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Report on the implementation of the UNICEF cost recovery policy

Summary

In decision 2006/7 of 2006, the Executive Board endorsed a simplified, harmonized and fiscally prudent cost recovery policy. UNICEF was requested to keep the Executive Board regularly informed on the actual costs recovered and on the impact of the applied rates on regular and other resources. The present document contains information related to the application of the UNICEF cost recovery policy, amounts recovered during the 2006-2007 biennium, and the impact on total regular and other resources.

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* E/ICEF/2010/1.

I. Introduction

1. The UNICEF recovery policy dates back to 1968, when the first UNICEF-assisted projects were presented to the Executive Board. In 1987, a cost recovery rate was applied to projects funded from other resources, with subsequent changes made to the rates in 1996, 1998, 2003 and 2006.

2. At its 2006 annual session, the Executive Board reviewed the cost recovery policy of UNICEF adopted in 2003 (document E/ICEF/2006/AB/L.4), and in decision 2006/7 set out the parameters of the current policy. The decision mandated a base recovery rate of 7 per cent for other resources income and a rate of 5 per cent for thematic contributions. The rate of 5 per cent was maintained for non-thematic funding raised by the private sector in programme countries. A reduction of 1 per cent in the cost recovery rate was approved in two categories: for joint programmes in cases where the Executive Director considers the reduction to be in the best interest of enhancing the collective efforts of United Nations agencies; and for contributions to UNICEF over \$40 million in cases where the Executive Director is satisfied that economies of scale are met. The Executive Board recognized that the recovery policy should be assessed within the broader framework of enhancing partnerships to help to achieve the Millennium Development Goals for children.

3. UNICEF continues to work in close cooperation with other members of the United Nations Development Group (UNDG) to harmonize the methodology and application of cost recovery. Harmonization of approaches to cost recovery among the United Nations system organizations was recommended in 2002 by the Joint Inspection Unit.¹ In 2005, the High-level Committee on Management (HLCM) reviewed the issue of cost recovery in order to draw up common principles that would compensate agencies fairly for their backstopping costs and prevent unreasonable competition among agencies.² Subsequently, the agencies of the UNDG Executive Committee agreed to the current harmonized recovery rate of 7 per cent. Despite progress made, more work needs to be done to achieve a systematic and common approach to cost recovery.

4. UNICEF will continue to report to the Executive Board on progress towards greater harmonization, including through the joint report on budget methodologies and cost classification requested by the Executive Board in decision 2009/20 for presentation at the second regular session of 2010.

II. The cost recovery methodology

Definitions of direct and indirect costs

5. UNICEF applies the following definitions of direct, fixed indirect, and variable indirect costs originally agreed on by the HLCM Working Group in 2005:³

(a) *Direct costs* are incurred for and can be traced in full to an organization's activities, projects and programmes in fulfilment of its mandate. Included are costs

¹ JIU/REP/2002/3, "Support costs related to extrabudgetary activities in organizations of the United Nations system" (2002).

² CEB/2005/HLCM/R.22.

³ CEB/2005/HLCM/R.22.

of project personnel, equipment, project premises, travel and any other input necessary to achieve the results and objectives set out in programmes and projects;

(b) *Fixed indirect costs* are incurred by the organization regardless of the scope and level of its activities and *cannot be traced unequivocally* to specific activities, projects or programmes. These costs typically include the top management of an organization, its corporate costs and statutory bodies not related to service provision. Because they are intended to finance ongoing core activities, fixed indirect costs should be funded from resources that are non-earmarked and predictable — that is, from regular resources;

(c) *Variable indirect costs*, usually referred to as programme support costs, are incurred by the organization as a function of and in support of its activities, projects and programmes, and *cannot be traced unequivocally* to specific activities, projects or programmes. Indirect variable costs should be funded from regular resources and other resources in the same proportion as these resources fund programme costs.

6. In a meeting on 28 September 2009, the UNDG HLCM Working Group on Cost Recovery Policy reaffirmed the 2005 definitions, stating that each agency remains accountable for the application of United Nations principles and modalities of cost recovery. The Sub-Group also noted that the cost recovery principle required the direct recovery from projects of the variable indirect costs incurred, in compliance with the triennial comprehensive policy review of operational activities for development of the United Nations System (General Assembly resolution 62/208 of 19 December 2007).

Calculation of variable indirect costs

7. UNICEF calculates the variable indirect costs associated with supporting other resources programmes in the context of the biennial support budget. First, the fixed costs in the support budget are defined and isolated. Second, the proportions of variable indirect costs for programmes funded from regular resources and other resources are determined. Finally, the portion of the biennial support budget allocated to variable indirect support costs for regular resources and other resources programmes are calculated using the proportions determined in step two. For 2004-2005, this calculation led to the proposal to simplify and reduce the recovery rate to 7 per cent for regular and other resources and to 5 per cent for thematic funds. It was recognized that these measures would provide an incentive for donors to provide less earmarked funding.

III. Application of the UNICEF cost recovery policy in the 2006-2007 biennium

8. The recovery amount for 2006-2007 was projected at \$161 million.⁴ The base recovery rate needed for variable indirect costs associated with other resources was estimated at 8.8 per cent. Since the implementation of the revised simplified cost recovery policy began, contributions to UNICEF have grown in both regular and

⁴ E/ICEF/2006/AB/L.4, "Review of the UNICEF cost recovery policy"(2006).

other resources. As a proportion of total income, regular resources increased from 34 per cent in 2004-2005 to 37 per cent in 2006-2007.⁵

9. As a result, actual cost recovery recorded for the biennium 2006-2007, as shown in Statement IV of the audited financial statements of UNICEF,⁶ amounted to \$225 million. This amount represents an average rate of 7.2 per cent of the total expenditures from other resources.

10. In order to compare the actual cost recovery to the actual reimbursable expenditures — that is, the variable indirect costs attributable to other resources — the same methodology and definitions as described in annexes I and II of document E/ICEF/2006/AB/L.4 for 2004-2005 were used for 2006-2007. Using the definitions in paragraph 5 above, fixed indirect costs and variable indirect costs were calculated for country offices, regional offices and headquarters locations. The calculations for 2006-2007, details of which are included in the annex to the present document, were as follows:

(a) *Fixed indirect costs* amounted to \$409 million (59 per cent of the total expenditures of the support budget). As noted above, these costs include the minimum core presence in a country or regional office, as well as headquarters offices dealing with such issues such as executive management, inter-agency coordination, support to the Executive Board, advocacy, research, partnerships, evaluation and audit;

(b) *Variable indirect costs* amounted to \$284 million (41 per cent of the total expenditures of the support budget). As noted above, these costs depend on the level of direct (programme) resources. The ratio of programme expenditures from regular resources to programme expenditures from other resources remained at the 2004-2005 level of 32/68. This ratio was then applied to determine the variable indirect costs attributed to regular and other resources, as follows:

(i) *Variable indirect costs attributed to regular resources* amounted to \$90 million (13 per cent of the total expenditures of the support budget);

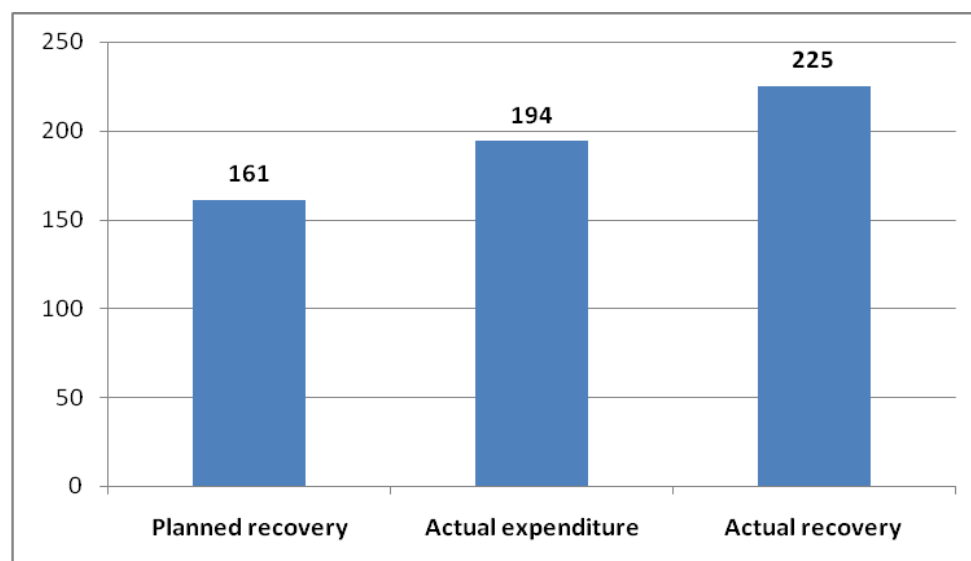
(ii) *Variable indirect costs attributed to other resources* amounted to \$194 million (28 per cent of the total expenditures of the support budget).

11. The actual variable indirect costs for 2006-2007 indicated above represent 6.2 per cent of the direct programme expenditures funded from other resources. In other words, the base rate calculation for 2006-2007 resulted in an actual recovery requirement of 6.2 per cent, whereas the actual recovery was 7.2 per cent. In real terms, the planned recovery rate amounted to \$161 million; the actual expenditure amounted to \$194 million; and the actual recovery amounted to \$225 million. This higher actual recovery can be attributed partly to the higher level of other resources income and partly to contributions still active under the previous recovery policy rates, which ranged between 5 and 12 per cent.

⁵ In 2006-2007, total income, including regular and other resources, amounted to \$5,794 million, an increase of \$1,055 million (22 per cent) over \$4,739 million in 2004-2005. Regular resources income grew by \$559 million (35 per cent). Other resources income further increased by \$496 million (16 per cent) over the extraordinarily high levels of \$3,136 million in 2004-2005, which had been attained mainly in the aftermath of the Indian Ocean tsunami.

⁶ A/63/5/Add.2. A total of \$135,109,000 was recovered from other resources-funded projects; \$89,783,000 was recovered from programmes and projects funded through emergency relief and rehabilitation.

Table 1
Comparison of cost recovery, 2006-2007
(In millions of United States dollars)



IV. Conclusion

12. The adoption by UNICEF of the cost recovery rates endorsed by the Executive Board in decision 2006/7 has furthered progress towards the goal of simplification, harmonization and fiscal prudence. As detailed in section III, in 2006-2007 the actual cost recovery from other resources exceeded both the planned recovery rate and actual expenditure. This actual recovery ensured that regular resources did not subsidize support costs for other resources programmes, as requested by the Executive Board in decision 2003/9 and recalled in decision 2006/7.⁷ Application of the standardized rates of the policy has also simplified transaction costs and has provided donors with greater clarity regarding the rate structure while at the same time establishing a basis for further harmonization with other United Nations funds and programmes.

13. Although it was recognized in the 2006 review of the UNICEF cost recovery policy that the adoption of the rates may pose a slight financial risk, especially regarding the thematic funding recovery rate of 5 per cent, this risk was mitigated by an increase in 2006-2007 in income from other resources.

14. UNICEF will continue to regularly inform the Executive Board on actual costs recovered and on the impact of applied rates on regular and other resources, in accordance with decision 2006/7. Since recovery rates of other resources should continue to support the priorities of the UNICEF medium-term strategic plan (MTSP), as requested in Executive Board in decision 2003/9 and recalled in 2006/7, the rates should therefore be reviewed at the end of the current MTSP cycle of 2006-

⁷ The balance between the actual recovery and actual expenditures is applied to the regular resources that are available for the implementation of the programme in the following year.

2013. At that time any major structural changes and ensuing modifications in cost structures would be most likely to occur. This time frame will allow a reasonable period in which to analyse the trends in other resources income, and the impact of the rates on regular and other resources will be more visible. The time frame will also coincide with the completion of the cost classification study being conducted by UNICEF, together with the United Nations Population Fund and the United Nations Development Programme, which will provide more clarity on what is included in direct and indirect costs.

Annex

Distribution of support expenditure for 2006-2007 into fixed costs and variable indirect costs*

(In millions of United States dollars)

	Total	Fixed costs/ core functions	Variable indirect costs	% of variable costs borne by		Variable costs borne by		% of OR support to total OR
	Support costs			RR	OR	RR	OR	programme
	(1)	(2)	(3)=1-2	(4)	(5)	(6)=3x4	(7)=3x5	(8)=7/OR prog.
Field offices								
Country offices	276.4	177.6	98.8	32%	68%	31.6	67.2	2.1%
Termination/after service insurance/others	6.9	6.9						
Regional offices	74.7	43.2	31.5	32%	68%	10.1	21.4	0.7%
Termination/after service insurance/others	1.9	1.9						
Central costs - security	20.7	20.7						
Subtotal, Field offices	380.6	250.4	130.3	32%	68%	41.7	88.6	2.8%
Headquarters (Programme support)								
Innocenti Research Centre	1.0	1.0						
Programme Division	28.0	7.1	20.9	32%	68%	6.7	14.2	
EMOPS excluding Operations Centre (incl. Geneva)	9.4	1.3	8.2	32%	68%	2.6	5.6	
Division of Policy & Planning - Prog Guidance	2.8	2.8						
Operations Centre	2.4	2.4						
Field support systems (ProMS and Cognos)	5.5	0.8	4.7	32%	68%	1.5	3.2	
Investment projects	0.4	0.4						
Supply Division (net of warehouse recovery)	19.2	3.5	15.7	32%	68%	5.0	10.7	
Subtotal, HQ prog. Support	68.7	19.2	49.6	32%	68%	15.9	33.7	
% distribution		28%	72%			23%	49%	
HQ common costs	20.7	5.8	14.9			4.8	10.2	
HQ after service insurance + termination	2.8	2.8						
Subtotal, HQ prog. Support	92.2	27.7	64.5	32%	68%	20.7	43.9	1.4%
Headquarters Management and administration								
Office of the Executive Director	9.6	9.6						
GMA	4.2	4.2						
Division of Communication	19.3	19.3						
Office of Japan	3.6	3.6						
Evaluation Office	2.8	2.8						
Office of Internal Audit	7.7	7.7						
Sharing of UN activities	4.6	4.6						
Division of Policy and Planning	10.0	6.1	3.9	32%	68%	1.2	2.7	
PFO (excluding units solely for OR)	7.1	3.6	3.5	32%	68%	1.1	2.4	
PFO fund monitoring unit/asst. fund-raising	2.2		2.2		100%		2.2	
Geneva Regional Office	17.6	7.7	9.9	32%	68%	3.2	6.7	
Geneva Regional Office solely for OR	0.6		0.6		100%		0.5	
DHR	21.8	8.1	13.7	32%	68%	4.4	9.3	
DFAM (excl. units solely for OR and Admin Serv)	16.5	5.7	10.8	32%	68%	3.5	7.4	
DFAM units solely for OR	3.5		3.5		100%		3.5	
Investment Projects	11.5	11.5						
ITD	46.8	15.5	31.3	32%	68%	10.0	21.3	
subtotal,	189.4	110.0	79.4			23.4	55.9	
Percentage		58%	42%			12%	30%	
HQ common costs	25.6	14.9	10.7			3.2	7.5	
DFAM - Administrative Services	7.1	4.1	3.0			0.9	2.1	
HQ after service insurance	1.8	1.8						
Total HQ Management and administration	223.8	130.8	93.1	29%	70%	27.4	65.5	2.1%
Recovered from other sources 1/	-3.5		-3.5				(3.5)	-0.1%
Global support expenditure,	693.2	408.9	284.3	32%	68%	89.8	194.5	6.2%
Total Programme expenditure (net of recovery)			4410.6	29%	71%	1276.6	3,134.0	

(Footnote on following page)

* Based on 2006-2007 actual expenditure.

(Footnote to annex table)

<u>1/</u> Total support costs	
Source: 2006-2007 Financial report and audited F/S A/63/5/Add.2 Statement IV p. 57	738,961
Less: Recovery from packing and assembly	(13,659.0)
Less: Transfer from income in respect of income tax reimbursement	(28,624.0)
Less: Agency commissions from admin of non- procurement trust funds and JPOs	<u>(3,529.0)</u>
	693,149.0
