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Meeting: Graham Joscelyne
(Internal Auditor)

Tuesday, November 12, 1996
4:30 - 5:15 p.m.

President Has Seen

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President Wolfensohl - Briefings Books for Presidents Meetings - Meeting Material
Graham Joscelyne - Internal Auditor - November 12, 1996



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A. CLASSIFICATION

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- ☐ Corporate Management
- ☐ Communications with Staff

- ☐ Phone Logs
- ☐ Calendar
- ☐ Press Clippings/Photos

- ☐ JDW Transcripts
- ☐ Social Events
- ☐ Other

B. SUBJECT: Graham Joscelyne, (Internal Auditor), Tuesday, November 12, 1996 @ 4:30 p.m.

DATE: 11/18/96

C. VPU

Corporate

- ☐ CTR
- ☐ EXT
- ☐ LEG
- ☐ MPS
- ☐ OED
- ☐ SEC/Board
- ☐ TRE

Regional

- ☐ AFR
- ☐ EAP
- ☐ ECA
- ☐ LAC
- ☐ MNA
- ☐ SAS

Central

- ☐ CFS
- ☐ DEC
- ☐ ESD
- ☐ FPD
- ☐ FPR
- ☐ HRO

Affiliates

- ☐ GEF
- ☐ ICSID
- ☐ IFC
- ☐ Inspection Panel
- ☐ Kennedy Center
- ☐ MIGA

D. EXTERNAL PARTNER

- ☐ IMF
- ☐ UN
- ☐ MDB/Other IO
- ☐ NGO
- ☐ Private Sector

- ☐ Part I
- ☐ Part II
- ☐ Other

E. COMMENTS: This brief contains: 1) JDW's memo RE: Autheman Meeting, 2) Memo from J. Muis (internal Controls), 3) memo from J. Einhorn RE: controls environment in the Bank & 4) 9/23 memo from M-A. Autheman

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OFFICE MEMORANDUM

DATE: November 7, 1996

TO: Mr. James D. Wolfensohn, President, EXC

FROM: *Jr. Andrew T. J. J. J.*
J. Graham Joscelyne, Auditor General, IAD

EXTENSION: 54812

SUBJECT: **Agenda for Meeting**

Below is a suggested agenda for our meeting scheduled for Tuesday, November 12, 1996:

1. Issues arising from reports submitted at the last meeting
2. New Issues from new reports submitted now
3. Follow-up required of IAD by the President
4. Communication with the Audit Committee
 - on the Review of Internal Controls
 - on other matters
5. Emerging issues from the President on which IAD should act or be aware of
6. IAD Administrative Reporting Line

The World Bank
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JAMES D. WOLFENSOHN
President

November 5, 1996

To: Mrs. Jessica Einhorn
Mr. Jules Muis
Mr. Sven Sandstrom
Mr. Gautam S. Kaji
Mr. Caio Koch-Weser
Mr. J. Graham Joscelyne

I met this afternoon with Marc-Antoine Autheman and expressed to him that we were treating his memorandum of September 23rd with great importance and urgency. I told him that we would be responding to him in depth on the four principle points raised:

- 1) decentralization;
- 2) process issues;
- 3) internal audit review of Bankwide controls; and
- 4) the role of the Controller.

I indicated to him that we had made considerable progress in reviewing these issues but that I was anxious to make a full presentation to the Audit Committee of the steps that we are taking, and that I would like to do so on a regular basis.

We agreed that we would prepare the first report by January 15, and subsequent reports at three-month intervals thereafter.

In addition, I undertook to look into the issue raised in Paragraph 30 of the 1996 Audit Committee Report calling for a written description of the mandate of IAD. I told him that I would respond to this issue within two weeks.


James D. Wolfensohn

cc: Mr. Marc-Antoine Autheman, EDS04

JULES W. MUIS
Vice President and Controller

October 22, 1996

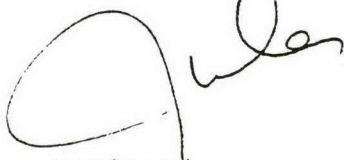
Mr. James D. Wolfensohn

Jim,

Audit Committee Memo on Bank's Internal Controls

The Chairman of the Audit Committee sent you a memo dated September 23, 1996 on the subject of "Adequacy of the Bank's Internal Controls - Implications of the Recent Case of Internal Fraud". In this memo he had raised the concerns of the Board regarding various aspects of the Bank's control framework and asked for the opportunity to discuss these issues. In consultation with Jessica and Shengman, we decided that this meeting should await the conclusion of the Annual Meetings and your overseas trip. We have, in the meantime, prepared a briefing note for you (attached) which, suitably updated, could form the basis of your written response to him after your meeting.

We are, of course, available to meet with you at your convenience to discuss this.



Attachment

cc: Ms. Jessica P. Einhorn, EXC
Mr. Shengman Zhang, SECV
Mr. Fayezul Choudhury, ACTDR
Mr. J. Graham Joscelyne, IADDR

Briefing Note in Response to Audit Committee's Memo to President

1. Mr. Autheman, the Chairman of the Audit Committee has, in a memo dated September 23, 1996 to Mr. Wolfensohn, voiced his concerns about the adequacy of the Bank's internal controls. The issues he raises and the responses to them are set out below.

Issues Raised by Audit Committee

2. The issues raised by Mr. Autheman are as follows :

(1) The investigation of the Main Complex project some three years ago, the Internal Audit investigation of the recent fraud case, and concerns expressed by Mr. Muis have all suggested that the degree of decentralization of the Bank's internal control environment was a significant factor that contributed to both of these situations.

(2) The Main Complex investigation and comments by Mr. Muis also suggested that the routine implementation of a process-driven approach was a control issue.

(3) The Committee also expressed disappointment that they have yet to see the results of the institution-wide review of internal controls which was included in the FY 95 IAD work program.

(4) The Committee believes that in order to satisfy itself on the effectiveness of the Bank's controls, it needs to have a clear understanding of the scope of the Controller's responsibilities and his authority to design and implement control systems. They also reserve judgment on the issue of functional reporting lines from individual VPUs to the Controller until they have a better understanding of the implications of this arrangement for the administration of internal controls.

Response

(1) Decentralization

3. Management agrees with the Audit Committee that the Bank's internal control environment needs to be more systematically and comprehensively aligned to the institution's decentralized structure. Management is now actively addressing this issue by clarifying the roles of both the Controller and the Chief Administrative Officers (or their equivalent) in the individual Vice Presidential Units and by establishing functional reporting lines from them to the Controller. These changes are designed both to help operational management carry out their control responsibilities, and to empower the Controller to carry out his responsibilities effectively. (See paras. 9-12 below.)

(2) Process Issues

4. In addition to the governance issue above, a number of fundamental steps are being implemented to strengthen the internal control framework. The major one is COSO, of which the Audit Committee is fully aware. COSO is a process whereby there is a top-down and bottom-up assessment of the control environment by the people who work within it, with open communications to, and the help of, Controller's. This process leads to the identification of specific areas for strengthening controls and, importantly, conveys the message that controls are the responsibility of all staff.

5. In the Controller's Vice Presidency, a number of initiatives are underway to improve the control framework over transaction processing. The secondary checks and balances provided by the Accounting Department are being reviewed and modernized, with a shift away from routine transaction monitoring to a more analytical and exception-based approach. Accompanying this shift will be a strengthening of ex ante, business-driven controls, rather than reliance on central ex post checks as the primary controls. Information systems on which managers across the institution rely for reports are also being modernized, which will enable more flexible reporting and more user-friendly access.

6. While the enhancement of processes will improve the control systems, this needs to be accompanied by a change in the process-driven mindset of many staff who work in these areas. The COSO exercise will improve both the understanding and awareness of controls, but on its own it is not sufficient. Training courses on internal controls are currently under development for Bankwide use, and a focused training strategy is being implemented for the Accounting Department. However, even after these initiatives are implemented, a skills mix issue will remain. Management is considering its options for addressing this problem.

(3) The Internal Audit Review of Bankwide Controls

7. A review of internal controls was initiated by IAD in FY 95. The Phase I report was completed and sent to the then President, but approval for the more in-depth Phase II was not received from him, apparently due to his illness. Since then, a new President, a new Controller, a new Auditor General, and the initiation of COSO have resulted in the comprehensive review of internal controls as originally envisaged not having been undertaken.

8. The Auditor General is of the opinion that the Bank Group is now ready for such a review, as COSO has been introduced in the financial complex and the Bank is beginning to settle into its new operating mode. This review has begun, and is scheduled to be completed by the end of FY 98. In the meantime, the Auditor General will report the status and findings to the President and the Audit Committee every six months. A more detailed note on the history of this IAD review is attached.

(4) The Role of the Controller

9. The Controller is responsible for the integrity of the financial information systems and ensuring that a concomitant appropriate control framework exists over the Bank's financial transactions. To discharge this responsibility, he must (i) lead in the design and implementation of effective institutional internal control systems; (ii) ensure that in a decentralized environment he has the tools to maintain effective oversight over the decentralized operation of the internal control framework; (iii) provide appropriate oversight and support to the decentralized units to maintain their ability to operate effective controls; (iv) have clearly understood institutional authority over these areas; and (v) work with external auditors and IAD to ensure that there is independent systematic evaluation of the effectiveness of the internal controls framework as a whole.

10. These responsibilities are not new, but management has decided to strengthen the Controller's ability to discharge these functions effectively. Therefore, as mentioned earlier, a functional reporting relationship has been established effective October 1 of this year, whereby a designated position in each VPU (the Chief Administrative Officer or Program Coordinator) will be responsible for the effective operation of the internal control framework in that VPU. While these positions will continue to have line responsibility to their respective Vice President, they will, additionally, be responsible to the Controller on matters relating to the internal controls

environment of the Bank's financial transactions. The Controller will have the authority to prescribe practices in this area, and will be involved in the selection for and evaluation of staff for these positions. In this way the Controller will have a direct means to ensure that an appropriate control framework is operating in the VPUs. Note that the current reporting relates to administrative expense transactions only. The most appropriate organizational relationship to strengthen the Controller's ability to exercise oversight over disbursement related control issues is still under consideration.

11. Early steps on the Controller's agenda, which have already been initiated, to operationalize the new reporting relationships include:

- (a) Surveying the organization structure, reporting relationships, staffing and control practices within each VPU to assess strengths and weaknesses;
- (b) Developing basic standards to be applied in each VPU, and sharing best practice models;
- (c) Identifying control needs of VPUs to be met by the center, e.g., additional control reports, training courses, etc;
- (d) Preparing an implementation plan for identified changes; and
- (e) Specifying working level coordination and liaison arrangements.

12. Management considers the above to be significant steps in strengthening central oversight over the internal control framework. They will ensure that the Controller is formally empowered to implement appropriate controls and gives him effective tools for doing so.

Conclusion

13. The adequacy of internal controls is ultimately a management judgment which seeks to achieve the optimal balance between the level of checks and balances on the one hand and an efficient business approach on the other. Unfortunately, but not uncommonly, the test of whether the balance is appropriate or not sometimes only surfaces when a control mishap occurs. Management had already reached the conclusion, even prior to the detection of the recent fraud, that the balance needed to be reassessed, and had begun this reassessment, drawing heavily on best practice in the outside world. Management is confident that it has underway a program which will significantly improve the control framework, and that the coordinated efforts of Controller's and the Internal Audit Department, through, inter alia, COSO, will provide a solid basis for the ongoing monitoring of its adequacy.

Response to the Audit Committee
IAD Involvement

In response to the memorandum from the Chairman of the Audit Committee to Mr. Wolfensohn, wherein he expresses disappointment at the non-availability as yet of results of an institution-wide review of internal controls by IAD, scheduled in the FY95 audit plan, IAD respond as follows:

1. In FY94, a general overview was included in the audit plan to be conducted by Mr. Maurice Mould (a retiree) on a consultancy basis. Apparently, no regular audit staff members were involved with him in this. During the year, he was asked by Sven Sandstrom to investigate the Headquarters Construction project budget overrun. As a result, he left the IAD work and the project was not picked up by other audit staff.

2. In FY95, the Joint Audit Committee requested that a review of internal controls be included in the audit plan. IAD selected a consultant and a Phase 1 report was completed giving a general overview of the status of internal controls in the Bank. The report on this phase went to the then VP and Controller and through him to the then President. Apparently, due to his illness, no response was received from him. His approval for Phase 2 would have resulted in internal controls being reviewed in considerable depth.

In the intervening period, the consultant headed a quality assurance review of the internal audit function. Several months later, the then Auditor General moved out of the department and was not replaced for some six months. The review did not materialize as the decision was made to await the arrival of the new Auditor General so that he could direct this piece of work.

3. In FY96, within a few months, Mr. Wolfensohn, the Controller and new Auditor General arrived at the Bank. It was obvious that stereotyped roles would be changed and the Bank itself would change. In order to review internal control and improve the control environment, the Controller undertook to introduce COSO Bank-wide. In an effort to be efficient, it was agreed upfront and in IAD's audit plan that IAD and Price Waterhouse would jointly evaluate the work done by the Controller in this regard. Mid way through FY96, it became obvious to IAD and Price Waterhouse that insufficient work had been completed by CTR to a stage at which a proper evaluation could be carried out. This was brought to the attention of the Controller. Thereafter the Controller informed the Audit Committee that the implementation of COSO Bank-wide would be restricted to internal controls over financial reporting in FY96. To meet this target, Price Waterhouse was engaged to assist with the implementation. This was completed at the very end of FY96, leaving no time for evaluation by IAD.

4. A review of internal controls has been raised with Mr. Joscelyne a number of times with the Chairman of the Audit Committee. Mr. Joscelyne has stated that, in his opinion, the Bank Group is now ready for a comprehensive review of internal controls as COSO has been introduced into the financial complex and the Bank is beginning to settle into its new operating mode. IAD have therefore begun such a review and have undertaken to complete it Bank Group-wide by the end of FY98. The review is to take two fiscal years due to IAD's resource limitations and the fact that there is considerable additional demand for IAD's services. However, the results of all audits undertaken by IAD since FY96 are being used to provide data for the comprehensive review of internal controls.

10/17 - Memo from
Jessica Einhorn

JESSICA P. EINHORN
Managing Director
Finance and Resource Mobilization

*Sven
What do
you think?
4/3*

Mr. J. Wolfensohn

October 17th, 1996

Jim:

As background for a future conversation, let me update you on a number of issues relating to the controls environment in the Bank:

- IAD
- I. ~~IDA~~ Reporting. I have had further consultations with both Graham and Jules and did a bit of my own reading. You may recall an earlier note – in which Graham pointed out that our present reporting relationships did not accord with best practices. I had originally favored an option whereby Graham would report directly to you on substantive matters but, for administrative purposes, I could be the manager. My thought was to shield you from administrative burdens and to establish some reporting relationship to me that would connote my interest in this area. However, Jules, and Graham, and the weight of general opinion, would argue against this “half way house”. Graham is Internal Auditor for the whole World Bank group; my recommendation would be for him to report directly to you and for you to delegate the few administrative responsibilities (i.e., signing travel, expense vouchers, etc.) to Shengman. Shengman serves this role for the MD’s and is even more appropriate for Graham given Graham’s group-wide responsibilities and his relationship with the Audit Committee and the Board.
 - II. Strengthening the Controls Environment. I think we have made a lot of progress through cooperation amongst the MD’s to facilitate the control work program. Most important, all the noise regarding the dual reporting relationships seems to be behind us. Jules made an excellent presentation to the MD’s regarding his “map” of the status of the controls framework in the operations areas and the work program before us. Caio and Sven are working with Jules to consider, in particular, the job description and skills requirements of a Control Officer in the VPs areas. At the same time, Jules and Graham have made a good deal of progress in coordinating their work programs to both assure consistency and avoid redundancy. During this catch up period of the next year or two, IAD will help CTR to role out the COSO self assessment program in the regions. Despite this unusual participation by IAD in the “design stage” of controls, they are both extremely sensitive to the need to maintain IAD’s arms length objectivity regarding controls implementation to assure unencumbered audits, in the future. We can discuss.

III. Against this background, we have a draft letter to Mr. Autheman, in response to his inquiries of September 23, 1996. That letter, plus attachments, can serve as a basis for a meeting between you and Mr. Autheman before you actually sign the note. If you agree to the change in the reporting relationships for Graham, you could inform Mr. Autheman of that decision, as well.

We have appreciated Don Conrad's advice and participation in some of these tasks. I think we are all more understanding and comfortable with both the need and benefits of management cooperation in this area, given the nature of the Bank's work and our governing structure. Specifically, given the Bank's development mission and organizational history, it's reasonable not to have a Chief Financial Officer (or a Chief Operating Officer, for that matter). Instead, we are a management team each with his/her prescribed areas of line authority and less prescribed areas of functional or managerial strength. That means, for example, that in the area of controls, it is my responsibility to "sponsor" this issue and try to smooth the path for cooperation. For implementation, whether on budgetary or borrower accountability, the responsibility is shared and defined by the respective line areas. Since the summer, I think there has been enough learning for that model to work much more smoothly in the future than, perhaps, in the recent past.

Finally, after we have had a chance to discuss these matters, I think it would be useful to give the approach your explicit sponsorship at one of your weekly meetings with the Vice Presidents.

A handwritten signature, possibly "J-", is located in the middle right section of the page.

cc: Messrs. Sandstrom, Koch-Weser, Frank, Conrad



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Subject / Title The Adequacy of the Bank's Internal Controls Implications of the Recent Case of Internal Fraud				
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