Global Environment Facility

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Agenda Item 11

PROPOSAL FOR A FEE-BASED SYSTEM FOR FUNDING GEF PROJECT IMPLEMENTATION

Recommended Council Decision

The Council having reviewed document GEF/C.13/11, *Proposal for a Fee-Based System for Funding GEF Project Implementation*, approves:

(a) the application of a fee-based system to determine Implementing Agencies' fees with respect to GEF projects; and

(b) a one-time disbursement of $70.78 million to the Implementing Agencies, representing the outstanding implementation and supervision costs of the agencies' portfolios of GEF projects approved by the Council through June 1999.

PROPOSAL FOR A FEE-BASED SYSTEM FOR FUNDING GEF PROJECT IMPLEMENTATION

OBJECTIVE

1. This paper presents a proposal for a fee-based system as the basis for the funding of Implementation Agencies' (IAs)[1] responsibilities in the implementation of GEF projects; and seeks Council's approval for:

- the implementation and operation of a fee-based system to determine Implementing Agencies' fees in respect of GEF projects; and

- a one-time disbursement of $70.78 million to the Implementing Agencies, representing the outstanding implementation and supervision costs of each Agency's portfolio of current Council-approved GEF projects.

BACKGROUND

2. The Global Environment Facility (GEF) FY00-02 Corporate Business Plan[2] had discussed extensively a proposal for the introduction of a fee-based system for the reimbursement of costs[3] incurred by the IAs in the implementation and execution of GEF projects. The issues examined in the discussions included:

- the benefits, principles and issues pertaining to a fee-based system;

- implementation of common activity-based accounting; and

- improvements to corporate budgeting.

3. As a transitional phase to a full fee-based system, the GEF FY99 Corporate Budget[4] was constructed on the basis of:

- a three-tier cost management approach of recognizing direct project costs (costs linked directly to a specific project), indirect costs (costs associated generally with projects but not directly incurred in respect of any specific project) and administrative overheads (corporate management costs);

- common coefficients of efforts for each GEF project-type/project cycle-phase for all three IAs; and

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[1] Specifically, United Nations Development Program (UNDP), United Nations Environment Program (UNEP) and World Bank (WB)
[2] *GEF Corporate Business Plan FY00-02* - GEF/C.12/11, September 11, 1998
[3] As provided in the "Instrument for the Establishment of the Restructured Global Environment Facility"
[4] *GEF Corporate Budget FY99* - GEF/C.11/4, March 6, 1998

- a standard weighted average staffweek cost for all three IAs, based on their respective average staffweek costs.

This approach provided GEF Secretariat and the IAs some experience with the use of a standard funding system to determine the budgetary requirements for their planned annual workprogram.

INTER-AGENCY WORKING GROUP ON A FEE-BASED SYSTEM

4. In early 1999, an Inter-Agency fee-based system Working Group (the Group), comprising financial/budget management staff from the three IAs and GEF Secretariat, was established with the objective of collaboratively developing and agreeing on a proposal for a framework for a fee-based system. The Group reviewed and considered the issues and implications of fee structure, methodology, process and implementation. In conclusion, it was agreed that a basic framework for a fee-based system would be implemented in FY00; and, that this would provide the basis for the funding of the IAs' implementation of GEF projects. This fee-based system would apply to all three IAs and would encompass all GEF projects. This total approach was deemed appropriate and necessary in order to enable proper determination and evaluation of the consequential impact, implications and effectiveness of a fee-based approach to funding GEF's work program and projects.

OBJECTIVES/BENEFITS OF A FEE-BASED SYSTEM

5. A properly implemented and maintained fee-based system, over the long-term, will strengthen financial management and cost-efficiency efforts by sustaining improvements in:

- transparency of project-direct and corporate management costs through accurate definition, identification and categorization of all costs;

- accountability for project output and performance by establishing relationships between workprogram delivery costs and workprogram output;

- comparability of project implementation cost performance among the IAs and GEF projects; and, with external comparators (e.g., development/assistance agencies) through the use of benchmarking, performance indicators/standards, etc.; and,

- predictability and stability in the flow of GEF funds.

6. In the realization of GEF's annual workprogram, a fee-based system will enhance ongoing financial management of project implementation through the more substantive cost analysis and understanding attained by:

- establishing the total cost of each project at project approval and, thus, facilitating the provisioning of corresponding GEF funds;

- promoting better understanding and management of the cost profiles, patterns and performance of the respective IAs and GEF projects, through periodic fee analysis and revision; which requires and, thus, encourages improved monitoring and recording of operational and financial data; and

- identifying separately project-direct costs and corporate management costs and facilitating financial management of their respective differing budgetary and expenditure profiles and behavior patterns.

7. A successful fee-based system will encourage IAs to more efficiently and effectively manage and deliver their projects within the agreed fee. The resulting steady and efficient implementation and execution of projects will accordingly stabilize the requirement for and the disbursement of project funds. Also, Trustee management of GEF Funds will be enhanced through improved resource-demand and disbursement projections. Additionally, a fee-based system would facilitate the implementation of the "Expanded Opportunities for Executing Agencies"[5] initiative, which is aimed at leveraging additional resources for the protection of the global environment.

PROPOSED IMPLEMENTATION OF THE FEE BASED-SYSTEM

8. The fee-based system is proposed for implementation in FY00. Therefore, the project implementation costs for the planned FY00 workprogram pipeline of the three IAs will be computed on this fee basis. Also, the implementation of a fee-based system will require disbursement of a one-time fee provision to each IA to cover the committed outstanding life-time implementation costs of their respective portfolio of current GEF projects, so as to encompass all GEF projects under a standard funding modality.

9. As presently proposed, the fee-based system will not impact upon the ***Executing Agencies' fee*** paid by the IAs to other agencies, organizations, national bodies, etc. for the performance of specific project execution activities. Executing Agency (EA) fees will continue to be negotiated by the IAs with the respective EA for each project; these fees being clearly segregated and identified as such in the project proposal/document. In the longer term, as experience is gained with the use and operation of a fee-based system, consideration will be given to the incorporation of EA fees and IA fees into a single comprehensive fee stucture; if a later review determines such an approach to be operationally and financially appropriate and viable.

GEF FY00 CORPORATE BUDGET

10. In previous years, the IAs' costs of implementing GEF projects were provided for and approved both as project-direct costs in GEF's annual Corporate Budget and as a component of

[5] GEF/C.12/10 – September 10, 1998; GEF/C/13/3 – May 1999

the project grant allocation. For FY00, under the fee-based system, such IAs' costs will be accordingly computed as IA fees; ***and, approved at the time of each specific project approval by Council***. These fees, so determined and approved, will cover the ***life-time implementation costs of the project***. In line with the proposed implementation of a fee-based system, all IA's costs for implementing all GEF projects planned for the FY00 workprogram, will be funded under this approach. ***Thus, a major consequence of introducing the proposed fee-based system is that each year's annual corporate budget will no longer provide for IAs' project-direct costs for their ongoing or planned projects.*** Previously, in addition to providing for the estimated costs of GEF's corporate management services, the annual Corporate Budget also provided for that immediate year's IA project-direct costs for development, preparation, supervision and evaluation of their current and planned projects, regardless of the multi-year duration of some projects.

ONE-TIME FEE PROVISION FOR CURRENT GEF PROJECTS PORTFOLIO

11. To encompass the current portfolio of GEF projects[6] under a standard funding modality of a fee-based system, it is proposed that a one-time fee provision be disbursed to each IA. This one-time fee provision essentially represents the total outstanding project implementation and supervision costs that, in any case, would be incurred in subsequent years for each IAs' current portfolio; ***the resources for which have already been committed and provisioned by the Trustee for GEF as a whole***. Previously, these resources would have been approved annually in each subsequent years' annual corporate budgets. This one-time disbursement in respect of each IAs' current portfolio would encompass all GEF projects within a standard funding modality under which the IAs would assume full ownership responsibility and accountability for the life-time project-direct costs for projects in their portfolio.

[6] Existing portfolio of Council approved work program projects as of June 30, 1999

12. For this purpose, the IAs have computed their required one-time fee provisions, based on (i) the estimated staffweeks required to complete the projects in their respective portfolios; and (ii) their staffweek cost. The required provision, totaling $70.78 million, is summarized below.

Table 1: One-Time Fee Provision for Implementing Agencies' Current Portfolio

Project Type	UNDP		UNEP		WB		Total	
	No. of Projects	$000	No. of Projects	$000	No. of Projects	$000	No. of Projects	$000
INV					126	47,420	126	47,420
TA	149	13,279	13	1,475			162	14,754
MSP	19	1,157	8	210	39	5,416	66	6,783
EA	109	1,019	38	804			147	1,823
Total	**277**	**15,455**	**59**	**2,489**	**165**	**52,836**	**501**	**70,780**

FEE METHODOLOGY

13. The fee methodology is based on the allocation of all IA costs into the following two cost categories (detailed in Annex 1) as they pertain to the GEF project cycle phases[7]:

- project-direct costs: relating to all project cycle tasks carried out directly in the development, preparation, supervision and evaluation of a specific project; and

- corporate management costs: relating to corporate responsibilities of institutional relations, policy & program development/management/coordination, outreach/knowledge management/external relations, management & finance and monitoring & evaluation.

The fee essentially encompasses all IA's project-direct costs, as defined above. Project preparation costs will continue to be funded separately through the Project Development and Preparation Facility (PDF), under existing guidelines and processes. With the introduction of an IA fee to cover the above costs, each IA's GEF expenditures can effectively be organized into the following categories: project grant allocation, PDF funds, IA fees, EA fees and IA corporate management costs.

14. For financial/budgetary management purposes, all GEF projects are categorized as one of four standard GEF project-types: Investment (INV); Technical Assistance (TA); Medium-Size Projects (MSP) and Expedited Enabling Activities (EEA). For each project-type, a fee is established which does not distinguish between project cycle phases within each project-type. The proper classification of projects is critical as it determines the applicable fee, as established under the Fee-Based System. In its immediate operation, the fee provides for the impact and implications of the project-scope variations of regional, global, joint and add-on projects. In the

[7] Phase I: Project Development; Phase II: Project Preparation; Phase III: Project Supervision; Phase IV: Project Evaluation

longer term, once adequate experience have been gained with the fee methodology, consideration can be given to factoring for work program and cost implications of other variables, such as, innovativeness, complexity, focal area, strategic partnerships, project size/duration/location, etc..

FEE STRUCTURE

15. A standard fee structure, which will be applied to all IAs, has been established in terms of a "flat-fee" for a standard project within each GEF project-type (summarized in Table 2). For global, regional, joint and add-on projects, currently, a "premium" expressed as a percentage of the fee will be allowed, based on a substantiated application by the IA on presentation of the project and fee proposals. Subsequently, based on accumulated cost experience with respect to the project variables discussed above, a table of fixed premiums will be established and factored into the fee structure. Importantly, these premiums should provide the IAs with the appropriate incentives to pioneer and undertake innovative and broad-based (global/regional/joint) projects in expanding and intensifying global environment efforts.

Table 2: Flat Fee Table for a Standard Project

Project-Type	**INV**	**TA**	**MSP**	**EEA**
Flat Fee	$942,000	$382,000	$146,000	$54,000

16. Each project-type's flat-fee has been computed based on the weighted average (weighted by the number of approved projects[8]) of the respective IAs' fee for those project-types in which they have been involved (i.e., WB for investment projects; UNDP and UNEP for technical assistance projects; UNDP, UNEP and WB for expedited enabling activities and medium-sized projects). The IA's fee for a project-type is a function of its "staffweek-coefficient" (the number of weeks necessary for one staff to deliver a project) and its "staffweek-cost" (the fully-loaded cost of one staff for one week).

[8] Based on total number of approved GEF projects as of December 31, 1998.

17. The formulas utilized in the fee computation are summarized in Table 3. The staffweek-coefficients and staffweek-costs employed in these computations are provided in Annex 2.

Table 3: Fee Computation Formulas

Project Type	Weighted Average Staffweek Coefficient
INV	WB fee
TA	$\frac{\text{(UNDP fee x no. of projects) + (UNEP fee x no. of projects)}}{\text{Total No. of UNDP + UNEP Projects}}$
MSP	$\frac{\text{(UNDP fee x no. of projects) + (UNEP fee x no. of projects) + (WB fee x no. of projects)}}{\text{Total No. of UNDP + UNEP + WB Projects}}$
EEA	$\frac{\text{(UNDP fee x no. of projects) + (UNEP fee x no. of projects) + (WB fee x no. of projects)}}{\text{Total No. of UNDP + UNEP + WB Projects}}$

18. The fee structure, as currently proposed, incorporates certain operational and business assumptions; for example:

- all project development costs, incurred prior to PDF/project approval, will be factored for by the respective IAs as part of their “cost-of-doing-business”; and

- the fee for a multi-year project does not explicitly factor for the financial implications of annual inflation in the later years as this would be contained by interest earned by the IAs on the disbursed fee.

During the first-year operation of the fee-based system, these issues will be further reviewed and monitored; and, recommendations will be made to address them, where deemed appropriate and necessary.

FEE PROCESS

19. Approval: The fee will be approved by Council, concurrent with Council approval of a proposed project for incorporation in the GEF workprogram; or by the CEO, concurrent with CEO approval of MSPs and EEAs.

20. Disbursement: The fee will be disbursed in one amount upon project approval, as above.

21. Refund: In case of a termination of an approved project, IAs are required to refund any outstanding fee balance to GEF by set-off against fees of future projects. Fee refunds are required only of Council approved projects that have been terminated for operational reasons. The substantiating reasons and refund amount, which is based upon the percentage of work completed, will be negotiated and agreed between the GEF Secretariat and the responsible IA. IAs are not required to refund any fee on “late-projects”, which are still expected to be delivered, although behind the scheduled completion date; in such cases, the operational issues would be addressed accordingly. For “dropped projects”, which are project concepts presented but deemed

not eligible or were not incorporated in a workprogram presented for Council approval, refunds do not apply since fees have not been approved nor are payable.

22. Reporting: In conjunction with their current quarterly financial reporting to GEF Secretariat and Trustee, all IAs will be required to report fees approved during each Fiscal Quarter; much as they are required to do for project grant allocations and corporate management costs.

23. Annual Inflation: To give consideration for each IA's parent agency's annual budgetary price adjustment for their next fiscal year's costs, an agreed annual inflation factor will be applied to the fee structure at the start of each of GEF's fiscal years.

24. Renegotiation/Revision: Once fully operational, the fee methodology/structure will be reviewed at three-yearly intervals by the IAs and GEF Secretariat collaboratively; and, if deemed appropriate, will be renegotiated and revised. If any major event/s or change/s occur which will affect materially and/or permanently an IA's or a project-type's operational and/or cost profile, either IA or GEF Secretariat may initiate an earlier review of fee impact and implications. In particular, a review of the fee for MSPs may be appropriate after adequate work program and cost experience is gained during the first year.

EVALUATION AND ENHANCEMENT OF FEE-BASED SYSTEM IN FY00

25. In its first year of operation, during FY00, GEF Secretariat and IAs will jointly monitor the operation and performance of the fee-based system and address any operational issues that may arise, within the proposed framework. Also, collaboratively, GEF Secretariat and the IAs will continue to enhance and standardize their financial and cost management practices, so as to provide comprehensive, relevant and accurate data to support the financial management of GEF's work program. These cost management practices will also enable improved operation of the fee-based system and facilitate the realization of its benefits. Towards the end of FY00, GEF Secretariat and the IAs plan to review: (i) the operation to-date of the fee-based system and factoring for the impact of other project-type variables, including innovativeness, complexity and risk; and (ii) GEF's fee structure performance benchmarked against the fee structures of other comparable agencies, institutions and organizations. Additionally, in consultation with the IAs, financial management reviews of a number of representative projects will be carried out with the objective of analyzing and better understanding overall project expenditure patterns and cost profiles (i.e., encompassing all cost categories of project grant allocation, project development and preparation costs, implementing agency fees, executing agency fees and corporate management costs). Based on the outcome of these reviews, a report will be prepared evaluating the impact of the fee-based system and incorporating recommendations to Council for enhancement of its operation.

Annex 1

<u>IMPLEMENTING AGENCIES' CORPORATE MANAGEMENT AND PROJECT-DIRECT COSTS</u>

Project Direct Costs

- all project cycle tasks (e.g., review, appraisal, briefings, consultations, documentation, advice, negotiations, financial/legal administration, reporting, coordination, etc.) ***carried out directly in respect of the development , preparation, supervision and evaluation of a specific project***

Corporate Management Costs - Implementing Agencies

- Assembly/Council/COP/STAP/Secretariat-related forums and meetings: participation, policy work, meetings, paper/report preparation/review; internalizing/coordinating GEF and governing bodies policies into IA's GEF workprogram/operations
- corporate business/workprogram/budget planning, preparation, monitoring and reporting (incl. quarterly corporate financial reporting to Trustee)
- financial/personnel/operational management and administration (incl. project database management; quarterly corporate financial projections and reports to Trustee; internal and external audit reviews)
- corporate outreach activities (e.g., workshops, publications, videos, orientations, etc.)
- review/evaluation of project/PDF proposals/reports/progress;
- review and preparation of GEF working papers/corporate M&E studies (including PIRs)
- improving technical expertise/network in regions/provide GEF operational guidance to staff
- participation in technical meetings/seminars/conventions/task forces/information dissemination
- mobilization of non-project specific co-financing; arranging bilateral and multilateral collaboration
- inter-agency coordination

Expense Categories Definition

Staff Salaries and Benefits	salaries and benefits paid to parent organization GEF staff
Consultants Salaries/Fees	salaries/fees paid to consultants
Mission Travel	travel and subsistence
General Operating Costs (see Note)	e.g. translation, communications, computing and information systems, general expenses, printing and publications, office equipment and supplies, support/temporary staff, training, seminars, honoraria, representation, contractual services
Institutional & Fixed Costs (see Note)	chargeback services from parent organization (i.e., UNDP, UNEP, WB) for administrative, personnel, accounting, auditing, legal, financial reporting, funds disbursement services and the use of office space/facilities.

<u>Note</u>: Depending on their respective parent organization's administrative and accounting policies and practices, Implementing Agencies may account for and report the expenses incurred under "General Operating Costs" and "Institutional & Fixed Costs" in one of either Expense Category.

IMPEMENTING AGENCIES' PROJECT-TYPE STAFFWEEK COEFFICIENTS

Project-Type	UNDP	UNEP	WB
INV	-	-	169.0
TA	67.0	76.4	-
MSP	26.0	25.8	24.5
EEA	10.0	10.6	5.4

IMPLEMENTING AGENCIES' AVERAGE STAFFWEEK COSTS

Expense Category (for definitions, refer to Annex 1)	UNDP $	UNEP $	WB $	Average Staff Year Cost $
Salaries (see Note 1)	140,400	124,900	113,676	126,325
Mission Travel	33,000	20,520	40,000	31,173
General Operating Costs (see Note 2)	43,300	68,368	70,000	60,556
Institutional & Fixed Costs (see Note 2)	20,300	33,428	16,000	23,243
	237,000	**247,216**	**239,676**	**241,297**
Average Staffweek Cost per IA*	5,512	5,749	5,574	5,612

* Based on 43 staffweeks per year

Notes:

1. The World Bank's "Salaries" amount reflects the weighted average of staff salaries and consultant fees.
2. Depending on their respective parent organization's administrative and accounting policies and practices, Implementing Agencies may account for and report the expenses incurred under "General Operating Costs" and "Institutional & Fixed Costs" in one of either Expense Category.