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Executive Committee of
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THE USE OF CONTINGENCY COSTS IN PROJECT PROPOSALS

(DRAFT)

Background

1. At the Eleventh Meeting of the Executive Committee, several representatives expressed concern at the level of contingency costs, assessed at 15 per cent for most of the projects. One representative drew attention to the impact on the Fund of a 15 per cent contingency cost and an additional 13 per cent agency support cost (charged by UNDP, UNEP and UNIDO) applied to project costs. Several representatives stressed that contingencies should be considered as such and not as automatic drawing rights. Another representative requested the Secretariat to carry out research on levels of contingency cost in international investment reports and report back to the Executive Committee (UNEP/OzL.Pro/ExCom/11/36, para. 112).

2. This paper addresses these issues by considering the current status, levels of contingency costs, and agency support costs and by concluding with recommendations for the Executive Committee's consideration.

Current status

3. Contingency costs are normally included in investment cost proposals and vary according to the level of uncertainty of the cost estimates. Project proposals have either not had contingency costs, had contingency costs applied against some uncertain cost items only, or had contingency costs applied as a percentage of all project costs. Investment project proposals submitted to the Committee between the Sixth and Eleventh Meetings were analyzed and it was determined that almost 8 per cent of the funds approved for these projects were for contingency costs. Contingency costs applied to these projects ranged from zero to 30 per cent. The highest contingency costs were for proposals for which permission to proceed was requested which does not require funds advanced.

4. Contingency funds are automatically drawn down as needed without additional Committee approval. Since contingency costs are the amount of variation expected to occur during project implementation and execution, they are likely to be expended during the course of project implementation. If they are not expended, implementing agencies will return unused grant resources to their Fund accounts and notify the Committee as part of their reporting on project monitoring/supervision.

5. Table 1 shows that proposals with no contingency costs accounted for 16 per cent of all proposals with contingency information submitted to the Executive Committee between the Sixth and Eleventh Meetings. Contingency costs calculated for only certain cost items accounted for 18 per cent of the proposals. However, the table shows that the majority of proposals (60 per cent) have contingency costs calculated on the basis of a percentage for all cost components (10, 15, or 30 per cent). Furthermore, Table 1 shows that since the Committee's Ninth Meeting, there has been a trend toward applying a percentage of all project costs for contingency instead of only those cost components with some degree of uncertainty.

Table 1

METHOD FOR CALCULATING CONTINGENCY COSTS BY EXECUTIVE COMMITTEE MEETING

Meeting	Number of Proposals Submitted	Projects with Contingency Information	No Contin-gency	Projects with Contingency Costs Applied to:		
				Some Project Costs	All Project Costs	Either Some or All Project Costs[1]
Sixth	5	2	0	2	0	0
Seventh	15	3	1	0	1	1
Eighth	8	8	5	3	0	0
Ninth	14	12	2	1	8	1
Tenth	33	25	0	4	21	0
Eleventh	18	17	3	2	10	2
Totals	**93**	**67**	**11**	**12**	**40**	**4**
Percent	-	100	16	18	60	6

Level of contingency costs

6. Engineering firms engaged in both international and domestic-only investment projects were contacted for their views on the appropriate level of contingency costs. Engineering firms operating domestically generally prefer to provide cost estimates at a level of accuracy that approaches no greater than 10 per cent of project costs without a contingency. This means that the contingency cost should not exceed 10 per cent. However for firms operating internationally, obtaining cost levels accurate to within 15 per cent for projects with international involvement is not unusual. For international work, physical and currency contingencies are often included in the contingency cost estimate.

[1]Although the proposals indicated that a contingency was included, they did not specify the method of applying contingency costs.

7. The World Bank stated that 15 per cent is appropriate for the level for contingency costs for the projects presented to the Executive Committee at this time. UNDP and UNIDO have recently included contingency costs of up to 15 per cent of project costs as has the World Bank.

8. All implementing agencies agree that contingency costs do not need to be applied to known costs (e.g., licenses, certain pieces of equipment, training costs, equipment and services already purchased, etc.) and as more experience is gained with certain project and equipment types, that uncertainty and contingency costs should be reduced.

Agency support cost

9. As mentioned above, attention was drawn to the impact on the Fund of a 15 per cent contingency cost and an additional 13 per cent agency support cost (charged by UNDP, UNEP and UNIDO) applied to project costs. Agency support costs and contingency costs are different cost items. Contingency costs account for uncertainty, but agency support costs (for the above mentioned three agencies) cover agency overhead, staff time, and other administrative costs.

10. Currently, the Treasurer transfers 13 per cent against all projects (including contingency) and work programme activities for the agency support cost following Executive Committee approval. However, these agencies do not charge the 13 per cent until the funds are expended, or in the case of UNDP, when funds are transferred to OPS. Thus, the 13 per cent support costs applied to contingency costs might be held in the implementing agencies' accounts and would be used only when contingency cost is used.

11. Thus far, the amount of funds corresponding to the 13 per cent on contingency costs is approximately US $220,000. Since Agency support costs are not determined until funds are expended and contingency fees are uncertain costs, funds for agency support costs charged against contingency costs might not be disbursed from the Treasurer until the final charges for support costs on actual expenditures are determined by the Agencies. However, to implement such a system, additional accounting would be necessary to treat the agency support costs resulting from contingency costs differently from all other costs.

Conclusion and recommendations

12. It is recommended that the Executive Committee adopt the following decisions:

(a) Implementing agencies should not apply physical contingency charges against known costs for project components (e.g., licenses, certain pieces of equipment, training costs, equipment and services already purchased, etc.); and,

(b) Implementing agencies should minimize contingency costs as experience is gained with standard equipment, technology and other project costs and in-field implementation and procurement.