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EXECUTIVE COMMITTEE OF
THE MULTILATERAL FUND FOR THE
IMPLEMENTATION OF THE MONTREAL PROTOCOL
Fifty-fourth Meeting
Montreal, 7-11 April 2008

ASSESSMENT OF THE ADMINISTRATIVE COSTS REQUIRED FOR THE 2009-2011 TRIENNIUM (FOLLOW-UP TO DECISION 50/27)

This document contains a progress report from the Consultant pursuant to decision 50/27 and 51/38. The contract was originally intended to begin in September 2007 however, due to delays in the contract approval process, the contract was initiated in January 2008. The final report will be submitted to the 55th Meeting.

COMPREHENSIVE INDEPENDENT ASSESSMENT OF THE ADMINISTRATIVE COSTS REQUIRED FOR THE 2009-2011 TRIENNIUM

Progress Report

To: Multilateral Fund Secretariat for the Implementation of the Montreal Protocol
April 7, 2008
Original

1. Background

The Multilateral Fund engages various implementing agencies to execute its goal of eliminating the consumption and production of ozone depleting substances in Article 5 countries in a finite time frame. Based on agreements with the Multilateral Fund Executive Committee, the implementing agencies are entitled to charge the Multilateral Fund Secretariat for administrative costs to enable them to complete the supervision, technical assistance, and monitoring obligations of the approved projects.

At its 50th Meeting, the Executive Committee of the Fund decided to authorize the Secretariat "to undertake a comprehensive independent assessment of the administrative costs required for the 2009-2011 triennium, using independent consultants or consulting firms as needed, and to report its conclusions to the First meeting of the Executive Committee in 2008 and requested implementing agencies to facilitate the participation of internal auditors, or other financial management personnel as appropriate, in the study team" (decision 50/27, para. C). The terms of reference adopted by the Committee are defined in decision 51/38 and attached as Annex I.

PricewaterhouseCoopers (PwC) has been contracted to perform this independent assessment.

2. Objectives of the Independent Assessment

There are multiple objectives of the independent assessment. These objectives can be split into the following categories:

a. Cash flows – The study team will perform a review of projected administrative costs incurred over time relative to the anticipated disbursement of agency fees and core unit costs projected with the phase out activities. The project team will identify various options to ensure the stability of donor nation contributions during the 2010 phase out period and the start up of the HCFC projects
b. Sufficiency of Funding – Assess the extent to which anticipated funding levels are sufficient for the agencies to meet their administrative cost requirements during the next triennium. In conducting this analysis, the sufficiency of funding will not only be based on a review of administrative costs, but also on the extent to which existing resources could be used to provide for future administrative cost requirements, taking into consideration the substantial balance in support costs that existed at the end of 2005 and 2006.
c. Efficiencies across MEAs – Implementing agencies also manage other MEAs and may have mandates with similar resource requirements as those required by the MLF. For example, UNFCCC. The project team will assess the plans put in place by the implementing agencies to take advantage of any efficiency opportunities that may exist.
d. Review of Bilateral Agencies – Bilateral agencies are more frequently being used by donor countries as a means of contributing to the MLF. The use of bilateral agencies to implement projects provides donor countries with an opportunity to dictate the nature of a relatively minor proportion of their

overall contributions. The project team will compare modalities of implementation between multilateral and bilateral agencies in order to identify the nature of project costs incurred by the bilateral agencies and the value added of this implementing method.

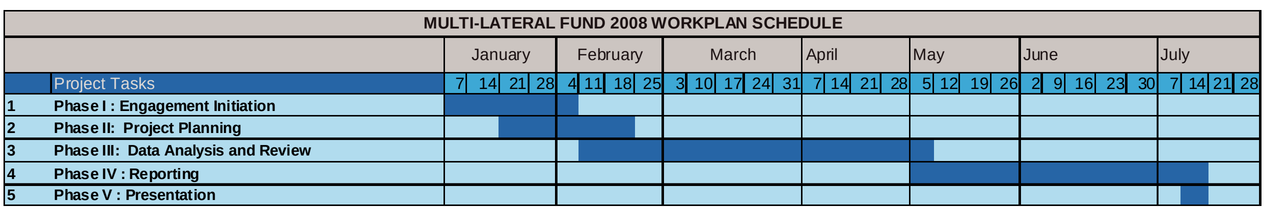
e. Experience of the implementing agencies with similar MEAs – The offices of implementing agencies are also involved in implementing activities for other multilateral environment agreements (MEAs). As part of the review, the project team will review the implementing agencies' activities for other MEAs. This will cover the cost regimes in place with other MEAs, the similarities between the regimes in terms of administrative cost requirements, and the overall reimbursement levels that the implementing agencies receive from all MEAs.

f. Inter-MEAs coordination activities - the MLF Executive Committee has previously decided that agency fees and core unit costs should not be spent on inter-multilateral environmental agreement coordination activities. The report will identify the extent to which the obligations of the agreements are being met within the context of agreed upon arrangements.

g. The Allocation and Effectiveness of Administrative Cost Regimes – The project team will perform a thorough analysis of the nature, scope, and historical expenditure patterns of agency administrative costs as well as project implementation trends. The analysis will assist in the identification of various administrative cost streamlining options taking into consideration the phase out and CAP-specific related activities over the next triennium and beyond.

3. Approach

To undertake this assessment, we have based our approach on five key project phases as follows, along with a high-level view of project timeline:



a. **Phase I:** Engagement Initiation – on-going

Upon notification of contract award, PwC has arranged to contact the Multilateral Fund Secretariat to establish a project initiation meeting. This meeting provided an opportunity to address contractual matters as well as other issues pertinent to the project. Our approach was to confirm, as soon as possible, the level of the review and report structure and content, and to work collaboratively with the Multilateral Fund Secretariat, implementing agencies and other stakeholders to produce an output that is both insightful and helpful.

b. **Phase II:** Detailed Planning – completed

Based on the project initiation meeting, our understanding of the project and extensive experience on similar engagements, PwC worked closely with the Multilateral Fund Secretariat to prepare a report outline and work plan approach based on the information provided as well as our own insights into the project. We confirmed expected timetables, visit schedules, and documentation reviews as well as produced an initial basic outline of the final report for discussion (presented in further details in the section "Report Outline").

c. **Phase III:** Data Analysis and Review – on-going

The data collection and analysis approach will be executed through desktop study, survey submissions, stakeholders interviews and site visits, using a collaborative process with the Multilateral Fund Secretariat and other pre-defined implementing agencies. A pilot test of our approach was performed with Environment Canada in early February. Refer to "Site visits" section below for further information.

Once the information has been obtained, the research team will conduct a comprehensive review and consolidation of the information. An evaluation of the information will be conducted in relation to the specified outline and criteria established for the project.

d. **Phase IV:** Reporting – March 2008 to July 2008

The initial results of the review will be compiled and synthesized into a first draft report, which will provide the intended content of the different chapters and sub-chapters, and indicate the expected conclusions. This initial draft report will be submitted to the Multilateral Fund Secretariat for review and all comments will be incorporated into the final report.

The final draft report will be completely edited and formatted prior to submission in accordance with the general layout used by the Multilateral Fund Secretariat. The team will ensure that any supporting documentation or background materials are appropriately referenced throughout the document and made available as annexes, where requested. The final draft report will be submitted to the Multilateral Fund Secretariat by June 30th, 2008, and will be presented to the 55th Executive Committee Meeting in July 2008.

e. **Phase V:** Presentations – July 2008 and Autumn 2008, to be confirmed

Based on the results of the report, a presentation will be prepared for the Executive Committee to provide a summary of the key elements of the project in terms of the approach and results. The presentation content and delivery locations will be confirmed with the Multilateral Fund Secretariat at a later point in the project.

4. Report Outline

This report outline sets the basis for our report to be communicated at the Executive Committee meeting in July 2008. The report will be divided into 5 sections plus annexes, detailed below.

Executive Summary
A summary explanation of the findings of the independent assessment of the report.

Introduction
This section will introduce the reader to the mandate undertaken. The focus of the section will be to provide an understanding of the context and objectives of the project, the scope of the analysis, and the supporting definitions relating to the assessment of the administrative cost regime to ensure standard comprehension of terms.

Methodology
This section of the report will focus on the approach taken by the project team in accomplishing our independent assessment of the administrative cost regime.
A presentation of the areas of focus of the analysis will also be provided, presenting specific challenges. The areas of focus (e.g. impacts of phase-out of projects, appropriateness of current administrative cost regime in the future, impacts of using bilateral agencies to implement Multilateral Fund projects, etc.) will be based on our preliminary assessment and on our discussions with key stakeholders.

Analysis and Key Findings
Based on our quantitative and qualitative data analysis and site visits and discussions with key stakeholders and peer groups, this section will present our analysis of the actual situation and the key findings and opportunities for improvement.
This section will provide our review of aspects such as the impact of current administrative cost regime, current cost accounting model, actual cash flow management practices and related challenges. Underlying reasons and impacts of project delays and unspent administrative funding will also be discussed in order to support a review of actual funding of Multilateral Fund and potential economies of scale in order to achieve triennium 2009-2011 objectives.

Recommendations
Based on a gap analysis between current state and future needs of the next triennium and high-level benchmarking with peer groups' approach to administrative costs, recommendations will be provided and future model for key areas will be suggested as necessary.

Conclusion
A high level conclusion of the findings of the independent assessment of the report.

5. Site visits

Site visits were planned from February 13 to March 24, 2008. Key findings will be presented by our Team Leader and Lead Researcher during the 54th Meeting of the Executive Committee in April 2008.

Agency	Status	Key contact	PwC researcher
UNIDO	Site visit in Vienna confirmed for March 10 and 11, 2008	Sidi Menad Si-Ahmed	Kenny Wong
UNDP	Site visit in New York confirmed for March 10 and 11, 2008	Suely Carvalho	Antoine Bourgoignie
UNEP	Site visit in Paris confirmed for March 13, 2008 Site visit in Nairobi to confirm.	Rajendra Shende	Kenny Wong
WORLD BANK	Initial conference call on February 25, 2008 Site visit in Washington confirmed for March 13, 2008	Steve Gorman	Jennifer Semerdjian Antoine Bourgoignie
ENVIRONMENT CANADA	Site visited on February 13, 2008	Philippe Chemouny	David Pascal Jennifer Semerdjian
UNFIP	Site visit in New York confirmed for March 12, 2008	Amir A. Dossal	Antoine Bourgoignie
UNFCCC	Site visit in Bonn confirmed for March 12, 2008	Asfaha Beyene	Kenny Wong
GTZ	Conference call with GTZ confirmed for March 12, 2008	Volkmar Hasse	Kenny Wong
AFD	Site visit in Paris to confirm on March 14, 2008	Beatrice Vincent	Kenny Wong
GEF	Site visit to confirm in Washington in the week of March 24, 2008	Yasemin Biro	Jennifer Semerdjian Antoine Bourgoignie

Annex I

TERMS OF REFERENCE

Introduction

1. These terms of reference have been prepared further to the decision of the Executive Committee at its 50th Meeting authorizing the Secretariat "to undertake a comprehensive independent assessment of the administrative costs required for the 2009–2011 triennium, using independent consultants or consulting firms as needed, and to report its conclusions to the first Meeting of the Executive Committee in 2008" (decision 50/27, para. c) and decision 51/38 adopting the draft terms of reference, as orally amended by the Committee, noting that the Fund Secretariat would present the costs based on bids received from qualified consultants to the Executive Committee at its 52nd Meeting.

Background

2. The Executive Committee signed agreements with the multilateral implementing agencies that allowed a charge of a percentage of all expenditures made from the Trust Fund specified in the approved project documents and work programmes (UNEP/OzL.Pro/ExCom/5/Inf.3, and 4 and UNEP/OzL.Pro/ExCom/8/29, Annex IV as amended by decision 25/2). For the World Bank, its agreement specified that it would be reimbursed for expenses incurred (UNEP/OzL.ProExCom/5/Inf.2). It should be noted that administrative costs are administered in accordance with the regulations, rules and directives of the agency concerned. There are no agreements with bilateral implementing agencies for their activities under the Multilateral Fund.

3. There have been four systems of administrative costs under the Multilateral Fund since its inception. Initially, UNDP, UNEP and UNIDO received a flat agency fee at a rate of 13 per cent of the value of project approvals as well as project preparation and country programme preparation activities. By contrast, the World Bank received an administrative, legal and financial budget as a funding element in its annual work programme that included project preparation and country programme preparation as administrative costs. It also received 3 per cent support costs on funds approved for each individual project to cover the fees of its financial intermediaries responsible for project execution.

4. At its 12th Meeting, the Executive Committee requested the Secretariat to conduct an administrative cost exercise focused on the need to evolve norms (UNEP/OzL.Pro/ExCom/12/6, para. 41). As a result, the first independent assessment was conducted and considered by the Executive Committee at its 14th Meeting (UNEP/OzL.Pro/ExCom/14/12). This resulted in the first systematic change when the World Bank requested the Committee to apply support costs at a level of 13 per cent for all its projects approved at, and following, the 17th Meeting (decision 18/10, para.b). With this change, all implementing agencies received 13 per cent of project costs as administrative costs.

5. The second independent assessment resulted in a third change to the administrative cost regime. This was initiated in response to a request at the Eighth Meeting of the Parties where the Parties asked the Executive Committee to work toward the goal of reducing agency support costs from 13 per cent to an average of below 10 per cent (decision VIII/4, para. 6). The Committee asked the consultant to identify options and approaches for reducing the overall level of administrative costs, focusing on revising the current uniform, fee-based system (decision 21/2). An assessment report was submitted by Coopers and Lybrand to the 26th Meeting of the Executive Committee (UNEP/OzL.Pro/ExCom/26/67). It resulted in an administrative cost regime that was initially applied to all agencies, but currently remains fully operational only for bilateral agencies, and applies partially to UNEP. This administrative cost regime applied an agency fee of 13 per cent on projects up to a value of US $500,000, an agency fee of 11 per cent on the value of projects exceeding US $500,000 up to a value of US $5 million, and an agency fee to be negotiated on a case-by-case basis for projects valued at more than US $5 million

(decision 26/41). This also applies to UNEP with the exception of its Compliance Assistance Programme (CAP) where the agency fee is 8 per cent of the annual cost of the CAP and institutional strengthening where agency fee costs are 0 per cent because the CAP programme administers the vast majority of institutional strengthening projects.

6. In the context of a series of meetings during which the Executive Committee considered issues related to its strategic planning for the compliance period, the Committee noted that although a fixed agency share of project resources (as was provided at that time as a tool for resource allocation) gives agencies more predictability regarding their support costs, it has the disadvantage of extending the allocated resources over unnecessarily long periods of time, as is the case with most of the methyl bromide projects. The Committee further noted that this might not have been tenable in the 2002-2005 triennium when a stricter time frame for project implementation would have to be followed. In deciding to eliminate agency shares, the Executive Committee invited another change to the administrative cost regime that would provide "UNDP, UNIDO and the World Bank with administrative budgets, together with a reduced rate of support costs for individual activities" (UNEP/OzL.Pro/ExCom/37/66, paras. 55-58). The Committee asked the Secretariat to address the matter with the understanding that total administration costs would not exceed existing total administrative costs (decision 37/68c).

7. The most recent administrative cost regime was proposed to the 38th Meeting with the intention that it would guarantee the maintenance of current staffing levels in the implementing agencies, their core activities, and provide sufficient support costs for project implementation on a predictable basis (UNEP/OzL.Pro/ExCom/38/59, para. 4). It includes US $1.5 million subject to annual review for a core unit in addition to applying an agency fee of 7.5 per cent for projects with a project cost at or above US $250,000 (including institutional strengthening projects and project preparation) and an agency fee of 9 per cent for projects with a project cost below US $250,000 (including country programme preparation) (decision 38/68). At its 46th Meeting, the Committee modified slightly the amounts of the core units and based them on the analysis in UNEP/OzL.Pro/ExCom/46/40. The base rates for core unit costs for UNDP and UNIDO were set at US $1.7 million instead of US $1.5 million and the Committee agreed to the possibility of an annual increase of up to 3 per cent for UNDP, UNIDO and the World Bank (decision 46/35).

8. At its 49th Meeting, the Executive Committee agreed to consider the capacity of UNDP, UNIDO and the World Bank to complete projects on time as a component of a review of administrative costs (decision 49/7(c)). Therefore, the Committee recognized the need for a more comprehensive assessment of the administrative cost regimes with a view to providing sufficient capacity to complete all activities needed to meet the needs of the Article 5 countries in their compliance efforts during the next triennium and to provide sufficient oversight and reporting for the Executive Committee, including taking into account current plans for the use of the balance of support costs and any related cash flow issues.

Items to be considered by the Consultant

9. At its 50th Meeting, during its review of proposed 2007 core unit costs, the Executive Committee was informed that there was a substantial balance in support costs amounting to between US $30.8 and US $40.8 million. Although this amount could have been used as it represented balances as at 31 December 2005 (in the first case) and only approved amounts for 2006 (in the second case), implementing agencies would continue to receive support costs on approvals and core unit costs at least until the end of the current triennium. Moreover, this amount could have theoretically covered support costs for an additional two to three years of overall administrative costs.

10. During the 2009-2011 triennium, CFCs, halons and CTC will be phased out by 2010. After 2010, only 20 per cent of the baseline for methyl bromide and 30 per cent of the baseline for TCA remain to be phased-out, along with the HCFC phase-out that is currently scheduled to occur by 2040. The

assessment of administrative costs should take into account the costs associated with closing activities for the 2010 phase-outs.

11. Support costs are provided to enable the implementing agencies to complete the supervision, technical assistance and monitoring obligations at the programme level through 2010 and beyond until projects are completed, completion reports and assessments have been conducted, and accounts have been reconciled and closed and all commitments in multi-year agreements have been fulfilled. They would also be used to monitor any projects with activities following 2010.

12. Support cost funds associated with projects cannot be used by the United Nations' implementing agencies until there is a project-related disbursement freeing the funds for use for administrative purposes. There may therefore be a cash flow issue to consider in determining whether funds are sufficient for the agencies to administer their existing and approved-in-principle portfolios to achieve the 2010 compliance targets. The assessment of the balance of support costs should take into account any such concerns with cash flow that might arise for the implementing agencies.

13. At its 49th Meeting, the Executive Committee agreed to consider the capacity of UNDP, UNIDO and the World Bank to complete projects on time in the context of its review of administrative costs at its 50th Meeting (decision 49/7(c)). The assessment should include a review of the administrative cost regimes of these agencies for Article 5 countries to achieve their compliance efforts during the next triennium, and meet their fiduciary responsibilities, and provide reporting to the Executive Committee. This should take into account current plans for the use of the balance of support costs and any related cash flow issues.

14. Although UNEP does not receive core unit costs, previous independent assessments also considered UNEP's administrative costs. As indicated above, decision 26/41 is the basis for administrative costs for UNEP and bilateral agencies. In determining the level of administrative costs in decision 26/41, Coopers and Lybrand considered historical costs for UNEP and the other agencies. Similarly, a review of UNEP administrative costs along the categories identified by Coopers and Lybrand should be undertaken. Since bilateral agencies have not been included in any assessment of administrative costs to-date, a similar review should be undertaken for existing agencies engaged in ongoing bilateral activities.

15. In undertaking this work, the consultant should take account of the previous reports prepared on this subject both by independent consultants and by the Secretariat. The information should be used to establish norms of the costs of administration of Fund projects. The categories of administrative costs employed in previous studies may also be used as a basis for the analysis but may be added to, or revised, as necessary. The extent to which existing resources could be used to address future administrative cost requirements should also be considered. The consultant should identify the services provided with administrative costs taking into account the different administrative cost regimes for UNEP and the other multilateral and bilateral implementing agencies.

16. The consultant should also take into account different implementation modalities used by the multilateral and bilateral implementing agencies. In some cases, administrative costs are used to administer programmes through other agencies while some agencies use their own staff to execute projects approved by the Executive Committee. In some cases, agency fees are transferred to the executing agency (for example, some agencies transfer funds to national executing agencies and/or financial intermediaries) and in other cases the fees are maintained to varying degrees by the agency administering the project.

17. The offices of implementing agencies dealing with Multilateral Fund matters are also involved in implementing activities funded for other multilateral environmental agreements (MEAs). At its 50th Meeting, the Executive Committee decided that the UNEP's compliance "CAP budget should only

be spent in accordance with the terms of reference for the financial mechanism contained in Article 10 of the Montreal Protocol and should not be spent on inter-multilateral environmental agreement coordination activities" (decision 50/26, para. a (iii)). The consultant should ascertain how this is being achieved for all agencies since the offices involved in activities for the Multilateral Fund are, for the most part, also involved in activities funded for other MEAs.

18. The consultant should also take into account the experience of the implementing agencies with similar multilateral funding mechanisms. In this respect, the administrative costs used for the Global Environmental Facility and other global and regional funds as applicable should be reviewed to inform a recommendation for future administrative costs of the Fund.

19. The consultant should propose any changes to the existing administrative cost regimes that would enable the implementing agencies to provide sufficient administrative support to Article 5 countries to help them achieve compliance during the next triennium with a view to providing sufficient capacity to complete all activities necessary for Article 5 countries to achieve their compliance efforts during the next triennium, enable implementing agencies to exercise their fiduciary responsibilities, and to provide sufficient oversight and reporting for the Executive Committee. In this respect, challenges for the next triennium (2009-2011) should be taken into account as mentioned above, in particular with respect to future control measures as well as the need to ensure that all commitments and financial accounts are closed. Any possible additional costs after 2011 would also have to be assessed taking into account any project activities expected to occur after 2010.

20. These terms of reference were orally amended by statements recorded in the report of the 51st Meeting of the Executive Committee as follows: "One Member, after noting that after 2010 only 20 per cent of the baseline for MB and 30 per cent of the baseline for TCA would remain to be phased out and that the HCFC phase-out was only scheduled to occur by 2040, said that the consultant should be asked to consider how the agencies' administrative structures and costs could be streamlined accordingly. Other Members suggested that decisions of the next Meeting of the Parties be considered as well and that it should not be presumed that there would be changes to the existing administrative cost regime. It should be made clear to the consultant that any changes had to be supported by the findings of the study."

21. Any changes to the existing administrative cost regimes should also take into account current plans for the use of the balance of support costs and any related cash flow issues mentioned above. To do this, the consultant should consider project implementation trends for the exiting portfolio of approved projects, earned versus unearned support costs, and fixed versus variable costs.