

**MULTILATERAL DEVELOPMENT BANKS (MDB)  
EVALUATION COOPERATION GROUP (ECG)  
Working Group on Private Sector Evaluation (WGPSE)**

**MDB-ECG Good-Practice Standards for  
Evaluation of  
Private Sector Investment Operations**  
Second Edition

**May 16, 2003**

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## **MDB-ECG Good-Practice Standards for Evaluation of Private Sector Investment Operations**

### ***I. Background and Context***

1. **MDB Task Force Report.** In 1996, a Development Committee Task Force called for harmonization of evaluation methodologies, performance indicators and criteria by the MDBs:

The development of objective indicators of performance is also essential for the public accountability of the MDBs and their ability to justify their use of public resources to shareholder governments, parliaments, and the public. Currently, it is not possible to compare their operational results, or even to describe them in a common language. Major public sector institutions like the MDBs must be able to account for their efforts in readily understood terms. A common methodology for evaluating their portfolios should be developed and kept up to date over time, with best practices in evaluation techniques being identified and disseminated. A determined effort should be made to harmonize performance indicators and evaluation criteria, taking into account the differing circumstances of each institution. The lessons learned from these evaluations should be shared among the MDBs with a view to applying them quickly in new operations.

The heads of the...MDB evaluation units...[should] be charged with elaborating common evaluation standards, including performance indicators; exchange experience with evaluation techniques, share results; and become the repository of best evaluation practices. The immediate task would be to develop, within a specified time period, methodology and criteria for assessing and rating the MDB's operational performance and development effectiveness.<sup>1</sup>

2. **MDB response.** The MDBs have accepted this mandate:

The [Evaluation Cooperation] Group<sup>2</sup> will continue its efforts to make evaluation results comparable and to have their findings properly translated into operational standards. Meeting in Hong Kong in October 1997, the MDB presidents...strongly endorsed further intensification of collaboration among MDB evaluation units in harmonizing evaluation standards and activities, defining more effective linkages between independent and self-evaluation....The harmonization dialogue will be extended to...evaluation of private sector operations.<sup>3</sup>

3. And the ECG has, in turn, set down its intentions:

The ECG (i) works to strengthen cooperation among evaluators and (ii) seeks to harmonize evaluation methodology in its member institutions, so as to enable improved comparability of evaluation results while taking into account the differing circumstances of each institution.

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<sup>1</sup> Development Committee, Task Force on Multilateral Development Banks, "Serving a Changing World-- Report of the Task Force on Multilateral Development Banks," March 15, 1996, p. 18.

<sup>2</sup> Referred to herein as the ECG.

<sup>3</sup> Development Committee, "Report from the Multilateral Development Banks on Implementation of the Major Recommendations of the MDB Task Force Report", March 26, 1998, p. 4.

Harmonization in the ECG includes increased information sharing and improved understanding of commonalities and differences in evaluation policies, procedures, methods and practices and is not interpreted by members as “standardization of evaluation policies and practices.”<sup>4</sup>

**4. Subsequent developments.** In 2001, the ECG issued “MDB-ECG Good-Practice Standards for Evaluation of Private Sector Investment Operations.” Among other things, this document called for periodic assessments of the extent to which the good-practice standards were being applied.<sup>5</sup>

5. The first assessment, completed in late 2002, not surprisingly found that harmonization was at an early stage. The members’ policies and practices were, on average, materially consistent with 39% of the standards. The ratings for individual member ranged from 8% to 93%. Three factors accounted for the shortfalls. First, some members believed they had insufficient leverage to mobilize the management and staff cooperation and budgetary allocations needed for adoption and application of the standards. Second, some had begun to address the issue of adopting the standards only recently. Third, a few disagreed with some standards or considered them to be inappropriate.<sup>6</sup>

6. Based on this assessment, the ECG’s Working Group on Private Sector Evaluation agreed in March 2003 on a number of revisions in the GPS-IO. The second edition of the GPS-IO, which accompanies this memorandum, reflects these revisions.

## ***II. The Revised Good Practice Standards for Investment Operations***

**7. The Standards.** Attachment 1 sets forth the revised GPS-IO. This Attachment also provides comments on the standards, the criteria to be used in rating the degree of harmonization achieved, and some examples of application the standards. Attachment 2 provides a glossary to facilitate an understanding of the standards, and Attachment 3 summarizes some terminology specific to individual MDBs.

**8. Core and non-core standards.** Some of the standards are necessary to permit comparability of operational results among the MDBs, as prescribed by the Development Committee. These are categorized as *core standards*. Others are not needed for comparability but are nonetheless designed to help improve accountability and learning within each institution. These are *non-core standards*.

**9. Good-practice and best-practice standards.** The *good practice standards* lay down the key principles that any development institution that finances the private sector should follow if it is to have a satisfactory evaluation system. The *best practice standards* reflect more detailed practices that are desirable but not essential.

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<sup>4</sup> ECG, “Amended ECG Mandate,” approved by ECG members April 2003.

<sup>5</sup> MDB, ECG, Working Group on Private Sector Evaluation, “MDB-ECG Good-Practice Standards for Evaluation of Private Sector Investment Operations, Main Text” April 23, 2001, p. 17. Referred to herein as the GPS-IO.

<sup>6</sup> Walter I. Cohn & Associates, LLC, “Benchmarking of ECG Members’ Evaluation Practices for Their Private Sector Investment Operations Against Their Agreed Good-Practice Standards,” October 18, 2002.

**10. Issues covered.** The standards cover a wide range of issues:

GPS Nos.	Scope
1-8	<i>The roles of independent and self-evaluation</i> <ul style="list-style-type: none"> <li>• The governance structure of the central evaluation department</li> <li>• The split of responsibilities between independent and self-evaluation</li> </ul>
9-15	<i>Evaluation timing, population, coverage and sampling</i> <ul style="list-style-type: none"> <li>• Identification of population from which sample for evaluation is to be drawn, including project maturity at evaluation</li> <li>• Evaluation coverage, i.e., proportion of population to be evaluated</li> <li>• Sampling</li> </ul>
16-25	<i>Instructions, execution, and independent validation, i.e., diligence and rigor of execution and review</i>
26-50	<i>Evaluative scope</i> <ul style="list-style-type: none"> <li>• Performance dimensions evaluated, i.e., development or transition outcome, MDB's investment profitability, and MDB's work quality</li> <li>• Indicators for each of these performance dimensions</li> <li>• Performance ratings—principles and benchmarks</li> </ul>
51-63	<i>Annual reporting and process transparency</i> <ul style="list-style-type: none"> <li>• Annual synthesis reporting, i.e., annual review</li> <li>• Process transparency, i.e., annual report</li> </ul>
64-73	<i>Identification of lessons, dissemination, and ensuring application of lessons</i> <ul style="list-style-type: none"> <li>• Identification of lessons</li> <li>• Dissemination of findings and lessons</li> <li>• Ensuring application of lessons</li> <li>• Disclosure</li> </ul>

**11. Issue not yet covered.** Although the GPS-IO define the performance dimensions to be rated, the performance indicators to be used in assigning ratings for these dimensions, and the criteria to be used in assigning ratings for these performance indicators, they do not incorporate rating benchmarks. To the extent that the Members have not adopted common benchmarks for what is required for each rating for each of the performance indicators, evaluative judgments cannot be compared.<sup>7</sup> This issue needs to be addressed, but the WGPSE's ability to agree on common benchmarks may be constrained, *inter alia*, by the lack of common benchmarks among the MDBs in their investment decisions.

### ***III. Implementation and Monitoring***

**12. Ratings harmonization.** In issuing the GPS-IO in 2001, the Members agreed to review periodically their measurement methods, ratings systems, guidelines and benchmarks with the aim of judging and reporting outcomes according to consistent standards and advancing the ECG's harmonization agenda as far as possible. To this end, they agreed to share all evaluation documentation, including self-evaluation instructions,

<sup>7</sup> For example, one institution may require a 10% economic rate of return for a satisfactory rating and another may require a 12% economic rate of return. Even if the first institution reports that 80% of its projects achieved satisfactory returns and the second one reports that 70% achieved satisfactory returns, one cannot conclude that the performance of the first institution is better than the second.

ratings guidelines, best-practice reports, annual reviews, and annual (evaluation system quality) reports on a confidential basis (all subject to editing as needed to protect confidentiality requirements). As Members reach further agreements on methods, rating standards, and benchmarks, they will document them in subsequent refinements of the GPS-IO.

**13. Convergence progress monitoring.** As indicated earlier, the Members also agreed in 2001 to arrange for periodic independent crosscutting assessments of the extent to which the good-practice standards are being applied in their agencies' evaluations and annual reporting and to report the findings to the MDB Presidents. The Members envisage a further benchmarking assessment in 2003.

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## GOOD PRACTICE STANDARDS – SECOND EDITION

<i>Std #</i>	<i>Core or Non-Core</i>	<i>Summary of Standard</i>	<i>Comments</i>
		<b>Roles of Independent and Self-Evaluation</b>	
		<b><i>Structure and role of independent evaluation, i.e., of Central Evaluation Department (CED):</i></b>	
1	Core	CED has a Board-approved mandate statement, designed to ensure independence and relevance.	Must be approved by Board of Directors to be rated as MC.
2	Core	<p><i>Good Practice.</i> The mandate provides that the Board of Directors oversees CED's work and that the CED's reporting line, staff, budget and functions are organizationally independent from the MDB's operational, policy and strategy departments and related decision-making.</p> <p><i>Best practice.</i> In addition, the mandate specifies that the Board has the ultimate decision authority for (1) hiring and terminating CED head and staff; (2) CED head's appointment terms and reporting structure; (3) CED head's and staff's grading, performance reviews and pay increases; and (4) the CED's budget.</p>	<p>BP and MC ratings require explicit statements in mandate or equivalent document.</p> <p>For a sample mandate, see <b>Exhibit 1</b>.</p>
3	Non-core	CED operates with full autonomy but in close consultation with the MDB's other departments to ensure as far as possible (subject to the primacy of sound evaluative principles and practices) coherence of corporate standards (as among operations, portfolio and strategy analysis, and evaluation) and good prospects for corporate ownership of CED's findings and recommendations for improvement. To this end, CED seeks alignment, as far as possible, of performance measures and standards used in evaluations and in non-CED reports to management and Board.	<p>Critical word is "operates." Does not require explicit statement in mandate.</p> <p>This GPS deals with actions taken by CED. GPS 70 deals with outcomes</p>
4	Core	Under its mandate, CED's scope of responsibility extends, without restriction, to all determinants of the MDB's operational results.	If management has right to approve or disapprove program, it can limit scope of responsibility and, thus, highest rating possible would be PC.
5	Core	The mandate states that CED has unrestricted access to MDB's staff, records, co-financiers, clients and projects. The mandate may, however, allow for restrictions on access to clients and projects in jeopardy cases, where an evaluator's visit could prejudice the MDB's financial interests or materially increase the risk of litigation. Should client access be restricted in jeopardy cases, the number of such cases should be reported in the MDB's annual report or annual review.	MC rating requires explicit statement in mandate.
6	Core	The mandate provides that CED transmits its reports to MDB's Board after review and comment by management but without management clearance or any management-imposed restrictions on their scope and contents.	MC rating requires explicit statement in mandate designed to protect MDB against management-imposed restrictions.
7	Non-	The mandate provides that CED's manager holds grade-rank at least equal	MC requires that provision be embodied in mandate. Specification of title meets this

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<i>Std #</i>	<i>Core or Non-Core</i>	<i>Summary of Standard</i>	<i>Comments</i>
	core	to that of operational department directors.	requirement if title implies grade-rank equivalent to operational department directors.
		<b><i>Responsibilities of operations departments in self-evaluation and related reporting:</i></b>	
8	Core	<p><i>Good practice.</i> Execute XASRs on investments<sup>8</sup> selected pursuant to GPS 14-15 in accordance with CED's sample selection and evaluation guidelines.</p> <p><i>Best practice.</i> In addition, deliver XASRs according to a schedule designed to spread the review load throughout the program year and allow CED to complete the annual review on schedule.</p>	
		<b>Evaluation Timing, Population, Coverage and Sampling</b>	
		<b><i>Identification of population from which sample for evaluation is to be drawn; timing of consideration for evaluation:</i></b>	
9	Core	Taking into consideration information on project maturity status provided by other departments, CED determines the <i>population</i> from which the investments to be evaluated each year are to be drawn.	Similar to GPS 14, which calls for CED's selecting the sample of projects to be evaluated.
10	Core	<p>The population from which the investments to be evaluated each year are to be drawn consists of the investments that will have reached <i>early operating maturity</i> (as defined in GPS 11 and 12) during the year.</p> <ul style="list-style-type: none"> <li>Subject to certain exclusions, specified below, the population includes all disbursed (including partially cancelled) investments<sup>9</sup>--whether still active or already closed (paid-off, sold or written off)--that have reached early operating maturity. The population also includes investments already closed, even if they never reached early operating maturity.</li> <li>Excluded from the population are dropped and cancelled investments, very small investments made under special promotional</li> </ul>	<p>Since visits to closed investments may not be feasible and since operational staff may be unwilling to devote resources to visiting closed investments, CED may carry out abbreviated desk reviews to evaluate these operations. The important thing is that they not be excluded from the population, which would introduce bias in reporting on overall outcomes.)</p> <p>For already-closed investments that are selected for an XASR, the XASR consists of the last available supervision report and the attached evaluative addendum.</p> <p>IFC's practices are reflected in <b>Exhibit 2.</b></p>

<sup>8</sup> For guarantee operations, references to "investments," here *et passim*, should be replaced by "guarantees."

<sup>9</sup> For guarantee operations, references to "disbursed investments," here *et passim*, should be replaced by "committed guarantees."



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<i>Std #</i>	<i>Core or Non-Core</i>	<i>Summary of Standard</i>	<i>Comments</i>
		<p>programs (e.g., direct investments in SMEs that are evaluated on a program basis through a CED special study), subscribed rights offerings and investments undertaken to help finance cost overruns on projects previously financed by the MDB.</p> <ul style="list-style-type: none"> <li>Projects that have not yet reached early operating maturity are excluded from the current evaluation year's population and rolled forward for inclusion in the population in a future year when they will have reached early operating maturity.</li> <li>Investments are included in the population from which the sample for evaluation is drawn only once, i.e., only for the year in which they will have reached early operating maturity</li> </ul>	
11	<b>CCore</b>	<p>All operations other than the financial markets operations specifically covered by GPS 12 are deemed to have reached <i>early operating maturity</i> when (a) the project financed will have been substantially completed, (b) the project financed will have generated at least 18 months of operating revenues for the company and (c) the MDB will have received at least one set of audited annual financial statements covering at least 12 months of operating revenues generated by the project.</p>	MC requires that definition of early operating maturity be consistent with GPS.
12	<b>CCore</b>	<p>Financial markets projects with identifiable sub-projects financed by the MDB's investment are deemed to have reached <i>early operating maturity</i> when:</p> <ul style="list-style-type: none"> <li>For lending operations: at least 18 months shall have elapsed after the MDB's final disbursement of its loan.</li> <li>For investment funds: substantially all of the projects financed will have generated at least 12 months of operating revenues.</li> </ul>	<p>This standard is not applicable to financial markets projects that do not finance identifiable sub-projects that can be linked to a MDB's assistance. These operations are covered under GPS 11.</p> <p>MC requires that definition of early operating maturity be consistent with GPS.</p> <p>Based on this standard, financial markets projects would be deemed to have reached early operating maturity at an earlier stage than other projects. Consequently, evaluations of financial markets projects are likely to be subject to a positive bias compared with other projects. The MDBs, however, are unlikely to have the information needed to apply GPS 11 to financial markets projects, particularly when they need to determine whether projects have reached early operating maturity. To provide a basis for a more appropriate standard, it would be useful for one of the MDBs to review a sample of its financial markets projects to determine the number of months required after final loan disbursement for substantially all sub-projects to meet the tests of GPS 11. Alternatively, one of the MDBs could review a sample of its financial markets projects to determine (i) whether a test calling for substantially all sub-borrowers to have completed their grace periods and begun to repay loan principal would yield results comparable to GPS 11 and (ii) whether the MDB would</p>

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Std #	Core or Non-Core	Summary of Standard	Comments
			have access to this information based on its normal reporting requirements.
		<b>Evaluation coverage:</b>	
13	CCore	<p><i>Good practice:</i> Preparation of XASRs (with XASR-As), PERs, or a combination of the two on a random, representative sample of sufficient size to establish, <i>for a combined three-year rolling sample</i>, success rates at the 95% confidence level, with sampling error not exceeding <math>\pm 5\%</math>, for the population's development (transition) outcome, MDB investment outcome and MDB work quality.</p> <p><i>Transitional good practice:</i> Preparation of XASRs (with XASR-As), PERs, or a combination of the two on a random, representative sample equivalent to 60% or more of the investments in the population. In using this standard, an MDB reports on the confidence level and sampling error applicable to the success rates for the population's development or transition outcome, MDB investment outcome and MDB work quality. An MDB can use this standard only until its combined three-year rolling population of projects reaching early operating maturity reaches 50.</p> <p><i>Best practice-Alternative 1:</i> Preparation of XASRs (with XASR-As), PERs, or a combination of the two on a random, representative sample of sufficient size to establish, <i>for a combined three-year rolling sample</i>, success rates at the 95% confidence level, with sampling error not exceeding <math>\pm 5\%</math>, for the population's development or transition outcome, MDB investment outcome and MDB work quality <i>within each of the MDB's current strategically targeted groups</i>.</p> <p><i>Best practice-Alternative 2:</i> Preparation of XASRs (with XASR-As), PERs, or a combination of the two on 100% of the investments in the population</p>	<p>XASRs are prepared by operating staff and then validated by CED, with the results reflected in an XASR-A. This approach is more efficient, and it fosters ownership of XASR and annual review findings and ratings judgments, learning from experience and accountability for results.</p> <p>PERs may lead to assignment of more accurate ratings and more useful lessons. By carrying out field visits, a CED is able to gather additional information that allows it to review a project in a new light and revise self-evaluation ratings that it might not have questioned based on a desk review of a self-evaluation report. Self-criticism is not a natural human inclination and is not encouraged in most organizations. Moreover, operational staff normally lack cross-cutting, wider experiences that would balance their experience with a specific project with other projects handled elsewhere in the institution.</p> <p>A CED has full discretion to carry out a PER on any operation. It will normally do so where an XASR's findings raise substantive validation or credibility challenges; where an XASR's quality was so poor, even after follow-up, as to not allow CED to independently establish the appropriateness of the XASR's ratings; or where it considers a PER to be useful for learning purposes.</p> <p>The standard calls for meeting certain confidence level and sampling error tests. These tests would be applied to the combined sample for the three years ending with the most recent year for which evaluation results are available. Thus, in an MDB's annual review for, say, 2004, it would look at the combined results of the evaluations carried out during 2001, 2002 and 2003.</p> <p>The good-practice standard is the minimum required for meeting the ECG's harmonization goal at the corporate level. However, to generate statistically significant sub-sample results for use in formulating corporate strategies or holding departments accountable for their results, a higher coverage would be needed, as envisaged in the best-practice standards.</p>
		<b>Sampling:</b>	
14	Core	The CED selects the operations for XASRs and PERs from the evaluation year's population (as defined above), subject to the following standard.	Similar to GPS 9, which calls for CED to determine the population from which the sample is to be drawn. The key point in both standards is that the CED selects the

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<i>Std #</i>	<i>Core or Non-Core</i>	<i>Summary of Standard</i>	<i>Comments</i>
15	Core	<p>If coverage is less than 100%, the sample should be both random and representative.</p> <p>Notwithstanding this principle, a CED may wish to select projects to be covered by PERs based, e.g., on the potential for learning, the high profile of an operation, credit and other risks, whether the sector is a new one for the MDB, the likelihood of replication, or the desirability of balanced country and sector coverage. If so and if the CED wishes to combine the PER with the XASR-A findings in reporting annual success rates, it uses stratified sampling methodology, as follows:</p> <ul style="list-style-type: none"> <li>• It splits the population into two strata. The first consists of the projects CED selects for PERs. The second consists of the remaining projects, i.e., the population other than the projects selected for the first stratum.</li> <li>• CED evaluates 100% of the first stratum. The success rates from the sample are, thus, identical to the success rates for this portion of the population.</li> <li>• CED selects a random sample from the second stratum. The operational staff prepares XASRs on the projects selected, and CED prepares XASR-As on these projects (or a random sample of them). The sample is sufficiently large to give reliable estimates of the success rates for that stratum.</li> <li>• Based on the weight of each stratum in the overall population, CED then calculates the weighted average success rates and sampling errors, following the normal procedures for stratified sampling.</li> </ul> <p>If the CED wishes to select projects to be covered by PERs as above <i>but does not wish to combine the PER with the XASR-A findings in reporting annual success rates</i>, it draws the sample to be covered by XASRs from the full population for the year, without previously eliminating the projects to be covered by PERs. To the extent that specific projects may be selected for XASR-As and PERs, CED would use the PER ratings, rather than the XASR-A ratings in reporting on success rates, since CED will have carried out a more rigorous review in these cases.</p>	<p>sample, not management or the operational staff.</p> <p>Only random or stratified random samples support performance inferences about the sampled population. Representativeness is important for <i>prima facie</i> plausibility of the results and because of performance variances among sub-sets of the population. For example, IFC has found that certain investment departments have generally achieved higher work quality than others; equity success rates are lower than for loans; large investments perform better than small investments; investments with specific loss provisions at evaluation tend to have lower outcome ratings; and greenfield projects have worse outcomes than expansion projects.</p>

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<i>Std #</i>	<i>Core or Non-Core</i>	<i>Summary of Standard</i>	<i>Comments</i>
		<b>Instructions, Execution and Validation</b>	
		<b><i>Instructions &amp; familiarization:</i></b>	
16	Core	<p>In consultation with operations departments, CED prepares, refines and disseminates instructions for the preparation of XASRs and PERs in sufficient detail to promote consistency and objectivity in execution scope, analysis and ratings.</p> <p>As part of dissemination efforts, some CEDs may wish to conduct workshops to familiarize the XASR teams with requirements and supporting documentation for achieving good-practice execution.</p>	
17	Core	<p><i>Good practice:</i> The instructions include ratings guidelines with benchmarks and standard reporting templates that include the performance ratings matrix.</p> <p><i>Best practice:</i> The instructions also include related documentation, such as an overview of the XASR program, a description of efficacious execution process steps, good-practice examples of XASRs from previous years' samples, and a list of execution mistakes to avoid (informed by past XASRs).</p>	IFC's instructions are shown in <b>Exhibit 3A, 3B and 3C</b> .
18	Non-core	CED maintains these instructions on its website.	
		<b><i>Execution:</i></b>	
19	Core	The research for XASRs and PERs draws from a file review; discussions with available staff involved with the operation since its inception; independent research (e.g. on market prospects); a field visit to obtain company managers' insights and to the project site to observe and assess outcomes; and discussions with parties who are knowledgeable about the country, company and project (e.g. MDB specialists, company employees and auditors, suppliers, customers, competitors, bankers, any relevant government officials, industry associations, and local NGOs).	MC requires, <i>inter alia</i> , a field visit for substantially all XASRs and PERs. Information on when the field visit took place and who participated in the field visit needs to be included in the XASR or PER or in the transmittal memo (GPS 20). Some MDBs may wish to call for information on persons interviewed (with titles and affiliations).
		<b><i>Review and independent validation:</i></b>	This sub-section is not applicable to PERs.
20	Non-core	<i>Good practice.</i> The standard transmittal memo on the XASRs executed by operations department staff incorporates the approval (or electronic check-off) by the responsible operations department manager.	The XASR findings comprise a set of representations by management (through the CED) to the Board, and a sign-off or check-off comprises the only written evidence of the operating management's endorsement of the staff's representations.

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<i>Std #</i>	<i>Core or Non-Core</i>	<i>Summary of Standard</i>	<i>Comments</i>
		<i>Best-practice.</i> In addition, the standard transmittal memo on the XASRs executed by operations department staff incorporates the approval (or electronic check-off) and, if relevant, cites disagreements by other departments, e.g., technical, environmental, economics and syndications.	
21	Non-core	To provide transparency with respect to field visits (GPS 19), the XASR or PER or the XASR transmittal memo provides information on when field visit took place and who (i.e., representatives of which departments) participated in the field visit.	
22	Core	CED conducts an independent review of each XASR to verify scope responsiveness, evident reliability of the analysis, impartiality and consistency in ratings judgments, and appropriateness and completeness of the identified lessons, and then, <i>for each randomly selected XASR to be used in the annual synthesis report on evaluation results</i> , prepares an XASR-A on the final-edition XASR that records its independent judgments on the report's quality in relation to the guidelines, assigned ratings and lessons.	See GPS 15 with respect to random sampling.  The format for IFC's XASR-As is provided in <b>Exhibit 4</b> .
23	Non-core	<i>Best-practice:</i> For XASRs recommended by CED, the relevant vice president, central portfolio manager, credit manager, or other manager at a level higher than the responsible officer and his or her manager chairs a review meeting that is attended by the XASR team and their managers, CED, and representatives of specialist departments (e.g. credit, technical and environmental, economics, legal, syndications and special operations) as relevant. Operations staff responsible for the operation at entry are invited to attend the review meeting, comment on the XASR's findings, or both.	
24	Core	Following preparation of each draft XASR-A, CED reviews with the XASR team and its manager the basis for its judgments where its ratings differ from those in the final edition XASR.	
25	Non-core	At the end of the program year and prior to submitting its annual review, CED sends a ratings validation variance memo to the responsible senior operations manager, with copies to the relevant XASR teams and their managers.	A sample ratings variance memo prepared by IFC's OEG is provided in <b>Exhibit 5</b> .

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<i>Std #</i>	<i>Core or Non-Core</i>	<i>Summary of Standard</i>	<i>Comments</i>
		<b>Evaluative Scope</b>	
		<b><i>Performance dimensions evaluated:</i></b>	
26	Core	<p><i>Good practice:</i> The scope of the XASR (and XASR-A) or PER includes, at a minimum,</p> <ul style="list-style-type: none"> <li>• The <i>project's development or transition outcome</i>, i.e., the project's "results on the ground" relative to the MDB's mission.</li> <li>• The <i>MDB investment's profitability</i> (contribution to its corporate profitability objective), and</li> <li>• The <i>MDB's work quality</i> (also referred to as bank handling, operational effectiveness, or execution quality).</li> </ul>	
27	Core	The operation's performance under each of these dimensions is analyzed according to standard indicators, and the operation's performance for each indicator is rated according to criteria and benchmarks specified in the guidelines.	IFC's practices are reflected in <b>Exhibits 3A</b> and <b>7</b> .
28	Core	The performance reflected in the relevant indicator ratings is synthesized into ratings for each of the three performance dimensions, specified above.	In addition, some members provide an overall outcome rating synthesizing the three performance dimensions.
29	Core	Project outcomes for each of the indicators are assessed on a "with v. without project" basis..	MC requires that this rule be specifically stated.
30	Core	Assessments of development or transition outcomes for each of the development or transition outcome indicators take into consideration the sustainability of the results.	
		<b><i>Indicators for the development or transition outcome:</i></b>	
31	Core	<p>The project's development or transition outcome is based partly on the <i>project's contribution to the company's business success</i>, measured mainly:</p> <ul style="list-style-type: none"> <li>• For capital expenditure projects: by the project's after-tax financial rate of return (FRR);</li> <li>• For financial markets projects: by the project portfolio's profit contribution to the financial intermediary or investment fund;</li> </ul>	<p>Evaluation of company business prospects is a key element in assigning a rating for or making a judgment on a project's contribution to company business success.</p> <p>EBRD assigns ratings for both (a) the project's contribution to the company's business success and (b) company performance with the project.</p>

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<i>Std #</i>	<i>Core or Non-Core</i>	<i>Summary of Standard</i>	<i>Comments</i>
		<ul style="list-style-type: none"> <li>For other projects: by the project's profit contribution and the achievements of the company's at-approval business objectives.</li> </ul>	
32	Core	The project's development or transition outcome is based partly on the <i>project's contribution to the country's private sector development and/or its development of efficient capital markets and/or its transition to a market economy.</i>	<p>For projects other than financial sector projects, IFC rates contributions to private sector development primarily on the development of a sustainable private enterprise and secondarily on project-induced effects, e.g., (i) upstream and downstream linkages to local private businesses, (ii) new technology, development of management skills, and employee training, (iii) enhanced private ownership, (iv) stronger local entrepreneurship, (v) greater competition and competitiveness, (vi) broad demonstration effects, (vii) follow-on investments by other investors, (viii) domestic capital market development (e.g., pioneering listing on stock exchange or significant broadening of listed value; first-of-a-kind financing instrument; introduction of international accounting standards or enhanced disclosure standards), (ix) development of infrastructure available to other private users, or (x) company's reputation and business practices as a positive corporate role model and quality investment asset, among other things, because of its corporate governance practices, (xi) whether project-related technical assistance or the project's activities and services have helped create conditions conducive to the flow of private capital into productive investment, including, e.g., changes in specific laws, regulations or an improvement in their administration and enforcement.</p> <p>For financial sector projects, IFC rates contributions to the development of efficient capital markets on the economic and financial profitability and growth prospects of sub-projects, pioneering attributes, transfer of banking skills or technology, resource allocation efficiency, impact on competition, demonstration effects, linkages, catalytic effects on other companies, financial market development, and whether project-related technical assistance or the project's activities and services have helped create conditions conducive to the flow of private capital into productive investment, including, e.g., changes in specific laws, regulations or an improvement in their administration and enforcement.</p> <p>EBRD rates contributions to transition to a market economy based on (i) competition; (ii) market expansion via competitive interaction in the sector and the industry; (iii) framework for markets: institutions, laws and policies that promote market function and efficiency; (iv) skills transfer and dispersion to the industry and economy as a whole; (v) demonstration effects: transfer of new behavior and patterns; and (vi) new standards for business conduct.</p>
33	Core	The project's development or transition outcome is based partly on its	

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<i>Std #</i>	<i>Core or Non-Core</i>	<i>Summary of Standard</i>	<i>Comments</i>
		<p><i>economic viability.</i></p> <p>For non-financial markets operations: Based mainly on the project's net quantifiable economic benefits and costs, as measured by the project's real economic rate of return (ERR).</p> <p>For financial market operations: Rated on whether the sub-projects financed are economically viable (as reflected, e.g., in sub-project ERRs or the portfolio credit or equity IRR performance combined with the absence of portfolio concentrations in protected industries); whether the project has led to use of economic viability criteria in the intermediary's or investment company's investment decisions; and benefits to the economy. In most cases, quantitative information on the economic viability of sub-projects is not available to the MDB. The judgment, therefore, relies on assessing portfolio financial performance and an assessment of the extent to which the intermediary or investment company invests in protected industries.</p>	
34	Core	The project's development or transition outcome is based partly on its <i>contribution to the country's living standards</i> . This rating reflects the project's economic benefits and costs to those who are neither its owners nor its financiers, i.e., customers, employees, government, suppliers, competitors, local residents, etc.	<p>One proxy to determine whether non-financiers are benefiting is the relationship of the quantifiable net benefit to all of society (captured in the ERR) to the net benefits accruing solely to the owners and financiers (captured in the FRR). <math>ERR &gt; FRR</math> suggests that benefits are accruing to people who have no investment at risk in the project. <math>ERR &lt; FRR</math> suggests that the project's owners and financiers may be benefiting at the expense of others. Not all outcomes, however, can be quantified and measured in the ERR. The rating, therefore, also reflects non-quantifiable outcomes and contributions to widely held development objectives, e.g., poverty reduction, social or gender inequality, concern for child labor, or regional or rural development.</p> <p>EBRD has no social mandate and considers that it, therefore, cannot assess contributions to improved living standards.</p>
35	Core	The project's development or transition outcome is based partly on its <i>environmental sustainability</i> (benchmarked against compliance with the MDB's specified standards in effect (i) at investment approval and (ii) at the time of the evaluation). "Environment" includes the physical environment and, to the extent covered by the MDB's policies, also includes social, cultural, and health and safety impacts.	<p>MC requires that performance be benchmarked against standards in effect at approval <i>and</i> at evaluation.</p> <p>EBRD bases its ratings on the environmental performance of the company and the extent of environmental change. It has no mandate to address social or cultural issues and considers, therefore, that it cannot assess performance with respect to these issues.</p>



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<i>Std #</i>	<i>Core or Non-Core</i>	<i>Summary of Standard</i>	<i>Comments</i>
			<p>IFC assigns an excellent rating for projects other than financial markets projects if the project meets the higher of IFC's current or at-approval requirements and has materially improved the company's overall environmental performance or that of other local companies; a satisfactory rating if the project is in material compliance with IFC's at-approval requirements and has been over the life of the project; partly unsatisfactory if the project is not now, or has not been, in material compliance with IFC's at-approval requirements, but deficiencies have been or are being addressed through on-going or planned actions; or unsatisfactory if the project is not in material compliance with IFC's at-approval requirements, and mitigation prospects are uncertain or unlikely. A project may have materially improved environmental effects but still be less than satisfactory because of continued non-compliance.</p> <p>For financial markets operations, IFC considers the environmental and social performance of the projects financed by the intermediary and the intermediary's environmental management system. IFC assigns an excellent rating if the company engages in practices and sets standards beyond those required for the project type. For example, it requires all projects it finances (not only IFC-financed sub-projects) to meet IFC's at-approval requirements and monitors and enforces compliance through visits and reporting; satisfactory if the company meets requirement for the project. For example, the company requires only the IFC-financed sub-projects to comply with IFC at-approval requirements, and monitor and enforces compliance through visits and reporting or else the project has no impact potential; partly unsatisfactory if the company requires sub-projects to comply with IFC at-approval requirements but does little or nothing to follow-up on compliance through visits and reporting or it does not require sub-projects to comply with IFC at-approval requirements but is taking action to implement appropriate procedures or IFC did not require sub-project reviews but there is no evidence of material negative environmental impacts; and unsatisfactory if the company does not require its sub-projects to comply with IFC at-approval requirements and action to implement procedures is doubtful or IFC imposed no at-approval requirements and a significant portion of the sub-project portfolio is causing materially negative environmental impacts.</p>
		<b><i>Indicators for MDB's investment profitability:</i></b>	
36	Core	<i>Good practice.</i> MDB investment's profitability is based upon the investment's <i>gross contribution</i> in relation to corresponding at-approval standards for minimally satisfactory expected performance.	

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<i>Std #</i>	<i>Core or Non-Core</i>	<i>Summary of Standard</i>	<i>Comments</i>
		<p><i>Best practice #1.</i> If reliable transaction cost data are readily available from management information system, MDB investment's profitability is based on the investment's <i>net profit contribution</i>, measured in risk-adjusted, discounted cash flow terms with ratings benchmarks set in relation to approval-stage minimum return threshold.</p> <p><i>Best practice #2.</i> If reliable transaction cost data are readily available from management information system, MDB investment's profitability is based on the investment's <i>net profit contribution in relation to the capital employed for the investment</i>, measured in risk-adjusted, discounted cash flow terms with ratings benchmarks set in relation to approval-stage minimum return threshold.</p>	
		<b><i>Indicators for MDB's work quality:</i></b>	
37	Core	The rating for the MDB's work quality is based partly on <i>at-entry screening, appraisal and structuring work</i> , i.e., how effectively the MDB carries out its work prior to approval of the investment.	
38	Core	The rating for the MDB's work quality is based partly on its <i>monitoring and supervision quality</i> , i.e., how effectively the MDB carries out its work after approval of the investment.	
39	Core	The rating for the MDB's work quality is based partly on its <i>role, contribution and additionality</i> , i.e., the need for the MDB's participation relative to other available financing and the quality of the MDB's additionality from inception to evaluation. The rating judgment considers compliance with basic operating principles, the MDB's contribution to client capacity building objectives (as relevant), it's the operation's consistency with furtherance of the MDB's corporate, country and sector strategies, and its clients' satisfaction with the MDB's service quality.	
40	Core	Assessments of the MDB's work quality should be made independently of the ratings assigned for development or transition outcomes and MDB's investment profitability. These assessments, which are benchmarked against corporate good practice, reflect the quality of the MDB's contributions to good or bad outcomes, not the good or bad outcomes themselves.	
		<b><i>Performance ratings—principles and benchmarks:</i></b>	
41	Core	Within the rating scales (e.g., ranging from <i>unsatisfactory</i> to <i>excellent</i> ), there should be balance between positive and negative characterizations	

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<i>Std #</i>	<i>Core or Non-Core</i>	<i>Summary of Standard</i>	<i>Comments</i>
		(i.e., if there are four ratings, two are less than good and two are good or better). The words used to describe these ratings should accurately reflect whether the judgments are less than good or else good or better.	
42	Core	Each of the evaluated performance attributes is assigned a rating using a 4- to 6-point scale for each indicator ratings and a 4- to 6-point scale for each synthesis rating.	.
43	Core	<p>The ratings benchmarks for the project's financial rate of return after-tax (FRR) can be determined by either of the following methods:</p> <p><b>Good practice (transitional).</b> Using an arbitrary scale, e.g., 20% or more after taxes in real terms for excellent, 10-19.9% for satisfactory, 5-9.9% for partly unsatisfactory, and &lt;5% for unsatisfactory.</p> <p><b>Best practice.</b> Comparing the re-estimated after-tax FRR in real terms with each project company's weighted average cost of capital at the time the project financing is committed. Although this approach is also subject to problems, it is clearly better than the alternatives. See Attachment 2.</p>	<p>The transitional good practice approach has the benefit of simplicity but does not take into consideration the differing riskiness of different projects as they relate to the financiers' minimum return expectations, which are reflected in the company's weighted average cost of capital. For example, a project expected at the time of evaluation to yield a real, after-tax FRR of, say, 14% in a relatively low risk country with a long-term take-or-pay off-take agreement from a financially strong buyer would normally be rated by any MDB as excellent. In contrast, a project expected at the time of evaluation to yield a real, after-tax FRR of, say, 16% in a relatively high-risk country from the production and export of an agricultural commodity that is subject to wide price fluctuations might nonetheless be rated as just satisfactory. In addition, since interest rates fluctuate, success standards for project returns must reflect.</p> <p>See <b>Exhibit 6.</b></p>
44	Core	The benchmarks for the project's real economic rate of return (ERR) are set in relation to the MDB's ERR benchmarks used in approving or rejecting projects. The ERR benchmarks may be universal or may vary by country or business sector. They are not, however, the same as the ERRs projected at appraisal for specific projects.	<p>Ideally, the benchmark would be equivalent to the opportunity cost of capital for each country for the period when the project was carried out. This approach, however, would not be practical, since no MDB has attempted to estimate the country-specific opportunity cost of capital on a systematic basis.</p> <p>Several MDBs have not explicitly established <i>ex ante</i> ERR acceptability benchmarks. A CED facing this problem might, until corporate standards are established, adopt an arbitrary scale, e.g., 20% or more for excellent, 10-19.9% for satisfactory, 5-9.9% for partly unsatisfactory, and &lt;5% for unsatisfactory.</p>
45	Core	<p><b>Good practice.</b> Loan performance benchmarks are set in relation to the MDB's expectations at approval.</p> <p><b>Best-practice:</b> Loan's net profit contribution (net of transaction and financing costs) is sufficient in relation to the MDB's return on capital employed target</p>	<p>By way of illustration of the good practice standard, IFC rates loans (and related operations) as follows:</p> <ul style="list-style-type: none"> <li>• Excellent. Fully performing and, through sweetener (e.g., income participation), expected to earn significantly more than the without sweetener paid-as-scheduled case.</li> <li>• Satisfactory. (i) loan expected to be repaid as scheduled; (ii) loan is prepaid and IFC has received at least 65% of the interest (net of prepayment penalties received) expected over the original life of the loan; (iii) loan has been</li> </ul>

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			<p>rescheduled and is expected to be repaid as rescheduled with no loss of originally expected income; (iv) all fees on an IFC guarantee are expected to be received and guarantee is not called or has been called but resulting loan is expected to be fully repaid in accordance with the terms of the guarantee agreement; or (v) IFC has not suffered any loss due to non-performance of the swap counterparty under a swap or other risk-management facility.</p> <ul style="list-style-type: none"> <li>• Partly unsatisfactory. (i) loan is prepaid and IFC has received less than 65% of the originally expected interest income (net of prepayment penalties received); or (ii) loan has been rescheduled or guarantee has been called and IFC expects to receive sufficient interest income to recover all of its funding cost but less than the full margin originally expected.</li> <li>• Unsatisfactory. (i) Loan is in non-accrual status; (ii) IFC has established specific loss reserves; (iii) loan has been rescheduled but IFC does not expect to recover at least 100% of its loan funding cost; (iv) loan has been or is expected to be wholly or partially converted to equity in restructuring of a problem project, or (v) IFC experiences a loss on its guarantee or risk-management facility.</li> </ul>
46	Core	<p><i>Good practice.</i> Equity investment rates of return are benchmarked (or discounted if an NPV measure is used) against standards for minimally satisfactory expected performance at approval.</p> <p><i>Best practice 1.</i> Equity investment rates of return are benchmarked (or discounted if an NPV measure is used) to reflect appropriate spreads over actual or notional loan yields for the same credit risk, in line with the policy-defined, at-entry approval standard.</p> <p><i>Best practice 2.</i> Where the MDB's investment features both a loan and an equity investment, their combined net profit contribution (net of transaction and loan financing costs) is sufficient in relation to the MDB's return on capital employed target.</p>	<p>Not relevant for institutions that do not make equity investments.</p> <p>Many institutions have not established policies defining at-entry approval standards for equity investments. A CED facing this problem might, until corporate standards are formally established, seek to determine the minimum general threshold effectively used for equity investments at approval.</p>
47	Core	Ratings of non-quantitative indicators require that relative qualitative judgments be made. The criteria should reflect the extent to which performance has been consistent with the MDB's policies, prescribed standards for corporate sustainability and recognized good-practice	

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<i>Std #</i>	<i>Core or Non-Core</i>	<i>Summary of Standard</i>	<i>Comments</i>
		standards. The criteria for the judgments should be clearly specified in the instructions for the preparation of XASRs and in the CED's annual review.	
48	Core	The synthesis ratings for the three dimension (development or transition outcomes, profitability to the MDB, and the MDB's work quality) reflect summary qualitative performance judgments based on the underlying indicator ratings. They are not simple averages of the indicator ratings.	
		<b>Standard XASR attachments:</b> These attachments provide the basis for review and independent verification of the XASR's judgments and conclusions. They include:	
49	Core	Details of the financial and economic rate of return derivations (with transparent assumptions and cash flow statements).	
50	Core	For each safeguard dimension addressed in the MDB's environmental and social guidelines, a comprehensive summary of environmental, worker health and safety, and social outcome compliance information with sufficient evidence from a field visit and/or client reporting to support the assigned outcome and related MDB work quality ratings.	EBRD has no social mandate and consequently considers that it cannot review social issues.
		<b>Annual Reporting and Process Transparency</b>	
		<b>Annual synthesis reporting: Annual Review</b>	
51	Core	CED prepares an annual review addressed to the MDB's management, staff and Board of Directors. The scope of the annual review includes, <i>inter alia</i> , a synthesis of the CED's validated findings from all XASRs and PERs generated and reviewed during the period covered.	
52	Core	<p>The annual review should provide sufficient information to make the reader aware of possible biases in the sample of projects covered by the annual review. Consequently, the annual review:</p> <ul style="list-style-type: none"> <li>• Describes how the population was identified, how the sample was selected and, if stratification was applied or part of the sampling was non-random, states the rationale.</li> <li>• Reports on the number of XASRs and PERs for the year.</li> <li>• Includes an annex profiling the important characteristics of the evaluated sample against the population (cf. GPS 15).</li> <li>• Reports on the mean number of months between the dates projects reached early operating maturity, as defined in GPS 11 and 12) and</li> </ul>	See <b>Exhibit 2</b> .

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<i>Std #</i>	<i>Core or Non-Core</i>	<i>Summary of Standard</i>	<i>Comments</i>
		<p>the dates the corresponding XASRs or PERs were issued.</p> <ul style="list-style-type: none"> <li>If less than 100% of the population has been covered, provides information on statistical confidence levels and states explicitly whether reported success rates can be attributed to population.</li> </ul>	
53	Core	The annual review either (i) describes the ratings criteria and benchmarks in an annex or else (ii) refers to a website providing this information.	See <b>Exhibit 7</b> .
54	Core	The ratings reported should be those of CED.	
55	Core	<i>Good practice.</i> CEDs should disclose the differences between CED and operating staff ratings and the materiality of the differences. Where CED ratings are reflected partly in XASR-As and partly in PERs, the CED should disclose the differences between CED and operating staff ratings separately for the XASRs and the PERs. The disclosure is made in global terms, not on a project-by-project basis and is limited to differences in binary outcome and work quality success ratings.	
56	Core	<p><i>Good practice:</i> For each rating dimension and indicator, the annual review shows the <i>proportion of the evaluated sample</i> in each performance-rating category.</p> <p><i>Best practice:</i> The annual review also shows, by dimension, the <i>proportion of total disbursed MDB financing</i> for the sample that is in each performance-rating category.</p>	<p>These results might be reported by saying, e.g., that projects with development outcomes rated as at least <i>mostly successful</i> comprised 64% by number and 68% of the total [MDB's name] financing that was disbursed in the evaluated sample.</p> <p>See <b>Exhibit 8</b>.</p>
57	Non-core	<p><i>Good practice:</i> The annual review analyzes the evaluation results and highlights the findings. In doing so, it notes whether findings are statistically significant.</p> <p><i>Best practice #1:</i> The annual review provides a synthesis description of the ratings patterns and their cross-cutting performance drivers under each indicator.</p> <p><i>Best practice #2:</i> The annual review provides the ratings for the previous few years to show how performance is evolving.</p>	<p>Parts of this GPS may be appropriate only when enough information is available to permit meaningful analysis. It may not be appropriate to include in each annual review.</p> <p>See <b>Exhibit 9</b>.</p>

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<i>Std #</i>	<i>Core or Non-Core</i>	<i>Summary of Standard</i>	<i>Comments</i>
58	Non-core	There is an annex containing a representative sample of XASR or PER abstracts prepared on operations selected from approximately the middle of each development or transition outcome-rating group, illustrating the application of the ratings. There is non-disclosure of any company specifics in the content of this annex to protect the confidentiality of client information. This GPS applies only to MDBs with at least 30 projects evaluated on a rolling three-year basis.	See <b>Exhibit 10</b> .
59	Non-core	The annual review makes recommendations to Management and the Board for improving the MDB's performance, based on an analysis of (i) the ratings and lessons learned patterns and (ii) other relevant CED evaluation studies and supporting investment portfolio analyses (where deeper evidence is needed on performance hypotheses from XASR and PER patterns). Findings section references are included with each recommendation as its empirical anchor.	See <b>Exhibit 11</b> .
60	Non-core	Management prepares and submits to the Board, for simultaneous consideration with the annual review in a Board discussion, a memorandum commenting on the annual review's findings and responding to each of its recommendations	See <b>Exhibit 12</b> .
61	Non-core	MDB maintains a tracking system for recording disposition by Management of each recommendation.	
		<b><i>Process transparency: Annual Report. (The annual report can be included in the annual review if an MDB wishes to do so.)</i></b>	
62	CCore	CED reports annually to the MDB's management and Board on the quality and efficacy of the MDB's evaluation system, including the self-evaluation system, any gaps in coverage of the MDB's operations, the work of CED, the generation and application of lessons learned in new operations, and any differences between the MDB's practices and the GPS.	See <b>Exhibit 13</b> .
		<b>Identification of Lessons, Dissemination, and Ensuring Application of Lessons</b>	
		<b><i>Identification of lessons:</i></b>	
63	Non-core	Lessons drawn in annual reviews and special studies should derive in part from the performance rating patterns for the projects reviewed and an	See <b>Exhibit 14</b> .

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		analysis of their drivers, particularly in the case of those indicators rated better or worse than satisfactory.	
64	Non-core	Lessons should be concise, prescriptive, and placed in the context of a material issue that was encountered in the evaluation so that its relevance to new operations can be determined easily, on a stand-alone basis.	
65	Non-core	The point of view and selectivity should focus on what the MDB might have done to obtain better results from the operation.	
		<b><i>Dissemination of findings and lessons:<sup>10</sup></i></b>	
66	Non-core	<p><i>Good practice:</i> The CED makes available to MDB staff the findings and lessons derived from the MDB's evaluation work.</p> <p><i>Best practice:</i> The CED makes available to MDB staff a range of user-friendly dissemination products covering the XASR and PER findings, the annual review and CED special studies, e.g., access to the full reports, an on-line searchable lessons retrieval network, electronic notification of new items, and PowerPoint slide-shows of annual review or special study findings.</p>	<p>According to <i>Review of the DAC Principles for Evaluation of Development Assistance – Final Report</i>, February 1998, para. 25, "On the matter of lessons learned from evaluations, it is clear that the users will rarely draw on such material unless required by agency leaders. The demand for the results of evaluations and the lessons they provide in an environment that promotes organizational learning is key. <i>At the same time, the supply of lessons and other knowledge that would benefit operations needs to be easily accessed in usable form.</i> The costs of searching out relevant material from evaluations, even when required, is a major disincentive to the lesson learning process. 'Just in time' practices in providing this material can facilitate use." (italics added) The availability of webpage-based intranet dissemination and searchable databases makes accessing relevant lessons much easier than in the past. It does, however, require the development of an MDB-specific thesaurus of terms and coding of each lesson using it to enable thematic subject searches.</p>
		<b><i>Ensuring application of lessons:</i></b>	
67	Non-core	<p><i>Good practice.</i> It is the responsibility of operational department managers to ensure that past lessons have been systematically researched, identified and applied in new operations.</p> <p><i>Best practice #1.</i> Standard processing documentation for new operations includes a prompt, <i>in early stage documents</i>, for relevant past lessons, complemented by a prompt, in final decision-stage documentation, for how the past lessons have been addressed in the appraisal and structuring of the</p>	MC rating requires that MDB's procedures specifically impose this responsibility.

<sup>10</sup> See also, "Good Practice in Lessons-Learned Dissemination and Application." <http://workspace.ecgnet.org/ecg/doclib.nsf/calendar?openview&count=1000>



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<i>Std #</i>	<i>Core or Non-Core</i>	<i>Summary of Standard</i>	<i>Comments</i>
		new operation.  <i>Best practice #2:</i> Procedures call for CED to review documents on new operations with respect to identification of relevant lessons from evaluated operations.	
68	Non-core	In its annual evaluation process report, CED reviews and reports to management and the Board the evidence available for judging the extent to which lessons are being incorporated in new operations.	
69	Non-core	<i>Good practice.</i> Internal corporate reporting (up to Board level) is broadly aligned with the evaluative framework.  <i>Best practice #1:</i> Reports, from project-level to department- and corporate-level, cover development or transition outcome, investment outcome and MDB work quality.  <i>Best practice #2.</i> Reports apply coherent and consistent benchmarks across projects and at all stages of the project cycle (appraisal, supervision/monitoring and evaluation).	Similar to GPS 3, but GPS 3 relates to input by CED, and GPS 70 relates to outcomes and internal coherence. This integration of evaluative scope, measurement standards, findings and reporting with corporate- and unit-level portfolio reporting caters for the results-based management principle and reality that “what gets measured, gets done,” and that properly “what gets done, gets measured coherently and consistently.” Without this integration, a disconnect is likely between predominant operational and career incentives and application of evaluation lessons for getting better outcomes.  See <b>Exhibit 15</b> .
		<b><i>Disclosure</i></b>	
70	Non-core	To protect client company confidentiality, the candor needed for effective corporate learning, and the risk to the MDB's credit rating that partial release of investment portfolio data (and related standards and benchmarks) might entail, the MDB does not disclose individual evaluation reports or the full text of the CED's annual review.	
71	Non-core	<i>Good practice:</i> The MDB's disclosure policy for evaluation products should be explicit, should be consistent with the MDB's general disclosure policy, and should cover all evaluation products.  <i>Best practice:</i> The MDB's disclosure policy is disclosed via the CED's web page, specifically noting any exceptions applicable to evaluation	

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		reports.	
72	Non-core	<p><i>Good practice:</i> The MDB includes an accurate summary of CED's major annual review findings in its Annual Report.</p> <p><i>Best practice:</i> CED prepares and posts on the MDB's external website an abstract of its annual review that accurately summarizes its essential findings, including the outcome and work quality ratings profiles, sampling representativeness, ratings criteria, benchmarks, and consistency with core GPS.</p>	See <b>Exhibit 16</b> .

## LIST OF EXHIBITS

### Examples of Selected Documentation<sup>11</sup>

(illustrative only and not intended to be interpreted as the only good practice)

- Exhibit 1:** OEG Terms of Reference (approved by the Board September 2002)
- Exhibit 2:** XPSRs, Sample Selection and Representativeness
- Exhibit 3a:** Non-Financial Markets Instructions (for XPSRs)
- Exhibit 3b:** XPSR Program Overview
- Exhibit 3c:** Getting There in Nine Steps – 2002
- Exhibit 4:** Sample XPSR
- Exhibit 5:** Memo RE: CY2001 XPSR Program, OEG's Final Ratings for the Annual Review of IFC's Evaluation Findings
- Exhibit 6:** WACC Benchmarks, 2003
- Exhibit 7:** Guidelines for Performance Ratings
- Exhibit 8:** Summary of XPSR Performance Ratings, from the 2002 Annual Review
- Exhibit 9:** Annual Ratings Trends from 1996 – 2001
- Exhibit 10:** Abstracts of Selected XPSRs
- Exhibit 11:** Recommendations for Improving IFC's Work Quality
- Exhibit 12:** Management Response: Annual Review FY2002
- Exhibit 13:** Table of Contents, Annual Review 2002
- Exhibit 14:** IFC Lessons Learned, XASR Examples
- Exhibit 15:** Department Scorecards
- Exhibit 16:** OEG Findings, Annual review, April 2003

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<sup>11</sup> These illustrative exhibits are provided by the Operations Evaluation Group (OEG) of the International Finance Corporation, and are current as of May 2003. **XPSR** = Expanded Project Supervision Report

## Glossary

Annual report	An annual report prepared by the CED for the MDB's board of directors and management covering the quality and efficacy of the MDB's evaluation system, including the self-evaluation system, any gaps in coverage of the MDB's operations, the work of CED, the generation and application of lessons learned in new operations, and any differences between the MDB's practices and the GPS-IO.
Annual review	An annual review prepared by the CED for the MDB's board of directors and management comprising, <i>inter alia</i> , a synthesis of the CED's validated findings from all XASRs and PERs generated and reviewed during the period covered.
Best-practice evaluation standards	Standards that are more detailed than the good-practice standards and are desirable but not essential to have a satisfactory evaluation system. Cf. good-practice evaluation standards.
Cancelled investment	An undisbursed, committed balance of an equity investment or loan, cancelled by mutual consent of the MDB and a project company. Cf. dropped investment.
CED	See Central Evaluation Department
Central Evaluation Department	The corporate unit charged with supporting the self-evaluation system for investment operations and reviewing its main products --the XASRs--in addition to producing annual reviews of the MDB's evaluation results, other independent evaluation studies and related dissemination responsibilities.
Closed investment	A disbursed investment that has been fully repaid, sold, or written off.
The company	Generally, the legal entity owning and implementing the project; the MDB's investment counterparty. For financial markets operations, the company is (a) the financial intermediary in the case of credit lines, bank equity investments, leasing companies, etc. or (b) the fund management company (as distinct from the normally separately owned investment fund itself) in the case of funds.
Core evaluation standards	The standards necessary to permit comparability of operational results among the MDBs, as prescribed by the Development Committee. Cf. non-core evaluation standards.

Disclosure	The systematic distribution of evaluation findings through various media (including mainly the MDB's external website) to the public at large, normally subject to certain restrictions specified in a Board-approved disclosure policy.
Dissemination	The systematic distribution of evaluation findings through various media within the MDB, generally without restriction as to contents, with the aim of promoting awareness and reinforcement of corporate objectives, success standards, accountability, and use of lessons for improved results.
Dropped investment, or droppage	A proposed investment approved by the MDB's Board of Directors that has failed to become a signed agreement. Cf. cancelled investment.
Early operating maturity	<ul style="list-style-type: none"> <li>For an investment other than a financial markets operation with identifiable sub-projects, the year during which (a) the project financed will have been substantially completed, (b) the project financed will have generated at least 18 months of operating revenues for the company and (c) the MDB will have received at least one set of audited annual financial statements covering at least 12 months of operating revenues generated by the project.</li> <li>For financial markets operations with identifiable sub-projects financed by the MDB's investment: <ul style="list-style-type: none"> <li>For lending operations: at least 18 months shall have elapsed after the MDB's final disbursement of its loan.</li> <li>For investment funds: the projects financed will have generated at least 12 months of operating revenues.</li> </ul> </li> </ul>
Expanded Annual Supervision Report	A standard, one-time annual supervision report for the year when the project reaches early operating maturity with an attached evaluative addendum ( <i>expanded</i> refers to the evaluative addendum), prepared on investments selected for evaluation by the CED. The addendum is a concise five-to-ten page document, executed in a standard template according to a set of instructions prepared by the CED, and featuring (1) analysis of specified performance dimensions with rated indicators and lessons learned for avoiding outcome shortfalls and getting better results in both future and portfolio operations. CED-verified XASR findings and performance ratings form the core of the CED's annual synthesis report (the annual review).

Good-practice evaluation standards	The key principles that any development institution that finances the private sector should follow if it is to have a satisfactory evaluation system. Cf. best-practice standards.
GPS-IO	Good Practice Standards for Evaluation of Investment Operations
Gross contribution	The gross revenues generated for an MDB by an investment before deducting associated costs. Cf. net profit contribution.
Independent evaluation	Evaluations undertaken by the MDB's CED, including Performance Evaluation Reports (PERs), XASR Assessments (XASR-As), special studies and annual reviews, the latter based largely or in part upon the findings of CED-verified XASRs, PERs and relevant portfolio performance data. (Sometimes referred to as direct evaluation.) Cf. self-evaluation.
The investment	The MDB's financing instrument specific to the operation being evaluated. Investments mainly consist of loans, loan guarantees, quasi-equity and equity investments.
Net profit contribution	The net profit earned by an MDB on an investment after deducting financial and transaction costs. Cf. gross profit contribution.
Non-core evaluation standards	Standards that are not needed for comparability of evaluation results among the MDBs but are nonetheless important to help improve accountability and learning within each institution.
The operation	The MDB's objectives, activities and results in making and administering its investment as partial financing of the company's project.
PER	See Performance Evaluation Report
Performance dimensions	The three basic dimensions subject to evaluation judgments, i.e., the project's development or transition outcome, the profitability of the investment to the MDB, and the MDB's work quality.
Performance indicators	The specific indicators providing the basis for the judgments on the three performance dimensions.
Performance Evaluation Report	An evaluation report prepared by the CED on an individual investment operation. It has the same scope and applies the same evaluative research standards (e.g., field visit-based), guidelines, measures and ratings standards as the XASR.
The project	Generally, the company's capital project or program and related business activity that have been partially financed by the MDB's investment selected for evaluation. In financial markets operations, the project

	generally refers to the financial intermediary's lending or investment program that is partially financed by the MDB.
Self-evaluation	Evaluation of an investment operation (through an Expanded Annual Supervision Report) that is undertaken by the staff of the MDB's operational department that has day-to-day, front-line responsibility and accountability for monitoring, administering and reporting on the investment operation that is being evaluated. (Sometimes referred to as indirect evaluation.)
SMEs	Small- and medium-scale enterprises
WACC	See weighted average cost of capital
Weighted average cost of capital	The average of the cost of a company's debt and equity financing weighted by their respective usage. See Attachment 4.
WGPSE	Working Group for Private Sector Evaluation of the Evaluation Cooperation Group
XASR	See Expanded Annual Supervision Report
XASR-A	See XASR Assessment
XASR Assessment	CED's instrument for conveying the findings of its desk review of each XASR. Its scope includes a judgment of the XASR's quality (responsiveness to scope guidelines, research depth, application of guideline-prescribed standards, and objectivity), appropriateness of assigned performance ratings, appropriateness and completeness of identified lessons, and issues for discussion in a Management-led review meeting (if CED recommends the XASR for such a review).

### Comparable Terms Used in Each Member MDB

Memorandum Term	Central Evaluation Department	Expanded Annual Supervision Report	On-line Lessons Database	Performance Evaluation Report	XASR Assessment
Abbreviation	CED	XASR	LRN	PER	XASR-A
<b>AfDB term</b>	Operations Evaluation Department	None	None for private sector projects (intended to be included in the actual retrieval system)	Project Performance Evaluation Report	None
Abbreviation	OPEV	--	SPEI	PPER	--
<b>AsDB term</b>	Operations Evaluation Office	None	None for private sector projects	Project Performance Audit Report	None
Abbreviation	OEO	--	--	PPAR	--
<b>EBRD term</b>	Project Evaluation Department	Expanded Monitoring Report	Lessons Learned Database	Operation Performance Evaluation Review	XMR Assessment
Abbreviation	PED	XMR	LLD	OPER	none
<b>EIB term</b>	Operations Evaluation	Scorecard / Project Completion Report (under review)	None	In-depth operations evaluation	(under review)
Abbreviation	EV	MR/ICR	--	ESR	--
<b>IDB term</b>	(under review)	(under review)	(under review)	(under review)	(under review)
Abbreviation					
<b>IIC term</b>	Office of Evaluation & Oversight	Expanded Annual Supervision Report	Lessons Learned Database	Not applicable	Project Evaluation Note
Abbreviation	OVE	XASR	LRD	Not applicable	PEN
<b>IFC term</b>	Operations Evaluation Group	Expanded Project Supervision Report	Lessons Retrieval Network	None	XPSR Evaluative Note
Abbreviation	OEG	XPSR	LRN	--	EvNote
<b>MIGA term</b>	Operations Evaluation Unit	(under review)	None	Evaluation of Guarantee Projects	None
Abbreviation	OEU		--	--	



## **Weighted Average Cost of Capital in Determining Benchmarks for Rating Real After-tax Financial Rate of Return (FRR)<sup>12</sup>**

### **Theoretical framework**

1. Financial and economic theory holds that a firm must expect an after-tax financial rate of return (FRR) on the funds it invests in its capital projects that is at least sufficient to induce investors to purchase and hold the firm's debt and equity.<sup>13</sup> Thus, the threshold satisfactory project FRR must be sufficient to meet the company financiers' inflation-adjusted, risk-weighted minimum return requirements.
2. Assuming that project business success is rated on a four-level scale (unsatisfactory, partly unsatisfactory, satisfactory, and excellent), three benchmarks are required. Conceptually, the lower benchmark for a satisfactory rating should be the FRR that a project company's financiers are likely to view as minimally satisfactory in rewarding them for their country, company, and instrument risk-weighted opportunity costs. The lower benchmark of the partly unsatisfactory FRR range should be the rate below which the equity investors as a group are almost certainly likely to regret having made their investments, taking into account their risk-weighted opportunity costs and their own weighted average costs of capital. The benchmark for an excellent FRR should be the rate above which a project's contribution to its company's profitability is sufficient to provide its equity investors with returns that are clearly well above their varying risk-weighted opportunity costs and costs of capital.
3. The minimum real return requirement is the weighted average after-tax cost to the company of the lenders' loan yields and the equity investors' minimally acceptable returns, adjusted for inflation, i.e., the project company's weighted average cost of capital (WACC). The WACC, thus, defines the minimum FRR for a satisfactory project business success rating.

### ***IFC's Application of this framework in estimating the WACC***

4. To estimate WACCs for each company evaluated, IFC's Operations Evaluation Group initially developed a model based on the company's cash flows as projected at approval, the internal rate of return on the loan, and the equity return deemed satisfactory for the investment.

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<sup>12</sup> The first six paragraphs are adapted from IFC, *Annual Review of IFC's Evaluation Findings: FY98*, December 1998, Annex 7.

<sup>13</sup> The application to start-up companies is straightforward. The relationship between investor return requirements and an existing company's expansion project FRR is more diffuse, since they will base their financing decisions on the company's overall "with project" prospects inclusive of existing operations. However, even in the case of a corporate financing for a multi-project capital program of an existing publicly traded company, before financing or approving it, the company's board and lenders must establish to their satisfaction that the capital program will make a sufficient contribution to the company's "with project" debt service coverage and future earnings relative to the risk it adds to the company's financial condition and existing earnings prospects. Normally, that assessment is made on a "with program" vs. "without program", incremental after-tax cash flow and net income basis.

5. Because of the complexity of this approach and the time needed to prepare the necessary worksheets, OEG has now adopted a shortcut for estimating the WACC. Based on the detailed estimates made for a large number of projects, OEG found that, in 80% of the cases, the *nominal* fixed rate equivalent interest rate that would have applied to an IFC US dollar loan at the time of approval of an investment was within  $\pm 50$  basis points of the after-tax WACC *in real terms* calculated by applying the formula, including a 300 basis point spread to its equity investors over the average internal rate of return on its debt financing. OEG, thus, defines the real WACC for a project as being equivalent to the nominal fixed rate equivalent interest rate that would have applied to an IFC US dollar loan at the time of approval.<sup>14</sup>

6. Based on the theoretical framework outlined in para. 2, OEG benchmarks are now as follows as follows:

Excellent	FRR exceeds WACC by 250 bp or more. At this level, the FRR would at least double the equity investors' spread over the company's borrowing cost.
Satisfactory	FRR between WACC and WACC plus 249 bp
Partly unsatisfactory	FRR less than WACC but equal to or greater than WACC minus 200 bp
Unsatisfactory	FRR equivalent to or less than WACC minus 200 bp. At this level, the FRR would provide a nominal equity yield equal to or less than the company's nominal borrowing cost.

#### *BRIEF CRITIQUE*

7. Clearly, basing project business success ratings on the WACC is better than the alternatives. Nevertheless, this approach can also be criticized.

- The WACC is typically determined by (a) calculating the relative weight of the company's equity and debt financing at market prices (not face values), (b) calculating the cost of equity by multiplying the relative weight of the company's equity by the risk-free interest rate plus the product of the stock's *Beta* and the market risk premium, (c) calculating the cost of the loan financing by multiplying the relative weight of the company's debt financing by the net of tax interest rate, and (d) adding the cost of the equity and loan financing. The market provides an objective basis for estimating these parameters for a publicly traded company. Estimates for a company that is not publicly traded are inherently less reliable.
- The rationale for setting the benchmark between satisfactory and excellent outcomes at 250 bp above the WACC and the rationale for setting the benchmark between partly unsatisfactory and unsatisfactory outcomes at 200 bp below the WACC are arbitrary. Some investors may consider an equity return 600 bp over the yield on fixed rate borrowings by the same company as excellent, but others may not. Similarly, some investors may consider an equity return a few basis points above the company's nominal long-term borrowing cost as satisfactory, but others may not.
- The OEG approach assumes that the project-specific interest rate adequately takes into consideration country, business sector, financial structure, and other risks. This assumption may not be true for the debt financing but not necessarily for the equity.

<sup>14</sup> Not all MDB's determine the fixed rate equivalent interest rate when they approve loans. They can, however, retrieve this information from Bloomberg. The command "USSW5 Currency Go" will provide 5-year swap rates going back ten or more years. The command "EUSA5 Currency Go" will provide 5-year swap rates going back to January 1999. Swap rates for other currencies can be found by using the "Help" function.

For example, the OEG approach does not take into consideration the influence of security or guarantees on the project-specific interest rate. Similarly, high leverage is likely to increase the riskiness of the equity to a greater extent than the riskiness of the debt financing.

- The OEG approach is based on the finding that the shortcut yielded similar results for 80% of the projects reviewed. This test was based on the projects evaluated by OEG over a 2-year period. It is not clear whether it would apply equally well to other periods, when economic conditions may have differed, or to other MDBs, which may have different interest rate policies. Moreover, the results differed by more than 50 bp for 20% of the projects reviewed. The ratings on these projects may distort reported findings and the lessons drawn from looking at successful and unsuccessful projects.<sup>15</sup>
- The OEG approach establishes the WACC based on US dollar interest rates. This approach may not be appropriate for (a) an MDB that operates in terms of Euros, (b) companies whose owners and creditors are mainly local and, hence, look to returns in local currency terms, or (c) companies whose debts are denominated mainly in a currency with materially lower interest rates, e.g., Japanese yen, or that benefit from subsidized public sector financing.<sup>16</sup>

April 4, 2003

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<sup>15</sup> According to OEG, the materiality of any such distortion is mitigated to a large extent because the success rates used in the annual review's analysis and reporting (such as for win-win outcomes and relative performance of strategic groups) are based upon binary groupings of the six-rating development outcome scale (*viz.*, mostly successful or better). Moreover, OEG points out that the project's business success is one of four ratings from which the development outcome is synthesized and that proximity to the WACC cutoff is taken into account at the margin in determining the synthesis development outcome rating.

<sup>16</sup> According to OEG, it overcomes these problems by translating the non-dollar currencies into dollars at the relevant forward rates. For local currencies, the assumption is that sophisticated investors in, and lenders to, large project companies will price their local currency loans taking into account currency depreciation risk, such that the *de facto* dollar equivalent yield will equalize. The same logic holds for the investors.

## VOLUME II: LIST OF EXHIBITS

### Examples of Selected Documentation<sup>17</sup>

(illustrative only and not intended to be interpreted as the only good practice)

- Exhibit 1:** OEG Terms of Reference (approved by the Board September 2002)
- Exhibit 2:** XPSRs, Sample Selection and Representativeness
- Exhibit 3a:** Non-Financial Markets Instructions (for XPSRs)
- Exhibit 3b:** XPSR Program Overview
- Exhibit 3c:** Getting There in Nine Steps – 2002
- Exhibit 4:** Sample XPSR
- Exhibit 5:** Memo RE: CY2001 XPSR Program, OEG's Final Ratings for the Annual Review of IFC's Evaluation Findings
- Exhibit 6:** WACC Benchmarks, 2003
- Exhibit 7:** Guidelines for Performance Ratings
- Exhibit 8:** Summary of XPSR Performance Ratings, from the 2002 Annual Review
- Exhibit 9:** Annual Ratings Trends from 1996 – 2001
- Exhibit 10:** Abstracts of Selected XPSRs
- Exhibit 11:** Recommendations for Improving IFC's Work Quality
- Exhibit 12:** Management Response: Annual Review FY2002
- Exhibit 13:** Table of Contents, Annual Review 2002
- Exhibit 14:** IFC Lessons Learned, XASR Examples
- Exhibit 15:** Department Scorecards
- Exhibit 16:** OEG Findings, Annual review, April 2003

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<sup>17</sup> These illustrative exhibits are provided by the Operations Evaluation Group (OEG) of the International Finance Corporation, and are current as of May 2003. **XPSR** = Expanded Project Supervision Report