

The Role of Estimating the Risks in the Costing of Structural Reforms

Establishing a costing methodology for the ERP, focus on the risk

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This learning initiative is delivered as part of the EU funded multi-country program aimed at Strengthening line ministries' capacities to assess fiscal implications of structural reforms.

Content of the presentation

- Importance of costing
- Methodology for costing- minimizing risks at the planning stage
 - ERP Costing
 - Detailed costing methodology
- Risk management framework
- Risk at the implementation stage
- Managing Fiscal Risks

Two components of fiscal assessment

- Financial planning („costing“)
 - Estimated costs of implementation
 - Available funding and funding gaps
- Broader fiscal implications of reforms
 - Increased revenues from increased economic activity or employment (indirect second-order effect)
 - Reduced revenues from tax allowances if they are part of the reform (tax expenditures)
 - Lower growth of expenditures due to reform (e.g. pension or health reform, PFM reforms)
 - Not a topic of this presentation

Why is costing of reforms important

- Budgetary planning
- Closing of funding gaps
- Consistency between „expenditure“ and „policy“ priorities
- Consistency between „fiscal strategy“ and „structural reforms agenda“

Identification of risks in costing

- Risks
 - factors that can cause a government's fiscal performance to deviate from what was forecast in the medium-term or,
 - pose a threat to sustainability over the long-term.

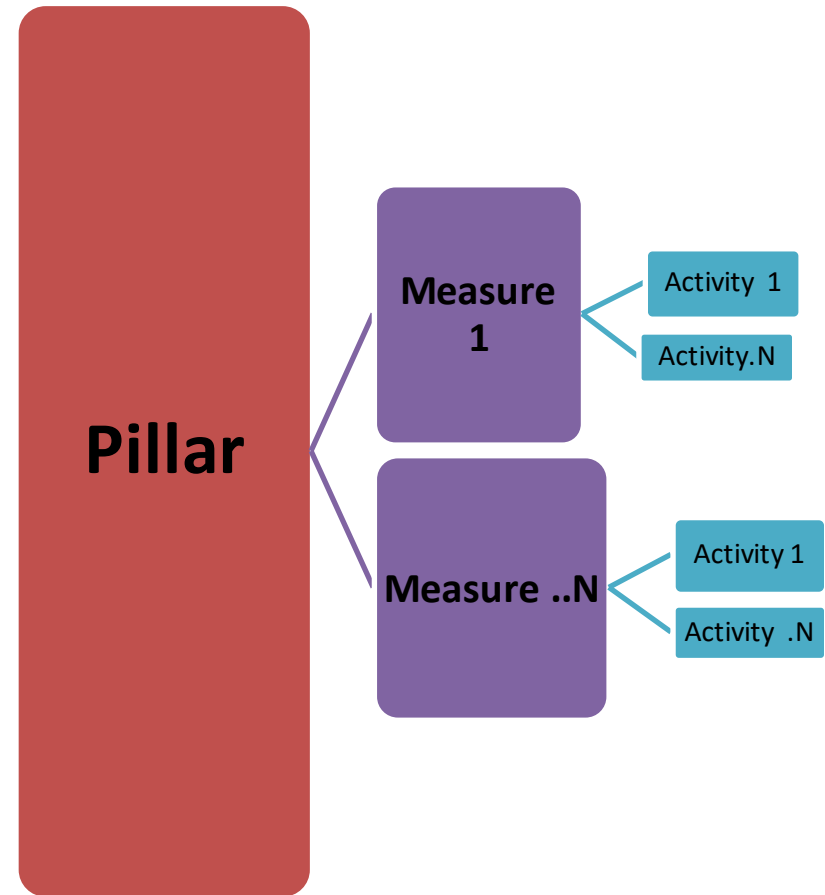
Two stages of Risks

- Risks at the planning stage
 - Identify the specific risks linked to the overall objective/activity
 - **Challenge:** can all risks be identified, quantified?
 - Minimize the uncertainty by detailed estimation of costs and funding
 - Apply detailed methodology on estimating policy costs
- Risks at the implementation stage
 - lack of funds
 - **unexpected additional costs**
 - delays in the implementation of critical structural reforms,
 - under-implementation of public investment,
 - political uncertainties,
- Risk management framework
 - Identify , analyse and evaluate risks linked to implementation of each objective/activity
 - how risk mitigation measures will be developed and deployed to reduce the likelihood and/or impact of risks;
 - roles and responsibilities for addressing risk mitigation measures

I. Minimizing risks at the planning stage

Costing methodology

- Use the best information available at the planning stage
- Define clearly measures
- Define clearly activities
- Some measures involves a number of activities

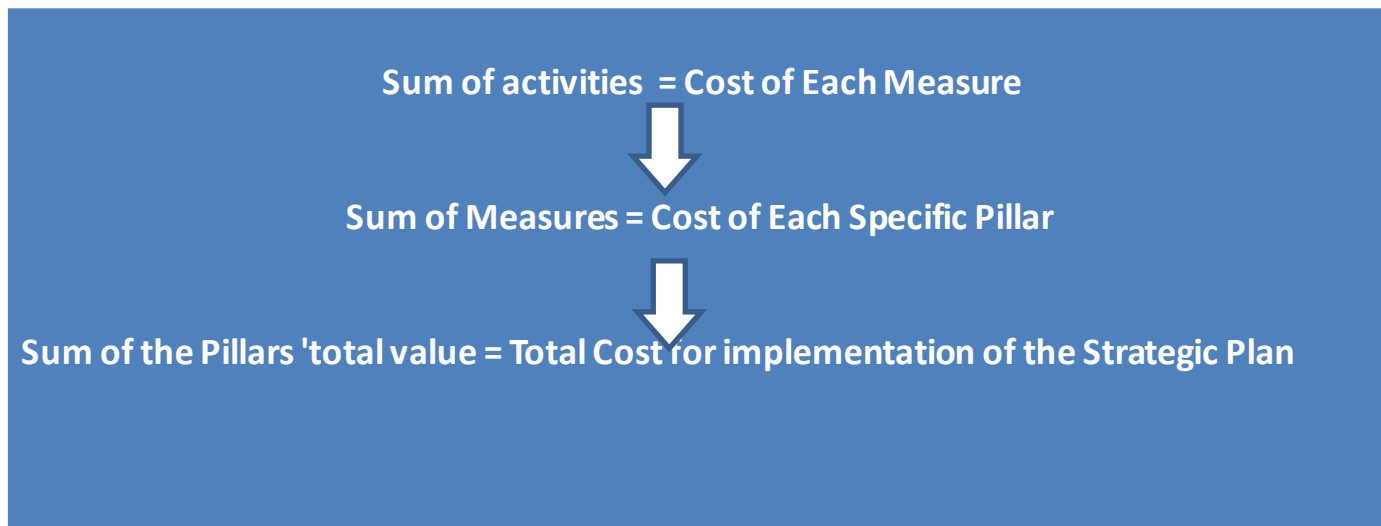


ERP-Methodology of costing

- Only “additional costs” are to be calculated in the table. This means that only those costs are to be calculated that would not be there if the measure would not be implemented.
- The table addresses only direct first-level costs of the reform measure. In case the reform measure can be implemented without additional costs, all spaces in the table should be filled with “0” (zero). In case the measure generates first-level implications on the revenue side of public finances (for example, an increase in budget revenues or an increase in pension fund contributions); this should be explained and quantified in a footnote to the table.
- Costing is to be done for a three-year period with the year X being the first year under the ERP, i.e. 2019.
- **If a measure is composed of several activities, a sub-table for each of them has to be prepared as an input for the summary table that shows costing for the structural reform measure as a whole – these sub-tables do not have to be included in the ERP**

Understanding the costing logic

- The costing process follows strictly a **bottom-up approach**
- **Develop table for each sub-activity/activity**
- **In the case of the Strategic Documents and/or ERP the following costing logic should be followed -**



How and Where to start?

- **Step I: Define clearly the outputs to be produced under each activity**
- **Step II: Identify the outputs for which implementation is done by the staff of the agency/ministry, therefore it will not require additional costs, only the costs of wages of the department/ministry staff.**
- **Step III :For each output identify all core activities required to be carried out in order to implement or produce it.**
- **Potential types of activities:**
 - Soft interventions: technical assistance, workshops, trainings, publications, information campaigns etc.
 - Financial support: subsidies, transfers, tax allowances
 - Investment: purchasing or development of IT systems, construction of public infrastructure

Example 1.

Activity 1.2 Increase inclusion in private preschool education

- Improving the existing Legislative Framework for Early Childhood Education and Care (Law on Preschool Education)

Output: Law (Approved Law)

1. Technical Assistance inputs (experts) – Donor
2. Organization of Conference

- Licensing of Private Preschool Institutions

Output: No of licensed preschools institutions

The licensing will be done by the staff of the Administration of Ministry of Education.

Continuation ...

- **Step IV : Identify all elements of costs involved in the implementation of each activity, indicating the inputs required.**
Inputs could be days of experts, number of trainings, workshops, number of office equipment, cost for production of a software, number of staff to be added, a new building to be built etc.
- **Step V: Once the required inputs are defined, apply the reference prices and calculate the total costs for the activity.**
- **Step VI: Make sure to include a reserve fund of 10-20% under each activity- **accounting for risks****

Example 2.

Example 2 Activity 2.1.1: Develop a regulation that will define the types of planning documents, their hierarchy, stages of planning process, consultation process, etc.

- **Expert inputs:**
 - External experts: 2 foreign experts, 2 local experts
 - 1. Foreign experts inputs $2 \times 40 \text{ w/days} = 80 \text{ w/days}$
 - $80 \text{ w/d} \times 1250 \text{ EUR} = 100,000 \text{ EUR}$
 - 2. Local experts inputs $2 \times 50 \text{ w/days} = 100 \text{ w/days}$
 - $100 \text{ w/d} \times 350 \text{ EUR/day} = 35,000 \text{ EUR}$
- **Consultation process with key stakeholders**
 - **2 workshops x 20 persons**
 - cost of one workshop $300 \text{ EUR (conf. room rent)} + 20 \times 20 \text{ EUR (lunch, coffee break)} + 20 \times 10 \text{ EUR materials} + 200 \text{ EUR (interpretation services)} = 1100 \text{ EUR}$. Both workshops: $2 \times 1100 = 2200 \text{ EUR}$
 - Total activity cost = $100,000 + 35,000 + 1100 = 136,100 \text{ EUR}$
 - + 10% contingency cost = $149,710 \text{ EUR}$

Categories of costs

- **personnel: wages and salaries** of additional personnel that will need to be employed for implementation of the activity or who will receive additional financial rewards (such as overtime work, incentive payments or promotions);
- **goods and services**, including the following
 - *training*: cost of workshops, training seminars, conferences, stakeholder consultations and other events organized for implementation of the activity;
 - *expertise*: cost of studies, expert opinions, consultancy, policy papers, legislation drafts and other technical assistance provided by national and international experts. With larger technical assistance projects, only expertise related to the activity should be included and not the total cost of the project;
 - *equipment*: new IT and office equipment that will need to be purchased for implementation of the activity, and expenditures for utilities.
- **subsidies and transfers**: total sum of additional subsidies and transfers that will be provided to the beneficiaries of the activity; including the cost per unit and the total amount
- **capital expenditures**: purchase or construction costs of buildings, roads and other infrastructure; purchases of technical equipment (e.g. laboratory equipment) and vehicles; purchases of land; payments for intangible assets (e.g. intellectual property rights) and other non-financial assets;
- **other costs** related to implementation of activities

Definition of the financial sources / financial gap

- **Reflection of the on-going project contribution**

during the costing process refer as much as possible on potential project proposals developed under current RFP for submission to donors for funding, or project documents that are already in the pipeline.

- **Identification of the financial resources**

budget allocations that are already included in the approved budget or MTEF; donor support (donations) that is already committed for implementation of activities, loans that are already agreed or negotiations are close to conclusion, public private partnership already agreed and contracted.

- **Identification of the financial gap**

Identify financing needs: total cost – already secured funding

The difference from the total costs required for implementation of activities and the amount of funds appropriated in the three mentioned above resources (Gov, budget , EU and Donors) will indicate the amount for which the funds are not yet ensured, named **Financial Gap**

Funding

- **Better planning of the financial resources;**
- **Effective use of foreign aid**
- **Establishing a realistic implementation action**
– **plan with a clear time table.**

Application in practice:

Structure of the costing tool / case of Kosovo

- Costing tool / product under the EU funded project
 - Designed in excel
 - User friendly
 - Designed in four main parts
- **First part** - derives from **the policy document**
Information on the activities, responsible institutions, outputs to be delivered, actions required to implement specific outputs/ activities

Structure of the costing tool

- Part 2: Areas for calculations of individual economic expenditures/ costs:** This part includes all relevant sections with all formulas included for calculation of potential costs of all inputs spent (based on economic classification), i.e. wages for additional staff to be recruited, cost of workshops, TA, etc

Expenditures under the economic category "Wages and Salaries: (Kodi 111)				Expenditures under the economic category "Goods and Services"(Kodi 130)																
Fund for additional staffsalaries			Total Cost Wages and Salaries	Expenses for conference/workshops and trainings (Kodi:1340)			Technical Assistance Cost (Kodi: 1340)						Purchase of office equipment (Kodi:1350)						Total cost of Goods and Services	
Nr	Average salary	Months		Worksh op average cost	No	Total amount	Local expertise			International experts			Computer equipment			Office equipment				
			Days				fee	Total	Days	fee	Transpo rt	Total	Piece	Unit/pric e	Total amount	piece	average price/uni t	total amount		
1	2	3	4(1X2x3)	5	6	7=5x6	8	9	10=(8x9)	11	12	13	14=(11x12)+13	15	16	17 (15x16)	18	19	20 (18x19)	21(7+10+14+17+20)

Structure of the costing tool

- Part 3 : Financial Resources.** In this part you need to include all available resources for implementation of each activity. In case there are no funds available under the three indicated financial resources, the amount of costs of activity will automatically result at column 38: Financial Gap.

Total costs		Financialsources			
The estimated cost of product/sub activity	Total activity expenses	State Budget	Donations	Loan	FinancialGap
33(4+21+24+31+32)	34	35	36	37	38= (33-35-36-37)

Structure of the costing tool

- **Part 4 : Financial Plan.** In this section it is important to indicate what will be the amount of budget allocated each year for implementation of the activity. This section should reflect both government budget and donors funds.

Annual Budget Allocation				
2017	2018	2019	2020	2021
39	40	41	42	43

Important notes – lessons learned

- ✓ Cooperation with line ministries crucial !!
- ✓ Budget and Policy Development Officials
- ✓ Clarity on cost implication is important in the costing phase
 - ❖ If the implementation of a given activity will be carried out by the staff – no need to calculate the cost. Administrative budget (i.e. wages of staff not to be considered)
 - ❖ In this case – just indicate “ **Administrative Budget**” – **already done in some activities**
- ✓ Available donors funded projects must be identified

Risk management framework



Risk management framework/template example

Pillars	Priorities/Objectives	Risk identification	Level of risk						Mitigating Measures	Responsible Institution/Body
		Description/Comment	Likelihood			Impact			Description / Comment	Description / Comment
		L	M	S	H	L	M	S		
	<p><i>Identify risks which risks or threats are likely to affect the accomplishment of the priority objective. It involves the identification of risks or threats that may adversely impact the achievement of a specific priority</i></p>	<p><i>Rate the level of likelihood and impact of risk to affect the objective/activity. Describe briefly reasons for such rating</i></p>						<p><i>Depending on the assessment of risks, an appropriate risk response has to be defined through the identification of mitigating measure. Please rank measures to be undertaken</i></p>	<p><i>Specify who is responsible for undertaking each mitigation action</i></p>	

I. Risk identification

- Risk identification involves determining which risks or threats are likely to affect the accomplishment of the priority objective/activity
- The risks associated with the achievement of a specific priority might be of different category /dimension nature such as:
 - 1) financial/budgetary constraints,
 - 2) capacity (human) constraints;
 - 3) institutional reasons;
 - 4) timely approval of laws and regulations;
 - 5) cooperation between units/institutions;
 - 6) external factors such as political development

I. Risk identification, example- PFM Strategy

	Priorities/Objectives	Risk identification	
		Category of risk	Description/ Comment
Pillars			
		<i>Identify category of risk from the alternatives given below</i>	<i>Identify risks which risks or threats are likely to affect the accomplishment of the priority objective. It involves the identification of risks or threats that may adversely impact the achievement of a specific priority</i>
	7.1 Establish the e-procurement system to carry out procurement activities	<ol style="list-style-type: none"> 1. financial/budgetary constraints, 2) capacity (human) constraints; 3) institutional reasons; 4) timely approval of laws and regulations; 5) cooperation between units/institutions; 6) external factors such as political development 	

II. Risk analyses and Evaluation

- Evaluation of risks level/ratings for each category of risk
 - **LOW** - may lead to a tolerable delay in the achievement of objectives
 - **MEDIUM** - Moderate effect. Risk factor may lead to delays or increase in cost.
 - **SUBSTANCIAL** - Major effect. Risk factor may lead to significant delays or non achievement of objectives
 - **HIGH** - May cause key objectives to fail. Very significant impact.
- Evaluate both the likelihood and the impact of a risk with regard to the specific activity

III. Risk Mitigation measures

- Mitigation of risks involves the identification of measures/ actions to reduce the likelihood that a risk will occur and/or reduce the impact of a risk that does occur.
- Depending on the assessment of risks, an appropriate risk response has to be defined through the identification of mitigating measures

Risk Mitigation measures

Mitigating Measures	Responsible Institution/Body
Description / Comment	Description /Comment
<i>Depending on the assessment of risks, an appropriate risk response has to be defined through the identification of mitigating measure. Please rank measures to be undertaken</i>	<i>Specify who is responsible for undertaking each mitigation action</i>

IV. Roles and Responsibilities

- Define the ultimate responsible unit/body for ensuring appropriate risk management processes are applied.

II. Risks at the implementation phase, ERP measures

ERP 2018	ERP 2019 Status of implementation (1-5)	Description of implementation	Reasons for failure
Reform measure #2: Reducing energy consumption through energy efficiency measures			
4) Feasibility study for the construction of district heating systems for Drenas, Kastriot, Prizren, Peja, Ferizaj, Gjilan, Mitrovica and Zvecan, funded by the Donor;	0	4. A request was made to the WBIF to do those feasibility studies, but we have been officially informed that this application will not be supported by them.	Lack of financial resources
6) Construction of central heating plant in Gjakova with biomass energy source;	0	6. District Heating Company JSC Gjakova has been waiting to the construction of the Cogeneration Plant, but	Lack of financial resources

II. Other risks at the implementation phase

- Other risks – other than financial but have financial implications:
 - Legislative delays
 - Establishment of specific funds (exp. EE, Innovation Funds, SME support funds)
 - Delays in the establishment of new institutions – delays in the EU funds
 - Example (IPARD)
 - Delays in implementing specific reforms/ failure to meet the targets
 - example disbursement of the SBS fund

Important issues to be considered!

- High donor reliance – delays in the donor procedures
- Reliance on foreign borrowings – lengthy procedures for ratifying international agreements
- Pay attention to contract details – extra fees/ additional payment- deviation from the initial timeline

Fiscal risks – government level

- The government's approach to managing risks follows a five-stage process, modelled on international best practice.
- (i) identify the source, scale and likelihood of the risk;
- (ii) disclose the risk to raise awareness and ensure accountability;
- (iii) mitigate the risk where cost-effective and consistent with broader policy objectives;
- (iv) provision for risks that cannot be mitigated but whose size and timing are relatively certain; and
- (v) accommodate residual risks when setting the overall fiscal policy stance.

Managing Fiscal Risks- Some Government Responses, IMF

- Policy interventions to understand, contain and reduce risks, collectively or one by one
 - Fiscal Rules
 - Budget Balance Rules
 - Wage rules
 - Debt Rules
 - New Institutions / Fiscal Councils

Example 1: Calculation of cost for a soft measure, cont.

Once the required inputs are defined, calculate the total cost for the activity

1. Cost of development of curricula:

- **Engagement of Local Expert for Curricula Development**
- **Assume you'll need 10WD Local Expert /curricula**
- **1 Curricula cost = $10 \times 250 \text{ EUR} = 2,500 \text{ EUR}$**
- **Cost of 2500 EUR x number of curricula to be developed**

2. Cost of trainers

- **Define number of teachers /groups/ training days**
- **2 Trainers x 50 EUR/day x 3 days x 131 groups = 39,300 EUR**

3. Cost of the workshop

- **Define number of attendees (30 persons)**
- **Cost of food/person (5 EUR)**
- **Number of Groups (131)**
- **$30 \text{ (persons)} \times 5 \text{ EUR (cost/pers)} \times 3 \text{ days} \times 130 \text{ groups} = 47,160 \text{ EUR}$**
- **Other spending material (190 EUR)**
- **$190 \text{ (spending material)} \times 131 \text{ groups} = 24,890 \text{ EUR}$**
- **Books (2 EUR)**
- **$2 \text{ EUR} \times 30 \text{ persons} \times 131 \text{ groups} = 79,910 \text{ EUR}$**

Example 2: Reorganization/ extra staff

Measure 2. PROMOTION OF FOREIGN DIRECT INVESTMENT			
Activity 2.4 Strengthening KIESA's capacities and reorganization	Sub activity : <ul style="list-style-type: none">Establishment of Pre- Investment Care Division	Indicator: Pre- Investment Care Division Established	Outputs: Employment of extra staff Purchasing of extra equipment

Example 2: Reorganization/ extra staff

Once the required inputs are defined, calculate the total cost for the activity

1. Cost of extra staff

- No of extra staff (5)
- Average wage (550 EUR)
- Months (48 months)
- $5 \text{ staff} \times 550 \text{ EUR/month} \times 48 \text{ months} = 132,000 \text{ EUR}$

2. Purchase of equipment

- Extra computers (5)
- Price per computer (500 EUR)
- $5 \text{ staff} \times 500 \text{ EUR} = 2500 \text{ EUR}$
- Other equipment – desks, chair (200 EUR)
- $5 \times 200 \text{ EUR} = 1000 \text{ EUR}$

3. Other spending material

- $5 \text{ staff} \times 150 \times 4 \text{ years} = 3000 \text{ EUR}$

Some tips to be considered

Example of outputs	Foreign Expert	Local Expert	Other costs	Assisting /Coaching
1. A simple manual	10 WD	10 WD		10-20 WD
2. A Complex manual	30 WD	20 WD	1 workshop	20-30 WD
3. A Simple law	20 WD	30 WD	1 workshop	20 – 30 WD
4. A Complex law	30-40 WD	30 WD	1-2 workshops	30 – 50 WD
5, Revision of current legislation	30-40 WD	50-60 WD	2-3 workshops	50 – 100 WD
6. Development of strategic / policy documents	50-60 WD	20-30 WD	2-3 workshops	100 - 200 WD
	80 – 100 WD	50 – 80 WD		