September 1, 2010



Management Expenses of Environmental Funds:

A Cost Review of the U.S. Enterprise for the Americas Initiative (EAI) and Tropical Forest Conservation Act (TFCA) Funds

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ACRONYMS

CSO	Civil Society Organizations
EAA	Enterprise for the Americas Agreement
EAI	Enterprise for the Americas Initiative
EFJ	Environmental Foundation of Jamaica
FCA	Forest Conservation Agreement
FCF	Forest Conservation Fund
FIAES	Fondo de la Iniciativa para las Américas (El Salvador)
FN	Fundación Natura
FONDAM	Fondo de las Américas (Perú)
FPAA	Fondo para la Acción Ambiental y la Niñez (Colombia)
JPAT	Jamaica Protected Areas Trust Limited
NGO	Non-governmental Organization
OC	Oversight Committee or Oversight Commission
RedLAC	Red de Fondos Ambientales de Latinoamérica y el Caribe
TFA	Tropical Forest Agreement
TFCA	Tropical Forest Conservation Act
TFCF	Tropical Forest Conservation Fund
USAID	United States Agency for International Development
USG	United States Government

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Acknowledgement

I am grateful to the EAI and TFCA Fund managers, Board and Oversight Committee members, financial and other staff who patiently explained the challenges that confront them, described the intricacies of their budgeting and financial monitoring practices, provided the numerous documents that I reviewed and answered my many questions.

Special thanks are extended to Panama's Fundación Natura, the Environmental Foundation of Jamaica and the Jamaica Protected Area Trust/Forest Conservation Fund which gave freely of their time and knowledge during my visits to their institutions.

I also want to thank my USG interlocutors from USAID, the US Treasury and the State Department for their guidance and thoughtful reflections on the draft report. Some of these reflections appear in Annex 8.

Summary and Key Conclusions

Through two Congressionally-authorized innovative debt relief programs, the 1991 Enterprises for the Americas Initiative (EAI) and the 1998 Tropical Forest Conservation Act (TFCA), USAID and the Departments of State and Treasury have jointly overseen the creation and operation of dedicated "Funds" designed to collect and distribute debt relief proceeds as grants in support of environmental protection, child survival and child development, and tropical forest conservation activities. To date, twenty-three Fund accounts have been created in 17 countries. Direct management of each "Fund" is entrusted to an expressly created or previously existing private, non-profit entity. Direct oversight is assured by a dedicated governing body, which can be a Board, Council or "Oversight Committee" (OC).

The broad operating principles, obligations and responsibilities of the managing entity, the oversight body and grant recipients are set out in legal agreements signed between the US Government, the beneficiary Government and, if the relief takes the form of a debt swap, other participating partners. These founding agreements provide for reimbursement, also from Fund proceeds, of the costs of day-to-day management and administration of the Fund and its programs, as well as servicing of the Board or Oversight Committee. Over time, various formulae were developed to set the limit on expenses. Fund Boards or OCs are expected to oversee performance vis-à-vis that limit through approval of the annual budget and review of its execution. Outcomes are to be confirmed in one or more ways: directly to the EAI/TFCA Administrator, through annual financial audits and by periodic independent evaluations.

While the approach has worked reasonably well over the nearly twenty years since the first Fund was established, Funds have found it difficult to operate within their own ceiling over time and have not consistently applied the practices that are intended to monitor and report on their performance vis-à-vis cost ceilings. In response, the EAI/TFCA Secretariat proposed that this study be undertaken to address the issues that have come to its attention. This study is based largely on review of the various founding agreements, evaluations, budgets, financial and management reports that serve to establish the ceilings and to manage, monitor and report on the costs incurred to manage and administer the Fund arrangements. Brief interviews were held with representatives of eleven Funds and visits were made to Panama and Jamaica to review their experience in more depth.

Setting Limits

It is common practice among donors to set a limit on the portion of their funding that grantees or recipients can claim as remuneration for administering the donor supported program or project. These funds are often referred to as "administrative costs", "indirect costs "or "overheads". The percent that can be claimed and the definition of the eligible costs vary among government, foundation and other types of donors. The USG has followed a similar practice for the group of EAI and TFCA Funds, but the definition of the eligible costs has evolved in an interesting way. The concept of "management expenses" was introduced into the Forest Conservation Agreements for debt swaps. Management expenses are defined to include the components of administration, management and the carrying out of the grant cycle, which together produce the grants that will achieve the objectives for which the Funds were created. The definition is supplemented with a list of detailed responsibilities of the Fund managing entity and other clauses that, taken together, provide a comprehensive picture of what is expected from the Fund managing entity and its governing Board or Oversight Committee. This all-inconclusive approach is well-suited to the EAI and TFCA Funds which are not project executing non-profits, but instead manage a stream of financing that over 10 to 26 years delivers a product, grants, to third parties. It also clearly demarcates grants from the costs of delivering grants. The limit that the USG, and other donors as well, place on costs are intended to maximize the funds available for grants, and thus the impact that the grant programs should achieve. The clear separation of costs and the use of a cost limit work together toward that goal and facilitate expense monitoring.

The concept of management expenses is relatively new and is not used in TFCA debt reduction agreements (i.e. Tropical Forest Agreements) which still refer to "administrative costs". This was also the practice for Enterprise for the America Agreements of the EAI program. It is no surprise, with the changes that have occurred over time, that current interpretations vary and the way costs are defined and reported do not always provide a complete picture of grant-making costs.

It is suggested that, going forward, the USG consider the following changes which are aimed at consistently applying the definition of costs/expenses to all Funds:

> *Future agreements for debt reductions could benefit from clarification to currently ambiguous language that overstates the role of the Board in day-to-day management and seems to define costs solely in terms of costs incurred by the Board. Introducing the broader concept of management expenses that is used in debt swap agreements would serve to align practice across all Funds irrespective of debt relief arrangements.*
>
> *All future agreements should incorporate the definition of allowable management expenses and supporting responsibilities of the managing entity provide a clear, complete and comprehensive treatment of the services that are required to administer, manage and deliver the grant program for which financing is made available.*

Managing Costs

Several different formulae are used for the group of EAI and TFCA Funds to establish the ceiling on administrative costs or management expenses which a managing entity can claim. Most of the formulae set the ceiling as a ratio of costs or expenses incurred annually to the annual payments made by the government into a spendable account. Boards and OCs are expected to approve budgets and monitor budget execution in line with the cost ceiling.

It is evident that Boards and OCs give due consideration to the cost limit specified in founding agreements when they approve budgets, yet the budgets of TFCA Funds are arriving at their cost limit more frequently and sooner than was the case for the earlier EAI Funds. Funds may be driven toward the cost limit faster as they feel the need to adopt more complex processes and systems that result from "best practice" recommendations, more stringent due diligence requirements as auditors and donors demand higher levels of assurance on grantee use of funds, board requests for strategic program changes (expanded geographic areas, new grantees, research and development of new business areas) and local regulations that affect personnel costs, which is by far the largest expenditure item for any Fund. Funds often need to devote their own resources to training grantees in order to receive viable grant proposals or strengthen implementation capacity. Spending is often deferred in key strategic areas such as fundraising or strategic and policy work, which are regularly cited by Fund evaluations as areas to which insufficient attention has been paid.

Few amendments have been made to the cost limits for TFCA Funds, which have instead adopted coping strategies such as levying charges on grants or deferring key strategic activities.

The EAI and TFCA founding agreements subscribe to the principle that managing entities would have their "reasonable costs" covered. The increase in the number of Funds that find it difficult to stay within their designated limits may signal that higher limits are justified. The USG may wish to consider the following when setting cost ceilings:

> *While the founding agreements have progressively improved the definition of management expenses as these relate to delivery of grants, it is not clear whether and how much of the other strategic cost areas the USG is willing to cover. General philanthropic practice does not generally include the objective of building the institutions to which the donor awards funding. The USG EAI and TFCA programs have, however, created the institutions that further the objectives the programs support. Institutional undertakings that merit inclusion when setting cost limits, but which are not clearly specified in existing founding agreements might include fundraising, grantee capacity building, staff and Board training, preparation of a broad strategic vision covering institutional goals.*

Funds should be aware that certain coping strategies they have adopted do not serve the objective of transparently delineating grants and grant management expenses. Expenditures should not be sourced by taxing grants or creating a special category of "program support costs". That practice, which has become widespread in the non-profit community and tacitly accepted for conservation funds, distorts the real cost of delivering conservation finance through grants.

> *It would be better to seek an adjustment of the limit on management expenses, or modify the formula for setting the limit than to adopt a practice that arbitrarily assigns a portion of costs to the grant program and then excludes them when calculating performance vis-à-vis the limit on management expenses.*

Boards or OCs do not take lightly their decisions to approve a budget at or above the required cost ceiling, but it is not evident that the decisions are taken with the certainty that the resources authorized allow the managing entity to meet all responsibilities and achieve strategic goals efficiently and effectively. Very few Funds currently have accounting and budgeting systems that can (i) disaggregate expenses according to the services they need to deliver in accordance with their administrative, management and operational responsibilities, (ii) present costs in terms of key strategic areas and (iii) analyze tradeoffs that will result in the best use of resources to achieve program and institutional objectives. While the ratio of management expenses (or administrative costs) to inflows is commonly seen as a measure of effective use of resources, other ratios and indicators can also be used to monitor progress toward institutional goals. Funds should adopt improved practices, and the USG should consider supporting Fund actions, in the following areas:

The use of a framework on indirect and direct costs for the purpose of budgeting, managing and analyzing costs would provide a powerful tool that could serve both Fund management and Boards/OCs.

Boards need to work with management to identify performance ratios and indicators that will allow them both to monitor whether resources are being used effectively (some would say with efficacy) and progress is being made toward achievement of objectives.

Funds could benefit from training and guidance on the principles, practices and accounting systems needed to identify, assign, apportion and analyze indirect and direct costs. Guidance could usefully be compiled in the form of a handbook which could support training and development of internal systems.

Expense Monitoring

In addition to Board and OC monitoring of cost ceilings, review of performance is also included in audits, through Fund self-reporting to the TFCA Secretariat and as part of independent evaluations. The following were observed when reviewing experience with the three reporting sources:

Audit reports can include a section on legal obligations or limitations that affect the funds being audited and can provide varying levels of assurance with respect to compliance with obligations. The highest level would require the auditor to perform its own calculation and confirm compliance and, to do this, the auditor must have a precise definition on which to base the calculation. A lesser level can be obtained when the auditor relies, based on general audit work, on management's own statement that it has complied. Most audit reports merely provide a breakdown of administrative expenses, but these are not a complete presentation of the costs defined by founding agreements. Should the USG wish to use audits for the purpose of monitoring cost ceilings, FCAs and TFAs will require precise definitions of management expenses and founding agreement audit requirements will need to specify the audit actions that should be incorporated in auditors' TORs to achieve the desired level of assurance.

Funds self-report results, including their expenses, to the USG each year for the production of a Congressional Report. Multi-year results for administrative costs, grant approvals, grant disbursements, leveraged funds, returns on investments and other operational results are provided in table form. The format is very useful to obtain a picture of Fund operations "at a glance". Funds report in US dollars to facilitate review and understanding. However, exchange rate fluctuations, especially local currency depreciation vis-à-vis the US dollar, can *result in distortions that make comparisons between years unreliable. It should be kept in mind that the exchange rate distortions also affect the value of grant approvals, disbursements and any other operating results that are tracked in value terms, which could lead to false conclusions on a Fund's performance over time. Reporting all data but the current year in local currency or notations to dollar denominated data should be considered.*

All evaluation reports that were reviewed discussed Fund performance compared either to the cost ceiling that appeared in the founding agreements or to the Board-approved cost ratio. Evaluations often make recommendations that, if adopted, would impact a Fund's management expenses. Funds that are already operating at or above their designated cost ceiling will have difficulty implementing recommendations that entail additional spending. Evaluators should, to the extent possible, indicate the effect their recommendations will have on costs and identify cost savings, if any, which could result from their recommendations.

A complete summary of opportunities for improving current practices of both the USG and Funds appears in Annex 7.

Cost Review of EAI and TFCA Funds

I. Background

Through two Congressionally-authorized innovative debt relief programs, the 1991 Enterprises for the Americas Initiative (EAI) and the 1998 Tropical Forest Conservation Act (TFCA), the United States Agency for International Development (USAID) and the Departments of State and Treasury have jointly overseen the creation and operation of dedicated "Funds" designed to collect and distribute debt relief proceeds as grants in support of environmental protection, child survival and child development, and tropical forest conservation activities. To date, twenty-three Fund accounts have been created in 17 countries. [1] Direct management of each "Fund" is entrusted to an expressly created or previously existing private, non-profit entity. Direct oversight is assured by a dedicated governing body, which can be a Board, Council or "Oversight Committee" (OC).

The broad operating principles, obligations and responsibilities of the managing entity, the oversight body and grant recipients are set out in legal agreements signed between the US Government, the beneficiary Government and, if the relief takes the form of a debt swap, other participating partners. These founding agreements provide for reimbursement, also from Fund proceeds, of the costs of day-to-day management and administration of the Fund and its programs, as well as servicing of the Board or Oversight Committee. In all cases, the amount that can be spent annually on administration is intended to have a fixed ceiling. The ceiling can be set by a formula stated in the agreement or by approval of specially empowered members[2] of the Board or Oversight Committee. Amendment of the ceiling is also subject to approval by the same Board members.

Over time, to accommodate diversity in the types of managing entities, the size of the Funds (which vary from US$3.1 million to US$41.6 million), the length of the payment schedules (10 to 26 years) and responsibilities of the managing entity, various formulae were developed to set a limit on expenses. Fund Boards or OCs are expected to oversee performance through approval of the annual budget and review of its execution. Outcomes are to be confirmed in one or more ways: directly to the EAI/TFCA Administrator, through annual financial audits and by periodic independent evaluations.

[1] The "Americas Funds" of the EAI program include Argentina, Bolivia, Chile, Colombia, El Salvador, Jamaica and Peru and Uruguay. The operating "TFCA Funds" include Bangladesh, Belize, Botswana, Colombia, Costa Rica, El Salvador, Guatemala, Indonesia, Jamaica, Panama (2), Paraguay, Peru (2) and the Philippines.
[2] The empowered members are the "Parties", i.e. the Board members representing the US Government and the national Government.

While the approach has worked reasonably well to instill cost discipline over the nearly twenty years since the first Fund was established, Funds have found it difficult to operate within their own ceiling over time and have not consistently applied the practices that are intended to monitor and report on their performance vis-à-vis cost ceilings. In response, the EAI/TFCA Secretariat proposed that this study be undertaken to address the various issues that have come to its attention. Annex 1 provides a copy of the Terms of Reference for the study.

This study is based largely on review of the various founding agreements, evaluations, budgets, financial and management reports that serve to establish the ceilings and to manage, monitor and report on the costs incurred to manage and administer the Fund arrangements. The 10th Annual Meeting of RedLAC, the network of environmental funds of Latin America and the Caribbean, to which many of the EAI and TCFA program funds belong, provided an opportunity to exchange views on preliminary observations and to interview Fund directors, finance staff and Board members. In addition, visits were made to Panama's Fundación Natura, the Environmental Foundation of Jamaica and the Jamaica Protected Areas Trust/Forest Conservation Fund to review their experience, practices and systems for cost management. The study reviewed results from 18 Funds that furnished the complete information requested from them and includes partial data for three Funds for which only limited information was available. Two closed Funds (Chile and Uruguay) were not included. A List of Persons Met is provided as Annex 2 and the list of Documents Reviewed is provided as Annex 3.

II. Status

Annex 4 is a summary table showing for each active EAI and TFCA Fund (1) the ratio that gives rise to the ceiling on expenses as it was set in the founding agreements[3], (2) any amendment to those documents that affected the original ceiling or ratio and (3) the most recent performance vis-à-vis the ceiling calculated by using the ratio in effect.

The summary table shows the following overall situation as of January 2010:

- For the EAI Program, four of the six Funds have amended their agreements to either increase the maximum percentage of allowable expenses or to increase the maximum and change the formula for the cost ceiling. The remaining two funds, the Colombia Americas Account and the Peru Americas Fund also amended their formula at some point, but indicated that their Boards no longer use the cost ceiling as a performance indicator.

- Of the ten operating TFCA Funds, only four Funds have either raised the maximum percentage of allowable expenses (Belize, Philippines) or modified the formula for calculating their cost ratio (El Salvador, Peru PROFONANPE). The

[3] The relevant founding documents for this study are the legal agreements that set the broad parameters for a Fund or an Account and its key governance structures. These include the Enterprise for the Americas Agreements (EEAs), Tropical Forest Agreements (TFAs) or Forest Conservation Agreements (FCAs)

remaining six Funds have retained the ceiling specified by their founding agreement or established by their Board or OC.

- Few Funds remained below the designated cost ceiling during the last financial year for which information was available. The performance ratios calculated by six of the Funds report on partial costs only, with various costs related to grant oversight charged to the notional allocation for grants.

The reasons for and significance of the practices summarized above will be discussed in the sections that follow. These sections review the approach taken to set the ceilings, experience managing within the ceilings and the practices for monitoring and reporting on results.

It should be kept in mind that the ratios of Annex 4 cannot be compared to one another in order to draw useful conclusions about the relative situation or performance of Funds. Although the group of Funds is homogeneous because it shares similar objectives, governance structures and grant making business model, each Fund operates in a distinctly different national environment and with wide variations in the value and duration of debt relief payments.

III. What's in a Ceiling?

Ratios in General

Over the past ten years, much has been written for the philanthropic community about the wisdom and usefulness of setting limits on overheads and using ratios to monitor performance of non-profits. Annex 3 includes a list of articles and briefs with conclusions that are generally relevant to experience with the EAI and TFCA Funds, even if the cited works base their findings on a more heterogeneous group of US-based non-profits. What is clear from these writings is that donor/supporters of non-profits use ratios, and particularly cost ratios, as indicators of how well recipients use resources in relation to their delivery of services or products. Cost based ratios are easy to calculate and can be tracked over time.

Classically, costs were monitored along with "outputs" as indicators of effectiveness. Newer thinking has turned to "outcomes" or desired changes in behavior or situations, as the determinants of impact. Given that conservation related outcomes often take years to manifest and a broad consensus is yet to be reached on what to measure and how, it is likely that outputs and cost-based performance ratios will continue to evoke donor interest for some time to come. The real interest in cost-based performance ratios should come, however, from a Fund's own management and oversight body, since they are useful tools when making business decisions and analyzing their results. It is generally accepted that performance ratios are most useful when tracking the performance of a single organization over time.

Defining Eligible Costs

A key concern of the United States Government (USG) as a donor to the EAI and TFCA Funds has been to maximize the resources from debt relief that will be used for activities that can achieve the objectives of the programs being financed. The more funds available for grants, the greater the possibility that grant supported activities will have a significant impact in the areas of child welfare or conservation.

To its credit, the US has adopted a balanced approach that also supports the development of institutions that make the grants and recognizes the need to cover their "reasonable" expenses. This is clear whether the agreement states the principle or implies it through a list of the functional duties to be performed. Since the beginning of the EAI, the principle of cost coverage has been established using three formulae which vary slightly.

a) The EAI and TFCA Funds created through debt reductions allow a Board or Commission to "draw sums from the Account to pay for administrative expenses of the Board" and to set the ceiling on annual administrative expenses. The Board's responsibilities are defined as management and administration of the Fund. Initially, in the EAI Funds' Enterprise for the Americas Agreements (EAAs), a brief list of activities appeared also. Later for the TFCA Funds, the list was expanded and additional clauses cited obligations such as audits that were then understood to also be chargeable as administrative expenses. The TFCA Tropical Forest Agreements (TFAs) include the following expanded activities to be carried out:

> "With respect to the management of the Fund, the Board shall:
>
> - Issue and widely disseminate a public announcement on the call for grant applications…
> - Receive applications for grants …and award grants …on the basis of an evaluation of applications on their merits;
> - Publicly announce grants awarded by the Board; …
> - Develop with each grant recipient a Grant Agreement…
> - Develop and submit to the Parties for their approval a long-term strategic plan for the operation of the Fund, including an annual budget showing prospective activities and expected administrative *and program* costs;…"

While activities associated with administrative expenses became clearer as the list was expanded, this approach has some elements that are not always easy to interpret:

- First, the wording suggests that costs to be reimbursed are related to the Board's activities while, in reality, the Funds governed by these agreements are often Foundations or other forms of non-profit organizations that have manager(s) and staff who do the actual tasks that the Board (comprised of members serving *ad honorem*) then reviews and approves. Several Agreements do state that an Executive director and staff can be hired, but most of the EAAs as well as the Philippines and Peru FONDAM-managed TFCF agreements make no such mention. Who can charge for what is not at all clear with such a formulation.

- Second, although the list of activities has grown over time, even this longer list is only partial, since it omits monitoring of grant-funded activities and use of funds. Monitoring is a critical function in any grant making program and one that has taken on more importance in the last five years as donors request evidence of impact and sufficient due diligence to ensure that funds are used for intended purposes. This omission may have led some funds to consider their costs of monitoring as outside "administrative costs" and to calculate their performance ratio without them.

- Finally, the reference to the budget (last bullet) requires a breakdown of administrative and program costs. "Program costs" are not defined in the agreement. They could be interpreted to be the grants, the costs of delivering or monitoring grants, or all of these. This undefined, but separate category of costs may account for why some funds have created a second cost category and exclude those costs when calculating what are commonly referred to as "administrative cost ratios" in line with the concept of a ceiling on *administrative* costs.

Future agreements for debt reductions could benefit from clarification in the areas mentioned above and could eliminate ambiguity by defining the expenses that are relevant for calculation of a limit on costs.

b) For the TFCA Funds supporting debt swaps, a different approach was used. In addition to an OC, these Funds provide for an Administrator in the role of managing entity. In general, Forest Conservation Agreements (FCAs) employ the broader term "management expenses", and include a definition that lists the functional activities that give rise to the expenses:

> "'Management Expenses' means such reasonable costs and expenses incurred in the ordinary course by the Administrator in connection with the management, review, technical assistance, oversight and administration of the FCA Grants Account."

Agreements that use this formula also state that the costs of serving as Secretariat to the Board or Oversight Committee are management expenses. While clearer and an improvement over the formula used in the EAAs or the TFAs, the definition of management expenses uses broad terms which themselves require further definition if they are to be fully understood and appropriately costed.

c) More recent FCAs (Guatemala, Costa Rica, Jamaica Forest Conservation Fund, Indonesia) also use the term "management expenses", define it as quoted above, yet go one step further to include a detailed list of the specific responsibilities of the Administrator. The responsibilities common to all four of the named Funds appear in Box 1. Additional clauses in those FCAs cover responsibility for accounting, preparation of financial statements, audits and program audits. This approach has several strong points:

- Eligible costs are defined in terms of "management" rather than "administrative" expenses. Administrative costs are often equated, rightly or wrongly, with indirect costs, i.e. general operating expenses that are not traceable to the desired product or service of the Fund. Administration is only one component of the definition of management expenses, signaling that other delivery costs are included as well.

- There is no ambiguity that "management expenses" does include the "program" or direct costs of grant making. The detailed list of the Administrator's responsibilities covers the full grant cycle from the call for proposals to monitoring. Therefore, these costs should not be excluded when calculating cost ratios.

- Administrative support to the OC, carrying out tasks that the OC might assign, keeping accounts, preparing financial statements and contracting audits may be arguable as indirect or direct costs, but once they are stated as obligations of the Administrator they also become eligible to be charged as management expenses.

Box 1 - Responsibilities of the Administrator

The Administrator shall have the following responsibilities :

(a) publicizing the availability of Grants to attract and engage potential Grant Recipients;
(b) soliciting proposals for Grants from potential Grant Recipients;
(c) conducting a preliminary analysis of whether each potential Grant Recipient is an Eligible Entity and reporting the results of such analysis to the Oversight Committee;
(d) reviewing all proposals for Grants …in order to analyze if such proposals conform to the requirements…, and reporting the results of such analysis to the Oversight Committee;
(e) …delivering to each Voting Member of the Oversight Committee all proposals received from potential Grant Recipients…(including any proposal which may not be eligible for a Grant based on the analysis made pursuant to clauses (c) and (d) above, together with a written report setting out the results of the analysis…:
(f) following the deliberations of the Oversight Committee and the issuance by the Oversight Committee of Grant award instructions…, obtaining a fully executed Grant Recipient Agreement and making Grant awards and disbursements in accordance with Oversight Committee funding decisions;
(g) evaluating, monitoring and auditing the Grant Recipient activities in accordance with written instructions received from the Oversight Committee and with international best practices, and reporting such evaluations and audits to the Oversight Committee;
(h) providing administrative services to the Oversight Committee; and
(i) exercising any other powers or responsibilities of the Oversight Committee…as requested by the Oversight Committee in writing.

Source: Forest Conservation Agreement, September 8, 2006

Future Agreements should ensure that the definition of allowable expenses is clear, complete and comprehensive. Use of a cost formula such as the one based on "management expenses" will focus Funds on the total cost of delivery and make it easier to determine how resources are allocated between grants and the costs of delivering the grant program.

Setting a Ceiling on Expenses

The table of Annex 4 presents the many different ratios used to set ceilings that were incorporated in the EAAs, TFAs and FCAs, or were introduced when agreements were amended. These include:

- Costs as a percent of payments made into a spendable account
- Costs as a percent of income, with income defined as payments in plus investment interest
- Costs as a percent of funds transferred by the Trustee (or equivalent)
- Costs as a percent of grant approvals
- Costs as a percent of funds authorized for disbursement
- Costs as a percent of grants disbursed
- The greater of a percent of payments in, or a percent of grants disbursed

By far the most frequently used formula is one that fixes a maximum of allowable expenses as a percentage of the debt reduction payments that will be made by the government. This formula, the variation that includes investment interest and the formula using transfers from the Trustee have the advantage of providing a predictable resource stream that in most cases is relatively stable or decreases less than 10 percent in dollar terms for at least the first five years of a Fund's operations.

When the falloff in payments accelerates or payments have declined substantially, Funds have turned to a formula that compares costs to grant approvals, or to estimated or realized disbursements. A percent of allowable expenses is set *ex ante* through the budget process. *Ex post* results might differ, however, since the number and amount of grants actually awarded or the amount of funds disbursed may not reach estimates, due to factors that are not always within the control of the Fund. For this reason, cost ratios based on approvals or disbursements are more suitable for Funds that have mature grant making programs with more regularized approvals and a solid portfolio of disbursing grants. A flexible formula has been introduced in three FCAs (Costa Rica, Guatemala, Jamaica Forest Conservation Fund) that allows the Board or OC to choose whichever of the two approaches described above is more favorable. This formula seems well-adapted to the normal life cycle of Funds for the reasons explained above and should reduce the need for amendments.

Finally, several FCAs (Bangladesh, Botswana, Paraguay, Peru FONDAM-managed TFCF) allow the Board or OC's specially empowered members, the US and national Government representatives, to select a formula and set a ceiling. Bangladesh's Arannayk Foundation's Board has set its ceiling in terms of administrative costs as a percent of total costs. Experience with this ratio is described in Box 2. The remaining three Funds had not yet fixed a ceiling at the time this study was underway, although Botswana had set its first budget as a percentage of deposits and was likely to adopt that ratio for the future.

Box 2 – Arannayk's Administrative Cost Ratio

Arannayk was not a good candidate to use a percentage of inflows ratio because government payments into the Fund declined rapidly, and were reduced by more than 23% of their original dollar value in the Fund's first five years. Instead, its Board set a cost limit using a ratio of administrative costs to total costs. Total costs are defined as administrative and program costs, with program costs comprised of the amount approved for grant financing plus various costs of monitoring and TA to grantees. While this ratio has some utility for monitoring the relative amount an institution spends on itself vs. what it spends on its product or services, the designation of a portion of costs as necessary to carry out the program and others serving a different cost of managing does not seem to reflect reality. Since Arannayk manages one TFCA fund only, nearly 100 percent of its costs are devoted to delivery of the program. In such a case, it is preferable to track performance using a clear "program ratio" that separates all costs of managing from the grants themselves. Still, it is only now, after several years of operation, that Arannayk's grant making program has matured to the point where a ratio of the cost of managing compared to the amount spent on grants, will give a reasonable view of performance.

In 2009, with the negotiation of the Indonesia TFCA agreement, the U.S. Treasury established a new approach to designating allowable coverage of administrative expenses by a Fund Administrator. Rather than identifying a specific percentage ceiling based upon an allocation amount (e.g. total government deposits), the Oversight Committee has been made responsible for determining the amount the Administrator can receive each year providing that the amount does not exceed a fixed amount in local currency that was established at Fund start-up by the Parties (in this case, the Government of Indonesia, the USG and the International NGO partner). The local currency amount approved by the Parties is neither a target nor a floor (e.g. an entitlement), but a cap. It is, however, adjustable for inflation (applied ex-ante following ex post analysis) and may be exceeded in any particular fiscal year provided that there is unanimous consent of the permanent members of the OC. The OC is committed through the FCA to "endeavor to keep the actual amount of Management Expenses as low as reasonably possible." This approach also identifies a predictable stream of income for coverage of management expenses, is less sensitive to exchange rate fluctuations and takes local inflation into account. Nonetheless, to be effective, it requires accurate initial estimates of the costs the Administrator will incur for the activities that will be undertaken over the life of the Fund. It is expected that this new approach will be used in setting the limit on allowable management expenses in future agreements.

IV. Managing Costs

Several Funds made detailed approved and actual budgets available in the interest of improving the understanding of how they plan and manage their expenses. Based on those documents and discussions with Fund staff and OC representatives, it is evident that Boards and OCs take their cost ceiling into account when approving the annual budget. What is not clear, even from the few Board minutes that were available, is how much analytical information is provided and what other performance indicators and ratios are used by Boards to assess the effective use of resources.

The role of the Board when approving resource use is to ensure that both volume and allocation of resources are coherent with strategic objectives of the institution and can achieve the agreed objectives of the program(s) under management. The strategic areas that conservation foundations or Funds pursue generally include, but are not limited to, grant making operations, grantee capacity building, fundraising, policy promotion/partnering and institutional development. For each of these areas, Boards should ask, and management should be able to demonstrate, what is being spent and what is obtained for resources used.

The strategic area that receives the most scrutiny from existing and potential donors that vest conservation funds is, undeniably, grant making. Grants, whether awarded competitively to non-governmental organizations (NGOs) and civil society organizations (CSOs) or transferred to park management entities, are the primary products that donors expect the Fund to deliver in order to achieve impact. The services that the Fund management and staff undertake to deliver grants are fairly well summarized in Box 1.

Adopting an Analytical Cost Framework

Whether managing resources using the "administrative cost" formula of the debt reduction Funds or using the "management expenses" formulae, a framework that allows management and the OC or Board to clearly see and analyze the costs of delivering grants as well as other key strategic activities is highly desirable. An approach that identifies and allocates costs or expenses as "indirect" and "direct" can provide a powerful framework for analyzing both the services that a Fund delivers and the different functional areas in which Funds put their resources to work. In very simple terms,

> *Direct Costs* can be identified with a particular product with relative ease and accuracy. These are often called "program costs". For the group of EAI and TFCA Funds, these costs will deliver the services the Fund provides to realize grants, possibly grantee capacity building and any other program or product that achieves an objective specified in the founding agreements.
>
> *Indirect costs* comprise those expenses that are not readily identified with a particular product, but are necessary for the general operation of the organization and the conduct of all activities it performs. These are management and administration services supplied from the core of the institution. It is here that costs associated with fundraising, strategic visions, new business development partnering, etc. usually originate.

The Bill and Melinda Gates Foundation offers the following simple definitions of indirect and direct costs to applicants seeking their financing. It should be noted that the Gates Foundation awards funding to entities that themselves execute a finite project, and that the total project funding received is allocated between the indirect and direct categories. This differs substantively from the concept of sinking funds or endowments of EAI and TFCA and other conservation funds whose managing entities are remunerated to deliver and oversee a stream of separate monetized products, i.e. grants, awarded to third parties. Although serving a different function, the Gates Foundation definitions aptly communicate the conceptual split between indirect and direct costs which is why they are provided here. This being said, the Gates Foundation guidelines also recognize that the designation of various costs as direct or indirect is open to interpretation. Variations can be expected by type of organization, an organization's mission as well as cost and accounting structures.

Box 3: Bill & Melina Gates Foundation Direct and Indirect Cost Definitions	
Indirect costs	***Direct Costs***
• Facilities not acquired specifically and exclusively for the project (e.g. Foundation, Institute, or University headquarters) • Utilities for facilities not acquired for and not directly attributable to the project • Information technology equipment and support not directly attributable to the project • General administrative support not directly attributable to the project. Examples are as follows: o Executive administrators o General ledger accounting o Grants accounting o General financial management o Internal audit function o IT support personnel o Facilities support personnel o Scientific support functions (not attributable to the project) o Environment health and safety personnel o Human resources o Library & information support o Shared procurement resources o General logistics support o Materiel management o Executive management (CEO, COO, CFO, etc.) o Other shared resources not directly attributable to the project o Institutional legal support o Research management costs • Depreciation on equipment • Insurance not directly attributable to a given project	• Salaries of employees directly attributable to the execution of the project o Includes Project Management o Includes administrative support solely dedicated to the project • Fringe benefits of employees directly attributable to the execution of the project o Includes Project Management o Includes administrative support solely dedicated to the project • Travel for employees directly attributable to the execution of the project • Consultants whose work is directly attributable to the execution of the project • Supplies directly attributable to the execution of the project • Sub-awards directly attributable to the execution of the project • Sub-contracts directly attributable to the execution of the project • Equipment acquired for and directly attributable to the execution of the project • Facilities newly acquired and specifically used for the grant project (excludes existing facilities). Examples include: o A new field clinic o New testing laboratories o Project implementation unit office • Utilities for facilities acquired for and directly attributable to the execution of the project • Information technology acquired for and directly attributable to the execution of the project • Internal legal and or accounting staff and/or external legal counsel or accountants directly attributable to the project

Source: Indirect Cost Guidelines for Applicant Organizations, Bill and Melinda Gates Foundation

The very similar business models of the EAI and TFCA Funds means that there will be similarities in the expenditure or budget line items that the Funds assign to indirect and direct costs. Annex 5 provides a table with a typical breakdown for direct and indirect costs for the EAI and TFCA Funds. Various expenditure items appear in both categories in line with the general definitions shown in Box 3 above.

Fund Cost Structures

There are two basic cost structures for the entities that manage the EAI and TFCA Funds. The first group manages exclusively, or almost exclusively, a Fund vested through one or the other of the two programs. The second group manages several Funds, sometimes one or more EAI and a TFCA, sometimes several funds or accounts vested by various donors. The different cost structures give rise to slightly different indirect and direct cost allocations.

a) Single Fund Managing Entities have nearly 100 percent of their expenses dedicated to one Fund. At first it might appear that there is little need to make a distinction between indirect and direct costs, since all costs are focused on one program. While this may be true for the purposes of monitoring performance vis-à-vis a cost ceiling, the ability to disaggregate costs will facilitate analysis for decision making and for discussion with potential donors when sharing of indirect costs will become relevant.

Executive management, central administrative services, rent, utilities, facilities operation, taxes, i.e. all expenditures which must continue to be made even if the sole grant-making program terminated could be included in indirect costs. These expenditures would deliver management and administration services for grant-making operations and may also support strategic and policy work, fundraising, new business development, etc in support of the general purpose of the institution. Direct costs would be those that finance the services to execute the grant-making cycle, as well as strategic work for the grant program. Capital expenditures for vehicles and office equipment are generally charged to direct costs, but might be allocated between the two categories.

It would not be unusual for a single Fund entity, especially in the early years, to see its costs concentrated in the direct cost category because efforts are focused inward on the launch and development of new operations. As entities mature and prepare to take on more roles and additional funding, central services for management and administration may expand at a faster rate than the services needed to deliver the Fund program because more strategic areas for institutional development will be pursued. This could translate into a higher proportion of indirect costs, although direct costs should always be the preponderant cost component (see discussion of the program ratio in the section Using Performance Ratios and Indicators).

b) Multi-fund Managing Entities. The cost structure for this group of Funds will be somewhat different from those of the single fund managing entities, primarily because the services for management and administration that are incurred centrally will need to be apportioned among several programs that may have different donors and objectives. A Board or OC that oversees an EAI or TFCA Fund of a multi-fund entity may not being reviewing the complete institutional costs, only its portion, but must be satisfied that costs charged to its Fund are appropriate.

There are eight managing entities in this second group, of which four (Colombia FPAA, El Salvador FIAES, Panama Fundación Natura, Peru FONDAM) manage more than one USG EAI or TFCA Fund.[4] Only three founding agreements specifically state that coverage of management expenses includes a portion of the indirect costs of the entity, but the general definition of management expenses can be interpreted to include those costs. Guidance on apportioning costs appears in only two founding agreements.

The Peru FONDAM TFA states the principle, and charges the Board with setting the rules for apportioning costs:

> "To the extent that administrative expenses relate to the shared operation of both the Tropical Forest Account and the Americas Account, the Board shall determine an appropriate proportional rate to draw from each account to pay for such administrative expenses."

Only the El Salvador TFA states a rule for apportioning costs which was likely added to ensure equitable apportioning among the two EAI and one TFCA Fund under management:

> "The proportional contribution under this Agreement to the collective administrative expenses of the Commission, including staff, and the operation of the Americas Fund shall not exceed the proportion that the dollar value of Account 3[5] bears in relation to the total dollar value of all Accounts in the Americas Fund, as computed on an annual basis."

Apportioning indirect costs in proportion to a value associated with each program under management is a commonly accepted practice. However, it is derived from the for-profit sector where an input – output relationship can be established. Such a relationship may not exist for non-profit entities whose business is grant making, and certainly does not exist for this group of Funds for which, in most cases, the nominal value of grants approved varies considerably from year to year, while management expenses are relatively stable. The El Salvador formula works well when all funds under management are EIA or TFCA sourced, which is the case for FIAES, but it may be problematic to apply it in a multi-donor context, particularly if other donors have more restrictive indirect cost financing policies.

The separate EAI and TFCA Funds managed by one entity may have different cost ceilings, and the presumption is that indirect costs will be apportioned and direct costs incurred in a way that allows each Fund to operate within its own cost limit. Some concerns have been raised that Funds do not respect that principle, that they over or under represent one or the other category of costs and allow subsidization between Funds. This is a difficult practice to control, and is best handled through Board or OC oversight of the budgets and performance of the programs against their objectives. Episodic cost transfers, made by management with full understanding, may be tolerable to meet unforeseen or cyclical events. However, the need for sustained

[4] Bolivia Fundación PUMA, Guatemala FCG, Indonesia Kehati and Peru PROFONANPE manage one EAI or TFCA Fund and activities and programs financed by other official donors and foundations. Colombia FPAA, Panama FN and Peru FONDAM also manage funding from other donors.

[5] Accounts and 1 and 2 are the EAI Funds and Account 3 is the TFCA Fund.

subsidies could indicate, at the very least, that the cost ceiling of the subsidized fund requires review, but could also be cause for concern because it might signal inefficiencies or ineffectiveness in the execution of one program. It should also be recognized that an element of arbitrariness will always be present when apportioning indirect costs, and the cost of trying to eliminate it could be greater than the resulting benefit.

Panama's Fundación Natura (FN) has devoted considerable thought and resources to developing a system for cost assignment and allocation, and has used cost analysis to present the tradeoffs in the services it must deliver as an Administrator faced with a restrictive cost ceiling. A summary of FN's challenges and cost analysis is provided in Annex 6.

The use of indirect and direct costs for the purpose of budgeting, managing and analyzing costs is a powerful framework that could serve both Fund management and Boards/OCs. Funds might benefit from training and guidance on the principles, practices and accounting systems needed to identify, assign, apportion and analyze indirect and direct costs. Guidance could usefully be compiled in the form of a handbook which could support training and development of internal systems. The RedLAC annual meeting could provide a convenient forum to deliver initial training, although additional accounting expertise would likely be required to develop Fund-specific analytical systems.

Using Performance Ratios and Indicators

It is through budget approval and review of budget execution that a Board or OC can control and monitor what is being obtained for funds that are being spent. Boards need to work with management to identify performance ratios and indicators that will allow them to monitor whether resources are being used effectively (some would say with efficacy) and progress is being made toward achievement of objectives. These ratios and indicators are a complement, not a substitute for, the limit on management expenses that not only the USG, but most donors require. Box 5 below offers several ratios that can be used by management to analyze resource use and track goals for the institution or a specific grant program.

The program ratio of Box 5 is probably the key ratio for non-profits. It receives the most donor attention, and is currently used by US NGOs in their publicity and fundraising campaigns as a measure of their effectiveness. This ratio can be calculated in several different ways:

Box 5 - Common Performance Ratios

The **program ratio** (also called the program efficiency ratio) is commonly defined as the relationship between "program expenses" (defined as funds a nonprofit devotes to its direct mission) and total expenses. It is commonly calculated for the organization as a whole using the formula: ***Program Expenses ÷ Total Expenses***. The common wisdom is that organizations should strive to achieve ever-higher program ratios, devoting as many of their resources to "program activity" as possible. However, caution must be exercised when interpreting the result, since the practical application of "program expenses" will vary widely among non-profits depending on their mission. A more precise way to define this ratio could be ***Direct Costs ÷ Total Costs,*** however the components of this formula also require clear definitions for the result to be meaningful.

Two different **fundraising ratios** are commonly used. The first, calculated as ***Fundraising Expenses ÷ Total Expenses***, measures the magnitude of spending on fundraising compared to an organization's total spending. The second, ***Fundraising Expenses ÷ Contributions Received*** assesses the effectiveness of fundraising. Both require an accounting and recording system that can accurately identify the expenditures made, including time spent by staff on fundraising.

A **funds leveraged ratio** indicates the additional funds provided by a grantee or other sources to match the grant dollars provided by a donor. To be meaningful, the counterpart funds must be monetized and not in-kind contributions. The ratio of ***Grantor Funding: Counterpart*** is generally established at the time of grant approval, but should be recalculated at project completion.

A **disbursement ratio** can be used to monitor grant program effectiveness since smooth progression in the use of grant funds will be related to the realism of project design and grantee implementation capacity. This is an important complementary ratio for organizations that set a cost limit based on grant approvals or disbursements. It is calculated as: ***Actual Disbursements ÷ Projected Disbursements.***

- If one accepts that "management expenses" as defined in TFCA founding agreements is a total cost concept, then the cost ceilings serve the function of a program ratio by making a clear division between what the Fund spends on itself to deliver and the grants it puts in the hands of grantees. Since respect of this ceiling is required in order to be compliant with the Fund founding agreements, the focus tends to be on setting budgets that do not exceed the ceiling. When the ratio has inflows as a denominator, this budgeting approach might work if annual payments are equal or increasing over the life of the pay-in schedule. Unfortunately, that is not the case, which is one of several factors that accounts for why Funds cannot remain below the ceiling for the duration of the pay-in period. A benchmark for monitoring performance against compliance could be derived by calculating the budget that would be allowable if the ratio were applied to the average annual pay-in (total amount due ÷ number of pay-in years x the maximum allowable percentage[6]) and comparing this to the proposed annual budget. A budget (i.e. total costs) that exceeds the benchmark average budget has to be compensated in the future by a budget that is below the average by an equal amount, otherwise, non-compliance becomes inevitable. If a Fund cannot deliver the required services near the average budget amount, except for the first few years that launch new operations, it should be able to explain what drives the higher costs and recommend actions (cost cutting, change in approach, raising the cost ceiling). The use of an estimated average budget as a benchmark is useful as an early warning for compliance issues, but the underlying assumption is that the cost ceiling has been set at a reasonable level to begin with.

- An "internal" program ratio can be calculated that compares direct to total costs per the second program ratio formula in Box 5. Beginning with the premise that management expenses represent total cost, this ratio will indicate how much of all Fund expenses are spent directly on services aimed at conservation impact. The ratio will vary according to cost structure (single Fund managing entities and less mature Funds will tend to have lower indirect cost components), but a ratio of 65-70 percent would be realistic.

- A program ratio could also be calculated following an approach similar to that of US non-profits. For grant-making entities, this would compare all "direct program costs" (in this case, direct costs + grant disbursements) to total program costs (indirect costs + direct costs + grant disbursements). The intent is to emphasize all costs devoted to the entity's mission. This formula may have a disadvantage for grant-making conservation funds, since grant disbursements are not expended by or under the control of a Fund, and often vary considerably from year to year. The expectation is that the program ratio will be relatively stable and, hopefully, increasing over time.

Certain strategic areas such as strategy and policy work, grantee capacity building or partnering, do not lend themselves to ratios, but should nonetheless be monitored through indicators that show whether funds spent are achieving desired strategic objectives. In the way of examples:

- Progress in areas of strategic priority for the grant program might be expressed in terms of volume and value of grants, wider geographic coverage, new grantees;

- Involvement to bring about policy changes might be deemed successful through new or modified policies that are adopted by Government or the number of grant operations that can benefit from successful policy changes;

- Depending on the type of grantee capacity building, results could be: a more diversified grantee base, more and higher quality proposals, timely receipt of grantee monitoring reports, more complete reports, adherence to disbursement schedule, etc.; and

[6] Of course, the calculation should be performed using US dollar values.

- Partnering progress might manifest as new relationships or improved relationships with current partners that are evidenced by the signature of MOUs, joint sponsorships and exchanges with public and private entities.

Observed Budgeting Practices

The practice of some Funds has been to set their budget equal to the amount that results from applying the cost ceiling specified in their founding agreement. On that basis, the managing entity can claim the maximum amount to cover management expenses from their Trustee in accordance with their founding agreements. Under-spending the budget creates deferred income which is then available for spending in the subsequent budget year. In the event of a budget overrun, accumulated unspent funds provide a reserve that can be spent down as needed. *Stricto sensu*, the limit on funding for management expenses is not intended to be used to establish the level at which Funds should operate; rather, it is the maximum that a Fund can claim when circumstances warrant it. In practical terms, however, creating a small reserve can help a Fund to manage uncertainty or cover extraordinary expenses and still respect a cost ceiling.

When actual expenses exceed the specified cost limit and there is no reserve, Funds have turned to the practice of "taxing grants" or placing an additional charge on each grant for services provided by the Fund. The five Funds that already use this practice indicated that a charge, sometimes a flat amount per grant or between 2 and 9 percent of the grant amount, is used to cover one or more services including monitoring, publicity, communications, technical advice, grantee training and audits. Three additional Funds mentioned that they are considering adopting this practice as they can no longer fully cover their expenses and remain within their cost ceiling. [7]

Except for very limited instances when a Fund must take over an activity that is normally a grantee responsibility (for example, a Fund hires the auditor to perform one audit of all small grantees, rather than each grantee making a separate arrangement), costs of services needed to deliver grants are legitimate management expenses that belong within the Fund's own cost structure. The concept of "program support costs" or "program support expenses" is widely used for non-profits, but there are multiple interpretations, and recent studies on non profits have revealed distortions from arbitrary practices used to circumvent regulations or improve performance ratios. It would be better to seek an adjustment of the limit on management expenses, or modify the formula for setting the limit than to adopt a practice that arbitrarily assigns a portion of costs to the grant program and then excludes them when calculating performance vis-à-vis the limit on management expenses.

Cost Drivers

Funds that have increased their ceiling or modified the formula for calculating it have done so after operating within the limit for at least five and up to twelve years. These are mostly EAI Funds that were created in the early 1990's.

[7] The U.S. Treasury explicitly precludes the use of this practice in a few of the more recent agreements.

Fewer amendments have been made to the limits for TFCA Funds, which have instead adopted coping strategies such as levying charges on grants or deferring institutional activities; a common observation of evaluation reports is that insufficient attention has been paid to preparing strategic outlooks or raising funds. Finally, newly created TFCA funds appear to be arriving at their limit sooner. The following have been cited by Funds or documented in reports as factors that may account for the evolution in the increase in Funds' management expenses:

- Knowledge has expanded with more than 15 years of experience and the lessons learned from evaluations. Good and best practice recommendations require Funds to adopt more complex processes and invest in better "infrastructure" (web sites, impact monitoring systems, etc).

- More stringent due diligence on grantees is expected as auditors (and donors) want greater assurance that funds have been used for intended purposes.

- Well-intentioned Boards and Oversight Committees ask their Fund administrator to take on more: to expand to remote or larger geographic areas, to work with new and often less experienced grantees, to research and develop new business areas.

- Three funds mentioned that new labor laws make it difficult for them to staff with agility and in function of need, as temporary hires can quickly acquire the right to be permanent staff. Personnel related costs represent between 50 and 80 percent of total costs for Funds which makes rigid labor practices a handicap when trying to manage costs.

- "Small" Funds cannot benefit from economies of scale as they need to have a critical mass of personnel to cover all management, administration and technical functions. Small Funds tend to be single-fund managing entities and therefore do not have several programs that can share the costs of institutional initiatives.

There is no doubt that Funds face growing and varied challenges to keep costs under control and meet expectations for efficiency, effectiveness and impact. Pursuit of improved management practices is a laudable goal, but recommendations should always be considered in terms of cost/benefit tradeoff to avoid creating cost burdens.

Other Costs

While the founding agreements have progressively improved the definition of management expenses as these relate to delivery of grants, it is not clear whether and how much of the other strategic cost areas the USG is willing to allow Funds to spend. General philanthropic practice does not generally include the objective of building the institutions to which the donor awards funding. The USG EAI and TFCA programs have, in fact, created institutions to further the objectives those programs support. The following are important institutional undertakings that merit inclusion as management expenses, but are not clearly specified in existing founding agreements.

Fundraising. Fundraising has little direct linkage to effectiveness of the conservation or child development programs supported by the USG, but fundraising expenses are critical to ensure longevity of the managing entities in which so much has been invested and/or to acquire additional funds to complement and reinforce the actions supported by the EAI and TFCA programs. Fundraising costs could include preparation of a strategy, skilled human resources and implementation of a campaign. Expenditure information used for this study does not provide insight into how many resources, if any, Funds allocate to fundraising, however independent evaluations and anecdotal information suggest that when budgets are tight, this activity languishes or is carried out in an ad hoc manner, through the good offices of Board members or a director.

Nothing in the founding agreements precludes spending on fundraising; it appears to be an allowable expenditure as one of the responsibilities that could be exercised should an OC or Board request it. If accepted, fundraising expenses must be monitored by the OC or Board, with effectiveness generally determined on the basis of funds raised per resources spent (see Box 5).

Training and Technical Assistance to Grantees. The community of practice for conservation funds considers grantee capacity building a *quid pro quo* for effective grant-making to produce the desired impact. Many of the EAI and TFCA Funds, and a fair number of the more than twenty conservation funds outside the two programs, have weathered difficult start-up of their grant making operations because of low quality grant proposals and inadequate grantee implementation experience. Several of the EAI and TFCA funds provide assistance to potential grantees by offering workshops on project design and proposal writing, and some finance mandatory workshops and seminars for first time grantees that teach project management skills and the specific accounting and reporting requirements of their grant monitoring practices. Most Funds also provide technical assistance during monitoring field visits to help grantees address the challenges they encounter. Grant supported capacity building often brings together key players and NGOs to learn about best practices, prioritize issues and provide input for policymaking. General benefits aside, the Funds state categorically that providing this support is vital to their grant programs.

How much the Funds allocate to capacity building activity varies considerably. At the high end is Bolivia's Fundación PUMA whose mission combines sustainable natural resource management and human development, with the result that nearly 20 percent of total management expenses financed from its EAI program support a series of "schools" that teach community groups concept development, detailed design and implementation skills. Representative of the Funds which use grants to deliver capacity building, the Environmental Foundation of Jamaica allocated in value terms between 1.3 percent and 7 percent of the annual total value of grants approved to capacity building over the three years from 2006/2007 to 2008/2009.

Language in nearly all founding agreements seems to support capacity building activities, but such language is not consistently clear:

- Half of the EAAs have very general language related to conservation and child development without naming specific activities.

- The definition of "management expenses" in FCAs includes "technical assistance" among the functional responsibilities of the administrator.

- The definitions of authorized expenditures or activities eligible for the use of grant funds in remaining EAAs, TFAs and FCAs refer to "training programs to increase…managerial capacities of individuals and organizations involved in conservation efforts" or "…education and training to develop capacity of local nongovernmental organizations" with an overall proviso that grants are used to conserve, maintain or restore tropical forests. These two formulations have been interpreted differently by Funds: some Funds consider delivery of grantee capacity building aimed at higher quality grants and grant management as an allowable management expense, while others consider it possible only through grants to a third party.

- Only the Colombia FCA clearly restricts capacity building by requiring that it be directly related to policy, planning and management of protected areas or the promotion of local conservation processes.

Given the strong support of the Fund community of practice, training, capacity building and technical assistance should be recognized as legitimate expenditures whether financed as a management expense or through grants. Which of the two delivery options is optimal for a given Fund should be a Board and management decision. If a Fund chooses to deliver using its own staff or a contractor, cost and effectiveness need to be monitored by the Board or OC to ensure the desired results are obtained (better proposals, higher proportion of grants awarded per call for proposals, timely reporting, issues resolved, increased disbursements). If delivery is financed using grants, a competent non-profit should be selected through a call for proposals and, like any other grant, the objectives, outputs and outcomes should be monitored.

Funding for grantee training and capacity building should not be sourced by taxing grants or creating a special category of "program expenses". That practice, which has become widespread in the non-profit community, and tacitly accepted for conservation funds, distorts the real cost of delivering conservation finance through grants. Nonetheless, Funds should be able to report separately on use of own resources for grantee training and capacity building, but this will only be possible when their accounting systems can identify the associated indirect and direct costs.

<u>Preparation of Strategic Plans.</u> Five Funds (Botswana, Guatemala, Indonesia, Paraguay, Peru FONDAM) are required to prepare a strategic plan setting priorities for the use of TFCA funds. Since the obligation appears in their founding agreements, the costs of meeting this obligation can be included legitimately as management expenses. In all instances, the TFAs or FCAs were signed within the last two years. For the remaining Funds, it is less clear whether provision has been made for work in this important area, but evaluations frequently cite the absence of a strategic plan indicating that resources are not being expended for this critical task. Consideration should also be given to support for a broader strategic work covering the development of the institution as a whole.

Institutional "Infrastructure". A practice of some Funds has been to calculate their cost ratios using the administrative expenses of their income and expense statements (personnel, fees, maintenance and repairs, etc.). Absent in some instances are the purchases of computers, furniture, office equipment and vehicles that Funds require to carry out their activities. Most of these assets are purchased at start up, but new equipment or renewals will certainly be necessary over the life of the Funds. Clarification is needed to ensure that the definition of management expenses is comprehensive in order for cost ratios to accurately reflect all reasonable expense items.

As noted previously, between 50 and 80 percent of Funds' management expenses are made up of personnel and personnel-related expenditures. Developing staff, the "human infrastructure", so that it can effectively perform multiple functions (a necessity in small organizations) or can expand its knowledge in line with evolving best practice is critical for institutions to realize their objectives. Very few Funds show any appreciable expenditure for staff training and development. Again, the language of recent agreements seems able to accommodate staff development, but cost ceilings that are set too low will not allow such expenditures to be made.

Periodic training for board members is another investment each Fund should undertake. Members come from varied backgrounds, but need to acquire knowledge outside of their area of expertise for sound decision making. Board members often cite training in the areas of finance and investment management as a high priority given their fiduciary responsibility. Should Funds put new accounting systems to support cost analysis in place, Boards will need to understand the principles and uses of the systems for their resource oversight role.

The areas discussed above (fundraising, grantee strengthening, strategy development, asset renewal, staff and board training) are critical to the development of strong institutions that are effective in the long term. If not already taken into account when setting cost ceilings, consideration should be given to making any necessary adjustments in order to support the development of strong institutions over the life of the USG program.

Fund Life Cycle

Several funds have questioned whether, given the long horizon of a Fund's operations and in many cases a declining payment schedule, there should not be several different formulae for calculating cost ceilings over the life of a fund. Review of the many documents provided by the Funds supports the premise that there is a life cycle, with noticeable cost patterns.

The early years, generally the first and second, newly created managing entities tend to incur costs well below their specified cost limit as they progressively hire staff, put in place their infrastructure and launch operations. This is not the case for multi-fund managing entities that have systems and practices in place and can rely on already established core functions to launch a new product. With few exceptions, Funds are able to live within their cost ceilings for the first five to seven years of operation.

Costs should stabilize when full services, beginning with the grant award process through field monitoring, are delivered over a relatively stable program. In practice, however, whether management expenses remain relatively stable or increase slightly over time, grant approvals do not follow that pattern, even with a one year lag. Increases or decreases to grant approvals seem disconnected from similar movements in costs. It is likely that Funds which experience this erratic pattern are confronting limited grantee absorptive capacity and/or strategic shortcomings.

As mentioned earlier in this report, some Funds switch from a formula based on inflows, to a formula based on costs as a percentage of approvals or disbursements when their costs begin to exceed the specified cost limit and their approvals and disbursements are robust and more regularized. It is likely, but impossible to document without the supporting direct/indirect cost data, that higher indirect costs begin to drive total costs toward the cost limit as these institutions seek new roles and attempt to expand. No matter which formula is utilized, Funds face a special challenge when inflows taper off. Investment of unused balances are generally made in very conservative fixed income instruments that yield positive returns but generally do not produce a "pot of gold" that will make the Fund sustainable in the long term. The presumption has been that Funds would raise additional financing to mitigate the effect of the declining inflows. This has not been the case. Funds facing a declining balance may have little choice but to cut costs and, in the absence of new funding, begin a winding up process.

The addition of an endowment component in newer Fund arrangements may be the antidote to reducing operations and instead ensure that the institutional investment and support for the EAI and TFCA objectives is sustainable in the long term. Only one Fund (Colombia) is entering this phase, so experience of the EAI and TFCA group is not yet in hand. Based on experience of the larger cohort of conservation funds which have managed endowments for more than fifteen years, the third stage of the life cycle would involve Boards or OCs setting a "spending rule" which designates a fixed amount of investment income that could be spent on both grants and management expenses. Within that spending rule, a fixed percentage would likely be set for the management expense component.

V. Monitoring Performance

There are various means by which an assurance can be provided to the USG on Fund performance in line with specified cost ceilings.

Reporting Through Audits

Audit reports can include a section on legal obligations or limitations that affect the funds they are auditing. Since there are only two types of eligible uses of EAI and TFCA funds, i.e. grants and the expenses of the Board or OC and Administrator, if a legal condition imposes restrictions, the auditor can address (some would say *should* address) whether the condition is being met. A clause introduced into the amendment of the Environmental Foundation of Jamaica's (EFJ) EAA requires the auditor to carry out such a review. The diplomatic note states: "It is, however, in the interest of the USG that the annual audit performed by the EFJ includes a review of the appropriateness of the proposed ceiling at 25 percent of the total annual grants disbursements."

The formula for determining EFJ's ceiling states that administrative expenses, including the fiscal audit may not exceed 25 percent per annum of total annual disbursements. In a note to the Statement of Changes, EFJ's auditor states the legal restriction, presents the calculation and confirms that EFJ has complied. This is a very high level of assurance, but it does require that the auditor have a clear definition of what constitutes "administrative expenses" for the purpose of the condition.

The auditor of Bolivia's America's Fund devotes a section in the audit report to compliance with legal obligations. However, for each obligation it is management that states whether or not the Foundation has complied. In such a case, the auditor is merely providing management's assertion that it is compliant. The auditor does not attest to the validity of management's statements through any type of testing or calculation performed through the statutory financial statements. This is a lower level of assurance than the one provided by EFJ's auditor, because the auditor has not taken a position. It nonetheless is a serious undertaking by Fund management.

The remaining Fund fiscal audit reports merely present summarized categories of administrative expenses in the notes to the financial statements. In the case of Jamaica's Forest Conservation Fund (JPAT is the Administrator) the audit includes a separate statement presenting an expenditure account in detail which the auditor states is "supplementary" to the statutory financial statements, but "fairly presented in all material respects in relation to the statutory statements". There is no mention of the expense ceiling restriction and no position on compliance taken by management or the auditor.

Should audits be used to confirm performance, a definition of management expenses that includes all eligible expenses will be necessary. The highest level of assurance may only be possible for Funds that manage a single program. For Funds that manage multiple programs, where allocation of indirect costs is at management's discretion, the approach using a management assertion may be the only option acceptable to an auditor.

Should audits be used to obtain an assurance on performance in relation to a cost ceiling, the following audit actions would be required:

- sufficient testing of the Grants account to provide a reasonable assurance that only grants awarded to third parties were spent from that account;

- confirmation that the account of the Administrator created for the purpose or receiving funds to cover management expenses has been credited with the amount approved by the Board for expenses during the budget year;

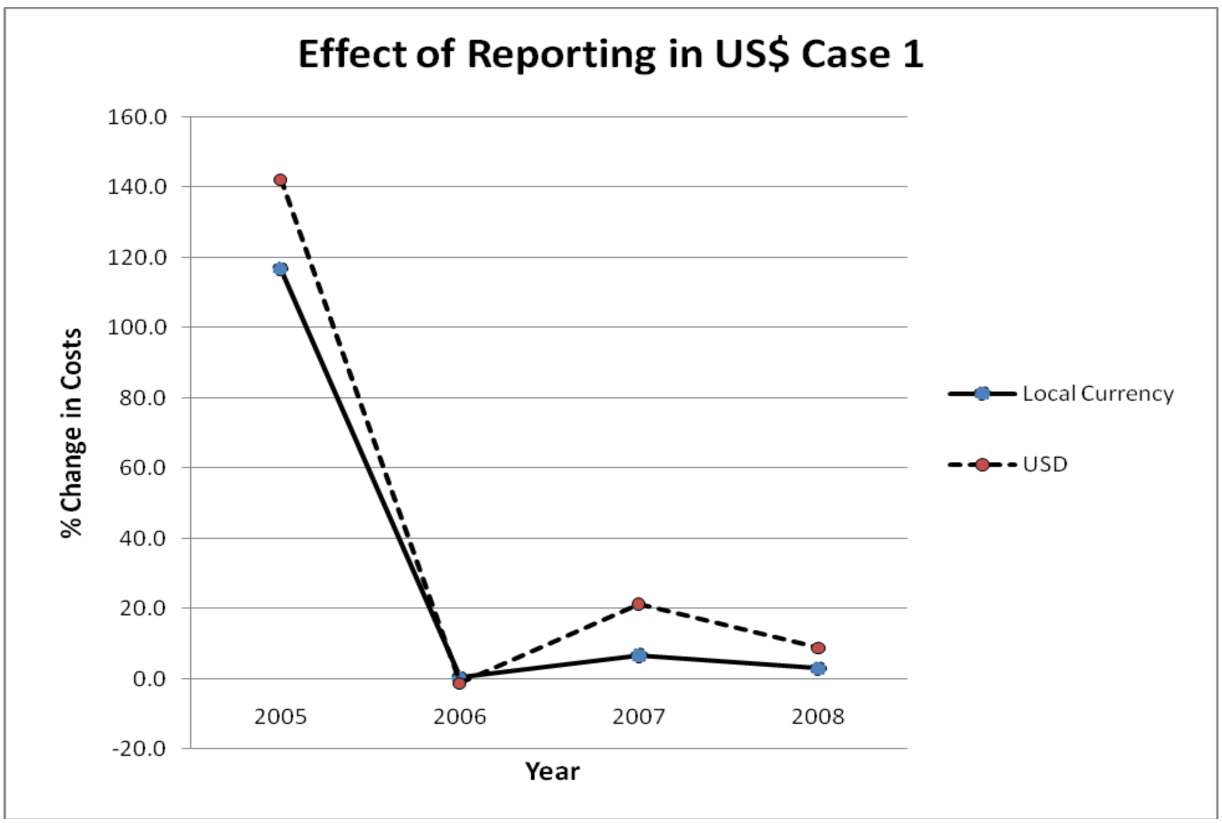
- confirmation that the amount expended from the Administrator' account complies or does not comply with the statutory obligation set out in the FCA (or with the objective approved by the Board/OC when the requirement is expressed in that manner).

Should this approach be adopted, the relevant founding documents would need to specify that the above be incorporated in the terms of reference of the auditor.

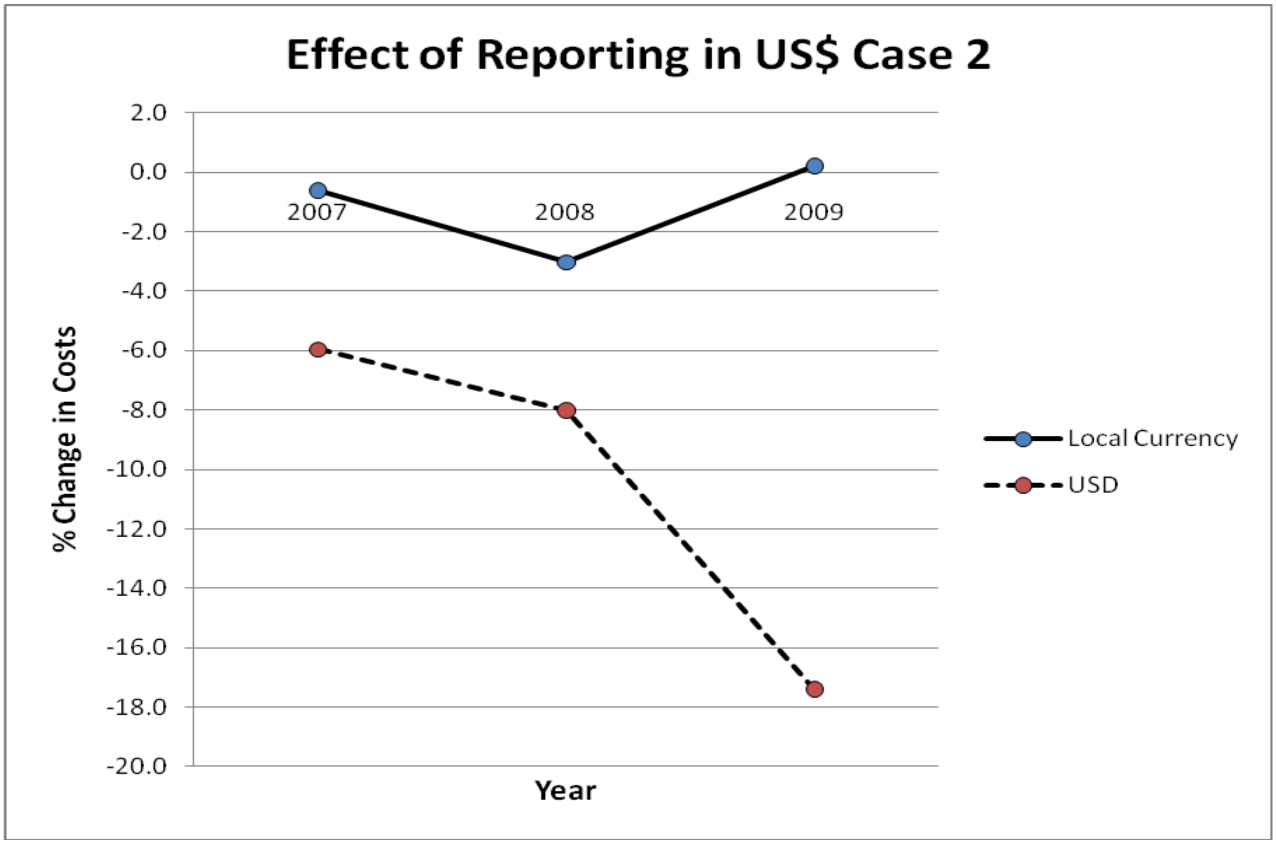
Self-Reporting

Funds self-report results, including their expenses, to the USG each year for the production of a Congressional Report. Multi-year results for administrative costs, grant approvals, grant disbursements, leveraged funds, returns on investments and other operational results are provided in table form. The format is very useful to obtain a picture of Fund operations "at a glance". There is undoubtedly under-reporting of administrative expenses in those cases where Funds are charging various direct costs to grants. Previous recommendations to clarify the definition of eligible expenses and eliminate ambiguities, as well as re-grouping all expenses using a total cost formula, should help correct this problem.

An additional issue arises as a result of converting data from their local currency into US dollars. While reporting in US dollars may facilitate review and understanding by USG constituents, exchange rate fluctuations, especially local currency depreciation vis-à-vis the US dollar, can result in distortions that make comparisons between years unreliable. Two graphs are provided below to illustrate the effect of reporting in US dollars.



Case 1 is a TFCA fund that began operations in 2005. Administrative costs calculated in local currency are beginning to stabilize in 2007/2008. When costs are calculated in dollars, the effect of currency fluctuation and a net appreciation of the local currency against the dollar over the four year period, serve to accentuate the small increases and decreases in costs that are actually occurring.



Case 2 is a mature EAI Fund with changes in administrative costs that vary only minimally from year-to-year. When the same costs are calculated in US dollars, the effect of a substantial depreciation of the local currency vis-à-vis the dollar is to present an organization with decreases of nearly 30 percent over the last four years in the cost of managing its Fund. In fact, nominal costs have decreased during that period, but only by 3.4%.

It should be kept in mind that the exchange rate distortions also affect the value of grant approvals, disbursements and any other operating results that are tracked in value terms, which could lead to false conclusions on a Fund's performance over time.

To provide useful, yet accurate, information, two separate tables might be used in the Congressional Report. Multi-year cost data could be presented in local currency, while current year information could be given in US dollars to give the reader a point in time reference of the magnitude of the Fund's operations. If reporting all results in US dollars is an obligation, an appropriate caveat should be added as a note to the summary table of each Fund.

Reporting Through Evaluations

All evaluation reports that were reviewed discussed Fund performance compared either to the cost ceiling that appeared in the founding agreements or to the Board-approved cost ratio. Evaluations were also forthright about the various practices of charging costs against grants.

In terms of presentation, the same risk of distortion is present when data are converted into dollars. Expressing results in local currency is preferable. When calculating a ratio of costs to inflows in local currency, evaluators should use the actual local currency value of funds paid in. Funds can easily provide the exact local currency value of payments received, since they are notified when government payments are made.

Evaluations often make recommendations that, if adopted, would impact a Fund's management expenses. Funds that are already operating at or above their designated cost ceiling will have difficulty implementing recommendations that entail additional spending. Evaluators should, to the extent possible, indicate the effect their recommendations will have on costs and identify cost savings, if any, which could result from their recommendations.

VI. Looking Forward

The analysis, observations and recommended changes of this study are intended to improve Fund management practices, and facilitate dialogue with and oversight by the USG. By supporting this study, the USG has indicated its willingness to identify and support solutions to improve performance going forward. On their part, the current cohort of EAI and TFCA Funds are encouraged to develop a response to this review, taking into account the recommended improvements to current practices as they are applicable.

TERMS OF REFERENCE
EIA/TFCA FUND ADMINISTRATIVE COST REVIEW

U.S. Agency For International Development (USAID)
U.S. Department of Treasury
U.S. Department of State

I. Purpose

The purpose of this administrative cost review of EAI/TFCA environmental funds is to compare sanctioned administrative cost limits with actual administrative expenditures (*in other words, compliance with the agreements*), to identify existing practices, and to recommend improved practices for indirect cost recovery. The expected outcome of the review is to eliminate the inappropriate or cryptic practices which circumvent policy limits, and to standardize the U.S. Government guidance on such matters for greater consistency and transparency.

II. Background and Context

There are two congressionally authorized innovative debt relief programs of interest for this consultancy. Both are designed to generate significant additional financing for the environment, child survival, and tropical forest conservation: (1) The Enterprise for the Americas Initiative (***EAI***) of 1991 (PL102-549) and (2) the Tropical Forest Conservation Act (***TFCA***) of 1998 (PL105-214), which is modeled closely after the EAI. These programs complement direct assistance provided by the United States Government through USAID and other agencies.

Both the EAI and TFCA offer eligible countries opportunities to reduce their official concessional debt owed to the U.S. Government (PL 480 and USAID debt) while generating funds locally for specified activities. Under each program, countries that meet certain economic and political criteria set forth in the legislation may redirect debt payments they would have made to the United States into local funds. Each local fund is administered by a local board or oversight committee comprised of representatives of the U.S. Government, the beneficiary government and local non-government organizations, with the last constituting a majority of its members. Payments into local funds are made by the beneficiary country in local currency based on a schedule of payments agreed by the United States.

The EAI and TFCA programs both establish, or contract with, a Fund Administrator (FA) to implement a grants program. The bilateral agreements through which these FAs are identified, often establish formulas limiting their allowable administrative expenditures. At times, no such limits are stipulated in the actual bilateral agreements but, instead, the parties approve the limits through the Boards/ Oversight Committees. In either case, there are formally identified means by which to amend the administrative rates ceilings. Currently, the process for formulating the rates is not standardized. Consequently, a large range of allowances exists.

This consultancy is funded exclusively for improving the USG policy guidance relative to the EAI/TFCA family of environmental funds and foundations. The six existing EAI country funds include: Argentina, Bolivia, Chile, Colombia, El Salvador, Jamaica, and Peru. The fourteen existing TFCA agreements include: Bangladesh, Belize, El Salvador, Peru (x2), Philippines, Panama (x2), Colombia, Jamaica, Paraguay, Guatemala, Botswana and Costa Rica.

III. Key Tasks

The consultant will work with the EAI/TFCA Secretariat housed in USAID/EGAT/NRM compare sanctioned administrative cost limits with actual administrative expenditures, to identify existing practices, and to recommend sound practices for indirect cost recovery. In order to do so, the consultant will***:*** **1)** ***review*** available materials from the EAI/TFCA Secretariat (e.g. agreements, Fund founding documents, correspondence, audits, analyses); 2) ***solicit*** additional information from the EAI/TFCA Funds as necessary; 3**)** ***identify*** approved limits and existing practices for treatment of administrative costs; 4) ***document*** the findings, conclusions and recommendations; and 5) ***provide*** draft input into USG guidance specific to EAI/TFCA Funds.

Specifically, the consultant will work with the EAI/TFCA Secretariat to:

1. Review of the EAI/TFCA bilateral agreements, particularly the sections on administrator responsibilities and management costs, to *identify the language used in each agreement concerning administrative costs.* If the information is not contained in the agreement or any subsequent amendments (e.g. exchange of diplomatic notes), then information will be requested directly from the Fund Managers or the U.S. Government representative on the Board/Oversight Committee directly. This information would normally include:

    a. ***The unit of measure used*** to define the administrative rate ceiling. The caps generally take the form of a *percentage* of some base figure.
    b. ***The allocation base figure used*** to define the administrative rate ceiling. For example, the allowable rate could be a percentage of deposits to the *grants account, the endowment account, total deposits, cumulative deposits, unspent balances, interest income, total inflows or total program expenditures.* Alternatively, the rate could be a percentage of *grants approved, grants disbursed or annual budgeted amounts*.
    c. ***The scope of the work*** *detailing specific administrative tasks required of the Fund Administrator.* Funds vary in their functions performed, for example a Fund may be charged with: financial management, grant-making, monitoring and evaluation, contracting, communications, staff development, entering a trust agreement and/or being the secretary to the Board/Oversight Committee, to mention a few.

2. Review EAI/TFCA Fund financial audits and supporting documentation to determine quite *how the Funds are calculating actual management fees*. Several variables play into this calculation. Most involve scale and the interplay between variable versus fixed costs. The variables include:

    a. Average grant size (grants usually share the same administrative costs regardless of size)
    b. Number of grants per year
    c. Geographical concentration/dispersion of grants
    d. Grant duration

3. Review the identification of specific cost objects (line items) and their accounting treatment as either indirect (administrative) or direct (program) costs. This also gets at how the Funds are calculating actual management fees, but very specifically examines variance in nomenclature (e.g. “program support” costs) and ensures comparison of apples to apples.

4. Determine whether and, if so, how EAI/TFCA Funds may be augmenting revenues for indirect cost recovery beyond the formally sanctioned rates. Also clarify the policies by which rates are formalized. This formal sanctioning can be cited directly from bilateral agreements, by-laws or simply through Board/Oversight Committee voting during annual budget approvals.

5. If feasible, analyze practices by which certain Funds cover management expenses with resources from multiple accounts (e.g. EAI grants acct., TFCA grants acct., endowment acct). Given the possibility of economies of scale, the study should review practices of shared or combined costing of management expenses.

6. Draft comparative findings, conclusions and recommendations for discussion among interested and affected USG stakeholders, the results of which would be incorporated in the consultant's draft input into USG guidelines and standards for EAI/TFCA Funds.

IV. Reporting and Deliverables

A concise final submitted report in electronic format (MS Word, or pdf) due at the completion of the assignment will be in the English language. The report will provide an assessment of the status of administrative rate treatment by the EAI/TFCA family of Funds and provide ***findings, conclusions and recommendations*** for corrective action and improved practices. ***USG guidance and standards*** for administrative expense treatment would subsequently be developed specific to the nuances of the EAI/TFCA program.

This exercise is not intended to be punitive. Rather, the USG is interested in transparent establishment of reasonable administrative cost ratios and program efficiency ratios. Whatever the USG guidance would be, it would be based on the principle of 'reasonableness' outlined in the Office of Management and Budget Circular A-122.

As stated in a 2001 publication[8], "indirect cost rates (ICRs) would be developed in order to be able to maximize real cost recovery, by having each funding source pay its fair share of indirect costs – ideally at the exact amount that the funded direct activities created the necessity or incurrence of the associated indirect costs (as expressed as a percentage, or ratio, of those direct costs). Indirect costs are real costs…when not properly funded, an organization's time, effort and resources must be diverted from proper mission-driven, programmatic delivery, to searching for alternative ways to cover imperative core costs. This can reduce the NGO capacity and effectiveness, ultimately harming the intended beneficiaries and other stakeholders." The USG recognizes this delicate balance between program efficiency and reasonable management cost that must be achieved by each unique Fund.

V. Timetables

Depending upon the source of this consultant (e.g. private contractor versus a USG employee), the time horizon for the assignment will vary significantly. The USG employee will be assumed to have other duties as required and be able to dedicate time to this task only intermittently. The assignment is anticipated to require approximately 160 hours of dedicated time, spread over a four month period.

Most of the time required will be in reviewing and assessing the existing documents filed at the EAI/TFCA Secretariat. Some additional documentation will be requested from the field (generally the

[8] Ortiz, Alfredo Core Costs and NGO Sustainability: Towards a Donor-NGO Consensus on the Importance of Proper Measurement, Control & Recovery of Indirect Costs. 2001. PACT Inc., Publications. The Nature Conservancy, PACT, The Summit Foundation and USAID. pp.6.

U.S. government representative on each Board or Oversight Committee). The EAI/TFCA Secretariat will assist with the target collection of information as required, hence reducing the level-of-effort required from the consultant.
The deliverables would be due no later than December 31, *2009*.

VI. Consultant Qualifications

The appropriate consultant is envisioned to be one individual who is very familiar the US Government overhead management requirements for NGOs and/or grant recipients.

The consultant would have the following minimum qualifications:

- Proven language proficiency in English (written and verbal)
- Graduate level degree or a minimum of 3 years experience in budgeting, finance, government contracting, accounting or a related field.
- Familiarity with the NGO accounting procedures (esp. Foundations)
- Good interpersonal and cross-cultural relationship skills.

VII. **Budget**

The source of the funding for this consultancy would the TFCA appropriation made to the Office of International Debt Policy of the U.S. Department of Treasury. The budget details can be specified as the favored hiring mechanism is identified.

A rough estimate for the consultancy would be $ _______ (160 hours plus mechanism overhead rates and contingencies). Some international travel may be anticipated.

VIII. Contact Information

The principal U.S. Government personnel associated with this consultancy are:

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Annex I: Collaboration With RedLAC

As mentioned, this review is funded exclusively for improving the USG policy guidance relative to the EAI/TFCA family of environmental funds and foundations. Nevertheless, the term of reference for the review are being shared with the Regional Network of Latin American and Caribbean Environmental Funds (RedLAC). Most EAI/TFCA Funds are members of RedLAC.

During a recent RedLAC General Assembly (Belize Nov.08), the Executive Committee (EC) recognized the importance of an administrative cost study to its membership and requested that the EAI/TFCA Secretariat consider using RedLAC as a "platform" for this comparative study. One of RedLAC's objectives is to "enhance the value of the network's intangible assets" (e.g. knowledge, methods, best practices). RedLAC generates products and services (e.g. specialize publications) under its brand name and value is created for these products and services when data becomes "useful, organized and analyzed information." The proposed EAI/TFCA study is one such opportunity that coincides with the network's comparative advantage.

The U.S. Government views RedLAC as a highly valuable partner and continues to support the network as best possible. In the case of this proposed study, the *interest and the outcomes* are highly specific to the USG EAI/TFCA programs and, while related, they differ somewhat from the RedLAC objectives. In addition, 1) the U.S. Treasury would be sponsoring the study, with TFCA appropriated dollars, for use specifically for TFCA program, 2) the motivation for the study is driven by the USG desire to take corrective action within the EAI/TFCA family of funds, and, 3) unlike RedLAC funds, the EAI/TFCA family of funds is relatively homogeneous because of their founding statutes, agreements, donor requirements, etc.

Arguably, a smaller sample size of somewhat homogeneous funds will allow a more profound analysis, the results of which would provide more meaningful and substantive USG guidance to this subset of environmental funds. Often broader studies combine such disparate objectives and variance of sample units that the outcome becomes dilute, generic and less meaningful. Consequently, while the participation of RedLAC in this study is most welcome, the initial analysis would best be focused on a manageable core of EAI/TFCA Funds. In fact, as the specific analytical questions are detailed, they most certainly will differ from those of RedLAC. The challenge, therefore, is to retain the interests and active feedback of both parties (the USG and RedLAC) in order to produce an initiative meeting the needs of both.

The USG welcomes RedLAC input and partial ownership of the effort (or its parallel or second generation). RedLAC participation in the study would add value in terms of scale (larger sample size), utility of the methodology and expanded application of the final product. The USG will openly share all phases of the process and product with RedLAC with the hope for genuine integration of results. Additionally, at the USG interest is principally to provide guidance to, and appropriate corrective action for, the EAI/TFCA funds (read: the US Guidance and Standards). This differs from the RedLAC desired outcome and, therefore, would not conflict with the RedLAC desire for a production and ownership of associated products (read: the analysis itself).

List of Persons Met

Fundación Natura

Zuleika Pinzon, Executive Director
Vilna Project Coordinator
Yolanda Jimenez, Project Coordinator
Leonor de Fadul, Administration and Finance Manager

USAID Panama

Rita Spadafora, Economic Growth and Environment Specialist

Jamaica Protected Areas Trust /Forest Conservation Fund

John Stephens, Chairman of the JPAT Board
Marilyn Headley, Chairperson of the Oversight Committee
Allison Rangolan McFarlane, Executive Officer
Renee Oliphant
Sara Simpson

Environmental Fund of Jamaica

Joan Grant Cummings, Chief Executive Officer
Barrington Lewis, Finance Director

Tropical Forest Conservation Fund Paraguay

Félix Kasamatsu, President

Fondo de la Iniciativa para las Américas El Salvador

Jorge Oviedo, General Manager
Maria Luisa Reina Vásquez, Administrative Council Chair
Mary Rodriguez, Environmental Specialist (USAID San Salvador=

Forest Conservation Botswana

Gogoitsiwe Moremedi, Chief Executive Officer
Meshack Keitumetse, Project Manager

Fundación para la Conservación de los Recursos Naturales y Ambienta en Guatemala

Yvonne Ramirez, Executive Director
Juan Carlos Godoy, TFCA Oversight Committee Member

Fondo para la Acción Ambiental y la Niñez, Colombia

José Luis Gomez, Executive Director
Luis Germán Botero, Administration and Finance Director

Fundación PUMA, Bolivia

Juan Carlos Chávez Corrales, General Manager

Fondo de las Américas, Peru

Juan Gil Ruiz, Executive Director

Instituto Nacional de Biodiversidad

Alonso Matamoros, Assistant Director, Planning
Maria Vargas Mata

Arannayk Foundation

Farid Uddin Ahmed, Executive Director

Fondo Nacional para Áreas Naturales Protegidas por el Estado

Herman Cabrera,
Favio Rios Bermudez, TFCA Account Coordinator

PACT Foundation, Belize

Sharon Perera, Executive Director
Anna Hoare, Board Member

Documents Reviewed

General Cost Literature

Non-profit Overhead Cost Study, Urban Institute's National Center for Charitable Statistics/ Center on Nonprofits and Philanthropy, and the Center on Philanthropy at Indiana University (2005), Briefs 1 - 5

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Keating, Elizabeth and Frumkin, Peter, How to Assess Non-Profit Financial Performance, October 2001

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Spergel, Barry and Taieb, Philippe, Rapid Review of Conservation Funds, Conservation Finance Alliance, May 2008

Documents of the Tropical Forest Conservation Act Secretariat

Operation of the Enterprise for the Americas Initiative and the Tropical Forest Conservation Act: 2008 Annual Report to Congress

Fund-Specific Documents

Argentina Enterprise for the Americas Account

An Evaluation of the Enterprise for the Americas Account at the Fondo para las Américas, October 2006

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Agreement between the Government of the United States of America and the Government of the People´s Republic of Bangladesh concerning the Establishment of a Tropical Forest Fund and a Tropical Forest Conservation Board, 12 September 2000
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Forest Conservation Agreement, September 28, 2001
Amendment No.2 to the Forest Conservation Agreement, May 2003
Amendment No.3 to the Forest Conservation Agreement, November 2004
PACT Foundation Financial Statements 31 March 2008
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Bolivia Enterprise for the Americas Fund

Modificación del Acuerdo entre el Gobierno de los Estados Unidos de América y el Gobierno de Bolivia relativo el Establecimiento de una Cuenta Ambiental de la Empresa de la Iniciativa para las Américas en el Fondo Nacional para el Medio Ambiente, 8 junio 2000
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Análisis de Costos y Gastos e Impacto en los Costos y Gastos de SAF y SIMEP Histórico de 2003 a 2006 y Proyección de Ingresos y Gastos 2007 a 2010
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Acuerdo entre la Republica de El Salvador y el Gobierno de los Estados Unidos de América relativo al establecimiento del Fondo y del Consejo Administrativo de la Iniciativa para las Américas, el 18 de junio 1993
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Agreement between the Government of the United States of America and the Government of the Republic of Paraguay concerning the Establishment of a Tropical Forest Conservation Fund and a Tropical Forest Conservation Board, 7 June 2006
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Peru Americas Fund

Agreement between the Government of the United States of America and the Government of the Republic of Peru concerning the Establishment of an Americas Fund and Administering Board, 24 December 1997
Fondo de las Americas Peru, Management Report, September 2006 to August 2007
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Forest Conservation Agreement (Fund 1), June 6, 2002
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Audit of the Institutional Financial Statements of the National Fund for Natural Areas Protected by the State PROFONANPE as of December 31, 2006 and 2005 (Certified Translation)
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An Evaluation of the Tropical Forest Conservation Act Fund, Peru, November 2007

Agreement between the Government of the United States of America and the Government of the Republic of Peru concerning the Establishment of a Tropical Forest Conservation Fund and Administering Board (Fund 2), Draft 2008

Philippines Tropical Forest Conservation Trust Fund

Agreement between the Government of the United States of America and the Government of the Republic of the Philippines concerning the Establishment
Tropical Forest Conservation Fund and Tropical Forest Conservation Board, 19 September 2002
Approved Budgets 2006, 2007, 2008
Tropical Forest Conservation Trust Fund Independent Evaluation, August 2008

EAI/TFCA Fund Summary Table

Tropical Forest Conservation Act Funds									
Country	Original Ceiling	Original Legal Obligation	Amended	Amended Obligation	Current Ceiling	Latest Year	Performance	Source*	Notes
Bangladesh	25% of total costs	Administrative expenses may not exceed a ceiling established by the Parties annually.			25%	2009	37%	2	2009 performance is calculated on actual expenditures. Total costs = core expends + program expends (grants & program expenses). Program expenses for 2008/2009 were 7% of total costs.
Belize	(1) PACT Foundation Endowment (2) For BAS, PfB and TIDE: 15% of a maximum 5% of the value of the endowment fund and 15% of deposits into the land management account	Endowment: (i) the amount of all disbursements from its endowment account in any fiscal year shall not in the aggregate exceed more than 5% of the total amount held on deposit ...on the last day of the previous fiscal year. (ii) ...BAS, TIDE, and PfB may each expend up to 15% of those funds authorized for disbursement in a given fiscal year on Overhead Expenses incurred in the ordinary course. Land Management Acct: ...each of PfB, BAS and IDEA may spend up to 15% of the funds deposited into its Land Management Account in a given fiscal year	2003		(1) PACT Foundation 30% of endowment interest (2) Others 30% of maximum 5% of the Endowment value + 30% of the Land Management Account	(1) 2009 (2) 2008	(1) 18.6% (2) 30% TIDE	5	

Botswana	10% of deposits	Administrative expenses shall not exceed a ceiling established by the Parties' representatives on the Board taking into account anticipated administrative expenses and funds available in the Fund. The Parties' representatives on the Board shall review and adjust, as appropriate, the ceiling for administrative expenses on an annual basis.			10%	2009	Budget set at 10%	4	Rate is based on funds paid in. No grant making activity to date.
Colombia	15% of transfers from the Trustee	The Management Expenses approved by the Oversight Committee shall under no circumstances exceed fifteen percent (15%) of the amounts received by the Administrator from the Trustee in a given year. The Administrator shall not be allowed to charge any fees or other charges to any Grant Recipient.			15%	2008	18.45%	2	*Does not include the amounts that FPAA charges to the grant account to cover promotion and communication, monitoring, and impact evaluation.*
Costa Rica	10% of deposits	The Management Expenses approved by the Oversight Committee with respect to a particular fiscal year shall under no circumstances exceed the greater of (a) ten percent (10%) of the Payment required to be made by the CBCR during such fiscal year, and (b) fifteen percent (15%) of the amount disbursed as Grants from the FCA Grants Account during such fiscal year. The Administrator shall not be allowed to charge any fees or other charges to any Grant Recipient.							No grant making activity to date

El Salvador	Varied with approved budget	Administrative expenses may not exceed a ceiling established by the Parties annually.	2001,2009	El Consejo puede retirar proporcionalmente sumas de la Cuentas 1, 2 y 3 necesarias para pagar los gastos administrativos del Consejo, incluyendo asistencia technica y las auditorias fiscales y programaticas requeridas segun este Articulo y el Articulo IV del Acuerdo de Fondo TFCA. El Consejo puede votar para pagar una tarifa de viaticos fija razonable para reembolsar, sin la necesidad de recibos, los gastos de los miembros del Consejo... por asistencia a reuniones del Consejo. Las sumas proporcionalmente retiradas de cada Cuenta no pueden exceder el 15% por ano de la respectiva cantidad total de donaciones aprobadas para implementacion en ese ano. Este porcentaje del 15% puede ser modificado por las Partes de vez en cuando por mutuo acuerdo.	15% of grant approvals	2008	22.00%	5	TFCA is Account 3. The TFCA Agreement was aligned with the EAI by the Amendment of 2009. *FIAES also "taxes" each grant about (1) 4% to cover the external audit and publicity, and (2) 5% to finance a technical advisor and training which is provided by FIAES staff.*
Guatemala	10% of deposits	The Management Expenses approved by the Oversight Committee with respect to a particular fiscal year shall under no circumstances exceed the greater of (a) ten percent (10%) of the payments required to be made by the GOG in such fiscal year, and (b) fifteen percent (15%) of the amounts disbursed as Grants from the FCA Grant account during such fiscal year. The Administrator shall not be allowed to charge any fees or other charges to and Grant Recipient.			10%	2008	9.87%	2	10% of payments into the Debt Account yielded the higher of the two formulae.

Indonesia	Decision taken to adopt a fixed amount in rupiahs.	The Oversight Committee shall determine the amount that the Administrator shall be entitled to receive as Management Expenses pursuant to clauses (i) and (j) of Section 6.7.1.; provided that Management Expenses with respect to each fiscal year beginning with the year 2010 shall not exceed a maximum amount to be determined by the GOI, the USG and CI prior to the Closing Date; and provided further that such maximum amount may be exceeded in a particular fiscal year with the unanimous approval of the Permanent Members of the Oversight Committee (other than the Permanent Member designated by KEHATI).							No grant making activity to date
Jamaica JPAT	10% of deposits + earnings	The Company shall have the right to expend on Management Expenses incurred in the ordinary course in any fiscal year up to the greater of (i) fifteen percent (15%) of the FCA Income that is disbursed to FCA Grant Recipients during such fiscal year or (ii) ten percent (10%) of the FCA Income that the Company is to receive pursuant to Section 3.1 for such fiscal year.			10%	2009	12.60%	2	*Does not include amounts charged to the grant account for capacity building activities and studies approved by the OC.*
Panama I	9% of payments into the Fund	The Fund Administrator shall have the right to expend in any fiscal year up to nine percent (9%) of the amounts that it receives from the Trustee during such fiscal year on Management Expenses.			9%	2008	19%	5	

Panama II	18% of payments into the Fund	The Management Expenses approved by the Oversight Committee shall adequately compensate the Fund Administrator for the services it provides under this Agreement, but shall not exceed eighteen percent (18%) of the aggregate of all amounts transferred by the Trustee to the Forest Action Fund in a given year.			18%	2008	18%	5	
Paraguay	Decision on ceiling not yet taken	Administrative expenses shall not exceed a ceiling established by the Parties' representatives on the Board taking into account anticipated administrative expenses and funds available in the Fund. The Parties' representatives on the Board shall review and adjust as appropriate, the ceiling for administrative expenses on an annual basis.							First grants expected to begin in March 2009. No evidence that decision on administrative expense ratio was taken.
Peru	5% of deposits + earnings	The Fund Administrator shall have the right to expend in any fiscal year up to five percent (5%) of the FCA Income that it receives from GOP hereunder during such fiscal year on Management Expenses incurred in the ordinary course.	2007	The Management Expenses approved by the Oversight Committee for a particular fiscal year shall under no circumstances exceed 15% of the average of the annual payments due and payable by the Government of Peru under this Agreement for each of the fiscal years 2007 through 2014.	15% of payments	2008	14.80%	2	The 2008 budget actuals indicate that expenses comprise the MEU and a contribution = to 5% of PROFONANPE's indirect costs.

Peru II	Decision pending	The Board may draw sums from the Tropical Forest Account necessary to pay for reasonable administrative expenses of the Board, including the audit required pursuant to paragraph (2)(D)(ii) of this Article. . Administrative expenses shall not exceed a ceiling established by the Parties' representatives on the Board, taking into account anticipated administrative expenses and funds available in the Tropical Forest Account. The Parties' representatives on the Board shall review and adjust, as appropriate, the ceiling for administrative expenses on an annual basis.							New Board constituted in 2008. Operations initiated in 2009.
Philippines	10% of grant approvals	Administrative expenses shall not exceed a ceiling established by the Parties and adjusted as needed, taking into account anticipated administrative expenses and funds available in the Fund.			10%	2007	13%	1	Formula is 10% as ratio of admin costs (supplies, rental, and salaries of admin personnel) to grant funding approved. Management expenses (salary and travel costs of the Project Officer) must not exceed 25% of any grant amount.

Enterprise for the Americas Funds									
Country	Original Ceiling	Legal Obligation	Amended	Amended Obligation	Current Ceiling	Latest Year	Performance	Source*	Notes
Colombia	10% of deposits	The ECOFONDO may draw sums from the Account necessary to pay for the administrative expenses, including the fiscal audit required purusant to this article, in accordance with the annual budget as approved pursuant to paragraph 7 above. These sums may not exceed 10% per annum of the total annual payments into the Account made by the Government of the Republic of Colombia pursant to Article II.2 of this Agreement, except as the Parties may otherwise agree by exchange of notes.	2000	The Council may authorize the withdrawal of sums from the Account necessary to pay for the technical, administrative and financial expenses, including the fiscal audit required pursuant to this Article, and those related to its operations in agreement with the budget and rates specified in the previous paragraph. The total of these sums shall not exceed the value agreed upon annually by the Parties and may be modified through an exchange of notes. The Council will work to establish a formula, for the approval of the Parties, to limit technical, administrative and financial expenses to the smallest possible percentage of those funds distributed to grantees consistent with recognized standards of accountability and effective technical support.	No fixed numeric target. Board sets performance goals each year with budget approval.				
El Salvador	7% of deposits	The Commission may proportionally draw sums from Accounts 1 and 2 as necessary to pay for the Commission's administrative, including technical assistance, expenses, including the fiscal and programmatic audits required purusant to this article. These sums may not exceed 7% per annum of the total annual payments made by the Government of the Republic of El Salvador to each account pursuant to Debt Reduction Agreement 1 and Debt Reduction Agreement 2, except as the Parties may otherwise agree by exchange of notes	1998, 2001,2009	The sums proportionally withdrawn from each account cannot exceed 15% per year of the respective total quantity of grants approved for implementation in that year. (See full text under TFCA).	15% of grant approvals	2008	10%	5	Initially set at 7%, amended to 10% in 1998 and then in 2001 "established by the Parties annually". *FIAES also "taxes" each grant about (1) 4% to cover the external audit and publicity, and (2) 5% to finance a technical advisor and training which is provided by FIAES staff.*

Bolivia	10% of deposits	Not available	2003	...Fundación PUMA queda autorizada a retirar fondos de la Cuenta para cubrir los gastos administrativos relacionados con la Operación de la Cuenta, conforme al Presupuesto aprobado por su Directorio con votos afirmativos de los representantes de las Partes, el Presupuesto de gastos administrativos no podrá ser superior al 15% de las transferencias anuales proyectadas para el financiamiento de proyectos....Los gastos administrativos relacionados con la operación de la Cuenta, no incluyen los costos de la administración y el manejo del Portafolio de Inversiones.... Este monto deberá incluir la auditoria financiera..., pero no debe incluir evaluaciones y auditorias independientes.... La Fundación tendrá la responsabilidad de preparar un presupuesto para estos gastos administrativos, que deben ser revisados y aprobados por el Directorio, incluidos los votes afirmativos de los representantes de las Partes.	15% of estimated grant disbursements	2009	15%/10%	3	Uses two formulae. SAF which covers administration costs and sets the budget at 15% of the projected transfers and SIMEP which is based on 10% of grant disbursements.
Argentina	10% of deposits	The Commission may draw sums from the Fund necessary to pay for the Commission's administrative expenses, including the fiscal audit required pursuant to this article. These sums may not exceed 10% per annum of the total annual payments made by the Govt of the Rep of Argentina..., except as the Parties may otherwise agree by exchange of notes.	1999	The Commission may draw sums from the Fund necessary to pay for the Commission's administrative expenses, including the fiscal audit required pursuant to this article. These sums may not exceed 15% per annum of the total annual payments made by the Govt of the Rep of Argentina..., except as the Parties may otherwise agree by exchange of notes.	15% of deposits	2008	13.00%	2	As payments ceased in 2008, the Fund now covers its operating expenses through an 8% tax on each grant. 2008 performance is reported by the FPLA as 10.2% of grant disbursements.

Jamaica	15% of deposits	The Board of the Foundation shall draw sums necessary to pay for the Foundation's administrative expenses, including the fiscal audit required pursuant to Article V.6. Except as the Parties may otherwise agree by exchange of notes, these sums may not exceed 15 percent per annum of: the annual payments into the Fund made by the Government of Jamaica pursuant to the Debt Reduction Agreements; and the annual investment income.	2002	The Board of the Foundation shall draw sums necessary to pay for the Foundation's administrative expenses, including the fiscal audit required pursuant to Article V.6. Except as the Parties may otherwise agree by exchange of notes, these sums may not exceed 25 percent per annum of the total annual Grants Disbursements.	25% of grant disbursements	2009	25%+	3	EFJ indicated that admin costs were below the ceiling until this year when high depreciation and declining disbursements contributed to an overrun.
Peru	See formula	The annual administrative costs may not exceed 3% of the resources of the FONDAM during the previous fiscal year, nor 20% of the total programmed costs for the current year, whichever is less.	2006	The Executive Secretary shall submit for the discussion and approval by the Administrative Council the Fund's annual budget, which will include an Income and Expenditures estimate. Regarding Expenses, the Council will approve annual disbursements for donations in the different modalities, portfolio management fees of the Fiscal Agent and other administrative and operational expenses of the Fund. The approved budget may be changed by the Executive Secretariat as long as it does not exceed the approved amount. Such changes must be reported to the Council. Any extension budget must be approved by the Council. (By-laws Art 26)	No fixed numeric target. Board sets performance goals each year with budget approval.				

Key to Sources:

1 - Latest Evaluation Report

2 - Calculated by Admin Cost Study

3 - Calculated by the Administrator

4 - Budget target; final outcome not yet available

5 - Congressional Report 2009

Management Expenses

Indirect Costs		Direct Costs
General & Administration Costs		**Program Costs**
office space (rental or mortgage)	*Operations & Maintenance (Facilities)*	
facilities operation, maintenance, sanitation (e.g. repairs, janitorial)		
utilities (e.g. electricity, water, phone)		
office equipment (e.g. furnishings, computers, printers, copiers, fax machines)		office equipment (e.g. furnishings, computers, printers, copiers, fax machines)
equipment repair and maintenance		equipment repair and maintenance
office vehicle		program vehicle
vehicle operation (fuel, lubricants, maintenance)		vehicle operation (fuel, lubricants, maintenance)
vehicle insurance		vehicle insurance
property insurance (e.g. facilities, vehicle, office equipment, liability)		
depreciation expenses		equipment and vehicle depreciation
capital improvement (e.g. construction)		
property taxes		
security		
salaries: executive director, office manager, bookkeeper, receptionist, other	*Personnel**	salaries: program staff
salary charges (health & life insurance, pension fund)		salary charges (health & life insurance, pension fund)
benefits (vacation, cost of living adjustments, 13th month)		benefits (vacations, cost of living adjustments, 13h month)
payroll taxes (applicable to staff included as indirect cost)		payroll taxes (applicable to program staff)
administration (staff development, retreats, personnel recognition, recruitment)		
office supplies (e.g. staplers, paper, clips, etc.)	*Administration*	
communications & reporting (e.g. copies, printing, postage, courier)		
information technology (server, LAN, router, software, domain, web design, web hosting)		
travel and subsistence [*exclusive of travel attributable to a grant or fundraising*]		travel and subsistence for the purpose of program execution
membership services & events (when established under a Company's Act)		
subscriptions and memberships, professional associations (e.g. RedLAC)		
permits & business licence taxes (if applicable)		

advertising & promotion/marketing (e.g. branding, outreach, publications, brochures, articles) new business development (R&D) (incl: proposal development, innovation)		advertising & publicity (call for proposals, results dissemination) training materials coordination meetings third party services (reviewers, monitoring, TA to grantees)
	Governance	OC or board meetings & associated expenses (e.g. Secretary functions) OC or Board commissioned studies & contracts (incl. evaluations) OC or Board development OC or board committee expenses professional services for the program (e.g. legal counsel) strategic planning
income taxes (e.g. interest and capital gains) financial fees (e.g. debt servicing) service fees (investment advisor, investment manager, broke) bank charges	*Financial*	annual independent audit service fees (investment advisor, investment manager, broker) bank charges

Fundación Natura: Using the Indirect/Direct Cost Framework

Background

Fundación Natura (FN) is the Administrator for two TFCA funds that benefit the Chagres and Darien National Parks. Both Funds were created through debt swaps valued at about US$10 million each, with pay-in periods of 12 and 14 years respectively. Both Funds are intended to finance private operators with the broad objective of achieving public-private co-management of the two parks.

Both Forest Conservation Agreements, signed in mid-2003 and mid-2004 respectively, use a simplified formula to define "management costs":

> "For purposes of this Agreement, "Management Expenses" means such reasonable costs and expenses incurred by the Fund Administrator in the ordinary course in connection with the management, review, technical assistance, oversight and administrative functions (including the administrative functions of the secretariat)…and grant administration provided by the Fund Administrator hereunder."

In these two cases, the FCAs offer no additional clarification of the duties of the Administrator.

The Darien FCA also states two additional principles that reinforce "management expenses" as the total of all costs required to manage the TFCA Funds.

> "The Management Expenses approved by the Oversight Committee shall adequately compensate the Fund Administrator for the services it provides under this Agreement."

> "The Fund Administrator shall not be allowed to charge any fees or other amounts to any party or any FCA Grant Recipient, the amounts designated as Management Expenses by the Oversight Committee being compensation in full for the services provided by the Fund Administrator pursuant to this Agreement."

Fundación Natura has adopted the total cost approach, and has put in place an accounting and budgeting system that allows it to allocate costs as direct and indirect, and to use those designations to analyse the services it must deliver as the Administrator in order to achieve the purposes for which the TFCA Funds were created.

In very broad terms, FN's duties as Administrator include:

- Administering the Funds (budgeting, accounting, procurement, reporting, etc)
- Serving the Oversight Committee
- Providing grants from the Funds to long-term and short-term recipients and overseeing their use of grant monies

Two entities, the Fundación Chagres and Fundación PA.NA.MA, were created with the expectation they would become the long-term recipients and further the stated objective of public-private co-management by complementing the activities of the National Environmental Authority in each of the parks. Various local NGOs and CSOs are the recipients of short-term grants for activities in the parks and their buffer zones.

The ceilings on management expenses were set at 9% and 18% respectively of the annual transfers to be made by the Trustee to FN.[9] Because of the difference in rates and the repayment schedules, the nominal value of the expense ceilings differ substantially: FN could receive an initial amount of $36,500, declining by about 10% per year over the 12-year repayment period, to cover expenses for managing the Chagres Fund, while it could receive a maximum of $82,600 annually until the penultimate payment year (year 13 of 14), when payments declined substantially, to cover its costs for managing the Darien Fund. While the tasks to be performed by FN are largely identical, the substantial difference in expense limits appear to be based on two assumptions: (1) the Fundación Chagres was to receive support from other parties which would assist adoption of co-management and facilitate grant administration tasks by FN and (2) the remote location of Darien was expected to result in higher costs. However, the move to co-management was more problematic than anticipated.

The Challenge

After several years of Fund operations, it became clear that the original assumptions about adoption of public private co-management for park operation proved to be optimistic, obliging FN to provide more support than anticipated to the private operators and carry out more substantive oversight. As a result, it became increasingly difficult to remain within the cost ceiling of 9% established for the Chagres Fund. FN's OC took an enlightened view which recognized that FN's responsibilities were different from what was envisioned and, in light of exceptional circumstances, accepted to approve budgets that were equal to or greater than the designated ceiling. The challenge for FN was to demonstrate for the TFCA Oversight Committee[10] the tradeoffs for amounts spent as management expenses, both in terms of delivery of services as the Administrator and achievement of objectives.

FN's first concern was that the definition of "management expenses" in the FCAs was broad and did not adequately convey the diverse services performed by an administrator. FN took the definition of the FCA and divided it into the two broad categories of management and administration and grant program operations, then developed the following detailed presentation of the services required to deliver in each area.

[9] In each case, transfers from the Trustee to FN can be no more than 50% of the annual payments made by the Government of Panama; the remainder is paid into an endowment created for each park.
[10] The same OC oversees both the Chagres and the Darien Funds.

Table 1: **Services Provided by Fundación Natura as Administrator**

Management and Administration	**Grant Program Operations**
• Administration and monitoring of the Fund • Consolidation, analysis and formulation of budgetary recommendations • Monitoring and inspection of approved projects disbursements • Systematic recording of operational accounts • Submission of accounts for the whole operation • Engaging the services of external financial auditors and submission of the audit to the OC and TFCA Secretariat • Organization of OC meetings and monitoring (minutes, reports ,etc) • Preparation of quarterly and annual reports • Attendance at TFCA annual meeting • Developing norms and rules to carry out the agreements – monitoring of the execution of agreements and contracts • Resolving contractual, operating and administrative disputes	1) Planning of "investments" 2) Publicity and call for proposals Promotion - Prepare documents for the competition - Publish the request for proposals – advertise the competition (medias, Web page) - Briefing meetings (inter-institutional coordination) - Workshop on preparing profiles Call for Proposals - Receipt of proposals - Verification of content - Evaluation by Review Committee - [Site visits, if necessary] - Decision by OC - Award and contract signature 3) Evaluation and Decision - Technical review committee meeting - Field verification visits - Evaluation formats - ex ante evaluation - Follow up on observations - Grant Agreement preparation 4) Monitoring and TA during Implementation - Preparation of a monitoring plan by subproject, in conjunction with the executing agent - Technical and administrative monitoring visits - Operating updates - Technical assistance for execution 5) Evaluation - Intermediate and final evaluations - Project closure 6) Dissemination of results/lessons learned - Promotion of Project results in shows, events and through communication medias - Preparation of printed disclosure materials

This is a useful approach for two reasons. First, Boards or OCs may be familiar with a grant making cycle, but may not have a full understanding of the many activities in which the Administrator must be involved to exercise appropriate technical oversight and due diligence. Second, knowing the services that are required, as well as the relationships between budget items and services being delivered, allows for a more meaningful discussion of what are reasonable costs for those services, the tradeoffs between spending and achievement of objectives (quantitative and qualitative) and the impact of taking on additional services (strategic visions, fundraising, grantee capacity building, etc).

FN's next task was to identify all of the costs necessary to deliver the services required of the Administrator.

Table 2 below presents the costs incurred by FN that are directly related to the purposes of the Chagres Fund. These are the "direct costs" of the Administrator. The first column provides FN's simple budget categories for direct costs, while the third column uses the format of Annex 5 to organize the items. Either presentation can be used as long as all budget or expenditure items are directly linked to delivery of a Fund's operations and it suits the analytical needs of the Board or OC.

Table 2: **Direct Costs of Fundación Natura as the Administrator**

Categorization of Fundación Natura*	Budget Items (Direct Costs)	Categorization using the Format of Annex 5
Personnel		**Personnel**
	Salaries	
	Representation	
	Benefits	
	Charges	
Assets		**Operations & Maintenance (facilities)**
	Computer purchase	
	Office furniture and equipment purchase	
Operating Costs	Fuel & lubricants	
	Office Equipment	
	Vehicle taxes	
	Vehicle insurance	
	Computer maintenance	
	Maintenance and repair of rolling stock	
		Administration
	Communications	
	Printing & photocopies	
	Membership	
	Hospitalization & life insurance	(Note: could also be included as personnel costs)
	Seminars & training	
	Project consultants	
	Announcements & disclosure of results	
	Coordination meetings	
	Local Transportation	
	Per diems	
	Advertising and disclosure	
		Governance
	Technical Committee	
		Financial
	Audit	
	Bank charges	

*Based on items included in the 2008 executed budget

The direct costs shown above are only partial, and do not offer a complete presentation of FN's costs as Administrator, however. FN manages several other Funds in addition to the two TFCA Funds, serving either as administrator or as fiscal agent with more limited responsibilities. It has about 20 staff who are allocated to operational and administrative functions (executive director's office, general administration, financial management and accounting). Physical facilities and the central administrative functions of executive management, accounting, etc. provide general services and support all of the Funds under management. In line with standard budgeting practice, FN apportions these goods and services among the various Funds as "indirect costs" (sometimes referred to as overheads). Table 3 below provides the indirect cost portion of management expenses using the same format as the table above.

Table 3: **Indirect Costs of Fundación Natura as the Administrator**

Categorization of Fundación Natura*	**Budget Items (Indirect Costs)**	**Categorization using the Format of Annex 5**
Personnel		**Personnel**
	Salaries	
	Representation	
	Benefits	
	Charges	
Assets		**Operations & Maintenance (facilities)**
	Computer Purchase	
	Office furniture and equipment purchase	
Operating Costs		
	Building rental	
	Equipment rental	
	Utilities (water, electricity)	
	Restroom, cafeteria, dispensary	
	Fuel & lubricants	
	Office equipment	
	Vehicle taxes	
	Vehicle insurance	
	Electrical equipment insurance	
	Computer maintenance	
	Vehicle maintenance	
	Financial system maintenance	
	Maintenance and general repairs	
		Administration
	Postal charges and Post Office Box	
	Paper and Office Supplies	
	Communications	
	Telephone & Facsimile	
	Printing & photocopies	
	Memberships & Subscriptions	
	Institutional development	
	Teaching materials	
	Newspapers & magazines	
	Hospitalization & Life Ins.	(Note: could also be included as personnel costs)
	Seminars & training	
	Professional Services or Contracts	
	Stamps and Notarial seals	
	Legal costs (labor, deposits, other)	
	Trustee meeting services	
	Employee services	
	General services	
	Travel	
	Local Transportation	
	Per diems	
		Financial
	Bank charges	

*Based on items included in the 2008 executed budget

Together, the direct and indirect costs comprise the "management expenses" that compensate FN for the services it delivers as Administrator. It is worth noting that the budget or expenditure items shown in italics appear both as direct and indirect costs, depending on whether they contribute to Fund specific or institutional services. While FN has an accounting system that supports the direct and indirect cost designations, interventions of financial staff and management are still required to ensure that costs are apportioned appropriately to the various Funds and, ideally, that they can also be dis-aggregated by functional cost area in line with objectives of the program (see below) or the institution (fundraising, new business development, grantee capacity building, etc). Personnel costs represent more than 50% of both indirect and direct costs, for FN, which is consistent with the cost structures of all EAI and TFCA Funds, so particular care must be taken to allocate those costs accurately.

FN is expected to manage the Chagres Fund to achieve objectives in four areas :

Grants to long-term recipients
Co-management
Measures of Success (an impact monitoring program)
Grants to short-term recipients

To determine what percentage of spendable inflows (payments into the sinking portion of the Fund as opposed to the endowment portion), would be necessary to deliver the services expected of the Administrator, FN simplified the declining pay-in schedule by taking the full sinking fund value ($5,067,940), and dividing it by the 12 years of pay-in to obtain an average annual pay-in amount. Based on that average, FN developed three scenarios showing different costs for service delivery by the Administrator for the period 2010-2016:

- At 11.3%, all services could be delivered (given amounts already expended, this would result in use of 13% of the total funds available over the life of the sinking fund).

- At 9.3%, services financed through indirect costs could be covered, but only the management and administration services and financial monitoring component of grant program operations (see Table 1) could be provided (this would result in use of 12% of the total funds available over the life of the sinking fund).

- At 5%, only reduced services financed through indirect costs (treasury management and secretariat to the OC) could be provided (this would result in use of 10% of the total funds available over the life of the sinking fund).

The main conclusion to be drawn from the above analysis is that, if held to the original ceiling of 9%, FN could not deliver the full services required of the Administrator. As previously noted, this resulted from the increased responsibilities which had not been envisaged when the Fund was created. To continue to deliver the required services, a ceiling above 9% would be justified.

The analysis does not conclude with the identification of an optimized spending level, but goes on to ask the key question of whether funds spent are achieving the stated objectives. The 2009 budget utilized considerably more than 11.3% of the funds transferred that year, and management expenses would have to decrease over time to remain within the ceiling of the first scenario. Even at previous higher spending levels, the allocation of funds received by recipients, co-management and Measures of Success was not optimal, and put the achievement of objectives at risk. Grants to short-term recipients were being crowded out by spending on interventions that were clearly not achieving the desired co-management goal. The issue was raised in the 2007 Evaluation of the Tropical Forest Conservation Act Funds and of Fundación Natura as the Administrator, but had not been resolved. The clear and well-presented cost analysis that demonstrates the financial impact of continued pursuit of what may be an attractive objective in conceptual terms yet too problematic to implement, should help focus decision makers on the need to take action and the "cost" of not doing so. As of the drafting of this case study, the outcome for the Chagres Fund remains undecided.

Summary of Opportunities for Improving Current Practices

It is suggested that, going forward, the USG consider the following:

1. Future agreements for debt reductions could benefit from clarification to currently ambiguous language that overstates the role of the Board in day-to-day management and seems to define costs solely in terms of costs incurred by the Board. Consistent application of the definitions of costs/expenses to all Funds could improve understanding by Funds and simplify oversight by the USG. To achieve this, ***the USG would need to introduce the broader concept of management expenses in all new agreements, irrespective of debt relief arrangements.***

2. Understanding and oversight could also be facilitated if all future agreements were to incorporate the definition of allowable management expenses and supporting responsibilities of the managing entity to provide a clear, complete and comprehensive treatment of the services that are required to administer, manage and deliver the grant program for which financing is made available. ***The USG may wish to ensure consistent treatment by utilizing, in all new agreements, a detailed list of administrator responsibilities in line with those presented in Box** 1.*

3. The USG EAI and TFCA programs have, more often than not, created the institutions that further the objectives of the programs supported by the USG. For these institutions to grow and thrive, ***the USG may wish to consider,* when defining allowable management expenses, *whether and how much of key strategic cost areas the USG is willing to include as allowable management expenses.*** Institutional undertakings that merit inclusion when setting cost limits, but which are not currently consistently specified in existing founding agreement, include fundraising, grantee capacity building, staff and board training and preparation of a broad strategic vision covering institutional goals.

4. The use of a cost formula based on the clear and comprehensive treatment of "management expense" will focus Funds on the total cost of delivery and make it easier to determine how resources are allocated between grants and the costs of delivering the grant program. ***While many founding agreements disallow the taxing of grantees and use of grant account monies for other than grants, the USG may wish to go one step further and state the principle in its FCAs that "management expenses" is intended to cover the total costs of managing the program.***

5. For the purpose of providing an assurance that Funds have complied with the limit set on management expenses, audit reports can include a section on legal obligations or limitations that affect the funds being audited. Auditors can provide varying levels of assurance with respect to compliance with legal obligations. The highest level would require the auditor to perform audit tests and to conclude based on its own calculation. ***Should the USG wish to require Fund audits to be subject to the highest level of assurance on this compliance requirement, FCAs and TFAs will require precise definitions and inclusion in the auditor's TOR of the following actions:***

- ***sufficient testing of the Grants account to provide a reasonable assurance that only grants awarded to third parties were spent from that account;***

- ***confirmation that the account of the Administrator created for the purpose of receiving funds to cover management expenses has been credited with the amount approved by the Board for expenses during the budget year;***

- ***confirmation that the amount expended from the Administrator's account complies or does not comply with the statutory obligation set out in the FCA (or with the objective approved by the Board/OC when the requirement is expressed in that manner).***

6. The teams that evaluate EAI and TFCA Fund operations and management practices should recognize the impact on a Fund's management expenses of evaluation recommendations. Evaluators should, to the extent possible, indicate the effect their recommendations will have on costs and also identify cost savings, if any, that could result from their recommendations. ***The USG should ensure that Terms of Reference for Fund evaluations incorporate this practice.***

7. Funds self-report results, including their expenses, to the USG each year for the production of a Congressional Report. Multi-year results for administrative costs, grant approvals, grant disbursements, leveraged funds, returns on investments and other operational outcomes are provided in US dollars rather than in the original local currency. Exchange rate fluctuations, especially local currency depreciation vis-à-vis the US dollar, can result in distortions that make comparisons between years unreliable and could lead to false conclusions on a Fund's performance over time. To minimize interpretational errors, ***the USG should consider reporting all comparative data in local currency or, if this is not feasible, noting limitations on the interpretation of dollar denominated data.***

On their part, Fund Management and Boards/Oversight Committees are encouraged to develop a response to this cost review. The following are recommended as improvements to current practices:

- Use performance ratios and indicators that will allow both management and the Board/OC to monitor whether resources are being used and progress is being made toward achievement of objectives.

- Adopt accounting and budgeting systems that support (i) allocation of costs as direct and indirect and (ii) analysis of Fund activities by strategic area (grant making, fundraising, grantee capacity building, etc.)

- Eliminate the practices of taxing grantees or assigning expenses as "program support costs" in order to cover a portion of Fund management expenses.

- Recognize the value to Fund staff and Board members of training and guidance on the principles, practices and accounting systems needed to identify, assign, apportion and analyze indirect and direct costs.

- Consider cost/benefit tradeoffs when contemplating adoption of improved management practices, in order to arrive at a solution that does not create a cost burden.

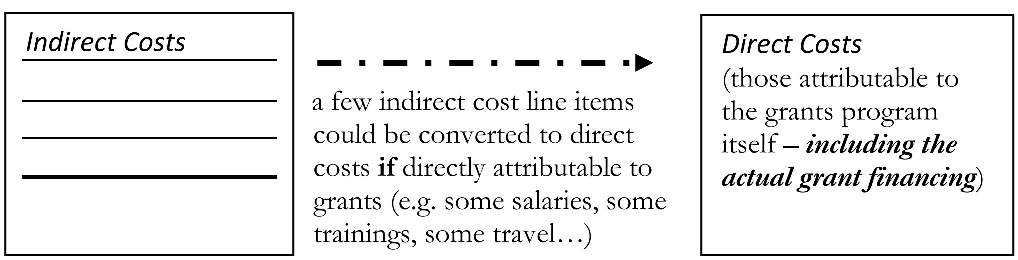
The Evolution of My Thinking
to Accommodate the Total Cost Concept proposed by the Cost Review

S.Lampman 5/26/10

A. The Creation of a Management Expense Category

In the rather complicated world of cost allocations, prior to this review, I thought that I had finally arrived at a rather sophisticated degree of resolution in my understanding. I knew that clarification of terms was vital. I also knew that regardless of the particular system employed by Funds, that at its essence, all line items would necessarily boil down to a set of indirect and direct costs. In as much, I developed my own 'Rosetta Stone' used to translate any Fund's financial reports into a common comparable format based upon direct and indirect costs (not unlike that presented by Kathy in Annex 5).

My relatively simple Rosetta Stone sliced up the cost world into a very comprehensive list of line items. The outcome looked something like this:



It should be note that a conceptual driver in my thinking, was the fact that, as stated in the Cost Review (pp.22 (V)), "…there are *only two types of eligible uses* of EAI and TFCA funds, i.e. grants and the expenses of the Board or Oversight Committee and Administrator…" In other words, if funds weren't released as grants, then they counted towards "overhead".

Upon reading Kathy's report, I was struck by the large number of "formerly indirect costs" (according to my worldview) that had made the leap to the direct cost category. I was surprised by not only the number of 'converts', but the existence of so many duplicate line items in both the indirect and direct cost categories. My world was shaken.

Kathy's proposed total cost scheme is actually quite rational. As a Fund Manager is faced with a significant administrative rate ceiling, the coping options available to the Fund Manager become:

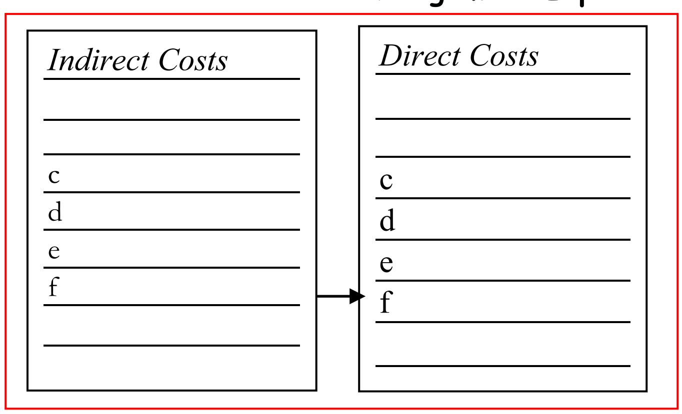
1. to raise the administrative rate ceiling;
2. to reduce the number of services performed (as nicely presented in Annex 6);
3. to improve upon inefficiencies and identify possible cost savings;

4. to reduce the number of indirect costs to a minimum by greater *attribution* of the functional line times to the direct cost side of the ledger (squeezing the lemon).

Option #4 becomes a favored option for many Funds, but ironically, the accounting sophistication required to disaggregate and track line item attributions to this level of detail, while demonstrating a high standard of professionalism, actually adds additional institutional costs. Nevertheless, this course of action may eventually be required of any Fund with multiple account cost structures ('Multi-fund Managing Entities').

Under Kathy's new proposal, having line item categories shared between the indirect and direct cost lists was not threatening to my worldview because, by including both costs under a Fund's broadly defined ***management expenses*** *(a.k.a. total costs)*, double counting was not an issue. This more comprehensive cost category is legitimately constituted of institutional costs (a.k.a. administrative costs) and "program costs", many of which previously had difficulty finding an accounting home. These program costs were variously called "service delivery costs", "program support costs", "direct costs of grant making", or even "grant program operations" (the latter term used in Annex 6, Tables 1).

Management Expenses



I agree that this makes some sense, particularly given the incremental evolution of historic EAI-TFCA agreements in an attempt to handle such matters. Without this larger management expense concept, we would continue to struggle with an entire set of line items that were not strictly institutional (administrative) nor explicitly part of grant financing – but instead, supported the program more broadly (e.g. Board support). Finding a reasonable home for these previously shifting costs is quite appealing!

To those who may wonder, therefore, why we should continue to use indirect and direct costs at all, now that a more inclusive management expense category has been created, Kathy correctly points out that the use of indirect and direct cost categories "allows an OC to review and approve, and management to manage, the budget analytically."

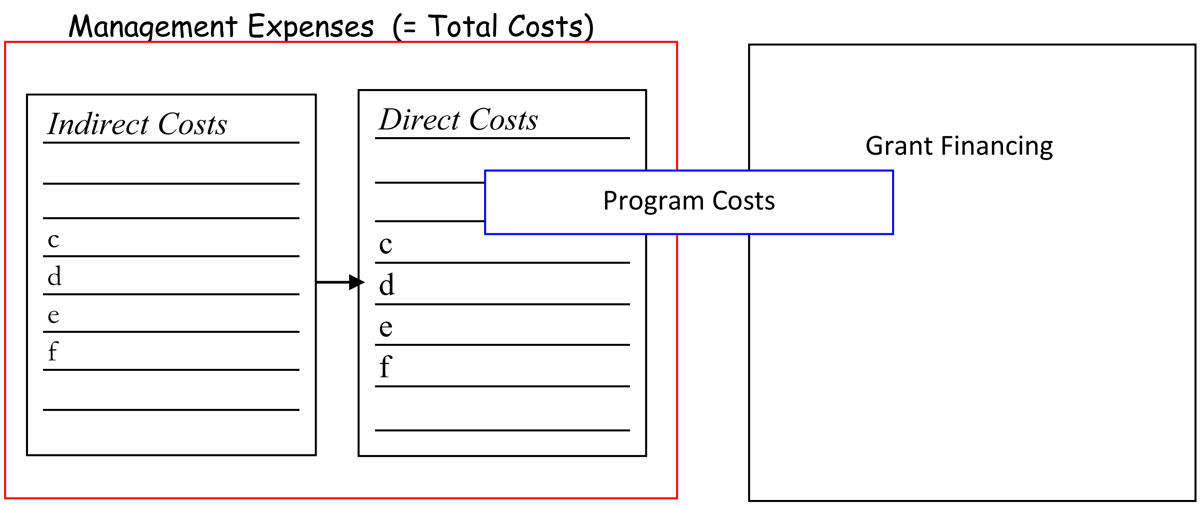
B. The Problem Merely Shifts

So far so good, the management expense category makes sense. However, our ***objective*** is to provide U.S. government guidance on a formula by which to determine a reasonable amount of reimbursement for management expenses. Does this new framing of costs get the U.S. government any closer to formulaic guidance?[11]

For any formulaic guidance to work well, there should not be "leakage" between cash outflow categories. For example, under the proposal above, by combining indirect and direct costs under management expenses, any concern for their distinction became moot relative to any guidance that only differentiated between grant-financing and non-grant financing. The latter is the donor's concern as it reflects the measure of program efficiency as characterized in the program ratios (Box 5).

The problem may now be that, while we indeed have reduced the amount of "leakage", it may have merely shifted into the cost category entitled "program costs".

In other words, the term "program costs" lacks clarity. In fact, as indicated throughout the Cost Review report itself, the term is variously used to include both the direct cost category of the management expenses **and** can include amounts approved for direct grant financing (see Cost Review pg. 5-parag. 2, pg. 8- Box 2, pg. 9-parag. 2, pg. 16- parag.3)). The diagram below illustrates how poorly defined "program costs" can create leakage and, therefore, potential loop holes in any formulaic guidance of management expense ceilings.



A classic example, and one that is not yet settled, is the expense incurred by Fund Administrators to monitor and evaluate (M&E) each grant.[12] Most would qualify these expenses as program costs, but there is not consistency in the placement of these costs as either management expenses charged under the Administrators cost ceiling or passed along directly as part of grant financing. This is not trivial matter as these can be significant costs. The challenge is even more acute under more recent TFCA agreements in which the U.S. government has explicitly disallowed "taxing of grantees" for such supervisory costs.

[11] Often the guidance is *in the form* of "management expenses cannot exceed X% of annual government deposits into the debt service account."

[12] See page 5, paragraph 1 on the Cost Review report. Also see page 6, Box 1, bullet (g). Some reputable Fund Administrators consider these grant monitoring costs as clearly chargeable to the grants themselves.

Kathy certainly recognizes this problem. In fact, Kathy writes that the Fund Administrators option of "allocating costs to a nether world of program costs which are defined nowhere in the founding agreements – is not really a legitimate option."

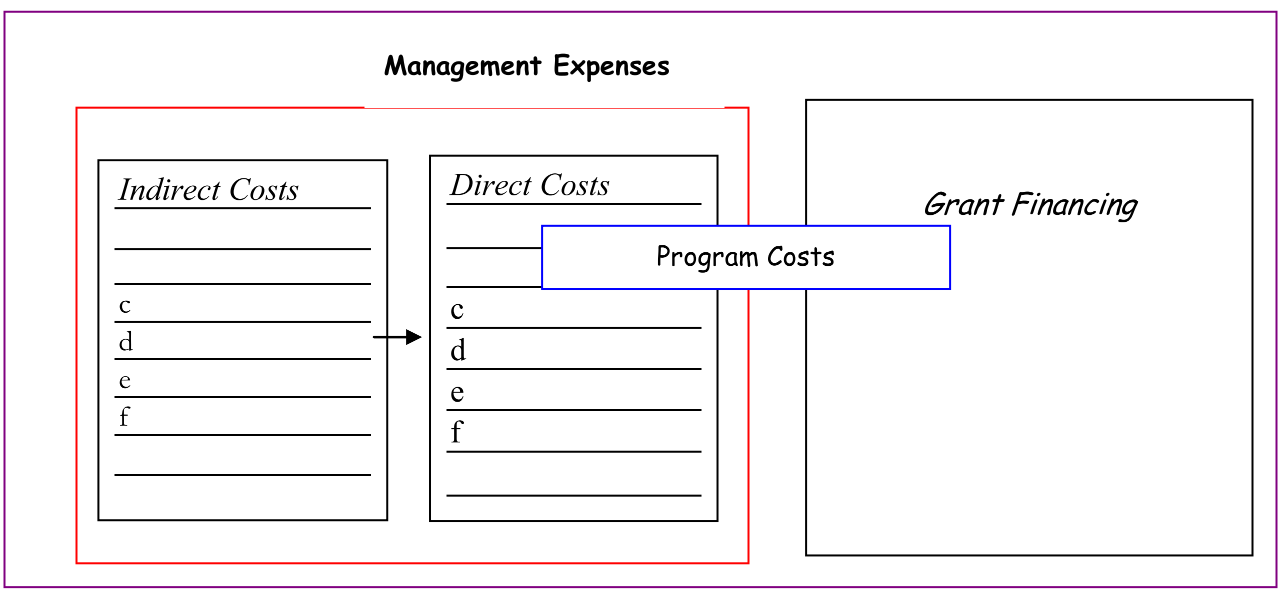
The cleanest way, that I see, to stop this leakage is to clearly *exclude* actual grant financing from the definition of program expenses. In other words, the funds awarded through a grant agreement are *not* to be considered "costs or expenses". By doing so, producing a formulaic guidance without leakage should be possible.

C. Misunderstanding of the Total Cost Concept

If one considers actual grant financing as a "cost or expense" then this can produce a misunderstanding of the total cost concept as proposed by the Cost Review. Unfortunately, I believe that the case presented in the Cost Review on Bangladesh (Box 2) contributes to this misunderstanding.

Box 2 defines total costs as "administrative and program costs, with program costs comprised of the amount approved for *grant financing* plus various costs of monitoring and technical assistance to grantees." The following illustration demonstrates the inclusion of grant financing in the concept of total costs:

Total Cost



This misunderstanding of total costs offers a perverse incentive for the Fund to increase its institutional costs without restraint. In other words, by including the Fund's management expenses in the calculation of the *total cost basis* from which an administrative rate could then be determined, seemed to offer an incentive for a Fund to increase its institutional costs. Doing so would create a bigger total cost "pie", hence making their 15% pie slice larger! This would represent little cost containment at all.

Table 1 (below) attempts to show how this misunderstanding of the total cost concept would be applied. It shows three scenarios illustrating how a fund could increase its allowable management expenses *without ever raising the amount provided in grant making.*

Table 1.

	A.		B.	(A+B)	(A+B)*.15
scenario	annual grant financing	% mang. Expense	Budgeted management expenses	Total Costs	management expenses allowed (15% of total)
a	1,000,000	15%	150,000	1,150,000	172,500
b	1,000,000	25%	250,000	1,250,000	187,500
c	1,000,000	40%	400,000	1,400,000	210,000

In order for the total cost concept to function well, "total costs" must be *exclusively* synonymous with "management expenses." If inflows are $1 million, and the ceiling is 15%, then the maximum of management expenses that the Administrator should claim for that year is $150,000, while $850,000 is reserved for grants. That is also why the ceiling acts like a program ratio.

D. Conclusion

In summary, properly understood and applied, the total cost concept should be applicable to the EAI/TFCA program. Kathy offers the following *positive* attributes of the total cost concept[13]:

"The total cost approach is a good thing, because it means that there can be no more arbitrary allocation between admin and program costs or incorrect charges to grants.... The concept of management expenses is meant to ensure that the maximum amount goes to grants that arrive in the hands of the beneficiaries (impact, impact, impact) and not to administration. In such a case, it should be much easier for the donor to monitor that objective using a total cost approach (and after all, "management expenses" is all-inconclusive as formulated). Furthermore, the concept is well-adapted to grant making NGOs because the main product of their services, grants, are discrete items that are transferred to third parties. The USG or private foundation approach vis a vis US NGOs is moderately relevant, but so many of those NGOs are executors, who provide services which are more abstract and can't be as easily divided from overheads ...."

The big issue remains what a reasonable split between grants and management expenses might be. While grant-making is the priority, building robust foundations should be a USG goal, but once again, the Board/OC has to ensure that spending is strategic and has demonstrable impact. Boards need the analytical tools in order to ask the right questions of management. The formulaic guidance remains principally a concern for the Board or Oversight Committee. Good oversight by the Board/OC keeps management expenses within a reasonable limit. The individual Boards/OCs should be annually revisiting the reasonableness of management expenses – often at the time of budget approvals.

[13] Personal communication – email.

What is the correct level for management expenses? It is the level at which the Administrator can *effectively and efficiently* deliver the required services.