As we learn from our experience and face new challenges, we are evolving IFC’s policies and internal review processes to deepen our sustainability capabilities, improve our service to clients, and increase our accountability to stakeholders.

**Updating Our Standards**

IFC’s social, environmental, and governance standards are the building blocks of our approach to sustainability and are embodied in IFC’s Safeguard Policies, Environmental, Health and Safety Guidelines, and Disclosure Policy. Together these provide a framework to help our clients manage project risks, account for stakeholder interests, and maximize the development impact of our investments. To ensure that the projects we finance continue to meet evolving sustainability expectations, IFC embarked on a review of our Safeguard Policies in FY04 in line with recommendations by the Compliance Advisor/Ombudsman.

**From Safeguards to a Sustainability Policy**

With current policies serving as a baseline for minimum standards, the safeguards will be recast as IFC’s **Policy and Performance Standards on Social and Environmental Sustainability**. The draft policy underpins IFC’s corporate commitment to sustainability, and includes social and environmental Performance Standards that equip clients with a new generation of risk management tools. The draft policy is supported by a set of Guidance Notes, further supplemented by IFC’s good practice publications, to help IFC and clients apply the standards to operations.
Emphasis on Social Goals
The draft Performance Standards place increased emphasis on social goals, integrating social and environmental impact assessment and providing new, comprehensive treatment of labor and working conditions and community health and safety. Significantly, the labor standard articulates worker rights in accordance with the International Labour Organization (ILO) Core Labor Standards. This is an example of how human rights have been incorporated in the new policy (see box, p. 39). The draft standards also cover in detail major environmental concerns, such as biodiversity and climate change.

Improved Risk Management for Clients
The draft Performance Standards encourage IFC’s clients to address sustainability issues in their business strategy, such that operational risks are identified and managed upfront rather than on an ad-hoc, reactive basis. We also hope to better assist clients in capitalizing on social and environmental opportunities that enhance business profitability and benefit local communities.

Consultation on the New Policy
To obtain feedback on the content and applicability of the draft Performance Standards, we have endeavored to consult broadly with clients and stakeholders during 2004, holding regional consultations in Rio de Janeiro, Manila, Nairobi, and Istanbul. Given the relevance of our policies to other parties, we have also met with conservation groups, NGOs, trade unions, industry, the Equator Banks, the SRI community, and partner institutions to solicit their input.

Toward a Global Benchmark
In updating our policies, IFC recognizes its responsibility in maintaining an effective global benchmark for the private sector in emerging markets. IFC standards will need to evolve to meet new sustainability challenges, and we will continue to work with our partners in the wider financial sector as they incorporate non-financial risks into business decision-making. Further information is available at: www.ifc.org/policyreview

At a Glance: IFC’s Policy and Performance Standards on Social and Environmental Sustainability

| IFC ONLY | IFC & CLIENTS | IFC & CLIENTS |
| PART I | PART II | PART III |
| IFC Policy Statement | Performance Standards | Implementation |
| IFC’s Commitment | PS1 Social and Environmental Assessment | Environmental, Health and Safety Guidelines |
| IFC’s Responsibilities | PS2 Labor and Working Conditions | Guidance Notes |
| How IFC Helps Clients | PS3 Pollution Prevention and Abatement | Good Practice Publications |
| | PS4 Community Health & Safety | |
| | PS5 Land Acquisition and Involuntary Resettlement | |
| | PS6 Conservation of Biodiversity and Sustainable Natural Resource Management | |
| | PS7 Indigenous Peoples and Natural Resource Dependent Communities | |
| | PS8 Cultural Heritage | |
| | PS9 Social and Environmental Management System | |
Updating IFC’s Environmental Guidelines

IFC’s policy review includes an ambitious two-year program to update the Environmental, Health and Safety Guidelines, which address our expectations for managing industrial impacts, specifically pollution prevention and control. The 73 guidelines cover a wide range of activities from oil, mining, and chemicals, to forestry and wind energy conversion. They are used by industry, regulators, academics, and financial institutions worldwide in addition to our clients as a source of reference on environmental performance.

IFC is consulting with technical experts to maintain the high standard and applicability of the guidelines across the market sectors we finance. The update will incorporate cleaner production and good management practices and will encourage industry performance in line with internationally accepted emissions and effluent standards to reduce overall loading to the environment. The process will streamline the guidelines for our clients and improve their applicability to projects, and provide performance benchmarks and indicators, thus improving their utility to the diverse community of external users. For more information on the guidelines update, see www.ifc.org/ehsguidelinesupdate

Improving Transparency and Disclosure

A critical element of IFC’s approach to sustainability is reflected in our approach to transparency. We know that disclosure builds trust, promotes efficiency and accountability, and enhances the development impact of our investments. Since IFC last updated its Policy on Disclosure of Information in 1998, public expectations concerning the level of transparency of publicly owned institutions and the private sector have increased. We are, therefore, reviewing our Disclosure Policy in close consultation with clients, industry groups, civil society, and government.

Balancing Confidentiality with Transparency

This review of our disclosure policy requires respecting the legitimate business confidentiality of our clients while fostering a culture of transparency and greater openness. The draft policy clarifies the roles and responsibilities of both IFC and clients regarding disclosure. It also elaborates general principles to guide our work, given the dynamic nature of the business climate in which IFC operates and our need to respond to unforeseen circumstances.

Reporting on Impacts and Development Outcomes

The draft Disclosure Policy acknowledges the importance of financial and nonfinancial reporting and the impact this has on performance—in particular, how such reporting can be used to assess IFC’s development outcomes. This means a renewed commitment to being open about our activities to the widest audience, facilitating inputs from affected communities, stakeholders, and the public. The draft policy also makes clear our clients’ obligations to inform and consult affected communities and other local stakeholders on issues of concern, impact mitigation, and project monitoring. It reflects a view that building trust through disclosure and consultation can deliver tangible benefits to clients by reducing project risks and enhancing outcomes. For more information on the Disclosure Policy review see www.ifc.org/disclosurereview
IFC AND HUMAN RIGHTS

IFC has provided guidance to companies for many years on how they can support human rights in their business operations. For example, IFC has encouraged clients to empower women and to provide healthcare to workers and clean water to communities. IFC, along with private sector companies and their stakeholders, have begun to understand that such services, community investments, and hiring policies have a human rights dimension that should be respected and supported. The challenge in this process is to identify the appropriate boundary between public and private responsibility, because human rights conventions were originally drafted to be applied principally by governments, not private parties. This conundrum is at the heart of the current business and human rights debate.

The exception to this boundary is the set of human rights that address the rights of workers, where employers clearly have a role to play in respecting and promoting labor rights. As attention to working conditions and respect for labor rights extend further and further down supply chains, and as emerging market companies strive to become global players, these companies will increasingly be expected to demonstrate that they are meeting international labor standards. We are providing more detailed requirements and guidance for clients on this issue by adopting a draft Performance Standard specifically on labor issues, accompanied by a Guidance Note and further Good Practice Notes to help clients interpret the international standards and apply them in their business.

IFC has chosen to weave other human rights principles into our draft Performance Standards (rather than prepare a stand-alone human rights Performance Standard). For example, several of the draft Performance Standards specifically address vulnerable groups that are often subject to discrimination. In some cases, clients may be asked to disaggregate their evaluation of project impacts and adopt differentiated mitigation and benefit-sharing measures as necessary to ensure that vulnerable persons are not discriminated against during project development and operation. The Performance Standard on Land Acquisition and Involuntary Resettlement, for example, reflects human rights considerations from a right-to-housing perspective.

As the discussion on private sector responsibility for human rights evolves, IFC will continue to engage with a wide range of actors to help develop practical tools that aid businesses in understanding their responsibilities in this area. For example, we are providing funding to the Danish Institute for Human Rights to develop a Web-based version of the Institute’s human rights compliance assessment tool for business. We are also participating in a project led by the International Business Leaders Forum to develop an introductory guide to human rights impact assessment for business, with inputs from business and NGOs. IFC will use lessons learned from these collaborations and from addressing human rights issues in the projects it funds to develop a tangible methodology for companies to address human rights in a way that adds value to their business and furthers IFC’s development goals.
Mainstreaming IFC’s Environmental and Social Expertise

To meet our goal of differentiating IFC from other lending institutions through our sustainability services, we are mainstreaming the principles and competencies that guide the work of our 40 social and environmental specialists throughout IFC’s investment departments. There are many challenges to reorienting the Corporation along these lines, but we hope this process of decentralization and co-location will better equip us to accomplish our development mission.

During 2004, we co-located over 60 percent of specialists in industry or regional departments. These “mainstreamed” social and environmental staff are engaged more frequently at all stages of the project cycle. This shift is allowing our specialists to engage at an earlier stage on projects, resulting in better integration of the financial and nonfinancial services that IFC offers clients. Mainstreaming has also resulted in our social and environmental specialists playing a more active role in business development for IFC, particularly in regional offices. This upstream involvement makes it easier for IFC to make the business case for sound social and environmental management, as opposed to relying solely on compliance requirements.

Sustainability Learning for IFC Staff

The Sustainability Learning Program (SLP) is designed to familiarize our investment staff with IFC’s many in-house resources to enhance the added value of an investment and the rationale behind a sustainable business approach for clients. Practical exercises and case studies are used to highlight specific ways that IFC can build better business by improving clients’ ability to identify social and environmental risks and opportunities. During FY04, 226 of our staff participated in sustainability training, joined at each session by NGO representatives, executives from IFC client companies, and industry experts. We are developing an updated training program for FY05 for selected IFC field offices, in addition to sessions for Washington-based staff.

Sharing Best Practice

Capturing the cumulative years of IFC’s project experience, knowledge, and lessons learned is essential to improving our work quality and development impact. As part of our commitment to learning and knowledge sharing, we continue to gather and disseminate sector-specific guidance, topical research, and good practice on sustainability issues relevant to the private sector.

Good Practice Publications

We have highlighted earlier in this report some examples of publications on sustainability-related issues, such as IFC’s new HIV/AIDS guide for mining companies, research on ecotourism business viability, and SRI in emerging markets. IFC also produces a regular series of Good Practice Notes written by our social and environmental specialists to guide clients and the wider private sector. Previous publications cover issues such as the workplace impacts of HIV/AIDS and Harmful...
Child Labor, Resettlement, Community Development, and Public Consultation. In FY04, we produced Addressing the Social Dimensions of Private Sector Projects to guide companies seeking to analyze the impact of their operations on communities. Social assessment is presented as an integral part of IFC’s environmental assessment process and as a tool for companies to identify value-adding opportunities that go beyond traditional mitigation measures to deliver broad development benefits. New in FY05 is IFC’s Biodiversity Good Practice Guide (see p. 29), and a series on labor and workplace practices.

Currently, we are ramping up our knowledge-building capacity to improve internal coordination and communication with the addition in 2005 of two new knowledge management officers based in our Environment and Social Development Department. They will help us to better capture IFC’s institutional learning to benefit staff and clients and to inform other stakeholders as they seek to understand IFC’s approach to sustainable development.

Evaluating IFC’s Development Impact

IFC’s Operations Evaluation Group (OEG) is responsible for the post-evaluation function within IFC and reports to IFC’s Board. OEG’s work aims to: (i) help provide accountability for achievement of IFC’s objectives; (ii) identify lessons from past experience to improve IFC’s operational performance and achieve better development results; and, (iii) help reinforce corporate objectives and values among staff. IFC’s self-evaluation system is based on guidelines established by OEG and provides feedback on the effects that IFC-funded projects have on companies, their financiers and clients, workforces, the environment, governments, and communities. For about half of IFC’s portfolio of five-year-old projects, evaluation teams examine the extent to which approval expectations and objectives were met, and why there were material variances. OEG independently validates the ratings, findings, and lessons which are then used to help inform decisions related to new projects.

Evaluating Sustainability Across the Board

Lessons learned from evaluated projects touch on many aspects of sustainability, including the projects’ environmental and social effects and their economic and financial viability. Completed self-evaluations are often the focus of management meetings chaired by a senior IFC portfolio or credit officer, and provide the material for informal presentations to IFC staff. In 2003, an evaluation of IFC’s investment in a best-practice Brazilian mining company showcased the company’s assistance to local communities, including programs to improve their skills and clean up their environment. Also in Brazil, a privately owned and operated road project was a success commercially and economically since it relieved congestion, but a spike in fatalities was an unanticipated impact. IFC learned that pedestrian and driver road safety awareness programs must be a component of future road projects.

Putting Lessons into Action

Project evaluation is also the building block for other OEG evaluation products, including recent special studies such as country impact assessments for Brazil and China, two of IFC’s biggest client countries; sector studies on extractive industries and private sector power generation; and thematic studies on investment climate and IFC’s assistance to SMEs. Every year, these studies and OEG’s Annual Review of IFC’s Evaluation Findings go to the Board’s Committee on Development Effectiveness (CODE) with recommendations for IFC management that are drawn from recurring findings. For example, OEG’s Extractive Industries Evaluation (which fed into the Bank Group’s broader Extractive Industries Review) made strong recommendations related to revenue management, mine closure, prerequisites for funding projects in countries with poor governance, and improving community consultation. Another example was OEG’s finding that poor environmental performance at the project level was closely linked to ineffective regulatory enforcement, often the case in frontier countries, and was the main driver of below-average development outcome ratings in these countries. In response, IFC is considering changing its operational environmental risk rating system to weight project environmental supervision priorities accordingly.

Dynamic Evaluation Framework

IFC’s current practice is to evaluate selected projects once, at early project maturity, but this practice is now changing. Plans are in place to assess development outcome prospects annually for every committed project and to monitor specific expected project impacts. These changes, and IFC’s intention to reward staff for achieving above-average developmental results, shows that IFC is committed to mainstreaming sustainability within its operations. OEG has committed to review its existing evaluation guidance and ratings criteria (Web site: http://www.ifc.org/ifcext/oeg.nsf/Content/xpsr) for 2005 to ensure that IFC’s rapidly evolving corporate standards for sustainable development are coherently embodied in the evaluation scope and ratings standards.
HOW DOES IFC EVALUATE A PROJECT’S DEVELOPMENT OUTCOME?

The development outcome is a bottom-line assessment of a project’s success on the ground, relative to what would have occurred without the project. In OEG’s 2004 Annual Review, covering a sample of 1995–1997 investment approvals, 58 percent of operations made positive contributions to development based on the top three ratings on a six-point scale from highly successful to highly unsuccessful. The overall rating is determined by the relative importance of four underlying indicators for each project:

Private Sector Development: 72% Success Rate

IFC projects contribute to private sector development by creating sustainable enterprises capable of attracting finance. Projects tend to have demonstration effects, linkages to suppliers or customers, and/or bringing technology and know-how transfer, training, or increased competition. Some projects also bring about improvements in the regulatory or enabling environment, or improve corporate governance. A high proportion (72 percent) of evaluated projects made such positive contributions.

Environmental, Social, Health and Safety Impacts: 64% Success Rate

IFC assesses a project’s impacts on its physical environment and social, cultural, and worker health and safety issues addressed by our safeguard policies. The project’s environmental, social, and health and safety effects were satisfactory or excellent in 64 percent of cases. Low ratings were due to material performance shortfalls, which, however, were usually corrected during the life of the project.

Economic Sustainability: 61% Success Rate

IFC rates a project’s economic sustainability on its contribution to economic growth as measured by its economic rate of return (ERR), taking into account net gains or losses by nonfinanciers, nonquantifiable impacts, and contributions to widely held development objectives such as direct poverty reduction, social or gender equality, and regional or rural development. Overall, 61 percent of the evaluated projects were judged to be economically sustainable.

Project Business Success: 39% Success Rate

A project’s business success, or financial sustainability, is a strong determinant of its wider development impacts. In the real sector, IFC compares returns to the company’s cost of capital. In the financial sector, IFC considers how the project contributed to the intermediary’s profitability, financial condition, and business objectives. Project business success scored lowest at 39 percent of evaluated projects. This figure reflects the commercial, country, and global business climate risks IFC and its investment partners face. Even when a project does not meet IFC’s high standards, typically people other than the project financiers (who get paid last) tend to benefit and companies may still be sustainably servicing their debt.

Compliance Advisor/Ombudsman

The Compliance Advisor/Ombudsman is an independent post that reports directly to the President of the World Bank Group with the aim of enhancing the development impact and sustainability of IFC (and MIGA) projects. The CAO responds to complaints from project-affected communities in order to improve social and environmental outcomes and to promote greater institutional accountability.

The CAO’s broad mandate as an ombudsman, auditor, and advisor means it has flexibility in responding to a complaint relating to an IFC project, finding practical solutions where possible, and engaging parties in constructive dialogue. The CAO’s independence and impartiality help foster the trust of local communities, NGOs, and IFC’s clients, and its independence from IFC’s management allows the CAO to provide objective advice to improve IFC’s work.

Since 1999, the CAO has received a total of 28 complaints. Ten of these are being assessed; seven were investigated and recommendations made; five have been rejected; two are involved in large, multiparty mediation; two were closed because the project was dropped or canceled; and two were closed as they could not be pursued further. Complaints have touched on such issues as the adequacy of: consultation and information sharing; compensation or other measures to offset loss of income; protective measures for water resources; mitigation measures more generally; and public safety provisions.

In FY04, the CAO continued to work on, and resolve, a complaint related to the COMSUR/Don Mario Gold Mine in Bolivia, and received 15 new complaints,
A PROJECT WITH A HIGHLY SUCCESSFUL DEVELOPMENT OUTCOME

The project was a two-year capital expenditure program to rehabilitate and expand a recently privatized water and sewerage system in a major capital city.

**Project Business Performance:** Excellent. The project was completed below budget and on time. Capacity increased by 26 percent, resulting in nearly 1 million new water customers and about 400,000 additional sewerage customers in a city of 9.4 million people. The company has been operating profitably throughout the IFC investment period.

**Economic Sustainability:** Excellent. The project made available a reliable, 24-hour, clean water supply for the first time in many disadvantaged neighborhoods. The project’s economic return of 36 percent reflected taxes paid and the consumer surplus. Also, company employees benefited from secure employment, improved working conditions and better pay. They could also own company shares.

**Environmental Impacts:** Satisfactory. Without the project, the adverse impacts on health associated with unsafe water would have remained a burden to people’s lives and the economy. The project helped the company work toward full compliance with local environmental obligations.

**Private Sector Development:** Excellent. The project engaged several contractors with a total of about 11,000 workers; some of these were SMEs set up by former employees. The provision of water enabled the establishment of schools and clinics in areas the company served.

A PROJECT WITH AN UNSUCCESSFUL DEVELOPMENT OUTCOME

The project was a renovation and upgrading of a company’s meat processing plants, aiming to enhance the quality of export products, expand the product range, and improve hygiene standards.

**Project Business Performance:** Unsatisfactory. The project failed financially, having been unsuccessful in positioning the company to expand into the domestic market at a critical time when export markets collapsed. The project helped improve the company’s overall efficiency, but the firm remained exposed to raw material price volatility, given that the dominant domestic operators controlled cattle supply.

**Economic Sustainability:** Unsatisfactory. The company benefited from an export subsidy, which helped its owners and financiers more than other members of society. A cattle disease outbreak overseas caused the company to restructure and reduce its labor force by closing two old plants in low-income areas.

**Environmental Impacts:** Satisfactory. The project created high safety standards for employees at one plant. Management ensured compliance with IFC environmental guidelines and local regulations, including air emissions, safety, and hygiene.

**Private Sector Development:** Partly Unsatisfactory. The project failed to stimulate a large-scale modernization of the domestic meat processing industry, which continued to be dominated by fragmented and inefficient operators who often violate hygiene standards.

14 of which related to the BTC Pipeline project. Four of these have been rejected and 10 are under assessment. One other complaint received and resolved in FY04 related to the Konkola Copper Mine in Zambia. In its advisory role, the CAO continues to actively stimulate debate and internal action on matters such as IFC’s approach to human rights.

During FY04, the CAO released an independent water study of the Yanacocha Gold Mine in Peru. The study’s objective was to evaluate whether the quantity of water available for human consumption and agriculture is adversely affected, and whether the quality of water has changed in ways that could make it unsafe for humans, livestock, and wild flora and fauna. The CAO hired independent hydrologists to carry out the work, which was innovative, in that local people—veedores (observers)—performed the monitoring and verification of water data collection. While the study is completed, follow-up work is still continuing as the community works to address the issues and problems raised. The study provides important lessons learned for IFC regarding best practices and participatory planning.

This study, the CAO’s 2003–4 Annual Report, and full details of complaints received, their status, and assessment are available at [www.cao-ombudsman.org](http://www.cao-ombudsman.org).