National Audit Office

Report
by the Comptroller
and Auditor General

Department for International Development

Oversight of the Private Infrastructure Development Group

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Key facts

£700m	70%	185m
maximum anticipated DFID funding of PIDG between 2012 and 2015	DFID's share of all donors' funding to PIDG by the end of 2013	number of people PIDG estimates will benefit from better services because of its agreed projects

£6.2 billion	reported by PIDG as the level of total investment in 35 PIDG-supported projects which are fully constructed and operational, including £220 million of donor funds
96 per cent	of DFID country teams agreed that lack of adequate infrastructure was a major barrier to economic development
£27 million	average amount of DFID's funding held unused in the PIDG Trust between January 2012 and February 2014
50 million	number of people PIDG estimates will benefit from new services from its investment in one project alone
12	deals agreed by PIDG in 2013, compared with a target set in 2012 of agreeing 20
£6.5 million	amount paid by DFID to PIDG in December 2011, which was only paid out to the relevant PIDG facility in April 2014
11,500	estimated number of jobs created partly because of PIDG's investment in a Ugandan hydroelectric power plant

Summary

1 The Department for International Development (DFID) leads the UK's effort to fight global poverty. In recent years, DFID has focused on boosting economic development. It considers that while economic growth in poor countries has increased in the last decade, for several countries it remains far below levels needed to lift them out of poverty.

2 In January 2014, DFID published a strategic framework: '*Economic development for shared prosperity and poverty reduction*'. It considers that trade and investment contribute to economic development and thus help countries move from aid dependency, by raising productivity, creating jobs and boosting incomes. Inadequate infrastructure, shallow financial sectors and weak capital markets are major barriers to trade and investment. DFID told us that it plans to double spending on economic development to £1.8 billion by 2015-16, subject to there being enough proposals providing value for money.

3 DFID identifies a need for substantial infrastructure investment in developing countries which cannot be met by public funding and aid alone. It therefore aims to increase private investment from both international and domestic investors. It describes the Private Infrastructure Development Group (PIDG) as the most important way of supporting this aim. PIDG is a multilateral organisation, founded by four donors including DFID in 2002, and governed by development agencies from eight countries and the World Bank.

4 PIDG seeks to overcome reluctance to invest because of concerns about finance shortages, high initial costs and low skill levels. It aims to operate where the private sector would not otherwise invest, to demonstrate the commercial viability of infrastructure projects. Donors commit funds which PIDG invests through its investment vehicles ('facilities') to mobilise investor capital and expertise for infrastructure investment. By stimulating infrastructure investment, PIDG expects to deliver substantial benefits to people in developing countries, including more and better services and jobs. This model is widely seen as innovative.

5 DFID sees PIDG as unusual among multilateral bodies in its focus on poor and fragile states, providing a means of targeting support at the countries where needs are greatest. DFID has increased its funding of PIDG from a total of £49 million in 2010 and 2011, to £258 million in 2012 and 2013. It also established a performance-related 'contestability mechanism' under which facilities can apply for £223 million of extra funding.

Scope and approach

6 This report examines whether DFID's interests in, and oversight of, PIDG deliver value for money and secure benefits for those in poverty in the targeted countries. Our focus is on DFID's role and interests. We considered PIDG performance in this light, but we did not audit its operations, projects or results. The report examines:

- DFID's strategy and the role of PIDG (Part One)
- Governance and engagement (Part Two)
- Reporting to DFID on PIDG's performance (Part Three)

Findings

DFID's growth strategy

7 **DFID has brought together a wide range of evidence to inform its growth strategy.** It has clearly articulated the role of infrastructure in promoting economic growth, gaining commitment from its country teams, 79 per cent of whom said that they were seeking to address a lack of private infrastructure investment. However, gaps remain in the evidence for the links between infrastructure investment and poverty reduction. DFID recognises the need to learn from its use of PIDG to increase the impact of its infrastructure work (paragraphs 1.15 to 1.17, 2.34 to 2.35).

8 **We consider that DFID's decisions to invest in PIDG have sometimes been based on insufficient analysis and scrutiny.** Its 2011 business case for a rapid scale-up of funding was informed by its multilateral aid review, which stated that PIDG was 'very good value for money'. We have previously concluded that the review is a much improved basis for allocating funding. However, the business case did not explain the reasons why it was appropriate to allocate £700 million between March 2012 and March 2015, or how funding should be allocated across facilities. It was also informed by the 2011 PIDG governance review but did not make governance reforms a condition of funding. Because it considered that its analysis in the multilateral aid review had been sufficiently scrutinised, DFID decided not to ask its quality assurance unit to assess its business cases for investments in multilateral bodies. This was despite the experimental nature of PIDG and the risks involved in its investments (paragraphs 1.24 to 1.26).

9 DFID wants PIDG to remain a multilateral body, with other donors closely engaged in its governance and operation. But DFID's rapid increase in funding could affect the relationship between PIDG and other donors. DFID contributed 88 per cent of PIDG funding from 2012 to 2013 inclusive and recognises that PIDG is still evolving. DFID's relationship with PIDG is therefore different from that which it has with other multilateral bodies. Its increased funding could produce an imbalance between the control of PIDG, shared equally between donors, and the risks to the UK. This could affect relationships with other donors, who already contribute fewer staff and financial resources. DFID told us that PIDG's governing council has considered the situation in detail, with other donors concluding that they were content that DFID continue to provide substantial funding (paragraphs 1.27 to 1.30).

10 The PIDG projects we reviewed will provide benefits – often for many people and in difficult environments. Projects are also likely to have unrecognised positive impacts. For instance, researchers from the Overseas Development Institute assessed that a PIDG-funded power plant in Uganda would create up to 11,500 jobs. Community and government representatives in recipient countries were largely positive about PIDG's innovative approach and the abilities and engagement of its employees (paragraphs 1.10 to 1.14, 3.17, Appendix Three).

Governance and engagement

11 DFID has increased its resources for overseeing PIDG and wields more influence than other donors. DFID's team has grown in three years (from 1.4 full-time equivalent employees to 4.7). DFID provides more challenge than most donors, and its central team engages well at governing council level (paragraphs 2.25 to 2.33).

12 DFID has worked to improve PIDG's governance and strategic thinking, but some of its processes have not evolved sufficiently rapidly to keep pace with its increased scale. PIDG has undertaken a programme of reforms and, encouraged by DFID, plans to commission a wide-ranging governance review in 2014. It has improved communications, established a chair's office, adopted a new code of conduct and operating procedures, and brought more financial expertise into its programme management unit. PIDG plans to introduce a live high-level risk assessment covering all board activities and wider developments, but this has not yet been implemented. PIDG's current governance model relies heavily on the commitment and capacity of non-executive board members. We found that they have a good mix of relevant skills, although their focus is more on financial than developmental impacts. As non-executives, they are only employed for up to 30 days a year, but, as PIDG grows, they have taken on executive functions. Some boards have responded by appointing executive management support (paragraphs 2.2 to 2.18).

13 **We consider that DFID has not ensured sufficient monitoring and transparency of PIDG administrative costs, although recent developments should strengthen PIDG's processes.** PIDG's travel policy allowed fully flexible business class fares for flights of more than four hours. Under this policy, some board members made large expense claims, for instance 15 flights booked since 2011 for more than £5,000 each. DFID told us that it has been working to tighten travel policies across multilateral organisations it supports, in line with the government's increased emphasis on controlling spending. PIDG is now improving spending procedures in key areas, informed by work commissioned after possible irregularities in administrative costs were missed for several years. In July 2014, it introduced a new travel policy excluding fully flexible business class fares. PIDG has not regularly published or monitored its total administrative and operational costs, which we estimate were £23.8 million in 2012, representing 2.8 per cent of funds available to invest (paragraphs 2.19 to 2.23, 3.30 to 3.32).

14 **DFID has not yet achieved effective communication and coordination between PIDG and DFID's country teams.** PIDG represents a large, high-profile and innovative investment for DFID in a policy area it is targeting. We saw some examples of the benefits of liaison, but several DFID country teams were concerned about a lack of coordination between their activities and PIDG. They were sometimes unaware of important project developments, potentially putting DFID's reputation at risk and meaning missed opportunities for cooperation. DFID plans to improve liaison between its country teams and multilateral bodies, focusing on the biggest and riskiest decisions (paragraphs 2.34 to 2.38).

PIDG's performance reporting to DFID

15 **PIDG reporting is transparent and wide-ranging, and it claims significant developmental impacts, although evaluation and external assurance are limited.** PIDG reports that nearly 185 million people will have new or better services because of its projects to date, and 214,000 people will have long-term employment. PIDG has sought to improve its comparatively advanced reporting of hard-to-measure impacts, working with other development finance institutions. It also has a schedule of periodic independent facility reviews, and had conducted 12 by the end of 2013. However, despite its experimental nature, PIDG has so far commissioned only one detailed project evaluation, and one independent evaluation of a facility. PIDG's quality assurance and verification system relies on data provided by projects, with limited external assurance. PIDG donors agreed in June 2014 to consider scaling up monitoring and evaluation, and committed US$250,000 to the evaluation of employment impacts (paragraphs 3.2 to 3.8).

16 DFID has encouraged improvements to performance reporting, but given PIDG's multilateral status, it relies on PIDG's own performance assessments. DFID has encouraged PIDG to be innovative in reporting its development performance, and it publishes a wider range of impacts than several more-established multilateral bodies. However, although we saw some evidence of challenge, DFID largely accepts PIDG performance estimates as accurate, using them in business cases and annual reports. The limitations in PIDG's reporting and quality assurance create the risk that DFID understates or overstates the achievements arising from its funding (paragraphs 3.9 to 3.11).

17 PIDG's estimated total impacts rely on a few projects, raising risks for DFID that are not systematically assessed. One project alone accounts for 50 million people projected to receive new services (45 per cent of the total claim), but PIDG is a small contributor and the project is facing difficulties. Support for another company accounts for 75 per cent of all expected long-term jobs created. It is unsurprising that project effects vary in size, particularly where projects may be transformational, but it raises risks to PIDG's overall expected impacts. We saw little evidence that PIDG and DFID were considering the risks to expected development impacts on a portfolio basis (paragraph 3.12 to 3.13).

18 DFID has encouraged PIDG to set targets for investment in low income and fragile states and for project numbers. PIDG reports mixed success in achieving them. PIDG exceeded two of its three key performance targets set in 2011, missing one for investment in poor countries. Three of the main DFID-funded facilities missed their latest targets for agreeing deals; and PIDG has pushed back milestones in response. PIDG has identified potential projects for DFID's new initiatives, but experience suggests projections may be over-optimistic (paragraphs 3.22 to 3.28).

19 DFID paid some money into the PIDG Trust well before funds were paid out to facilities, because of over-optimistic expectations. Between January 2012 and February 2014, an average of nearly £27 million of DFID funding remained in the Trust. Depending on assumptions about alternative uses for this money, the opportunity cost to the UK taxpayer was between £0.2 million and £2 million. One DFID payment, of £6.5 million, was in the Trust between December 2011 and April 2014. DFID kept its holdings under review but was too optimistic about when the funds could be used. It explains the delays as due to difficulties in agreeing changes to PIDG's operating model and establishing new initiatives. DFID has encouraged PIDG to develop a central Treasury Policy by July 2014, and has agreed to use promissory notes for some future payments. Following actions by DFID and PIDG, the balance of DFID funding in the PIDG Trust fell to £5.9 million at the end of May 2014 (paragraphs 3.33 to 3.36).

Conclusion on value for money

20 DFID's investment in PIDG is a key plank in its strategy to encourage private sector development in poor countries, helping to mobilise private investment and provide vital infrastructure. While gaps in the evidence remain, the use of commercial expertise to support private infrastructure investment aligns with DFID's evolving strategy. Many PIDG projects look likely to achieve both good development impacts and financial returns, often in difficult environments.

21 DFID has successfully encouraged PIDG to improve its targeting of investments and performance reporting. But its oversight of PIDG has overall been insufficient to ensure value for money from its substantially increased funding. PIDG is providing important benefits to poor people, but DFID lacks sufficiently robust information to demonstrate that investment in PIDG is the best option. DFID's financial control has also been lacking, allowing the PIDG Trust to hold DFID funding averaging nearly £27 million since 2012. DFID has recently made good progress in tackling these issues, which will put it in a better position to achieve value for money. But we consider that it should have taken more action earlier given its decision in 2011 to increase funding for PIDG fivefold.

Recommendations

22 DFID should:

a **Improve how it critically reviews its funding of the activities of multilateral bodies such as PIDG, only releasing funds once there is a clear need for the money and the capacity to make good use of it.** This will enable it to compare PIDG with other options and avoid large unused cash balances.

b **Do more to hold PIDG to account at governing council meetings and other engagements.** DFID is responsible for large sums of UK taxpayers' money invested through PIDG. It needs to ensure that it and other donors have the information and capacity to ensure this is spent wisely, for instance by improving central oversight mechanisms, increasing analysis of development impacts and providing greater challenge of the data it receives.

c **Promote closer liaison between its country teams, other parts of HM government and PIDG facilities, and increase awareness of its support for PIDG in recipient countries.** This will help to tackle problems with projects before they become intractable, and to promote the UK's role in supporting private infrastructure development. DFID should ensure that its country office programmes complement and collaborate with the riskiest activities of multilateral bodies where possible.

23 Using its position as the largest PIDG donor, DFID should:

a **Ensure the governance review planned for 2014 assesses PIDG's procedures independently and comprehensively**, particularly the capacity of boards to handle increasing workloads. This should include a review of how to ensure value for money from the management of the PIDG Trust.

b **Promote greater scrutiny of key risks by the donors' governing council.** This should include assessment of development performance, project pipelines and financial controls. A more structured approach to risk and long-term planning would help donors to engage effectively with strategic issues.

c **Support rigorous independent evaluations of facilities and projects**, and of the case for infrastructure investment, ensuring that their lessons are widely disseminated. This could help to demonstrate the developmental and commercial effectiveness of PIDG's work to other donors and investors.

d **Encourage an in-depth assessment of PIDG's quality assurance and verification processes**, including their systems for external validation.

24 Given the importance of these issues, we expect DFID to have a clear plan for addressing them before taking further strategic decisions on PIDG. If it decides to invest further in PIDG after 2014-15, it should make funding conditional on governing council agreement to substantial strengthening of PIDG's governance.