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EXECUTIVE COMMITTEE OF
THE MULTILATERAL FUND FOR THE
IMPLEMENTATION OF THE MONTREAL PROTOCOL
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AN ISSUE PAPER ON SUPPORT COST: FOLLOW-UP TO DECISION 34/65

I. Introduction

1. In its Decision 32/31 the Executive Committee requested UNEP to “produce a paper showing how the 13 per cent allowance for support costs was utilized in general terms and also in specific similar projects already implemented”. This decision was prompted by the inclusion of a component on “project assistance monitoring and evaluation” in a request from UNEP for the approval of the RMP of Benin.

2. UNEP submitted the requested document (UNEP/OzL.Pro/ExCom/34/52 and Add.1) to the 34th meeting of the Executive Committee. The document provided detailed information on the use of the programme support cost and on the distribution of funds accruing from this cost between UNEP DTIE (substantive) and UNON (administration). The document also provided an analysis of projects showing how the monitoring and evaluation budget line in an approved and implemented project was disbursed.

3. After considering UNEP/OzL.Pro/ExCom/34/51 and Add.1, the Executive Committee decided:

- “(a) To consider in greater depth, at its 35th Meeting, the issue of support costs, particularly with regard to the possibility of:
 - (i) adjusting the distribution of support costs between the substantive departments and the administrative departments within the implementing agencies;
 - (ii) increasing the support costs paid to implementing agencies for administering smaller projects, without increasing the overall proportion of resources for such costs;
 - (iii) ensuring that any adjustment of support costs would be fully in line with the financial rules and regulations of the United Nations system;
- (b) To request the Secretariat of the Multilateral Fund to prepare an issue paper in consultation with the UNEP Treasurer and UNEP/DTIE.

(Decision 34/65)”

4. The Secretariat discussed the implementation of the decision with the four Implementing Agencies during the interagency coordination meeting held in Montreal in early September 2001. It transpired during the discussion that the issue of support costs of the implementing agencies had been adequately addressed by a Consultant (Pricewaterhouse Coopers) in a study considered by the Executive Committee at its 26th Meeting (UNEP/OzL.Pro/ExCom/26/67). It was therefore agreed that each implementing agency would review the cost distribution as determined by the consultant and confirm their continued validity. The results of the review by each implementing agency is reported in Section II of the paper.

5. In submitting their contributions to the Secretariat for the preparation of this paper, the Implementing Agencies also expressed their views and concerns about the small projects in their portfolio and the implication of such projects on the cost of implementing such projects. The issues related to the possibility of realigning the support cost percentages are discussed in Section III of the paper. Section IV provides information on the financial rules and regulations of the United Nations on support cost.

II. Distribution of support cost

6. In 1998, Pricewaterhouse Coopers, the consulting firm contracted to study the administrative cost of the implementing agencies, used a template with standard cost items to collect cost data from implementing agencies and later calculate the actual administrative cost of each implementing agency in administering Fund projects.

7. The template that the consultant used did not try to distinguish cost distribution between substantive and administrative departments of each agency but rather between direct and other (indirect) costs which are standard accounting principles. In order to address the point raised in the decision about the distribution between the substantive and administrative departments, the Secretariat proposed to the Implementing Agencies the following differentiation of support costs, using the cost items from the Consultant's template:

- Costs incurred by substantive departments: Direct cost of the Montreal Protocol coordinating unit including salaries and associated benefits of staff, project-related travel, rental of office, equipment, office supplies and telecommunications, contractual services; reimbursement to country and field office; direct cost of the executing agencies like domestic implementing agencies and financial intermediaries.
- Costs incurred by administrative departments: Reimbursement of central services including human resources, accounting, management information systems, procurement and legal services, and general office and administration.

8. The Secretariat requested the Implementing Agencies to confirm that the proposed categorization is a reflection of the distribution of cost items in the Consultant's template, and that the categorization was still valid.

9. In their response to the proposal from the Secretariat, UNDP, UNIDO and the World Bank accepted the cost categorization proposed by the Secretariat and provided the cost break-down between the substantive departments and the administrative departments in their agencies, as shown in the following table. UNEP reported that the distribution between the two categories included in its paper to the 34th Meeting was still valid and provided the cost distribution, as shown in the table.

Implementing Agency	Cost by substantive departments as % of total support cost	Cost by administrative departments as % of total support cost
UNDP	92	8
UNEP	60.5	39.5
UNIDO	76	24
World Bank	95	5

The issue on the cost distribution between the substantive and administrative departments within each agency

10. The issue with regard to the support cost distribution between the substantive departments and the administrative departments within each implementing agency should in principle remain an internal management issue of each agency. This would appear to be in line with the agreement of the Executive Committee with each of the agencies. The relevant text from each of these agreements is reproduced below:

UNDP: “The Trust Fund shall be charged with a percentage of all project expenditures made from the Trust Fund which shall, in accordance with UNDP regulations, rules and directives, be utilized by UNDP in reimbursement for support services provided by the selected executing agencies and/or by UNDP itself and would include other support services as required. The amount required for such costs shall be specified in the approved project documents and work programmes.”

UNEP: “The Trust Fund shall be charged with a percentage of all project expenditures made from the Trust Fund, which amount shall, in accordance with UNEP regulations, rules and directives, be utilized by UNEP in reimbursement for support services provided by any selected implementing agencies other than UNEP and/or by UNEP itself. The amount required for such costs shall be specified in the approved project documents and work programmes.”

UNIDO: “The Special Account shall be charged with a percentage of all project expenditures made from the Special Account which shall, in accordance with UNIDO regulations, rules and directives, be utilized by UNIDO and would include other support services as required. The amounts required, as well as agency support costs, shall be specified in the approved project documents and work programmes.”

World Bank: “The World Bank will be reimbursed annually in full for the expenses incurred by it for the activities it undertakes pursuant to these arrangements. The reimbursement will be made on the basis of estimated costs, subject to adjustment as of the end of the Bank’s financial year, and will be charged against the resources of the OTF.”

11. However the cost distribution could become an issue in front of the Executive Committee, if there is reason to believe that an agency had augmented its support cost with resources from the approved project cost.

12. In that case, the Executive Committee may wish to consider an examination of the support cost distribution between the two categories within the agency concerned. Such an examination could be requested from such an agency in the context of the internal and external audit to be conducted by the agency, as stipulated in its agreements with the Executive Committee.

III. Realigning percentage of support cost between large and small projects

13. The Implementing Agencies were requested to provide comments on support costs for small projects. Their responses are summarized as follows:

UNDP: Confirmed that the 13 percent administrative cost does not fully cover the costs of implementing smaller projects. UNDP is bound by its 1998 Executive Board directive that UNDP's core funds can not be used to subsidize trust fund activities.

UNEP: Noted that over 50% of the projects are for an amount that is no more than US \$50,000, and often much less. In each case, the same reporting requirements are applied as for a project ten times greater. Hence, on a proportionate basis, the costs of providing administrative services for these small projects are much higher than those incurred on a large project. Therefore, the projects can be said to be very management intensive.

UNIDO: Reported that the results of a survey in 1998 of a representative sample of small projects showed the administrative cost of such projects were between 16.3 to 24.5 percent.

World Bank: Reported that the limited technical capacity of small industries, the difficulty of tracking and monitoring these projects and its implementation modality through the local financial intermediaries require a higher level of support cost for administering these small projects. However the large production sector projects in their portfolio provided the buffer to balance out the higher cost of the smaller projects and enabled it to achieve an average of 13 percent overall. It also expressed its concern over the likelihood of higher cost of administering the innovative financing schemes that it is developing in its national phase out plans, and the impact of close and on-going interaction between the Bank staff and the national team in implementing the national phase out plans.

14. It is recalled that the current support cost regime was the outcome of an adjustment introduced by the Executive Committee in 1998, and has replaced the initial support cost regime

which was based on a flat 13% across board. The current regime compensates the services of the implementing agencies along the following guidelines:

- To apply an agency fee of 13 percent on projects up to a value of US\$500,000;
- For projects with a value exceeding US\$500,000 but up to and including US\$500,000, an agency fee of 13 percent should be applied on the first US\$500,000 and 11 percent on the balance;
- To assess projects with a value exceeding US\$5,000,000 on a case-by-case basis.

15. The decision of the Executive Committee to assess the possibility of “increasing the support costs paid to implementing agencies for administering smaller projects,” was set within clear parameters that the overall proportion of resources for such costs should not increase. There could be two issues associated with the attempt of realigning the percentages of the support cost.

The issue of future project portfolio

16. The overall financial implications of realigning the support cost percentages will depend on the future project portfolio of the Fund, which in turn is determined by the configuration of the remaining ODS consumption in Article 5 countries. Therefore the examination of the support cost should take a forward-looking approach, especially in the context of the strategic goal of the Fund in future years.

17. From the configuration of the remaining ODS consumption in the majority of the Article 5 countries, work that remains to be done would be mostly in the refrigeration servicing sector and even in the countries which still has some remaining ODS manufacturing industries to be converted, the size of the enterprises might not justify the continuation of the project-by-project approach but rather an umbrella or sector approach. From this perspective, it is expected to see an increase in the number of sector or umbrella projects, RMPs and national phaseout plans rather than individual small projects. These multi-year projects/programmes will require a change of services to be provided by the implementing agencies from recruiting consultants and equipment procurement to providing direct advice on various aspects on implementing compliance. The new services expected from the agencies may require a greater degree of direct consultation between the agency staff and local people in Article 5 countries and the services may spread over a period of several years. How will the support cost regime accommodate this change of services?

18. The RMPs and national/sector phase out plans, depending on the size of the remaining ODS consumption of the countries concerned, could vary significantly in value, however the services expected from the agencies may be the same. In other words a smaller RMP may not demand proportionally less attention from the agency staff than a larger RMP. However if the same support cost percentage is applied to all the RMPs irrespective of their size, the quality of services for the smaller RMPs may not be the same as those delivered to the larger RMPs.

19. Therefore the first issue that should be considered in realigning the support cost percentages is the projected development of the project portfolio of the Fund and the expected services from the implementing agencies to service this portfolio. Could the current support cost regime with the current expenditure level on such cost serve the future portfolio? Or will the

implementing agencies be able to develop a diversified portfolio with varying sizes of projects to accommodate the future development?

The issue of defining a small project

20. The intent of increasing the support cost to smaller projects is to provide greater incentive to developing and implementing these projects, assuming that these projects are currently being under-compensated for support cost, as was indicated in UNEP's paper (UNEP/OzL.Pro/ExCom/34/52 and Add.1). The key to implementing such a policy is to reach these projects.

21. There are different ways of defining a small project and project budget is one of them. While using the project budget as the defining criterion is straight forward and easy to administer, it may not always do justice to the different types of projects which demand a differing level of effort by implementing agencies in administering such projects. For instance a project preparation of \$30,000 may require minimum effort in administration if there are already well developed project templates and a readily available team of local experts. On the other hand a \$30,000 recovery and recycling training project may require searching for a consultant, procuring the training equipment and delivering it to the training site, translating the training material in the local language, selecting the trainees, preparing the training site and scheduling every component for the timing of the opening. The effort of delivering this project is evidently more demanding than the project preparation.

22. Therefore the attempt to defining a small project should go beyond the project budget to look at the effort required in administering different types of projects and the issue is the examination of the criteria to be used in defining small projects.

IV. Financial rules and regulation of the United Nations on support cost

23. The control of the United Nations on support cost is laid down in the Administrative Instruction ST/AI/286 which was issued on 1 January, 1982 under the subject Programme Support Accounts. A copy of the document is available with the Secretariat for reference. In the following only the relevant sections are reproduced.

“PROCEDURES FOR THE APPROVAL AND MANAGEMENT OF PROGRAMME SUPPORT ACCOUNTS

I. General

- A. This instruction covers the management of programme support moneys received in respect of trust funds and of operational funds provided to the United Nations by the United Nations Development Programme (UNDP), the United Nations Fund for Population Activities (UNFPA) and the specialized agencies.

- B. Within the guidelines established in this instruction, the authority to approve and allot programme support budgets in respect of technical co-operation projects implemented by offices away from Headquarters will be delegated to the heads of those offices.

III. Preparation of annual budgets

- B. Programme support resources should be used in areas where a demonstrable relationship exists between the supporting activity concerned and the activities which generated the programme support revenue. In this respect, offices utilizing programme support resources should ensure an equitable distribution among project management, programme management and the central administrative functions (i.e., finance, personal and general services). Programme support resources may be used for substantive backstopping of projects in technical co-operation programmes. The range of object codes for which programme support funds may be used includes:
 - 1. Posts – Professional and General Service;
 - 2. Consultants;
 - 3. Temporary assistance, overtime;
 - 4. Travel;
 - 5. Rental of space;
 - 6. Office supplies and materials;
 - 7. Office equipment;
 - 8. Miscellaneous expenses.”