EP

United Nations
Environment
Programme

Distr.
LIMITED

UNEP/OzL.Pro/ExCom/16/14
14 February 1995

ORIGINAL: ENGLISH

Executive Committee of
the Multilateral Fund for the
Implementation of the Montreal Protocol

Sixteenth Meeting
Montreal, 15-17 March 1995

PROPOSAL ON A MODIFIED FUND MANAGEMENT SYSTEM: SEQUENTIAL FUNDING

I. The need for a new Fund management system

Enhanced efficiency of the Fund operations

1. The year 1994 has seen a marked expansion in the number of project proposals submitted to the meetings of the Executive Committee. This is especially true for the submission to the Fifteenth Meeting, where a total of some 120 project proposals worth over US $170 million were received by the Secretariat.

2. This is certainly a positive phenomenon because it shows:

- Article 5 countries are committed to phasing out ODSs;
- The Multilateral Fund is living up to its mandate of providing an incentive for early phase-out; and
- The implementing agencies have improved their efficiency in project preparation and formulation.

3. The other side of the enhanced efficiency of the Fund operation is that the balance of contributions to the Fund at the time when the Executive Committee meets may not always be sufficient to meet the resource requirements of the funding requests to the Committee. At the Fifteenth Meeting of the Executive Committee, a shortfall of US $12.54 million occurred for the first time in the short history of the Multilateral Fund. The luxury of running a surplus of funds the Committee has always had until the Fifteenth Meeting will not likely be repeated in the future. What happened at the Fifteenth Meeting signals the realness and urgency of the matter. The worst case could be that the Committee has a very low fund balance just ahead of a scheduled meeting. This could happen, especially at the first Executive Committee meeting of the year, when the available balance at the last meeting of the Executive Committee of the previous year had been disbursed to cover the obligations approved at that meeting and the contributions for the current year have not yet come in.

Pattern of the receipt of contributions to the Fund

4. From the experience of the past few years, there seems to be a pattern to the receipt of contributions to the Fund. In most cases, the time of payment is dependent upon the national budgeting cycle and parliamentary approval schedule. The graphs annexed at the end of this paper present the payment pattern of contributions over the past four years by month and by quarter. An observation of the quarterly contribution over the period 1991-1994 as presented in Graph I, reveals that the largest amount of contributions were received mainly in the second and fourth quarters of the year. The experience of the monthly pattern of payments in 1991, 1992, 1993 and 1994 as shown in Graph II, confirms this trend. Thus, the pattern of the average monthly payments during these four years as shown in Graph III indicates that 17 per cent of payments made during the year are paid during April, 12 per cent during August, 11 per cent during September, and 20 per cent during October. The balance of the payments are received in less significant amounts in the other months of the year.

9. Various alternatives are being examined by the Executive Committee to deal with the situation. The purpose of this paper is to look at one of the alternatives, i.e. the possibility of modifying the current financial management system with the aim of rationalizing the dichotomy of running shortfalls of funds on project approvals on the one hand, and accumulating idle cash in implementation on the other hand.

III. Sequential funding

10. Sequential funding, as the term suggests, is a mechanism where funding is provided on a sequential basis or, in other words, according to a schedule established on the basis of certain criteria, need-for-cash basis, for instance. This is in comparison to the current practice of a one-time and up-front disbursement system.

How the mechanism functions

- How does the current system function?

11. The current funding system can be categorized as one-time and up-front disbursal system whereupon, following the approval of a project by the Executive Committee, the Treasurer will transfer immediately either in cash or promissory notes to the responsible implementing agency the entire commitment represented in the approved budget. After the completion of the transfer of funds from the Treasurer to the responsible implementing agency, the financial obligation of the Multilateral Fund to the project is completed. In other words, the project has no more claims against the Multilateral Fund.

- How does the proposed mechanism function?

12. Under the sequential funding mechanism, the Treasurer would not disburse to the responsible implementing agency the entire amount of the budget when a project is approved by the Executive Committee. Instead, the Treasurer would disburse to the implementing agency according to a schedule established by the implementing agency for the project on the basis of the need for funds. This schedule may spread across several years depending upon the project. Following this mechanism, the Treasurer may only have to disburse, for instance, 20 per cent of the budget of the project at the time when the project is approved by the Executive Committee and the remaining 80 per cent of the obligations could be disbursed in subsequent years. A disbursement schedule could be established by the implementing agency on an annual basis, as indicated in Example 1.

Example 1

Project Title	Approved Budget (US $)	DISBURSEMENT SCHEDULE						
		1995	% of total	1996	% of total	1997	% of total	TOTAL (US $)
Conversion of refrigeration facilities in (*country*)	1,000,000	200,000	20	600,000	60	200,000	20	1,000,000

<u>Implications of the Mechanism on the Multilateral Fund management</u>

<u>Merits of the Mechanism</u>:

13. Reduce the immediate call on the Fund resources. The burden of financing is stretched out over a time range, one to three years, for instance. In theory, it may enable the Executive Committee to approve more projects than the available cash on hand. This is especially important when the Multilateral Fund has a low fund balance in advance of a scheduled Executive Committee meeting;

14. Reduce the funds build-up in the implementing agencies; and

15. Channel funds to where they are most needed.

<u>Demerits of the Mechanism</u>:

- Carry-over of obligations: A complication in financial management

16. Under the current financial management system, the financial obligation of the Fund is completed with the approval of the project and transfer of funds to the responsible implementing agency. Therefore, the Executive Committee always begins each of its meetings with zero outstanding obligation and whatever commitments it enters into during any meeting will be new ones.

17. Under the proposed financial management system, the Multilateral Fund would maintain an outstanding obligation to the project equal to the unfunded portion of the approved budget. If those outstanding obligations extend into future years, the Multilateral Fund will enter a new year with these outstanding obligations from previous years plus any new obligations the Executive Committee may make in the new year. This introduces a complication into the financial management as currently followed by the Treasurer. In addition, the financial reporting by implementing agencies would also have to be adjusted as indicated in Example 2.

Example 2

Status of the Fund
as of 31 December 1995

Income

Expenditures

Obligations from previous year(s):
Obligations for current year:

Total

- Conformity to Terms of Reference of the Multilateral Fund

18. The proposed sequential funding mechanism would extend the burden of funding over a duration of several years according to project disbursement schedules and would enable the Executive Committee to approve more projects than the available cash on hand at any particular point in time. However, this practice appears inconsistent with the following requirement of the Terms of Reference of the Fund:

> "No commitments shall be made in advance of the receipt of contributions, but income not spent in a budget year and unimplemented activities may be carried forward from one year to the next within the financial period" (UNEP/OzL.Pro/4/15, Annex IX, para. 20).

19. According to paragraph 20 of its Terms of Reference, the Executive Committee cannot commit to funding beyond the amount of available cash on hand. Commitment in this sense requires that 100 per cent of the budget for a project must be available before the project can be approved by the Committee. Once funds are committed to one project, those funds cannot be reallocated for any other purpose.

20. Under this requirement, the proposed sequential funding mechanism is still possible but projects would have to be separated into individual requests (sub-projects) according to the required project disbursement schedules. This would mean that the Committee would initially only commit to funding the first required disbursement for a project. Subsequent disbursements would be submitted as separate stand-alone sub-projects. In effect, the Committee would not be able to commit to the entire project up-front.

- Standing agreements between the Implementing Agencies[1] and the Executive Committee

21. The agreements between the implementing agencies and the Executive Committee do not allow any commitments to be made prior to the receipt of payments from the Fund. If the principles of sequential funding are found acceptable, the legal agreements between the Executive Committee and the implementing agencies should be amended.

IV. Findings and Conclusions

1. The current financial management system of one-time and up-front disbursement upon project approval creates cash build-up and blocks funds for extended periods unproductively, especially for projects with multi-year duration.

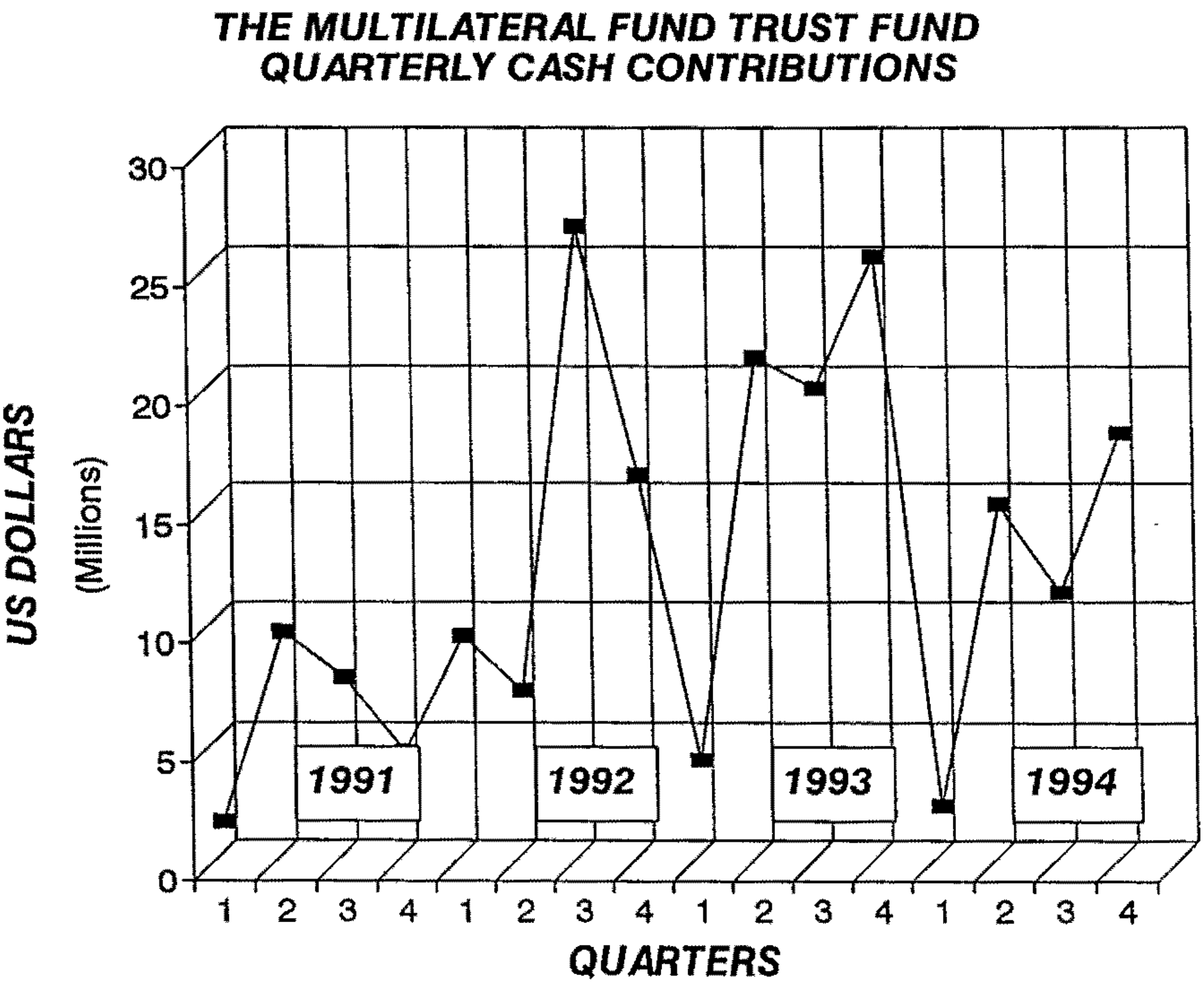
2. The proposed sequential funding mechanism could help to rationalize the paradoxical situation of running a shortfall in project approvals and building up idle cash on the implementation side.

3. Under the current Terms of Reference of the Fund, a sequential funding mechanism could only commit to partial project funding. The Terms of Reference of the Fund would have to be modified by the Parties to enable funding according to a project disbursement schedule along with a commitment to full funding without cash on hand.

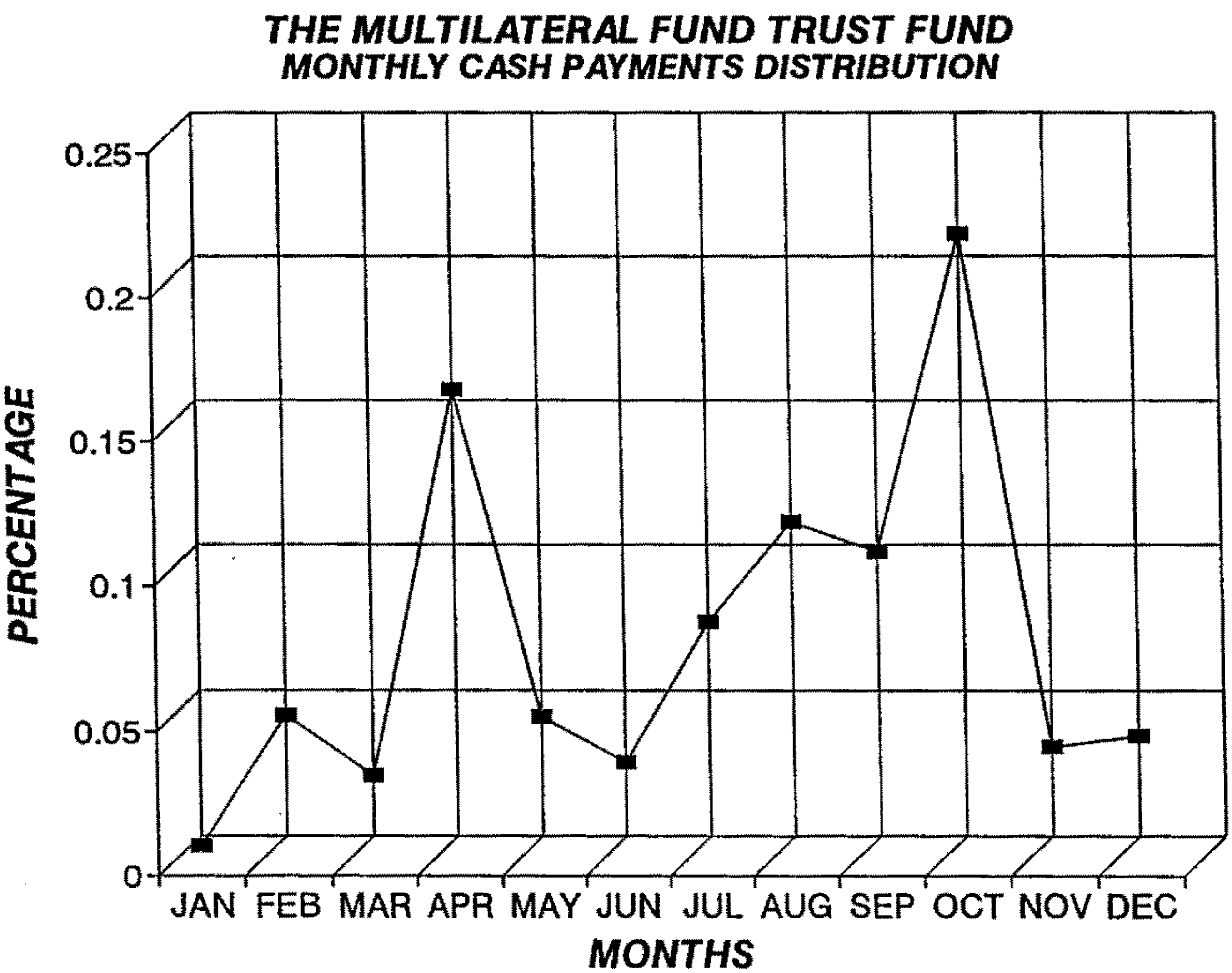
---

[1] Refers to Agreements between the Executive Committee and UNDP, UNEP and the World Bank. The Agreement between the Executive Committee and UNIDO does not contain any provision on this.

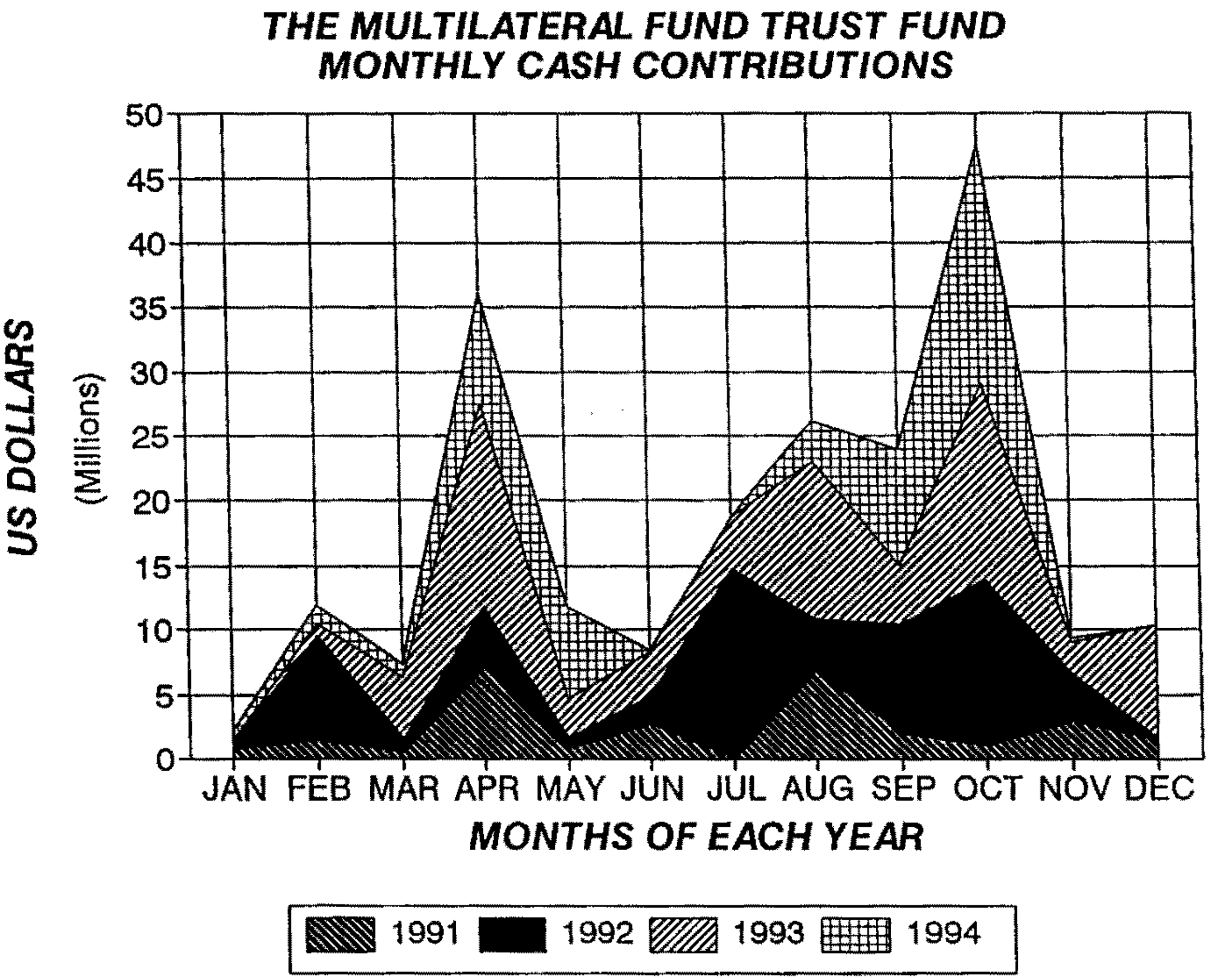
GRAPH I


THE MULTILATERAL FUND TRUST FUND
QUARTERLY CASH CONTRIBUTIONS
US DOLLARS
(Millions)
0
5
10
15
20
25
30
1991
1992
1993
1994
1 2 3 4 1 2 3 4 1 2 3 4 1 2 3 4
QUARTERS

GRAPH II


THE MULTILATERAL FUND TRUST FUND
MONTHLY CASH PAYMENTS DISTRIBUTION
PERCENTAGE
0.25
0.2
0.15
0.1
0.05
0
JAN FEB MAR APR MAY JUN JUL AUG SEP OCT NOV DEC
MONTHS

GRAPH III


THE MULTILATERAL FUND TRUST FUND
MONTHLY CASH CONTRIBUTIONS
US DOLLARS
(Millions)
50
45
40
35
30
25
20
15
10
5
0
JAN FEB MAR APR MAY JUN JUL AUG SEP OCT NOV DEC
MONTHS OF EACH YEAR
1991
1992
1993
1994