

AFRICAN DEVELOPMENT FUND



**Status Report on
Enhancing Portfolio Management
(Background Paper #2)**

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Executive Summary

The Bank has substantially increased efforts to improve portfolio management. The ratio of problem projects has been contained at 10% of the portfolio, elapsed time between approval and effectiveness has been reduced, the disbursement ratio has been increased marginally and a significant number of projects is in the process of cancellation. On the other hand, the number of projects at risk and the number of aged and non-performing operations that require cancellation remain too high, operations continue to take longer to implement than the anticipated period at appraisal, delays persist in procurement and disbursement processes, and auditing and preparation of project completion reports continues to lag behind schedule. This note provides an update on the status of efforts to date, and summarizes measures being taken to further deepen and strengthen portfolio management and improve operations quality.

The Bank is committed to further enhance and improve portfolio management to ensure effective and efficient use of resources and to achieve more and clearer development effectiveness. Regional Directors, in consultation with the Sector Directors, have assumed responsibility for determining country and regional lending and work programs, and for allocating the budget for the effective execution of annual lending and portfolio management work programs, hence jointly becoming accountable for the delivery of the agreed strategy and for the overall health of the portfolio.

The Bank has made modest progress in efforts to enhance portfolio management and it is committed to step up efforts and provide resources to deliver its programmes in this area during 2007. The Bank will continue to work with RMCs in limiting interventions at the country level to a few sectors, ensuring timely fulfilment of loan conditions, better management of procurement and disbursement activities, stepping up loan cancellations to clean up the portfolio and timely preparation of project audit reports and PCRs. The institutional reforms that are being implemented have placed the Bank in a better position to achieve the targets it has set itself to deepen and enhance portfolio management. The following key objectives and targets have been set for 2007:

- ✓ Prepare the programming tools which include 18 CSPs, 5 JAS and 3 RAS, 118 other Economic and Sector Works, 8 CSP mid-term reviews and 2 CSP completion reports;
- ✓ increase average size of operations to about **UA 24 million** per operation;
- ✓ effectively implement the revised review process;
- ✓ achieve appropriate skills mix in preparation missions;
- ✓ reduce specific loan conditions to **an average of 2 conditions per operation**;
- ✓ finalise IT part of the revision of supervision reporting format;
- ✓ achieve an average of 1.5 supervisions per active operation
- ✓ reduce procurement processing period to **4.4 months** from 9 months;
- ✓ empower country offices under a revised delegation of authority;
- ✓ reduce disbursement application processing time from 15 to **10 days**;
- ✓ raise disbursement ratio from 22% to 25 %.
- ✓ Cancel at least **UA 400 million** non-performing, inactive and aged operations;
- ✓ **Clear** the audit backlog to zero;
- ✓ reduce PCR backlog by undertaking the 65 PCRs

1. Introduction

1.1 A specific programme to improve Bank Group portfolio quality and management, in order to enhance and better demonstrate development effectiveness, was set out in the ADF-X Action Plan prepared in 2004. The action plan provided a framework for implementation of measures to improve portfolio quality and performance, by linking country dialogue and programming with project design, implementation and portfolio evaluation. It was envisaged that successful implementation of the Action Plan would enhance portfolio quality and ensure development effectiveness by reducing the level of non-performing operations to less than 10% of the portfolio.

1.2 Progress in the implementation of the Action Plan has been mixed. Some tangible improvements have been made as follows: (i) the number of problem projects has been reduced and maintained at around 10%; (ii) average age of the portfolio has been reduced to 4.2 years; (iii) the period between project approval and effectiveness has decreased to an average of 12 months; and (iv) disbursement ratio has increased in relation to the amounts of undisbursed loan/grant balances to 22 %, but it remains below the target level of 25%.

1.3 However, progress in some key areas of the action plan remain unsatisfactory: (i) the projects at risk and commitment at risk have remained high at 42% and 38% respectively; (ii) while the number of ageing operations as a ratio of overall portfolio has declined to 11%, the number of aged and non-performing operations that are eligible for cancellation has remained high at around 30%; (iii) projects continue to take longer to implement than anticipated at appraisal; (iv) the number of operations in the portfolio, and therefore the resources intensity of effective supervisions, has remained large due to the small average size of operations; (v) long delays persist in disbursement and procurement processes; and (vi) auditing of Bank projects and preparation of project completion reports have lagged behind schedule.

1.4 The Bank has stepped up its efforts to further enhance and improve portfolio management to ensure effective and efficient use of resources and to achieve development effectiveness. This note provides an update on measures being taken to deepen and strengthen portfolio management and improve operations quality.

2. Measures to Strengthen Portfolio Management

2.1 The key elements of portfolio management being addressed include country dialogue and programming, project start up, implementation (procurement and disbursement process), supervision, audit, reporting, portfolio clean up, collaboration with partners at the country level and project completion.

2.2 **Enhancing Country Dialogue and Programming:** The Bank has made major strides in aligning its Country Strategy Papers (CSPs) with the countries' Poverty Reduction Strategy Papers and National Development Plans, which are aligned to the Millennium Development Goals. Result Based (RB)-CSPs and RB-Logframes, with improved outcome indicators, have been introduced and are in use. These tools have increased selectivity in operational programming, and have ensured better impact, respectively. To ensure complementarity, the Bank coordinates its support and activities with other donors, so that no sectors are neglected. The Bank is also more actively participating in joint analysis and

preparation of Joint Assistance Strategies (JAS) and Regional Assistance Strategies (RAS). In addition, more rigour is being applied to ensure quality-at-entry through thorough and vigorous review of operations formulation documents. In this regard:

- A total of 17 Result Based-CSPs were prepared in 2006, most of them specifying no more than 3 focal areas for operations. In 2007, 18 new CSPs will be prepared; they will be more selective, reducing the number of focal areas to one or two.
- One JAS was prepared in 2006; 5 JAS and 3 RAS will be prepared in 2007 and will be a key vehicle for improved coordination and greater selectivity.
- Emphasis is being placed on managing for results and impact of the RB-CSPs through mid-term reviews and completion reports in line with the Bank's Result Measurement Framework, for both public and private sector operations. In this respect, 8 CSP mid-term reviews and 2 completions assessments will be carried out in 2007.
- Regional Directors, in consultation with the Sector Directors, have assumed responsibility for determining country and regional lending and work programs; they are moving towards responsibility for allocating the budget for the effective execution of annual lending and portfolio management work programs, hence becoming both empowered and accountable for the delivery of the agreed strategy and for the overall health of the portfolio.
- Country and Thematic Teams have been strengthened and empowered through enhanced skills mix and delegation of authority, to enable them to effectively influence the programming, design and management of country portfolios, and in the development of Country Strategy Papers.
- The Bank is increasingly using existing country systems for project management where it has been established that there are adequate institutional capacity and controls to ensure fiduciary safeguards. About 60 percent of operations appraised in 2006 did not propose establishment of parallel PIUs and would be implemented through the government's existing structures.

2.3 **Enhancing Quality-at-Entry:** Central to improving the quality of the Bank portfolio and hence its development effectiveness is quality at entry. Management has put in place mechanisms which are fundamental to enhancing the quality of operations at entry, laying a strong foundation for successful implementation and impact on the ground. These measures include a significantly revised internal review process, establishment of a Senior Management level Operations Committee, introduction and intensive management level review of mission Concept Notes, peer review and revision of the appraisal report format. Project Preparation and Appraisal Missions are being extended and enhanced (i) anchored on country analytical tools such as ESW; and (ii) undertaken with appropriate skills mix to ensure adequate design and preparation of operations, and adequately address cross cutting issues such as environment, gender, poverty and population.

2.4 **Size of Operations:** The large number of small-sized operations, coupled with protracted portfolio implementation, has inflated the Bank's portfolio size and stretched supervision resources too thinly. Management is undertaking stringent measures to ensure design of larger operations. The preparation of the 2007 ADF operation lending program was

closely monitored to ensure selectivity, limiting Bank's new interventions in the few selected areas that are aligned to its current areas of focus and CSPs. The average size of approvals is expected to increase from the current UA 17.3 million per operation to about UA 24 million, thus reducing the number of new operations from 110 in 2006 to 88 in 2007. The enhanced review process, built around stronger and empowered Country Teams, will guide and monitor the implementation of this measure, ensuring that operations prepared for Bank financing are of adequate and cost-effective size. Countries with small allocations of less than UA 10 million will be supported in only one intervention.

2.5 ***Speeding up implementation:*** Substantial reduction in the time it takes operations to be declared effective and hence to commence procurement and disbursement process after approval is essential. Management has made concerted efforts to substantially reduce and simplify loan conditions to ensure their timely fulfilment. The result has been a substantially reduced period between projects' approval and effectiveness. For example, out of 100 operations approved in 2005 and 2006 that have been declared effective, 82% became effective within 12 months of approval or less, against an average of 16 months recorded for operations approved in 2004. Country offices have been instrumental in these achievements as they prompt RMCs to sign and ratify loans, and assist RMCs, where need be, in the fulfilment of specific loan conditions within a reasonable time. Additional gains are expected as the country offices are fully staffed and equipped.

Box 1: Example of Shortened Period from Approval to Loan Effectiveness

The following projects took one month or less to become effective :

1. Fisheries Development Project in Chad for UA 10 million took 14 days;
2. Rural Water Infrastructure Rehabilitation and Extension Project in Burundi for UA 12 million took 1 month ;
3. Nsele - Lufimi and Kwango-Kenge Roads Rehabilitation Project in DRC for UA 52.45 million took 10 days;
4. Support to Secondary Education in Malawi for UA 15 million took 1 month;
5. First Poverty Reduction Budget Support Programme in Madagascar for UA 35 million took 1 month;
6. Support to HIV/AIDS, Malaria & TB for SADC took 1 month

2.6 ***Portfolio Supervision:*** Management has put in place strengthened mechanisms to monitor and enhance portfolio supervision as well as enhance the quality-at-supervision. These include:

- Enhanced staff recruitment which has ensured better staff skills mix for supervision missions, allowing in-depth assessment of project/programme implementation, problems identification and resolution.
- Increased supervision frequency, which enable a supervision rate of 1.3 (missions/project) in 2006 against a target rate of 1.5. The target rate is expected to be attained in 2007 as the size of the portfolio is reduced through rigorous portfolio cleanup and

more active engagement by better staffed field offices. In 2007, about 569 field supervisions and mid-term review missions are scheduled to be undertaken.

- Intensive supervision of problem and potentially problematic projects, targeting at least two supervisions per project per year.
- A Quality of Supervision Assessment is underway to document the quality of the Bank's supervisions and constraints, and propose mitigating measures.
- A programme to systematically alert staff and management when supervision data have not been entered in SAP is under preparation. This will ensure that supervisions undertaken from now onwards are systematically reflected in the Bank's computer system. Training in SAP has been intensified and made mandatory for operational staff, which is issued with competence certificate on completion.

2.7 It is worth pointing out that the average number of operations per task manager in the Bank is 4.3 compared to 0.88 for the World Bank. In addition, one support staff assists four task managers in the Bank, compared to a ratio of 1:1.5 in the World Bank.

2.8 The Bank Group supervision report format has been revised and made a more effective tool to guide portfolio supervision and monitoring, focussing more on results and outputs. The new format will guide staff in the supervision exercise to ensure that:

- risks and factors that most influence project outcomes are adequately identified and effectively monitored;
- Task Managers are more analytical on progress toward achieving development objectives and intermediate outcomes;
- performance of government institutions monitoring the project implementation as well as performance of the Bank in responding to reported problems and requests for "No Objection" are adequately assessed;
- sustainability of the various aspects of the project, management of risks and implementation of Cross-cutting issues (environment, gender, poverty, population and participation) are adequately monitored.

2.9 **Procurement constraints:** Management is determined to reduce considerably delays in the procurement process. The target is to reduce the processing period: (i) for competitive bidding modes of procurement from the current period of 9 months to 4.4 months; (ii) the shortlist mode from 6 months to about 1 month; and (iii) for consultants from 7 months to about 4 months. In order to achieve these targets, procurement procedures have been effectively harmonised with other development partners (subject to Board approval), with the aim of shortening and simplifying the process, and reducing transactions costs. Country procurement systems are being used selectively where there are adequate controls on a case by case basis, and contract amounts eligible for post review increased. Country offices are screening procurement documents on the ground, and guiding the governments' staff in the procurement process. At the institutional level, management has prepared a significant restructuring of the entire Procurement and Financial Management unit, with significantly increased resources and accountability. The delegation of authority is being broadened and

staffing strengthened to give country offices more procurement responsibilities, while enforcing adequate fiduciary controls. The Bank has maintained its vigorous training of government and Project Implementation Unit staff on Bank rules and procedures, procurement and disbursement methods, rules and procedures. Early results are encouraging, with a global reduction of the procurement process period from 13-20 months to the current 9 months.

2.10 ***Disbursement flows:*** Management has set to attain a target disbursement ratio of 25% (expressed as the ratio of disbursements during the year to the undisbursed balance of the Bank's portfolio at the end of the previous year). The undisbursed balance which stood at UA 6.2 billion in December 2006, will be reduced by UA 1.55 billion during 2007 to achieve the target of 25%. Recruitment of staff in the country offices to screen disbursement applications has yielded progress, and the disbursement ratio increased from 18% in 2004 to 25% in 2005, but decreased slightly to the current level of 22%. Additional gains are expected from the ongoing review and streamlining of disbursement processes, aimed at reducing the time for processing disbursement applications. The review is intended to (i) minimize applications referred to Task Managers; (ii) eliminate redundant steps in the disbursement process; (iii) review disbursement approval levels; and (iv) move more towards post review of disbursement documentation. A revised disbursement handbook, simplifying and providing more clarity on disbursement rules and procedures is being finalised.

Box 2: Disbursement Ratios in 2005 and 2006

Source of Finance	Disbursement (UA millions)			Disbursement Ratio (%)		Un-disbursed Balances		
	2004	2005	2006	2005	2006	2004	2005	2006
ADB	630	596	548	39.10%	29.50%	1,524.35	1,857.00	2,030.09
Total Public Sector	508	520	495	35.80%	27.90%	1,449.98	1,775.17	1,946.98
Total Private Sector	122	76	53	101.70%	65.00%	74.37	81.83	83.11
ADF	680	691	685	19.70%	18.00%	3,505.53	3,812.33	4,135.37
NTF	5	3	5	7.00%	10.60%	48.4	51.32	38.36
Bank Group	1,316	1,290	1,239	25.40%	21.70%	5,078.28	5,720.65	6,203.83

2.11 ***Portfolio Clean-up:*** A total of UA 257 million (116 operations) has been identified to be cancelled by end March 2007, and formal consultation procedures are underway. A minimum of an additional UA 200 million will be similarly cancelled by December 2007. The measures that have been put in place to improve the Bank's projects/programmes quality at entry, and to speed up commencement and implementation of projects/programmes, will curb the level of problem projects. To complement these efforts and ensure a healthy portfolio, another major exercise being carried out is to weed out operations already experiencing implementation difficulties, which not only negatively affect portfolio performance, but also tie down scarce resources from more productive investments. The breakdown of cancellations in process by sector and source of finance is presented in box 2 below.

Box 2: Operations Targeted for Immediate Cancellation

Sector		Number	Value
Agriculture:	ADF	41	72,886,066
	ADB	3	2,434,981
Industry - ADF		2	463,175
Multi-sector - ADF		10	40,965,357
Public Utility	ADF	19	37,781,894
	ADB	1	3,108,510
Social		21	28,080,947
Transport	ADF	16	65,751,027
	ADB	1	1,721,317
	NTF	2	4,022,651
Grand Total		116	257,215,925
Total ADF		109	245,928,467
Total ADB		5	7,264,808
Total NTF		2	4,022,651

2.12 Further assessment has established that an additional 114 operations for a commitment value of UA 528 million have either not been signed for more than 180 days, have not disbursed for 2 years or are aged and are therefore eligible for cancellation. RMCs are being strongly advised on the status of these operations and their imminent cancellation unless they are immediately signed or start disbursing. Aged operations which are still active are targeted for partial cancellation, leaving adequate amounts to cover any ongoing contracts. It is thus estimated that an additional UA 200 million will be cancelled by December 2007.

2.13 **Audit Reports:** The Operations Complexes have maintained the momentum on the intensified follow up on the preparation and submission of audit reports, and have targeted to achieve full compliance on submission of audit reports, with zero audit backlog, by December 2007. In 2006, a total of 118 audit reports were registered in SAP against a target of 100 reports. This trend will be maintained, and it is expected that the current backlog of 106 operations will be cleared by the close of 2007. This achievement has been aided by the importance that management has accorded this exercise and stepped up enforcement of the Bank's regulations on non compliance on audit submissions, systematically issuing notices of disbursement suspension on loans with overdue audit reports. Strengthening the financial management capacity of the Procurement and Financial Management Unit as proposed, will substantially improve performance in this critical activity.

2.14 **Project Completion Report (PCR) Backlog:** Clearance of the backlog on preparation of project completion reports has been stepped up and is on track. Management expects to clear about 90% of the backlog by December 2007. The focus is on operations approved since 1995, which can provide more relevant lessons learned. By June 2006, a total of 95 public and private sector operations (excluding studies and institutional support operations) required a PCR. Between June and December 2006, a total of 13 PCRs were prepared and distributed to the Board for information, leaving a backlog of 73 PCRs. An additional 65 operations are scheduled for preparation in 2007, which would reduce the backlog to only 8

PCRs. The importance of this exercise is the lessons drawn which are systematically being incorporated in the formulation of new operations. Lessons learned are therefore being tracked.

2.15 **Disclosure of information:** In line with the Bank's Disclosure Policy, preparation of the documents for disclosure of the status of implementation of Bank Group operations is underway. They will be published on the Bank's website during the year 2007. The disclosure to the public will put into scrutiny the manner in which both the Bank and the governments are discharging their responsibilities in the implementation of projects. It will promote transparency and accountability at the country level.

3. **Summary Status of implementation of Measures to Improve Portfolio Management**

The summary status of implementation of measures to improve portfolio management is presented in the annex. The forward momentum achieved during the second half of 2006 has been maintained and management is on track to deliver in accordance with the set benchmarks.

4. **Way Forward**

4.1 The institutional reforms that are being implemented have placed the Bank in a better position to achieve key targets to enhance portfolio management. The reforms are essential to reposition the Bank as a more dynamic, responsive and flexible knowledge institution with a stronger country focus, higher operational effectiveness and efficiency, and improved selectivity with quality and accountability. Successful implementation of the reforms will thus enhance Bank Group's operational capacity and development effectiveness.

4.2 The Bank has made progress in some areas as discussed above, but significant additional progress is needed. It is committed to step-up efforts and provides resources to achieve the following measures during 2007:

- ✓ Prepare the programming tools which include 18 CSPs, 5 JAS and 3 RAS, 118 other Economic and Sector Works, 8 CSP mid-term reviews and 2 CSP completion reports;
- ✓ Enhance selectivity and increase further the average size of operations to about **UA 24 million** per operation;
- ✓ Rigorous implementation and enforcement of the revised review process;
- ✓ Preparation missions are adequately staffed with appropriate skills mix;
- ✓ Reduce further specific loan conditions to only those that are critical to the implementation of a given project, ensuring that more difficult conditions are fulfilled before approvals;
- ✓ Finalise IT part of the revision of supervision reporting format;
- ✓ achieve an average of 1.5 supervisions per active operation;
- ✓ Finalise the streamlining and simplifying of procurement, reducing the processing period to **4.4 months** from the current 9 months;
- ✓ Revise the delegation of authority to empower country offices to approve procurement of small amounts (pre-determined thresholds) and to screen procurement documents for larger amounts;

- ✓ Finalise the streamlining and simplifying of the disbursement processes, reducing application processing time from 15 to **10 days**, and raise disbursement rate to above **25%**;
- ✓ Adequately staff all field offices in order to be fully involved with procurement and disbursement issues and portfolio supervision;
- ✓ Cancel at least **UA 400 million** worth of non-performing and aged operations by December 2007;
- ✓ **Clear** the audit backlog to zero and ensure systematic follow-up and entry into SAP of audit recommendations;
- ✓ Reduce PCR preparation backlog by **at least 90%**;
- ✓ Post to the Bank website the status of operations under implementation of all active countries by May 2007 and once every year thereafter.

4.3 The Bank is fully committed to ensuring implementation of these measures. It will work with the RMCs in limiting interventions to only a few sectors, ensuring timely fulfilment of loan conditions, speeding up commencement of procurement process and request for disbursements, loan cancellations and auditing of projects' accounts.

Summary Status of implementation of Measures to Improve Portfolio Management

	Indicators	Current Status	Target by December 2007
1	<p><i>Enhance country dialog and programming:</i></p> <ul style="list-style-type: none"> - ensure all Bank CSPs are aligned to the countries' PRSPs - ensure all operations in 2007 are fully aligned with Country Strategy Priorities 	<ul style="list-style-type: none"> - All Bank's RB-CSPs aligned to the countries' PRSPs - Operations going to the Board are aligned to RB-CSPs 	<ul style="list-style-type: none"> - all Bank RB-CSPs continue to be aligned to the countries' PRSPs - Operations approved in 2007 aligned to RB-CSPs
2	<p><i>Enhance quality at entry by:</i></p> <ul style="list-style-type: none"> - ensuring adequate period for preparation and appraisal missions with appropriate skills mix 	<ul style="list-style-type: none"> - Period spent in the field marginally improved to between 10 and 15 days - Staff skills mix still unsatisfactory 	<ul style="list-style-type: none"> - all preparation and appraisal missions spending at least 15 working days in the field - missions undertaken with full complement of skills mix.
3	Increase average size of operations	Operations average size increased to UA 20.61*	- Operations average size increased further to UA 24
4	Reduce further the specific loan conditions to improve operations' implementation start-up	An average of 4 conditions per project	- reduce to only those critical for project implementation **
5	<p><i>Improve portfolio supervision by:</i></p> <ul style="list-style-type: none"> - improving quality of supervision <p>- stepping up supervision frequency of operations</p>	<ul style="list-style-type: none"> - IT part of the revision of the supervision report format underway to be completed by May 2007. - Quality-at-supervision assessment exercise under preparation - Supervision rate at 1.3 per project 	<ul style="list-style-type: none"> - revision of supervision format completed with IT part revised. - Quality-at-supervision assessment exercise undertaken. - target of 1.5 supervisions per project achieved
6	<p><i>Improve on the procurement processes:</i></p> <ul style="list-style-type: none"> - streamline and simplify procurement processes to reduce processing delays and improve procurement performance <p>- Strengthen and empower country offices with adequate staff and resources, and expanded delegation of authority.</p>	<ul style="list-style-type: none"> - Review of procurement process at finalization stage. - ground work being laid on further delegation of authority 	<ul style="list-style-type: none"> -simplified rules and procedures of procurement finalised and in use, reducing processing period for procurement from 9 months to about 4.4 months - adequate powers delegated to country offices which are adequately staffed

Summary Status of implementation of Measures to Improve Portfolio Management (cont'd)

	Indicators	Current Status	Target by December 2007
7	<p><i>Improve the disbursement process:</i></p> <ul style="list-style-type: none"> - reduce disbursement delays - improve disbursement flows and raise the rate of disbursement 	<ul style="list-style-type: none"> - Disbursement processing period stands at 22 days - Disbursement ratio slightly improved to 22% 	<ul style="list-style-type: none"> - Disbursement processing period effectively reduced from 15 to 10 days - Disbursement ratio target of 25% achieved
8	<p>Enhance portfolio clean-up through cancellation of non-performing and aged operations and completed operations</p>	<p>UA 8 million cancelled since December 2007</p>	<p>An additional UA 400 million cancelled</p>
9	<p><i>Ensure all Bank Group operations are audited</i></p> <ul style="list-style-type: none"> - Clear audit backlog - Task Managers systematically transmit to the countries audit recommendation for each audit report submitted and follow-up on their implementation, and the information entered into SAP. 	<ul style="list-style-type: none"> - An audit backlog of 106 to be cleared. - Transmission and follow-up of audit recommendations being systematically carried out and entered in SAP 	<ul style="list-style-type: none"> - Zero audit backlog - Transmission and follow-up of audit recommendations for all audit reports received in the Bank entered in SAP
10	<p>Clear the backlog of Project Completion Reports (PCRs), and generate lessons for incorporation in new operations.</p>	<p>18 PCRs prepared since December 2006</p>	<p>At least 65 PCRs prepared leaving a backlog of only 8</p>
11	<p>Disclosure of information on portfolio implementation</p>	<p>Documents for status of operations under implementation being prepared for publication in the Bank's website.</p>	<p>Status of operations under implementation posted into the Bank's website for active country.</p>

*2006 Approvals

** Essential conditions fulfilled before approval