



# Global Environment Facility

GEF/C.15/6  
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GEF Council  
May 9-11, 2000  
Agenda Item 10

## REPORT ON THE IMPLEMENTATION OF THE FEE-BASED SYSTEM

**Recommended Council Decision**

The Council, having reviewed Document GEF/C.15/6, *Report on the Implementation of the Fee-Based System*, takes note of the progress that has been achieved in the first-year of operation of the fee-based system and welcomes the revised approach to determining fees.

## **INTRODUCTION**

1. At its May 1999 meeting, GEF Council approved the use of a fee-based system<sup>1</sup> to reimburse the project implementation costs incurred by an Implementing Agency with respect to GEF projects. Under this system, on Council or CEO approval of a project, the Implementing Agency would be provided with a one-time flat-fee that would cover the entire life time implementation costs of that project, even in the case of a multi-year project. To strengthen the implementation of the fee-based system, Council requested that GEF Secretariat<sup>2</sup> (i) further enhance the fee-based system to account for common project-variables; (ii) benchmark GEF's fee structure against the project implementation costs of comparable organizations; (iii) develop with Trustee guidelines for a phased disbursement of the one-time fee provision; and (iv) report on its experiences after its first year of operation.

2. The fee-based system was approved by Council to be applied to all GEF projects submitted to Council and CEO for workprogram approval from July 1, 1999. Effectively, however, the fee-based system was first applied to projects proposed for work program approval at the December 1999 Council meeting; because there was no July 1999 inter-sessional. This included the authorization of fees for Medium-Sized Projects and Expedited Enabling Activities that had been approved by the CEO since July 1, 1999. Although some issues were encountered in assigning fees for a couple of projects proposed for the December 1999 work program, the fee-based system was applied for the January 2000 Inter-sessional and the May 2000 work program. This was done in order to accumulate a full year's experience with the fee-based system, which would properly enable a more complete understanding of any implementation issues.

3. When the fee-based system was approved, it was generally acknowledged that implementation of the fee-based system in the first year would be very much a pilot-type operation and that further enhancement and some revision, in all probability, would be necessary and appropriate once some experience had been gained in its operation. This paper reports on the first-year experience with the implementation of the fee-based system. It discusses the primary issues encountered and presents proposals with the objective of enhancing and reinforcing the fee-based system as the primary mechanism for reimbursing an Implementing Agency's project implementation costs.

## **FEE ADJUSTMENTS FOR IDENTIFIED PROJECT-VARIABLES**

4. Project-variables (such as focal area, country/regional/global scope, joint implementation, risky/innovative concepts, replications, etc.), which could materially affect the implementation costs of a project, were reviewed jointly by the Implementing Agencies and GEF Secretariat. It was agreed that the fee-based system would, in its immediate operation, provide only for the implications and impact of the project-scope

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<sup>1</sup> *Proposal for a Fee-Based System for Funding GEF Project Implementation.* GEF/C.13/11 dated April 1, 1999

<sup>2</sup> *Joint Summary of the Chairs – GEF Council Meeting, May 5-7, 1999* dated May 10, 1999

variables of regional, global, joint and innovative projects<sup>3</sup>. However, sufficient data and experience did not currently exist to support the establishment of pre-determined adjustment factors that could be applied to the flat-fee to account for these identified project variables.

5. For FY00 project proposals, therefore, the Implementation Agencies were asked to propose and substantiate any estimated project-variable adjustments to the flat-fee in terms of additional staffweek coefficients or extraordinary expenditures required by the project. Using this approach, a number of approved projects were assigned fees that, while anchored on the established flat-fee structure, were adjusted to account for the impact of identified project-scope variables. It is likely that these fee adjustments for project-variables will continue in this manner until such time that sufficient historical cost data is accumulated.

### **BENCHMARKING REVIEW OF GEF PROJECT IMPLEMENTATION COSTS**

6. A benchmarking review of GEF's fee structure and project cost management practices, including its project implementation costs, has been carried out and is being reported upon separately<sup>4</sup>. The objectives of benchmarking against the project implementation costs and cost reimbursement methods of other comparable development agencies, were to determine:

- (a) the reasonableness and appropriateness of GEF's flat-fee structure; and
- (b) the efficiency and effectiveness of GEF's financial management of its project implementation costs.

Key issues and concerns reviewed with the involved comparator organizations confirmed that, overall, GEF's project cost management practices were sound and adequately methodical and demanding.

### **PHASED DISBURSEMENT OF ONE-TIME FEE PROVISION**

7. To encompass the current portfolio of GEF projects<sup>5</sup> under a standard funding modality of the fee-based system, a one-time fee provision for each Implementing Agency was concurrently approved by Council. This one-time fee provision essentially represents the total outstanding project implementation/supervision costs that would be incurred in subsequent years for each Implementing Agency's current portfolio. In consultation with Trustee, guidelines were established for the disbursement of the one-time fee provision over a three year period commencing July 1, 1999. This phased disbursement takes into account the following: (a) the current status and disbursement profile of the project portfolio presently under implementation; (b) the projected implementation/supervision costs; and (c) completion of disbursement of the one-time fee

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<sup>3</sup> In brief, regional projects encompass a number of countries; global projects involve a number of geographical regions; joint projects are jointly implemented by more than one agency; innovative projects are risky/new in nature/concept.

<sup>4</sup> *Report on a Benchmark Review of Implementing Agency Fees.* GEF/C.15/Inf 7.

<sup>5</sup> Existing portfolio of Council approved work program projects as of June 30, 1999

provision within a reasonable time-period. On this basis, the Implementing Agencies determined the following fee requirements to be disbursed on July 1 of each Fiscal Year (in \$ millions):

	<b>FY00</b>	<b>FY01</b>	<b>FY02</b>	<b>Total</b>
<b>UNDP</b>	7.5	4.8	3.2	15.5
<b>UNEP</b>	1.1	1.3	0.1	2.5
<b>WB</b>	24.0	15.0	13.8	52.8
	<u>32.6</u>	<u>21.1</u>	<u>17.1</u>	<u>70.8</u>

8. It was agreed that the one-time fee will be disbursed in accordance with this schedule, subject to the following provisions that:

- (a) towards the end of FY00, the projections for FY01 and FY02 be adjusted to take into account both the actual implementation achieved during that fiscal year and any revised resource requirements for the outer years;
- (b) fee disbursements be effected and accounted for separately from project grant disbursements as non-fungible funds; project grant disbursements are earmarked and allocated to specific projects in order to ensure that funds are available when needed; and
- (c) interest income earned on disbursed fees will be retained by the Implementing Agencies to be used to accommodate the effects of inflation-price increases upon implementation costs.

#### **FIRST-YEAR APPLICATION OF THE FEE-BASED SYSTEM**

##### *Implementing Agencies' Experience*

9. Each respective Implementing Agency's experience with the fee-based system differed to the extent by which their proposed projects incorporated certain identified project-variables, which distinguished them substantively from typical GEF baseline projects. In the case of typical or baseline GEF projects, the published flat-fee was straightforwardly and objectively applied, without any further intervention. Where the project varied in scope/nature as a result of the incorporated project-variables, the respective Implementing Agency had to provide supporting analyses and negotiate the additional resources required to fund the estimated additional implementation costs.

10. During FY00, **UNEP**, whose proposed projects comprised mainly Medium-Sized Projects and Expedited Enabling Activities, did not experience any substantive difficulties in applying the fee-based system. In the one case where the identified project-variables of a specific project anticipated additional implementation expenditures, these were determined by detailed analysis of the estimated resource requirements. The fundamental concern of **UNDP's** and **World Bank's** experience was focussed primarily on the proper categorization of some of their proposed projects, as Investment or as Technical Assistance projects, for the purpose of fee assignment (as in paragraph 11 below).

### ***Categorization of Investment and Technical Assistance Projects***

11. For financial and budgetary management purposes, all GEF projects typically have been categorized as one of four standard GEF project-types: investment project, technical assistance project, medium-Size project or expedited enabling Activities. Under the fee-based system, flat fees had been established respectively for each of these project-types. Thus, the proper categorization of each proposed project became critical as it would determine the applicable flat-fee, under the fee-based system. During the fee negotiations for the December 1999 Council project proposals, it became evident that (i) there were no established or agreed definitions that authoritatively distinguished a project as an investment or technical assistance project; and (ii) some projects encompassed investment and technical assistance elements in varying combinations. An Implementing Agency's historical operational preponderance in a particular project-type (such as, the World Bank in investment projects and UNDP in technical assistance projects), inadvertently, became the deciding factor. The categorization of projects as medium-size projects and expedited enabling activities, however, did not present any issues as these have well established specific financial thresholds.

12. Despite the absence of common definitions of investment and technical assistance projects, the majority of the full-size projects proposed by UNDP and World Bank were categorized based on their respective traditional workprogram profiles. A very small number of projects, however, necessitated some discussion and negotiations to determine the appropriate fee. Ultimately, the fees for these projects were computed on the basis of the established flat-fee structure, taking into account the cost implications of the specific nature of the respective projects.

### ***Standard Flat-Fees or Per-Project Computed Fees***

13. The fee-based system was developed on the basis that an Implementing Agency would recover its project implementation costs by fully accomplishing the planned numbers of each respective GEF project-type, in a typical annual workprogram portfolio based upon GEF's Business Plan projections. Consequently, on this premise, the same fixed flat-fee is assigned to all projects within a project-type, regardless of the size of their respective project grant allocation or duration of implementation. In practice, this resulted in (a) a situation where the assigned fee did not seem representatively correct for the size/duration of the project; and (b) an issue as to whether the fee appropriately should be intended to recover the Agency's overall project implementation costs or each project's specific implementation costs.

### **PROPOSED REVISION TO FEE STRUCTURE**

14. Taking into account the experience of the first year of operation of the fee-based system, it is proposed that the fee structure be revised, as from July 1, 2000, for those projects previously categorized as investment or technical assistance projects. These projects will no longer be categorized as such for fee purposes. All such full-sized GEF projects, which typically exceed \$1.0 million in proposed project grant allocation, will be

categorized as full-sized projects. Medium-sized projects and enabling activities will continue to be assigned fees based on the existing flat-fee structure.

15. The proposed revision to the fee structure will continue to ensure that the following accepted principles of a fee-based system are maintained:

- (a) **transparency** of computation to facilitate costs monitoring and analysis, benchmarking to comparators, etc.;
- (b) **simplicity and objectivity** of application to avoid/minimize the need for project-specific negotiations;
- (c) **cost efficiency** of project implementation through encouraging comparative advantages between the Implementing Agencies and providing appropriate incentives for cost management; and
- (d) **enhanced effectiveness** of financial management of GEF resources

16. Under the current flat-fee structure, a project's allocated fee does not necessarily reflect its actual implementation costs because the fee structure and its computation were: (a) conditional on each agency delivering its planned annual work program driven by GEF's projects pipeline; (b) designed to cover each agency's total annual project implementation costs; and (c) premised on its utilization only as an internal pricing mechanism among the three Implementing Agencies. Experience has shown, however, that operational circumstances demand a fee structure that **establishes a direct and relevant relationship between a project's implementation costs and its corresponding fee**, thus, providing more appropriate signals for cost and portfolio management.

17. Under the proposed revision, the fee for a full GEF project would be computed individually, using the following formula that would account separately for the costs of the identified project implementation components:

Fee = \$ [  $a(\text{project grant}) + b + c(\text{no. of years implementation}) + d$  ], where:

$a$  = a fixed relative-value factor of the project grant allocation as a proxy to reflect the intrinsic **complexities** of the project (which are difficult to establish and quantify objectively) manifested in project preparation and development;

$b$  = a fixed average-per-project amount for **project/grant administration costs** on the premise that such costs should not vary dramatically between projects;

$c$  = a fixed average-per-project amount for each year of **supervision cost** required by the estimated duration of project implementation; and

$d$  = a negotiated amount to provide for, as applicable, the cost impact of (i) joint, regional/global and innovative project-variables; and (ii) partnering with regional development banks/other executing agencies; which is not incorporated nor factored into any of the above baseline fee values.

It is proposed that the dollar-value constants  $b$  and  $c$ , and the factor  $a$  be determined initially by regression analysis based upon pooled historical project data from the Implementing Agencies for typical GEF projects (i.e., those not incorporating project-variables, such as regional/global, joint and innovative projects).

18. To illustrate the use of the proposed formula, using purely hypothetical amounts/factors, a proposed project, with a life of 6 years, requesting a \$5.0 million grant would receive an Implementing Agency fee of \$440,000, computed as follows:

(a)	Complexity (say 1.8% of \$5.0 million)	\$ 90,000
(b)	Project/grant administration( say \$80,000)	\$ 80,000
(c)	Supervision (say \$45,000 x 6 years)	\$270,000

#### **FY01 FOLLOW-UP ACTIONS**

19. In FY01, to implement the above proposals, GEF Secretariat and the Implementing Agencies will collaboratively:

- (a) finalize and agree on a proposed fee revision which will be applied to all full-sized GEF projects proposed for workprogram approval, as from July 1, 2000; and
- (b) continue to monitor and review the experience of applying the fee-based system.