

# Climate Public Expenditure and Institutional Review, Vanuatu

April 2014



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## Executive Summary

This report on the Climate Public Expenditure and Institutional Review (CPEIR) for Vanuatu provides a review of the country's policies, institutional arrangements, and public expenditure on activities related to climate change and disaster risk reduction (CC/DRR). It has been undertaken as part of a wider Risk Governance Assessment<sup>1</sup>, rather than as a stand-alone project.

The Review found that CC and/or DRR activities accounted for 2.9% of Vanuatu's GDP (and 13% of Budget expenditure) in 2012<sup>2</sup>. This comprised 1,870million VT in expenditure from the Operating Fund and 194 million VT from the Development Fund (most of which has been contributed by development partners).

It is notable that Vanuatu has been receiving a lower share of funding for climate change adaptation than most other Pacific Island countries - and that Pacific Island countries have only received about 1.5% of world-wide funding<sup>3</sup>. This is despite the fact that Vanuatu is considered to be the country most vulnerable to climate change and disasters in the Pacific and in the world.

In coming years, greater levels of donor funding are likely to be available for climate change adaptation as the economies and budgets of Developed Countries recover from the Global Financial Crisis. As well, as a Least Developed Country, Vanuatu is likely to benefit from the United Nations goal of promoting at least half of these countries to 'Developing Country' status by 2019. (However, becoming a Developing Country will also stop Vanuatu gaining access to the Global Environment Fund's Least Developed Climate Fund.)

To be in a better position to take advantage of CC/DRR funding that will become available, it is important for Vanuatu to establish strong, efficient and sustainable governance arrangements, and to demonstrate a track record in maintaining these arrangements. Vanuatu can do this by targeting NIE accreditation, which will also give it direct access to funding from the Adaptation Fund and potentially other sources of funding for climate change.

This report finds that the most logical candidate for NIE is the newly-established Ministry of Climate Change<sup>4</sup> and sets out how it can gain NIE accreditation. In doing so, it **recommends that Vanuatu seek assistance to design, resource and implement the required actions in that Ministry, the Ministry of Finance and the Office of the Auditor-General.**

The report also **recommends that the Office of the Prime Minister classify projects with CC/DRR objectives and publish details in the Annual Development Report.** This will provide transparency to policy makers and development partners on how the funding allocated to the various types of CC/DRR projects and activities aligns with the Government's priorities.

At the same time, the review recognises the need to clarify these priorities and the associated plans. This involves updating and refining the various Government plans to set out its development priorities in more detail and the crosscutting CC/DRR strategies that link to these.

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<sup>1</sup> The Risk Governance Assessment was initiated by the Vanuatu Government to critically analyse the structure of the National Advisory Board on Climate Change and Disaster Risk Reduction and to assess the capacities of agencies undertaking CC/DRR activities.

<sup>2</sup> These amounts are quite sensitive to how Ministry expenditure has been classified - see Table 6.1.

<sup>3</sup> Source: OECD ODA database.

<sup>4</sup> The relevant Minister's title, per Extraordinary Gazette 9 of 11 April 2013, is Minister of Climate Change Adaptation, Geohazards, Meteorology and Energy. The Ministry is commonly known as the 'Ministry of Climate Change' which is the term used in this report.

## 1. Introduction

### Key Points

- Pacific Island countries are amongst the countries that will be most affected by climate change, but have only received 1.5% of funding worldwide.
- Within the Pacific, Vanuatu receives a lower amount of development aid for Adaptation projects than countries with similar or lower levels of vulnerability.
- It is important for Vanuatu to establish strong, efficient and sustainable governance arrangements and demonstrate a track record in maintaining them, to be in a better position to access anticipated increases in funding for Adaptation.

This report provides the results of a Climate Public Expenditure and Institutional Review (CPEIR) for Vanuatu.

For the first time, the CPEIR was undertaken as part of a broader Risk Governance Assessment, rather than as a stand-alone review. In doing so, it drew on much of the institutional and policy assessments that provided the foundation for the Risk Governance Assessment. At the same time, it provided the financial management assessment, and associated recommendations, for the Risk Governance Assessment.

This joint approach avoided duplication and ensured the harmonisation of the two assessments and their recommendations. The approach was particularly appropriate in view of the recent changes to the country's institutional structures, and the development of a draft *Climate Change and Disaster Risk Reduction Policy*, which occurred as part of the Risk Governance Assessment.

### 1.1 Background

The need to develop the economy and to adapt to the impacts of climate change are of particular relevance to Vanuatu.

The country is one of five 'Least Developed Countries' in the Pacific, and one of forty-eight in the world. As the United Nations has adopted the goal of promoting at least half of these countries to 'Developing Country' status by 2019, Vanuatu can benefit from the greater focus this would bring to donor funding that targets economic development.

As well, Vanuatu is considered to be country having the highest risk of natural hazards in the world.<sup>5</sup>

Into the future, it is important for Vanuatu to establish strong, efficient and sustainable governance arrangements, and to demonstrate a track record of maintaining them over several years, so that it is in a better position to take advantage of funding that will become available - both on the way to reaching 'Developing Country' status and to implement climate change and disaster risk reduction (CC/DRR) activities.

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<sup>5</sup> Source - *World Risk Report 2012*

## 1.2 Objectives, Methodology and Report Structure

### Objectives

The primary objective of this CPEIR is to review the expenditure on activities that relate to CC/DRR and the extent to which this expenditure is guided by existing policy and institutional responsibilities. A second objective is to review other Government policies and practices that may have a positive or negative impact on its CC/DRR policy objectives.

The review further provides:

- the basis for recommendations on improvements to policies, institutions and public financial management as they relate to the achievement of CC/DRR outcomes for Vanuatu;
- a list of issues to address so that a candidate agency can gain accreditation as a National Implementing Entity for the Adaptation Fund (and potentially other funding sources).

### Methodology

The methodology for the CPEIR part was derived from the *Climate Public Expenditure and Institutional Review methodology*. It also took account of the analysis in *CPEIRs: What have We Learnt*, as well as advice from the UNDP on a budget review undertaken in Kiribati.

In doing so, the Vanuatu review adopted a wider scope than previous CPEIRs, by:

1. including an analysis of Disaster Risk Reduction projects and expenditure;
2. taking up suggestions in *CPEIRs: What have We Learnt*, by undertaking a ‘first-pass’ assessment of other interventions that affect a country’s response to climate change and disaster risk reduction, namely:
  - a) ‘dirty expenditures’ which conflict with the aims of CC/DRR policies, programs and projects;
  - b) revenue policies that could support CC/DRR objectives;
  - c) the operation of public-private partnerships that may be relevant to CC/DRR activities.
3. assessing the feasibility of various funding modalities in Vanuatu, including direct access to the Adaptation Fund by gaining National Implementing Entity (NIE) accreditation;
4. identifying viable NIE candidates, assessing the capability of the most preferred candidate and developing a list of actions required to gain that accreditation.

Hence, the methodology adopted in Vanuatu involved:

- a) Reviewing relevant Climate Change policies, the National Adaptation Plan of Action and previous Public Expenditure assessments;
- b) Defining “Climate Change Adaptation”, “Climate Change Mitigation” and “Disaster Risk Reduction” in the Vanuatu context using relevant examples drawing on local policy documents and workshop reports;
- c) Identifying current Institutional Arrangements and Information Sources (on-Budget and off-Budget);
- d) Collecting information on projects and activities, assess their degree of relevance, and identify and analyse corresponding annual expenditure between 2008 and 2012;
- e) Identifying the relevant institutions, their role, interactions and capacity gaps;
- f) Assessing the feasibility of the various funding modalities in Vanuatu, using the *Pacific Climate Finance Assessment Framework*, having regard for the Paris Declaration and the Accra Accord on development assistance;
- g) Assessing potential candidates for National Implementing Entity accreditation;

- h) Identifying and discussing issues in mainstreaming CC/DRR funding and financial management;
- i) Recommending immediate and medium/long term actions to improve the governance of CC/DRR funding so that:
  - it is directed to the Government's higher priority activities and is coordinated with other projects;
  - it is being used efficiently and effectively;
  - it builds the capacity of institutions – particularly at the local level.
- j) Undertaking a first-pass assessment of other Government policies and practices:
  - 'dirty' expenditures
  - revenue policies
  - Public Private Partnerships.

Note that for the purpose of making comparisons between countries, the Report uses the OECD's database of International Development Statistics to which the 'Rio markers' of Climate Change Mitigation and Climate Change Adaptation have been applied in order to determine the funding by country. In contrast, the CPEIR methodology uses data from the recipient jurisdictions, using their own accounting systems and classifications to analyse public expenditure, and is therefore not comparable.

The CPEIR methodology was implemented as part of the Risk Governance Assessment over a ten-week period from October to December 2013.

The main documentary sources of information are listed in Annex 1. Input and feedback were provided by staff of the Ministries of Climate Change and Finance, as well as a range of other stakeholders and the members of the Risk Governance Team as listed in Annex2.

### ***Report Structure***

The body of the report is structured as follows:

- sections 2, 3 and 4 provide an analysis of current policy, institutions and public financial management respectively;
- section 5 draws on this analysis to identify the gaps that need to be addressed if a candidate agency is to gain National Implementing Entity accreditation and hence direct access to the Adaptation Fund (and potentially other funds with similar requirements);
- section 6 provides an historical analysis of CC/DRR activities and expenditure over the five-year period from 2008 to 2012;
- section 7 gives a 'first pass' review of Government policies and practices that may have a positive or negative impact on its CC/DRR policy objectives.

## **1.3 The Risks, their Costs and Financing**

### ***Climate Change and Disaster Risks in Vanuatu***

The scientific review undertaken as part of the Vanuatu Risk Governance Assessment identified the key impacts of climate change and disaster risks facing the country as:

- **Temperature** - An increase in daily temperatures from 1995 to 2040 of 1.2°C and 2.3°C by 2070<sup>6</sup>. Extreme temperatures (including heat-waves) will reach higher levels and become more

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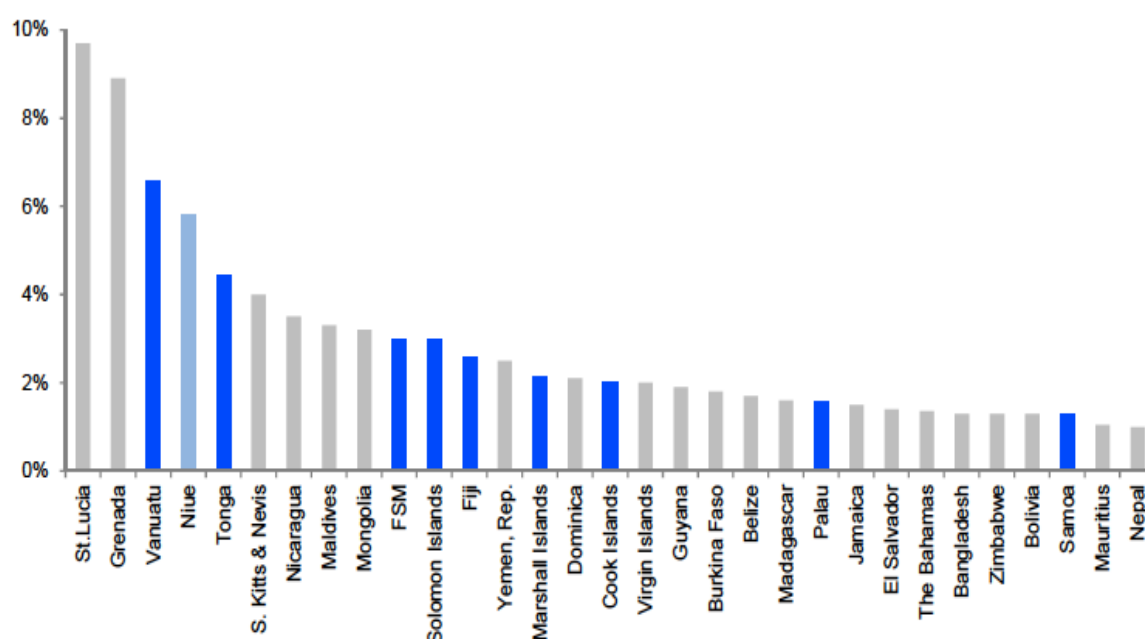
<sup>6</sup> These compare with the forecast global average increases of 1.9°C by 2040 and of 3.6°C by 2070.

frequent. By 2040, the 1-day maximum that currently occurs once every 20 years, will occur every second year.

- **Coral reefs** - An increase in sea surface temperatures will bring Vanuatu into a zone where coral bleaching will be frequent (above 29.5°C). Episodes of high sea surface temperatures will increase - in Efate, the increase will be from about 10% of the time to 25% of the time by 2040. As well, it is anticipated that ocean acidification will have damaged 80% of the coral reefs around the world in 20 years. As reefs play a crucial role in coastal protection, food security and tourism, the expected loss of coral reefs is the most significant impact for Vanuatu.
- **Sea level rise** - will continue and accelerate, while at the same time, land will rise due to plate tectonics. (For Port Vila, a net rise of 159cm is projected for 2100).
- **Rainfall** - The duration of dry periods will become longer. The 1-in-5 year dry period will lengthen from under 19 days to 28 days. Extreme rainfall will become more frequent and intense. By 2040, the 1-in-100 year rainfall event will have increased in intensity by about 10%. The frequency of extreme rainfall events will increase between 1.2 and 2.5 times.
- **Geo-hazards** - Being on the Pacific 'rim of fire', Vanuatu faces a range of other hazards not related to climate change:
  - Earthquakes
  - Volcanoes
  - Land/mud slides
  - Floods
  - Tsunamis/storm surges
  - Liquefaction (normally of reclaimed land in an earthquake).

In relation to current losses from natural disasters, Figure 1.1 shows that Vanuatu is already suffering one of the highest levels in the world relative to the size of the economy.

**Figure 1.1 Estimated Average annual losses from Natural Disasters (% of GDP)**

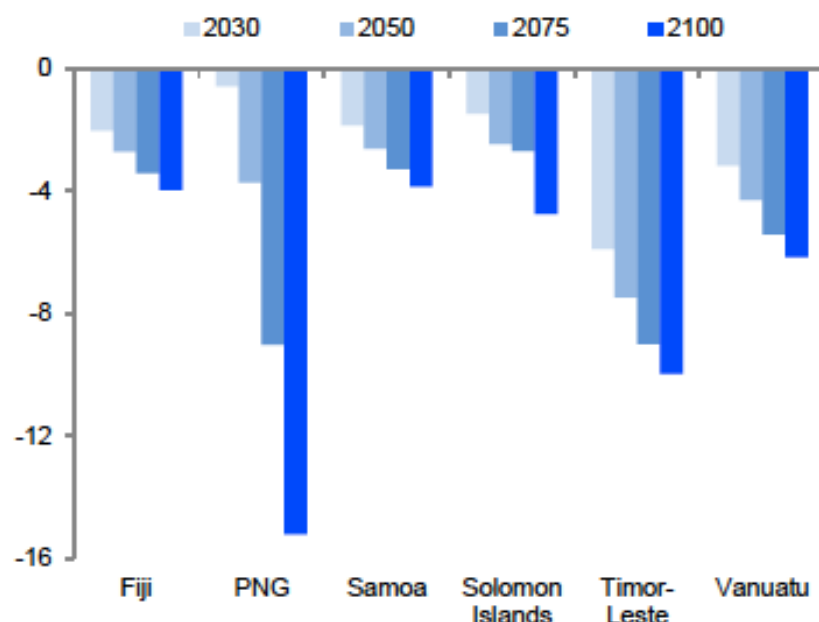


Sources: World Bank, 2010 and World Bank, 2011

### Cost of Climate Change

According to a recent study by the Asian Development Bank - *The Economics of Climate Change in the Pacific* - climate change will impose an increasing economic cost on Vanuatu. If emissions remain high, economic growth low, and there is a slow move to low-emission energy (scenario A2), the cost will reach 3.5% of GDP in 2030 and keep rising, as shown in Figure 1.2.

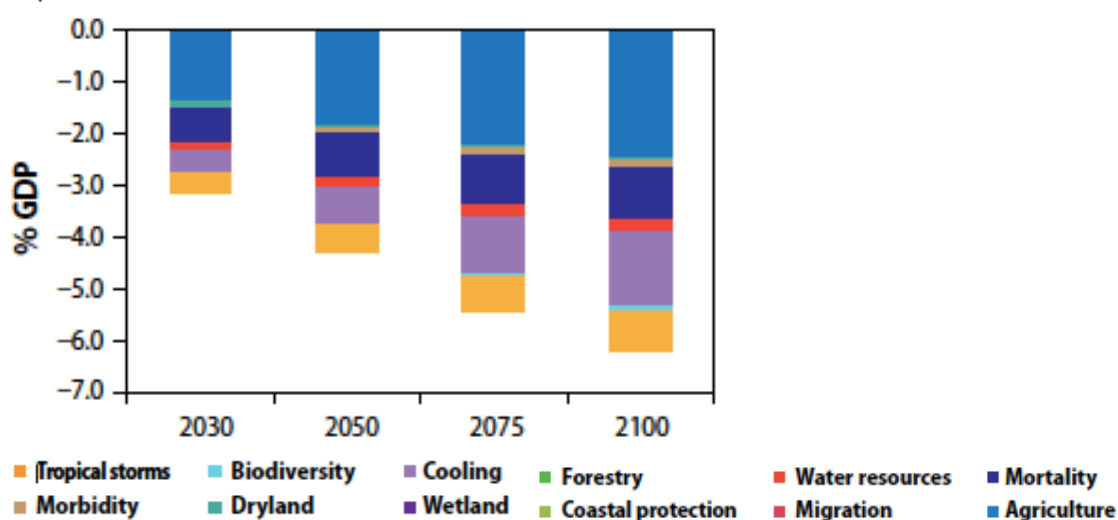
Figure 1.2 Estimated climate change costs (% of GDP)



Source: ADB *The Economics of Climate Change in the Pacific*

Figure 1.3 shows the modeled impacts on sectors of the economy and on human health, with Agriculture being the sector most affected.

Figure 1.3 Sectoral and Human Impacts in Vanuatu



Source: ADB *The Economics of Climate Change in the Pacific*

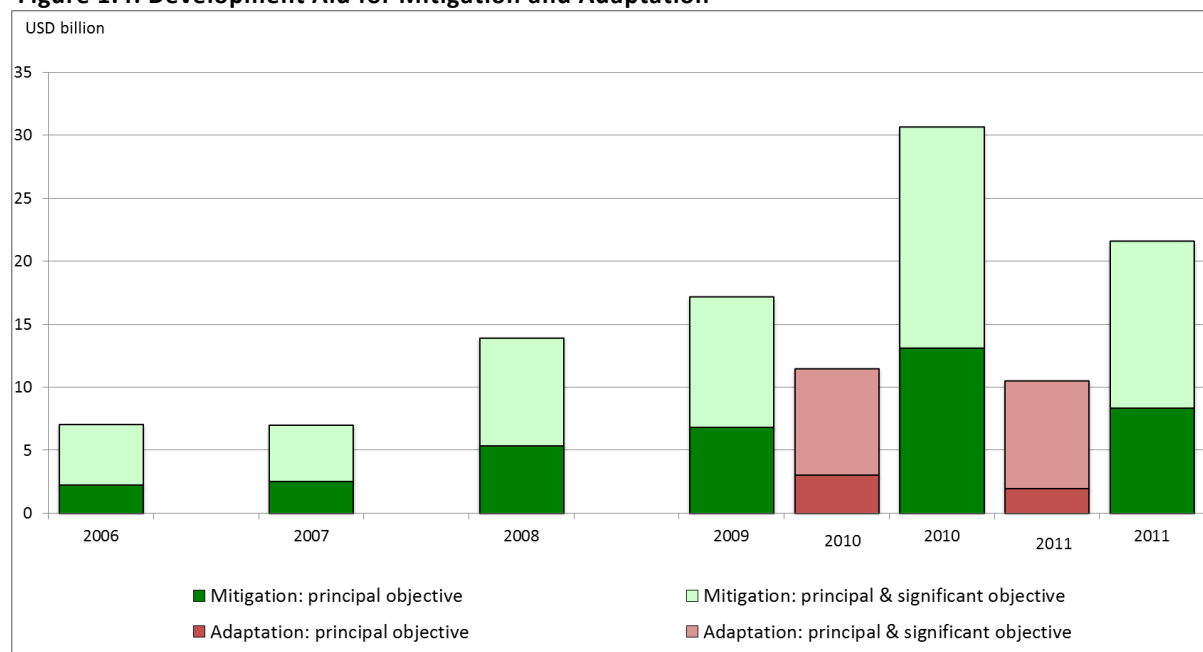
To adequately adapt to these changes, starting now, the annual cost is estimated to be 1.5% of a country's GDP. For Vanuatu, this equates to an investment of US\$9.5million per year. This is substantially higher than the amount of development funding currently being spent on projects that have Adaptation as their principal objective (as shown later in Figure 1.5).



### *Funding for Climate Change*

In terms of climate change mitigation, the level of donor funding world-wide has grown considerably - from US\$6billion to US\$31billion<sup>7</sup> - prior to the impact of the Global Financial Crisis on the budgets of OECD countries, as shown in Figure 1.4.

**Figure 1.4: Development Aid for Mitigation and Adaptation**



Source: OECD IDS database

For Adaptation, funding to date has been well below that for Mitigation, as shown in Figure 1.4. While the OECD has only identified data on Adaptation funding since 2010 (and the 2012 figures are not yet available), it is expected that funding for Adaptation will be of increasing significance over the next decade, as:

- the economies and Budgets of developed countries recover from the Global Financial Crisis; and
- pressure continues from less developed countries for developed countries to allocate a higher proportion of their funding commitments to Adaptation.

Some global funding mechanisms that are explicitly designed to provide climate change finance include:

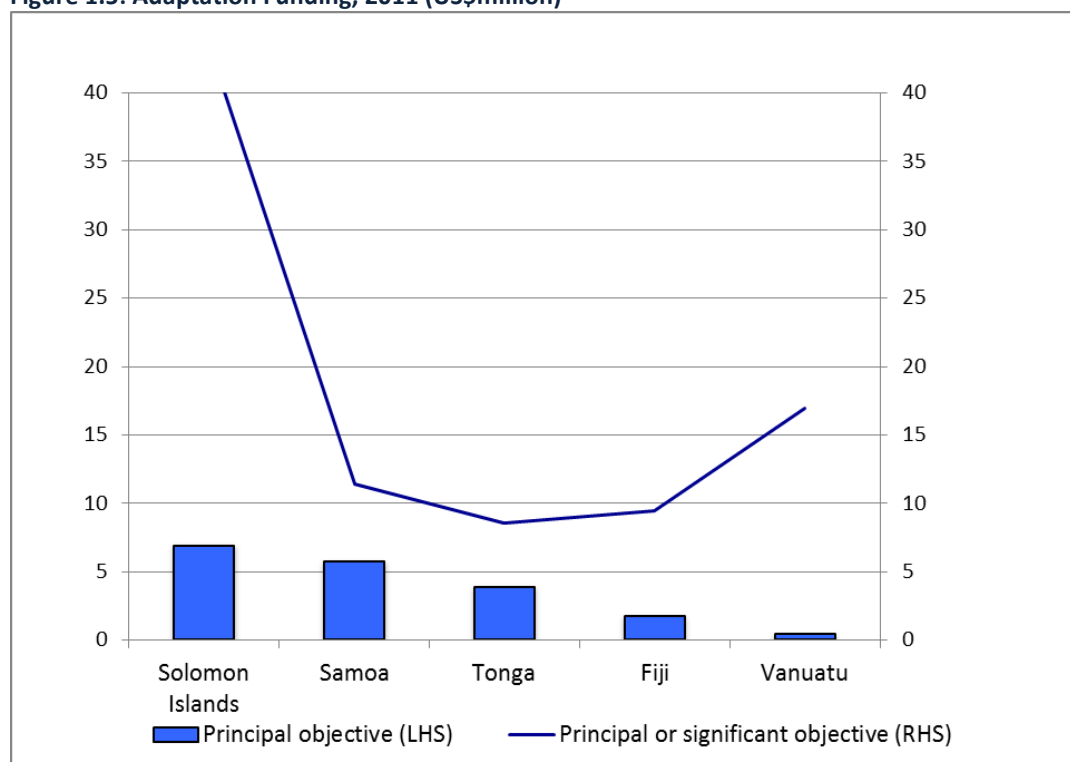
- the Adaptation Fund, set up under the UNFCCC Kyoto Protocol;
- the Global Environment Facility, which has been funding a small grants program in Vanuatu through the UNDP office in Fiji and VANGO; and
- the Green Climate Fund, which is yet to receive any substantive funding.

As well, there is a variety of other global, regional, bilateral and multi-national mechanisms that provide funding for activities that have CC/DRR objectives, whether as a principal, significant or incidental objective.

<sup>7</sup> Note that this increase may reflect a change in the tagging of existing funding levels, rather than additional funding.

However, Pacific Island countries only receive 1.5% of climate change Adaptation funding worldwide, despite being amongst the countries most affected. The allocation of Adaptation funding varies significantly within the Pacific also, as shown in Figure 1.5.

**Figure 1.5: Adaptation Funding, 2011 (US\$million)<sup>89</sup>**



Source: OECD IDS database

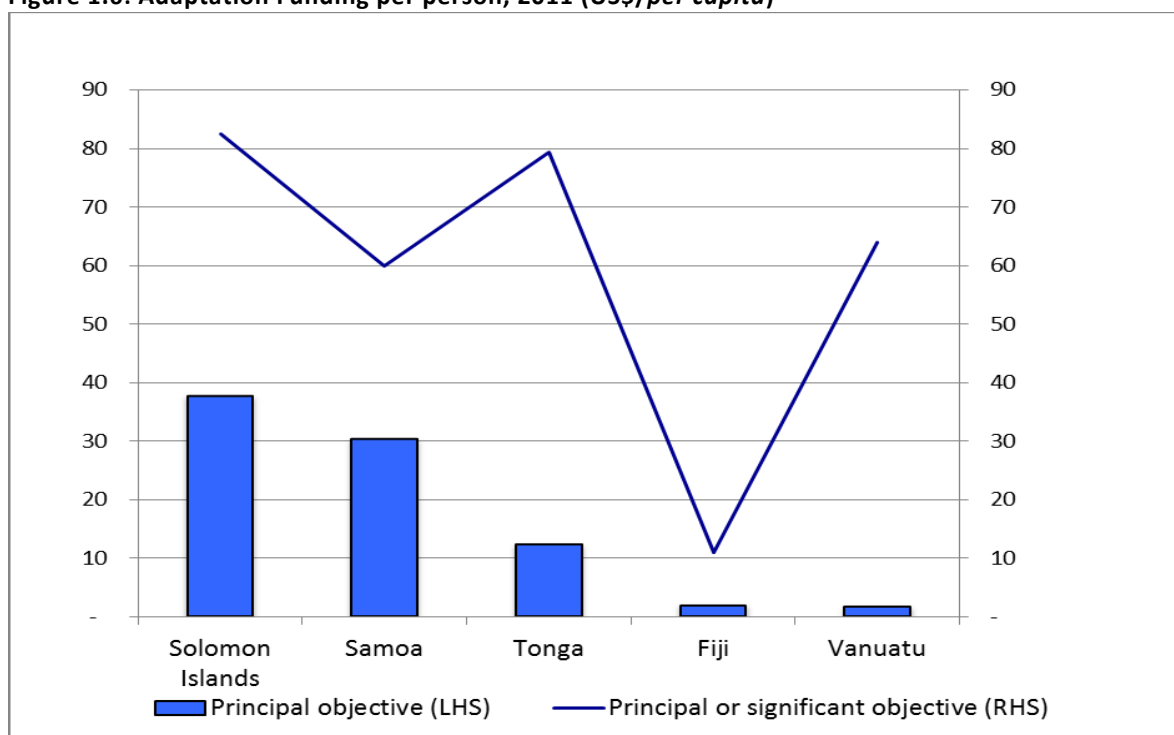
Where a country has a high level of funding with Adaptation as a 'Significant Objective' rather than as the 'Principal Objective', it is likely to be a by-product of existing development funding, rather than additional funding for Adaptation. For example, a long-running program to provide water tanks for remote villages can be counted as Adaptation funding if the program documents are revised to specify that Adaptation is a significant objective, even though there is no new funding involved.

Vanuatu has received significantly less than other Pacific Island Countries - whether on an absolute basis as shown in Figure 1.5, or on a *per capita* basis as shown in Figure 1.6.

<sup>8</sup> The Handbook on OECD-DAC Climate Markers provides that:

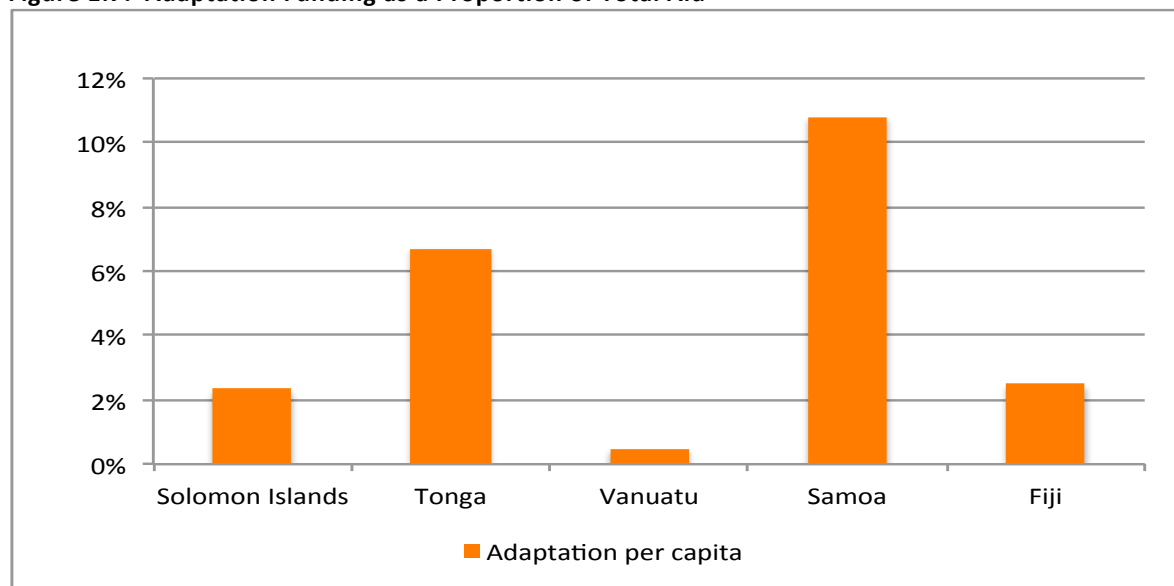
- Principal objectives are those which can be identified as being fundamental in the design of the activity and which are an explicit objective of the activity; and
- Significant objectives are those which, although important, are not one of the principal reasons for undertaking the activity.

<sup>9</sup> The level of funding for Adaptation may be understated as not all funding channeled through NGOs may be reported to governments or the OECD. In Vanuatu, much funding through NGOs is not reported to Government, although the proportion spent on Adaptation projects (other than the funding already accounted for by bilateral and multilateral agencies) is likely to be relatively small.

**Figure 1.6: Adaptation Funding per person, 2011 (US\$/per capita)**

Source: OECD IDS database

Figure 1.7 shows that Vanuatu has also had the lowest proportion of Adaptation funding to total development aid.

**Figure 1.7: Adaptation Funding as a Proportion of Total Aid**

Source: OECD IDS database

Whether measured on an absolute or *per capita* basis, or as a proportion of total aid, the differing levels of Adaptation funding across countries is likely to reflect their differing efforts and governance arrangements, rather than their differing needs.

For Vanuatu, this disparity between needs and funding highlights the importance of better articulating the impact of the hazards it is facing, and of having a well-documented national plan that incorporates adaptation activities into its overall development priorities.

## 2. Policy Analysis

### Key Points

- Climate change has recently gained greater focus within Vanuatu's Government, with the creation of a new Ministry of Climate Change, inclusion of the issue as a Budget priority, and the development of a draft whole-of-government policy.
- For this greater focus to make a difference, there is a need to integrate strategies to address climate change vulnerability, as a cross-cutting development issue, into the proposed replacements for the *Priorities and Action Agenda* and the *National Adaptation Plan of Action* and for the latter to include a prioritized list of more detailed strategies to guide funding for development.
- Most development partners require countries that cannot meet their requirements to accept project-specific 'alternative arrangements'. This project-driven focus does little to build sustainable capacity in areas such as procurement and audit.
- The Ministry of Climate Change needs to avoid being project-driven so it can focus more on supporting the National Advisory Board through a Secretariat that can:
  - coordinate research;
  - provide policy advice;
  - appraise project proposals;
  - liaise with donors, implementing agencies, NGOs, and Local Government;
  - arrange independent evaluations where required; and
  - operate a small grants scheme.

### 2.1 Vanuatu's Position on Climate Change

For the first time, Vanuatu Budget for 2013 listed the environment and climate change as one of the Government's strategic priorities (and shortly thereafter instituted a machinery-of-government change with a new Ministry of Climate Change). At the same time, Vanuatu has little capacity to re-allocate Budget resources from other priorities towards climate change adaptation, noting that it is a Least Developed Country, with per capita income of around US\$3,000.

At the COP 19 in Warsaw, Vanuatu played a role as a member of several groupings - the Least Developed Countries, the Alliance of Small Island States and the G77/China grouping. In his opening briefing at COP 19, Vanuatu's Minister for Climate Change Adaptation, Meteorology, Geo-hazards, Environment, Energy and Disaster, identified six priority issues – adaptation, finance, gender, capacity building, education training, and public awareness. The Vanuatu delegation also focused on discussions on climate change Loss and Damage and the operationalization of the Green Climate Fund.

### 2.2 National and Sector Strategies

Vanuatu has a number of policy documents that relate to disaster risk and climate change. Each of them provides some guidance on climate and disaster risk, and on national and sector priorities.

The Government's *National Action Plan on Disaster Risk Reduction and Disaster Management 2006-2016* was reviewed in 2010 and includes a revised set of priorities.

Vanuatu also issued its *National Adaptation Plan of Action* (NAPA) in 2007. The NAPA identified the following broad climate change priorities for Vanuatu:

1. agriculture and food security
2. water management policies/programmes

3. sustainable forestry management
4. community based marine resource management programmes
5. sustainable tourism.

There is an expectation that the National Adaptation Plan of Action (NAPA) would contain a list of prioritised strategies that guide the provision and scheduling of climate change funding from development partners. However, the Plan is at a relatively high level, does not list and prioritize specific actions, and is generally not referred to in project documents. It is anticipated that the NAPA will be replaced from 2015 with a National Adaptation Plan (NAP).

The following aspects of the existing NAPA reduce its strategic nature. It is suggested that the replacement NAP:

- specific adaptation strategies and actions based on local risk analysis, rather than list potential scenarios and adaptation options broadly;
- provide for a process of community engagement, and include community adaptation strategies;
- take account of social and gender inclusiveness in the adaptation options.

As well, a draft *National Climate Change and Disaster Risk Reduction Policy* is being developed<sup>10</sup>, and will be finalised based on the findings of the Risk Governance Assessment.

### ***Priorities and Action Agenda***

More broadly, the Government's *Priorities and Action Agenda 2006-2015* recognizes a number of development constraints and challenges which apply to any development project in the country:

- Widely scattered and mountainous island geography;
- Vulnerability to natural disasters;
- Small domestic market with little potential for economies of scale;
- Increasingly competitive international markets for tourism and investment;
- Social and cultural system with limited understanding and experience with business concepts and practices.

It notes that these are mostly physical or external factors and beyond Government's immediate ability to influence, but that Government can help to alleviate their adverse impact through appropriate policies and international cooperation.

On the positive side, the Agenda notes that the nation possesses some important advantages:

Strong traditional culture which promotes social stability and family welfare; and fertile land, natural resources and unspoilt environment.

In relation to the Environment, the Agenda notes that:

"the effects of global warming on climate are hard to predict, but it is likely that storms will become more severe and that climatic zones will shift, affecting rainfall patterns and drought. Sea level rise would have an impact in the future especially as many roads and settlements are close to the coast".

As with the NAPA, the strategies to address this challenge and the various other environment challenges are high-level - for example the strategy to "Develop and implement risk reduction

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<sup>10</sup> Supported by the Pacific Islands Climate Change Adaptation Program (PICCAP) and SPC-GIZ.

programs in communities". It is understood that the *Priorities and Action Agenda 2006-2015* is to be replaced by a *National Sustainable Development Plan 2015-2020*.

## 2.3 Agency-level Policies and Planning for CC/DRR

As the lead agency on this policy issue, the new Ministry of Climate Change is responsible for driving the climate change policy agenda across Government.

However, the Ministry does not yet have an approved long-term corporate plan to guide the implementation of this responsibility. Some of the agencies have prepared their own plans without strategic guidance from the Ministry, but their strategic planning process is non-strategic as there do not seem to be strong links between the various departments. Although various Government documents discuss the need to consider climate change, it is a challenge for a number of departments to operationalize this within core business functions. The Department of Education and the Department of Agriculture and Forestry have, however, adopted a CC/DRR focus in their policies and have started some activities with support from development partners<sup>11</sup>.

There is no formalised data management system to support evidence-based policy making and prioritisation of CC/DRR strategies, programs and projects. Each entity collects and maintains separate data sets and in many cases these are not linked to local government. The Department of Environment has an informal database, but information is only collected whenever its officers have the opportunity to go into the field. There is an identified need to streamline the current system and to make it more formal. The Department has an agreement with National Statistics Office to share data.

## 2.4 Monitoring and Evaluation for CC/DRR

Feedback to the Risk Governance Assessment is that the impact of the many development projects implemented over the years has been mixed and in some cases, not fully known. Many of the ministries and departments consulted during the assessment do not have an efficient monitoring and evaluation system, and in some cases no system at all.

It is recognized that the absence of an effective monitoring and evaluation system has greatly hampered the government having useful information and insight, and importantly, providing performance feedback on government programs. This has led to major constraints implementing government programs, policies and projects and the move towards evidence-based policy making.

To address this capacity gap, the government established a dedicated Monitoring and Evaluation Unit within the Prime Minister's Office. The primary roles of this unit are to:

- Lead the preparation of an annual assessment of development progress using the Annual Development Report;
- Monitor and evaluate the impact of government policy (*Priorities and Action Agenda, Planning Long, Acting Short 2009-2012*, Council of Ministers decisions); and
- Facilitate policy feedback and recommendations to the Council of Ministers, the Office of the Prime Minister, and amendments to the auditing of government policies.

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<sup>11</sup> *National Curriculum Statement* and *National Forest Policy* with support from SPC-GIZ.

<sup>11</sup> *Vanuatu education in emergency policy, 2013-2017* and *Guide to Climate Change and Disaster Risk Reduction Engagement within the Agriculture Sector, 2013*

The Unit works closely with the Sector Policy Analysts in the Department of Strategic Policy and Planning and Aid Coordination within the Prime Minister's Office, Expenditure Analysts in the Ministry of Finance, and staff in line ministries, to monitor the implementation of programs and activities, and ensure they are in line with government policy priorities.

In the Ministry of Climate Change and its various departments and units, there is no formal monitoring and evaluation system and so far only limited capacity. Until there is, any achievements of the Ministry will not be reported on in the Government's Annual Development Report prepared by the Prime Minister's Office.

The majority of agencies consulted, including at the local government level, agreed that the absence of a structured monitoring and evaluation framework was a weak element in their operations.

## 2.5 Policy on Climate Change Mitigation

Vanuatu has received considerable assistance in relation to climate change mitigation and renewable energy.

Into the future, the *Vanuatu National Energy Road Map 2013-2020* sets five priorities and targets for the energy sector. One objective is to mitigate climate change through renewable energy and energy efficiency – with targets of:

- 40% renewable energy generation by 2015, and 65% by 2020;
- 20% improvement in diesel efficiency by 2020; and
- comprehensive data collection on energy efficiency to set realistic targets.

The Road Map proposes a medium-term program (2013-2020) that includes:

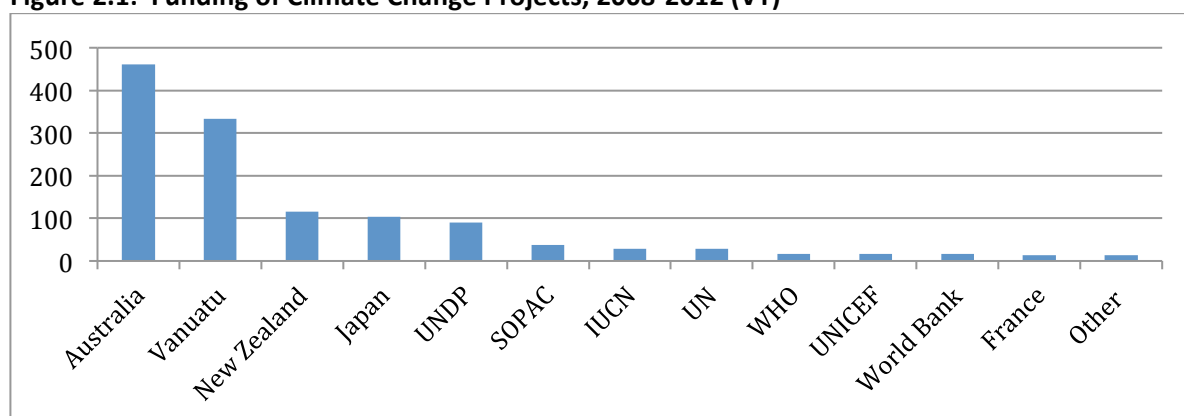
- policies and legislation to implement a framework for public private partnerships, subsidies and resource development;
- investment in infrastructure, including a capital subsidy for the Efate geothermal project; and
- institutional capacity building.

Proposed and planned projects that contain a climate change mitigation element include:

- an \$11million Energy Access Project proposed by the ADB for 2014, is to expand the existing distribution grids, develop hydropower, and pilot a grid-connected solar system in Luganville;
- a geothermal plant, in conjunction with Kuth Energy, proposed for the north of Efate.

## 2.6 Funding of Climate Change Projects

Over the five-year period to 2012, the funding for climate change related projects has largely been sourced by Australia, as shown in Figure 2.1.

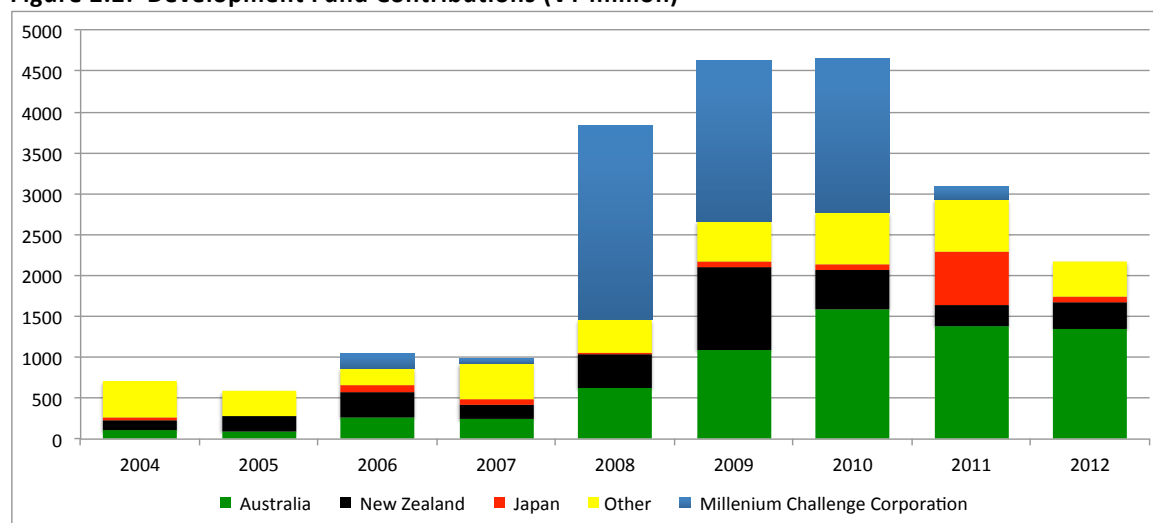
**Figure 2.1: Funding of Climate Change Projects, 2008-2012 (VT)**

Source: CPEIR database

Note: The amount attributed to Vanuatu is the flow-through of funding from unidentified external sources.

## 2.7 Role of Development Partners

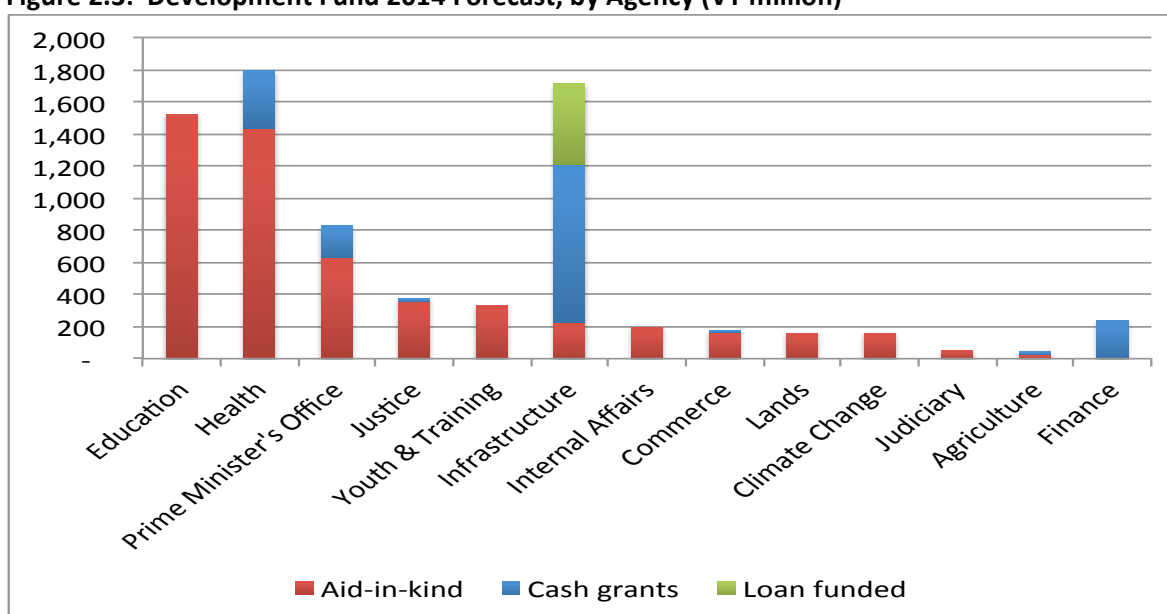
Grants and aid-in-kind funded 32% of the total public expenditure of VT 24 billion in 2012. At 8% of GDP, these sources provide a substantial contribution to the economy. The level and sources of donor contributions to the Development Fund have varied considerably over the last decade, as shown in Figure 2.2.

**Figure 2.2: Development Fund Contributions (VT million)**

Source: CPEIR database

In addition to the cash grants paid into the Development Fund shown in Figure 2.2, substantial assistance is also provided through aid-in-kind and external loans. The amounts of these that relate to each agency, as estimated in the 2014 Budget, are shown in Figure 2.3.



**Figure 2.3: Development Fund 2014 Forecast, by Agency (VT million)**

Source: Government of Vanuatu Budget 2014

Of the total estimated cost of development projects of VT 7.6 billion in 2014, almost 70% (VT 5.3 billion) will be funded outside the Budget, as aid-in-kind directly to ministries, other organisations and the community.

The larger amounts of aid-in-kind are set out in Table 2.1

**Table 2.1 Aid-in-kind Projects > VT 100million**

Project	Size (VT million)
Vila Central Hospital	831
Vanuatu Education Sector Program	781
Scholarships	702
National Convention Centre	450
TVET	333
Stratem Rod Blong Justice	238
Port Vila Urban Development - grant portion	223
Health Sector Program	175
Tourism Assistance Program	157
Global Climate Change Alliance	157

Source: Government of Vanuatu Budget 2014

The budgeted expenditure of VT 16.3 billion in 2013 is largely allocated to running costs of government, while capital investment is largely funded by development partners, with project appraisal, procurement, management and reporting being largely provided by contractors.

Vanuatu has developed limited capacity to meet the requirements of development partners to enable donor-funded activities to be mainstreamed into Government systems and procedures. This lack of capacity is not helped by the project-by-project, department-by-department approach to capacity development that has been the pattern to date. It is clear that the assessment of needs

and the prioritization of activities have been largely driven by donors, rather than by Government strategies and plans, or the needs of communities themselves.

The need for alternate arrangements for project management is understandable from the perspective of a donor funding a large project, but a project-by-project approach, with multiple alternate arrangements across individual Departments, does little to build up a core whole-of-Government capability. In a small developing country in which qualified staff are spread thinly across agencies, developing a whole-of-Government capacity should be a priority.

### ***Capacity Shortages***

An example of donor-driven alternate arrangements is the current Port Vila Urban Development Project that the Asian Development Bank is helping to finance. It is bypassing Government systems due to the shortage of qualified staff in the Ministry of Infrastructure and Public Utilities.

The Bank's risk assessment concluded that:

“Although the government has been involved with ADB in the past and [on] current ongoing development partner projects, these projects have typically been managed through separate PMU [project management units] per project, staffed by international consultants. Consequently, agencies like MIPU do not currently have the required capacity to manage projects on their own and thus may be unable to accommodate ADB demands.”

To address this risk, the ADB-Government of Vanuatu Memorandum of Understanding provides for a number of ‘alternate arrangements’ to comply with ADB requirements. An example of an alternate arrangement for this project was the establishment of a project website with procurement-related information such as the list of bidders, name of winning bidder, amount of contract awarded and list of goods/services procured. However, it is considered that the project funding for this could have been better spent contributing to a similar website for the Central Tenders Board.

## **2.8 Conclusions**

Improving governance of climate change and disaster risk reduction requires a strategic and unified vision. Much work in this regard has been progressed by national and provincial government as well as civil societies<sup>12</sup>. The current challenge is for the new Ministry of Climate Change to develop this strategy, without being distracted by the operational requirements of existing projects.

This means building the required policy capability and cross-agency relationships in the NAB Secretariat while quickly building the corporate services support needed for the units within the Ministry, including the NAB Secretariat, to operate effectively. The concerns recently expressed by development partners about the absence of project reports (since well before the Ministry was created) points to the need for action in this area.

The current lack of capability is also a critical issue if the Ministry hopes to gain National Implementing Entity accreditation, as discussed in section 7.

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<sup>12</sup> Concept Note, Strengthening Climate Change and Disaster Risk Governance in Vanuatu.

### 3. Institutional Analysis

#### Key Points

- The Ministry of Climate Change lacks a strategic plan to guide the business plans for its Departments and units, and to make better use of the planned establishment of provincial offices by the National Disaster Management Office.
- The NAB Secretariat within the Ministry needs to develop monitoring and evaluation skills, to link to the Government system in the Prime Minister's Office and to coordinate with the Vanuatu Statistics Office, rather than seeing donor-driven evaluations done on a project-by-project basis.
- Implementation of the *Decentralization Act* can facilitate provincial, area and community level planning and coordination of departmental/ donor/ NGO development projects, including for CC/DRR adaptation, but it is hampered by the lack of resources for Area Secretaries and Councils.

#### 3.1 Coordination of Climate Change

The Vanuatu Government has recently recognized the importance of better coordinating activities relating to climate change and disaster risk reduction by creating a new Ministry - the Ministry of Climate Change.

Local Government (Provincial Councils and Area Councils) also has an important role to play in planning and implementing CC/DRR activities, and coordinating with Departments in accordance with the Government's Decentralization policy.

#### 3.2 Ministry of Climate Change

The new Ministry of Climate Change was established in March 2013, bringing together a number of existing departments and units. As yet, there is no Corporate Plan for the Ministry that provides the over-arching vision and direction - a shortcoming that has been raised by stakeholders outside and inside the Ministry.

The departments and units of the Ministry most relevant to this review are discussed below.

##### ***Vanuatu Meteorology and Geo-hazards Department***

This is the largest Department within the Ministry. Staffing will increase from 50 to 89 if the proposed new structure, which is with the Public Service Commission for review, is approved.

The *Meteorology Act* 1989 provides the mandate for the Department and its Meteorological Service. Work is underway to draft a new Act following adoption of the proposed National Climate Change and Disaster Risk Reduction Policy.

As well, a new departmental Strategic Plan for 2014-2023 is due to be launched in late 2013.

##### ***National Disaster Management Office***

The policy framework which drives the mandate for the Office is the *National Disaster Act 2006*.

The Office has a business plan but it is not linked to the Government's *Priority Action Agenda* or *Plan Long, Act Short*. It is more a list of activities driven by the available budget, rather than a plan that might influence budget priorities.

There are currently eight staff at national level, and it is planned to have six staff at the provincial level. Provincial disaster management committees have been established, however these are not working efficiently and only one has an approved plan. Sanma Province, for example, has been waiting two years for feedback on its plan.

Although the Office infrastructure has been greatly improved, its capacity is still quite weak despite significant injections of technical assistance over time. Its reputation in some provinces and across departments is not always positive. Staff turnover is a problem, as is the lack of a structured professional development strategy to guide capacity building, including induction training for new staff and career progression.

### ***Department of Environmental Protection and Conservation***

This department was established in 1986 as the Vanuatu Environment Unit. It was upgraded to a department in 2009, with a mandate to oversee the formation and review of policies and legislation to facilitate ecologically sustainable development, and to protect and conserve Vanuatu's natural resources or environment.

The *Environmental Protection and Conservation Act* 2002 is the principal legislation governing Vanuatu's overall environment management. It has undergone a major review to include the mainstreaming of climate change and has regulations requiring Environmental Impact Assessments. Other current and proposed legislation includes the *Ozone Layer Protection Act*, the *Waste Management Bill*, the *Pollution Control Bill* and draft regulations on Community Conservation Areas and Specified Endemic Species.

The Department is currently developing its Strategic Plan 2013-2018 with support from SPC-GIZ, although staff are unsure how the Government's *Priorities and Action Agenda 2006-2015* and *Planning Long, Acting Short 2009-2012* link to the mandate of their Department.

The organization has ten staff. There is an intention to expand its outreach capacity to all six provinces, and to have sections specialising in waste management, EIA compliance, ozone and biodiversity.

### ***Department of Energy***

This Department does not have a legal framework, although it does administer the *Electricity Act*, the *Geothermal Act*, the *Petroleum Act* and the *Utilities Resolution Act*. Its structure changed from being a unit of the Department of Mines and Minerals to a separate department in 2011, but the number of staff was reduced.

A ten-year national energy road map is in place. There is currently a lack of clarity in areas such as factory waste and energy efficiency.

## **3.3 Local Government Structure**

Under the *Decentralization Act*, there are two layers of Local Governments - Local Government Councils at the Provincial level and Area Councils. Some provinces (such as Shefa) have created an intermediate layer called "Sub Districts".

### ***Provincial Councils***

Each Provincial Government Council comprises officials elected for four years, and appointed members, including the Provincial Secretary who is selected by the Public Service Commission under the *Public Service Act*.

The Secretary General is the Chief Executive Officer of a Local Government Council. They are responsible for all books, records and other documents of the Council. Each Council has a Local Government Fund consisting of the grants received from the central government and all local taxes, fees, rents, fines and profits from trade levied by the Council.

### **Area Councils**

Each Area Council is supported by an Area Secretary appointed by the Provincial Council. They comprise delegates representing Chiefs, Churches, Women, Youth and the Disability sectors. The *Decentralization Act* specifies the functions of Area Councils as:

- Review and consolidate community action plans for each community within that area council division or district;
- Develop an area council Strategic Development Plan for the relevant area council division or district;
- Coordinate, monitor and report to the relevant Provincial Government Council on the implementation of the relevant area council Strategic Development Plan.

An area council must hold its meetings at least four times each year. The funds of an area council consist of monies received from the relevant Local Government Council and other sources.

### **Co-ordination between Central and Local Government**

The *Decentralization Amendment Act* requires the establishment of a Technical Advisory Commission within a Local Government Region. The Commission consists of the Secretary General of the region, who is the chair, and the heads of government departments based in the region. The functions of the Commission are to:

- Review and consolidate action plans for each area council in the Region;
- Develop a Local Government Region Strategic Development Plan for approval by the Local Government Council;
- Coordinate, monitor and report to the Council on the progress of implementation of the Strategic Development Plan;
- Assist the Secretary General in the coordination of government services in the Region.

It is mandatory for provincial governments to engage with Technical Advisory Commissions, and to include government services in planning processes. However, this is not effective owing to limited resources, capacity, guidelines and systems.

## **3.4 Conclusions**

The Risk Governance Assessment found, in relation to the Ministry of Climate Change, that:

1. The current planning process is non-strategic and is fragmented within specific agencies. The Ministry does not yet have a corporate plan or other document that demonstrates alignment with the national priorities and strategies in *Priorities and Action Agenda 2006-2015*, *Planning Long, Acting Short 2009-2012* and the strategic priorities in the Budget.
2. There has been no systematic assessment of required skills sets, existing skills and training needs. Most training is *ad hoc* and not related to a human resource development plan or training needs analysis.
3. The lack of an overall monitoring and evaluation system, other than ones driven by donors on a project-by-project basis, means there is no linkage to the Government system being developed in the Prime Minister's Office.
4. There is a need for legislative changes to clarify the responsibilities of the Departments within the Ministry in relation to climate and disaster risk.

5. The proposed establishment of six provincial offices for the National Disaster Management Office could result in overlapping mandates, be confusing for provincial departments regarding coordination, and duplicate expenditure with other parts of the Ministry.

In relation to Local Government, the Assessment found that:

1. While the *Decentralization Act 2006* outlines the roles and responsibilities of the local administration, there are significant capacity and resource challenges that limit the implementation of the Act. These include conflicting priorities between elected officials and appointed officials tasked to manage the local government structures on a day-to-day basis. As well, Area Secretaries/Councils are under-resourced and incapable in many instances of performing their mandated responsibilities.
2. The current planning at provincial and area council levels tends to be non-strategic and *ad hoc* and there are no consistent templates to guide planning. Most do not have a long-term strategic plan and there is no provision for community needs to influence planning and priorities.
3. Many projects implemented by Government, International NGOs, United Nations agencies and regional agencies generally bypass local government systems. This means that local officials are unable to monitor progress on programs affecting their communities, nor are they able to benefit from these programs in implementing their own Ministry's priorities.

## 4. PFM Analysis

### Key Points

- Vanuatu's centralized system of public finance and budgetary control has allowed it to maintain a generally sound level of fiscal discipline.
- However, there has been a degree of overspending and non-compliance by some Ministries.
- There is also a lack of financial management skills in many agencies, and a lack of qualified auditors in the Office of the Auditor-General to audit donor-funded projects.
- PFM reviews show gradual improvements in areas where assistance has been provided, while poor ratings remain for internal and external audit, legislative oversight and donor practices.

### 4.1 Budgeting

The steps in Vanuatu's annual (calendar year) Budget process are set out in the Budget Calendar in Annex 3.

The process starts with the development of a pre-Budget Policy Statement which specifies the Government's strategic priorities for the Budget, as well as its fiscal and economic targets. The 2014 Policy Statement includes nine priorities including, for the first time, a priority relating to the environment, namely:

“Enhance protection and conservation of Vanuatu's natural resources and biodiversity, taking climate change issues into consideration.”

This budget priority reflects the creation in March 2013 of the new Ministry of Climate Change.

For each annual Budget, the Government seeks to have some flexibility to fund New Policy Proposals. The guiding policy is that these proposals should:

- fit within the overall fiscal envelope;
- be well researched to reinforce the Government's priorities;
- be within the Ministries' capacity to implement within the time frame;
- develop economic capacity and growth;
- be sustainable in terms of recurrent costs.

Budget submissions are assessed by the Ministerial Budget Committee having regard for the pre-Budget Policy Statement and the guiding policy on New Policy Proposals.

The key aspects of Vanuatu's public finances are set out in Table 4.1.

**Table 4.1: Fiscal Aggregates (VT billion)**

	2011 Actual	2012 Actual	2013 Budget	2014 Budget	2015 Forecast	2016 Forecast
<b>Government Operations</b>						
Revenue	12.8	13.6	14.6	15.3	16.1	17.1
Expenses	13.4	13.9	13.9	14.2	14.2	14.6
<i>Operating Balance</i>	-0.6	-0.3	0.7	1.0	1.8	2.4
<b>Donor Operations</b>						
Revenue	3.0	2.2	4.3	1.8	1.4	1.0
Expenses	2.1	1.9	4.3	1.8	1.4	1.0
<i>Operating Balance</i>	0.9	0.3	0.0	0.0	0.0	0.0
<b>Sources of Funds</b>						
Consolidated Operating Balance	0.3	0.0	0.7	1.0	1.8	2.4
Borrowings	1.2	1.1	-0.3	-0.1	1.9	2.4
<b>Applications of Funds</b>						
Capital Expenditure	1.9	1.1	0.4	1.0	3.1	3.6
Capital Injections/withdrawals	-0.3	-0.1	0.0	0.0	0.7	1.2
<b>Debt</b>	14.7	15.3	15.3	15.2	17.1	19.6
as % of GDP	21%	21%	20%	19%	19%	20%

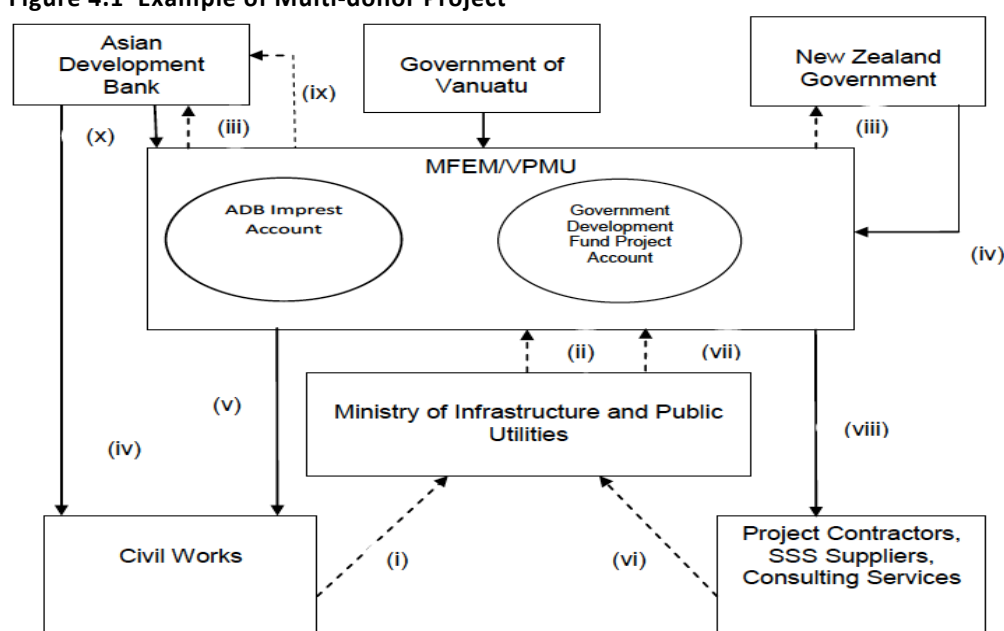
Source: Government of Vanuatu 2014 Budget

### Donor Funding

The Budget includes, for information purposes, a 'Forecast Funding from Donors' statement. For 2014, this statement disclosed:

cash grants (through the Development Fund) of VT 1.8 billion;  
aid in kind (using donors own systems) of VT 5.3 billion;  
funded from external loans of VT 0.5 billion.

There are different approaches to aid funding amongst donors – even for a jointly-funded project. Figure 4.1 is an example of one donor (the ADB) contracting directly for civil works on a project while another donor (New Zealand) lets Vanuatu procure the other contractors and suppliers.

**Figure 4.1 Example of Multi-donor Project**



The *OECD Aid Effectiveness 2011* report estimated that only 54% of aid to Vanuatu was reported to central agencies. It found that the reasons for this included:

- unsystematic reporting by project implementation units to government
- weak financial reporting abilities among line ministries and insufficient inter-ministerial reporting mechanisms
- delays in project implementation
- lack of a central database on aid disbursements.

There has reportedly been an increase in the development aid flowing through the Treasury's Development Fund in recent years, although, as discussed later, even where aid funding is mainstreamed, procurement, project management and audit processes are often not mainstreamed, but managed through parallel or hybrid processes. The reasons for this include donor requirements and the shortcomings in Government capacity. For example, procurements through the Central Tenders Board have reportedly taken nine months compared with three months for a similar item using a parallel system.

## 4.2 Financial Management and Control

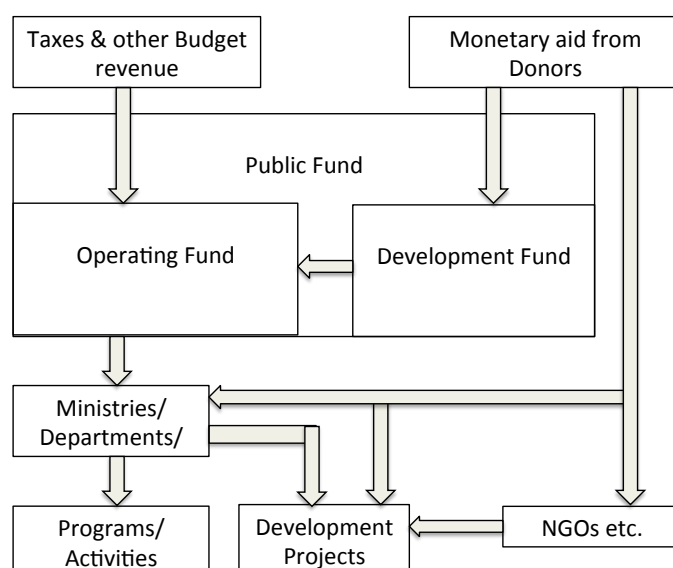
When the Budget is passed, departments input line items (generally for "Personnel Emoluments", "Other Goods and Services" and "Capital Expenditure") into the Vanuatu Budget Management System which uploads the details into the Financial Management Information System – SmartStream – for expenditure management and funds control.

The public financial management system operates with centralized payment and budget controls, including monthly warrants to control cashflows from the Operating Fund. Under the *Public Finance and Economic Management Act*, only the Ministry of Finance can hold bank accounts, including for trust funds. This includes the bank accounts for the Development Fund which holds moneys from development partners.

Besides the Development Fund, there are several other trust funds which the Director-General of the Ministry of Finance has approved under the Act, but these are only to hold trust moneys, rather than public revenue that should be paid into the Public Fund. This requirement provides significantly tighter control than was previously the case when there had been a proliferation of trust funds set up by Ministries.

The flow of revenue and monetary aid through the Public Fund is shown in Figure 4.2.

**Figure 4.2 Flows through the Public Fund**



### ***Fiscal Discipline***

In recent years, the control of expenditure has improved significantly, as shown in Table 4.2.

**Table 4.2 Budget Expenditure Variances**

<b>Year</b>	<b>Budget * (VT billion)</b>	<b>Actual * (VT billion)</b>	<b>Variance</b>
2009	12.2	12.5	-3.0%
2010	14.1	13.9	+0.8%
2011	13.7	13.7	+0.2%
2012	14.4	14.1	+2.6%

\* Excluding public debt and donor payments

Source: *Public Financial Management Performance Measurement Report, 2013*

At the same time, the Budget has been in deficit for several years due to revenue shortfalls. To the third (September) quarter of 2013, there was a fiscal deficit of VT 320 million, although after adjusting for the spending of donor funds received in previous years, the result was a surplus of VT 67 million.

The 2014 Budget provides for a surplus of VT 591 million, which the Budget indicates will be used for external debt repayments.

In relation to Budget support, it is notable that there was no allowance for it in the 2013 and 2014 Budgets, following the receipt of only 10% of the anticipated VT 700 million of Budget support from the European Union in 2012.

Notably, the 2014 Budget also provides for the start of a reversal in the large declines in capital expenditure that occurred in 2012 and 2013, as shown in Table 4.1. This upturn may place stress on Vanuatu's capacity to manage development projects, particularly with further large amounts of aid funding being considered after these estimates were developed.

### ***Agency-level Financial Management***

At the agency level, departments access SmartStream online to submit Local Purchase Orders, which are checked for 'available funds' against budget line items for departments, and against the total funding for the relevant program/project account in the Development Fund), before they can be printed and issued to suppliers. Requests for virements (budget transfers between line items) need to be approved by the Ministry of Finance.

To pay a supplier's invoice, departments need to give Ministry of Finance a payment requisition, signed by an authorized delegate, with the printed Local Purchase Order, and evidence of delivery of the goods or services. Compliance with this requirement for documentation and authorization of expenditure is subject to independent checking by the Internal Audit Unit in the Ministry of Finance.

To support the Government's decentralization policy, the Ministry of Finance has established Financial Service Bureaus and agencies with businesses in the provincial centres. These bureaus allow officials in outlying areas to issue purchase orders to local suppliers and to have them paid locally.

### ***Accounting Skills***

The Office of the Auditor-General has advised that accounting skills are in short supply in Departments and in the provincial governments, which have been unable to prepare auditable

financial statements. As well, the Office itself is several years behind in auditing the Government's financial statements due to difficulties in attracting and retaining staff.

The Office currently has 10 staff of a complement of 23. The Auditor-General's report for the years 2005 to 2009 was tabled in 2012 (the previous one being tabled in 2007) and the report on 2010 was tabled in 2013. Due to this lack of resources, many donors have outsourced the audits of donor-funded projects to accounting firms, although the Auditor-General has gained the agreement of most donors for him to review the terms of reference for these outsourced audits.

A recent positive development has been the establishment of audit committees for the Ministry of Finance, the Education Ministry and the Health Ministry.

### 4.3 PFM Performance

Public Financial Management Performance Measurement Reviews have been carried out in 2006, 2009 and 2012. A comparison of the ratings in these reviews is given in Table 4.3.

**Table 4.3: PFM Ratings<sup>13</sup>**

Item	2006	2009	2012
<i>A. Budget Credibility</i>	A--A	B--A	AACA
<i>B. Comprehensiveness &amp; Transparency</i>	AAD+BDC	BBC+BDC	BBB+BDC
<i>C(i). Budget: Policy based</i>	B+D+	BC+	AC+
<i>C(ii). Budget: Predictability &amp; Control</i>			
Taxes	C+C+D+B	BB↑D+A	BBD+B+
Cash balances, debt & guarantees	C+	C+	C+
Payroll controls	C+	C+	C+
Procurement	-	D+	-
Non-payroll Internal controls	C+	C+↑	C
Internal audit	D+	C	D+
<i>C(iii). Accounting, Recording &amp; Reporting</i>			
Timeliness of accounts reconciliation	B	B	B
Information on resources received by agencies	C	C	D
In-year Budget Reports - quality & timeliness	B+	B+	B+
Annual Financial Statements - quality & timeliness	B+	A	B+
<i>C(iv). External Scrutiny &amp; Audit</i>			
External Audit	D	D	D
Legislative Scrutiny	C+D	C+↑D	C+D+
<i>D. Donor Practices</i>			
Predictability of Direct Budget Support	D	C+	D
Financial Information from donors	D	D+	D+
Aid managed using national procedures	D	D↑	D

A more detailed comparison of the ratings in the 2009 and 2012 reviews is in Annex 4.

While noting that there have been some differences in methodology between the reviews, the ratings do show a gradual improvement in a number of areas, particularly where there has been assistance provided, such as under AusAID's *Governance for Growth* program. At the same time,

<sup>13</sup> For ease of comprehension, ratings of criteria that do not directly relate to this assessment, such as of Taxes, have not been shown separately.

several areas have stayed at a low level, or gone backwards, including internal audit, external audit legislative scrutiny, procurement and donor practices.

#### 4.4 Project Management Costs

The Terms of Reference for this review sought an assessment of the level of project management costs for CC/DRR projects.

The Ministry of Finance has not adopted any standard percentage estimates for project management costs, or standard costs of staff overheads, as the Government's contribution to donor-funded projects has generally been the provision of staff and other resources, as agreed on a project-by-project basis.

Generally, development partners produce budgets which specify the costs of project management units and the auditing of project accounts (where required). The project management costs for a major infrastructure project for example - the ADB-Vanuatu Inter-island Shipping Support Project - were 17% of the overall project cost. This comprises 14% for external resources and 3% for the VPMU's 'in-kind' resources of personnel, office space, etc..

The cost of project evaluations depends largely on the work required to measure a baseline and subsequent log-frame outcomes. For example, the evaluation surveys required for the largest donor-funded program in recent years – that funded by the Millennium Challenge Corporation - cost US\$1.5million out of the budget of US\$52million – which is 3%. The evaluation of smaller projects is likely to cost more than 3%, depending on the outcomes to be measured and the ease of measuring them.

Based on projects for which records are available, the proportion of project management costs can vary between 3% and 17% depending on the size and complexity of the project, and whether auditing and evaluation are included.

#### 4.5 Conclusions

Overall, Vanuatu's system of budgetary and expenditure control operates well, and has been steadily improving, as evidenced in the various PEFA/PFM performance reports and feedback from the Auditor-General.

Aspects that have not rated well, and which have not improved, include:

- External audit
- Internal audit
- Legislative scrutiny
- Procurement
- Donor practices
  - Predictability of direct Budget support
  - Financial information from donors
  - Aid managed using national procedures

As well, there are issues of non-compliance in certain Ministries - particularly poor spending control, the use of 'unofficial' purchase orders to by-pass SmartStream controls, and the recruitment of staff before obtaining a 'financial visa' from Ministry of Finance. To date, no such issues have been raised in relation to the new Ministry of Climate Change.

## 5. NIE Accreditation

### Key Points

- NIE accreditation gives countries direct access to funding from the Adaptation Fund, but is difficult for small countries to get.
- Nevertheless, targeting NIE accreditation will bring benefits by improving donor's confidence in Vanuatu's national systems, including in relation to procurement.

To obtain direct access to the Adaptation Fund, a country must have a legally-recognised entity accredited as a National Implementing Entity (NIE) by the Accreditation Panel of the Fund's Board.

Without a legal entity that has NIE accreditation, a country can only receive funding from the Adaptation Fund through a Multilateral Implementing Entity (such as the World Bank, UNDP and others) or a Regional Implementing Entity (the Pacific Region has only just gained one - SPREP). As well, the 50% cap on funding that can be channelled through a Multilateral Implementing Entity means that an RIE is the only source for countries that do not have an NIE.

In future, greater volumes of climate change funding are expected to be available from the Green Climate Fund. This fund is expected to have similar requirements for MIEs, RIEs and NIEs (i.e. direct access to funding as applies to the Adaptation Fund)

### 5.1 NIE Standards

The Adaptation Fund Board has set the following fiduciary standards for an entity to gain NIE accreditation:

#### Financial integrity

- the ability to accurately and regularly record transactions and balances to an appropriate standard as attested by a competent authority
- the ability to safeguard, manage and disburse funds effectively to recipients on a timely basis
- the competence to produce forward-looking plans and budgets
- legal status to contract with the Adaptation Fund and third parties

#### Institutional capacity

- procurement procedures that provide for transparent practices, including those concerning competition
- capacity to undertake monitoring and evaluation
- ability to identify, develop and appraise projects
- competency to manage or oversee project execution

#### Transparent and self-investigative powers

- freedom to blow the whistle on issues of fraud and gross mismanagement
- objective policy for self-regulation.

It is widely acknowledged that gaining NIE status is not easy for small countries. To date, fifteen countries have an NIE (largely in Africa and South and Central America)<sup>14</sup>, but no Pacific Island Country has one. The Climate and Development Knowledge Network has noted that:

“Accessing finance through an NIE favours those nations with established institutions that have developed existing relationships with international donors and development organizations, as well as an existing track record in delivering development programmes. The scale of finance offered through the GCF [Green Climate Fund] would likely magnify these inequalities.” (website accessed 17 October 2013)

As indicated in section 7.3, a gap analysis has been carried out to assess how the fiduciary standards would be met in Vanuatu.

## 5.2 Filling the Procurement Gap

The Central Tender Board has received assistance from the AusAID *Governance for Growth* program, to overcome the constraints referred to above and as identified in PFM Performance Reviews. This assistance included:

- the development of a new Government Contracts and Tenders Act and Regulations – for expected introduction in late 2013
- the development of standard bidding documents and contracts – currently being piloted in the larger Ministries of Health, Education and Infrastructure and Public Works
- a corporate plan for the Board, with KPIs
- a proposed website and database of tenders
- an expanded organizational structure with a full-time Secretary and two new positions of Assistant Secretary, awaiting approval by the Public Service Commission
- a complaints handling committee and process
- a proposed awareness and training program, including for Provincial Secretaries.

However, implementation of several of these measures, including designing and implementing a tenders website and database to the transparency of procurements, is not expected to occur in the near future.

## 5.3 Conclusion

While it will take some time for an agency in Vanuatu to demonstrate the track record required for NIE accreditation, it is a worthwhile medium-term goal as it will leverage improvements at the whole-of-Government level, as well as in the Ministry itself.

This is evidenced by the experience in Senegal (Bugler and Rivard, 2013) where the actions required for NIE status have reportedly led to strong national ownership of adaptation projects, and helped improve the country’s institutional capacity overall – not just in managing climate change projects.

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<sup>14</sup> According to the Adaptation Fund's website, the NIEs accredited to date are in Jamaica, Senegal, Uruguay, Benin, South Africa, Belize, Jordan, Rwanda, Kenya, Mexico, Argentina, India, Costa Rica, Morocco and Chile.

## 6. CC/DRR Activities and Expenditure

### Key Points

- This section analyses expenditure on climate change adaptation, mitigation and disaster risk reduction activities.
- The Working Group's classification of agency and project expenditure results in an estimate of 3.5% of GDP as being climate related. However, this figure is quite sensitive to how Operating Fund expenditure by large agencies is classified.
- The analysis of Development Fund expenditure is more reliable than that of the Operating Fund as there is more information available on development projects.
- It is useful to classify Adaptation projects into headings of Water Supply; Reef Monitoring and Rehabilitation; Conservation, Land Management and Food; Forestry; Health and Disease; and Adaptation Generally.
- This identifies sectoral trends and allows policy makers to compare spending levels under each heading with Government priorities.

### 6.1 Methodology

#### *Classification of Activities*

Activities have been classified based on the environmental and social outcome they are contributing to – 'Climate Change Mitigation', 'Climate Change Adaptation' and 'Disaster Risk Reduction'<sup>15</sup>.

**Climate Change Mitigation** – activities that help stabilize greenhouse gas concentrations in the atmosphere by promoting efforts to reduce or limit greenhouse gas emissions or to enhance greenhouse gas capture.

Examples of mitigation activities include:

- more efficient use of fuels;
- reduction in electricity system losses and end-use;
- use of hydro, solar, wind, geothermal or wave power;
- insulation of homes and businesses;
- re-afforestation.

**Climate Change Adaptation** – activities that aim to increase the capacity and resilience of human or natural systems to the impacts of climate change and climate-related risks.

Examples of adaptation activities include:

- Improved water catchment, distribution and water quality in villages;
- Upgrading of infrastructure to cope with changing environmental impacts;
- Public health addressing climate-related disease;
- Introduction of drought-tolerant crops;
- Changes to policies and improvements in capacity at national and local levels to effectively implement and sustain adaptation measures;
- Relocating villages and people affected by more frequent storm surges and other extreme weather events;
- Regrowth of mangroves, coral reefs, sea-grass beds - whether to protect foreshores or

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<sup>15</sup> This report and the associated Risk Governance Report have adopted the broad definition of Disaster Risk Reduction used in Vanuatu, namely the "Prevention, Mitigation, Preparedness and Response Activities that a community may decide to undertake to reduce present and future hazard impact".

reestablish or protect fisheries;

- Other activities that meet the criteria of climate change adaptation funds (e.g. Global Environment Fund, PPCR).

Expenditure on activities that relate to more than one of these categories has been apportioned based on an assessment of the relative benefits to each outcome.

**Disaster Risk Reduction** – other activities that reduce the impact of natural hazards.

Examples of activities not related to climate change include:

- geohazard warning systems;
- activities that reduce the impacts of tsunamis, earthquakes and volcanoes;
- re-location of villages and people away from volcanoes and areas subject to landslip.

Where it is unknown whether Disaster Risk Reduction activities are related to climate change, they have been classified as 'Disaster Risk Reduction-General'.

### *Scope of Expenditure*

The analysis includes all activities funded through the Operating Fund and the Development Fund. This includes expenditure by:

- the Constitutional bodies
- the ministries and their departments, including grants to other public sector agencies.

It does not include other expenditure by entities within the public sector - namely:

- Non-commercial statutory bodies
- Provincial governments
- Municipalities
- State owned entities - corporations and commercial statutory bodies.

Details of expenditure on activities by these excluded bodies is not readily available (and in many cases is not produced), but it is unlikely that their expenditure on CC/DRR activities would be significant. A list of the entities in these categories is in Annex 5.

### *Relevance of Activities*

Activities are classified as being of **High Relevance** if their primary objective is to:

- improve climate resilience;
- contribute to mitigation of risks from climate change; or
- reduce or mitigate the risk of disasters.

These activities include:

- Crop research for resilient species (exports and food security)
- Obtaining climate resilient cassava species (food security)
- Protecting biodiversity of endemic species – fishes, trees, root crops etc.
- Obtaining climate resilient species of coconut (protecting export potential)
- Animal protection particularly cattle to vector borne diseases (protecting export revenue)
- Replanting vegetation to prevent coastal erosion
- Climate change mitigation (e.g. renewable energy, energy efficiency)
- Disaster risk reduction and disaster management capacity
- The additional costs of changing the design of a program to improve climate resilience to cyclones and floods (beyond routine maintenance or rehabilitation)
- The portion of an infrastructure project that is specifically climate-proofing the infrastructure
- Linking climate forecast information to Agriculture



- Responding to recent cyclone or flooding if it has added benefits for future extreme events
- Healthcare for climate sensitive diseases including malaria, dengue fever, water borne diseases
- Building capacity to plan, manage and monitor climate change projects and demonstrate effectiveness, including early warning and monitoring
- Raising awareness about climate change policy

Activities are of **Medium Relevance** if their secondary objective is to:

- improve climate resilience;
- contribute to mitigation of risks from climate change; or
- reduce or mitigate the risk of disasters.

These activities include:

- Forestry and agriculture motivated primarily by economic or conservation objectives, because this will have some mitigation effect.
- Water storage, water efficiency and irrigation motivated primarily by improved livelihoods through protection against drought.
- Bio-diversity and conservation, unless explicitly aimed at increasing resilience of ecosystems to climate change (or mitigation)
- Eco-tourism, because it encourages communities to put a value of ecosystems and raises awareness of the impact of climate change.
- Forestry motivated by economic or conservation objectives, if it has some mitigation effect
- Water storage, water efficiency and irrigation that is motivated primarily by improved livelihoods if this will also provide protection against drought
- Bio-diversity and conservation, unless explicitly aimed at increasing resilience of ecosystems to climate change (or mitigation)
- Eco-tourism, because it encourages communities to put a value of ecosystems and raises awareness of the impact of climate change
- Livelihood and social protection programs, motivated by poverty reduction, but building household reserves and assets and reducing vulnerability. This includes programs to promote economic growth, vocational training, financial services and the maintenance and improvement of economic infrastructure, such as roads

Activities are of **Low Relevance** if their objectives are only indirectly related to:

- improve climate resilience;
- contribute to mitigation of risks from climate change; or
- reduce or mitigate the risk of disasters.

These activities include:

- General infrastructure activities that have a climate-proofing element, unless the specific climate-proofing aspect can be calculated separately.
- Programs aimed at improving water quality, general livelihoods, motivated by poverty reduction, building household reserves and assets and reducing vulnerability.
- General planning capacity, either at national or local level, unless explicitly linked to climate change.
- Water quality, unless the improvements in water quality aim to reduce problems from extreme rainfall events, in which case the relevance would be high
- General livelihoods, motivated by poverty reduction, but building household reserves and assets and reducing vulnerability
- General planning capacity, either at national or local level, unless it is explicitly linked to climate change, in which case it would be high.

- Livelihood and social protection programs, motivated by poverty reduction, but building household reserves and assets and reducing vulnerability. This will include programs to promote economic growth, including vocational training, financial services and the maintenance and improvement of economic infrastructure, such as roads.

Activities are of **Marginal Relevance** if their objectives are only very indirectly or theoretically related to:

- improve climate resilience;
- contribute to mitigation of risks from climate change; or
- reduce or mitigate the risk of disasters.

These activities include:

- Any short term or programs (including humanitarian disaster relief)
- The replacement element of any reconstruction (splitting off the additional climate element as high relevance)
- Education, health, justice and public order projects without an explicit climate change or disaster risk element.

Similarly, activities are of **No Relevance** if their objectives are not related to the three primary objectives.

### ***Classification Principles***

- An activity or project is relevant if it aims to improve climate resilience, mitigate climate change or disaster risks.
- A large project with both high and lower relevance parts can be split into two parts if there is a logical split.
- If relevance is not clear, the lower classification is used.
- Assumptions to classify projects are recorded to provide consistency with future classifications, and any comparisons between countries.

Expenditure has been weighted according to its degree of relevance to climate change and disaster risk reduction, as follows:

- High relevance - 80%
- Medium relevance - 50%
- Low relevance - 25%
- Marginal relevance - 5%
- No relevance - 0%.

### ***Types of Activities***

Climate-related activities and funding have been assessed in a workshop as being of high, mid-level, low, marginal or no relevance in the following primary categories:

- Climate change mitigation
- Climate change adaptation
- Disaster risk reduction.

To provide a finer view of Adaptation expenditure, these activities were further categorized as:

- water supply
- reef monitoring and rehabilitation
- conservation, land management and food
- forestry
- health and disease

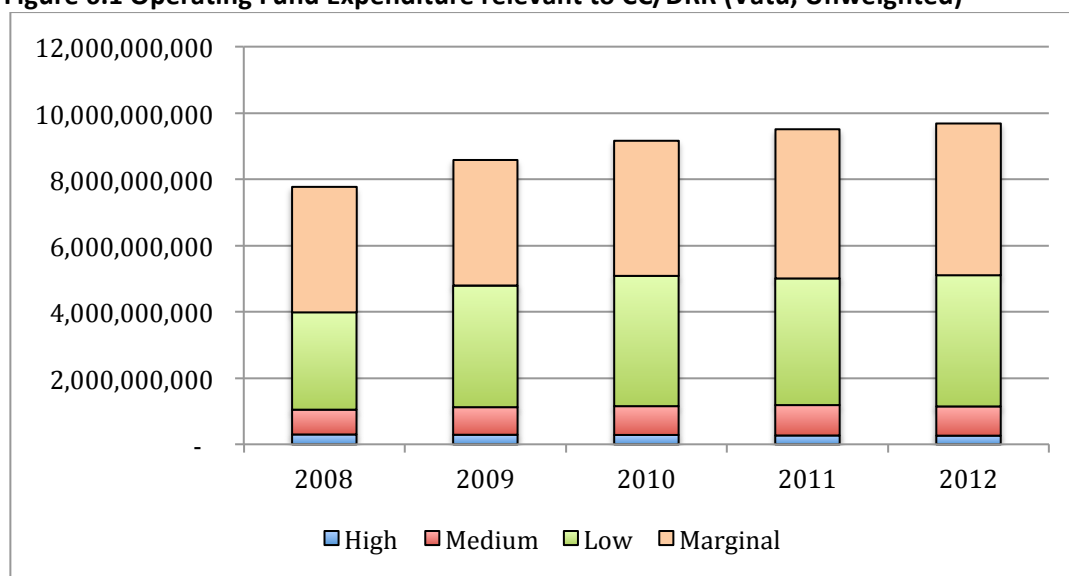
- transport
- adaptation generally.

## 6.2 Analysis of Expenditure

### *Operating Fund*

Over the last five years, there has been little change in the level of spending from the Operating Fund on activities that have are of 'high' or 'medium' relevance to CC/DRR, as shown in Figure 6.1. The growth in 'low' or 'marginal' expenditure (in unweighted terms) relates to activities such as Internal Security and Border Control, and Shipping (which have been classified as 'low' relevance).

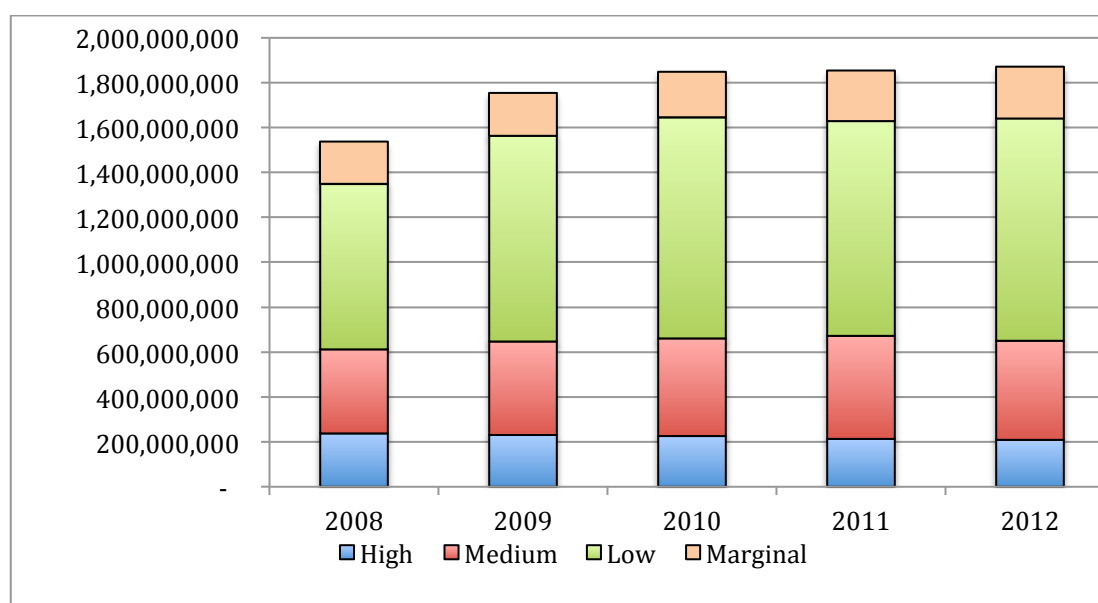
**Figure 6.1 Operating Fund Expenditure relevant to CC/DRR (Vatu, Unweighted)**



Source: CPEIR database

However, applying the relevance weightings to the Operating Fund expenditure shows that there has been a flattening out in recent years - see Figure 6.2.

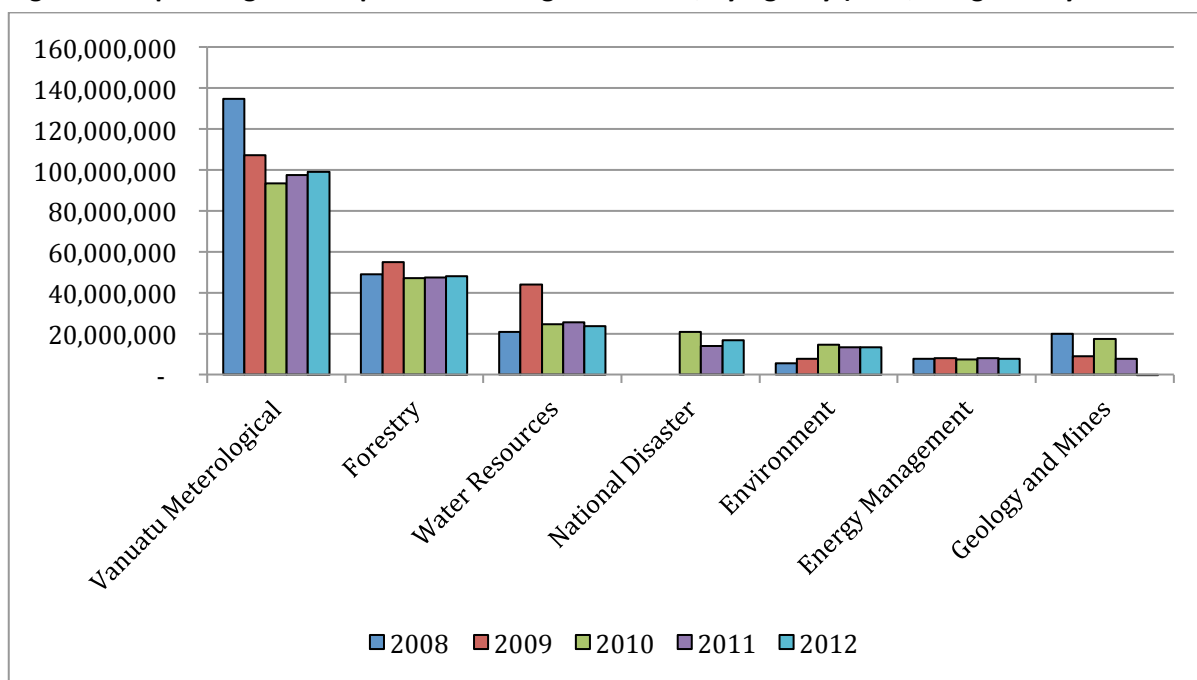
**Figure 6.2 Operating Fund Expenditure relevant to CC/DRR (Vatu, Weighted by relevance)**



Source: CPEIR database

Figure 6.3 shows the contributions of the agencies with expenditure highly relevant to CC/DRR.

**Figure 6.3 Operating Fund expenditure of high relevance, by Agency (Vatu, Weighted by relevance)**



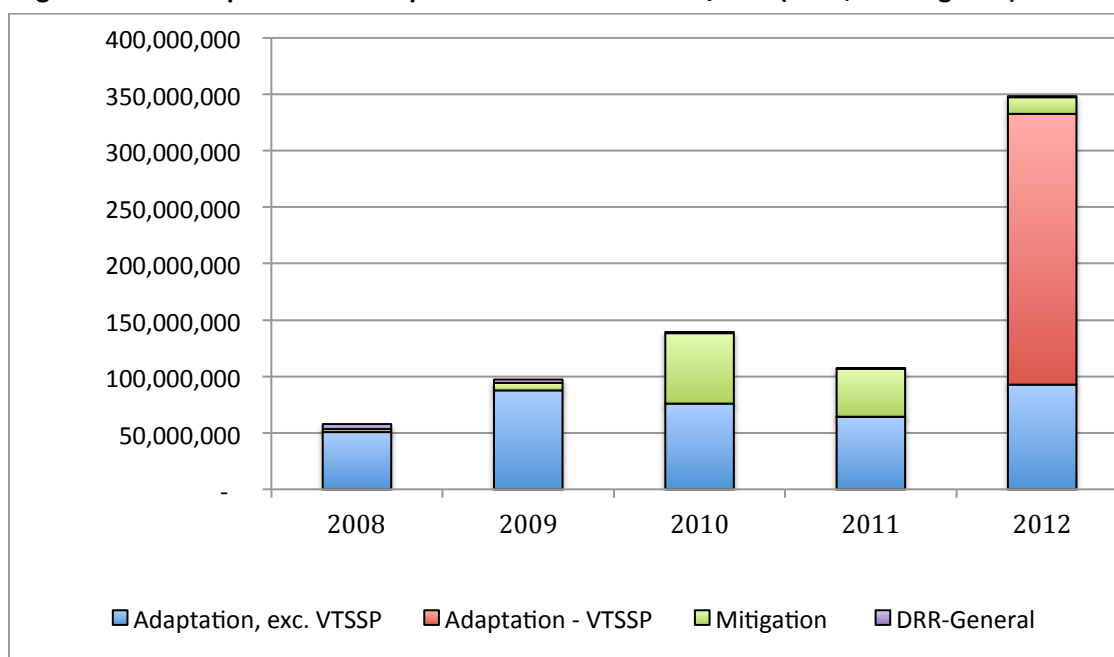
Source: CPEIR database

The classification of agency expenditure is somewhat subjective and, in the case of larger agencies, it can have a significant impact on the assessment of how much expenditure is related to climate change. Table 6.1 (on page 38) provides a sensitivity analysis on the agencies whose expenditure makes a significant difference.

As expenditure from the Operating Fund largely is generally classified according to organizational structures, its relevance to CC/DRR activities cannot be classified as reliably as expenditure from the Development Fund, which relates to specific projects.

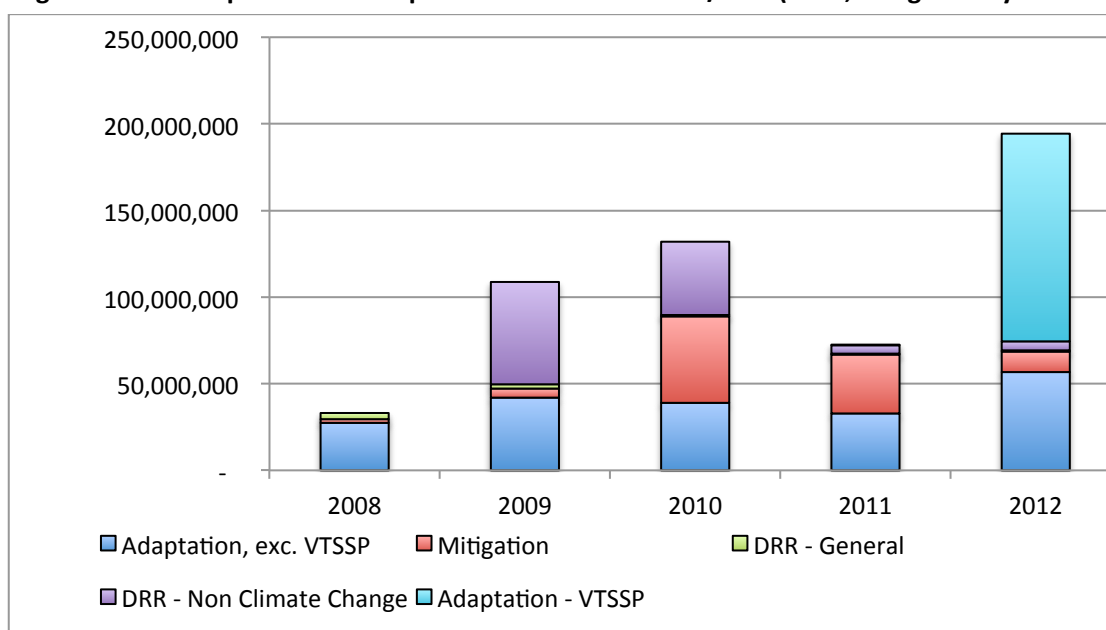
### ***Development Fund***

The time series of Development Fund expenditure on the main categories of projects in Figure 6.4 show enormous variability year-to-year.

**Figure 6.4 Development Fund Expenditure relevant to CC/DRR (Vatu, Unweighted)**

Source: CPEIR database

When weighted for relevance, and with the large impact of the Vanuatu Transport Sector Support Program separated out, the trend in expenditure is shown in Figure 6.5.

**Figure 6.5 Development Fund Expenditure relevant to CC/DRR (Vatu, Weighted by relevance)**

Source: CPEIR database

This figure shows that the large variability over the last five years is primarily attributable to:

- periodic expenditure related to geo-hazards (classified as DRR – Non Climate Change);
- the start of a large program, the Australia-funded Vanuatu Transport Sector Support Program (VTSSP) to rehabilitate and improve the maintenance of the roads on Tanna, Ambae and Malekula; and

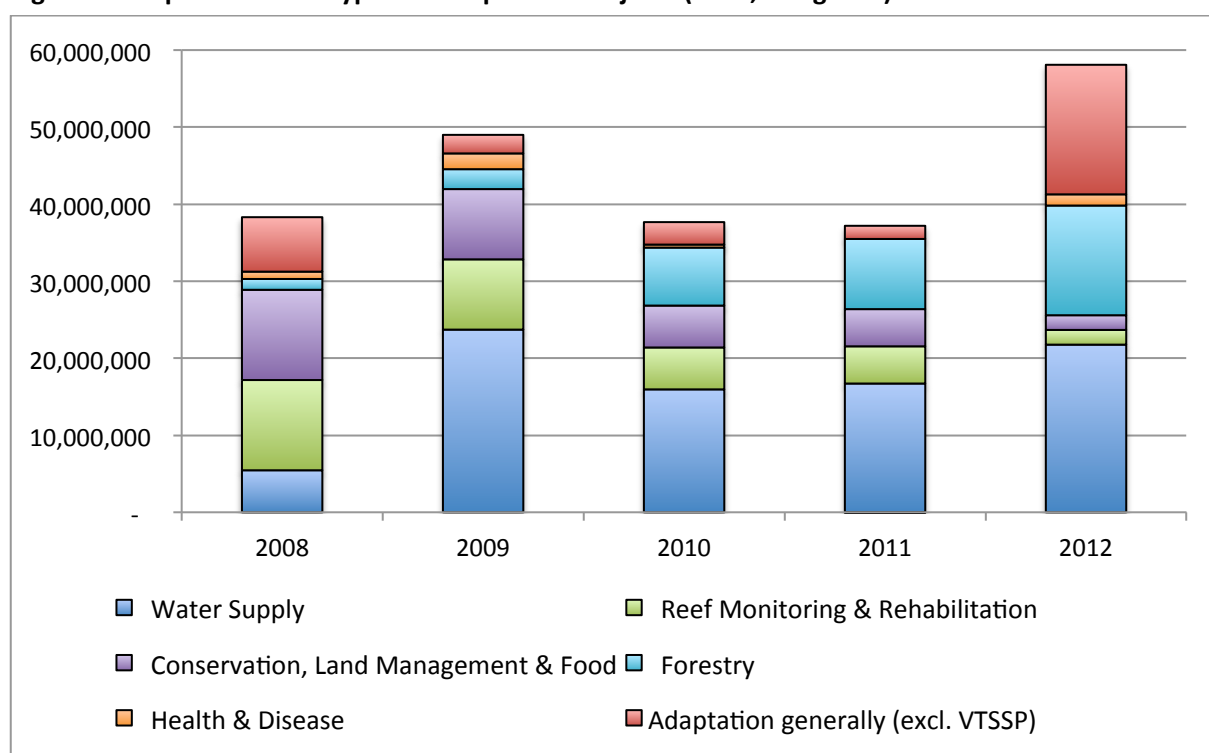
- the decline in mitigation expenditure following completion of Phase 2 of the Sarakata Hydro Dam project funded by Japan. This project doubled the supply of renewable energy to Luganville - with generating capacity of 1,200 kW.

To look beyond such one-off factors, it is useful to analyse expenditure on particular sectors or types of projects within the Adaptation heading. Accordingly, the Adaptation projects which incurred expenditure between 2008 and 2012 have been categorised as:

- water supply - 40 projects
- fisheries and marine resources - 14 projects
- conservation, land management and food - 16 projects
- reef monitoring and rehabilitation - 3 projects
- forestry - 4 projects
- health and disease - 7 projects
- transport - 1 project (the Vanuatu Transport Sector Support Program)
- adaptation generally - 7 projects.

Figure 6.6 gives a time series of expenditure in these categories, weighted by the degree of relevance of each project to CC/DRR.

**Figure 6.6 Expenditure on types of Adaptation Projects (Vatu, Weighted)**



### **Combined Expenditure**

The analysis of expenditure from the Operating Fund and the Development Fund shows that:

1. CC/DRR expenditure has grown in nominal terms from VT 1,570 million in 2008 to VT 2,064 million in 2012;
2. In relative terms, the increase has been from 2.4% to 2.9% of GDP;
3. In 2012, 91% of climate relevant expenditure was sourced from the Operating Fund, while 9% was from the Development Fund (noting that greater reliability can be placed on the analysis of expenditure from the Development Fund);

4. From the Development Fund, expenditure on Adaptation projects grew from VT 27 million in 2008 to VT 177 million in 2012. Including expenditure classified as DRR-General expenditure (which may or may not relate to climate change), the growth over that period was from VT 31 million to VT 177 million. Excluding the one-off impact of the Vanuatu Transport Sector Support Project, the increase was from VT 31 million in 2008 to VT 57 million in 2012;
5. For 2012 (and most of the 5-year period reviewed), the largest category of Adaptation projects was for Water Supply (VT 22 million), followed by Adaptation generally (VT 17 million) and Forestry (VT 14 million). Together, these three categories comprised 93% of total development expenditure on Adaptation in 2012.

In relation to the assessment that 2.9% of GDP was the level of spending on climate change activities in 2012, Table 6.1 provides a sensitivity analysis to show the extent to which this figure is impacted by the classification of agency expenditure.

**Table 6.1 Sensitivity Analysis of Climate Change Expenditure Classification**

Agency	Original Expenditure Classification	Lower Expenditure Classification	Change in GDP%	Revised GDP (cumulative from 2.88%)
Public Works	Low	Marginal	0.24%	2.64%
Internal Security	Low	Marginal	0.26%	2.38%
Health	Medium, Low & Marginal	Marginal	0.24%	2.14%
Schools	Marginal	None	0.26%	1.89%

### 6.3 Conclusions and Recommendation

In the absence of cost-benefit analyses on most of these projects, it is not possible to conclude that the overall benefits outweigh the costs - or that the additional project expenditure on 'climate proofing' (which is not separately accounted for) exceed the additional benefits of adaptation. In any event, it is not clear that a financial quantification of benefits would be valid or useful.

What is useful is an analysis of trends over time, and a comparison of levels of spending in each sector or category with the Government's priorities. This gives an indication of cost-effectiveness (that is, the relative cost of projects that are or similar priority to Government in terms of their benefit).

For example, it would be useful to know if targeting Adaptation through Forestry projects is a higher Government priority than spending on Conservation, Land Management and Food projects. Figure 6.6 shows that spending on Forestry projects has increased significantly over the period 2008 to 2012, while spending on Conservation, Land Management and Food has fallen over the same period.

The apparent lack of a connection between expenditure and Government priorities can be attributed, at least partly, to the lack of detail in the National Adaptation Plan of Action. It highlights the need for the proposed replacement plan to include a prioritised list of strategies to guide development funding.

*To facilitate a better analysis of CC/DRR expenditure and its impact on Vanuatu (to the extent it can be assessed through the evaluation of programs and projects), it is recommended that the Prime Minister's Office classify:*

1. *all approved projects that have Mitigation, Adaptation, or Disaster Risk Recovery as their principal or a significant objective;*

2. *projects with Adaptation projects as their principal or a significant objective as being for:*
  - a. *water supply*
  - b. *reef monitoring and rehabilitation*
  - c. *conservation, land management and food*
  - d. *forestry*
  - e. *health and disease*
  - f. *transport*
  - g. *adaptation generally;*
3. *all these projects as having High, Medium, Low, Marginal relevance to the relevant category, and publish these categorisations in the Annual Development Reports.*



## 7. Options to Better Access Climate Change Funding

### Key Points

- To better access climate change funding, Vanuatu should:
  - have an entity gain NIE accreditation; and
  - establish a small grant program for CC/DRR projects that operates with the UNDP-contracted arrangement for Global Environment Facility small grants.
- Of the entities that would be candidates for NIE accreditation, the Ministry of Climate Change is the most logical given its lead agency role, but as yet it lacks plans, policies, systems and skills. A fall-back option is the Vanuatu Project Management Unit, which has a track record in project management and financial management but a lack of staff.
- A list of actions required - by the Ministry of Finance, internal audit, the Office of the Auditor-General and the Ministry of Climate Change - to gain NIE accreditation is given in Table 7.3.
- It is recommended that the Government seek assistance to undertake or fast-track these actions. Many of these will strengthen Vanuatu's national systems, and provide greater assurance to donors that they can use government systems, rather than by-pass them.

### 7.1 Financing Options

The May 2013 *Pacific Climate Change Financing Assessment Framework* developed by the Pacific Island Forum Secretariat, UNDP and AusAID analyses the various options for countries to better access climate change financing. The Framework has been used to identify the key issues in Vanuatu, and to assess the options, as set out in Table 7.1.

**Table 7.1: Financing Options**

Option	Merits	Cautions
Direct General Budgetary Support	<ul style="list-style-type: none"> <li>• Facilitates a predictable and strategic approach to planning, implementation and sustainable capacity development at the national level.</li> <li>• Reduces the significant administrative burden of multiple project development, reporting and monitoring.</li> <li>• Delivers assistance directly against country's own identified priorities in the context of their development objectives.</li> </ul>	<ul style="list-style-type: none"> <li>• Applicable mostly to bilateral assistance sources of funding where donor has long standing relationship.</li> <li>• Donor receptiveness is heavily dependent on confidence in transparency and accountability of national systems, with a robust national planning process and public financial management. Smaller countries are unlikely to meet the requirements of budget support in the short to medium term.</li> </ul>
	<b>Vanuatu Assessment:</b> Only one of Vanuatu's donors has provided budget support (the EU in 2010) but this has since ceased. The main bilateral donors (Australia and New Zealand) provide support on a program and project basis.	

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Direct Sector Budget Support	<ul style="list-style-type: none"> <li>• As above.</li> <li>• Can provide a useful mechanism for donor harmonization at the national level in key sectors such as energy, infrastructure, health, and education.</li> <li>• Donors may be inclined to begin with sector budget support, and work towards general budget support.</li> </ul>	<ul style="list-style-type: none"> <li>• Climate change is such a cross cutting issue, it may fragment a holistic approach to prioritization.</li> <li>• In the absence of sector plans with targets/priorities and a resource envelope, it can be difficult to account for funds and their contribution to outcomes.</li> </ul>
	<b>Vanuatu Assessment:</b> Vanuatu does not have many sector plans due to the small number of Ministries, and the lack of planning capacity in most agencies.	
National Funds including Trust Funds	<ul style="list-style-type: none"> <li>• Can avoid some of the delays and inflexibility of direct Budget support.</li> <li>• Harmonizes different sources of funds and accommodates “one off” contributions and non-traditional partners.</li> <li>• Funds can be matched with government priorities, resourcing and timelines e.g. building a budget-funded road with additional resources from a trust fund for climate proofing.</li> <li>• Governance and management can be varied over time to reflect donors’ confidence in reforms to planning, project assessment, financial management and monitoring &amp; evaluation.</li> <li>• Aligns closely with the Paris Declaration.</li> </ul>	<ul style="list-style-type: none"> <li>• Depending on type of Trust Fund, it can require a high initial investment, or if contributions are drip-fed will take time to operationalize.</li> <li>• Requires significant donor engagement and consultation to begin with.</li> <li>• Requires clear objectives and a strong governance structure.</li> </ul>
	<b>Vanuatu Assessment:</b> Vanuatu already has a Trust Fund (the Development Fund) to account for donor moneys. The Fund has subsidiary accounts for specific projects and multi-project funding.	
Community Based Funds/ Small grants program	<ul style="list-style-type: none"> <li>• Provides an incentive for communities to develop and implement CC/DRR development plans.</li> <li>• Allows communities to direct funds to their local priorities and improves awareness and ownership.</li> <li>• Builds capacity at the provincial/area level.</li> <li>• Smaller start-up funding may be required.</li> <li>• Aligns with the Government policy on decentralization.</li> </ul>	<ul style="list-style-type: none"> <li>• Establishing and maintaining community based funds or a small grants program can require significant work.</li> <li>• Poor objectives and weak community interest/ownership may see the fund fail to produce sound outcomes.</li> </ul>

	<p><b>Vanuatu Assessment:</b> The NAB Secretariat proposes to establish a small grants program in 2014 to channel funding directly to Community Based Organizations for adaptation and disaster risk reduction projects. To avoid duplication, this program should coordinate with the existing small grants programmes.</p>	
National Implementing Entity	<ul style="list-style-type: none"> <li>• An NIE provides direct access to finance, allows harmonization with national plans, builds capacity, improves ownership and accountability, and avoids duplication of national systems, plans and priorities.</li> <li>• Achieves better targeting of national priorities.</li> <li>• Reduces transaction costs by removing the intermediary role of an MIE or RIE.</li> </ul>	<ul style="list-style-type: none"> <li>• It is difficult for smaller countries to gain NIE accreditation given their capacity constraints.</li> </ul>
	<p><b>Vanuatu Assessment:</b> This report recommends that the Government aim to have the Ministry of Climate Change gain NIE accreditation. (It is noted that on 1 November 2013, SPREP was accredited as a Regional Implementing Entity for the Adaptation Fund. This provides an opportunity for Vanuatu to get better access to adaptation funds, although it does not bring the longer-term benefits of building sustainable capacity within the Government's own systems. Notably, SPREP is undertaking to document the lessons learnt from its accreditation process to help member countries gain NIE status.)</p>	
National Development Banks	<ul style="list-style-type: none"> <li>• There is already a mechanism for linking community interests and the banks operations.</li> <li>• Provides a mechanism to engage private sector partners through loans and grants.</li> </ul>	<ul style="list-style-type: none"> <li>• There is a potential for political interference which reduces donor confidence.</li> <li>• Incorporating an understanding of climate risk into loan products requires the development of specific commercial skills.</li> </ul>
	<p><b>Vanuatu Assessment:</b> The Ministry of Finance and the Office of the Auditor-General do not consider the relevant institution - the Vanuatu Agricultural Development Bank - to be a viable option for accessing and managing climate finance.</p>	
Regional/Sub-regional fund	<ul style="list-style-type: none"> <li>• A regional Trust Fund has many of the benefits of a national Trust Fund.</li> <li>• Can ensure funds for the region do not get reallocated to another region because countries individually cannot access them.</li> <li>• Can improve harmonization for the array of existing donors in the region.</li> <li>• Provides access for smaller countries unable to gain direct access without NIE accreditation.</li> </ul>	<ul style="list-style-type: none"> <li>• Imposes another layer of bureaucracy.</li> <li>• A clearly negotiated policy of scope, objective and guidelines for equitable allocation and distribution, may take some time to negotiate amongst countries.</li> <li>• If not directly accountable to the UNFCCC process, it may not provide a conduit to global funds.</li> </ul>

	<b>Vanuatu Assessment:</b> This is an option which a regional agency like SPREP could administer, but it would involve an additional layer of administration and cost. Hence it would not be a preferred financing option for Vanuatu.	
Regional Capacity Support Facility	<ul style="list-style-type: none"> <li>• Forum Island Counties' increasing demands for technical, project development and implementation support from available external stakeholders could be supported by such a facility.</li> <li>• Such a facility could draw on, and connect, the existing array of climate change experts in the region (including CROP, NGOs, UN agencies, MDBs and financing institutions).</li> <li>• If designed appropriately, could provide a less expensive alternative to developing a regional fund.</li> </ul>	<ul style="list-style-type: none"> <li>• Models vary between small-scale technical support mechanisms to staffed secretariats.</li> <li>• This is very much at a concept phase and needs to be explored more thoroughly before an assessment of its potential can be made.</li> </ul>
	<b>Vanuatu Assessment:</b> A regional facility would be beneficial to Vanuatu if it provides additional resourcing, but as with the SPREP RIE, it should develop government systems and capacity, rather than by-pass them.	

## 7.2 NIE Candidate Options

Advice from various stakeholders in Government was that the capacity of line ministries, state owned entities and provincial governments in project management and financial management is quite limited. The gaps in line ministries' financial management was confirmed in the 2012 *Financial Management Report* prepared by the Ministry of Finance and Economic Development - which assessed the financial management capability of each Ministry.

An initial assessment into whether either the Ministry of Finance and Economic Management or the Ministry of Climate Change could gain NIE accreditation, was undertaken by the United Nations Development Program (UNDP) and Pacific Islands Forum Secretariat (PIFS) in August 2013. This initial assessment identified a significant number of gaps that would need to be addressed before NIE status could be obtained.

These gaps included:

- documenting and introducing new systems and procedures,
- building staff capabilities; and
- demonstrating a successful track record over several years in the areas of project appraisal, project management, financial management, audit and evaluation.

The CPEIR confirmed the gaps identified in this initial assessment in discussions with a range of stakeholders and reviews of relevant documents and legislation.

The option of creating an entirely new entity to gain NIE status is not proposed as it would compound the problem of attracting suitably qualified staff to effectively coordinate and oversee the range of climate change and disaster risk projects through the project management cycle – from planning to operation to evaluation.

The Ministry of Finance and Economic Management and the Office of the Auditor-General both advised that the only viable candidates for NIE status were the Ministry of Climate Change and the Vanuatu Project Management Unit<sup>16</sup>.

Of these, the most obvious candidate is the Ministry of Climate Change, given its role in supporting the National Advisory Board on CC/DRR. One of the mandates of this Board is to:

"Advise, guide and coordinate the development of national CC & DRR financing processes."

A comparison of the two candidates is given in Table 7.2.

**Table 7.2 NIE Candidates**

Criterion	Ministry of Climate Change	Vanuatu Project Management Unit
<b>Financial Integrity</b>		
Ability to accurately & regularly record transactions and balances to an appropriate standard	Ability being developed	Has the ability, but in-house resources are limited
Ability to safeguard, manage & disburse funds effectively to recipients on a timely basis	Ability being developed	Has the ability, but in-house resources are limited & overseen by donors.
Competence to produce forward-looking plans & budgets	Ability being developed	Has the ability, but in-house resources are limited.
Legal status to contract with the Adaptation Fund & third parties	Yes, as a gazetted Ministry	Yes, as part of the Office of the Prime Minister
<b>Institutional capacity</b>		
Procurement procedures that provide for transparent practices, including those concerning competition	Agency specific procedures and Central Tender Board systems under development	Generally relies on or uses donors' procurement requirements. As well, in-house resources are limited.
Capacity to undertake monitoring & evaluation	Ability being developed, with an M&E advisor to be appointed	M&E generally undertaken by or for donors
Ability to identify, develop & appraise projects	Ability being developed	Functions largely carried out by donors for large projects.
Competency to manage or oversee project execution	Ability being developed	
<b>Transparent &amp; self-investigative powers</b>		
Freedom to blow the whistle on issues of fraud & gross mismanagement	Fraud, corruption & mismanagement policy, training recommended, with complaint handling mechanism.	Fraud and mismanagement risks largely managed by donor mechanisms.
Objective policy for self-regulation	Separate internal audit function recommended	No separate internal audit function.

<sup>16</sup> This Unit was established in August 2011 to coordinate large infrastructure projects - those over VT 1 billion. The Unit expects to have an on-going role after its current projects are completed, but currently has only three staff (with another two on maternity leave), and has experienced difficulty in recruiting qualified staff.

Given the lead agency role of the Ministry of Climate Change and the restrictions faced by the Vanuatu Project Management Unit, the best candidate for NIE accreditation is the Ministry.

### 7.3 Capacity Gaps

A Capacity Assessment for NIE accreditation has been carried out (as detailed in Annex 6). The assessment provides a gap analysis, from which the actions required to gain accreditation, have been developed. These actions are listed in Table 7.3.

**Table 7.3: Preliminary actions required for NIE Accreditation**

<p><b>Ministry of Finance and Economic Management</b></p> <ol style="list-style-type: none"> <li>1. Finalize the 2012 Financial Statements, and prepare the 2013 and 2014 Financial Statements for audit by 30 March in the following year.</li> <li>2. Ensure the 2012, 2013 and 2014 Financial Statements continue to comply with International Public Sector Accounting Standards (IPSAS).</li> <li>3. The Central Tenders Board to: <ul style="list-style-type: none"> <li>• establish a Tenders website and database</li> <li>• develop procedures that allow for timely procurement for mainstreamed development projects.</li> </ul> </li> </ol>
<p><b>Internal Audit</b> (Ministry of Finance Internal Audit Unit or an accounting firm)</p> <p>Develop a risk-based internal audit plan each year (to include an audit of the procurement function) in consultation with the Audit and Ethics Committee and the Office of the Auditor-General. Internal audits to be carried out in accordance with the plan by MFEM Internal Audit Unit or outsourced provider.</p>
<p><b>Office of the Auditor-General</b></p> <p>Clear the backlog of external audit reports so that Financial Statements are tabled in a timely way.</p>
<p><b>Ministry of Climate Change</b></p> <ol style="list-style-type: none"> <li>1. Prepare a financial statement that complies with IPSAS.</li> <li>2. Establish an Audit and Ethics Committee, with a charter to: <ul style="list-style-type: none"> <li>• review internal and external audit reports;</li> <li>• establish an effective whistleblower system;</li> <li>• monitor ethical standards;</li> <li>• monitor the operation of the fraud, corruption and mismanagement policy;</li> <li>• provide an annual report on activities for inclusion in the Ministry's annual report.</li> </ul> </li> <li>3. Produce project accounts from SmartStream in formats required by the Adaptation Fund and development partners, and have them audited.</li> <li>4. Establish and document the internal controls.</li> <li>5. Define the financial management duties of the Secretariat and Project Management Unit officers, and ensure a separation of incompatible duties as part of the system of internal control.</li> <li>6. Set out generic payment procedures, especially for projects.</li> <li>7. To develop a corporate plan for the Ministry, and a business plan and 3-5 year budget projections for the Secretariat/Project Management Unit.</li> <li>8. Produce a budget report for 2013 in early 2014.</li> <li>9. Develop generic procurement procedures, with reference also to procurement procedures required by particular donors/MDBs; liaise with the Central Tenders Board to provide training and awareness of staff in the Secretariat and Project Manager Unit on the Government and donor/MDB mandated requirements; and liaise with the Board and donors/MDBs on the use of the new standard tender documents and contracts.</li> <li>10. Specify the roles of the Secretariat and Project Management Unit in project specification and design. Develop project templates that align with those of development partners and also allow for projects funded through a small grants program.</li> <li>11. Develop, implement and demonstrate a project appraisal process that aligns with those of development partners and also allows for the appraisal of projects funded through a small grants program.</li> </ol>

12. Develop a risk management policy, strategies and templates for projects, including a process to ensure a speedy solution will be found.
13. Undertake project appraisals with risk management strategies.
14. Develop procedures to review project designs.
15. Develop standard formats for project budgets and reports that meet the needs of the NAB and donors/MDBs.
16. Develop detailed monitoring and evaluation procedures and report formats for differing types/sizes of project, which are consistent with the Adaptation Fund's Evaluation Framework and Guidelines.
17. Design, implement and demonstrate a system of project closure, including evaluation reports on the impacts.
18. Take on responsibility for developing and/or reviewing logic frames / Results Based Management baselines and reporting for projects, and for facilitating independent project evaluations.
19. Develop a Fraud, Corruption and Mismanagement policy that particularly applies to the management of funds and resources for CC/DRR projects.
20. Train staff on the Fraud, Corruption and Mismanagement policy.
21. The Director-General to adopt an environmental and social policy consistent with that of the Adaptation Fund, and make an explicit commitment to abide by it.
22. Establish a complaint handling mechanism, including contact names within the Ministry and the Ombudsman's Office.

## 7.4 Conclusions and Recommendation

The most viable options in the short to medium term for Vanuatu to better access and apply climate change funding are to gain NIE accreditation and to build on existing small grants programs to ensure adaptation and development are occurring at the local community level.

As the Ministry of Climate Change has only been in existence for a short time, and its project management and financial management systems are still being developed, it is expected to take at least three years before it can demonstrate the track record required for NIE accreditation, it is a worthwhile medium-term goal as it will leverage improvements at the whole-of-Government level, as well as in the Ministry itself.

This is evidenced by the experience in Senegal (Bugler and Rivard, 2013) where the actions required for NIE status have reportedly led to strong national ownership of Adaptation projects, and helped improve the country's institutional capacity overall – not just in managing climate change projects.

If the Ministry of Climate Change is unable to start demonstrating the capability required for NIE accreditation, the alternate option is the Vanuatu Project Management Unit.

*It is recommended that the Government seek assistance to design, resource and implement actions required for the Ministry of Climate Change to gain NIE accreditation, having regard for other capacity building reforms underway and the country's capacity to implement and sustain the required changes.*

## 8. Other CC/DRR Policies and Practices

### Key Points

- There are a number of ways that Government CC/DRR objectives can be achieved other than by spending.
- The diesel excise subsidy provided to electricity generators to reduce the cost of electricity can create a disincentive to move from diesel fuel to renewable sources. It would be better to target the subsidy to poorer households.
- Increasing, or at least indexing, the fuel excise will help reduce carbon emissions (and the country's increasing reliance on imported fuel) as well as provide more Budget flexibility for largely unfunded priorities such as Decentralisation.
- The Government has a number of public private partnerships, but no policy to provide guidance on the allocation of risks and benefits, or on their disclosure.

As indicated in section 1.2, the CPEIR methodology adopted for Vanuatu was extended to include a first-pass assessment of the following policies and activities:

1. 'Dirty' expenditures
2. Revenue policies
3. Public-private partnerships.

These are commented on below.

### 8.1 'Dirty' expenditures

These are funded activities that conflict with, or limit the effectiveness of, recurrent and development expenditures that target climate change or disaster risk reduction outcomes.

The tax exemptions on diesel fuel used to generate electricity cost VT 295 million in 2011. While it is understandable that the Government wants to limit electricity cost increases in locations reliant on diesel generators, subsidizing electricity generators to use fossil fuels can slow the transition to renewable energy.

This subsidy for fossil fuel conflicts with the Government's policy in the National Energy Road Map of to "Reduce reliance on imported diesel and petroleum products through efficiency improvements in the transport sector and through investment in renewable energy in the power generation sector." and the targets of 40% of renewable energy generation by 2015 and 65% by 2020.

To implement this policy while also meeting the goal in the Road Map of providing "Access to secure, reliable and affordable electricity for all Citizens by 2030", the better approach would be to eliminate the fossil fuel subsidy to generators and arrange for them to pass on a 'per kilowatt hour' subsidy in household bills.

This would level the playing field between renewable energy, diesel generators and hybrid approaches when suppliers or donors are looking to fund an expansion of the supply system. As well, it would allow the Government to control the cost of the subsidy, rather than let it increase substantially as fuel costs increase and the number of households accessing electricity grows.



## 8.2 Revenue policies

The Department of Customs and Inland Revenue collects customs duty and excise on fuel imports. The customs duty and excise on fuel is:

Fuel	Customs duty	Excise	VAT
Unleaded petrol	15 vatu/litre	20 vatu/litre	12.5%
Diesel	5%	15 vatu/litre	12.5%
Aviation fuel & kerosene	5%	4 vatu/litre	12.5%

The reliance of Pacific Island countries on imported fuels is likely to increase significantly as their economies grow. This will lead to cost increases, while the non-indexation of customs duty and excise on fuel will lead to a decline in the real value of revenues.

A separate review of taxation options available to the Government has estimated that a 5 VT/litre increase in the excise on petrol and diesel (which would increase the retail price of fuel by approximately 3%) would raise up to 200 million VT, depending on the offsetting level of subsidy to electricity generators through the excise exemption.

If the Government adopts this increase as a Budget option, it will help reduce carbon emissions and provide Budget flexibility for priorities such as Decentralization, which is considered to be largely unfunded.

## 8.3 Public-private partnerships

Currently, Vanuatu has a number of public-private partnerships (PPPs), but no formal policy or legislation.

Its annual Financial Statements do report on contingent liabilities arising from the guarantees and indemnities under various risk sharing arrangements. Separate disclosures are made for any large guarantees and indemnities, including for the National Bank of Vanuatu and Air Vanuatu.

In July 2013, a Singapore-based company was contracted to upgrade Vanuatu's airports and to operate them under a 50-year franchise. An unsuccessful Court challenge to the contract highlights, according to the Asian Development Bank, the importance of probity and transparency in forming PPPs.

The recent arrival of a fibre optic cable connecting with the Southern Cross Cable Network in Suva is the result of a PPP between the National Provident Fund, the project company, Interchange Ltd and the ANZ Bank as lenders. Although not classified as a PPP, the capital costs of the privately-operated wind farm were substantially funded by the European Union.

Into the future, the National Energy Road Map provides for a public private partnership framework relating to the proposed US\$230 million investment to:

- provide off-grid access;
- increase access within concession areas through targeted capital subsidies for the poor; and
- build the Efate geothermal power and island ring network.

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**Annex 2: Meetings****Ministry of Finance and Economic Management**

Brian Wabaiat, Budget Accountant  
 Joshua Nava, Budget Advisor  
 Benjamin Osenius-Eite – FMIS Advisor  
 Dorothy Ericson – Deputy Director, Financial Operations  
 Tony Sewen – Director, Department of Finance  
 Lucy Simon – Senior Accountant, External (Development Fund)  
 Nirose Silas – Principal Internal Auditor  
 Primrose Toro – Chief Accountant

**Ministry of Climate Change Adaptation, Meteorology, Geo-Hazards, Environment, Energy and Disaster Management**

Brian Williams – Manager, Project Management Unit  
 Paul Audin – NAB Advisor  
 Peta Turnbull – NAB Technical Advisor  
 Rebecca Duffy – NAB Technical Advisor  
 Malcolm Dalesa – Principal Science Officer Adaptation  
 Rebecca Iaken – Monitoring and Evaluation Officer  
 Dorah Wison - UNDP Vanuatu National Officer, Pacific Risk Resilience Programme

**Prime Minister's Office**

Johnson Naviti - Head of Aid Coordination Unit  
 Roan Lester - Analyst

**Vanuatu Project Management Unit**

Johnson Wabaiat - Program Director  
 Anna Tavoia – Financial Management Officer  
 Tony Telford – Project Management Advisor

**Office of the Auditor-General**

John Path - Auditor-General  
 Beulah Daunakamakama - NZAO Advisor

**Oxfam**

Alex Mathieson, Vanuatu Director

**VANGO**

Charlie Harrison, Executive Chair

**Risk Governance Assessment Team**

Ian Rector  
 Bikash Dash  
 Bob Shead  
 Peter Kouwenhoven

## Annex 3: Budget Process

## Vanuatu Budget Calendar

