

African Development Bank Group



REVIEW OF THE BANK GROUP'S COST-SHARING FORMULA

NOVEMBER, 2010

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LIST OF ABBREVIATIONS

ADB	African Development Bank
ADF	African Development Fund
AsDB	Asian Development Bank
BDIR	Board of Directors
BGOV	Board of Governors
CGSP	General Services and Procurement
CIMM	Information Management
COBS	Strategy and Budget
ECON	Chief Economist Office
FFCO	Financial Control Department
FFMA	Financial Management Department
FNVP	Financial Vice Presidency
FO	Field Office
HIPC	Heavily Indebted Poor Countries
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFC	International Finance Corporation
IFRS	International Financial Reporting Standards
MDB	Multilateral Development Bank
MDRI	Multilateral Debt Relief Initiative
NTF	Nigeria Trust Fund
OIVP	Operations III - Infrastructure, Private Sector & Regional Integration - Vice Presidency
OPEV	Operations Evaluation
OPSM	Private Sector
ORPC	Operational Resources and Policies
ORPF	Procurement and Fiduciary Services
ORQR	Results and Quality Assurance
ORRU	Partnership and Cooperation Unit
ORSB	Operations Regional South 2
ORVP	Operations I - Country & Regional Programs & Policy - Vice Presidency
OSGE	Governance, Economic and Financial Reforms
OSVP	Operations II - Sector Operations - Vice Presidency
PCR	Project Completion Report
SEGL	General Secretariat
TRS	Time Recording System
UA	Unit of Account
WB	World Bank

EXECUTIVE SUMMARY

The African Development Bank Group (the Bank Group) delivers its operational programs through three entities: The African Development Bank (ADB), the African Development Fund (ADF) and the Nigeria Trust Fund (NTF). The Group has a single combined administrative expense budget and records expenses, when incurred, against such budget. While the three windows are complementary, they are statutorily required to be legally separate and distinct. Statutorily (under Article 31 of ADF agreement and Article IX of the NTF Agreement), the ADF and NTF are required to reimburse the ADB for the fair value of their use of the offices, staff, organization, services and facilities in accordance with arrangements made between these two entities and the ADB. These arrangements take the form of a sharing of costs through a defined cost sharing formula. The separation principles enshrined in both the ADF and ADB Agreements prohibit each institution from bearing the expenses, costs or losses of the other.

An appropriate cost-sharing formula permits a reasonable allocation of shared expenses, in response to the statutory requirements described above, thereby enabling the financial statements of each entity to reflect the costs of conducting its business. The Bank Group's practices for allocating shared expenses are similar to those of comparable MDBs that operate both a market-based lending window and a concessional lending window.

The current formula used to allocate costs between the three windows of the Bank Group has been applied since 1994. Like most other MDBs, the Bank Group's operational activities have evolved over the years in all areas and notably with regard to its private sector operations. This has varying effects on the relative work-effort in delivering the operational programs of each entity. Certain exogenous developments, such as the MDRI and IFRS fair-value accounting requirements, have also affected the application of the formula. In this regard, the introduction of UA budgeting from 2010, along with the planned implementation of comprehensive cost accounting and simplified time-recording for professional staff in Operations departments in 2011/2012 is expected to provide additional information on the key drivers of the operational costs of the Bank Group, thereby providing an important opportunity to make further improvements to the current formula.

Against the background summarized above, Management undertook a study (with the assistance of an independent consultant with substantial experience in this subject with other International Financial Institutions) with the primary objective of identifying opportunities to improve the current formula or its application, to faithfully and reasonably reflect the evolution to date of the Bank Group's business activities. The review was to examine whether the Bank Group was making the best use of the available information to allocate its administrative costs. Each element of the formula was therefore scrutinized, taking into account the views of staff and managers regarding the factors that drive the costs, to determine whether it adequately reflected the business activities of the Bank Group.

The review included: (i) consultations with managers on operational factors that impact upon administrative expenses and on ways of enhancing the formula, (ii) surveys through the use of questionnaires to obtain the views of Operations staff on their experience with the costs of their activities, (iii) benchmarking to gather information from comparator organizations about their cost allocation practices, and (iv) bilateral discussions and exchanges with Board Members.

The key conclusions and recommendations of the review are as follows:

- Overall, the current cost sharing formula remains a useful cost allocation tool. The cost shares produced by the formula are reasonable when benchmarked with other MDBs and in relationship to the lending volumes, average loan sizes and active portfolios of ADB and ADF.
- **The review also identified certain refinements that could be immediately made in some detailed elements of the formula based on currently available information, while fully respecting the spirit and core principles of the formula.**

These are essentially:

- The allocation of costs related to private sector operations directly to the ADB window;
- Application of a revised weight of 50% to loans in the portfolio under execution;
- Application of revised weights to project-financing grants (same weights as project loans for approvals and for the portfolio under execution) and technical assistance grants/loans (50% for approvals and 30% for the portfolio under execution);
- Application of 50% weight to MDRI assets and exclusion of HIPC assets, and.
- [Exclusion of certain inactive loans eligible for cancellation \(i.e. loans and grants that remain unsigned for more than 12 months\)](#) from the cost sharing formula.

Management believes that these improvements would produce cost shares that better reflect the factors that drive the costs of the Bank Group. If the changes were applied retroactively to allocate the 2009 administrative costs, the proposed refinements would result in cost shares of approximately 31.2%, 67.0% and 1.8% for the ADB, ADF and NTF, respectively.

In the longer-term, as previously noted, the information from the cost accounting and the time recording systems being implemented would provide additional insights or perspectives regarding how staff-time and other resources are actually spent in delivering the services of the Bank Group, thereby providing opportunities for further improvements to the formula.

Further, Management recommends that the formula be reviewed periodically (every 3 years) to assess its continued relevance in the context of the evolving business activities of the Group.

I. INTRODUCTORY BACKGROUND

1.1 In recent years, concerns have been expressed regarding the fairness of the current cost sharing formula. The steady increase over the years in the share of the ADF has often been cited as a reason for a review of the formula. Such concerns have been expressed by certain shareholders during the course of both the GCI-VI and ADF replenishment discussions. In response to such concerns and noting the statutory requirements for a fair cost-sharing formula, Management initiated a review with the assistance of an independent consultant with substantial experience in this subject with other International Financial Institutions. The fundamental purpose of the review was to examine whether the Bank Group was making the best use of the available information to appropriately allocate its administrative costs. The method and elements of the current cost sharing formula were therefore extensively reviewed to determine whether they adequately reflected the business activities of the Group and the views of staff and managers regarding the factors that drive the costs. Thus there was no expectation or predetermination of cost shares, or evaluation of alternative scenarios of cost shares, as part of the review.

On April 29, 2010, the Board of Directors held informal discussions on the cost-sharing formula presented by the consultant, during which comments were made on the proposals for short-term and long-term adjustments. Subsequently, on July 14, 2010 a formal Board discussed the revised proposal. During the latter discussions, further issues emerged and the document was referred to AEFI and CODE for a deeper technical review. [The AEFI/CODE meeting was held on October 14, 2010 and a large majority of members agreed on the broad thrust of the proposal. However, they requested further clarifications on the short-term adjustments. Management conducted an additional survey which confirmed the weights, based on the differentiating characteristics of projects under execution versus project approvals, as well as project loans versus technical assistance grants/loans. The treatment of inactive loans has also been refined to reflect management's overall assessment of the extent of time spent in the follow up of such loans. The proposals presented in this report reflect the results of the survey and address concerns raised during the AEFI/CODE meeting.](#)

1.2 This report is organized in 8 sections. After this introductory background, the second section of this report recalls the statutory requirements and principles underpinning the cost-sharing formula. Section 3 briefly presents the current cost-sharing formula, its application in relation with the evolution of the Bank's business and expenditure profile as well as the comparison with other MDBs. Section 4 highlights the rationale for a review of the formula. Sections 5 and 6 present the two-stage process of adjusting the formula with: (i) some short-term improvements to the parameters that could be made to the current formula, and (ii) longer-term adjustments to factor in the evolving cost drivers of the Bank business, the implementation of the enhanced budgeting framework and cost accounting as well as prospects for better cost determination to be supported by a simplified time recording system. Section 7 provides the impact of the review on each institution of the Bank Group. The conclusions of the review are summarized in Section 8.

II. GUIDING PRINCIPLES FOR THE BANK GROUP'S COST-SHARING FORMULA

Statutory Requirements for Fair Allocation of Costs Incurred

2.1 The African Development Bank (ADB), the African Development Fund (ADF) and the Nigerian Trust Fund (NTF) that constitute the three windows of the Bank Group are legally and financially independent institutions not subjected to accounting consolidation. But they are administered in a combined organization to execute the shared mandate of catalyzing the social and economic development of the regional member countries of the Bank Group. Hence, with the very limited exception of certain costs that are specifically attributable to and therefore chargeable to a specific Bank Group window, the administrative costs of the Group are incurred by ADB on behalf of the Group. The Bank Group has a single administrative expense budget for meeting the costs of the three institutions.

2.2 Statutorily (under Article 31 of ADF agreement and Article IX of the NTF Agreement), the ADF and NTF are required to reimburse the ADB for the fair value of their use of the offices, staff, organization, services and facilities in accordance with arrangements made between these two entities and the ADB. These arrangements take the form of a sharing of costs through a defined cost sharing formula.

2.3 Furthermore, Article 11 of the Agreement Establishing ADB requires such separation of costs. In the specific case of the NTF, the total amount to be reimbursed should not exceed 20% of the gross income of the NTF. This implies that the ADB assumes the responsibility for any excess over such defined upper limit.

2.4 Any cost sharing arrangement must comply with these statutory requirements. An appropriate cost-sharing formula results in an allocation of shared expenses in a manner that reasonably reflects the costs of conducting the business of each Bank Group window. The cost sharing formula is therefore important to, but not influenced by, all discussions regarding, or that take into account, the financial position and outlook of each window. Examples of such discussions include ADF replenishment negotiations, periodic reviews of the NTF, reviews of the pricing of ADB products and annual reviews of the ADB by the rating agencies. The Group's cost sharing practices are similar in all material aspects to those of comparable MDBs that operate both a market-based lending window and a concessional lending window.

2.5 Also, the Bank's Financial Regulations (Regulation 3.4 and 4.3) require (i) that costs appertaining exclusively to a particular funding source (i.e. Ordinary Resources or Special Resources) should be charged to such source; and (ii) for the Board of Directors to determine the apportionment of other administrative expenditures in conformity with the relevant rules and regulations.

Cost-allocation Principles and Requirements

2.6 The generally accepted principles and requirements of effective cost allocation set out in cost accounting literature include the following:

- Cost allocation should reflect the business activities performed and the nature and amount of costs should be transparent.
- The parameters used for cost allocation should reflect the factors that generate the costs (i.e. cost drivers) and be clearly identifiable and measurable. There should be an established objective and logical linkage between the administrative cost incurred and the indicator used for sharing such cost.
- Recording and reporting of cost data should be comprehensive and reliable: (i), covering all categories of the running costs and products of the institution; (ii) ensuring consistency and comparability over time; and (iii) enabling necessary decisions to be taken in a timely manner. More importantly, for every activity undertaken, it should identify the institution for which the work is done, how much time is spent on that activity, and what cost is involved.
- Cost data must be transparent, accessible and traceable for audit trail purposes.

Other Guiding Principles

2.7 In addition to the above principle, best practices indicate that the formula should also reflect the following attributes:

- **Simplicity, continuity and reasonableness** – in the context of the very dynamic nature of the Bank Group’s business and associated costs, the formula should provide some level of continuity with previous versions and be as simple to apply as possible. Increased complexity does not necessarily improve the final results of the formula. Finally, reasonableness means that the formula should fairly reflect, as closely as possible, the factors that drive the Bank’s administrative costs.
- **Transparency and dynamism** – the formula should not be predetermined or reverse engineered. Implicit in the formula is the fact that the derived shares are not invariant to time, since the parameters and their value as well as the Bank’s assets fluctuate from period to period and future values cannot be predicted with certainty and accuracy. New cost sharing arrangements provide a new base for reimbursing expenses and should not be used to make adjustments retroactively. Therefore, the formula should be subjected to periodic review.
- **Objectivity**– There is no scientific method of allocating costs and informed judgments often need to be made by business managers regarding cost drivers and cost attribution. Consistent with the statutory requirements, such judgments should not be driven by the financial implications for a given entity or ad hoc political negotiations.

III. THE CURRENT COST-SHARING FORMULA AND REASONABLENESS OF ITS RESULT

3.1 The Bank's cost sharing formula has undergone several revisions¹ all aimed at deriving fair and objective measures to apportion costs incurred by the Bank Group among the three institutions. The most recent update of the cost sharing formula, adopted in 1994, has served its purpose reasonably well overall, with the premise underlying the formula remaining relevant to date.

Cost Sharing Parameters

3.2 The current cost sharing basis for the Bank Group (ADB, ADF & NTF) is based on 3 sets of parameters:

- Category and nature of expenditure: Specific and sharable expenses, operational and non-operational expenses;
- Activity parameters with the number of [loans](#) and grants as the cost driver;
- Stock of operations² or balance sheet parameter which is the volume of outstanding assets.

3.3 **Category of expenditure to be shared:** The classification and traceability of expenditures are paramount in the application of the cost sharing formula. In this regard, Bank Group administrative expenses are divided into two broad categories:

(i) **Specific expenses**, which are expenses that are incurred directly by each institution and that ought to be directly assigned to the given institution, such as general capital increase related expenses for ADB and Replenishment related expenses for ADF; and

(ii) **Shareable expenses**, which are all pooled costs that cannot be attributable to a specific entity and which nevertheless must be allocated. The allocation principle is that the shareable expenses should be assigned on the basis of the number and type of activities carried out on behalf of each institution. For this purpose, costs are further categorized into: (i) operational and (ii) non-operational expenses. The scope and coverage of these expenses have been refined with the institutional reforms undertaken in 2006 that allows for a fine-tuning of the organization with categorizations of cost centers (i.e. organizational units) into direct operations and operations support. Table 01 summarizes the categorization of the Bank group expenditures.

¹ Different formulae have been applied for the period 1974-1981; 1982-1983; and 1994 to the present.

² All lending operations and their related financial assets.

Table 01: Expense Categorization for Cost-Sharing

	Cost category	Nature of Expenditure
I	OPERATIONAL EXPENSES	Cost associated with direct operations and their support activities
1	Direct Cost of Operations Activities	Costs of all business units whose activities consist entirely of providing direct client services (ORVP, OIVP and OSVP)
a)	Lending origination and Execution	Project cycle related activities ³
b)	Aligning Lending with Strategic Priorities	Country Programming activities - Non lending activities (Country Dialogue, Knowledge, Analytical and Advisory Services)
c)	Cross-cutting and Global/Regional Work	Global Programs
2	Operations Support costs	Costs of all units whose activities are substantially performed to support client services (OPEV, ORPQ, GECL.2, FTRY.4, FFCO.3, etc.)
II	NON-OPERATIONAL EXPENSES	Costs Associated with Institutional Programs Not Directly Linked to Operations

3.4 **Activity Parameters**—The principal business of the Bank is the provision of resources for funding of development projects through loans and other financial instruments. Other developmental activities include technical assistance and studies relating to projects and programs. The two indicators most often used to measure the volume of work are the numbers of activities carried out during a specific period and the amount of resources managed or committed to the activities carried out (number of projects under active implementation, assets under management, etc.). For cost sharing purpose these cost drivers factor three dimensions, to which a specific weight is assigned:

- The phase of the project & program in the project cycle: approval and execution in the cycle
- The type of instrument: loans, equity investments, guarantees, technical assistance, grants
- The type of client: public sector and private sector.

Table 02 presents the activity drivers and their evolution since 1993. It indicates that some of the activities were insignificant at the inception of the current formula. This is particularly the case for private sector projects.

³ These include: loan identification, preparation, assessment, appraisal, negotiation, approval, signature, administration, supervision and completion.

Table 02: Activity Parameters

Type of Instruments	Weight		Number of Approvals					
	Approval	Execution	1997			2009		
			ADB	ADF	NTF	ADB	ADF	NTF
Project & Programs loans	100%	100%	13	58	-	17	35	3
Project Financing Grants	30%	30%	-	-	-	-	27	-
Technical Assistance	30%	30%	-	30	-	14	14	-
Private Sector Loans	100%	100%	8	-	-	30	-	-

3.5 **Balance Sheet Parameter**—The size of the total assets under management excluding Trust Fund assets, Fixed Assets and ADB’s equity investment in ADF, is the parameter used to allocate non-operational expenses.

The Cost-Sharing Method

3.6 The cost-sharing mechanism involves 5 steps summarized below:

- (a) Classifying the Bank Group administrative expenses into Operational and Non-Operational expenses and determining the corresponding proportions;
- (b) Estimating the shareable expenditures by adding shareable depreciation to total administrative expenditure and subtracting the direct (specifically identifiable) costs of each institution;
- (c) Allocating the Operational costs, obtained by multiplying shareable expenditures by the proportion of expenditures classified as operational, to ADB, ADF, and NTF in proportion of the number of **loans**, studies and grants approved during the year and those under implementation at the end of the previous year. *Currently, all grant-financed activities, and technical assistance activities as well as loans, are factored at a weight of 30%⁴.*
- (d) Allocating the non-operational component of shareable expenditures to ADB, ADF and NTF according to the size of the balance sheet assets of each institution.
- (e) Adding up the operational, non-operational and specific cost components of each institution. In addition, the administrative expenses borne by NTF are limited to 20% of NTF’s gross income⁵, with ADB assuming any residual expenses.

Annex 5 presents the process flow of the cost sharing mechanism.

Evolution of the Results of the Formula and Validity of the Methodology

3.7 The cost sharing formula adopted in 1994 after a thorough study of cost sharing practices in comparator institutions, has been applied consistently over the years. Its

⁴ The 30% weight reflects the relatively lower work-effort required for technical assistance projects.

⁵ This cap is required under the Revised NTF Agreement.

application has resulted in cost shares for the ADB, ADF and NTF summarized in Table 03 while Annex 6 provides the detailed cost sharing formula in its various components. The cost allocations over time have been driven by three main trends: (i) the steady increase in the share of the operational expenses of the Bank Group which currently account for around 70% of the total expenses; (ii) the increase in the ADF share of total value of assets under management; and (iii) the growing number of TA loans and grants. Based on the premise that no cost allocation is perfect and that the number of activities and balance sheet size are reasonable bases for the allocation of operational and non-operational expenses, respectively, one can reasonably conclude that the fundamental logic of the cost-sharing formula remains valid. However, as both the parameters of the formula evolve with the growing and changing business profile of the Bank, some fine-tuning opportunities in the short-term have been identified (presented later in Section 5).

Table 03: Recent History of Cost Shares

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
ADB	37%	38%	36%	33%	34%	32%	29%	28%	30%	26%	27%	24%	23%	25%	28%
ADF	61%	59%	62%	65%	64%	66%	69%	70%	69%	72%	72%	74%	75%	74%	71%
NTF	2%	3%	2%	2%	2%	2%	2%	2%	1%	1%	1%	2%	1%	1%	0.4%

Relevance and Reasonability of the cost shares

3.8 In order to assess the reasonableness of the cost sharing formula in general and the appropriateness of the shares of ADF in particular and its comparability to other MDBs, it is important to consider certain high level indicators. The most relevant and commonly used ones are: (i) the level of business activity in terms of the volume of lending generated to administrative expenses incurred; and (ii) cost shares relative to the number of eligible countries in each window.

Ratio of Lending Volumes to Administrative Expenses

3.9 The ratio of lending volumes to administrative expenses is a macro indicator of the trend and relationship of these expenses over a period of several years vis-à-vis lending which generates income. An important long-term trend brought out in Figure 1(a) is that over the period 2002-2009, ADF's administrative expenses have risen at about the same rate as its annual lending volume.

3.10 In reaching this conclusion, two caveats should be kept in mind:

- *Year-to-year fluctuations in lending* can be partly accommodated by adding to or drawing down the pipeline of projects under preparation, so that changes in lending volumes may not necessarily have a linear impact upon administrative expenses.
- *Non-lending costs form a part of ADB and ADF administrative expenses*, but non-lending outputs are excluded from the lending volume used to derive the ratio. However, this does not detract from the usefulness of the ratio, consistent with the views expressed by 63% of respondents to the survey that the volume of non-lending work in a country is related to the volume of lending work in the country.

3.11 Divergent trends between ADF and ADB ratios of lending to administrative expenses

-Figure 1(a) also shows some divergent trends between ADF and ADB: the ratio of lending volume to administrative expenses has been fairly steady for ADF from 2002-2009, while it has fluctuated significantly for ADB. In addition, ADF's ratio has been lower than that of ADB throughout this period. The reasons for these two differences are clarified in Figure 1(b): (i) while ADF's average size of loans has increased steadily to double from 2002 to 2009, ADB's average loan size has varied sharply from year to year; and (ii) ADF's average loan size has been smaller than that of ADB in each year. When taken together, Figures 1(a) and 1(b) also show that ADB's ratio rose in those years in which its average loan size increased. In this respect, the average loan size is an important variable because in MDBs the lending origination and execution costs per project are not significantly affected by loan size as the same processes are normally followed regardless of the loan amount. Thus, because ADF loans are smaller than ADB loans, they are generally more expensive to originate and execute for each UA lent. Staff responses to the questionnaires support this conclusion. A large number of respondents (70%) to Question #3 of the second questionnaire (Annex 2) believed that time spent on ADF projects was higher than on ADB projects by 25% or more; and a similar number responding to Question #4 confirmed that the size of a loan does not influence its origination and execution costs.

Figure 1(a): Ratios of Lending Volumes to Administrative Expenses

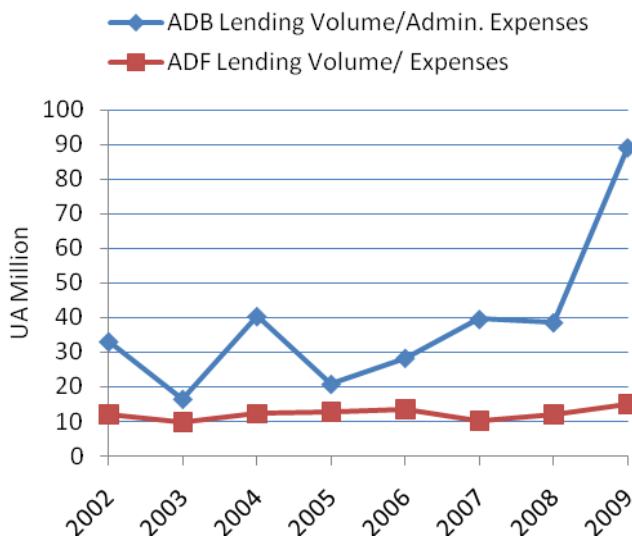
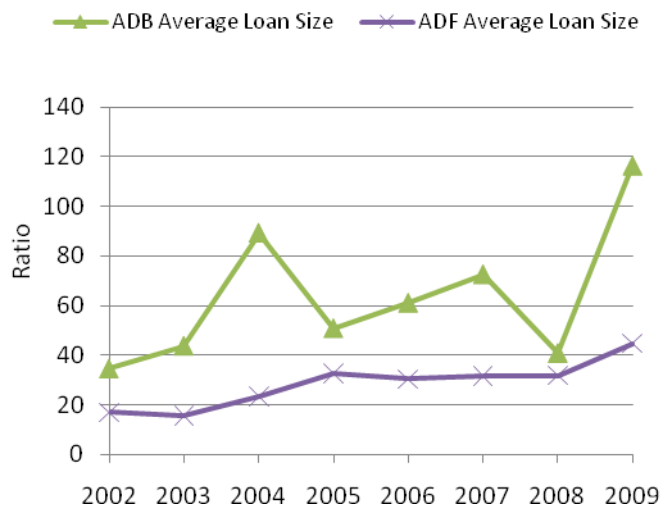


Figure 1(b): Average Sizes of ADB and ADF Loans



Relative Coverage of Countries

3.12 With respect to this macro-level indicator, it is to be noted that 38 of 53 Regional Member Countries are ADF-only countries. Among the ADB eligible countries, the number of active borrowers was not significant until recently. As a result, a large portion of new

approvals is for ADF. Staff indications are that the level of work effort required in project approval and execution tend to be different between country categories. Hence, for a given project, less time is required in countries with more efficient institutional, administrative and fiduciary structures than in countries where institutional management and implementation capacity may be weaker.

Comparability with Other MDBs

3.13 The comparison with sister institutions, provides an important perspective on the overall reasonableness of the results of the current formula. While there are differences between the operational activities of ADB, ADF and other MDBs (such as types of countries covered and the volume of private sector work), the allocated administrative expenses of ADB and ADF, relative to their annual lending volumes, are broadly similar to the allocations between the concessional and market windows of comparators.

Average Loan Size & Ratio of Lending Volume to Administrative Expenses

3.14 The ADF and ADB ratios of lending volumes to administrative expenses in 2008 were compared with those of three other MDBs. Subject to the limitation of comparing the ratios in a single year instead of over a longer period (as noted in paragraph 3.10), this comparison, summarized in Table 04, shows the following:

- ADF's ratio is broadly similar to those of the Asian Development Fund (AsDF) and IDA.
- The ratio for ADB does vary from those of the Asian Development Bank (AsDB) and IBRD. As AsDB has a private sector window like ADB, it is regarded as the closest comparator to ADB. The reason for the difference between ADB's and AsDB's ratios is that AsDB has a much larger average loan size than ADB.
- IBRD's ratio is not directly comparable with those of ADB and AsDB for three reasons: (i) ADB's ratio jumped sharply from 21 in 2005 to 40 in 2007, as its average loan size increased by 40%; (ii) unlike ADB and AsDB, IBRD only makes public sector loans; and (iii) compared with AsDB's fairly even distribution of loan amounts, IBRD's distribution was skewed by 7 large loans of \$500 million or more; excluding these large loans, IBRD's average loan size was \$100 million (UA65 million).
- The ratio for IFC was also examined, in order to look at the impact of private sector loans on the ADB ratio. IFC's ratio was slightly lower than that of ADB in 2008, but was broadly in line with the average level of the ADB ratio over the period 2002-2008.

Table 04: Average Loan Size & Ratio of Lending Volume to Administrative Expenses for 2008 - Comparison of ADB & ADF with Some Other MDBs

Indicator	Concessional Window			Market/Private Sector Window			
	ADF	AsDF	IDA	ADB	AsDB	IBRD	IFC
(a) Ratio of lending volume to administrative expenses	12	10	13	39	63	12	30
(b) Average loan size in UA million.	32	25	36	41	92	88	29

Number of ADF versus. ADB Borrowers

3.15 The number of eligible borrowers from the concessional window versus the market window is a macro indicator of the scale of operations of these two windows. As such, these numbers can be used to gauge broadly the reasonableness of the shares of costs allocated to these windows. The limitation of this indicator is that it does not take into account the range, mix and volume of services being provided to the countries in each window, which are normally driven by the development assistance strategy for each country. However, even with this limitation, the cost shares of the concessional and market windows can be expected to broadly reflect the ratio of the number of eligible countries in each window. Table 05 shows that the ADF:ADB cost shares, like those of the concessional and market windows in AsDB and the World Bank (IBRD & IDA), are approximately proportionate to the ratio of the numbers of member countries covered by each window.

**Table 05: Number of Member Countries & Cost Shares in 2008
Concessional Window & Market Window**

Window	ADB/ADF			IBRD*/IDA			AsDB/AsDF		
	No. of Countries	Percent age	Cost Share	No. of Countries	Percent age	Cost Share	No. of Countries	Percent age	Cost Share
Concessional	38	72%	74%	78	50%	47%	28	58%	53%
Market	15	28%	25%	78	50%	53% *	20	42%	47%

* The cost share includes development grants of \$176 million in 2008, which were charged entirely to IBRD in accordance with usual practice; the grants amounted to about 8% of the total costs.

IV. RATIONALE AND PROCESS FOR THE REVISION OF THE COST-SHARING FORMULA

4.1 The analysis performed above indicates that the Bank's cost-sharing formula yields overall reasonable results and comparability with other MDBs. This raises the question as to the need or necessity for a review. There are several reasons for such review. As any cost-

sharing formula, it is subject to periodic reviews to ensure alignment with the business growth profile of the institution. Since the last review initiated in 1993, several developments have occurred that affect the parameters of the formula and the quality of information related to the various components of the parameters. Accordingly, this review is considered necessary, as further elaborated upon below.

Recent Developments with Impact on Cost-Sharing Formula

4.2 The parameters of the cost-sharing formula that serves as the basis for the allocation of Bank Group administrative expenses between ADB, ADF and NTF have been affected by a number of recent developments. These are essentially:

Change in the Activity and Lending Instrument Profiles

4.3 The present formula relies exclusively on the number of loans and grants approved and under execution with equal weights to origination as well as execution. Refinement of cost data over the years indicates that these two phases in the project life require different work effort. Another related issue is the exclusion of non-lending activities which during the revision of the formula in 1993 were relatively smaller than direct project lending. Non-lending services delivered to clients are likely to become increasingly important as – like other major MDBs – the Bank Group emphasizes its role of being a Knowledge institution. Also, while non-lending activities are generally driven by the due diligence work and advisory services associated with lending, in some countries (such as post-conflict and fragile states) non-lending services may take precedence over lending, which may then follow depending on country conditions and the results of analytical and advisory and policy-related work.

Increasing Private Sector Operations

4.4 From the inception of the formula up to the early 2000s, the volume and complexity of private sector operations were relatively low, compared to the total volume of Bank Group operations. Therefore, the impact of their exclusion from the formula was marginal. The growing increase in that portfolio in the Bank Group's development activities introduces another dimension to be integrated into the formula. Private sector operations are exclusively financed from the ADB window. Since revenues related to private sector operations are recognized in the ADB financial statements, the related costs should to the extent possible be identified and charged exclusively to the ADB, irrespective of whether some operations actually take place in ADF countries.

Decentralization and Field Offices' Costs

4.5 Another evolution in the Banks' business is the decentralization. From a small number of (7) offices in 1993, the field office (FO) network currently comprises some 25

offices. The current practice is to treat all FO costs as shareable expenses. Indeed, every FO cannot be associated exclusively with ADB or ADF because private sector operations, although financed exclusively by ADB, are also carried out in countries that normally borrow from ADF. However, costs incurred by FOs for originating and executing private sector operations (and attributable to ADB) can be estimated by using the ratio of the number of private sector operations to number of total operations in each country where an FO is located.

HIPCs and MDRI

4.6 The ADF balance sheet includes HIPC and other grants totaling UA 1.5 billion at 31 December, 2009. As these assets, unlike active loans, do not require loan administration and other non-operational supporting activities, they can be removed from the ADF balance-sheet assets for calculating ADF's share of non-operational expenses. Similarly, as cancelled MDRI loans (UA 4.1 billion at 31 December, 2009) require lower administrative effort compared with active loans, attaching a 100% weight to these assets would not be reasonable for calculating ADF's cost share.

Changes in Financial Reporting

4.7 Changes in the financial reporting requirements, particularly those relating to financial instruments in general and, in particular, the adoption of the fair value option in 2005, have significantly impacted the balance sheet particularly of the ADB and consequently have an impact on the application of the cost-sharing formula.

Implementation of Budget reforms

4.8 The Board approved various budget reforms in July 2007 with gradual implementation of cost accounting, UA budgeting and time recording system, expected to be completed by 2012. The implementation of these changes will have an impact on the cost-sharing parameters and should enhance the quality of information used for the determination of cost-sharing.

Other Specific Issues

4.9 There are also changes expected in the coming years due to the increased private sector lending to LICs, revision of the longer-term institutional strategy, the growing importance of knowledge products and advisory services, etc.

As result of the above developments, the review is considered as timely.

Gradual and Phased Approach to the Adjustment of the formula

4.10 In light of the above, there are a number of changes or refinements that could be made to the current formula. These may be grouped into two categories: (i) refinements

related to parameters that are associated with the application of the cost-sharing principles, in order to reflect the specific circumstances of the Bank's evolving operating environment and portfolio; and (ii) changes related to adjustments to cost drivers to reflect the future business growth of the Bank as well as full implementation of cost accounting and its attendant time recording system. The latter category is contingent upon a credible time recording system⁶ and is therefore not feasible in the near term.

4.11 Management therefore proposes a two-step process: (i) refinement of the parameters and their relative weights and (ii) longer-term adjustments to introduce traceable cost drivers and segregation of expenses.

4.12 In proposing a two-step process, Management is cognizant that cost allocation is not an exact science as it frequently requires informed judgments to be made by business managers about cost drivers and objective methods of cost attribution. As such, the objective of cost allocation is to meet the test of fair measurement and overall reasonableness with regard to the attribution of costs to the relevant drivers, rather than an unrealistic level of precision. Any formula that is to be derived from both short-term and longer-term adjustments will require some degree of simplicity if it is to remain easy to apply and to evaluate.

V. PROPOSED SHORT-TERM REFINEMENTS TO CURRENT FORMULA

5.1 The assessment of possible short-term improvements to the current formula, starting with the 2010 cost allocation focused on: (i) adjustment of the weights attached to the active portfolio versus loan approvals and weights assigned to project-financing and TA grants versus loans; (ii) adjustments related to full allocation of Private Sector operations costs to ADB; (iii) treatment of HIPC and MDRI assets; and (iv) other specific adjustments to cater for some specific type of loans and active portfolio clean-up.

Adjustment of Weights of the Activity Parameters

5.2 Although objectively there are differences in work-effort between origination and execution, loans and grants, ordinary asset management and MDRI assets, there are some difficulties in quantifying with a high degree of accuracy, the weights to assign to the various parameters in the formula. Data series availability and consistency across years are limiting factors in the quantification process. In this context, the historical data available have to be complemented by the results of the surveys undertaken at three successive evaluations of the parameters of the formula within the context of this study. For this purpose, Management undertook a sensitivity analysis to show the implications of various weight changes on the formula. This would provide a reasonable guide for decision making until a simplified time recording system becomes effective.

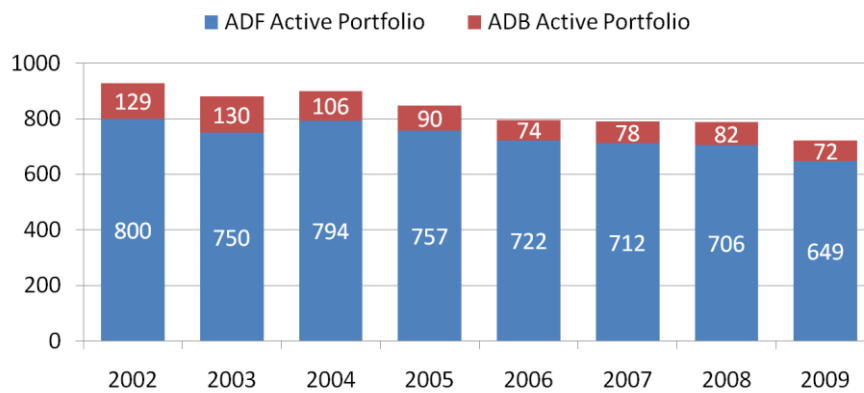
⁶ Implementation of a simplified and auditable time-recording system is a long process.

Active Loans & Grants portfolios versus Approvals

5.3 **The portfolio size is the most important factor resulting in the current cost share** of ADF relative to ADB as summarized in Table 06. This is because in the current formula the number of loans and grants in the active portfolio is given equal weight to the number of annual approvals. Due mainly to its portfolio size, ADF has a 78% share of the Bank Group’s operational costs in 2009. This 78% share is partially offset by ADF’s 57% share of non-operational expenses (allocated according to the asset size of each institution), so that ADF’s share of the total costs comes to around 71%.

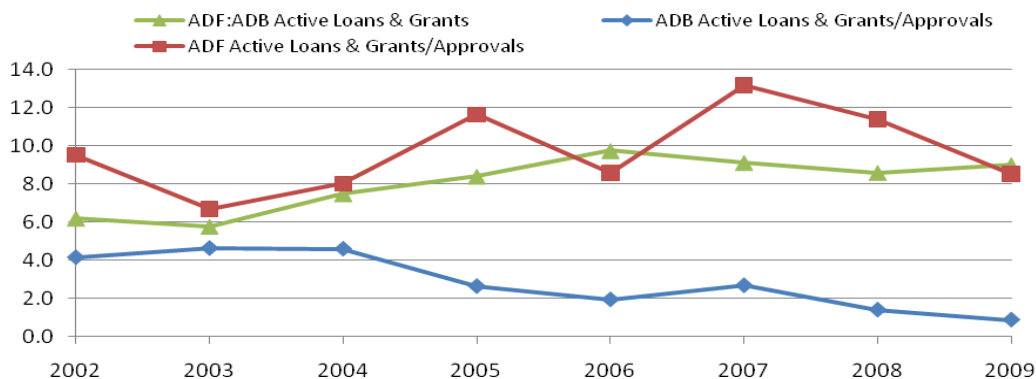
5.4 **The number of active loans and grants in the ADF portfolio has been historically high compared with its number of annual approvals.** During 2005-2009, the number of loans and grants in the ADF active portfolio has ranged from about 9 to 13 times the number of its loans and grants approved each year (see Figure 2b); in the last two years, the ratio has been declining from the high of 13 reached in 2007.

Figure 2a: Evolution of ADB and ADF Active Portfolio



In contrast, over 2005-2009 the ADB portfolio size has ranged from 1 to 3 times its number of annual approvals, and the ratio has shown a declining trend as indicated in figure 2b.

Figure 2b: Ratio of Number of Active Loans & Grants to Number of Loan Approvals



5.5 **The ratio of the active portfolio size to annual approvals reflects mainly the speed with which the operations are implemented.** . Using disbursement rates as a proxy for the pace of implementation, it was noted that the ADF and ADB ratios of active portfolio size to annual approvals were consistent with their disbursement ratios. As of November 2009, ADF had a disbursement ratio of 16%, and ADB had public sector and private sector disbursement ratios of 30% and 64%, respectively⁷. Tables 6A and 6B show the evolution of both approvals and projects under execution for the three windows.

Table 06A: ADB Annual Approvals and Size of Active Portfolio

	2009	2008	2007	2006	2005	2004	2003	2002
Approvals:								
Loans	48	44	23	17	17	17	17	31
Grants	33	14	6	21	17	6	11	0
Total Approvals	81	58	29	38	34	23	28	31
Portfolio at Previous Year-End:								
Public Sector	46	64	67	67	81	98	115	123
Private Sector	26	18	11	7	9	8	15	6
Total Portfolio	72	82	78	74	90	106	130	129

Table 06B: ADF Annual Approvals and Size of Active Portfolio

	2009	2008	2007	2006	2005	2004	2003	2002
Approvals:								
Loans	35	35	34	35	31	45	53	54
Grants	41	27	20	49	34	54	59	30
Total Approvals	76	62	54	84	65	99	112	84
Portfolio at Previous Year-End:								
Loans	355	396	397	403	437	491	474	494
Grants	294	310	315	319	320	303	276	306
Total Portfolio	649	706	712	722	757	794	750	800

Review of weighting of parameters for the active portfolio

5.6 The basis for attaching equal weight to the number of loans and grants in the active portfolio and the number of annual approvals was examined with respect to (i) the experience of the Operations departments; and (ii) the available data from other MDBs.

5.7 **Differentiating time spent on project execution and approval** - The staff responses to Question #1 of the second questionnaire⁸ (Annex 2) were not entirely conclusive and were also counter to the experience of other MDBs (as discussed in

⁷ Source: ADB 2010-2012 Programme and Budget Document.

⁸ As shown in question 1 of Annex 2, 54% of staff responded that, on average, more time was spent on a project in execution during a year than on a project approved during a year. However, referring to the responses to Question #2 of the same questionnaire, 74% of these staff indicated that the difference in time spent was 25% or less. In contrast, while 46% of staff responded to question 1 that, on average, more time was spent on a project approved during a year than on a project in execution during a year, 70% of these staff indicated in question 2 that the difference in time spent was 50% or more.

paragraph 5.9). Further assessment of the details of this questionnaire and the responses indicates that the staff responses were due to the following reasons:

- Given the size of the active portfolio (particularly for ADF), staff do spend more time on projects in execution, than on the much smaller number of projects approved each year, for the **entire portfolio**. The survey was not very explicit, as it was meant to request the amount of time spent during the approval and execution phase, **per project rather than for the entire portfolio**, in order to properly reflect weights in the formula.
- The breakdown of the responses by department showed that staff in sector departments and FOs, which have a larger share of responsibility for project execution or larger portfolio under supervision than project approval, responded that more time was spent on a project in execution than on a project approved.
- Due to the 9-10 years or so, on average, that an ADF project remains in the active portfolio, it is understandable that staff believed that they spent more time overall on a project in execution than on a project approved during the much shorter project approval cycle.

5.8 Given the divergent views in staff responses to the previous questionnaires reflecting the scope and scale of activities covered, Management sent a new questionnaire to Operations staff in September 2010. In this questionnaire staff were requested to provide specific information, in terms of the average number of days **per project spent in each year in 2008 and 2009** on the various project cycle activities related to project approval and execution. The new questionnaire was also more explicit as it provided a sample response and interpretation of this response, and was prepared with the collaboration of an experienced Director that covered several sector Departments. The time data reported by staff were then averaged across all respondents. The staff responses are summarized in Annex 8 and show that, *on an annual basis*, the average staff time devoted to the execution of each project in the active portfolio is about 56% of the average staff time spent during the origination phase of each project. This conclusion is also consistent with the following performance data reported in the ADB 2010-2012 Programme and Budget Document: as of November 2009, 50% of operations were supervised twice a year. The volume of execution work represented by this percentage determines the total staff time devoted each year to portfolio execution, and thus it provides additional confirmation of the findings from the staff responses to the new questionnaire.

5.9 **Benchmarking for the active portfolio** - To benchmark the above findings, reference was made to average cost data for 2005-2007 reported by the AsDB in its 2009 Budget Document; this information is set out in Table 07. The World Bank (WB) has not disclosed similar information in recent years, but data from earlier years indicated that the average cost per year to execute a project was about 1/3 of the average cost of project origination per year. Thus the cost data from the AsDB and WB are fairly consistent.

Table 07: AsDB Project Origination & Execution Costs – 2005-2007 Average (US\$'000)

	Public Sector Projects	Private Sector Projects
Project Origination Costs – Per Project	356	325
Project Execution Costs – Per Project Per Year	57	31
Ratio of Annual Execution Costs/Annual Origination Costs *	0.3:1	0.2:1

* This ratio is not disclosed by AsDB, but it has been calculated here based on the reasonable assumption (taking into account WB experience) that the elapsed time on project origination does not exceed 2 years, on average.

5.10 Proposed weighting adjustments for the active portfolio- Based on the above analysis and further interviews of sector departments, it was concluded that the weight attached to *the number of loans and grants in the active portfolio should be less than the current 100%*. Pending a more precise determination based, among other things, on time recording system and analyses of data generated by the system when its reliability is established, Management is proposing as an interim measure that such weight be pegged at 50%.

Review of weighting of parameters for Grants (Project Financing Grants and Technical Assistance Loans/Grants)

5.11 The weight of 30% attached to TA grants and loans (both the number of approvals and the number of active loans and grants) was also reviewed against cost information from AsDB and WB. The cost data reported by AsDB show that TA origination costs are about 13% of loan origination costs, and TA execution costs are about 40% of loan execution costs. For the WB, the proportion is around 1/3 for origination costs (similar data is not available for execution costs). However, both of these MDBs use trust funds to finance TA activities, and the use of these resources is not included in the reported costs.

5.12 Moreover, unlike the AsDB and WB, ADF makes project-financing grants which can be expected to require more staff-time than TA grants. On the basis of a questionnaire sent to senior staff of the Operations departments requesting their views on the time spent on origination and execution of project-financing and TA grants, compared with the time spent on loans presented in Annex 3, followed by interviews to clarify some of the responses provided, Management made proposals on the weights to be applied to project-financing and TA grants. It was concluded that projects financed by grants are similar to projects financed by loans and require exactly the same amount of time at origination and execution. On the other hand, TA grants require much less time at origination and execution when compared to regular loans. [The results of this questionnaire are also confirmed by the new questionnaire undertaken in September 2010, as presented in Annex 8.](#)

5.13 Proposed Weighting Adjustments for Project-financing and TA Loans & Grants

Management proposes to attach the weights summarized in Table 08 to the two types of grants. These revised weights are considered to reflect more appropriately – than the

current 30% weight – the staff time spent on the origination and execution of project-financing and technical assistance grants, relative to loans.

Table 08: Proposed Weights for Grants Relative to Loans

Type of Grant	Current	Approvals	Portfolio under execution
Project Financing Grants	30%	same as loans	same as loans
Technical Assistance Loans & Grants	30%	50%	30%

Private Sector Operations

5.14 Private sector operations are exclusively financed from the ADB window. Revenues related to private sector operations are recognized in the ADB financial statements. Therefore, as an accounting principle, private sector related costs, incurred through the ADB window⁹, should be excluded from the shareable expenses and assigned directly to ADB.

HIPCs and MDRI

5.15 In the context of the third survey of this study, accounting and policy departments handling HIPCs and MDRI issues were requested to provide the relative time effort requirements of the assets maintained under debt relief initiatives. The indications were that these assets require lower administration effort compared with active loans, and attaching a 50% weight to these assets would be reasonable for calculating ADF’s cost share.

Other Short Term Adjustments

5.16 **Cut-off for inactive loans-** During the joint AUF/ICODE meeting, certain Board members suggested the inclusion of inactive loans and grants, albeit at a smaller weight, to recognize the costs incurred to follow up on such loans and grants. There was also a request to align the definition of inactive loans with the loan cancellation guidelines. After careful consideration of these suggestions, Management is of the view that a complete alignment of the definition of “inactive loans and grants” for purposes of cost-sharing to the definition of “loans and grants eligible for cancellation” per the loan cancellation guidelines could result in the improper exclusion of the costs associated with the follow up activities on such loans and grants. However, Management believes that the ADB Group time associated with loans and grants that have not been signed and therefore not yet effective 12 months following the date of their approvals are typically not significant. Accordingly, the definition of inactive loans and grants for purposes of the application of the cost sharing formula is now refined to refer only to loans and grants that remain unsigned for more than 12 months.

⁹ The ADB window is currently the sole financing window for private sector operations.

5.17 **Adjustment for countries benefiting from a loan and a grant for the same project** - Countries classified in the “yellow light” category under the ADF debt sustainability framework are usually provided a loan and a grant for the same project. An adjustment will be made in the loan database to avoid double counting these lending operations.

Impact of the Proposed short term Adjustments on the Results of the Formula

5.18 The combined result of the changes to the current formula proposed is presented in Table 9, and Annex 5 presents the proposed changes in the same format as Figure 1 for purpose of comparison. As noted earlier, the current formula produces reasonable results; however, the implementation of the changes would enable the formula to better reflect the evolution of business activities since its introduction in 1994, as well as the views of staff and managers surveyed during this review.

**Table 9: Indicative ADB and ADF Cost Shares for 2009
Simulation of the Impact of Proposed Changes on the Current Formula**

	Current Cost Share	Cost Share with Proposed Changes ¹⁰
ADB	27.4% *	31.2%
ADF	70.8%	67.0%

* Before any adjustment that may be needed to limit NTF’s cost share to 20% of its gross income.

5.19 The following additional points should be noted with regard to the effect of the proposed short-term changes on the 2009 cost shares shown in the above table:

- The various proposed short-term changes (detailed out in [Annex 6](#) and [Annex 7](#)) would affect the cost shares of the three entities in different directions and varying percentages. The sum-total of these effects is shown in Table 9.
- Given the important purposes for the use of the formula, as noted earlier, and possible variations in the resulting future cost shares due to changes in the parameter values, the application of a standard of materiality – i.e., the percentage impact of the proposed changes relative to the current cost shares – was not considered germane to the review.
- The impact of the changes on the cost shares for 2010 and future years will depend upon the values in each year of the parameters included in the cost-sharing formula, e.g., the number of loans and grants approved for each window, the sizes of their active portfolios and their balance sheet assets at the previous year-end. As such, the future cost shares cannot be predicted ahead of the relevant fiscal year-end.

VI. POSSIBLE LONGER-TERM IMPROVEMENTS TO CURRENT FORMULA

6.1 As demonstrated in the previous sections, the fundamental logic behind the current formula remains valid and the cost shares produced by the formula are overall reasonable when compared with the external benchmarks provided by other MDBs and when examined

¹⁰ If the formula is applied retroactively to the year 2009

in the context of the lending volumes, average loan sizes and active portfolios of ADB and ADF. However, in view of future developments in the Banks' business, a further breakdown of cost drivers could enhance the accuracy of the formula. The budget process and its associated cost accounting system, affords the opportunity to enhance the quality of information used for the determination of cost-sharing amongst the Bank Group entities and thereby its acceptability. Given the requirements of these enhancements, they cannot realistically be implemented in the short-term.

6.2 It is important to note that these proposed longer-term adjustments are not intended as a substitute to the proposed short-term fine tuning, but rather as part of ongoing efforts to assure the continuing relevance and reasonableness of the cost sharing formula. For instance, given the growing complexity of the Bank's balance sheet (development related exposure and treasury operations as well as their related operational and non-operational activities) and the variety of non-operational expenses, further segregation of these expenses is preferable. Such breakdown would require a separate indicator for each category or cost item to reflect the work effort involved. By using these more refined and traceable indicators the accuracy and objectivity of the formula could be further enhanced.

6.3 The various options assessed in this respect are summarized below.

Classification of Operational and Non-Operational Expenses

6.4 The current practice is to divide the costs of each cost center into operational and non-operational expenses on the basis of a categorization made during 2006 institutional reforms. The categorization provides a reasonable breakdown based on the general characteristics and nature of each cost center's business activities and level of contribution to the core business of the Bank (i.e. lending). For new business units created since 2006, COBS has similarly decided on the breakdown of their expenses. While, on the face of it, this approach is reasonable, it does not involve the use of measurable and monitorable parameters as the bases for allocation of some Non-Operations departments' expenses. The longer-term objective of the organization fine-tuning is to give priority and impetus to operations departments and country focus and drive the activities of support departments toward that target. This entails a more rational way to classify expenses as the institution grows and the number of cost centers increased since 2006. For example, the classification of FFCO3 (Loan Disbursement) whose costs are treated as 100% operational, while the costs of FFCO4 (Loan Accounting) are treated as only 50% operational, should be reviewed to reflect the changes in the work efforts.

6.5 The Bank should consider adopting a more systematic approach (see Box 1) to classifying the expenses of cost centers as operational vs. non-operational, that would be also consistent with the practices of other MDBs. Alternatively, a thorough review of the current allocation percentages should be undertaken to remove the inconsistencies of the type noted above.

Box 1: An Approach to Classifying Cost Center Expenses

- *Costs of all business units whose activities consist entirely of providing direct client services (ORVP, OIVP and OSVP), and costs of all units whose activities are substantially performed to support client services (ECON and OPEV), are treated as operational expenses. This will involve no major change from current practice.*
- *Costs of all other business units are treated as non-operational expenses, while recognizing their contribution to Operations activities by using the operational expense shares to allocate the bulk of non-operational expenses. This will involve a major change from current practice.*

Allocation of Operational Costs

Need to Improve Lending Indicators for Allocation of Operational Costs

6.6 The numbers of lending operations approved during the year and included in the year-end active portfolio may be regarded as reasonable indicators of the volume of staff and other resources deployed for lending origination and execution. However, the use of this indicator for cost allocation rests on the assumption that the origination and execution of each loan requires an equal amount of staff-costs and other resources. Replies received from Operations business units to the first questionnaire used for this review¹¹ indicated a clear recognition of the following:

- Differences between the costs of ADB, ADF and NTF tasks were not all in one direction, i.e., some tasks were more expensive for ADB than ADF/NTF, while others were more expensive for ADF/NTF than ADB.
- The cost differences were caused, or at least influenced by, a multiplicity of operational factors that could not be captured sufficiently through the use of the numbers of lending operations as the allocation parameter.

6.7 Another limitation of the exclusive use of lending-related indicators to allocate all operational costs between ADB, ADF and NTF is that they do not recognize the importance of non-lending services delivered to clients. These services are likely to become increasingly important as – like other major MDBs – the Bank Group emphasizes its role of being a Knowledge Bank. Also, while non-lending activities are generally driven by the due diligence work and advisory services connected with lending, in some countries (such as post-conflict and fragile states) non-lending services may take precedence over lending, which may then

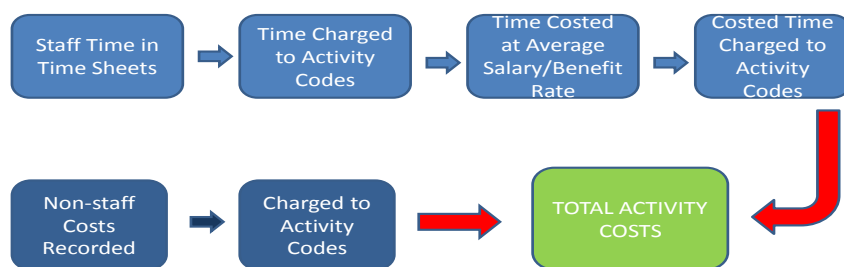
¹¹ The questions in the questionnaire included the following: Operations Departments were requested to indicate the approximate differences between ADB and ADF/NTF with regard to time spent on various tasks related to financing and non-financing activities, and then to indicate if there is a connection between those differences and various operational factors, such as the amount of financing, implementing agency capacity and country conditions (e.g., fragile state), etc.

follow depending on country conditions and the results of analytical and advisory and policy-related work.

Options to Allocate Operational Expenses

6.8 Comprehensive cost accounting will offer the opportunity to quantify the costs of ADB and ADF products and services (see Figure 3 for a simplified schematic). Thus implementation of comprehensive cost accounting opens up the practical possibility of adopting a cost-sharing formula that captures how staff-time and other resources are actually spent in delivering the Bank Group’s client services.

Figure 3: Schematic of Comprehensive Cost Accounting System



- TRS activity codes to cover all financing, non-financing & admin. activities.
- Admin. time at dept. level unrelated to specific financing/non-financing activities would be charged to all activities as percentage of activity costs; admin. time at VP level could be similarly charged or treated as overheads.

6.9 Despite the considerable effort required to implement a TRS/cost accounting system, it is an essential and integral part of an effective cost allocation and management process because it provides information on the actual use of staff-time for which the Bank Group (similar to other MDBs) expends more than 50% of its administrative expense budget. With increased flexibility, incentives for timeliness and completeness of forms filled by staff, a TRS/cost accounting system can be reasonably expected to generate high-level data on staff costs (e.g., at country, sector or theme level) at an accuracy of around 80%. Such data, together with the capture and attribution of other direct costs (such as business travel and consultants) can yield cost shares that reflect the actual use of resources far more closely than is possible with the current use of lending-related indicators as proxies for cost drivers. With a reliable TRS/cost accounting system, starting in 2012, the Bank Group should adopt a cost-sharing formula that uses the staff costs and other direct costs charged to development financing activities as the primary basis for sharing of direct costs of public sector financing operations that are financed by ADB, ADF or NTF.

6.10 Whenever better cost information bases could be made available through TRS, the following parameters should be used for allocating other operations costs between the three entities:

- **Direct costs of public sector financing activities that are financed by more than one window** should be shared between ADB, ADF and NTF according to the ratio of the amount of financing by each window.
- **Direct costs of private sector financing from the ADB window in all countries** should be fully charged to ADB, as it is currently the sole financing window for these operations.
- **Direct costs of non-financing activities¹²** should be allocated—to the extent possible—based on the financing window involved; an example would be the costs of studies related to the private sector, which would be fully charged to ADB.
- **For non-financing activities of ORVP, OIVP and OSVP not financed by a specific window**, the direct costs should be allocated between ADB, ADF and NTF according to their shares of the total direct costs of all other activities (both public and private sector); the rationale for such allocation is that those non-financing activities that cannot be identified with a specific window benefit all other activities funded by the three windows according to their scale, as measured by their direct costs.
- **Indirect costs of ORVP, OIVP and OSVP**, e.g., management costs in Operations Departments (including Field Offices) and non-staff costs (e.g., office rent) of Field Offices, should be allocated to ADB, ADF and NTF according to their shares of the total direct costs of public and private sector activities, both financing and non-financing. The rationale is that management activities and field office presence benefit all work performed by the three Operations vice-presidencies.
- **Direct and indirect costs of ECON and OPEV that are not specifically identifiable with and charged to ADB, ADF or NTF¹³** should be allocated between the three windows on the same basis as the indirect costs of ORVP, OIVP and OSVP, and for the same reason as stated above.

Allocation of Non-Operational Costs

Need for an Adequate Substitute to Relative Asset Size to Allocate Non-Operational Expenses

6.11 The use of the relative asset sizes of the three entities to allocate non-operational expenses under the current formula does not meet the test that cost allocation should be based on clearly identifiable cost drivers. It may be argued that asset size (i.e., balance sheet value) is an approximate indicator of the size of an institution and, therefore, its volume of administrative expenses. However, given the dynamic and evolving profile of the balance sheet, it becomes clear that values of assets do not drive most administrative

¹² Non-financing activities would include (but may not be limited to): sector studies, analytical and advisory work, country dialogue, country strategies, country portfolio review, aid coordination, safeguards assessments, financial assessments, technical assessments and portfolio assessments.

¹³ An example of specifically identifiable costs would be those incurred for an EADI course or OPEV review that exclusively addresses the private sector (i.e., ADB-specific) or fragile states (ADF-specific).

expenses, with the sole exception of fixed-asset values which determine depreciation expenses (usually not a major expense category for MDBs).¹⁴ Much more important is the fact that balance sheet values may be significantly impacted by exogenous factors (such as the MDRI initiative) that have little or nothing to do with the operational costs of an institution. Another issue with the current practice is that non-lending services (as well as lending services) drive non-operational expenses, but unlike lending services they have no direct impact on asset size.

Alternative Options for Allocation of Non-Operational Expenses

6.12 For some non-operations activities it is possible to identify **specific indicators** that can be identified as related to ADB, ADF or NTF and are measurable; therefore, these parameters should be used to allocate expenses between the three entities. In the case of the Bank's financial activities the necessary statistics were readily available. These activities and their respective parameters are listed in Table 10 below.

6.13 For all other non-operations activities, the ADB/ADF/NTF ratio of total operations costs (ORVP, OIVP, OSVP, ECON and OPEV) could be used to allocate expenses, on the grounds that these institutional activities are largely driven by operations activities that represent the core business of the Bank Group

Table 10: Specific Parameters for Allocation of Certain Non-Operational Expenses

Activity	Specific Parameter for Expense Allocation	Comments
Loan Disbursement	Number of transactions for year	<i>Change from current practice</i> -- identifiable and measurable cost driver
Loan Accounting	Average number of outstanding loans during year	<i>Change from current practice</i> -- identifiable and measurable cost driver
Investment & Trading Room	Average size of investment portfolios during year	No change from current practice
Capital Markets & Financial Operations	100% to ADB	No change from current practice
Asset & Liability Management	Staff time spent on ADB vs. ADF activities	<i>Change from current practice</i> -- identifiable and measurable cost driver
Treasury Risk Management	Average size of borrowings & investment portfolios during year	<i>Change from current practice</i> -- identifiable and measurable cost driver
ADF Replenishment Work	100% to ADF	No change from current practice
Language Services	Costs of translation for ADB, ADF and NTF	<i>Change from current practice</i> -- identifiable and measurable cost driver

¹⁴ While the size of borrowings drives the interest expenses of ADB, these expenses are of a financial nature and are not part of its administrative expenses. Another argument in support of the current practice could be that lending approvals, disbursements and repayments (which drive a range of direct and indirect costs) result in changes in the value of loans outstanding.; however, project approvals impact upon loans outstanding with time lags, depending upon the timing of loan effectiveness, and these activities affect the year-end asset size and do not have any impact on asset size at the beginning of a year. Finally, in the case of CGSP, rented properties at Headquarters and Field Offices drive administrative expenses but such property is not reflected in asset size (i.e., as the value of real estate).

VII. IMPACT OF THE REVIEW ON THE BANK GROUP INSTITUTIONS

Impact on ADB

7.1 As indicated in Table 9 above, the review of the Bank Group's cost-sharing formula will result in a marginal increase of 3.8% in ADB cost share, from 27.4% to 31.2%. Applying such increase to the Bank Group's administrative budget for the year 2010 of UA 264 million will result in an increase in ADB administrative expenses of UA 10 million. This represents an increase of 14% on ADB 2010 budgeted administrative expense of UA 72 million. When translated into equivalent spread this would correspond to around 5 basis points

7.2 Cost containment efforts and effective management of budget pressure areas through savings and efficiency gains could offset this increase so that it would not be reflected as an increase in the lending spread. In the worst case scenario the cost implication will not be automatically passed through to borrowers, in line with commitments made in the sovereign pricing discussions¹⁵ to fully cover administrative expenses by 2013.

7.3 The increase in ADB administrative expense is expected to represent 5% of its projected allocable income¹⁶ of UA 194 million for the year 2010. Such increase will impact marginally the Bank's capacity to transfer resources to reserves or development initiatives for the year 2010. This increase will also have a negligible impact on the Bank's financial strength, as the projected risk capital of UA 4,735 million for the year 2010 will only decrease by 0.21%.

Impact on ADF

7.4 The proposed fine-tuning of the Bank Group's cost-sharing formula would result in a decrease of approximately UA 10 million in ADF administrative expenses. Such improvement in annual internal resources would increase the Fund's commitment capacity substantially (to the tune of approximately UA 77 million) during the next replenishment period.

Impact on NTF

7.5 With regard to the NTF, the review will result in a very marginal increase in its cost share by 0.1%. However, given that NTF expenses are capped at 20% of its gross income with ADB assuming any residual expenses, the proposed change in methodology will have no impact on NTF financial statements.

¹⁵ ADB/BD/WP/2010/15 rev.1: Proposal for revised loan pricing for sovereign and sovereign guaranteed operations

¹⁶ The allocable net income excludes the fair valuation of borrowings and derivatives and is based on financial projections as of September 2010.

VIII. CONCLUSIONS

8.1 The review of the Bank Group's cost sharing formula and cost allocation practices of comparable institutions indicates that there is no perfect method. An appropriate cost-sharing formula permits a reasonable allocation of shared expenses, in response to the statutory requirements and shall comply with general cost allocation principles.

8.2 The review concluded that the current formula produced results that are reasonable overall when compared with the external benchmarks provided by other MDBs and when examined in the context of the lending volumes, average loan sizes and active portfolios of ADB and ADF. At the same time, the review has identified opportunities for improvements that can be made in the short-term, starting with the cost allocation for 2010. These improvements would produce cost shares which better take into account the factors that drive the costs of the Bank Group, consistent with the evolution in the businesses of the Bank Group.

8.3 In this regard, Management is making the following recommendations:

Short Term Adjustments

- i. Revised weights of 50% should be applied to loans in the active portfolio,
- ii. Revised weights should be applied to project-financing grants (same weights as project loans for approvals and for the portfolio under execution) and technical assistance grants/loans (50% for approvals and 30% for the active portfolio); for this purpose, a single operation should be recorded as a loan where a country benefits from both a loan and a grant for the same project;
- iii. Costs related to private sector operations should be directly allocated to the ADB window; and
- iv. 50% weight should be applied to MDRI assets as they require a lower administration effort compared to regular loans, and exclusion of HIPC assets; and
- v. [Inactive loans eligible for cancellation](#) (i.e. [loans and grants that remain unsigned for more than 12 months](#)) should be excluded from the cost sharing formula.

Periodic Review of the Cost-Sharing Formula

The Bank Group should also periodically ([every 3 years](#)) review the cost-sharing formula to assess its continued relevance in the context of the business activities of the Group.

Longer-Term Adjustments

- i. The Bank Group should leverage upon the time recording and comprehensive cost accounting systems being implemented in 2010, to adopt a cost-sharing formula that captures how staff-time and other resources are actually spent in delivering the Bank Group's client services.
- ii. Where feasible, specific indicators should be used to allocate non-operational expenses; for all other non-operational expenses, the allocation ratio of operational expenses based on cost accounting would also provide the parameter for allocation of non-operational expenses.

Comparator MDBs' Practices

Questionnaires were sent to ASDB, EBRD, EIB, IADB and WB, with the objective of learning about their cost-sharing methodologies and reviewing their applicability to the Bank Group. The EBRD and EIB indicated that they do not have concessional funding windows. Below are summaries of their cost-sharing methodologies and the implications for the Bank Group. While this information is useful for reference, the comparator MDBs' practices do not offer practical solutions that would improve the current cost-sharing formula of the Bank Group.

Asian Development Bank:

A 3-year moving average of the total number of loans approved for the market-based (MW) and concessional funding (CW) windows is used to allocate administrative expenses. Each regional operations department's expenses are allocated based on the 3-year moving average of the total number of loans approved for that department. All other administrative expenses are allocated based on the overall 3-year moving average of total number of loans approved for MW and CW after deducting the income/fees earned for the administration of trust funds. Some specific cost centers such as the Funding Division of Treasury and Private Sector Operations Department are 100% charged to MW. The Investment Division of Treasury cost center is allocated based on the average investment portfolio for MW and CW, and the Office of Risk Management cost center allocation ratio is 95% to 5% between MW and CW.

Although the AsDB uses a 3-year moving average of the number of loans approved, this cost-sharing formula has limitations similar to those of the Bank Group's current formula, with regard to the exclusive use of lending-related indicators.

Inter-American Development Bank:

Under its Multilateral Debt Relief and Concessional Finance Reform initiative, IADB switched in 2008 from a time-recording data-based cost allocation to specific (and declining) percentages of administrative expense allocations to its CW. The purpose of this change was to increase resources for heavily indebted poor member countries. The IADB approach to cost-sharing is a top-down cap governed by its objective of augmenting resources for its CW-funded member countries and, as such, it is not considered germane to this review.

World Bank (IBRD/IDA):

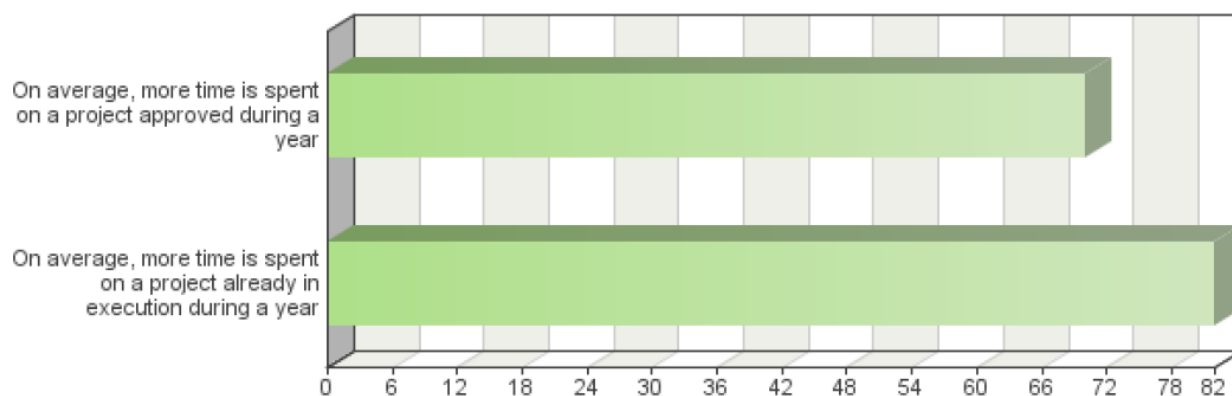
The WB uses a time recording (TRS) data-based cost-allocation formula that was implemented in 2002 and has been subject to periodic reviews and refinements since then. The basic parameter used for allocating the costs of operations activities is the country-specific costs of MW and CW as recorded in the TRS/cost accounting system. Specific indicators are used for

certain non-operations costs, similar to those used by the AsDB. The WB formula is fairly complex and requires the use of cost accounting to capture the primary cost drivers. In addition, the organizational structure of the Bank Group is different from WB, e.g., private sector operations are located within ADB, as opposed to the separation of public and private sector operations between IBRD and IFC in the WB Group; also, the structure and responsibilities of the WB Regional and Network vice-presidencies are substantially different from those of ORVP, OIVP and OSVP. Therefore, besides its complexity, the WB formula does not fit the Bank Group's needs in many significant aspects.

ADB – Review of Cost-Sharing Formula
Summary of Staff Responses to Second Questionnaire

Question 1

In a typical year, Bank staff work on (i) projects approved during the year and (ii) projects approved in previous years BUT in execution during the year. Please rate the following from your experience of Bank operations?

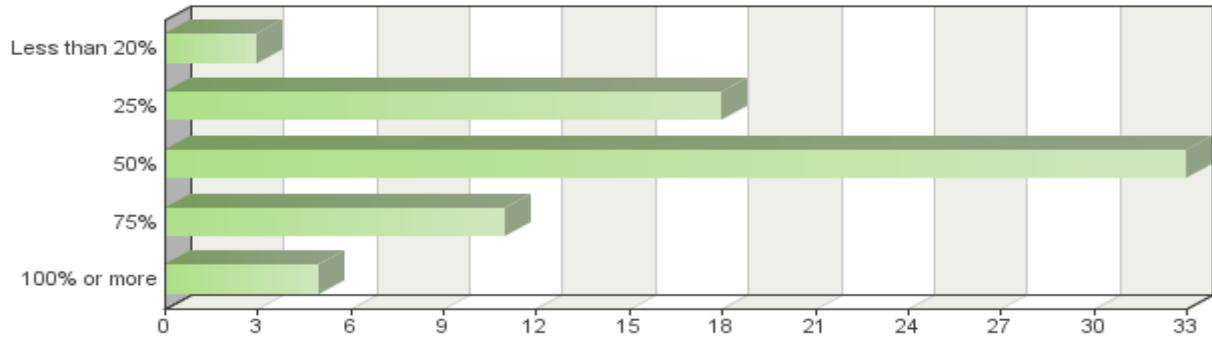


Choices	Num. of replies	Percentage of replies	Cumulative Percentage
On average. more time is spent on a project approved during a year	70	46%	46%
On average. more time is spent on a project already in execution during a year	82	54%	100%
Total	152	100%	

Question 2

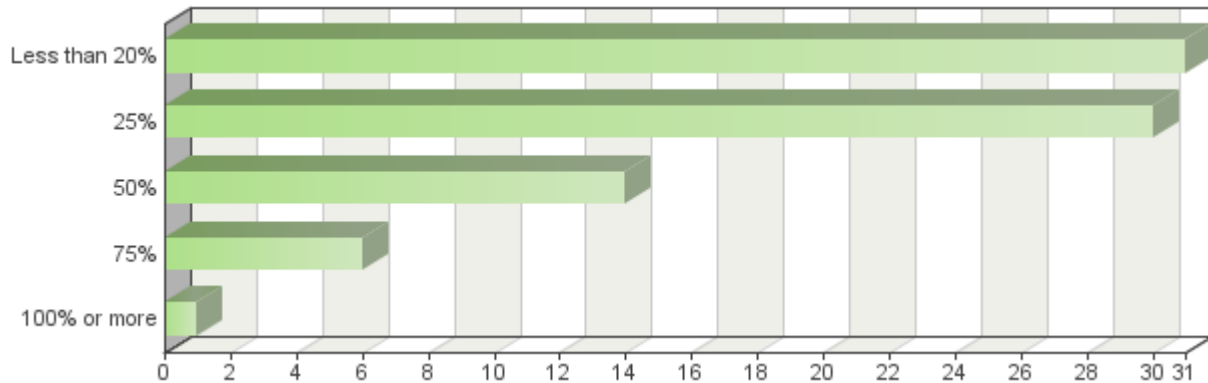
On average, how much more time is spent on a project approved during a year than on a project in execution during that year?

Results for respondents who answered "On average, more time is spent on a project approved during a year" to the previous question



Choices	Num. of replies	Percentage of replies	Cumulative Percentage
Less than 20%	3	4%	4%
25%	18	26%	30%
50%	33	47%	77%
75%	11	16%	93%
100% or more	5	7%	100%
Total	70	100%	

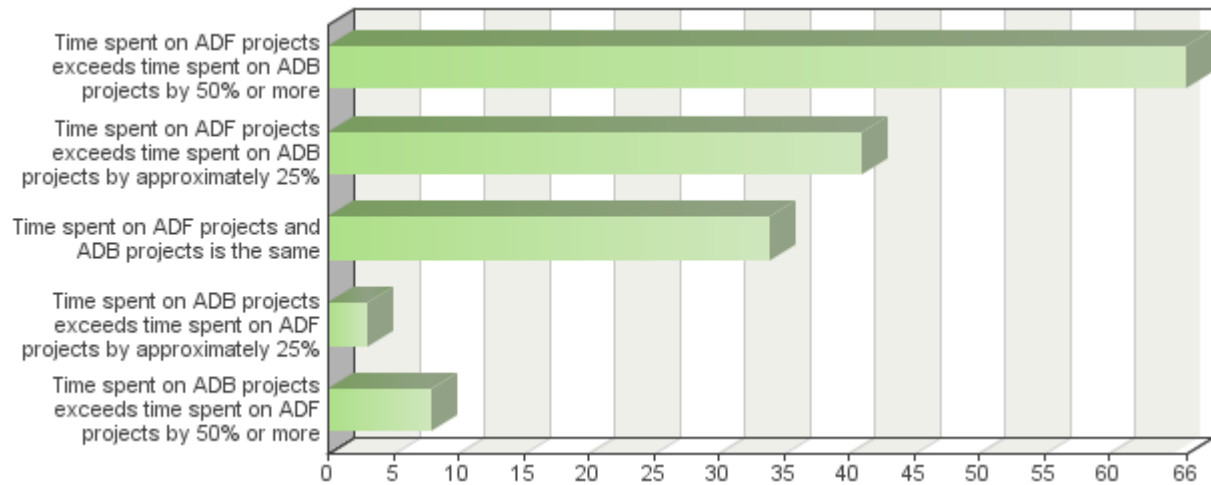
Results for respondents who answered: "On average, more time is spent on a project already in execution during a year" to the previous question.



Choices	Num. of replies	Percentage of replies	Cumulative Percentage
Less than 20%	31	38%	38%
25%	30	37%	74%
50%	14	17%	91%
75%	6	7%	99%
100% or more	1	1%	100%
Total	82	100%	

Question 3

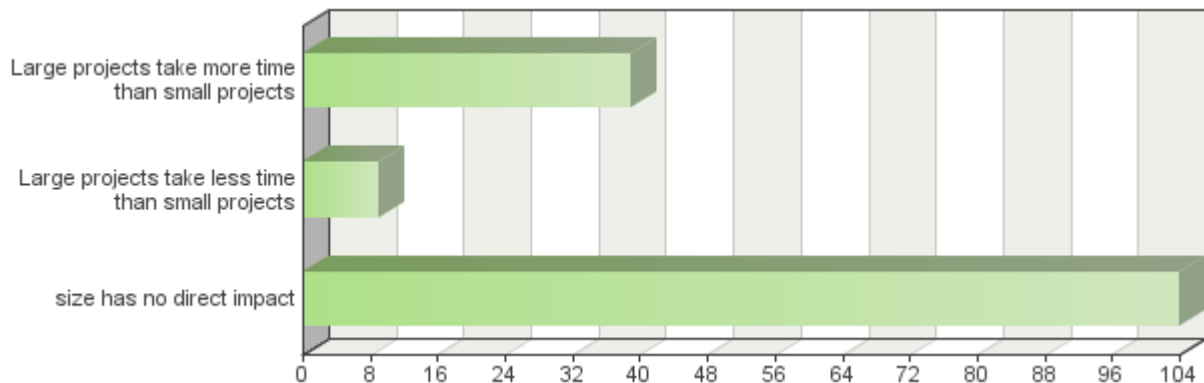
Comparing the average time spent on origination (from identification to loan effectiveness) and execution of ADF projects relative to ADB projects, please rate the following statements:



Choices	Num. of replies	Percentage of replies	Cumulative Percentage
Time spent on ADF projects exceeds time spent on ADB projects by 50% or more	66	43%	43%
Time spent on ADF projects exceeds time spent on ADB projects by approximately 25%	41	27%	70%
Time spent on ADF projects and ADB projects is the same	34	22%	93%
Time spent on ADB projects exceeds time spent on ADF projects by approximately 25%	3	2%	95%
Time spent on ADB projects exceeds time spent on ADF projects by 50% or more	8	5%	100%
Total	152	100%	

Question 4

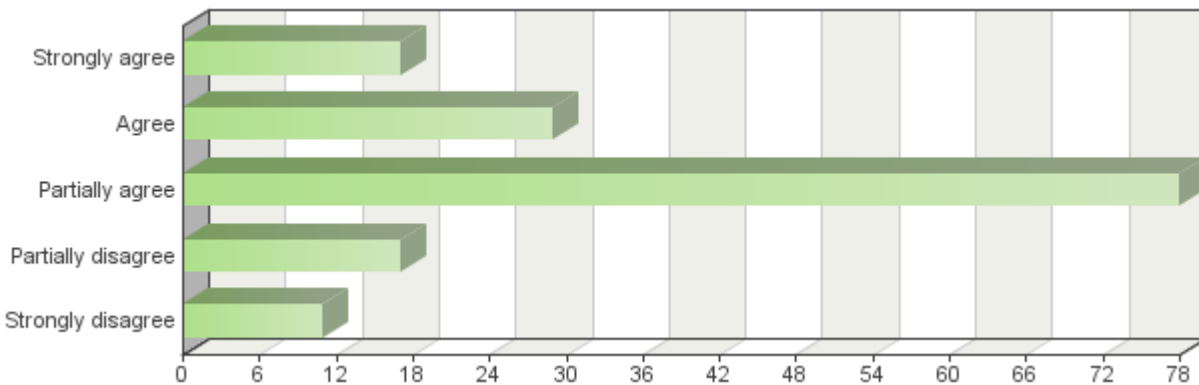
Rate the impact of the size of a loan on the time spent on its origination and execution:



Choices	Num. of replies	Percentage of replies	Cumulative Percentage
Large projects take more time than small projects	39	26%	26%
Large projects take less time than small projects	9	6%	32%
size has no direct impact	104	68%	100%
Total	152	100%	

Question 5

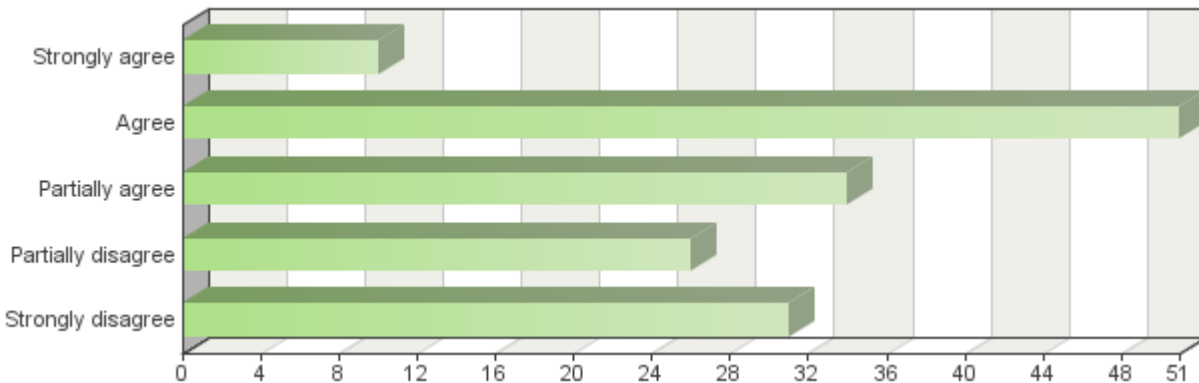
Rate following statement: The time spent by staff on project origination and execution is mainly driven by factors external to the Bank.



Choices	Num. of replies	Percentage of replies	Cumulative Percentage
Strongly agree	17	11%	11%
Agree	29	19%	30%
Partially agree	78	51%	82%
Partially disagree	17	11%	93%
Strongly disagree	11	7%	100%
Total	152	100%	

Question 6

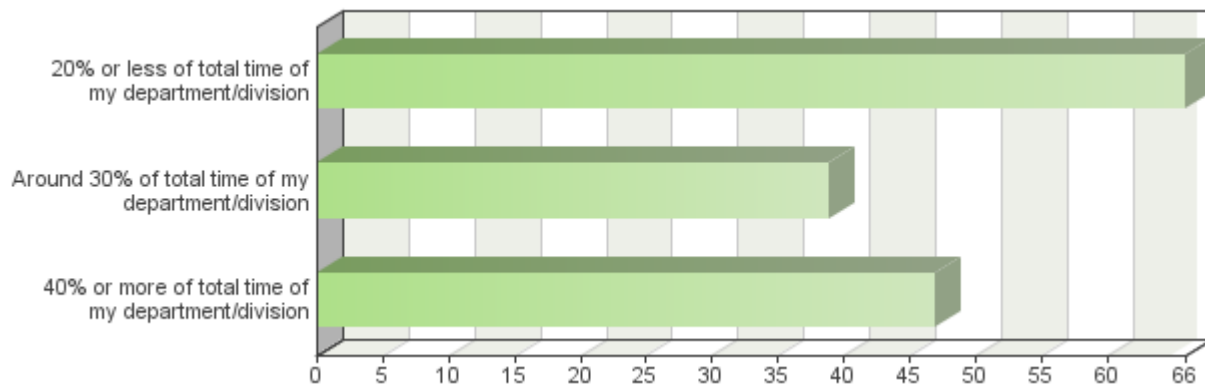
Rate the following: There is a strong link between the volume of non-lending work (e.g., economic and sector work) performed in a country and the volume of work related to lending.



Choices	Num. of replies	Percentage of replies	Cumulative Percentage
Strongly agree	10	7%	7%
Agree	51	34%	40%
Partially agree	34	22%	63%
Partially disagree	26	17%	80%
Strongly disagree	31	20%	100%
Total	152	100%	

Question 7

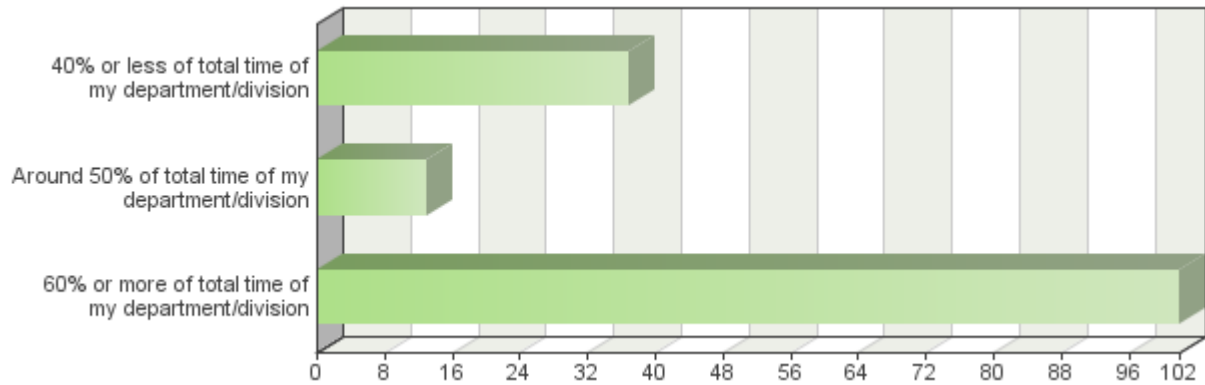
Please provide an estimate of the following: in an average year, non-lending work takes up approximately the following proportion of total time of my department/division.



Choices	Num. of replies	Percentage of replies	Cumulative Percentage
20% or less of total time of my department/division	66	43%	43%
Around 30% of total time of my department/division	39	26%	69%
40% or more of total time of my department/division	47	31%	100%
Total	152	100%	

Question 8

Please provide an estimate of the following: in an average year, ADF work takes up about ___% of total time of my department/division.

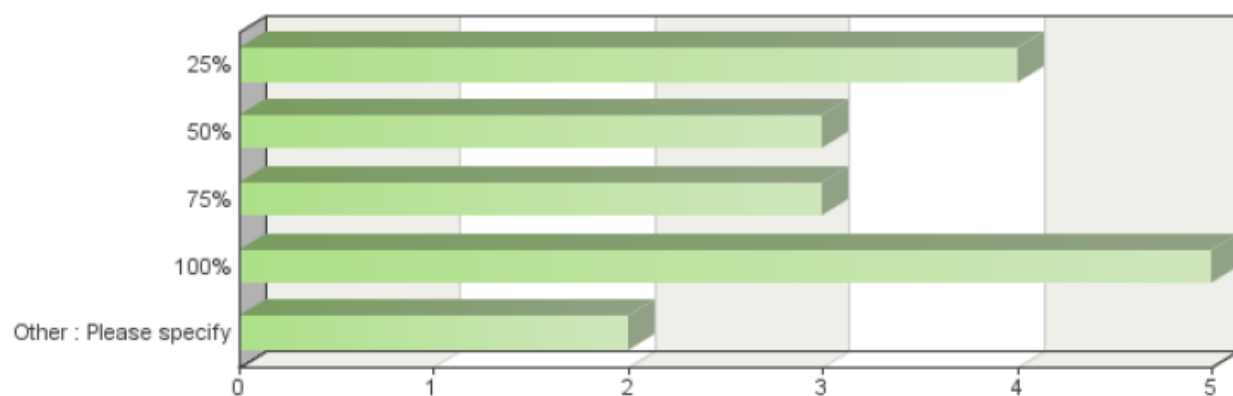


Choices	Num. of replies	Percentage of replies	Cumulative Percentage
40% or less of total time of my department/division	37	24%	24%
Around 50% of total time of my department/division	13	9%	33%
60% or more of total time of my department/division	102	67%	100%
Total	152	100%	

ADB – Review of Cost-Sharing Formula
Summary of Staff Responses to Third Questionnaire

Question 1

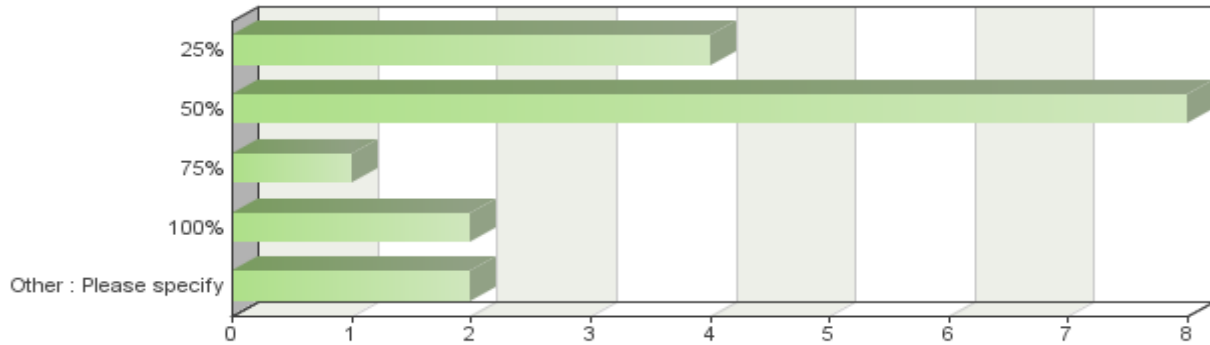
On average, the following percentage of staff time is required for the origination of project financing grants when compared to time required for the origination of loans



Choices	Num. of replies	Percentage of replies	Cumulative Percentage
25%	4	24%	24%
50%	3	18%	41%
75%	3	18%	59%
100%	5	29%	88%
Other : Please specify	2	12%	100%
Total	17	100%	

Question 2

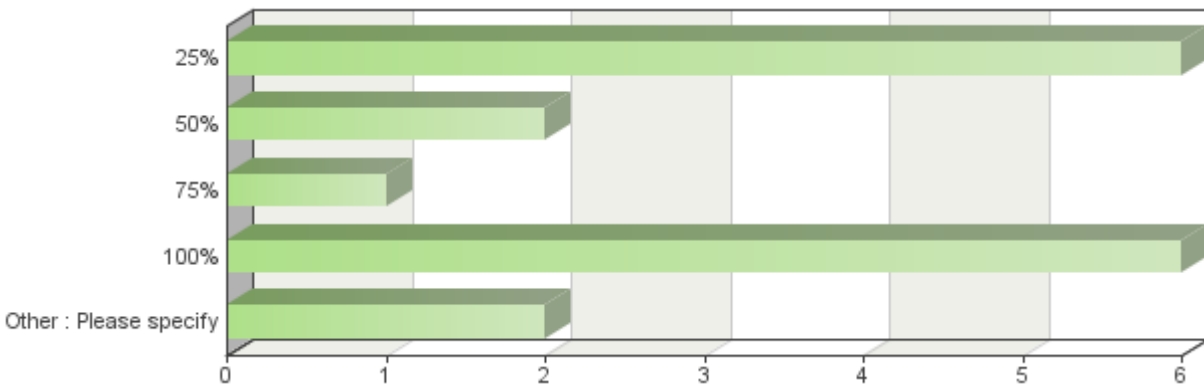
On average, the following percentage of staff time is required for the origination of Technical assistance grants (non-project financing) when compared to time required for the origination of loans



Choices	Num. of replies	Percentage of replies	Cumulative Percentage
25%	4	24%	24%
50%	8	47%	71%
75%	1	6%	76%
100%	2	12%	88%
Other : Please specify	2	12%	100%
Total	17	100%	

Question 3

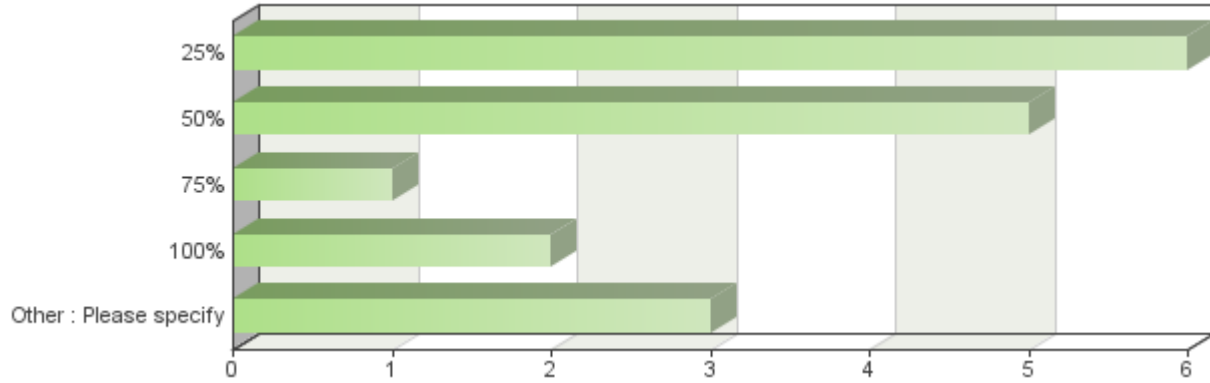
On average, the following percentage of staff time is required for the execution of project financing grants when compared to time required for the execution of loans



Choices	Num. of replies	Percentage of replies	Cumulative Percentage
25%	6	35%	35%
50%	2	12%	47%
75%	1	6%	53%
100%	6	35%	88%
Other: Please specify	2	12%	100%
Total	17	100%	

Question 4

On average, the following percentage of staff time is required for the execution of Technical assistance grants (non-project financing) when compared to time required for the execution of loans



Choices	Num. of replies	Percentage of replies	Cumulative Percentage
25%	6	35%	35%
50%	5	29%	65%
75%	1	6%	71%
100%	2	12%	82%
Other: Please specify	3	18%	100%
Total	17	100%	

Additional Options for Possible Short-Term Improvements to Cost-Sharing Formula

Operational expenses are currently shared between ADB, ADF and NTF according to the number of lending and TA operations during the year, as well as the number of lending and TA operations under active supervision and execution at the end of the previous year. TA projects are included with a weight of 30% in determining the number of lending operations. There are four possible alternatives that could be considered as a way to make marginal refinements to the above parameters over the longer term; these are discussed below in the interest of a full discussion of all available options. But the case for implementing these changes is not entirely convincing. **More importantly, since the Bank Group is on course to implement TRS and cost comprehensive accounting from 2010, these refinements should not be considered for implementation.** Keeping the above discussion in mind, the marginal refinement options below are:

- (a) Include in the current parameters, the UA volume of lending approved during the year as well as the volume of loans outstanding at the end of the previous year.
- (b) Replace the one-year numbers currently used with 3-year averages, i.e., the number of lending operations for the previous year, current year and next year, and a similar average for the number of lending operations under active loan supervision and execution.
- (c) Weight the numbers currently used to reflect the sectoral mix of lending so that the numbers of projects in sectors that require higher staff efforts are given an increased weight.
- (d) Use an appropriate combination of (a), (b) and (c).

The argument in favor of option (a) is that some large loans can be complex, innovative and made to countries with relatively more advanced economies, and, as such, may require more intensive staff efforts for preparation and supervision. However, in the experience of most MDBs, it is found that, in general, the size of loans is not an important determinant of staff efforts, as the same operational procedures need to be complied with, regardless of loan size. Staff responses to Question #4 of the second questionnaire also confirmed this point. Therefore, there is no clear evidence in support of use of this option.

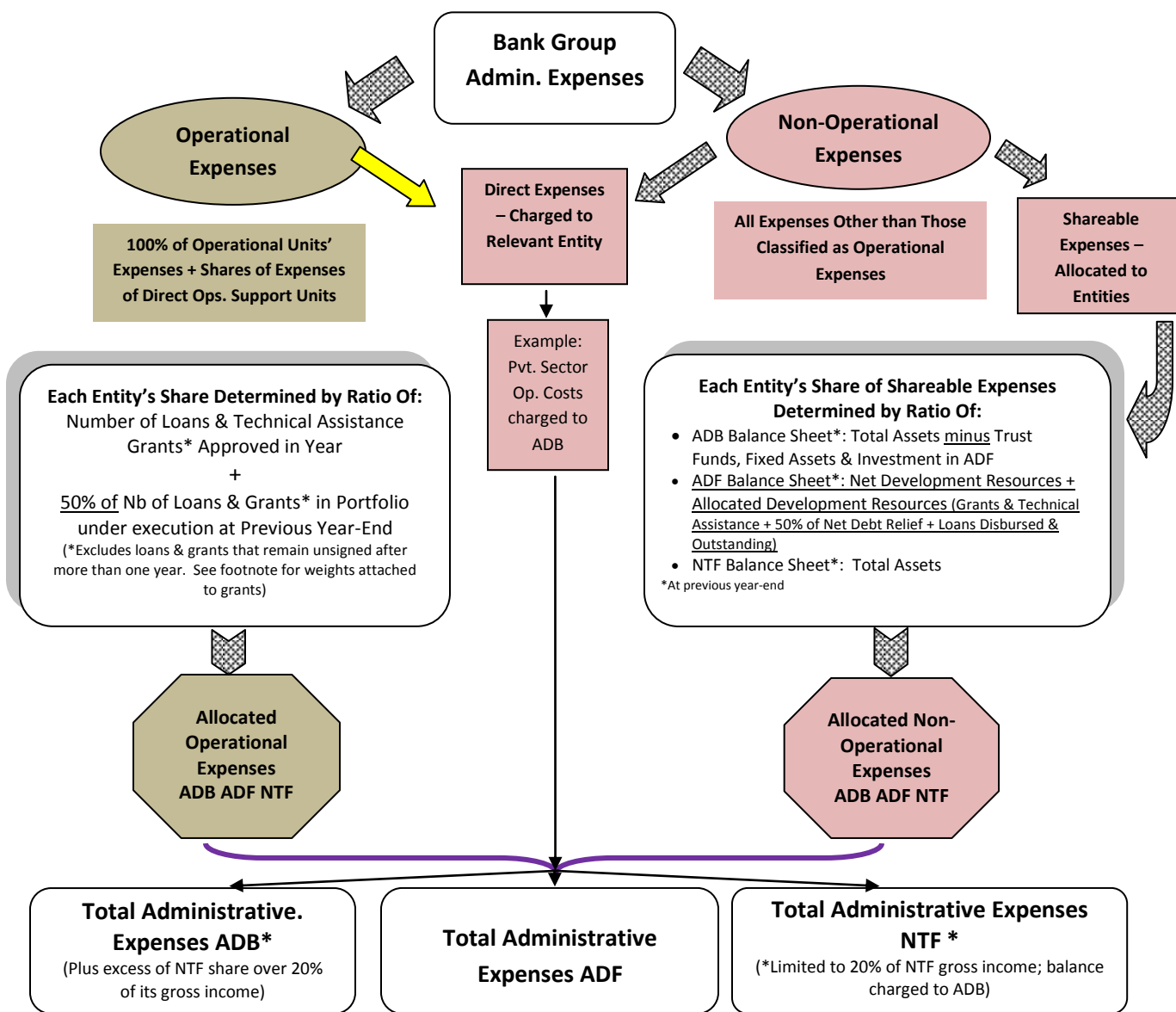
The rationale for option (b) is that it smoothes out possible year-to-year fluctuations in the numbers of loans approved during a year and active lending operations at a year-end. While these numbers may fluctuate from year to year due to country, regional and global factors, the amount of staff effort expended does not normally vary to a similar extent because some of the fluctuation may be absorbed through building up or drawing down the pipeline of lending projects, or through increasing or reducing the amount of non-lending work. For this reason, WB used a 3-year average of number of projects approved prior to 2002 when its current TRS-

based formula was implemented, and it forms the principal allocation parameter used by AsDB (see Annex 1).

Regarding option (c), the general experience of MDBs is that loans in the social sectors such as education and health – as well as in innovative infrastructure projects – require greater staff effort than in other sectors. Therefore, there may be some justification for attaching a higher weight to the number of loans in the more staff-intensive sectors, compared to loans in other sectors. From the responses received to the first questionnaire, the evidence gathered in support of this option was not conclusive. OPSM believed that staff time spent on financing activities in the infrastructure, corporate finance and financial sectors were higher than for other sectors; however, this is not relevant as under the principles of cost-sharing, all of OPSM expenses should be allocated to ADB as it is the sole financing window for private sector financing. As for the other responding departments, ORPF, ORQR and ORRU thought that financing activities in the infrastructure and social sectors were more expensive than in other sectors; ORSB felt agriculture was more expensive than other sectors; OSGE believed that infrastructure, rural development and capacity building were the most expensive areas of financing; but ORPC did not see a strong connection between the level of staff effort and the particular sectors in which activities were carried out. In view of these differing responses, a further survey of Operations Departments would be needed before a decision could be taken on whether to attach greater weights to the number of financing projects in certain sectors. However, as noted above, this report does not recommend the implementation of such a change, hence the issue of a further survey is considered moot.

The above discussion also indicates that there is no clear rationale for option (d). Hence, this option is not further discussed in this report.

Proposed Short-Term Changes to Cost-Sharing Formula
 (Note: Proposed changes are highlighted below)



Note: Weights attached to number of grants relative to number of loans: (a) project-financing grants: 100% for approvals and 50% for portfolio under execution; and (b) TA grants: 50% for approvals and 30% for portfolio under execution.

Cost-Sharing for Year 2009 Using the Current Formula
(Amount in UA million)

	Source (*)	ADB	ADF	NTF	Total
A- Operational					
1- Number of projects & programmes of loans approved during the year	Annual Report	48	35	3	86
2- Number of projects & programmes of loans under execution at the end of the previous year	FFCO. 4	72	355	10	437
3- Number of technical assistance loans & grants approved during the year	Annual Report	33	41	-	74
4- Number of technical assistance loans & grants under execution at the end of the previous year	FFCO.4	-	294	-	294
B- Non Operational					
Assets	FFCO.1				
For ADB, Amount of assets excluding :		12,570.95			
- Trust fund assets at the end of the previous year		-			
- Fixed assets at the end of the previous year		11.73			
- Equity participation to ADF at the end of the previous year		63.87			
For ADF, Amount of assets including :					
- Net Development resources			5,781.38		
- Disbursed outstanding loans			4,866.01		
- MDRI loans cancellation			4,069.90		
- HIPC Grants			1,351.48		
- Grants and Technical Assistance			184.00		
Total Assets (UA million)		12,495.34	16,252.76	287.63	29,035.74
C- Cost Sharing					
Total Administrative Expenses					224.66
Total Depreciation					4.68
Total Administrative Expenses Including Depreciation					229.34
D- Total Non Sharable Expenses (Direct Administrative Exp)		0.85	-	-	0.85
E-Trust Funds Management Fees	FFCO 1	0.93			0.93
F- Total Sharable Expenses					227.56
G- Share of Expenses:					
Operational Expenses	COBS				163.53
Operational Expenses/ (Total Administrative Expenses)					71.86%
Non Operational Expenses					64.03
Non-Operational Expenses/ (Total Administrative Expenses)					28.14%
H - Final Share					
Share of Operational Expenses	FFMA	0.15	0.56	0.01	0.72
Share of Non Operational Expenses		0.12	0.16	0.00	0.28
Total Share		26.85%	71.40%	1.75%	100.00%
Sharable Expenses		61.09	162.47	3.99	227.56
Direct Expenses		1.78	-	-	1.78
I- Administratives expenses		62.88	162.47	3.99	229.34
BUDGET PART					
Total Bank Group Administrative Actual Expenses	224.66				
<i>Less Direct Administrative Expenses including:</i>	0.85				
- Total Non Shareable expenses for ADB	0.85				
- Total Non Shareable expenses for ADF	0.00				
<i>Less Revenues from the Management of Trust Funds</i>	0.93				
Sub-Total for Actual less Direct Administrative Expenses		59.84	159.13	3.91	222.88
Shared Depreciation		1.26	3.34	0.08	4.68
Total Shareable Expenses		61.09	162.47	3.99	227.56
Total Sharable Expenses in Percentage		26.85%	71.40%	1.75%	100%
Plus Direct Expenses & Revenues from the Management of Trust Fund					
Direct Administrative Expenses		0.85	0.00	0.00	0.85
Revenues from the Management of Trust Funds		0.93	-	-	0.93
Total Administrative Expenses		62.88	162.47	3.99	229.34
Total Administrative Expenses		27.42%	70.84%	1.74%	100.00%
(*) See next pages for more informations on the source of data					
(**) In the event that the share of actual Bank Group Administrative expenditure attributable to NTF exceeds 20% of NTF gross income, the excess over such percentage is borne by ADB.					

Cost-Sharing for Year 2009 Using the Proposed Formula
(Amount in UA million)

	Source (*)	Weight	ADB	ADF	NTF	Total
A- Operational						
Projects and program loans						
a- Number of projects & programmes of loans approved during the year	Annual Report	100%	17	35	3	55
b- Number of projects & programmes of loans under execution at the end of the previous year	FFCO.4	50%	66	330	10	406
Projects financing grants						
c- Number of project financing grants approved during the year	Annual Report	100%		15		15
d- Number of project grants under execution at the end of the previous year	FFCO.4	50%		85		85
Technical assistance grants						
e- Number of technical assistance loans & grants approved during the year	Annual Report	50%	32	13	-	45
f- Number of technical assistance loans & grants under execution at the end of the previous year excluding project grants	FFCO.4	15%	-	188	-	188
B- Non Operational						
Assets	FFCO.1					
For ADB, Amount of assets excluding :			12,570.95			
- Trust fund assets at the end of the previous year			5.40			
- Fixed assets at the end of the previous year			11.73			
- Equity participation to ADF at the end of the previous year			63.87			
For ADF, Amount of assets including :						
- Net Development ressources				5,781.38		
- Disbursed outstanding loans				4,866.01		
- MDRI loans cancellation (weighted by 50%)				2,034.95		
- Excluded HIPC Grants (1351.475)				-		
- Excluded Grants and Technical Assistance (184)				-		
Total Assets			12,489.95	12,682.34	287.63	25,459.92
C- Cost Sharing						
Total Administrative Expenses						224.66
Total Depreciation						4.68
Total Administrative Expenses Including Depreciation						229.34
D- Total Non Sharable Expenses (Direct Administrative Exp)			11.67	-	-	11.67
E-Trust Funds Management Fees	FFCO 1		0.93			0.93
F- Total Sharable Expenses						216.74
G- Share of Expenses:						
Operational Expenses	COBS					152.71
Operational Expenses/ (Total Administrative Expenses)						70.46%
Non Operational Expenses						64.03
Non-Operational Expenses/ (Total Administrative Expenses)						29.54%
H - Final Share						
Share of Operational Expenses	FFMA		0.13	0.56	0.02	70.46%
Share of Non Operational Expenses			0.14	0.15	0.00	29.54%
Total Share			27.19%	70.94%	1.87%	100.00%
Sharable Expenses			58.93	153.75	4.06	216.74
Direct Expenses			12.60	-	-	12.60
I- Administratives expenses			71.53	153.75	4.06	229.34
BUDGET PART						
			ADB	ADF	NTF (**)	Total
Total Bank Group Administrative Actual Expenses	224.66					
<i>Less Direct Administrative Expenses including:</i>	11.67					
- Total Non Shareable expenses for ADB	11.67					
- Total Non Shareable expenses for ADF	0.00					
<i>Less Revenues from the Management of Trust Funds</i>	0.93					
Sub-Total for Actual less Direct Administrative Expenses			57.66	150.43	3.97	212.07
Shared Depreciation			1.27	3.32	0.09	4.68
Total Shareable Expenses			58.93	153.75	4.06	216.74
Total Sharable Expenses in Percentage			27.19%	70.94%	1.87%	100%
Plus Direct Expenses & Revenues from the Management of Trust Fund						
Direct Administrative Expenses			11.67	0.00	0.00	11.67
Revenues from the Management of Trust Funds			0.93	-	-	0.93
Total Administrative Expenses			71.53	153.75	4.06	229.34
Total Administrative Expenses			31.19%	67.04%	1.77%	100.00%

(*) See next pages for more informations on the source of data

(**) In the event that the share of actual Bank Group Administrative expenditure attributable to NTF exceeds 20% of NTF gross income, the excess over such percentage is borne by ADB.

Note: ADF figures, compared to table 2, have been adjusted to avoid double counting for projects which have grant and loan components.

Information on the Source of Data

Items	Information
a- Number of projects & programmes of loans approved during the year	Figures are obtained from the Annual Report and from ESTA 1 when the Annual Report is not finalized
c- Number of project financing grants approved during the year	
e- No of technical assistance loans & grants approved during the year	
b- Number of projects & programmes of loans under execution at the end of the previous year	Figures are obtained from a file on Loan Status produced by FFCO4
d- Number of project financing grants under execution at the end of the previous year	Figures are obtained by adjusting the data from FFCO4 file on loan status based on historical approval of project financing and technical assistance grants.
f- No of technical assistance loans & grants under execution at the end of the previous year	
Trust Funds Management Fees	Figures are obtained from FFCO 1
Share of Operational Expenses	Figures are obtained from COBS document providing the breakdown of the expenses of each operational unit.
Share of Non-Operational Expenses	
Final Share	The final share by company for operational/non operational expenses is obtained by applying the cost sharing formula.

Description of Key Adjustments to the Formula

	Items	Old formula	Proposed Formula	Adjustments
Weights of operational items	a- Number of projects & programmes of loans approved during the year	100%	100%	<ul style="list-style-type: none"> • The new weights are based on the results of the survey. • The figures used for the portfolio under execution exclude loans and grants under execution that have not been disbursing nor repaying for more than a year since their approval.
	b- Number of projects & programmes of loans under execution at the end of the previous year	100%	50%	
	c- Number of project financing grants approved during the year	30%	100%	
	d- Number of project financing grants under execution at the end of the previous year	30%	50%	
	e- No of technical assistance loans & grants approved during the year	30%	50%	
	f- No of technical assistance loans & grants under execution at the end of the previous year	30%	30%	
ADF Assets (UA million)	MDRI loan cancellation	4069.9	2034.95	50 % weight applied
	HIPC Grants	1351.48	-	Excluded
	Grants and technical assistance	184	-	Excluded
Direct Expenses	Private sector expenses	-	10.82	Private sector administrative expenses are excluded from total administrative expenses and applied to ADB as direct cost
Share of expenses	Operational expenses share	71.86%	70.46%	The new share operational/non operational expenses was obtained after removing the Private sector expenses from Total expenses.
	Non operational expenses share	28.14%	29.54%	

Current operational expenses share by company formula

$$\frac{(a+b)+30%*(c+d+e+f)}{(\sum a+\sum b)+30%*(\sum c+\sum d+\sum e+\sum f)}$$

Where \sum_i represent the total of the item i

Proposed operational expenses share by company formula

$$\frac{(a+c+50%*e)+50%*(b+d+30%*f)}{(\sum a+\sum c+50%*\sum e)+50%*(\sum b+\sum d+30%*\sum f)}$$

Where \sum_i represent the total of the item i

Annex 7: Impact of Proposed Changes on ADB and ADF Cost Shares for 2009

		ADB Cost Share	ADF Cost Share	Comments
Current Formula		27.42%	70.84%	
Impact of Short-Term Adjustments				
1	Excluding private sector costs from the formula and charging them to ADB	25.93%	72.29%	This propose change results in an increase of the ADF cost share primarily because the number of approved and active ADB loans reduces when Private sectors expenses are charged directly to ADB
2	Reduce ADF assets amount by removing HIPC and grants and technical assistance, and apply a weight of 50% on MDRI amount	30.13%	68.11%	The rationale for applying a 50% weight for MDRI and excluding HIPC assets when sharing non-operational expenses is that these assets generally require limited loan administration.
3	Applying a 50% weight to loans and grants in the active portfolio (under execution) .	31.54%	66.56%	This recommendation also a more significant impact on ADF because of its larger volume of active loans. The 50% weight is based on the results of the survey.
4	Applying adjustment to Project Financing Grants and Technical Assistance Grants as follows: - 100% for project fin. Grants approved during the year - 50% for project financing grants under execution - 50% for TA grants approved during the year - 30% for TA grants under execution	31.06%	67.24%	The proposed weights are based on the results of the survey. ADF share is slightly reduced because of its relatively higher number of project financing grants and TA grants.
5	Excluding inactive loans and grants (i.e. loans and grants that remain unsigned for more than 12 months)	31.19%	67.04%	This recommendation has a more significant impact on ADF because of larger volume of inactive loans.

[Annex 8](#)
[Analysis of the Questionnaire held in September 2010](#)
[on the Review of the Bank's Cost-Sharing Formula](#)

QUESTIONNAIRE FOR OPERATIONS STAFF ON TIME SPENT ON PROJECT CYCLE ACTIVITIES

1- BACKGROUND & PURPOSE OF QUESTIONNAIRE:

Until recently, the Bank Group had not used time sheets to record the time spent by Operations staff on various project cycle activities. The absence of time sheets has presented difficulties in the current review of the formula for sharing administrative costs between ADB, ADF and NTF. Specifically, without information on time spent, it is not possible to determine how to translate the number of outputs (project loans, TA loans, project-financing grants and TA grants) into costs. **The purpose of this questionnaire** is to request your help in providing your best estimates of the time you spent on project cycle activities.

2- INFORMATION REQUESTED:

Taking into account your recent experience in **2008 and 2009** with the origination and execution of project loans, TA loans, project-financing grants and TA grants, please provide in the table below your **best estimate of the average time (in number of days) that you spent per project, in EACH YEAR 2008 and 2009**, for each type of lending instruments and for the 5 groups of project cycle activities listed in the table below.

In the "**Comments**" column, please explain briefly the **operational reasons** (ADB internal or client-related) why the time spent on any particular group of activities is different between project loans, TA loans, project-financing grants and TA grants.

In providing your response, please carefully note the following:

1. You are requested to estimate **your average time spent per project, on each activity for all ADB and ADF projects, in EACH YEAR in 2008 and 2009**, where you were responsible for performing the activity.
2. **You are not required to estimate the total time** spent on an activity in the years before 2008.

For illustration purposes, Annex A of this questionnaire presents the responses provided by a staff in OITC
3-QUESTIONNAIRE

Staff member Name _____ Dept _____ Division _____

Time Spent – Please provide **the Average Number of Days** spent **per Project** for each type of Lending instruments and during the various phases of the project cycle, **in EACH YEAR in 2008 & 2009 for the 2 windows ADB and ADF¹**

Project Phases	Detailed Steps	Lending Instruments								Comments
		Project Loans		Technical Assistance Loans ²		Project-Financing Grants		Technical Assistance Grants ²		
		ADB	ADF	ADB	ADF	ADB	ADF	ADB	ADF	
Phase 1 – Origination	Identification, Preparation, Assessment & Review process ³									
	Appraisal & Review Process									
	Negotiation & Approval ⁴									
Phase 2 – Execution	Signature, Administration, Supervision & Mid-Term Review ⁵									
	Completion									

¹ NTF is not included in the table due to the limited volume of operations.

² Includes: Institutional Capacity Loans and Grants.

³ Includes: Lending Program Preparation (LPP), Mission Program Preparation (MPP), Identification (IDEN), Preparation (PREP), Environmental Assessment (ENVA), Risk Assessment (RISKA) and Legal Assessment (LEGA).

⁴ Includes: Negotiation (NEGO), Approval (APPV) and Effectiveness (EFFE).

⁵ Includes: Signature (SIGN), Launching (LAUNC), Loan Administration (LOAD), Supervision (SUPE), Work Outs (WRKO), Follow Up (FLUP) and Mid-Term Review (MTRW).

Annex Sample questionnaire completed by a staff in OITC

Project Phases	Detailed Steps	Lending Instruments								Comments
		Project Loans		Technical Assistance Loans		Project-Financing Grants		Technical Assistance Grants		
		ADB ²	ADF	ADB	ADF	ADB	ADF	ADB	ADF	
Phase 1 – Origination	Preparation, Assessment & Review process ³		40							
	Appraisal & Review Process		50							
	Negotiation & Approval ⁴		5							
Phase 2 – Execution	Signature, Administration, Supervision & Mid-Term Review ⁵		10							
	Completion									

This sample questionnaire was completed by a staff in OITC for illustration purposes and indicates the following:

- The staff member primarily worked on ADF Project loans and was not involved in technical assistance loans and project financing grants in each year in 2008 and 2009.
- In each year in 2008 and 2009, the staff member spent on average **40 days per project** for the preparation and assessment of projects and **50 days per project** for the appraisal and review process. It is important to note that the staff member may have worked on several projects during these 2 years, but was requested to provide only the information on the average time spent per project.
- The staff member was not able to complete the “comments” column because he did not work on various lending instruments types.

Analysis of Responses Received to the Questionnaire

The questionnaire was sent to approximately 200 staff in the sector departments in Operations (OSAN, OSHD, OSGE, OWAS, ONRI, OITC, ONEC) of which 60 staff responded.

The responses are summarized in Table 1 below, prepared by compiling the responses and dividing the total time spent per project for a specific lending instrument and institution, as reported by all staff, by the total number of staff who provided responses in each case..

Table1: Summary of responses received – Time spent by staff per project (in days)

Project Phases	Detailed Steps	Lending Instruments							
		Project Loans		Technical Assistance Loans		Project-Financing Grants*		Technical Assistance Grants	
		ADB	ADF	ADB	ADF	ADB	ADF	ADB	ADF
Phase 1 – Origination	Identification, Preparation, Assessment & Review process	21	26	7	4	NA	26	26	15
	Appraisal & Review Process	25	28	5	4	NA	26	8	12
	Negotiation & Approval	3	4	4	4	NA	6	10	5
Phase 2 – Execution	Signature, Administration, Supervision & Mid-Term Review	17	27	6	8	NA	24	10	15
	Completion	3	17	3	2	NA	18	1	2

**Project financing grants are approved only on the ADF window*

Table 2: Analysis of Total Time Spent during Origination Phase vs Execution Phase

The result is obtained after combining responses for ADB and ADF and adding average time spent per project for each step of the origination phase, as well as for the execution phase

The result of 56% is in line with the proposal to apply a weight of 50% to project during their execution phase and 100% during the origination phase.

Project Phases	Detailed Steps	Project Loans ADB & ADF	Technical Assistance Loans ADB & ADF	Project-Financing Grants ADB & ADF	Technical Assistance Grants ADB & ADF	Total
Phase 1 – Origination	Identification, Preparation, Assessment & Review process	47	11	26	41	
	Appraisal & Review Process	53	9	26	21	
	Negotiation & Approval	7	8	6	14	
TOTAL AVERAGE TIME		107	28	58	76	269
Phase 2 – Execution	Signature, Administration, Supervision & Mid-Term Review	44	14	24	25	
	Completion	19	5	18	2	
TOTAL AVERAGE TIME		63	19	42	27	152

EXECUTION PHASE AS % OF ORIGINATION PHASE : 56%

Table 3: Analysis of Total Time Spent on ADF Project Loans Compared with ADF Project-Financing Grants

The result is obtained by comparing the time spent per project for ADF projects financed by loans and for ADF projects financed by grants.

The time spent on the 2 types of lending instruments is very similar and is in line with the proposal to apply the same weights for project financing grants as for project loans.

Project Phases	Detailed Steps	ADF Project Loans	ADF Project-Financing Grants	ADF Projects financing grants as % of Projects loans
Phase 1 – Origination	Identification, Preparation, Assessment & Review process	26	26	98.5%
	Appraisal & Review Process	28	26	95.6%
	Negotiation & Approval	4	6	140.8%
TOTAL AVERAGE TIME		58	58	100.2%

Phase 2 – Execution	Signature, Administration, Supervision & Mid-Term Review	27	24	91.1%
	Completion	17	18	108.9%
TOTAL AVERAGE TIME		44	43	98.0%

Table 4 : Analysis of Total Time spent on Project Loans vs. Technical Assistance

The result is obtained by comparing the average time spent per project loans to the total average time spent for TA loans and Grants. This result is in line with the proposal of applying to TA loans and grants a 50% weight at the origination phase and a 30% weight at the execution phase.

Project Phases	Detailed Steps	Lending Instruments		Technical Assistance as % of Project Loans	
		Project Loans ADB & ADF	Average for Technical Assistance Loans & Grants- ADB & ADF*		
Phase 1 – Origination	Identification, Preparation, Assessment & Review process	47	27	57%	Technical Assistance as % of Project Loans at origination
	Appraisal & Review Process	52	15	29%	
	Negotiation & Approval ⁴	7	11	157%	
TOTAL AVERAGE TIME		106	52	49%	49%
Phase 2 – Execution	Signature, Administration, Supervision & Mid-Term Review	44	19	43%	Technical Assistance as % of Project Loans at execution
	Completion	19	4	21%	
TOTAL AVERAGE TIME		63	23	37%	37%

*The average for ADB & ADF TA loans & grants is obtained by averaging time spent per project in Table 1

