

ADS Mandatory Reference: N/A  
ADS Supplementary Reference: 317

(CURRENT STATUTORY REQUIREMENTS)

USE OF FIXED AMOUNT REIMBURSEMENT  
METHOD FOR LOCAL COST FINANCING

A. **Policy**

It is AID policy to use the fixed amount reimbursement method where the project structure and available qualified personnel in the Mission or from the host country meet the criteria discussed in Section C, below. While the criteria and preconditions for using the fixed amount reimbursement method may be difficult to meet, the benefits from the method are such that field Missions should seek to apply the method as often as possible. The "pure" Fixed Amount Reimbursement (FAR) Method described in Section B and the variations described in Section D are acceptable alternatives, even though not all the latter provide for the reimbursement of a fixed amount.

B. **Definition of Fixed Amount Reimbursement Method**

1. The primary distinction between this method and other disbursement methods is that the reimbursement is made for outputs rather than inputs; AID is, therefore, not concerned about the procedures used by the B/G in acquiring the inputs. It is merely concerned about the conformance of the outputs to previously agreed specifications or standards. In the "pure" FAR method, a further distinction from other disbursement procedures is that AID's payments are not based on actual cost. Rather, the amount of reimbursement is fixed in advance based upon reasonable cost estimate reviewed and approved by AID. Reimbursement is made upon physical completion of a project or subproject or a quantifiable element within the project. There are two essential aspects of this method:

- a. The definition of a total project (subproject or a quantifiable element within a project), the preparation of cost estimates and an agreement in advance on the amount of AID's contribution, and
- b. Reimbursement upon satisfactory completion of the agreed upon work.

2. **Determination of Project Costs and Amount of AID Contribution**

a. The recipient government and AID identify the project for which U.S. assistance is desired, together with estimated financial requirements for the total project as well as subprojects. The recipient government may include in it estimates of costs and amount for inflation for the expected time period for project implementation not to exceed two years, based on available information and study. The recipient government submits design specifications and cost estimates for review and approval by AID.

b. AID determines the amount of its contribution to the total project and the allocation of its contribution to specific subprojects and/or elements.

The amount of AID's contribution to the total project will be controlling. If unforeseen cost increases are encountered, these will be borne by the recipient. If costs are less than those estimated, AID's contribution will not be reduced.

### 3. **Reimbursement Method**

The recipient government using its own funds proceeds with implementation of the project. The AID Mission, with its own staff or consultants, monitors and conducts periodic inspections to satisfy itself that the project is being implemented in accord with agreed specifications in order to facilitate final inspection and acceptance. When the project, subproject or element has been completed, AID makes a final inspection and if acceptable AID reimburses the recipient the agreed amount for the project, subproject or element. (See: C. **Criteria and Procedures** for description of subproject or element.)

## C. **Criteria and Procedures**

1. Based on AID experience to date it has been concluded that the fixed amount reimbursement method can be successfully utilized for many AID-financed projects, capital or noncapital. However, because of the financial burdens placed on the executing agency, the fixed amount reimbursement method seems to be the most appropriate for low cost, short-term projects (generally two years or less), or projects which can be made divisible into segments small enough to enable the executing agency to complete subprojects or quantified elements within the project, before receiving AID disbursement. Subprojects or elements should be generally of such nature that they may be completed on no more than 9 to 12 month from the date of initiation of work.
2. Subprojects or elements should be self-sustaining units that will be useful and desirable in their own right, regardless of whether other subprojects or elements are completed.
3. The reimbursement method lends itself particularly well to projects under which a large number of physically separate construction activities are to be carried out, or where a specific quantity of a commodity (such as textbooks) are to be produced.

4. Where AID disbursements are not related to identifiable goods or services but to other criteria, such as budgetary or administrative performance, the fixed amount reimbursement method is not applicable.

5. It is particularly important that the Mission assure itself that the recipient organization has sufficient qualified staff and experience to proceed with effective implementation of the project.

6. Use of the fixed amount reimbursement method requires that the Mission either through its own staff or through contract can provide periodic inspections of the project as well as certification that the subprojects or elements have been completed in accordance with plans and specifications. As AID reimbursement is based upon completed subprojects rather than actual costs, savings from the estimated costs will accrue to the recipient country or organization. It is, therefore, particularly important that attention be given to guaranteeing that the projects be implemented in accordance with agreed plans and specifications and that any possible collusion between implementing and inspection personnel concerning modifications in inputs be avoided.

7. An important criterion that must be met relates to the requirement that AID make a determination that a subproject or element has been completed prior to reimbursement. It is quite probable that there will be cases where this determination will not be appropriate due to a failure to meet previously agreed upon specifications. In such cases reimbursement must be refused. It is necessary that the Mission carefully evaluate the implications of such action on the relationships between AID and the host government. The host country should be fully apprised of the risk involved in the procedures that will be followed before deciding to use the fixed amount reimbursement system.

8. The fixed amount reimbursement method assumes that the recipient country and organization has sufficient financial resources to provide necessary working capital so that delays in reimbursement until completion of a subproject or element will not have a detrimental effect on project implementation. The Mission should thoroughly analyze the financial standing and resources and budgetary procedures of the recipient organization prior to recommending the use of the fixed amount reimbursement method.

9. The use of this method or of the variations described in Section D, below, should be discussed in the Project Paper. The paper should also explain the method which will be followed to secure local currency resources.

## **D. Alternative Procedures**

There are a number of acceptable variations in reimbursement methods which may be adopted. While these variations differ in important aspects from the fixed amount reimbursement method, their use meets some of the objectives and advantages of the fixed amount reimbursement method. The variations include the following:

### **1. Advance of AID Funds**

From time to time there will be situations when the host country does not have the budget to provide working capital on a current basis so as to permit projects/subprojects to get underway expeditiously. This may particularly be true in a number of Relatively Least Developed Countries (RLDC's) where budget funds are in short supply. Under these circumstances and following a thorough review of the host country's/recipient's financial position and budgetary procedures, AID could consider advancing funds to permit work to begin. When reimbursement is made for completed subprojects, AID would deduct a pro rata amount from each payment until the advance is completely worked off with final reimbursement. All other criteria and procedures set forth for fixed amount reimbursement (C. above) will apply.

### **2. Fixed Amount Reimbursement with Escalation Negotiated Periodically**

When inflation is a major problem, AID can consider negotiating periodic increases in its fixed amount contribution to the subproject(s). This arrangement would be most applicable where AID is financing many small subprojects of the same type over a number of years; e.g., construction of 150 schools over a period of two to three years. In this situation, AID would agree to a fixed amount reimbursement for, say, 50 schools to be completed during the first year and renegotiate the fixed amount contribution for the schools to be constructed during subsequent years. The advantage of this approach would be to permit AID and the borrower to price project costs more realistically and reach agreement on a realistic fixed amount contribution. It would avoid including substantial escalation in the AID fixed amount contribution. All other criteria and procedures set forth for the fixed amount reimbursement (C. above) will continue to apply.

### **3. Percentage of Actual Cost Reimbursement**

a. From time to time certain projects financed by AID will not permit completion of design specification at the outset so as to be able to establish reasonable cost estimates for individual subprojects.

For example, a rural works project, which is labor intensive, includes a large number of small diverse subprojects (feeder roads, bridges, small irrigation, etc.) and where many of these subprojects are scattered over a wide geographic area, is a good case in point. Projects of this type do not lend themselves to "fixed amount" reimbursement because design specifications and cost estimates for individual subprojects are made during the life of the project. However, it is possible to identify design criteria and construction procedures which will be used and on which cost estimates will be based. Thus, while the fixed amount reimbursement procedure cannot be applied, AID could reimburse for a fixed percentage of actual costs of completed subprojects. Under these circumstances, the "actual costs" to be shared by AID should be either: 1) defined in the project agreement, which would set forth the elements of costs or, 2) specified as an amount in an Implementation Letter as soon as actual costs can be determined and, following which, would not be subject to revision. For the purposes of defining "actual costs", liquidated damage recoveries by the Host Country (HC), if any, during its administration of the construction activity, need not be netted against total allowable costs. It may be assumed that damages, agreed to in writing and in advance with independent contractors, would not exceed real economic losses suffered by the HC due to construction delays or other contractual nonperformance. Prior to reimbursement AID would require documentation and evidence which would verify actual costs expended for the subproject(s) and a certification by the Borrower that the subproject(s) has been completed in accordance with agreed on design specifications and other criteria. In addition, AID would provide for inspection of the facilities under construction and final inspection of the completed subproject(s). Such inspection could be done on a total or sample basis, depending on our assessment of the capability of the Borrower/implementing agency.

b. At the outset, AID would agree to financing a fixed ratio; e.g., 50% of the actual cost of each subproject completed. If subproject costs increase, AID would be financing a larger amount than expected although the ratio would remain the same. Unless the Borrower is prepared to increase his contribution, cost escalation would lead to a reduction in the number of subprojects financed with AID resources, because AID's contribution to the overall project is fixed.

c. This alternative is not as attractive as the fixed amount reimbursement procedure; however, there are still a number of advantages in its use:

(1) AID's overall dollar commitment to the total project remains the same;

(2) AID does not increase its percentage contribution to an individual subproject which will remain fixed; and

(3) AID only reimburses for completed subprojects. If the subproject is not completed, AID does not pay.

d. Each of the methods, of course, has advantages and disadvantages which should be considered in making a determination of the method to be follow.

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