United States Government Accountability Office

Report to Congressional Requesters

June 2022

INTERNATIONAL DEVELOPMENT ASSOCIATION

Additional Information Sharing Could Enhance U.S. Treasury Oversight of Key Risks

Accessible Version

GAO-22-104657

GAO Highlights

Highlights of GAO-22-104657, a report to congressional requesters

Why GAO Did This Study

The U.S. is one of the largest contributors to IDA. IDA has traditionally financed its operations primarily by raising funds every 3 years from donors like the U.S. and using funding from loan repayments. In 2015, UN members adopted the 2030 Sustainable Development Goals to address global challenges such as poverty. To help low-income countries meet these goals, IDA in 2018 began issuing bonds on the capital markets to raise additional funds to provide more loans.

GAO was asked to review IDA's financial model. This report examines: (1) IDA's funding sources and allocations; (2) how market borrowing has affected IDA's process for assessing countries' financing needs, and IDA's financial and risk management framework; (3) how IDA assesses key risks to its financial sustainability; and (4) the extent to which Treasury oversees IDA's financial and risk management. GAO reviewed and analyzed IDA financial documents, data on IDA's funding from fiscal years 2012 through 2025, and Treasury documents. GAO also interviewed IDA and Treasury officials, and development finance experts.

What GAO Recommends

GAO recommends that Treasury direct the U.S. Executive Director of IDA to request that IDA provide to its Board of Directors 1) more information on the model IDA uses to estimate the total risk it faces from borrower country defaults and 2) information on the steps IDA is taking to account for incomplete debt data as it measures risks of borrower defaults. Treasury concurred with both recommendations.

View GAO-22-104657. For more information, contact Chelsa Kenney at (202) 512-2964 or KenneyC@gao.gov.

June 2022

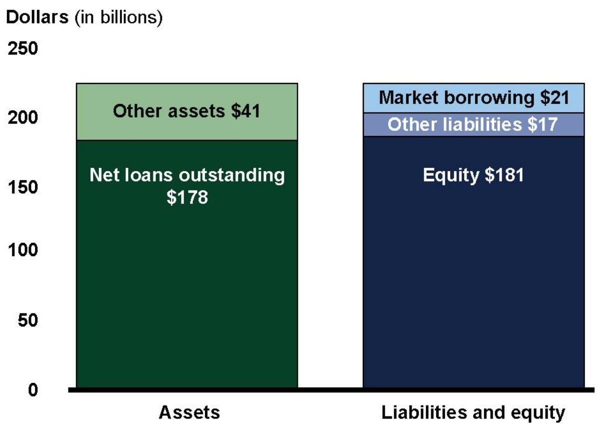
INTERNATIONAL DEVELOPMENT ASSOCIATION

Additional Information Sharing Could Enhance U.S. Treasury Oversight of Key Risks

What GAO Found

Since 2018, the World Bank Group's International Development Association (IDA), which provides financial assistance to low-income countries, has diversified its funding sources by leveraging its equity to borrow from capital markets. As of fiscal year 2021, IDA had borrowed about $21 billion from capital markets. IDA primarily allocates its funds for grants and loans on concessional terms (below market rates). While market borrowing allows IDA to increase its financing, it represents a change in its operations and funding approach.

Figure: IDA's Condensed Balance Sheet, Fiscal Year 2021



Source: GAO analysis of International Development Association (IDA) data. | GAO-22-104657

Accessible Data Table for Highlight Figure

Dollars in billions

FY 2021	Net loans outstanding	Other assets	Equity	Other liabilities	Market borrowing
Assets	$178	$41	0	0	0
Liabilities and Equity	0	0	$181	$17	$21

Market borrowing has not affected IDA's process for assessing financing needs of countries. However, IDA revised its financial and risk management framework to reflect increased financial risks due to market borrowing. IDA also enhanced its analysis of the risk of borrowers defaulting on their IDA loans.

IDA's largest financial risk is the potential for borrower countries to default on loans from IDA. While defaults to IDA have historically been low, there are external factors that could affect borrower repayment to IDA, such as how much debt those borrowers owe to other creditors and the legal terms of that debt. To measure this risk and understand how much IDA can safely borrow from the markets, IDA models the maximum potential loan losses from borrower countries defaulting that it could face over 3 years.

The Department of Treasury conducts oversight of IDA through the U.S. Executive Director, an IDA Board member. IDA has shared some information on its loan loss model, such as certain model inputs, with its Board. However, the Board does not have important information, such as the model's key assumptions, that would enhance its oversight of IDA's risk management. Recommended practices for strong risk management include providing sufficient information to stakeholders. In addition, Treasury has not requested information on how IDA accounts for incomplete debt data, such as China's loans to low-income countries, in its risk assessments. This information would support the U.S. and IDA Board members in assessing the quality of IDA's risk management.

Contents

Abbreviations

ALM	Asset Liability Management
COVID-19	Coronavirus Disease 2019
DSC	Deployable Strategic Capital
GDP	gross domestic product
HIPC	Heavily Indebted Poor Country
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Financial Corporation
IMF	International Monetary Fund
ISO	International Organization for Standardization
MDRI	Multilateral Debt Relief Initiative
MIGA	Multilateral Investment Guarantee Agency
PBA	Performance Based Allocation
SEC	Securities and Exchange Commission
TRA	Total Resources Available
TRR	Total Resources Required
UN	United Nations
USED	U.S. Executive Director

U.S. GOVERNMENT ACCOUNTABILITY OFFICE
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June 2, 2022

The Honorable Patrick Leahy
Chairman
Committee on Appropriations
United States Senate

The Honorable Maxine Waters
Chairwoman
Committee on Financial Services
House of Representatives

The United States is one of the largest contributing members of the World Bank Group's (World Bank) International Development Association (IDA), an international organization established in 1960 that provides financial assistance to the world's poorest countries for social and economic development.[1] The U.S. Department of the Treasury leads U.S. engagement with and has oversight responsibility for multilateral development banks, including IDA. IDA has traditionally financed its operations largely through contributions from donors and repayments on its loans to borrowing countries. In fiscal year 2018, IDA introduced market borrowing (by issuing bonds) into its business model as another source of funding. While raising funds from the capital markets by issuing bonds allows IDA to increase its financing, it represents a significant and complex change in its operations and funding approach.[2]

[1]The World Bank includes five institutions that carry out its mission to reduce poverty, increase shared prosperity, and promote sustainable development. These institutions include IDA, the International Bank for Reconstruction and Development (IBRD), the International Finance Corporation (IFC), the Multilateral Investment Guarantee Agency, and the International Centre for Settlement of Investment Disputes. As of 2021, IDA had 174 members, which include donor and borrower countries. The United States has agreed to contribute about $60.3 billion to IDA since the organization's establishment. For IDA's most recent authorization of funding for fiscal years 2023 through 2025, referred to as the IDA 20 replenishment, the United States agreed to contribute over $3.5 billion.

[2]Capital markets issue and trade financial instruments, such as bonds and shares, to secure long-term financing. Capital markets include bond markets, which are the markets for longer-term debt instruments issued by governments and by financial and nonfinancial corporations.

IDA and its borrowers face a number of challenges as many low-income countries experience higher debt burdens and the consequences of the COVID-19 pandemic, which the United Nations (UN) estimates pushed an additional 100 million people into extreme poverty.[3] The World Bank has reported that in the past decade countries accrued the largest and fastest growing levels of external debt since the 1970s.[4] This external debt increased to its highest levels as countries financed their efforts to address the pandemic.[5] Recognizing the greater need for assistance during the pandemic, the Group of 20 established the Debt Service Suspension Initiative.[6] This initiative offered a suspension of debt service payments owed by 73 countries to other sovereign governments through December 2021. While the initiative did not suspend debt owed by these countries to multilateral institutions like IDA, IDA and its members agreed to provide additional concessional assistance to IDA borrowers from April 2020 through fiscal year 2022.

We were asked to review IDA's financial model, including how market borrowing affects it, as well as changes to IDA's financial and risk management processes. This report examines: 1) IDA's funding sources and allocations; 2) how market borrowing has affected IDA's process for assessing countries' financing needs and its framework for financial and risk management; 3) how IDA assesses key risks to its financial sustainability; and 4) the extent to which Treasury oversees IDA's financial and risk management.

To describe IDA's funding sources and allocations, we analyzed replenishment data from fiscal years 2012 through 2025 that IDA reports

[3]United Nations, *The Sustainable Development Goals Report 2021* (United Nations: 2021). Low-income countries eligible for IDA support are those with a Gross National Income (GNI) per capita below an established threshold updated annually by IDA, or countries that are above the threshold but not creditworthy to borrow from the IBRD. The GNI per capita threshold was $1,205 for fiscal year 2022. We refer to countries that receive assistance from IDA as borrower countries throughout this report.

[4]M. Kose, P. Nagle, F. Ohnsorge, and N. Sugawara, *Global Waves of Debt: Causes and Consequences* (Washington, D.C.: 2021). External debt is the outstanding amount of actual current and non-contingent liabilities that require payments of principal or interest by a debtor country to foreign creditors at some point(s) in the future.

[5]World Bank Group, *Global Economic Prospects* (World Bank Group: 2021).

[6]The Group of 20, or G20, is a forum for international cooperation on global economic and financial issues. Its members include the United States as well as 18 other countries and the European Union.

annually in its public financial statements.[7] To assess the reliability of the replenishment data in IDA's financial statements, we compared the current and historical data published with data for overlapping years in past IDA replenishment reports. In addition, we reviewed information provided by IDA regarding its collection and validation of replenishment data. We also requested IDA review and verify the figures to determine if any changes had occurred since publication. We determined the data were sufficiently reliable for describing IDA's funding sources and allocations for the years we reported. To describe IDA's balance sheet data, we analyzed information published in IDA's financial statements for fiscal years 2017 through 2021. To verify IDA's balance sheet data, we reviewed the results of external audits and explanatory notes in IDA's financial statements, and interviewed officials in the World Bank Controller's Office, which manages IDA's financial reporting.[8] We determined that IDA's balance sheet data were sufficiently reliable for describing IDA's assets, liabilities, and equity for the years we reported.

To assess how market borrowing has affected IDA's process for assessing countries' financing needs and its framework for financial and risk management, we reviewed IDA reports on its Performance Based Allocation system and its hybrid financial model. We also discussed the effect of market borrowing on lending and grants with World Bank officials in the Corporate Finance Department and in the World Bank Treasury's Capital Markets and Investments Department. We also reviewed IDA's revised financial and risk management framework which IDA instituted to borrow on the capital markets. We discussed with these World Bank

[7]IDA and its members, which include donors and low-income countries that receive funds from IDA, regularly review the adequacy of IDA's resources and authorize additional funding through a process called replenishment. This process usually takes place every 3 years. The IDA 19 replenishment authorized funding for fiscal years 2021 through 2022. IDA and its members agreed to shorten the IDA 19 replenishment period, originally covering fiscal years 2021 through 2023, to 2 years. IDA took this step to reallocate its resources and provide additional assistance to countries during the COVID-19 pandemic. IDA moved up negotiations for the IDA 20 replenishment, which will cover fiscal years 2023 through 2025, returning IDA to the standard 3-year replenishment period.

[8]An external auditor audits IDA's financial statements annually. The audit covers IDA's financial reporting, such as its balance sheet, and IDA's internal control over this financial reporting, based on criteria established in the Internal Control-Integrated Framework (2013), issued by the Committee of Sponsoring Organizations of the Treadway Commission. For the years in our scope, fiscal years 2012 through 2021, the external audits found that IDA's financial reporting presented fairly, in all material respects, the financial position of IDA and that it had maintained, in all material respects, effective internal control over its financial reporting.

officials how the framework addresses IDA's increased financial risks from market borrowing and how IDA determines how much to borrow.

To assess how IDA measures key risks to its financial sustainability, we reviewed IDA's financial statements, annual and quarterly risk reports, documentation of its credit rating methodology, and information on its model for maximum potential losses. We also reviewed credit rating agency evaluations of IDA. In addition, we interviewed IDA risk management officials, officials responsible for the World Bank's debt data system, and experts from think tanks and trade groups. We also interviewed International Monetary Fund (IMF) officials for additional perspective on debt sustainability risks. Finally, we reviewed recent reports on transparency in borrower country debt.

To determine the extent to which Treasury oversees IDA's financial management processes, we reviewed documentation from Treasury and IDA detailing IDA financial and risk management analysis, including requests and feedback provided to IDA by Treasury. We identified key processes used in IDA risk management and compared access to information underlying these processes by Treasury and the IDA Board to international standards for risk management and internal control.[9] We also interviewed agency officials from Treasury, including the Office of the U.S. Executive Director, and officials from IDA. See appendix I for additional information on our scope and methodology.

We conducted this performance audit from December 2020 to June 2022 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[9]International Electrotechnical Commission and International Organization for Standardization. *Risk Management—Risk Assessment Techniques.* IEC 31010 6.1-6.4. Geneva: IEC, 2019; Committee of Sponsoring Organizations of the Treadway Commission. *Internal Control- Integrated Framework* (New York: American Institute of Certified Public Accountants, 2013). While the IEC standards were not written for IDA, we identified useful general practices on risk management that align with Committee of Sponsoring Organizations of the Treadway Commission standards, which IDA applies to its internal controls on financial reporting.

Background

Types of Assistance Provided by IDA

IDA provides grants and loans to support a range of development efforts in 74 low-income countries.[10] It provides grants—funding for which no repayment is required—to countries at high or moderate risk of debt distress.[11] According to IDA reporting, the majority of IDA's lending products are concessional loans, which are loans IDA provides at zero or very low interest rates and long maturities.[12] Since 2014, IDA has also offered loans without concessional terms, or non-concessional loans, to countries that meet certain criteria. For example, IDA offered non-concessional loans during fiscal years 2014 through 2020 to eligible borrower countries that had recently progressed past the threshold for IDA assistance.

IDA's Periodic Authorization Process to Replenish Funding

IDA and its members, which include donors and low-income countries that receive funds from IDA, regularly review the adequacy of IDA's resources and authorize additional funding through a negotiation process

[10]IDA also provides guarantees for projects and programs in member countries to help mobilize private financing for development purposes. For example, a policy-based guarantee could include a guarantee to cover defaults of debt service payments.

[11]Under the Joint World Bank-International Monetary Fund (IMF) Debt Sustainability Framework for Low-Income Countries, the World Bank and IMF determine a rating of low, moderate, or high risk of debt distress, or in debt distress by the extent to which a country's external debt burden breaches a specific threshold. This framework assesses a country as being in debt distress when the country starts experiencing difficulties servicing its debt. A country's risk of debt distress guides the terms of financing it can access from IDA. Beginning with the IDA 20 replenishment, IDA reports that it will provide countries at moderate risk of debt distress concessional loans with 50-year maturities and no interest rate, with the exception of countries classified as small states that will continue to receive a combination of grants and concessional loans.

[12]IDA measures whether a loan is concessional by the loan's grant element. The grant element is calculated as the difference between the nominal or face value of a loan and the net present value of all scheduled principal and interest repayments, discounted at a market interest rate. The grant element is often expressed as a percentage of the loan's face value. IDA typically considers a loan concessional if the loan's grant element is greater or equal to 35 percent of the loan's face value.

called replenishment. Replenishments determine IDA resources and factor into IDA's overall financial planning.[13] Generally, this process takes place every 3 years. IDA completed its 20th replenishment negotiations on December 15, 2021. IDA and its members moved up negotiations for this replenishment and agreed to shorten the IDA 19 replenishment period, originally covering fiscal years 2021 through 2023, to 2 years (fiscal years 2021 through 2022).[14] IDA took this step to reallocate its resources and provide additional assistance to countries during the COVID-19 pandemic. IDA 20 will cover fiscal years 2023 through 2025, resuming the standard 3-year replenishment period.[15]

IDA's Revised Financial Model for Meeting the UN's 2030 Sustainable Development Goals

Since 1960, IDA has primarily relied upon donor grant contributions, loan repayments, and funding transfers from other World Bank Group agencies to finance its assistance.[16] In 2015, the UN General Assembly adopted the 2030 Agenda for Sustainable Development, recognizing the significant global challenges of poverty, hunger, inequality, and climate change. This agenda's sustainable development goals align with IDA's mission to finance programs that reduce poverty and inequalities, boost economic growth, and improve living conditions. According to IDA, that same year it initiated changes to its financial model to increase its funding

[13]During replenishment negotiations, IDA's members meet to assess IDA's financial capacity and the medium-term demand for new IDA financing. Members decide the policy framework, agree upon the amount of financing to make available for the replenishment period, and commit to the funding contributions required to meet these goals. According to IDA, the replenishment process requires IDA to adapt continuously to respond to its borrower's needs.

[14]IDA's fiscal year begins on July 1 and ends the following June 30.

[15]According to IDA officials, as part of the IDA 20 replenishment, IDA introduced new loan terms. For example, IDA introduced concessional loans with maturity of 50 years, a grace period of 10 years, and no interest rate or service charge. IDA also introduced concessional short maturity loans that have fewer concessional terms than other IDA concessional loans, as a lending option for borrowing countries to use as they address the effects of the COVID-19 pandemic. According to officials, these steps along with other measures allowed IDA to expand the replenishment size while keeping donor contributions at the same level.

[16]World Bank organizations that have transferred funds historically to IDA include the IBRD and the IFC.

sources and allocate more assistance to low-income countries taking steps to achieve the sustainable development goals by 2030.

First, IDA in 2015 introduced debt financing whereby certain donors provided loans to IDA on concessional terms. Donors provide these loans, referred to as concessional partner loans, to IDA under similar concessional terms as IDA's loans to low-income countries. According to IDA reporting, concessional partner loans are a mechanism for donors to increase the volume of their contributions, which they typically give as grant funding, to IDA.

Second, IDA in 2018 started market borrowing or raising additional funds by issuing bonds on the capital markets. IDA leverages its equity—its assets that remain after subtracting all of its liabilities—to borrow from the capital markets.[17] IDA cannot directly use its equity as a source of funding for new lending because the assets underlying its equity largely consist of future repayments.[18] IDA expects to receive these repayments from borrower countries over several decades based on the highly concessional terms of IDA loans. As a result, IDA chose to borrow against its equity to raise funds on the capital markets.[19] The resulting model, which IDA refers to as the "hybrid financial model," combines IDA's original funding sources with debt financing from concessional partner loans and funds raised by IDA from market borrowing.

IDA Assistance to Low-Income Countries Facing Risks of Debt Distress

While IDA provides grants to countries at high or medium risk of debt distress, as of September 2021, nearly half of the countries that receive assistance from IDA face high risks to their debt sustainability.[20] Some of these countries have historically experienced high levels of debt distress.

[17]IDA's equity was $180.9 billion as of fiscal year 2021. Equity, or an entity's capital, is the difference between an entity's assets and liabilities. Assets are everything that an entity owns that has value. Liabilities are everything that an entity owes to others.

[18]These future repayments will come from borrower countries for loans contracted with IDA in prior years.

[19]IDA's approach of leveraging its equity to raise funds on the capital markets is consistent with standard bank practices.

[20]*Debt Sustainability Analysis (DSA)*, in the World Bank Debt & Fiscal Risks Toolkit, accessed February 15, 2022, https://www.worldbank.org/en/programs/debt-toolkit/dsa.

IDA has participated in mechanisms to help reduce or relieve debt for these borrower countries based on certain conditions, and with compensation from donors for IDA's provision of such debt relief. For example, the World Bank and IMF in 1996 launched the Heavily Indebted Poor Countries (HIPC) Initiative to reduce external public and publicly guaranteed debt[21] for low-income countries that met certain criteria, such as carrying out economic and social reforms.[22]

In 2005, recognizing that low-income countries needed further assistance, the IMF approved the Multilateral Debt Relief Initiative (MDRI), which IDA adopted in 2006. According to IDA, the goal of the initiative was to accelerate the progress of these countries toward achieving the UN Millennium Development Goals.[23] MDRI offered full debt relief for eligible debt that countries owed to IDA and other participating institutions.[24] For both HIPC and MDRI debt relief, donors agreed to compensate IDA fully for loan repayments IDA did not receive because of forgiven debt.[25] Figure 1 highlights these and other key financial events in IDA's history.

[21]Public debt is an external obligation of a public debtor like a national government. Publicly guaranteed debt is an external obligation of a private debtor that is guaranteed for repayment by a public entity like the national government.

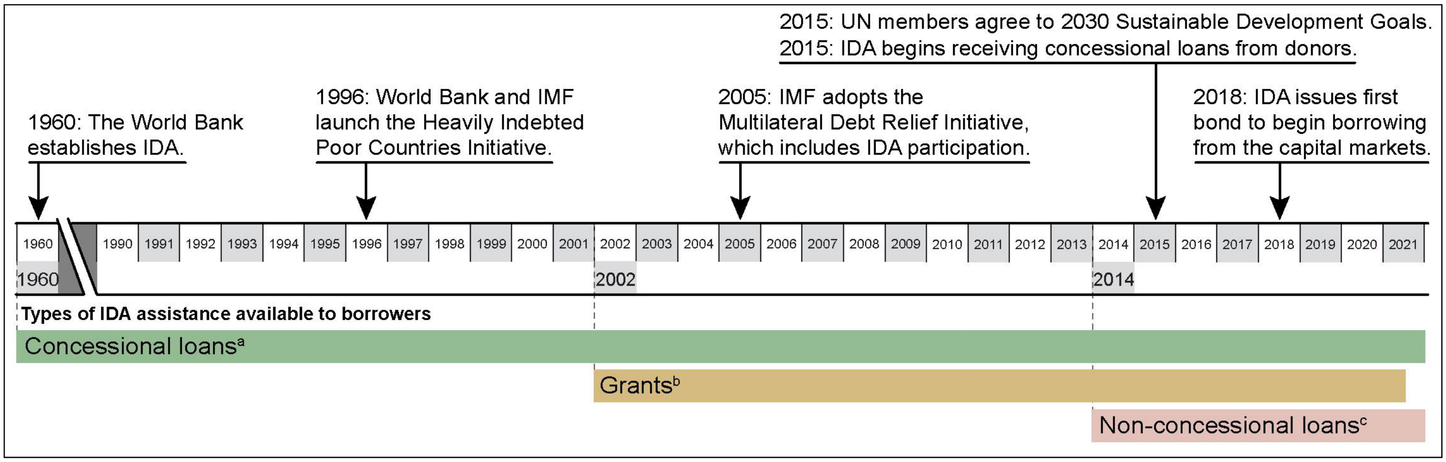
[22]We have previously reported on the HIPC Initiative's financing challenges as well as options for providing additional relief to help countries achieve debt sustainability and lower debt service burdens. See GAO, *Developing Countries: Achieving Poor Countries Economic Growth and Debt Relief Targets Faces Significant Financing Challenges,* GAO-04-405 (Washington, D.C.: April 14, 2004) and *Developing Countries: Debt Relief Initiative for Poor Countries Faces Challenges*, GAO/NSIAD-00-161 (Washington, D.C.: June 29, 2000).

[23]The Millennium Development Goals (MDG) began in 2000 as a global effort to halve poverty rates and address a number of other development issues by 2015. The UN instituted the Sustainable Development Goals to continue the work that began under the MDGs.

[24]GAO, *Developing Countries: U.S. Financing for Multilateral Debt Relief Initiative Currently Experiencing a Shortfall*, GAO-08-888R (Washington, D.C.: July 24, 2008).

[25]As of fiscal year 2021, IDA has provided debt relief on $2.1 billion of loans (including service charges) under HIPC, and $40.2 billion of loans under MDRI.

Figure 1: Timeline of Key IDA Financial Events and IDA Assistance



Legend: International Monetary Fund = IMF; United Nations = UN.

Source: GAO summary of International Development Association (IDA) information. | GAO-22-104657

[a]Concessional loans are loans IDA provides at zero or very low interest rates and long maturities. IDA measures whether a loan is concessional by the loan's grant element. The grant element is calculated as the difference between the nominal or face value of a loan and the net present value of all scheduled principal and interest repayments, discounted at a market interest rate. The grant element is often expressed as a percentage of the loan's face value. IDA typically considers a loan concessional if the loan's grant element is greater or equal to 35 percent of the loan's face value.

[b]Grants are funds for which IDA requires no repayment. Starting in 1996 IDA provided grants on a limited basis, primarily to clear borrowers' overdue payments on their IDA loans, but in 2002 IDA began offering grants as a major type of assistance.

[c]Non-concessional loans have a grant element that is less than 35 percent of the loan's face value. IDA has offered non-concessional loans to eligible countries that meet certain criteria.

Reporting from the World Bank and the IMF indicates that external debt levels in low-income countries have increased along with the number of countries at high risk of debt distress. According to the World Bank, median external debt in IDA countries increased from 35 to 50 percent of gross domestic product (GDP) between 2010 and 2020.[26] As of September 2021, the World Bank and IMF identified 29 countries at high risk of external debt distress and seven countries in debt distress, which account for 36 of 74 countries under the Debt Sustainability Framework

[26]Diego Rivetti, *Debt Transparency in Developing Economies* (World Bank: Washington DC: 2021).

for Low Income Countries.[27] The COVID-19 pandemic has increased debt sustainability concerns for these countries.

In response to growing debt sustainability concerns, IDA introduced the Sustainable Development Finance Policy in 2020 to increase debt transparency and address debt vulnerabilities among its borrowers. According to IDA, this initiative aims to incentivize transparent and sustainable financing among IDA countries and increase coordination between IDA and other creditors in support of these countries' efforts.

Treasury Oversight of IDA

Treasury is responsible for U.S. oversight of IDA, conducted through several formal and informal mechanisms. Treasury officials stated they engage daily with IDA to advance U.S. interests and to ensure the protection and effective use of donor contributions. Treasury structures its engagement with IDA through four official entities: the IDA Board of Directors, the Office of the U.S. Executive Director, the World Bank Audit Committee, and the U.S. Deputy.

- **IDA Board of Directors.** The IDA Board of Directors is responsible for the general operations of IDA. The United States appoints the U.S. Executive Director (USED), one of the Board's 25 sitting directors. According to IDA, its Board meets twice a week to oversee IDA's daily operations, such as deciding on financing (grants and loans) approvals, budgets, country assistance strategies, market borrowing, and other financial matters.
- **U.S. Executive Director's Office.** The USED represents U.S. policy and interests on the IDA Board and acts on behalf of Treasury. Staff from Treasury and other U.S. agencies support and advise the USED, as do administrative staff from the World Bank, according to Treasury officials. Treasury officials engage with the USED daily and share formal proposals about IDA. Treasury officials indicated that USED manages all communications between the World Bank and Treasury. It also coordinates formal and informal meetings between Treasury and IDA's financial and risk departments. In addition, the USED consults with Treasury's Office of Multilateral Development Banks on

[27] *Debt Sustainability Analysis (DSA)*, in the World Bank Debt & Fiscal Risks Toolkit, accessed February 15, 2022, https://www.worldbank.org/en/programs/debt-toolkit/dsa. According to the IMF, this joint framework assists low-income countries in ensuring that they are making lending decisions that align with long-term debt sustainability.

IDA policy proposals and advises the National Advisory Council on International Monetary and Financial Policies, which Treasury chairs, on the IDA replenishment process and policy priorities related to international finance institutions.[28]

- **World Bank Audit Committee.** The USED serves on the World Bank Audit Committee (hereafter referred to as the Audit Committee), one of five committees that assist the IDA Board in oversight activities. According to World Bank policy, the Audit Committee oversees IDA's financial policies, accounting, risk management, internal controls, and institutional integrity. Its members examine IDA's quarterly and annual risk reports, audited financial statements, and regular activity reports. External auditors coordinate their quarterly and annual assessments of internal controls over financial reporting through the Audit Committee.[29]
- **U.S. IDA Deputy.** IDA deputies from each member country negotiate IDA's replenishments and engage with management for the review of financing terms and conditions as well as the overall replenishment portfolio. The U.S. Deputy, a Treasury official, provides input into those negotiations on behalf of the United States with support from Treasury and USED staff. U.S. officials stated that they informally discuss their ideas on priorities for upcoming replenishments with IDA management and other stakeholders prior to formal discussion during replenishment negotiations. IDA deputies also meet during a midterm review and solicit feedback from their respective senior officials on the ongoing replenishment round and other IDA matters.

Treasury has identified five U.S. financial interests that shape its oversight of IDA as of February 2022:

- Maintaining focus on IDA's core mission to provide concessional resources to the poorest countries, which includes ensuring a robust recovery from the COVID-19 pandemic in low-income countries through response efforts.

[28]The Secretary of the Treasury is required to report annually to Congress on the participation of the United States in the international financial institutions (IFIs). 22 U.S.C. § 262r; Exec. Order No. 11,269, 31 Fed. Reg. 2813 (Feb. 14, 1966), as amended. The Secretary is also required to report to Congress on how the World Bank's IDA-financed projects contribute to the eventual graduation of a representative sample of countries from reliance on concessional financing and international development assistance. 22 U.S.C. § 262r-6(b)(2).

[29]According to Treasury officials, the external auditor meets with the Audit committee without IDA management in attendance at least once per year as part of their assessment of IDA's financial reporting.

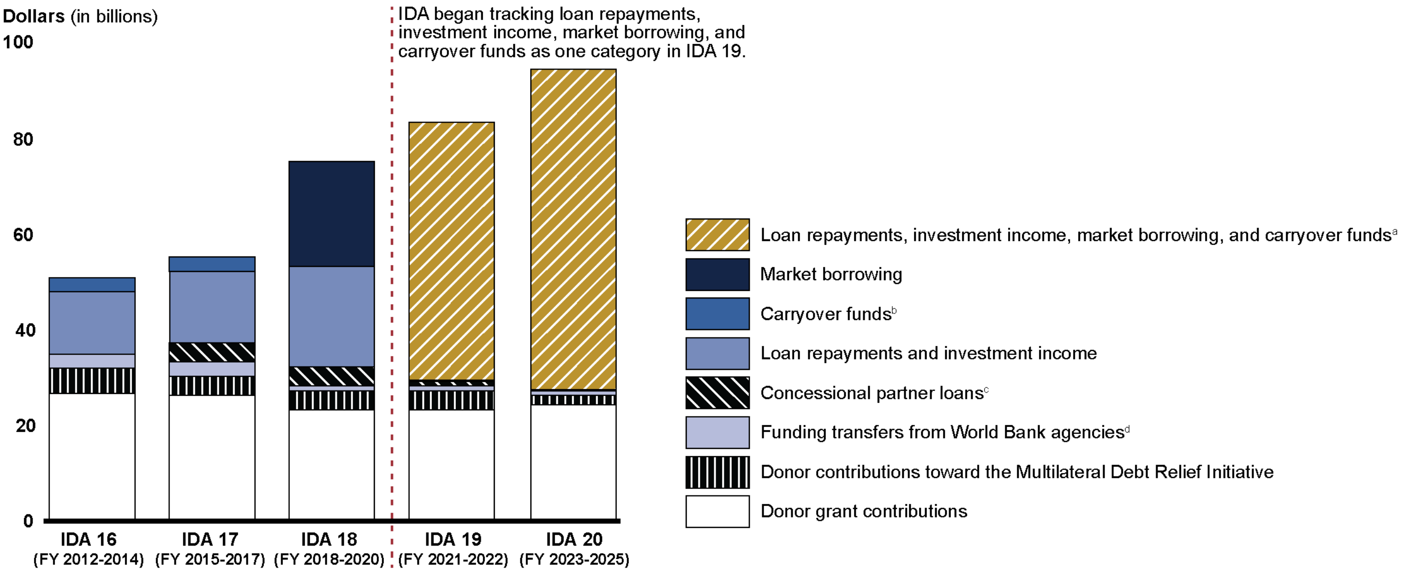
- Using donor contributions to adjust lending terms to concessional levels to maintain an adequate amount of concessional financing for IDA programs.
- Ensuring that donors are not obligated to future commitments beyond the current replenishment.
- Increasing non-concessional loans for countries with capacity and debt sustainability.
- Ensuring that IDA manages its resources responsibly, which includes following risk management practices and prudent use of existing IDA equity.

IDA Diversified its Funding Sources and Allocates Funding Primarily through Concessional Loans and Grants

IDA Recently Diversified its Funding Sources to Include Market Borrowing

The largest source of IDA's funding historically has been donor contributions. However, IDA's funding from other sources has increased since 2015 with the introduction of new funding sources and more loan repayments. As of fiscal year 2021, IDA's funding sources include donor grant contributions; donor contributions toward the MDRI; funding transfers from World Bank agencies; concessional partner loans; loan repayments and investment income; carryover funds; and market borrowing (see fig. 2).

Figure 2: IDA's Funding Sources by Replenishment, Fiscal Years 2012 to 2025



Legend: Fiscal year = FY.

Source: GAO analysis of International Development Association (IDA) data. | GAO-22-104657

Accessible Data Table for Figure 2
Dollars in billions

	IDA 16 (FY 2012-2014)	IDA 17 (FY 2015-2017)	IDA 18 (FY 2018-2020)	IDA 19 (FY 2021-2022)	IDA 20 (FY 2023-2025)
Loan repayments, investments, market borrowing, and carryover funds	0	0	0	$54	$67
Market borrowing	$0	$0	$22	0	0
Carryover funds	$3	$3	0	0	0
Loan repayments and investments	$13	$15	$21	0	0
Concessional partner loans	$0	$4	$4	$1	$0.3
Funding transfers from World Bank agencies	$3	$3	$1	$1	$1
Donor contributions toward the Multilateral Debt Relief Initiative	$5	$4	$4	$4	$2
Donor grant contributions	$26	$26	$23	$23	$24

Note: IDA's market borrowing began in fiscal year 2018 during the IDA 18 replenishment, and concessional partner loans began in fiscal year 2015 during the IDA 17 replenishment. IDA and its members, which include donors and low-income countries, agreed to shorten the IDA 19 replenishment period, originally covering fiscal years 2021 through 2023, to 2 years. IDA took this step to provide additional assistance to countries during the COVID-19 pandemic. The total amount originally approved for IDA 19 and reflected in this figure was $82 billion. However, IDA and its members agreed to move $11 billion of this total to the IDA 20 replenishment.

[a]Starting with the IDA 19 replenishment, IDA no longer separated the data for four funding source categories, which include loan repayments, investment income, carryover funds, and market borrowings. IDA reported these four categories as one group called "reflows, carryover, and borrowings." IDA stated that its replenishment would no longer separately reflect these categories due to IDA's adoption of a balance sheet management approach to track this information.

[b]Carryover funds include unused funding from the previous replenishment.

[c]Concessional partner loans are those provided on concessional terms directly by donors as a funding source for IDA's activities. Countries that agreed to provide concessional partner loans at various points from the IDA 17 through IDA 20 replenishments include Belgium, Canada, China, France, Japan, Saudi Arabia, and the United Kingdom.

[d]The World Bank Group's International Bank for Reconstruction and Development and International Finance Corporation (IFC) have transferred funds to IDA. IFC discontinued transfers to IDA following agreements made in 2018 to support IFC's expansion of activities in IDA countries.

- **Donor grant contributions.** Donors contribute funding in the form of grants during each replenishment to help finance IDA assistance. Donor grant contributions include funding toward IDA grants, compensation for the HIPC Initiative, and in some replenishments clearance of arrears that borrowers may have on their IDA loans. For IDA 20, donors agreed to provide $23.5 billion in grant contributions, which represented about one-fourth of the funding sources ($93 billion) of that replenishment.[30] The donor contributions approved for the IDA 19 replenishment are also $23.5 billion.
- **Donor contributions toward the MDRI.** In addition to standard grant contributions, donors agreed in 2006 to compensate IDA over a 40-year period for all lost repayments on IDA loans caused by debt cancellation under the MDRI. Donors agreed to contribute about $1.8 billion for this initiative in IDA 20, which was about 2 percent of the IDA 20 replenishment.
- **Funding transfers from World Bank agencies.** Historically, the World Bank agencies IBRD and IFC have transferred funds to IDA to demonstrate their support for the organization, according to IDA.[31]

[30]The total replenishment value for IDA 20 includes $11 billion carried over from the IDA 19 replenishment. IDA and its members agreed to shorten the IDA 19 replenishment to 2 years to reallocate resources and provide additional assistance to countries as they respond to the COVD-19 pandemic.

[31]IBRD provides loans, guarantees, risk management products, and advisory services to middle-income and creditworthy low-income countries. IFC aims to encourage growth of the private sector in developing countries by creating new markets, mobilizing investors, and sharing expertise.

The Board of Governors for IBRD and for IFC approve the funding transferred from these agencies to IDA each year. The actual transfer amount depends on IBRD's and IFC's earnings. For the IDA 20 replenishment, IBRD committed to transferring $800 million (about 1 percent of IDA's resources). According to IDA, the IFC discontinued transfers to IDA following agreements made in 2018 to support IFC's expansion of activities in IDA countries.

- **Concessional partner loans.** As part of the IDA 17 replenishment, IDA and its members agreed to institute concessional loans provided by donors, referred to as concessional partner loans, as another option that donors could use to provide funding to IDA.[32] For the IDA 20 replenishment, one donor agreed to provide over $300 million in concessional partner loans. According to IDA's balance sheet, donors had provided about $8 billion in these loans by the end of fiscal year 2021 (see table 1).[33] Donors provide these loans under similar terms as those offered under IDA's concessional loans to low-income countries. The maturities of the concessional partner loans are currently either 25 years (with a grace period of 5 years), or 40 or 50 years (with a grace period of 10 years).
- **Loan repayments and investment income.** This category of funding includes repayments on IDA loans, such as repayments on principal, interest received on certain concessional loans, and loan service charges from past and current borrowers. According to IDA reporting, loan repayments have become available in significant amounts since the IDA 11 replenishment due to factors such as the historical growth of IDA's loans. Investment income is earned on IDA's invested resources, such as from government bonds. These investments, among other mechanisms, provide a ready source of liquidity when IDA needs to meet cash requirements for its loan and grant disbursements.
- **Carryover funds.** Some replenishments have residual funds from unutilized commitments at the end of the replenishment period, which IDA then carries over to the next replenishment's funding. In recent years, these unused funds have included funds that IDA and its

[32]Donors that provide concessional partner loans receive certain voting rights based on the grant element of the loans. IDA members, including donors, vote to decide on specific policies, such as decisions made during the IDA replenishment process. The about $8 billion of concessional partner loans in financial statements exclude the grant element, which is accounted for in IDA's equity.

[33]The United States has not provided concessional partner loans as of IDA 20. According to Treasury officials, the United States has prioritized providing grant contributions to IDA to increase the amount of grants available as assistance to IDA countries.

members set aside to help countries that meet certain criteria clear their arrears for overdue IDA loan repayments. IDA reports that it carried over $11 billion for the IDA 20 replenishment.

- **Market borrowings.** IDA began market borrowing in 2018 to raise additional funds that would increase IDA's assistance to countries as they took steps to address the UN Sustainable Development Goals by 2030. By the end of fiscal year 2021, the total amount of IDA's market borrowing was $20.6 billion, an increase of about 72 percent or $8.6 billion from the prior year (see table 1).

Table 1: IDA Condensed Balance Sheet, Fiscal Years (FY) 2017 to 2021 (in billions of US Dollars)

	FY 2017	FY 2018	FY 2019	FY 2020	FY 2021
Assets					
Net loans outstanding	138	146	152	161	178
Other assets	35	39	37	38	41
Total assets	**173**	**185**	**189**	**199**	**219**
Liabilities					
Grants	7	9	12	9	7
Concessional Partner Loans[a]	4	6	7	8	8
Market Borrowings	None[b]	1	3	12	21
Other Liabilities	4	5	4	2	2
Total Liabilities	**15**	**21**	**26**	**31**	**38**
Equity (Total Assets minus Total Liabilities)	**158**	**164**	**163**	**168**	**181**

Source: GAO analysis of International Development Association (IDA) data. | GAO-22-104657

[a]Concessional partner loans are those provided on concessional terms directly by donors as a funding source for IDA's activities. Countries that agreed to provide concessional partner loans at various points from the IDA 17 through IDA 20 replenishments include Belgium, Canada, China, France, Japan, Saudi Arabia, and the United Kingdom.

[b]IDA started market borrowing in fiscal year 2018.

IDA's Primary Allocations Are for Concessional Loans and Grants

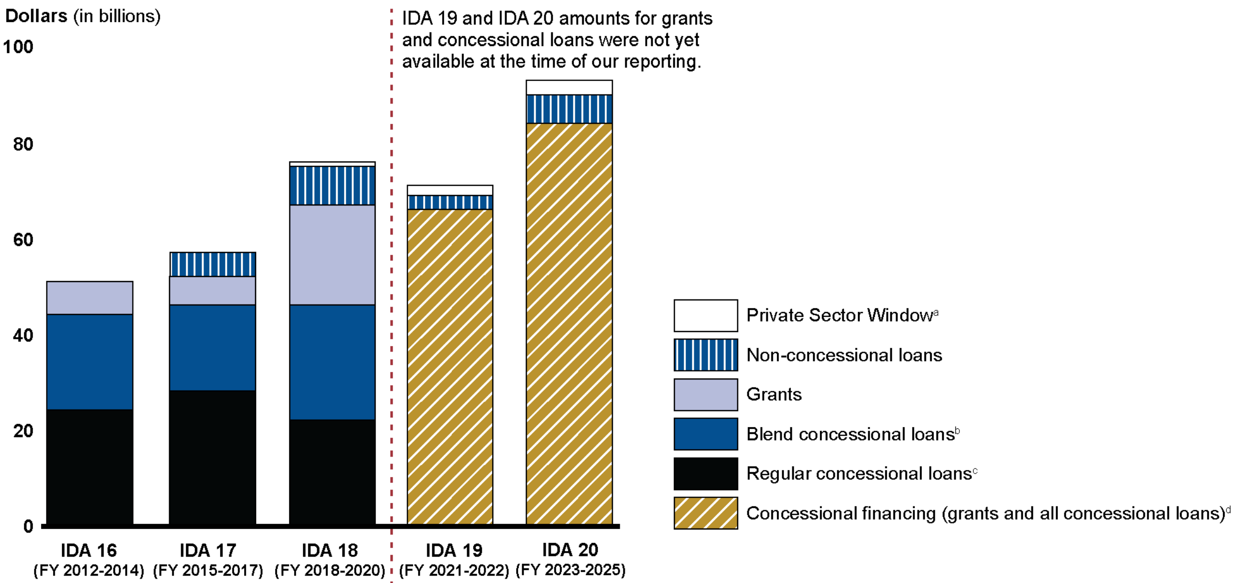
As of fiscal year 2021, IDA's primary allocation of funds were for concessional financing, which includes concessional loans and grants.[34] According to its reporting, IDA plans to allocate 91 percent (about $85 billion) of the IDA 20 replenishment to concessional financing, which includes grants and concessional loans that carry zero or very low interest rates and maturities over 12 to 50 years.[35] IDA's total allocations as of fiscal year 2021 include two types of concessional loans, regular and blend; grants; non-concessional loans; and funding to facilitate

[34]IDA determines specific funding allocations through its Performance Based Allocation process, which is described in the next section. IDA determines the composition of grants and concessional loans a borrower country will receive based on the country's risk of debt distress as assessed by the World Bank and IMF in their debt sustainability analysis.

[35]Final amounts of IDA's allocations for grants and regular and blend concessional loans for IDA 20 were not available at the time of our reporting.

private sector investment that IDA calls a “Private Sector Window” (see fig. 3).

Figure 3: IDA 16 through IDA 20 Allocations by Replenishment, Fiscal Years 2012 to 2025



Legend: Fiscal year = FY.

Source: GAO analysis of International Development Association (IDA) data. | GAO-22-104657

Accessible Data Table for Figure 3
Dollars in billions

Allocation	IDA 16 (FY 2012-2014)	IDA 17 (FY 2015-2017)	IDA 18 (FY 2018-2020)	IDA 19 (FY 2021-2022)	IDA 20 (FY 2023-2025)
Regular concessional loans	$24	$28	$22	0	0
Blend concessional loans	$20	$18	$24	0	0
Grants	$7	$6	$21	0	0
Non-concessional loans	0	$5	$8	$3	$6
Private Sector Window	0	0	$1	$2	$3
Concessional financing (grants and all concessional loans)	0	0	0	$66	$84

Note: IDA 16 total allocations were $51 billion; IDA 17 were $58 billion; IDA 18 were $75 billion; IDA 19 were $71 billion; and IDA 20 were $93 billion. IDA accounts for guarantees under the concessional and non-concessional loan categories. IDA and its members, which include donors and low-income countries, agreed to shorten the IDA 19 replenishment period, originally covering fiscal years 2021 through 2023, to 2 years. IDA took this step to frontload its resources and to provide additional assistance to countries during the COVID-19 pandemic.

[a]The Private Sector Window is a joint initiative between IDA and two other World Bank Group agencies, the International Finance Corporation and the Multilateral Investment Guarantee Agency, to facilitate private-sector investments. IDA introduced the initiative during the IDA 18 replenishment.

[b]As of fiscal year 2021, blend term concessional loans have a 0.75 percent service charge, a 1.25 percent interest rate, a 5-year grace period, and a 30-year maturity.

[c]As of fiscal year 2021, regular concessional loans have a 0.75 percent service charge, a zero percent interest rate, a 6- to 10-year grace period, and a 38- to 40-year maturity.

[d]Final amounts of IDA's allocations of grants and regular and blend concessional loans for IDA 19 and IDA 20 were not available at the time of our reporting.

- **Regular concessional loans.** As of the IDA 19 replenishment, regular concessional loans have a 0.75 percent service charge, a zero percent interest rate, a 6- to 10-year grace period, and a 38- to 40-year maturity. Borrowers rated as being at low or medium risk of debt distress receive regular concessional loans as 100 percent and 50 percent of their financing, respectively.[36] While the total concessional loan amount remained the same between IDA 17 and IDA 18 at $46 billion, the mix of regular and blend concessional loans fluctuated. Regular concessional loans decreased from $31 billion in IDA 17 to $22 billion in IDA 18 as more countries became eligible for grants, according to IDA.
- **Blend term concessional loans.** IDA offers blend term concessional loans, which have a 0.75 percent service charge, a 1.25 percent interest rate, a 5-year grace period, and a 30-year maturity. Countries that are eligible for and receive blend loans are eligible for both IDA and IBRD financing. These loans increased from $15 billion in IDA 17 to $24 billion in IDA 18.
- **Grants.** IDA provides grants to countries at high or medium risk of debt distress and under the GNI per capita threshold that qualifies them to receive assistance only from IDA. As of IDA 19, countries that have not exceeded this income threshold and which IDA assesses to be at high risk of debt distress only receive grants. Those countries assessed to be at moderate risk receive 50 percent grants and 50 percent concessional loans. Grants more than doubled from $9 billion in IDA 17 to $20 billion in IDA 18. According to IDA, since revising its model to increase its total funding sources, IDA has been able to shift

[36]IDA identifies a borrower's risk of debt distress rating based on the joint World Bank-IMF Debt Sustainability Analysis.

most new donor contributions to financing grants and subsidizing the interest of concessional loans.

- **Non-concessional loans.** IDA began providing non-concessional loans in the IDA 17 replenishment through an initiative to support projects with a strong effect on development, referred to as the Scale-up Window. According to IDA, countries at high risk of debt distress are ineligible to receive this non-concessional financing. For IDA 20, the overall amount of non-concessional loans approved were at about 7 percent ($6.3 billion) of IDA's total allocation, an increase of about 3 percentage points from IDA 19. These loans follow IBRD loan pricing with a variable interest rate, and have an average repayment maturity of up to 20 years and a maximum final maturity of 35 years.
- **Private Sector Window.** IDA introduced the Private Sector Window in IDA 18 as a joint initiative of IDA, IFC, and the Multilateral Investment Guarantee Agency (MIGA) to facilitate private-sector investments in countries that are only eligible for IDA assistance and considered fragile and conflict-affected states. IDA allocated over 2 percent ($2.5 billion) of the IDA 20 replenishment to the Private Sector Window. The Private Sector Window facilitates investments through means such as blending IDA funds with IFC investments to support small and medium enterprises.

IDA Has Not Changed Its Process to Assess Country Financing, but Revised Its Financial and Risk Management Framework

Market Borrowing Has Not Affected IDA's Process to Determine Countries' Needs for Loans and Grants

According to IDA officials, IDA assesses the amount of loans and grants for IDA countries through the Performance-Based Allocation (PBA) process. Officials said the introduction of market borrowing did not affect this process. The PBA considers economic and financial factors, such as gross national income per capita and the amount of debt a borrower country owes. The PBA also considers a range of performance indicators, including how a country manages IDA projects and programs.[37] The performance-related factors are the largest element of the country's PBA rating, which is the basis for determining the concessional lending a country is eligible to receive.

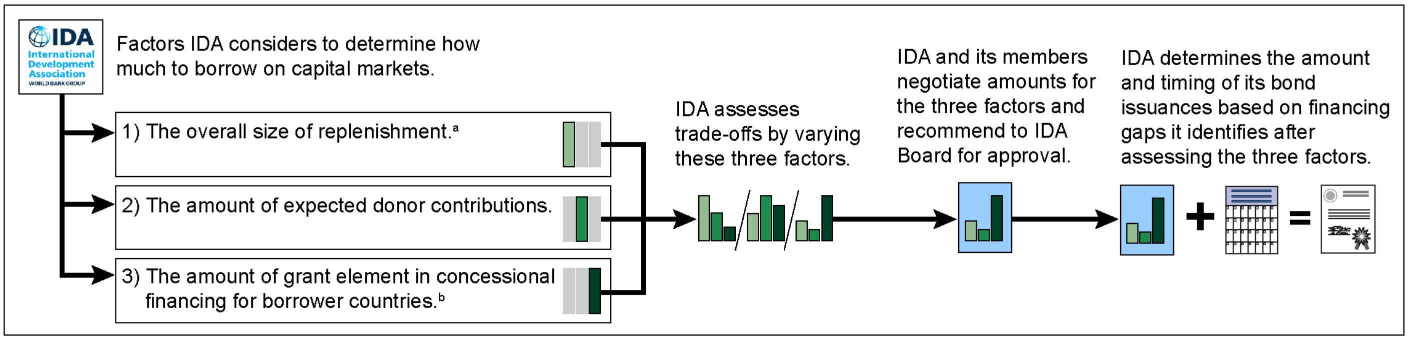
IDA financial documents indicate that IDA determines the amount and timing of market borrowing to fulfill any unmet financial obligations after taking into account country financial needs and total funding. IDA also assesses trade-offs, such as the degree of concessionality versus the volume of loans. For example, providing more concessional financing, such as concessional loans, would require more donor contributions to subsidize the interest on these concessional loans or less lending, and thus reduce the need for market borrowing, according to IDA.

IDA officials stated that IDA determines the amount to borrow on the capital markets based on financing gaps it identifies as part of the financing framework agreed on during the replenishment. The replenishment, approved by IDA's Board of Governors, includes the overall volume of financing, the amount of expected donor contributions, and the amount of concessional financing.[38] IDA determines the timing of its market borrowing based on when it needs additional funds to meet financial obligations, such as loan disbursements agreed upon during the replenishment. Figure 4 illustrates this process. According to IDA officials, the World Bank's key organizational goals are to help countries end poverty, boost shared prosperity, and achieve the UN's 2030 Sustainable Development Goals. To reach these goals, IDA aims to continue using its hybrid financial model to increase concessional lending and the volume of financing available to low-income countries, and ensure that it remains financially sustainable.

[37]IDA also does a performance-based assessment of a country's policy and institutional framework that involves a review of 16 criteria grouped into four categories. Those four categories with examples of the criteria are: 1) economic management, such as fiscal policy; 2) structural policies, such as a country's business regulatory environment; 3) social inclusion policies, such as social protections and labor; and 4) public sector management, such as the quality of budgetary and financial management.

[38]The IDA Board of Governors is IDA's senior decision-making body and consists of one Governor appointed by each of the 174 members of IDA.

Figure 4: IDA's Determination of Market Borrowing Needs



Source: GAO analysis of International Development Association (IDA) data. | GAO-22-104657

[a]IDA and its members, which include donors and low-income countries that borrow from IDA, regularly review the adequacy of IDA's resources and authorize additional funding through a process called replenishment that usually takes place every 3 years.

[b]IDA measures whether a loan is concessional by the loan's grant element. The grant element is calculated as the difference between the nominal or face value of a loan and the net present value of all scheduled principal and interest repayments, discounted at a market interest rate. The grant element is often expressed as a percentage of the loan's face value. IDA typically considers a loan concessional if the loan's grant element is greater or equal to 35 percent of the loan's face value.

IDA officials stated that IDA's outstanding market borrowing balance is currently below its liquid assets but is likely to exceed its liquid asset balance in the next 1 to 3 years. IDA officials have said that in general, after IDA's market borrowing exceeds its liquid asset balance, IDA will use market borrowing to fund non-concessional lending. Interest rates for non-concessional loans are closer to those offered by IDA bonds than for concessional loans, which will allow IDA to obtain a return on the non-concessional loans comparable to the return on the bonds it has to repay. For bonds funding IDA's concessional loans, when market interest rates are above lending rates, IDA will use donor contributions or its equity to fund the difference between interest rates. IDA officials said that when bond proceeds start to fund concessional loans, they will first fund concessional loans that carry higher interest rates—such as blend term concessional loans—and thus require less subsidy from donor contributions. Blend term concessional loans account for about one-third of IDA's total outstanding loan balance. Officials also said IDA will not use bond proceeds to fund grants.

IDA Revised Its Financial and Risk Management Framework to Manage Increased Financial Risks from Market Borrowing

To manage increased risks from market borrowing, IDA revised its financial and risk management framework during the IDA 18 replenishment.[39] While IDA's largest source of financial risk continues to be country credit risk, or the risk of borrower countries defaulting on their IDA loans, market borrowing has also increased IDA's existing financial risks, such as liquidity and interest rate risks. For example, IDA revised its financial and risk management framework to manage its additional liquidity risk, or the requirement to have sufficient cash on hand to meet expected lending and the increased financial obligations caused by market borrowing.[40] IDA's portfolio also faces a greater interest rate risk. IDA began its market borrowing by issuing bonds at market interest rates with maturities of 5 to 10 years. IDA plans to continue expanding and growing the share of longer maturity bonds.[41] On the lending side, IDA holds concessional loans with below market interest rates and maturities covering decades. Given that market interest rates fluctuate, IDA may need to hold more equity to support its concessional lending if interest rates increase, which could also affect its ability to do more market borrowing. To address these risks, IDA revised its financial and risk management framework to ensure it can repay its market borrowing,

[39]Credit rating agencies have given IDA a triple-A rating, which means that its bonds have a high level of creditworthiness with the strongest capacity to repay investors. Credit rating agencies noted that IDA has preferred creditor status, which means that borrower countries have historically serviced debt owed to the World Bank and the IMF before servicing debt owed to other creditors. According to IDA, this preferred creditor status is not a legal or contractual obligation but has been observed as standard practice. According to credit rating agencies, IDA's bonds also do not have "callable capital." Callable capital provisions would require additional funding, such as by donors to meet debt obligations if needed.

[40]According to IDA financial statements, IDA holds enough liquidity to cover the next 2 years of its cash outflows, for example for loan disbursements and repayments on its market debt.

[41]Since it issued its first bond for $1.5 billion in April 2018, IDA has had multiple debt issuances—in the form of both bonds and bills—for a total of nearly $21 billion as of June 30, 2021. According to IDA, these issuances increased in fiscal year 2020 due to the COVID-19 pandemic to address the increased demand from borrower countries for financial assistance. In addition, IDA has lengthened the maturity of its bonds from 5 years in 2018 to 15 years in 2021.

meet lending and other financial obligations, and remain financially sustainable. The framework now includes:

- **Asset liability management (ALM).** IDA updated its ALM policies to manage the increased financial risks to its balance sheet. These risks include liquidity risk, interest rate risk, among others. IDA revised its ALM policies to ensure it could meet lending and other financial obligations, such as market borrowing payments, and remain financially sustainable. IDA uses financial derivative contracts, such as interest rate swaps, to manage its interest rate risk.[42]
- **Risk exposure management.** IDA established new policies for risk exposure management to ensure that its lending portfolio is not subject to a substantial negative effect from a single source, such as a country with substantial IDA loans defaulting on those loans. To manage this risk, IDA set a limit on the amount of loan exposure (or outstanding loans) from a single borrower at 25 percent of IDA's equity. Such policies for risk exposure management are consistent with international financial practices.
- **Capital adequacy framework.** IDA also established a new capital adequacy framework. IDA's financial documents indicate that IDA must hold sufficient capital to ensure it can cover its financial obligations in the event of significant, unexpected loan losses, such as widespread defaults on IDA's loans. As part of its capital adequacy framework, IDA calculates its Deployable Strategic Capital (DSC). The DSC equals the amount of IDA's capital (Total Resources Available or TRA) left after subtracting the amount IDA would need to cover potential financial losses (Total Resources Required or TRR) and a conservation buffer of funding that is 10 percent of IDA's TRA, as illustrated in figure 5. IDA reports the DSC as a percentage, which represents the proportion of its capital that IDA can use as "risk

[42]A derivative is a security that derives its values from an underlying reference item or items such as an interest rate or exchange rate. An interest rate swap is a contract between two parties to exchange one stream of interest payments (such as fixed-rate interest payments) for another (such as variable interest rate payments) over a set period. Financial institutions use interest rate swaps to offset potential future losses. In addition, to support IDA's liquidity holdings, IDA has a short-term (less than 1 year) commercial paper program that currently maintains an outstanding amount issued of between $3 to $4 billion equivalent with an average maturity of approximately 3 to 4 months.

capital" for market borrowing.[43] IDA's policy, as required by its Board of Directors, is to maintain the DSC at or above zero percent. A DSC of zero would represent IDA leveraging nearly all of its deployable capital, with its TRR and conservation buffer remaining.[44]

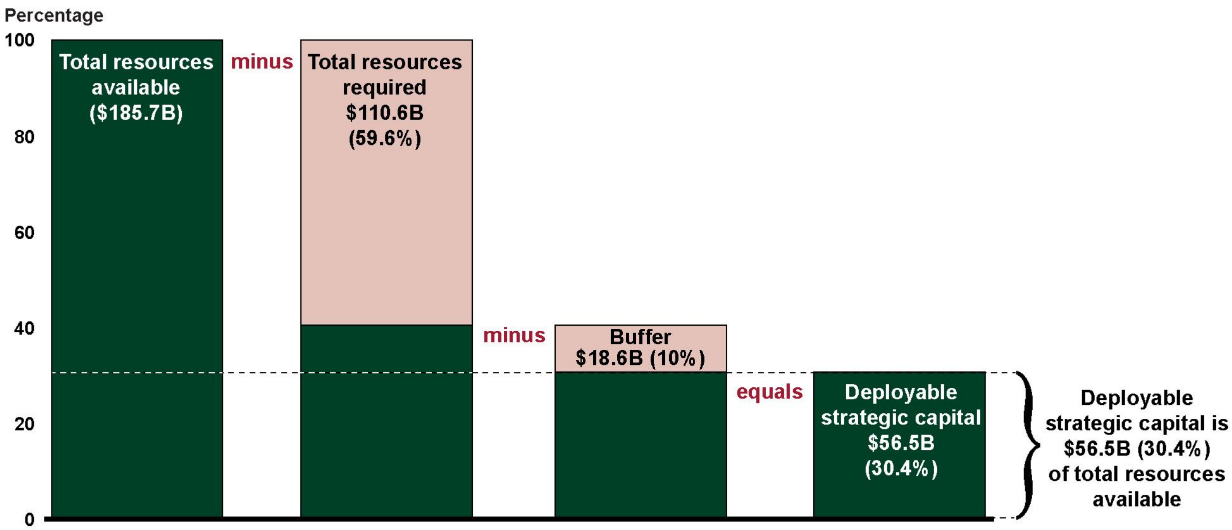
TRR is an important component of IDA's annual calculation of capital available to leverage for market borrowing. As discussed in the next section, IDA measures TRR by estimating potential financial losses, particularly loan losses from borrower countries defaulting on their IDA loans.[45]

[43]As of June 2017, prior to market borrowing, IDA had built up $158 billion in equity (IDA's assets minus liabilities). IDA's equity depends on the value of future loan repayments it expects to receive from its borrowers over decades. As a result, IDA's equity is not cash available for IDA to use for additional lending. Market borrowing enabled IDA to use this equity as "risk capital" to back its bonds and increase its total financial resources in the near term.

[44]According to IDA officials, the conservation buffer would roughly allow IDA to absorb the loss from default of one to two of IDA's largest borrower countries. IDA-only countries are those that are below a certain gross national income per capita threshold and are not eligible to receive financing from IBRD.

[45]TRR also includes, for example, potential financial losses from the following: operational risks such as business continuity challenges during the pandemic; losses in IDA's investment portfolio; and undisbursed loan and grant commitments, according to IDA. According to IDA officials, the largest single component of TRR is a present-value adjustment, which reduces the valuation of IDA's loan assets and therefore its equity. However, the present-value adjustment reflects a change in accounting assumptions rather than true uncertainty.

Figure 5: IDA's Assessment of Available Capital to Leverage for Market Borrowing, as of June 2021



Source: GAO analysis of International Development Association (IDA) data. | GAO-22-104657

Accessible Data Table for Figure 5

	Percentage	Dollar Value in Billions
Deployable Strategic Capital	30.4	56.5
Buffer	10	18.6
Total Resources Required	59.6	110.6
Total resources available	100	185.7

Note: Deployable Strategic Capital represents the amount of IDA's capital (Total Resources Available) that exceeds the amount IDA would need to cover potential financial losses (Total Resources Required), and a conservation buffer that is 10 percent of IDA's Total Resources Available.

Since IDA issued its first bond in 2018 and through fiscal year 2022, the DSC had been, on average, in the mid-30 percent range. As of fiscal year 2021, IDA's market debt was about $20 billion and the DSC was about 30 percent. IDA expects to issue in fiscal year 2022 about $10 billion equivalent of medium to long-term debt in a variety of markets and currencies, and this number is projected to increase. As IDA borrows more, the DSC will decline because IDA will leverage more of its available capital to issue bonds and provide more loans. IDA officials said that because of the World Bank's goals and IDA's role in helping to meet the UN's 2030 Sustainable Development Goals, IDA aims to maximize its support to IDA countries by leveraging nearly all its available deployable equity over this timeframe.

A DSC below zero would indicate that IDA is leveraging equity it could need to cover loan losses in its current lending portfolio in the event of a serious economic downturn. IDA has a policy to implement if the DSC should fall below zero. Under that policy, when the DSC falls below zero, IDA told us they would immediately notify the Board to take actions to bring the DSC above zero. Three months from the date on which the DSC falls below zero, and in the absence of IDA Board approval of continued lending or the recovery of the DSC above zero, IDA would not approve any new lending or other financing. In addition, IDA would not approve any new lending if the DSC falls to minus 10 percent of TRA, which would indicate that IDA has fully utilized its conservation buffer.

More market borrowing could also increase IDA's financing costs to repay its bondholders and for refinancing. For example, due to market borrowing IDA will have to refinance its market debt periodically given the longer duration of IDA loans, which can involve additional costs if interest rates increase above rates on the original bonds.[46] At the time of our reporting, IDA was requesting a Securities and Exchange Commission exemption for securities IDA issues. According to IDA officials, this exemption would lower IDA's borrowing costs and allow it to sell its bonds to a wider number of investors, including a large number of smaller institutional investors.[47]

[46]This will occur because IDA's market debt has a shorter maturity than do some of its loans with maturities that cover decades. IDA bases its refinancing requirements on how much of its existing debt matures and needs replacement. Because of refinancing, the amount of IDA's new debt issuance over the life of its loans is several times that of the loan amount.

[47]IDA has issued bonds in the European Union but not in the United States because, according to IDA officials, IDA does not have a Securities and Exchange Commission exemption from securities laws that other multilateral development banks like IBRD and IFC have. See 22 U.S.C. § 282k and 22 U.S.C. § 286k-1 for exemptions for securities issued by IFC and IBRD, respectively.

IDA Implemented a Process to Measure Country Credit Risk, but Some Aspects Are Not Transparent

When IDA Began Market Borrowing It Implemented a Process to Measure Country Credit Risk

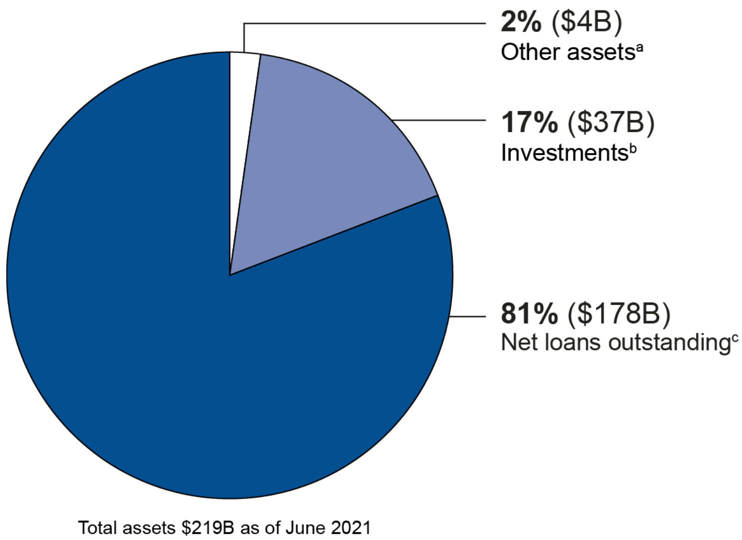
When IDA introduced market borrowing to its financial model, it expanded its process for measuring country credit risk,[48] which is the risk of borrower countries defaulting on loans from IDA and the largest financial risk IDA faces.[49] IDA borrows against its equity to raise funds from the capital markets, and its equity is largely dependent on the value of outstanding loans that borrower countries owe to IDA. As shown in figure 6, these loans constituted 81 percent of IDA's assets as of June 2021. According to IDA, borrower countries have historically had high rates of repayment to IDA. Nevertheless, IDA faces inherent risks and challenges in lending to these low-income countries, as many IDA countries have been and currently are at a high risk of debt distress. Now that IDA is borrowing from capital markets, IDA's ability to accurately measure country credit risk is critical to ensure it can still meet its lending and financial obligations in the case of unexpected loan defaults.[50]

[48]According to IDA officials, prior to market borrowing, IDA had a more limited process for measuring country credit risk. For example, IDA calculated a loan loss provision, which is the expected amount of loan losses, but did not measure total potential loan losses, which is the maximum potential loan losses it could face over 3 years.

[49]Other potential risks to IDA include the risk of having to borrow at increased interest rates; the risk of losses in IDA's investment portfolio; and operational risks, such as business continuity challenges during the pandemic. The introduction of market borrowing led to increased liquidity risk and interest rate risk, but, according to IDA officials, country credit risk will continue to be the largest source of financial risk to IDA.

[50]IDA also monitors near-term country credit risk using portfolio performance indicators. These indicators include (1) the number of borrowers with loans more than 30 days overdue; (2) the value of outstanding loans to countries in default; and (3) loan portfolio concentration, or the percent of outstanding loans owed by IDA's largest borrowers. Regarding portfolio loan concentration, for example, in its fiscal year 2021 financial statement, IDA reported that the top 10 countries with the highest amount of outstanding loans to IDA represented 66 percent of IDA's total exposure. IDA also reported that three of its borrowers were in default status as of fiscal year 2021.

Figure 6: Composition of IDA's Financial Assets as of June 2021



Source: GAO analysis of International Development Association (IDA) data. | GAO-22-104657

Accessible Data Table for Figure 6

Asset	Dollars in billions	Percentage
Net loans outstanding	$178	81%
Investments	$37	17%
Other assets	$4	2%
Total assets as of June 2021	$219	

[a]Other assets include, for example, trust funds that IDA administers on behalf of donors to provide additional resources to certain development activities.

[b]IDA has investments in assets, such as sovereign bonds and asset-backed securities, which provide a source of liquidity or assets that it can use to convert to cash, generate income, or manage foreign exchange risks.

[c]Net loans outstanding is the sum of unpaid loans that borrower countries owe to IDA, minus loan origination costs that were deferred and a provision for expected loan losses.

To measure its total country credit risk, IDA first assesses the risk from each individual borrower country using the following process:

1. An IDA country analyst compiles a report of relevant information about the country, such as economic structure and growth prospects; balance of payments risks; external debt and liquidity; fiscal policy and public debt; monetary and exchange rate policy; governance and social factors, among others. The analyst collects this information from a range of public and private sources, and analyzes it with the help of discussions with colleagues in the World Bank's regional

offices, the World Bank's Macroeconomics, Trade, and Investment unit, and at the IMF; and occasionally country visits.

2. The IDA country analyst uses this information to propose a credit rating for the borrower country, representing that country's risk of default to IDA. The country analyst presents the report and proposed credit rating to the IDA Ratings Committee.[51]
3. A second IDA country analyst leads the IDA Ratings Committee discussion of the proposed rating. The Ratings Committee then debates the rating, using additional information such as the most recent World Bank-IMF debt sustainability analysis (DSA), and then votes on what rating to assign.

After assessing the risk from each individual borrower, IDA then estimates maximum potential loan losses it could face over 3 years using the following steps:

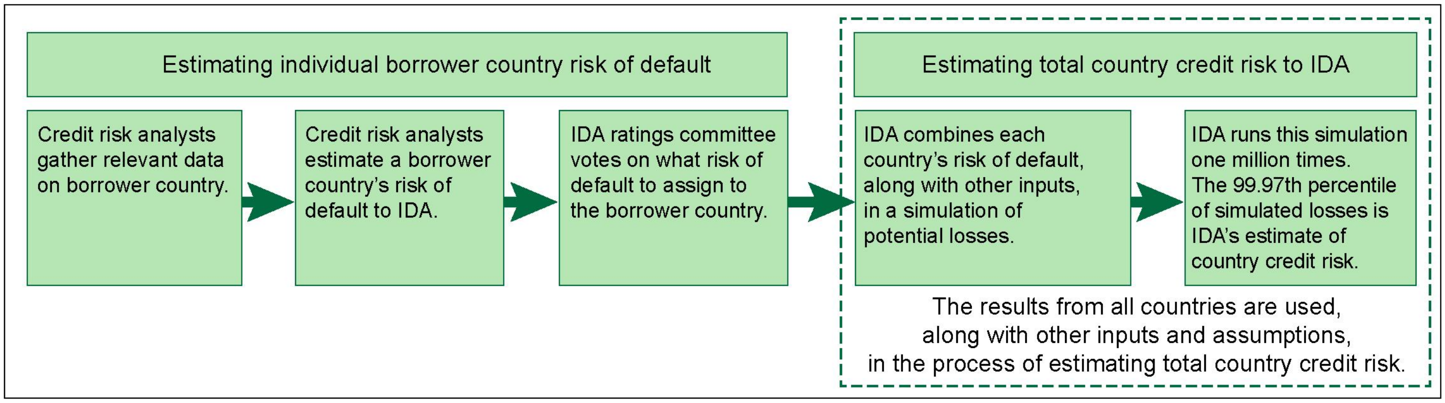
4. IDA combines each of the estimated borrower risks of default, along with other inputs and assumptions, to run a model of potential loan losses.[52] To do this, IDA uses a Monte Carlo model, which approximates the likelihood of certain outcomes by performing multiple trial runs, using random variables drawn from a specified range. According to IDA officials, the inputs into its model include IDA's assessments of risk of default associated with each borrower country (derived from the credit rating process); assumptions about losses in the event of country default; and other assumptions, such as the correlations among borrower defaults. The model uses these inputs to generate an estimate of potential loan losses.
5. IDA runs this potential loan loss model one million times, according to IDA officials, and uses the 99.97th percentile of loan losses generated by the model as its measure of total country credit risk. If the model results reflect real-world conditions, the 99.97th percentile provides IDA a 0.03 percent chance of incurring higher losses than anticipated.

Figure 7 illustrates IDA's full process to measure total country credit risk.

[51]The IDA Ratings Committee consists of IDA country analysts within the World Bank's Chief Risk Office, Credit Risk Department. The committee's chair is the World Bank's Director, Country Credit Risk; the World Bank's Head, Sovereign Risk; or an acting chair as delegated by the Director.

[52]IDA refers to this model as its portfolio credit risk model, or Risk-Adjusted Allocation of Capital model. IDA refers to the output of this model as its estimate of maximum probable losses. In this report, we refer to this model as the potential loan loss model, and to its output as IDA's estimate of potential loan losses, or total country credit risk.

Figure 7: IDA's Process for Measuring Its Total Country Credit Risk



Source: GAO analysis of International Development Association (IDA) data. | GAO-22-104657

Note: IDA assesses each borrower country's risk of default at least once per year. The IDA ratings committee consists of the IDA country analysts within the World Bank's Chief Risk Office, Credit Risk Department. The committee's chair is the World Bank's Director, Country Credit Risk; the World Bank's Head, Sovereign Risk; or an acting chair as delegated by the Director. IDA measures total country credit risk by estimating maximum potential loan losses, or the maximum amount of capital it would need to cover a 3-year series of loan defaults. To estimate maximum potential loan losses, IDA uses a Monte Carlo model, which approximates the likelihood of certain outcomes by performing multiple trial runs using random variables drawn from a specified range.

According to IDA officials, IDA developed and validated its potential loan loss model with the help of outside consulting agencies. IDA validates the model every few years, using both an internal model validation unit and external consultants, and the model incorporates developments in the field of financial risk modeling, according to IDA officials.[53] IDA has shared high-level summaries of external validation methodology and findings with the IDA Board, as well as other high-level information about the model, such as a list of certain model inputs. This information is important but IDA could provide additional information to help its Board understand and oversee its risk modeling. The IDA Board could benefit from information on:

- **The key assumptions and parameters of the model and the basis for those choices or estimates.** IDA has shared with its Board some key parameters and assumptions of the model, such as a list of certain model inputs. These include the estimated probability of default of each borrower, IDA's exposure to each borrower, the

[53] IDA uses the same potential loan loss model as IBRD. IBRD has used this model since 1998 and updated it in fiscal year 2012. The previous reviews of the model occurred before IDA began using it. According to IDA officials, at the time of our review there was an ongoing external review of IDA's capital adequacy framework, including its potential loan loss model.

amount of financial loss assumed in the model if a country defaults, and the assumed correlations among borrower defaults. However, IDA has not provided its Board with information that explains how it chose or estimated these or other key parameters and assumptions of the model. Information on how IDA chose or estimated these parameters, and how they interact in the model to create an estimate of potential losses, could aid IDA's Board in understanding and overseeing risk associated with IDA's lending activities.

- **Sensitivity of model results to the choice of assumptions or parameters.** IDA has shared with its Board the results of sensitivity analyses by external consultants. However, these analyses only tested the sensitivity of the model to a few of the model's assumptions.[54] IDA could share the results of other key sensitivity tests with its Board, such as the sensitivity of model results to assumptions about losses when a country defaults, or to assumptions that determine how often country defaults occur simultaneously. Sensitivity analyses can test whether the selection of parameters is sound and whether the model is stable and not overly sensitive to small changes in key inputs.[55]

Access to information on model assumptions and sensitivity would allow the Board to better understand uncertainty in model results and make operational changes or provide suggestions for improvement, if necessary. According to IDA officials, IDA has not shared this information in the past because it is highly technical, but is open to sharing more of it with its Board. IDA officials also stated that they have not provided additional information on the potential loan loss model in order to maintain independence over its estimates of the risk of default for each borrower country, which is one of the model's inputs.[56] IDA can share more information about its potential loan loss model, such as the information

[54]IDA does share with its Board the outcomes of different stress tests on the TRR model, but does not share information about the sensitivity of model results to the choice of model assumptions or parameters. For example, the 2021 Annual Risk Report includes a "slow vaccine rollout" stress test scenario, with a stunted global economy recovery from the pandemic, resulting in a 5 percent increase in TRR. However, these stress tests use the existing TRR model assumptions and parameters, rather than providing information about the sensitivity of the TRR model to changes in assumptions or parameters.

[55]International Electrotechnical Commission and International Organization for Standardization. *Risk Management- Risk Assessment Techniques.*

[56]IDA's Board of Directors is composed of representatives from countries, some of which are IDA's borrowers. IDA officials explained that, in order to maintain independence over their credit rating process, information shared with the Board must not include information that could identify individual country credit ratings.

described above, without sharing the values of this particular input or other country-specific information. We discuss later in the report how this type of information could enhance U.S. Treasury's oversight of IDA.

IDA Has Taken Steps to Address Data Gaps in Borrower Default Risk, But the Process is Not Fully Transparent

While IDA is taking steps to address gaps related to debt data, its Board does not have information on how it is accounting for these data gaps in its process to assess the risk of default from each of its borrowers. According to IDA officials, one of the most important indicators used in the assessment of borrower default risk is the borrower country's external debt and how that debt could affect IDA's preferred creditor status. Preferred creditor status is the expectation that a creditor will be the first creditor, or one of the first creditors, that the borrower will repay even in the event of a default to other creditors. According to IDA, a number of incentives exist for borrowers to avoid defaulting on loans from IDA, such as IDA's policy of not providing new disbursements after default and its role as a lender during economic downturns.[57] However, there are external factors that could affect IDA's preferred creditor status with each borrower, such as how much debt those borrowers owe to other creditors, and the legal terms of that debt. For example, according to recent research, a borrower country might have a contract with another creditor that stipulates that the creditor can seize assets in the event of a default.[58] These contract terms could incentivize the borrower to default on loans from IDA before defaulting on loans from the other creditor.

IDA borrower countries have been increasingly borrowing in ways that may be less transparent to IDA. For example:

- **Non-Paris Club lending:** Until the late 1990s, most lending to low-income countries came from the Paris Club, a group of creditor countries that agrees to share lending information with World Bank, or

[57]According to IDA, other incentives for borrowers to treat IDA as a preferred creditor include but are not limited to the fact that IDA is a shareholder co-operative where its borrowers are also stakeholders; and the World Bank's policy of treating defaults to IDA as defaults to IBRD and vice-versa.

[58]See Rivetti, *Debt Transparency in Developing Economies;* and Peterson Institute for International Economics, Kiel Institute for the World Economy, Center for Global Development, and AidData at William & Mary, *How China Lends: A Rare Look into 100 Debt Contracts with Foreign Governments* (2021).

from international financial institutions.[59] However, according to a World Bank report, low-income countries are increasingly borrowing from non-Paris Club creditors, particularly Chinese government institutions, for which there are concerns about transparency in their lending practices. These other creditors now account for twice as much outstanding external debt as the Paris Club creditors.[60]

- **State-owned enterprise borrowing:** State-owned enterprises are firms that are fully or partially government owned and operated, and in some circumstances their debt is guaranteed by the government. According to reports from the World Bank and IMF, these firms now account for an increasing portion of sovereign debt.[61] Borrowing countries can have trouble collecting and providing data on state-owned enterprise debt due to weak debt management and recording systems, according to IDA officials. As a result, borrower countries often do not report all of their state-owned enterprise debt to the World Bank's Debtor Reporting System.
- **Collateralization:** According to recent research, over the past 20 years, more sovereign debt contracts have included terms that use special bank accounts or revenue from natural resources as collateral.[62] These terms could affect IDA's preferred creditor status. According to a World Bank report, these loan agreements give borrowers access to additional credit, but limit the borrower's ability to freely direct cash flows generated from its own natural resources. In addition, borrower countries often exclude resource-backed loans from their public debt reporting.[63]

According to IDA officials, IDA is taking steps to address the issue of incomplete debt data when estimating borrower risk of default by using multiple public and non-public data sources. IDA's borrowers are required to report loan-by-loan information on their public and publicly guaranteed debt to the World Bank's Debtor Reporting System. However, according

[59]The Paris Club, formed in 1956, is a group of bilateral creditor countries that meets to negotiate sovereign debt rescheduling and debt relief.

[60]Rivetti, *Debt Transparency in Developing Economies.*

[61]See World Bank, *World Development Report 2022: Finance for an Equitable Recovery* (Washington, DC: 2022) and International Monetary Fund (IMF) *Fiscal Monitor: Policies to Support People During the COVID-19 Pandemic.* (Washington, D.C.: 2020).

[62]Peterson Institute for International Economics, *How China Lends*.

[63]Rivetti, *Debt Transparency in Developing Economies.*

to IDA officials, borrower countries often do not report all of their public and publicly guaranteed debt, typically due to weak debt management systems. The unreported debt tends to be state-owned enterprise debt, which according to recent research, is also more often from non-Paris Club members and may be collateralized.[64] According to IDA officials, IDA uses additional sources of data in its country credit rating process, such as detailed data collected for the IMF-World Bank Debt Sustainability Analyses; information from the IMF World Economic Outlook and other IMF documentation; and information collected when a borrower undergoes debt restructuring with other creditors. For example, according to IDA officials, IDA is able to collect collateralization information during debt restructuring negotiations with other creditors.

IDA officials stated that when estimating a borrower's risk of default, IDA country analysts also validate debt and balance of payment data across multiple sources, and focus on the totality of a country's debt rather than individual loans. Lack of debt transparency may also be a large determining factor in a borrower country's rating. While IDA officials said they have the necessary information to assess borrower country debt and its effect on IDA's preferred creditor status, the Board does not have detailed information on the steps IDA uses in their country credit rating process to overcome risks from potentially incomplete debt data. For example, the Board does not have information on the extent to which IDA is able to gather information on less transparent debt; the extent of uncertainty that remains after this information-gathering process; how IDA incorporates this remaining uncertainty into its credit rating process; and the remaining risk, if any, posed by this incomplete data. In the next section, we discuss how additional information on IDA's process to address data gaps would enhance the Board's, and therefore Treasury's, ability to conduct oversight.

[64]Rivetti, *Debt Transparency in Developing Economies.*

Treasury Monitors IDA's Financial and Risk Management, but Has Not Reviewed Key Information for Measuring Credit Risk

Treasury Reviews Key Sources of Information to Monitor Implementation of IDA's Financial and Risk Management Framework

Treasury reviews information collected from several key sources as part of its oversight of IDA's financial and risk management framework instead of performing its own financial analyses. According to agency officials, Treasury primarily reviews and monitors IDA's quarterly and annual financial statements, accompanying evaluations, and quarterly and annual risk reports.[65] Key information provided through these sources include:

- Financial ratios, such as liquidity and debt levels, and net income, which provide a basis for analysis and insight into IDA's cash flow and internal projections. Rapid changes in these ratios may indicate a potential concern, according to Treasury officials.
- Capital adequacy, which is a key indicator and measurement used in decision making around IDA's financial sustainability.[66]
- Concessional financing levels, loan projections, and repayments, which are key inputs for IDA financing decisions and future borrowing plans.
- Credit, interest rate, and liquidity risks, which all inform IDA risk management processes.

[65]Accompanying evaluations include, for example, the 2018 IDA exposure management framework—a tool used by the World Bank to ensure IDA implementation of financing negotiated during replenishment rounds, while maintaining capital adequacy and liquidity above the required thresholds needed to maintain a triple-A rating and deliver appropriate assistance levels to IDA. Treasury reviewed this framework for compatibility with the World Bank and IMF Debt Sustainability Framework for Low-Income Countries. Treasury also compared credit rating agency reports for IDA with information in IDA's asset-liability management and risk management frameworks. These frameworks outline IDA's assessment of risk factors and internal controls developed to manage those risks.

[66]Capital adequacy is IDA's measure of how much capital it must hold to ensure that it can cover its financial obligations in the event of significant unexpected loan losses.

Treasury officials stated that they also review the annual multilateral development bank reports from the top three credit rating agencies[67] and compare their findings with information produced by IDA. As IDA considered revising its financial model to include debt financing, IDA commissioned and received credit ratings reports from Standard & Poor's and Moody's. According to IDA officials, IDA asked these agencies to review policies and features implemented as part of its new model for investor protection and maintenance of IDA's Triple-A rating. IDA officials stated that IDA shared these reports with IDA Deputies and the Audit Committee. IDA's credit rating directly affects its ability to borrow from capital markets at preferred rates. Other evaluations, such as external audits conducted by an independent contracted organization on IDA financial reporting, provide Treasury with additional information on the quality of IDA internal controls and alignment with established frameworks such as on IDA's risk management, according to a Treasury official. Treasury has also made requests for specific documents or information from IDA as needed.

As part of its oversight of donor contributions and concessional lending, Treasury examines reports produced during the replenishment process for information on IDA's borrowing on the capital markets and assumptions regarding donor contributions. These reports include implementation status updates and proposed adjustments to replenishment allocations, as well as retrospective reports that explain financial and programmatic changes instituted by IDA throughout the replenishment cycle.

Finally, in addition to internal and external reporting on IDA, Treasury also monitors debt sustainability information for countries borrowing from IDA. Treasury officials stated that they track changes to this information using a variety of sources, such as credit rating agency assessments and publicly available IMF data. They also stated that Treasury experts monitor country current affairs and sovereign debt. This information contributes to Treasury's understanding of some of the data used by IDA to assess risk of default among its borrowers, as well as the level of concessionality needed in future IDA assistance. Treasury officials acknowledged that uncertainties exist in data available on borrower country external debt, especially debt owed by state-owned enterprises.

[67]Treasury reviews reports from Standard & Poor's Global Ratings (Standard & Poor's), Moody's Investors Service (Moody's), and Fitch Ratings.

They also noted that the World Bank and G20 are pursuing efforts to improve information sharing.

Treasury Provides Feedback to IDA Based on Information Provided

Treasury provides feedback on IDA proposals, requests additional analyses from IDA, and shares its perspectives on financial and market developments through the USED.[68] Examples of this feedback include:

- **Replenishment negotiations.** Treasury and other participants negotiate IDA's funding through multiple replenishment round meetings, with U.S. funds appropriated by Congress. At the conclusion of the negotiations, IDA produces a Deputies report that incorporates U.S. views and priorities, along with perspectives from other IDA deputies, borrowing countries, and relevant stakeholders. According to Treasury officials, Treasury meets with World Bank management and other donors during this process to share perspectives and ask questions about materials provided. For example, Treasury documents show that during the IDA18 replenishment the agency requested additional analysis on short- and long-term scenarios to assess the effect that borrowing on the capital markets would have on donor contribution levels.
- **Audit committee reviews.** As a member of the audit committee, Treasury discusses IDA's financial policies and issues, and receives information on these matters. During these reviews, Treasury may make suggestions on financial matters. For example, after IDA began borrowing on the capital markets, Treasury officials stated they worked closely with IDA to update its risk management framework for better management of its equity and sensitivity to interest rates.
- **Ad hoc discussions.** According to Treasury officials, Treasury initiates ad hoc discussions as needed for specific efforts. For example, Treasury discussed IDA's pilot interest rate swap program—

[68]The U.S. President appoints and the U.S Senate confirms the U.S. Executive Director (USED). The USED represents U.S. policy and interests on the IDA Board and acts on behalf of Treasury.

intended to manage interest rate risk—with IDA.[69] Treasury expressed concerns about the proposed size for the initial sum of money, or principal, used in the program. Subsequently, IDA reduced the initial principal value to one-third of the amount originally proposed. According to Treasury officials, IDA has no current plans to expand the program.

Treasury Lacks Information on Two Elements of IDA's Risk Management Framework

Although Treasury reviews various IDA assessments and information that inform IDA's risk management, we found additional information on two elements key to IDA risk management would improve Treasury oversight. First, Treasury, along with other executive directors on the IDA Board, has received limited information on IDA's potential loan loss model, which estimates the long-term financial risk of borrower countries defaulting on their loans to IDA. Treasury, through the USED on the IDA Board, does not have important information on the key assumptions and parameters of the model, or the sensitivity of model results to changes in those factors. The results of this model are key inputs that IDA uses to measure its financial sustainability and determine how much of its equity it can use to support additional borrowing on the capital markets.

IDA has shared with its Board, including the USED, high-level information about the potential loan loss model, including summaries of external validation and findings, some results of sensitivity analyses conducted on the model by external consultants, and information on certain assumptions and model inputs. The USED agreed that having access to additional information on assumptions underlying IDA's loan loss model could be helpful to further assess the risks to IDA. IDA states that it has not shared additional technical information with the USED or other members of its Board to maintain independence in its assessment of the risk of default for each borrower country. While we agree that IDA's ability to measure credit risk independently and objectively is vital, IDA has created summaries of other potentially sensitive aspects of its country

[69]Under the program, IDA swaps fixed interest rate payments it receives from its borrowers for floating interest rate payments from a seller. Market interest rates at the time of the transaction determine the swap rates. This approach provides additional protection to IDA from interest rate fluctuations and enables it to reduce the amount of capital it sets aside to manage interest rate risk. However, the swaps program may expose IDA to volatility in reported income as the market value of the swaps fluctuates or adversely affects IDA should future fixed-rate interest rates be lower than the floating rate.

credit risk assessment, such as the country credit rating process, that it could share with the Board. We believe IDA could use a similar approach to share information with the IDA Board on the potential loan loss model without sharing country-specific information that would threaten IDA's ability to measure risks without undue influence. IDA officials stated they are open to sharing more information with the Board apart from these sensitive items. Stakeholders, such as Treasury through the USED, should engage with and collect sufficient information to understand risk assessment decisions made by an organization and to determine whether the risk is acceptable, according to the International Electrotechnical Commission (IEC) and International Organization for Standardization's (ISO) *Risk Assessment Techniques 2019*.[70]

The Audit Committee, of which Treasury is a member, is responsible for oversight of IDA's risk management and the adequacy and effectiveness of financial policies and controls. According to the Committee's Terms of Reference, it should receive regular reports from IDA's operating units to meet its oversight responsibilities.[71] As a Committee member, Treasury makes requests for additional information and provides feedback on oversight issues it prioritizes. IDA has a responsibility to be responsive to its Board members and donors as they continue to fund its operations. Transparency of the analytical choices, assumptions, and data that inform economic analyses, particularly those of IDA's loan loss model, allows internal stakeholders such as the Audit Committee to understand the implications of these analyses and their associated risks.[72]

Second, Treasury, through the USED on the IDA Board, lacks sufficient information on the steps IDA is taking to account for incomplete debt data in its country credit rating process. IDA has access to many sources of public and confidential debt data and supports reforms to increase debt transparency. IDA has provided some information to its Board on its efforts to address gaps related to debt data and the weight and attention it gives to debt transparency and quality in its risk rating process. However, the IDA Board has not requested specific information on how IDA

[70]International Electrotechnical Commission and International Organization for Standardization, *International Standard: Risk Management—Risk Assessment Techniques.*

[71]IDA, Terms of Reference of the Audit Committee, Revised and Approved by the IDA Board June 10, 2020.

[72]GAO, *Assessment Methodology for Economic Analysis*, GAO-18-151SP (Washington, D.C.: Apr. 10, 2018).

accounts for risks associated with incomplete borrower debt data in its credit rating process.

Uncertainty in debt data reporting may affect IDA's estimates of the risk of borrower countries defaulting on their IDA loans, which is the biggest risk IDA faces. Treasury officials were not able to comment on how uncertainty in debt data on borrower countries affects IDA's country credit ratings. Officials stated that they do not review the extent to which IDA is able to gather debt information or how IDA incorporates any remaining uncertainty into its country credit process. Treasury relies on IDA to determine borrower countries' outstanding debt and assess subsequent individual borrower country risk of default. Given the importance of information about borrower country debt in IDA's estimate of potential loan losses, it is important that Treasury and other Board members understand the steps IDA is taking to account for incomplete data in its risk management process so that the Board can fully assess the quality of IDA's risk management. IEC/ISO guidelines state that entities should identify any uncertainties and gaps in the information used in risk assessments and communicate them to decision makers, particularly any effects of uncertainty identified as part of sensitivity analysis.[73] Such practices are important since gaps or errors in data may result in inaccurate risk estimates and miscalculation of potential loan losses.

Conclusions

Since 1960, IDA has provided financing primarily through concessional loans and grants to the world's poorest countries. To accelerate the development of low- and middle-income countries, the UN established the 2030 Sustainable Development Goals. Recognizing the need to provide additional financing to low-income countries to meet these goals, IDA supplemented its traditional funding sources of mainly donor contributions and loan repayments by leveraging its sizable equity to borrow from the capital markets.

Borrowing from the capital markets introduces new operational challenges that will require increasingly sophisticated risk management approaches, particularly as IDA substantially increases its borrowing over

[73]International Electrotechnical Commission and International Organization for Standardization, *International Standard: Risk Management—Risk Assessment Techniques.*

time. As a result, IDA has updated its financial and risk management framework. Since most of IDA's assets are loans to low-income countries, the risk of default on these loans poses the largest risk to IDA. Over the years, IDA borrowers have faced difficulties repaying their external debt, resulting in debt relief initiatives and additional donor contributions to compensate IDA for debt relief it provided. External debt levels are increasing and low-income countries are facing higher risks of debt distress due to the COVID-19 pandemic.

IDA has adopted a more robust process for assessing the risk of countries defaulting on their IDA loans, but its Board has limited information on the underlying assumptions and parameters it uses in the loan loss model, which affects the resources it can leverage for market borrowing. Additional information on the key aspects of IDA's model would provide greater assurance to the IDA Board, including Treasury through the USED, that IDA is appropriately assessing the risk of countries defaulting on its loans and is setting aside sufficient resources for such a possibility, even as it takes on additional risk through market borrowing. Moreover, it is unclear what steps IDA is taking to account for incomplete debt reporting in its assessment of potential borrower defaults. Additional information on IDA's process would provide greater assurance to Treasury, along with other members of the IDA Board, that IDA is appropriately accounting for possibly incomplete debt data which could contribute to larger than expected losses to IDA.

Recommendations for Executive Action

We are making the following two recommendations to the Department of the Treasury:

The Secretary of the Treasury should direct the U.S. Executive Director of IDA to work with the other Executive Directors to request additional information underlying IDA's loan loss model—including key assumptions of the model and sensitivity analyses of model results—necessary to conduct oversight of IDA's financial sustainability. (Recommendation 1)

The Secretary of the Treasury should direct the U.S. Executive Director of IDA to work with other Executive Directors to request information from IDA on steps it is taking to account for uncertainty in certain debt data, such as incomplete information on loan terms and state-owned enterprise debt, as it measures the risks of borrowers defaulting. (Recommendation 2)

Agency Comments and Our Evaluation

We provided a draft of this report to Treasury and the World Bank for review and comment. Treasury and the World Bank provided written comments that we have reproduced in appendixes II and III, respectively. Treasury concurred with our recommendations. IDA acknowledged the recommendations and expressed a commitment to work closely with its Board of Directors to facilitate information sharing related to the areas we identified. Treasury and the World Bank provided technical comments that we incorporated as appropriate.

We are sending copies of this report to the appropriate congressional committees, the Secretary of the Department of the Treasury, the President of the World Bank, and other interested parties. In addition, the report is available at no charge on the GAO website at https://www.gao.gov.

If you or your staff have any questions about this report, please contact me at (202) 512-2964 or KenneyC@gao.gov. Contact points for our Offices of Congressional Relations and Public Affairs may be found on the last page of this report. GAO staff who made key contributions to this report are listed in appendix IV.

Chelsa Kenney
Director, International Affairs and Trade

We were asked to review the World Bank Group's International Development Association's (IDA) financial model, including how market borrowing affects it as well as changes to IDA's financial and risk

Appendix I: Objectives, Scope, and Methodology

management processes. This report examines: 1) IDA's funding sources and allocations; 2) how market borrowing has affected IDA's process for assessing countries' financing needs and its framework for financial and risk management; 3) how IDA assesses key risks to its financial sustainability; and 4) the extent to which the Department of the Treasury oversees IDA's financial and risk management.

To describe IDA funding sources and allocations, we compiled and analyzed replenishment data that IDA reports annually in its public financial statements.[1] We reviewed data in these statements for IDA replenishments 16 through 20, which cover fiscal years 2012 through 2025. The management decision and analysis section of IDA's financial statements, which includes information on IDA's replenishment financing, is not subject to the external audit of IDA's financial reporting (described below). According to IDA, while the external auditor does not offer a final opinion on this section, the external auditor reviews the management decision and analysis section of its financial statements to ensure that the information is materially consistent with the information in IDA's financial reporting. To assess the reliability of the replenishment data in IDA's financial statements, we compared data for overlapping years published in IDA's replenishment reports for replenishments 16 through 19, to the extent that data were available.[2] We also reviewed information provided by IDA on how it collects and validates replenishment data. We requested that IDA review and verify the figures we collected to determine if any changes had occurred since the statements' publications.

[1]IDA and its members, which include donors and low-income countries that borrow from IDA, regularly review the adequacy of IDA's resources and authorize additional funding through a process called replenishment. This process usually takes place every 3 years.

[2]IDA published the funding source and allocation data for IDA 20 in February 2022 in the IDA 20 final replenishment report. As a result, we did not have additional information to compare this data.

For IDA's reporting on the financing for the 19th and 20th replenishments, IDA did not separate the data for four funding source categories, which include loan repayments, investment income, carryover funds, and market borrowings. IDA reported these four categories as one category called "reflows, carryover, and borrowings." IDA stated it did not separately reflect these categories in the IDA 19 and 20 replenishments financing due to IDA's adoption of a balance sheet management approach to track this information. According to IDA, while IDA can break down the cash inflows it will receive in future years into these categories, it cannot easily assign the amounts to a specific replenishment since it can use these funds interchangeably to disburse projects in any replenishment.[3] Additionally, the IDA 19 replenishment was ongoing during our review and the IDA 20 replenishment would not begin until fiscal year 2023. As a result, we could not report results for both replenishments for individual concessional financing categories of IDA grants, regular concessional loans, and blend term concessional loans. We therefore reported the total concessional financing for IDA 19 and IDA 20. We determined that IDA's funding source and allocation data were sufficiently reliable for describing IDA's funding sources and allocations for the years we reported.

To describe IDA's balance sheet, we compiled and analyzed information on IDA's equity, liabilities, and assets for fiscal years 2017 through 2021, which IDA reports in its public financial statements. To verify IDA's balance sheet data, we reviewed the results of external audits of this information and explanatory notes in IDA's financial statements, and interviewed officials in the World Bank Controller's Office, which manages IDA's financial reporting. IDA's external auditor annually audits IDA's financial statement information, including IDA's balance sheets, related statements of income, comprehensive income, accumulated deficit changes, cash flows, and related notes.[4] These audits also cover IDA's internal control over its financial reporting, based on criteria established in the Internal Control-Integrated Framework (2013), issued by the

[3]Internally, IDA does report annually its projected market debt from borrowing on the capital markets in future years as part of IDA's assessment of its financing needs and their effect on IDA's capital adequacy. IDA shares this information with donors and reports actual market borrowings in its annual financial statements.

[4]IDA appoints its external auditor to a 5-year term—subject to annual reappointment—with a limit of two consecutive terms, based on the recommendation of IDA's audit committee and approval by its Board. IDA's external auditor from fiscal years 2009 through 2018 was KPMG. IDA appointed its current external auditor, Deloitte, to a 5-year term that began in fiscal year 2019.

Committee of Sponsoring Organizations of the Treadway Commission. For the years in our scope, the external audits found that IDA's financial reporting presented fairly, in all material respects, the financial position of IDA and that it had maintained, in all material respects, effective internal control over its financial reporting. We also reviewed information provided by the Controller's Office and interviewed officials from this office on their management and validation of IDA's financial reporting. We determined that IDA's balance sheet data were sufficiently reliable for describing IDA's assets, liabilities, and equity for the years we reported.

To assess how market borrowing has affected IDA's process for assessing countries' financing needs, we reviewed documents and interviewed World Bank officials from its Corporate Finance Department on its policies and procedures for each of these elements. We reviewed IDA documents that addressed its lending capacity such as IDA replenishment reports, annual audited financial statements, and quarterly financial reports to determine IDA's available financial resources to support its lending capacity. We also reviewed IDA documents on its modeling of projected financial resources including model factors and assumptions.

We reviewed IDA documents that addressed how it determines its lending portfolio, such as IDA replenishment reports and papers provided to IDA's Board of Directors as part of replenishment negotiations and routine IDA Board meetings. From this review, we determined that IDA assesses its lending portfolio, including the amount and type of lending for IDA countries, through the Performance Based Allocation (PBA) system. We discussed the PBA system with World Bank officials to understand how IDA uses it to determine lending capacity to support its portfolio.

We determined how IDA assesses the effect of market borrowing on its lending capacity and portfolio by reviewing IDA reports on its hybrid financial model and financial and risk management framework. We discussed with World Bank officials in the Corporate Finance Department and in the Treasury's Capital Markets and Investments Department how IDA addresses enhanced financial risks of market borrowing through this framework. We also reviewed IDA's processes and discussed with these officials how IDA determines how much to borrow from the capital markets, including related modeling and assumptions; the effect of market borrowing on other financial resources, such as donor contributions and lending; and associated trade-offs. We discussed with World Bank officials the effects of market borrowing on concessional lending and grants. We reviewed IDA's bond issuances and Standard & Poor's and

Moody's credit ratings since IDA's first bond issuance in 2018. We reviewed relevant reports and interviewed officials from the Center for Global Development, the International Institute of Finance, and the Jubilee Debt Campaign on their perspectives of IDA's market borrowing and its effect on IDA's lending, as well as changes in low-income country debt distress.

To assess how IDA measures key risks to its financial sustainability, we reviewed IDA financial statements, IDA annual and quarterly risk reports, and credit rating agency evaluations of IDA. We also interviewed IDA risk management officials and officials from the Center for Global Development. To understand how IDA monitors and measures country credit risk, we reviewed IDA annual risk reports, financial statements, and documentation of IDA's credit rating methodology and its model for maximum potential losses, and interviewed IDA risk management officials. To understand the level of uncertainty in data for borrower country debt, we interviewed officials responsible for the World Bank's debt data system (the Debtor Reporting System), IMF officials, IDA risk management officials, and experts from think tanks and trade groups. We also reviewed recent reports on transparency in borrower country debt from AidData, a research group at the College of William & Mary, and from the World Bank and IMF.

To determine the extent to which Treasury oversees IDA's financial and risk management, we reviewed reports, memos, and other documentation from Treasury and IDA detailing IDA financial and risk management frameworks, analyses, and oversight activities, including information and analysis requests and feedback provided to IDA by Treasury. We identified key processes used in IDA risk management and assessed the availability of information on the methodology, data, and assumptions underlying resulting analyses. We then compared access to this information by Treasury and the IDA Board to international standards for risk management and internal control.[5] We determined that the risk analysis and implementation components of risk management standards

[5]International Electrotechnical Commission and International Organization for Standardization. *Risk Management—Risk Assessment Techniques.* IEC 31010 6.1-6.4. Geneva: IEC, 2019; Committee of Sponsoring Organizations of the Treadway Commission. *Internal Control- Integrated Framework* (New York: American Institute of Certified Public Accountants, 2013). While the IEC standards were not written for IDA, we identified useful general practices on risk management that align with Committee of Sponsoring Organizations of the Treadway Commission standards, which IDA applies to its internal control controls over financial reporting.

were significant to our objective, and compared the transparency of these components with economic analysis methodology that allows internal stakeholders to understand implications and associated risks.[6] We interviewed agency officials from Treasury, including the Office of the U.S. Executive Director; officials from IDA; and representatives from development finance organizations to gather information on key measures and data available for monitoring country debt risk.

We conducted this performance audit from December 2020 to June 2022 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

[6]GAO, *Assessment Methodology for Economic Analysis*, GAO-18-151SP (Washington, D.C.: Apr. 10, 2018).

Appendix II: Comments from the Department of the Treasury

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

May 13, 2022

Chelsa Kenney
Director, International Affairs and Trade
Government Accountability Office
441 G St. N.W.
Washington, DC 20548

Dear Ms. Kenney:

The Department of Treasury (Treasury) appreciates the work conducted by the Government Accountability Office (GAO) in recent months, culminating in your report entitled, "*International Development Association: Additional Information Sharing Could Enhance U.S. Treasury Oversight of Key Risks.*" My staff have engaged intensely and productively with your team. We have appreciated the constructive interactions and agree that independent oversight is crucial to the success of IDA.

Treasury overall agrees with the substance of the report and the detailed recommendations. We concur with GAO's first recommendation that Treasury direct the U.S. Executive Director of IDA "to work with the other Executive Directors to request additional information underlying IDA's loan loss model—including key assumptions of the model and sensitivity analyses of model results—necessary to conduct oversight of IDA's financial sustainability." As the report acknowledges, Treasury requests and IDA provides a substantial amount of information on its risk modeling and stress testing that speak to IDA's underlying financial strength and prudent risk management. However, we agree that additional information on some of the underlying assumptions and parameters could further benefit shareholders in their oversight.

Treasury also concurs with GAO's second recommendation, that Treasury direct the U.S. Executive Director of IDA "to work with other Executive Directors to request information from IDA on steps it is taking to account for uncertainty in certain debt data, such as incomplete information on loan terms and state-owned enterprise debt, as it measures the risks of borrowers defaulting." The report correctly notes that Treasury uses our own and external analyses related to IDA countries' debt sustainability, including level of transparency in debt reporting, to inform our oversight of IDA's finances, but we would welcome such additional information.

We will direct our U.S. Executive Director to convey both recommendations to IDA management. Treasury shares the broader concerns GAO highlights regarding developing countries' debt transparency and has been working closely with like-minded shareholders to help advance the goal of regular debtor and creditor data reconciliation, to include strengthening the transparency, quality and consistency of debt data, fiscal policy, public investment management, and debt disclosure.

Sincerely,

Alexia Latortue
Assistant Secretary for Trade and Development

Appendix III: Comments from the World Bank

WORLD BANK GROUP

ANSHULA KANT
Managing Director and
World Bank Group Chief Financial Officer

May 13, 2022

Ms. Chelsa Kenney,
Director, International Affairs and Trade
U.S. Government Accountability Office
441 G Street, NW
Washington, DC 20548

Dear Ms. Kenney,

Re: *Management Response to Draft Report GAO-22-104657- International Development Association*

Thank you for the opportunity to comment on this draft report. The International Development Association (IDA) appreciates the U.S. Government Accountability Office's (GAO) work in planning and conducting its review on IDA's financial model.

We are pleased to note GAO's recognition of IDA's development mandate of providing grants and concessional loans to support development efforts in low-income countries, which is made possible by IDA's long-established periodic replenishment process and enhanced by the introduction of capital market bond issuance. These enhancements increase IDA's financing and support to its client countries and help meet the charge of IDA's shareholders to advance development goals. We also appreciate GAO's review and acknowledgement of the corresponding revisions that IDA has implemented to its financial and risk management framework to support its triple-A market bond issuer status to protect bond investors while enhancing support to IDA borrowers.

We would like to acknowledge GAO's two recommendations, namely that U.S. Treasury should direct the U.S. Executive Director to request that IDA provides to its Board of Directors (i) more information on the model IDA uses to estimate the total risk it faces from borrower country defaults, and (ii) information on steps IDA is taking to account for incomplete debt data as it measures risks of borrower defaults.

IDA remains fully committed to working closely with its Board of Directors to facilitate their understanding of the model IDA uses to estimate the risk it faces from potential borrower's defaults. In an environment of heightened debt distress, IDA deals with debt data gaps through various steps, including but not limited to loan-by-loan data analysis in the World Bank's Debtor

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Ms. Chelsa Kenney -2- May 13, 2022

Reporting System and detailed data collection for the IMF-World Bank Debt Sustainability Analysis. In addition, the country's data robustness is factored in when assessing transparency, governance and institutional capacity in IDA's program decision making at the country level.

Sincerely,

Anshula Kant

Anshula Kant
Managing Director and World Bank Group Chief Financial Officer

GAO Contact

Appendix IV: GAO Contact and Staff Acknowledgments

Chelsa Kenney at (202) 512-2964, or KenneyC@gao.gov

Staff Acknowledgments

In addition to the contact named above, Mona Sehgal (Assistant Director), Jasmine Senior (Analyst in Charge), Katie Bassion, Deirdre Sutula, Maureen Luna Long, Michael Hoffman, Aldo Salerno, and Neil Doherty made key contributions to this report. In addition, Ashley Alley, Grace Lui, Risto Laboski, LaDonna Towler, and Larissa Barrett also contributed to this report.

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