

Preparing an Expanded Project Supervision Report

Instructions for Financial Markets Projects

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XPSR Program Overview

INTRODUCTION

An XPSR (Expanded Project Supervision Report) is a regular PSR with an Evaluation Findings. XPSRs are the only instrument to systematically evaluate the development results of IFC's investment operations. This paper describes the purposes of the XPSR system, the processes involved, staff responsibilities, XPSR review meetings and how the results are disseminated and applied.

PURPOSES

Accountability

The first purpose of the XPSR system is to meet a Board requirement that IFC accounts to its Board and shareholders for achievement of its Corporate Purpose and objectives in its core investment operations.

(a) IFC's Purpose is stated in Article I of its Articles of Agreement: "The purpose of the Corporation is to further economic development by encouraging the growth of productive private enterprise in member countries ...".

(b) In May 1999, IFC defined its Mission Statement: "To promote sustainable private sector investment in developing countries, helping to reduce poverty and improve people's lives".

(c) High-quality, focused evaluation has become an important requirement for sustaining shareholder support for IFC in the evolved climate of diminished political support in Part I countries for foreign aid in general, reduced budget allocations, competition among the various aid agencies, and increased demands for transparency and accountability by governments.

Learning

Even more important is the second purpose of the XPSR: to contribute to learning. The overwhelming feedback from XPSR teams confirms that writing an XPSR is an important personal learning experience. As one of the feedback providers put it, writing an XPSR is "potentially the best training tool for new colleagues". XPSRs also identify lessons to help improve the performance of IFC operations. XPSR findings are synthesized and analyzed by IEG at the end of each XPSR cycle and are presented in the annual review of evaluation findings. The annual review is discussed in a formal meeting of the Board Committee on Development Effectiveness (CODE) and is subsequently endorsed by CODE to the full Board. IEG synthesizes lessons by sector, country and thematic subjects and disseminates these via its website. IEG also synthesizes XPSR findings and lessons for presentations on IFC's portfolio performance in specific sectors or departments, highlighting lessons for future operations. IFC encourages staff to apply the lessons in their analysis and decision-making across the operations cycle, starting from the early review stage.

Collateral Applications

The third purpose of the XPSR is to provide updated information and analysis from which IFC can monitor developments against expectations and manage its investments. XPSR findings are also useful inputs to

departmental business plans, restructuring work plans, divestment timing planning, IFC's loss provision estimates, and portfolio reporting to the Board. Finally, they are used in IEG's special evaluation studies, as training tools (e.g. IFC's induction training program, credit course, etc.) and in periodic reports on the development contribution of IFC operations.

PROCESSES

Every year IEG selects a random sample, which covers projects approved five calendar years prior to the current year and have generated at least 18 months of operating revenues (covered by at least two sets of company annual audited accounts).

IEG is responsible for designing and maintaining the XPSR infrastructure, including preparation of these guidelines, the suggested evaluation findings execution steps and instructions for assigning performance ratings and writing lessons emerging from the operation. It also reviews the XPSRs after they are prepared and validates the findings.

Operations departments directors and portfolio managers are responsible for assigning and guiding the XPSR teams, quality control, contributing insights from a continuity perspective and their experience of other operations.

CONTENT

The XPSR has two main parts: (i) the Project Supervision Report (PSR); and (ii) the Evaluation Findings. For the purposes of the XPSR, it is essential for the PSR to present sufficient basic information on the project under evaluation.

The text of the XPSR's Evaluation Findings should normally not exceed five pages, accompanied by pages showing FRR/ERR/ROE calculations, and sub-project information for financial markets projects, as relevant. A field visit is highly recommended. The Evaluation Findings includes:

- a. An assessment of the likely achievement of the broad objectives (presented in the Board Paper) for the operation;
- b. Rating of the project's emerging development impacts, IFC's investment performance, and IFC's operational effectiveness;
- c. A discussion of the rationales for the performance ratings;
- d. Comparisons of appraisal projections with actual outcomes for key financial and operating indicators, with brief explanations for material variances; and
- e. Identification of emerging lessons from the experience to-date.

REVIEW PROCESS

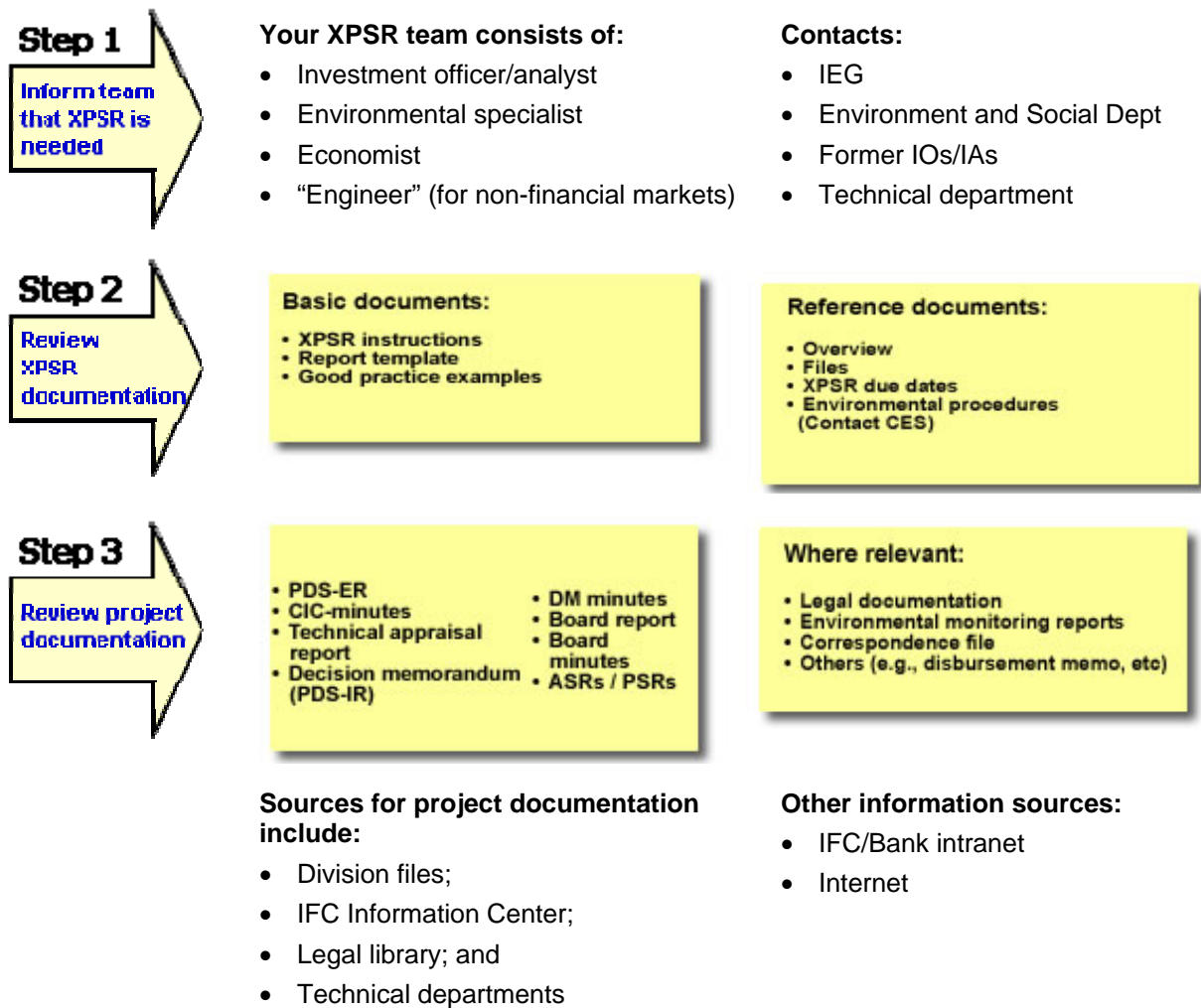
XPSRs follow the PSR policy on distribution, i.e., the portfolio manager circulates them to the Corporate Investment Committee (CIC) on a no-objection basis for projects with no major issues. An electronic copy of the XPSR is sent to IEG at the time the report is circulated to the CIC.

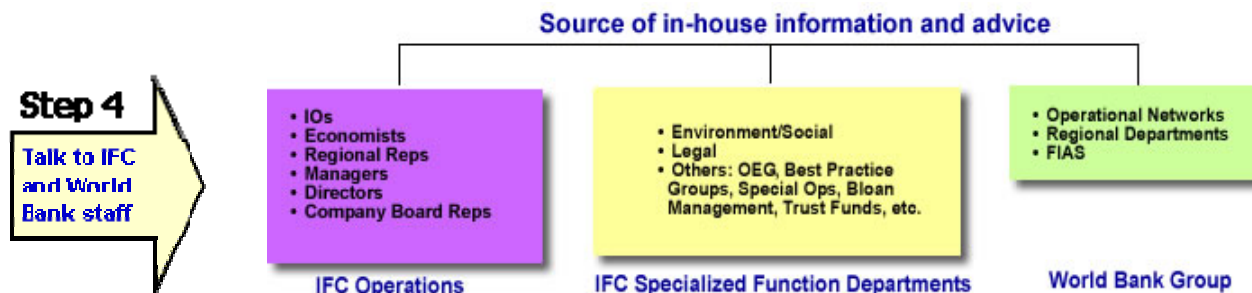
IEG reviews each XPSR and prepares an Evaluative Note (EvNote) to assess the evaluative ratings independently, to ensure corporate-wide consistency in the application of rating guidelines. Following a discussion of the draft EvNote with the XPSR team, IEG revises the EvNote as appropriate and sends it to the CIC. A copy is also sent to IFC's Information Center to be filed as an attachment to the XPSR.



Completing Your XPSR: Getting There in Nine Steps

Before embarking on writing up the Evaluation Findings, the XPSR team researches the relevant files, interviews IFC staff involved in the operation over its life, obtains inputs from other functional units, conducts field research as necessary and carries out the analysis needed to respond to the XPSR instructions. Leaving sufficient time to write the Evaluation Findings and obtaining all required clearances well ahead of the scheduled CIC Portfolio circulation date is key. Summarized below are the detailed steps in preparing the Evaluation Findings.





At an absolute minimum, talk to at least one member of the original project team, ideally the original IO.

- Step 5**
Send questions to client
- After reviewing available information against XPSR instructions, the IO/IA should prepare written questions for company/project. The scope should cover still-to-go projections for company and project.
 - Include environmental compliance questions.
- Step 6**
Recommended field visit
- Draft the XPSR (to identify information gaps).
 - Develop a list of contacts and arrange key meetings before going to the field.
 - Fill-in the required information as you obtain it.
 - Verify information — don't rely only on the company.
 - Allow time for meetings with non-company parties.
- Step 7**
Draft XPSR
- Condense information.
 - Assign ratings and explain their rationales.
 - Identify and prioritize useful lessons.
 - Seek the advice and input of the appraisal team, departmental peers, regional Department, etc.
 - Discuss draft with IEG.
- Step 8**
Obtain clearances
- Sign-off by the following parties is required:
- Department Management.
 - Department Economist.
 - Environment Division.
- Step 9**
Release XPSR
- Save the XPSR as version, not as draft
 - Portfolio Manager circulates PSR-bookmark to CIC members and CEXOE (cc: CIC assistants).
 - XPSR are only considered final when the PSR is finalized and circulated and contains all relevant attachments (XPSR, FRR/ERR calculation, ROE calculation, and where applicable the sub-project template for Financial Markets projects).



Advice from Previous XPSR Teams

So here it is, the top 10 suggestions from previous XPSR teams.

The theme throughout is to start EARLY!

- Touch base with your IEG contact early on
- Read the online XPSR Guidelines
- Talk to key players as early possible, e.g. appraisal team members, other responsible IOs, and project company
- Understand the project first by reading through documentation (Board paper, appraisal report, decision book etc.)
- Start organizing early
- Get other XPSR team members (technical, environment, etc.) involved early
- Clearly define the scope of the project in the XPSR
- Get draft out early to have several rounds reviewed
- Look at the XPSR good practice examples
- Talk to colleagues who have worked on an XPSR in the past



Guidelines for Financial Markets Projects

INTRODUCTION

IEG encourages short and concise XPSRs with no more information than is necessary to support evaluative judgments (ratings) and lessons. Five pages is usually sufficient. If you have any questions at any stage of the process, please contact your IEG counterpart or the IEG Help Desk at (202) 458-2299.

Definitions used in the XPSR:

- *operation* refers to IFC's objectives, activities and results in making and administering its investment;
- *financial intermediary (FI)* refers to the legal entity in which IFC is making its investment and that is undertaking the project and may be a bank, non-bank financial institution (NBFIs), investment fund or fund management company;
- *project* refers to the specific FI objectives and portfolio of projects that were partially (or wholly) financed by the IFC investment – as described in the Board report – it is not a legal entity; and
- and *investment* refers to the specific IFC financing instrument (loan, equity, underwriting, etc.).

The XPSR's Evaluation Findings, and each of its dimensions and indicators, address a project's contribution to **IFC's purpose and mission**: to promote sustainable private sector investment in developing countries, helping to reduce poverty and improve people's lives. They also evaluate the investment's impact on IFC's financial sustainability, and IFC's work quality in executing the operation. IFC uses XPSR findings to account for accomplishment of its purpose and mission, to learn from past operations, to identify needs for systemic improvements, and to improve selection and execution of new operations and IFC's strategy.

The XPSR assesses performance of the project since its inception, i.e. what has happened until now, and what might happen in the future. Future prospects should be realistically assessed, taking into account past performance as well as any changes (including external factors) that have affected, or are likely to affect, the project and FI over the rest of the project's life.

There are many different types of financial markets projects. These instructions focus on operations implemented by FIs that ultimately finance real sector investment projects (sub-projects). If you have difficulties applying these instructions to other FI operations (e.g., NBFIs, private equity funds, credit rating agencies), please contact IEG.

Project Description, Rationale, and Without Project Case: Start the Evaluation Findings with a brief description of the project, its objectives, its rationale and the "without project" counterfactual – a plausible paragraph on what you believe would have happened if the project had not proceeded. The "without project" counterfactual may be different from the "without IFC" counterfactual (the project may still have proceeded but on different terms). A starting point may be the project documentation at approval, but usually more information about what would have happened without the project is available at the evaluation stage (e.g. knowledge about external factors, etc.).

It is not always easy to assess what would have happened without the project, but this section should offer an educated and plausible guess. For example, “without the project, leasing would probably not have been introduced in that country; there would have been less competition and higher interest rates; the FI would have had more (or less) significant asset-liability mismatches; lending volumes would have been (a lot or somewhat) lower; 25 private enterprises would probably not have had access to financing (or with shorter maturities); the FI would have put more (or less) money into government T-bills; etc.”

DEVELOPMENT OUTCOME

DEVELOPMENT OUTCOME RATING

Concept

This rating is a synthesis of the overall impact of the project on the development of its host country, and thus implicitly addresses how well the project has contributed to fulfilling IFC's *purpose* and *mission*. A project's development outcome encompasses all effects on a country's economic and social development. Development impacts are evaluated on a "with versus without project" comparison, i.e. considering (i) what happened with the project and, (ii) counterfactually, what would have happened without it. Distinguish, to the extent possible, the project from the FI's performance. For example, when a project was to support SME lending which only constitutes a small portion of the FI's portfolio, the XPSR should focus on the SME-portfolio's performance more than the FI's overall performance, or when IFC invests in a fund management company that already has funds under management, the XPSR should focus on the incremental effect of the project supported through IFC's investment on the fund manager's profitability.

Indicators

In the XPSR, the project's development outcome is measured across four indicators: **project business performance**; **economic sustainability**; **environmental, social, health and safety effects**; and contribution to **private sector development**. Each of these measures a distinct aspect of the operation's performance in fulfillment of IFC's Article 1 purpose and mission. The development outcome rating is a bottom-line assessment of the project's results on-the-ground, and not an "average" of these four indicators.

Evaluation standard

Considering the four indicators, rate the operation's overall impact on the development of its host country on a six-point scale:

- **Highly successful:** A project with overwhelming positive development impacts, with virtually no flaws. Indicates the type of project IFC should use publicly to illustrate the contribution of private sector development to the World Bank Group's mission.
- **Successful:** A project without material shortcomings, or some very strong positive aspects that more than compensate for shortfalls.
- **Mostly successful:** A project which may have some shortcomings, but with a clear preponderance of positive aspects. The guiding principle should be: if all of IFC's projects were mostly successful, we should just be able to justify our existence as development institution.
- **Mostly unsuccessful:** A project with either minor shortcomings across the board, or some egregious shortcoming in one area which outweighs other generally positive aspects.
- **Unsuccessful:** A project with largely negative aspects, clearly outweighing positive aspects.
- **Highly unsuccessful:** A project with material negative development aspects with no material redeeming positive aspects to make up for them.

For any rating of *mostly successful* or better, IFC should be able to explain convincingly (without embarrassment) to a public audience why it rates this project a "success".

PROJECT BUSINESS PERFORMANCE

Concept

Project business performance measures the project's long-term impact on the FI's profitability and viability. Investors have diverse goals, but ultimately there is only one bottom line: financial returns. Sufficient financial returns are necessary to attract and reward private investment. IFC projects are normally one of two types, both of which can be structured as either loan or equity:

- **targeted funding** – usually either a loan (credit line) where IFC wishes to encourage the FI to develop business in specific sectors (SMEs, exporters, micro-finance etc.) and therefore the use of the funds is expected to be limited to the identified sector rather than the FI's overall portfolio, or equity in an equity fund. In the case of targeted funding, it is possible to identify sub-projects funded by IFC's project;
- **general funding** – where the effect of the IFC project is spread over the whole portfolio of the FI, such as a corporate loan or an equity investment in an FI other than an equity fund. In the case of general funding it is not usually possible to identify sub-projects funded by the IFC project.

Either type of project can include "institution-building" components (possibly through technical assistance), which may not have a quantifiable financial return. These should be considered under this rating to the extent that they have affected the FI's profitability, or are likely to affect it in the future. An example of capacity building would be development of staff skills and procedures (such as credit skills and loan appraisal standards) that will allow profitable pursuit of operations beyond the IFC-financed project at reduced transaction costs.

Indicator

In **targeted funding** where IFC's funds were used to finance or co-finance identifiable sub-projects, the primary indicator is the sub-projects' profitability and credit quality, and therefore their long term financial impact on the FI. In the case of credit lines, compare the profitability of the sub-project portfolio to the rest of the FI's portfolio (sub-project portfolio performance should demonstrate to the FI whether the targeted sector is worth developing into a sustainable business segment).

The XPSR should identify the sub-projects and attach brief descriptions of each, including industry sector, purpose of loan, amount originally advanced and currently outstanding, date of advance, original term of loan, interest rate, and credit quality (identifying overdue payments, and amounts of provision).¹ Multiple loans made to the same client should be identified individually. A summary profile for a fund's investees should contain at a minimum: sub-project name, sector, time of first investment, amount of investment at cost (in US\$ and as relevant also in local currency), latest valuation (and basis thereof), and internal rate of return.

In **general funding** (without identifiable sub-projects), the primary indicator is to what extent the project has affected – positively or negatively – the FI's long-term profitability and viability or, in newly established institutions, the primary indicator is the FI's overall profitability (actual and projected) and viability.²

Relevant profitability indicators may include: ROAE, ROAA, net interest margin, provisioning/default rates, operating expenses/total income, share of interest income (and more generally, income from stable sources) in total income (as opposed to accounting income such as foreign exchange gains or securities reclassification gains and volatile and one-off income such as securities trading gains and real estate sale proceeds). When an FI is listed, its stock price performance can give a good indication of the returns to the FI's shareholders, but this may be an unreliable indicator of project performance, particularly where

Notes:

¹ See either an actual good practice example or another suggested format for sub-project reporting. Where the number of sub-projects or projects exceeds 20, a summary profile (for example by sector, by instrument, etc.) suffices.

² The investment's profitability to IFC is separately addressed under the evaluation of IFC's investment outcome and may differ. Project business performance addresses the intermediary's profitability from the point of view of all FI financiers.

the project constituted only a relatively small portion of the FI's operations, or when there are significant short-term fluctuations. Please see the suggested [list of indicators](#) suitable for evaluating the FI's business success.

In order to evaluate the FI's viability, the XPSR should also discuss the main risk areas identified by analyzing the FI's financial statements, e.g. capital adequacy, asset quality and structure (including the comparative size of the government securities and loan portfolios), provisioning adequacy (indicated by the open loan exposure), extent of related party lending, industry sector concentrations (especially to high risk sectors, e.g. real estate development), individual borrower and group concentrations, asset and liability maturity profile and mismatches, foreign exchange exposures (including mismatches between sub-loan currency and the currency of sub-borrower revenues) and interest rate exposures, and funding concentrations.³ Most of these can be expressed as a percentage of the loan portfolio or of the FI's risk-weighted capital. In this context, the XPSR should assess the operating policies of the FI to ascertain whether the risks are being prudently managed.

Other issues discussed in detail under "Economic sustainability" and under "Private sector development – impact of the investment climate" below can be briefly addressed here to the extent that they materially affect the FI's profitability. Examples include macroeconomic conditions, the degree of dollarization in the economy, interest rate and exchange rate distortions and/or volatility, subsidies (direct or indirect) that may exist in the financial market, the depth and sophistication of financial markets (e.g. market domination by state banks which influence domestic pricing), government pressure in such areas as financing state owned enterprises, and policies by domestic supervisory bodies that affect financial results (e.g. provisioning).

To evaluate the **institution building** aspects of the project, the XPSR should address to what extent the project has fulfilled its objectives as stated at project approval in the Board Report/original decision memorandum (for example, resource utilization; the project's success in reaching its targets – SMEs, start-up ventures, etc.; FI performance in applying agreed approval/supervision criteria).

Where the project had a technical assistance (TA) component, the XPSR should assess its outcome, try to identify whether any of the TA needs were not addressed, and include comments from the FI's management as to the effectiveness of the TA. If applicable, TA provided by IFC should be compared to that provided by other IFIs, e.g. EBRD, EIB, EU, ADB.

Evaluation standard

Rate the expected project business performance according to the project's expected (long-run) financial impact on the FI or, in the case of newly established FIs, according to their expected (long-run) profitability⁴ and viability. Where quantitative information is not available to separately address the project's financial impact, discuss with the main project sponsor(s) and the FI's management how they would rate the project's financial impact and provide a rationale for the rating.

Notes:

³ The list suggests possible focus areas. There is no need to discuss all of them in the XPSR; however, the accompanying PSR is expected to include a detailed analysis of financial statements and to cover all risk areas.

⁴ The evaluation guidelines for IFC's investment outcome contain rating benchmarks for equity returns to IFC. While IFC might not have an equity investment or be a minority equity investor, these benchmarks may serve as an indicator in evaluating the adequacy of returns to all equity holders.

The benchmarks are:

	Targeted Funding	General Funding
• Excellent:	Project substantially raised the FI's profitability and substantially improved its viability	High overall profitability of the FI expected in the case of newly established FIs
• Satisfactory:	Project had a neutral to positive effect on profitability and improved viability	Adequate overall profitability expected
• Partly unsatisfactory:	Project returns were sufficient to cover cost of associated debt, but did not provide adequate returns to equity holders or detracted from viability	Expected long-run returns to equity holders don't provide a risk premium over the cost of debt financing
• Unsatisfactory:	Project returns insufficient to cover cost of associated debt or harmed viability	Expected long-run returns to equity holders less than cost of debt financing

Where the project is other than *satisfactory*, explain why, discussing the main drivers of the shortfalls or excellent performance, e.g. market and investment volume; interest rates, spreads and equity returns; resource utilization and portfolio size; resource allocation (sub-project/fund investee performance or overall portfolio quality, sector/geographical allocation); cost structure; execution schedule; contractual/management arrangements; technology, training and productivity; management quality; force majeure events.

Projects are owned by FIs, and successful FIs can have unsuccessful projects and vice versa. Comment on the FI's prospects as a viable, internationally competitive institution. Focus on any issues that might threaten the FI's survival and thus could endanger realization of the still-to-go IFC project benefits.

ECONOMIC SUSTAINABILITY

Note: This section of the XPSR must be cleared by the departmental economist. For projects with significant impacts on the local community, the social development specialist should also be consulted.

Concept

IFC's purpose is to "further economic development ... in its member countries" (encouraging private sector development is the means to achieving that purpose). Growth and development are not synonymous, but economic growth provides the resources necessary for development. Projects with high economic returns contribute to a country's economic growth, whereas those with low or negative economic returns detract from it. Not all development aspects can be quantified, and this indicator therefore also considers qualitative aspects, including to what extent a project has contributed to IFC's mission – helping to reduce poverty and improve people's lives.

This section evaluates the project's and sub-projects' effects on the local economy and the associated benefits and costs. Address to what extent, as a result of the project, resources are being allocated more efficiently and in particular to what extent the FI's portfolio or the sub-projects are providing a net economic benefit. Use the financial performance as baseline, but assess also any systemic (e.g. interest or exchange rate controls, crowding out by state-owned banks) or portfolio-specific (e.g. concentration in protected sectors) distortions. Discuss whether and to what extent the FI considers economic (in addition to financial) viability criteria in its financing decisions – for example, do the FI's credit decisions take market distortions such as trade barriers into account?

To the extent possible, also try to assess the project's impact on people other than the investors in the FI: owners of FI client companies and their customers and employees, government, competitors, local residents, etc. Examples of economic benefits and costs accruing to them are:

- benefits or costs for FI clients associated with cost of, or ease of access to, financial services, indicating increased or decreased financial market efficiency;
- contribution to government revenues, for example resulting from taxes paid by the FI or by sub-projects;
- contribution to widely-held development objectives such as poverty alleviation, social or gender equality, concern for child labor, or regional development;
- community services such as supporting local industry groups, education programs, community facilities;
- employment generated/preserved, training, real wages, quality of the workplace, non-wage employee benefits (e.g. provision of a crèche, medical treatment, education of dependents). However, please note that in financial intermediary operations the direct employment effects are often insignificant and, for example, a large workforce in the FI might be a sign of an inefficient institution;
- negative effects: government subsidies that reduce the resources available to other programs in order to benefit the project's owners; interest rate or exchange rate distortions exploited by the project which reduce the efficiency of the financial system; reliance on collateral or government/third-party guarantees to pay for loans which supported bad projects; support of inefficient projects benefiting from protection which raises prices for local consumers; providing foreign exchange financing to sub-projects that are unable to bear currency risk and suffer from a devaluation.

Indicator

The economic impact of a financial market project can be gauged by:

- assessing the project's financial impact on the FI;
- assessing the sub-projects' financial performance, economic benefits and costs; and
- determining to what extent the financial performance of the FI and the sub-projects is influenced by economic distortions.

For example, an FI's portfolio might be concentrated in a highly protected sector, and therefore the contribution to economic growth might be less than the portfolio profitability would indicate. (Going forward, this would also constitute a risk for the FI.) On the other hand, due to poor structuring, lacking protection for minority investors, or lacking ability to enforce contracts, an FI's portfolio might be performing poorly, even though the economic impact of the sub-projects it finances is positive.

Evaluation standard

The project's contribution to economic sustainability should be rated:

- **Excellent:** when the project has substantially increased the efficiency of financial markets and/or the vast majority of sub-projects are economically viable and the project has made a substantial and wide-spread contribution to improving living standards.
- **Satisfactory:** when the project has positively influenced the efficiency of financial markets and/or most of the sub-projects are economically viable as defined by: (a) sub-borrower portfolio quality is better than, or equal to, the higher of the rest of the FI's loan portfolio or the market average; (b) the aggregate equity fund portfolio return before management fees is satisfactory⁵; or (c) more than half of equity fund investees have positive equity returns while aggregate portfolio return before management fees is less than satisfactory but no less than zero.
- **Partly unsatisfactory:** when the project has made no positive contribution to the efficiency of financial markets and/or a large portion of the sub-projects is not economically viable as defined by: (a) sub-borrower portfolio quality is worse than the higher of the rest of the FI's loan portfolio or the market average; or (b) more than half of equity fund investees have zero or negative equity returns while aggregate portfolio return before management fees is less than satisfactory but no less than zero.
- **Unsatisfactory:** when the project has negatively affected living standards or the efficiency of financial markets and/or the majority of sub-projects is not economically viable as defined by: (a) sub-borrower portfolio quality is worse than both the rest of the FI's loan portfolio and the market average; or (b) the aggregate equity fund portfolio return before management fees is negative.

Notes:

⁵ Using the investment outcome equity benchmark for active investments. If the project had substantial non-quantifiable benefits or costs that constitute a compelling rationale for a higher or lower rating, these should be stated in the XPSR.

ENVIRONMENTAL AND SOCIAL EFFECTS

Note: This section of the XPSR must be cleared by the environmental specialist. For projects with significant social concerns (e.g. resettlement), the social development specialist should also be consulted.

Concept

IFC's Policy and Performance Standards on Social & Environmental Sustainability (2006) consider social and environmental sustainability as an important component of development outcome quality in the projects that IFC finances. That operations are carried out in an environmentally and socially responsible manner is not only sound business practice, but also a necessary condition for sustainable development.

The XPSR's assessment of "Environmental and Social Effects" should cover: (i) the project's environmental performance in meeting IFC's requirements; and (ii) the project's actual environmental impacts through its sub-projects, including pollution loads, conservation of biodiversity and natural resources and, in a broader context, social, cultural and community health aspects, as well as labor and working conditions and workers' health and safety. Compliance with IFC's individual requirements at appraisal should be clearly stated in the XPSR. IFC's Policy and Performance Standards and World Bank Group guidelines should be considered a proxy for what IFC considers acceptable environmental standards, but effects on the ground are what this indicator and its rating should address.

The goal of IFC's environmental requirements for FIs is twofold: (i) enhance the environmental management capacity of the FI; and (ii) fund sub-projects or catalyze investments in projects whose operations meet the applicable IFC environmental requirements. The XPSR should therefore address how the project meets both these goals.

Indicator

Environmental, social, health and safety (ESHS) effects, "Environmental and Social Effects" should be evaluated relative to:

1. IFC's requirements⁶ and guidelines and the local standards that would apply to the same project if appraised today;
2. IFC's requirements and local standards that prevailed at the time of approval;
3. covenanted requirements in the Investment Agreement and its attachments (e.g. reporting requirements, conditions of disbursement, remediation action plans, environmental management plans) and in the signed commitment letter; and
4. environmental and social management practices that go "beyond compliance" required by IFC.⁷

Specify which environmental category applied for the project at approval and which would apply today (in 2006 IFC approved the new "IFC E&S Review Procedures", ESRP), including which environmental "type" the project would be in (see [IFC's Procedure for FIs](#).) If you require assistance in identifying the correct version of a World Bank Group policy or guideline that applied at the time of approval, please contact CES.

Notes:

⁶ "IFC's requirements" in this context include depending on the FI-type and legal agreements: training of the staff with environmental responsibilities, establishing an Environmental Management System, annual reporting, IFC's clearance of sub-projects, and sub-projects' compliance with exclusion lists. IFC's policies, performance standards, Environmental & Social review Procedures and guidelines and – to the extent they are applicable in a specific case – World Bank Group policies and guidelines, as well as host country requirements. IFC's current and 1998 requirements and the 1993 requirements are online.

⁷ For example: an FI Type 1 applies WBG guidelines and policies rather than host country requirements; an FI Type 2 applies IFC requirements to all investments, not just IFC-financed subprojects; an FI develops its own internal environmental training program; an FI actively fosters environmental improvements in the projects it finances like carbon trading, energy efficiency, biodiversity or community programs e.g. using Technical Assistance or other grant funding, etc.

Procedure For Environmental And Social Review of Projects (1998): As a general rule, for FI Type 1 operations the emphasis of the evaluation should be relatively more on the quality of the FI's EMS and reporting, and ensuring that the FI has nominated trained staff to implement its EMS. For FI Type 2 and 3 operations, the emphasis should be mainly on the environmental effects and compliance of the sub-projects, visiting a sample of sub-projects if at all possible. If sufficient documentation on the sub-projects is available, it may be possible to derive an informed opinion on performance from desk reviews. For projects where the FI provides debt or lease financing for equipment or other assets which represent a small portion of the total project or the investee company's balance sheet, the FI should use professional judgment regarding the scope of environmental and social review, the focus being on the impact of the equipment or assets financed.

IFC E&S Review Procedures (2006): The FIs that are engaged only in Retail Operations are categorized as a Category C investment without environmental and reporting requirements. Other FIs are categorized to Category FI investments with requirements depending on IFC's investment instrument and FIs sub-loan portfolio, as described in ESPR.

Evaluation standards

- **Excellent:** The project has maintained the FI's excellent Environmental Management System (EMS) or materially improved the efficacy of the FI's overall environmental risk management (e.g. through training and introduction of a well functioning EMS) and the environmental performance of portfolio companies. In addition, the FI has provided transparent and detailed reports on time, verifying that the project (and sub-projects, as applicable) has consistently met IFC's requirements at approval and its environmental effects are deemed acceptable in view of IFC's current requirements. IFC should be able to use projects rated *excellent* as role models for positive environmental effects.
- **Satisfactory:** The project meets either IFC's at approval requirements or IFC's current requirements and its environmental effects are deemed acceptable overall. For all FI project types, trained staff implement an appropriate EMS that has been functioning over the project life (as reflected also in acceptable environmental standards being applied to projects financed by the FI). The sub-projects are and have been in substantial material compliance with IFC's requirements for the life of the project.
- **Partly unsatisfactory:** The project does not meet IFC's requirements, but the shortfalls are either being corrected or negative impacts are moderate. For example: the FI's EMS is adequate, but some sub-projects have resulted in environmental damage; or the sub-projects visited have acceptable environmental standards, but the EMS is materially inadequate; or an FI (type 1) initially had no EMS, but has recently introduced a functioning EMS.
- **Unsatisfactory:** The project does not meet IFC's requirements and substantial negative effects are known or likely, e.g: the FI's EMS is completely inadequate and nothing is known about sub-project performance; the EMS has material shortcomings and some sub-projects have negative environmental effects; while the EMS appears adequate, a significant portion of sub-projects have negative environmental effects; some sub-projects have resulted in substantial and irreversible environmental damage.
- **No opinion possible (NOP):** Where, after best efforts, the relevant information to establish material compliance (or lack thereof) cannot be obtained, e.g. because of insufficient or missing Annual Environmental Performance Reports (AEPRs), a rating of "no opinion possible" (NOP) may be assigned. Use of the NOP rating should be a last resort, after reasonable effort has been made to obtain the necessary information.
- **Not applicable (NA):** If the project was classified as category C (no impact) and that categorization has remained valid over the life of the project so far (and is likely to remain so going forward), then the correct rating is *not applicable*. If, despite its category C classification, the project has in fact had actual or potential environmental and social impacts, then it should be rated accordingly.

Where the rating is NOP, the project supervision report should describe the steps IFC is taking to obtain the necessary information, including a timetable. A NOP rating may point to a shortcoming in IFC's front-end work quality (e.g. if investment agreements did not allow IFC to get access to the relevant information) and/or to a shortcoming in IFC's supervision (e.g. IFC did not follow up sufficiently to monitor and ensure compliance).

PRIVATE SECTOR DEVELOPMENT

Concept

IFC's *Purpose*, specified in IFC's Article I, is "encouraging the growth of productive private enterprises", and to that end, IFC shall "seek to stimulate, and to help create conditions conducive to, the flow of private capital, domestic and foreign, into productive investment". This indicator addresses to what extent the FI has developed into a corporate role model – positive or negative – and whether the project has contributed to IFC's purpose by spreading the benefits of growth of productive private enterprise beyond the FI.

Financial markets projects can contribute to this purpose in three ways: by contributing to the growth of sustainable and viable financial institutions, to the development of the financial markets in which they operate, and by financing sustainable and viable private enterprises in the real sector.

Indicators

Important factors to consider are:

- impact on domestic financial market development through enhanced competition, increased liquidity, new products, improved services, easier access to financing for domestic clients (e.g. SMEs);
- demonstration effects in the local economy, attracting investments in other intermediaries;
- greater resource allocation efficiency beyond the project FI and resource mobilization beyond the project;
- introduction of international accounting standards and/or enhanced disclosure standards;
- new technology, development of management skills, and employee training;
- stronger local entrepreneurship or enhanced private ownership;
- the FI's governance quality, reputation and business practices as a positive corporate role model and quality investment asset.

Positive effects also include changes in the legal and regulatory framework and its administration that improved the enabling environment, for example by making transactions more secure and flexible and providing economic actors with the freedom, flexibility, and security to acquire, use, and leverage property rights. The enabling environment includes how the laws and regulations are set, administered, enforced and adjudicated. In a positive enabling environment, a non-intrusive, efficient, and respected public administration sets widely understood rules for economic activity, enforces them uniformly and universally in a predictable manner, and changes them through transparent means. Evaluate whether project-related technical assistance or the project's activities, goods and services have brought about changes in the enabling environment and cite changes in laws, regulations, or their administration. For example, the introduction of international accounting standards, enhanced disclosure, or prudent risk management practices in the market may, in turn, result in these standards being adopted by the regulatory authority/central bank.

Negative impacts may include: negative demonstration effects due to poor performance; poor reputation of the FI leading to a negative effect on the financial sector or private enterprises; poor allocation of resources in the FI's portfolio detracting financing from the private sector (e.g. increasing exposure to the government through purchases of T-Bills, or excessive volume of loans made to state-owned enterprises); project-induced restrictions on competition; delays of reforms or entry by other intermediaries; introduction of laws and regulations worsening the enabling environment, etc.

Where project impacts extend to the local financial markets (e.g. increasing the amount of term financing, introducing new products, improving the sector's liquidity), the local central bank may be able to comment or provide pre-project and current data for comparison. Appropriate indicators may include the ratio of private sector loans to GDP, the percentage of term loans in the banking system, aggregate liquidity, or the percentage of loans to specific sectors (SMEs, housing finance etc).

Discuss, but do not rate, the impact of the investment climate on the project. “Investment climate” refers to country conditions, including legal, regulatory, and judicial framework, rule of law, institutional capacity, investment incentives and barriers, peace and order situation, level of corruption, and access to cost-effective labor, domestic finance, business support services, information, infrastructure, and other productive inputs. You may want to use Institutional Investor Country Credit Ratings (IICCR) and the Heritage Foundation Index of Economic Freedom at project approval and at present as proxies for estimating investment climate characteristics and changes.

Evaluation standard

Rate the performance according to these standards:

- **Excellent:** considering its size, the project improved the enabling environment or otherwise made a substantial contribution to the growth of private enterprises or efficient financial markets.
- **Satisfactory:** the project had some, but no major positive impacts.
- **Partly unsatisfactory:** the project had mostly negative impacts, which, however, are not expected to be of long duration or broad applicability (e.g. a failed project without substantial negative demonstration effects).
- **Unsatisfactory:** substantial negative impacts of broad applicability and/or expected to be of long duration.

Briefly describe which of the factors described above (or others) were most important in this judgment and why they are the relevant considerations.

IFC INVESTMENT'S PROFITABILITY

IFC'S INVESTMENT OUTCOME RATING

Concept

Investment performance is essential to IFC's sustainability and to accomplishing its corporate purpose. This section assesses the extent to which IFC has realized to date, and expects to realize over the remaining life of the investment, the loan income and/or equity returns that were expected at approval.

Evaluation standard

If IFC made only a loan or only an equity investment, then the overall investment outcome rating is the same as the rating for the loan or equity indicator as applicable. If IFC made both loan and equity investments, they are rated separately and the overall investment outcome rating is synthesized from them as follows:

Investment outcome rating for different gross contribution loan and equity ratings

Loan Rating	Equity Rating			
	<i>E</i>	<i>S</i>	<i>PU</i>	<i>U</i>
<i>E</i>	<i>E</i>	<i>E</i>	<i>S</i>	<i>S, PU or U</i> ¹
<i>S</i>	<i>E</i>	<i>S</i>	<i>S</i>	<i>PU or U</i> ²
<i>PU</i>	<i>S</i>	<i>S</i>	<i>PU</i>	<i>PU or U</i> ²
<i>U</i>	<i>-</i> ³	<i>-</i> ³	<i>U</i>	<i>U</i>

Notes:

E = Excellent; *S* = Satisfactory; *PU* = Partly unsatisfactory; *U* = Unsatisfactory

¹ *S* if weighted average of effective loan interest rate and equity IRR \geq FR + XXX bp; *U* if $<$ FR - XXX bp; otherwise *PU*.

² *PU* if weighted average of FR and equity IRR \geq FR - XXX bp; otherwise *U*.

³ For this unlikely event, consult IEG.

Weighted averages should be based on dollar amounts of IFC's disbursed investment.

If the XPSR team believes the above guidelines to be inappropriate in specific circumstances, they may present the rationale for assignment of a different outcome rating than those indicated above.

GROSS CONTRIBUTION – LOAN

Note: These ratings guidelines refer to senior loans. Other loan-type investments (e.g. convertible loans and other quasi-equity investments) are too diverse to set one evaluation standard. Therefore, please contact IEG.

Indicator

The primary indicator for this rating is whether the FI is current on its payments to IFC (interest, fees etc.). It is also important to assess the likely future debt-servicing capacity of the client FI – for example, recent payments may have been made, but the outlook for future payments is doubtful, whether caused by the deteriorating macroeconomic situation in the country, deteriorating interest income of the FI (possibly due to poor portfolio performance), or excessive foreign exchange or off-balance sheet exposures that could produce a large one-off loss to the FI.

Evaluation standard

The loan is rated as follows:

- **Excellent:** Fully performing and, through a sweetener (e.g. income participation), it is expected to earn significantly more than a loan priced “without sweetener” would have earned if paid as scheduled. There is no indication that debt service payments will not remain current in future.
- **Satisfactory:** (i) loan expected to be paid as scheduled; or (ii) loan is prepaid in full; or (iii) loan has been rescheduled and is expected to be paid as rescheduled with no loss of originally expected income. In the case of an IFC guarantee, all fees are expected to be received, and guarantee is not called, or called but expected to be fully repaid in accordance with the terms of the guarantee agreement. In the case of an IFC swap or other risk-management facility, IFC has not suffered any loss and expects no loss due to non-performance of the swap counterparty. There is no indication that debt service payments to IFC will not remain current in future.
- **Partly unsatisfactory:** Loan has been rescheduled, or guarantee is called and in either case IFC expects to receive sufficient interest income to recover all of its funding cost but less than the full dollar margin originally expected. If all payments to IFC are current, but there is doubt whether payments can remain current in future, then a *partly unsatisfactory* rating may be preferable. For example, IFC may establish “flag” loss reserves of modest size (no more than 10%) for reasons such as country conditions, which are not related specifically to IFC’s project. In these cases, a *partly unsatisfactory* rating may be used rather than *unsatisfactory*.
- **Unsatisfactory:** (i) loan is in non-accrual status; or (ii) IFC has established specific loss reserves; or (iii) loan has been rescheduled but IFC does not expect to recover at least 100% of its loan funding cost; or (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.

If IFC’s loan is prepaid, then the correct rating is *satisfactory*. However, the XPSR should note whether or not IFC received compensation for loss of interest income during the remaining term, for example in the form of prepayment penalties. Separately, as part of the assessment of IFC’s work quality, the XPSR should reflect whether IFC structured its investment appropriately to mitigate the risk of prepayment (for example through a step-down in interest margin following project completion) or to provide for compensation in the event of prepayment occurring.

GROSS CONTRIBUTION – EQUITY

Indicator

Calculate the nominal equity IRR (also called return on equity or ROE). Unless more recent information is available, the equity IRR calculated by the Corporate Portfolio Management Group (CPM) may be used. If the XPSR team recalculates the equity IRR using projected dividends and capital gains, it should explain the reasons for divergences from CPM's estimate and attach the calculations and assumptions.

In projecting equity cash flows, the dividend projections should be based on discussions with FI management on dividend timing and payout considerations, and should take into account local company law (e.g. concerning reserve requirements), the FI's loan covenants, and its minimum cash constraints. Indicate how and when IFC is likely to sell its investment. Where IFC's exit is expected to be through a put at a contractually specified price, assess the enforceability of the put and the prospects for timely realization of the put value.

Evaluation standard

The rating criteria for equity investments are based on a comparison of the nominal equity IRR with the actual (or notional) fixed rate loan interest rate (FR) that was (or would have been) approved to the same FI. IEG has placed information on the cost of funds, notional fixed rate loans, and spread ranges for specific projects with equity investments at the following link: [Fixed rate loan interest rate.⁸](#) Note that comparison of the equity IRR estimated at evaluation either with the expected return at approval or with the equivalent return on US Treasuries, is not an appropriate standard for rating the investment.

The benchmarks are:	A: For closed investments or active investments with put options that specify a minimum return to IFC (and IFC expects to exercise the option at that value) ⁹	B: For equity investments firmly planned to be fully sold within 12 months of the XPSR date, such that the exit value is reasonably well-established	C: For equity not fully sold and more than 50% of undiscounted positive cash flows are still-to-go by more than 12 months
• Excellent:	Equity IRR \geq FR+X%	Equity IRR \geq FR+X%	Equity IRR \geq FR+ X%
• Satisfactory:	Equity IRR \geq FR+X% ¹⁰	Equity IRR \geq FR+X%	Equity IRR \geq FR+ X% ¹¹
• Partly unsatisfactory:	Equity IRR \geq FR	Equity IRR \geq FR+X%	Equity IRR \geq FR+X%
• Unsatisfactory:	Equity IRR < FR	Equity IRR < FR+X%	Equity IRR < FR+X%

Notes:

⁸ The "fixed rate" (FR) loan (equivalent) is determined as follows: (1) Investments which have a fixed rate senior loan in addition to the equity: FR is the actual interest rate for the fixed rate loan. (2) Investments which have a variable rate loan in addition to the equity: FR is the Cost of Funds (CoF) plus the spread approved for the variable rate loan. CoF is the 10-year fixed rate swap equivalent of 6-month LIBOR as of the investment's commitment date. Equity-only investments: Notional FR is the CoF plus the country spread (from IFC's Weekly Pricing Guidelines) prevailing as of the investment commitment date.

⁹ Where IFC's expected equity exit is by means of a put option specifying a minimum return but enforceability is doubtful, the equity investment should be treated as an active investment with more than XX% of undiscounted positive cash flows still-to-go by more than 12 months (scenario C).

¹⁰ For example, if a notional senior loan would have attracted a fixed rate of XX%, the *satisfactory* equity IRR for a closed investment would be in the range XX% to below XX%.

¹¹ For example, if a notional senior loan would have attracted a fixed rate of XX%, the *satisfactory* equity IRR for an investment not yet sold would be in the range XX % to below XX%.

IFC'S WORK QUALITY

IFC'S WORK QUALITY RATING

Concept

This section addresses three areas of IFC's operational performance: (1) screening, appraisal and structuring; (2) supervision and administration; and (3) role and contribution. Did IFC apply good practice standards in these areas, such as those identified in its policies and procedures and guidance notes (e.g., IFC's credit notes)? The variance analysis of appraisal projections against actual outcomes in the XPSR should help identify the strengths and weaknesses of IFC's operational performance, as well as valuable operational lessons. However, do not let the outcome unduly affect the work quality ratings. An unsatisfactory development and investment outcome can be caused by external factors, unforeseeable (e.g. force majeure), or foreseen (e.g. realized market risk). A satisfactory outcome can be achieved even though IFC did a poor job appraising and supervising the project, had insufficient role and made no contribution. However, if IFC did (or could have and did not) improve the project's development or investment outcome, this should be reflected in this section. For example, if the environmental performance is other than *satisfactory*, the XPSR should specifically address IFC's environmental work quality.

Evaluation standard

Based on the ratings of the three indicators: (1) appraisal, (2) supervision, and (3) role and contribution, rate IFC's overall work quality on a four-point scale as below. Bearing in mind that IFC's ability to influence the quality of an operation is greatest between screening and disbursement, this rating should reflect the overall quality of the value added by IFC, at each stage, to the operation's development outcome and to IFC's profitability. The IFC work quality rating can be no lower than the worst indicator, and no higher than the best indicator. The rating should be:

- **Excellent:** if IFC's performance was exemplary;
- **Satisfactory:** if IFC's performance was materially up to a high professional standard;
- **Partly unsatisfactory:** if there was a material shortfall in at least one area;
- **Unsatisfactory:** if there were shortfalls in several areas or an egregious shortfall in one area which led (or under less favorable circumstances could have led) to a less-than-*satisfactory* development or investment outcome.

SCREENING, APPRAISAL, AND STRUCTURING

Concept

Evaluate to what extent IFC has professionally executed its front-end work to a sustainable corporate performance standard. IFC's operating policies and procedures, as well as its credit notes provide guidance on what IFC considers an appropriate professional standard.

Indicators

Evaluate IFC's processing of the project at entry. Identify the materially deficient or particularly commendable areas in IFC's screening, appraisal, and structuring.

Screening and appraisal:

- Examine the Board paper and the various supporting documents – CIC meeting minutes, decision meeting memorandum, appraisal reports, BTO reports, etc.
- Analyze and comment on the effectiveness of IFC's assessment of project risks (risks that the project would fail to meet the intended development objectives or generate adequate returns), using IFC's credit notes as the best-practice guidelines for analyzing the assessment at appraisal of the project's creditworthiness. Did the screening/appraisal team adequately identify the main risks? What, if any, were missed?
- Review the assessment at appraisal of sponsors/management (their capacity, character, commitment, experience and reputation), country conditions (political; economic – local currency value, inflation, and interest rates; legal; business environment); project concept (fit with the likely market, competitive strength); local financial market characteristics (depth and liquidity; number, size, and types of participants including state-owned FIs; asset-liability profiles; income structure; and related systemic risks); non-FI private sector characteristics (size and depth compared to the state-owned enterprises, prospective borrower credit quality or potential investee profitability, subsidies and other relevant distortions); risks inherent in the project FI (governance quality; capitalization; loan portfolio quality and concentration; income composition and profit history; fund manager's track record for funds; etc.).
- Review the financial plan and assumptions used in the project's financial projections for completeness. In hindsight, were the parameters used in the sensitivity analysis at appraisal consistent with market and FI situation at the time? Were the assumptions realistic?
- Review the effectiveness of implementing IFC's at-approval procedure for [environmental appraisal](#). Were the key environmental risks of the sub-project portfolio and type of IFC's investment adequately identified in screening of the environmental category and determining the key Environmental, Social, and Health & Safety (ESHS) requirements? Were IFC's environmental procedures, policies, guidelines and performance standards appropriately translated to the requirements in the Environmental and Social Clearance Memorandum and legal documents and the signed commitment letter? Did IFC make sure that the FI had adequate EMS and trained staff to implement it? Did project appraisal assess the adequacy of policies or supervision standards of the local environmental authority? Did the appraisal identify training needs and procedural adjustments? Did IFC take into account available relevant lessons from other operations? If issues or concerns were raised at appraisal – for example in IFC's review process, by the World Bank, civil society or other stakeholder groups – were they appropriately addressed?

Structuring:

- Were the risks identified at screening/appraisal addressed in the structuring of IFC's project, and was their proposed mitigation adequate?
- Were the terms, conditions, and security suitable for both the FI and IFC's needs?
- Was loan pricing commensurate with market practices and risks?
- Evaluate whether, in hindsight, IFC's loan covenants were relevant, practical, adapted to the particular country and project, and contributed to mitigating risks and realizing objectives. Loan covenants should be adapted to the particular country and project, depending on the adequacy of local supervision standards, local financial market development, and the FI's track record. Still, as a necessary minimum, covenants should include the minimum capital adequacy ratio (based on risk-weighted assets); maximum open loan exposure (or other loss provisioning guideline); single borrower, group, and industry exposure limits (including, if necessary, specific sectors); related party exposure limit; and maximum foreign exchange exposure. If needed to ensure the FI's prudent functioning, covenants may also include maximum maturity and interest rate gaps; minimum liquidity ratio; maximum investment in government securities/T-Bills; off-balance sheet exposures; etc.
- Appropriate reporting requirements should be incorporated into legal documentation to enable IFC to monitor compliance and track the fulfillment of development objectives identified by IFC at approval.
- Were the identified training needs and procedural adjustments, particularly with respect to environmental matters, reflected in project design?
- Did IFC consider improvements to the FI's governance and operating standards, and require that the FI adopt or amend operating policies?
- In the case of **targeted funding**, the XPSR team should check whether IFC's project documentation included a definition of "eligible borrower" for credit lines or "eligible investee" for equity funds, so that the FI would be aware of IFC's targets and requirements. Reporting requirements for targeted funding should include regular reports on sub-projects, sufficient to monitor performance and achievement of objectives.
- Did IFC structure its loan in a way as to mitigate the risk of prepayment or to provide for compensation in the event of a prepayment occurring (for example, through a prepayment penalty).
- Evaluate the decision to take equity (if applicable) and the structuring of the equity investment. Was there a significant upside potential and a realistic exit option to realize a return commensurate with IFC's risk? Where the expected exit was through a put option, evaluate to what extent it was enforceable, and whether the pricing was adequate. If the anticipated exit was by means of the stock market, evaluate whether this exit was realistic given the depth of that market.
- In case of an equity investment, were the interests of minority shareholders, including IFC, appropriately protected? Note that, even if IFC's loan has appropriate covenants, it is usually preferable also to cover key issues in the shareholders' agreement if applicable (since loans may never disburse, or may be (p)repaid before the equity is sold). Consider whether this was, or should have been, done within the project reviewed in the XPSR. Was the role of a technical advisor (if any) carefully defined?

In summary, did IFC identify the most important risks that could reasonably have been identified at the approval stage, and mitigate them to the extent possible? Keep in mind that not all risks can be mitigated, but the risk-reward profile should be acceptable.

Evaluation standard

Rate IFC's screening, appraisal and structuring as follows:

- **Excellent:** if IFC's front-end work could serve as a best-practice example;
- **Satisfactory:** if it materially met IFC's good practice standards (see for example IFC's credit notes);
- **Partly unsatisfactory:** if there was a material shortfall in at least one important area;
- **Unsatisfactory:** if there were material shortfalls in several areas or a glaring mistake or omission bordering on negligence in at least one important area.

SUPERVISION AND ADMINISTRATION

Concept

Supervision, for this purpose, starts after commitment of IFC's funding. Evaluate to what extent IFC has professionally executed its supervision, taking into account that the appropriate level of supervision will depend on a project's circumstances. IFC's **Operational Procedures** provide guidance on what IFC considers an appropriate professional standard.

Indicators

Review previous PSRs prepared on the project/FI, compare them to the XPSR findings, and explain any major discrepancies. Assess whether the FI's reporting, and IFC staff visits were adequate to monitor developments, manage risks, identify opportunities, ensure compliance with covenants and more generally contribute to the operation's financial and developmental success. Did IFC identify emerging problems, and were IFC's responses timely and appropriate?

Evaluate the adequacy of IFC's monitoring of the FI's environmental performance. Did IFC adequately re-appraise the project and the environmental category with new appropriate requirements if IFC's investment instrument or ESHS risks of the FI's portfolio changed? Were A and B category sub-projects adequately appraised and monitored by IFC or the FI, or by using environmental consultants when appropriate? Were Environmental Impact Assessment and Environmental Audit reports and Corrective Action Plans adequate and submitted for IFC's approval if required? Was the quality of Annual Environmental Performance Reports (AEPRs) reviews adequate and were potential deficiencies properly identified with request for corrective actions? Were the requests submitted to the Investment Officer and the FI? Did IFC make sure that the corrective actions were implemented?

If IFC has Board representation, did IFC use it to enhance its supervision of the FI and to gain better access to market and country intelligence? Did IFC's Board nominee help monitor whether the operating policies and procedures of the FI reflected good practices and were implemented appropriately?

Evaluation standard

Rate IFC's supervision and administration as follows:

- **Excellent:** if IFC has always kept itself promptly and fully informed about the project's and FI's performance in all material areas and used this knowledge proactively to improve the project's development outcome and/or IFC's investment outcome;
- **Satisfactory:** if IFC has kept itself sufficiently informed to react in a timely manner to any material change in the project's and FI's performance and took timely action where needed;
- **Partly unsatisfactory:** if IFC's supervision was insufficient to monitor the project's and FI's performance and/or IFC did not take timely and appropriate action;
- **Unsatisfactory:** if IFC missed material developments, and/or did not use information to intervene in a timely and appropriate manner.

IFC'S ROLE AND CONTRIBUTION

Concept

IFC's Article I specifies its developmental role, which is captured in three basic operating principles ("IFC's ABC"). This section evaluates how well IFC fulfilled this developmental role.

- **Additionality/Special Contribution Principle** – *“IFC should participate in an investment only when it can make a special contribution not offered or brought to the deal by other investors.”* What was IFC's additionality? Highlight any pioneering or innovative dimensions, and evaluate whether IFC's financing could have been replaced by private financing on acceptable terms if the same security had been offered. If IFC has Board representation, to what extent did IFC use it to provide assistance and direction to the FI and to improve its governance, financial performance and developmental results? Comment on the effectiveness of project-related technical assistance, if applicable.
- **Business Principle** – *“IFC will function like a business in partnership with the private sector and take the same commercial risks.”* Did IFC accept the same commercial risks and earn the same returns as private participants in the same risk categories (e.g. co-equity investors, co-lenders)? If performance materially surpassed IFC's appraisal projections, did IFC receive any upside gain commensurate with its investment risk? If IFC obtained special recourse security, such as a put or guarantee, explain the circumstances and rationale.
- **Catalytic Principle** – *“IFC will seek above all to be a catalyst in facilitating private investors and markets in making good investments.”* Did IFC bring private investors and lenders to the project opportunity, mobilize funding, or attract better terms for the FI than would otherwise have been the case? (Since IFC's B-loans confer certain advantages to commercial banks, the test is whether they would have entered into the transaction, and on terms as favorable to the FI, absent IFC's involvement.)

Consider the above three operating principles if and as material to your evaluation, and also consider the following:

- **IFC's Timeliness, Efficiency, and Client Satisfaction** - Were IFC's interactions with the sponsors and FI timely and efficient? Comment on any issues relating to staff continuity and whether and how it has affected the operation. Note any positive or negative feedback from the client or suggestions for improvement.
- **Relevance within IFC's Country Strategy** - Was IFC's support for the project relevant in addressing the country's development priorities and consistent with IFC's current country strategy? Where the country strategy has evolved over time, you may also want to comment on changes since the project's approval.
- **Governance:** One of the ways IFC can have an impact on developing financial markets is through introducing improved standards of governance. This goes beyond good front-end work in formulating covenants, and can be especially significant where IFC has a board member. IFC's contribution may include assistance with audit committee creation and functioning, formulating asset-liability policies, credit policies, clarifying the distinction between the roles of shareholders/sponsors and management, helping protect minority shareholders, and clarifying the role of technical advisors. Did IFC's involvement encourage the FI to improve corporate governance? Did IFC insist on introducing higher standards in policies and procedures and was IFC's effort successful?
- **Environment:** IFC's role and contribution in enhancing client's environmental management, identification and mitigation of environmental risks, introducing training and additional environmental improvements like carbon trading, energy efficiency and biodiversity programs and Technical Assistance funding in sub-projects.

Indicators

Assess the project's genesis, the rationale for IFC's support, and IFC's involvement in the project (at approval and ongoing). As the basis for assessing IFC's role and contribution, consider what would have happened if IFC had not financed this project.

- Would the FI (and/or sub-borrowers) have found alternative financing (on similar terms)?
- Would the project have been more or less successful?
- Did the FI actively seek alternative financing before coming to IFC, and what was the outcome?
- Did IFC maximize opportunities to improve corporate governance and environmental management?
- Did IFC deliver on all its expected contributions as set out in the Board approval documents?

Consider what IFC added and what possible additional value IFC could have contributed to the project's design, or what IFC could have done differently to improve project or FI performance and development impacts. For illustrative examples of what constitutes significant added value by IFC, see IFC and the Road to Sustainability.

Evaluation Standard

Apply the following rating guidelines:

- **Excellent:** IFC's role was essential for the project to go ahead and IFC made a major contribution to make it a success;
- **Satisfactory:** IFC's role and contribution were in line with its operating principles;
- **Partly unsatisfactory:** IFC's role or contribution fell short in a material area; and
- **Unsatisfactory:** IFC's role was not plausibly additional and IFC did not deliver its expected contribution.

EMERGING LESSONS FROM EXPERIENCE TO-DATE

ISSUES AND LESSONS FOR IMPROVED PERFORMANCE

From the experience to date, identify the most important issues and the lessons for improving IFC's business in order of priority: focus on how IFC can improve the development and investment outcome of its operations, and its own operational work quality. In particular, identify lessons that illustrate the business case for sustainability: for example, how a good environmental management system or good corporate governance improved the FI's competitiveness or vice versa. Address drivers of ratings other than *satisfactory*. The lessons may be positive (things that worked and should be repeated) or negative (mistakes that should be avoided). Good, well-written lessons: are specific but widely applicable; describe lessons learned rather than general principles; are derived directly and specifically from the experience of the operation and are self-contained. Be responsive to the following guidelines and suggestions.

- Focus on issues and lessons of general relevance to IFC operations that could guide IFC in screening, structuring, appraisal, negotiation, supervision and post-evaluation.
- Consider (i) the issues' materiality and relevance to the operation's outcome, and (ii) what, with hindsight, IFC should have done to improve the operation's overall performance.
- Consider lessons relating to the three performance dimensions addressed in the XPSR: development outcome; IFC's investment outcome; and IFC's contribution and operational work quality.

Be specific and focus on suggestions to improve quality. For example:

- If FI management was weak, consider how IFC could have: (i) discovered this weakness at appraisal, (ii) better mitigated the risk, and (iii) intervened more effectively when the problem was detected. It is not a helpful lesson to write "ensure that FI management is strong."
- If the financial projections proved materially optimistic, consider the underlying reasons (e.g. flawed forecasting models, little experience of the forecasters, poor training, and too little skepticism) and formulate the lessons and recommendations for achieving a better forecast next time. It is not a helpful lesson to write "make realistic projections."
- If the project featured negative sociological or environmental effects, consider whether and how IFC's procedures should be adapted to address these potential effects in the appraisal, covenant formulation, disbursement and supervision stages. It is not helpful to write "make sure that adequate account is taken of environmental effects."
- If IFC's investment featured essentially equity risk but limited upside potential, consider (i) whether the screening tools should be sharpened to make this prospect more evident, or (ii) whether and how IFC might have structured its investment to better balance the risk and reward prospect.
- Avoid repeating what happened, and be concise in elaborating the underlying issues.

Examples

The lessons should be self-standing, transparent, prescriptive, and operationally oriented with a view to providing guidance for improving future performance. A concise headline should reflect the lesson's gist and be written in a way to help IFC staff zero in on relevant lessons quickly. Lessons should be presented in the format of the following examples:

- *REDACTED*

Examples of sustainability-related lessons:

- *REDACTED.*

- *REDACTED.*

- *REDACTED.*



Guidance Note on Price Adjustment Techniques

INTRODUCTION

This note addresses:

- Why use real prices?
- When to use real prices, when nominal prices?
- Which currency should be used?
- How to convert between different units of measurement.

Why use real prices?

Due to inflation, the value of money changes over time: US\$100 would have bought over 5 times as much 50 years ago, and about 10% more 5 years ago. To make meaningful comparisons which are not affected by inflation, we have to use the same “unit of account”: real prices. Real prices always have a “base year”, usually the appraisal year. Please make sure you specify what year you use as base year for your analysis.

When to use real prices, when nominal prices?

It is not necessary (nor meaningful) to convert an entire balance sheet or income statement into real prices, since several line items (e.g. depreciation, interest payments, etc.) would require differentiated conversion factors. It is usually also not necessary to compare actual and estimated project costs in real prices, unless the implementation period is particularly long or inflation particularly high. However, projected and actual prices (and US\$ margins), revenues and costs should be compared in real terms. The financial rate of return (FRR) and the economic rate of return (ERR) should also be estimated in real prices. However, some measures use nominal benchmarks to evaluate performance, such as accounting returns (e.g. return on equity), and should therefore be calculated in nominal terms.

Which currency should be used?

Many of IFC’s loans (and payment obligations for the client company) are denominated in US\$. IFC evaluates equity returns in US dollars, last not least because IFC’s financial performance is being evaluated based on dollar-denominated income statements and balance sheets. (Many foreign investors do the same.) Therefore, US\$ are usually the appropriate measure. However, when a company is selling into the domestic market, is owned by domestic investors and has debt obligations in local currency, real local currency comparisons can sometimes be more appropriate to evaluate its success and can supplement the dollar-based analysis. How to deal with this situation is elaborated in the section on ‘special cases’.

HOW TO CONVERT BETWEEN DIFFERENT UNITS OF MEASUREMENT

Converting actual results (in nominal LCU) to real US\$ of the appraisal year

In most cases, IFC staff prepares projections at appraisal in real prices, using the appraisal year as base. The actual results are usually available in nominal local currency (e.g. from income statements) and can be compared to projections by using the following steps:

1. Divide the actual results (e.g. prices, revenues, costs, etc.) in nominal local currency units (LCUs) by the average exchange rate for the period under consideration to obtain nominal US\$. For balance sheet data, use the exchange rate of the date the balance sheet.
2. Multiply the nominal US\$ by the US GDP deflator of the base year (in this case the appraisal year) and divide them by the US GDP deflator of the year for which you have the results to obtain real (appraisal year) US\$.

Converting real US\$ from one base year into real US\$ of another base year

In some cases you might wish to choose a different base year, for example the year in which you write your report. To do that, convert the original projections (say they are in real 2000 US\$) to real 2006 US\$ by multiplying them by the US GDP deflator for 2006 and dividing them by the US GDP deflator for 2000:

Converting nominal US\$ into real US\$ of today

Since many people relate better to today's prices, you may sometimes wish to compare in today's US\$. To do that, multiply the data in nominal US\$ by the 2006 US GDP deflator and divide them by the US GDP deflator of the respective year.

SPECIAL CASES

Board Report in nominal US\$

Sometimes Board Report figures are in nominal US\$. In those cases, you will usually also find an assumption regarding (US) inflation. It is still preferable to compare the projections to actuals in real US\$, since otherwise the comparison is influenced by how well inflation was forecast. To convert to real US\$,

1. Calculate the inflation index using the US-inflation rate projected in the Board Report. The base year has an index of 100. Each subsequent year has an index of the index of the previous year times (1 + inflation rate, in percent).
2. Multiply the figures from the Board Report (projected nominal US\$) by the inflation index of the base year and divide them by the inflation index of the respective year.

Board Report in nominal local currency units (LCU)

In some cases, Board Report projections are in nominal local currency units. In these cases, you will usually also find projections for domestic inflation.

1. Calculate the domestic inflation index using the inflation projections (see above).
2. Multiply the nominal LCU by the base year index (100) and divide them by the projected inflation index of the respective year to obtain real (base year) LCU.
3. Divide the real (base year) LCU by the base year exchange rate to obtain real (base year) US\$.

Analysis in Real Local Currency Units

When a company

- is selling into the domestic market;
- is owned by domestic investors; and
- has debt obligations in local currency

real local currency comparisons may be more appropriate to evaluate its success and can supplement the dollar-based analysis.

The previous example illustrates how Board Report projections in nominal LCUs can be converted to real LCUs (by just omitting the third step). If projections are in real US\$, simply divide by the exchange rate to obtain real LCUs.

For actual results, use the (actual) domestic inflation rate to calculate the inflation index. The procedure is the same as explained above. The base year (say, 1996) has an index of 100, each subsequent year has an index of the previous year's index multiplied by $(1 + \text{inflation rate})$. To obtain real LCU, multiply the actual results (in nominal LCU) by the index of the base year (100) and divide by the index of the year in which they occur.



Suggested Indicators for Assessing FI Project Business Success

This note provides a framework for evaluating the business performance of financial institutions. It presents a range of indicators suitable for assessing and describing the project business success of IFC-supported projects in the financial markets.

C.A.M.E.L

The XPSR's rating of project business success is a measure of the project's impact on the past and future performance of the FI's profitability and viability. Depending on the project size compared to the entire FI, sometimes it is hard to distinguish the project performance from the FI's performance overall. Nevertheless, irrespective of the type of IFC financing (general or targeted), the analytical overview should at least cover CAMEL:

- Capital adequacy
- Asset quality
- Management quality
- Earnings performance
- Liquidity structure and balance sheet

Before starting the CAMEL analysis, examine the following policies of the borrower:

- interest accrual policy;
- loan provisioning practices;
- maximum loan to deposit ratio; and
- equity capital adequacy (as percent of total assets).

These should be in line with internationally accepted best practice standards. You may need to make appropriate adjustments to profitability and capital adequacy calculations in the event that the FI's practices do not conform to these standards.

To start the analysis, assess the general framework of the financial system and the FI's competitive position within it, both currently and since IFC's appraisal. Recognize systemic issues and risks. Also assess the suitability of and compliance with IFC's covenants.

Capital Adequacy

- Analyze CAR level, trends throughout project life and prospects for near future. Compare with peers.
- Identify systemic risks related to CAR.
- Analyze quality of capital (share of tier I, tier II and tier III capital).
- Assess if CAR adjustments are needed due to: low level of provisioning, risk weightings (e.g. zero weight for government securities could be an issue), intangibles, deferred taxes, derivatives and off-balance sheet commitments.
- Does FI meet local and IFC's guidelines?

Asset Quality

Breakdown by earning assets and review of their credit quality:

(a) Loans:¹²

- Total loans amount, proportion of total assets, growth trends vs. peers and macroeconomic conditions.
- Identify any systemic risks (including issues with legal regulations) related to the loan portfolio quality.
- Loan concentration by single client, group, related party exposure (on and off-balance sheet), type of borrowers (public, commercial, retail, housing, etc.), sector, currency, etc.
- NPLs – level and trend of NPLs over the project life, including the basis for NPL classification (e.g. NPLs covering principal in arrears and principal outstanding for loans past due over 90 days), particularly high exposure to any sector or borrower, FI's efforts to reduce NPLs. Does the FI meet IFC's and local covenants for the level of NPLs. Compare to peers.
- Provisions – assess the adequacy of the level of provisions (following the NPLs breakdown by category: watch, doubtful, substandard, loss). Do provisions cover NPLs only or do they include past due interest as well. Assess whether the FI meets local and IFC's guidelines.
- Open loan exposure – current level and trend over project life, and factors affecting changes (e.g. increased equity may artificially reduce the open loan exposure). Assess if FI meets IFC's guidelines.

b) Fixed income securities.

c) Equity securities.

d) Off-Balance Sheet items.

Management Quality

- Expertise and experience;
- Strategic vision;
- Corporate governance;
- Ownership structure;
- Organizational structure; and
- Staff – training, knowledge, compensation.

Earnings Performance

- Profitability ratios: ROAE, ROAA, net income, net interest margin (when applicable) – current level, trends and factors affecting, peer comparisons.
- Income stability: analyze net interest income (from loans, securities, interbank market) vs. non-interest income (fee and commission, FX gains, securities trading gains); provisions; operating expenses. Trend and share of interest receivable.
- Provision burden (provisions/net interest income).
- Extraordinary items.
- Efficiency ratios: cost/income ratio¹³ and/or cost/assets ratio– current level, trends and peer comparisons.
- Analyze FI's stock performance, if listed, and issues that have affected the stock market performance.

Notes:

¹² Indicators of declining loan quality: excessive growth, especially if already high generation, high concentration, related party lending, weak credit procedures, poor pricing, restructurings.

¹³ Cost/income = (non interest expenses excluding loan loss provisions) / (net interest income plus non-interest income).

Liquidity and Balance Sheet

- Size of assets, trends, breakdown by group of assets (minimum risk, trading, investments, loans, others)¹⁴, extent of exposure to the government and state owned enterprises, risks for the largest exposures.
- Funding diversity and stability – sources of funding, their size and trends, breakdown by class with description of potential risks (e.g. share of short term funding, cost of funding vs. market average, type, term and volatility of deposits, deposit concentration ratio), reliance on one source of funding.
- Maturity mismatch ratio for 1 or 3 months. Identify existing or potential liquidity risks and any related mitigating factors.
- FX risk (open foreign exchange exposure risk).
- Interest rate risk.

RETURN ON INVESTED CAPITAL

Lastly, use the FI's ROIC as an indicator of project business success and a measure of the return to all financiers (debt plus equity) under these conditions:

- The calculation should be done for the total project life. Include past actual and projected future performance (explain key assumptions with respect to volume, portfolio quality and margins).
- The terminal value should be carefully estimated. It should take into account unrealized losses and premium/loss on sale. Revaluation of reserves should be eliminated from total assets in highly inflationary countries.
- Annual flows should be adjusted for provisioning based on the portfolio quality.

At present, there is no specified minimum satisfactory benchmark ROIC, but the XPSR should justify the project business success rating in the context of the estimated ROIC.

Notes: _____

¹⁴ Minimum risk assets: cash and inter-bank deposits. Trading assets: securities (trading book), reverse repos, derivatives (mark to market gain). Investments: securities (held for sale and to maturity), associates. Other: other real estate owned, foreclosed assets, accrued interest income.



Suggested Template for Sub-Borrower Reporting

INDICATORS OF SUB-BORROWER PERFORMANCE

Debt Service Obligations:

Is the sub-borrower current on debt service obligations under the sub-loan? If any sub-borrowers are not current on their debt payments, attach a separate sheet to explain. For example: Client #; Payment overdue by x days; Recovery (i) very likely; (ii) likely; (iii) unlikely; (iv) very unlikely.

Economic Distortions:

Is the sub-borrower benefiting from protection or government subsidies? Protection can be in the form of import duties (or import bans) on competing products, restriction of competition (e.g. particularly onerous licensing conditions, monopoly rights), etc. Subsidies can either be direct government payments, subsidized prices for inputs or outputs, export incentives, etc. If this applies to any sub-borrower, attach a separate sheet indicating sub-borrower number and a brief description of the protection or subsidy.

Environmental and Social Performance:

Is the sub-borrower (and/or project funded by the sub-loan) in compliance with local environmental guidelines? Attach a separate sheet to explain. If 'yes', explain how compliance was assessed; if 'no', mention areas of non-compliance. If the same procedure to assess compliance applies to all sub-borrowers and/or sub-projects, one statement suffices; otherwise, provide borrower/project-specific information.

Please use the following table format to characterize the performance of the FI's sub-portfolio:

Loan #	Name of client	Sector	Exporter (approx. percent exports)	Original loan size	Date of disbursement	Date of maturity	Is sub-loan still in grace period?	Outstanding balance	Is sub-borrower current on debt service obligations?	Is sub-borrower benefiting from protection or government subsidies?	Is sub-borrower in compliance with local environmental guidelines?
1											
2											
3											
4											
5											
...											

Please use the following table format to characterize the performance of each of the sub-borrowers:

Loan #:	Year following disbursement (0 = year preceding disbursement)							
	0	1	2	3	4	5	6	7
Sales								
Net profit after tax								
Net worth								
Employment								



Some Avoidable Mistakes From Previous XPSRs

After reviewing several hundred XPSRs, IEG staff drew up the following list of the errors that we encountered most frequently, as reflected in the Evaluative Notes. IFC is a learning-oriented institution, gifted with a bright and well-motivated staff. Think of this list as an incomplete map of a field with landmines. Your job is to get through the field and emerge on the other side as a hero...or a Director. We hope that, by circulating this map, we will help people to avoid revealed landmines and make a safe passage. Alternatively, if you make a mistake it will be by stepping on a new landmine and we can update our map accordingly.

1. No clear description of the project

It may seem obvious that you have to know exactly what the project is before you can evaluate it, but a few souls have made it difficult on themselves by not identifying clearly and analyzing the project. (This arose most often in the case of corporate financings.) A related problem is:

2. Not separating the components of a project

If a project comprises distinct and diverse components, then these should be described and analyzed separately – their performances may vary widely, and it's misleading to ignore the variances and their causes. Still, the assigned performance ratings should reflect a synthesis of the sub-component performances.

3. Confusing the project with the company

They are not the same, and the XPSR requires independent judgments of each according to its relevant performance parameters. A related problem is:

4. Mixing up different operations with the same company

Think in terms of incremental commitments. Where IFC has financed a series of projects through several investments in a company, despite how well or badly the other projects went, each XPSR is meant to evaluate only a specific operation, project, and investment – the one selected for this XPSR. The XPSR team has to sort out the marginal contribution of the operation, and to isolate its effects from those of other operations.

5. The heart by-pass operation was a success ... but unfortunately, the patient died

A company's and project's business performances must be rated solely on the basis of their outcomes, not in relation to the source of their shortcomings, or what might have been if only there hadn't been an unfortunate turn of events subsequent to disbursement (such as a market collapse, "irrational" competitive response, change of management and/or business strategy, adverse currency movement, etc.). The quality of IFC's front-end appraisal and supervision intervention are addressed separately in the operational effectiveness section, so there's plenty of opportunity to show how extraneous factors affected the project.

6. Inadequate field research

The Board's primary expectation of the XPSR system is that it evaluates results on the ground in a developing country, not on a piece of paper in Washington, D. C. The best XPSRs were those whose teams

visited all the key actors in the project from customers to suppliers, local government officials, and trade associations. An XPSR cannot be fully responsive without this research, and IFC's selective system of evaluation provides sufficient resources for the marginal cost of the field time.

7. Weak economic analysis

An economic analysis begins with a clear statement of benefits and costs and a model – either explicit or implicit – of how the project will affect market-determined prices and quantities. Financial analysis is something different. It can be complementary, but it is generally a poor surrogate for economic analysis.

8. Ignoring the “without project” case in analyzing project economics

(1) If the project sells into a slack-capacity market, its incremental value-added to the economy was generally below the border value of replacement imports; (2) If the company would have produced a net cash flow of X without the project, then the project economic benefit stream cannot include X.

9. Changing models between ex ante and ex post evaluations

An important part of the XPSR is a comparison of expectations, at the time of appraisal, to actual outcomes. However, if different financial or economic models are used, this must be explained and the variance should be qualified. If there was an error in the models at appraisal, the error should be corrected – rather than repeated – but the XPSR should be clear about how much of the variance is explained by changes in the model and how much by the parameters.

10. Investment objectives

Those cited in the XPSR should be the same as in the Board Report.

11. Poor labeling of tables to indicate currency, constant, or current

Some comparisons require constant currency (either local or US\$) and some require nominal. A good XPSR will make the units of account clear, in every table, and will provide the conversion factors (exchange rates, inflation rates) that would allow an independent evaluator to check results and to understand the relationship of the tables to each other.

12. Asserting rather than demonstrating or convincing

Evaluation must be based on objective data and relate results to objectives. The burden of proof falls on the XPSR team to assemble enough objective data to convince a skeptical but open-minded audience that their judgments of performance are correct.

13. Using V-shaped projections

Price and quantity projections should be based on probability-based expected values and not on the hope that future fortuitous developments will salvage a heretofore disappointing rate of return performance. We often see price and quantity data that show a weak or even declining trend from the day the project was approved until the day the XPSR was written. Then, miraculously, the trend reverses and the future is where we hoped it would be when we appraised it. Now, it's true that most markets have their ups and downs, but it can't be true that the best predictor of a market bottom is the date that an XPSR is written!

14. Weak demand analysis

Mistakes in the identification of the fundamental driving force underlying demand and overlooking its significance in case of a downturn.

15. Unanswered questions

A well-crafted XPSR will raise many questions about what was (or was not) done, how, and why. What makes an XPSR stand out from the rest is that it will also answer all the questions it raises, or at least say why the answers couldn't be had – and what should be done about that in future reporting requirements.

16. Repetition and verbiage

Looking at an operation's outcome from several perspectives encourages repetition, and the accountability demands of the pro forma's structure encourages it. Our advice, here and elsewhere, is "Say it once, and say it concisely." Or, at the risk of being pedantic, "Less is more. Be selective. Figure out what's material, and focus on it. Don't reiterate. Five pages, no more." And, respect the section emphasis (length) balance.

17. No statement of assumptions

All financial and economic projection models are based on assumptions. A good model is one in which the assumptions and the derivation of results are transparent. Sometimes, there is even a sensitivity analysis to show the significance of the assumptions. A bad model is one where you search all day and still can't figure out what the analyst did or why.

18. Misunderstanding sustainability and viability

The sustainability and viability judgment is sometimes rendered on the basis of the project's performance alone, rather than on the basis of the whole company (where there are several product lines) or the group (where IFC's investment is in one of the subsidiaries) within the enabling environment (the country and sector). If it's like a corporate onion with several layers, then each layer needs to be independently evaluated to arrive at the prospects judgment.

19. Financial calculations

(1) Non-transparent equity exit assumptions. (2) Some staff have used a multiple of company earnings as the terminal value of the project investment, instead of the residual value of the project's assets. (3) The value of the initial working capital investment should be recouped at the end of the project life. (4) Missing basic price comparison with major competitors (i.e. room prices, etc.) and forgetting industry discount practices. (5) Variance analysis not done in constant dollars – Board projections in constant approval year dollars with actuals in current dollars.

20. Projections of the enabling environment

Companies and projects don't operate in a vacuum jar, but we see projections of future results that were consciously made through the famed "rose-colored lenses." The problem is also reflected in optimistic assumptions about exit values for equity investments in volatile countries. The appropriate solution is to use expected values that explicitly incorporate upside and downside valuations and not a "most likely" or "most favorable" outcome.

21. Inadequate upstream review of draft XPSRs

Teams need to allow time for comments and peer discussion among a range of staff and managers including specialists, regional, and – if the project warrants – World Bank. Drafts of the XPSR should be sent to anyone who has worked on the project and who is still in IFC.

22. Confusion among standard terms: operation, company, project, investment

In the context of an XPSR, the operation refers to IFC's objectives, activities and results in making and administering its investment; the company refers to IFC's investment counterparty; the project refers to the specific company objectives, capital program and related business activity that was partially financed by the IFC investment selected for the XPSR, as described at approval in its Board report; and the investment refers to IFC's investment instrument (loan, equity, underwriting, etc.). "Through this operation, IFC supported the Acme Mining Company's zirconium expansion project with an investment comprising a \$5 million in equity investment in the Company's shares and a \$25 million loan."

23. Using the before-tax FRR as the basis for the Project business success rating

The tax-collector must be paid and, moreover, has a ranking claim ahead of lenders and shareholders. Most Board report estimates of the FRR have been based upon pre-tax FRRs. But, as an indicator of the Project's expected business success over its life – reflected in its net cash flow – we are interested in the after-tax FRR. For the purposes of the variance analysis, compare apples-with-apples – if the Board report projected only the before-tax FRR, base the comparison accordingly.



Frequently Asked Questions

What is an XPSR?

An XPSR (Expanded Project Supervision Report) is an addendum to the PSR. It is distributed electronically with the PSR.

How is the XPSR different from DOTS

DOTS has been developed to enable IFC to systematically articulate expected development results at project approval and track them during project supervision. DOTS covers all active projects in the portfolio. XPSR's are randomly selected for approximately half of those projects in the portfolio that have reached operating maturity. An XPSR provides a more thorough analysis of a project's development and investment outcome quality over the whole life of the investment, plus an assessment of IFC's own work quality associated with the project. The DOTS and XPSR systems are complementary; they share, for example, the same framework for rating development impacts.

What makes a great XPSR?

In nominating, and in making a short-list from the nominated XPSRs, IEG considers:

- objectivity;
- responsiveness to guidelines;
- quality of analysis;
- indicator rating judgments; and
- the relevance and clarity of lessons.

In addition, IEG considers:

- timeliness; and
- length of the report (i.e., shorter and more concise reports got a higher rating) but applies a lesser weight than the other report quality indicators.

Who can provide country-specific input for my XPSR?

Regional Economists / Strategists should be available for consultation on country specific issues but, Regional Economists / Strategists are not normally members of the core XPSR team and they will not be responsible for drafting sections of the XPSRs. Responsibility for all project specific issues lies with the Industry Department (and its economist), such as, for example, the FRR and ERR calculations.

Do XPSRs require a field visit?

IEG strongly recommends a field visit because, without one, it is very difficult or impossible to evaluate development impacts, including environmental and social effects. However, IEG, given the changing security environment in many countries where we operate understands that a trip may not always be possible and does not insist on field visits. After 9/11, the World Bank Group suggested the following, which is still applicable:

- follow your department's general travel policy;
- safety and security must continue to come first in all situations;

- inform IFC office (or WB Country Director) in advance and keep them informed about your whereabouts;
- you and your family should feel comfortable with the decision to travel.

Where no field visit takes place, we encourage investment staff to contact IEG to discuss alternative plans to obtain the necessary information to complete the XPSR.

Who must sign off on my XPSR before it is finalized?

Sign-off by the following parties is required:

- Department Management.
- Department Economist.
- Environment Division.

Is there a specific methodology for calculating an FRR and ERR?

IFC has not yet developed a standard methodology for calculating FRRs and ERRs. Your Portfolio Manager, Economist or IEG can provide guidance or review your calculations, especially for more difficult projects that involve expansion, corporate loans or economic distortions.

How does IEG define the “project”?

The “project” is the operation, project, or investment that was funded based on a specific Board approval. The “project” is not the same as the company. In expansion projects or for companies where IFC has made multiple investments, the XPSR team must determine the marginal contribution of the operation that is being evaluated and isolate its effects from those of other operations. IEG provides guidance on the evaluation of corporate loans and encourages you to consult your IEG counterpart early to agree on the project definition as early as possible. Note: Occasionally, a Board Report seeks approval for more than one operation, project, or investment and is assigned multiple project IDs. In most of these cases, all projects supported by the approval would be considered the “project” for the purpose of the XPSR.

How do XPSR ratings differ from other ratings like the CRR, ESRR?

Other IFC ratings provide a risk rating at the time the rating is applied. XPSR ratings are life-of-project ratings that take into consideration past performance and likely outcomes. IFC also does not apply work quality ratings to projects during regular supervision.

Is an abridged version of the XPSR required?

No, just a final version.

Is a cover memo needed for an XPSR?

No separate cover memo is required. Hard copy distribution of the XPSR should be avoided as much as possible, but if it is required staff should simply follow the PSR distribution.

How do I alert recipients that an XPSR has been distributed electronically?

You should note this in the Subject box of the Bookmark screen before distribution.

Who gets a copy of an XPSR?

The distribution list is identical to the PSR distribution list.

Where can I find an XPSR transmittal memo template for Environment?

The memo will come from the Environment Division and should be included as an electronic attachment to the XPSR.

- *REDACTED.*