Monitoring and update of IFC’s response to the

CAO Audit of IFC dated June 2009

related to IFC’s investments in:
Wilmar Trading (IFC No. 20348)
Delta–Wilmar CIS (IFC No. 24644)
Wilmar WCap (IFC No. 25532)
Delta–Wilmar CIS Expansion (IFC No. 26271)

Executive Summary

The CAO Audit Report dated June 19, 2009, found that IFC did not apply its Performance Standards to several investments connected to the Indonesian palm oil sector. This monitoring report makes public the status of IFC’s specific actions to address the CAO conclusions as stated in the June 19, 2009, CAO Audit Report. CAO’s monitoring is limited to follow up on the conclusions made by CAO in its audit report.

IFC’s response to the audit includes development of a strategic approach to future palm oil investments and a review of its current involvement in Indonesian palm oil, an Advisory Services program aimed at the Indonesian palm oil sector, and commitment to address several of the audit findings as part of IFC’s ongoing policy review. CAO observes that substantial commitments have been made by IFC to address the audit findings, but it is still too early to verify that the actions will have the intended effect. CAO fully acknowledges that closing CAO’s audit findings is only one part of an overall approach by IFC to address the concerns connected to the palm oil sector globally. The audit will remain open while CAO monitors the outcome of IFC’s actions.

Office of the Compliance Advisor/Ombudsman (CAO)

for the
International Finance Corporation (IFC)
Multilateral Investment Guarantee Agency (MIGA)
Members of the World Bank Group
Background

CAO’s Audit report on IFC’s involvement in the Wilmar group, dated June 19, 2009\(^1\), concluded that IFC did not meet the intent or requirements of its own Performance Standards for its assessment of the Wilmar trade facility investment (Wilmar Trading and Wilmar WCap). As for the Wilmar refinery investment (Delta – Wilmar CIS and Delta - Wilmar CIS Expansion), CAO concluded that IFC failed to assess the supply chain plantations or other companies and suppliers linked through the Wilmar Group, as required by its Performance Standards.

Finally the CAO concluded that the adoption of a narrow interpretation of the investment impacts—in full knowledge of the broader implications—was inconsistent with IFC’s asserted role, mandate of reducing poverty and improving lives, and a commitment to sustainable development.

Since CAO is completely independent from IFC and IFC’s management, CAO has no mandate to instruct IFC to act. However, CAO’s Operational Guidelines states that in cases where IFC is found to be out of compliance, CAO Compliance will keep the audit open and monitor the situation, until actions taken by IFC assure the CAO that IFC will move back in to compliance. The CAO will make public the status of all CAO compliance cases.

This monitoring report makes public the status of IFC’s specific actions to address the conclusions stated in the June 19, 2009, CAO Audit Report. This monitoring report is based on information IFC has shared with the CAO as of April 15, 2010. CAO’s monitoring is limited to follow up on the conclusions made by CAO in its audit report.

In August 2009, civil society organizations urged the President of the World Bank Group to suspend further financing of the Indonesian oil palm sector. The President responded by informing the civil society organizations that he had instructed IFC not to approve any new investments in palm oil until there is a new strategy in place. In November 2009, civil society raised concerns about the coordination between the public and the private sectors arms of the World Bank. In response to this concern, the President responded by assuring civil society that no new World Bank Group public sector investments in oil palm would be approved until a comprehensive common approach to palm oil investment is in place throughout the World Bank Group.

\(^1\) See [www.cao-ombudsman.org](http://www.cao-ombudsman.org) for the full report
Detailed comments on IFC’s responses to CAO’s Audit Report conclusions

CAO Audit Report Observation 3.1.1

CAO concluded that IFC had no specific strategy that provided guidance for engagement in the Indonesian palm oil sector, despite the recognized social, environmental, and governance sensitivity of the sector, prior IFC and WBG experience, and IFC’s own recognition of the significance of its engagement in the sector.

IFC’s response and action 3.1.1
Shortcoming acknowledged by IFC in its official response. IFC states that it is in the process of developing a global palm oil strategy. This strategy will, according to IFC, guide investment operations as well as advisory services, and the strategy will also guide how IFC will engage with stakeholders. IFC committed to active and iterative consultations with relevant stakeholders, such as industry, financial institutions, civil society and indigenous peoples’ organizations. IFC stated on its web site that it will incorporate input from key stakeholders participating in the Roundtable on Sustainable Palm Oil while developing the strategy. The strategy was first estimated to be finalized for review by Feb 2010, but the time line was later extended by IFC.

IFC also stated that development of the strategy would provide an opportunity to analyze the broader issues regarding the sector in Indonesia.

IFC stated that it will develop and implement an Advisory Services program targeting the palm oil sector in Indonesia, with special attention to improving the capacity of smallholders/ suppliers. IFC will seek to define this program in consultation with relevant stakeholders, such as industry, financial institutions, civil society and indigenous peoples’ organizations. IFC suggested the initial focus areas to include promotion of fair labor practices, promotion of best practices in land tenure/ community consultations, promotion of RSPO and promotion of community conflict resolution regimes.

IFC states that it will attempt to further assist RSPO and support biodiversity work through BACP, and that IFC will attempt to develop an Indonesian Agri BEE program to identify regulatory constraints and develop solutions.

In April 2010, IFC publicly released a paper outlining the framework for development of a palm oil strategy, together with a note specifying the main components in the consultation process to be launched.

CAO monitoring comment 3.1.1
CAO will continue to monitor whether the strategy will be specific enough, and address and give guidance on the social and environmental issues to an extent that is likely to have mitigated adverse outcomes and delivered positive outcomes in the specific cases audited.

CAO finds IFC current commitments and initial actions, although somewhat delayed compared to IFC’s initial time plan, indicative of a constructive approach attempting to address the issues raised. CAO fully acknowledges that closing CAO’s audit findings is
only one part of an overall approach by IFC to address the concerns connected to the palm oil sector globally.

CAO will continue to monitor whether IFC’s strategy and approach, in combination with revised procedures, have the potential to fully or partly mitigate the concerns raised by socially and environmentally impacted people on the ground. See Chapter 1.8 of the CAO Audit Report.

CAO will continue to monitor how success/failure of the new strategy will be measured, how IFC intends to establish baseline data at provincial and country level in order to measure success of the new strategy, and the effect of IFC’s investment driven assessment work as well as IFC Advisory Services sector work.

CAO will continue to monitor IFC’s approach to consultation and stakeholder dialogs in the review process as well as during the later implementation.

CAO has reviewed the documentation provided by IFC, and can conclude that substantial commitments have been made to address the issue of lack of guidance for IFC on a strategic level, and related works such as gathering relevant sector information and commitment to support work to improve situations on the ground throughout the sector.

**CAO Monitoring Conclusion 3.1.1**

CAO concludes that it currently does not have the concrete evidence that actions taken by IFC have the intended effect. CAO observes that substantial commitments have been made, and it is too early to expect any evidence of actions and resulting outcomes. Item remains open and under monitoring.

**CAO Audit Report Observation 3.1.2**

CAO concluded that, from a due diligence perspective, IFC’s environmental and social review procedures do not adequately address the particular characteristics of trade financing, or other similar kinds of investments. At present, there is no procedure implemented for such investments that addresses the sector, country and commodity based risks.

**IFC’s response and action 3.1.2**

Acknowledged and accepted by IFC. IFC updated the Environmental and Social Review Procedures (ESRP) on August 14, 2009 to “2.2.4 For investments involving trade finance, the environmental and social Categorization should reflect the risks of the prospective client company, its operations, holdings and activities. It is possible that the risks posed by a vertically integrated company, where the same company owns, or has direct influence upon, several levels (echelons) of the supply chain, are greater than the risks posed by a pure commodity trader who does not own or influence any levels of the supply chain and that all they do is trade or exchange of raw or primary products. Supplemental considerations affecting categorization include future proposed developments such as land acquisition, commodity pricing variations in the supply chain which potentially indicate a low wage labor situation, and known or potential social abuses.”
CAO monitoring comment 3.1.2
CAO's view is that this revised procedure mitigates the possibility for investments such as the ones in Wilmar Trading to be categorized as 'C'. See also 3.3.3.

CAO monitoring conclusion 3.1.2
Item closed.

CAO Audit Report Observation 3.1.3
CAO concluded that the difference in scope of environmental and social reviews for a category 'A' or 'B' project, versus a category 'C' project is considerable. As a result, IFC is exposed to the possibility that significant internal and external commercial pressure is placed on IFC's categorization process to decide a Category 'C' result.

IFC response and action 3.1.3
IFC states in its action plan that the Performance Standard review will include discussions, and a resolution, of the categorization issue. It also states that processing issues will be discussed and resolved.

CAO monitoring comment 3.1.3
Item remains open and under monitoring.

CAO Audit Report Non compliance 3.2.1
CAO concluded that IFC did not meet the intent or the requirements of the Performance Standards in its assessment of the Wilmar trade facility investment (Wilmar WCAP, IFC No. 25532), and that the project should not have been categorized as 'C'. The 'C' categorization led to an assessment that was too narrow in its scope and too limited in its execution, and that in turn failed to trigger assessment of applicable Performance Standards.

IFC response and action 3.2.1
Acknowledged and accepted by IFC. See item 3.1.2. Actions have been taken to address the non compliance on a systemic level for future investments. IFC also stated that audited investments had been closed. IFC has defined the scope for a review of Wilmar’s current plantation operations against the Performance Standards.

CAO monitoring comment 3.2.1
IFC has shared with CAO the Terms of Reference defining the scope of a review of selected plantation operations against the Performance Standards. CAO will continue to monitor IFC’s actions, and whether the review against the Performance Standards in combination with other actions will adequately address the concerns raised, and the shortcoming of using a Category “C” classification as concluded in the audit.

CAO monitoring conclusion 3.2.1
Systemic change to prevent repeating the practice identified in the audit has been monitored under 3.1.2 and closed. The audit findings related to the specific investments will remain open under monitoring. See also 3.3.3.
CAO concluded that the IFC assessment of Delta Wilmar CIS Expansion (IFC No. 26271) failed to take into account the supply chain plantations and other companies and suppliers linked to the Wilmar Group, as required in the Performance Standards. This led to a scope of IFC’s due diligence that was too narrow and limited, and that in turn failed to trigger assessment of applicable Performance Standards.

*IFC response and action 3.2.2*
Acknowledged and accepted by IFC. IFC states that its intent is to address the issue on a systemic level during the Performance Standard review.

IFC is in the process of initiating a review of Wilmar’s plantation operations against the Performance Standards in order to mitigate its current risk exposure (See 3.2.1). IFC in addition states that it will develop a supply chain mapping template and other tools.

IFC, in its approach to address the strategy issue, further states that it will develop an Indonesian Palm Oil Advisory Services Program which will include development of smallholder baseline and improvement programs.

*CAO monitoring comment 3.2.2*
Systemic change after the performance standard review will be followed up by CAO by assessing the Wilmar case through the lens of the new procedures once they exist. CAO will not under the scope of this audit continue to monitor other non Wilmar-related cases under the future process.

CAO will monitor the outcomes of the use of the mapping template and other tools to establish whether such mapping exercise will provide a guidance and rationale for inclusion or exclusion of on the ground assessment of social and environmental conditions along Wilmar’s supply chain.

CAO will monitor IFC’s Palm Oil Advisory Service Program to understand on what level this program will operate, and whether the program will be connected to the outcome of a supply chain mapping, and how the program will interact with the investment triggered reviews of palm oil operations.

*CAO monitoring conclusion 3.2.2*
CAO will continue to monitor. Item remains open and under monitoring.

CAO concluded that the narrow interpretation of the investment impacts—in full knowledge of the broader implications—was inconsistent with IFC’s asserted role, mandate and commitment to sustainable development.

IFC’s response and action has not explicitly acknowledged or addressed this conclusion, but accepted the implication of it by accepting shortcomings in the application of procedures.
CAO monitoring comment and conclusion 3.2.3
CAO will continue to monitor and report on the other audit conclusions related that formed the basis of conclusion 3.2.3. Item remains open and under monitoring.

CAO Audit Report Underlying cause 3.3.1
CAO concluded that commercial pressures were allowed to prevail and overly influence the categorization and scope and scale of environmental and social due diligence in the Wilmar Group investments. As a result, IFC’s development mandate and mission were not robustly represented in the decision-making processes.

IFC response and action 3.3.1
IFC states in its action plan that the Performance Standard review will include discussions, and a resolution, of the categorization issue. It also states that processing issues will be discussed and resolved.

CAO monitoring conclusion 3.3.1
See also 3.1.3. Item remains open and under monitoring.

CAO Audit Report Underlying cause 3.3.2
CAO concluded that significant differences between the social and environmental due diligence approaches for a Category ‘A’ and ‘B’ project versus a Category ‘C’ project create pressure on IFC both internally and externally to structure an investment so that it falls within the Category ‘C’ range.

IFC response and action 3.3.2
IFC states in its action plan that the Performance Standard review will include discussions, and a resolution, of the categorization issue. It also states that processing issues will be discussed and resolved.

CAO monitoring conclusion 3.3.2
See also 3.1.3. and 3.3.1. Item remains open and under monitoring.

CAO Audit Report Underlying cause 3.3.3
CAO concluded that incorrect assumptions were made about the impact of certain types of financial products (trade facilities) without proper consideration of the sector and country context of the investment. IFC should not have assumed that a trade facility project would be a Category ‘C’ without appropriate screening of the full context of the investment. IFC should have considered the impacts of its investment, rather than a narrow interpretation of specific financial flows.

IFC response and action 3.3.3
IFC states in its action plan that the Performance Standard review will include discussions, and a resolution, of the categorization issue.

CAO monitoring comment 3.3.3
The shortcoming directly related to the Wilmar investments was addressed under 3.2.1 and 3.1.2. CAO will continue to monitor how the broader issue will be resolved in the revised Performance Standards.

**CAO monitoring conclusion 3.3.3**

Item remains open under monitoring

**CAO Audit Report Underlying cause 3.3.4**

CAO concluded that IFC paid inadequate attention to civil society monitoring reports and concerns about continuing social, environmental, and economic problems in the oil palm industry in Indonesia.

**IFC response and action 3.3.4**

Acknowledged by IFC. IFC's public document defining the framework of developing a global palm oil strategy includes several commitments of consultation and interaction with relevant stakeholders, including civil society organizations.

**CAO monitoring comment 3.3.4**

CAO will continue to monitor the outcome of IFC’s interaction with relevant civil society organizations, and whether it results in an inclusive, iterative process of meaningful consultation. CAO will also monitor how IFC intends to assure itself that it pays adequate attention to civil society organizations after closure of the palm oil strategy process.

**CAO monitoring conclusion 3.3.4**

Item remains open under monitoring

**Summary**

CAO finds IFC current commitments and initial actions, although somewhat delayed compared to IFC’s initial time plan, indicative of a constructive approach attempting to address the majority of the conclusions made in the audit report. CAO fully acknowledges that closing CAO’s audit findings is only one part of an overall approach by IFC to address the concerns connected to the palm oil sector globally. CAO finds that at this stage certain conclusions still remain to be addressed as they form pieces in larger processes, CAO finds that others have been addressed but it is still too early to verify that the actions will have the intended effect. One out of the ten conclusions in the June 2009 Audit Report has at this stage been closed out.

The audit will remain open until CAO sees evidence that provides it with assurance that the remaining conclusions will be addressed.