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DFID

Department for
International
Development

Reference

From:

Ext:

Date:

27 March 2006

CC:

PS/PUSS
PS/Permanent Secretary
Mark Lowcock
Nemat Shafik
Richard Calvert

To: 1. Michael Anderson (*agreed; I am grateful to the team for the work put into this review, which is an important part of monitoring our risks in Iraq; though the review does not explicitly address fraud, I am satisfied that the risk of fraud is much reduced from mid 2005*)

Iraq Programme Team
Special Advisors
Mike Green

2. Martin Dinham [*Agreed. This is a slightly updated version of the draft the SoS saw on the visit to Iraq. There will be a chance to discuss it if he would like to do so, when we meet tomorrow at 13.15. MD 27/3*]

3. PS/Secretary of State

IRAQ: PORTFOLIO QUALITY REVIEW

Issue

1. The Iraq Programme is high risk, so does it represent reasonable value for money and have reasonable impact?

Recommendation

2. I recommend that the Secretary of State take note of the attached review of portfolio quality.

Timing

3. Routine. The Secretary of State discussed a draft of the review with Martin Dinham during his recent visit to Iraq.

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Communications and Parliamentary Handling

4. None at this time. We will incorporate some of this material in standard press lines where appropriate.

Information

5. The Iraq programme has a high concentration (71%) of high risk projects by DFID standards. The attached review assesses the level and types of risks in the Iraq Programme.

6. The review looks at the success/impact scoring across the programme and also at the value for money implications of above average numbers of low scoring projects. It concludes that many of the projects represent value for money even though they are only likely to partially achieve their objectives. Many projects have side-benefits in terms of leverage and influence of other donors or of Iraqi organisations. Measures to mitigate risks are in place.

Senior Programme Manager, Iraq
MENAD

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IRAQ: PORTFOLIO QUALITY REVIEW March 2006

SUMMARY

- 71% of the live Iraq portfolio is High Risk
- Most of the portfolio is subject to similar political and security risks, so room to balance risk is limited
- Political and security conditions are worse than anticipated in 2004
- To date, 44% of the live portfolio scores 1 or 2 in PRISM (objectives likely to be completely or largely achieved). Most projects scored 3 (objectives partly achieved), with only one at 4 (achieved to a very limited extent), and none at 5.
- High Risk projects can be worthwhile and value for money even if they fall short of total success against original objectives
- Many projects have benefits beyond their stated purpose, in terms of setting policy agendas, leveraging other donors' resources and influencing their direction, and giving DFID credibility to influence Whitehall.

INTRODUCTION

1. In September 2003, the UK pledged £544m for reconstruction in Iraq. DFID has delivered its part of the pledge through a mixture of support to NGOs (£6m), contributions to the multilateral effort (£159m), and bilateral technical assistance and investment programmes (£139m). The purpose of this note is to assess the quality of the programming in the Iraq bilateral portfolio.

2. DFID has responded to pressures to act with urgency and to deliver visible results within very short timeframes. This has applied to all our investments – from delivering infrastructure improvements noticeable on the ground, to pressing the World Bank and UN trust funds to disburse quickly and effectively, to showing immediate results from our capacity building work at the centre of Government. The requirement for urgency is related to maintaining political and popular momentum for reconstruction, and the need to demonstrate feasibility to other donors.

3. Although DFID is a small player in Iraq, we have added significant value. Our efforts are dwarfed by the USA's \$18bn reconstruction programme staffed by some 5,000 civilians. But the Coalition has frequently given highest priority to security and political issues, and less priority to other areas, such as institutional capacity building where DFID has made a real difference.

4. DFID has been active in a number of policy areas including economic reform and capacity building. In these areas, we provide intellectual leadership and a challenge function, using our projects as a base to reinforce important policy messages and demonstrate alternative approaches. In this regard, a side benefit of our programmes is that they increase our ability to influence bigger players. For example, we have informed US Embassy thinking about the need to prioritise and sequence economic reforms. We have also had success in helping to ensure that Iraqi authorities and Iraqi perspectives are included in policy debates. We have rigorously prioritised within our own portfolio, confining ourselves to areas where we judge we have comparative advantage.

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5. Iraq is a high-risk environment, and has become riskier over time. There are a large number of significant country risks including a highly volatile security environment, significant foreign military presence, unclear constitutional arrangements, and an oil dependent economy with high levels of unemployment. There is also a sizeable risk of deepening sectarian and intra-Shia violence. The region's desire for greater independence (and share of the oil revenues) is never far from the surface and it is unknown whether the centre will be able to remain in control.

6. In tandem, we face considerable difficulties in engaging with our Iraqi partners. In politics uncertainty over medium term leadership leaves weak incentives for Iraqi officials to act, and distracts most politicians, so that we have had to rely on a few select Ministers to push forward and deliver on the economic and centre of government projects. There is systemic corruption and weak administrative capacity at all levels of Government. Many partners, especially at lower levels, have shown little appetite for strategic planning or engagement with donors. We expect the political and security uncertainties to continue.

7. At the project level, the security situation has steadily deteriorated since late 2003. This has severely restricted the physical movement of DFID and consultant staff for more than 18 months and reduced our ability to monitor, implement and manage our projects. It has also increased the costs of having staff in Iraq. As many of our staff can only infrequently meet with partners or visit project sites, technical issues are often more difficult to solve than in more normal environments. This is especially true on our infrastructure work, but equally applicable to our capacity building projects. Our inability to effectively monitor activities on the ground also increases the fiduciary risk across the portfolio. There are also significant security risks to local staff (i.e. intimidation of site engineers) who work on UK projects.

8. Given this background we have used a range of strategies to achieve the best results from our programme:

- **Constant monitoring and management of individual projects** through weekly reports, weekly videoconferences, regular visits from project teams, and hands on management from staff in-country (all of which is hampered by security).
- Accommodating security conditions by **using innovative techniques** such as working through local Iraqi engineers on our infrastructure programmes and helping the Ministry of Finance set up an office inside the International Zone.
- Using the fragile states analysis to **focus on a few immediate priorities** – strengthening the central Government institutions and getting Iraq's economic reform programme on track – with significant rates of return.
- **Systematically tracking poor performing** projects though the attached matrix (Annex A), monitoring progress and implementing detailed plans for tackling weaknesses.
- **Adapting our method of delivery** where levels of fiduciary risk are judged as too high.
- Building **clear exit strategies** into our projects and dedicating significant effort to leveraging in resources and leadership from other donors, especially the World Bank

- **Working closely with Whitehall** to ensure that other Government departments understand our objectives and use their influence to help us deliver.

9. In hindsight, our original assessments of security (that it would steadily improve) and political risks (that a stable effective government would take office) were optimistic. However, we have adapted our projects' aims accordingly and judge that despite this we have a reasonable chance of significant successes.

10. All DFID postings in Iraq are currently 6 months, but most staff stay an average of 10 months. In London, postings are 12-18 months. Recruiting and retaining high quality staff to operate effectively in a very pressured and hostile environment has proven difficult. The high levels of turn over have reduced our institutional memory and increased the learning curve. At best this has been disruptive, at worst it has led to some poor decisions. There are high rates of "burn out" amongst staff – particularly our consultants – spending extended periods of time in Iraq. That the FCO faces a worse staffing situation than DFID is testimony to the resilience and courage of our staff.

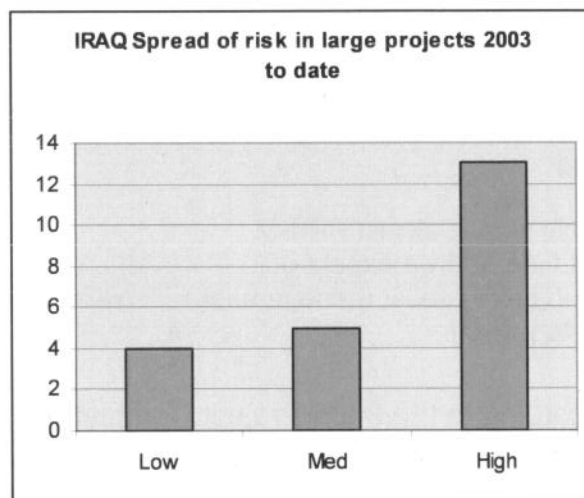
ANALYSING THE IRAQ PORTFOLIO

11. The graphs set out below provide an overview of the risk levels and PRISM scores of the programme.

11a. We are investing most in high risk projects...

22 projects account for 91% of total DFID commitments on Iraq since March 2003. These are the large projects, in excess of £4m. 59% of these projects were assessed as high risk.

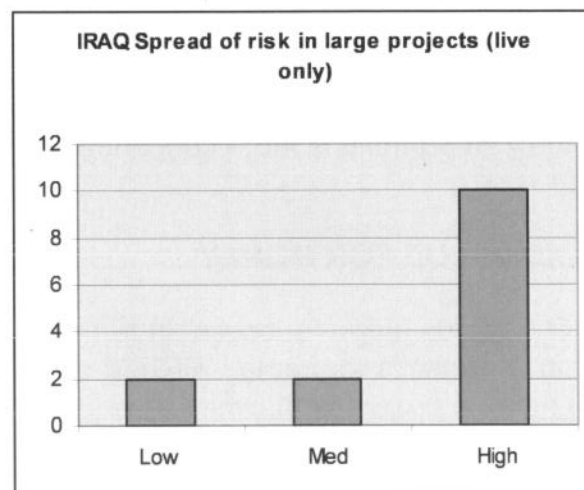
By value, 57% of DFID commitments were high risk.



11b. ...and our portfolio is getting riskier over time

A large and increasing share of projects are assessed as high risk. Of the 15 large projects that are still live, 71% are assessed as high risk.

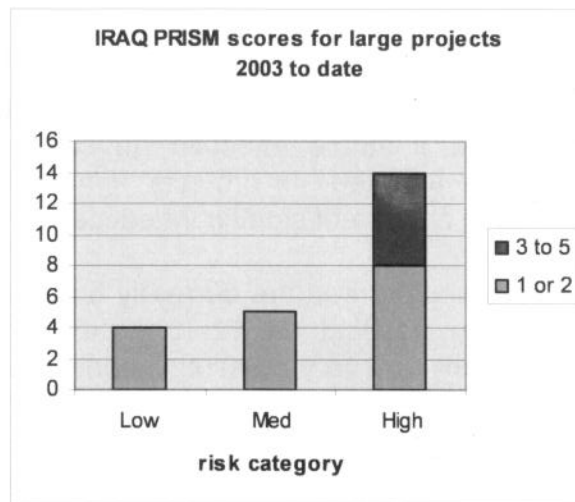
The main risks are due to security and political conditions. These apply across the whole programme, so it is difficult to offset high risk projects with lower risk projects, and to achieve a risk balanced portfolio.



11c. About half the high risk projects are largely successful...

Of the large projects with PRISM scores, most attracted a 1 or 2, meaning they would achieve most of their outputs and objectives.

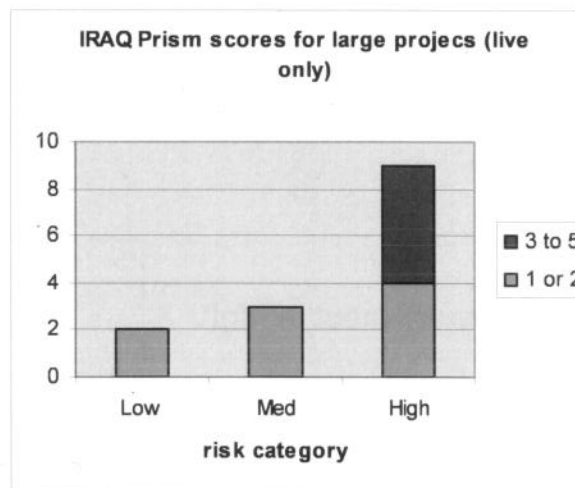
Projects attracting PRISM scores of 3, 4 or 5 were all high risk. These will only achieve some of the purpose or outputs of the project as designed.



11d. ...and this may or may not improve.

Of the large live projects, the majority still score 1 or 2, indicating "mostly successful".

Six out of 10 high risk projects score 3 or less. This accounts for at least 56% of the live portfolio by value. This is not enough to conclude that "success" in the Iraq programme is improving or deteriorating.



More projects should attract PRISM scores over time and we expect our investment in more robust management techniques to pay off.

– not all projects have PRISM scores at this time

NB

12. According to the 2005 Project Completion Report Synthesis, the Iraq programme is riskier and lower-scoring than the DFID average. Some 68% of all DFID projects score 1 or 2, compared to just 44% for Iraq. While the DFID average for high risk projects is just over 10%, over 70% of the Iraq programme is high risk. Across DFID, medium risk projects tend to get better scores than high risk ones, and the same holds true for Iraq. The Synthesis Report also found that discrete service delivery (especially health) and poverty reduction projects tend to score well compared to governance and human rights projects – the Iraq portfolio is more concentrated in the latter areas.

IMPACT AND VALUE FOR MONEY

13. PRISM scores judge "success" in terms of achieving project purpose and outcomes as set out in a project's logframe. PRISM scores do not indicate the degree of success required to make a project worthwhile or value for money. Many high risk projects may be designed to be worthwhile even if successful in only a limited number of their aims. Therefore, an "unsuccessful" PRISM score for a high risk project does not necessarily indicate that it is having a low impact or represents low value for money. A portfolio with

many projects that are high impact as well as high risk can afford a number of "partial failures" yet still achieve an acceptable impact and represent good value for money.

14. In Iraq much of the portfolio is susceptible to the same political and security risks. A deteriorating security situation or political conditions affect the entire portfolio. The Iraq programme has adopted a number of mitigation measures in the face of a worsening security and political situation. In part due to these efforts, we believe that the overall portfolio is delivering useful performance in many areas. Fragile states analysis also indicates that, in general terms, action in post-conflict situations is bound to be high risk but that partial success can still be transformational.

15. Here we assess four live projects with PRISM scores of 3 or less in terms of value for money and likely impact.

- **Iraq Infrastructure Services Programme (IISP)** (April 2005 – March 2007, £40m, scored 3 in November 2005): This project was designed to deliver a package of investments in southern Iraq's power and water infrastructure. It was assessed as high risk at the design stage with security and technical difficulties identified as two key factors. The deteriorating security situation in southern Iraq has caused delays and additional costs to be incurred - hence the PRISM score of 3. But in fact, it is likely that all the individual investments will deliver acceptable rates of return; for example, a recent economic appraisal of the PS2 component estimated a payback within one year. In Baghdad, the project's policy component is facilitating World Bank engagement in Iraq's energy sector, including preparations for IDA loans and advisory services to the Ministry of Electricity and Oil. A thorough Output to Purpose Review is now underway, which will assess these issues in more detail.
- **Southern Iraq Employment and Services Programme (SIESP)** (November 2004 – June 2006, £20.5m, scored 4 in August 2005): This project was designed to support the post-transition period in southern Iraq by increasing employment opportunities and ensuring the maintenance of some essential utilities.

The employment generation side of the project was designed in a way which required lots of monitoring to ensure that money was well spent. The security situation made that impossible and due to weak management some fraud occurred.

On the other hand, the Emergency Response Fund component of the programme is dealing with critical failures in essential services such as power, water, sanitation and solid waste. This Fund has implemented 39 projects including:

- rehabilitation of the control room at Khor Az Zubayr power station, bringing 50MW back to the national grid
- emergency repair of a 132KV transmission line from Hartha power station to parts of Basra city, serving 1.5 million residents
- cleaning 7000 septic tanks providing improved sanitation facilitations to 40,000 residents

One infrastructure element -- Operation Ampere -- is still open. Designed by the military to put in place point power generators, it has been affected by poor Iraqi ownership, uncertain fuel supplies, and a worsening security situation.

- **Economic Reform Programmes I & II** (May 2004 – October 2007, £18m, Phase I scored 3). This is the second phase of our technical assistance programme on economic reform with the Ministry of Finance. We judge our support influential in helping Iraq pull together its 2005 budget and secure the Standby Arrangement with the IMF. Although achievement of these milestones is not due exclusively to DFID's consultants, we have provided valuable thinking on negotiating tactics, presentation issues and policy options. Our team has delivered a package of targeted training to a new Macro-fiscal Policy Department inside MoF which has been instrumental in forecasting revenues and expenditures, although with questionable sustainability. Consequently, while some of our more ambitious objectives for this programme will probably not be achieved, the magnitude of the issues we are tackling means that the overall impact of the programme will remain significant. This also applies to the second phase of the project.

In hindsight, our original objectives were optimistic. The score of 3 for Phase I reflects this, rather than poor performance or inflexibility in delivery. Since the ERP programme played a significant role in delivering an IMF Stand By Arrangement, which in turn triggered phase II of the Paris Club debt relief package, we believe the project represents good value for money.

- **Support to the Centre of Government** (second phase: August 2005 - June 2006, £13.26m, PRISM scoring to be confirmed but likely to be either 3 or 4). This programme was designed to help key institutions at the centre of government develop the structures, capacity and skills necessary to lead and sustain the process of building an effective government in Iraq. It was assessed as High Risk and remains so. The identified risks - which have come to pass - include worsening security, transport and logistical problems, scepticism by the Iraq Strategic Review Board, high turnover of local interlocutors, and resistance to advice. The project was also designed on the assumption that the interim government would become more focused and effective, which has not occurred.

The project's impact on central government structures should be seen in this context. Prior to the project's first phase, the Council of Ministers Secretariat and committees, and Government Communications Directorate did not exist. Not only have they been established, but this phase has seen progress in their operations (although if current constraints continue the overall purpose is unlikely to be met). The project also provides a potential bridgehead for other donors to become active, and a platform for engagement in wider issues such as civil service reform. The team has institutional memory and experience, and is well-placed to engage effectively with a new government.

- **Emergency Public Administration Project** (Feb 04 – date, £4.9m, High Risk, PRISM score 3). This project was designed to provide emergency support to Iraq's system of public administration, and to lay the foundations for longer term development of that system. The project was designed prior to the handover of sovereignty to the Iraq Interim Government. It was successful in establishing short-term capacity within key institutions at the centre of government, responding to needs of caretaking administrations, and providing information for donors. Phase One finished on a positive note with strong support from counterparts in COMSEC and the Prime Ministers Office. There were clear achievements in getting institutions established in an operational way in challenging circumstances.

There was less progress in building capacity in the ministries. This was primarily due to the security situation which made travel very difficult. Other problems included: Iraq's lack of familiarity in dealing with donors and articulating requirements; lack of information before the project started which made focus difficult; constraints faced by the consulting firm Adam Smith Institute (ASI) in prioritising work because of heavy demand at the centre of government; and lack of continuity in ASI management and personnel in key areas (also due to the security situation). Value for money - as opposed to PRISM scoring - has not been separately assessed for this project.

16. In assessing the performance of the Iraq portfolio overall, it should be recognised that even projects which have not or are unlikely to achieve their full outputs and purpose as designed, do have significant side benefits. These include raising the visibility of issues or steering the agendas of Iraqi authorities or other partners. For example, the Ministry of Interior project has a limited direct impact but has put the Ministry of Interior 'on the map' with Whitehall and international partners as a critical department for capacity building effort. Other projects not only leverage other donor resources, but also give DFID the credibility to bring late arrivals up to speed – this is true of some of our infrastructure projects. Support to economic reform has not transformed the Iraqi economy, but has helped cement valuable relationships with the IMF and Paris Club creditors, without which Iraq might be in a much worse state.

MENAD
March 2006

Annex 1: Projects Scored 3 or Below

IRAQ PROJECTS SCORING 3 OR BELOW Updated March 2006		
Project	Score	Purpose, what the problem was and what is being done to fix it
ILAC justice sector project £2.2m Reviewed 6/05 High risk	3	<u>Purpose:</u> Strengthen the independent and professional practice of key actors in the justice sector. <u>What the problem was:</u> Objective was to train judges and other staff <i>in</i> Iraq. But security means this was not possible. <u>What is being done to fix it:</u> Training continues outside of Iraq due to security. But impact will be less than originally planned as no mentoring is possible. Project due to complete 31 March 2006.
Economic reform programme £13m (Phase II) Phase 1 reviewed High risk	3	<u>Purpose</u> To build sustainable capacity within the Ministry of Finance to lead and manage a coherent programme of macroeconomic reform <u>What the problem was</u> High level of political uncertainty in the run-up to and following the elections on 15 December has made our counterparts reluctant to set out a 2 year work programme for our technical assistance. <u>What is being done to fix it</u> We have agreed a package of support to the Government until the new Government takes office. This covers the IMF standby arrangement, fiscal federalism, social safety nets, and communications. We will agree a broader package of support and conduct a review in the summer 2006.
IMF training for Iraq's sub-account £3.1m Reviewed 08/05 Medium risk	3	<u>Purpose:</u> To provide capacity and support to the fledgling government of post-conflict Iraq on key issues of economic governance and financial management. <u>What the problem was:</u> Lack of IMF in-country presence. <u>What is being done to fix it:</u> 'Off-shore' training from IMF is useful to expose Iraqi officials to international best practise. But on-the-ground training, as originally envisaged, would be better. Implementation is slow and unlikely to improve until the IMF sends international consultants to Baghdad. We are in discussion with them to end the project given that progress has been slow. We will conduct a full review in March 2006.

<p>Governorates capacity building project (GCBP)</p> <p>£20.5m Reviewed 11/05 High risk</p>	3	<p><u>Purpose:</u> To implement a new capacity building programme in the four southern Governorates of Iraq. To manage the reconstruction effort effectively and to reduce poverty through local economic development.</p> <p><u>What the problem was:</u> Ineffective consultancy team leadership at the beginning of the project and continuing access and security problems across all four southern governorates.</p> <p><u>What is being done to fix it:</u> Management of the project is now effective following remedial action. A one-year no-cost extension was approved in February 2006 with newly focused outputs meaning there is now potential to achieve a 2. Progress is assessed as good and expected to continue at this level over the remainder of the project period in all output areas. The project has made major progress, but the next 6 months will be critical given the impact of Provincial Reconstruction Teams (PRTs). Innovative ways of working are used by the team (ie use of Iraqi project staff). Advisers are also playing a central role in donor coordination in southern Iraq. We have only made limited progress on this given the difficulties in security and continuing political volatility (Basra governor has cut off communications with UK personnel).</p>
<p>Iraq infrastructure services programme (IISP)</p> <p>£40m Reviewed 12/05 High risk</p>	3	<p><u>Purpose:</u> To address Iraq's short-term and longer-term infrastructure needs, particularly power and water in southern Iraq.</p> <p><u>What the problem was:</u> Delays; not meeting deadlines; risk of not delivering infrastructure in difficult security situation; movements severely constrained since 7 September (emergence of deadly IEDs and just prior to Warrior incident); sub-contractors sometimes experiencing hostility to UK staff (ie builders on the water tower project were intimidated by local militias); management difficulties with Technical Advisory Team (TAT) managing the IISP team; delays to capital goods procurement; and project selection limited by security options and by Iraqi central government vacillation.</p> <p><u>What is being done to fix it:</u> TAT removed from management line. Increased use of Iraqi staff to attend meetings and visit sites. Use of digital photographs and videos to enable international staff to verify work at sites. Working group established between DFID and MND(SE) to manage risks on delivery of key projects. Working closely with Crown Agents to resolve procurement problems. Continued close monitoring of timelines. SAIC appointed in Baghdad to liaise with Ministries.</p>
<p>Southern Iraq Employment and Services Programme</p> <p>£24.5m Reviewed 12/05 High risk</p>	4	<p><u>Purpose:</u> To support the post-transition period by increasing employment opportunities and ensuring the maintenance of essential services.</p> <p><u>What the problem was:</u> Employment very difficult to monitor in security situation, and some fraud occurred. Infrastructure programme had difficulties in implementation, especially Operation Ampere (summer generation capacity pushed by MOD). We have hit a series of technical delays.</p> <p><u>What is being done to fix it:</u> Emergency internal audit of employment generation programme to address immediate financial management issues. Termination of activities where limited monitoring revealed lack of impact or possible fraud. Infrastructure programme also needs a bit more equipment and training before an expected finish in June 2006.</p>

<p>Support to the centre of government – phase II (SCOG)</p> <p>£13.6m</p> <p>Results of review not yet finalised</p> <p>High risk</p>	<p>(3 or 4 likely)</p>	<p><u>Purpose:</u> To help key institutions at the centre of government develop the structures, capacity and skills necessary to lead and sustain the process of building an effective government in Iraq.</p> <p><u>What the problem was:</u> Changing Ministerial personal resulted in low commitment to project activities. Initial timeframe for programme very ambitious, given that central institutions had to be established from scratch.</p> <p><u>What is being done to fix it:</u> Use of qualified returning Iraqis to improve government confidence in the technical assistance. Fortunately recent changes in government personal suggest more positive attitude towards the programme. PM particularly keen to use consultants to improve systems. However, uncertainties in the future make-up of government make medium term planning, essential for capacity building efforts, difficult. Need to rethink approach during this hiatus. Governance Adviser due to visit to make full assessment of options.</p>
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IRAQ: CURRENT PORTFOLIO OF LIVE PROJECTS

Project	Start date	£m	PAM	Risk	Score
Iraq Infrastructure Services Programme	15-Jun-05	40,000	Inclusive	High Risk	3
Southern Iraq Employment and Services Programme	23-Aug-04	24,500	Enabling	High Risk	4
Capacity Building in the Southern Governorates	06-Aug-04	20,500	Enabling	High Risk	3
Emergency Infrastructure Project	01-Sept-03	20,000	Inclusive	High Risk	2
Red Cross 2005 Appeal	17-Mar-05	14,000	Focused	Low Risk	
Support to the Centre of Government	22-Jul-05	13,260	Enabling	High Risk	(3 or 4)
Economic Reform Programme II	05-Jan-06	13,000	Enabling	High Risk	
Iraq : Small Business Finance Facility	29-Mar-04	8,500	Enabling	Medium Risk	
Technical Advisory Team Transition Programme South	09-Sep-04	7,400	Enabling	Medium Risk	
BBC World Service Trust	07-May-04	6,735	Inclusive	High Risk	2
Civil Society Fund	01-Jun-04	5,000	Enabling	Medium Risk	3
Political Participation Fund	13-Oct-04	5,000	Enabling	High Risk	
Emergency Public Administration reform	30-Apr-04	4,900	Enabling	High Risk	3
Economic Reform & Transition	08-Jul-04	4,680	Enabling	High Risk	3
IMF Support – Technical sub account for Iraq	01-Jul-03	3,150	Enabling	Medium Risk	3
Iraq Inter. Legal Consort (ILAC) Justice Sector	06-Feb-04	2,286	Enabling	High Risk	3
Media Development Project	01-Aug-03	1,156	Enabling	High Risk	1
Iraq : Support for Donor Coordination and Liaison	01-Aug-04	1,116	Enabling	Medium Risk	
UNEP Post Conflict Environmental Assessment	02-Feb-04	717	Enabling	Medium Risk	n/a
Solidarites Sanitation	05-Feb-04	215	Inclusive	Medium Risk	n/a
Humanitarian Advice to the Iraqi Interim Government	01-Jan-05	175	Enabling	High Risk	n/a

PRISM Scoring System:

- 1 = Likely to be **completely** achieved
- 2 = Likely to be **largely** achieved
- 3 = Likely to be **partly** achieved
- 4 = Only likely to be achieved to a **very limited extent**
- 5 = **Unlikely** to be achieved
- X= Too early to tell

NB - Some of the above projects have yet to be scored.

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