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Mr. Chairman, Ranking Member Biden, Members of the Committee, I welcome your invitation to appear before you today to report on the efforts of the European Bank for Reconstruction and Development ("EBRD") to combat corruption. I share your belief in the importance of combating corruption in the international development system and have made this issue a priority for the Office of the U.S. Executive Director at the EBRD.

The Under Secretary of the Treasury for International Affairs, John B. Taylor, testified before this Committee on July 21, 2004, that the Administration takes very seriously the fight against corruption and that we all have an obligation to help ensure that the multilateral development banks (MDBs) undertake effective anti-corruption efforts. The capital comes from the taxpayers of their shareholder countries, and those taxpayers are entitled to the assurance that the MDBs will use those monies in an appropriate and efficient manner. As Under Secretary Taylor noted in his testimony, the U.S. Treasury and the U.S. Director's office at the EBRD work together to promote anti-corruption measures at the Bank. Our office is committed to advancing integrity, anti-corruption and transparency efforts at the EBRD.

The EBRD's President, Jean Lemierre, sent a July 16, 2004 letter to the Committee describing the EBRD's anti-corruption initiatives. My September 20, 2004 letter to the Chairman also described some of those efforts and reaffirmed our continuing support for the EBRD's efforts to combat corruption. My testimony today will touch upon matters referred to in my and President Lemierre's letters, focusing on what was accomplished in this important area in 2004 and what my office is pursuing this year.

Our goal is, and has been, for the EBRD to have a corporate culture and environment that features enhanced corporate governance, internal controls and compliance and that promotes good governance in its countries of operations. While there was progress towards that goal in 2004, it is clear that there is more that we and the EBRD can do.

The EBRD's Operations

The EBRD currently conducts its investment activities in twenty-seven countries that formerly were either a part of the former Soviet Union or of the Soviet bloc. The Agreement Establishing the European Bank for Reconstruction and Development requires that it apply sound banking principles in all its operations, and the Bank makes no concessional loans. The agreement also requires that at least 60% of the EBRD's investment activities be in the private sector. Over the fourteen-year life of the Bank, 72% of its signed agreements for debt and equity financing have been in the private sector, and in 2004, the figure was 86%.

The EBRD's purpose is to foster the transition of its countries of operation towards open market-oriented economies. Eight of the EBRD's countries have such economies and are now members of the European Union. An additional two countries with open market-oriented economies are expected to join the EU in 2007, and a third country may join in 2008. Their histories, and those of the sixteen other countries of operation, have left all the EBRD's countries of operation with a challenge when it comes to addressing and dealing with corruption issues.

Unlike those MDBs that lend regularly to governments and that have the option of extending structural or sectoral adjustment loans, the EBRD does not have significant leverage with the governments of its countries of operation. In addition, some of the countries do not engage in sovereign borrowing at this time because of IMF assessments of debt sustainability. In other cases, the EBRD's financial operations have been restricted to private sector projects only as a result of the countries' lack of commitment to the economic and political principles set forth in the Agreement Establishing the European Bank for Reconstruction and Development. And, of course, there is the Bank's unique approach to transition through private sector investment which limits direct leverage with the governments of all of the EBRD's countries of operations.

EBRD Governance and Anti-Corruption Efforts at the Country Level

Notwithstanding its lack of leverage with the governments of its countries of operation relative to that of the other IFIs, the EBRD uses its resources to work with those governments to address the burdens placed by corruption on their economies and the transition process. It is the EBRD's view that corruption and fraud cripple progress and poison the investment climate and that a corrupted investment climate limits the effectiveness of the EBRD's private sector focus on transition. Consequently, the EBRD maintains an active policy dialogue on the subject with the governments of its countries of operation and supports that dialogue in a variety of ways.

One method of support comes from publicizing the levels of corruption in each country. The EBRD and the World Bank created the Business Environment and Enterprise Performance Survey ("BEEPS"), which is designed to generate comparative measurements of a range of interactions between business entities and the state including corruption, political influence, and regulation. The initial BEEPS in 1999 interviewed 4000 firms in twenty-two transition countries. By 2002, the number of firms interviewed was 6000, and the BEEPS covered all of the EBRD's countries of operation other than Turkmenistan. In 2005, the EBRD and the World Bank will conduct a third round of BEEPS that will include interviews of 8000 firms in all of the EBRD's countries of operation. This latest round is intended to focus on the poorest countries of operation. The results of the BEEPS can be found on the web sites of the EBRD and the World Bank. Following the two earlier reports, the EBRD analyzed the results in its annual Transition Report, which included a table on the frequency and extent of the "bribe tax" in each country of operation.

Additional focus on the problem of corruption resulted from the 2003 establishment of Business Principles for Countering Bribery. The EBRD, working with Transparency International and Social Accountability International, other NGOs,

business groups and trade unions, led the effort to establish the Principles. On the anniversary of the United Nations Convention against Corruption in December of last year, the EBRD joined with the other MDBs in reaffirming their shared commitment to the fight against corruption in their respective operations and projects.

Every other year, the EBRD adopts a Country Strategy for each country of operation, which contains a business environment section that describes, among other things, the state of corruption and levels of governance. The EBRD posts each Strategy on the Bank's web site, and in 2004 had the strategies translated into the official native language of fourteen countries of operation.

The EBRD continues to operate its Legal Transition Program, which addresses corruption and good governance issues and which seeks to assist the creation of an investor-friendly, transparent and predictable legal environment to improve the investment climate in the Bank's countries of operations. By advancing improvements in governance and regulatory frameworks, the EBRD helps its countries of operations to reduce the opportunities for corruption.

The EBRD developed and has conducted its Corporate Governance Sector Assessment Project since 1999. It assesses the quality of corporate governance legislation vis-à-vis the standards set by the OECD's Principles of Corporate Governance. The assessment is conducted every other year, and the Bank will conduct its third survey this year and will publish it in 2006. Country specific reports can be accessed from the EBRD's web site. Good legislation is one thing, and implementation is another. Therefore, since 1995, the Bank has annually evaluated implementation of these laws in its Legal Indicator Survey. This information can be accessed on the web site. The Legal Transition effort extends to a judicial capacity initiative in the early transition countries. This year there will be a focus on building judicial capacity in Georgia.

Program activities in 2004 included:

- Hosting a Legal Roundtable on Promoting Fair Competition during its April 2004 Annual Meeting. The roundtable stressed the importance of sound competition policies and institutions to facilitate transition to the market economy and attract foreign investment;
- Publication in April 2004 of the EBRD's annual report, Law in Transition, which focused on competition law and policy; and
- Publication in the autumn of 2004 of an online supplement to Law in Transition, LiT online, which focused on how to establish a favorable legal environment in the early transition countries in the region, namely Azerbaijan, Armenia, Georgia, Moldova, Kyrgyzstan, Tajikistan, and Uzbekistan.

The EBRD's Institutional Governance

To promote good governance effectively in its countries of operation, the EBRD must make sure that its own operations are consistent with best practices, and 2004 saw progress on the governance and anti-corruption fronts. In April, the Board

of Directors approved new terms of reference for the Audit Committee for the first time in a decade. The effect of this approach was to strengthen Audit Committee authority and responsibility. The U.S. took a leading role in the effort to modernize the terms of reference on the grounds that an unregulated institution using taxpayer dollars has a special responsibility to examine the state of its own governance measures on a regular basis in light of best private sector practices and to adopt those practices in the conduct of its own affairs.

The Audit Committee Terms of Reference formally set out for the first time a number of Committee responsibilities relating to:

- the integrity of the EBRD’s financial statements and its accounting, financial reporting, and disclosure policies and practices;
- the soundness of its internal controls regarding finance and accounting measures and their effective implementation;
- the status and performance of the Bank’s compliance, internal audit, project evaluation and risk management functions and their ability to perform their duties independently; and
- the independence, qualifications and performance of the Bank’s external auditor.

Today, the Audit Committee has the explicit authority to take a range of actions with respect to the external auditors, from participation in the selection process and compensation to the scope of each year’s proposed audit and the review of the accuracy and integrity of the Bank’s financial statements and other key financial disclosures prior to their release. The Committee is to be a participant in the discussion and resolution of any disagreements between management and the external auditors. To date, none have arisen. The Terms of Reference formally codify the Committee’s right to meet with the external auditor, the Internal Auditor, the Chief Compliance Officer (“CCO”) and the Director of the Project Evaluation Department without management being present, and it has exercised that right on a regular basis.

The Audit Committee must periodically review and evaluate Internal Audit, Project Evaluation and the Chief Compliance Officer (collectively, along with Risk Management, the “Internal Functions”) to assess whether: their roles are appropriate for the Bank’s purposes and needs; their policies, procedures, methodologies, budgets and staffing resources are adequate for them to perform their roles; and they are performing to expectations. The Committee must be consulted prior to the engagement of the heads of the Internal Functions (except the head of Risk Management), and the Bank’s President can remove them only in accordance with the guidance of the Board of Directors given in executive session.

Independence and Coordination of Internal Functions

While the independence of the Internal Functions has been enhanced by the new Audit Committee Terms of Reference, the question of actual independence remains to be fully resolved. This is especially the case of the EBRD’s evaluation function where the Bank lags behind members of its peer group which have the function reporting directly to directors who make the decisions as to hiring and removal and the function’s budget. Then Deputy Secretary of the Treasury, Samuel

W. Bodman, pointed out in his address to the Governors at the EBRD's 2004 annual meeting:

“The Bank's promotion of improved legal structures and good corporate governance contributes to improvements in the business environments of its countries of operation. It seems logical – and, we would argue, is required – that the EBRD itself should adhere to the highest standards of corporate governance. The EBRD, like other international financial institutions, is a steward of the taxes paid by the citizens of its members and, as such has significant and serious responsibilities to its shareholder nations.

“And so, we are pleased that the Bank has committed to establish a strong framework of internal controls and assessment procedures for the 2004 financial statements and beyond. This commitment will serve as a powerful example to other international financial institutions.

“Yet our work is not done. More progress is needed, particularly on the independence of key individuals and the improvement of transparency and disclosure policies.”

My office has been, and will continue to be, a strong proponent of the independence of the Internal Functions. The Bank's President now expresses support for independence of the evaluation function, and we anticipate the Board will approve a change in 2005. We and other members of the Audit Committee do not believe that management's initial proposals for guaranteeing the independence of the evaluation function are sufficient, and we will be working to improve the final product. We will continue to push this year in the Audit Committee for complete independence for the evaluation function and for further independence of the other Internal Functions.

Of course, having good policies and procedures in place is only the first step in a comprehensive corporate governance and anti-corruption program. Coordination of the Internal Functions and making use of their individual activities are important. For example, the Internal Auditor reported to the Audit Committee that an examination of compliance by bankers with the Bank's integrity check requirements found failures to comply fully. That has led to a number of improvements which the U.S. has promoted and supported. These include development by the CCO of an integrity training program which is required for all directors, officers and employees of the EBRD. I participated in the pilot program and in the final program as well. To date, virtually all employees, directors and management have completed the “Integrity Matters” training course, which is mandatory for all new employees.

Code of Conduct

In my September 20, 2004 letter to you, I wrote that I and my fellow Audit Committee members believed that the EBRD's existing Code of Conduct was outdated and that we would work for adoption of a new, revised version. The Board is in the process of considering a new Code of Conduct to replace the existing Code, which was adopted in 1991 and which has not been formally amended since. We anticipate adoption of a new Code of Conduct in 2005.

The EBRD's Compliance Function

The EBRD's Office of the Chief Compliance Officer (“OCCO”) is charged with promoting good governance and ensuring that the highest standards of integrity

are applied to all activities of the Bank in accordance with international best practice. It deals with conflicts of interest, corruption, confidentiality and money laundering.

The EBRD did not have a compliance officer before 2000, and since then the Bank has had three CCOs and an Acting CCO. In June of 2004, the Bank hired its third CCO after an extensive search lasting more than a year from the time the prior incumbent gave notice of his intention to leave the EBRD. Notwithstanding the Bank's initial record, there are grounds for optimism that the new CCO will build on the record of accomplishment of the predecessor Acting CCO and will establish an efficient and well run compliance function which is part of the EBRD's everyday operations. She has extensive experience in creating a compliance function at the OECD where she was head of the Anti-corruption Division and led the drafting and implementation of a mechanism to monitor an international treaty on corruption. She brings a long record of experience with the Financial Action Task Force, or FATF, and with anti-corruption NGOs.

Since her arrival, the CCO has been engaged in bringing on board staff with which to meet the considerable demands on the office in making the compliance function a part of the everyday work of the EBRD. The OCCO is now responsible not only for handling all matters related to fraud and corruption, but also for the functioning of the Bank's Independence Recourse Mechanism which enables individuals outside the Bank to submit complaints concerning individual projects. In assessing a complaint, the CCO can recommend a compliance review (i.e., has EBRD complied with certain policies) or a problem-solving initiative, or both or neither. Since it was launched in mid-2004, there has been only one complaint submitted, and the CCO determined that it was not covered by the IRM procedures.

At the moment, the CCO reviews some, but not all, projects presented to the Board. This review includes checking the integrity of the beneficial owners, promoting more transparent ownership structures, and reviewing corporate governance standards and practices. We have been promoting further CCO participation in the project approval process to address any integrity concerns with the persons or entities involved in projects. At a recent Board meeting, the President supported increased involvement by the CCO in the project preparation process. This will require additional resources, and there is general support within the Audit Committee – the terms of reference of which require it to review the adequacy of resources for the Internal Functions – for greater involvement and for providing the necessary additional resources to the CCO. Our office will continue to push for that involvement in every project that is submitted to the Board for its consideration and will support providing the additional resources necessary for that complete involvement to be effective. The Bank's President has committed to us that he will make the necessary resources available to the CCO, and this commitment was reiterated by the management before the full Board when it considered the 2005 budget. The Audit Committee will receive a status report from the CCO in May and will review the adequacy of OCCO's resources.

Given our concern that each proposed project should have undergone a thorough integrity review prior to its submission to the Board and our belief in the importance of accountability, we developed an integrity certification and worked successfully with other shareholder offices to require the inclusion of the certification

in all project documents. It says: "all actions required by applicable EBRD procedures relevant to the prevention of money laundering, terrorist financing and other integrity issues have been taken with respect to the project, and the project files contain the integrity checklists and other required documentation which have been properly and accurately completed to proceed with the project." The CCO has determined that intentionally misleading the Board constitutes misconduct, and a false certification certainly should have consequences for those responsible.

We have urged the Bank management to compile and publish an annual anti-corruption report and have provided them with copies of the reports of the Asian Development Bank and the World Bank. We have requested that statistical summaries and case studies of fraud and corruption cases pursued by the Bank's investigations unit be part of any such report. EBRD Management has approved in principle the production and publication of an anti-corruption report, and the CCO is currently putting together an internal working group which will meet to consider the report's scope and format. The first EBRD anti-corruption report is now scheduled to be published in late fall. Our goal in 2005 is to have clear and comprehensive reporting of the Bank's anti-corruption efforts which is easily available to the public.

More broadly, we do not believe that the EBRD's public disclosure practices meet the test of best practices for MDBs. We voted against the Public Information Policy in 2003 for that reason and we continue to press for more information to be made public on a timely basis. For example, we consistently argue that the Country Strategy development process would be enhanced by making drafts available for public comment and that summaries of minutes of Board meetings should be made public as well. (U.S. votes on projects are made available on the U.S. Treasury web site.) Our support for enhanced public disclosure is not shared by all directors, and we will likely not be able to effect material improvements until 2006 when the next scheduled review will take place.

In sum, while important work remains, the requirement for inclusion of the integrity certification, directors' support for the new CCO and discussion of integrity matters in Board and Audit Committee meetings evidence an increased Board interest in integrity issues.

Allegations of Fraud and Corruption Whistleblower Protections

The EBRD maintains a telephone hotline for reporting of allegations of fraud, corruption or other misconduct in Bank activities or projects. An independent contractor operates the hotline. Access to the hotline is toll free, and use is confidential. All matters reported to the hotline are referred to OCCO for follow-up and investigation. The EBRD's web site sets out detailed information about the hotline and compliance issues at the Bank, including the access codes for toll free reporting on a country by country basis. Collect calls can be made from most of the EBRD's countries of operations. The EBRD keeps statistical records of the use of the hotline. The contractor provides monthly reports on the use of the hotline. The EBRD's Compliance In-Box, which can be accessed through the EBRD's website, appears to be the preferred method of making fraud and corruption allegations. In 2004, there were no reports of corruption or misconduct to the hotline; however, the

In-Box receives about one complaint per month relating to internal staff misconduct or to procurement.

The EBRD has a whistleblower protection mechanism, which is based upon three separate, but inter-related, procedures. EBRD employees have a duty to report suspected misconduct to the CCO, and it is the CCO's responsibility to assess if such allegations warrant further investigation. If an investigation into an allegation is warranted, the CCO commences a fact-finding inquiry and upon its conclusion, makes a recommendation to the Vice President for Human Resources as to whether a formal accusation of misconduct should be raised. While EBRD makes every effort to protect the identity of a whistleblower, it does not guarantee anonymity because disclosure may, in some cases, be required in order to proceed with an investigation. Whistleblowers are protected against retaliation, and the CCO will respond to any employee who acts to retaliate against a whistleblower, which has not been needed so far. In addition, a whistleblower can pursue an independent course of action via the EBRD's Administrative Tribunal.

The Board recently met with the CCO to discuss the Bank's whistleblower protections. The CCO stated that EBRD has in place a viable whistleblowing protection mechanism. Nevertheless, the CCO has made recommendations for improvements. The CCO has recommended that EBRD should be more proactive in making employees aware of their reporting duties and protections. EBRD has posted a whistleblower statement with questions and answers on the intranet with links to the three relevant procedures and on the internet. The CCO's view, which we support, is that the whistleblower mechanism is evolutionary and should be kept under review to ensure it meets best practice. In the next few months, the Bank will also review the procedures that form the whistleblower mechanism. At that time we will consider areas for improvement.

Anti-Money Laundering and Anti-Terrorist Financing Efforts

The EBRD applies measures for combating terrorist financing in both its public and private sector operations. These measures are based on detailed due diligence procedures and internal training programs. In addition, the EBRD promotes more effective anti-money laundering and anti-terrorist finance practices with both the banks and national authorities in the Bank's countries of operation.

The EBRD has "know your customer" procedures, and the responsibility for their implementation falls on the Operation Team for each of the Bank's investment projects. Operation Teams must perform extensive due diligence on the integrity of all prospective clients. Integrity checks undertaken before committing any funds include verification that no client or prospective client is on the United Nations Security Council lists of entities and individuals suspected of supporting terrorist activities. The use of the Office of Foreign Assets Control (OFAC) list is a required part of the due diligence process, and the CCO has worked with EBRD's Banking and Risk Management division to revise the current procedures in order to ensure that several important lists, including OFAC's and those of other U.S. government agencies, are included as part of the due diligence process.

Because operations with financial institutions pose additional risk, the Bank requires additional due diligence before proceeding with a financial institutions project. Procedures for financial institutions include an Anti-Money Laundering Red Flag Checklist to assist the Bank's team to properly assess the client's anti-money laundering policies and procedures, including counter-terrorist financing activities. Key requirements, such as know your customer, staff training, reporting suspicious transactions, record keeping, and the role of the anti-money laundering compliance officer, should be in place and properly implemented by the prospective client before any disbursement. The nature of the specific requirements for a given client is tailored to reflect the perceived risks. Some requirements (e.g., training for all staff members) could be fully achieved at a later stage of project implementation, such as during the disbursement phase, if that would not materially affect the soundness of the client's overall anti-money laundering framework.

Moreover, to address the specific risks emerging in the Bank's financial institutions portfolio of operations, the Bank's standard loan agreement includes an affirmative covenant committing the borrower to institute measures to prevent money laundering/terrorist financing when using EBRD funds. After the borrower signs this certification, potential money laundering/financing terrorism risks are assessed by the EBRD at each periodic project review. The Bank typically conducts project reviews at least semi-annually and does so more frequently if a project is on the EBRD's watch list.

Where there remain unanswered questions after completion of the EBRD's standard due diligence procedures, the Bank has four investigative firms on retainer under a framework agreement to conduct additional investigations. The decision to use an outside firm can be initiated by the Credit/Transaction Risk Unit in the Risk Management Vice Presidency, the OCCO, or the Banking Department, which can use their services not only for AML/ATF purposes, but whenever there are integrity or reputational risk concerns. In 2004, the Bank commissioned sixty-seven investigations. In exceptional circumstances where an investigative firm, which is not a party to the framework agreement, has special expertise or knowledge, the Bank can retain the services of that firm.

The EBRD provides anti-money laundering/counter-terrorist financing (AML/ATF) training for staff as well as for the banks with which it does business and governmental authorities. In the past, the Bank's Risk Management section regularly organized AML/ATF seminars for staff and conducted three seminars in 2004. Responsibility for this education effort now lies with the CCO, and during 2005, participation in a new AML/ATF training course will be compulsory for all the staff members involved in the development of projects.

The EBRD seeks to improve AML/ATF procedures in its countries of operation through engagement with banks and the national authorities. The EBRD has two primary objectives. First, the EBRD wants the authorities to impose realistic obligations on banks instead of extensive reporting requirements with no follow up of the suspicious transactions reported. Second, it wants bank managements to commit their organizations to actively pursue AML/ATF measures rather than passively comply with government regulations.

In late 2003, the EBRD organized three pilot seminars in Kazakhstan, Macedonia, and Bosnia-Herzegovina to promote better understanding of sound AML and ATF procedures. These seminars indicated that training is needed to nurture an almost non-existent communication channel between banks and AML/ATF authorities and to provide them with the benefit of lessons learned from western banks and financial intelligence units.

Following the pilot seminars, the EBRD has designed, with EU and Swiss government support and financing, a €1 million training initiative to raise awareness of the importance of a proper AML/ATF legal framework at the political level and to help banks to design, review, and improve their policies. The training, involving experts from large western banks known for their proactive work on AML/ATF, will take place in the region to ensure that the people responsible for AML policies in the banks can attend. The CCO expects to roll out seminars by July 2005 and will focus on the poorer countries of operation, where practices are least developed. Attendance at the seminars will not be confined to EBRD clients.

Adoption of a COSO System of Internal Controls

Beginning in 2003, we urged the Bank to adopt a COSO system¹ of internal controls over its financial reporting. In May of last year, management agreed to do so and committed that the internal controls would be in effect for the preparation and publication of the Bank's financial statements for 2004. At the May 2004 annual meeting, Deputy Secretary Bodman acknowledged management's commitment and said:

“...we are pleased that the Bank has committed to establish a strong framework of internal controls and assessment procedures for the 2004 financial statements and beyond. This commitment will serve as a powerful example to other international financial institutions.”

Bank management delivered on its commitment. It identified and tested 847 financial controls. This process, in which both the Bank's internal and external auditors were involved, required many hours of staff and management time, and the EBRD incurred substantial costs.

The EBRD completed successfully the testing of its financial controls, and its 2004 financial statements, which have been approved by the Board, contain a Management statement signed by the President and the Vice President, Finance, and audited by the Bank's external auditors, PricewaterhouseCoopers, confirming that the Bank maintained effective internal controls over its financial reporting as contained in the Annual Financial Report for 2004. This is the first time the Bank has included such a statement in its Financial Report, and the EBRD is one of the first organizations to do so outside the United States where this assertion is mandatory for listed companies.

¹ COSO (Committee of Sponsoring Organizations of the Treadway Commission) is a voluntary private sector organization dedicated to improving the quality of financial reporting through business ethics, effective internal controls, and corporate governance.

As part of the COSO project, the Bank also completed an operational risk self assessment exercise and established a framework for continued development of an operational risk identification, measurement, mitigation and management capacity. Management, which expresses a low tolerance for operational risk, refined key risk indicators and identified 239 controls for dealing with operational risk. These controls address a variety of risks, including reputational risk. The Bank is in the process of hiring an operational risk manager. Starting this year, Management will provide the Board with quarterly reports on the Bank's exposure to credit, market and operational risk.

Management has expressed confidence that the COSO system of internal controls is a sustainable part of the culture of the EBRD. It believes that the certification process relating to financial controls is now entrenched, and the operational risk management process is well underway. To maintain intra-Bank coordination and facilitation and to ensure maintenance of focus and continuity, management has established a COSO and Operational Risk Management Unit. This unit reports to the Vice President, Finance with respect to internal financial controls certification and to the Vice President, Risk Management with respect to the operational risk management process. On a day to day basis, the unit will work with the Controller and the Director of Risk Management. Moreover, the Certification of Internal Financial Controls Steering Committee, which was formed to oversee the process of adopting and implementing the new controls system, will continue its function and meet several times a year to provide supervision over the certification process, while the Operational Risk Management Group will continue its role of providing supervision over the operational risk management process.

Procurement

The EBRD's public sector operations frequently involve procurement of goods, civil works, and services by governmental entities. In 2004, the EBRD's public sector borrowers signed 157 procurement contracts with an aggregate contract value of €681 million. EBRD financing of these contracts was €559 million. The number of contracts signed by borrowers and the aggregate volume represented declines of 13.3% and 22.5% respectively from 2003. In 2004, 77.7% of all contracts and 96.6% of total contract value was procured by open tendering.

The foregoing figures do not include contracts for consultancy services. The Bank's Consultancy Services Unit ("CSU") administers the majority of these contracts. The Office of the General Counsel, the Turn Around Management Group and the Nuclear Safety Department all have the authority to retain consultants directly. The total value of the 1620 consultancy contracts issued by the EBRD in 2004 was €18.76 million. This represented an 8.25% increase in value and 1.0% increase in number over 2003. CSU issued 730 contracts with an aggregate value of €5.91 million, and 78.04% of these contracts in terms of the value were awarded following competitive selection procedures.

In connection with the adoption of the COSO system of internal controls, the CSU reviewed its controls and procedures with the Bank's external consultants and the in-house team. CSU's controls and processes were considered to be appropriate

and the audit trail relating to its compliance functions sufficient to demonstrate the proper application of the necessary processes and approvals.

The EBRD, with the assistance of an outside consultant, has developed a course for new staff that provides them with training in the basic principles of public sector procurement. The course was finalized in 2004, and one seminar was held. Additional courses will be held in 2005 for all professionals who have been working at the EBRD for at least six months.

During 2004, the EBRD retained the services of an independent procurement consultant to review three completed projects to assess whether the procurement, contracting and implementation processes which had been followed were consistent with the corresponding loan agreements and whether the principles of economy and efficiency, transparency and accountability as stated in the Bank's Procurement Policies and Rules ("PP&R") were satisfied. The report has been delivered, and the EBRD is assessing which recommendations for follow-up action can be implemented this year.

The EBRD's Procurement and Technical Support Unit is charged with reviewing all proposed contracts above specified levels as an integrity check before the EBRD's Banking Department registers its "no objection" to a proposed contract. Last year, 38% of the contracts subject to the selective review process were sent back for completion, clarification or improvement before a "no objection" could be provided. This represents a reduction from the percentage sent back in 2003, which was 45%.

The EBRD addresses the problem of potential fraud and corruption in these procurements by following the procedures set out in its PP&R. The EBRD has established its Procurement & Contracting Committee ("PCC") to review all allegations of fraud and/or corruption in the context of the procurement process or when the Bank receives procurement-related complaints. If the PCC concludes that the allegations are substantiated, it refers the case, together with its recommendation for appropriate measures (e.g. barring firms or individuals from future participation in the procurement for EBRD-financed contracts). With respect to firms or individuals, the EBRD will reject a proposal for an award to such firm or individual and will declare him or it ineligible, either indefinitely or for a stated period of time, to be awarded a Bank financed project. In the event that a representative of a client or a beneficiary of the Bank's financing has engaged in fraud or corruption, the Bank will cancel the portion of the Bank's financing allocated to the contract in question.

The Bank does not limit its actions to its own funded projects, but has the ability to "cross bar" where a client has been found by a judicial process in an EBRD country of operation or other official enquiry to have engaged in corrupt or fraudulent practices. This would include enquiries conducted by another MDB. EBRD policy would require the names of firms or individuals that are debarred to be published on the Bank's web site. To date the World Bank is the only other IFI that requires that names of sanctioned firms and individuals be made public. The EBRD receives, on a strictly confidential basis, the ADB list of debarred firms. The EBRD examines both the World Bank and ADB lists to determine whether any firms or individuals to which

the Bank is considering providing financing or that it may be transacting business with are on the lists.

There were sixteen procurement complaints concerning EBRD financed or administered contracts in 2004 as compared with twenty-four in 2003 and fourteen in 2002. The Bank did not uphold any of the complaints in 2004, but did so for three complaints in 2003 and two in 2002. Three of last year's complaints came through the EBRD's Compliance In-Box and alleged fraud and corruption. The OCCO referred them to the PCC, but no evidence substantiating the allegations was found. The CSU received one procurement complaint in 2004, and after review by the PCC, the complaint was not upheld.

We understand that all allegations of corruption and fraud have been investigated according to the Bank's procedures, but these investigations have not resulted in debarment of any firm or individual or the cancellation of financing in recent years.

We recently questioned why the EBRD has never debarred a firm or individual when the World Bank, the Asian Development Bank, and the African Development Bank have. In response to the foregoing question, Bank staff outlined plans for 2005 to strengthen oversight of public procurement, including a greater emphasis on up-front work to improve fiduciary compliance and increased due diligence and monitoring during contract implementation. Bank management is sensitive to the fact that there have been no substantiated cases of procurement-related fraud or corruption in EBRD-financed public procurements in recent years. This sensitivity follows naturally from the EBRD's awareness that many of its projects are implemented in a high risk environment for fraud and corruption.

In March of 2005, EBRD took additional steps to strengthen oversight of public procurement. The PCC's membership was expanded to include the CCO and the Head of COSO and Operational Risk, and the chair of the PCC will be the Deputy General Counsel to reduce any perception of potential conflict of interest. In addition, the PCC's terms of reference were amended to transfer the responsibility for investigating allegations concerning fraud and corruption to the CCO from the Director, Procurement and Purchasing Department. The process of independent procurement reviews will be expanded in 2005. Because the EBRD recognizes that ensuring a fair and transparent procurement award process is insufficient to prevent corruption that can occur in the implementation phase, it will engage in more proactive monitoring with early identification of possible implementation red flags.

The EBRD expresses confidence that its ex-ante approval process at various stages of the tendering process is conducive to a fair and transparent contract award process. Furthermore, tenderers can and do avail themselves of the Bank's complaint procedure as stipulated in its PP&R. Third parties can use the hotline or Compliance In-Box to flag possible problematic cases. There have been relatively few allegations that have been brought to the attention of the EBRD.

Standard Contractual Provisions

The Bank imposes a number of financial covenants on its borrowers. For example, banks to which the EBRD makes loans must comply with an affirmative covenant to “institute and maintain internal procedures satisfactory to the Bank for the purpose of preventing the Borrower from becoming an instrument for money laundering, terrorism financing, fraud or other corrupt or illegal purposes.” Similarly, non-bank borrowers must represent and warrant that they are “in compliance with all applicable laws concerning money laundering” and that neither they nor any of their officers, directors or authorized employees, agents or representatives has (i) paid, promised to pay or offered to pay, or authorized the payment of, any commission, bribe, pay-off or kickback related to the project that violates any applicable law or entered into any agreement pursuant to which any such commission, bribe, pay-off or kickback may or will at any time be paid; or (ii) offered or given any thing of value to influence the action of a public official, or threatened injury to person, property or reputation, in connection with the project in order to obtain or retain business or other improper advantage in the conduct of business.” At each loan drawdown or interest rate rollover period, each borrower must report that it continues to be in compliance with its covenants.

As a matter of routine, borrowers must maintain procedures, records and accounts adequate to reflect, in accordance with internationally accepted accounting standards consistently applied, the operations, resources and expenditures relating to EBRD-financed projects. In addition, private sector borrowers must have audited financial statements prepared in accordance with internationally accepted auditing principles and standards. Typically, the Bank requires borrowers to authorize their auditors to communicate directly with the EBRD at any time concerning their account and operations.

The Bank’s Operations Administration Unit, which is a part of the EBRD’s Finance Vice Presidency, monitors compliance with material loan conditions including covenants. Failure to comply can lead to acceleration of the loan. Bank management confirmed to the Board that failure to comply with the Bank’s anti-corruption covenants is a material breach which will be enforced as vigorously as the breach of a financial covenant. Urged strongly by the U.S., the Audit Committee has been increasingly interested in the process of assessing the systems in place for ensuring compliance with these legal covenants. As a result, the EBRD now must inform the Board of the issuance of any waivers of material conditions. The Audit Committee has directed the Project Evaluation Department to report on the use of waivers, and this report is due to be delivered in 2005.

Conclusion

Since my arrival in 2002, the U.S. Director’s office has made improvements in EBRD governance and anti-corruption measures a priority. Last year saw progress, and there is a foundation for further progress this year. We intend to push for greater independence of the Internal Functions, increased resources to enable them to take on more responsibility, and a continued focus at all levels on integrity issues.

Mr. Chairman, as noted earlier in my testimony, our goal is, and has been, for the EBRD to have a corporate culture and environment that features enhanced corporate governance, internal controls and compliance and that promotes good governance in its countries of operations. My office is committed to continuing our efforts to that end.