Review of Cofinancing in the Australian Aid Program

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THE SCOPE OF THIS REVIEW

Official cofinancing is an arrangement under which a Multilateral Development Bank (MDB) and one or more member governments collectively fund activities in partnership with a developing country. This review examined activities that AusAID cofinanced, on a 'joint' or 'parallel' basis, with the World Bank and Asian Development Bank (ADB).

Under parallel cofinancing, participating donors finance separate components of the activity with the individual donor able to follow its own procurement procedures for the components it finances. AusAID will normally cofinance, though grant funding, a portion of the technical assistance component(s), while the MDB provides the bulk of its support in the form of a loan negotiated with the borrower government.

Under joint cofinancing, the MDB and other donors finance expenditures from a common list of goods and services in agreed proportions. A lead MDB will be responsible for financial management of the activity, including procurement. AusAID's grant contribution is generally disbursed from a cofinancing trust fund established at the Bank.

The recommendations produced by this review should go a long way toward countering the pitfalls of cofinancing identified in this report. This will enable cofinancing to deliver the potential for achieving AusAID's development objectives in a world in which a more collegiate and program focused approach is being pursued by the donor community.

Developments in AusAID since the Review of Cofinancing

The AusAID Executive has endorsed the review recommendations, with the exception of Recommendation 7, which will be assessed in the context of a future review of AusAID's performance information systems.

AusAID has developed a comprehensive implementation plan to take the recommendations forward.

Evaluation responsibilities

The review team consisted of:

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The views expressed in this report are those of the review team, not necessarily those of AusAID.

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TABLES

ACRONYMS

ADB	Asian Development Bank
AIDAB	Australian International Development Assistance Bureau now AusAID
AMB	Activity Monitoring Brief
AMC	Australian Managing Contractor
ARIC	Asia Recovery Information Center
AusAID	Australian Agency for International Development
LAMP	Land Administration and Management Project
LIL	Learning & Innovation Loan
MDB	Multilateral Development Bank
NGO	Non-government organisation
PAD	Project Appraisal Document
PDD	Project Design Document
PG	Partner Government
PNG	Papua New Guinea
PPTA	Project/Program Preparatory Technical Assistance
QAG	Quality Assurance Group
SAP	Structural Adjustment Program
SPTF	Single Purpose Trust Fund
TA	Technical Assistance
TAG	Technical Advisory Group
WASPOLA	Water Supply and Sanitation Policy and Action
WB	World Bank

1 EXECUTIVE SUMMARY

1.1 Objectives

The aim of this evaluation was to provide AusAID with an overview of the performance of cofinanced activities and a considered assessment of the practical utility of cofinancing as a form of aid.

The evaluation had two objectives:

- To assess the quality of parallel and joint cofinanced activities (to discover lessons and good practice);
- To identify the advantages and disadvantages of using cofinancing as a development mechanism to achieve AusAID's program objectives.

1.2 Methodology

The review team used a combination of qualitative, quantitative, and participatory methods to evaluate a sample of cofinanced activities. The sample consisted of 8 activities (refer to Annex 3 for details), which were randomly selected from the total population of cofinanced activities. Where possible, the review team also captured information from cofinanced activities that were outside the sample. A desk and field review were conducted, which encompassed a review of literature and information on cofinanced activities, including the electronic database, and a series of interviews with a range of AusAID staff, contractors, partner government officials, MDB staff and Australia's Executive Directors to the World Bank and the ADB. The evaluation was conducted under the guidance of an AusAID Peer Review Group, who approved the methodology, design and work plan, and provided feedback on the draft report.

1.3 Background

The Minister for Foreign Affairs underscored the importance of engagement with multilateral organisations in his 11th Annual Statement to Parliament. The large resources that the MDBs can mobilise allow them to tackle important infrastructure needs of developing countries that are well beyond the scope of bilateral donors such as Australia. MDBs are also well placed to promote policy dialogue with member countries on what are sometimes sensitive issues, especially related to good governance.

The Minister noted that Australia will continue to work closely with the Multilateral Development Banks (MDBs) in key regional countries through joint policy dialogue, sharing strategic analysis, and cofinancing which provides a significant boost for Australia's own program funding. Australia will also seek to strengthen our engagement strategies with key multilateral partners through making more explicit our expectations of their role and programs.

1.4 Changes in the Cofinancing Environment since the Last Review

AusAID cofinancing activities were last reviewed in 1994.[1] That review pointed to the potential benefits of cofinancing for the Agency. It also noted institutional impediments within AusAID to the realisation of these benefits.

Since then the level of activity cofinanced by AusAID has increased. Activities against which there was expenditure in 2000-2001 represent an AusAID commitment of about $229 million. Cofinancing arrangements with the ADB, in particular, have increased in recent years.

Moreover, several recent developments further increase the potential importance of cofinancing in AusAID operations. The most important of these developments are:

- The ADB has encountered reductions in grant funds available to complement their lending operations, increasing AusAID's attractiveness as a cofinancing partner[2]
- The recent move on the part of the major MDBs to decentralise their operations to either regional or country offices has reduced the problems of managing cofinancing activities in partnership with partner governments and AusAID
- As partner countries continue to develop, the pooling of donor funds, sector wide approaches and partner government execution are likely to increase in importance, further increasing cofinancing opportunities for AusAID.

A large and increasing supply of cofinancing opportunities greatly broadens the range of options available to AusAID for achieving its strategic objectives.

However, the cofinanced activities reviewed for this Report, suggest that at an operational level there is widely differing experience within AusAID of the success of cofinancing.

1 AIDAB, *Cofinancing: Past Experience and Future Directions*, July 1994.

2 The ADB is anticipating a shortfall in funding due to the reduction in untied Japanese grant funds. While it is not clear whether the World Bank is experiencing the same shortage of grant funding, competition for funds for other regions increases AusAID attractiveness as a cofinancing partner within the Asia Pacific region.

1.5 Advantages to AusAID of Cofinanced Activities

Cofinancing provides AusAID with important opportunities to achieve objectives that cannot easily be achieved on a stand-alone basis. There are areas in which AusAID would like to become involved but, for various reasons, would have difficulty in undertaking bilateral activities. For example, there are significant advantages in working on major wide-ranging economic and social reform issues within a cofinanced framework.

The most important of the potential benefits (discussed in more detail in Chapter 4) are:

- Cofinancing can provide financial and policy leverage in the achievement of AusAID development goals.
- Cofinancing can assist donor coordination and harmonise delivery, reducing the administrative burden on partner governments. It enables AusAID to work alongside other donors without overlap and increases policy and sector dialogue. In practice, however, effective donor coordination with a cofinanced framework requires further development to ensure this potential benefit is fully realised.
- Cofinancing can facilitate the movement towards a sector wide strategic approach. This considerably increases the probability that the activity will yield sustainable improvements.

1.6 Problems associated with AusAID Cofinancing

There is considerable variation within AusAID when it comes to experience with cofinancing. One problem that has emerged in some activities has been an inconsistency between the objectives of AusAID and those of the cofinancier. This has sometimes centered on the emphasis MDBs can place on the need to achieve lending targets. Other problems (discussed in more detail in chapter 5) have included the following:

- Delays in delivering undertakings to the activity by one participant can have adverse implications for other participants in the cofinanced activity. This is a common management problem with parallel cofinanced activities.[3]
- Poor and inconsistent activity management procedures by partners can create problems for AusAID involvement.
- In some cases Australian visibility in the activity has not been commensurate to its dollar contribution. However, this should be balanced against instances where the Australian profile has been larger than its financial contribution might warrant.

3 This occurred with the ADB cofinanced Lao Girls Basic Education project.

Proposals to manage each of these problems have been suggested in Chapter 5 of this Report. The key is to anticipate rather than react to these problems as they emerge.

1.7 Recommendations

Chapter 6 contains the recommendations of the Report, with an explanation of each. In summary, these are:

Recommendation 1: AusAID should adopt a more proactive and structured approach to identifying cofinancing opportunities, which is tailored to meet individual country program strategy objectives. A more proactive approach would entail:

- Designated AusAID officers regularly reviewing the MDB's activity pipeline to identify and report on potential cofinancing opportunities that are consistent with country program strategies.
- Requesting that the Banks' country offices regularly provide pipeline information, with discussions on cofinancing opportunities being held in conjunction with already established MDB consultations (for example, consultative group meetings).
- Engaging with MDBs at a much earlier stage in the MDB activity development cycle than the appraisal stage (when activity design is largely firmed up). Engagement should be at the identification or concept development stage for the World Bank, and Project or Program Technical Assistance (PPTA)/ feasibility study stage for the ADB.

Recommendation 2: Wherever possible, AusAID and the MDB should prepare a single activity design document for parallel cofinanced activities rather than separate documents for the components funded by each agency. Where appropriate, AusAID and the MDB should engage in joint design preparation for joint activities. The production of a single design document should help reduce the problems associated with the linking of components and donor coordination.

Recommendation 3: To ensure the design of a cofinanced activity takes account of AusAID priorities, AusAID should conduct joint activity appraisals with the MDBs (at the identification/preparation stage).

Recommendation 4: AusGUIDE should be updated to address cofinancing specific issues related to each stage of the activity cycle. This material should also be reflected in the Program Strategy Toolkit, and cofinancing experience should be added to the AusAID Knowledge Warehouse (AKWa). Guidelines should:

- outline steps required for the preparation stage of a cofinanced activity, including steps required for a risk assessment and tips on strategies for managing cofinancing specific risks.
- provide check lists of generic issues associated with cofinancing that need to be considered in activity appraisal, eg. management/coordination structures, reporting requirements, Australian identity considerations, and activity Administration Agreements with MDBs.

Recommendation 5: AusAID staff managing cofinanced activities should be briefed on MDB activity cycles, internal clearance systems, relationship to partner governments and other fundamental institutional differences. The briefing should also cover the material included in the cofinancing guidelines such as: formulating an appropriate management approach for the activity, preparing risk matrixes for cofinanced activities and negotiating the initial administration agreement.

Recommendation 6: Individual activity Administration Agreements or equivalent between AusAID and the cofinancier should be amended to cover all areas of cofinancing related risk, including cooperative action to counter these risks. Monitoring and reporting requirements for the activity should also be fully described in the Administration Agreement.

Recommendation 7: Activity Monitoring Briefs (AMBs) should also be used to assess overall performance of cofinanced activities, not just AusAID funded components of an activity.

Recommendation 8: Where AusAID has a comparative advantage within a particular sector (eg. Governance, Education and Roads) or a particular country, (eg. PNG and the Pacific), parallel cofinancing delivery mechanisms should be considered because of our in-country capacity to more effectively manage and monitor implementation. Where the MDB has comparative advantage, or where drawing on a wider pool of international expertise is desired, joint cofinancing should be considered.

Recommendation 9: The approval documentation for cofinanced activities should include a specific strategy for ensuring adequate Australian identity.

Recommendation 10: In determining the appropriate form of cofinancing, parallel or joint, AusAID needs to balance the resource implications of the alternative forms with the potential of these alternatives to achieve desired objectives. For example, joint cofinancing may offer significant administrative savings but not provide enough profile or engagement for a strategically important initiative. On the other hand, parallel cofinancing may require greater administrative resources, but may also provide an increased level of profile and influence.

Recommendation 11: Endorse cofinancing as an important form of aid that offers a range of benefits that are consistent with AusAID's strategic objectives. For example, cofinancing:

- enables AusAID to move from activity based assistance to alternative forms of assistance more consistent with the objectives of enhanced sector/donor coordination and multilateral engagement; and
- enables AusAID to engage in high-risk high-return activities, such as wide-ranging social and economic reform programs, with risks allocated in advance and shared between partners.

The above recommendations should go a long way toward countering the pitfalls of cofinancing identified earlier in this Report. This will enable cofinancing to deliver the potential for achieving AusAID's development objectives in a world in which a more collegiate and program focused approach is being pursued by the donor community.

Tables A1.1 and A1.2 present a series of questions relating to any proposed activity that will assist in determining whether an activity may be suitable for cofinancing and, if so, the type of cofinancing arrangement that may be appropriate.

2 COFINANCING ARRANGEMENTS

2.1 Types of Cofinancing Arrangements

The MDBs promote cofinancing of development activities and programs in order to augment their own assistance funds with funds from both official and commercial sources and to establish closer coordination with official donors on country programs, policies, and priorities for expenditures. Official cofinancing is an arrangement under which a Multilateral Development Bank and one or more member governments collectively fund activities in partnership with developing countries.

The sub set of official cofinancing with which this Report is concerned[4] covers funds, provided as grants by AusAID, for activities involving the World Bank and Asian Development Bank (ADB) on a joint or parallel basis[5]. Table 1 provides a summary of the use made of joint and parallel funding by different countries.

Most official cofinancing is on a parallel basis. Under parallel cofinancing the participating donors finance separate components of the activity, with the individual donor able to follow its own procurement procedures for the components it finances. AusAID will normally cofinance, through grant funding, a portion of the technical assistance component(s), while the MDB provides the bulk of its support in the form of a loan negotiated with the borrower government. The loan provides financing for goods, works, and services aimed at creating the physical and social infrastructure necessary for poverty alleviation and sustainable development (including pre-identified equipment, materials, civil works, technical and consulting services, studies, and incremental recurrent costs).

Under joint cofinancing the lead MDB is responsible for financial management of the activity, including procurement[6]. Joint cofinancing arrangements have a common list of goods and services that are procured, normally following the MDB's procurement guidelines, and including recruitment of consultants,

4 Trust Fund Services have been excluded from the Terms of Reference for this Report. This is partly due to the World Bank currently undertaking a process of reform in selected trust fund programs.

5 Joint cofinancing arrangements are sometimes difficult to distinguish from single purpose trust funds (SPTF). SPTFs, as used by the World Bank, are freestanding funds also used directly for technical assistance. In theory, the difference appears to be that joint cofinancing arrangements operate to meet agreed expenditures for a specific purpose while SPTFs do not have a budget with a list of agreed expenditures.

6 The procurement processes must be in accord with rules set down by the MDB concerned. Implementation may be through the recipient government.

disbursement of equipment and activity supervision. The AusAID contribution is generally disbursed from a cofinancing trust fund established by the MDB. Identification, preparation, appraisal, and supervision of cofinanced activities are normally carried out in accordance with the MDB's standard policies and procedures.

The MDB's recover their incremental costs for services that are provided to cofinanciers. A fee structure is developed based on the level of service provided. Fees differ between MDBs.

Table 1: Grant funds provided for cofinanced activities by country donors

Country	Joint	Parallel
Australia	X	X
Belgium	X	
Canada		X
Denmark	X	X
Finland	X (small)	X
France	X	
Germany		X
Japan	X	X
Netherlands	X	
Norway	X	X
Spain		X
Sweden	X	
Switzerland	X	
United Kingdom		X
USA		X

Note: Trust Funds are excluded from the Terms of Reference for this Report

Donor countries have different arrangements covering their official cofinancing and trust fund activities. Some countries, such as Australia, have MOUs with the Multilateral Banks covering all their cofinancing activities. Other donors, including some of the larger countries, do not have a formal MOU.

The MOU of 8 October 1993 on Channel Financing with the ADB relates to all technical assistance which AusAID agrees to cofinance on an untied basis. Untied funds provided by AusAID for cofinanced ADB technical assistance are sourced through the umbrella framework of this MOU.

Where AusAID has additional funds available outside the cofinance facility, individual cofinancing agreements for technical assistance and components of loan projects can be negotiated.

2.2 Past Experience

Whilst the MDBs have undertaken cofinancing operations since the 1960s, cofinancing first emerged as an important supplementary source of funds in the 1980s[7] and has developed since that time. In the period 1992-94 about 57% of ADB loans were for cofinanced activities. The corresponding figure for the World Bank was 51%.

AusAID cofinancing involvement dates from the 1980s. A cofinancing agreement was signed by AIDAB and the World Bank in 1986, and a memorandum of understanding on cofinancing with the ADB in 1990. Since then AusAID cofinancing activity with the MDBs has grown rapidly. A new Cofinancing and Trust Fund agreement will be signed with the World Bank in 2003.

A 1994 review of cofinancing[8] concluded that cofinancing offers potential benefits in three main areas: improved quality of aid, trade benefits for Australian firms and efficiency gains in aid delivery. However the Report concluded that "constraints arising from AIDAB's internal culture and operational methods have hindered more effective use of cofinancing".[9]

The report identified as a major issue the question of whether AIDAB cofinancing should be tied to a requirement to procure goods and services in Australia. The report came down strongly in favour of tied cofinancing, despite the fact that the ADB was reluctant to engage in tied cofinanced activities.[10] The greater willingness in recent years of AusAID to engage in untied cofinancing has been one of the factors influencing the growth of joint cofinanced activities, and is reflected in the rise in the share of activities partnered with the ADB. Between 1993-94 and 2000-01, the share of cofinanced activities involving ADB rose from 22% in 1993-94 to 42% in 2000-01.

AusAID does not have records that enable a comprehensive list of all cofinanced activities, classified by expenditure and type of arrangement, over the period 1994-2002 to be readily obtained.

Table 2 summarises changes in the extent of AusAID cofinancing in recent years. The overall increase in the numbers and value of cofinanced activities is the result of AusAID's increased engagement with the MDBs.

7 For example the ADB first developed a cofinancing policy in 1981-82.

8 AIDAB *Cofinancing: Past Experience and Future Directions*, AIDAB, 4 July 1994. There was also an earlier review: *Review of AIDAB Cofinancing*, Canberra 1992

9 AIDAB 1994, page ii.

10 Tied cofinancing reduces the efficiency of aid in that the procurement of goods and services is constrained and the most efficient supplier may not necessarily be selected.

Table 2: Cofinanced activities with World Bank and ADB 1993-94 and 2000-01

Cofinancing Partners	1993-94	2000-01
ADB	6	14
World Bank	21	19
ADB as % of total	22%	42%

Notes: Excludes Trust Fund involvement as this is outside the Terms of Reference for this Review

For those activities with expenditures in 2000-2001 total commitments were $228.9 million of which 44% by value was attributed to ADB.

As shown in Table 3, in terms of number of cofinanced activities, the share of joint cofinanced activities has increased markedly compared with 1993-94. There are two major reasons for this increase. Firstly, the MDBs generally prefer joint to parallel arrangements because they give the MDB greater control over the activity.[11] Secondly, joint cofinancing activities are easier to negotiate and involve a lower commitment of AusAID time and resources to the activity. Parallel cofinancing requires much more planning and management on the Australian side and timing issues are often crucial to the overall success of the activity.

It should be noted, however, that in terms of value, parallel cofinanced activities still account for the overwhelming majority of commitments (about 78% of total cofinanced funding). The difference between the share in terms of numbers and value reflects the markedly different size of the two types of activities. Currently the average AusAID parallel cofinanced activity involves a commitment of $10.3 million while a joint cofinanced activity averages $4.1 million.

TABLE 3: Cofinanced activities by type of arrangement 1993-94 and 2000-01

Cofinancing Arrangement	1993-94	2000-01
Joint	13	18
Parallel	14	15
Joint as % of total	48%	55%

Notes: For those activities with expenditures in 2000-2001 total commitments were $228.9 million of which 22% by value was attributed to joint cofinanced activities. The difference between the share of joint in numbers and share of joint by value of commitment is because the average joint cofinanced activity is only $4.1 million compared to an average size of parallel cofinanced activities of $10.3 million.

11 For example in an interview with the Principal Director, Office of Cofinancing Operations, ADB, the preference for joint cofinancing was explained in terms of the greater control that ADB could exert over joint cofinanced activities.

2.3 Future Directions

Future use of cofinancing by AusAID should be considered against the background of important developments that will affect the demand, supply and type of cofinancing opportunities available globally over the next few years:

- **TA funds available to the ADB are shrinking.** TA funding for the ADB has been falling and is likely to continue to do so for the next three or four years. In particular, Japanese support for untied ADB trust funds is being substantially reduced. In this environment AusAID is likely to encounter growing interest from the ADB in cofinancing grant funded TA activities to complement loan operations.
- **The MDBs will have difficulty meeting demand for funds for activities in South East Asia and the South Pacific.** Demand for available cofinanced funds is increasing in areas such as Africa, the Middle East, Latin America and the Caribbean region and Central Europe.[12] This growth in demand will increase the attractiveness of AusAID as a supplier of cofinancing funds for activities in South East Asia and the South Pacific.
- **MDBs are decentralising their operations.** The World Bank has decentralised its management of country operations in the Asian region, particularly to the Bangkok and Manila offices. World Bank presence has also been strengthened in a number of countries of interest to AusAID, such as Laos, Cambodia and Papua New Guinea. More recently, the ADB has also moved to decentralise its operations,[13] partly with a view to putting more pressure on slow moving partner governments executing ADB activities. A review of ADB's regional office strategy is due shortly. This process of decentralisation by the MDBs provides a better environment for AusAID cofinancing.[14] It facilitates ongoing interaction between program staff belonging to AusAID, the MDB, and Partner Governments, both for the purpose of identifying possible cofinancing opportunities and for managing and monitoring activities.

12 Latin America and the Caribbean accounted for $US2.3 billion which represents the largest share of World Bank cofinancing in 2002. Other major cofinancing areas for the World Bank in 2002 were Africa ($US1.3 billion), and the Middle East-North Africa region ($0.4 billion).

13 It is unlikely that ADB decentralization will follow the World Bank pattern completely. ADB regional offices will typically have less regional resources than their World Bank counterparts and will have less autonomy.

14 One problem that has been identified in this review concerns management problems that arise when MDBs attempt to manage cofinanced projects from head office.

- **The development cooperation environment is evolving.** As AusAID's partner countries continue to develop, traditional bilateral activities are likely to become less important in AusAID's country assistance strategies.[15]

  There is an increasing tendency for donors to establish an agreed country strategy. Agreed country strategies are likely to be associated with donors adopting a more coordinated approach to activity implementation, which will be a factor determining the extent of cofinancing activities in the future. This development is also likely to place increasing emphasis on activities to promote general economic and social reform, including improved governance.

  As progress is made in these areas, donor assistance, including that from AusAID, may gradually migrate from the traditional bilateral activity independently managed by the donor toward pooled funding, eventually managed by the partner government. This is likely to be accompanied by greater flexibility in uses to which donor funds can be put and will increase the importance of cofinancing in AusAID operations.[16] The greater the success of development assistance by AusAID and other donors (particularly in the poverty reduction and governance area) the greater the need for AusAID's modus operandi to shift to more arms length forms of funding.[17]

- **Other major aid donors in the region have indicated important shifts in the type of aid they will provide to the region.** Large country donors may in the future seek to enter areas of interest to Australia. A senior Japanese Foreign Ministry official announced recently that "For the last several decades our assistance to Indonesia was focused on infrastructure, but now we are shifting to a newer approach, such as software assistance, and reform assistance for the police, justice system and municipal system,"[18] In October 2002 the Japanese Prime Minister indicated that Japan would support Indonesian democratisation efforts and offered an additional $US26 million in aid to fight terrorism and continue the country's economic reform agenda. These shifts have implications for AusAID and will increase the need for coordination of aid funds.

15 "Numerous project level interventions can clutter partner country agendas and standard 3-5 year project interventions may not be the best vehicle to achieve sustainability." The Hon Alexander Downer MP, Australian Aid – Investing in Growth, Stability and Prosperity, September 2002, page 50.

16 Once this stage has been reached the partner government is likely to be well placed to graduate from reliance on donor assistance to increased reliance on international capital flows and private sector development.

17 If, however, attempts to improve governance have not succeeded and accountability concerns remain, there will be a need for AusAID to have ongoing direct engagement.

18 Australian Newspaper, Tokyo Economic Correspondent, 6 November 2002.

AusAID's participation in cofinancing will be increasingly sought by the MDBs. One major reason for this is the type of aid offered by AusAID. Funding for grant aid as offered by AusAID is becoming increasingly scarce. The ADB, in particular, faces a major reduction in its funds available in grant form for technical assistance as a result of the decline in the supply of funds for these purposes from Japan.[19] The World Bank has increasingly competing demands for grant funds that will make the provision of grant aid to the Asian and Pacific regions more difficult. AusAID is well placed to make decisions about participation from a wide range of opportunities that it will be offered. AusAID will be in strong position to influence the conduct of cofinanced activities in which it participates.

A further reason for increased demand for AusAID resources in cofinancing opportunities is that AusAID has unique experience in some countries and technical skills in particular fields of expertise. Nowhere is this more apparent than in Papua New Guinea where Australia has an understanding of administrative procedures and community attitudes that would greatly benefit cofinanced activities. It is possible to point to current cofinanced activities in PNG that would have benefited greatly from increased AusAID input.

On balance it appears that, over the next few years, AusAID will be offered many more cofinancing opportunities than can be met from its available resources.

There is evidence to suggest that, despite the passage of time since the 1994 AusAID Report on Cofinancing, there remains ambivalence within AusAID about the merits of cofinancing. At the strategy level there is commitment to increased interaction with the MDBs in accordance with AusAID's corporate objective.[20] However, at an operational level there exists widely differing experience of the success of cofinancing. There is a lack of knowledge about MDB operations. There are also uncertainties about integrating AusAID and MDB activity cycles and resolving administrative differences with MDB staff. As yet there is no well enunciated strategy for staff at all levels to work towards achieving AusAID objectives through the use of cofinancing. This may be assisted through the provision of formal briefing for AusAID staff in MDB procedures and activity cycles, and the development of guidelines for activity managers of cofinanced activities.

19 This was confirmed at a senior level within the ADB.

20 The corporate objective is 'To advance Australia's national interest by assisting developing countries to reduce poverty and achieve sustainable development'. See The Hon Alexander Downer MP, "Australian Aid – Investing in Growth, Stability and Prosperity", September 2002, page 18.

3. COFINANCING: THE INTERNATIONAL CONTEXT

As was pointed out in the previous chapter, AusAID is likely to face an increase in the supply of cofinancing opportunities as the availability of funds, particularly grant funds for technical assistance, becomes tighter. Internationally, the regions of special interest to AusAID are likely to exhibit increased competition for partners in MDB activities.

This environment presents AusAID with both challenges and opportunities. It is arguable that AusAID may not fully appreciate its inherent attractiveness to the MDBs as a small, specialised, cofinancing partner. AusAID participation in a cofinanced development activity offers the MDB a number of important benefits.

- **MDBs will look for AusAID to complement their loan funds with a TA grant component.** The World Bank is placing increasing importance on the need for loans to be accompanied by a technical assistance component in order to increase the sustainability of the development activity.[21] However, recipient governments usually prefer that loan funds are focussed on the creation of tangible assets or clearly defined future revenue streams to cover future loan servicing. They normally seek grant rather than loan funds for technical assistance components. The World Bank, however, does not provide grant funding from its core contributions from member countries. Instead, it relies on trust funds from member countries for this purpose. While the ADB does provide grant funding, this is in short supply and sources are likely to be severely restricted in the short to medium term due to the projected sharp fall in the Japanese trust funds on which the ADB has, in the past, heavily relied upon for grant funds. In these circumstances AusAID offers MDBs an important additional source of grant funding for technical assistance to complement loan operations. MDBs face a risk that loan cofinanced operations may not be sustainable when contractors finish and the operation and maintenance phase commences under control of ministries which may be short of skills and poorly managed. The increased technical assistance that flows from the availability of grant finance leverages the loan funds and increases the likely sustainability of the loan cofinanced activities.
- **As the MDBs face increasing demands from various new regional sources, the MDBs, particularly the World Bank, will look to work in regional partnerships with other donors.** In some instances, particularly post-conflict situations, the MDBs have identified advantages in a region-wide response to development challenges facing a particular country in the region. Australia's special interest

21 World Bank, "The Bank's Cofinancing Strategy", March 1995, page 7. TA can increase sustainability through better project design; the provision of training; and institutional strengthening measures.

and concern in South-East Asia and the South Pacific gives it a greater role in regional cofinancing for such countries than many out-of-region donors. From the perspective of the MDBs, AusAID regional resources provide a major attraction for MDBs looking for potential cofinancing partners in South-East Asia and the South Pacific.[22]

- **A perceived benefit to MDBs from cofinancing with AusAID is the speed with which AusAID can mobilise donor resources for joint cofinancing arrangements.** By contrast, the World Bank has an elongated activity development cycle. This reflects a bureaucratic structure in which task managers are subject to a complex web of internal clearances associated with the Bank's organisational structure, as well as the more stringent requirements for preparing a loan operation rather than a grant. In the case of the ADB, there is frequent, substantial slippage in the activity preparation. ADB often does not have the necessary on-ground resources for rapid response and, if it does, the requirements for clearance with head office in Manila can lead to delays.

  AusAID's advantage in speed of response is potentially attractive to the MDBs in post-conflict or natural disaster situations.[23] It may also be attractive to the MDBs where the circumstances of an operation make progressive engagement[24] an attractive option, with AusAID undertaking the early pilot components.[25]

- **AusAID has a high reputation in ADB as a well-managed organisation which can offer a range of skills that complement ADB operations.[26]** Australia has developed technical skills in such diverse areas as land management and agricultural issues. It also has regional institutional experience in the South Pacific, particularly PNG. From an MDB perspective there is an advantage in drawing on these skills in a cofinancing arrangement in order to increase the sustainability of the activity.

22 This is also reflected in a comment by a World Bank interviewee that cofinancing with a European donor involves a much lower level of engagement than does cofinancing with AusAID. This is because many out-of-region bilateral donors have other priorities, such as Central Europe. They do not usually have the resources resident in the region that would be comparable to AusAID.

23 The ADB Director General, South Asia Department, suggested that AusAID could play a major role in post-conflict situations due to the speed with which it can mobilize resources. He mentioned Sri Lanka and Nepal in this context.

24 Progressive engagement may include strategies such as small-scale preparatory activities or technical assistance. For example, the World Bank uses LIL loans (less than $5 million) to undertake pilot activities that are used to lay the ground work for larger activities. LIL loans do not require Board approval, thereby facilitating more rapid mobilisation of assistance.

25 Whilst there are cases where AusAID response could be improved when considering parallel arrangements, there are cases, even in parallel cofinancing, where AusAID response is faster than that of the MDB.

26 There was an accepted view within the World Bank that AusAID has special skills relating to the South Pacific and particularly PNG.

4 THE ADVANTAGES TO AUSAID OF COFINANCING ACTIVITIES

In the previous Chapter the factors that are likely to result in AusAID being offered more regional cofinancing opportunities were outlined. Whilst there are reasons for the MDBs to actively seek cofinancing arrangements with AusAID, there are also reasons why AusAID needs to enter into these arrangements in order to achieve its corporate objective.

The most important reason is that AusAID's limited resources mean that it needs to be very careful in engaging in high-risk high-return activities, such as wide-ranging economic reform, on a stand-alone basis. Cofinancing enables the risks to be shared and provides the opportunity for AusAID to concentrate on those areas where it has a comparative advantage.[27]

This Chapter identifies some of the factors that should influence whether AusAID participates in specific cofinancing opportunities in the region.

In summary, cofinancing:

- provides important opportunities to achieve objectives that cannot easily be achieved on a stand-alone basis
- facilitates a sector wide strategic approach and national government execution
- can provide financial and policy leverage in the achievement of AusAID development goals
- can provide economies of scale due to resource pooling
- can assist donor coordination and harmonise delivery of activities
- allows AusAID to increase its policy skills and analytical capacity.

4.1 Cofinancing – the Advantages for AusAID

- **Cofinancing provides important opportunities to achieve objectives that cannot easily be achieved on a stand-alone basis.** There are areas in which AusAID would like to become involved but, for various reasons, would have difficulty in undertaking bilateral activities.

  For example, there are significant advantages in working on major wide-ranging economic and social reform issues in a cofinanced framework.

27 See for example the Andhra Pradesh Highways Project where Australian specialised knowledge about management and maintenance of non urban roads could not have been used unless the activity had an infrastructure component as its major component.

Governance issues, for example, are now regarded as a centrepiece of Australia's aid program.[28] They are also a high priority for the MDBs.[29]

Governance activities and economy-wide reform activities fall into the category of activities that offer large benefits.[30] However, at the same time, they often involve high risk because they require a high level of partner government commitment and preparedness to make economy-wide decisions that benefit the community as a whole but may adversely affect relatively small, powerful vested interests.

Governance activities, with an emphasis on budget reform, currently form an important component of the AusAID cofinancing component. There are significant advantages in approaching these multi-faceted issues in a coordinated way, usually with a parallel cofinancing arrangement.

There are other examples of cofinanced activities where the major perceived advantage has been the difficulty of undertaking a stand-alone activity in the area. Past Indonesian political difficulties have meant that it was difficult to implement stand-alone programs relating to water supply and sanitation, despite the fact that Australia has experience and expertise in the area. Participation with the World Bank in a joint cofinanced activity was considered a good way to maintain engagement in this area, and was cited by AusAID officials involved with the activity as one of the major reasons behind AusAID participation in the Water Supply and Sanitation for Low Income Communities (WSSLIC) activity in Indonesia.[31]

- **Cofinancing facilitates a sector-wide strategic approach and national government execution.** The case for AusAID adopting a proactive cofinancing strategy derives from its corporate objective: 'To advance Australia's national interest by assisting developing countries to reduce poverty and achieve sustainable development'.[32] Successful development is accompanied by growing recipient country capacity to manage both

28 Australian Minister for Foreign Affairs, Eleventh statement to the Parliament on Australia's development cooperation program, 24 September 2002, page 3.

29 For example World Bank lending to borrowers in South Asia for Public Sector Governance activities increased from $US261.0 million in 2001 to $US678.0 million in 2002. See World Bank Annual Report, 2002, Vol 1, page 97.

30 Governance reform is often a necessary precursor to other aid. Recent World Bank research suggests that donor assistance works best within a framework of satisfactory governance structures and a domestic commitment to reform. See World Bank Annual Report, 2002, Chapter 1.

31 This was considered a second best approach to stand alone activities that could not proceed because of political difficulties.

32 The Hon Alexander Downer MP, "Australian Aid – Investing in Growth, Stability and Prosperity", September 2002, page 18.

domestic and donor resources through improvements in financial management and execution and other aspects of governance. This approach has the potential to considerably increase the probability that the activity will yield sustainable improvements.

If AusAID is to adopt a sector-wide approach there are two important implications. First, it is likely to mean that donor assistance will trend away from bilateral activities and toward cofinanced arrangements that facilitate sector coordination and management. Second, coordinated approaches are likely to be complemented by an increased focus on government rather than donor execution. Most MDB activities financed by loan funds are now executed by partner governments.

Willingness by AusAID to engage in cofinancing is the key to participation in this evolutionary process. Cofinancing provides a vehicle for a relatively small donor such as AusAID, with a history of bilateral and relatively small-scale activities, to move from activity-based assistance to forms of assistance more consistent with partner government responsibility for resource allocation. The Water Supply and Sanitation Policy Formulation and Action Planning (WASPOLA) in Indonesia[33] is a good example of AusAID using cofinancing as a way of beginning to refocus from bilateral activities to a sector-wide approach with greater emphasis on encouraging an appropriate policy environment. It should be noted that a reluctance to engage in cooperative resourcing may result in AusAID's role in the donor community being diminished as the nature of donor assistance evolves over the longer term.

- **Cofinancing can provide financial and policy leverage in the achievement of AusAID development goals.** Financial leverage allows AusAID to exert an influence on an activity that is disproportionate to the AusAID financial contribution. It can also result in policy leverage on both partner governments and MDBs to direct resources in ways that are more compatible with AusAID objectives. For example, AusAID participation in a cofinancing arrangement may increase the volume of MDB resources directed to countries in the Asia Pacific region by making the total package available for cofinancing marginally more attractive in the Asian and Pacific region. This increases the level of achievement of the AusAID corporate objective compared to the situation in which the same AusAID resources had been applied to bilateral activities. Cofinance arrangements also allow AusAID to become involved in activities that are much larger

33 AusAID is funding the Regional Water and Sanitation Program for East Asia and the Pacific (WSP-EAP) under the World Bank/UNDP Water and Sanitation Program to implement the activity.

than AusAID resources would otherwise permit. Provided the activities are carefully selected, and the Australian contribution reflects areas of Australian expertise, AusAID can have an influence that considerably exceeds its financial contribution. An example of this is the Andhra Pradesh Highways project where an Australian commitment of $A1.8 million has resulted in involvement with a large activity involving $US350 million of loan funds for infrastructure.[34]

- **Cofinancing can enhance donor coordination and harmonise delivery of related activities.[35]** Donor coordination can be a problem where several donors operate separately in the same sector. Cofinancing enables AusAID to work alongside other donors, with reduced overlap and increased policy and sector dialogue. Cofinancing normally ensures AusAID receives monitoring information and has the option of participating in monitoring missions. A good example of the way in which cofinancing provides improved coordination is the parallel cofinanced AusAID/ADB Strengthening Planning and Accounting (SMIS) activity in Kiribati. This activity commenced as two separate stand-alone activities conducted by AusAID and ADB. When the AusAID activity had already commenced and the ADB activity was about to commence it was found that there was considerable overlap in scope, and common skills were required. The response was to enter into a cofinancing arrangement to improve coordination. Whilst there were problems with this activity because of the late development of cofinancing arrangements, it was clear that the activity required a cofinancing approach in order to improve coordination.

  In the case of Cyclone Waka Rehabilitation activities in Tonga, joint cofinancing was found to be an effective way of delivering emergency infrastructure in a coordinated way.[36]

  There should, however, be a caveat regarding the ability of cofinancing to effectively coordinate and deliver activities. Cofinancing is not a substitute for careful examination by AusAID of the proposed activity. There are examples where activities have been cofinanced without adequate examination of the activity design, resulting in subsequent problems during

34 Care needs to be taken in considering leverage issues. Too much leverage may result in AusAID having very little influence on the conduct of the activity.

35 It should be noted that cofinancing, by itself does not necessarily produce donor coordination. However, it provides a useful framework in which that objective can be achieved.

36 Note that there are other ways to deliver emergency support, such as through Trust Funds and direct support of appropriate NGOs. In the Cyclone Waka case cofinancing was suggested as an appropriate response by the Government of Tonga.

implementation.[37] In practice, donor coordination continues to pose substantial challenges within a cofinanced framework. To ensure the success of cofinanced activities, donors must establish effective management and monitoring mechanisms to ensure ongoing coordination at all levels. Care must also be taken to ensure that interlinked activity components are coordinated effectively.

- **Cofinanced activities can be a way in which AusAID increases its policy skills and analytical capacity.** MDBs often have skills and expertise from which AusAID would benefit. Cofinancing provides a way to transfer skills from one organisation to another. It should be noted that this is a two-way process and can form the basis for long-term partnerships, such as that between AusAID and the World Bank in land titling.
- **Cofinancing can provide economies of scale due to resource pooling and reduce the administrative burden on partner governments.** This advantage applies largely to joint cofinanced activities. Management of multiple donor contributions by one donor reduces the resources needed for procurement, management and monitoring.[38] MDB loans may also fund complementary activities which AusAID would not normally support, such as purchase of assets. Conversely, AusAID can provide technical assistance and capability building inputs which are limited under loan funding. It should also be noted that cofinancing might also deliver economies to recipient governments due to the reduced burden of dealing with multiple donors with different administrative requirements and timetables.

37 For example the jointly cofinanced Maritime Navigation Aids Project in PNG was entered into based on the ADB's quality processes and project design because this was considered to be a way to become quickly involved in the sector with minimal Australian expenditure of resources. AusAID could have offered valuable advice on the design of this project. If this advice could not, for some reason be acted upon, then AusAID's best policy would have been not to become involved.

38 In some cases if separate projects are being conducted in a small economy there is a problem that local resources may be in such short supply that costs increase. In this case a joint activity offers potential savings due to resource pooling. An example of this was the Cyclone Waka Rehabilitation Project where resource pooling and the associated economies were perceived as a major reason for entering into a joint cofinancing activity.

5 POTENTIAL DISADVANTAGES OF COFINANCING

Despite the advantages of cofinancing that were outlined in the previous chapter, attitudes in AusAID appear to be ambivalent about the merits of cofinancing relative to bilateral financing. This is not without reason. The sample of cofinanced activities reviewed for this Report indicates a number of risks which can undermine the success of a cofinanced activity. These risks need to be proactively managed in order to achieve the potential gains discussed in the previous chapter.

The key to managing these risks is to identify them at an early stage when AusAID may have some negotiating coin that can be used to ensure that activity designs minimise risk. AusAID often appears to come in late to cofinanced activities when an activity has often been already conceived and the MDB's main priority is to find a grant donor.[39] There are many examples where AusAID entered an activity at a comparatively late stage, which limited the influence that AusAID could have on the overall design of the cofinanced activity. The Coral Reef Management and Rehabilitation Project in Indonesia is an example where AusAID had little influence on the overall concept embodied in the activity because it commenced its formal participation after the design was finalised.

The risks associated with cofinancing include:

- Inconsistency of AusAID and cofinancier objectives
- Delays in delivering undertakings to the activity by one participant can have adverse implications for other participants in the cofinanced activity
- Conflicting activity preparation timetables
- Unwillingness by MDBs to respond to issues raised by AusAID
- Inconsistent cross conditionalities
- Poor and inconsistent activity management procedures by partners
- Insufficient transparency for AusAID purposes
- Australian visibility not commensurate to dollar contribution.

39 Comments that supported this view were also given to the Consultants by senior AusAID officials.

5.1 Cofinancing – Issues to Date Experienced by AusAID

- **Inconsistency of AusAID and cofinancier objectives.** One issue that has arisen in the past is inconsistency of donor objectives and priorities. An example of this arose in the Asia Recovery Information Centre Project, which was joint cofinanced with the ADB.[40] In this case the ADB, which was also the implementer, had a wider objective of producing an Asian monitoring centre while Australia, as the sole financial contributor, had a narrower objective focusing on information relating to the Asian economic recovery.

  There is a widely held perception within AusAID that MDBs place a high degree of importance on achieving internal lending targets, which can lead to differing priorities between donors. Moreover, lending targets have been difficult to achieve in South East Asia because of the Asian recession.[41] There is also a perception that the roles in relation to the partner government differ between the MDB and AusAID. In countries where MDBs do not have in-country presence, activity management may be less pro-active, with a tendency to make intermittent interventions rather than engaging in ongoing consultations. The MDBs are less able to assist partner governments with the day-to-day program management issues. By contrast, AusAID's approach is to a greater extent based on partnership, supported by on-going in-country engagement.

  SUGGESTED SOLUTION: There needs to be a strong initial agreement in place that contains agreed objectives and a written understanding that it requires agreement by all donors to depart from these objectives or to change timing and resource commitments. AusAID needs to be prepared to enforce this agreement if attempts are made by a donor to unilaterally change the objectives or timing of the activity. However, it should be noted that it may not be possible to resolve all these problems. At the very least AusAID needs to be aware of potential problems in this area and monitor the situation.

- **Delays in delivering undertakings to the activity by one participant can have adverse implications for other participants in the cofinanced activity.** Activity delays can be a major problem with complex parallel cofinanced activities where some components rely on the completion of other components that supply inputs. The Financial Management Improvement Program (FMIP) in Papua New Guinea illustrates this problem. This parallel cofinanced activity

40 This project had some special features in that AusAID contributed finance while ADB was the implementation agency and contributed physical resources such as professional staff time, software and hardware.

41 Partly because of Asian lending difficulties, the major regions for cofinancing by the World Bank in 2002 were Latin America and the Caribbean region, Africa region, and the Middle East and North African regions.

involved the management by AusAID of the Provincial Financial Management Training (PFMTP) component. As an input to PFMTP, AusAID relied on the delivery of accounting and budget software and procedure design to be provided by a parallel ADB managed component, which was to have been implemented prior to the commencement of the training component. An eighteen-month procurement delay in the ADB component meant that the contractors for the AusAID component were in the field before the systems that they were to use to train provincial staff had been produced. With hindsight this proved fortunate because the design of the training component had failed to identify crucial prerequisites, such as documenting the existing system and ensuring that provincial officials understood and accepted basic concepts (e.g. bank reconciliation) that had to be in place before training on the new system could commence. It should be noted, however, that this was by accident rather than conscious design. This type of problem is common with parallel cofinanced activities.

SUGGESTED SOLUTION: Risks associated with potential activity delays should be identified early. AusAID should generally prefer to become involved in components such as technical assistance, that are usually undertaken at the commencement of the activity, rather than activities that rely on other components being undertaken in order to provide inputs. A particular risk is associated with MDB delays in negotiating loans. Unlike the ADB, the World Bank has attempted to address this risk by having activities "project ready" before the activity commences.[42] Other activity delays occur because of failure of domestic governments to meet their undertakings. This risk can usually be identified. In some cases, such as in Laos and PNG, there are unrealistic expectations regarding the ability of the recipient government to deliver. These issues need to be addressed in activity design. If they cannot be resolved, then AusAID should consider carefully whether this an appropriate activity on which to expend funds.

- **Conflicting activity preparation timetables. Long activity preparation cycles appear to be the norm at the MDBs.** Several interviewees in the MDBs noted that AusAID can move faster than the MDBs in developing a activity.[43] This partly reflects the more time consuming processes in developing loan agreements with partner governments, together with more onerous internal

42 The WB requires projects to be approved by the Board to be "project ready". In practice this means that loans have been approved and are ready for draw down, procurement issues have been dealt with, and MOUs are in place for executing Government authorities, before Board approval.

43 Note this applies more to joint than parallel arrangements, however there are examples where even in parallel arrangements AusAID has moved faster than the MDB.

clearance processes of the MDBs. However, long preparation cycles in the MDBs can result in program difficulties for AusAID. Alternatively, AusAID funds may be held for undesirably long periods in activity trust accounts.

It is also possible for conflict in activity preparation timetables to result in AusAID entering the activity late (as in the case of the Philippines Land Administration and Management Project). AusAID is sometimes unwilling to commit to cofinancing an activity until the bank's activity design is finalised. In the case of the World Bank this normally occurs at the Project Appraisal Document (PAD) stage of the Bank's project preparation cycle. However, this document is the last stage before Board consideration, and by this stage the Bank's internal clearance processes have usually locked in the design.

SUGGESTED SOLUTION: To avoid conflicting activity preparation timetables it is desirable for AusAID to be involved in the earlier stages of identification, concept development and pre-appraisal. MDBs must also demonstrate a willingness to respond to AusAID's concerns about particular elements of an activity. As the MDB's often seem to present cofinancing proposals to AusAID relatively late in their preparation cycle this may require AusAID to be more proactive in ascertaining possible cofinancing activities which are in the MDB pipeline. This would require cofinancing to be seen as a tool to be managed pro-actively by AusAID rather than in a reactive or opportunistic manner.

It is also desirable that both AusAID and the MDB use common activity design documents. While there is a view that the World Bank PAD is insufficiently detailed to form the basis for an AusAID project design document (PDD), log frame and contracting (the PAD is filled out in a Lotus Notes template on the World Bank's intranet) there appears to be no reason why the PAD should not contain attachments with the level of specificity required by AusAID.

- **Unwillingness by MDBs to respond to issues raised by AusAID.** Unwillingness by AusAID to commit to cofinancing has in the past been exacerbated by the propensity of MDBs not to address AusAID's specific concerns about particular elements of an activity. As a result, AusAID has, on occasion, chosen not to formally agree to cofinance an activity until the MDBs design document was in an advanced stage of preparation and AusAID could clearly see that their concerns had been respected and taken into account.

  SUGGESTED SOLUTION: AusAID should engage with the MDBs at the earlier stages of identification and concept development. AusAID should also conduct joint pre-appraisal missions with the MDBs, and ensure concerns are reflected in the design document. Early engagement with the MDBs offers AusAID a range of potential benefits such as:

- avoiding relegation to "junior partner status"
- not being viewed solely as a source of funding
- enhancing AusAID's analytical skills

Where AusAID's concerns are not adequately addressed, AusAID should carefully consider whether continued participation in the activity is warranted.

- **Inconsistent cross conditionalities:** These can occur, for example, when a cofinancing arrangement is being implemented in a country where a Structural Adjustment Program (SAP) is also being operated by the MDB. SAPs invariably have conditionalities attached to them and it is possible for the country to reach a stage where the MDB makes a decision that undertakings have been breached and it withdraws from involvement with the government. For example, the World Bank has at times withdrawn from PNG and it has currently withdrawn from the Solomon Islands. If this were to occur while a cofinancing arrangement was in place there would be an inevitable disruption to the cofinanced activity.

  SUGGESTED SOLUTION: In general it appears undesirable for AusAID to cofinance where the cross-conditionalities with the MDB component are tight enough to risk the success of AusAID's component. In this regard, it appears that the Canadian Aid Agency does not enter into cofinancing arrangements where there is cross conditionality between the partner components. However, rather than an outright veto on cofinancing where there is cross conditionality, this should enter AusAID's activity approval process through the risk assessment for the activity. Thus cross-conditionality in a difficult environment such as PNG would result in a risk assessment which is heavily weighted against cofinancing. High quality front-end analysis is necessary where significant cross conditionality is involved.

- **Poor and inconsistent activity management procedures by partners can create problems.** An example of this problem can be seen in Basic Education – Girls Project in Laos. It was suggested that MDBs may be less interested than AusAID in resolving hands on activity management problems since their role is often that of arms length financier. Where the activity is government executed, there may be insufficient pressure on the government from the MDB to keep to activity timetables. As far as the MDBs are concerned, the thrust of this concern appears to apply to the ADB rather than the World Bank. Problems of poor activity management by the recipient government were identified in Laos and PNG. In some parallel cofinancing cases there are differing reporting requirements. In these cases the recipient government often seeks help from the AMC to meet their reporting requirements from the MDB and then these reports are redone to meet AusAID requirements.[44]

SUGGESTED SOLUTION: An important part of the more proactive approach to cofinancing recommended in this report is a more active approach to dialogue with the cofinancier on activity management issues. This should not occur only at the time of supervision missions. ADB's move to decentralise operations provides AusAID with increased opportunity to liaise and address issues as they arise.

- **Insufficient transparency for AusAID purposes:** In some cofinanced activities there were concerns about the lack of activity performance information being provided as a matter of course. Concerns were also raised about AusAID being relegated to junior partner role in supervision missions.

  SUGGESTED SOLUTION: Provided AusAID adopts a pro-active role on entry to a cofinancing arrangement these problems should be soluble. AusAID should clearly negotiate the reporting arrangements that it needs and how conflicts will be addressed. These issues should be documented and attached to the Administration Agreement, or equivalent, for the activity.

- **Australian visibility not commensurate to dollar contribution.** In a number of instances it was suggested that the MDB role in activities cofinanced by AusAID had received a higher profile than that of AusAID. This should be balanced against instances where the Australian profile has been larger than its financial contribution might warrant.

  SUGGESTED SOLUTION: It appears to be an occupational hazard for a small bilateral aid agency cofinancing with a large and well-known MDB that the activity will tend to be identified with the MDB, particularly if the MDB is responsible for the more visible components of the project, such as infrastructure. The problem may, however, be less acute where the activity is government executed and both the MDB and AusAID are identified as cofinanciers. In this case AusAID may receive a higher profile than its contribution would strictly justify.

44 This problem was raised by one of the members of the Peer Review Group.

6 RECOMMENDATIONS

The following set of recommendations is intended to address cofinancing related risks identified in the preceding chapter. The recommendations should go a long way toward countering the pitfalls of cofinancing and enhance the potential for cofinancing to achieve AusAID's development objectives in a world in which a more collegiate and program focused approach is being adopted by the donor community.

Recommendation 1: *AusAID should adopt a more proactive and structured approach to identifying cofinancing opportunities, which is tailored to meet individual country program strategy objectives. A more proactive approach would entail:*

- Designated AusAID officers regularly reviewing the MDB's activity pipeline to identify and report on potential cofinancing opportunities that are consistent with country program strategies. The aim would be to identify and maintain a menu of possible cofinanced activities which might offer AusAID a cost-effective way of achieving its development objectives. This approach to pipeline management would integrate with the AusAID focus on program wide approaches and on increasing its engagement with the multilateral agencies. The Banks' country offices should facilitate the provision of this information, with discussions on cofinancing possibly being held in conjunction with already established MDB consultations (for example, consultative group meetings).
- Engaging with MDBs at an earlier stage in the MDB activity development cycle than the appraisal stage (when activity design is largely firmed up). Engagement should be at the identification or concept development stage for the World Bank, and Project or Program Prepatory Technical Assistance (PPTA)/ feasibility study stage for the ADB.

As discussed in Chapter 3, opportunities for cofinancing are likely to grow over the next few years due to reduced funds and increased competition for funds available to MDBs for technical assistance, decentralisation of their activities and growth in use of sector-wide approaches.

While there is a clear commitment for AusAID to "...strengthen its engagement strategies with key multilateral partners..."[45], the use of cofinancing with the MDBs for this purpose remains relatively unstructured. In the past, cofinancing has frequently been adopted on an opportunistic and reactive basis. Moreover

45 The Hon Alexander Downer MP, Australian Aid – Investing in Growth, Stability and Prosperity, September 2002, page 57.

there appears to be a wide range of attitudes in AusAID toward the use of cofinancing to meet developmental objectives. This reflects widely varying experience of cofinancing within AusAID - which in turn reflects the past somewhat ad hoc operational approach to managing cofinancing.

Information provided in the preparation of this Report suggests that AusAID often appears to come in late to cofinanced activities when an activity has been already conceived and the MDB's main priority is to find a grant donor. On occasion, AusAID has relied heavily on activity preparation and appraisal by the MDB, rather than engaging as an equal partner in the review process. Experiences with cofinancing suggests that it is unwise to commit funds to a cofinanced activity without an adequate prior review.

The proactive pipeline management proposed will allow AusAID, as a sought after partner for cofinancing, to influence the way that cofinancing arrangements are formulated and ensure that AusAID objectives are incorporated. It is vitally important that AusAID become involved in cofinanced activities at as early a stage as possible. Once the activity has received internal approvals in the MDB it will be harder to modify it to meet AusAID's procedures and objectives.

The approach to cofinancing should also be country specific, as the appropriate strategy will depend on a number of factors including the extent of country expertise possessed by AusAID, the quality of governance and the sectors that are of particular concern within the country. This will also enable aid strategies in individual countries to "...increasingly engage with and be driven by partner countries' own strategies for development".[46] This approach is supported by the 2001 AusAID Strategic Plan, which states that "selection of aid activities will flow more directly from program strategies. We [AusAID] will make more strategic choices in our programs, recognising that these choices can have a major impact on our overall development effectiveness."[47] It also states that Program areas will prepare an operational pipeline that defines the link between program strategies and proposed new activities."[48]

Extending this more program focused approach to embrace cofinancing activities will enable AusAID to make early approaches to the MDB in regard to cofinancing activities of interest, rather than waiting for a later and more uncertain approach from the MDB. This should be part of a country specific strategy for engagement, involving posts in proactive relationship management

46 The Hon Alexander Downer MP, Australian Aid – Investing in Growth, Stability and Prosperity, September 2002, page 50.

47 AusAID Strategic Plan, Improving Effectiveness in a Changing Environment, December 2002, Section 1.1.2

48 Op cit, Section 1.1.2.

with in-country MDB staff and a structured process for reporting on MDB pipeline developments, for example, on a six monthly basis.

This would also give more concrete effect to the MOUs between AusAID and the MDBs which formally require annual consultation on opportunities for cofinancing.[49]

Recommendation 2: *Wherever possible, AusAID and the MDB should prepare a single activity design document for parallel cofinanced activities rather than separate documents for the components funded by each agency. Where appropriate, AusAID and the MDB should engage in joint design preparation for joint activities. The production of a single design document should help reduce the problems associated with the linking of components and donor coordination issues.*

It is desirable that the MDB and AusAID use a common design document. Where a World Bank Project Appraisal Document (PAD) is involved the level of detail is likely to be insufficient for AusAID contracting purposes. However the level of specificity required by AusAID could be included in an annex to the PAD. This document should provide adequate structure and detail to allow AusAID to proceed with preparing tendering and contracting documents. The request for tender and draft contract for the AusAID funded technical assistance component could be included as an attachment to the design document.

Recommendation 3: *To ensure the design of a cofinanced activity takes account of AusAID priorities, AusAID should conduct joint activity appraisals with the MDBs (at the idenification preparation stage).*

Appraisal by AusAID needs to be conducted at the identification/preparation stage of the MDB activity development cycle, preferably in collaboration with the MDB. Once activity preparation has reached the stage of the draft Project Appraisal Document for the World Bank, or draft Report and Recommendation of the President for the ADB,[50] it becomes difficult for AusAID to influence or change the design, and in particular, to address AusAID priorities (such as treatment of gender or environment issues). This is because internal clearance processes of the MDB will have commenced the lock-in of the activity design.

49 The ADB MOU of 28 August 1990, states: "4.2 For the purpose of effective consultation, the Government (Australia) and the Bank (ADB) will, prior to each annual consultation, exchange provisional lists of Activities that each party considers suitable for cofinancing. Two months before such exchange, the Government will provide the Bank with information pertaining to its development cooperation program for the next fiscal year, including the Government's aid priorities with regard to countries, sectors and Activities."

50 Whereas an appraisal document for AusAID is still in the process of project development, the MDBs have reached the final stage of project preparation, making it difficult to amend the design.

Fortunately there are usually quite long lags between the approved World Bank Project Concept Document and final draft Project Appraisal Document. The same appears to apply to the ADB Project Preparatory Note and Report and Recommendation of the President. Provided AusAID engages with the MDBs at the identification/preparation stage, it has a window of opportunity to exert a formative influence on the activity design. However, in order to capitalise on this opportunity, AusAID will need to adopt the proactive approach to cofinancing management recommended in this Report rather than a reactive approach driven by the MDB's own activity preparation cycle.

AusAID's appraisal stage is crucial for ensuring that risks associated with cofinancing (described in Chapter 5) are proactively managed.

However, there is limited guidance in AusAID procedures. AusAID's Appraisal Note format merely states that "if the activity is a parallel cofinanced activity, the appraiser must assess whether there was adequate opportunity for the study team to ensure that the Australian-funded components meet AusAID quality criteria."

This falls short of an adequate treatment of cofinancing issues at the appraisal stage for AusAID, and the role of the appraiser in regard to cofinancing proposals is considerably broader. It is at this point that the risk matrix/assessment proposed in an earlier recommendation and proposed management responses should be assessed. Under the existing guidelines the appraiser determines whether there is "...an appropriate clarification of roles and responsibilities, including funding obligations, between AusAID, the contractor and the partner government to be confident of the successful implementation of the total activity."[51] This should be broadened to include relations with the cofinancier.

Recommendation 4: *AusGUIDE should be updated to address cofinancing specific issues related to each stage of the activity cycle. This material should also be reflected in the Program Strategy Toolkit, and cofinancing experience should be added to the AusAID Knowledge Warehouse (AKWa). Guidelines should:*

- *outline steps required for the preparation stage of a cofinanced activity, including steps required for a risk assessment and tips on strategies for managing cofinancing specific risks.*
- *provide check lists of generic issues associated with cofinancing that need to be considered in activity appraisal, eg. Management/coordination structures, reporting requirements, Australian identity considerations, activity Administration Agreements with MDBs etc.*

51 AusGUIDE Stage 3: Appraisal, Appraisal Note Format.

AusGUIDE is almost entirely framed around traditional bilateral activities and there is virtually no mention of cofinancing procedures or the management of associated problems. While AusGUIDE discusses new approaches to aid delivery under the heading of activity preparation, it does not cover possible implications for cofinancing of moving to more collaborative approaches.[52]

There is valid concern in AusAID about more guidelines. Consultations with staff during the Work Practices Review "...highlighted that staff are concerned about excessive complexity in our administrative procedures and that this is preventing them from concentrating on the more value-added activities."[53] Ultimately the more effective use of cofinancing will follow from the re-positioning in AusAID culture toward a focus on program-wide approaches, developmental effectiveness, in-country activity management and monitoring and coordination with multilateral organisations. Nonetheless guidelines relating to cofinancing will assist the process of change and provide business process checklists in the new environment.

The guidelines are intended to help AusAID staff participate with MDB staff in drawing up cofinanced activity designs that adequately reflect AusAID objectives. The guidelines would draw on experience of common cofinancing problems outlined in Chapter 5 of this Report. They would also cover definition of partner responsibilities, monitoring and resolution of differences between the parties. The guidelines should be prepared in consultation with cofinancing areas of the MDBs. They could be shared with partner governments in the context of each cofinancing activity. Some preliminary considerations in preparing the guidelines are included in Annex 1.

The guidelines should also provide a framework for a 'cofinancing risk management strategy' for cofinancing proposals. The cofinancing risk assessment/matrix is intended to identify cofinancing-specific risks so that they can be proactively managed by AusAID staff before problems become difficult to resolve and compromise activity outcomes. For example, this might include a risk assessment to identify possible tensions between AusAID objectives/standards and likely MDB behaviour in the implementation phase, and a risk matrix to assign risk management roles and responsibilities. The risk assessment/matrix should also address the tendency for MDB loan financed activities to be locked in rigidly by the loan agreement while AusAID has an interest in greater flexibility to respond to emerging circumstances as the activity proceeds. The risk management strategy may involve nothing more than an appropriate frequency of monitoring by AusAID staff or an appropriate intensity of relationship management in regard

52 The new approaches are discussed in AusGUIDE's section on the five stages of the activity cycle, Stage 2: Activity Preparation, 3.5 New Approaches to Aid Delivery.

53 AusAID Strategic Plan December 2001, Annex 1, Why Change?

to AusAID's cofinancing partner. The purpose of the strategy is to ensure that AusAID officials are aware of management responsibilities in preventing difficulties, as well as solving them after the event. The key to managing these problems is to identify them at an early stage, when AusAID may have some negotiating coin that can be used to design the activity in such a way that these problems are minimised. The main areas of risk are outlined in Chapter 5 of this Report.

A key purpose of the current review is to throw light on the experience of cofinancing in AusAID. Currently there is little formal documentation of AusAID's cofinancing experience. AusAID's Lessons Learned Database makes no reference to cofinancing. Similarly the AusAID Quality Frame does not contain substantive standards relating to cofinancing aspects of quality at entry, although these are central to the success of cofinancing activities. Quality Standard 3.10 simply states that "For parallel cofinanced activities adequate opportunity [should be] provided to ensure Australian-funded components meet AusAID quality criteria." While the supporting note suggests that "Proposals from cofinancing partners [should be] subject to adequate assessment and adjustment by AusAID", there is no recognition of the generic risks associated with cofinancing, as discussed in Chapter 5 of this Report.

Recommendation 5: *AusAID staff should be provided with briefing which encompasses MDB activity cycles, internal clearance systems, relationship to partner governments and other fundamental institutional differences. The briefing should also cover the material included in the cofinancing guidelines such as: formulating an appropriate management approach for the activity, preparing risk matrixes for cofinanced activities and negotiating the initial administration agreement.*

MDB objectives can differ from those of AusAID and MDB management processes are complex. User-friendly materials covering these issues do not appear to be readily available. To help fill the gap, AusAID staff exposed to cofinancing should be provided with briefing in the structure, culture and processes of the MDBs. Awareness of cultural differences with AusAID will enable AusAID staff to better reconcile the needs of the MDB with those of AusAID.

The most successful cofinanced activities are where AusAID, MDB and recipient government officials have a good personal relationship based on mutual respect and understanding. Even the best planned cofinanced activity will be at risk if there is a failure to coordinate and liaise effectively between AusAID and the cofinancier. This is likely to require more intensive relationship management than for bilateral activities.

Engagement with partners should normally be in country. This is facilitated by both the move toward decentralisation by the MDBs, and AusAID's shift to in-country activity management and monitoring. However, post staff will need an appreciation of the effort that needs to be put into relationship management in order to reap the advantages of cofinancing for AusAID.[54] These should be covered in the above-mentioned guidelines for AusAID staff.

Recommendation 6: *Individual activity Administration Agreements or equivalent between AusAID and the cofinancier should be amended to cover all areas of cofinancing related risk, including cooperative action to counter these risks. Monitoring and reporting requirements for the activity should also be fully described in the Administration Agreement.*

The Administration Agreement with the cofinancier is approved at the appraisal stage (in conjunction with finalising the activity design document). Measures to manage potential problems associated with adoption of a cofinancing approach should be reflected in this agreement, since they are likely to involve cooperation on the part of the cofinancier as well as AusAID.

Earlier recommendations have emphasized the importance of AusAID input into the early design and identification/preparation of a cofinanced activity in order to ensure that AusAID's interests are adequately addressed in implementation. This would also imply that AusAID also has an interest in monitoring arrangements which cover those aspects of particular interest to AusAID. Where monitoring information is largely generated by the MDB it is important that the Administration Agreement ensures that AusAID's needs are met.

Recommendation 7: *AMBs should also be used to assess overall performance of cofinanced activities, not just AusAID funded components of an activity.*

For parallel projects, AMBs are typically used to report on the performance of AusAID funded components, rather than overall activity performance. This means that an AusAID funded component might be rated as satisfactory, even when the activity as a whole has shortcomings (such as poor coordination or delays). There are good reasons to try and capture activity performance as a whole, as this effects the overall sustainability and effectiveness of AusAID funded inputs. To ensure AMBs adequately capture performance issues, they should be used to measure performance of MDB managed components, as well as AusAID managed components.

54 Quality Standard 8.1 states "Desk and Post staff have been provided with the necessary tools and training for achieving high quality activities".

Recommendation 8: *Where AusAID has comparative advantage within a particular sector (e.g. Governance, Education and Roads) or a particular country, (PNG and the Pacific), parallel cofinancing delivery mechanisms should be considered because of our in-country capacity to more effectively manage and monitor implementation. Where the MDB has comparative advantage, or where drawing on a wider pool of international expertise is desired, joint cofinancing should be considered.*

Recommendation 9: *The approval documentation for cofinanced activities should include a specific strategy for ensuring adequate Australian identity.*[55]

Recommendation 10: *In determining the appropriate form of cofinancing, parallel or joint, AusAID needs to balance the resource implications of the alternative forms with the potential of these alternatives to achieve the desired objectives. For example, joint cofinancing may offer significant administrative savings but not provide enough profile or learning gain for what is a strategically important initiative. On the other hand, parallel cofinancing may require greater administrative resources, but may also provide greater profile and influence.*

A key part of the AusAID appraisal process is a review of the activity resourcing (both human and material) proposed in the activity design document.

The sample of cofinanced activities reviewed for this Report suggested that in some instances the post may lack time and resources to take a close interest in a cofinanced activity, or even to attend monitoring meetings. However, coordination and harmonisation within a cofinancing arrangement is a management intensive activity, particularly for parallel cofinanced activities. In this regard, activity identification and appraisal should particularly take account of the management intensity of responses to the risk assessment and reflect these in approving the administrative resourcing of cofinanced activities. Resource considerations need to be balanced against the objectives sought from the cofinancing relationship. While parallel cofinancing is generally more resource intensive from a management perspective, it may provide Australia with greater profile and influence. On the other hand, joint cofinancing is typically less resource intensive, but affords less identity and influence.

55 Since Australia will almost always be the smaller and less high profile partner this is a perennial problem for cofinancing and options need to be negotiated for the circumstances of each activity, but against the background of generic guidelines.

Recommendation 11: *Endorse cofinancing as an important form of aid that offers a range of benefits that are consistent with AusAID's strategic objectives. For example, cofinancing:*

- *enables AusAID to move from activity based assistance to alternative forms of assistance more consistent with the objectives of enhanced sector/donor coordination and multilateral engagement; and*
- *enables AusAID to engage in high-risk high-return activities, such as wide-ranging social and economic reform programs, with risks shared between partners.*

AusAID is re-positioning for a more collaborative and program focused donor environment. In the preface to the current AusAID Strategic Plan, Minister Downer stated "our understanding of development effectiveness is also evolving. There is an emerging international consensus that increased aid effectiveness requires [inter alia]:

- greater coordination among development partners
- less reliance on stand-alone activities unconnected to coordinated approaches."[56]

Cofinancing offers the potential to facilitate sector and donor coordination.

56 AusAID Strategic Plan December 2001, Preface. The Minister notes that the Strategic Plan "...is designed to position AusAID to respond effectively to the changing international environment. It is a reflection of AusAID 's on-going process of renewal and improvement."

ANNEX 1
SUGGESTED AUSAID APPROACH TO COFINANCING

1.1 Approach to Cofinancing

The sample of cofinanced projects studied in this review suggests there is a need for caution with regard to cofinancing[57]. There are a number of problems that need to be pro-actively managed if cofinancing is to offer its full potential in meeting AusAID's corporate objective. The major change is the need for pro-active management rather than the reactive approach of the past. Program managers need to be able to identify potential cofinancing activities and to have the necessary skills to develop cofinancing proposals. The earlier that AusAID can identify and appraise a proposal the greater the chance that AusAID's interests can be accommodated.

Cofinancing approaches will differ substantially from country to country. For some countries, such as PNG, where AusAID has special expertise, the approach may require increased use of parallel cofinancing. This could also apply to some other South Pacific countries. In South East Asia the strategy would usually be joint cofinanced activites with an increasing share executed by the recipient government using MDB procurement guidelines and financial control.

In this section suggestions relating to the development of an approach to cofinancing have been developed. In our discussions with AusAID staff, it is envisaged that recommendations accepted by AusAID would be incorporated into a set of guidelines for AusAID officials. However, it should be noted that it is impossible to devise a single set of guidelines that will meet all contingencies that might arise with cofinancing. This is because there are such wide variations in the activities involved, including the activity size and the environment in which the activity is to be implemented.

While there are benefits to be obtained from engaging in cofinanced activities, the review of activities undertaken for this Report clearly shows that cofinancing not only requires the same kind of skills and experience that is required in the design and management of stand alone projects, but also understanding of the special features of cofinanced arrangements. Indeed cofinancing may require more intensive management than bilateral activities.

57 Note that our review of AusAID cofinanced activities spread wider than those in the sample. Conclusions from the sample projects were reinforced by the review of activities falling outside the sample.

Table A1.1 Issues that should be considered when deciding whether cofinancing is an appropriate vehicle for an AusAID activity

What are AusAID's objectives in the sector?
Is the proposed activity consistent with counterpart priorities, AusAID's sectoral priorities and the Country Program Strategy?
Is cofinancing the best aid delivery mechanism to achieve these objectives? (The relative merits of cofinancing compared to other aid delivery mechanisms should be assessed).
Are there common objectives that AusAID and other donors might wish to achieve?
Are there financial, environmental, social, technical, managerial or political difficulties in carrying out an exclusive stand-alone project?
Is this an activity which, consistent with AusAID's corporate objectives, requires financial resources or political influence, beyond those available to AusAID (particularly relevant where significant policy reform is involved)?
Is there a danger of duplication with other activities either currently being implemented or planned by other donors if a bilateral approach is adopted by AusAID? (note that cofinancing by itself will not prevent duplication, but an MDB sponsored cofinanced effort may create pressures for other donors to coordinate).
Is there a possibility that AusAID could influence a large activity, consistent with its own objectives, that may be outside AusAID's financial or managerial capabilities with a relatively small amount of grant-funded technical assistance?
Is there a need to deliver goods and services quickly and in a coordinated way, for example as a response to an emergency situation? (Joint cofinancing can be used but there may be preferable mechanisms such as trust funds, NGOs etc)
Has an MDB or the partner government approached AusAID with a proposal to cofinance in a particular sector/area? Is AusAID aware of possible cofinancing opportunities that may be envisaged by the MDBs?
Is this activity a high-risk high-return project associated with broad economic and social reform objectives, where risk sharing with another major donor may be advantageous?

1.2 The Decision to Cofinance

In deciding whether cofinancing is appropriate, the issues set out in Table A1.1 should be considered. If one or more of the questions posed in Table A1.1 are answered in the affirmative, then there may be a case to consider cofinancing.

It is important that no cofinancing arrangement be entered into without prior review of the proposed approach and agreeing with proposed participants, including the recipient government, on objectives. For some small joint cofinance activities, this does not necessarily involve a detailed review. There are, however, instances where AusAID has committed funds to a cofinanced activity without going through a detailed process of prior review of the proposed approach.[58]

1.3 The Decision relating to the type of Cofinancing Arrangement

If cofinancing is identified as the preferred option, then it is necessary to consider the type of cofinancing arrangement that might be appropriate. Table A1.2 identifies issues that should be considered when deciding the nature of the cofinancing arrangement.[59] It is important that AusAID makes these decisions early so that AusAID can be involved from the inception stage of the MDB project cycle. AusAID has a history of becoming involved at a late stage in cofinancing arrangements.[60]

AusAID must agree with the design, and the design must cover all aspects of importance to AusAID. Ideally there will not be two sets of design documents.

If possible, parallel cofinancing should be confined to activites where AusAID components have minimal dependency on other components delivered by other agencies and do not involve cross conditionalities[61]. Parallel cofinancing may also be more appropriate than joint cofinancing for activities where greater Australian profile or identity is sought.

58 For example in the PNG Navigational Aids project a review by AusAID of the proposed activity plan would have been of great assistance to the project.

59 Consideration of the option of Trust Funds is outside the TOR for this Report. As a general rule Trust Fund operations provide less control of the expenditure than for other forms of cofinancing. The advantage of Trust Funds is that, if the MDB decides to implement quickly Trust Funds will facilitate fast implementation.

60 For example Cyclone Waka (AusAID only became involved when the project was in its final stages of preparation for submission to the WB Board). The Kiribati Strengthening Planning and Accounting activity (SMIS) referred to earlier was another example where the cofinancing arrangements were only considered at a late stage. The Indonesian Water Supply and Sanitation Policy and Action (WASPOLA) activity referred to earlier is also another example of late involvement. The Coral Reef Management and Rehabilitation Project was one where there was early involvement but the commitment to participate was made relatively late.

61 Cross conditionalities occur when conditionalities that apply to one activity will indirectly apply to another.

Table A1.2 Issues that should be considered when deciding the type of cofinancing arrangement

Issue	Response
Does AusAID have particular expertise in the subject and/or the region? For example AusAID has unique experience in the South Pacific, particularly PNG. Issues such as land administration, and delivery of services in remote locations, and agricultural sector activities are areas where AusAID could claim to have leading edge expertise	If AusAID does have special expertise, and particularly if the MDB may not have the same experience, then consider parallel cofinancing where AusAID has a defined role and can also contribute to overall management.
Does AusAID perceive benefits in participating directly in activity management? (For example, AusAID may have established expertise- such as PNG)	Direct participation will mean that parallel cofinancing arrangement is required.
Is there a need to deliver goods or services in a coordinated way, for example as a response to an emergency situation?	In these circumstances joint-cofinancing arrangements may be desirable.
Is this an area where AusAID does not have access to significant technical expertise or where AusAID regards the MDBs or their agencies as having special expertise?	Joint cofinancing is probably the appropriate arrangement.
Are there a large number of donors (more than 3) that want to become involved in the activity?	Consider joint cofinancing as there may be coordination difficulties with parallel cofinancing.

1.4 Activity appraisal

Suggestions that relate to assessment of the design of the activity are set out below:

- **Keep the cofinancing arrangements as simple as possible.** Minimise the number of donors in the cofinancing arrangements consistent with donor coordination issues. This is particularly important for parallel cofinancing arrangements.

- **Attempt to anticipate the management information that will be required.** WASPOLA is an example of a project in which AusAID recognised the need for performance information only after the project had commenced. Ensure that the log-frame provides a realistic framework for monitoring progress and assessing performance.

- **Where the problems associated with cofinancing cannot be resolved by a pro-active management strategy, ensure that the non-manageable component of risk is included in the activity risk analysis**. This will ensure that the cost effectiveness of the project in achieving AusAID's objective is assessed in the light of the full risk.

- **Make the effort to compare the MDBs objectives, values and procedures with those of AusAID.** Where differences are identified (for example, the need for the MDB to achieve regional lending targets) ascertain the implications for AusAID involvement and explicitly address potentially adverse implications with the MDB before committing to cofinancing.

- **Explore options for progressive engagement as far as possible.** This is more easily achieved for a World Bank Learning and Innovation Loan (LIL) or similar small scale MDB operation than for larger loan operations. However, even for larger loan operations, explore scope for AusAID playing a pilot role.

- **Carefully consider the agency (or agencies) for implementation.** In the case of parallel cofinancing this will usually be a contractor, employed by AusAID using AusAID procurement guidelines. In the case of joint cofinancing, there may be components that are executed by the recipient government using MDB guidelines, while in other cases the MDB will procure a contractor using its guidelines. If the partner government has the capacity to act as an executing agency, then this may be the desired option as it will increase the probability of sustainability.

However, in many countries the lack of skills and experience and the weak governance structures may mean that the risks of failure are such that it is preferable for the MDB to manage implementation through a contractor selected according to the MDB's procurement rules.

1.5 The Importance of the Administration Agreement, or equivalent

Having decided to cofinance and having considered the structure of the basic agreement, it is important to develop, in conjunction with other donors, a detailed administration agreement. Many of the problems and misunderstandings that arise with cofinanced agreements could have been resolved with better administration agreements. AusAID is in its best negotiating position at this time. It is often difficult for AusAID to change the way the activity is managed once the administration agreement has been settled. This is particularly important for parallel cofinanced projects, but it also applies to joint cofinanced arrangements. The agreement should cover the following issues:[62]

- **Objectives need to be identified, agreed and outlined in the administration agreement.** In the case of parallel cofinanced agreements the outputs and timing of each component to be delivered by each donor should be outlined, describing how the agreed activity management responsibilities and how the various components contributed by donors are to be integrated.
- **Ensure that the agreement has undertakings to provide statistical material necessary to meet AusAID's performance information requirements.**
- **Financial arrangements and undertakings made by each participating agency should be described in detail.** In joint cofinanced agreements where AusAID pays funds into a trust fund, the agreement should contain details of the amount and timing of AusAID payments to the trust fund; the charges made by the MDB for management of the trust fund;[63] and (possibly) a the requirement for 3 monthly reports by the Bank to AusAID showing itemised amounts drawn down, and the amount remaining in the fund. Parallel cofinanced operations will not require the same detailed financial reporting because each donor has responsibility for their own procurement. However, parallel cofinancing agreements should contain a notional budget and details of expenditure proposed by each donor.
- **Any conditionalities imposed by any donor need to be documented in the agreement.** If, for example, the recipient government has a Structural Adjustment Program in operation with the Bank and this has conditionalities that could affect the Bank's participation in the cofinanced agreement, details of the conditionalities should be provided to AusAID. If the activity involves

62 Note that this list of issues to be covered by the initial agreement is not designed to be comprehensive, as various agreements will have unique issues that need to be included.

63 The charges made by MDBs for management of trust funds differ substantially. For example, the World Bank sometimes takes into the account the interest earned on the funds, ADB does not.

administrative reform in an area where there are many domestic agencies involved, it has been found useful to impose as a conditionality that all concerned agencies must sign an MOU with the Bank that outlines their responsibilities and any undertakings that are required of them.

- **The agreement should describe the proposed management approach for the activity and its components.** There should be agreement to involve AusAID in supervision meetings, and other key meetings, with appropriate notice to be provided to participants. There should be requirements to provide significant reports and other material to AusAID in a timely manner. There should be agreement for regular review of the activity and agreed procedures for participating donors to raise issues relating to the activity with other donors. The agreement should also contain a description of the proposed institutional framework for engaging with the recipient government.
- **The agreement should document any undertakings, and the associated time frame for these undertakings, that are made by the recipient government and its relevant agencies.**

In negotiating the administration agreement, AusAID officials should be aware that the opportunities to enter into cofinancing arrangements with the MDBs will exceed AusAID's resources. Given the imbalance between demand and supply of MDB technical assistance funds, AusAID is in a strong negotiating position. It is preferable for AusAID to err on the side of conservatism and to refrain from entering into an agreement rather than to accept an agreement that does not meet its basic standards or to enter into an agreement that has not been fully assessed.

1.6 Activity Management

- **Where parallel cofinancing arrangements are adopted, give formal and informal coordination a high priority.** This includes time reserved for regular informal consultation. Experience has shown that a successful cofinanced activity often depends on good working relations between the participating agencies and between AusAID and the implementation agency.
- **When establishing a steering committee give careful consideration to appropriate structures.** All steering committees must have recipient government representation. Some steering committees have donor representation as well as recipient government representation, while others do not. Based on this review, it seems preferable to have donor representation along with recipient government representation, although with joint cofinancing it may be possible to confine the donor representation to the

MDB, with other donors having observer status. A second issue is to determine the size of the steering committee. Various models have been tried. At one end of the spectrum there is the inclusive steering committee that will include all affected domestic agencies. At the other end of the spectrum is the very small high-level steering committee that can make decisions quickly. The various models have both advantages and disadvantages[64] and the final choice will depend on the nature of the activity, recipient government resources, and the number of recipient government agencies that require direct involvement.

- **When joint cofinancing arrangements are adopted avoid junior partner status.** Where the MDB or partner government executes the activity it is primarily up to AusAID whether or not it is treated as an equal or junior partner by the MDB. AusAID will be valued for its input. Where post and desk have no time for input other than financial, AusAID risks relegation to a junior partner status and the gains from cofinancing may be compromised. It is important that the initial agreement outlines the mutual obligations of the partners that are designed to avoid junior partner status.

1.7 Activity Monitoring

- **Monitoring is facilitated if there is a good initial agreement in place that clearly identifies responsibilities for monitoring and the provision of information to other participants.**
- **AusAID needs to be flexible in its monitoring requirements and be sensible in its interpretation of the initial agreement**. This review of cofinanced activities clearly showed that an activity was most likely to succeed if there were good relations between officials based on mutual respect and on clear prior understanding of responsibilities.
- **Actively participate in joint supervision missions.** It is important to note that the quality of monitoring by the MDBs depends in part on whether they have in country representation. Ensure that there is an agreed schedule of supervision missions and that the schedule is followed. Prior to joint supervision meetings it is often useful to meet informally with donors and agree on issues that need to be covered in the meetings. There have been instances where MDB representatives have raised important issues at supervision meetings where the recipient government was represented, that had not been discussed or considered by AusAID.

64 Perhaps the most relevant experience involves the Philippines LAMP project where at the outset the inclusive model was used with all 19 agencies involved having representation and, later in the project, the steering committee was down-sized to have high level presidential representation so that decisions could be made quickly.

ANNEX 2
TERMS OF REFERENCE

1 Scope of the Evaluation

The evaluation will:

- Review available data on cofinanced activities including the database (AMS) records, Activity Manager assessments of cofinanced project performance (AMBs), and WB/ADB supervisory reports;
- Assess the quality of a sample of current activities through a detailed study of their performance. The sample of projects to be examined will include a number of WB and ADB projects, both joint and parallel. The number of each type of cofinanced project will be determined by their contribution to total financial approvals for last financial year. A number of different geographical regions will be included in the sample;
- If warranted, include field visits where discussions will be held with posted AusAID officers, consultants, Partner Government (PG) officials and other stakeholders including ADB and WB officials;
- Review AusAID policies, procedures and guidance, along with those of the MDBs, with a view to recommending improvement in both;
- Consider the extent to which WB and ADB's cofinancing policies and procedures align with Australia's aid objectives. An assessment should be made of the risks associated with cofinanced activities with recommendations to improve the capacity of AusAID's management to respond to these; and
- Review policies and approaches adopted by other donors (eg DFID, CIDA, USAID, and Irish Aid) with a view to comparing experiences and identifying innovative policy and operational approaches.

2 Method

To evaluate cofinanced activities the team will use a combination of qualitative, quantitative, and participatory methods. The evaluation will commence with a desk review including HMCB and other relevant Sections. The desk review will involve a review of literature and information on cofinanced activities, including the electronic database, and a series of structured interviews with a range of AusAID staff, contractors and PG officials. Members of the DAC Evaluations Committee will be contacted to provide information on other donors' policies regarding cofinancing. The desk review will use a rapid review technique to examine a sample of activities using a set analytical framework. The analytical framework will incorporate the existing AusAID quality assurance frame, modified, where necessary, to capture specific attributes of cofinanced activities.

The evaluation will be conducted under the guidance of an AusAID Peer Review Group who will be responsible for approving the methodology, design and work plan, commenting on the draft report prepared by the team and endorsing the completed report for submission to AusAID's Executive. The Peer Review Group may include membership from AusAID Branches, e.g. HMC, ORE, CLTB, PNG, and ESG, and, where appropriate, external adviser(s).

A field assessment will be considered, based on the analysis of findings and issues identified in the review. The purpose of a field visit would be to validate strengths and weaknesses of cofinanced activities identified in the desk review and to review the procedures and partnerships required to implement those activities.

Consultations with the MDBs and Australia's Executive Directors will be undertaken during the evaluation.

EVALUATION TEAM OUTPUTS

Desk Review

At the conclusion of the desk review and staff interviews in AusAID Canberra the Team will have:

- Prepared a draft methodology, including an analytical framework;
- Reviewed available literature on cofinancing policies and procedures, sourced from AusAID and other donors;
- Identified gaps in knowledge and requirements for expansion and verification of information;
- Developed a detailed work plan to implement the task, including allocation of Team responsibilities;
- Become familiar with issues to be examined during a field visit;
- Developed assessment instruments, interview schedules and questions;
- Drafted Summary Reports for each of the activities in the sample for detailed review;
- Finalised a field visit itinerary (if necessary);
- Prepared an annotated format for the draft overall report.

Field Study (if warranted and approved by AusAID)

Upon completion of the field visits the Team will have:

- Finalised the Summary Reports (SRs) for each of the activities in the sample for detailed review including those visited in the field. These SRs should highlight any findings that differ from the latest available AMB report; list strengths and weaknesses; identify both activity-specific and broad lessons.
- Prepared a draft overall report, for consideration by the AusAID Peer Group, which details the findings and recommendations of the Team.
- Conclusions from field/desk studies;
- Guidance on the consideration of cofinance interventions when designing Country Program strategies;
- Quality standards and indicators for cofinanced activities.

3 Qualification, Skills and Development Experience Requirements

The team leader will possess extensive experience in design, monitoring and evaluation of aid activities. A sound background in issues around measuring aid effectiveness is required. Excellent writing skills are essential. Experience working with an IFI or in supervision of cofinanced activities would be an advantage.

The team leader will be assisted by an international development specialist who will possess experience in design, review and performance information assessment of ODA funded activities in developing countries.

4 Reporting

The team will prepare a concise 2–3 page report on progress/issues for circulation prior to each of the Peer Review Group meetings.

A Summary report will be prepared for each of the activities in the sample for detailed review, including any visited in the field. The relevant desk and post officers will comment on these reports.

The final output of the review will be a 20-25 page final report. The draft final report, incorporating desk and field findings, will be submitted to AusAID within two weeks of completion of the field visit. The report will be considered by the Peer Review Group and comments provided back to the review team. The final report will be submitted after receipt of comments from AusAID.

5 Timing

It is anticipated that the consultant(s) will spend a total time of approximately 30 working days (to be finalised) broken down as follows:

- Two working days familiarisation with the AusAID activity database and cofinanced activity documentation;
- Eleven days for the desk review, assessment of project documents, analysing issues, and the drafting of summary reports;
- Up to ten days on field visits (destination and final duration to be confirmed); and
- Up to seven days on analysis and report preparation.

Desired completion date is on or before 31 October 2002.

ANNEX 3
SAMPLE OF 8 RANDOMLY SELECTED ACTIVITIES COFINANCED WITH THE MDBS

Activities in brackets were not part of the original sample but were discussed as part of this review.

Cofinancing with the Asian Development Bank (ADB)

PARALLEL COFINANCING

- Provincial Financial Management Training Program: PFMTP as part of FMIP – financial management improvement program (PNG).
- Strengthening Planning and Accounting: SMIS (Kiribati)
- Basic Education – Girls Project (Lao PDR)
- [Integrated Community Health Services Project: ICHSP: Philippines]
- [Provincial Regional Municipal Development Project: PRMDP: Philippines]
- [Coral Rehabilitation and Management Project: COREMAP: Indonesia]

JOINT COFINANCING

- Asia Recovery Information Centre: ARIC (Bank as implementer thus similar to a WB Single Purpose Trust Fund)
- [Maritime Navigation Aids Project]

Cofinancing with the World Bank

PARALLEL COFINANCING

- Land Administration and Management: LAMP (Philippines)
- [Lao Land Titling Project: Lao PDR]

JOINT COFINANCING

- Andra Pradesh Highways Project (India)
- Cyclone Waka Rehabilitation Activities (Samoa)
- [Water Supply & Sanitation for Low Income Communities: WSSLIC: Indonesia]

SINGLE PURPOSE TRUST FUND

- Water Supply and Sanitation Policy and Action Planning: WASPOLA (Indonesia)
- [Water Performance Enhancement Program: WPEP: Philippines]

Review of Cofinancing in the Australian Aid Program
Evaluation and Review Series
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Cofinancing is an arrangement under which a Multilateral Development Bank (MDB) and one or more member governments collectively fund activities in partnership with a developing country.

This review examines activities that AusAID cofinanced, on a joint or parallel basis, with the World Bank and Asian Development Bank. The reviews outlines the advantages and disadvantages of using cofinancing as a form of aid, and recommends a range of measures to maximum the benefits and minimise the risks associated with cofinancing.

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