



CAO COMPLIANCE

CAO Investigation of IFC

CAO Ref: C-I-R9-Y12-F165

April 27, 2015

CAO Investigation of IFC Investment in Avianca S.A., Colombia

Case of:

Complaint from Global Unions on behalf of unions representing employees of Avianca

Office of the Compliance Advisor Ombudsman (CAO)
for the
International Finance Corporation (IFC) &
Multilateral Investment Guarantee Agency (MIGA)
Members of the World Bank Group

Executive Summary

This compliance investigation relates to a 2008 investment by IFC in Avianca, a Colombian headquartered airline (Avianca or the client). IFC's investment comprised a total of US\$50 million in loans which were paid back in full, two years ahead of schedule in 2013. The IFC investment was targeted to support the client's fleet upgrade program.

This compliance process was triggered by a complaint from unions representing employees of Avianca. More specifically, the complaint raises allegations that:

- (a) Avianca has violated IFC Performance Standard 2 (PS2) – Labor and Working Conditions – in particular by discriminating against union members and taking various measures to discourage union membership;
- (b) IFC failed at various stages in the project cycle to properly manage issues related to its client's compliance with PS2;
- (c) IFC and/or its client failed to disclose documents as required by the IFC Performance Standards and Policy on Disclosure of Information;
- (d) IFC failed to conduct a rigorous assessment of PS2 compliance at Taca Airlines subsequent to its merger with the client.

In accordance with the CAO mandate, with its focus on IFC's compliance with its environmental and social obligations, this investigation report is organized around the IFC project cycle.

Environmental and Social Review

In relation to the pre-commitment phase of the project cycle, CAO finds that IFC did not adequately understand the PS2 risk attached to this investment prior to commitment. This was a product of a number of factors including: (a) shortcomings in IFC's review of its client's E&S Assessment process; (b) insufficient analysis of country or sector level PS2 risk as applied to the project; (c) a failure to ensure that PS1 E&S Assessment, disclosure or consultation requirements were implemented in relation to labor issues at the client; and (d) the lack of a structured assessment of client commitment and capacity in relation to PS2 issues.

In particular CAO finds that IFC's pre-investment E&S Review did not ensure that its client had conducted an integrated process of E&S Assessment that covered "all relevant E&S risks and impacts of the project" including PS2 issues "and those who are likely to be affected by such risks and impacts" as required by PS1. Rather, in response to concerns being raised by unions a separate Labor Assessment was proposed as a condition of disbursement.

Disbursement

CAO finds that IFC did not give appropriate consideration to the adequacy of the initial Labor Assessment required from the client as a condition of disbursement. As a result the basis for IFC's engagement with its client around PS2 issues was significantly weakened. In a context where IFC staff were or should have been aware of significant company and country level labor risks CAO finds that IFC's decision to disburse US\$35 million to the client in July 2009 was made without sufficient basis to meet the requirement of the 2006

Sustainability Policy that “IFC does not finance new business activity that cannot be expected to meet the Performance Standards over a reasonable period of time” (para. 17).

General Supervision

Following commitment, IFC’s obligation is to supervise a client’s E&S performance in accordance with its Sustainability Policy and procedures.

In relation to this investment, CAO finds that the IFC team responded to PS2 concerns by requiring a series of Labor Assessments and negotiating corresponding action plans with its client. As part of this process the IFC team identified compliance issues and “worked with the client to bring it back into compliance” as required under the Sustainability Policy.

Weaknesses in supervision, however, meant that IFC staff struggled to understand the Freedom of Association issues raised by the complainants at the level of detail needed to ensure that they were being adequately addressed. As a result, CAO finds that IFC did not develop and retain the information needed to assess the status of its client’s compliance with the Performance Standards (PSs) as required by its project supervision procedures. These issues were compounded by significant delays in the preparation and review of information on the client’s performance under PS2.

Lacking an adequate information basis on which to assess the status of the client’s compliance; absent effective leverage; and without appropriate tools at its disposal, CAO finds that IFC made limited progress in addressing the issues which formed the basis of the unions’ complaint to CAO.

Reasons for the weakness of IFC’s supervision as identified by CAO include: (a) genuine complexities in assessing and addressing Freedom of Association issues, particularly in companies and countries with fractious histories of union/management relations; (b) delays and methodological shortcomings in the Labor Assessments conducted; (c) gaps in the extent to which the Labor Assessments answered their Terms of Reference; (d) inadequate reviews of the Labor Assessments by IFC; (e) what IFC staff described as variable commitment to resolving the issues on behalf of the client; (f) what IFC staff described as a lack of leverage to achieve tangible progress on PS2 compliance, particularly after loan was disbursed in mid 2009; and (g) IFC management’s unwillingness to exercise remedies in a context where the non-compliance was seen as less than blatant and dialogue with the client continued.

Of broader importance in relation to project supervision, CAO notes that IFC’s policies and procedures provide staff with limited guidance on how to respond to complaints regarding a client’s E&S performance. This is particularly relevant in a case such as this one where a client is the subject of serious and ongoing allegations in relation to the application of a Performance Standard.

Disclosure and Consultation

Concerns around the adequacy of disclosure and consultation were raised in the unions’ complaint to CAO regarding this project. In particular, the complaint argued that Avianca and/or IFC should have disclosed Avianca’s Labor Assessments and resulting Action Plans.

In relation to its own disclosure duties, CAO finds IFC to have met then current policy requirements.

On the other hand, CAO finds non-compliance in relation to IFC's supervision of its client's consultation and disclosure requirements under PS1.

In particular, CAO finds that IFC did not adequately supervise the requirements that its client:

- (a) disclose the findings of its Labor Assessments (which CAO considers to be "Assessment documents" for the purpose of PS1);
- (b) engage in "effective consultation" as part the preparation of either its Labor Assessments or the resulting Action Plans, in particular the PS1 requirement that effective consultation should be based on the "prior disclosure of ... draft documents and plans;" or
- (c) disclose Action Plans, updated versions of the Action Plan, and report regularly on progress against its Action Plans.

In CAO's view, these shortcomings in IFC's supervision of its client's consultation and disclosure requirements were significant in that they contributed to the difficulties that IFC had in assessing the status of its client's compliance with the substantive requirements of PS2.

Adequacy of IFC policies, procedures and staffing structures.

The TOR for this audit asked CAO to assess whether IFC policies, procedures and staffing structures provide a robust framework for the advancement of the objectives of PS2 in its clients. The TOR for this audit also asked CAO to analyze the immediate and underlying causes of any non-compliance identified.

In this context, CAO observes limitations with regard to: (a) the depth and expertise of IFC E&S staff in relation to PS2 issues; (b) IFC's methodology in relation to pre-investment review of PS2 issues; and (c) the leverage, tools and resources that the IFC team working project had to address the PS2 issues with its client during supervision.

About CAO

CAO's mission is to serve as a fair, trusted, and effective independent recourse mechanism and to improve the environmental and social accountability of the private sector lending and insurance members of the World Bank Group, the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA).

CAO (Office of the Compliance Advisor Ombudsman) is an independent post that reports directly to the President of the World Bank Group. CAO reviews complaints from communities affected by development projects undertaken by IFC and MIGA.

CAO compliance oversees investigations of the environmental and social performance of IFC and MIGA, particularly in relation to sensitive projects, to ensure compliance with policies, standards, guidelines, procedures, and conditions for IFC/MIGA involvement, with the goal of improving IFC/MIGA environmental and social performance

For more information about CAO, please visit www.cao-ombudsman.org

Acronyms

ACAV, ACDAC & SINTRAVA	The complainant unions
AMR	Annual Monitoring Report
BTOR	Back to Officer Report
CAO	Office of the Compliance Advisor Ombudsman
CEO	Chief Executive Officer
CES	Environmental and Social Development Department [at IFC]
CODs	Conditions of Disbursement
E&S	Environmental and Social
ESAP	Environmental and Social Action Plan
ESRD	Environmental and Social Review Document
ESRPs	Environmental and Social Review Procedures
ESRR	Environmental and Social Risk Rating
ITUC	International Trade Union Confederation
ESRS	Environmental and Social Review Summary
ESRP	Environmental and Social Review Procedure
ESRR	Environmental and Social Risk Rating
ICAO	International Civil Aviation Organization
IFC	International Finance Corporation
ILO	International Labour Organization
LESS	Lead Environmental and Social Specialist
MIGA	Multilateral Investment Guarantee Agency
PS	IFC Performance Standards
PS1	IFC Performance Standard 1: Social and Environmental Assessment
PS2	IFC Performance Standard 2: Labor and Working Conditions.
PVB	<i>Plan Voluntario de Beneficios</i> (Voluntary Benefit Plan)
TOR	Terms of Reference

1. Overview of the CAO Compliance Process

CAO's approach to compliance is set out in its Operational Guidelines (March 2013).

When CAO receives an eligible complaint, it first undergoes an assessment to determine how CAO should respond. If the CAO compliance function is triggered, CAO will conduct an appraisal of IFC's/MIGA's involvement in the project, and determine if an investigation is warranted. The CAO compliance function can also be triggered by the World Bank Group President, the CAO Vice President or senior management of IFC/MIGA.

CAO compliance investigations focus on IFC/MIGA, and how IFC/MIGA assured itself of project environmental and social (E&S) performance. The purpose of a CAO compliance investigation is to ensure compliance with policies, standards, guidelines, procedures, and conditions for IFC/MIGA involvement, and thereby improve E&S performance.

In the context of a CAO compliance investigation, at issue is whether:

- The actual E&S outcomes of a project are consistent with or contrary to the desired effect of the IFC/MIGA policy provisions; or
- A failure by IFC/MIGA to address E&S issues as part of the appraisal or supervision resulted in outcomes that are contrary to the desired effect of the policy provisions.

In many cases, in assessing the performance of the project and implementation of measures to meet relevant requirements, it is necessary to review the actions of the IFC client and verify outcomes in the field.

CAO has no authority with respect to judicial processes. CAO is neither a court of appeal nor a legal enforcement mechanism, nor is CAO a substitute for international court systems or court systems in the countries where IFC operates.

Upon finalizing a compliance investigation, IFC/MIGA is given 20 working days to prepare a public response. The compliance investigation report, together with any response from IFC/MIGA is then sent to the World Bank Group President for clearance, after which it is made public on the CAO website.

In cases where IFC/MIGA is found to be out of compliance, the CAO keep the investigation open and monitors the situation until actions taken by IFC/ MIGA assure the CAO that IFC/MIGA is addressing the non-compliance. The CAO will then close the compliance investigation.

2. Background

2.1 Investment

Avianca (“the client” or “the company”) is one of the largest airlines in Latin America and the largest in Colombia, operating from its main base at El Dorado International Airport, Bogota. IFC invested in the company in 2009 with a view to supporting it to renew its fleet, reduce costs, improve efficiency and safety as well as provide better passenger service.

IFC’s commitment to the company totaled US\$50 million comprising a subordinated (or C) loan of US\$15 million and a straight senior (or A) loan of US\$35 million disbursed in November 2008 and July 2009 respectively.

Since its merger with San Salvador based Taca Airlines in 2010, Avianca has been a subsidiary of a holding company, AviancaTaca Holding S.A., which in turn is owned by Synergy Group Corp., the Brazil based conglomerate which controlled Avianca at the time of the IFC investment.

2.2 Complaint

The complaint in this case was submitted to CAO in November 2011 by the International Trade Union Confederation (ITUC) in cooperation with the International Transport Workers Federation (Global Unions) and national level unions (ACAV/ACDAC and SINTRAVA) representing employees of Avianca.

As set out in the letter of complaint from Global Unions and the CAO Ombudsman Assessment Report,¹ the allegations raised by the complainants can be summarized as follows:

- (a) That Avianca has violated IFC Performance Standard 2 (PS2) – Labor and Working Conditions – in particular by discriminating against union members and taking various measures to discourage union membership;
- (b) That IFC failed at various stages in the project cycle to properly manage issues related to its client’s compliance with PS2;
- (c) That IFC and/or its client failed to disclose documents as required by the IFC Performance Standards and Policy on Disclosure of Information;
- (d) That IFC failed to conduct a rigorous assessment of PS2 compliance at Taca Airlines subsequent to its merger with Avianca.

2.3 Scope of Compliance Investigation

On April 16, 2013 CAO published terms of reference defining the scope of this compliance investigation around the following questions:

- a) whether IFC exercised due diligence in its review and supervision of the PS2 risks attached to the Project; in particular

¹ Available at http://www.cao-ombudsman.org/cases/case_detail.aspx?id=176.

- whether IFC's approach to PS2 issues during the E&S review process was commensurate to risk and otherwise compliant with relevant policies and procedures;
 - whether IFC was in a position to make an informed judgment as to the likelihood that the investment would meet the requirements of PS2 prior to disbursement; and
 - whether IFC's record of supervision constituted an adequate and timely response to specific concerns being raised by unions regarding the client's PS2 performance.
- b) whether IFC policies, procedures and staffing structures provide a robust framework for the advancement of the objectives of PS2 in its clients.

The terms of reference include in the scope of the investigation "developing an understanding of the immediate and underlying causes for any non-compliance identified by the CAO."

Given CAO's mandate this report does not make findings of fact in relation to the client's actions.

2.4 Methodology

This investigation was conducted in accordance with the CAO Operational Guidelines (2013) with inputs from CAO staff and an expert panelist. The CAO investigation team reviewed a range of relevant documentation and conducted interviews with IFC management and staff who had direct knowledge of the project. The team also interviewed representatives of the complainant unions. Due to scheduling difficulties, CAO was not able to organize an interview with a representative of the IFC client's management.

Given the issues raised by the complaint and the requirements of the CAO investigation terms of reference CAO determined that it was not necessary to conduct a field visit for the purpose of preparing this Investigation Report.

In order to maximize the opportunity for candid sharing of information, CAO conducts meetings with IFC staff on an individual basis. In these meetings a number of staff reflected critically on the team's approach to PS2 issues around this investment. CAO notes IFC's view that some of these comments are subjective and not consistent with the view of the team as a whole.² Where referenced these views are acknowledged as the views of individual staff and not necessarily those of IFC. Staff comments are included to the extent that they illuminate the underlying causes of the findings set out in this report.

Due to the existence of a confidentiality agreement between IFC and its client, certain non-public information belonging to the client to which CAO has access, is not referred to in this report.

² IFC, Comments on draft Compliance Investigation Report (April 28, 2014).

2.6 Project Timeline

Date	Milestone, Events and Documents
June 2004	Local unions submit complaint to ILO against Avianca, alleging anti-union dismissals in the context of restructuring.
May 2007	IFC Early Review documentation. No PS2 concerns identified.
March 2008	IFC Investment Review Meeting. No PS2 concerns identified.
June 2008	IFC E&S Review Summary disclosed states that “All employees ... are free to unionize and have the right to collective bargaining” while also noting “complaints with regard to labor aspects...”
July 2008	Global Unions submit a complaint via the IFC Labor Portal asserting that Avianca has violated PS2 with regard to issues of Freedom of Association.
Sept. 5, 2008	Global Unions statement addressed to the President of the World Bank Group; claims IFC’s due diligence for Avianca’s investment insufficient.
Sept. 8, 2008	Loans to Avianca totaling US\$50 million approved by IFC Board.
Sept. 26, 2008	Loan Agreement executed: Includes as a condition of any disbursement that a Labor Assessment has been conducted to IFC’s satisfaction.
Jan. 22, 2009	First Disbursement: Full disbursement of the C Loan, US\$15 million.
Feb. 26, 2009	First Labor Assessment and Action Plan submitted to IFC by Avianca.
July 16, 2009	Second Disbursement: Full disbursement of the A Loan, US\$35 million.
Oct. 2009	Announcement of merger between Avianca and El Salvador based Taca Airlines.
April 2010	First supervision review by IFC E&S staff.
Oct. 2010	Second supervision review by IFC E&S staff.
May 2011	Second Labor Assessment completed.
July 2011	IFC Transaction Manager meets with Avianca CEO to discuss PS2 issues.
Aug. 2011	IFC Regional Industry Director writes to Avianca CEO outlining IFC concerns around PS2 compliance.
Sept. 2011	Letter from Avianca CEO assuring IFC that Avianca is committed to acting on the recommendations of the Labor Assessments.
Nov. 15, 2011	Letter from Avianca CEO to IFC CEO indicating that Avianca and IFC have come to agreement on an Action Plan to address PS2 issues.
Nov. 30, 2011	Letter from Avianca Human Resources Department to union leaders summarizing Action Plan items agreed with IFC.
Dec. 2011	Third supervision review by IFC E&S staff. IFC and Avianca discuss gaps regarding PS2 compliance and agree on an Action Plan.
Oct. 2012	Third Labor Assessment completed.

Date	Milestone, Events and Documents
Nov. 2012	Fourth supervision review by IFC E&S staff. IFC commissions advice from local counsel in relation to ongoing union concerns regarding Freedom of Association at Avianca.
May 2013	Taca labor audit.
Sept. 2013	IFC receives advice from local counsel in relation to Freedom of Association issues at Avianca.
Dec. 2013,	Avianca prepays loan to IFC in December 2013, 2 years ahead of schedule.

2.7 Additional Background on ILO Committee on Freedom of Association Cases

Concerns regarding anti-union discrimination by the company have been the subject of a number of complaints brought to the International Labour Organization (ILO) Committee on Freedom of Association. These complaints allege that Avianca had in place systems and practices that breach various ILO conventions, namely Convention 87 (Freedom of Association and Protection of the Right to Organise), Convention 98 (Right to Organise and Collective Bargaining) and Convention 154 (Collective Bargaining).³

In particular, during the period 2004 to 2007, unions complained to the ILO that: (a) the company was requiring flight attendants to accede to a voluntary benefits plan as a precondition for signing the employment contract, with the result that these workers could not then join the union; (b) the company was offering employees higher wages in return for withdrawing from the union; (c) workers dismissed during an earlier restructuring process were in fact replaced by others from cooperatives or other companies who did not have Freedom of Association rights; and (d) the client was otherwise in breach of its Collective Agreements in various respects.

In relation to the ongoing proceedings regarding the company with the ILO, CAO notes references from the Committee on Freedom of Association dated March 2010. Of relevance, the Committee cites the company's position that the "voluntary benefit plan was devised in response to pressure from non-unionized workers to have their own scheme of benefits, which are no greater or better than those established in the collective agreement" (para. 592). CAO also notes the Committee's view that:

[W]hen the company offers improvements in the conditions of work to non-unionized workers through individual benefits, there is a serious risk that the bargaining capacity of the union will be undermined and that discriminatory situations will occur which favour non-unionized workers; moreover, this can also lead unionized workers to relinquish their union membership. The Committee therefore requests the Government to ensure that the voluntary benefit plan is not applied in such a way as to undermine the position of the trade unions and their bargaining capacity, in accordance with Article 4 of Convention No. 98, and that no pressure is placed on workers to join the plan (para. 593).⁴

³ ILO Case No. 2362 (complaints filed 2004/2005), case details are available at www.ilo.org.

⁴ ILO, Informe en el que el Comité pide que se le mantenga informado de la evolución de la situación - Informe núm. 356, Marzo 2010 <http://goo.gl/ZGxeM0>

CAO also notes references from the Committee on Freedom of Association dated November 2012 regarding additional allegations raised by the complainant unions.⁵ These include allegations that “the enterprise had an agreement with one of the country’s public prosecution services” to deny long standing ACAV members visas to the USA; and on the basis of this agreement that “a list was sent to the [US] embassy naming a group of flight attendants who were alleged drug traffickers” (para. 43). These allegations are noted by the ILO as being denied by Avianca which asserts that it “does not interfere in the freedom of the authorities of other countries to issue visas [and] has sent no official communication whatsoever to the embassy in question in an effort to have it deny visas to workers who are members of the trade union...” (para 44). The same report also cites six of instances in which union members are alleged to have been dismissed without cause. In respect to these cases, the ILO notes the company’s position that the dismissals were the outcome of serious misconduct and that at court proceedings are ongoing in relation to five of the six (one having been decided in Avianca’s favor) (para. 47).

A note on the national context for labor relations in Colombia is also relevant at this point. As described by the United States State Department in 2007, for political reasons, Freedom of Association in Colombia “was limited in practice” and “[v]iolence against union members and anti-union discrimination discouraged workers from joining unions and engaging in trade union activities, and the number of unions and union members continued to decline.”⁶

⁵ ILO, Effect given to the recommendations of the committee and the Governing Body - Report No 365, November 2012, <http://goo.gl/SahhL9>

⁶ US State Department (2006) Colombia: Human Rights Report. <http://goo.gl/IZQHe4>

3. Investigation Findings

3.1 Applicable Policies, Procedures and Standards

As IFC's investment in the client was processed in 2007/2008, the IFC Policy on Social and Environmental Sustainability (the Sustainability Policy, 2006) applied at the time of approval. Issues of IFC's duty to disclose information relating to the project were governed by the Policy on Disclosure of Information (2006). In addition IFC has Environmental and Social Review Procedures (ESRPs), which are updated from time to time. The ESRPs describe in further detail IFC's approach to the implementation of its Sustainability Policy and Performance Standards.

IFC's Performance Standards (2006) were incorporated into the loan agreement and define the client's Environmental and Social (E&S) obligations. Given the nature of the complaint to CAO Performance Standard 2 (PS2) on Labor and Working Conditions is of particular relevance.

Substantively, PS2 requires that the client "will not discourage workers from forming or joining workers' organizations" and "will engage with such worker representatives" (para. 10). PS2 also provides that the client will:

base the employment relationship on the principle of equal opportunity and fair treatment, and will not discriminate with respect to aspects of the employment relationship, including ... compensation (wages and benefits), working conditions and terms of employment, access to training [or] promotion... (para. 11).

In addition, IFC notes that the requirements in PS2 have been guided by the ILO's eight fundamental conventions (para. 2). This includes Convention 87 on Freedom of Association and Convention 98 on the Right to Organize and Collective Bargaining which provides in Article 1 that "[w]orkers shall enjoy adequate protection against acts of anti-union discrimination in respect of their employment."

Performance Standard 1 (PS1) is also relevant in as it establishes client requirements in relation to E&S assessment, E&S management systems, consultation and disclosure. This CAO compliance investigation is organized chronologically following the IFC project cycle, dealing first with issues related to IFC's pre-commitment E&S due diligence.

3.2 Environmental and Social Review

IFC requirements

In relation to the pre-commitment phase of the project cycle, the key question for CAO is whether IFC exercised due diligence in its review of the project's Environmental and Social (E&S) impacts. In this case, specific questions arise regarding IFC's review of PS2 issues. The underlying principle established by the IFC Policy on Social and Environmental Sustainability (the Sustainability Policy, 2006) in this respect is that "IFC does not finance new business activity that cannot be expected to meet the Performance Standards over a reasonable period of time" (para 17).

In conducting its pre-project due diligence, IFC is required to conduct an E&S review "commensurate with the level of the E&S risks" of the Project (Sustainability Policy (2006)

para. 13). In conducting this review IFC should consider both the “E&S risks as assessed by the client” and “the commitment and capacity of the client to manage expected impacts” (para. 15). IFC should also consider whether the “client’s E&S assessment meets the requirements of PS1” and if not, require additional assessment (*Ibid*).

Given this framework, a brief discussion of client requirements under PS1 is also important. These include the requirement of the client to conduct a process of Social and Environmental Assessment (the Assessment) that will consider in an integrated manner “all relevant E&S risks and impacts of the project ... including the issues identified in Performance Standards 2 through 8...” “and those who are likely to be affected by such risks and impacts” (PS1, para 4). PS1 specifies that “the Assessment” be “adequate, accurate and objective” and prepared by appropriately “qualified and experienced persons” (PS1 para 7).

In terms of process, PS1 requires “effective consultation” with “affected communities.” Effective consultation, PS1 provides, “should be based on the prior disclosure of relevant and adequate information, including draft documents and plans” and should begin early in the ... Assessment process” (PS1, para. 21). Once final, the IFC client is required to “publically disclose the Assessment document” (para. 20).

Where gaps are identified that need to be addressed for the client to meet the requirements of the Performance Standards, IFC requires the client to prepare an Action Plan (ESRP 3; PS1, para. 16).

While not provided in PS2 itself, IFC’s 2007 Guidance Note on PS2, provides a framework for the “Labor Assessment (PS2) Component of a Social and Environmental Assessment”. This acknowledges that “A labor assessment may be carried out at different levels, depending on IFC’s initial assessment of the project risk posed by labor practices.” Further details of an approach to PS2 risk identification, assessment and management are provided in an IFC “Labor Toolkit” initially prepared in 2006 and updated in 2008.⁷

At the identification stage, the Toolkit recommends an initial “country/sector check” designed to gauge both the likelihood and severity of PS2 related risk in a project. This would include country or sector issues such as “Freedom of Association.” A subsequent section on “assessment” in relation to Workers Organizations suggests an analysis of any “history of workers’ organization conflict in the sector or at the workplace.” If a history of problems in labor relations is identified this “should be taken seriously and should lead to further due diligence checks on the client [as] a history of problems is more likely to lead to conflict in the future and can be an indicator of poor management practices.” The Toolkit also suggests asking questions about anti-union discrimination including “less favorable treatment for individual workers” who choose to join a union.

IFC’s Pre-Investment Environmental and Social Review

Documentation of IFC’s investment begins in May 2007 when an Early Review was conducted. At this stage, and through until after the conduct of the Investment Review Meeting in March 2008, it would appear that IFC had no specific concerns regarding labor issues in relation to the project. On this point, in relation to issues of Freedom of

⁷ IFC (2008) Labor Toolkit v.2. Available at: <http://goo.gl/T9hpsL>

Association, IFC's Environmental and Social Review Summary, published in June 2008 reported that all employees were free to unionize and had the right to collective bargaining. It also noted:

... some **complaints with regard to labor aspects have been raised** by external organizations. Avianca will provide IFC with status reports on these complaints, including measures implemented or planned to ensure compliance with PS2 (...) In order to be in line with best practices, Avianca will amend, as necessary, its HR policies and agreements with contractors and cooperatives and suppliers to ensure non-employee workers are retained in a manner consistent with this PS (p.3) [*emph. added*].⁸

In August 2008, as part of the investment approval process, IFC concluded that the client was in compliance with PS2 as all employees were free to unionize and had the right to collective bargaining. IFC also noted the complaints before the ILO and committed to ensuring that a Labor Assessment would be performed in order to have a detailed review of the unresolved cases and monitor continuous compliance with PS2.

In discussions with CAO, IFC staff indicated that once they became aware of the complaints to the ILO they spoke to representatives of the client's management, ILO and the ITUC. These discussions, together with a review of the complaints to the ILO and a review of the client's human resources policies, formed the basis for the description of the labor issues associated with the project outlined above.

This explanation is consistent with IFC's documentation of its pre investment due diligence. In relation to PS1, for example, IFC did not document the conduct of an integrated process of E&S Assessment by the client, rather referring to detailed monitoring and maintenance procedures which conform to ICAO requirements.⁹ As explained by IFC, the investment was aimed at upgrading the client's airline fleet and did not result in any affected communities. Therefore, community engagement requirements under PS1 were considered not applicable. In relation to PS2, IFC briefly summarized the client's Human Resources policy, noting the existence of the ILO complaints, but stating that all employees were free to unionize. According to IFC, client capacity and commitment in relation to PS2 issues was deemed adequate as the client had committed to do a Labor Assessment and address any gaps during supervision.

IFC included in its loan agreement provisions requiring a Labor Assessment to be conducted to IFC's satisfaction, prior to any disbursement of the loan. Terms of reference (TOR) for this assessment were annexed to the loan agreement.

Relevantly, IFC required that the Labor Assessment would assess the adequacy of Avianca's Freedom of Association and collective bargaining practices to meet the objectives of IFC's PS2. In particular the IFC required that the Labor Assessment would:

- a) Compare the terms of employment (rights and benefits) as set out in contracts for unionized and non-unionized employees;

⁸ IFC. Environmental and Social Review Summary (2008). Available at: <http://goo.gl/eyuBVD>
Note: The complaints referred to here are those made to the ILO and discussed in section 2.7 above.

⁹ International Civil Aviation Organization (ICAO).

- b) Assess the whether the company's practices comply with Colombian labor law and PS2 in relation to Freedom of Association and collective bargaining;
- c) Account for all pending cases before the ILO, national labor agencies and/or domestic judicial system against the company.

IFC did not specifically require that the Labor Assessment involve engagement with the unions representing workers at the company.

Also of relevance, IFC included in its loan agreement, standard covenants requiring compliance with IFC's Performance Standards and more specifically requiring that its client establish a Human Resources policy consistent with PS2.

Conclusion

CAO finds that IFC did not adequately understand the PS2 (ie. labor related) risk attached to its investment prior to commitment. This was a product of a number of factors including: (a) shortcomings in IFC's review of its client's E&S Assessment process; (b) insufficient analysis of country or sector level PS2 risk as applied to the project; (c) a failure to ensure that PS1 E&S Assessment, disclosure or consultation requirements were implemented in relation to labor issues;¹⁰ and (d) the lack of a structured assessment of client commitment and capacity in relation to PS2 issues.

In particular CAO finds that IFC's E&S Review did not ensure that its client had conducted an integrated process of E&S Assessment that covered "all relevant E&S risks and impacts of the project" including PS2 issues "and those who are likely to be affected by such risks and impacts" (PS1, para 4). Rather, in response to concerns being raised by unions a separate Labor Assessment was proposed as a condition of disbursement. As explained by one staff member with direct knowledge of the project: "we learnt about labor issues late in the review process, and the team was compelled to do as much as they could with the limited time available."

Further CAO finds that IFC did not adequately analyze its client's "commitment and capacity" in relation to PS2 compliance. IFC staff responsible for the project expressed concerns about these issues to CAO. As one IFC staff member with direct knowledge of the project explained: "there should have been acknowledgement from day one that there was an issue ... we were naïve in relation to PS2 ... it would have been better to say frankly to the Board 'this company will not comply to PS2.'"

In this context, CAO finds that IFC determined that the client was in compliance with PS2 when it did not have sufficient basis to support that conclusion. It follows that, prior to commitment, IFC was not in a strong position to reach a favorable determination on the threshold question of whether the project could be expected to meet the requirements of the Performance Standards (Sustainability Policy (2006) para. 17).

Once aware of complaints to the ILO regarding its client, IFC acted by identifying the need for a Labor Assessment. This measure responded to the lack of an Assessment covering PS2 issues in a context of significant potential risk.

¹⁰ Detailed discussion of consultation and disclosure requirements as applied to this investment are found at section 3.5 below.

However, given ongoing disputation between the client and some of its unions; significant country governance risks in relation to Freedom of Association; and in the absence of consultation with the complainant unions as part of project preparation – CAO finds that it would have been consistent with the IFC Sustainability Framework to require detailed assessment of PS2 issues prior to commitment. Postponing the Labor Assessment until after commitment meant that IFC concluded the loan agreement absent a detailed understanding of the PS2 related risks that attached to the investment. As a result, IFC lost the opportunity to negotiate more detailed PS2 related requirements in the loan agreement.

Moreover, the requirement to undertake a Labor Assessment did not sufficiently address either the issue of client commitment or that of whether there had been effective consultation with workers and their representatives. In the circumstances, CAO finds that it would have been consistent with PS1 for IFC to have included as conditions of commitment or disbursement, specific disclosure and consultation requirements, and a requirement to agree on an Action Plan addressing the findings of the Labor Assessment following consultations with workers and their representatives.

On the basis of the above, CAO finds that IFC’s pre-project E&S review did not meet the Sustainability Policy requirement of being “commensurate with the level of [Project] E&S risks” (para. 13).

3.3 Disbursement

IFC requirements

According to the ESRPs in place at the time of first disbursement (v.2, 2007) IFC’s role in project supervision includes “ensuring that any E&S Conditions of Disbursement (CODs) are met by the client prior to disbursements” (para. 6.1). The Lead E&S Specialist (LESS) assigned by IFC to a project is responsible for obtaining requisite information from the Transaction Leader to determine the status of any E&S CODs (para. 6.2.1); informing the Transaction Leader if there are any E&S CODs not complied with (*Ibid.*); and providing clearance of E&S CODs (para. 6.3.2).

E&S CODs are set out in the September 2008 Loan Agreement between IFC and its client. These include, as a condition of any disbursement, satisfactory completion of a Labor Assessment in accordance with attached TOR.

As explained by IFC, although listed as a condition of any disbursement in the body of the Loan Agreement, completion of the initial Labor Assessment should properly have been considered a condition of the second disbursement on the basis of a footnote in the TOR for the Labor Assessment which states that IFC’s client had the option to do the Labor Assessment at any point of time from now to the second disbursement.

IFC’s Handling of Disbursements

A key early E&S supervision activity was IFC’s review of the initial Labor Assessment

Fieldwork for the initial Labor Assessment was conducted in December 2008. IFC’s first disbursement was processed on January 22, 2009. The client submitted a final version of

the Labor Assessment to IFC on February 26, 2009, one month after first disbursement. A review of relevant documentation and interviews with IFC staff reveal no indication that satisfactory completion of the Labor Assessment was considered as a condition of the January 2009 disbursement.

Documentation of a review of the initial Labor Assessment by IFC E&S was not available. This is material in the context of a number of apparent shortcomings in the Assessment. Given that the objective of the Labor Assessment was framed in terms of assessing the adequacy of the client's Freedom of Association and collective bargaining practices, it is notable that the Assessment's analysis of issues of Freedom of Association amounts to one page of the 35 page report, and that the Assessment does not reference national legal requirements, the IFC Performance Standards, or the specific allegations of made by the unions. CAO further notes that the Assessment does not address IFC's key requirements for the Labor Assessment, in particular the requirements to analyze: (a) the differences in contract benefits for unionized and non-unionized employees, and (b) domestic labor cases brought against the company.

In this context, it is also notable that IFC E&S expressed dissatisfaction with the initial Labor Assessment, describing it as being of low quality. The extent of engagement with the complainant unions was identified by IFC E&S as a particular shortcoming with the initial Labor Assessment. As a result when a second Labor Assessment was commissioned in 2010, IFC required that it be carried out by a different consulting firm.

The client's request for second disbursement was received on July 10, 2009 and disbursement was processed on July 16, 2009. The request for disbursement as received from the client includes a statement that the initial Labor Assessment had been conducted to IFC's satisfaction.

Conclusion

IFC did not consider satisfactory completion of the initial Labor Assessment as a requirement of first disbursement although it was set out as a condition of *any* disbursement in the Loan Agreement. As explained by IFC, this was due to a lack of clarity in the drafting of the Loan Agreement and the intent of the parties was to give the client up until second disbursement to complete the Labor Assessment.

In relation to the second disbursement (July 2009), IFC appears to have satisfied itself of completion of the initial Labor Assessment without clearance from IFC E&S. CAO finds that there were shortcomings in the completeness and quality of the Labor Assessment that were evident to IFC E&S at the time. A review of the Labor Assessment, was however, not documented. In these circumstances, CAO finds that IFC did not meet the E&S clearance requirements as specified in ESRP 6.2.1 in relation to the second disbursement.

CAO further finds that IFC did not give appropriate consideration to the adequacy of the initial Labor Assessment required as a condition of disbursement. As a result, the basis for IFC's engagement with its client around PS2 issues was significantly weakened. This situation, CAO finds, compounded problems with the structure for supervision of the project that stemmed from the shortcoming in IFC's pre investment E&S review as set out in Section 3.2. above.

The absence of a rigorous review of the unions' allegations of breaches of Freedom of Association and anti-union discrimination against the requirements of PS2, meant that - at the point of disbursement - IFC was not in a position to make an informed judgment as to the likelihood that the investment would meet the requirements of PS2. As indicated in Section 3.2. above, there were in fact significant doubts among IFC staff responsible for the project as to whether the client was genuinely committed or had the capacity to meet the requirements of PS2. In these circumstances, CAO finds IFC's decision to disburse to the client was made without sufficient basis to meet the requirement Sustainability Policy that "IFC does not finance new business activity that cannot be expected to meet the Performance Standards over a reasonable period of time."

3.4 General Supervision

IFC requirements

Following commitment, IFC's obligation is to monitor the client's E&S performance in accordance with its Sustainability Policy and ESRPs. Relevantly, this includes the requirement to review project performance on the basis of the client's commitments in the investment agreement and Action Plan and, in cases where a client fails to comply with these commitments, to work with the client to bring it back into compliance (Sustainability Policy, 2006, para. 26). It also includes a requirement to respond to "changed project circumstances" (*Ibid.*). In cases where the client fails to reestablish compliance, the Sustainability Policy provides that IFC should exercise "appropriate remedies" (*Ibid.*). As articulated in the ESRP in place since 2010 through its E&S supervision IFC will "develop and retain the information needed to assess the status of compliance with the Performance Standards (PSs) ... and the Environmental and Social Action Plan (ESAP or Action Plan)."¹¹

IFC's Supervision of its Client

2010

IFC recorded its first supervision of this investment in April 2010. This included both a review of the client's first Annual Monitoring Report (AMR 2009), information from a visit by an E&S specialist to the client's Bogota offices, and consultations with union representatives. While noting that the initial Labor Assessment was inconclusive in relation to issues of Freedom of Association, IFC's April 2010 supervision document concludes that the client has implemented some labor practices which could be used to deter union membership. In particular, it notes that differences in benefits between workers under different contract types can be interpreted as discriminatory (against unionized labor). A continued series of labor assessments (every six months) is proposed until these concerns have been addressed. At this point, IFC also recommends that the labor assessment process be expanded to include Taca Airlines (El Salvador) which had recently been acquired by the client.¹²

¹¹ *ESRP*, v5., para. 1.

¹² The Taca audit was to be completed pursuant to amendments to the loan agreement between IFC and the Company that were concluded in the course of the Avianca – Taca merger. These included a provision that extended the E&S provisions of the original loan agreement to the operations of TACA in addition to those of Avianca.

The April 2010 supervision document also identifies what are described as failures in relation to the initial Labor Assessment, particularly insufficient engagement with the unions as part of the Assessment process. As a result, IFC E&S recommends that a different consultant be contracted to undertake the next labor assessment. Finally, the supervision document remarks that the client's 2009 AMR provides no information on PS2 issues and includes suggested text requesting that the client provide additional information in the next AMR. At this point IFC assigns the project an E&S Risk Rating of 3 (partially unsatisfactory).¹³

The second recorded supervision activity¹⁴ occurred following a site visit in September 2010. This took place at the same time as fieldwork for the second Labor Assessment. Based on meetings with unions and management and preliminary results of the labor assessment, the supervision documentation finds that there were questions about project performance in relation to PS2 issues including compliance with approval requirements. At this point IFC gives the project an E&S Risk Rating of 4 (Unsatisfactory).

2011

Due to significant delays on the side of the consultants, the second Labor Assessment was not finalized until May 2011.

Following the second Labor Assessment, in August 2011, IFC firmed in its view that the client needed to do more to address PS2 compliance issues (including Freedom of Association). As a result, in August 2011, IFC management conveyed to the client that it was out of compliance with PS2. This led to what the IFC team saw as a positive response from the client and, in November 2011, a new Action Plan from regarding labor issues.

In December 2011, as a result of what IFC saw as an agreement to a robust action plan and management changes in the client's human resources department, IFC upgraded its assessment of project ESRR from 4 (Unsatisfactory) to 3 (Partially Unsatisfactory).

A review of the client's 2010 AMR (received in May 2011) was completed by IFC with significant delay in April 2012. As with the 2009 AMR, IFC notes that the 2010 AMR is incomplete and insufficient to demonstrate compliance with PS2 requirements. Again text is suggested requesting that the next AMR include additional information, in particular in relation to labor issues. Again the project is assigned an ESRR of 3 (Partially Unsatisfactory).

2012

Further recorded supervision activities occurred following a site visit by IFC E&S staff in August 2012 and with the review of the client's 2011 AMR in December 2012. The site visit took place at the same time as fieldwork for the third Labor Assessment and

¹³ E&S Risk Ratings (ESRR) are a tool used by IFC to evaluate the potential social and environmental risk of projects. ESRR includes in its computation an element of performance and risk on a scale of between 1 and 4.

¹⁴ Key steps in IFC's E&S supervision of a project are captured in what are known as Recordable Supervision Activities. These include Site Supervision Visits and reviews of client Annual Monitoring Reports.

incorporates draft findings of this Assessment. The IFC supervision documentation notes partial progress on implementation of the 2011 labor action plan and identifies additional actions the which the client should make to ensure compliance with IFC requirements related to Freedom of Association. This is consistent with the findings of the third Labor Assessment.

To advance what is an increasingly technical discussion around PS2 compliance, the 2012 supervision documentation notes that IFC commissioned advice from local counsel in relation to Freedom of Association issues at the client. In relation to the 2011 AMR, IFC again notes that the client has not provided required information in relation to labor issues. Regarding the complainants' concerns that IFC did not conduct a rigorous assessment of PS2 compliance at Taca Airlines subsequent to its merger with the client, CAO notes that the supervision documentation includes as a next step that a labor assessment of Taca be scheduled for December 2012.¹⁵

2013

Project supervision experienced further delays in 2013. The Labor Assessment of Taca, which was scheduled for December 2012, was completed in June 2013. The opinion that IFC had requested from local counsel that was described as pending in the November 2012 supervision document (see above), was finally delivered in September 2013. Neither the Taca Labor Assessment nor the opinion from local counsel had been incorporated into IFC's record of supervision activities at the time this CAO investigation report was written (March 2014).¹⁶ In relation to the advice from local counsel received in September 2013, CAO notes IFC's view that this should not be disclosed on the basis that it is subject to attorney-client privilege.

IFC's review of its client's 2012 AMR was recorded in October 2013. At this point, IFC maintained the client's ESRR at 3 (Partially Unsatisfactory) on the basis that the client had not presented sufficient information to demonstrate compliance with the IFC Performance Standards, in particular agreed PS2 indicators.

As explained to CAO by IFC staff assigned to the project, the sense of the team was that if IFC were to push too hard on PS2 issues, the client would pre-pay the loan, a result which was not desirable in relation to a client which had an above average level of credit worthiness. In these circumstances, it was explained that absent "blatant non-compliance," IFC would continue to work through the issues with the client. In relation to a customer service business like the airline industry, it was explained that the airline's

¹⁵ This is to be completed according to amendments to the legal agreement between IFC and the client that extend the E&S provisions of the legal agreement to cover the operations of TACA in addition to those of Avianca.

¹⁶ While no IFC review of the Taca Labor Assessment was available at the time of writing, CAO is mindful of the complainants' assertion that there are no unions at Taca. CAO is also mindful that there exist past public allegations against Taca related to anti-union discrimination, and that the country context of El Salvador (where Taca was based) is one where laws on freedom of association and the right to collective bargaining are reported not to be consistently upheld (See US State Department Country Report on Human Rights – El Salvador (2012); *Airline Pilots Association, International, Afl-Cio v. Taca International Airlines, S.A.*, 748 F.2d 965).

growth and profitability did not suggest a major problem in terms of staff / management relations.

Finally, CAO notes that in December 2013, 2 years ahead of schedule, the client fully repaid its loan to IFC. As a result, at the time of writing, Avianca was no longer an IFC client.

Conclusion

The IFC team responded to PS2 concerns regarding its client by requiring a series of Labor Assessments and negotiating corresponding action plans. As part of this process CAO finds that the IFC team identified compliance issues and “work[ed] with the client to bring it back into compliance” as required under the Sustainability Policy (para. 26).

Weaknesses in the supervision of the Labor Assessments¹⁷ and client E&S reporting requirements, however, meant that IFC staff struggled to understand the Freedom of Association issues they had identified, at the level of detail needed to ensure that the issues were being adequately addressed. As a result, CAO finds that IFC did not “develop and retain the information needed to assess the status of [its client’s] compliance with the Performance Standards (PSs)” – the stated objective of project E&S supervision as set out in the ESRP. These issues were compounded by significant delays in the preparation and review of information on the client’s E&S performance.

This situation was partially remedied in September 2013 (more than 5 years after concerns were initially raised by the unions with IFC) when IFC received advice from local counsel in relation to Freedom of Association issues at the client. Given the late stage at which it was received, however, IFC was not able to incorporate recommendations contained in the advice into project supervision prior to the client’s pre-payment of the loan.

Lacking adequate information on which to assess the status of the client’s compliance, absent effective leverage and without appropriate tools at its disposal, CAO finds that IFC made limited progress in addressing the issues which formed the basis of the unions’ complaint to CAO. Reasons for the weakness of IFC’s supervision as identified by CAO include: (a) genuine complexities in assessing and addressing Freedom of Association issues, particularly in companies and countries with fractious histories of union/management relations; (b) delays and methodological shortcomings in the Labor Assessments conducted; (c) gaps in the extent to which the Labor Assessments answered their Terms of Reference; (d) inadequate reviews of the Labor Assessments by IFC; (e) what IFC staff described as variable commitment to resolving the issues on behalf of the client; (f) what IFC staff described as a lack of leverage to achieve tangible progress on PS2 compliance, particularly after the loan was disbursed in mid 2009; and (g) IFC management’s unwillingness to exercise remedies in a context where the non-compliance was seen as less than blatant and dialogue with the client continued.

¹⁷ Here CAO refers specifically to shortcomings with regard to: (a) the TORs adopted for the Labor Assessments and the extent to which these responded to the specific allegations being raised by the unions; (b) IFC’s reviews of the Labor Assessments against the TORs and the requirements of PS2; and (c) IFC’s supervision of the consultation and disclosure requirements as applied to the Labor Assessment and resulting action plans.

Of broader importance in relation to project supervision, CAO notes that IFC's policies and procedures provide staff with limited guidance on how to respond to complaints regarding a client's E&S performance. This is particularly relevant in a case such as this one where a client is the subject of serious and ongoing allegations in relation to the application of a Performance Standard.

3.5 Disclosure and Consultation

Concerns around the adequacy of disclosure and consultation were raised in the unions' complaint to CAO regarding this project. In particular, the complaint argued that Avianca and/or IFC should have disclosed its client's Labor Assessments and resulting Action Plans.

IFC requirements

IFC and its clients are committed to disclose certain information as part of the project cycle. While recognizing that transparency is fundamental to fulfilling its development mandate, IFC also respects the confidentiality of certain business information. Applicable requirements were set out in the Performance Standards and the Policy on Disclosure of Information (both 2006).

IFC's E&S disclosure requirements under the 2006 policies are focused on the ESRS. According to the Policy on Disclosure of Information, the ESRS must be disclosed and, "along with the ESRS," IFC must "make available electronic copies of, and where available, links to any relevant social and environmental impact assessment documents prepared by or on behalf of the client, including the Action Plan" (para. 13(a)).

In addition, under PS1, an IFC client is required to disclose:

- a. "the Assessment document" where a client has undertaken a "process of Social and Environmental Assessment" (para. 20).¹⁸
- b. "the Action Plan" prepared when "the client identifies specific mitigation measures and actions necessary for the project to comply with applicable laws and regulations and to meet the requirements of Performance Standards 1 through 8" (para. 16);
- c. "the updated mitigation measures and activities" included in subsequent versions of the Action Plan (para. 26); and
- d. "periodic reports that describe progress with implementation of the Action Plan" (para. 26).

As noted above, in terms of process, PS1 requires "effective consultation" with "affected communities." Effective consultation, PS1 provides, "should be based on the prior disclosure of relevant and adequate information, including draft documents and plans" and should begin early in the ... Assessment process" (PS1, para. 21). Any Action Plan developed by the client to address E&S issues must also reflect the outcomes of the consultative processes required by PS1 (*Ibid.*)

Disclosure and Consultation in Relation to Avianca

¹⁸ Note the conduct of a "process of E&S Assessment" is a client requirement under PS1 (para. 4).

In this case, IFC disclosed an ESRS in June 2008. The ESRS notes that the client will provide IFC with status reports on “measures implemented or planned to ensure compliance with PS2”; however, no Action Plan or E&S impact assessment documentation is disclosed on the IFC website. As explained by the IFC team, this was because no E&S Impact Assessment or Action Plan was prepared prior to disclosure of the ESRS. In contrast to the current Access to Information Policy (2012), the IFC team explained that, in its understanding, the Policy on Disclosure of Information (2006) did not require “post board” disclosure of Action Plans or Assessment documentation by the IFC.

Regarding the client’s disclosure requirements, the IFC team indicated that the client would only be required to disclose Assessment documents and Action Plans in cases where significant adverse effects to affected communities are identified.¹⁹ Therefore, given that the Project objective was the upgrading of client’s airline fleet which affected no community, it is the IFC team’s view that the client was not required by PS1 to disclose any E&S documentation. However, IFC notes that the team encouraged the client to share documentation on a voluntary basis. In explaining why documentation around the initial (2008) Labor Assessment was not disclosed, the team’s view was that it would have been counterproductive to push for disclosure at the time given tensions between unions and management and the fact that there existed internal structures for dialogue between the client and its unions based on Colombian law. By 2011 the team indicated that the atmosphere was more conducive to dialogue and as such that the client was encouraged again to disclose its revised Action Plan. While the view from IFC E&S was that the Action Plan itself should be disclosed, the client instead sent a letter informing unions of a number of activities being carried out in fulfillment of the company’s commitments to IFC.

Conclusion

Having considered the IFC team’s views in the context of the relevant policy provisions, CAO finds that IFC complied with the disclosure requirements under the 2006 Policy on Disclosure of Information. Under this (now superseded) Policy post-Board disclosure was the obligation of the client, with IFC in a monitoring role.²⁰ As such IFC was not required to disclose the client’s Labor Assessments or its agreed Action Plans related to labor issues.

On the other hand, CAO finds non-compliance in relation to IFC’s supervision of its client’s consultation and disclosure requirements under PS1. CAO does not concur with IFC’s view that the requirement to disclose Assessment documents and Action Plans under PS1 was properly interpreted to exclude labor related issues. Indeed the contrary is suggested both by the structure of PS1 which requires integrated assessment and management of E&S risks and impacts including those covered by PS2 (Labor and Working Conditions), and by PS2 (para. 20) which refers back to PS1 in terms of assessment and management requirements (which include consultation and disclosure).

¹⁹ At the time of the initial Labor Assessment, CAO notes that the E&S Specialist assigned to the project recommended the disclosure of the Executive Summary of the Assessment as well as the Action Plan. This recommendation, however, was not taken up.

²⁰ IFC Disclosure of Information Policy, 2006, para 13(a); IFC Performance Standard 1, 2006, para. 20.

Similarly, CAO is unable to support IFC's argument that disclosure is discretionary in cases where a client has contentious relationships with its workers or their union representatives. Indeed, disclosure and consultation, while difficult, may be most important in such circumstances.

In particular, CAO finds that IFC did not adequately supervise the requirements that its client:

- (a) disclose the findings of its Labor Assessments, including the Taca Labor Assessment (which CAO considers to be "Assessment documents" for the purpose of PS1);
- (b) engage in "effective consultation" as part the preparation of either its Labor Assessments or the resulting Action Plans, in particular the PS1 requirement that effective consultation should be based on the "prior disclosure of ... draft documents and plans;" or
- (c) disclose Action Plans, updated versions of the Action Plan, and report regularly on progress against its Action Plans.

In CAO's view these shortcomings in IFC's supervision of its client's consultation and disclosure requirements were significant in that they contributed to the difficulties that IFC had in assessing the status of its client's compliance with the substantive requirements of PS2.

CAO also notes that the presence of a confidentiality agreement between IFC and its client has limited the extent to which CAO has been able to refer to the client's Labor Assessments and Action Plans in this report.

3.6 Extent to which IFC policies, procedures and staffing structures support PS2 objectives

The TOR for this audit asked whether IFC policies, procedures and staffing structures provide a robust framework for the advancement of the objectives of PS2 in its clients. The TOR for this audit also asked CAO to analyze the immediate and underlying causes of any non-compliance identified.

This section of the CAO investigation report draws together an analysis of IFC's approach to the application of PS2 to its investment in the client as set out in the sections above. The following themes are developed:

- (a) limitations in the depth and expertise of IFC E&S staff in relation to PS2 issues;
- (b) limitations in IFC's methodology in relation to pre-investment review of PS2 issues;
- and
- (c) limitations on the leverage, tools and resources that the IFC team working project had to address the PS2 issues during supervision.

This report treats each of these issues in turn, though they are clearly interlinked.

Limitations of depth and expertise in relation to PS2 issues

In undertaking its analysis, CAO notes that labor issues were introduced as a part of IFC's E&S framework with the Performance Standards in April 2006. Thus at the time this project was prepared (2008), issues of labor and working conditions (PS2) were a relatively new addition to IFC's suite of environmental and social policies. CAO also notes that IFC's E&S department is comprised primarily of environmental specialists. The second primary area of expertise is social development with social specialists generally having expertise across one or more of the following fields: resettlement, indigenous issues and community engagement. Deep expertise in labor issues was and continues to be rare among E&S staff.

IFC has sought to address this issue by providing training to E&S staff. As explained by a member of IFC staff assigned to this project, however, this training only scratches the surface and does not equip E&S generalists to engage effectively with a client on difficult PS2 issues. According to other IFC staff, the training aims at helping E&S staff to identify where a labor specialist is needed.

Responding to the need for staff with deeper expertise on PS2 issues, the IFC E&S department has designated three social specialists as regional PS2 focal points with a role to provide advice and backstopping support to other E&S staff on labor issues. In addition, in 2013, IFC contracted with a consultancy firm specializing in labor issues. This contract provides a framework for the firm to provide advice to IFC in relation to investments with complex PS2 issues. This is a significant new initiative which could be used to respond to a range of findings from this investigation.

Limitations in methodology for pre-investment PS2 review

IFC's approach to this project suggests that its methodology for identifying and monitoring PS2 compliance issues is underdeveloped. This manifested in a number of ways, including (a) sparse pre-commitment analysis of PS2 issues at the firm, country and sector levels; (b) lack of a structured approach to consultation and disclosure, including stakeholder mapping around PS2 issues; and (c) lack of a structured approach to the assessment of client commitment and capacity in relation to PS2 issues. The IFC Labor Toolkit prepared initially in 2006 and revised in 2008 provides useful guidance for IFC staff on identifying and assessing PS2 related risk, particularly as relates to Freedom of Association. However, it appears that the approach outlined in the Toolkit has not been fully incorporated into IFC practice and procedures.

Limitations of leverage, tools and resources for effective supervision of PS2 issues.

As set out in the IFC Labor Toolkit, "Freedom of Association is one of the most difficult labor issues for which it suggest definitive methods of moving towards compliance." This is the case "on account of the different legal systems that are in place throughout the world and also as a result of the political complexities that can be associated with this issue." CAO endorses these observations.

In an investment such as this, IFC's approach to supervision – relying heavily on a series of Labor Assessments and resulting Action Plans – presented at best a partial solution to a complex problem. CAO notes that weaknesses in IFC's timely review and feedback on the Labor Assessments, which were commissioned in the course of the project, hindered effective supervision of the project. CAO also notes that the above mentioned Labor

Toolkit was originally envisaged as including a module on monitoring PS2 issues in IFC investments, which does not appear to have been developed.

Disbursing fully before any substantive actions were required to address the PS2 issues identified in the immediate pre and post commitment phase of the project, meant that IFC had limited leverage in its subsequent discussions with the client around implementation of agreed Action Plan items. This issue was compounded by the fact that the Action Plans agreed with IFC following the Labor Assessments were not incorporated into the loan agreement and therefore not legally binding. IFC could require advance repayment of the loan – but only if the client was out of compliance with its obligations under loan agreement. And this appeared to the IFC team to be a drastic and unwarranted measure given the client’s strong financial performance, its willingness to engage with IFC in relation to the ongoing PS2 concerns, and a lack of what was characterized as “blatant non-compliance.”

This analysis suggests three key shortcomings in terms of the leverage, tools and resources that IFC had at its disposal in pursuing the objectives of PS2 in relation to this project.

Firstly, CAO finds that a more robust approach to IFC’s PS2 review could have led to earlier and clearer analysis of the compliance issues being raised by the unions, as well as a clearer articulation of the consultation and disclosure requirements of the Performance Standards as applied to the client. Earlier, clearer articulation of the compliance issues, CAO finds could have sharpened the dialogue between IFC and its client, led to the negotiation of contractual terms that were better suited to the PS2 risks that existed at the client, and thus increased IFC’s leverage in relation to the supervision of these risks.

Secondly, CAO finds that IFC did not apply tools that might have supported more effective resolution of the issues. These include measures designed to promote active workplace cooperation and social dialogue (particularly dialogue between unions, management). Further, on the basis of international experience, CAO finds that converting the results of labor audits into positive developments at the enterprise level, often requires active and intensive externally facilitated remediation programs, going well beyond the type of supervision and annual follow up on Action Plans commitments offered by IFC.

Thirdly, CAO finds that the structure of the relationship between IFC and its client (as defined by the loan agreement) provided little support for the positive resolution of the PS2 issues that dominated project supervision. In particular CAO notes the lack of a path for incorporating Action Plan commitments that emerged after commitment into the framework of the loan agreement. CAO also notes the lack of a system to incentivize good E&S performance short of the threat of IFC declaring the client in default of the loan; a threat which both IFC staff and its clients know to be hollow in circumstances such as those described in this report. In such circumstances, CAO finds that a system of more graduated incentives may be useful in encouraging improved E&S performance.

Annex 1: Summary of Key Findings

<i>Environmental and Social Review</i>
IFC's pre-project E&S review in relation to labor issues was not commensurate to risk.
IFC's E&S Review did not ensure that its client had conducted an integrated process of E&S Assessment that covered "all relevant E&S risks and impacts of the project" including PS2 issues.
IFC did not adequately analyze its client's "commitment and capacity" in relation to PS2 compliance.
IFC did not have sufficient basis to support the assertion contained in the Board paper that its client was in compliance with PS2.
In a context of ongoing disputation between the Company and some of its Unions; significant country governance risks in relation to Freedom of Association; and in the absence of consultation with the complainant unions as part of project preparation - it would have been consistent with the IFC Sustainability Framework to require more stringent due diligence prior to commitment.
It would have been consistent with PS1 for IFC to have included as conditions of commitment or disbursement, specific disclosure requirements, and a requirement to agree on an Action Plan addressing the findings of the Labor Assessment following consultations with workers and their representatives.
<i>Disbursement</i>
IFC did not give appropriate consideration to the adequacy of the initial Labor Assessment prior to disbursement. As a result the basis for IFC's engagement with its client around PS2 issues was significantly weakened.
This situation compounded problems with the structure for supervision of the project that stemmed from weaknesses in the TOR for the Labor Assessment and the CODs incorporated into the Loan Agreement.
IFC's July 2009 disbursement was made without sufficient basis to meet the requirement of the Sustainability Policy that "IFC does not finance new business activity that cannot be expected to meet the Performance Standards over a reasonable period of time."
<i>General Supervision</i>
The IFC team identified compliance issues and "work[ed] with the client to bring it back into compliance" as required under the Sustainability Policy.
IFC did not "develop and retain the information needed to assess the status of [its client's] compliance with the Performance Standards (PSs)," as required by the ESRP.
Lacking an adequate information basis on which to assess the status of the client's compliance; absent effective leverage and without appropriate tools at its disposal, IFC made limited progress in addressing the issues which formed the basis of the unions' complaint to CAO.
<i>Disclosure and Consultation</i>
IFC complied with the disclosure requirements under the 2006 Policy on Disclosure of Information.
IFC did not adequately supervise the requirements that its client: <ul style="list-style-type: none"> (a) disclose the findings of its Labor Assessments; (b) engage in "effective consultation" as part the preparation of either its Labor Assessments or the resulting Action Plans, in particular the requirement that effective consultation should be based on the "prior disclosure of ... draft documents and plans;" or (c) disclose Action Plans, updated versions of the Action Plan, and report regularly on progress against its Action Plans.
<i>Extent to which IFC policies, procedures and staffing structures support PS2 objectives</i>
IFC's implementation of PS2 suffered from limitations in three key areas: (a) depth and expertise of E&S staff on PS2 issues; (b) methodology for pre-investment PS2 review; and (c) leverage, tools and resources for effective supervision.

Annex 2: CAO Investigation TOR

[...]

Scope of the Audit

The focus of compliance auditing is on IFC, and how IFC assured itself of project environmental and social performance at appraisal and during supervision.

As set out in CAO's appraisal report the focus of the compliance audit will be the following:

- a) whether IFC exercised due diligence in its review and supervision of the PS2 risks attached to the Project; in particular
 - o whether IFC's approach to PS2 issues during the E&S review process was commensurate to risk and otherwise compliant with relevant policies and procedures;
 - o whether IFC was in a position to make an informed judgment as to the likelihood that the investment would meet the requirements of PS2 prior to disbursement; and
 - o whether IFC's record of supervision constituted an adequate and timely response to specific concerns being raised by unions regarding the client's PS2 performance.
- c) whether IFC policies, procedures and staffing structures provide a robust framework for the advancement of the objectives of PS2 in its clients.

The scope of the audit also includes developing an understanding of the immediate and underlying causes for any non-compliance identified by the CAO.

Audit Criteria, Approach and Preliminary Timeline

The audit criteria are the conditions for IFC's involvement, including IFC policies, performance standards, guidelines, procedures, and other requirements. Specifically these include the IFC's Policy and Performance Standards on Environmental and Social Sustainability (2006); relevant International Labour Organization and United Nations Conventions (as set out in Performance Standard 2) and applicable provisions of national law.

In the context of this audit CAO also notes the recent publication of the World Bank's *World Development Report 2013* which emphasizes the importance of 'good jobs' in the private sector as a driver of economic and social development. For IFC, a 'good job' has been defined as one which reflects the core elements of PS2, "and recognizes that the pursuit of economic growth through employment creation and income generation should be accompanied by protection of the fundamental rights of workers."ⁱ

The approach to the audit is described in the CAO Operational Guidelines (April 2007), and states that the working definition of compliance auditing adopted by CAO Compliance is as follows:

A compliance audit is a systematic, documented verification process of objectively obtaining and evaluating evidence to determine whether environmental and social activities, conditions, management systems, or related information are in conformance with the audit criteria.

The audit will typically be based on a review of documents, interviews, observation of activities and conditions, or other appropriate means. The verification of evidence is an important part of the audit process.

The preliminary time schedule is for CAO to have a draft audit report ready by August 2013. CAO's Operational Guidelines state that the draft audit report is to be circulated to senior management of IFC and all relevant departments for factual review and comment. Comments should be submitted in writing to the CAO within 15 working days of receipt by the departments. Upon receiving comments on the draft, CAO Compliance finalizes the report. The final report is submitted to the senior management of IFC for a response. The audit report and any response from IFC is forwarded to the Office of the President of the World Bank Group. Once the President is satisfied with the response by IFC management, the Office of the President provides clearance for the audit report and the response. After clearance, CAO Compliance shares the audit report and the management response with the World Bank Group Board and discloses both documents on the CAO Web site.

As per its established practice CAO will engage an audit panel to work with it on this task. For this particular audit, CAO considers the following as necessary for the audit panel;

- Significant expertise in relation to issues of labor standards and working conditions, particularly in the context of emerging economies.
- Knowledge of IFC's Performance Standards, particularly Performance Standard 2, as well as applicable Environmental and Social Review Procedures.
- Experience and knowledge of compliance auditing.
- Demonstrated ability to analyze policies and practices and develop proposals for reform in complex institutional contexts.
- Relevant country and / or regional experience.

ⁱ *IFC Jobs Study: Assessing Private Sector Contributions to Job Creation and Poverty Reduction* (2013), p.131.