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RELATIONSHIP BETWEEN CONTINGENCY, SUPPORT AND INSTITUTIONAL STRENGTHENING COSTS

ALLOCATION OF COST COMPONENTS

FRAMEWORK FOR PAPER TO BE CONSIDERED BY THE EXECUTIVE COMMITTEE

Background

1. The Executive Committee of the Multilateral Fund for the Implementation of the Montreal Protocol has, over the last three years, approved funding for a number of non-investment project related initiatives (such as Institutional Strengthening) which are not directly part of the actual ODS phaseout project but which are necessary for program and project implementation. This has evolved in response to the various needs and requirements of implementing a wide variety of activities and investment projects, subject to different approaches to project execution/implementation adopted by the implementing agencies. The Executive Committee has been supportive of these various approaches, realizing that each is more or less suited to specific country-level circumstances.

2. As project implementation progresses, and the various implementation approaches are further refined, new initiatives have been identified by the implementing agencies which, if implemented, would contribute to acceleration of project implementation, funds disbursement, and ODS phaseout. Such initiatives were presented at the 15th Meeting of the Fund Executive Committee (EC). These included requests for funding of training of financial agents and for technical audits upon subproject completion. This lead the EC to raise certain questions about the relationship between these various components, and whether there was any double counting. The elements, and their inter-relationships, which were of particular interest to the EC, included the following:

- Institutional Strengthening
- Implementing Agency Fees
- Financial Agency Fees
- Administrative Costs (including technical audits)
- Training Costs (including training of Financial Agent)
- Contingency

3. On the last point, the EC has already considered a paper (UNEP\OzL....) on this subject and requested that the implementing agencies minimize their requests for contingency fees whenever feasible and possible, particularly with the growing experience in project implementation and the larger volume of actual costs now being documented through project supervision and completion reports. The EC has also issued guidelines on eligibility of various components of Institutional Strengthening activities. The implementing agencies have provided, at different times, clarification on the uses of the other costs which are more closely associated with administrative costs.

4. Clearly, project implementation and overall program development require a number of support activities which need to be funded in order to ensure proper implementation and give assurance to the EC that the allocated Funds are being utilized appropriately. But given the differing implementation approached of the various implementing agencies and their respective costs of doing the Montreal Protocol business, and the different reporting standards and methodologies (UNEP Treasurer is presently

finalizing a standard financial reporting format which all implementing agencies will adopt), there has been some confusion about the relationship between these costs. This paper will attempt to clarify the situation. The framework proposed to be followed for this paper is presented herein. The various sections will be elaborated to provide useful details to the reader.

5. In addition to the two papers referenced above, this paper will also consider findings of the study commissioned by the EC on the administrative costs of the MFMP funding mechanism which was considered by the EC at its 14th Meeting.

Categories of Costs and Definitions

6. The various components which are to be considered in this analysis were listed in the preceding section. Before undertaking a detailed analysis of the inter-relationships between the various components, it is useful to define and classify these into two distinct categories: (a) Project-Related Costs, and (b) Project Implementation Costs.

7. The first category, that of Project-Related Costs, consists in those expenditures which are directly related to the preparation and actual cost of the ODS phaseout projects and that of other activities where funds flow directly to the beneficiary countries (such as institutional strengthening). The second category, that of Project Implementation Costs, consist in those costs incurred by the Implementing Agencies, that is the cost of doing the MP business. This typically includes the Implementing Agency Fee (UNDP, UNEP, UNIDO), Administration, Legal and Processing Costs (World Bank) and Financial Intermediary Fee (World Bank).

8. The distribution of these cost components amongst the two cost categories is illustrated in Figure 1. The full-length paper will also provide standard definitions.

Relationship Amongst the Various Cost Components

9. Each one of the components under study is targeted at achieving a very specific goal or is intended for a specific purpose. The method of illustration used in Figure 2 is called a Vennes Diagram, which provides a convenient way of showing the areas of actual and potential commonality between the various components. Figure 2 illustrates in more detail the nature of the activities which are undertaken within each component and the areas where these activities are (or could be) common among the various components. For example, the common area represented by the letter "A" represents activities that are typically undertaken by the Financial Agents (on behalf of the World Bank) or by the implementing agencies themselves (in this case UNDP, UNEP and UNIDO). These activities may include procurement, disbursement or other related activities. Other observations of significance are:

- Contingency costs are not related to any of the administrative costs incurred by the implementing agencies. Contingency costs are part of the Project Costs. Contingencies are typically based on inflation indices and, for physical contingencies, will be higher for activities where there is little track record of completed costs.

- Institutional Strengthening is usually independent of the other components, although, as will be presented in a subsequent section, certain implementation mechanism do rely on the institutional strengthening components to support project implementation, particularly where no financial agent has been identified

- The costs for Implementing Agency Fee, Financial Agent Fee and Administration are intended to cover the same program management and implementation costs.

<u>Review of Cost Component (under preparation)</u>

10. This section will review each cost component in more detail and clarify the significance of each component to project implementation and the potential areas of overlap if clear definitions and allocation rules are not defined.

11. Some of the questions/issues which will be addressed in this section include the following:

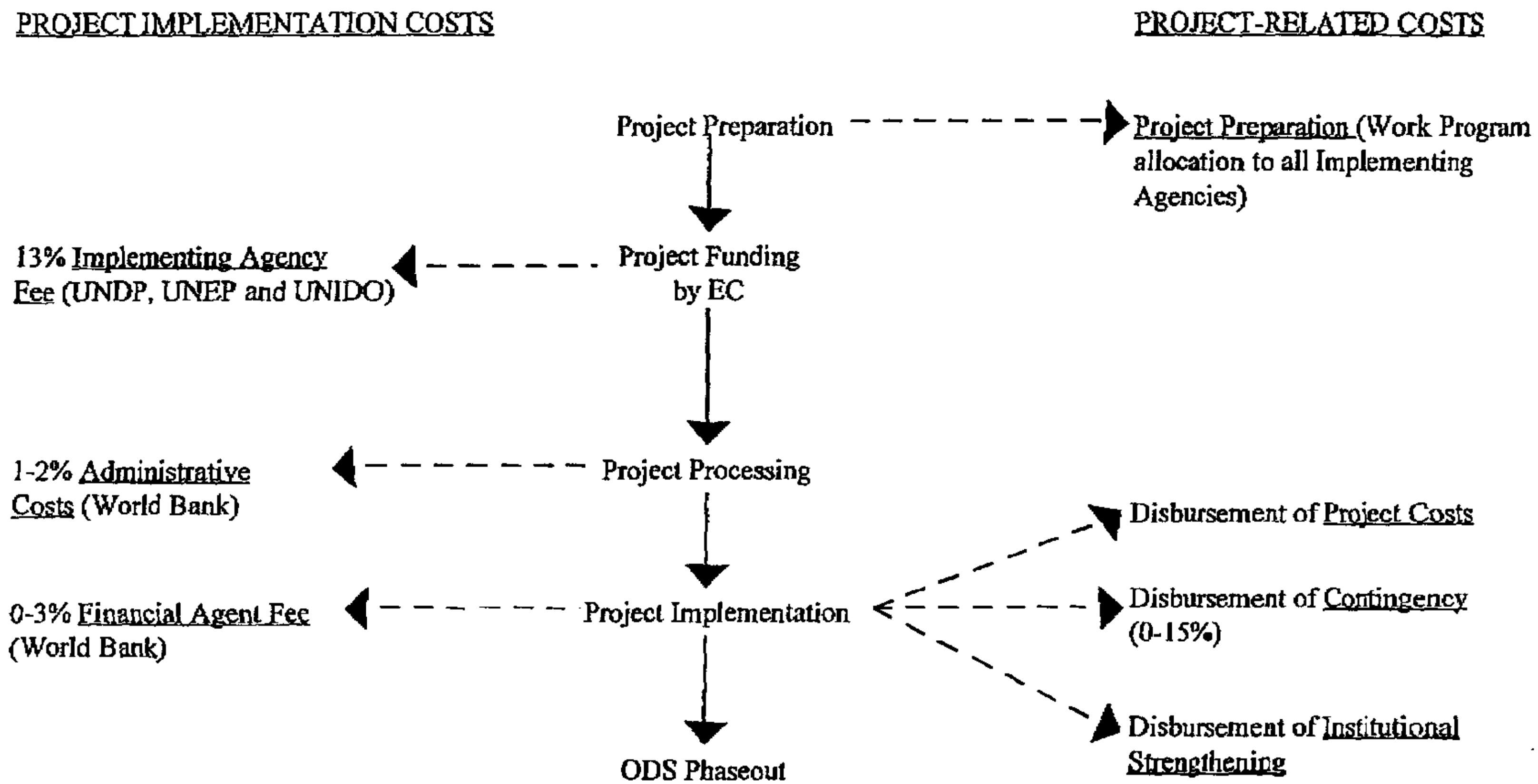
- Relevance of training as a support to institutional strengthening activities.

- Relevance and appropriateness of technical audits and training of financial intermediaries as part of project implementation mechanism.

- The roles of institutional strengthening and financial intermediation in project implementation.

Figure I

Allocation of Various Cost Components



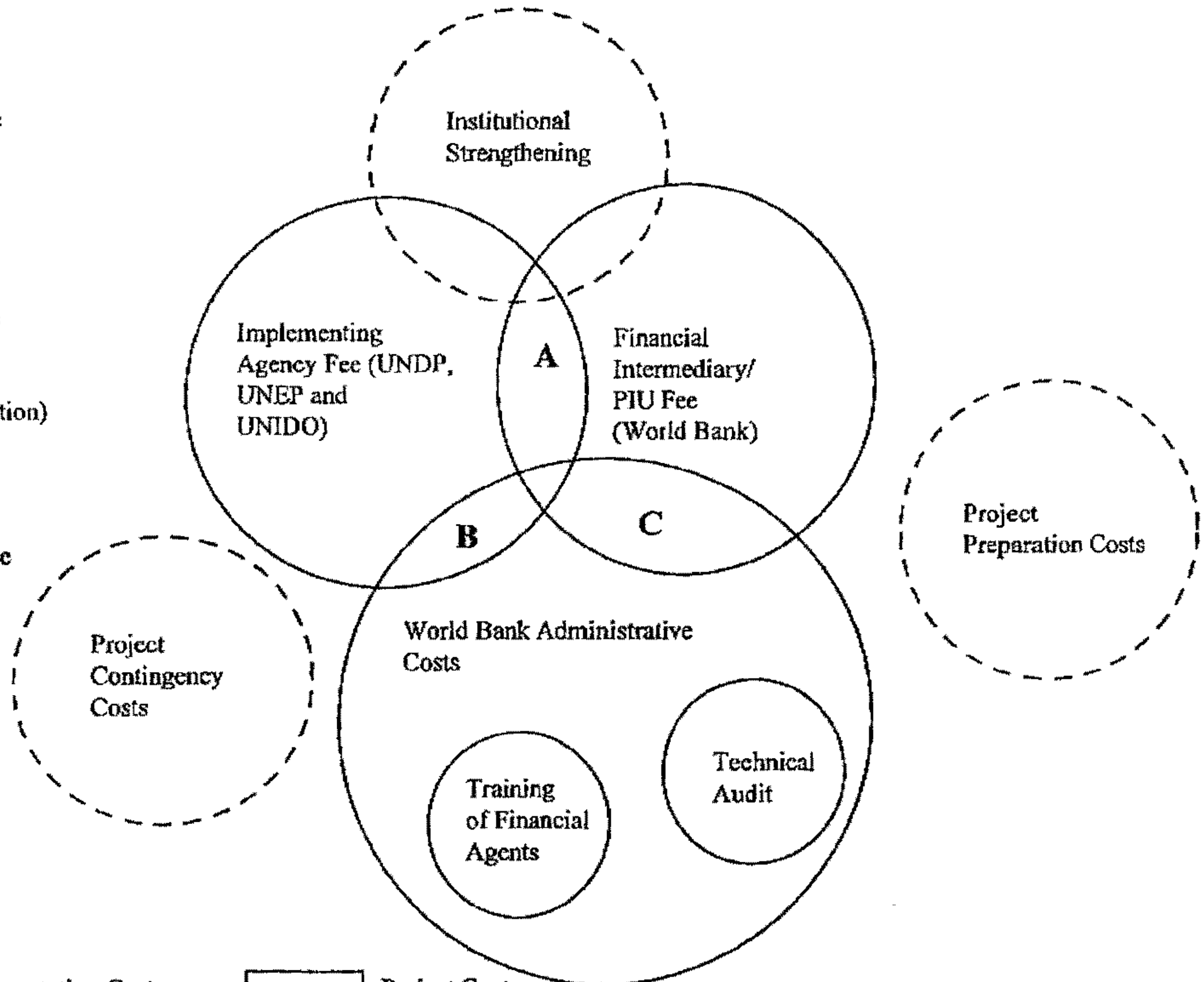
Inter-Relationship Amongst the Various Components

Figure II

A: Represents area where <u>activities</u> are covered by Implementing Agency Fee or Financial Agency Fee (such as procurement and disbursement)

B: Represents area where <u>activities</u> are covered by Implementing Agency Fee or World Bank Administrative Costs (such as program coordination)

C: Represents area where <u>activities</u> are covered by Financial Agency Fee or World Bank Administrative Costs (such as supervision of sub-projects)



Project Implementation Costs (solid line) — Project Costs (dashed line)