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منظمة الأغذية والزراعة للأمم المتحدة | 联合国粮食及农业组织 | Food and Agriculture Organization of the United Nations | Organisation des Nations Unies pour l'alimentation et l'agriculture | Продовольственная и сельскохозяйственная организация Объединенных Наций | Organización de las Naciones Unidas para la Alimentación y la Agricultura

FINANCE COMMITTEE

Hundred and Fifty-second Session

Rome, 21 - 22 January 2014

Method for Calculating the Indirect Support Cost Rate for WFP

Queries on the substantive content of this document may be addressed to:

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EXECUTIVE SUMMARY

- WFP's policy on the indirect support cost rate was reviewed in 2002 and a method for determining the rate was established in 2006. The operational context has changed significantly since then and the Management Plan (2014–2016) proposed a review in 2014 to ensure that the policy and method support the Strategic Objectives and the Management Results Framework.
- A proposed two-phase review of the indirect support cost rate will be undertaken in consultation with the Board in the first half of 2014 and will draw on advice from the Finance Committee.
- Phase 1, covered in this paper, outlines the context and the drivers of the review.
- This paper also highlights a number of questions for the Board's guidance.
- Consultations with the Board at the 2014 First Regular Session will shape phase 2 of the review and the Secretariat's approach to determining a proposed indirect support cost rate.

GUIDANCE SOUGHT FROM THE FINANCE COMMITTEE

- The Finance Committee is requested to review the "Method for Calculating the Indirect Support Cost Rate for WFP" document and endorse it for consideration by the Executive Board.

Draft Advice

- **In accordance with Article XIV of the General Regulations of WFP, the FAO Finance Committee advises the WFP Executive Board to note the "Method for Calculating the Indirect Support Cost Rate for WFP" document.**

برنامج الأغذية العالمي

Programme Alimentaire Mondial

World Food Programme

Programa Mundial de Alimentos

Executive Board
First Regular Session

Rome, 10–11 February 2014

RESOURCE, FINANCIAL AND BUDGETARY MATTERS

Agenda item 4

For consideration

METHOD FOR CALCULATING THE INDIRECT SUPPORT COST RATE FOR WFP

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NOTE TO THE EXECUTIVE BOARD

This document is submitted to the Executive Board for consideration.

The Secretariat invites members of the Board who may have questions of a technical nature with regard to this document to contact the WFP staff focal points indicated below, preferably well in advance of the Board's meeting.

Assistant Executive Director, RM* and CFO**:	Mr M. Juneja	tel.: 066513-2885
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* Resource Management and Accountability Department
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EXECUTIVE SUMMARY

WFP's policy on the indirect support cost rate was reviewed in 2002 and a method for determining the rate was established in 2006. Because the operational context has changed significantly since then, the Management Plan (2014–2016) proposed a review in 2014 to ensure that the policy and method support the Strategic Objectives and the Management Results Framework.

An indirect support cost rate is applied to every contribution received as a means of reimbursing WFP for Programme Support and Administrative expenditure when implementing projects, which is incurred predominantly at Headquarters and the regional bureaux. This complies with the principle of full cost recovery for operations, and with the General Rules in meeting "the full operational and support costs of [each donor's] contributions".[1]

The proposed two-phase review will be undertaken in consultation with the Board in the first half of 2014.

Phase 1, covered in this paper, outlines the context and the drivers of the review:

- The 2012 Quadrennial Comprehensive Policy Review calls for harmonization of indirect support cost policies in the United Nations.
- WFP's current and future resourcing environment will be a factor in setting the indirect support cost rate.
- Value for money must be maximized: the indirect support cost rate is seen as a proxy for programme support and administrative efficiency and is a means of optimizing operational efficiency and effectiveness.
- WFP's cost and support structures are changing, particularly with increasing use of non-food approaches.

This paper also highlights a number of questions for the Board's guidance:

- WFP is a 100 percent voluntarily funded organization, and does not have a core budget: should core funding or different funding approaches to fixed and variable costs be considered?
- Recognizing that some costs related to support and administration are covered from other sources, should WFP continue to consider multiple sources for funding costs such as security and non-recurring investments?
- Should WFP continue with a single indirect support cost recovery rate, or should the rate vary according to the type of intervention?

[1] General Rules, Article XIII.2.

- Could WFP use variable indirect support cost rates to encourage resource mobilization, for example through South-South cooperation or host-government contributions?

Consultations with the Board at the 2014 First Regular Session will shape phase 2 of the review and the Secretariat's approach to determining a proposed indirect support cost rate. The outcomes will be presented at informal consultations between March and May, and the recommendations on WFP's indirect support cost rate will be submitted at the 2014 Annual Session.

DRAFT DECISION*

The Board takes note of "Method for Calculating the Indirect Support Cost Rate for WFP" (WFP/EB.1/2014/4-B/1) and looks forward to further analysis based on its guidance and to the Secretariat's recommendations on the indirect support cost rate at the 2014 Annual Session.

* This is a draft decision. For the final decision adopted by the Board, please refer to the Decisions and Recommendations document issued at the end of the session.

OBJECTIVES OF THE INDIRECT SUPPORT COST REVIEW

1. The review of the indirect support cost (ISC) rate in 2014 gives the Secretariat an opportunity to engage with the Board and donors on issues affecting WFP's operating context and business model. The objective is to frame WFP's ISC policies to support the Strategic Objectives of the Strategic Plan (2014–2017) and the Management Results Framework.

2. WFP needs to respond to changes in the operational environment, particularly the large fluctuations in the volume and modalities of food assistance and contributions. The ISC rate must therefore be robust enough to cover Programme Support and Administrative (PSA) costs, which include fixed and variable costs, at different levels of funding.

3. The aim is to identify a simple and transparent method for calculating and applying ISC rates, taking due account of developments in the United Nations system. The Secretariat will consult the Board informally and formally with a view to proposing an ISC rate in the Management Plan (2015–2017).

4. A two-phase approach is proposed: the first, covered in this paper, outlines WFP's current thinking and the questions that will shape the discussion. The Board's guidance will help to frame the informal discussions and the proposals for the second phase.

5. Informal consultations are proposed between March and May 2014 to enable the Board and the Secretariat to consider initial progress. A second paper containing the conclusions and recommendations of the review will be submitted at the 2014 Annual Session.

BACKGROUND

Indirect Support Cost Policies and Practices in WFP

6. The 1995 Report of the Formal Working Group of the Committee on Food Aid Policies and Programmes (CFA) recommended the adoption of full-cost recovery, whereby contributions received would be allocated to the actual food and external transport costs of a project, a share of landside transport, storage and handling, direct support costs and associated ISC. The CFA also recommended that the ISC rate be updated annually[2] on the basis of cost studies, and approved differentiated rates for the various programme categories.

7. The Executive Board, which succeeded the CFA in 1996, established a working group to review WFP's resource and long-term financing policies in 1998 and subsequently approved its recommendation 2.4 for a single recovery rate for all programme categories[3] (emphasis added):

> "*That the ISC rate be the same for each programme category*. The single rate be determined by applying the approved Programme Support and Administration budget to the projected [direct operational costs] and [direct support costs] of the activities for the biennium. The single rate principle will be subject to review through the normal budget setting process and be able to be discontinued by decision of the Executive Board. *The single ISC rate will be fixed […]*"[4]

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[2] In 1997 the Board approved adoption of ISC rates for a biennium rather than a single year.

[3] WFP/EB.2/98/11.

[4] WFP/EB.3/98/4-D.

8. A review of the ISC rate submitted to the Board's 2002 Third Regular Session considered the gap between PSA expenditures and ISC income, and compared WFP's approach with those of United Nations and non-governmental organizations.[5] The Board approved the establishment of the PSA Equalization Account to record gaps between PSA expenditures and ISC income, and the reduction of the single ISC rate to 7.0 percent for 2003.

9. In 2006, the Secretariat proposed, and the Board agreed, that the ISC rate be determined on the basis of actual audited financial results.[6] The Secretariat has since presented the derived ISC rate in every Management Plan. Although the ISC rate as determined on the basis of the actual audited financial results has been consistently higher, it has been retained at the 7.0 percent rate throughout this period.

10. Since 2003, WFP has demonstrated that it can partner with corporations, foundations and individuals to generate resources to support its programmes. In 2014, the private-sector function will be integrated into the PSA budget to ensure that private-sector donors continue to cover the management and administration costs related to their contributions.

ISSUES RELATED TO THE CURRENT INDIRECT SUPPORT COST POLICY

Success of the Resource and Long-Term Financing Plan

11. The Secretariat believes that the simplicity and transparency of the resource and long-term financing model contributes to WFP's appeal as a partner because it is easy to understand and it clarifies the cost structure of projects.

Sufficiency of Indirect Support Cost-Generated Income

12. The ISC rate, which is established in every Management Plan and has remained at 7.0 percent since 2003, appears to be insufficient to cover all support and administration-related costs. For example:

- United Nations costs such as those for the Department of Safety and Security (UNDSS) have been charged to the General Fund, but this approach is becoming unsustainable for WFP.
- Capacity-development initiatives in WFP have relied on additional donor trust funds: these are welcome, but they are less predictable and usually directed, and are subject to less external governance and oversight than PSA allocations.
- WFP has from time to time sought the Board's approval for supplementary PSA allocations to cover organizational reform.

Indirect Support Cost Rate Variability

13. WFP currently applies a 7.0 percent ISC rate for all programme categories. Trust funds administered by the regional bureaux or Headquarters for activities such as internal capacity development typically have an ISC rate of 7.0 percent.

14. There is some variability in WFP's ISC rates, with greater flexibility under trust funds. Country-specific trust funds that are locally generated apply an ISC rate of 4.0 percent because limited support is required from Headquarters and regional bureaux, and some support costs are incurred by the recipient governments, which are typically the main source

[5] WFP/EB.3/2002/5-C/1.

[6] WFP/EB.A/2006/6-C/1.

of funding. These trust funds enable country offices to assist governments with the management and implementation of programmes aligned with WFP's objectives. Some contributions such as government counterpart cash contributions do not involve any ISC.

15. ISC rates for contributions from private-sector donors reflect the nature of the partnership and vary in size and complexity. The average ISC rate applied is 12.0 percent.

DRIVERS FOR THE 2014 INDIRECT SUPPORT COST REVIEW

16. The following drivers will inform the ISC review:

- i) the Quadrennial Comprehensive Policy Review (QCPR) and harmonization;
- ii) resource mobilization;
- iii) maximizing value for money; and
- iv) adapting to WFP's changing financial framework.

Quadrennial Comprehensive Policy Review and Harmonization

17. The 2012–2016 QCPR has a number of mandates relevant to the ISC review:

- The Boards of funds and programmes are requested to adopt a cost-recovery framework for implementation in 2014. The framework should be transparent, harmonized and based on full cost recovery, from core and non-core resources proportionally.
- The Secretary-General is requested to propose that the Boards adopt a common definition of operating costs and a standard system of cost control, bearing in mind that business models may differ.
- The funds and programmes are requested to agree on the concept of "critical mass of core resources": this means that agencies with core and non-core resources should define the minimum level of resourcing required to implement their mandates.

18. WFP's financial systems are not entirely consistent with these mandates – it does not have core resources, for example – but the Secretariat acknowledges that these issues affect ISC and must be considered in the review.

19. As part of United Nations harmonization, WFP must be aware of developments in United Nations organizations. For example: i) the United Nations Development Programme, the United Nations Population Fund, the United Nations Children's Fund and UN-Women have reviewed cost definitions and classification of activities and adopted a common cost-recovery rate of 8.0 percent; and ii) the World Health Organization and the Food and Agriculture Organization of the United Nations (FAO) have differentiated ISC rates (10.0 percent for emergency projects and 13.0 percent for development activities) and also apply a "cost recovery uplift" mechanism on staff costs to recover certain costs related to support and administration;[7] they are reviewing their support cost policy.

Resource Mobilization

20. WFP recognizes that the resourcing environment is changing and wants to encourage more flexibility and predictability in voluntary contributions. The approaches of other United Nations organizations could be examined to see whether the ISC rate is used to encourage unearmarked or multi-year contributions, or contributions from certain donors.

[7] See FAO Finance Committee FC 151/8, "Comprehensive Report on FAO's Support Cost Policy" (November 2013).

21. Most income is received from traditional donor governments, but there is increasing scope for contributions from host governments and non-traditional donors. The ISC rate could be used to promote South–South or triangular cooperation, for example, and to encourage resourcing from developing countries for capacity development and national strategies in support of the Strategic Plan.

22. There are also more opportunities for private-sector contributions. Under WFP's private-sector partnerships and fundraising strategy,[8] the management fee charged to private-sector donors is based on the established ISC rate plus a percentage to cover the additional management and administrative costs. This practice could be compared with that of other United Nations organizations.

23. Multi-partner trust funds currently account for a small portion of WFP's income, but they are becoming more important; they are implemented according to United Nations Development Group guidelines, which limit fees for support to 7.0 percent. Access to global funds such as The Global Fund to Fight AIDS, Tuberculosis and Malaria and the Global Environment Facility will become more important as WFP expands its innovative financing. Their ISC guidelines and potential restrictions on direct and indirect support costs will need to be evaluated.

Maximizing Value for Money

24. The ISC review must consider value for money in relation to ISC income and PSA expenditure. The ISC rate is sometimes regarded as a proxy for efficiency because it funds the PSA budget. But PSA expenditures at Headquarters or in the regional bureaux can improve cost-effectiveness in other areas: for example, a PSA initiative to improve supply chains with ISC funding could lead to savings at the country level.

Adapting to WFP's Changing Business and Financial Framework

25. The Strategic Plan (2008–2013) started WFP's evolution from food aid to food assistance. The financial framework was approved in 2010 and implemented in 2013 to reflect this shift: it changed the financial structure of projects, establishing three tools – food, cash and vouchers, and capacity development and augmentation – and their cost components such as landside transport, storage and handling and other direct operational costs.

26. Direct support costs (DSC) are now calculated as a percentage of operational costs rather than a rate per metric ton. This provides more predictable DSC funding and improves comparability among projects.

27. The introduction of significant levels of non-food activities and the different cost and support structures necessitates a review of the related ISC.[9]

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[8] WFP/EB.A/2013/5-B.

[9] The uncertainty of WFP's funding continues to affect country offices. The Secretariat will therefore review the financial framework to find ways of improving WFP's funding structure: this will include expansion of the Working Capital Financing Facility to maximize the stability and predictability of operations and WFP's impact on beneficiaries.

Issues for Guidance

28. This section sets out the issues on which the Secretariat seeks the Board's guidance. These are:

i) the funding model for PSA costs;
ii) use of other funding sources to cover costs related to support and administration;
iii) implications for ISC of the transition to food assistance; and
iv) resource mobilization.

Funding Model for Programme Support and Administrative Costs

29. What are the implications of the absence of core funding in WFP? Should different funding approaches to fixed and variable indirect costs be considered?

30. Unlike other funds and programmes, WFP does not receive a core budget to cover or offset PSA costs. Instead, the ISC rate applied to every project funds WFP's PSA expenditure.

31. As a voluntarily funded organization, WFP must adjust its overhead costs annually in relation to the resources received or forecast – and expenditures are not easily scaled to changing operational levels. With an increase in operational activity, average costs should decrease once fixed costs are covered, but in times of contraction it is difficult to reduce costs in proportion to the reduced activity level while maintaining operational efficiency.

32. In view of current discussions of core funding, critical mass and support cost policies in specialized agencies, alternative models must be examined. Phase 2 of the analysis will therefore include:

- examination of the merits of a core budget;
- examination of variable and fixed PSA expenditures; and
- consideration of alternative models such as core or non-core funding to cover variable or fixed PSA expenditures.

Use of other Funding Sources to Cover Costs Related to Support and Administration

33. Some support and administration-related costs at WFP are covered from other sources such as the PSA Equalization Account, the General Fund and trust funds. In view of this, how should ISC be interpreted and what should be the scope of PSA funding from ISC recovery? Should WFP continue to consider multiple sources to fund functions such as:

- *Security.* Costs such as WFP's annual USD 10 million contribution to the UNDSS are charged to the General Fund. Should they be charged to the PSA budget or to country operations through a "cost recovery uplift" on staff costs, as is the case in some specialized agencies?
- *Capital costs.* Should WFP seek donor commitment or expand the Capital Budgeting Facility to fund or underwrite large-scale one-time initiatives to reduce the burden on the PSA budget, the PSA Equalization Account and the General Fund?
- *Innovations.* Should the cost of innovation continue to be covered by additional trust funds, or by ISC recovery?

34. The PSA budget is limited in its coverage at WFP; the small PSA allocation to country offices is inversely proportional to their size. WFP needs to find additional sources of funding for innovations such as cash and vouchers, Purchase for Progress, the Forward Purchase Facility and the Business Process Review.

35. It should also be noted that the PSA budget covers costs over which the Secretariat has little control and which are increasing: an example is the shared cost of UNDSS, which is charged to the General Fund. Since 2006, the main source of income for the unearmarked portion of the General Fund is interest income from WFP's investment portfolios, bank and money market accounts. This is offset with realized and unrealized gains and losses on investments and currency exchange adjustments, which cannot be allocated to other funds. The WFP Management Plan (2014–2016)[10] states that WFP must find long-term funding for UNDSS costs that are not linked to projects: in view of the reduction in interest income credited to the General Fund, this must be implemented from 2015 onwards.

36. The Secretariat has little control over the costs of United Nations activities such as the Resident Coordinator system. These are charged to the PSA budget as a central appropriation even though they pertain to country-level operations.

37. A number of operational support costs have been pooled to ensure that standards and efficiency are maintained. It can be demonstrated that such approaches are delivering savings to operations, and there are cost-recovery schemes intended to attribute costs directly to projects: examples include telecommunications licences and services, FoodSat and the Global Vehicle Leasing Programme. Country offices are concerned about cost-recovery schemes because they are administered at the Headquarters level and hence perceived to be indirect in nature – which also makes it difficult sometimes to fund them as direct project costs.

38. Non-recurring initiatives are currently funded from a supplementary budget through the PSA Equalization Account, the unearmarked portion of the General Fund, or a corporate trust fund if there is donor interest or an allocation of multilateral contributions. The initiatives help to improve efficiency and effectiveness, but the decisions may be based on funding availability rather than organizational priorities.[11]

39. The PSA Equalization Account enables WFP to balance the difference between PSA expenditure and ISC income to reduce the risk of insufficient resources should ISC income fail to materialize at the expected rate. The PSA Equalization Account is reviewed by the Board in the Management Plan, and has a recommended target level of four months of indirect expenditures. There are no clear guidelines for the use of PSA Equalization Account surpluses.

40. Phase 2 of the analysis will consider: i) whether WFP should revisit how ISC and DSC are interpreted and charged; ii) the scope of support and administrative funding from ISC recovery, including the merits of introducing "cost recovery uplift" on staff costs, and how to reduce the dependency on a variety of unpredictable funding sources to finance recurring and non-recurring initiatives; iii) whether the current PSA Equalization Account target level is appropriate, and whether planned or realized PSA Equalization Account surpluses should be used for non-recurring investments; and iv) guidelines for the use of the

[10] WFP/EB.2/2013/5-A/1, paragraphs 217–218.

[11] The new Capital Budgeting Facility will enhance the governance process for appraising and realizing economic benefits from non-recurring investments funded through the facility and repaid through a repayment plan.

unearmarked portion of the General Fund and the PSA Equalization Account for approved types of expenditure.

41. Some of these issues are administrative matters related to charging costs to projects, for example as ISC or DSC. However, a common understanding with partners of the principles and practice for allocating costs to different cost components would be desirable.

42. In line with initiatives in other agencies, expenditures could be classified as DSC and charged to projects, but the effect of increasing charges to small country offices for corporate requirements must be assessed against increasing the PSA support budget and hence the ISC rate.

43. The inclusion of expenditures for the central costs of innovation or capital projects, for example, which have hitherto been incurred outside the PSA budget, could require an increase in the ISC rate and lead to unfavourable donor perceptions of WFP's ISC rate. The Secretariat will consider ways of funding strategic investments, for example by optimizing the use of the PSA Equalization Account and the Capital Budgeting Facility, and maximizing innovations that can be funded through directed contributions.

Implications for Indirect Support Cost of the Transition to Food Assistance

44. What are the implications for WFP's transition to food assistance under the Strategic Plan (2014–2017)? Should WFP continue with a single ISC recovery rate for full cost recovery, or should the rate vary by programme category or activity type?

45. Until 1998 WFP applied different rates to the different programme categories. The Secretariat currently applies a 7.0 percent ISC rate for all programme categories: emergency operations, protracted relief and recovery operations, special operations, development projects and country programmes.

46. The current ISC model was established in 1998 and has worked well where WFP's principal activity has entailed the receipt and transport of food to beneficiaries. But the transition to food assistance, with a broader range of responses and increasing levels of activities that do not involve food transfers, entails a transformation of cost composition and support structures. In 2012, for example, cash and voucher transfers were projected to account for 5 percent of total operational requirements, but in 2014 cash and voucher transfers are estimated at 19 percent of projected operational requirements. A review of the related ISC is called for.

47. Phase 2 of the analysis will include: i) examination of direct and indirect cost structures for different types of interventions; and ii) modelling of various ISC rates for different programme categories and types of interventions.

48. The introduction of differentiated ISC rates has hitherto been seen as adding to the complexity and cost of managing ISC rates based on programme categories or activities. And ISC rates differentiated by programme category could bring the risk of promoting the use of inappropriate programme categories.

Resource Mobilization

49. Could WFP use variable ISC rates to incentivize South–South cooperation, host government contributions, unearmarked contributions, multi-year contributions and private-sector contributions?

50. As noted earlier, the approved ISC rate of 7.0 percent is used as the baseline, but in fact multiple rates are applied.[12] The Private-Sector Partnerships and Fundraising Strategy (2013–2017),[13] envisages multiple ISC rates based on the additional costs associated with engaging with the private sector.

51. To implement the Strategic Plan (2014–2017), WFP will aim to be the partner of choice for governments by increasing their capacities to establish, manage and scale up their own safety-net programmes. These activities are mainly funded by recipient governments through country office trust funds, with minimal support from Headquarters, to contribute to the food and project costs of programmes in their countries.

52. Phase 2 of the analysis will draw on experience in other organizations to: i) assess the effect of the ISC rate on attracting donors to WFP and the types of restrictions placed on contributions; ii) decide whether variable or flexible ISC rates encourage contributions from non-traditional donors for activities such as South–South cooperation; iii) consider whether WFP should adopt variable ISC rates for different classes of contributions – directed or non-directed, multilateral or bilateral – and for different types of donors; and iv) consider whether the complexity of the ISC rate structure would be offset by the gain of attracting these contributions.

53. Reducing ISC rates to create incentives for resource mobilization may be justified by the correspondingly lower support costs. Recipient governments may, for example, require less support from WFP for country-led operations, and a lower ISC rate would allow the operations to be incorporated into country programmes rather than trust funds. Where lower ISC rates have to be subsidized from ISC recovered for other donations, the subsidy should not be significant.

NEXT STEPS

54. In phase 2 of the ISC review the Secretariat will consider the Board's guidance and address the issues identified in this paper.

55. A series of informal consultations will be held in March, April and May 2014 to share the outcomes of phase 1 and seek additional inputs. The views expressed by the Board and the Secretariat will be incorporated into the final paper to be submitted for approval at the Board's 2014 Annual Session.

[12] The Executive Director can waive the application of the ISC rate to certain types of contributions under General Rule XIII.4. Different ISC rates are applied to bilateral contributions and trust funds.

[13] WFP/EB.A/2013/5-B.

ACRONYMS USED IN THE DOCUMENT

CFA	Committee on Food Aid Policies and Programmes (precursor of the Executive Board)
DSC	direct support costs
FAO	Food and Agriculture Organization of the United Nations
ISC	indirect support costs
PSA	Programme Support and Administrative [budget or costs]
QCPR	Quadrennial Comprehensive Policy Review
UNDSS	United Nations Department of Safety and Security