Annotated Outline - Joint Cost Recovery Paper

Background

UNDP, UNFPA, UNICEF and UN Women (the agencies) are pleased to provide a summary of the planned content and evidence-based proposals of the joint cost recovery paper to be submitted at their respective Executive Boards (EB) annual sessions. This note presents the outline of the paper with annotated highlights and key assumptions that will be reflected in the EB paper.

I. Introduction

The introduction will contain a summary of the relevant EB decisions related to the agencies' effort towards a harmonized cost recovery methodology, noting that cost recovery refers to the requirement for the organization to ensure that regular resources are not used to subsidize the implementation of programmes funded from other resources. As requested by the EB, the structure of the report will contain evidence-based proposals on cost recovery. The proposals are summarized in Section II and the financial implications for each agency are presented in Annex I. The overarching principles of all the proposals are:

1. Continue a harmonized methodology across the agencies
2. Maximize allocation of regular resources to programmatic activities
3. Minimize cross subsidization between regular and other resources
4. Continue to be efficient and competitive within the overall development cooperation system

II. Presentation/Discussion of Proposals

The paper will discuss the nature of functions covered under each proposal and the impact that each of these proposals has on the indirect cost recovery for each agency (i.e., indirect cost recovery from project budgets).

To recall, indirect costs are those that are incurred in support of the organization's activities and programmes that cannot be traced to any particular project(s). Examples of this support include:

a. Corporate executive management
b. Corporate resource mobilization
c. Country office regional or corporate management
d. Corporate accounting and financial management staff
e. Internal audit function at HQ and unit level
f. Institutional legal support
g. Corporate human resources management

Direct costs are those that can be traced directly to the delivery of particular programmes and projects and are fully costed and part of the project budget. Examples of direct project costs include:

a. Cost of missions and travels incurred specifically to carry out or support project activities
b. Cost of Staff and Consultants hired for the project
c. Cost of Policy advisory services (fully costed: staff cost, share of office rent, utilities, communications, supplies and office security)
d. Cost of processing transactional services (finance, procurement, HR, and logistics)
e. Equipment, including Information Technology equipment, maintenance, licenses and support for the project
f. Project audit and evaluation fees.

a) Proposal One - Continuation of the Current Cost Recovery Policy

The first proposal is continuation of the current cost recovery policy in effect since 2014. The current methodology identifies certain functions that are to be covered solely from regular resources or directly funded from programmes. These include the costs below:

a) development effectiveness – directly contribute to achievement of development results;
b) UN Development Coordination – agency specific, not harmonized;
c) critical cross-cutting management functions – integral to the agency's mandate
d) non-comparable special purpose – agency specific, not harmonized.

The paper will discuss the current cost recovery policy based on principles, approach and harmonized methodology and cost recovery rates for funding the institutional budget of each agency. The calculation for the four agencies will be presented as a baseline for comparison. Based on the methodology approved by the EB, a general, harmonized cost-recovery rate of 8 per cent for non-core contributions was approved. The UNDP/UNFPA EB decision (2013/9) underscored that the principle of harmonized rates applied equally to differentiated cost recovery rates and endorsed differentiated cost-recovery rates as excerpted here:

"…Endorses a general, harmonized cost-recovery rate of 8 per cent for non-core contributions that will be reviewed in 2016, with the possibility of increasing the rate if it is not consistent with the principle of full cost recovery, proportionally from core and noncore funding sources, as mandated by the quadrennial comprehensive policy review of operational activities for development of the United Nations system; and decides that the review of the cost-recovery rate will take place after the analysis and independent assessment of the reports mentioned in paragraphs 15 and 17, below;

5. Underscores that the principle of harmonized rates will also apply to differentiated cost recovery rates, with the aim of promoting collaboration among United Nations organizations and avoiding competition in resource mobilization, and further endorses the following differentiated cost-recovery rate structure: (a) a harmonized 1 per cent reduction for the thematic contributions at the global, regional and country level in UNDP, UNFPA and UNICEF (8 per cent - 1 per cent = 7 per cent), with the United Nations Entity for Gender Equality and the Empowerment of Women (UN-Women) maintaining the 8 per cent as a temporary arrangement; (b) maintaining the existing preferential rates for government cost-sharing, South South contributions and private-sector contributions;

6. Decides that existing agreements will be honoured using the previous cost- recovery rates and that new or renewed agreements will comply with the present decision;

7. Decides that, on an exceptional basis and when the urgency of the circumstances requires, the Administrator of UNDP and the Executive Director of UNFPA may consider granting a waiver of the cost-recovery rates on a case-by-case basis, taking into account specific priorities, modalities that incur lower management costs, and harmonization goals, and that the Executive Board will be informed of these waivers in the annual financial reports;

8. Decides that the new cost-recovery methodology and related rates will be applied as of 1 January 2014; …"

The paper will highlight the importance of the cost recovery concept which is actually relevant to all of the proposals described in this outline:

a) the application of direct cost to be recovered from projects by charges to the project budget. The agencies have faced challenges in implementing direct cost recovery. Some funding and national government implementing partners are unwilling to include eligible direct costs in programmes.

b) the application of indirect cost recovery rates for recovery of indirect costs. While the cost recovery rate is established based on estimates, actual costs will be different, which could lead to cross subsidies, hence a level of flexibility is important. Longer-term institutional agreements, including with UN partners, have locked in lower cost recovery rates. In addition, some funding and national government implementing partners are unwilling to accept the standard cost recovery rates. Furthermore, due to different rates approved by the EB, the effective cost recovery rates will always be lower than the standard 8% rate.

b) Proposal Two - Implementation of modular 'LEGO building block' approach (Option A or Option B)

The second proposal is a methodology that expands upon the modular 'LEGO' approach previously presented to the EB (in April 2017 and January 2018). This methodology harmonizes the allocation of regular resources across 'blocks' or groups of functions (green, yellow and blue) that are fundamental to the agency's organizational identity. Specific functions will also vary from one entity to another depending on their size and business model. The modular LEGO approach defines the total level of resources, and provides the breakdown in dollar amounts for three LEGO blocks. Staff proforma staff costs and related non staff costs have been used as a proxy to calculate the resources required.

The allocation process results in a level of protected regular resources and, as a derivative, the cost recovery rate required to ensure that institutional budget requirements are met. The modular LEGO approach supports transparent reporting on the utilization of regular resources.

In the January 2018 EB informal, LEGO option A was presented and described. It established a modular approach which allowed for consideration of the specific essential functions to be funded from regular resources. The blocks are independent of each other in LEGO Option A, providing a way to build the final model on EB-defined priorities for use of regular resources, while noting the logical connections among the functions in each block. Blocks chosen would remain the stable regardless of changes in the volume of contributions and of future Institutional Budget estimates. The agencies noted that the LEGO blocks presented were for illustration/guidance and subject to change depending on the final combination of the entire LEGO blocks that would be chosen.

An adjusted version, LEGO Option B, which highlights the differences in size and business models of each agency, will also be presented. LEGO Option B represents an application of the LEGO approach taking into account the difference in size and funding composition of an agency, driven by regular and other resources designation, serves as the basis to tailor by agency the elements that would be 'protected' in each function. The 'protected elements' would be funded by regular resources.

Annex I contains the high level financial implications of the application of each proposal for each agency. The difference in parameters assumed for LEGO Option B calculations by individual agencies will be provided.

The proposals in the paper will present evidence to reflect the annualized dollar amounts in 'cross-subsidy' on what the respective notional rates represent for indirect cost recovery vs. what an 8% nominal rate would mean. This indicates the following:

a. for UNICEF and UNDP - the proposals reflect a 'subsidy' from other to regular resources;
b. for UN Women and UNFPA - the proposals reflect a 'subsidy' from regular to other resources;
c. Relative to the size of the organizations, the levels of subsidy are small.
d. The calculations will also be presented for the four agencies combined as a total.

III. Open Strategic Issues

The third section of the paper will present a summary of factors which may influence the relative attractiveness of the proposals in Section II and thus influence a decision. This section will explain the pros and cons of the issues given the different business models of the agencies.

The issues include:

a) the unknown practical implications of the outcome of UN System reform. While the Secretary General has presented a roadmap to the General Assembly, no formal decisions have been taken by the Member States;
b) there are issues related to the relative competitiveness of the agencies covered under a harmonized approach to cost recovery vs. other UN entities in the development sphere not subject to harmonization. This presents an economic challenge to the individual agency's ability to maintain cost recovery targets when it is being 'undercut';
c) similarly, there are issues of competitiveness vs other players in the development sphere (IFIS, private sector, foundations) who can and do offer similar services;
d) humanitarian considerations in service delivery and nexus implications, which frequently result in a much higher level of direct costs;

e) new business initiatives are being undertaken by agencies which are outside the context of current cost recovery framework and may be better implemented as fees for service rather than based on a percentage of delivery achieved;

f) in the long term, noting the changes that occur in business models over time, it would be appropriate to undertake a broader review of the current cost classification system which underpins the cost recovery framework. This review may also result in meaningful changes to the methodology.

IV. Summary and recommendation for Executive Board decision

The paper will conclude with a summary and propose elements of a decision for the Executive Board.

V. Annexes

Annex

Table 1 - High level financial implications of the application of each proposal for each agency[1]

	UNDP (2018-2019)			UNICEF (2018-2021)			UNFPA (2018-2021)			UN Women (2018-2019)		
	Current model	LEGO option A (per Jan/18 presentation to EB)	LEGO option B Application of LEGO blocks to UNDP business model	Current model	LEGO option A (per Jan/18 presentation to EB)	LEGO option B Application of LEGO blocks for UNICEF business model	Current model	LEGO option A (per Jan/18 presentation to EB)	LEGO option B Application of LEGO blocks for UNFPA business model	p	LEGO option A (per Jan/18 presentation to EB)	LEGO option B Application of LEGO blocks for UN Women business model
A: Regular resources	$1,353m - 12%	$1,353m - 12%	$1,353m - 12%	$6,420.3m - 27%	$6,420.3m - 27%	$6,420.3m - 27%	$1,392.3m - 39%	$1,392.3m - 39%	$1,392.3m - 39%	$400m - 45%	$400m - 45%	$400m - 45%
B: Other resources	$10,320m - 88%	$10,320m - 88%	$10,320m - 88%	$17,550.6m - 73%	$17,550.6m - 73%	$17,550.6m - 73%	$2,194.1m - 61%	$2,194.1m - 61%	$2,194.1m - 61%	$480m - 55%	$480m - 55%	$480m - 55%
C: Cost of functions protected by regular resources	$367m	$533m	$413m	$814.5m	$975.1m	$857.6m	$345.2m	$414.7m	$359.8m	$126.2m	$131.8m	$132.3m
D: Notional cost recovery rate	5.9%	5.8%	7.0%	6.6%	6.6%	7.1%	11.3%	8.9%	9.5%	9.7%	8.9%	8.8%
E: Cost recovery from regular resources using notional rate	$76m	$74m	$88m	$397.0m	$396.5m	$428.0m	$141.0m	$114.0m	$120.6m	$35.3m	$32.7m	$32.5m
F: Regular resources available for programmatic component	$910m [67.3% of total]	$746m [55.1% of total]	$852m [63.0% of total]	$4,243.8m [66.0% of total]	$4,083.6m [63.6% of total]	$4,169.7m [65.0% of total]	$906.1m [65.1% of total]	$863.6m [62.0% of total]	$874.0m [62.8% of total]	$238.5m [60% of total]	$235.5m (58.9% of total)	$235.2m [58.8% of total]

[1] For UNDP, cost of functions protected by regular resources under CO leadership include the 'Resident Representative' portion of full leadership and, as such, it is treated as a partially funded post.

Table 2. Annualized 'subsidy' between regular and other resources for each proposal vs. current cost recovery rate

A. Calculations for each agency separately

		UNDP			UNICEF			UNFPA			UN Women		
		Current model	LEGO option A (per Jan/18 presentation to EB)	LEGO option B Application of LEGO blocks to UNDP business model	Current model	LEGO option A (per Jan/18 presentation to EB)	LEGO option B Application of LEGO blocks for UNICEF business model	Current model	LEGO option A (per Jan/18 presentation to EB)	LEGO option B Application of LEGO blocks for UNFPA business model	p	LEGO option A (per Jan/18 presentation to EB)	LEGO option B Application of LEGO blocks for UN Women business model
A: Notional cost recovery rate		5.9%	5.8%	7.0%	6.6%	6.6%	7.1%	11.3%	8.9%	9.5%	9.7%	8.9%	8.8%
B: Cost recovery from other resources with the notional cost recovery rate		$289	$283	$336	$271	$271	$292	$56	$45	$48	$21	$20	$20
C: Cost recovery from other resources with an 8% cost recovery rate		$382	$382	$382	$325	$325	$325	$41	$41	$41	$18	$18	$18
D: (C - B) Difference in cost recovery between the notional cost recovery rate and an 8% cost recovery rate	Subsidy from other resources to regular resources	$93	$99	$46	$54	$54	$33						
	Subsidy from regular resources to other resources							($15)	($4)	($7)	($3)	($2)	($2)
E: for reference - annualized size of the organization (total regular and other resources)		$5,837	$5,837	$5,837	$5,993	$5,993	$5,993	$897	$897	$897	$440	$440	$440

B. Calculations for the four agencies combined as a total

	Current model	LEGO option A	LEGO option B
Net subsidy (from other to regular resources)	$129	$147	$70
Fer reference - annualized size of the four agencies combined (total regular and other resources)	$13,166	$13,166	$13,166