



AUDIT MONITORING AND CLOSURE REPORT

CAO Audit of IFC
CAO Compliance

C-I-R6-Y08-F096
March 27, 2013

Monitoring of IFC's response

to the CAO Audit of 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)

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 monitoring and closure report makes public the status of IFC's specific actions to address CAO conclusions as stated in the CAO's Audit Report of June 19, 2009, as per the most recent update of March 2013. This is the second CAO Monitoring Report, complementing the CAO report dated April 22, 2010. The CAO's monitoring is limited to following up on the conclusions made by the CAO in its Audit Report.

IFC's response to the audit included development of a strategic approach to future palm oil investments; a review of its current involvement in the Indonesian palm oil sector; 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. The CAO finds that IFC's commitments and actions constitute a substantial approach to addressing the conclusions reached in the CAO Audit Report. The CAO finds that at this stage the CAO has seen evidence that the adopted strategic approach is implementable, that IFC has reviewed its involvement in the Indonesian palm oil sector, that Advisory Services projects have been defined, and that IFC is following through on its commitment to resolve the identified shortcomings regarding its categorization process. The audit will therefore be closed. The CAO reiterates that the CAO is mandated only to monitor how IFC addresses the shortcomings identified in the CAO audit as they related to how IFC approached and processed its investments. The 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.

About the CAO

The CAO's mission is to serve as a fair, trusted, and effective independent recourse mechanism and to improve the environmental and social accountability of IFC and MIGA.

The CAO (Office of the Compliance Advisor Ombudsman) is an independent post that reports directly to the President of the World Bank Group. The CAO reviews complaints from communities affected by development projects undertaken by the two private sector lending arms of the World Bank Group, the International Finance Corporation (IFC) and the Multilateral Investment Guarantee Agency (MIGA).

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

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1. Background

The CAO's Audit Report on IFC's involvement in the Wilmar Group, dated June 19, 2009, concluded that IFC did not meet the intent or requirements of its own Performance Standards (PS) in its assessment of the investment in the Wilmar trade facility Wilmar Trading and Wilmar WCap.¹ Regarding the investment in the Wilmar refinery (Delta–Wilmar CIS and Delta-Wilmar CIS Expansion), the 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 PS.

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 commitment to sustainable development.

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 March, 2013. The CAO's monitoring is limited to follow up on the conclusions made by the CAO in its Audit Report.

The CAO is at this stage assured that actions taken by IFC since the 2009 audit have mitigated the possibility that similar investments would again be processed in violation of the intent of IFC's policies.

With this Monitoring Report, the CAO will close the audit.

2. Status

In the 2009 response, IFC stated that it would develop a global palm oil strategy. According to IFC, this strategy would guide investment operations as well as Advisory Services, and the strategy would 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 organizations, and indigenous peoples' organizations. IFC also stated that development of the strategy would provide an opportunity to analyze the broader issues regarding the sector in Indonesia.

IFC released an Issues Paper on April 21, 2010, and held consultations in Washington, DC; Medan, Pontianak, and Jakarta, Indonesia; San Jose, Costa Rica; Accra, Ghana; Amsterdam, and Frankfurt from April 23 to September 1, 2010. Subsequently, IFC issued a draft "World Bank Group Framework for Engagement in the Palm Oil Sector," dated July 22, 2010, and a revised draft for final public comment on January 6, 2011. A final draft was reviewed by the Board on March 24, 2011 and the final report and statement were issued on April 1, 2011.

¹ See www.cao-ombudsman.org for the full report.

The World Bank Group has developed four pillars through which it could work with other stakeholders to strengthen the economic, social, and environmental underpinnings of the palm oil sector:

- Policy and regulatory environment
- Sustainable private sector investment
- Benefit sharing
- Codes of sustainable practice.

The World Bank Group and IFC have developed “A Revised Collaborative Approach to Implementation,” consisting of:

- Early assessment
- Integrated approach
- Good Practice Note for Staff Guidance
 - Risk screening and assessment tool (for IFC). Specifically, the Approach states that in its assessment of new palm oil investments, IFC will utilize a new tailored country, sector and project risk assessment framework that takes into account the issues highlighted through the consultation process.
- Strengthened collaboration
- Monitoring and evaluation

Also of note, IFC states that it has revised its risk assessment approach and environmental procedure to reflect the recommendations of the CAO and the feedback from the consultation process.

The suspension on palm oil investments was lifted April 1, 2011.

The World Bank Group/IFC have prepared *Status Reports* on the implementation process of its four pillar framework.

IFC stated that it would develop and implement an Advisory Services program targeting the palm oil sector in Indonesia, with special attention to improving the capacity of smallholders/ suppliers.

In addition to continuing the support and engagement through the Roundtable on Sustainable Palm Oil (RSPO), IFC has initiated three Advisory Services projects in an effort to implement the *IFC Strategy for Engagement in the Palm Oil Sector*.

Advisory Service (Project 579387, Indonesia)

“The goal of this project is to provide solid understanding of sustainability practices that can increase the benefits flowing to smallholders and local communities from palm oil operations, as well as clear guidance to palm oil companies for action in this direction.”

Advisory Services (Project 594007, Indonesia)

“In the oil palm sector, IFC Indonesia aims to (1) improve sustainable rural livelihoods by increasing yields, responsible intensification of independent oil palm smallholder

plantings, (2) enable investment in smallholder farms, (3) empower smallholders through better organization and transparency in the marketing of their FFB and relations with CPO mills, and (4) integrate smallholders into global markets for sustainably produced commodities.”

Advisory Services (Project 593807, Indonesia)

“The overall objective of the project is to demonstrate that strategic community investment tools can lead to operational benefits to plantations in the palm oil and forestry sectors.”

3. Comments and Conclusions from CAO Monitoring

CAO Audit Report Observation 3.1.1

The 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 World Bank Group experience, and IFC’s own recognition of the significance of its engagement in the sector.

CAO Monitoring Comment 3.1.1

The CAO’s view on IFC’s new strategy is that it provides guidance on the social and environmental issues such that it would have had significant impact on IFC’s decision process, had it been applied when reviewing the specific cases audited.

The CAO finds that IFC’s commitments and actions constitute a substantive approach to address the issues raised.

The 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 CAO commends IFC’s holistic approach to addressing the issues identified.

CAO Monitoring Conclusion 3.1.1

The CAO concludes that IFC’s strategy provides guidance on the social and environmental issues that were identified as lacking at the time when IFC reviewed and processed the specific cases audited. The CAO has reviewed evidence of the implementation of said policy and is of the opinion that the provisions have had the intended effect.

CAO Audit Report Observation 3.1.2

The CAO concluded that, from a due diligence perspective, IFC’s environmental and social review procedures did not at the time adequately address the particular characteristics of trade financing, or other similar kinds of investments. At the time of the audit, there was no procedure implemented for such investments that addressed the sector, country, and commodity-based risks.

CAO Monitoring Conclusion 3.1.2

The item was closed in 2010.

CAO Audit Report Observation 3.1.3

The 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.

CAO Monitoring Comment 3.1.3

See also discussion on Audit Report Observations 3.3.1 and 3.3.2. IFC has partly addressed the issues by introducing different subcategories to the FI (financial intermediaries) category. IFC has not specifically addressed the issue related to undue commercial pressure on the categorization process. The CAO remains of the opinion that this poses a risk to the institution. The CAO leaves the option open to address this issue under a more systemic review through its Advisory function, not directly relating it to the IFC investments in the Wilmar Group. The item, as it relates to this audit is closed.

CAO Audit Report Noncompliance 3.2.1

The CAO concluded that IFC did not meet the intent or the requirements of its 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 Category 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.

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 was closed in 2010. The audit finding related to the specific investments is closed. See also discussion on Audit Report Observations 3.2.2, 3.1.3, and 3.3.3.

CAO Audit Report Noncompliance 3.2.2

The 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 PS. 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 PS.

CAO Monitoring Conclusion 3.2.2

The CAO finds that the revised approach applied by the implementation of the new IFC strategy partly mitigates noncompliance 3.2.2, and that the IFC Guidance Note (GN 14–10) should mitigate any repetition of the approach used by IFC when processing its investments in Wilmar. See also discussion on Audit Report Observations 3.1.1. This item is closed.

CAO Audit Report Noncompliance 3.2.3

The 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 actions did not explicitly acknowledge or address this conclusion, but acknowledged the implication of it by accepting shortcomings in the application of procedures.

CAO Monitoring Comment and Conclusion 3.2.3

The CAO has monitored and closed other audit-related conclusions that formed the basis of conclusion 3.2.3. This item is closed.

CAO Audit Report Underlying Cause 3.3.1

The 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.

CAO Monitoring Conclusion 3.3.1

See also discussion on Audit Report Observations 3.1.3. and 3.3.2. The CAO has monitored and closed other audit-related conclusions that formed part of the basis of conclusion 3.3.1. This item is closed, with specific reference to the comment under 3.1.3.

CAO Audit Report Underlying Cause 3.3.2

The 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.

CAO Monitoring Conclusion 3.3.2

See also discussion on Audit Report Observations 3.1.3. and 3.3.1. This item is closed.

CAO Audit Report Underlying Cause 3.3.3

The 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 project 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.

CAO Monitoring Conclusion 3.3.3

See discussion on Audit Report Observations 3.1.2 and 3.2.1. This item is closed.

CAO Audit Report Underlying Cause 3.3.4

The 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.

CAO Monitoring Conclusion 3.3.4

This item was closed in 2010.

4. Summary

The CAO finds that IFC's commitments and actions constitute a constructive approach to address the conclusions reached in the Audit Report. At this stage, the CAO finds that all items have been closed. Therefore, the CAO closes this audit.

Annex. IFC Performance Standards Relevant to the CAO Audit

Performance Standard 1, Paragraph 10

10. Where the client can reasonably exercise control, the risks and impacts identification process will also consider those risks and impacts associated with primary supply chains, as defined in Performance Standard 2 (paragraphs 27 and 28–29) and Performance Standard 6 (paragraphs 30 and 31).

Performance Standard 2, Paragraphs 27–29

Supply Chain

27. Where there is a high risk of child labor or forced labor² in the primary supply chain, the client will identify those risks consistent with paragraphs 21 and 22 above. If child labor or forced labor cases are identified, the client will take appropriate steps to remedy them. The client will monitor its primary supply chain on an ongoing basis in order to identify any significant changes in its supply chain and if new risks or incidents of child and/or forced labor are identified, the client will take appropriate steps to remedy them.

28. Additionally, where there is a high risk of significant safety issues related to supply chain workers employed by a primary supplier, the client will introduce procedures and mitigation measures to ensure that primary suppliers within the supply chain are taking steps to prevent or to correct life-threatening situations.

29. The ability of the client to fully address these risks will depend upon the client's level of management control or influence over its primary suppliers. Where remedy is not possible, the client will shift the project's primary supply chain over time to suppliers that can demonstrate that they are complying with this Performance Standard.

Performance Standard 6, Paragraph 30

Supply Chain

30. When there is the potential for natural and/or critical habitats to be significantly adversely impacted by the client's primary suppliers, the client should give preference to purchasing from suppliers that can demonstrate that they are not significantly adversely impacting these areas. Where a client is purchasing primary production (especially but not exclusively food and fiber commodities) that is known to be produced in regions where there is a risk of significant conversion of natural and/or critical habitats, systems and verification practices will be adopted as part of the client's ESMS to evaluate its primary suppliers.³ The systems and verification practices will (i) identify where the supply is coming from and the habitat type of this area; (ii) provide for an ongoing review of the client's primary supply chains; (iii) limit procurement to those suppliers that can demonstrate that they are not contributing to significant conversion of natural and/or critical habitats (this may be demonstrated by delivery of certified product, or progress towards verification or certification under a credible scheme in certain commodities and/or locations); and (iv) where possible, require actions to shift the client's primary supply chain over time to suppliers that can demonstrate that they are not significantly adversely impacting these areas. The ability of the client to fully address these risks will depend upon the client's level of management control or influence over its primary suppliers.

² The potential risk of child labor and forced labor will be determined during the risks and impacts identification process as required in Performance Standard 1.

³ Primary suppliers are those suppliers who, on an ongoing basis, provide the majority of living natural resources, goods, and materials essential for the core business processes of the project.