994 but was declined, on the grounds that to be effective, its activities would need to be adversarial vis-a-vis the government of a given country -- rendering them political in nature and therefore ineligible for Bank support. It is now seeking to open a dialogue with the Bank to explore opportunities for collaboration, including funding from the SGP. TI's track record thus far should dispel the notion that it is a "watchdog" organization dedicated to exposing specific instances of corruption, and instead should demonstrate that it works in countries at the invitation of -- and in partnership with – the government concerned.

VII. MINIMIZING THE BANK'S EXPOSURE

A. The Time is Ripe

38. There is clearly growing concern about corruption. Long relegated to neutral jargon reflecting the macroeconomist's view that money is fungible (e.g., euphemisms such as "commissions," "rent-seeking," "facilitation payments"), corruption is now increasingly and openly recognized as an obstacle to economic development. The proliferation of multi-party elections in developing countries and in countries in economic transition has led to public debate on a number of key issues, not openly discussed previously, including corruption. This was reflected at the July 1995 meeting of the Development Committee Task Force on the Role of the Multilateral Development Banks (MDBs), at which "there was a strong consensus that the MDBs should not invest in countries where corruption and waste were rampant...."[15], and in the World Bank President's October 1995 Annual Meetings speech, in which he specifically called for the elimination of corruption. A conclusion of this paper is that the time is ripe for the Bank to take a more coherent, orchestrated, proactive, and visible role in this debate – at the country, regional, and global level. It is too critical an issue to the Bank's basic mission of poverty alleviation and economic development, to ignore it or to delegate it completely to others. Indeed, ignoring the problem renders the Bank complicit through its inaction. As the derivation of the word instructs, all parties to corruption (direct or indirect) are *com rumptus*, i.e., "jointly broken." To take no further action beyond what the Bank has already done or is currently doing would jeopardize the Bank's reputation for financial integrity and in particular, its development effectiveness. The Bank is in a unique position to address corruption in a meaningful way. But to that end, the Bank must be willing to lose (at least temporarily) some of its lending volume. Moreover, the Bank has a fiduciary responsibility to lead by example. In many developing countries, the Bank's procurement guidelines raise the overall standard for transparency in international competitive

---

[15]Record of Discussion, Development Committee Task Force on the Role of the Multilateral Development Banks, Third Meeting, London, July 10-11, 1995 (SecM95-866), para. 4.

bidding procedures. Similarly, the Bank needs to articulate its own anti-corruption strategy and policies, and enforce them. The demonstration effect could be powerful.

39. The Bank should consider a series of next steps, some to prevent and some to redress corruption, and organized around four aspects of accountability: (i) systemic accountability; (ii) accountability of suppliers, and their governments, under Bank projects; (iii) accountability of the Bank's borrowers; and (iv) accountability of Bank management and staff for monitoring the quality of project financial management at entry and thereafter, compliance with financial covenants and Bank procurement guidelines, and for use of the Bank's financial resources. Many of the recommendations below -- to be prioritized after due consultation with other VPUs --are not new; they have been discussed and endorsed by management, but most remain unimplemented. Unlike past reports and action plans, the recommendations here are aimed at (i) galvanizing a concerted, visible and coordinated effort, at the highest levels of management and across the Bank, to address corruption issues affecting the Bank both as a lender and as an employer; (ii) going beyond mere exhortations to enforce the Bank's own policies and procedures more systematically, to a monitorable action plan with the active engagement, commitment and budgetary priority of management; and (iii) linking the Bank's anti-corruption strategy to the Bankwide COSO initiative's emphasis on effectiveness and accountability for financial controls. And while this paper focuses on IBRD and IDA, management should consider the following recommendations in the context of articulating a Bank Group strategy and action plan (i.e., to include IFC and MIGA as well), since corruption is a threat to the mission and effectiveness of the Bank Group as a whole.

B. Systemic Accountability

40. Corruption is a way of transacting business that can permeate the commercial, social, and political fabric of a society. It is unrealistic to expect that Bank projects could be immunized by foolproof Bank procedures and controls from the surrounding economic environment. Furthermore, no country is spared from corruption. It is not a problem unique to developing countries, as evidenced by recent events in Korea, Germany, the United Kingdom, Italy, Japan, and the United States, to name a few. Nor is corruption perpetrated only by the recipients of illicit payments. The party willing to pay a bribe is equally complicit or very often, even the driver. Therefore, while the Bank should take immediate actions to strengthen its efforts to ensure the financial integrity of projects undertaken with proceeds from IBRD loans and IDA credits (discussed in paras. 59-67 below), the Bank must also take a more inter-disciplinary, holistic, and necessarily longer term, approach to the issue of corruption. A multi-country as well as a country-specific approach is needed.

(i) Multi-Country Initiatives

41. Linkage. The recently leaked draft discussion paper on a possible multilateral debt relief initiative has triggered several negative reactions in the press, on the grounds that such a scheme would essentially constitute a "gift" to corrupt Third World leaders and would condone their form of governance. Of course, rejecting such a plan does not compel repayment of the outstanding debt by those who have siphoned off funds for private gain; the debt burden still falls on the poor. More to the point, when made by a developed country that officially condones the payment of bribes to foreign officials by domestic firms bidding on donor-financed projects, this argument is hypocritical. Management should consider linking a multilateral debt relief initiative (should one materialize) to the articulation and implementation of a coherent anti-corruption strategy on the part of the Bank. Because corruption is prevalent in many borrower countries that would not be

eligible for debt relief, such linkage would need to be made carefully, with the Bank pursuing debt relief and an anti-corruption strategy as parallel, complementary endeavors.

42. Collaboration. By their nature, multi-country activities are generally not feasible through the Bank's lending program. But there are alternatives. The Bank should step up its efforts to support the development of international accounting standards, and best practice guidance for accounting and auditing, and for establishing legal and regulatory frameworks (particularly for banking and commerce) as well as enforcement capacity. It can do this via increased grant support from the Special Grants Program (SGP) for international NGOs and professional associations. (See para. 36 above for a list of potential recipients.) In addition to grant support, the Bank should engage in collaborative efforts with some of these organizations, such as cosponsored conferences and workshops. Building on its work to date in the area of transparency and accountability, EDI should host a series of seminars on these issues, specifically targeted at government officials from borrower countries (rather than Bank/IMF staff and academics, as in the past). These seminars should be led, at least in part, by non-Bank experts (again, ref. para. 36 for a list of possible sources). EDI should also give priority to procurement training courses for borrowers. The Vice President and Controller should actively liaise with international professional associations and multilateral and bilateral donors to harmonize standards for financial accountability -- which currently differ and hence stretch developing countries' limited capacity in this area even further.

43. Awareness Raising. The Bank must be willing to play a lead role in the international debate on the economic consequences of corruption. Although a good deal of work has already been done on the economic aspects of corruption and how to combat it, notably by Robert E. Klitgaard, the Bank should undertake a major research initiative such as a World Development Report (WDR) on this issue. A major research paper on corruption published by the Bank would raise awareness and put the issue squarely on the development agenda, where it belongs from both the donors' and borrowers' standpoint. To take advantage of the existing expertise outside the Bank, research efforts should include the involvement of others such as Professor Klitgaard, Professor Susan Rose-Ackerman (a Yale law professor currently on a Visiting Research Fellowship at the Bank), and TI. The Bank's 1983 WDR dealt with "Management in Development," and included an informative chapter on "Reorienting Government" with a box on corruption. But the subject is so crucial to the development process, it should constitute a freestanding WDR theme in itself.

44. The purpose of such an endeavor would be to improve understanding of the dynamics of corruption; its implications for private sector development, public sector management, and macro policy dialogue and reform; and options for addressing it. Research would focus on the economic determinants of corruption (e.g., a civil service that is politically based, poorly paid, and inadequately skilled), the impact of decentralization, deterrents (e.g., deregulation), and the economic implications. Regional variations and comparative implications would be examined for developed, developing, and transitioning countries, in terms of distribution of illicit payments (e.g., domestic consumption versus capital flight and consumption of luxury imports), transaction costs (i.e, the extent to which some bribes are efficiency enhancing, while others are efficiency inhibiting), the incidence of petty versus grand corruption, and the impact on poverty alleviation and on private sector development and the attraction of private investment (foreign and domestic). The research would include an assessment of the divergent yet parallel interests of both developed and developing countries in wrestling with how to combat fraud, bribery, and corruption. The study would also include an assessment of the impact of (i) the United States Foreign Corrupt Practices Act and the anti-bribery laws of Peru, Singapore, and Ecuador, their enforceability, and the consequences of compliance as well as noncompliance; and (ii) the *de facto* "pro-corruption" laws of developed countries, allowing tax deductibility of bribes paid abroad. A comparative analysis of domestic versus transnational bribery would also be made.

(ii) Country-Level Initiatives

45. Bank action to address the issue of corruption systemically at the country level is also needed. To complement the multi-country initiatives described above, the Bank should collaborate with the IMF, other multilateral development banks, and borrowers to include the enactment and enforcement of anti-corruption policies in economic and regulatory reform programs, and give priority in development strategies to building local capacity in accounting and auditing, and legal and regulatory frameworks and enforcement, based in part on Country Financial Accountability Assessments. Capacity building should be approached in several ways: (i) more technical assistance loans (freestanding or components) to address weaknesses in these areas; (ii) capacity building components in financial sector and private sector development loans to help establish an effective Auditor General's Office (i.e., competent, independent, and adequately funded and staffed), and adequate pay scales and training for civil servants working in governments' accounting, auditing, and legal agencies or ministries (e.g., the Auditor General's Office, the Attorney General's Office); (iii) more Institutional Development Fund (IDF) grants for building national capacity in these areas; and (iv) high level country visits by the Bank's Senior Vice President and General Counsel and Vice President and Controller, respectively, to raise borrowers' awareness of the importance of institutional development and professionalism in these areas to effective governance, poverty alleviation and economic development.

46. It is equally if not more important to address corruption by working to eliminate the incentives that spawn it: burdensome and excessive regulations, licensing, significant authority vested in bureaucrats, multiple layers of approval required for transactions with government, monopolies, monopsonies, and lack of public awareness of the costs of corruption. The Bank must continue to work with its borrowers to design public and private sector reforms aimed at eliminating these incentives, and at promoting a transparent, competitive investment climate.

C. Accountability of Suppliers and their Governments

(i) Pro-Corruption Laws

47. Some choose to portray the context for corruption as one in which an official of the procuring government demands a bribery payment, as a requirement for awarding the bid to a given firm. But very often the tables are turned, and it is the other partner asking to "dance the tango." That is, a representative of the bidding firm (whether an employee or a contracted third party) initiates the corrupt transaction, by offering a bribe to a government official. And these firms are encouraged to do so under their governments' policy (common in many European countries) of allowing corporate tax deductions for the payment of foreign bribes -- in contrast to the payment of domestic bribes, which is considered a criminal offense. These tax deductions are at the expense of taxpayers in their home countries, and inflate multi-fold the debt burden of the poor in the world's developing countries.

(ii) Anti-Corruption Laws

48. To address this complicity of a number of donor countries, the Bank together with the IMF and other multilateral development banks should work with the OECD and the European Community, to put pressure on their respective member countries to adopt anti-corruption laws (e.g., the equivalent of the U.S. Foreign Corrupt Practices Act). At a minimum, the Bank should seek repeal of the tax deductibility, on the books in many donor countries, of foreign bribes. Such laws could be designed to go into effect only after a significant number of major countries has enacted them, in order to avoid undue advantage to those not enacting such laws.

Such an initiative is crucial to the success of any effort on the part of the Bank to address corruption. Without tackling this side of the equation, the impact of the Bank's related initiatives will be greatly diminished. The Bank's President should therefore take the lead in engaging the donor countries -- specifically his counterparts, their Finance Ministers -- to confront this issue openly and frankly, and its implications for development and for the cost effectiveness of the MDBs they help to support.

49. The Bank could also push for universal adoption of an international convention negotiated by the World Trade Organization (WTO) that would make transnational corruption (bribery in particular[16]) a crime. The treaty could include an international grievance mechanism, similar to that in the GATT Agreement for Government Procurement. Drafts of such a treaty are already under consideration by several regional organizations (the Council of Europe and the Organization of American States), but it would clearly have the greatest impact if it were signed more broadly and included the G-7 countries as signatories, as they account for such a large share of transnational bidding. Once this treaty was in effect, the Bank could take the further step of limiting bid eligibility for procurement under Bank projects to firms based in countries that have signed the treaty. The Bank should also ask the UN Commission for International Trade Law (UNCITRAL) to draft a model Foreign Corrupt Practices Act (taking account of lessons learned through the United States' experience with such a law[17]) for national governments to enact.

(iii) Technicality and Integrity

50. Some, TI in particular, have called for the Bank to adopt a "no bribery pledge" as a requirement for suppliers' eligibility to bid on Bank projects. This was rejected by OPR and LEG on the grounds that it violated the Bank's current procurement guidelines regarding qualification, which state that a bidder may be disqualified (pre or post bid) only on "technical" grounds (i.e., the bidder does not have the "capability and resources ... to perform the particular contract satisfactorily"), and they felt that this aspect of the guidelines should not be changed. OPR and LEG also concluded that a pledge on the part of bidding firms would be ineffective without the force of law behind it in their home countries. And because the payment of foreign bribes is allowed under the tax laws of many member countries to enhance their firms' competitiveness abroad, the Bank's Board would not likely approve a "no bribery pledge" requirement by the Bank for bidders on Bank projects. OPR and LEG therefore concluded that it was preferable for borrower governments to adopt a law banning corruption (or bribery more specifically), as has been done in Peru, Singapore, and Ecuador. It is more enforceable than a voluntary pledge, and has the support of (at least some members of) the borrower government. And as noted in para. 19 above, the Bank's Instructions to Bidders have been adapted to situations where such a law exists.

51. But the Bank should avoid legalistic escapism. Disqualification on "integrity" grounds is just as valid, as doing so on "technical" grounds. Therefore the Bank's procurement guidelines and bidding documents should include a no-bribery pledge, to be signed by a senior official of the bidding firm. Such a signature is not meaningless without the force of law behind it in the firm's home country. (If it were, letters of representation to external auditors would be meaningless.) In summary, the Bank should tackle the issue from both sides -- i.e., the legalistic approach with donor governments and the integrity approach with bidding firms. And if successful with the

---

[16]Bribery would need to be broadly defined, in order to encompass less obvious bribes, such as inflated bids, contributions to officials' favorite charities, etc.

[17]See a 1995 study entitled "The United States Foreign Corrupt Practices Act: The Effectiveness of a Unilateral Act," by Jill D. Rhodes, consultant to the Bank's OPR Department.

former on a global basis, the latter may no longer be necessary. Until then, both are needed, as complementary initiatives to address the accountability of suppliers and their governments.

D. Accountability of the Bank's Borrowers

(i) Immediate Actions

52. The borrower is responsible for ensuring sound project financial management at entry and financial covenant compliance, but these are often lacking. There are several corrective actions the Bank should take, some of which could be taken immediately:

(a) Make proper project financial management a precondition for loan effectiveness by requiring, for every loan and credit, regional sign-off prior to project implementation on the adequacy of the project accounting system in place; offset some if not all of the associated costs by relaxing requirements for project audits (e.g., require more limited reviews rather than full audits), which even if submitted on time, are completed well after the period covered and are therefore of limited value in terms of project management.

(b) Include a mandatory review of financial accountability issues relevant to a given project at the key review stages (Initial Executive Project Summary, Final Executive Project Summary, and Loan Committee), highlighting outstanding issues flagged in reports of the borrower's Auditor General; have the Internal Audit Department (IAD) conduct a compliance and effectiveness audit of these reviews on a periodic basis.

(c) Include in all Public Expenditure Reviews not only an assessment of (i) the allocation of resources, but (ii) the government's institutional capacity to manage budgets and public expenditures, (iii) the accounting framework within which government funds are accounted for and controlled; and recommendations on how to address weaknesses.

(d) Make Board consideration of new Bank loans to a given borrower contingent on financial covenant compliance under all Bank loans under implementation in that country.

(e) As is done with overdue payments, make it official Bank policy to suspend disbursements if an audit (or more limited review, per (a) above) is overdue by a given number of days (e.g., 90 days -- a slightly more relaxed timeframe than the 60-day policy in the event of an overdue payment).

(f) Require that written terms of reference for all audit engagements in connection with Bank-financed projects be submitted to the Bank for no-objection review, prior to the audit engagement (as is already done with engineering consulting assignments).

53. The Bank's current Instructions to Bidders for projects in countries with an anti-bribery law say that violation of that law "may" result in disqualification. Similarly, the Bank's Standard Bidding Documents (SBDs) state that any attempt by a bidder to influence the bid processing, evaluation and award "may" result in bid rejection. The word "may" leaves open the possibility that bribery could be tolerated. This gives a bad signal and could also serve as a loophole. OPR should revise this wording, by changing "may" to "will," to eliminate the ambiguity.

(ii) **Longer Term Actions**

54. Accountability Performance. The Bank should make proper financial management a development objective in its own right and as such, a priority for Bank financing. A more aggressive schedule for conducting Country Financial Accountability Assessments should be implemented, with such an assessment to have been carried out for each borrower country by the year 2000 and updated every five years.[18] The purpose of these reviews should be not only to identify possible areas for institution and capacity building, but also to serve as direct input to the Country Assistance Strategies, discussions at Consultative Group meetings, and the annual Lending Allocations Review. With respect to the latter, DEC should consider explicitly integrating the results of these assessments into its country performance ratings for IDA borrowers.

55. Bidding Grievances. The Bank's procurement guidelines say that "if a Borrower has awarded a contract after obtaining the Bank's approval on a 'no objection' basis [i.e., the Bank has conducted a prior review], the Bank will declare misprocurement only if the 'no objection' was issued on the basis of incomplete, inaccurate or misleading information furnished by the Borrower...." Elsewhere in the guidelines, it states that the current process for determining whether this was the case in a given situation is for the complaining bidder to submit its complaint in writing to the Bank, and the Bank then takes responsibility for resolving the matter. However, if a complaint is made regarding the award of a contract subject to post (as opposed to prior) review by the Bank, the Bank turns over the matter to the borrower government for response and any appropriate action, which will then be reviewed by the Bank's task manager during the next supervision mission (perhaps as much as three to four months later). While about one-third of the dollar value of Bank-financed procurement contracts are subject to post review, in terms of numbers of contracts more than 80% are subject to post review. Therefore, with the vast majority of contracts subject to post review by the Bank, for most contracts resolution of a complaint can result in delays, and is the responsibility of the party against whom it has been made, namely, the borrower government -- with the likely effect of either discouraging complaints from being filed in the first place, or unofficial blacklisting of the complaining firm by the borrower government.

56. The Bank should therefore consider revising its grievance procedures for would-be suppliers alleging procurement malfeasance under Bank projects, and it should consolidate a description of those procedures (for prior and post review contracts, prior and subsequent to contract award) in a freestanding section in the Bank's procurement guidelines. OPR should lead this effort, in cooperation with LEG, CTR, IAD, and the Regions. One option for revising the grievance procedures would be to facilitate recourse to the Bank (e.g., via a hot line, with the Bank then turning over the matter to one or more independent firms contracted by the Bank, or continued use of the Inspection Panel). Whatever mechanism is selected, it will be important to ensure adequate capacity for handling complaints objectively but expeditiously, so as not to cause undue project delays. In addition, the grievance mechanism for suppliers should be described in the Bank's Instructions to Bidders.

57. Policy Dialogue. In the context of policy dialogue (including Policy Framework Paper discussions), and private sector development and financial sector work, the Regions should explicitly discuss corruption, anti-corruption enforcement capacity, and linkage of these issues to the country's economic performance; and encourage borrowers to adopt an anti-corruption law and to put in place the capacity to enforce it. At the same time, as stressed in para. 46 above, the Bank must continue, in its policy dialogue with client countries, to press for the elimination of the

---

[18] Due to competing priorities Country Financial Accountability Assessments (recommended in the FRAT Report) have had a slow start, relative to Country Procurement Assessment Reviews which are required for each country every four years.

incentives that spawn corruption, and for the promotion of a transparent and competitive investment climate.

58. Teeth. Suppliers can be "blacklisted" by the Bank for misprocurement. But borrowers are held to a lower standard; funds used for misprocurement are to be repaid in full, and the amount of an investment loan is reduced by the amount of funds used for misprocurement. Management should therefore establish stronger sanctions -- with penalty clauses beyond the amount misappropriated -- for borrowers that have willfully engaged in misprocurement. And the Bank could also consider discontinuing or severely curtailing its lending to borrowing countries not enacting anti-corruption legislation or not signing an international convention, on the grounds that official condonation of corrupt practices is a major impediment to country performance.

E. Accountability of Bank Staff

(i) Financial Management and Covenant Compliance

59. Drudgery. While the borrower is responsible for *ensuring* sound project financial management at entry (crucial to sound project management) and financial covenant compliance thereafter, Bank staff are responsible for *monitoring* them. The record of borrowers' performance in these two aspects of project implementation is weak, in part due to weak institutional capacity in a number of borrower governments. But a second major factor is inadequate monitoring by the Bank. Task managers are usually not qualified in this area (they are more likely to be macroeconomists than financial analysts or accountants); they have little time for such responsibilities during supervision missions; the current incentive structure promulgated by management puts task managers under some pressure to disburse and does not motivate them to delegate these monitoring responsibilities to others (e.g., consultants, Technical Department staff). Independent *ex post* field review of SOEs (e.g., by local accounting firms) was recommended by the Portfolio Management Task Force, but has not generally been implemented, as Country Departments generally focus far more on substantive project implementation issues rather than the relative drudgery of accounting systems and process compliance -- even though poor financial management and breach of compliance at the project level are often a sign of more systemic accountability weaknesses.

60. Diagnosis. To address these problems, the Bank should take several actions. First, the Regions should follow the Africa Region's lead, and assemble a Regional team to perform more in-depth review (including some physical verification, not just cursory document reviews) of SOEs, for a sample of problem projects identified in collaboration with LOA. The findings should shed some light on the nature and extent of faulty SOEs. This diagnostic approach would form the basis for a Regional strategy to strengthen the Bank's monitoring of borrower accountability. But this is only a start; the Regions should apply more scrutiny to the procurement process (see paras. 66-67 below). And in aggregate, the Regional findings -- together with input from the Bank's procurement and disbursement specialists as well as supervision task managers -- could contribute to some quantification of misprocurement under Bank-financed projects.

61. Focal Point. While all of the Regions already have on staff at least one accounting and auditing expert -- and these staff meet monthly with ACTCO management -- this expertise is fragmented and has no functional leadership from the Regional Vice President's office. This expertise currently resides in a Technical Department division in four Regions and in a Country Department Director's front office in two others. To provide Regional leadership and a focal point at the Regional Management Team (RMT) level, there should be a structured position of Regional Accounting and Auditing Adviser, housed in the front office of each Regional Vice President. This

Regional Accounting and Auditing Adviser would oversee the Region's efforts to monitor the quality of project financial management at entry and financial covenant compliance thereafter, work with task managers and ACTCO to identify and address borrower accountability issues in the Region (including independent SOE verification), assess the Region's staff skills in accounting and auditing (currently there are about 100 formally qualified accountants in the Bank, of whom two-thirds are in the Regions), make recommendations -- to be discussed by the Controller with the Regional Vice Presidents and MPS -- for filling skills gaps through training and recruitment, and provide the impetus and intellectual leadership for a more aggressive timetable for Country Financial Accountability Assessments. Like the Regional Procurement Adviser, the Regional Accounting and Auditing Adviser would report to either the Senior Operations Adviser or the Regional Vice President, and would have a dotted line reporting relationship with ACTCO.

62. Accountability and Compliance Specialists. As noted above, just as task managers are not currently motivated to give priority to carrying out all of their monitoring responsibilities themselves, similarly they are not motivated to oversee delegation of them to others. As evidenced by the Bank's experience in acting on the recommendations of the Portfolio Management Task Force Report to establish more of an "implementation" culture in the Bank, it is a very difficult and slow process to change internal incentives. This is not to say that no effort should be made to move away from undue emphasis on commitment and disbursement volume; indeed, incentives should be changed to promote quality at entry and development effectiveness (see para. 65 below). But the current reality is overloaded task managers, who perceive the accountability and compliance aspects of their monitoring responsibilities as drudgery in relation to the more creative work of project design and the technical challenges of project implementation. To address this problem, the Regions should consider forming a team of financial, accounting, and procurement specialists in each Regional Technical Department, who would serve as consultants to task managers. Task managers would delegate to this team responsibility for monitoring project financial management at entry (a team member would participate in each appraisal mission, for this specific purpose) and thereafter compliance with financial covenants and procurement guidelines. Each member of this team would be responsible for monitoring financial management and compliance for a given portfolio of projects. They would have a dotted line reporting relationship to the Regional Accounting and Auditing Adviser.

63. SOE Reviews. The Regions should institute systematic independent *ex post* field review and verification of SOEs, on a routine and random sample basis. To help ensure an arm's length relationship with the borrower, this independent verification should be under the Bank's direction, whether at the Bank's expense or funded by the borrower via Bank loans or counterpart funds. The Bank should take advantage of its own reputation and procurement clout, by engaging large international accounting firms to undertake independent SOE review and verification work, within a contract framework negotiated with these firms' worldwide headquarters (rather than on an *ad hoc* and local basis, as is currently done). This should lead to lower costs and enhanced quality of such certifications.

64. Internal Audits. IAD should randomly select a fixed, preannounced number of divisions per Region per year, in which to audit supervision reports for a two-month period, to determine whether task managers are in fact having investment loan SOEs (which are accounting for an increasing share of IBRD/IDA disbursements) independently reviewed (including some physical verification) systematically on a random sample basis. The same internal audit practice of random sampling should be instituted for project audit compliance.

65. Incentives. Building on the work of the Portfolio Management Task Force, CTR should work with the Regions, Central Vice Presidencies, and MPS to change the incentives, such that both managers and staff are motivated to report and address corruption, rather than ignore it (which can lead *inter alia* to low morale), even if it is at the expense of commitments and/or disbursements.

The incentive system (in particular, the performance rating system) should be changed to reward outcome rather than output -- e.g., establishing quality at entry in project financial management, flagging accountability issues and taking corrective measures to enforce financial covenants, as opposed to rewarding favorable portfolio ratings. Performance Management Process (PMP) forms should be amended accordingly; for example, competencies should explicitly and positively value (i) the identification of breaches of Bank policies and guidelines in Bank projects, and (ii) implementation of appropriate sanctions and/or corrective measures. Management contracts should not just relate dollar inputs to outputs measured in terms of the number of loans, reports, and Country Assistance Strategies (CASs); rather, they should also include benchmarks for the unit's ability to monitor project financial management and financial covenant compliance, and to ensure systematic independent review of investment loan SOEs. In other words, there should be explicit linkage of a unit's self-assessment under COSO to the performance evaluation process.

(ii) Procurement

66. Post Reviews. Under current procedures, task managers are responsible for random post reviews of procurement contracts with a dollar value below a threshold specified in the loan or credit agreement. These contracts totaled $6 billion in FY94, and represented 36% of the total dollar value of Bank project procurement contracts, but a disproportionate 82% of the total number of such contracts. Many of these contracts are for local procurement, with documentation in local languages or dialects, and provide a tremendous opportunity for misuse of funds. As with reviewing SOEs, it is unrealistic to expect task managers to give review of these numerous contracts high priority. CTR therefore supports OPR's proposal to EXC that post reviews be conducted on a systematic, sampling basis by Bank field offices, with the necessary local staff or consultants and supervisory resources totaling $2-3 million per year. The Regions would be responsible for ensuring that this work was done, and task managers could delegate this responsibility to the accountability and compliance specialists in each Technical Department, proposed in para. 62 above. To ensure greater independence, post reviews should be at the Bank's expense, and not paid for by the borrower. IAD should include review of this procedure in its field office audits.

67. Whistle Blowing. While the Bank's Code of Professional Ethics calls for Bank staff to "report to supervisors any departure by other staff members from ...[the Bank Group's] policies, rules, or procedures," there is currently no policy regarding how staff are to handle reports or suspicions of violation of the Bank's procurement guidelines on the part of borrowers and/or suppliers. This is an important issue, particularly given the role that task managers play, either in directly selecting consulting and accounting firms or in influencing their selection by the borrower. CTR and OPR should establish Bank staff's obligations in this regard, determine what mechanisms would need to be in place in order to follow up appropriately on such leads, and with input from MPS and LEG, address these issues clearly in the Staff Rules. Relevant language should also be included in the "integrity letter" (see paras. 68-69).

(iii) Bank Financial Resources

68. Integrity Letters. In addition to being responsible for monitoring project financial management and borrower compliance with financial covenants, Bank staff are accountable for their use of the Bank's own financial resources. (They are also accountable for resources entrusted to the Bank, for which a trust fund letter of representation was already introduced.) To reinforce the importance of one's accountability, management might consider adopting a practice in the commercial banking industry, of having every staff member sign an "integrity letter" not only

prospectively upon appointment, as is currently done,[19] but retrospectively on an annual basis. The text of the "integrity letter" upon appointment would be amended to include a pledge to abide by certain standards (not merely to have reviewed and understood them, which is the current wording). Furthermore, the substantive text of both letters would be integral or annexed to the letters themselves, and not merely referenced therein; and the addressee would be the President of the Bank rather than the Manager of the Staff and Consultants Appointment Unit in MPS.

69. The annual "integrity letter," which would cover the prior year, would state that the staff member is not aware of (i) any unreported matters potentially embarrassing to the Bank; (ii) any instances of fraud or corruption committed either by Bank staff related to the use of Bank or fiduciary resources, or by borrowers in the context of the Bank's lending program or other services; or (iii) any breaches of professional confidence by Bank staff (including leaking of confidential papers) – apart from any exceptions to be noted at the end of the letter by the signing staff member. There will, of course, be gray areas (e.g., suspected, rather than known, fraud or corruption). In that event, the relevant Staff Rule (see para. 67 above) should require the staff member to consult with the Ethics Officer or IAD. And the annual "integrity letter" would include a statement that in matters of uncertainty or doubt, such consultations have taken place. As part of this initiative, the text of Staff Principle 3 ("General Obligations of Staff Members") and Staff Rule 3.01 ("Outside Activities and Interests") should be amended to address specifically the issue of Bank staff's independence, *inter alia* from firms (in particular, consulting and accounting firms) engaged by the Bank and/or by the borrower. The agreed final text for both "integrity letters" would need to be cleared by MPS, the Ethics Officer, CTR, IAD, OPR and LEG.

70. Whistle Blowing. Management should also consider revising the Code of Professional Ethics, so that it not only obliges staff to report to supervisors any departure by other staff members from the Bank's policies, rules, or procedures but, more specifically, any departure by other staff members from "due regard to the appropriate use of World Bank Group resources." Management should consider establishing a "hot line," either to IAD or the Ethics Officer, for reports of suspected or known misuse by staff of the Bank's financial resources (budget or trust funds), including for the selection of consultants in line with the Bank's guidelines.

71. Preventative Post Mortem. The Ethics Officer should make reports to the Auditor General on the underlying causes and circumstances (motives and opportunities) which led to each case of a breach of the Bank's Staff Rules and/or the Bank's Code of Professional Ethics, so that IAD may assess whether preventative measures are needed. Currently, there is no such formal mechanism in place to link the efforts of the Ethics Officer with those of IAD. As fraud is not only an ethical problem but also a financial control problem, IAD will continue to involve CTR as appropriate in matters under review by the Ethics Officer.

---

[19]The current procedure is for each staff member and long-term consultant, upon becoming an employee of the Bank, to sign the following statement, addressed to the Manager of the Staff and Consultants Unit in MPS: "I have reviewed and understand the World Bank's Staff Principle 3, 'General obligations of Staff Members,' and Staff Rule 3.01, 'Outside Activities and Interests.'"