ADF-11 Deputies Report

11 December 2007
London, United Kingdom

AFRICAN DEVELOPMENT FUND

Acronyms and Abbreviations

ADB	African Development Bank
ADF	African Development Fund
ADF-X or ADF-10	Tenth General Replenishment of the African Development Fund
ADF-11	Eleventh General Replenishment of the African Development Fund
ADI	African Development Institute
AFFM	African Fertilizer Financing Mechanism
APRM	African Peer Review Mechanism
AWF	African Water Facility
APRM	African Peer Review Mechanism
AU	African Union
BWIs	Bretton Woods Institutions
CDP	Country Dialogue Paper
CfA	Commission for Africa
CPA	Country Performance Assessment
CPIA	Country Policy and Institutional Assessment
CSP	Country Strategy Paper
FDI	Foreign Direct Investment
FSF	Fragile State Facility
GDP	Gross Domestic Product
HIPC	Heavily Indebted Poor Countries
ICA	Infrastructure Consortium for Africa
ICF	Investment Climate Facility
ICSP	Interim Country Strategy Paper
IDA	International Development Association
IMF	International Monetary Fund
JAI	Joint Africa Institute
LIC	Low Income Country
MDGs	Millennium Development Goals
MDRI	Multilateral Debt Relief Initiative
MoU	Memorandum of Understanding
MSMEs	Micro, Small and Medium-Scale Enterprises
NEPAD	New Partnership for Africa's Development
NTFG	Nordic Trust Fund for Governance
ODA	Official Development Assistance
PBA	Performance Based Allocation
PBL	Policy-Based Loan
PCCF	Post Conflict Country Facility
PCR	Project Completion Report
PPP	Public–Private Partnership
PRSP	Poverty Reduction Strategy Paper
RBM	Results-Based Management
RISP	Regional Institutional Strategy Paper
RMC	Regional Member Country
RO	Regional Operation
RSP	Regional Strategy Paper
RWSSI	Rural Water Supply and Sanitation Initiative
SPA	Strategic Partnership for Africa
UNECA	United Nations Economic Commission for Africa
WB	World Bank
WPP	Water Partnership Program
WRM	Water Resources Management

Executive Summary

Consultations for the Eleventh Replenishment of the African Development Fund were conducted at a moment of great promise and opportunity for Africa, but also one of great challenge. Africa's recent economic performance has been its best for decades providing thereby the prospects for substantially accelerated and more widely shared development. At the same time, much of Africa remains mired in deep poverty, the social, human and physical infrastructure needed for inclusive growth is inadequate, and numerous fragile and post-conflict countries face immense challenges in moving to a path of durable progress. The coming three years represent a final opportunity to make significant progress towards the MDGs. The multiplication of sources of finance, including vertical and global funds, the private sector, and new sovereign financiers, provides many welcome new opportunities; but it also adds substantial new pressures for improved donor collaboration and coordination, for strengthened regional public financial management capacity, and for increased focus and selectivity on the part of traditional partners such as the ADF in order to ensure delivery of demonstrably superior results.

ADF-10**:** There has been a substantial sharpening in ADF's focus during the past few years, and a clear improvement in its delivery capacity. The Bank is transitioning from a period of financial consolidation to one of comprehensive and ambitious operational reform, built on sharper strategic focus, a reinforced mandate, and a strengthened core emphasis on results. The first phases of this reform have already been completed. They have included a major restructuring, the opening of new country offices, a new management team, streamlined business processes, and greater country focus in operations with resources more clearly allocated to priorities and in response to performance. The result is greater delivery capacity, operational impact, coordination with others, and client focus. Significantly scaled up ADF-10 resources, totaling UA 4 billion, have been fully committed in more focused sectors, with more resources being allocated to better performing countries. Demand for Fund assistance from RMCs and for multinational projects has well surpassed the Fund's financial resources. At the same time, a review of ADF-10 results also confirms the need to intensify and extend efforts to (i) measure and report operational results and instill results-based management throughout the institution; (ii) ensure quality at entry for ADF strategies and operations; (iii) instill a continuous supervision culture; (iv) enhance learning and accountability through evaluation; and (v) improve results through more effective decentralization and harmonization. Specific measures will be adopted in ADF-11 to address these priorities.

ADF as the partner of choice for aid delivery in Africa**:** With its continental mandate, sole focus on African development priorities, unique relationships with African member countries and African institutions, capacity to build productive partnerships across the African development and investor communities and to mobilize finance on a large scale, and the growing confidence of its principal financiers, the ADF is positioning itself as the partner of choice for aid delivery in a more selective set of activities. Through greater focus, improved partnerships and strengthened country presence, the Fund will continue throughout ADF-11 to strengthen its role as a major and reliable actor in its areas of focus and the partner of choice for the development community.

Operational Priorities for ADF-11**:** The Fund will focus on three core and mutually reinforcing operational priorities: infrastructure, governance, and regional integration. These focal areas will be the primary operational paths through which the Fund will deliver prioritized investments in support of: stronger and more inclusive growth; recovery and renewed progress in fragile states; agriculture and rural development; and social and human development. They will also be the principal means through which the Fund will achieve better mainstreaming of critical cross-cutting objectives, especially with respect to gender, environment and climate change.

Resource allocation**:** To reward performance and use development resources most effectively, ADF-11 resources will continue to be allocated predominantly through the PBA framework. In order to increase the predictability, reduce the volatility and simplify the allocation system, Deputies agreed to a revised PBA formula and to five key improvements to the allocation system for ADF-11, based on the review of the PBA implementation to date and the findings of the MDB working group: (i) ADF's PBA exercise will be done at the beginning of each calendar year; (ii) the calculations will use DSF ratings as of January 1 of each operational year; (iii) latest available population data from agreed sources will be held constant over the course of the ADF-11 cycle; (iv) per capita income data will be updated for the annual PBA calculation on the basis of a 3-year moving average; and (v) the Country Portfolio Performance Rating (CPPR) will include only actual problem projects; it will use quarterly data instead of annual data; and it will use a compressed project rating scale.

In addition to the envelope for country PBA allocations, 25% of the ADF-11 replenishment will be set aside for the allocation of resources, in part through PBA linked mechanisms, to fragile states and regional operations respectively.

Regional Operations**:** Deeper regional integration within Africa and between it and the rest of the world is essential to leverage Africa's existing assets and build new opportunities for growth and development. Investing to promote regional integration has been a core priority for the Fund and is an area of substantial unmet demand on the part of its regional member countries. Deputies supported a new strategic framework for regional operations, and agreed on an operational focus on infrastructure, clear eligibility and prioritization criteria for financing, and specific cost-sharing out of beneficiary countries' PBA allocations to ensure country ownership and a link to performance. A specifically designated envelope of 17.5% of the ADF-11 replenishment to support regional operations was agreed.

Fragile States**:** Fragile States pose a particular challenge for Africa and for the ADB. Where countries have made demonstrable progress -- from conflict and decline to stability and growth -- a unique window of opportunity exists for carefully targeted Fund assistance to accelerate the transition process. Deputies supported a special Fund initiative to provide scaled up support to specific post conflict and transitional countries, as well as for deeper Fund engagement in other fragile circumstances. A new Fragile States Facility will provide: (i) incremental resources for a limited period, with clear and strict eligibility criteria, a specific allocation and phasing out mechanism, and monitoring, delivery and exit provisions; (ii) arrears clearance; and (iii) supplementary targeted support for capacity building, knowledge management, etc. The existing Post-Conflict Country Facility (PCCF) will be incorporated into the FSF. The amount of resources allocated to the FSF under the ADF-11 replenishment will be 7.5%.

Development Effectiveness and Managing for Results**:** The Fund is committed to strengthening the implementation of the agenda on Managing for Development Results during ADF-11 in order to achieve better outcomes and report on them more systematically. The ADF will consolidate its action plan around a two-tiered results measurement framework which monitors development effectiveness at the country and regional levels and institutional effectiveness at the agency level. This framework will emphasize measures to *directly strengthen the focus on results on the ground* and the institutional management policies and procedures required to deliver them. It will also focus on reinforcing *the institutional and country incentives and systems that drive implementation of good policies*. Key reforms will be carried out to strengthen the focus on results at all phases of the operations development and delivery cycle, aimed at: i) ensuring quality at entry for ADF strategies and operations; ii) instilling a continuous supervision culture to support implementation; iii) enhancing learning and accountability through evaluation; and iv) improving results on the ground through greater decentralization and harmonization. On this latter point, the Fund has adopted clear targets for monitoring its progress towards implementation of the Paris Declaration objectives.

Compensation for Debt Relief and grant financing**:** Commitments to compensate the Fund for loans cancelled under the MDRI, estimated at UA 1.473 billion during the ADF-11 disbursement period, will be included in the cashflow stream of the Advance Commitment Capacity up to 85% for qualified commitments and 100% for unqualified commitments. The compensation for costs related to ADF-11 grant financing will continue to be addressed using the two pronged approach including an upfront charge on grants for foregone income and a pay-as-you-go mechanism for foregone principal reflows.

Burden sharing, bank transfers**:** Deputies agreed that a large structural gap was not desirable and that a gap of less than 5% would be reasonable to accommodate new donors or additional contributions by donors wishing to increase their burden share or to contribute without increasing their burden share. Bank management will recommend to its Board of Governors that ADB transfers to the Fund be doubled to UA 60 million for the ADF-11 period and will reassess annually the feasibility of transferring additional net income to the Fund. Furthermore, a proposal will be submitted each year to the Board of Governors of the Bank to allocate to the Fund the realized income generated from the clearance of arrears of Fragile States through the FSF, with due consideration given to the financial integrity of the Bank.

***Replenishment Size*:** Deputies agreed on an ADF-11 resources level of UA 5,760,927,837 for the period 2008-2010, which includes (i) a replenishment level of UA 3,697,957,801 comprising donor subscriptions of UA 3,541,351,001 and a 4.235% technical gap and (ii) Advance commitment capacity of UA 2,062,970,035.

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ADF-11 REPLENISHMENT

DEPUTIES REPORT

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1. Introduction

1.1 Consultations regarding the Eleventh Replenishment of the African Development Fund (ADF-11) come at a moment of great promise and opportunity, as well as of great challenge and testing. Africa's economic performance and its prospects for substantially accelerated and more widely shared development have never been more favorable. The traditional providers of development assistance are committed to increasing significantly their support, and highly capable new entrants are making their presence felt on a major scale.

1.2 But, clear progress notwithstanding, the challenge of achieving self-sustaining growth and equitable development in Africa remains largely unmet. Poverty levels are among the world's highest, and human development indicators remain among the lowest, reflecting limited access to clean water and sanitation, energy, education, and capable public services. There is a global consensus – partly captured by the Millennium Development Goals and partly reflecting the growth and development experience elsewhere – that the foundation for greater progress on all of these fronts both can and must be strengthened over the next few years.

1.3 The African Development Fund (ADF) is positioned to make a more substantial and effective contribution to help Africa seize its great opportunities and overcome its great challenges. Under new leadership, the African Development Bank Group has transitioned from a period of consolidation to one of comprehensive and ambitious reform, built on a sharper strategic focus, a reinforced mandate, and a core emphasis on delivering demonstrably superior results. Since its creation in 1973, the Fund has grown substantially in size, stature and capability. The significantly increased envelope of resources provided during the ADF-10 replenishment period (2005-2007) has been allocated selectively, with the bulk going, as intended, to the better performers, and to a more selective range of sectors. The Bank Group has achieved significant delivery on the wide ranging and ambitious targets agreed in the ADF-10 replenishment, and mechanisms for sustained and deepened implementation of reforms have been substantially strengthened.

1.4 With membership spanning Africa and four other Continents, a sole focus on African development priorities, specific mandates from and unique access to other African institutions, the capacity to build productive partnerships across the African development and investor communities, the ability to mobilize finance on a large scale, and the strong confidence of its principal financiers, the Bank Group is the premier African development institution. The Bank is committed to leveraging these unique assets more fully, and earning a position as the development partner of choice in Africa.

1.5 The ADF-11 Replenishment Consultation has served to renew and reinforce the compact between the Fund, its Members, and the African people, and to build a strong consensus around institutional focus and priorities going forward. Consultations included State Participants in the Fund, Participants representing beneficiary countries, observers from multiple other development institutions, and Management and staff of the African Development Bank.[1]

1.6 ADF Deputies reaffirmed their strong partnership with and support for the African Development Bank and Fund, and for a selected set of Fund priorities and commitments for the 2008-2010 period. They agreed on an overall resource level of UA 5,604,321,037

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[1] They held four meetings in Dar Es Salam, Tanzania on 14-15 March 2007; Tunis, Tunisia on 11-12 June 2007; Bamako, Mali on 20-21 September 2007; and London, United Kingdom on 10-11 December 2007. The meetings were chaired by Mr. Sven Sandström. See Annex XI for a list of working documents prepared for these meetings.

excluding technical gap (UA 5,760,927,837 including, corresponding to an increase of 52 percent over ADF-10 resources in order to support the Fund's delivery on the agreed program.

1.7 In response to Deputies' guidance, the Fund made a series of commitments that, while challenging and ambitious, are essential to achieve these expectations: a sharper strategic and operational focus on infrastructure, governance and regional integration; and increased support to Fragile States; with increased emphasis on investing in key drivers of growth and integration; resource allocation to reinforce performance and results; continued internal reforms to strengthen delivery capacity, including more effective decentralization and field presence; rigorous integration of clear performance benchmarks and results monitoring into all activities, including to ensure higher quality at entry and accountability for results across the organization; and, intensified partnerships and harmonization with the wider donor community.

1.8 This report communicates the substance of the consultation on the Eleventh Replenishment of the African Development Fund. It summarizes the directives and guidance provided by Deputies and the commitments made by the Fund for the ADF-11 replenishment period (2008-10). It will serve as the basis for updating the Fund's Policy Guidelines for ADF Operations, which will be submitted for the approval of the Board of Directors together with a Policy Implementation Matrix to guide the operations of the Fund under ADF-11.

2. New Opportunities and Challenges for Africa

Development Challenges and Opportunities

2.1 Africa has always presented a study in contrasts, and perhaps now more so than ever. By many important measures, its economic and governance situation has improved substantially, reflecting improved economic policies and management, improved governance in many countries, favorable cyclical factors such as the strong global economy and high prices for natural resources, the increase in development assistance, especially debt relief, and material improvements in the investment climate and private capital flows.

2.2 Yet poverty remains pervasive, human development indicators remain among the lowest in the world, and far too many people have far too few opportunities to build healthier and more prosperous lives. High levels of exclusion, poor nutrition, gender inequality, high child and maternal mortality, the burden of disease, low rates of educational attainment, and severely inadequate basic infrastructure all remain significant obstacles to sustained, self-generating and inclusive economic and social development. Despite progress in some areas, Africa remains well off-track to achieve the Millennium Development Goals (MDGs).

2.3 Africa is also particularly vulnerable to the still-emerging challenge of climate change, with effects on economic performance, livelihoods of the poor, and key assets including agricultural production and infrastructure. It faces substantial challenges from internal conflict, and in restoring growth and development where conflict has been resolved. It lacks the infrastructure needed to promote trade and private sector development, and economic integration is patchy. Domestic and external resources remain sharply limited relative to the scale of financing needs and the degree of competition across a huge range of priorities. Corruption remains a significant challenge in too many countries and the governance, capacity and institutional underpinnings of capably performing and accountable states require sustained improvement.

2.4 Finally, Africa faces huge resource gaps, both human and financial to meet these challenges and get out of the low equilibrium trap. Savings and investment rates remain very low, and although FDI flows to ADF countries have more than doubled since 2000, they still account for only 3.1% of GDP, and tend to be concentrated in resource-rich countries.

2.5 Thus the overall picture in Africa remains very mixed. Clear and hopeful progress in some important areas has created a stronger foundation for higher sustained growth and human development, there is a greater range of opportunities today than in the past, and the commitment of Africa's development partners has never been greater. But the challenges and needs remain vast and compelling: mobilizing adequate resources, both domestic and external, to meet priority investment needs; ensuring that these resources yield their intended outcomes; supporting an improved policy context for diversification, competitiveness, and growth; promoting gender equality and, unlocking the skills, energy and capacity of Africa's enormous human potential. These are the key challenges to which African governments and their development partners, including the ADF, must step up in the years immediately ahead.

The Evolving Architecture of Development Finance in Africa

2.6 The traditional architecture of development finance in Africa has changed dramatically in just a few years, with increasing fragmentation and complexity. This has major implications for all development partners, traditional and otherwise. Non-traditional public sector investors are a new and rapidly growing presence in many countries which offer significant opportunities while posing substantial challenges for established partnerships. Special purpose vertical public funds are providing large amounts of new finance and considerable delivery capacity in selected areas. New and large-scale benevolent funds are doing the same. Most of Africa's long-standing partners, notably in the G8 and European Union, have pledged an intensified focus on the Continent and in particular to double aid to Africa by 2010.

2.7 These developments, in particular the increasing aid fragmentation, have substantially increased several long-standing challenges for both aid providers and recipients. An effective response will require greater selectivity; for much closer and more effective coordination in areas where institutional capacities and country priorities overlap; increased harmonization, to minimize the burden on limited and overstretched capacity at the country level. We must build longer-term productive partnerships in place of the temporary or opportunistic collaboration that has been more the norm in the past; develop creative new partnerships, especially with those offering a very different mix of skills and instruments, such as the private sector. We must improve the quality at entry of operations so that countries and development partners have clarity as to their purpose, fit and expected impact; increase transparency and knowledge sharing among the different institutions; and manage for results in the context of operations that may involve multiple partners. Substantial and coordinated efforts to meet some of these challenges are underway among most of the traditional partners, and most have made specific commitments, including in the Paris Declaration on Aid Effectiveness.

2.8 For traditionally broad-based development institutions such as the ADF, the challenge of selectivity is fundamental. Huge, unmet demand and compelling needs exist across the development spectrum, and this has been reflected in a portfolio of operations and analytical work across a similarly wide spectrum. But institutional resources and capacities are limited, as they are at the country level, and the demonstrable impact of Fund operations has varied greatly across different sectors. For both the Fund and its RMCs, this compels a review of the choices of the past, and provides a firmer basis for a more strategically selective approach going forward. For example, the social sectors now receive a considerable majority of ODA, while the proportion of these resources directed to infrastructure has declined sharply. Special purpose organizations have moved strongly into sectors such as health. Meanwhile, support for regional integration and multinational projects has traditionally been very limited, even as the demand for such investments has grown dramatically.

2.9 The very significant increase in private capital flows to African countries is another critical element of the emerging new architecture for development finance, but is very concentrated on resource rich countries. Concessional development assistance remains critical for low income African countries. Nonetheless the new pool of investors offers opportunities for creative and catalytic partnerships for African countries and for the Bank. There is today a rich new range of possibilities for the ADB to engage with the private sector in Africa, including in ADF countries, in ways that can substantially advance its core purposes (see section 4.19 on the synergies between the Fund and the private sector).

2.10 All of the key partners active in supporting Africa's development – the RMCs themselves, traditional bilateral and multilateral partners, new entrants including the private sector – are working to adapt effectively to these profound transformations, challenges, and opportunities. As an African institution, working across the continent and with a rapidly increasing private sector portfolio, the ADB has a central role to play. The ADF-11 replenishment is a critical opportunity to underpin the Bank's contribution.

Donors Commitments to Scale up ODA

2.11 The public commitment of the wider donor community to supporting Africa's development has never been stronger or more fully articulated at the highest political levels. In 2005, G8 and other countries committed to double their assistance to Africa by 2010; major additional steps have been taken to cancel debt, particularly with respect to the multilateral institutions; commitments have been made to improve the quality and predictability of assistance and reduce obstacles to its effective use. There is a clear consensus that these additional efforts are necessary to increase both the volume and the impact of development assistance for priority investments; that strengthened performance and government commitment should be reinforced rapidly and predictably; and, that sufficient absorptive capacity exists, despite the many implementation constraints that remain. However, as set out in the 2006 Global Monitoring Report by the World Bank, increased flows to Sub-Saharan Africa have been mainly for debt relief, humanitarian and food aid. Delivering additional new resources to support critical new development investments in country thus largely remains an effort in progress.

3. The Role of ADF in the Aid Architecture in Africa

3.1 The Fund's delivery capacity has been substantially strengthened over the ADF-10 period, due in part to implementation of wide-ranging institutional reforms. Nevertheless, there is a clear need to build further on the progress that has been made, including through additional policy and process improvements and stronger execution in key areas. Strengthened selectivity, country focus, and results-based management all require intensified focus for the Fund to earn a position as the partner of choice for aid delivery in Africa.

Results during ADF-10

3.2 Deputies gave particular emphasis to the need for the Fund to demonstrate development results clearly and convincingly, both with respect to past operations and, especially, to establish a performance framework for the utilization of ADF-11 resources going forward. A review of progress and demonstrable results during the ADF-10 period provided the following broad findings:

- *Country outcomes*: On average, ADF-eligible countries accelerated progress on economic growth, poverty reduction and human development during the ADF-10 period, exceeding past rates of change. To further improve performance under ADF-11, they will need to deepen reform in the areas of governance, investment climate and regional integration.
- *ADF contribution*: The ADF made a significant contribution to country development outcomes in recent years, based on a comprehensive assessment of the outputs and outcomes of operations exiting the portfolio in seven key sectors. Project implementation and achievement of outputs led to measurable changes in peoples' behavior and living standards on a range of indicators within the project zones. However, the review also highlighted that such outputs and outcomes were not systematically measured against objectives and that less than 60% of the projects completed between 2002-2006 were rated satisfactory overall by the Bank.
- *Institutional reforms*: Of the nearly 100 agreed institutional reforms in the Action Plan to Improve the Implementation of Operations during ADF-10, 66% were fully or substantially met, with another 24% partially met. On a narrower set of indicators agreed at the mid-term review, 90% were fully or substantially met. Notable areas of progress include achieving operations staffing targets; establishing 23 field offices; introducing results-based Country Strategy Papers, increasing project supervision

ratios; and reducing the share of problem and at-risk operations. Areas where implementation difficulties and delays were noted include results focus both at the design stage and during implementation and business process reforms. A report on the status of incomplete commitments and proposed actions will be submitted to the Board of Directors in the first quarter of 2008.

3.3 The review also highlighted the need to intensify and extend efforts to: i) ensure quality at entry for ADF strategies and operations; ii) instill a continuous supervision culture; iii) enhance learning and accountability through evaluation; and iv) improve results through greater decentralization and harmonization. Specific measures will be adopted in ADF-11 to address these priorities (see proposals in section 5 below and in Annex V).

Becoming the Partner of Choice for Aid Delivery in Africa

3.4 As a **pan-African development institution** engaged across the continent, the Bank Group has a unique role to play as the voice of Africa vis-à-vis the donor community. It has built strong connections and relationships of trust through partnerships and special mandates. In addition to its regular collaboration with the AU and the UNECA on all major development issues for the Continent, it has been given lead mandates by the NEPAD in Banking and Financial Regulations as well as Corporate Governance, for the implementation of the African Peer Review Mechanism (APRM), and in infrastructure. The Bank also has the mandate to promote regional integration, and is an active contributor to the on-going AU initiative to rationalize Regional Economic Communities.

3.5 **Special Mandates:** In addition to its mandates from African Institutions, the Bank has been mandated by RMCs and donors to manage several major initiatives in the fields of infrastructure, water and sanitation, private sector development, agriculture, capacity building and project cycle activities. Despite some delays in implementation, the Fund is strengthening its capacity, not only in the operational areas of such initiatives but also as a resource mobilizer, administrator of trust funds and in donor coordination.

3.6 **Areas of Expertise:** With more than 40 years of operational experience on the Continent, the Bank has developed particular expertise in a number of areas, including infrastructure, governance and regional integration through regional operations, where it has achieved good results in terms of implementation, risk exposure and transaction costs. The Bank Group has increasingly exploited the substantial synergy and cross-fertilization that exists between its public and private sector operations, and this is clearly an area of particular promise going forward.

3.7 **One-stop shop:** With its integrated structure, the Bank can act as a one-stop shop for its clients in its areas of operations, offering both public and private sector financing, technical assistance, capacity building and knowledge services.

3.8 The Fund is committed to continue and strengthen its adaptation to the new challenges and opportunities of the changing aid architecture, and in doing so to strengthen its relevance and leverage its unique assets. Firstly through greater selectivity: the Fund will continue to sharpen its focus on a limited number of sectors where it can have a demonstrable impact (see section 4.2 below). Secondly, through its greater country presence, the Fund will better define and play its role at the country level, in coordination with its development partners (see section 5.4 below). Thirdly, the role of the Fund relative to its development partners will also be adjusted through the systematic review of, or the development of new partnerships, for a better allocation of responsibilities at the regional, country and sector levels (see Section 5.5 below). A report on the role of the Fund in this evolving aid architecture incorporating the results of consultations with RMCs will be submitted to Deputies at the MTR.

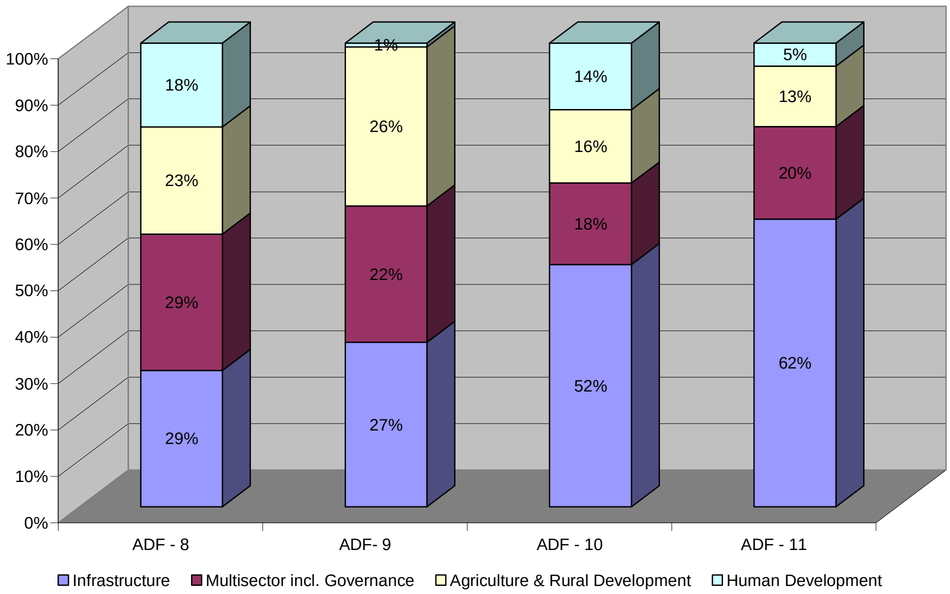
4. Operational Priorities for ADF-11

4.1 Participants supported an enhanced ADF-11 focus on promoting poverty reduction through growth by investing in three core mutually reinforcing operational priorities: infrastructure, governance, and regional integration. These core focal areas will be the primary operational paths through which the Fund will deliver prioritized investments in support of: stronger, more inclusive growth; recovery and renewed progress in fragile states; agriculture and rural development; and social and human development. They will also be the principal means through which the Fund will achieve better mainstreaming of critical cross-cutting objectives, particularly gender issues, environmental sustainability, and climate change. During the first quarter of 2008, the Bank will finalize its Medium Term Strategy for 2008-2012 taking into consideration guidance received during the replenishment consultations.

4.2 In addition to the centrality of performance based allocation, ADF-11's proposed operational priorities embody three key principles:

- *Country ownership*: Relying on clearly defined regional and country priorities reflecting client commitment and demand;
- *Selectivity and results*: Focusing on areas within the ADF core mandate, and where the Fund can effectively deliver demonstrably superior results; and
- *Complementarity and partnership*: Intensifying internal and external coordination to reduce duplication, leverage resources, improve efficiency and ensure that priority country needs are met.

Figure 1 - Sectoral Distribution (by volume) of ADF resources: ADF 8 to ADF-11



Core Operational Priorities

a. Infrastructure

4.3 Infrastructure, broadly defined, is critical for growth, private sector development, increased competitiveness and productivity, and economic integration; for improved access to basic services; and for creating employment opportunities and market development. It contributes directly to the development of other sectors and the achievement of key MDGs; for example, clean water and sanitation, and access to schools and clinics are essential to achieve core health and education objectives.

4.4 Infrastructure activities will be significantly scaled up under ADF-11, with investments focused mainly on energy, transportation, water and sanitation, and ICT as follows:

- *Energy*: Focus on power pools and interconnections, production, transmission and distribution grid projects, cleaner/lower carbon energy sources, including renewable energy;
- *Transport*: Focus on regional transport corridors, rural roads, integrated projects (that incorporate various means of transport), rehabilitation and maintenance programs;
- *Water and sanitation*: Focus on rural water supply and sanitation and the promotion of integrated management of water resources, secondary focus on urban and peri-urban water supply and sanitation as well as small and medium towns;
- *ICT*: focus on priority initiatives reducing the digital divide between countries and regions, and between towns and rural areas.

4.5 The Fund will ensure that adequate funding mechanisms for infrastructure maintenance are put in place and implemented in order to improve the sustainability of the sub-sectors. All infrastructure activities will be pursued in full compliance with the ADB's environmental and social safeguards, enforced through pre-approval due diligence and regular monitoring.

4.6 In addition, there are strong synergies and interdependencies between infrastructure and the other areas of focus of the Fund, such as governance and regional integration. Robust management, regulation and budgetary systems are essential to ensure effective implementation and sustainability of infrastructure investments. The Fund will therefore pay special attention and cooperate with its development partners to support the building of adequate institutions and capacity in infrastructure projects to ensure efficient management of the sub-sectors and projects. Furthermore, bridging the continental infrastructure gap requires a regional approach and the main focus of the Fund's regional operations will therefore be infrastructure.

4.7 Beyond catalytic project finance, by working in partnership with the AU/NEPAD, the Regional Economic Communities and other major donors such as the World Bank, the European Commission and the EU African Infrastructure Fund, the Bank will promote a coordinated and prioritized approach to infrastructure development. It will continue also to provide leadership for initiatives such as the NEPAD Infrastructure Project Preparation Facility, and the Infrastructure Consortium for Africa. The Bank's enhanced focus on facilitating private sector investment in infrastructure also offers strong potential to leverage ADF resources as a catalyst for private investment in ADF countries.

b. Governance

4.8 Governance issues are central and corruption is a major impediment to economic growth and development. Capable states provide the essential context for equitable growth and poverty reduction; for the effective management of public resources; for making and implementing sound policies and building accountable institutions; for private sector development and risk-taking; and, for reliable delivery of essential public services. Governance will therefore be scaled up at the heart of the Fund's work, both as a key component of specific operations and on a stand-alone basis.

4.9 The Bank Group is in the process of adopting new governance strategic directions, which will be submitted to the Boards of Directors for approval in early 2008, together with an action plan. Deputies supported the four proposed pillars of intervention of the Fund in governance and anti-corruption during ADF-11:

- *At the Regional level*: Encouraging and supporting regional initiatives and organizations, promoting regional charters, international best practice standards and codes of good financial governance;
- *At the Country level*: Assisting RMCs in improving the management of public resources, strengthening capacity in the management of natural resources, and

helping to build robust budget and financial control systems, as well as institutions to provide oversight and accountability;

- At the Sector level: Focusing on the prevention of corruption and waste especially in the infrastructure sector through increased capacity building to strengthen country procurement systems; and
- *In Fragile States*: Strengthening capacity, transparency and accountability in financial governance in particular in the management of natural resources.

c. Regional Integration

4.10 Over the past decade, regional integration has been recognized by African organizations and the international donor community as essential to increase competitiveness and productivity, expand trade, pool resources for investment, enlarge local markets, and industrialize efficiently by taking advantage of the scale of production that large markets provide.

4.11 In addition to the socio-economic considerations underpinning the importance of regional integration, and the Bank's expertise in supporting ROs, the case to further scale up ADF support for regional integration is reinforced by the fact that bilateral donors have traditionally given low priority to this area. As a result, the Bank Group has emerged as the one of the lead financiers of ROs in Africa, primarily through the ADF window, accounting for nearly a quarter of all multinational investments in Africa in 2005.

4.12 Deputies agreed that the primary focus of ADF-financed ROs during the ADF-11 period should be on infrastructure projects that promote regional integration, in line with the overall operational priorities of the Fund. There will be an emphasis on optimising synergies between regional infrastructure programmes and development in the agriculture, health and education sectors. Examples include regional energy and transport programmes that would support agro industry and related trade amongst African countries, ICT and energy programmes that would support use of e-services in the health and education sectors, and transboundary water resources management and sanitation programmes that would enhance health sector programmes.

4.13 Scaled up support to ROs will be provided under a new strategic framework to be adopted by the Bank Group in early 2008, the main features of which are described in Annex II. The Framework will, inter alia, seek to promote: (i) country ownership, through basic eligibility requirements that ensure operations are driven by RMC demand and demonstrate strong commitment; (ii) development impact through selected prioritization criteria; and (iii) financing modalities that reinforce the link with country performance and commitment, with the financing of one third of the cost of ROs from the affected RMCs' country allocations, subject to a 10% cap for RMCs with an ADF-11 country allocation below UA 20 million. Selective support may be provided on a case-by-case basis for regional public goods, such as water resources management, environment and climate change, in line with the Fund's operational priorities. The Fund may also support building the capacity of selected regional institutions to promote the regional integration process, and executing agencies in respect of project planning and implementation (e.g. through the NEPAD IPPF). The *Strategic and Operational Framework for Regional Operations* to be considered by the Board of Directors in the first quarter of 2008 will provide a clear definition of regional public goods eligible for limited and selective support out of the RO envelope; such support would be provided on a case by case basis, including as a possibility through grants and without cost-sharing.

4.14 The maximum amount of resources allocable to ROs under ADF-11 in addition to country allocations will be 17.5% of the ADF-11 envelope. A report on the implementation and performance of the regional operations framework, including the implementation of the cost-sharing system, caps for smaller countries, and support to regional public goods will be submitted to Deputies for the ADF-11 Mid-Term Review.

Engagement in Fragile States

4.15 Deputies agreed that the Fund's existing mechanisms to support fragile states have not adequately addressed either the special needs or the emerging opportunities of post-conflict and transition countries. The Bank Group will therefore adopt in 2008 a framework for enhanced engagement in Fragile States (the "Fragile States Framework"), the main principles of which are described in Annex III.

4.16 Under a newly created Fragile States Facility (FSF) scaled up support will be provided to eligible fragile states during the ADF-11 period, under three pillars:

- *Pillar I - supplemental financing*: Incremental resources will be provided to countries in post-crisis/transition situations during a limited period of time, with clear and strict criteria to be met for eligibility to the incremental resources, a specific allocation and phasing out mechanism, and monitoring, delivery and exit provisions;
- *Pillar II – arrears clearance*: A pool of resources will be set aside in a dedicated sub-facility to provide arrears clearance to these eligible post-crisis/transition states;
- *Pillar III – targeted support*: A limited pool of resources will be set aside to allow the Bank to provide supplementary targeted support for capacity building, knowledge management, etc. in a wider range of fragile countries.

4.17 The Bank Group will design the FSF in such a way as to enable donors to make additional voluntary contributions to the Facility.

4.18 In addition, the Bank Group will adapt its business practices and procedures and strengthen its internal capacity, including through staff secondment or presence in selected fragile states, to deliver assistance and measure results in fragile states, while enhancing strategic partnership frameworks with other MDBs, partner agencies and institutions working in fragile states, including the UN.

4.19 The existing Post-Conflict Country Facility (PCCF), through which arrears clearance has been achieved in selected country cases, will be incorporated into the FSF. Additional ADF resources (for ADB arrears clearance) are identified as part of the overall FSF financing envelope. The amount of resources allocated to the FSF under ADF 11 will be 7.5% of ADF-11 resources. The amount to be made available for arrears clearance will be determined within this envelope in accordance with the Framework for Enhanced Engagement in Fragile States to be approved by the Board. The specific operational policies of the FSF with respect to arrears clearance are also set out in Annex III. A report on the operations and performance of the Fragile States Facility will be submitted to Deputies for the ADF-11 Mid-Term Review.

Cross-cutting Themes

a. Synergies Between the Fund and the Private Sector

4.20 There are many synergies between ADF activities and the private sector, first amongst which is the key role played by the core operational priorities of the Fund in the development of the private sector. The Fund's strategy to leverage private sector investment in ADF countries during ADF-11 will focus on the following four priority areas and will be designed for clear development impact, including measurable indicators, and additionality:

(i) *Supporting the foundations of private sector development*: By investing in infrastructure and regional integration;

(ii) *Strengthening the Investment climate*: Through support to macroeconomic, regulatory and financial sector governance reform; stronger anti-corruption frameworks and greater transparency; and encouragement and support to the implementation of the EITI by its RMCs. This includes the transparency and audit to international standards of payments made by the companies concerned, the revenues received by

Governments, and the contributions made by the ADB Group. The Bank's involvement in broad-based initiatives such as the Investment Climate Facility for Africa (ICF) will complement regional, national and project level initiatives;

(iii) *Promoting PPPs*: Through advocacy, technical assistance and finance for the preparation and implementation of Public-Private Partnerships in the infrastructure sector.

(iv) *Facilitating financial intermediation / microfinance*: through the promotion of opportunities for local entrepreneurs both in the informal and formal sectors, including in particular female entrepreneurs and facilitating access to finance and technical support through microfinance programs as project components or stand alone operations financed by the Fund or through the Bank's private sector window.

4.21 CSPs will incorporate Bank Group support to investment climate and private sector operations, including the role of the Bank Group in leveraging private financing or participation, and will contain appropriate private sector development indicators.

b. Agriculture, Natural Resources Management, Social and Human Development

4.22 As indicated above the ADF will continue, through its areas of focus, to make a contribution to development outcomes in these sectors. Particular interventions will be determined by country priorities but also take into account, and complement, investments made by development partners, particularly vertical funds and specialized agencies, to ensure RMC development priorities are covered.

4.23 *Agriculture and Natural Resources Management:* Given the importance of agriculture as a source of livelihoods for Africa's people, growth for its economies, and poverty reduction more broadly, the Fund will continue to provide assistance in selected niches. This could include infrastructure and other targeted operations providing direct benefits to rural communities; and agro-industry development with a special focus on developing public-private partnerships. The selectivity of the Fund's intervention in this sector will be reviewed and adjusted upon finalization of the ADB / IFAD *Joint Evaluation of Agriculture and Rural Development in Africa*. In Natural Resources Management, the Fund will focus primarily on projects that address climate change risk management, for example through strengthening the management of shared natural resources.

4.24 *Social and Human Development:* ADF will provide selective support to develop human capital through strengthened and effective education, health and social protection systems. Primary and secondary educational infrastructure will be strengthened in coordination with partners. The Fund will promote vocational and higher education, science and technology interventions with the objective of developing human capital necessary to achieve economic growth and address diversification of employment opportunities. Using mainly a regional-focus centre of excellence approach, the Fund will support RMCs build their capacity and skills base for global competitiveness. In health, besides continuing to reinforce the health systems, the Fund will also actively strengthen capacity in regional member countries to effectively use increased resources from other donors, in particular from the health vertical programs (such as the Global Fund, the US Emergency Plan for AIDS in Africa, etc.). All human development interventions will promote equity in access to social services, targeting girls and those from geographically disadvantaged areas in particular.

c. Gender, Environment and Climate Change

4.25 *Gender*: Mainstreaming in the Fund's lending and non-lending operations will be further strengthened to promote equitable access for women and men to the benefits of Bank's project activities and to target specific benefits to women wherever possible. To support gender mainstreaming, the Fund will: (i) increase and enhance the use of Gender Profiles, especially joint gender assessments (with the WB and/or other partners in the field); (ii) increase sensitization and incentives of Board, management and staff at all levels to promote and mainstream gender-related issues; (iii) support capacity building for gender-disaggregated data collection and reporting, including in project completion reports, (iv) enhance specialized staff capacity; and (v) ensure more effective prior review of gender issues in individual operational proposals and incorporate appropriate components and monitorable indicators into project design.

4.26 *Environmental Issues*: Environment will also be further mainstreamed in the Fund's lending and non-lending operations to promote the sustainable management of scarce natural resources. The Fund will: (i) increase sensitization and incentives of management and staff at all levels on environmental issues; and (ii) ensure more effective prior review of environmental issues in individual operational proposals and incorporate appropriate components and monitorable indicators into project design. Regular monitoring will be undertaken to ensure full and consistent implementation of environmental and social safeguards.

4.27 *Climate change:* Recognizing the emergence of new challenges from climate change and increasing climate variability, the Fund is actively working with its development partners to finalize its strategy to support RMCs in responding to the climate change challenge. In addition to participating to the joint MDBs study on the climate change agenda, the Fund is developing its response to climate change in a Clean Energy Investment Framework (CEIF), and a Climate Risk Management (CRM) Policy which will be presented to the Board of Directors in 2008 (see Annex IV). These frameworks will recognize that the Bank's assistance will be targeted and will clearly lay out areas for the Bank's intervention through its lending and non-lending program consistent with the Bank core mandate and operational priorities. The Fund will also ensure that its new investments incorporate appropriate design elements and precautions; it will build further on the progress already being made to integrate such specific features into individual operations.

4.28 A detailed review of the capacity and adequacy of Bank Group staffing in gender, environment and climate change will be undertaken in 2008 as part of a wider review of the skills and capacity of the Bank.

d. Knowledge Activities

4.29 The Bank Group will continue to strengthen its knowledge, research and dissemination capacity throughout ADF-11 to provide intellectual leadership on development issues in Africa and to ensure a stronger African voice in international debates on African development, in accordance with a new Strategy for Knowledge Development which will be finalized in the first quarter of 2008 on the basis of the guidance received from the Board of Directors. This strategy will set out the main goals and rationale for knowledge generation, measurement and sharing for the 2008-2010 period.

4.30 It is expected that as part of this strategy, the Bank Group will continue to provide non-lending services to RMCs in the form of policy formulation and dialogue, economic and sector work (ESW), institutional support and capacity building, organization of conferences – including the African Economic Conference - and round tables.

5. Development Effectiveness and Managing for Results

5.1 The Bank Group will further strengthen its implementation of agreed internal reforms to increase its development effectiveness and focus on results, and build further on these efforts in selected critical areas. Top priority will be given to achieving a sharper strategic focus; increased delivery capacity and client focus; better coordination with development partners; adoption and implementation of a comprehensive and substantially strengthened results framework and set of internal processes to deliver it; and, further strengthening of independent evaluation work.

Increased Delivery Capacity and Client Focus

5.2 In 2008, the Bank will complete a comprehensive revision of its business processes, a key set of changes needed to improve project design and quality at entry, project implementation and monitoring and increase accountability at all levels of the organization. Internal process streamlining will substantially increase Bank staff efficiency and effectiveness in project appraisal and procurement oversight, and contribute to improved disbursement rates. The comprehensive reform of internal resource allocation and budget processes approved in 2007 will give managers greater ability to deploy resources according to priorities, as well as greater accountability for delivery and results. The impact of these reforms on Fund operations will be systematically monitored through a strengthened ADF-11 results framework with clear targets for quality at entry, supervision, evaluation, decentralization and harmonization (see Annex V) and through strengthened independent evaluation. The Bank Group will closely monitor the impact of the business process reforms on programming and delivery and propose enhancements during ADF-11. Reports will be presented to the Board of Directors annually and to Deputies at the MTR.

5.3 Furthermore, the Fund will continue to increase its client focus and delivery capacity by strengthening its country presence, and delegating more authority to field offices staff. This strengthened country presence will help in the Bank Group's implementation of the Paris Declaration, in particular for joint analysis, programming, missions, monitoring and evaluation, and in the definition at the country level of the role of the various development partners (see section 5.4 below). The institutional impact of strengthened country presence will be monitored as part of the ADF-11 results framework as well as through independent evaluation studies. An independent/external evaluation of the impact and effectiveness of decentralization, including with respect to its contribution to improved development effectiveness and results, will be prepared and submitted to the Deputies at the MTR.

Coordination, Harmonization and Partnerships

5.4 The Bank Group will continue to strengthen and improve its interaction and collaboration with multilateral and bilateral development partners in order to align better to RMC’s priorities, systems and procedures:

- Strategic Partnerships: With the main multilateral organizations and with key bilateral donors defining areas of cooperation, complementarity, joint work, sharing of knowledge and information;
- At the Regional Level: It will continue to review in a systematic way its long-standing MOUs to assess their continued applicability, and will conclude new MOUs or strategic partnership arrangements which provide specific joint action plans, focused areas of cooperation, and sharing of information and knowledge;
- At the Country Level: Greater country presence will allow the Bank Group to play a much more active and constructive role in the donor community, with a view, under RMC’s leadership, to improve donor partnership, coordination and complementarity, and better define the priorities, posteriorities and division of labor between donors best suited to the development strategy of each RMC. It will increase the number of joint country assistance strategies (JAS) prepared with other donors;
- At the Sector Level: The Bank will increase its joint work with selected development partners around a more limited set of sectors and will intensify efforts to ensure joint products and fully effective harmonization, whenever possible; and
- At the Project Level: The Bank Group will increase its role as a catalyst of other sources of finance, particularly for Regional Operations, and this role will be tracked in the ADF-11 results framework.

5.5 All new or revised partnerships will follow the principles of the Paris Declaration, notably harmonization of procedures and instruments, selectivity of partners and collaboration based on comparative advantages, and results management for maximum impact on poverty reduction. Partnerships will put emphasis on strengthening the coordination and harmonization mechanisms which are crucial for more aid effectiveness. In particular, the Bank Group will fully harmonize its procurement rules, standard bidding documents and practices with those of the World Bank, subject to restrictions related to the rule of origin. Increased attention will also be given to joint evaluation activities. (OPEV will chair the MDBs’ Evaluation Cooperation Group in 2008.) The percentage of support delivered through RMCs procurement and public financial management systems will be increased (see target in section 5.17 below), subject to those systems meeting Bank standards according to the evaluation criteria and processes to be agreed by the Board of Directors.

5.6 Management will submit to the Fund's Board of Directors for consideration a proposal to amend Article 15(4) of the Fund Agreement to permit universal procurement in Fund operations. This is intended, among other things, to remove a substantial obstacle to closer collaboration with development partners through joint operations at the country level.

5.7 In addition, the revised technical cooperation fund framework of the Bank Group, including in particular the use of standardized conditions and the untying of all trust fund resources, should enhance the role and effectiveness of the Bank Group in the administration of third party resources.

Country Strategies and Project Design

5.8 The Fund will continue to use the full range of strategy papers at its disposal in which to set out its medium-term assistance strategy to countries, regions and institutions and provide the justification for the use of ADF resources. The Fund’s strategy papers will be informed by country-owned poverty reduction strategies (PRSs) and regional strategies, as the starting point for defining its interventions, and national/regional development plans. The Fund will incorporate the sectoral and thematic priorities, and the outcome indicators articulated in PRSs and, where appropriate, its own technical analysis and fiduciary assessments as well as those of other development partners, into the design of its own strategy papers. CSPs will include a specific indicative pipeline of all proposed project and policy-based loans and grants showing the results targets identified in the CSP to which each operation will contribute.

5.9 The ADF-11 lending program will focus on operations' designs that are aligned with development effectiveness best practices in order to maximize project benefits and outcomes. The Bank is committed to improve its project and program results frameworks to include specific and quantified results targets with interim progress indicators and referenced against baseline figures. An independent/external evaluation of quality at entry in ADF 11 operations, including results measurement baseline and follow up, will be carried out and submitted to the Deputies for review at the MTR.

Managing for Development Results

5.10 Participants emphasized the need to strengthen implementation of the agenda on Managing for Development Results during ADF-11 in order to achieve better outcomes and report on them more systematically. For reporting purposes, the ADF will consolidate its action plan around a two-tiered results measurement framework which monitors development effectiveness at the country and regional levels and institutional effectiveness at the agency level (see Annex V for summary indicators). This framework will emphasize measures to *directly strengthen the focus on results on the ground*, and the institutional management policies and procedures required to deliver them. It will also focus on reinforcing *the incentives and systems that drive implementation of good policies*.

5.11 <u>Development effectiveness: monitoring and reporting country and project outcomes</u>. The results measurement framework will continue to monitor the progress of ADF-eligible countries on a selected set of development outcome indicators. These indicators will reflect areas of increasing emphasis under ADF-11, particularly governance, regional integration, private sector development, infrastructure provision and new technology. The set of indicators for ADF-10 will be largely retained, with the addition of an indicator to monitor engagement in the *Extractive Industries Transparency Initiative* (EITI) and conversion from the previous public financial management indicator to the broader and internationally-agreed *Public Expenditure and Financial Assessment* (PEFA) framework. The Fund will make efforts to identify relevant, measurable indicators for key priorities such as regional operations (sector specific indicators), fragile states, sanitation, gender, and climate change and make proposals at the MTR, with retroactive calculation of ADF-11 baseline data for those indicators deemed sufficiently robust for inclusion. With greater standardization of output and outcome indicators in key sectors, and improved PCR quality and delivery, project outcomes and impact will be more systematically measured and reported.

5.12 *Institutional Effectiveness: Implementing Results-oriented Reforms.* Key reforms needed to strengthen the focus on results cover all phases of the operations development and delivery cycle, from initial design through implementation to evaluation and feedback. They are aimed at: (i) measuring and reporting operational results and instilling results-based management throughout the institution; (ii) ensuring quality at entry for ADF strategies and operations; (iii) instilling a continuous supervision culture to support implementation; (iv) enhancing learning and accountability through evaluation; and, (v) improving results through more effective decentralization and harmonization. The Bank will make further efforts to incorporate in the institutional effectiveness tier of the results measurement framework suitable indicators to monitor the mainstreaming of cross-cutting issues in Bank operations. Paragraphs 5.13 to 5.16 below elaborate on the reforms that will be carried out and monitored under each block of Tier II of the ADF-11 results measurement framework (see Annex V).

5.13 *Ensuring quality at entry for strategies and operations.* Reform efforts will focus on integrating high-quality results frameworks into Country Strategy Papers and project documents, reviewing logical frameworks during the project concept review, introducing peer review of project design and providing timely technical support to task teams on articulation of the logframe and design of appropriate monitoring and evaluation systems. The provision of baseline data on expected outcomes will be a top priority of the Fund. The Fund will move towards making adequate baseline data a requirement for Board presentation of investment operations (see target in Annex V). Standardized output and outcome indicators will be mandated for key sectors, in order to facilitate comparative and aggregate reporting. The statistical capacity of RMCs will be addressed in country strategies and measures to reduce priority gaps will be proposed in coordination with development partners. The Fund will track and report regularly on its investments in developing statistical capacity.

5.14 *Instilling a continuous supervision culture to support implementation.* Priority will be given to executing regular supervision and making the portfolio management information system easier to use and access. Staff performance incentives and sanctions will be introduced for semi-annual updating of portfolio information, and a more results-based supervision report will be mainstreamed. The movement toward fungible, dollar budgeting, along with deeper staff capacity in field offices, will help eliminate the bias toward missions, and strengthen collaboration between field-based and Tunis-based sector staff. Greater clarity on the delegation of authority to field offices, and a redoubled effort to build procurement and financial management capacity in field offices will allow the gradual transfer of responsibilities to the field for continuous and more effective supervision, improved country dialogue and better harmonization.

5.15 *Enhancing learning and accountability through evaluation.* A key measure to improve the ability of ADF to report on results will be the mandatory completion of supervision reports and project completion reports within one month of supervision mission and six months of project closing respectively, supported by stronger incentives and sanctions. Revised indicators for ADF-11 will capture the timely posting of completion reports, to ensure relevant feedback into on-going strategies and new operations as well as the inclusion of gender-disaggregated data, to promote appropriate focus on gender equality issues. Improving the quality of project supervision and PCR will also be a priority. The Bank will proceed with internal harmonization of rating scales to allow for more consistent ratings of outcomes and performance throughout the project cycle, across sectors and over time. Independent and effective evaluation is critical to enhancing the ADF's ability to learn from experience in order to strengthen policy and operations. OPEV will align key elements of its evaluation program towards ADF priorities and will provide evaluation results in time for the MTR. OPEV evaluations will routinely assess the availability and use of baseline data, the use of common indicators within sectors, and the overall strength of logframes. Furthermore, the Bank will increase OPEV's independence by requiring the Board's concurrence for decisions regarding the appointment and dismissal of the Director of this department. (See Annex VI)

5.16 *Improving results through more effective decentralization and harmonization*. Participants noted with satisfaction that many field offices are now open and operational, but highlighted that field offices need to be adequately staffed with the right skills mix according to the specific operational requirements. Transfer of supervision and decision-making responsibility to the field during ADF-11 should ensure both improved service delivery and quality, and adherence to applicable fiduciary safeguards, Board policies and guidelines. Effective communication with and oversight by responsible central Departments must be ensured. Appropriate changes to policies and practices will be introduced to enable the ADF to be more present in local donor consultation frameworks at the sector and macro-levels, and to allow harmonization in line with Paris Declaration goals. This will allow ADF to better support national strategies and programs, participate in joint missions and analyses, join in pooled funding arrangements, harmonize procurement and financial management procedures, and adopt unified and country-based monitoring and evaluation systems. ADF will report on adherence to all Paris Declaration indicators as part of the MTR.

5.17 *Implementation, Incentives and Reporting on Results*. The Bank will adopt concrete measures to extend and deepen the Fund's results management Framework during ADF-11. These measures, which are further described in the Revised paper on *Results Reporting for ADF-10 and Results Measurement Framework for ADF-11,* include institutional arrangements to manage for results; new incentives and strengthened accountability, as well as improved and more regular reporting on results. The Bank further reconfirms the as-yet unimplemented ADF-10 commitment to post on the web the project implementation progress reports.

Implementation of the Paris Declaration

5.18 The Bank Group has made progress in meeting the objectives of the Paris Declaration (ownership, alignment, harmonization, managing for results, and mutual accountability), but has also met challenges which could delay the Bank's attainment of some of the Paris Declaration targets beyond 2010 (use of country financial management / procurement systems, avoid parallel PIUs, aid is more predictable, joint missions). In order to address those challenges, the Bank Group has adopted the following additional measures and benchmarks which will be strictly monitored during ADF-11:

Indicators		Status (2006)	Projected (2007)	Projected (2008)	Projected (2009)	Projected (2010)	Paris Collective Targets (2010)
3	Aid flows aligned on national priorities	94%	94%	100%	100%	100%	94%
4	Strengthen capacity by coordinated support	33%	42%	50%	60%	72%	50%
5a	Use of country financial management systems	41%	39 %	41%	43%	45%	59%
5b	Use of country procurement systems	41%	39%	41%	43%	45%	*
6	Avoid parallel PIUs	6.6		60%	72%	86%*	2.4
7	Aid is more predictable	58%	60%	66%	73%	80%	87%
9	Use of common arrangements or procedures	47%	45%	47%	49%	51%	66%
10a	Joint missions	16%	21%	23%	25%	28%	40%
10b	Joint country analytic work	78%	78%	82%	86%	90%	66%

* *For Additional details about the indicators and targets: see* ADF, Implementation of Paris Declaration Commitments, September 2007, Bamako, Mali

Fiduciary Safeguards

5.19 The Bank Group has further improved its fiduciary controls and safeguards to ensure that ADF funds are used for their intended purpose and in compliance with Bank rules and policies. Recent reforms include the implementation of a zero tolerance environment for corruption and mishandling of resources, and a comprehensive Whistleblower Policy to improve the discovery and investigation of cases. Further strengthening the fiduciary environment of the Bank Group, described in Annex VI, will remain a continuing priority throughout the ADF-11 period. OPEV will evaluate the risks and benefits of decentralization, including fiduciary safeguard aspects. Using a risk-based approach, OAGL will periodically audit Headquarters and selected field offices concerning the adequacy of the Bank's fiduciary safeguards and report to the Board.

5.20 Specific internal mechanisms to strengthen Management's follow-up on internal Audit findings will be introduced in the first half of 2008. The Fund will improve the quality, timeliness and accessibility of documents released to the public via the Bank Group's website. Management also commits to a functionally independent Office of the Auditor General and regular independent audits of internal management controls for meeting operational objectives, complying with policies of the Bank and preventing fraud. The scope and findings of these audits will be made available to the Boards of Directors.

6. Resource Allocation, Financing Terms and Financing Instruments

Country Eligibility

6.1 The poorest countries will remain the major beneficiaries of ADF resources, with country creditworthiness, performance, and per capita GNI as the fundamental criteria for eligibility. Debt Sustainability Assessments prepared in conjunction with the World Bank and IMF will determine country creditworthiness as follows (see also Annex VII):

- **Category A:** Countries deemed not creditworthy for non–concessional financing by the WB - ADF access only;
- **Category B:** Countries deemed creditworthy for blend financing by the WB - blend of ADB and ADF access; and,
- **Category C:** Countries deemed creditworthy for non–concessional financing by the WB - ADB access only.

6.2 The resource eligibility rule for Category A countries will have two exceptions: (i) access to the private sector window of the Bank, and (ii) access to non-concessional resources for enclave projects, provided these meet the conditions set out under the Bank's agreed policy and do not contravene any of the conditionalities that form part of a program funded by the BWIs.[2]

Performance Based Allocation

6.3 Deputies reaffirmed the centrality of the performance based allocation (PBA) system as the core mechanism for allocating ADF-11 resources so as to ensure that proportionally more resources go to those recipients best positioned to utilize them more effectively. During the ADF-11 period the Fund will continue to use the PBA framework to allocate the bulk of ADF resources to eligible countries on the basis of country needs and performance.

6.4 Based on the review of the PBA implementation to date and the findings of the MDB working group on PBA, Deputies agreed that the Fund will implement a number of specific changes (detailed in Annex VIII) to increase the predictability and reduce the volatility of the allocation system and to simplify the formula. Five key improvements to the ADF-10 system are introduced for ADF-11:

- ADF's PBA exercise will be done on a calendar year basis;
- The calculations will use DSF ratings as of January 1 of each operational years;

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[2] Enclave projects provide a mechanism through which the Bank funds can be used in the financing of self-sustaining projects in Category A countries. Access to such financing depends on the project fulfilling specific economic, financial, managerial, and legal conditions such as being supported by an appropriate guarantee, and promising to produce substantial net foreign exchange to cover its debt obligations. It is expected that such projects will not only have a positive impact on the economy but also attract foreign investors.

- Latest available population data from agreed sources will be held constant over the course of the ADF-11 cycle;

- Per capita income data will be updated for the annual PBA calculation on the basis of a 3-year moving average; and

- The Country Portfolio Performance Rating (CPPR) will include only actual problem projects instead of actual problem projects and potential problem projects; it will use quarterly data instead of annual data and, it will use a compressed project rating scale.

6.5 To further simplify the formula for greater transparency, the following adjustments are also introduced in line with IDA 15:

- The Country Policy and Institutional Assessment (CPIA) will include only the first three clusters (A, B, and C) of the agreed indicators to eliminate double counting of governance;

- The Governance factor will comprise the current CPIA cluster D. With this change and the elimination of the potential problem projects from the CPPR, the procurement element has been removed from the governance factor, but the governance factor effective weight will not change.

- The following new additive formula has been adopted, in harmonization with IDA:

  Country performance rating = $(0.26\ CPIA_{A\text{-}C} + 0.58\ CPIA_{D} + 0.16\ CPPR_{REV})$

  Country allocation = f (Country performance rating^4, Population , GNI/capita $^{-0.125}$)

6.6 ADB Management has certified that under the formula, the effective weight of the key variables will be unchanged relative to the formula employed under ADF-10.

Application of Debt Sustainability Framework (DSF) & Debt Sustainability Assessment (DSA)

6.7 The Enhanced HIPC Initiative, the Multilateral Debt Relief Initiative (MDRI), and bilateral initiatives have reduced significantly the stock of debt to sustainable levels, thus enabling beneficiary countries to allocate more internal resources to priority development investments.

6.8 In order to avoid the build-up of excessive debt in the future, ADF-11 financing terms, and the share of grants, will remain based on a country-by-country analysis of the risk of debt distress using the annual IMF/WB Debt Sustainability Framework (DSF), and the forward-looking DSA. The Bank has reached agreement with the World Bank and IMF to deepen its direct participation in this work and will be participating in DSF/DSA missions on a selective basis. The Fund will continue to apply the Modified Volume Approach (MVA), under which a 20 percent volume discount is applied on grants, sub-divided into: (i) an incentives related portion of 9.88% percent to help maintain the strength of the Fund's incentive system as reflected in its PBA, and (ii) a charges-related portion of 10.12 percent, to cover foregone charges on ADF-11 grants. Fragile states will only be subject to the charges-related volume discount.

6.9 The Fund will establish a provision for the grant financing of the portion of the cost of regional operations that is attributable to ADF-only countries eligible for grants under the debt-distress criterion. Further, the grant component of regional projects will be subject only to the charge-related volume discount to avoid increased costs to the Fund in terms of foregone charge income.

6.10 The Bank is developing a policy regarding the accumulation of non-concessional debt by ADF borrowers patterned on the IDA policy, to ensure a coordinated response to countries that have taken on new non-concessional debt after receiving debt reduction

Special Resource Allocations

6.11 Special resource allocations will be made for Regional Operations and Fragile States during ADF-11, with clear linkages to the PBA system in order to maintain its centrality (as further described in sections 4.14 and 4.19 above).

6.12 *Regional operations*: A special allocation of up to 17.5% of the ADF-11 replenishment envelope will be made for the financing of the costs of ROs which are not financed from county PBA allocations.

6.13 *Fragile States*: A special allocation representing 7.5% of the ADF-11 replenishment envelope will be made for the Fragile States Facility.

Re-allocation of Funds

6.14 Under previous ADF replenishment cycles, unused PBA resources from non-performing countries were reallocated during the third year of the replenishment to performing countries under certain specific eligibility criteria. The eligible country had to: (i) be a performing country with an adjusted CPA ≥ 3.0; (ii) demonstrate high absorptive capacity; (iii) not be under Bank Group sanctions; and (iv) the project had to conform to ADF lending and financing priorities.

6.15 In order to reallocate resources strictly under the PBA system, all unused PBA resources[3] under ADF-11 will be treated as part of the allocable pool of resources for the third year PBA exercise, and allocated fully according to the PBA methodology. The decision on the disposition of unused FSF resources will be made by Deputies in the context of ADF-12 replenishment discussions.

Resource Allocation by End-use

6.16 Out of the total amount of available ADF-11 resources (including internally generated resources, transfer from the Bank net income and other additional resources), initial allocations will be made to the Fragile States Facility (FSF) and for regional operations as specified above.

6.17 Of the remaining balance of resources, country allocations will be made on the following basis:

- At least 75 per cent for specific investment projects and programs and technical assistance operations. The vast majority of these resources will be allocated to Category A countries, with up to 5 percent to Category B Countries; and
- No more than 25 percent of the aggregate country allocations would be extended via policy-based loans and grants.

6.18 The Board of Directors may authorize grants to African regional institutions. Unless such institutions are national in character, such funds would be drawn from the resources earmarked for multinational projects.

Financing Instruments

6.19 The Fund will continue to use throughout ADF-11 its financing instruments in a manner that responds to the development needs of client countries. In particular, in the light of the differences among Fund countries, the Fund will continue to adapt its financing instruments to the changing dynamics among Fund countries, and to consider new and innovative financing instruments to better respond to the development needs of RMCs.

3 Given that the regional operation envelope has a cap rather than a fixed amount, any amount unused below the cap shall be considered as unused PBA resources.

6.20 *Project and Program Loans and Grants:* These instruments comprise project and program loans and grants including multinational projects, sector investments, and lines of credit. Project investments through loans and grants will continue to be the primary vehicle for Fund support to countries during ADF-11.

6.21 *Policy-Based Operations:* in accordance with the principles of the Paris Declaration, the Fund will conduct its program based policy operations in a selective manner, focusing on countries which are good performers under the Fund's CPIA, with CSPs providing the justification for PBL allocations. The Fund will take responsibility for the design of policy-based operations, in countries where the macroeconomic situation is judged acceptable, where sufficiently transparent financial and budgetary procedures exist and in accordance the Bank Group's policies and guidelines on policy based lending. The Fund will also carry out budget support operations, through Development Budget Support Lending, in countries that have, inter alia, Economic and Political Stability as well as Government Commitment in addition to a well-designed PRSP or National Development Plan, a viable macroeconomic and financial framework, a strong and genuine partnership with the donor community and other stakeholders, strong implementation and monitoring mechanisms, and effective, transparent and adequate fiduciary and budgetary systems.

7. ADF-11 Financial Management and Replenishment Framework

Compensation for Debt Relief and Grant Financing

a. Compensation for the MDRI

7.1 Compensations for loans cancelled under MDRI are included in the cashflow stream supporting the Advanced Commitment Capacity (ACC) of the Fund. In light of the horizon of relevance for the Advanced Commitment Authority model, compensation during the ADF-11 disbursement period (2008-2020), backed by firm commitments would serve to maximize the level of ACC for ADF-11. The following criteria are used to determine the extent of inclusion of donor pledges in the ACA:[4]

- Unqualified commitments: 100 % inclusion as donors represent predominantly investment grade credits;
- Qualified commitments: 85% inclusion, with the 15% discount factored in to reflect the uncertainty in terms of timeliness of payments. This safety margin ensures that the flow of ADF-11 ACC is not affected by delayed payments;
- Pledges not covered by commitments: Are not included in the ACA and therefore reduce the Fund's commitment capacity.

7.2 The compensation for loans cancelled under MDRI during the ADF-11 replenishment period (2008-2010) is estimated at UA 144 million, and UA 1,473 million for the ADF-11 disbursement period (2010-2020).

b. Compensation for Grants

7.3 In order to maintain the financial integrity of the Fund, the compensation for costs related to the ADF-11 grant financing will be addressed using a two-pronged approach, as in ADF-10, wherein the foregone income due to grants are covered by an upfront charge on grants, while foregone principal reflows are offset, as they arise during future replenishments, using the

[4] C.f. *ADF Implementation Modalities of the Multilateral Debt Relief Initiative*, ADF/BD/WP/2006/31, 5 April 2006.

"Pay as you go" approach. Participants confirmed their commitment to provide additional resources for this purpose.

Commitment Authority

7.4 *Advance Commitment Authority (ACA):* Since ADF-10, the Advance Commitment Capacity derived under the ACA framework has been used as the contribution from internal sources to the Fund's total commitment capacity during a replenishment period. Deputies approved the core financial assumptions underlying the ACC and endorsed Management proposal for an ACC established at UA 2,062,970,035 for ADF-11.[5]

Burden Sharing, Bank Transfers and Replenishment Size

a. Burden Sharing

7.5 Deputies discussed the structural gap and the interlinked question of burden shares, indicating a range of views reflecting individual circumstances. They agreed that the widening ADF structural gap was a major concern but were of the view that a small technical gap was desirable to (i) give donors the flexibility to increase their burden shares during particular replenishments without exceeding the target replenishment level, (ii) accommodate donors whose funding available for a replenishment exceeds their targeted burden share level and (iii) accommodate new donors. Deputies agreed that a structural gap of no more than 5% would be considered reasonable.

b. Bank Transfers

7.6 Since ADF-8, Management has recommended and the Bank Board of Governors has approved an allocation of UA 30 million from the net income of the Bank to the Fund over each 3-year replenishment period. Because of the strengthened financial position of the Bank, and the need to increase the resource envelope available for financing development projects in the 38 regional member countries for which only concessional financing through the public sector window is permissible under the Bank Group's credit policy, Management has undertaken to recommend to the Bank Board of Governors that the Bank's net income allocation to the Fund be increased to an amount of at least UA 60 million during the ADF-11 replenishment period. This will represent an increase of up to 100%. Furthermore, Management will, on an annual basis, reassess the feasibility of transferring additional net income to the Fund and make appropriate recommendation to the Board of Governors of the Bank. While acknowledging that this is a decision for the Board of Governors and Board of Directors of the Bank, Deputies expressed disappointment with this comparatively low level of transfers to the Fund.

7.7 In addition, a proposal will be submitted to the Board of Governors of the Bank to approve, on an annual basis, the allocation to the Fund of the realized income generated from the clearance of arrears of Fragile States through the FSF, with due consideration given to the financial integrity of the Bank.

c. Replenishment Level and Other Resources

7.8 Deputies agreed on an ADF-11 resources level of UA 5,760,927,837 for the period 2008-2010, which includes:

A replenishment level of UA 3,697,957,801 comprising:

- Donor subscriptions of UA 3,541,351,001; and
- A 4.235% technical gap;

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5 The assumptions for the calculation of the Advanced Commitment Capacity are among others: (i) Assumed grant funding level of 28.38% and grant fee of 10.12% for ADF-11; (ii) ADB transfers of UA 60 million over the period 2008-2010; (iii) 84% Compensation for MDRI (based on commitments and indications received as of 11 December 2007). For further details, see: *Long-term Financial Integrity of the ADF*, June 2007, Tunis; and *ADF Financing Framework 2*, September 2007, Bamako.

Advance commitment capacity of UA 2,062,970,035.

7.9 Supplemental contributions from donors having the economic capacity to do so in order to further enhance the operations of the Fund during the ADF-11 period are welcomed by Management.

7.10 Deputies recognized that delays in making payments could jeopardize the commitment capacity of the Fund and urged all State participants to make their payments on time to minimize the potential carry-over of ADF-11 resources to ADF-12.

Effectiveness and Advance Subscription Scheme, Subscription Procedure

7.11 The effectiveness and advance subscription scheme, as well as the subscription procedure and standard encashment schedule for ADF-11 are contained in Annex X hereto.

8. Institutional Developments

Prospective New Members and Donors

8.1 The Bank Group is currently holding discussions with Turkey, Luxembourg and Croatia about participation in the Fund and membership in the Bank. Management will continue its discussions with other countries that have expressed an interest in joining the Bank Group as well as others, to enlarge participation in the Fund.

ADF Governance Structure

8.2 Deputies discussed the paper on Options for a Comprehensive Framework for Enhancing the Governance Structure of the ADF. They expressed broad support for the guiding principles and the approach to develop a specific proposal for review by the Boards of Directors and requested that a final decision be taken at the 2008 annual meeting. Deputies emphasized that they should remain involved in the process; specifically, any proposal for change in the replenishment process should be submitted to them for review and decision.

9. Mid-Term Review

9.1 Fund operations will be reviewed, adopting the same format as the replenishment consultations, during the second year of ADF-11 operations. While the timing of this review will depend on when ADF–11 becomes effective, it will not be later than 18 months after the effectiveness of the replenishment, and before release of the last tranche.

9.2 The review should discuss the progress made against the Results Framework for ADF XI and in implementing the decisions set out in this Report. In particular the progress made in implementing:

- The operational priorities set out in this Report;
- The framework for enhanced engagement in Fragile States; and
- The strategic and operational framework for regional operations.

9.3 In addition, the Fund will submit for consideration at the Mid-Term Review:

- An independent/external evaluation of quality at entry in ADF 11 operations;
- An update on the Debt Sustainability Framework;
- An update on how the results framework is operating and a presentation of results reporting, including possible adjustments to country and institutional performance indicators and addition of new indicators;
- An update on the implementation of the MDRI;
- A report on the impact of the business processes reforms on programming and delivery;
- Independent evaluation of the effectiveness and impact of decentralization, including with respect to its contribution to improved development effectiveness and results;

- A report on the role of the Fund in the aid architecture;
- A report on the scale of policy based operations approved in the first half of ADF-11;
- A progress report on adherence to the Paris Declaration indicators; and
- A report on options to improve the cost-effectiveness of the replenishment process.

9.4 The progress made shall be considered against the ADF-11 Program Implementation Matrix attached as Annex I to this report.

10. Selection of the ADF-12 Coordinator

10.1 A chairperson for the ADF-12 Replenishment negotiations will be selected by Deputies by the time of the ADF-11 mid-term review.

11. Recommendations

11.1 Deputies of State Participants and Representatives of Borrowing Countries approved the contents of this report in London, United Kingdom on 11 December 2007.

ANNEX I – ADF-11 IMPLEMENTATION MATRIX

	ISSUE	COMMITMENT	ACTION	TARGET DATE
	CORE OPERATIONAL PRIORITIES			
1.	Operational priorities	▪ ADF activities will focus on 3 core operational priorities: infrastructure, governance, regional integration	▪ MTR report	MTR
2.	Governance	▪ Formulate new Governance Strategic Directions paper	▪ Board approval	Q1 2008
3.	Regional operations	▪ Finalize the *Strategic and Operational Framework for Regional Operations* ▪ Monitor implementation of new framework and impact of ROs	▪ Board Approval ▪ Annual Board report, implementation report to MTR	Q1 2008 MTR, On-going
4.	Fragile States	▪ Finalize Revised Framework for Enhanced Engagement in Fragile States. Adopt Operational Guidelines for Fragile States Facility ▪ Transformation of the PCCF into the FSF ▪ Monitor implementation of new framework and impact of operations in FS	▪ Board approval ▪ Board approval ▪ Annual Board report, implementation report to MTR	Q1 2008 Q1 2008 MTR, On-going
	CROSS CUTTING THEMES			
5.	Gender	▪ Adopt revised gender action plan 2008-2010 ▪ Adopt Gender Guidelines for infrastructure sector	▪ Board approval ▪ Guidelines circulated	2008 2008
6.	Climate change	▪ Finalization of the clean energy investment framework and climate risk management strategy	▪ Board approval	2008
7.	Cross-cutting issues	▪ Review of the capacity and adequacy of Bank Group staffing in gender, environment and climate change	▪ Report to the Board	2008
	DEVELOPMENT EFFECTIVENESS AND MANAGING FOR RESULTS			
	Increased Delivery Capacity and Client Focus			
8.	Business processes	▪ Complete revision of business processes ▪ Monitor impact of new business processes on Fund operations	▪ Full implementation ▪ Regular reporting through KPIs, MTR report	2008 On-going, MTR
9.	Rule of origin	▪ Transmission to the Fund's Board of Directors of a draft resolution for the Board of Governors	▪ Board recommendation submitted	2008
10.	Decentralization	▪ Independent evaluation of the risks and benefits of	▪ MTR report	MTR

	ISSUE	COMMITMENT	ACTION	TARGET DATE
		decentralization		
	Coordination, Harmonization and Partnerships			
11.	Procurement	▪ Fully harmonize procurement rules and consultant rules and standard documents with WB rules and standard documents.	▪ Board approval	2008
	Development Effectiveness and Managing for Results			
12.	Enhancing learning and accountability	▪ OPEV will align key elements of its evaluation program towards ADF priorities	▪ OPEV report on evaluation results	MTR
13.	Managing for results	▪ An independent/external evaluation of quality at entry in ADF 11 operations ▪ Monitor implementation of the ADF-11 results framework, including possible adjustments to country and institutional performance indicators and addition of new indicators ▪ Adoption of internal mechanisms to strengthen Management's follow-up on internal Audit findings	▪ MTR report ▪ Annual reports to the Board ▪ MTR report ▪ Information to the Board	MTR Annually MTR Q2 2008
14.	Fiduciary safeguards	▪ Periodic audit by OAGL of selected field offices ▪ Independent audit of internal management controls	▪ Report to the Board ▪ Report to the Board and Deputies	Regular 2010
	Resource Allocation			
15.	PBA	▪ Modification of PBA formula	▪ Country allocations	Yearly
16.	Debt sustainability	▪ Adoption of a policy on non concessional debt accumulation by ADF Countries	▪ Board Approval ▪ Implementation updates to the Board as required	2008
	Financial Management			
17.	MDRI	▪ Update on the implementation of the MDRI	▪ Report to Deputies	MTR
18.	Net Income Transfers	▪ Proposal to Board of Governors for allocation of realized income generated from arrears clearance	▪ Recommendation to the Bank Board	Yearly
	Institutional development			
19.	ADF governance structure	▪ Specific proposal for Board review	▪ Recommendation to Board	2008

Annex II – Strategic and Operational Framework for Regional Operations

A *Strategic and Operational Framework for Regional Operations* incorporating the basic principles and operational specificities agreed by Deputies will be submitted to the Bank Group's Boards of Directors for approval in early 2008.

The Bank Group's work on ROs will focus selectively on areas where it can achieve outstanding results with clear development impact and where there is clear demand and ownership from RMCs. The Bank Group will increasingly work in partnership with others, including country and regional dialogue on regional integration in general, and the identification, development and implementation of ROs.

Operational focus: The Bank Group's focus will primarily be on cross-border infrastructure to improve African competitiveness, delivery of basic services and market building opportunities, by building on the Bank's broader focus on infrastructure. Support for the provision of regional public goods may also be considered and would be provided on the basis of the agreed financing mechanism set out below.

Eligibility criteria: Clear eligibility criteria will be established to ensure that ROs are: (i) sponsored by an appropriate entity, (ii) regional in character; and, (iii) backed by committed sponsors.

Prioritization criteria to channel resources to the highest-quality operations:

- *Development impact*: As measured by the project's contribution to economic growth, regional integration and the provision of RPGs; and
- *Strategic alignment*: Relative to continental and regional strategies (identification as priority operations under NEPAD or REC regional integration plans) and the Bank Group's own strategy (selectivity, partnership, leveraging Bank Group capacity).

Financing mechanism: A meaningful link to performance can be achieved through the use of ADF country allocations to cover part of the cost of each operation, while also increasing incentives for participation in ROs by augmenting available country funds with the ADF regional envelope.

- *Country contributions*: ADF-eligible countries will generally be expected to utilize a portion of their PBA-derived country allocations to cover one-third of the project costs attributed to them.
- *Regional envelope contribution*: The remaining two-thirds will come from the ADF regional envelope.

This arrangement promotes country ownership and commitment, while providing very substantial financial incentives to participate in regional projects. To accommodate the specific constraints faced by small countries, a ceiling of 10% on the amount of drawdown on individual ADF country allocations will be applied to countries with relatively small ADF allocations (UA 20 million or less). For other countries that participate in multiple operations or other special cases that may arise, exceptions may be granted on a case-by-case basis and subject to Board approval. Operations in support of regional public goods involving multiple countries and/or RECs may be proposed on a selective basis. The *Strategic and Operational Framework for Regional Operations* to be considered by the Board of Directors in the first quarter of 2008 will provide a clear definition of regional public goods eligible for limited and selective support out of the RO envelope; such support would be provided on a case by case basis, including as a possibility through grants and without cost-sharing.

The Bank Group will reinforce its **results measurement and development impact assessment framework** for ROs. In view of the complexity and importance of regional projects, solid baseline studies and data collection will be required and will be explicitly funded in new projects when necessary. Monitoring and supervision for results will also be enhanced.

Annex III – Framework for Enhanced Engagement in Fragile States

The Bank's enhanced support to Fragile States will be provided through a new Fragile States Facility (FSF). The new facility will include a supplemental funding / targeted support component, covering Pillars I and III, and an arrears clearance component, covering Pillar II. The Bank Group will design the FSF in such a way as to enable donors to make additional voluntary contributions to the Facility. A Framework for Enhanced Engagement in Fragile States and *Operational Guidelines for the Fragile States Facility* based on the principles below will be submitted to the Bank Group's Boards of Directors for approval in early 2008.

Pillar I: Supplementary Financing

- <u>*Eligibility*</u>: A two-stage selection, stage 1 - countries in post crisis and transition situations which meet key conditions of peace and security and key socio-economic needs indicators; stage 2 - for countries meeting stage 1 criteria: evidence of commitment to a sound program to improve macroeconomic conditions, pursue sound debt and financial management practices, and ensure transparency of public accounts. Participants specifically agreed on the list of states that currently meet stage 1 criteria.
- <u>*Allocations*</u>: Countries assessed to be eligible will have access to a supplemental allocation equal to their base ADF-10 allocation multiplied by a top up factor; minimum UA 5 million allocations will be excluded from the base against which supplemental allocations would be calculated. Such funds would be made available in full upon approval by the Board of Directors for each country. The terms would be identical to terms established by the DSF/DSA framework.
- <u>*Eligibility period*</u>: Base period of 3 years, with the possibility of continued support for 3 more years subject to: availability of funding beyond the ADF-11 period ; and satisfactory performance during the first cycle as determined by formal review, and approved by the Board of Directors.
- <u>*Strategic Priorities*</u>: governance/capacity building and rehabilitation/reconstruction of basic infrastructure as articulated in country strategies; leadership in other critical areas, such as peace and security, will be left to other partners.

Pillar II: Arrears Clearance

- The FSF will incorporate an arrears clearance mechanism for eligible Pillar I countries. A detailed proposal, which will take into account the PCCF past experiences, the practice of sister institutions and various cost sharing options, and propose clear criteria to determine the size of eligible countries' contribution and the burden sharing model, will be submitted for Board review and approval.
- The arrears clearance sub-facility of the FSF will be designed to be able to receive additional donor contributions.

Pillar III: Targeted Support

- <u>*Eligibility*</u>: Full range of fragile countries (including countries moving towards more fragility).
- <u>*Support*</u>: Secondments for capacity building, small grants to non-sovereigns for service delivery, knowledge building and dialogue.

Intensified partnerships to ensure focus and coherence: The proposed strategy is grounded on the OECD-DAC Principles for Good International Engagement in Fragile States and situations. A key element of this framework is agreement on appropriate division of labor in country contexts. Bank's engagement with FS will be undertaken in close concert with other parties, including UN agencies, the African Union, the Economic Commission for Africa, NEPAD, and multilateral and bilateral agencies.

Annex IV – New initiatives in Clean Energy and Climate Change

Clean Energy Investment Framework

The Bank will play a significant role in support of energy development and access for all, transition to low-carbon economy, and climate change adaptation and risk management in Africa. The framework is founded on three pillars.

- *Pillar I on Energy Access*: Will help African governments to put in place an adequate policy and institutional framework to creating and maintaining an enabling environment and to galvanize strong partnerships in support of Africa's energy development investment program.
- *Pillar 2 on Climate Change Mitigation*: Will include focus on strengthening RMC capacities in comprehensive energy development planning, the transition to low-carbon development, revamping of energy and power pricing and regulatory oversight activities and maximizing carbon credit income.
- *Pillar 3 on Climate Adaptation*: Aims at safeguarding and enhancing the effectiveness of Bank investments in a changing climate, as well as providing Bank support to its Regional Member Countries (RMCs) in the area of climate risk management (CRM) and climate adaptation. The pillar will specifically support the identification and preparation of climate adaptation and risk management initiatives, build critical capacities, and support promising programs at the continental and sub-regional levels, and in the most vulnerable countries, ecosystems, and socio-economic sectors to promote climate resilient development. The pillar will also include activities such as raising awareness, and strengthening climate early-warning systems, improving the quality of climate information, education and increasing participation.

Climate Risk Management (CRM) policy

- *Pillar 1 Targeted Assistance to RMCs*: The CRM policy will focus on supporting climate risk management by RMCs, including, capacity building, sensitization to country-specific vulnerabilities, climate risks, threats and opportunities (specifically including the private sector and civil society) and playing a catalytic role in mobilizing resources for climate-proofing RMC investments.
- *Pillar 2 Due diligence in Bank operations*: The CRM policy will focus on ensuring due diligence in Bank Group projects and country/sector planning. In particular, ensuring that the most sensitive Bank Group operations have integrated appropriate climate risk analysis whose findings and conclusions are adopted in project designs.

Annex V – Results Framework for ADF-11

Tier 1: Development Effectiveness – Country Outcome Indicators during ADF-11

Indicator	Baseline Year	Baseline Value
Growth and Poverty Reduction		
GDP per capita (US$ constant 2000)	2006	358
Population Living below $1/day (PPP) (%)	2004	33
Governance and Transparency		
Public Expenditure & Financial Assessment Score (1 to 7)	2007	3.12
Worldwide Governance Indicators Avg. Score (-2.5 to 2.5)	2006	-0.80
Extractive Industries Transparency Index (% compliance)	2007	20.5
Regional Integration and Trade		
Africa's Share of Global Trade (%)	2006	2.63
ADF Countries' Trade with Africa (US$ millions)	2006	38,216
Private Sector Development and Investment Climate		
Cost Required for Business Start-up (% of GNI per capita)	2006	190
Time Required for Business Start-up (days)	2006	58
Global Competitiveness Index Ranking (1 to 7)	2007	3.1
Staple Crops Yield Index (2002 value = 100)	2005	115
Economic Infrastructure		
Access to Improved Water Source (% of population)	2004	55
Access to All-season Road (% of rural population)	n.a.	n.a.
Household Electrification Rate (% of households)	2001	22
Fixed Lines & Mobile Phone Subscribers (per 1,000)	2005	69
Internet Users (per 1,000)	2005	20
Human Development		
Under-five Child Mortality (per 1,000 live births)	2006	165
Ratio of Girls to Boys in Primary and Secondary School (%)	2004	85
Primary School Completion Rate (%)	2004	58

Tier II: Institutional Effectiveness - Internal Reform Indicators during ADF-11

Indicator	Baseline Year	Target Year	Baseline Value	Target Value
Ensuring quality at entry for strategies and operations				
% of new CSPs with satisfactory baseline data at entry	2006	2009	33	70
% of new ops with satisfactory baseline data at entry	2006	2009	37	70
% of budget support disbursed on schedule	2006	2009	55	75
Avg. elapsed time - approval - 1st disbursement (months)	2006	2009	24	12
Instilling a continuous supervision culture				
% of operations formally supervised twice a year	2006	2009	36	50
% of ops with Quality of Supervision rated satisfactory	2007	2009	42[1]	66
% of problem projects in on-going portfolio	2006	2009	14	10
Annual disbursement rate of on-going portfolio (%)	2006	2009	18	22
Avg. elapsed procurement time (weeks)	2006	2009	70	40
Share of projects eligible for cancellation (%)	2006	2009	27	15
Enhancing learning and accountability through evaluation				
% of exiting projects with timely completion report	2006	2009	9	45
% of PCRs rated satisfactory[2]	2003-05	2009	45	75
% of PCRs reporting gender-disaggregated data	2005-06	2008-09	TBD	TBD
Improving results on the ground through decentralization and harmonization				
% of professional staff based in field offices	2006	2009	5	15
% of portfolio managed from field offices	2006	2009	0	15
% of aid in common arrangements (Paris #9)	2006	2009	47	49
% of missions conducted jointly (Paris #10a)	2006	2009	16	25

[1] *Preliminary result to be confirmed*
[2] *Baseline to be updated to 2005-2007 by January 2008*

Annex VI – Fiduciary Safeguards

This Annex presents a brief overview of the Fiduciary safeguards which have been put in place by the Bank Group.

1. AUDIT, FINANCIAL MANAGEMENT AND CONTROL FRAMEWORK

External Financial Audit

1.1 The Bank Group has an external financial audit function that ensures an independent (as defined by the International Federation of Accountants (IFAC)) review of financial statements and internal controls. The financial statements are audited in accordance with International Accounting Standards (IAS) and an opinion on those financial statements is issued, annually by the external auditor. The annual audit report is publicly disseminated annually on the Bank's public website. In 2006, management for the first time provided a formal assertion regarding the effectiveness of internal controls over financial reporting. Starting in 2007, in addition to the management assertion, the external auditors will also issue an opinion concerning internal controls over external financial reporting in the Bank Group's Annual report. The Bank has an Audit and Finance Committee, whose members are members of the Board of Directors appointed by the President.

Internal Control Frameworks

1.2 The Bank has a dedicated unit established to monitor internal controls & risks using the COSO framework. The Internal Control Unit, in conjunction with management, documents key activities and process over financial reporting identifying and assessing key controls inherent in the processes. The Bank Group is committed to have undertaken regular independent audits of internal management controls for meeting operational objectives, complying with policies of the Bank and preventing fraud. The scope and findings of these audits will be made available to Deputies.

Financial Disclosure

1.3 The Code of Conduct applicable to Bank staff regulates conflicts of interests and requires Staff members to disclose, at any time, any direct or indirect personal interest under consideration by the Bank and any financial or business interest which might reasonably reflect unfavorably on the Bank. The Code of Conduct also outlines prohibited personal financial interests with regards to certain activities. Failure to adhere to standards contained therein may be sanctioned, as unsatisfactory conduct or serious misconduct under the Staff Regulations and Rules. The Anti-Corruption and Fraud Investigation Division (see below) is responsible for investigating allegations or whistle blowing on fraud, corruption and malpractices or suspicions in the Bank and in activities financed by the Bank.

Internal Audit

1.4 The Internal Audit Division within the Office of the Auditor General (OAGL) carries out internal audits in accordance to IIA Standards. The Bank recently reorganized its Internal Audit functions in accordance with best practices: (i) renaming of the existing Internal Audit Department as the Office of the Auditor General ("OAGL"); (ii) Restructuring of the OAGL into two divisions - Anti-Corruption and Fraud Investigation Division and Internal Audit Division; and (iii) appointment at the head of the OAGL of an Auditor-General ("AG").

1.5 The AG reports directly (administratively) to the President of the Bank and functionally to the Audit and Finance Committee. The President has the authority to appoint and remove the AG in consultation with the Board of Directors. The appointment of the AG is for a period of five years renewable once and he/she is not eligible for staff appointment thereafter. The OAGL is responsible for developing a flexible annual audit plan using appropriate risk-based methodology, including any risk or control concerns identified by management. A section on internal audit activities for the year is included within the Bank's Annual Report.

2. PROJECT/ACTIVITY PROCESSES AND OVERSIGHT

Project Appraisal Standards, including safeguards measures

2.1 The Bank's Guidelines for Financial Management and Analysis of Projects (the "Guidelines") define the steps to be taken at the various stages of the project cycle. The Guidelines outline that the Bank selects projects which will most effectively contribute to the economic and social development of the country concerned. The Bank's approach is consistent with the 2005 Paris Declaration in that programs and projects selected for Bank support are part of the RMC's national development strategy. The Guidelines specify that the analysis of projects should be carried out through an integrated approach including a thorough evaluation of the physical, economic, financial, stakeholder and risk aspects of each project in a single consistent framework.

2.2 The process for screening of projects to determine the project's environmental and social category is done immediately after project identification by staff with environmental and social expertise in sector operations and the policy department. The Bank's Integrated Environmental and Social Impact Assessment Guidelines are reference material for staff to consider crosscutting themes (e.g. poverty) while assessing the environmental and social impacts of a project.

2.3 Policy-based operations are focused on countries which are good performers under the Fund's CPIA, with CSPs providing the justification for PBL allocations, and where the macroeconomic situation is judged acceptable with sufficiently transparent financial and budgetary procedures. Budget support operations may only be provided to countries that have, inter alia a clear commitment to a well-designed PRSP or National Development Plan, a viable macroeconomic and financial framework, a strong and genuine partnership with the donor community and other stakeholders, strong implementation and monitoring mechanisms, and effective, transparent and adequate fiduciary and budgetary systems.

2.4 The Guidelines include a section on performance indicators which includes a checklist to be referenced when selecting performance indicators, a description of performance indicators on which the Bank focuses (operating, capital adequacy and liquidity), and a description of the tools used to measure these indicators.

2.5 The Boards of Directors review and approve each operation of the Bank or the Fund, affording a final check of the compliance of operations with the Bank Group policies and procedures before a project is approved.

Procurement and Financial Management

2.6 The Bank ensures accountability in procurement amongst its staff members, both for internal procurement and for procurement in the projects it finances, in accordance with OECD DAC standards. The procurement policy of the Bank is guided by five basic considerations: (i) need for economy and efficiency in project implementation; (ii) equal opportunity for all eligible suppliers and contractors to compete in the supply of goods and services; (iii) encouragement of the development and participation of contractors and suppliers from regional member countries; (iv) the importance of transparency, accountability, competency and non-discrimination in the procurement process; (v) combating fraud and corruption in the procurement process.

2.7 The Bank carries out Project Procurement Audits and Post Procurement Reviews on randomly chosen projects during the year. Country Procurement Assessments are done jointly with the World Bank. The Procurement and Financial Management Unit maintains a database of procurement actions to produce the Bank's monthly business bulletin, the Bank's procurement information magazine, and the Quarterly Operational Summary. The bulletin provides a full overview of the ADB group procurement opportunities, list of approved projects, pipeline of projects, general and specific procurement notices

2.8 The Bank has Guidelines on Financial Management and Analysis of Projects providing Bank management and staff, borrowers, co-financiers and investors with a comprehensive and understandable directory of standards of financial management and financial analysis for the assessment, implementation and operation of Bank funded projects.

2.9 Following the reorganization of the Bank, the dedicated financial management and procurement functions have been joined in the Procurement and Financial Management Unit which provides technical support to operations departments regarding their fiduciary responsibilities. The unit supports good governance in projects through assurance of compliance with procurement and financial management procedures.

New safeguards under the decentralization policy

2.10 Decentralization with the related delegation of authority remains subject to the Bank's general institutional fiduciary framework which has been strengthened considerably.

2.11 In addition, field offices Staff members who will be responsible for taking procurement or disbursement related action will always be supervised by international staff posted from Headquarters. This safeguard will further ensure that actions are taken by staff members who are familiar with the applicable rules of the Bank and have a high level of engagement with the Bank. In addition, international staff members will be rotated consistent with the maximum field office posting duration or even less as an additional safeguard. Management also ensures that staff members receive continuous complementary training for validation purposes. Furthermore, to ensure adequate knowledge of the procurement rules and procedures of the Bank as well as best practices, Directors and Managers will be gradually required to be accredited by the Procurement and Financial Management Unit (ORPU), under its future procurement accreditation mechanism scheme.

2.12 Appropriate IT and communications facilities are also being deployed to ensure that the data and information available at Headquarters are available in the field offices with a view to ensure that decisions are taken on the basis of adequate information.

Monitoring and Project-At-Risk-Systems

2.13 Projects are monitored 1.5 times per year for normal project or 2 times per year for projects at-risk, and the Fund is committed to increasing the percentage of projects monitored at least twice a year (see results framework matrix). A logical framework is in place with specific indicators. The Post Completion Reports are performed by the Task Managers and approved by their supervisor prior to submission by Country Director to OPEV for review who reports directly to CODE.

2.14 The standard performance indicators via the Supervision Summary are leveraged to standardize the methodology. A logical results-framework is in place with specific indicators regarding: (i) Project Implementation; (ii) Procurement Performance; (iii) Financial Performance; (iv) Activities and Works (iv) Impact on Development (achievement of objectives; sustainability of results and institutional development impact).

2.15 The rating scale per the Project Performance in the Supervision Summary will indicate that a project is at-risk with a rating less than 2 for either Implementation Progress or Development Objectives. Once a project is considered at-risk, it carries the at-risk flag for the duration of the project's life.

Evaluation Function

2.16 The evaluation function at the Bank Group includes both self-evaluation and independent evaluation systems. Self-evaluation includes reviews undertaken by operations at project, sector and country level. For example, operations staff are required to prepare a Project Completion Report (PCR) - an evaluative review - for each operation.

2.17 Independent evaluation is undertaken by the Operations Evaluation Department (OPEV): a department of the Bank that reports directly to the Committee to Development Effectiveness (CODE). OPEV serves the Bank by undertaking unbiased, independent evaluations of the Bank's operations, policies and procedures.

2.18 Evaluation aims to enhance learning and accountability and, ultimately, to promote development effectiveness. OPEV's vision is to make a significant and measurable contribution to the Bank's effectiveness and accountability, by providing relevant lessons and recommendations for continual improvement of Bank polices and operations. This means that OPEV must produce a substantial volume of high quality evaluations which are relevant, timely and based on sound evidence and systematic analysis. Equally important is effective communication of evaluation findings, lessons and recommendations for consideration by staff, management and the Bank's partners and stakeholders, including the Board. The adoption of evaluation lessons and recommendations, including formal responses by management, is an essential element in the evaluation system (OPEV is currently developing a key performance indicator to track this aspect). More widely, the Bank requires sound systems for self-evaluation, operated in a consistent way by well-trained staff. OPEV has an oversight role here, in ensuring that the evaluation function is robust and appropriate to the needs of the Bank group.

2.19 Responsibility for development progress ultimately rests with RMCs, where effective monitoring and evaluation capacity is generally weak. An important aspiration for the region is for effective evaluation and reporting of development results. The Bank has a contribution to make here through capacity building support for planning, monitoring and evaluation, as well as for strengthening production and use of statistics.

2.20 OPEV is progressing towards its goals. Both the budget and staff complement have been significantly increased in the recent past, and OPEV's independence strengthened by ensuring that the budget, once approved by the Board, is 'ring-fenced' (i.e. not subject to arbitration by management). OPEV reports to the Board of Directors through the CODE. This ensures that OPEV operates independently of management. The Director of OPEV is appointed by the President in consultation with the Board for a term of five years renewable only once and is not eligible for reappointment to the staff of the Bank upon the expiry or earlier termination of his or her term. The Bank Group will increase the independence of OPEV by strengthening the Board's role in the appointment or dismissal of the Director of this department (i.e. the President of the Bank Group will require the Board's concurrence in decisions regarding the appointment or dismissal of the OPEV Director).

2.21 OPEV has shifted the balance of its work from mainly project level evaluation towards high level evaluation of policies and strategies at sector, country and corporate levels, and is currently reviewing its work program to sharpen the focus on the Bank Group's strategic priorities, including key aspects of ADF performance. Evaluation reports are publicly disseminated on the ADB's public website, and attention is now being given to improved communication of evaluation results. OPEV also has a role to play in strengthening evaluation capacity both within the Bank Group and in RMCs.

2.22 OPEV's work is harmonized with good practice standards of the Evaluation Cooperation Group (ECG) (a network of evaluation units of the Multilateral Development Banks, which the OPEV Director will chair in 2008) as well as those of the OECD's Development Assistance Committee. OPEV is committed to a set of guiding principles: to be responsive to the Bank's strategic needs; to provide credible and useful results; and to use efficient and appropriate approaches and methods, safeguarding integrity throughout.

2.23 The conditions are therefore right for independent evaluation to make an increasing contribution to the work of the Bank. As indicated in the RMF for ADF XI, this will include a set of evaluation studies to inform the mid-term review of the ADF.

3. INVESTIGATIONS

Anti-Corruption and Fraud Investigation Division

3.1 The Board of the Bank approved in November 2005 the establishment of an Anti-Corruption and Fraud Investigation Division ("Division"). The Division has not only the key role, but is the only entity in the Bank Group with the mandate and authority to undertake, direct, and control investigations into allegations of fraud, corruption, and other misconduct. The Division has the overriding mandate to undertake unhindered investigations into allegations of corruption, fraud and malpractices or suspicions. Investigations are conducted in conjunction with the policies, rules and regulation of the Bank.

3.2 The Anti-Fraud Corruption and Fraud Investigation Division is responsible for reporting to the Auditor General, head of the Office of the Auditor General ("OAG") on allegations received, screened, and their investigation status.

3.3 As outlined within the Whistle Blowing and Complaints Handling Policy, the Anti-Corruption and Fraud Investigation Division is responsible for the following: (i) registering allegations and where the identity of the Bank Personnel is known, acknowledging receipt of all allegations;

(ii) Investigating an allegation to determine whether an act of fraud, corruption, or other misconduct has occurred and if so, the party or parties responsible; and (iii) Determining the actual violations of policies, rules and regulations of the Bank and the parti(es) responsible.

3.4 The Bank is a member of the International Financial Institutions Anti-Corruption Task Force Framework, which has established international guidelines and principles for investigations.

Compliance Review and Mediation

3.5 A Compliance Review and Mediation Unit ("CRMU") has been established for the purpose of providing people adversely affected by a project financed by the Bank with an independent mechanism through which they can request the Bank to comply with all its own policies and procedures. The mechanism is available when two or more affected persons believe the Bank has failed to comply with any of its policies and procedures during the design, appraisal, and/or implementation of a Bank project.

Hotline & Whistleblower Protection

3.6 The Whistle Blowing and Complaints Handling Policy ("the Policy") defines a whistleblower as any person or party who conveys or is proven to be about to convey a concern, allegation or any information indicating that fraud, corruption or another other misconduct is occurring or has occurred.

3.7 The Policy states that retaliation shall not be permissible against any whistleblower. Retaliation means any act of discrimination, reprisal, harassment or vengeance, direct or indirect, recommended, threatened or taken against a whistleblower by a person because the whistleblower has made a disclosure pursuant to this Policy.

4. BUILDING THE FIDUCIARY CAPACITY OF RMCS

4.1 The Bank is using both lending and non lending activities to increase fiduciary capacity of RMCs.

Non lending activities

4.2 The non lending activities include analytical studies and reports, organization and participation in capacity building seminars and work shops as well as policy dialogue on both national and regional level. Non lending activities are being undertaken in close collaboration with other regional and non regional partner institutions in the spirit of operationalizing the Paris Declaration on Aid Effectiveness and Harmonization.

4.3 The main non lending activities of the Bank include:

- Country Financial Accountability Assessments (CFAA);
- Financial management Review of Bank Projects (FMR-BP);
- Country Governance Profiles (CGPs);
- Country Procurement Assessment Report (CPAR); and
- Public Expenditure reviews (PER).

4.4 The Bank is also is active in non lending activities in areas such as:

- Decentralization and local governance;
- Improved service delivery and governance;
- Capacity building/workshops with parliament representatives;
- African Peer Review Mechanism (APRM);
- Extractive Industries Transparency Initiative; and
- Fragile States – Post Conflict Countries;

Lending activities

4.5 The Bank provides assistance to RMCs to strengthen their governance structures and institutional capacity, including fiduciary, using Policy Based Lending, Development Budget Support Lending and Project financing. Both loans and grants are used to finance the operations which are fully undertaken in close collaboration with other regional and non regional partner institutions both on a regional and national level in areas such as:

- Public Sector reforms;

- Macro economic management;
- Transparent budgeting and expenditure management;
- Judicial and legal reform;
- Enhanced systems of public accountability; and
- Combating corruption.

Annex VII – Classification of Regional Member Countries

A. Countries Eligible for ADF Resources Only*

Angola
Benin
Burkina Faso
Burundi
Cameroon
Cape Verde
Central African Republic
Chad
Comoros
Congo
Congo, Democratic Republic
Côte d'Ivoire
Djibouti
Eritrea
Ethiopia
Gambia
Ghana
Guinea
Guinea-Bissau
Kenya
Lesotho
Liberia
Madagascar
Malawi
Mali
Mauritania
Mozambique
Niger
Rwanda
Sao Tomé and Principe
Senegal
Sierra Leone
Somalia
Sudan
Tanzania
Togo
Uganda
Zambia

B. Countries Eligible for a Blend of ADB and ADF Resources

Nigeria
Zimbabwe

C. Countries Eligible for ADB Resources Only

Algeria
Botswana
Egypt
Equatorial Guinea
Gabon
Libya **
Mauritius
Morocco
Namibia
Seychelles
South Africa
Swaziland
Tunisia

* Except for limited ADB lending for enclave and private sector projects
** Libya is not a Borrowing Member Country

Annex VIII – PBA Framework for ADF-11

1. Introduction

1.1 This annex presents the agreed allocation methodology for ADF funds during the ADF-11 period. It briefly reviews the current framework and describes specific technical adjustments agreed for the ADF-11 period.

2. ADF-10 PBA Framework

2.1 The PBA system places country needs and performance at the center of the allocation process. Needs and absorptive capacity are assessed annually on the basis of GNI per capita and population. Performance is assessed annually as follows:

- The Country Policy and Institutional Assessment (CPIA), which tracks the performance of the country's policy and institutional framework to promote growth and reduce poverty with 16 criteria grouped into 4 equally weighted clusters: (A) economic management; (B) structural policies; (C) policies for social inclusion and equity; and, (D) public sector management;
- The Country Portfolio Performance Rating (CPPR), which assesses a country's portfolio implementation performance based on the percentage of projects at risk;
- A Governance Factor (GF) made up of five criteria from the CPIA governance cluster (cluster D) and one procurement element from the CPPR; and,
- A post Conflict Enhancement Factor (PCEF) to provide additional resources to post-conflict countries.

2.2 ADF resources are then allocated on the basis of an agreed formula using these country performance assessments (CPA),[6] population, and GNI per capita indicators. Under ADF -10, the current ADF PBA formula for country (A_i) is shown below:

$A_i = \quad CPAi^{2.0} * P * (GNI/P)^{-0.125} \qquad CPA_i = [(0.7*CPIA + 0.3*CPPR) * (GF) * PCEF]$

In addition, two changes introduced under ADF-10 affect country allocations. With the Integration of the IMF/World Bank Debt Sustainability Framework (DSF), grant allocations are subject to a 20% upfront volume discount[7]. A portion of the discount (12%) is used to compensate the ADF for forgone loan repayments, and the remainder (8%) is reallocated across all ADF-only countries according to the PBA. For Multilateral Debt Relief Initiative (MDRI) recipient countries, the "netting-out" mechanism deducts the amount of forgone ADF debt service. Donor resources provided to ADF for foregone reflows are then reallocated to all ADF-only countries on the basis of the PBA system.

2.3 In the context of the MDB Technical PBA Working Group and the ongoing IDA-15 and ADF-11 negotiations Bank staff have examined a variety of issues related to both the design and the application of the PBA formula. A series of recommended technical adjustments were identified in the course of these consultations and have been put before Deputies in the current replenishment discussions.

3. ADF-11 PBA Framework

3.1 Under ADF-11, two main sets of refinements to the system will be implemented. The following set of changes will help increase predictability of resources as agreed with Deputies:

- The timing of the PBA assessment and DSF classification cycles will be aligned with the ADF operational calendar year;
- Data for country population will be held constant over the ADF-11 period;
- Annual GNP/capita data for each country will be derived as a moving 3-year average; and

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6 Currently, the CPA also includes a factor to provide additional resources for designated post-conflict countries.

7 The 20% discount is intended to address moral hazard concerns associated with providing soft terms to some of the poor performing countries and to transfer more resources to grant-eligible countries in present value terms.

- The portfolio review factor (CPPR) will measure projects at risk based on actual problem projects only, excluding potential problem projects from the measurement to reduce volatility; average quarterly data will be used and a new conversion scale on the rating of actual problem projects will be adopted.

3.2 The second main set of adjustments will simplify the formula to achieve greater transparency and eliminate elements of double-counting:

- To eliminate double counting of governance, the CPIA will include only the first three clusters of the current CPIA under ADF-10;
- The Governance Factor (GF) will comprise cluster D of the CPIA; such a change in addition to the elimination of potential problem projects from the CPPR imply that the procurement element is no longer included in the GF; and
- The Post-Conflict Enhancement Factor will be eliminated upon approval of the proposed Fragile States Framework.

3.3 Two options were considered to simplify the structure of the formula: a linear construction and a geometric construction. The two options were compared with the current benchmark formula with the following objectives: (i) retain the current effective weight of components of the current formula as directed by Deputies; (ii) track as closely as possible the allocations resulting from the current formula; and (iii) make it easier to understand the primary factors that determine changes in allocations.

- **Benchmark Formula**[8]

$$A_i = [(0.7*CPIA_{A\text{-}C} + 0.3*CPPR_{REV}) * (CPIA_{D})]^{2.0} * P * (GNI/P)^{-0.125}$$

- **Geometric Formula**

$$A_i = [CPIA_{A\text{-}C}^{0.26} * CPIA_{D}^{0.58} * CPPR_{REV}^{0.16}]^{4.0} * P * (GNI/P)^{-0.125}$$

- **Linear Formula**

$$A_i = [(0.26*CPIA_{A\text{-}C} + 0.58*CPIA_{D} + 0.16*CPPR_{REV})]^{4.0} * P * (GNI/P)^{-0.125}$$

3.4 Both options comply with the above mentioned principles. The revised effective weight of governance is 58% whereas it was 59% in the old formula, but when factored in the new additive allocation formula the effective weight remains unchanged. Testing both options over the ADF 10 period show that they also track closely allocation results obtained with the current benchmark formula. The average difference in allocation resulting from the geometric formula and the linear formula compared to the current benchmark formula is respectively 0.4% and 0.8%. While the geometric formula tracks current allocations slightly more closely, the linear construction has much greater simplicity, particularly with respect to explaining the linkage between indicators and allocation results. It is therefore proposed to adopt the above-mentioned linear formula under ADF-11. These changes are fully harmonized with changes agreed under IDA 15. The grant discounts and MDRI netting out mechanisms will apply as in ADF-10.

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[8] For comparison purposes among the three formula, the current formula was revised to take into account the new CPIA with three clusters and the new governance factor and the new CPPR.

Annex IX – ADF Financing Terms for Individual Countries (2007 DSF)

Country Category	2007 DSF Traffic Light	% grant in 2007
Angola	Yellow	50%
Benin	Yellow	50%
Burkina Faso	Yellow	50%
Burundi	Red	100%
Cameroon	Green	0%
Cape Verde	Green	0%
Central African Republic	Red	100%
Chad	Red	100%
Comoros	Red	100%
Congo DRC	Red	100%
Congo, Rep. Of	Red	100%
Cote d'Ivoire	Red	100%
Djibouti	Red	100%
Eritrea	Red	100%
Ethiopia	Yellow	50%
Gambia	Red	100%
Ghana	Green	0%
Guinea	Red	100%
Guinea-Bissau	Red	100%
Kenya	Green	0%
Lesotho	Yellow	50%
Liberia	Red	100%
Madagascar	Green	0%
Malawi	Yellow	50%
Mali	Green	0%
Mauritania	Yellow	50%
Mozambique	Green	0%
Niger	Yellow	50%
Rwanda	Red	100%
Sao Tome & Principe	Red	100%
Senegal	Green	0%
Sierra Leone	Yellow	50%
Somalia	Red	100%
Sudan	Red	100%
Tanzania	Green	0%
Togo	Red	100%
Uganda	Green	0%
Zambia	Green	0%
Blend Countries		
Nigeria	Green	0%
Zimbabwe	Green	0%

Annex X – Effectiveness and Advance Subscription Scheme, Subscription Procedure

After consideration of the issues for which provisions have been made in the Resolution, Deputies established the following terms and conditions for subscriptions in respect of the Eleventh Replenishment:

(i) The Replenishment will come into effect when the Fund has received the Instruments of Subscription representing an aggregate amount equivalent to at least 30 per cent of the Subscriptions. It is expected that this level of subscription will be attained by 31 March 2008 or such later date as determined by the Board of Directors (the "Effective Date);

(ii) In order to enable the Fund to meet Operational Commitments before the entry into effect of the Eleventh Replenishment, the Fund, in addition to the ability to commit ACC resources after the ADF-11 Resolution has been approved, is authorized, when the level of subscriptions received aggregates 20 per cent of total pledges, to use for Operational commitment an amount equivalent to the first commitment tranche of each Instrument of Subscription received before the Effective Date, unless the subscribing State Participant specifies otherwise when depositing its Instrument of Subscription. This Advance Subscription Scheme will be implemented without prejudice to the Advance Facility Scheme under which any State Participant may authorize the use of any portion of its subscription for commitment purposes before the entry into effect of the Eleventh Replenishment;

(iii) Subscriptions may, in exceptional cases, be qualified and State Participants intending to do so will notify the Fund to that effect. Such qualified subscriptions shall be subject to the conditions specified in the Resolution;

(iv) Subscription pledges listed in the Annex to the Resolution on the Eleventh Replenishment have been determined in Units of Account (UA) and have been converted into Units of Obligation of the individual participants on the basis of daily exchange rates, averaged monthly, expressed in terms of Currency Units per SDR as given by the IMF for the six-month period commencing 1 April 2007 and ending on and including 30 September 2007. Subscriptions shall be denominated in SDR of the IMF, a currency used for the valuation of the SDR or the currency of the individual State Participant, except that if the economy of a State Participant experienced a rate of inflation in excess of 10 per cent per annum in the period 1 January 2004 - 31 December 2006, as determined by the Fund, the State Participant's Subscription will be denominated in SDRs or, at the option of the State Participant, in a currency used for the valuation of the SDR;

(v) Subscriptions will, to the extent of payment, carry voting power in the manner specified in the Resolution on the Eleventh Replenishment. However, if the Eleventh Replenishment has not entered into effect by 31 March 2008, advance subscriptions will carry voting power to the extent of payment;

(vi) Terms of payment have been determined such that the Fund will have the resources it needs to operate satisfactorily and to reflect the multilateral character of the Eleventh Replenishment. Payment in respect of each subscription will be made in three installments, of which the first installment will be made on or before 30 April 2008 or 30 days after the Effective Date, whichever is earlier, with the second and third installments falling due respectively on or before 30 April 2009 and 30 April 2010; any State participant may, by a written declaration, indicate to the Fund that it intends to make payment at earlier dates or in fewer instalments or different proportions not less favourable to the Fund than those specified in this or in the next paragraph.

(vii) As an exceptional case when a State Participant cannot, due to its legislative procedures, make payment in respect of the first installment by the stated date, payment in respect of that installment should be made within 30 days of the deposit of its Instrument of Subscription. Subsequent payments in respect of qualified subscriptions shall be made within 30 days as and to the extent that the relevant installment becomes unqualified and subject to the annual payment dates specified for unqualified subscriptions. A State Participant who has deposited a Qualified Instrument of Subscription shall inform the Fund of the status of its subscription (i.e., whether legislative approval has been received or not) not later than 30 days after the annual payment dates specified for unqualified subscriptions;

(viii) At the time of depositing its Instrument of Subscription, each State Participant shall indicate to the Fund its proposed program of installment payments.

(ix) Encashment of notes shall be in accordance with the replenishment specific (fixed schedule) encashment system, adopted by the Board of Directors in March 2000. The encashment schedule shall cover a period of 10 years from 2008 to 2017. A standard encashment schedule shall be prepared for each State Participant in his currency of obligation, using the profile indicated in Schedule I hereto. Should a State Participant wish to adopt an encashment schedule other than the standard, the Fund shall agree with the State Participant on a revised encashment schedule for its unqualified subscription that yields at least an equivalent value to the Fund in present value terms;

(x) The size of each commitment tranche will be equal to one-third of the amount of total subscriptions;

(xi) The rules governing the commitment of each of the three tranches have been formulated in such a way that the first tranche will be committed from the Effective Date (or before that date, if it is an Advance Subscription); the second tranche from 31 March 2009, or the Effective Date, whichever is later; and the third tranche from 31 March 2010 or the Effective Date whichever is later; and

Schedule I

Standard Encashment Schedule for ADF-11

Encashment Year	Encashment Percentage
2008	3.43%
2009	7.76%
2010	12.58%
2011	14.77%
2012	14.87%
2013	13.70%
2014	11.74%
2015	9.74%
2016	8.40%
2017	3.01%
Total	100.00%

Annex XI – List of Working Papers for the ADF-11 Consultations

Dar Es Salam Meeting (14-15 March 2007)

Background Paper 1	Corporate Performance Monitoring and Management
Background Paper 2	Status Report on Enhancing Portfolio Management
Background Paper 3	Restructuring Procurement and Financial management Services
Background Paper 4	Decentralization Progress Report
Background Paper 5	Human Resources Management Update
Background Paper 6	Progress on Operational Business Process Reforms
Background Paper 7	Budget Process Enhancement
Background Paper 8	Long-Term Financial Sustainability of the ADF
Background Paper 9	Exchange rate Determination for ADF-11
Background Paper 10	Enhancing Engagement in Fragile States
Background Paper 11	Enhanced Role for ADF in Regional Integration and Multinational Operations
Background Paper 12	Action Plan for Water Sector Operations
Discussion Paper 1	Strategic Priorities and Key Issues for ADF-11

Tunis Meeting (11-12 June 2007)

Background Paper 1	Technical Note on Input Data for the 2007 PBA Exercise
Background Paper 2	Progress Report on Institutional Reforms
Background Paper 3	Update on Multilateral Debt Relief Initiative, Grant Levels and Compensation
Background Paper 4	Preliminary Observations of the African Development Bank High Level Panel
Discussion Paper 1	Deputies Report: Draft Annotated Outline
Discussion Paper 2	Enhanced Engagement in Fragile States - Revised Approach
Discussion Paper 3	ADF-11 Financing Framework
Discussion Paper 4	Long-term Financial Integrity of the ADF
Discussion Paper 5	Multinational Operations Proposed Framework
Discussion Paper 6	Procurement Rules of Origin
Discussion Paper 7	Strategic Directions and Indicative Lending Scenarios

Bamako Meeting (20-21 September 2007)

Background Paper 1	Bank Group's Contribution to Governance in Africa: Strategic Orientations (2008-2010)
Background Paper 2	Update on the Gender Plan of Action
Background Paper 3	Implementation of Paris Declaration Commitments
Background Paper 4	Progress Report on Institutional Reforms
Background Paper 5	Towards a Framework Document for the Strategic Plan, 2008-2012
Background Paper 6	Update on Multilateral Debt Relief Initiative (MDRI) and Grant Compensation
Discussion Paper 1	Options for a Comprehensive Framework for Enhancing the Governance Structure of the ADF
Discussion Paper 2	Draft Deputies Report
Discussion Paper 3	ADF-11 Financing Framework 2: Discount Rates, Grant Financing & Replenishment Scenarios
Discussion Paper 4	Enhanced Engagement in Fragile States
Discussion Paper 5	ADF-11 Strategic and Operational Framework for Regional Operations
Discussion Paper 6	Resource Allocation

Additional Background paper: Resource allocation scenarios

London Meeting (10-11 December 2007)

Discussion paper 1	Results Reporting for ADF-10 and Results Measurement Framework for ADF-11
Discussion paper 2	Deputies Report