

**ANNUAL REPORT ON
PORTFOLIO PERFORMANCE**

FISCAL YEAR 2006

**FEBRUARY 13, 2007
(MAIN REPORT)**



QUALITY ASSURANCE GROUP

ACRONYMS AND ABBREVIATIONS

AAA	Analytic and Advisory Activities	IP	Implementation Progress
AFR	Africa Region	ISR	Implementation Status and Results Report
APL	Adaptable Program Loan	KPI	Key Performance Indicators
ARD	Agriculture and Rural Development Sector Board	LCR	Latin America and the Caribbean Region
ARPP	Annual Report on Portfolio Performance	LICUS	Low-Income Countries Under Stress
CAS	Country Assistance Strategy	MDGs	Millennium Development Goals
CAAA	Country Analytic and Advisory Activities	M&E	Monitoring and Evaluation
CFAA	Country Financial Accountability Assessment	MIC	Middle-Income Countries
CEM	Country Economic Memorandum	MNA	Middle East and North Africa Region
CMU	Country Management Unit	MP	Montreal Protocol
CODE	Committee on Development Effectiveness	NLTA	Non-Lending Technical Assistance
CPAR	Country Procurement Assessment Review	OESW	Other Economic and Sector Work
CPIA	Country Policy and Institutional Assessment	OPCS	Operations Policy and Country Services Network
CPPR	Country Portfolio Performance Review	PCR	Project Completion Report
CSR	Controller's, Strategy and Resource Management	PER	Public Expenditure Review
DO	Development Objectives	PIP	Portfolio Improvement Program
DPL	Development Policy Lending	PN	Policy Notes
EAP	East Asia and Pacific Region	PPAR	Project Performance Assessment Report
ECA	Europe and Central Asia Region	PREM	Poverty Reduction and Economic Management Network
ED	Education Sector Board	PRSC	Poverty Reduction Support Credit
EMT	Energy and Mining Sector Board	PSG	Public Sector Governance Board
ENV	Environment Sector Board	PSDN	Private Sector Development Network
EP	Economic Policy Sector Board	QAG	Quality Assurance Group
ERL	Emergency Recovery Loan	QEA	Quality-at-Entry Assessment
ESSD	Environmentally and Socially Sustainable Development Network	QER	Quality Enhancement Review
ESW	Economic and Sector Work	QSA	Quality of Supervision Assessment
FSE	Finance Network	RTA	Reimbursable Technical Assistance
FY	Fiscal Year	SAP	Systems, Applications, and Products
GEF	Global Environment Facility	SAR	South Asia Region
GRAAA	Global and Regional Analytic and Advisory Activities	SDV	Social Development Sector Board
HDN	Human Development Network	SF	Special Financing
HNP	Health, Nutrition and Population	SFR	Strategy, Finance and Risk Management
HR	Human Resources	SP	Social Protection Sector Board
IBRD	International Bank for Reconstruction and Development	TA	Technical Assistance
ICR	Implementation Completion Report	TF	Trust Fund
ICRR	ICR Review	TR	Transport Sector Board
IDA	International Development Association	TTL	Task Team Leader
IEG	Independent Evaluation Group (formerly OED)	UD	Urban Development Sector Board
IG	Investment Grade	VPU	Vice Presidential Unit
INF	Infrastructure Network	WS	Water Supply and Sanitation Sector Board (formerly WSS)
INV	Investment Operations		

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EXECUTIVE SUMMARY

1. The Annual Report on Portfolio Performance provides the Board and Senior Management with a strategic overview of the size, composition and quality of the Bank's lending portfolio and the Analytic and Advisory Activities (AAA) program. It also provides Senior Management real time information to assess what is working well, or less well, together with recommendations on measures to sustain or improve the quality and effectiveness of the lending portfolio and of the AAA program -- two key vehicles for delivering results to our clients.

LENDING PORTFOLIO SIZE AND COMPOSITION

2. The Bank's FY06 portfolio (1,468 operations with \$95.2 billion of net commitments) shows relative stability by comparison with FY05, along with continued strength in IDA and INF approvals and improved resource transfer. However, net commitments remain about 12 percent lower than at the end of FY01. Notwithstanding the shrinkage in net commitments, disbursements in FY06 were 21 percent higher than the FY01 level due to the shift towards quick-disbursing DPLs (Development Policy Lending) as well as the improved disbursement performance for investment operations. IBRD net commitments account for 56 percent of the total (as against 64 percent in FY01) with IDA's share increasing to 42 percent from about one-third five years ago.

3. Annual approvals in FY06 reached \$23.9 billion, continuing the upward movement of the previous two years. The significantly higher level of IBRD investment approvals achieved in FY05 was increased further in FY06. For IDA, the FY06 approvals were the highest level ever, and consistent with the agreed Bank priorities; one-half of them were in the Africa Region. Overall, however, the increased approvals in FY06 were offset by increased exits—mostly due to unusual bunching in closure of several large DPLs in LCR.

4. At a more disaggregated level, over the past five years, there have been several noteworthy shifts among Regions and Networks. AFR's share of total net commitments grew from 13 percent to 20 percent while both LCR and EAP shrank significantly—reflecting a general shift towards the poorer clients and in the case of LCR, greater use of fast-disbursing, single-tranche operations. Among the Networks, net commitments over the last five years declined for HDN and ESSD. However, with some investments in rural and social infrastructure now being financed as part of multi-sectoral projects managed by other Networks, the actual reductions in net commitments are not quite as large as they may appear. Finally, data for the past two years show positive results from the Middle-Income Countries (MIC) and Infrastructure initiatives, as well as from recent measures to modernize, streamline, and simplify Bank processes. These efforts have helped stem the decline in IBRD net commitments while increasing the relevance of Bank support and providing a stronger basis for increased investment lending and faster disbursements.

LENDING PORTFOLIO PERFORMANCE

5. Project-level IEG evaluations continued the positive trend of the past decade and the share of satisfactory outcomes now hovers around 80 percent. Development outcomes for IDA

projects achieved a 77 percent satisfactory rating, which, although still below the 85 percent outcome for IBRD operations, are an improvement over previous years. Bank management has recently taken active measures to enhance the Bank's performance and organizational response to Fragile states whose 56 percent satisfactory outcome level remains of concern.

6. Considerable variations exist in development outcomes between Regions and Sectors. Two regions, AFR and MNA, continue to trail the Bank's average based on number of projects, though the difference is smaller in terms of net commitments. Among the Sectors, Transport with over 90 percent satisfactory outcomes is the best performer overall. Finance, Social Protection and Water Supply and Sanitation also show significantly above-average performance. At the other end, the outcomes for the Environment, Public Sector Governance, Health and Private Sector Development remain a matter of concern, especially because progress in these areas is at the heart of the MDG agenda. Among lending instruments, Development Policy Lending (DPLs) at 83 percent satisfactory performed better than Investment operations (INV) which were at 77 percent in terms of numbers but the two are virtually identical in terms of lending volumes.

BANK PERFORMANCE

7. Evaluation data suggest that while country factors are the strongest predictors of project outcomes, Bank performance is also a major contributory factor. Satisfactory Bank performance during preparation and appraisal leads to better project designs, adapting global knowledge to country circumstances. Timely risk identification and mitigation during project supervision also contributes to better outcomes.

8. Results from the latest Quality-at-Entry and Quality of Supervision assessments indicate continued solid performance with major deficiencies limited to no more than five to ten percent of the total samples. However, in about a third of the cases the Bank's performance is only Moderately Satisfactory, suggesting significant missed opportunities. Areas for improvement vis-à-vis Quality-at-Entry include: (i) lowering project complexity to match it better with the country's institutional capacity; (ii) better risk assessment and mitigation; (iii) introducing a workable results framework; and (iv) ensuring readiness for implementation at entry. For improving supervision performance, the focus needs to be on: (a) timely identification and assessment of threats to the development outcomes; (b) paying more attention to institutional capacity building; (c) making effective use of performance indicators; (d) having managers devote more time to guiding staff on supervision issues; and (e) greater candor in rating the quality of project implementation.

MANAGING PORTFOLIO PERFORMANCE

9. Effective management of the portfolio performance depends critically on a sound system for tracking portfolio status and for timely identification of risks. Despite long-standing efforts to improve the quality of portfolio reporting (most recently through the reform of the ISR system in early 2005), under-reporting of risks remains a problem. Findings from the recently completed assessment of Supervision Quality suggest that in FY06, less than half of the problematic projects were so identified by staff and managers in the ISRs. QSA findings also point to

frequent failures in the ISRs to trigger risk flags (e.g., Project Management problems, Financial Management problems or weak M&E systems) to facilitate early resolution of these problems.

10. Extrapolating the findings from the latest Supervision Assessment, a more realistic estimate of the current *Project-at-Risk* is likely to be about 25 percent, significantly higher than the 14 percent level reported in the ISRs. One major consequence is that portfolio performance indicators derived from the ISR database--*Projects-at-Risk*, the *Realism Index*, and the *Proactivity Index*--have now become less reliable and meaningful concepts for tracking and managing the portfolio performance. They do not provide “early warning” of risks that threaten the achievement of project development objectives thereby undermining the Bank’s ability to adopt appropriate corrective measures. The most problematic in this respect is the *Realism Index*.

11. Based on a specially commissioned review of the experience with the current *Project-at-Risk* System as well as evaluation findings from the IEG, the ARPP recommends revising the current *Realism Index* to make it a more meaningful measure of the quality of portfolio reporting. The proposed change would link it directly to actual recent outcomes reported by IEG, lowering the end FY06 index from an 80 percent level under the current system to about 50 percent. EAP and MNA among Regions, and Environment and Urban Development among Sectors, would experience the greatest change. In contrast, the change for LCR, Transport and Social Protection is likely to be quite minimal. The target for the *Revised Realism Index* would be retained at the 70+ percent level. Depending upon the impact of this change, the other portfolio indicators may also need to be revisited in the coming year.

12. Beyond systems and measures, the main issue at the core of project performance ratings is the inadequate accountability of those using and signing off on performance and risks in project implementation. Senior Management needs to ensure that the incentives to and accountabilities of staff and managers are re-balanced to support a more robust risk management system during supervision.

ANALYTIC AND ADVISORY ACTIVITIES

13. Analytic and Advisory Activities (AAA) are a key component of the Bank’s toolkit for promoting economic development and reducing poverty among its clients. They provide the basis for the Bank’s policy dialogue with clients, the development of country assistance strategies and the design of effective lending programs. They are also an important instrument for building institutional capacity and promoting aid coordination and harmonization among the donor community. During FY06, the Bank spent a total of \$222 million on AAA--almost 30 percent of the total expenditure on country services.

14. AAA expenditures have grown from \$143 million in FY02 to \$222 million in FY06, reflecting a Bank strategy to bolster its AAA program. This period was characterized by a sharp increase in expenditures and deliveries between FY02 and FY03 and a modest decline between FY05 and FY06. The increased focus on AAA resulted in a rise in the share of country services allocated to AAA (i.e., the “Country AAA intensity”) from 24 percent in FY02 to 29 percent in FY06. Consistent with the agreed LICUS initiative, there has been a rapid increase in AAA expenditures in the LICUS countries with the “AAA intensity” increasing from 18 percent in

FY02 to 30 percent in FY06. With the progress made in reducing the backlog of Core Diagnostic Reports, the AAA focus has been shifting towards demand-driven tasks in support of the Infrastructure Initiative and the MDG agenda. Expenditures for Global and Regional tasks are also becoming a more important part of the AAA program.

15. Various quality assessments suggest steady improvement in AAA relevance and likely impact with 90+ percent of the AAA work now rated satisfactory. However, there is scope for greater impact through more attention to dialogue and dissemination aspects.

16. Over the past few years, QAG assessments have pointed to numerous errors in task coding and reporting in the Bank's information systems. This report has identified additional weaknesses that affect data reliability and diminish the value of trend analysis. Despite major efforts over the past few years in strengthening the planning, tracking and management oversight of the AAA program, these areas remain a cause for concern with potential for significant further gains.

RECOMMENDATIONS

17. A stocktaking of the ARPP follow-up to the recommendations of the last ARPP suggests only modest progress, reflecting in part the relatively long lead times needed for results in some of the areas. In particular, the realism of portfolio risk ratings and the management of the AAA program continue to be problematic with significant scope for improvement. Most recommendations made last year still remain valid. Taking into account the carry over agenda from the last ARPP and the findings from this ARPP, the key recommendations¹ are as follows:

- Address the areas of weaknesses and missed opportunities during project appraisal and supervision focusing;
- Strengthen accountabilities of teams and managers and examine how to achieve greater realism in portfolio reporting;
- Modify the current *Realism Index*, basing it on recent IEG evaluations, to make it more robust and less susceptible to under-reporting of risk; and
- Strengthen managerial oversight to improve tracking and management of the AAA program.

¹ The full list of recommendations can be found in Chapter V.

I. INTRODUCTION

OBJECTIVES AND APPROACH

1.1 The Annual Report on Portfolio Performance provides the Board and Senior Management with a strategic overview of the size, composition and quality of the Bank's portfolio and the Analytic and Advisory Activities (AAA) program². It also provides Senior Management real time information to assess what is working well, or less well, together with recommendations on measures to sustain or improve the quality and effectiveness of the lending portfolio and of the AAA program--two key vehicles for delivering results to our clients.

1.2 The FY06 ARPP draws on materials that are prepared as part of regular portfolio monitoring functions carried out by the Regions and Networks, supplemented by project/portfolio data in the Bank's management information systems. It also draws on assessments and data commissioned from several special studies. Consistent with past ARPPs, the report uses a five-year timeframe (FY01–06) to examine medium-term trends in the portfolio. In preparing the ARPP, extensive consultations were held with managers and staff from around the Bank.

STRUCTURE AND COVERAGE

1.3 The report is organized into five Chapters. Chapter II reviews the recent trends in size and composition of the lending portfolio. It analyzes trends by source of financing, instrument, Regions, grouping of countries, Networks, Sectors and Themes. Chapter III assesses overall portfolio performance results as well as issues associated with measuring and reporting the risks of the portfolio of lending operations not achieving their development objectives. It discusses measurement of reported outcomes and outlines some suggestions for improving the assessment of development outcomes for the Bank portfolio. It also discusses changes in the *Realism Index* to make it a more meaningful measure of the quality of portfolio reporting. Chapter IV takes stock of the Analytic and Advisory Activities. It focuses particularly on trends in the program size, deliveries, and quality of AAA, drawing on selected recent QAG assessments. Chapter V examines progress in implementing recommendations of the FY05 ARPP, and summarizes this year's key recommendations. The Statistical Appendix contains a detailed set of supporting statistical material. As agreed with CODE, and in order to avoid duplication, this ARPP does not address directly the Results agenda, which is to be the subject of a separate report by the Results Secretariat.

² AAA product lines discussed in this report are ESW and TA. ESW and TA include fee-based and reimbursable tasks. Other AAA product lines not covered here include Donor and Aid Coordination, Research Services, World Development Report and Impact Evaluation.

II. PORTFOLIO SIZE AND COMPOSITION

2.1 The Bank's portfolio remained relatively steady in FY06, arresting the declining trend of several years until FY04. IBRD and IDA approvals in FY06 increased strongly but this was offset by exits of a similar amount. The upward trend of increased share of the Africa Region in the total portfolio also continued. Amongst Networks, INF and ESSD are the only large Networks that increased their portfolio. FY06 IDA approvals were the highest ever, and one-half of them were in the Africa Region. Measures implemented under the modernization and simplification agenda have resulted in a strong portfolio of Simple and Repeater operations and in Additional Financing operations with lower processing time and costs. Portfolio composition has continued to shift from higher to lower income level countries. Disbursements in FY06 also registered a strong increase from FY01 and FY05.

PORTFOLIO SIZE AND TRENDS

2.2 The Bank's portfolio consists of 1,468 operations with net commitments of \$95.2 billion³ in FY06 (Box 2.1). Net commitments have been relatively stable in real terms⁴ for the past three years but are some 25 percent below its peak level in FY99 (Figure 2.1). Continuing the healthy recovery of the past few years, approvals in FY06 reached \$23.9 billion and were eight percent higher than FY05 and 23 percent above the level 10 years ago. Disbursements in real terms this year were some 11 percent higher than in FY05, reflecting the expansion in new approvals over the past three years. The current disbursements (\$20.9 billion) are at about the same level as ten years ago (the disbursement levels reached in FY98-99 were an anomaly reflecting the Bank's response to the East Asia and Russian Financial Crises). The commendable disbursement performance reflects an increase in fast-disbursing Development Policy Lending (DPL), and an increase in the disbursement ratio for investment operations to 24 percent from 20 percent 10 years ago.

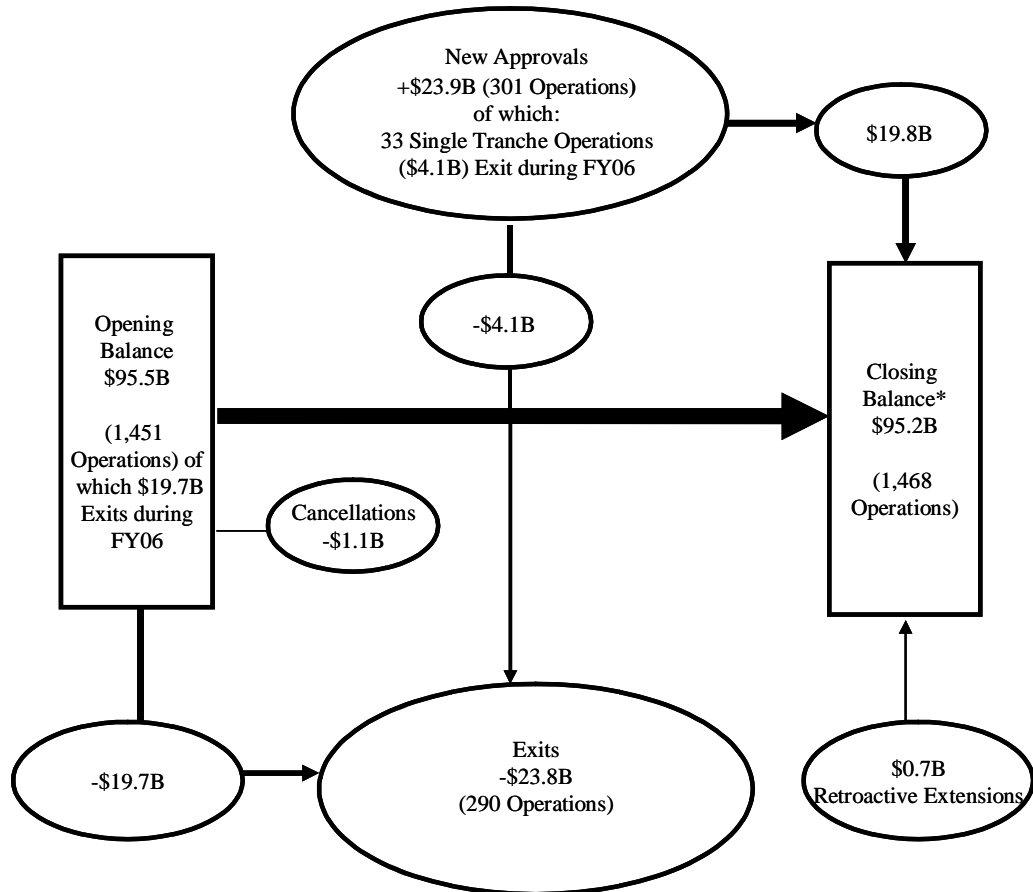
2.3 The portfolio size in the future will depend largely on the level of IDA replenishment, and on the level of Bank engagement with IBRD partner countries, in particular through successful implementation of the modernization and simplification agenda to reduce the costs of doing business. Based on current plans, annual approvals during FY07-09 are expected to be in the \$22-25 billion range, and the portfolio is expected to stabilize around the current level.

³ Portfolio and approval figures do not include guarantees. A more detailed definition of the portfolio is in Annex 2, and a description of portfolio dynamics is provided in Box 2.1.

⁴ Trend lines in Figure 2.1 are in real terms. All other financial data in this chapter are in nominal terms.

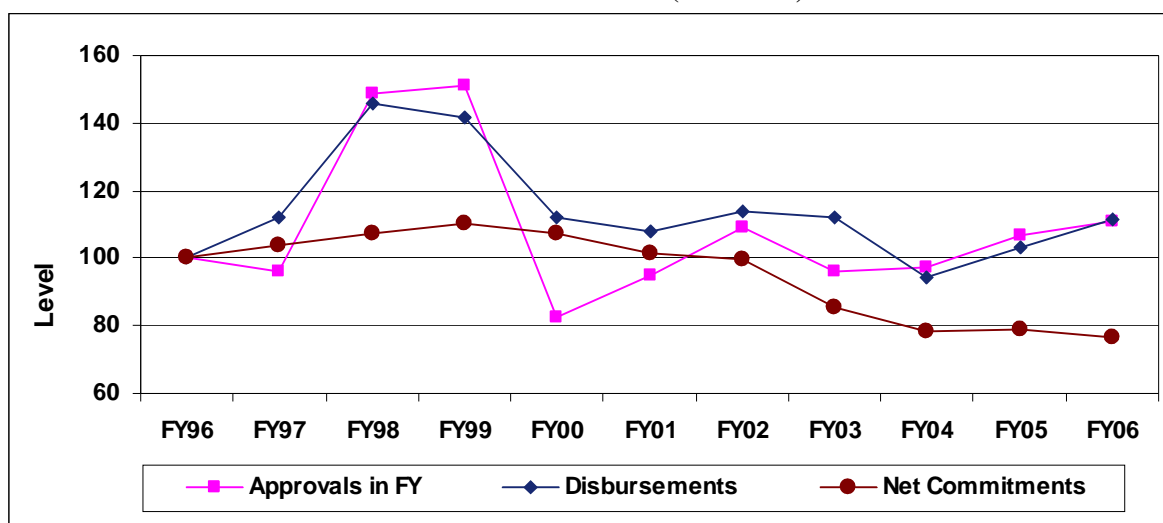
BOX 2.1: THE PORTFOLIO DYNAMICS

The portfolio as defined in the ARPP is a “stock” concept. Lending by contrast is a “flow.” The Bank portfolio consists of the IBRD loans, IDA credits and grants, GEF grants, Montreal Protocol, and Special Financing operations (financed in part out of the Bank’s net income). It only includes operations that are active at the end of the fiscal year. It excludes operations which are closed or fully disbursed during the year. It is recorded as the sum of individual operations’ commitments, net of cancellations, if any. The chart below illustrates those relationships for FY06 based on the Business Warehouse (BW) data.



* Closing balance of FY06 includes approximately \$0.7 billion (6 projects) in projects closed in previous years, which were reopened in FY06.

FIGURE 2.1: KEY TRENDS (FY97=100)



2.4 End-year portfolio figures do not capture quick-disbursing operations that enter and exit the portfolio during the same fiscal year because of their single tranche design (see Box 2.1). In FY06, there were 33 such operations for a total of \$4.1 billion in commitments, accounting for 17 percent of total approvals (Table 2.1); these figures represent a quadrupling in number and more than doubling in dollar terms over FY01 levels. A contributing factor to this trend was the increasing use of programmatic Development Policy Lending (DPL) in a series of operations, phased to support countries in achieving their reform programs within an integrated framework, with triggers for moving from one operation to the next. While this trend first began in LCR, which continues to be a very large user of DPLs, it is now also significant in all other regions except MNA. Not surprisingly, the processing cost of these operations (Bank average preparation/appraisal and supervision costs of \$358,000 and \$31,000, respectively) compare very favorably with those of all other operations (\$489,000 and \$321,000, respectively). However, the impact of these single tranche DPLs on longer term institutional reforms remains to be assessed.

TABLE 2.1: SINGLE TRANCHE LOANS/CREDITS BY REGION (US\$ MILLION)

Region	FY01		FY05		FY06	
	No. of Projects	\$ Amount	No. of Projects	\$ Amount	No. of Projects	\$ Amount
AFR	1	47	11	900	10	950
EAP	0	0	2	305	2	401
ECA	2	25	4	225	6	561
LCR	3	1,237	6	1,103	7	1,433
MNA	1	120	1	100	0	0
SAR	1	350	6	1,105	8	785
Bank-wide	8	1,779	30	3,737	33	4,129

GUARANTEES

2.5 Guarantees are available to all countries eligible for borrowing from IBRD or IDA to mobilize private sector participation, help catalyze debt with extended maturities, and lower financing costs. Such guarantees aim to reduce risks of private transactions in emerging markets,

mitigate risks that are beyond the control of the private sector, open new markets and improve project sustainability. By end FY06, 31 Guarantee operations (\$2.5 billion) for 29 projects had been approved, with an estimated \$10.2 billion of private capital mobilized. Approvals include eight partial credit, 21 partial risk, and two policy-based Guarantees. The majority of approvals since inception of the Guarantee program have been for infrastructure projects, with AFR accounting for most of the recent approvals and potential guarantee operations. Partial Risk Guarantee covering debt service default on loans to private sector projects caused by government failures to meet contractual obligations to private investors is the most common type of guarantee used in recent years. In FY06, three Guarantees for a total of \$64 million were approved for two projects.

BOX 2.2: QUALITY-AT-ENTRY OF IBRD/IDA GUARANTEES

The QAG assessment covered all nine IBRD and IDA Guarantees approved in FY05/06. Six Guarantees are in Africa, and one each in EAP, ECA, and LCR. The review concludes that:

- The Guarantee instrument is useful for supporting private sector investments in infrastructure, particularly in Africa. The use of the Guarantees to support privatization/concessions of existing assets is a creative extension of the Guarantee program. It offers potential for replication in other countries;
- The use of Guarantee as the instrument of choice for Bank/IDA support was assessed to be generally appropriate;
- There has been good cooperation among the Bank, MIGA and IFC staff;
- Overall the Quality-at-Entry of Guarantees was rated 78 percent Satisfactory. While three are rated Highly Satisfactory, two were rated Unsatisfactory;
- Understanding of the Guarantee instrument is still inadequate among staff, especially the basic macroeconomic and sector policy requirements that should underpin a Guarantee. The risk of the Guarantee being called, which should be at the heart of risk assessment for Guarantees, was rarely assessed;
- Inadequate readiness for implementation was the most common weaknesses for guarantees rated Moderately Satisfactory or less. As a result, several Guarantees have encountered significant delays in reaching financial closure;
- Attempts to wholesale Guarantees through intermediaries show certain issues of policy and practice that must be resolved if the Bank is to pursue this type of Guarantees; and
- The internal review process for Guarantees has been weak and was insufficiently focused on technical design aspects. There is a need for both simplifying and strengthening the process.

Follow up to some of these findings and recommendations are already underway.

2.6 Because of their unique characteristics, the Guarantee amounts are not included in the portfolio figures discussed in this chapter. The Bank's portfolio of 31 Guarantees is spread through six regions, with AFR and EAP leading with nine and seven operations respectively followed by ECA with four operations. The highest Bank exposure is however concentrated in the EAP and ECA regions. The Power Sector accounts for 60 percent of Guarantee operations, followed by the Financial Sector with 10 percent. There are 19 new operations currently under preparation. Given the growing volume of Guarantees, and in response to senior management request, QAG carried out an assessment of Quality-at-Entry of Guarantees approved in FY05/06 and preliminary findings are

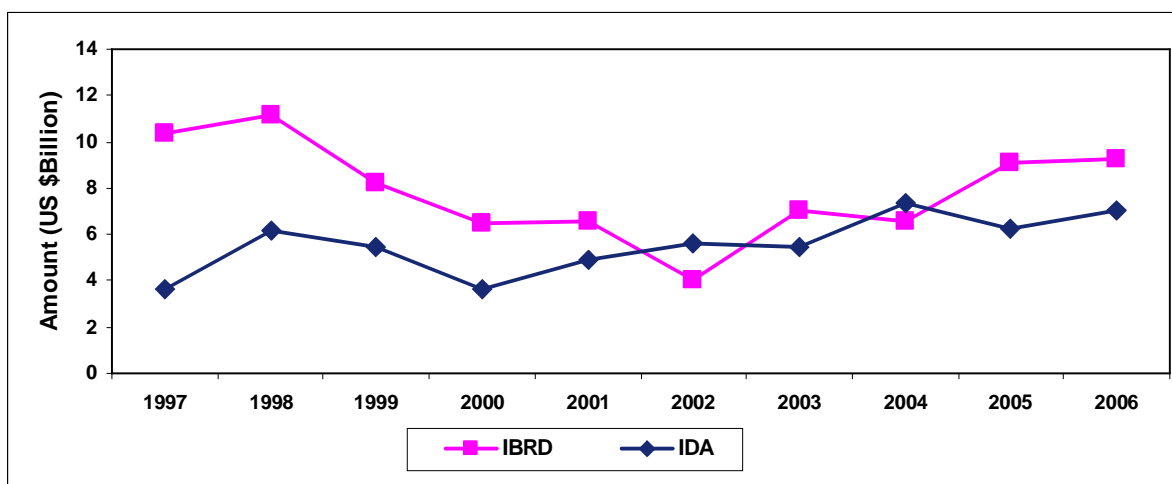
summarized in Box 2.2. [Note: Findings are preliminary because the assessment report is yet to be finalized].

IBRD PORTFOLIO

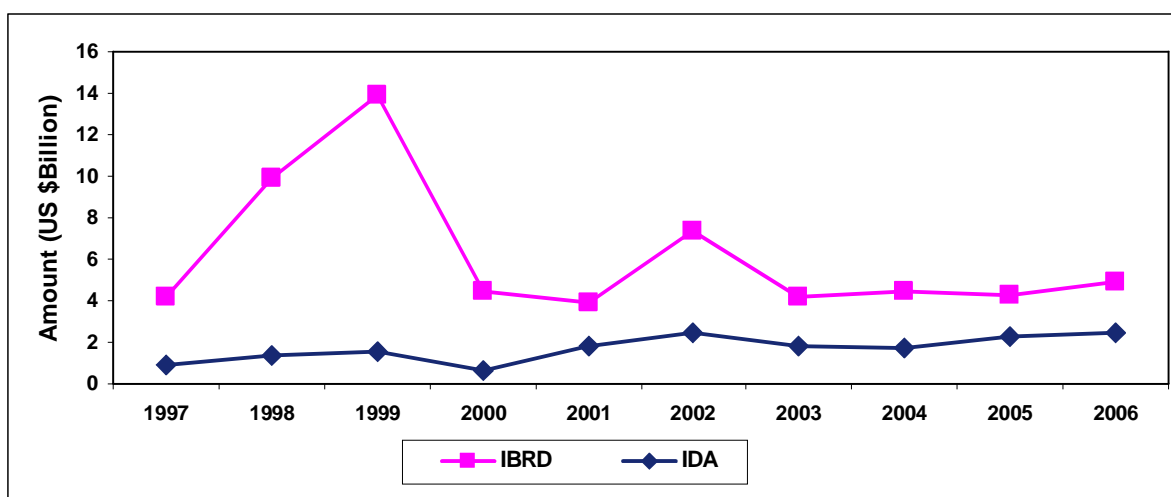
2.7 The Bank portfolio is composed of IBRD loans, IDA credits, Global Environment Facility (GEF)/Montreal Protocol (MP), and Special Financing (SF) grant funds. IBRD net commitments of \$53.1 billion account for the largest part (56 percent) of the Bank's net commitments of \$95.2 billion, although this share has declined from 64 percent in FY01. In FY06, IBRD net commitments shrank by about two percent, because of exits exceeding approvals, mostly in LCR whose net commitments shrank by \$2.2 billion despite an increase of \$1 billion in approvals. Net commitments in LCR and EAP are 64 percent and 59 percent, respectively, of the levels in FY01.

2.8 Compared with an average of \$7.2 billion in annual IBRD investment lending during FY02-06, the \$9.2 billion in FY06 was an improvement that built upon, and sustained the expansion of almost 40 percent of lending achieved in FY05 (Figure 2.2A). Among the Regions, the increase of \$1.2 billion in LCR, mainly in Brazil and Argentina, was able to offset the decline in investment approvals in SAR and ECA.

FIGURE 2.2A: INVESTMENT APPROVALS



2.9 New IBRD lending commitments for Development Policy Lending in FY06 were at \$4.9 billion, close to the average for the last five years, and mostly concentrated in LCR and ECA, which together accounted for 90 percent of total approvals (Figure 2.2B). The IBRD Development Policy Lending net commitments of \$5.8 billion in FY06 are one third less than its level of \$8.7 billion in FY01 (Statistical Appendix, Table 2.4), largely because of the shift toward single tranche operations.

FIGURE 2.2B: DEVELOPMENT POLICY LENDING APPROVALS

2.10 The higher level of IBRD investment lending achieved in the last two years is the cumulative result of several recent initiatives and their consolidation: scaling-up of the Bank's support for more effective responses to the specialized needs of Middle-Income Countries through the MIC Action Plan (paras. 2.13 and 2.14); modernization and simplification of internal Bank processes to meet Borrowers' needs in a more timely and flexible manner (para. 2.15); and the Infrastructure Action Plan to revitalize lending and help clients to address unmet infrastructure investment needs and broader development goals. Box 2.3 provides an example of how these initiatives have played out in practice to increase the relevance of Bank support and provided a stronger basis for increased investment lending.

IDA AND TRUST FUND PORTFOLIOS

2.11 IDA approvals at around \$9.4 billion in FY06 were at a historic high, and represent a 10 percent increase from FY05 (Statistical Appendix, Table 2.17). At the same time, the current IDA net commitments of \$39.8 billion are seven percent larger than in FY01. IDA net commitments in Africa recorded a 12 percent increase in FY06, and now account for 46 percent of total IDA net commitments compared with 38 percent in FY01 (Statistical Appendix, Table 2.1). The HDN sectors experienced a significant decline in FY06 in their IDA net commitments because exits exceeded approvals, but this was offset by increases in INF and ESSD net commitments. The increase in INF net commitments is due in part to an increase in new approvals resulting from the implementation of the Infrastructure Action Plan. When viewed in terms of FY06 IDA approvals, Africa experienced a 24 percent increase over FY05, while approvals in South Asia declined by 11 percent. Together these two Regions accounted, respectively, for 50 percent and 27 percent of IDA approvals in FY06. Among the Networks, ESSD approvals increased by 142 percent over FY05, while in the other Networks approvals either declined or remained approximately unchanged. Three-fourths of IDA approvals were for investment lending and the remainder for DPLs, which accounted for about one quarter of the total during the past five years. Given the need for a longer-term perspective to strengthen institutional capacity and policy frameworks, AFR has increasingly used programmatic lending for both investment and development policy support. Box 2.4 provides insights from the recently completed Quality of Supervision Assessment (QSA7) of operations for public sector management and civil service reform, on how a coordinated approach involving integration of staff skills, borrower ownership, and partnership with donors can help improve IDA's impact.

**BOX 2.3: IMPLEMENTING THE INFRASTRUCTURE ACTION PLAN
SUPPORTING THE ENERGY COMMUNITY OF SOUTH EASTERN EUROPE (ECSEE)**

This \$1 billion Adaptable Lending Program to support the development of the Energy Community was approved by the Board in FY05, and \$418 million has been committed to date. Bank financing is being provided on a regional basis to support seven countries; as well as Kosovo under a closely related TA project. It is tailored to the needs of individual countries to meet their commitments under the regional Treaty which formally established the Energy Community. The first-phase loan to Romania under the program was approved by the Board in January 2005, while seven subsequent operations have since been approved by the Bank's Management.

South Eastern Europe faces the need for very large addition to generation capacity and matching transmission and distribution system requirements, if severe power shortages and supply interruptions are to be avoided. Financing requirements are about \$30–40 billion, calling for significant private sector participation. Through the Energy Community, an EU-compatible regional market is being developed, representing a much larger and more attractive destination for prospective investors.

The Bank's support for analytical work has been a vital element in helping to focus on a least-cost basis across national boundaries. Through a Generation Investment Study, the Bank helped, in partnership with other donors, build institutional capacity for rational energy planning, develop databases, and promote a shared understanding by policymakers and energy planners.

In addition to the AAA support, the Bank also facilitated the design and implementation through the choice of an APL that sets reachable, yet meaningful goals, many of which have been reached in most countries, such as the signing and ratification of the Treaty, and having an electricity regulator and a transmission operator established and operational.

QAG panels reviewing the Quality-at-Entry of the APL program and of the analytic work highlighted the following strong aspects for this cross-country initiative: synergistic links to the EU efforts in the energy sector; effective institutional arrangements; responsiveness to the clients' needs; and the introduction of an elaborate set of information interchange and coordination bodies. Panelists also noted that the APL has repositioned the Bank to lend in areas from which it had previously withdrawn and contributed to an effective and timely response to clients' needs.

2.12 Operations financed by Trust Funds (GEF/Montreal Protocol) and Special Financing operations, financed in part out of the Bank's net income, had net commitments in FY06 of about \$2.3 billion, the same level as in FY05 but about 42 percent more than in FY01. New commitments of about \$0.3 billion were approved with Trust Fund financing in FY06. Although not included in the portfolio, recipient-executed Trust Funds, including Multi-Donor Trust Funds for country specific and regional emergency operations are being increasingly set up by the Bank and other donors. TFO has sponsored the creation of a new product line for recipient-executed activities where the Bank has a fiduciary responsibility. A total of 16 large, country-specific Multi-Donor Trust Funds are currently being managed by the Bank. These Funds have a total commitment of over \$4 billion and a net fund balance in FY06 of over \$2.2 billion.⁵ New contributions in FY06 to major programs such as the Afghanistan Reconstruction Trust Fund, Multi Donor Trust Fund for Indonesia Aceh and Niah, Multi-Donor Trust Funds for Sudan, Iraq Reconstruction Trust Fund, and the Trust Fund for East Timor, were about \$879 million, and disbursements about \$544 million. Given the growing volume

⁵ See FY06 Trust Fund Portfolio Review, *Moving to Accountability for Results*, November 10, 2006 (Table 1.4).

of recipient-executed Trust Funds, including Multi-Donor Trust Funds, and reputational risks they pose for the Bank, it is recommended that they be recorded in the Bank's portfolio, and subjected to regular Bank processes and quality assurance mechanisms for tracking and managing the health of the portfolio.

**BOX 2.4: PROGRAMMATIC SUPPORT FOR LONG-TERM CHANGE
CIVIL SERVICE REFORM IN TANZANIA**

The Tanzania Civil Service Reform Program provides the evidence of implementation over several years of the programmatic approach in helping clients. By definition, the scope of the reforms is broad, so as to address linkages between issues of incentives and policy change, modernization of systems and processes, and reinforcement of capacity. The challenge in design was to set a series of goals ambitious enough over a reasonable timeframe to effect tangible differences in accountability, performance, and delivery of public services, while ensuring ownership of borrower implementing staff and local agencies.

The QAG Panel that assessed quality of the Bank's supervision of this operation noted several areas of excellence. These provide insights into how some of the Bank's changes in recent years through decentralization, support for programmatic rather than project lending, and partnership with clients and other donors have played out for results. In particular, the Panel noted that the combination of staff skills in the field, of sector specialists and fiduciary staff, permitted attention to both policy reform and problem solving. Borrower ownership was thus consolidated by real-time joint interventions of the client, along with other donors and the Bank in addressing issues or moving to the next stage of reform. Supervision is joint, considerable resources are leveraged through other donors, and the latter have delegated responsibility for follow-up on procurement and financial management to the Bank because of demonstrated credibility.

According to the panel, the supervision effort was appropriately focused on the following key development issues: (i) rationalizing public sector pay and linkage with performance; (ii) getting an M&E system launched after initial delays and failed efforts; and (iii) modernizing the payroll and HR management system. The project's results to date show delay as against initial expectations, but the latter were clearly over-optimistic. Implementation was fully integrated into the country dialogue, taking into account macroeconomic and fiscal constraints. A main conclusion of the project team and the Panel is that the Bank needs to be more realistic in the time expected for a comprehensive program of public service transformation and for building capacity at various levels.

IMPLEMENTATION OF MIC AGENDA

2.13 The FY05 ARPP reported on the implementation of the MIC agenda. Since the MIC task force presented its recommendations four years ago, the Bank has continued to make progress on improving its responsiveness to clients' demands. Examples include the expanded menu of financing and risk management products, reducing non-financial costs of doing business with the Bank, broadening its freestanding delivery of knowledge services, and offering treasury management services on the basis of cost recovery. MICs are looking for more customized financial and advisory services from the IBRD, although traditional bundled lending and knowledge management products remain important for many MICs. Box 2.5 presents an interesting example of a customized Bank-country partnership.

**BOX 2.5: CUSTOMIZED COUNTRY PARTNERSHIP:
THE CASE OF KAZAKHSTAN**

Kazakhstan is at the front end of a major oil boom and by 2001 the World Bank had lost its place at the policy table, faced a small and shrinking portfolio, and a supply-driven analytical work program that was of poor quality. But there were good reasons for the Bank to stay engaged. Despite plentiful resources and rapid economic growth, the quality of education and health services were under threat, and much of the infrastructure out of date, expensive or of poor quality.

To stay engaged, the Bank needed to work in partnership with the client, provide top-quality expertise, and improve its internal processes. Relevant measures adopted by the region resulted in the following:

- **Partnership.** Agreement was reached on a Country Partnership Strategy that has no end date, no project or AAA lists, but an annually negotiated business plan.
- **Knowledge.** This turned out to be a key driver of the improved relationship. The Joint Economic Research Program (JERP) has driven the re-engagement. Unlike pay-for-service arrangements, this engaged both sides for its funding, and made both accountable for relevance and quality.
- **Bank Processes.** A Central Asia Operational Team was established to process pipeline and portfolio better. It also engaged the Government in a discussion on how it could speed up and improve the Borrower part of the project cycle.

The evidence shows a major turn-around. While the Bank delivered an average of \$0.6 million for AAA per year between 2000 and 2003, the figure increased to \$2.2 million between 2004 and 2006. Similarly, after a period of flat lending (\$28 million on average between 2001 and 2004), approvals subsequently increased to an annual average of about \$100 million. The average preparation time for investment lending declined from 29 months during FY97-FY03, to 17 months in the last three years.

2.14 Lending to MIC clients in FY06 was \$16.7 billion, an increase of six percent over FY05 and 40 percent over FY01. Extensive consultations with representatives from MIC countries and development partners were held in the course of preparing a new paper, “*Strengthening the World Bank’s Engagement with IBRD Partner Countries.*” This culminated in an updated MIC agenda that calls for:

- Accelerating actions for better and more flexible country-partnership strategies;
- Reducing the non-financial cost of doing business with the Bank by streamlining internal Bank procedures, and supporting the use of country systems where those systems meet mutually agreed and verifiable indicators;
- Simplifying loan pricing and preparing options to ensure competitiveness of IBRD loans;
- Mainstreaming IBRD participation in originating and administering public-sector lending at the sub-national level; and
- Providing fee-based expert services, unbundled from lending and on a larger scale, where the Bank has comparative advantage.

While it is too early to project the likely impact of the above actions on the portfolio, the Bank has committed itself to streamline its processes in the above areas, and to report on progress at the next Annual Meeting.

MODERNIZATION AND SIMPLIFICATION AGENDA

2.15 The FY05 ARPP also reported on the implementation of the Modernization and Simplification agenda. Simplified internal processes for simple and repeater operations have continued to impact positively on the Bank's portfolio. The quality of these operations was reviewed by QEA7 and found to be satisfactory. During FY06, 58 Simple and Repeater operations were approved for an amount of \$3.3 billion compared to 31 operations in FY05 for an amount of \$2.3 billion. Preparation time under this program averaged less than 12 months per operation, which is about 25 percent less than the average for investment operations, and at an average cost of about \$250,000 compared to \$380,000 for investment operations. In addition, since June 1, 2005, a total of \$1.1 billion in net commitments have been approved under the new Additional Financing policy for operations. Another encouraging sign of efficiency gains is the reduction in elapsed time between project concept and Board approval for all investment operations from 18 months in FY03 to 15.5 months in FY06. Given the growing volume of additional financing, the next assessment of Quality-at-Entry proposes to pay particular attention to these operations.

REGIONS AND COUNTRIES

2.16 **Regional Trends.** Three regions (AFR, ECA, and MNA) experienced an increase this year in their net commitments, while the other three regions experienced a decline. Over the last five years, AFR's share of total net commitments grew to 20 percent from 13 percent in FY01 (Table 2.2). While net commitments in MNA grew modestly over the past five years and remained steady in ECA and SAR, they declined sharply in EAP and LCR by 32 and 34 percent, respectively. Africa is the only region with substantially larger net commitments in FY06 than in FY01, showing an increase of \$4.1 billion. The decline in SAR net commitments in FY06 over FY05 was in major part due to lower than anticipated lending in India, mainly in the HNP sector. MNA's increase in net commitments in FY06 over FY05 was helped by a \$500 million Financial Sector Policy Loan to Egypt. An analysis of disbursements over the past five years shows that LCR increased resource transfers to client countries by nine percent in FY06 over FY01, and by 48 percent over FY05, in major part due to doubling of disbursements for DPLs from \$1.7 billion in FY05 to \$3.3 billion in FY06. LCR accounted for 28 percent of Bank-wide disbursements in FY06. Disbursements in AFR and SAR in FY06 were also higher by 74 percent and 65 percent over FY01, but declined in EAP by 24 percent over the past five years.

**TABLE 2.2: PORTFOLIO DISTRIBUTION AND DISBURSEMENTS BY REGION
(US\$ BILLION)**

Region	Commitments			Disbursements		
	FY01	FY05	FY06	FY01	FY05	FY06
AFR	14.5	16.6	18.6	2.3	4.0	4.0
EAP	28.8	20.2	19.5	3.4	2.6	2.6
ECA	16.1	15.9	16.5	2.8	3.4	3.0
LCR	25.2	19.0	16.6	5.4	4.0	5.9
MNA	5.9	5.6	6.6	0.8	0.7	1.0
SAR	17.7	18.2	17.4	2.6	4.1	4.3
Bank-wide	108.3	95.5	95.2	17.3	18.8	20.9

2.17 Portfolio Concentration. The FY06 portfolio includes operations in 124 countries, with a heavy concentration in ten countries, which together account for about one half of net commitments; by comparison, half the commitments in FY01 were accounted for by just seven countries.⁶ The decline in the level of concentration is evidenced by the share in total net commitments of the seven countries that were both on the FY01 and FY06 list declining, respectively, from 52 percent (\$55.4 billion) to 43 percent (\$41 billion). The largest decline in net commitments during this five-year period occurred in China (\$6.7 billion), Mexico (\$3.2 billion), Argentina (\$3.1 billion), India (\$2.2 billion), and Indonesia (\$2 billion). On the other hand, during the same period the combined net commitments in Vietnam, Bangladesh, and Ethiopia increased from \$6.7 billion to \$8 billion. In comparison, this year about 70 of the smallest borrowers account for only five percent of net commitments. In terms of number of projects, however, there is much less of a disparity between the group of ten largest borrowers and the group of 70 smallest borrowers, which account, respectively, for about 26 and 21 percent of the portfolio. These numbers illustrate the adaptability of the Bank lending program to the diverse needs, interests and absorptive capacities of different borrowers.

2.18 Portfolio Trend by Country Grouping. The net commitments with the largest decline (41%) over the past five years concerns the IBRD Investment Grade (IG) grouping of countries (Table 2.3). The IG and IBRD Only net commitments, however, held steady in FY06 due to a large increase in lending over FY05, by almost 40 percent to IG countries and nine percent to IBRD Only countries, but this was offset by an increase in the volume of exits. China and India have the two largest single country portfolios. Similar to IG country net commitments, China's net commitments have declined by 39 percent during the period FY01-FY06, and by 11 percent in FY06. Although lending to China increased in FY06 by 37 percent to \$1.5 billion, exits exceeded approvals. Declines in India's net commitments in FY06 are mainly due to lower lending by almost \$1.5 billion and a large volume of exits. Problems in lending to India's health sector have now been resolved and there are encouraging signs for strong lending in FY07.

⁶ The ten largest borrowers in FY06 were India, China, Turkey, Brazil, Vietnam, Argentina, Mexico, Indonesia, Bangladesh, and Ethiopia, which had a combined population of close to 3.4 billion or 62 percent of the total population of Low and Middle-Income Countries. The seven largest borrowing countries in FY01 were China, India, Mexico, Brazil, Argentina, Indonesia and Turkey.

**TABLE 2.3: PORTFOLIO BY CLIENT GROUPING
(US\$ BILLION)**

Commitment	FY01	FY05	FY06	% Change FY01-06
IBRD Investment Grade	18.4	10.9	10.8	-41
China	17.5	12.0	10.7	-39
IBRD Only (Others)	27.3	25.7	25.5	-6
India	13.5	12.8	11.3	-16
Blend	7.3	5.6	6.1	-16
IDA Only	21.4	23.5	25.2	18
LICUS	2.9	4.4	4.4	53
Multi-Country	0.1	0.7	1.2	799
Bank-wide	108.3	95.5	95.2	-12

2.19 Fragile states or LICUS countries represent a critical challenge for the Bank and make up a significant segment of IDA's portfolio (Statistical Appendix, Table 2.8). Two regions, AFR and EAP account for two-thirds of the LICUS portfolio by number of projects and AFR accounts for about two-thirds of LICUS net commitments (Table 2.4). The increase in the portfolio size of the LICUS countries during the past five years is in major part due to high levels of lending to Afghanistan and Democratic Republic of the Congo.

TABLE 2.4: PORTFOLIO IN FRAGILE STATES (LICUS) BY REGION

Region	Portfolio Size (FY06)		
	No. of Projects	Net Commitments	
		\$ M	%
AFR	56	2,847	65
EAP	24	254	6
ECA	12	271	6
LCR	5	70	2
MNA	8	83	2
SAR	17	873	20
Bank-wide	122	4,397	100*

* Figures do not tally due to rounding.

2.20 Net commitments for multi-country or regional projects have increased from an insignificant level in FY01 to \$1.2 billion in FY06, with most of the increase in the Africa Region. The multi-country portfolio is mainly focused on regional infrastructure (e.g., power and gas grids), export promotion through trade facilitation, transport corridors and financial sector integration. Given the impetus provided under IDA 14, and challenges of such multi-country projects, it is recommended that the upcoming assessment of Quality-at-Entry pay particular attention to the quality of these operations.

NETWORKS, SECTORS AND THEMES

2.21 The Networks with the largest portfolio remain INF, HDN and ESSD, and together they account for 87 percent of total net commitments (Table 2.5). The INF portfolio is the largest, with net commitments representing 46 percent of the total. The HDN Network has seen its portfolio continuing to decline. The decline of the PREM Network portfolio has to be seen in the context of

increases in single tranche DPLs, which are approved and disbursed in the same year, and, therefore, do not show up in the stock of the end-year portfolio. Despite increased lending in FY06, PREM's portfolio declined because exits exceeded approvals. Approvals in FY06 for PREM, PSDN and FSE have increased by \$1.4 billion, \$0.8 billion and \$0.5 billion, respectively, over FY05, but approvals for HDN, ESSD and INF have declined. For the first time in the past five years, new portfolio entries have been larger than portfolio exits resulting in a small increase in the portfolio in terms of number of projects.

**TABLE 2.5: PORTFOLIO DISTRIBUTION BY NETWORK
(US\$ BILLION)**

Network	Net Commitments		
	FY01	FY05	FY06
ESSD	22.4	19.3	19.9
FSE	4.2	3.3	3.5
HDN	24.5	22.3	19.8
INF	43.9	42.5	43.6
PREM	10.4	5.8	5.0
PSDN	2.8	2.2	3.3
Bank-wide	108.3	95.5	95.2

2.22 The five largest sectors in the Bank's portfolio are Transportation; Public Administration, Law and Justice; Health and Other Social Services; Water and Sanitation; and Energy and Mining, together accounting for 72 percent of total net commitments (Table 2.6). Transportation has remained the largest sector in the Bank's portfolio, with net commitments at about \$20 billion in FY06 and FY01. The Energy and Mining sector shows the largest variation among all sectors, with a decline in net commitments from \$14.2 billion in FY01 to \$10.1 billion in FY06, with most of the decline occurring in electric power. In this context, recent initiatives (see Box 2.3) should help position the Bank strategically for greater relevance to meeting clients' needs for competitive and economic electric power supply. Net commitments for all other sectors have either declined significantly or remained only slightly below the levels in FY01 (Statistical Appendix, Table 2.7).

2.23 In terms of themes that typically cut across sectoral boundaries, the current portfolio for Financial and Private Sector Development is the largest at 18 percent of total commitments, slightly below the level in FY01 (Table 2.6). The share of the portfolio for Human Development, Public Sector Governance, and Trade and Integration has grown during the period FY01-06, while the share of Environment and Natural Resource Management has experienced the largest decline from 16 percent in FY01 to 12 percent in FY06. It is worth noting that because the statistics collected and reported in the SAP are based on operations mapped to sectors, it is difficult to track and assess cross-cutting themes such as gender because there are currently no operations mapped to gender. A related issue is the frequent failure by TTLs to select gender as a theme even when the operation may have gender implications or components.

**TABLE 2.6: PORTFOLIO BY SECTOR OF FOCUS AND THEME
(% SHARE IN COMMITMENTS)**

Sector/Theme	FY01	FY06
Sector		
Agriculture, fishing, and forestry	9	9
Education	9	9
Energy and mining	13	11
Finance	6	5
Health and other social services	13	12
Industry and trade	5	5
Information and communications	1	1
Public Administration, Law, and Justice	16	17
Transportation	19	21
Water, sanitation and flood protection	10	11
Total*	100	100
Theme		
Economic management	2	1
Environment and natural resources management	16	12
Financial and private sector development	19	18
Human development	11	13
Public sector governance	8	9
Rule of law	2	2
Rural development	14	14
Social dev/gender/inclusion	7	8
Social protection and risk management	6	7
Trade and integration	3	5
Urban development	13	12
Total*	100	100

* Figures do not tally due to rounding.

2.24 Net commitments for the Financial and Private Sector Development (FSE and PSDN) increased from \$5.5 billion in FY05 to \$6.8 billion or seven percent of the total net commitments in FY06 (Statistical Appendix, Table 2.3). However, since this theme is frequently included as a component or objective in multi-sectoral operations, its share of total net commitments at 18 percent is much higher. A QAG review of compliance with the Bank's Operational Policy 8.30 for Financial Sector Operations managed by non-FSE units has raised several compliance issues. Additional reviews were carried out to assess the performance of the following non-dedicated components (i.e., the relevant components are included in operations being managed by another sector unit): Transport, Water Supply and Sanitation, and Information and Communication Technology. Findings from these reviews raise concerns about the quality of Bank performance in preparing and supervising non-dedicated components in multi-sector operations, as compared with single sector operations. These assessments recommend greater inputs from sector specialists and allocating additional budgets for the supervision of these non-dedicated components.

CONCLUSIONS AND RECOMMENDATIONS

2.25 The earlier declines in the portfolio have been stabilized, and both IBRD and IDA approvals and disbursements continued the upward trend of the past two years. Recommendations aimed at better tracking and monitoring changes and trends in portfolio composition include:

- Given the increasing volume of recipient-executed Trust Funds and reputational risks they pose for the Bank, it is recommended that they be recorded in the Bank's portfolio, and subjected to regular Bank processes and quality assurance mechanisms for tracking and managing the health of the portfolio; and
- In view of the growing volume of: (i) Additional Financing operations; (ii) multi-country or regional projects; and (iii) multi-sector operations, it is recommended that they should be given special attention in the upcoming assessment of Quality-at-Entry of operations approved in FY06 and FY07.

III. PORTFOLIO PERFORMANCE

3.1 The improving trend in development outcomes of completed projects financed by the Bank continued in FY06 with satisfactory outcomes now surpassing the agreed target of 80 percent. There are, however, substantial differences in performance by the type of client, Region and Sector Board, suggesting opportunities for further improvements. While country capacity is a key determinant of success, Bank performance on quality-at-entry and the quality of supervision are also important in ensuring that problems are identified early and issues addressed appropriately.

3.2 The recently completed Quality of Supervision assessment suggests that while overall supervision performance remains commendable, some aspects, particularly monitoring and evaluation and reporting of portfolio risks continue to be problematic. QSA panels found that over half of risky and problem projects are not being identified as such by staff and managers. One major consequence of this is that portfolio performance indicators (e.g., *Projects-at-Risk*, *Realism Index*, and *Proactivity Index*) derived from staff ratings, have become less reliable for tracking portfolio performance, undermining the Bank's ability to adopt corrective measures in a timely fashion. Based on analysis done as a part of this ARPP, modifications are proposed to the "*Realism Index*" to make it a more meaningful measure of the quality of portfolio reporting. The overarching issue in this respect is of managerial accountabilities and incentives for the quality of portfolio reporting. Depending on the progress made on this in the coming years, further systemic changes may be necessary.

EVOLUTION OF DEVELOPMENT OUTCOMES

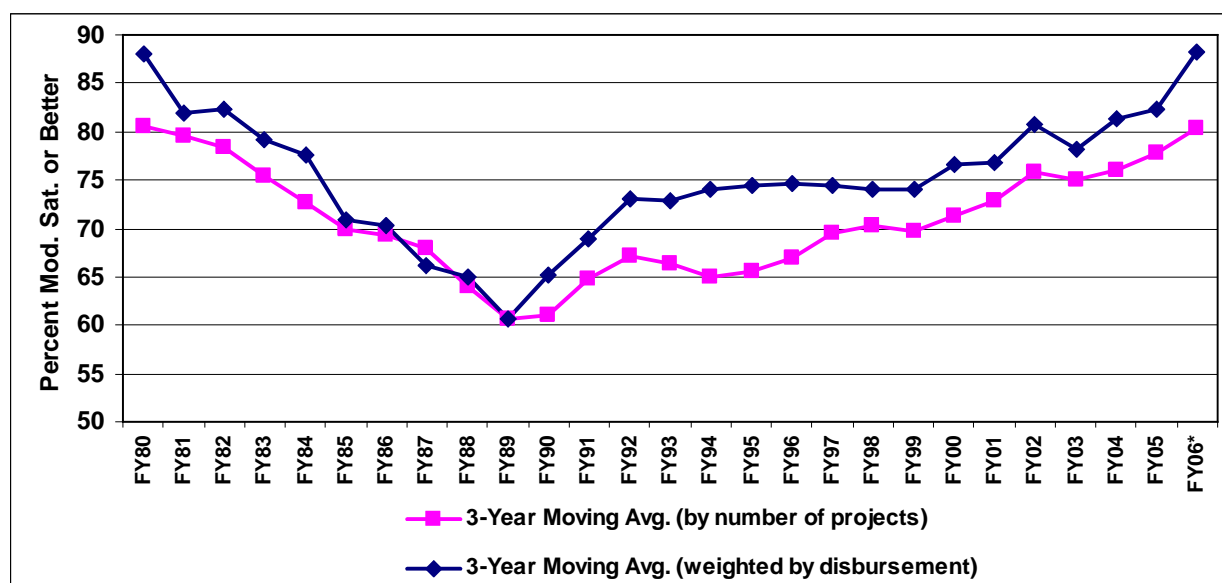
3.3 The development outcomes of operations exiting the Bank's portfolio rated satisfactory by IEG (Box 3.1) have continued the recovery that started in the mid-1990s. In FY06, satisfactory development outcomes are estimated to be 81 percent by number of projects, and 91 percent when weighted by disbursement. Because of significant year-to-year volatility, the development outcome trends are best analyzed using three-year moving averages (Figure 3.1). On that basis, ten years ago, one out of three operations exited the portfolio with unsatisfactory outcomes accounting for a quarter of the disbursements. Now, only one out of five operations, is unsatisfactory, accounting for about 12 percent of disbursements.

BOX 3.1: RATING SCALE

As part of the harmonization effort, IEG, OPCS and QAG have agreed to use the same six-point scale for rating purposes.

The first three ratings (***Highly Satisfactory***, ***Satisfactory and Moderately Satisfactory***) indicate a satisfactory outcome (i.e., above the line) while the last three ratings (***Moderately Unsatisfactory***, ***Unsatisfactory and Highly Unsatisfactory***) indicate an unsatisfactory outcome (i.e., below the line). Unless specified otherwise, the terms "satisfactory" or "unsatisfactory," when used in this chapter, follow the above definitions.

FIGURE 3.1: DEVELOPMENT OUTCOMES (FY80-06)



Source: IEG except for FY06* which is a QAG projection.

3.4 Development Outcomes by Region. A breakdown of satisfactory development outcomes for FY03-06 by number of operations shows significant variations across Regions (Table 3.1). EAP, ECA, LCR and SAR have satisfactory outcome ratings in the 80 percent plus range, while AFR and MNA's satisfactory outcomes are in the low 70 percent range. Satisfactory outcomes, weighted by disbursements, are slightly better for most regions. EAP and ECA regions have disbursement weighted satisfactory development outcome ratings in the 85-90 percent range, and SAR, MNA are also in 80 percent plus range. AFR and LCR have disbursement weighted satisfactory outcomes slightly below the 80 percent plus level of other regions. LCR's low satisfactory outcomes rating at 78 percent, weighted by lending amounts, is mainly due to relatively poorer performance of DPLs at 75 percent than for investment operations at 81 percent.

TABLE 3.1: OUTCOMES BY REGION AND LENDING INSTRUMENT (FY03-06)

Region	DPL		INVESTMENT		ALL OPERATIONS	
	Outcome by Number % Sat.	Outcome by Dollar Amount % Sat.	Outcome by Number % Sat.	Outcome by Dollar Amount % Sat.	Outcome by Number % Sat.	Outcome by Dollar Amount % Sat.
AFR	75	78	68	78	70	78
EAP	88	98	82	90	83	91
ECA	91	98	81	79	83	87
LCR	80	75	83	81	82	78
MNA	100	100	69	76	72	82
SAR	86	90	79	79	80	82
Bank-wide	83	82	77	83	78	82

3.5 The low satisfactory outcomes in AFR reflect both "country" and "Bank" factors. AFR is home to the ten poorest countries receiving Bank assistance and these countries account for 28 percent of the region's total net commitments. Completed projects in Fragile states (LICUS

countries) in the Africa region (Table 3.2) have satisfactory outcomes of 48 percent. These countries have difficult environments, with weaknesses in governance, institutions and policies, all outside the Bank's control, which explain a good part of the lower outcome ratings. However, lower Quality-at-Entry and Quality of Supervision in these countries, which are fully within the Bank's control, are also contributing factors. Satisfactory development outcomes in AFR improved to 70 percent in FY03-06 from 64 percent in FY00-02, and when weighted by disbursement, to 78 percent from 65 percent. The low satisfactory development outcome in MNA at 72 percent during FY03-06, compared to 82 percent in FY00-02, is similarly due to the problems in Fragile states, which have satisfactory development outcomes of only 43 percent. Year to year data on LICUS outcomes is also presented in Statistical Appendix, Table 3.18.

3.6 Fragile States or LICUS countries represent critical challenges for the Bank and in particular make up a significant segment of the IDA portfolio (Table 3.2). There is large scope for improvement in Quality-at-Entry and Quality of Supervision, both of which are aspects under the Bank's control. The Bank has introduced the LICUS initiative since 2002 and an IEG review of the initiative was completed in FY06.⁷ The review's main conclusion was that, "the initiative has increased Bank attention to LICUS, but it is too early to assess outcomes." However, the review identified organizational capacity as a major constraint to implementation in a LICUS context. Bank management is taking a number of actions to enhance the Bank's organizational response through a three-tier strategy focused on: (i) the increased field presence in Fragile states; (ii) the establishment of a stand-by capacity of experienced sector and operational staff to support Bank teams in emergency and crisis situations; and (iii) the provision of stronger institutional back up to emergency and fragile situations through additional guidance, cross-country sharing of lessons, and rapid response teams in central and regional units. Furthermore, the enhanced organizational response and a new OP/BP on Rapid Response to Emergencies will shortly be presented to the Board. These measures should improve Bank performance and also help improve the quality of operations in Fragile states.

TABLE 3.2: OUTCOMES IN FRAGILE STATES (LICUS) BY REGION

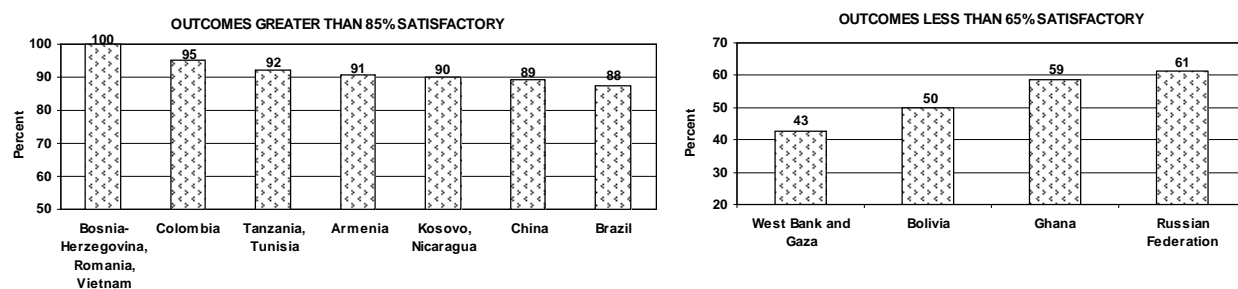
Region	No. of Projects	IEG % Satisfactory (FY03-06)
AFR	42	48
EAP	14	64
ECA	13	77
LCR	0	NA
MNA	14	43
SAR	3	100
Bank-wide	86	56

* Figures do not tally due to rounding.

3.7 High satisfactory outcomes, however, are possible even in countries with low income and lower institutional capacities. Clients with especially high or low satisfactory outcomes are shown in Figure 3.2. The high performing group includes clients from most Regions.

⁷ Engaging Fragile States, IEG, 2006.

FIGURE 3.2: FY03-06 OUTCOMES FOR SOME SELECTED CLIENTS



3.8 Development Outcomes by Sector Boards. A detailed analysis of development outcomes by major Sector Boards (Table 3.3) shows that their relative performance varies significantly when measured based on the number of projects and when weighted by disbursement. The Transport sector continues to outperform other sectors in satisfactory development outcomes in terms of number of projects, while four sectors (Environment, Public Sector Governance, Health, Nutrition and Population, and Private Sector Development) have satisfactory development outcomes below the Bank's average of 78 percent. When weighted by disbursement, only three Sector Boards (HNP, Economic Policy, and Environment) have satisfactory development outcomes that are below the Bank's average of 83 percent. It should also be noted that Network affiliation does not seem to have much impact on development outcomes as both higher performing and lower performing sector boards are found in each Network; e.g. Rural and Environment in ESSD, and Education and HNP in HDN. These results underscore the need for more cross-fertilization between Sector Boards in the same Network.

TABLE 3.3: OUTCOMES BY SECTOR BOARD
(% SATISFACTORY, FY03-06)

Sector Board ^{a/}	% SATISFACTORY (by no. of Projects)	% SATISFACTORY (Weighted by Disbursement)
Transport	91	91
Rural	84	86
Financial	84	96
Education	83	84
Water & Sanitation	83	93
Economic Policy	81	65 ^{b/}
Social Protection	81	94
Urban Development	79	84
Energy, Mining & Telecom	78	85
Environment	71	73
Public Sector Governance	69	87
Health, Nutrition, Population	64	64
Private Sector Development	61	83
Bank-wide	78	83

a/ For Sector Boards with 15 or more evaluations.

b/ Satisfactory development outcomes for the Economic Policy Sector on a weighted disbursement basis are low mainly because of one large DPL operation that exited in FY03. Excluding this one DPL, satisfactory outcomes, weighted by disbursement, for EP would have been 92 percent.

3.9 With development outcomes at 64 percent satisfactory by number of projects, the HNP sector faces performance problems, particularly in low CPIA countries. Improved performance of HNP, including the HIV/AIDS portfolio, especially in the AFR region (Box 3.2), is critical for progress in achieving the MDGs. Project designs need to be better adapted to a country's implementation capacity. Also needed are proactive supervision efforts with a focus on the use of performance indicators to assess progress on results, and candid and timely recognition of, and prompt actions to resolve, implementation problems. In Environment, excessive project complexity, weak institutional capacity, inadequate implementation readiness, and failure to restructure problematic projects are the main problems. A new HNP strategy is at an advance stage of preparation. It discusses issues of poor sector performance and proposes to sharpen Bank focus on results on the ground and on concentrating future Bank efforts on its comparative advantages, particularly in health system strengthening, health financing and economics. It also proposes to support government leadership and international community programs to achieve these results and to exercise greater selectivity in engaging with global partners.

BOX 3.2: AFRICA REGION HIV/AIDS PORTFOLIO

The Multi-Country HIV/AIDS Program (MAP) was launched in 2000 as a multi-sectoral, emergency response to the epidemic, focusing on advocacy, capacity building, and adopting "exceptional" measures to combat the disease, especially through community engagement. Twenty-nine country and four regional projects were approved with credits and grants totaling \$1.32 billion, of which roughly two-thirds has been disbursed. A self-evaluation by the Region of the MAP Program found that, in addition to increasing access and significant service delivery in prevention, care and treatment, the MAP Program has been catalytic in bringing development partners together to pursue harmonized procurement, supply chain management procedures, M&E systems and the development of unified national AIDS strategies. The final outcome of these operations, however, is a cause for concern. According to IEG ratings, more than half of the completed HIV/AIDS projects in the Region have unsatisfactory outcomes. QSA7 Panelists noted the overly ambitious Development Objectives of these projects and under-estimation of difficulties during implementation. Other areas for improvement included: M&E, procurement, and project management and coordination. Based on better epidemiological knowledge and information, and lessons from experience, the Region is addressing these shortcomings through:

- restructuring of the projects by revising their development objectives, and strengthening of the results scorecard;
- heightened focus on capacity building, particularly with regard to fiduciary aspects and M&E; and
- providing extra support for project supervision and portfolio monitoring.

The Region has also introduced an early warning system to identify potential problems. Some early success has been achieved in improving the supervision of HIV/AIDS projects in Africa and the supervision of Guinea HIV/AIDS Project was judged to be "Highly Satisfactory." This effort needs to be continued to improve the results from the rest of the portfolio.

3.10 QSA data suggests significant missed opportunities due to lack of candor in the Public Sector Governance sector. Low development outcomes by number of projects in this sector are of particular concern because of the Bank's increased focus on improved public financial management, public administration, legal and judicial reform, and governance. Main problems with completed projects include: complex project designs, weak institutional arrangements, lack of correct appreciation of

government commitment to reform actions, inadequate attention to political economy issues of proposed reforms, inadequate risk management, and limited use of performance indicators to assess progress.

3.11 **Gender.** Although the quality of supervision of gender issues shows a slight improvement in QSA7 compared to the QSA6 level, it continues to be low. Panels noted that, while many Task Teams readily acknowledged the relevance of gender issues, there was a sense that they lacked support and guidance in dealing with these issues during supervision.

3.12 **Development Outcomes by Source of Funding.** IDA operations had a satisfactory outcome rate of 77 percent in FY06 compared to 72 percent in FY03 on a three-year moving average, while IBRD operations had a satisfactory outcome rate of 85 percent in FY06 with a similar improving trend. Despite this overall improvement, however, outcomes in LICUS countries remain generally low (para. 3.6). In contrast, according to IEG, MIC operations that exited the portfolio during FY03-FY06 have achieved satisfactory development outcomes of 82 percent.

3.13 **Development Policy Lending Operations (DPLs).** As shown in Table 3.1, DPLs have similar disbursement weighted satisfactory outcome levels (82%) to those of investment operations (83 percent). However, the performance of investment operations by numbers is somewhat lower because of the impact of smaller countries, especially those with lower income.

3.14 **Single Tranche DPLs.** This category (para. 2.4) includes an increasing share of all DPLs and comprises operations that are approved and fully disbursed in the same year. Satisfactory development outcomes for single tranche DPLs were in the 90 percent plus range in FY06 on a three-year moving average. While nine of these operations were unsatisfactory (four in AFR, three in LCR, and two in SAR), none of them rated the Development Objectives (DO) in the ISRs, in part because these DPLs are approved on the strength of up-front actions.

TRACKING OF DEVELOPMENT OUTCOMES

3.15 The Bank has been a pioneer in evaluating and reporting development outcomes of projects and programs it supports. Currently, all projects at completion are subject to Implementation Completion Reports (ICRs) by staff with independent validation of their findings and lessons by the IEG through desk-based ICR Reviews (ICRRs). Additionally, IEG prepares more in-depth Project Performance Assessment Reports (PPARs) for about 25 percent of completed projects (Box 3.3). PPAR ratings override IEG's earlier ICRR ratings, so that the portfolio-wide results reported by IEG are a combination of those in the PPARs (for about a quarter) and the ICRRs (for the remainder). As explained in Box 3.3, IEG does not select projects for PPARs based on a random or representative sample; accordingly, it is not possible to extrapolate the PPAR findings to the entire portfolio.

BOX 3.3: EVOLUTION OF PPAR COVERAGE BY IEG

Until the early 1980s, IEG prepared Project Performance Audits on all projects about one year after exit to analyze the extent to which project objectives had been attained and reasons for deviation. The main factor for 100 percent coverage of completed projects for independent audits was driven by the Board's concerns for accountability of Bank Management. In 1983-84, the audit coverage was reduced to 50 percent of completed projects because of the budgetary and staffing reality of IEG's growing portfolio and studies program. The audit ratio was further reduced to 40 percent in 1986 and again to 25 percent in 1997 to generate the resources needed to allow IEG to focus on evaluations at a Country, Sector and Thematic levels. The audit ratio remains at 25 percent today.

The PPAR has evolved into an in-depth project evaluation based on field work, and is prepared by IEG on average within three years after project completion. Projects for PPARs are selected along a number of criteria, including the potential to learn lessons from innovative projects, usefulness as building blocks for IEG's Sector, Thematic, and Country Assistance Evaluations, and lack of information in the ICR or difference of opinion between IEG and the Region on ratings between the ICR and ICR Reviews.

3.16 Tracking of development outcomes is important to improve the effectiveness of the Bank's operational work, to strengthen institutional accountability, and to help reduce reputational risks to the Bank. Several important steps are already underway to strengthen the Bank's outcome tracking system including strengthening of Project-level M&E systems to provide better underpinning for evaluations and refinements of the ICR/ICRR process to resolve methodological issues. In partnership with DEC, IEG is also considering detailed statistical analysis of the PPAR data to look for further insights into the historical trends.

BANK'S PERFORMANCE DURING PROJECT PREPARATION AND SUPERVISION

3.17 IEG evaluation data suggest that while country factors are the strongest predictors of project outcomes, the Bank's performance is also a major contributory factor. Satisfactory Bank performance during preparation and appraisal leads to better project design adapted to country situation. Improved risk identification and mitigation during implementation, and project restructuring to adjust to changing country circumstances, also contribute to successful outcomes.

3.18 **Quality-at-Entry.** Since FY97, QAG has carried out seven assessments of Quality-at-Entry, and the results were reported in the last ARPP. The last Quality-at-Entry assessment of projects approved in FY04-05 (QEA7) shows that overall satisfactory quality is about 90 percent.⁸ A breakdown of the findings of QEA7, however, shows that 28 percent of projects are in the moderately satisfactory category, indicating missed opportunities during preparation for corrective actions to enhance development impact.⁹ Shortcomings in Quality-at-Entry can be addressed by paying more attention to the following four main factors that have been shown in IEG evaluations and QAG assessments to contribute to successful outcomes:

⁸ Projects in LICUS have lower Quality-at-Entry at 80 percent satisfactory. MIC operations, on the other hand, have higher Quality-at-Entry at 97 percent satisfactory.

⁹ Starting with QSA6 and QEA7, QAG shifted the assessment from a four to a six-point scale of Highly Satisfactory (HS), Satisfactory (S), Moderately Satisfactory (MS), Moderately Unsatisfactory (MU), Unsatisfactory (U) and Highly Unsatisfactory (HU).

- Lower project complexity that better matches the design with a country's institutional capacity;
- Comprehensive assessment of the risks and feedback into project design;
- Operationally relevant results framework and baseline data at entry; and
- Greater project readiness for implementation at entry.

3.19 Quality of Supervision. The recently completed Seventh Quality of Supervision (QSA7) assessment of the Bank's performance during supervision in FY05-06 shows overall satisfactory quality at 95 percent compared to 90 percent in QSA6 (Table 3.4). The share of the portfolio in the moderately satisfactory category, however, has increased to 43 percent from 25 percent in FY03-04. In addition, supervision quality in the satisfactory or better category has declined from 65 percent in FY03-04 to 52 percent in FY05-06, across all quality dimensions (Figures 3.3A and 3.3B). These results are a cause of concern and indicate missed opportunities as well as substantial room for improvement. At the regional level, ECA, AFR, MNA and SAR have improved their performance in QSA7, while EAP and LCR have shown a slight decline.

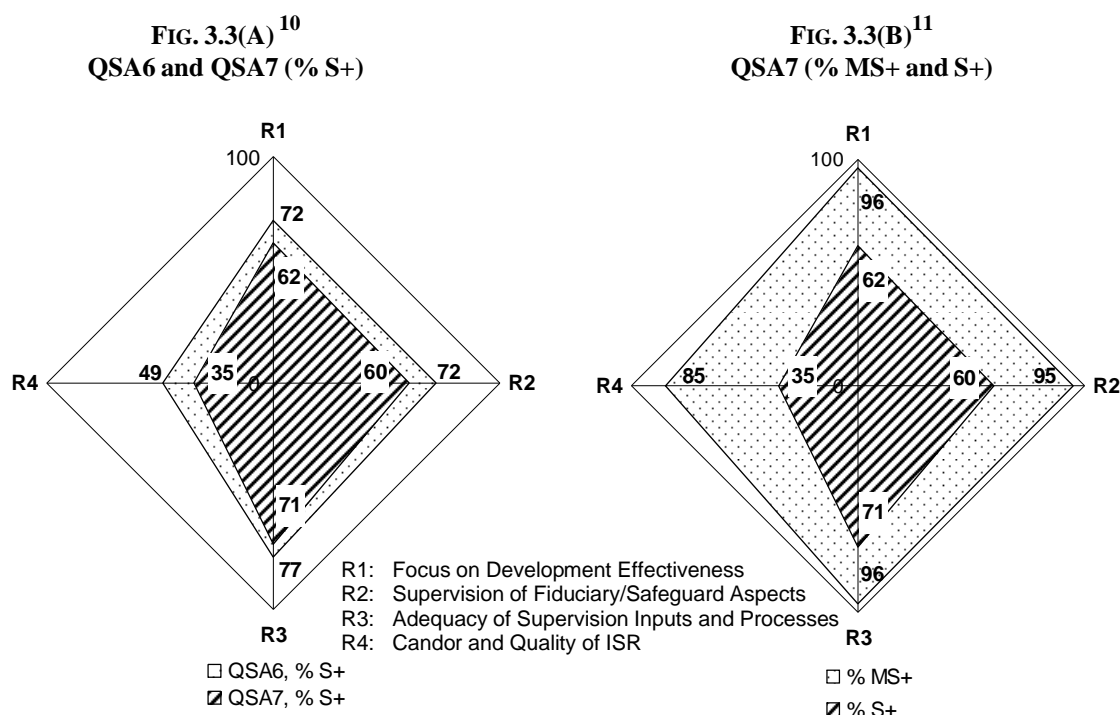
**TABLE 3.4: QUALITY OF PROJECT SUPERVISION
QSA6 (FY03-04) and QSA7 (FY05-06)**

	% Satisfactory		of which % Moderately Satisfactory	
	QSA6	QSA7	QSA6	QSA7
Region				
AFR	85	97	32	36
EAP	96	92	17	49
ECA	90	98	10	34
LCR	100	94	31	47
MNA	75	93	33	55
SAR	80	93	28	52
Network				
ESSD	86	94	32	44
FSE	100	100	32	53
HDN	91	90	35	41
INF	94	100	22	47
PREM	91	91	10	46
PSDN	77	92	0	8
Source of Funds				
IBRD	94	94	25	50
IDA	88	97	25	41
LICUS^{a/}		88		52
Bank-wide	90	95	25	43

^{a/} QSA6 assessment was not stratified by LICUS group of countries.

3.20 Quality of supervision in LICUS countries at 52 percent moderately satisfactory and 88 percent satisfactory is below the Bank's averages. Major issues are: (i) lack of focus on development effectiveness, including efforts to build capacity and approach to building institutions; (ii) lack of management guidance on and responsiveness to supervision issues; and (iii) poor quality of project performance ratings. LICUS operations also have very low ratings on sustainability. With extremely weak institutions in LICUS, more focus on institution building and the intensity and quality of Bank supervision could have a major impact on project outcomes. The Bank needs to assign more experienced staff and managers to supervise projects in these countries, as research has shown that supervision can have a high pay off in terms of improving outcomes.

FIGURE 3.3 – QUALITY OF SUPERVISION BY DIMENSION



3.21 A detailed analysis of QSA7 shows the following main weaknesses:

- Failure to correct in a timely manner quality-at-entry problems related to weaknesses in project design, poor quality of results framework in the PAD, lack of readiness for implementation at approval, and inadequate risk assessment;
- Lack of timely identification and assessment of threats to achievement of development outcomes;

¹⁰ S+ only includes two of the three ratings that are above the line (i.e., Highly Satisfactory and Satisfactory).

¹¹ MS+ includes the three ratings that are above the line (i.e., Highly Satisfactory, Satisfactory and Moderately Satisfactory).

- Inadequate management attention and actions. Supervision efforts by, and the skill mix of task teams, are areas where more effective guidance and support from both country and sector management could have made a difference;
- Inadequate budget resources in about a fifth of the sample; and
- Poor performance reporting of QSA7 projects resulting in understatement of the riskiness of the portfolio as reported to management. The ISRs continue to suffer from lack of candor and there are problems with the quality and timeliness of data to support performance indicators. Compared with the ISRs, panelists identified twice as many problem projects and three times as many risk flags in both FY05 and FY06.

3.22 Quality of supervision can be improved by more attention to the following:

- Ensuring that needed technical expertise is present in supervision teams;
- Strengthen incentives and accountabilities to improve the quality of supervision reporting;
- Address factors that impede timely management attention and actions on supervision issues;
- Address supervision skill mix issues by ensuring that decentralized staffs have adequate access to specialized and global skills;
- Provide guidance and training to task teams in the area of improving the results framework, including disseminating best practice examples across regions; and
- Ensure that procurement and financial management specialists are better integrated with supervision teams.

PORTFOLIO RISKS AND REALISM OF RATINGS

3.23 The effectiveness of the system to measure portfolio performance and status (*Projects-at-Risk* flag system, *Realism Index*, and *Proactivity Index*) depends on the quality of the ISRs (Annex 2). However, if risks are under-reported in the ISRs, management's ability to focus timely attention on problems is compromised. As reported in previous ARPPs, candor and realism of portfolio reporting are long standing problems. In response to proposals in previous ARPPs, some actions have been initiated:

- In early 2005, revisions to ISR system placed greater emphasis on results and made them more issues and action oriented;
- Some regions, particularly AFR, are strengthening supervision effort for problem projects, and this is encouraging more candid reporting by TTLs and sector managers (Box 3.4); and
- Intensified attention from senior managers, as in the case of *Net Disconnect* between IEG ratings and the ratings in last ISR, has provided increased incentive for managerial attention.

Nevertheless, the overall situation remains problematic.

3.24 Based on the FY06 ratings in the ISRs, only ten percent of the portfolio was classified as having serious problems and a further four percent acknowledged as having potential problems. Based on this, other related indicators (realism and proactivity) are currently being reported and used (Statistical Appendix, Tables 3.1 and 3.2). However, QAG's analysis shows that the following three factors raise questions about the reliability of the current portfolio risk system:

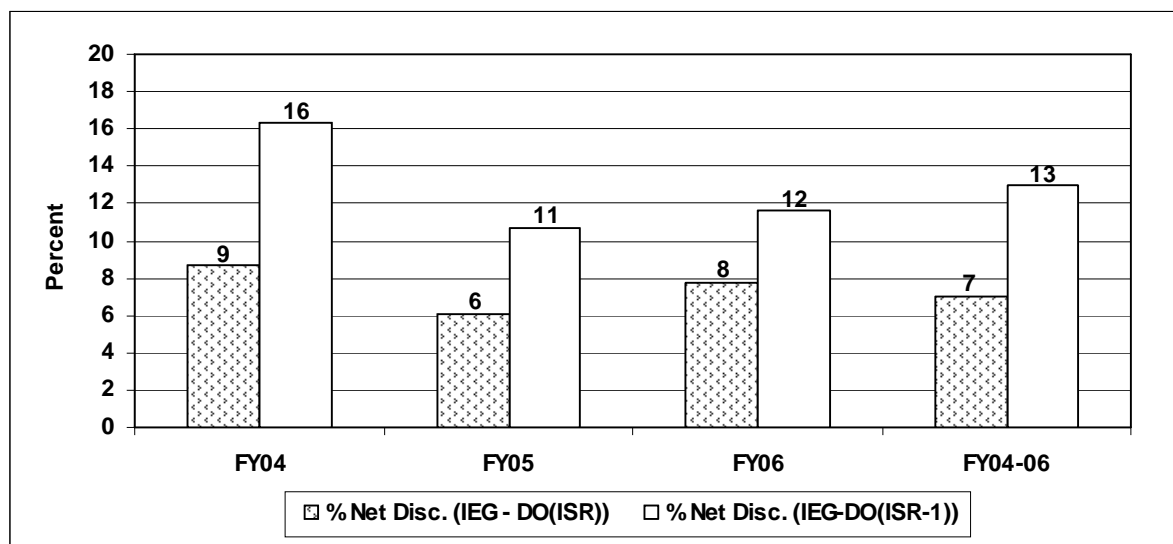
- Excessive optimism in the ratings means that many risky and problematic projects are not being identified as such by staff and managers, and, therefore, do not generally receive the resources and attention they require. Validation of the ISR ratings by the QSA7 Panels shows that 14 percent of the FY06 portfolio is at risk of not meeting its development objectives (DOs) and an additional 11 percent of the portfolio is having implementation problems and require intensive attention (IP unsatisfactory), for a total of 25 percent of the portfolio facing serious issues;
- The *Net Disconnect* (the gap between the ratings for DO in the last ISR before closing and IEG's outcomes ratings at exit), which declined from 15 percent in FY03 to seven percent in FY04-06, may be sending a false signal of improved candor in reporting (Figure 3.4). Analysis shows that the lower level is too often due to downgrading of the DO ratings in the last ISR before project closing (through so called "death-bed conversions"). When measured based on ISR ratings one year prior to closing, the *Net Disconnect* during FY04-06 was about 13 percent. While such late downgrading of the DO ratings in the ISRs reduces the *Net Disconnect* (which is monitored by senior Management), it is more important to recognize problems early on to permit timely corrective actions; and
- In addition to serving as an "early warning" risk system for Management on the health of the portfolio, the *Projects-at-Risk* rating is used in the formula for allocation of IDA resources. This may distort incentives for candid reporting.

3.25 QSA reviews point to frequent failures in the ISRs to trigger discretionary risk flags. Validation of risk flags by QSA7 Panels shows that the ratings for M&E, Project Management, and Financial Management, which are good predictors of project development outcomes, should have been rated unsatisfactory in 39, 28 and 16 percent of the FY06 ISRs, respectively, compared to the five-six percent range assigned by regional staff and managers (Statistical Appendix, Table 3.25).

3.26 A review of IEG's outcomes ratings shows that whenever an ISR assigns a Moderately Satisfactory (MS) rating to the Development Objectives (DOs), there is a higher likelihood of the outcome being rated Unsatisfactory by IEG (31% of the instances) than in instances where DOs in the ISR are rated Satisfactory (7%). The MS ratings are, therefore, useful to guide attention to areas where there is a need for more focused attention to improve project performance.

3.27 A review of the ISRs by the ECA region carried out in mid-FY06 found that 70 percent of the ISRs were satisfactory for realism of the key ratings. About 40 percent of the ISRs were satisfactory on the realism of the key ratings, and also on results framework. While results orientation was satisfactory for 75 percent of the ISRs reviewed by ECA, it was concluded that there is room for reducing the number of cases where the links between indicators and ratings were perceived as weak. In some cases, the ECA review found excessive focus on implementation and disbursements to gauge progress instead of paying more attention to progress towards meeting development objectives. Therefore, the ECA review emphasized the need for using results as the main source for justifying ratings, including cases where rating upgrades were undertaken.

FIGURE 3.4: NET DISCONNECT BETWEEN IEG OUTCOMES AND ISR RATINGS DURING FY04-06



3.28 The ISR sign off system by Sector Managers has not so far assured candid reporting of potential risks and there is a continuing perception that a Task Team Leader of a problem project is himself or herself a problem. The FY06 COSO Report¹² noted that Sector Staff and Country Management Units feel that both formal and informal incentives were primarily focused on getting projects to the Board, with quality, safeguards and supervision being secondary. Additionally, the COSO Report noted that despite the behavioral references in the annual staff performance evaluation process to teamwork, staff continue to believe that their performance is being measured on individual rather than team achievement. Moreover, a problem project or a project that moves into the At-Risk category comes under Management scrutiny and the TTL is asked to fix the problem quickly, in many instances without adequate Management guidance and/or resources. Box 3.4 provides details of an innovative process introduced in FY06 by the Africa Region to address this concern.

3.29 One major consequence of the excessive optimism in the ISRs' risk ratings is that portfolio performance indicators derived from the ISR database—*Projects-at-Risk*, the *Realism Index* that measures the degree of unreported problems, and the *Proactivity Index* that measures actions taken to resolve identified problems--have now become less reliable. They do not provide “early warning” of risks that threaten the achievement of project development objectives. This weakness compromises the ability of managers to devote in a timely manner resources and attention to the more risky portion of the portfolio.

¹² IBRD and IDA FY06 COSO Year-end Report (No. AC2006-0093), October 13, 2006 (paras. 68-69).

BOX 3. 4: STRENGTHENING SUPERVISION OF PROBLEM PROJECTS: THE AFRICA APPROACH

In FY06, the RVP of the Africa Region encouraged staff to be more candid and responsive to implementation problems. The Region provided additional funding for intensive supervision of problem projects from an escrow fund of \$1.1 million on a demand basis. Thirty-seven problem projects received funding and results have been promising. About one-half of these projects have been upgraded and/or restructured. Lessons learned indicate the need to agree up-front on a strategy to address systemic issues, establish close links between funding and the proposed actions and expected results, and to complete corrective actions during the fiscal year. The Region is continuing to provide additional funding for supervision of projects in difficulty in FY07. Task Teams have been encouraged to access the funds early in the Fiscal Year. Sector Units will prepare quarterly progress reports on the proposed actions.

AFR's average supervision budget in FY06 for both problem (\$136,000) and non-problem (\$105,000) projects is the highest among all regions. Average supervision budget Bank-wide in FY06 is \$112,000 and \$90,000 for problem and non-problem projects, respectively, showing less differentiation in supervision effort between the two categories. More modest increases in budgets for problem projects can also be found in SAR, EAP and ECA. Recently-approved project restructuring procedures will further improve incentives, lower procedural constraints, and encourage more flexibility during implementation.

3.30 Based on QSA findings and IEG's exit ratings, a more realistic estimate of *Projects-at-Risk* is likely to be about 25 percent, significantly higher than the 14 percent level reported in FY06. This level is consistent with the reported unsatisfactory outcomes of 22 percent in FY03-06. The current *Projects-at-Risk* system, therefore, needs recalibration so that it can provide a more realistic estimate of the share of the portfolio that is at risk of not achieving the development objectives.

3.31 Mindful of the increased distortions in the measurement of portfolio performance, QAG commissioned a special review of the projects at-risk system, and subsequently undertook further analysis to evaluate the impact of changes in the methodology for estimating portfolio riskiness and realism of project ratings.¹³ The review recognized that the existing *Projects-at-Risk* system is not producing realistic results in the absence of adequate incentives for more candid reporting and increased managerial attention.

3.32 **Revise the Realism Index.** Further strengthening of efforts to inculcate greater candor in performance ratings could be achieved by intensifying Senior Management attention to this issue; and improving incentives for recognizing implementation risks and increasing candor in the ISR ratings. Based on the findings from the latest review, the ARPP recommends revising the current *Realism Index* to make it a more meaningful measure of the quality of portfolio reporting, to simplify its calculation and to make it more robust. The revised *Realism Index*¹⁴ will link it directly to actual recent outcomes reported by IEG thereby making it more dependent on actual outcomes. It will be calculated as the ratio of the number of problem projects recognized by staff and managers to the level of IEG's outcomes that are below the line in the most recent three years (equivalent to about 1,000 evaluations), on a rolling basis. While there is remarkable persistence in IEG's ratings on a country and sector basis, it is recognized that in some cases rapid improvement in outcomes can

¹³ "Review of the Risk Flag System," by Marc Blanc, Nidhi Khattri, Joshua Wimpey, and Irina Tratch, July 2006; and "Improving Portfolio Management, Proposed Changes in the At-Risk Flag System," QAG, August 27, 2006.

¹⁴ Currently, the *Realism Index* is calculated as a ratio of actual problem projects to total number of projects at risk (sum of actual problem projects and potential problem projects) (see Annex 2).

occur. Accordingly, if regions provide sufficient justification, OPCS can agree to override historic performance data and to introduce an alternative expected risk measure (e.g., by relying on the last year's IEG ratings rather than the three year average). Applying the proposed modification will result in an initial lowering of the end FY06 index from 80 percent to 50 percent as shown in Table 3.5. EAP and MNA among the Regions, and Environment and Urban Development among Sectors would experience the greatest change. In contrast, the change for LCR, Transport, and Social Protection is likely to be quite minimal. The target for the *Realism Index* would be retained at the 70+ percent level. In order to improve the index Bank-wide, some 70 additional projects (or about 5% of the portfolio) would have to be classified as Problem Projects. Depending on the impact of this change, other portfolio indicators may also need to be revisited in the coming year.

TABLE 3.5: COMPARISON OF CURRENT AND PROPOSED REALISM INDEX (AS OF JULY 1, 2006)

	Active Portfolio		Latest 1,000 IEG Evaluations		% Realism Index		
	No. of Projects (A)	% Problem Projects (B)	No. of Evaluations (C)	% Unsat. Outcomes (D)	Current (E)	Proposed [(B/D)*100]	
REGION							
AFR	371	15	253	30	72	50	
EAP	229	6	144	22	93	26	
ECA	315	9	220	15	90	59	
LCR	289	13	200	19	81	71	
MNA	110	9	96	24	100	38	
SAR	151	10	87	21	79	48	
OTH	3	0	0	NA	NA	NA	
NETWORK							
ESSD							
Environment	130	6	58	29	67	21	
Rural Sector	247	9	155	17	85	51	
Social Development	28	18	10	30	71	60	
Sub Total	405	9	223	21	78	41	
FSE	53	8	42	17	80	45	
HDN							
Education	136	9	98	17	67	51	
HNP	152	18	74	35	82	52	
Social Protection	67	16	71	21	92	78	
Sub Total	355	14	243	24	80	60	
INF							
Energy and Mining	133	11	64	25	94	45	
Global Information/Comm. Tech.	12	17	8	0	100	NA	
Transport	152	9	88	11	81	75	
Urban Development	77	5	57	19	57	27	
Water Supply & Sanitn	99	14	46	22	88	65	
Sub Total	473	10	263	18	84	57	
PREM							
Economic Policy	19	26	68	19	83	100	
Poverty Reduction	6	0	11	0	NA	NA	
Public Sector Gov	97	11	93	27	85	42	
Sub Total	122	13	172	22	84	59	
PSDN							
	60	10	57	39	67	26	
TOTAL	1,468	11	1,000	22	80	50	

CONCLUSIONS AND RECOMMENDATIONS

3.33 The conclusions and recommendations are:

- **Quality at Entry and Supervision.** Address the areas of weakness and missed opportunities during project appraisal and supervision;
- **Realism Index.** Modify the current *Realism Index*, basing it on recent IEG evaluations, to make it more robust and less susceptible to under reporting of risk. In case the regions feel that major changes in country conditions require exceptions, they can be agreed to following a review by OPCS; and
- Strengthening **accountabilities** of teams and managers and examining how to achieve greater realism in portfolio reporting.

IV. ANALYTIC AND ADVISORY ACTIVITIES

4.1 Analytic and Advisory Activities (AAA) are a key component of the Bank's tool-kit for promoting economic development and reducing poverty among its clients. They provide the basis for the Bank's policy dialogue with clients, the development of country assistance strategies, and the design of effective lending programs. They are also important for building institutional capacity and promoting aid coordination and harmonization among the donor community. During FY06, the Bank spent (both from its own budget and TFs) a total of \$222 million on AAA, with almost 30 percent of the Regional country services budgets being devoted to these activities.

4.2 AAA expenditures have risen over the past five years resulting in a significant increase in outputs delivered to the clients, reflecting a conscious management decision to strengthen and deepen the AAA program. Various assessments of AAA quality also suggest steady improvement in their relevance and likely impact with over 90 percent of the AAA work now rated Satisfactory. However, there is scope for greater likely impact through more attention to dialogue and dissemination. Despite major efforts over the past few years in strengthening the planning, tracking and managing of the AAA program, these areas remain a cause for concern with potential for significant further gains in efficiency and effectiveness of resources used for AAA. This Chapter presents a stock taking of AAA activities in terms of expenditures and deliveries, and a review of activities by client and Networks/Sector Boards. The Chapter concludes with a discussion of key issues and related recommendations.

TRENDS IN AAA EXPENDITURES AND DELIVERIES

4.3 **Overall Expenditures and Deliveries.** As shown in Table 4.1(A), overall AAA expenditures have grown from \$143 million in FY02 to \$222 million in FY06--an increase of 55 percent in nominal terms and 31 percent in real terms. Seen in the context of a stable Bank budget overall for the past few years, the trend in AAA expenditures is indicative of the increasing importance of "knowledge" activities in the Bank's assistance programs. During this period, expenditures and deliveries of AAA products experienced a sharp increase between FY02 and FY03 and a modest decline between FY05 and FY06. Two factors contributed to the initial increase. First, responding to perceived gaps in the availability of basic building blocks of analytical work, special priority was attached by Management to increasing the stock of ESW reports, especially diagnostic work. These products account for slightly more than half the increase in deliveries and even a greater percentage of the increase in expenditures. Second, starting in FY03, Network anchor deliveries were formally brought under the AAA governance framework, adding about 120 deliveries for that year.

TABLE 4.1A: AAA PROGRAM BY COST (\$M) (BANK-WIDE)

	FY02	FY03	FY04	FY05	FY06
A. Tasks in Progress at the Beginning of the Year	108 (100%)	142 (131%)	163 (151%)	183 (169%)	184 (170%)
B. Total Expenses in FY	143 (100%)	168 (117%)	189 (132%)	200 (140%)	222 (155%)
C. Tasks Delivered in FY	92 (100%)	129 (140%)	139 (152%)	166 (180%)	163 (177%)
D. Tasks Dropped in FY ^{a/}	7 (100%)	7 (96%)	16 (212%)	18 (251%)	24 (327%)
E. Expenses of Tasks Delivered in Previous FYs	10 (100%)	11 (108%)	14 (144%)	14 (141%)	19 (194%)
F. Tasks in Progress at the End of the Year (A+B-C-D-E)	142 (100%)	163 (115%)	183 (129%)	184 (130%)	200 (141%)

TABLE 4.1 B: AAA PROGRAM BY NO. OF TASKS (BANK-WIDE)

	FY02	FY03	FY04	FY05	FY06
A. Tasks in Progress at the Beginning of the Year	787 (100%)	1,065 (135%)	1,256 (160%)	1,222 (155%)	1,087 (138%)
B. Tasks Initiated in FY	1,164 (100%)	1,399 (120%)	1,340 (115%)	1,179 (101%)	1,087 (93%)
C. Tasks Delivered in FY	725 (100%)	1,065 (147%)	1,037 (143%)	1,045 (144%)	908 (125%)
D. Tasks Dropped in FY ^{a/}	161 (100%)	143 (89%)	337 (209%)	269 (167%)	193 (120%)
E. Tasks in Progress at the End of the Year (A+B-C-D)	1,065 (100%)	1,256 (118%)	1,222 (115%)	1,087 (102%)	1,073 (101%)

^{a/} Dropped AAA tasks that were dropped in FY07 are treated as Dropped in the fiscal year in which the last expense took place. Data as of January 17, 2007 represents partial cleanup of AAA program. The figures in brackets denote trends in AAA using FY02=100%. FY02 is used as base year since this is the first year for which comparable data is available for such analysis. Costs include both BB and TF.

4.4 Three factors account for the decline in deliveries between FY05 and FY06. The more important one (accounting for more than half the decline) reflects the Regions' drive to adopt a more programmatic approach by consolidating tasks to optimize resources, improve Management oversight, and prevent fragmentation of nonlending activities. These efforts, in turn, help explain the more modest decline in expenditures for delivered tasks. Reduction in the number of diagnostic reports (para. 4.12) is the second factor contributing to the decline. The third factor was tighter

management of the task codes through the introduction of the TA governance framework.¹⁵ These figures need to be treated with care, however, since as indicated in para. 4.24, some of the changes are simply due to inappropriate coding¹⁶ or reporting of AAA activities.

4.5 Along with the increase in AAA expenditures, there has also been a modest rise in average unit cost, which at about \$186,000 per delivered task is now about 10 percent higher in (real terms) than in FY02 (Statistical Appendix, Table 4.10). This increase may reflect the added cost linked to the increasingly participatory nature of AAA work and to greater efforts at the consolidation of tasks noted above, at coordination with other partners, and more attention to dissemination. Three other noteworthy trends are the increase in post delivery expenditures (i.e., those associated with tasks delivered in the previous year), the increase in the number of and expenditures for dropped tasks, and the leveling of the number of tasks in progress. These aspects are discussed below.

4.6 **Post Delivery Expenditures.** These expenditures fund various activities occurring after delivery of a task to the client (e.g., output finalization, translation of documents, dissemination of findings, and in some instances, further field visits). Expenditures for dissemination (for the purpose of this analysis, they are equated with those for post delivery) are currently \$19 million, or nearly double the FY02 level. This increased focus on dissemination is a welcome development and response to earlier ARPP recommendation. However, the data should be interpreted with caution. Some dissemination activities occur prior to task delivery (i.e., they appear under the line item for tasks delivered in the fiscal year); large expenditures have been entered in the system several years after task client delivery, raising doubts as to whether they were dissemination activities; and some tasks may have required further work for completion, thus overstating the resources going into dissemination. Given that post delivery expenditures are now a significant share of AAA expenditures, and the data reliability issues, better monitoring of these expenditures, as well as of their likely impact and effectiveness is recommended. Future AAA assessments should include a review of post delivery expenditures. Dissemination aspects are further discussed in paragraphs 4.18, 4.24 and 4.26.

4.7 **Dropped Tasks.** The Bank has generally encouraged the dropping or cancellation of activities (ESW, TA or lending) if they encounter insurmountable difficulties which would prevent them from achieving the desired results. As shown in Table 4.1(A), the cost of dropped AAA activities increased from \$7 million in FY02 to \$24 million in FY06. Over the past three years, some 800 tasks (about a quarter of all AAA tasks initiated) with an aggregate cost of about \$60 million have been reported as dropped. Disaggregation of the data on dropped tasks suggests the problem to be more acute in AFR, for Global and Regional AAA, and for TA. Contrary to good management practices, many dropped tasks also seem to carry a high price tag (average of \$125,000 in FY06) suggesting that they are being dropped too late in the task cycle.

¹⁵ Starting in FY05, certain ESW and TA output types (e.g., Consultations/Country Dialogue and Conferences/Workshops) were reclassified into TA while other ESW and TA activities were reclassified into product lines outside the AAA umbrella.

¹⁶ The word “coding” refers to the selection of a product line. Inappropriate coding or miscoding refers to the selection of an inappropriate product line for a particular activity (e.g., an ESW task is created and then used to fund a project appraisal or supervision activity; a TA task is created to conduct an internal knowledge activity, etc.).

4.8 Caution is needed in interpreting the above findings because of the data quality. It would seem, however, that about one quarter of the costs associated with dropped tasks could be attributed to changes in the Bank's classification of activities as well as the reclassification of AAA activities into other product lines, which means that the expenditures were not totally lost (though the conversion distorts the true cost of activities in the new product lines). Another 20 percent of the costs associated with dropped activities are due to factors such as changes in the CAS or client priorities. The balance or roughly half, which represents 5 percent of AAA expenditures, reflect probably inadequate Management oversight over the initiation, implementation and completion of AAA activities. A priority for the coming year should, therefore, be better management of the AAA program to bring down the volume and cost of dropped tasks. This also points to the need for regular monitoring and for future AAA assessments to review of dropped tasks.

4.9 **Tasks in Progress.** As shown in Table 4.1(B), the stock of tasks in progress at the end of the fiscal year, which had risen sharply in FY03, appears to be stabilizing. There were 1,073 AAA tasks in progress at the end of FY06 with total expenditures of about \$200 million. Between FY02 and FY06, there has been a modest increase in the number of tasks in progress, while expenditures increased by about \$60 million. Among the Regions, AFR had the highest number of AAA tasks in progress (288 tasks), representing 26 percent of the total, and together with EAP these two regions accounted for about 46 percent of AAA tasks in progress. End FY06 work in progress can also be divided into Global and Regional AAA (256 tasks costing \$81 million) and Country AAA (817 tasks costing \$119 million). The relatively high cost already incurred for GRAAA tasks in progress (averaging \$315,000 compared to \$146,000 for Country AAA) is worrisome, suggesting the need for further scrutiny.

AAA DELIVERIES BY OUTPUT TYPE

4.10 During the past couple of years there have been several major changes in the delivery of AAA activities along output types. The most noteworthy changes between FY05 and FY06 were the decline in the delivery of core diagnostic reports, other diagnostic reports, policy notes, and TA products. These changes are discussed in the following paragraphs.

4.11 Delivery of **Core Diagnostic Reports**,¹⁷ which are a sub-set of ESW, declined from 122 in FY04 to 81 in FY06. This was in line with the Bank's decision in 2004 that once gaps in country coverage by core diagnostic products (including CPAR, CFAAA, PER, POR and CEM/DPR) were eliminated, the frequency of such reports would be programmed on a country-by-country basis, depending on the types and level of the Bank engagement and partner country priorities and circumstances, and the availability of relevant knowledge from development partners. Another factor contributing to this decline is the shift toward Integrative Fiduciary Assessments, which integrate in a single activity the work otherwise carried out under stand-alone PERs, CPARs, and CFAAs. This shift may also have contributed to the small increase in unit costs.

TABLE 4.2: MAJOR AAA PRODUCTS (FY02-FY06)

AAA Products	Deliveries (#) ^{a/}					Initiation to Completion Costs (US\$ Million) ^{b/}				
	FY02	FY03	FY04	FY05	FY06	FY02	FY03	FY04	FY05	FY06
ESW Reports	253	443	487	501	472	41	69	82	96	98
Core Diagnostic Reports	87	119	122	90	81	17	26	24	22	21
Other Diagnostic Reports	43	101	123	140	123	6	15	18	22	25
Advisory Reports	123	223	242	271	268	18	28	39	52	52
ESW Policy Notes/Other Products	206	283	247	193	129	18	23	27	36	19
Policy Note	115	153	152	193	129	10	14	16	36	19
Other ^{c/}	91	130	95	NA	NA	8	9	12	NA	NA
All ESW Products	459	726	734	694	601	59	92	109	132	117
TA Output Types										
Client Document Review	17	27	22	21	21	2	5	3	3	2
Institutional Development Plan	61	83	92	90	70	16	15	17	13	17
Knowledge-Sharing Forum	46	78	102	132	77	5	12	14	21	15
Model/Survey	26	22	13	13	11	5	2	2	2	2
"How-To" Guidance	115	129	74	95	128	18	16	9	11	15
All TA Products	265	339	303	351	307	45	50	43	49	52
All AAA Products	724	1,065	1,037	1,045	908	103	141	153	181	168

a/ Delivery means delivery to the client.

b/ Initiation to Completion costs include post-delivery costs. Costs include both BB and TF.

c/ In FY05, most Other ESW output types (e.g., Conferences/Workshops and Consultation/Country Dialogue) were reclassified as TA.

¹⁷ Core diagnostic reports include Poverty Assessments (PORs), CEMs/Development Policy Reviews (DPRs), Public Expenditure Reviews (PERs), Country Procurement Assessment Reports (CPARs), Country Financial Accountability Assessments (CFAAs), and Integrative Fiduciary Assessments (PFs).

4.12 A recent review¹⁸ covering a more restricted universe of diagnostic studies found that at the end of FY06:

- 54 percent of active IDA-eligible countries¹⁹ had five up-to-date core diagnostic products, compared to only 13 percent at the end of FY03, with about 85 percent of active IDA-eligible countries having up-to-date PERs, CFAAs, and CPARs at the end of FY06; and
- There has been a growing tendency, particularly in AFR, to integrate PERs, CFAAs, and CPARs in one task.

Looking forward, for the next several years it is unlikely that there will be major changes in the number of core diagnostic reports prepared by the Regions.

4.13 **Other Diagnostic and Advisory Reports.**²⁰ These two ESW report type categories primarily seek to lay the foundation for sector dialogue and for Bank lending. There has been a slight decline in the number of Other Diagnostic Reports delivered in FY06 and a leveling off in the number of Advisory reports delivered. However, expenditures on these two report types have either remained constant or increased showing a continuation of the earlier trend towards more effort on these customized reports that respond to client demand and less towards core diagnostic reports. This is a welcome development that confirms that customized diagnostic work is not being crowded out by core diagnostic work. This should also limit the risk of gaps in the Bank's sector and macroeconomic knowledge in individual countries.

4.14 **Policy Notes.** Within ESW, a noteworthy change in FY06 was the sharp decline in the number of Policy Notes delivered to the client, which after peaking in FY05, declined by about a third, while expenditures declined by nearly 50 percent. As a result, the share of Policy Notes in total AAA expenditures dropped from 20 percent in FY05 to 11 percent in FY06. The average cost of Policy Notes has increased from \$88,000 in FY02 to \$148,000 in FY06 and appears high given that they are meant to be quick-response, short, focused pieces. By output type (Statistical Appendix, Table 4.12), Policy Notes are among the outputs showing the largest increase in preparation time (four months) compared to FY02. Short, effective Policy Notes of the type initially conceptualized are still being prepared but in some instances there appears to be a clustering of related policy notes into a larger piece, which partly explains the decline in delivery numbers as well as the increase in average cost and preparation time.

4.15 **Technical Assistance.** There was a modest increase in TA deliveries during the period FY02-FY06 with a small increase starting in FY05 following the reclassification of most Other ESW output types as TA. Nevertheless, Table 4.2 shows relative stability in TA delivery during the review

¹⁸ World Bank, IDA 14 Mid-Term Review: ESW Progress, October 2006.

¹⁹ IDA-eligible countries include both IDA and Blend countries.

²⁰ Other Diagnostic reports and Advisory reports are more customized to client demand and provide macroeconomic and sector knowledge. Other Diagnostic reports include Accounting and Auditing Assessments, Corporate Governance Assessments, Country Environmental Analysis, Country Gender Assessments and Education Sector Review to name a few. Advisory reports cover topics such as Commodities, Debt and Creditworthiness, Foreign Trade, Law and Justice, Energy, Infrastructure etc.

period. The most recent QAG assessments of the quality of Technical Assistance²¹ found its quality to be strong and often superior to that of ESW. In particular, the assessments noted that TA was a very valuable knowledge transfer tool that had been used quite effectively by the Bank. The clearer focus and articulation of results of TA was generally found instrumental in making TA effective in achieving its objectives. The assessments found that the strength of TA activities was their strategic relevance in support of the client's development agenda and the quality of dialogue and dissemination associated with them. However, as one assessment found that these tasks were affected by coding issues, several actions have been initiated to improve performance, including the launch of the TA governance framework in FY05.

AAA BY CLIENT

4.16 **Country AAA.** The increased focus on "knowledge" activities has meant a rise in the share of country services allocated to AAA (i.e., the "Country AAA intensity")²² from 24 percent in FY02 to 29 percent in FY06 (Statistical Appendix, Table 4.13). As is to be expected, the intensity varies considerably among Regions and countries. Over the five-year period, MNA has had the highest intensity (34%), in part due to the large Program of Reimbursable TA in the Gulf countries. At only 18 percent, the AAA intensity in LCR is the lowest reflecting stronger capacity for analytical work within the Region but also perhaps a tighter budget envelope for the LCR Region. The AAA intensity was lower for IDA countries (22%) than for the IBRD borrowers (28%) due to the greater perceived priority of lending in the former. Consistent with the agreed LICUS initiative, there has been a rapid increase in AAA expenditures in the LICUS countries with the AAA intensity increasing from 18 percent in FY02 to 30 percent in FY06.

4.17 The AAA program retained a high degree of concentration during the FY02-06 period, with 10 countries accounting for 21 percent of total deliveries and a quarter of all expenditures.²³ Seven of these countries (India, China, Indonesia, Brazil, Vietnam, Pakistan and Philippines) are also countries with large lending portfolios suggesting considerable synergies between the lending and AAA activities. The list also includes, however, two countries (Russia and Thailand) with little or no lending but where AAA is at the heart of the country partnership strategy. Saudi Arabia, with a fully reimbursable TA program, is the remaining country on the list.

4.18 Preliminary results from Phase II of the Country AAA Assessment, currently underway, confirm the Phase I findings reported in the last ARPP and suggest continuing strong performance in terms of analytical quality as well as closer alignment with client development frameworks and CAS objectives. Although the Stage II Country AAA assessment shows some early signs of progress in this area, dissemination continues to need more attention. It needs to be planned and funded as an integral part of task design and management. All too often the Bank is missing opportunities to integrate and disseminate AAA of potential interest to clients. This reduces the potential of the Bank to contribute to development as an agent of change, particularly in the more open political environments that now characterize many clients. More progress is also needed in improving

²¹ Assessment of the quality of Nonlending Technical Assistance delivered to the client in FY04 and the Country AAA assessment of Nonlending Technical Assistance delivered to the client during the period FY02-04.

²² The country intensity is a measure of the relative effort devoted to Country AAA. It is obtained by dividing all AAA expenditures for a given country by all expenditures for country services for that country.

²³ Statistical Appendix, Tables 4.6 and 4.7.

coherence of Country AAA programs and integrating them better with related work by other donors and by the clients themselves. The likely impact at the individual task level is strong, particularly when the Bank facilitates and supports, rather than leads and dominates the policy-making process. However, there is some scope to further improve likely impact through greater management attention, particularly during the task preparation and dissemination stages. Phase II Assessment covering a total of 17 country programs is expected to be completed in April 2007 and full results and recommendations should be available by end FY07.

4.19 Assessing AAA impact is difficult given attribution issues. As part of its AAA assessments QAG assesses the likely impact of each task or country AAA program. The Country AAA assessments identified several AAA programs, whose likely impact was rated highly satisfactory. From the Bank's perspective the common features of these successful AAA programs include: i) strong managerial attention at-entry and during implementation; ii) continuity and quality of staff; iii) strong dialogue and participatory approach to promote government ownership; and iv) adequate budgetary resources. Box 4.1 discusses several such AAA programs. In light of the sizeable Bank resources devoted to AAA, IEG has launched an evaluation that will assess the extent to which AAA has met its stated objectives, and derive findings on how to improve the effectiveness with which AAA products meet their objectives. The evaluation will review the extent to which ESW/TA informs lending, policy, builds analytical capacity, informs/stimulates public debate and influences other donor activities. However, given the enormous difficulties related to attribution, IEG does not intend to evaluate AAA's impact on the development outcomes related to the Millennium Development goals.

Box 4.1: Selected Country AAA Programs with High Likely Impacts

The likely impact of the Vietnam AAA program was found extremely high in particular because it helped improve Vietnamese understanding of the broad requirements of moving towards and managing a market economy. The panel assessing the quality of this AAA program also felt that it is likely to continue to play a significant role in the reform process. The panel noted that the Bank facilitated and supported, rather than led or dominated the policy making process.

The panel assessing the quality of Chile's AAA program found that its likely impact on the client was highly satisfactory. The panel noted that authorities have taken maximum advantage of the Bank's ESW work in all areas of the AAA program to improve policy implementation. As a result the program has had a significant impact in terms of likely revisions to incentive arrangements for regional development and SME development, the establishment of innovative regimes for new initiatives (social protection and rural infrastructure services) and improvements in existing national systems for financial management, procurement and financial supervision. The Panel found that managerial attention had been particularly impressive both at entry and during implementation and that highly qualified staff and consultants had been selected.

The El Salvador AAA program's likely impact was rated highly satisfactory based on actions already taken by the government and the prospect for future actions. The panel felt that this program has made a substantial intellectual contribution to the government's approach to reform and poverty reduction, as well as to the quality of the debate at the level of government ministries and in civil society at large. Key Salvadorian counterparts openly acknowledged this contribution and they and foundations and think-tanks emphasized the need for continued engagement with the Bank. The Panel noted the strong involvement of the Country and PREM teams.

4.20 The MNA Region has had Reimbursable Technical Assistance (RTA) programs in five Gulf countries (Bahrain, Kuwait, Oman, Qatar, and UAE) since 2002 and in the Kingdom of Saudi Arabia since 1975. Both programs are intended to be totally “paid for” and largely demand-driven; are not guided by country assistance or partnership strategies, and were managed in each case by a dedicated unit outside the country-sector organization.

4.21 At the MNA Region’s request, QAG undertook separate Quality Enhancement Reviews (QERs) of these programs in FY06, adopting an approach similar to Country AAA assessments. The main findings of the QERs were that the Programs have been subject to ad hoc programming, and corresponding unpredictability and uncertainty because of the absence of a longer-term framework that defines priorities for undertaking AAA--factors that have contributed to weak internal incentives. The QERs found a measure of ambivalence on the part of Bank Management about the appropriate role for the Bank, the modality of its engagement, the evolution of that engagement over time similar to that of a paid consulting firm. The QERs also noted that the limited contribution of the Programs to capacity development and the growing reservations by the clients about the Programs also contributed to this ambivalence.

4.22 Against this backdrop, the QAG Panel outlined three options for the future of the RTA program--continue along the present lines, scale back the Program, or recast the relationship with the recipient countries to that of a sustained, strategic partner and policy advisor (as with any other client country) versus a “paid, ad-hoc consulting firm.” Following discussions of options within the Bank and with clients, the Region is in the process of implementing the third option.

4.23 **Regional AAA.** While AAA has traditionally been directed to the country level, a growing share of AAA output is Regional in scope. Since FY02, the cost of Regional deliveries has tripled (from \$14 million to \$39 million) compared to a 60 percent (nominal) increase in Country AAA deliveries. In FY06, Regional AAA deliveries amounted to close to one-fifth of the total AAA delivered to the clients in terms of number of tasks and close to a quarter of the total delivery cost.

4.24 Given the growing importance of Regional AAA in the Bank’s work, QAG assessed a sample of such tasks delivered during July 2004 to December 31, 2005. The assessment found the quality of Regional AAA comparable to that of Country AAA. In particular, the likely impact of these tasks was found to be high, above 90 percent. However, the assessment noted some missed opportunities for greater likely impact due to insufficient attention to dialogue and dissemination aspects. In particular, panels found that dissemination strategies at entry were often vague, imprecise, incomplete and that actual dissemination arrangements were often ad hoc and opportunistic, reflecting both a lack of resources and well thought out strategy. Also, opportunities for greater impact were missed as a result of the insufficient engagement of key stakeholders. Panelists identified 13 good practice tasks, including the Shocks & Social Protection in Central America ESW task (Box 4.2) which was rated highly satisfactory. The assessment found that quality was good in ECA, LCR, EAP but was lagging in AFR. Another area in need of improvement is the quality of trust funded tasks where weaknesses were attributed to failure to follow the Bank’s quality assurance mechanisms. The assessment also found that improper coding and reporting of tasks remains an issue, resulting in inflated numbers of Regional AAA tasks and playing a large role in the apparent significant increase in Regional AAA expenditures during the period FY02-06.

**BOX 4.2: SHOCKS AND SOCIAL PROTECTION IN CENTRAL AMERICA
LESSONS FROM THE COFFEE CRISIS**

The Shocks and Social Protection study is part of an ongoing engagement between the Bank and its counterparts in Central America on social protection, comprising both policy dialogue and operational support to governments to extend basic services to their poorest inhabitants and to protect the most vulnerable from the impacts of shocks.

This \$260,000 Economic and Sector work was undertaken in response to requests from several Central American governments for support in understanding the welfare impacts of the coffee crisis--an unprecedented decline in world coffee prices between 1997/98 and 2001/02--and its broader lessons for public policy.

The quality of this task was rated Highly Satisfactory overall. Its strategic relevance was found particularly high given that its objectives were highly supportive of the Bank's advocacy role, of the policy dialogue and provided a strong underpinning to strategy development. Quintessentially demand-driven, it was designed to go beyond a short-term response to a particular crisis and seek to improve the effectiveness of social safety nets in dealing with any kind of shock. The Panel also noted that the quality of the analysis was first rate, the findings persuasively presented, and the quality of the written output excellent.

The Panel rated the task's likely impact as Highly Satisfactory since substantial results had already been achieved less than six months after completion of the task. In Nicaragua, a pilot safety net program embodying the main findings of the work has already been initiated. In El Salvador, a conditional cash transfer program had been launched as the first phase of development of a safety net. The Panel also noted that prospects for achieving further results were good in Honduras and, even though not part of this task, in Panama and possibly Colombia as well.

4.25 **Global AAA.** Since FY02, the cost of reported Global AAA deliveries has tripled (from \$2 million to \$6 million) compared to a 60 percent (nominal) increase in the Country AAA. However, in FY06, Global AAA remained a small share of total AAA.

4.26 QAG assessed a sample of such tasks delivered during July 2004 to December 31, 2005. The assessment found the quality of Global AAA inferior to that of Country AAA but recommended treating this finding with caution as it may be caused by issues with the current classification of Global activities under the ESW and TA product lines. OPCS has since agreed to review the appropriateness of the classification of Global activities under the AAA line of products. The assessment found that some of these global tasks had significant likely impact including the Costs of Compliance with International Agro-Food Standards ESW task (Box 4.3). However, similarly to regional AAA, the assessment found missed opportunities for greater likely impact, due to insufficient attention to dissemination aspects. The assessment found that quality was good in HDN but was lagging in INF. As noted for regional AAA (para. 4.24) above, the quality of trust funded tasks was also found to be weaker.

**BOX 4.3: COSTS OF COMPLIANCE WITH INTERNATIONAL AGRO-FOOD STANDARDS –
A GLOBAL PERSPECTIVE**

This global task was to better define the nature of the agro-food standard challenge facing developing countries in international markets for high-value agricultural products in order to bring about an attitudinal and strategic shift in relation to agro-food standards and trade. Since much of the conventional wisdom held that emerging standards were barriers to trade, and that developing countries had few options to respond, this ESW was to alter this paradigm by instilling or strengthening the notions that developing countries do have room for maneuver in designing policies and strategies to ensure compliance with the standards--and hence, continued international market access and competitiveness.

The Panel concluded that this \$320K task had been Highly Satisfactory overall. In particular, it noted that the strategic relevance of the task was very high because its objectives were highly consistent with the Bank's sector strategies in both rural development and trade. Task timeliness was found very good in the context of the stalled Doha Round of trade negotiations and the increasing recognition by three of the existing world standards making bodies that they did not have the economic competence needed to complement their technical expertise. The quality of the written report was found outstanding, with an excellent summary and well presented recommendations.

Actual dissemination arrangements were found exemplary, including an impressive E-learning program with WBI, a dedicated Trust Fund for mainstreaming, a well-designed and comprehensive website and frequent presentations by the main authors to diverse audiences.

Finally, likely impact was also rated Highly Satisfactory because the task has already had a substantial impact on governments (who have requested Bank assistance in developing strategic visions for using standards to improve national agro-food trade competitiveness or have incorporated strategic analyses related to standards as components in export competitiveness and trade studies), the wider development community, as well as the Bank.

AAA BY NETWORK NETWORKS/SECTOR BOARDS

4.27 There were considerable differences in the number and cost of AAA deliveries by Networks/Sector Boards (Statistical Appendix, Table 4.2) and summarized below:

- **Infrastructure.** After peaking in FY03, deliveries in this Network experienced a decline though expenditures continued to grow and the cost per task this year (\$216,000) is more than double the cost in FY02 (\$105,000). The rapid increase in expenditures of nearly three-fold between FY02 and FY06 was partly in response to the Bank's Infrastructure Initiative aimed at reversing the decline in lending in the Infrastructure sectors. There are sharp year-to-year fluctuations in expenditures for AAA activities among the sectors in this Network but when considered over the last five years, the Urban Sector received the largest share of resources (46%) followed by Energy (23%), WSS (13%), Transport Sectors (9%) and GIC (9%). The data need to be interpreted with care, however, as some of the trends highlighted are possibly driven by the coding practices of INF's Global Programs and Partnerships (GPPs). Some GPP products that had earlier been coded as Knowledge Products are now coded as AAA and City Alliance tends to code their tasks as Bank outputs whereas some GPPs do not.
- **PREM.** Expenditures in this Network have increased gradually over the past five years but with the rate of increase being slower than in other Networks. As a result, although

PREM still has the largest share of AAA deliveries, this percentage has declined from 33 percent of the total in FY02 to 29 percent in FY06. PREM still leads in the delivery of AAA products though the Network's share declined slightly over the period. Economic Policy accounts for nearly half the expenditures in the Network. Poverty Reduction, in line with the Bank's continued emphasis on poverty, saw an increase in expenditures of nearly 50 percent between FY02 and FY06. There was also a sharp increase in expenditures per task to \$247,000, largely reflecting the undertaking of more substantive poverty assessments.

- **ESSD.** Both expenditures and deliveries declined from the FY05 record level. Declines were especially pronounced in the Environment and Social Development sectors, while the Rural Sector registered an increase for the fourth year in a row.
- **Other Networks.** The Financial and Private Sector Development Networks experienced a sharp decline in the number of deliveries though these themes were also addressed in many AAA activities managed by other Networks. As for Human Development, the slight increase in Education and the more pronounced increase in Social Protection more than offset the decline in Health, though it was noted that Health issues (e.g., HIV/AIDS) were frequently taken up in work conducted by other sectors.

KEY ISSUES IN AAA MANAGEMENT

4.28 **Zero Cost Deliveries.** Bank data show that a number of tasks are reported every year as delivered to the client with a zero cost. There are close to 300 such tasks during the review period, of which 32 in FY06. A quick review of the 32 FY06 zero cost deliveries shows that they are overwhelmingly located in the Africa Region (23 out of 32). All Activity Initiation Summaries (AIS) for these tasks were approved by managers although most did not include an estimated task budget. Several AIS indicate that work was indeed carried out and an output delivered to the client although no expenditure was recorded. These anomalies affect data reliability and can be directly traced to poor managerial oversight and weak monitoring of AAA activities.

4.29 **Tracking AAA Programs.** Over the past few years, QAG assessments (most recently of GRAAA) of AAA Quality pointed to numerous errors in task coding and reporting in the Bank's information system. Despite major efforts and significant improvements over the past few years, quality of the data remains a major constraint to effective management and oversight of the Bank AAA programs. Key problems in the management of the AAA information system, which is based on inputs and updates provided by the Task Teams, include:

- Inadequate incentives for accurate reporting including end-of-the year pressures for inflating deliveries and reluctance to report unviable (dropped) tasks in a timely fashion;
- Incomplete monitoring tools to provide management with meaningful summary information in a timely fashion. While the current monitoring system monitors AAA deliveries it does not focus on upstream monitoring of AAA activities (i.e., monitoring entries of new tasks into Bank systems as well as monitoring the implementation of tasks in progress) and cannot identify anomalies in system entries in a timely fashion;

- Poor quality of task level data with reporting responsibilities often assigned to junior staff with limited familiarity of the underlying concepts and without adequate supervision by the TTLs; and
- While progress has been made in defining the ESW and TA product lines, other product lines have not yet been fully defined. This leads to frequent miscoding of activities both within AAA and with other product lines.

4.30 The data deficiencies have meant a need for periodic “clean up” efforts to resolve problems accumulated over a period of time, which are expensive in terms of staff time and efforts and also make it difficult to analyze trends over time. Eliminating the need for such periodic clean ups calls for tighter oversight of the AAA process (e.g., work in progress, slippage, delays in delivering policy notes, coding, reporting and dropped projects) by Regional and Network managers. There is also scope for OPCS, CSR, and ISG to work together with the operations staff to resolve the underlying problems for a more sustainable systemic improvement.

RECOMMENDATIONS

4.31 Considering the short period between approval of the FY05 ARPP recommendations (strengthening management oversight, eliminating delays in AAA delivery, ensuring accurate coding and reporting and better dissemination of results), and the preparation of the present report, the limited progress to-date is understandable. These recommendations, especially the first three, still remain valid. More specifically, given the issues identified in this ARPP, it is recommended that:

- Strengthen managerial oversight and monitoring of the AAA program. The Regions/Networks should clearly define the preferred arrangement for AAA oversight. Specifically, the responsibilities of the Chief Administrative Officer, Chief Economist, and Quality Directors should be clearly defined;
- CSR, in cooperation with Regions/Network Anchors, other concerned units (including QAG as appropriate) and OPCS should identify a set of indicators that would enable effective monitoring and reporting on ESW and TA activities from task initiation through task completion; and
- Future AAA assessments to review dropped tasks as well as post delivery expenditures.

V. RECOMMENDATIONS

A. STATUS OF FY05 ARPP RECOMMENDATIONS

TABLE 5.1: IMPLEMENTATION STATUS

RECOMMENDATION	STATUS
I. STRENGTHENING LENDING AND PORTFOLIO MANAGEMENT	
Improving the Quality-at-Entry of operations in low CPIA countries.	Not Rated QEA8 (covering lending during FY06/07) to assess progress. Results to be reported in the next ARPP.
Improving Candor and Realism of portfolio performance ratings.	Moderately Unsatisfactory Commendable actions have been taken to put in place a system for identifying high risk operations ex-ante. However, QSA findings indicate that candor in portfolio reporting remains a serious issue.
Improving Development Outcomes in lagging sectors (Environment, Health, Private Sector Development and Public Sector).	Not Rated Too early to judge; preliminary results point to limited progress.
Identifying potential weaknesses in current Fiduciary Policies and propose remedial measures.	Satisfactory <ul style="list-style-type: none"> • A strategy paper for Strengthening Bank Group Engagement on Governance and Anticorruption was issued and its implementation is underway; • Measures to strengthen the Bank's Public Financial Management work are in place; and • The INT Department introduced a Voluntary Disclosure Program.
II. ANALYTIC AND ADVISORY ACTIVITIES	
Improving Management Oversight of AAA.	Moderately Satisfactory Quality and relevance of AAA activities is high but concerns remain about effective monitoring and use of AAA resources. In particular, AAA monitoring and oversight between task initiation and delivery is weak and does not permit the identification of anomalies (work in progress, slippage, delays in delivery, coding, and reporting) before formal delivery.
Strengthening AAA Dissemination.	Moderately Satisfactory Attention to dissemination has improved and additional resources are being provided but the likely impact of these efforts remains uncertain.
Controlling Delays in AAA Delivery.	Moderately Satisfactory While AAA delivery overall remains within acceptable limits, slippage (the difference between planned and actual delivery) continues to grow and has now reached about eight months.

III. RESULTS FRAMEWORK	
Training staff on managing for results.	Not rated. To be reported on separately by the Results Secretariat. QSA7 results indicate about half the portfolio still lacks a sound results framework.
Implementing the Results Reporting System.	
Monitoring of CAS implementation.	
OVERALL	Moderately Satisfactory

B. FY06 ARPP RECOMMENDATIONS

As summarized above, there has been only modest progress in follow-up to the recommendations of the last ARPP, reflecting in part the relatively long lead times needed for results in some of the areas. The realism of portfolio risk ratings and the management of the AAA programs, in particular continue to be problematic with significant scope for improvement. Most recommendations made last year still remain valid. The FY06 ARPP includes the following recommendations:

- Include recipient-executed Trust Funds in the Bank's portfolio, and subject them to regular Bank processes and quality assurance mechanisms for tracking and managing the health of the portfolio;
- Give special attention to Repeater and Additional Financing operations, multi-country or regional projects and multi-sector operations in the upcoming assessment of Quality-at-Entry;
- Address the areas of weakness and missed opportunities during project appraisal and supervision;
- Modify the current *realism index* to make it more robust and less susceptible to under-reporting of risk;
- Strengthen accountabilities of teams and managers and examine how to achieve greater realism in portfolio reporting;
- Strengthen managerial oversight to improve tracking and management of the AAA program. The Regions/Networks should clearly define the preferred arrangement for AAA oversight. Specifically, the responsibilities of the Chief Administrative Officer, Chief Economist, and Quality Directors should be clearly defined;
- CSR, in cooperation with Regions/Network Anchors, other concerned units (including QAG as appropriate) and OPCS should identify a set of indicators that

would enable effective monitoring and reporting on ESW and TA activities from task initiation through task completion; and

- Future AAA assessments to review dropped tasks as well as post-delivery expenditures.

Annex 1**THE PORTFOLIO – AN OVERVIEW TABLE**

Fiscal Year	FY01	FY02	FY03	FY04	FY05	FY06
	Net Commitments (\$ M)					
Opening Balance	117,589	108,261	104,577	96,930	94,703	95,479
IBRD	79,761	69,295	64,741	57,336	52,791	54,309
IDA	36,403	37,346	37,860	37,436	39,763	38,902
TF	1,426	1,620	1,976	2,157	2,149	2,267
Approvals in FY	17,508	19,789	18,729	20,353	22,215	23,904
IBRD	10,487	11,452	11,231	11,045	13,334	14,135
IDA	6,764	8,068	7,283	9,035	8,559	9,446
TF	257	270	216	273	322	322
Cancellations in FY ^{a/}	4,652	1,881	3,258	1,792	2,092	1,132
IBRD	4,410	1,557	2,890	1,437	1,588	917
IDA	242	323	368	355	504	215
TF	0	0	0	0	0	0
Exits	22,050	21,682	24,242	20,716	20,081	23,827
IBRD	16,340	14,302	16,499	14,056	10,734	14,419
IDA	5,598	7,252	7,532	6,333	9,021	9,194
TF	112	129	212	327	325	214
Errors in reconciliation ^{b/}	-134	90	1,124	-72	733	769
PORTFOLIO: end-year balance	108,261	104,577	96,930	94,703	95,479	95,194
<i>Real ^{c/}</i>	<i>126,781</i>	<i>124,019</i>	<i>106,930</i>	<i>97,734</i>	<i>98,534</i>	<i>95,194</i>
	Number of Projects					
Opening Balance	1,593	1,561	1,543	1,516	1,466	1,451
IBRD ^{d/}	768	718	680	642	582	567
IDA	737	739	748	753	764	765
TF	88	104	115	121	120	119
Approvals in FY	256	252	258	265	297	301
IBRD ^{d/}	91	96	99	87	116	112
IDA	134	133	141	158	158	167
TF	31	23	18	20	23	22
Exits	284	275	289	319	317	290
IBRD ^{d/}	141	133	138	149	133	125
IDA	133	125	139	147	160	147
TF	10	17	12	23	24	18
Errors in reconciliation	-4	5	4	4	5	6
End-Year Balance ^{b/}	1,561	1,543	1,516	1,466	1,451	1,468

a/ Cancellations represent partial reduction in commitments but do not include commitments for projects that exit in the fiscal year. They therefore reduce commitment amounts but not the number of projects in the portfolio.

b/ End-year balance may not equal opening balance plus approvals minus cancellations and exits due to synchronization errors between systems.

c/ FY06 prices, based on Manufacturers Unit Value (MUV) Index.

d/ The Number of Projects in Business Warehouse for IBRD Source of Funds includes Blend operations.

Annex 2**BASIC PORTFOLIO DEFINITIONS AND DATA SOURCES****PORTFOLIO DEFINITIONS**

1. The portfolio covered by the FY06 ARPP includes all IBRD, IDA, GEF, Montreal Protocol, and Special Financing operations approved through FY06 and excludes those that were completely cancelled and/or closed during the fiscal year. All dollar figures are in nominal terms unless otherwise stated. IBRD/IDA commitment deflators varied by 17 percent between FY01 and FY06. Terms used in reference to the portfolio include:

- ***Portfolio.*** All loans approved through FY06 excluding those which were closed or completely cancelled prior to the end of the fiscal year. The portfolio includes GEF, IBRD, IDA, Montreal Protocol, and Special Financing operations. The portfolio only includes operations that are active at the end of the fiscal year;
- ***Actual Problem Projects.*** Projects for which Implementation Progress is rated unsatisfactory and/or the Development Objectives are rated as unsatisfactory;
- ***Country Client Groupings.*** Countries are grouped according to the level of their income, size, risk and performance for purposes of portfolio trend analysis. IBRD Investment Grade Countries include countries that have high credit ratings. There are presently 29 countries in this group. The LICUS country group (severe and core only) includes 26 countries with low CPIA ratings. China and India, with populations over one billion each, are in individual categories because of their size. The other three groups are IBRD Only, IDA Only, and Blend. They are categorized according to IDA/IBRD eligibility criteria. Country groupings are mutually exclusive. Therefore, the IBRD Only group excludes Investment Grade countries and China. The Blend group excludes India, and the IDA only group excludes LICUS;
- ***Commitments at Risk.*** Commitments at risk of not meeting their development objectives. This includes commitments associated with both actual and potential problem projects;
- ***Country Policy and Institutional Assessment (CPIA).*** The Country Policy and Institutional Assessment is an annual exercise in which country teams provide input to OPCS in order to assess the quality of each borrower's policies and institutions in the areas generally considered to be relevant to economic growth and poverty reduction and effective aid use;
- ***Deflator.*** Where so indicated nominal net commitments have been converted to real terms by using Manufacturers Unit Value (MUV) Index Deflator converted to 2006 \$ by using an index of 1.17 for FY01, 1.19 for FY02, 1.10 for FY03, 1.03 for FY04, and 1.03 for FY05;

- ***Development Objectives (DO).*** The rating of an operation's DO is based on the likelihood of attaining the development objectives set in the Project Appraisal Document or as formally revised during Implementation. This rating may be satisfactory or unsatisfactory and is the responsibility of the Task Team Leader, who must report on it, at least, annually in the *Implementation Status and Results Report*. The DO rating takes into account not only implementation progress, but also other factors such as inappropriate design, unforeseeable adverse economic and financial developments, price fluctuations of project outputs, and changes in government policy;
- ***Disbursement Ratio.*** The ratio of disbursements during the fiscal year to the undisbursed balance at the beginning of the fiscal year, investment operations only;
- ***Implementation Progress (IP).*** The IP rating is based on an overall judgment of implementation performance in relation to the benchmarks in the Project Appraisal Document or as formally revised during implementation. The rating is the responsibility of the Task Team Leader, who reports it generally at least once a year in the ISR;
- ***Net Commitments.*** Total commitments net of cancellations for all projects in the portfolio;
- ***Net Disconnect.*** The difference between the percentage of projects rated as unsatisfactory by IEG and the percentage rated by the Regions in the final ISR as unsatisfactory for achieving their development objectives;
- ***Portfolio Improvement Program (PIP) Country.*** A country designated for intensive portfolio monitoring and supervision. Normally, PIP countries are those with 50 percent plus of projects and/or 35 percent plus of commitments at risk, with more than eight active projects and/or \$250 million in commitments. Once designated for intensive monitoring, graduation to normal status requires evidence of robust and sustainable improvement;
- ***Portfolio Improvement Program (PIP) Project.*** A project with more than \$200 million in commitment at risk;
- ***Potential Problem Projects.*** Projects which are rated satisfactory on IP and DO but have other risk factors historically associated with unsatisfactory outcomes. The criteria to consider projects as potential problem projects are described below in the Section on "Measuring Portfolio Performance;"
- ***Proactivity Index.*** The proportion of projects rated as actual problem projects 12 months earlier that have been upgraded, restructured, suspended, closed, or partially (20% plus) or fully canceled;
- ***Projects-at-Risk.*** Projects at risk of not meeting their development objectives. Projects at risk is the sum of actual problem projects and potential problem projects;

- **Quality-at-Entry Assessment (QEA).** A periodic exercise conducted by QAG to measure the Quality-at-Entry of projects shortly after they are approved by the Board. Quality-at-Entry is a prime determinant of successful development outcomes, and deficiencies in design are difficult to correct during Implementation. The foundations of a project are laid during Preparation, before it enters the portfolio. QEA7 was the last Quality-at-Entry exercise and covered all projects approved by the Board in FY04–FY05;
- **Quality of Supervision Assessment (QSA).** A periodic exercise conducted by QAG to measure the quality of supervision for projects, during a specific period. The Quality of Supervision Assessments are real time reviews of overall supervision performance for the previous two years. The assessment focuses on the quality of the supervision of Bank projects and not on the quality of the projects per se. The most recent exercise, QSA7, covered FY05–FY06; and
- **Realism Index.** The ratio of actual problem projects to total projects at risk.

MEASURING PORTFOLIO PERFORMANCE

2. Experience shows that IP and DO ratings have tended to be over-optimistic when compared to the outcomes ratings that projects are given by IEG upon completion. To address this deficiency, the FY96 ARPP introduced the concept of projects at risk as the basic measure of portfolio performance.

3. Projects at risk include both actual and potential problem projects. Potential problem projects are those that, although rated as satisfactory for both IP and DO, are affected by factors likely to bring about an eventual unsatisfactory outcome. These projects are identified by criteria (“flags”) that take into account not only various aspects of actual implementation experience, but also other relevant factors such as economic management and past portfolio performance in the country. Specifically, potential problem projects are identified as projects exhibiting three or more of the following twelve risk “flags” for investment projects:

- **Legal Covenants.** Any of the Critical Legal Covenants rated "Not Complied with" in the last ISR;
- **Safeguards.** Ratings of MU, U or HU on any Applicable Safeguard Policy in the last ISR;
- **Counterpart Funds.** Counterpart Funding rated MU, U or HU in the last ISR (formerly the Financial Performance Flag);
- **Monitoring and Evaluation (M&E).** Monitoring and Evaluation rated MU, U or HU in the last ISR;
- **Financial Management.** Financial Management rated MU, U or HU in the last ISR;
- **Procurement.** Procurement rated MU, U or HU in the last ISR;

- **Project Management.** Project Management rated MU, U or HU in the last ISR;
- **Long-Term Risk.** Project with IP or DO rated MU, U or HU for any 24 months cumulative during the life of the project. This flag is removed when the project has been rated MS, S, or HS for IP and DO for the previous 24 months;
- **Effectiveness Delay.** Elapsed time between Board approval and effectiveness of more than nine months for investment and more than three months for emergency operations. This flag is turned off three years after Board approval;
- **Disbursement Delay.** Disbursement delay of 24 months or more for investment and 6 months or more for emergency operations. Delay is calculated based on the initial or formally revised disbursement schedule for the project;
- **Country Environment.** Located in a country with weak economic management (CPIA rating of less than 3.0 on a scale of 1 to 6). Once "flagged," the CPIA rating must exceed 3.5 for the flag to be removed. This flag also includes countries which are in a conflict or post-conflict environment; and
- **Country Record.** Located in a country with a net disconnect of 20 percent or more, or where net commitments associated with unsatisfactory projects (as rated by IEG) represent more than 40 percent of commitments for completed projects over the previous five years. In cases where the sample of IEG evaluations is too small, ICR data, data on mature projects, and experience of other donors is used to arrive at a robust conclusion. This flag also captures countries with less than Moderately Satisfactory Country Assistance Evaluation (CAE) ratings by IEG in previous five fiscal years.

4. For Development Policy Lending operations, potential problem projects are identified as projects with two or more of the following seven flags (at least one project specific):

- **Monitoring and Evaluation.** Monitoring and Evaluation rated MU, U or HU in the last ISR;
- **Project Management.** Project Management rated MU, U or HU in the last ISR;
- **Long-term Risk.** Project with IP or DO rated MU, U or HU for any 24 months cumulative during the life of the project. This flag is removed when the project has been rated MS, S or, HS for IP and DO for the previous 24 months;
- **Effectiveness Delay.** Elapsed time between Board approval and effectiveness of more than six months for policy-based lending. This flag is turned off three years after Board approval;
- **Disbursement Delay.** Disbursement delay of 6 months or more for policy-based lending. Delay is calculated based on the initial or formally revised disbursement schedule for the project;

- **Country Environment.** Located in a country with weak economic management (CPIA rating of less than 3.0 on a scale of 1 to 6). Once "flagged", the CPIA must exceed 3.5 for the flag to be removed. This flag also includes countries which are in a conflict or post-conflict environment; and
- **Country Record.** Located in a country with a net disconnect of 20 percent or more, or where net commitments associated with unsatisfactory projects (as rated by IEG) represent more than 40 percent of commitments for completed projects over the previous five years. In cases where the sample of IEG evaluations is too small, ICR data, data on mature projects and experience of other donors is used to arrive at a robust conclusion. This flag also captures countries with less than Moderately Satisfactory CAE ratings by IEG in previous five fiscal years.

5. The at-risk ratings provide a better picture of the current state of the portfolio than IP/DO ratings taken in isolation, because they are more comprehensive and provide an early warning of potential failures and their causes.

6. **Golden Flag.** The projects at risk concept, however, is not perfect. It has been noted that some operations that get flagged as "risky" are subsequently evaluated as Satisfactory because risks have been addressed, and others that are evaluated as unsatisfactory were not captured by the system. To correct for this, the Regions can override the at-risk rating with a thirteenth flag first introduced in FY97--the "Golden Flag." In each of the fiscal years from FY03–06, approximately one percent of the portfolio had the golden flag. A Golden Flag for a project is turned off if the project becomes unsatisfactory for IP or DO, or the total number of at risk flags for that project goes below three for investment and below two for policy-based lending operations. If the project subsequently gets three or more at-risk flags for investment and two or more for policy-based lending operations, a new request and justification for a Golden Flag is required.

DATA SOURCES

7. Data for the ARPP Report and Statistical Tables are taken from the Bank's Business Warehouse. The ISR ratings used in the ARPP were "frozen" by ISG as of June 30, 2006. Other data sources include the Loan Accounting System for data on disbursements and cancellations.

8. Blend operations include both IDA and IBRD. In the ARPP Statistical Tables, number of projects, portfolio status indicators, IEG outcomes and net disconnect for blend operations are included under IBRD. Commitment amounts, however, are included under IDA and IBRD, respectively.

9. All costs related to AAA in the ARPP Report and Statistical Tables include both Bank Budget (BB) and Trust Fund (TF).

10. LICUS country category in the ARPP Report and Statistical Tables is based on the list of LICUS countries as of July 7, 2006 from LICUS Web site.

PORTFOLIO CLASSIFICATION

11. The portfolio is classified in the ARPP by region, network/sector board, sector, theme and lending instrument.²⁴
12. The “Projects (No.)” column in the Statistical Appendix, Tables 3.11 to 3.18 includes only those projects that are rated by IEG.

²⁴ These classifications are assigned by Task Team Leaders during project preparation. While the classification by Regions is reliable, there are ambiguities and overlaps in the classification by sectors and lending instruments, e.g., projects which belong to the Urban Development sector board may be misclassified by the task team to other sector boards.

PORTFOLIO CLASSIFICATION

A. REGION	B. NETWORK/SECTOR BOARD	C. SECTORS	D. THEMES	E. LENDING INSTRUMENTS
<p>Africa (AFR)</p> <p>East Asia and Pacific (EAP)</p> <p>Europe and Central Asia (ECA)</p> <p>Latin America and the Caribbean (LCR)</p> <p>Middle East and North Africa (MNA)</p> <p>South Asia (SAR)</p> <p>Multi Regional (OTH)</p>	<p><u>ESSD</u></p> <p>Environment</p> <p>Rural Sector</p> <p>Social Development</p> <p><u>FSE</u></p> <p>Finance</p> <p><u>HDN</u></p> <p>Education</p> <p>Health, Nutrition and Population</p> <p>Social Protection</p> <p><u>INF</u></p> <p>Energy and Mining</p> <p>Global Information/Communications</p> <p>Transport</p> <p>Urban Development</p> <p>Water Supply and Sanitation</p> <p><u>PREM</u></p> <p>Economic Policy</p> <p>Gender and Development</p> <p>Poverty Reduction</p> <p>Public Sector Governance</p> <p><u>PSDN</u></p> <p>Private Sector Development</p>	<p><u>Agriculture, Fishing, and Forestry</u></p> <p>General agriculture, fishing and forestry sector</p> <p>Irrigation and drainage</p> <p><u>Education</u></p> <p>Primary education</p> <p>Tertiary education</p> <p><u>Energy and Mining</u></p> <p>Power</p> <p><u>Finance</u></p> <p>Banking</p> <p><u>Health and Other Social Services</u></p> <p>Health</p> <p>Other social services</p> <p><u>Industry and Trade</u></p> <p>General industry and trade sector</p> <p><u>Information and Communications</u></p> <p>Telecommunications</p> <p><u>Law and Justice and Public Administration</u></p> <p>Central government administration</p> <p>Sub-national government administration</p> <p><u>Transportation</u></p> <p>General transportation sector</p> <p>Roads and highways</p> <p><u>Water, Sanitation and Flood Protection</u></p> <p>General water, sanitation and flood protection sector</p> <p>Sewerage Water supply</p>	<p><u>Economic Management</u></p> <p>Macroeconomic management</p> <p><u>Public Sector Governance</u></p> <p>Administrative and civil service reform</p> <p><u>Rule of Law</u></p> <p>Law reform</p> <p>Legal institutions for a market economy</p> <p><u>Financial and Private Sector Development</u></p> <p>Infrastructure services for private sector development</p> <p>Other financial and private sector development</p> <p>Regulation and competition policy</p> <p>State enterprise/bank restructuring and privatization</p> <p><u>Trade and Integration</u></p> <p>Export development and competitiveness</p> <p><u>Social Protection and Risk Management</u></p> <p>Improving labor markets</p> <p><u>Social Dev/Gender/Inclusion</u></p> <p>Participation and civic engagement</p> <p><u>Human Development</u></p> <p>Education for all</p> <p>Health system performance</p> <p><u>Urban Development</u></p> <p>Access to urban services and housing</p> <p>Municipal governance and institution building</p> <p>Other urban development</p> <p><u>Rural Development</u></p> <p>Rural services and infrastructure</p> <p><u>Environment and Natural Resources Management</u></p> <p>Environmental policies and institutions</p> <p>Pollution management and environmental health</p> <p>Water resource management</p>	<p><u>Investment Operations</u></p> <p>Adaptable Program Loan (APL)</p> <p>Emergency Recovery Loan (ERL)</p> <p>Financial Intermediary Loan (FIL)</p> <p>Learning and Innovation Loan (LIL)</p> <p>Sector Investment & Maintenance Loan (SIM)</p> <p>Specific Investment Loan (SIL)</p> <p>Technical Assistance Loan (TAL)</p> <p><u>Development Policy Operations</u></p> <p>Development Policy Lending (DPL)</p> <p>Debt and Debt Service Reduction Loan (DRL)</p> <p>Expanded Co-financing Operation (ECO)</p> <p>Poverty Reduction Support Credit (PRC)</p> <p>Programmatic Structural Adjustment Loan (PSL)</p> <p>Rehabilitation Loan (RIL)</p> <p>Sector Adjustment Loan (SAL)</p> <p>Special Structural Adjustment Lending (SSL)</p> <p>Structural Adjustment Loan (SAL)</p>

COUNTRY CLIENT GROUPINGS

Country Client Groupings	Country	Country Client Groupings	Country
IBRD Investment Grade (IG)	Aruba	IBRD (Continued)	Ecuador
	Bahamas, The		Egypt
	Barbados		Equatorial Guinea
	Botswana		Fiji
	Bulgaria		Finland
	Chile		France
	Croatia		Gabon
	Cyprus		Germany
	Czech Republic		Greece
	El Salvador		Guatemala
	Estonia		Iceland
	Hungary		Iran
	Kazakhstan		Iraq
	Korea, Republic of		Ireland
	Latvia		Israel
	Lithuania		Italy
	Malaysia		Jamaica
	Mauritius		Japan
	Mexico		Jordan
	Namibia		Kuwait
	Poland		Lebanon
	Romania		Libya
	Russian Federation		Luxembourg
	Slovak Republic		Macedonia, FYR of
	Slovenia		Malta
South Africa	Marshall Islands		
Thailand	Micronesia, Federated States of		
Trinidad and Tobago	Morocco		
Tunisia	Netherlands		
CHINA	China		New Zealand
IBRD	Algeria		Norway
	Antigua and Barbuda		Oman
	Argentina		Palau
	Australia		Panama
	Austria		Paraguay
	Bahrain		Peru
	Belarus		Philippines
	Belgium		Portugal
	Belize		Qatar
	Brazil		San Marino
	Brunei Darussalam		Saudi Arabia
	Canada		Seychelles
	Colombia		Singapore
	Costa Rica		Spain
	Denmark		St. Kitts and Nevis
	Dominican Republic		Suriname
			Swaziland
		Sweden	

Country Client Groupings	Country	Country Client Groupings	Country
IBRD (Continued)	Switzerland	IDA (Continued)	Mauritania
	Syrian Arab Republic		Moldova
	Turkey		Mongolia
	Turkmenistan		Mozambique
	Ukraine		Nepal
	United Arab Emirates		Nicaragua
	United Kingdom		Niger
	United States		Nigeria
	Uruguay		Rwanda
	Venezuela		Samoa
INDIA	India		Sao Tome & Principe
Blend	Albania		Senegal
	Azerbaijan		Sierra Leone
	Bolivia		Sri Lanka
	Bosnia-Herzegovina		Tajikistan
	Dominica		Tanzania
	Grenada		Uganda
	Indonesia		Vanuatu
	Pakistan		Vietnam
	PNG		Yemen
	Serbia & Montenegro	Zambia	
	St Lucia		
	St Vincent		
IDA	Armenia		
	Bangladesh		
	Benin		
	Bhutan		
	Burkina Faso		
	Cambodia		
	Cameroon		
	Cape Verde		
	Djibouti		
	Ethiopia		
	Gambia		
	Georgia		
	Ghana		
	Guyana		
	Honduras		
	Kenya		
	Kiribati		
	Kyrgyz Republic		
	Lesotho		
	Madagascar		
	Malawi		
	Maldives		
	Mali		
Mali			

Annex 3**FY07 PIP COUNTRIES AND PIP PROJECTS****PIP COUNTRIES**

Region	Country	No. of Projects	Net Commitment (\$ Million)	Commitment at Risk (\$ Million)	Projects at Risk (%)	Commitment at Risk (%)	FY06 PIP Country
AFR	Chad	7	273	186	71	68	Y
AFR	Eritrea	7	254	164	71	65	Y
AFR	Guinea	9	192	127	33	66	N
AFR	Malawi	10	317	83	30	26	Y
AFR	Niger	9	299	82	33	28	Y
AFR	Nigeria	20	1,843	489	40	27	Y
ECA	Ukraine	12	1,009	260	25	26	Y
ECA	Uzbekistan	5	237	141	60	60	Y
LCR	Argentina	29	3,492	1,330	48	38	Y
LCR	Bolivia	6	266	105	33	40	N
LCR	Dominican Republic	8	304	212	50	70	Y
MNA	Lebanon	6	297	20	17	7	Y
MNA	West Bank and Gaza	8	83	43	50	52	N
SAR	Bangladesh	24	2,052	782	29	38	N
Total		160	10,918	4,027	41	37	
Bank-wide Portfolio		1,468	95,194	11,000	14	12	
% Share of PIP Countries		11	11	37			

PIP PROJECTS

Region	Country	Project Name	Network	Commitment at Risk (\$ Million)	FY06 PIP Project
LCR	Argentina	AR Economic Recovery Support SAL	FSE	500	Y
LCR	Argentina	AR National Highway Asset Management	INF	200	Y
LCR	Mexico	MX: III Basic Health Care Project	HDN	350	Y
SAR	Bangladesh	BD Private Sector Infrastructure Dev	INF	199	Y
SAR	Bangladesh	HNP Sector Program	HDN	300	N
SAR	India	TN Roads	INF	348	N
SAR	India	Mumbai Urban Transport Project	INF	542	N
SAR	India	India Tsunami ERC	INF	465	N
Total				2,904	
Bank-wide Portfolio				11,000	
% Share of PIP Projects				26	