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para la
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FINANCE COMMITTEE

Hundred and Thirty-seventh Session

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**PRELIMINARY ANTICIPATED COST INCREASES
FOR 2012-13**

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EXECUTIVE SUMMARY

- The methodology for calculating cost increases in the Programme of Work and Budget (PWB) 2012-13 follows the approach previously approved by the Finance Committee, Council and Conference. The cost increase estimates cover the recosting of Regular Programme inputs from 2010-2011 to 2012-13 levels to deliver the Programme of Work, namely for personnel services, goods and services.
- For the purposes of illustrating the cost increase calculations presented in this document, the 2010-11 net appropriation budget level of USD 1,000.5 million is used pending issuance of the Director-General's proposed PWB 2012-13. The cost increases for 2012-13 on USD 1,000.5 million have been calculated at USD 42.5 million, which corresponds to a biennial cost increase of 4.2 percent, equivalent to a 2.8 percent annual increase.
- USD 31.9 million (or 74 percent of the total) are for Personnel Services equivalent to a 4.3 percent increase in the biennium (or 2.8 percent per year).
- USD 10.6 million are for Goods and Services, including other human resources, travel, general operating expenses, furniture and equipment, equivalent to a 4.2 percent increase in the biennium (or 2.8 percent increase per year).
- The cost increase figures presented are based on information available at the time of the preparation of this document. Trends and decisions that could impact the estimated cost increases will continue to be monitored, and any significant changes to the cost increase assumptions and estimates will be reported to the Governing Bodies prior to the Conference in June 2011.

GUIDANCE SOUGHT FROM THE FINANCE COMMITTEE

The Finance Committee is requested to take note of the preliminary anticipated cost increases for 2012-13 and provide any comments or guidance thereon.

Draft Advice

- **The Committee took note of the preliminary anticipated cost increases for 2012-13.**

I. Introduction

1. Cost increases for 2012-13 represent the incremental cost of personnel services and other goods and services arising from the recosting of these inputs at 2012-13 values compared with the 2010-11 Net Appropriation. Using the 2010-11 net appropriation budget level of USD 1,000.5 million for illustrative purposes, the cost increases for 2012-13 have been calculated at USD 42.5 million, which corresponds to a biennial cost increase of 4.2 percent, equivalent to a 2.8 percent annual increase.
2. This note elaborates on the methodology used by FAO to calculate cost increases on the Net Appropriation and provides additional information on the assumptions, events and forecasts applied in preparing the cost increase estimates in the PWB 2012-13, in particular for staff costs. The figures presented in this document are preliminary. Figures will be updated, as appropriate, based on the resource plans being prepared for the MTP 2010-13/PWB 2012-13 document which will be presented to the 138th Session of the Finance Committee in March 2011.

II. Methodology for calculating cost increases

A. FAO's methodology

3. The methodology for calculating cost increases in the PWB 2012-13 follows the approach previously approved by the Finance Committee, Council and Conference. The cost increase estimates cover the recosting of Regular Programme inputs from 2010-2011 to 2012-13 levels to deliver the Programme of Work, namely for Personnel Services, and Goods and Services. The cost increase estimates are developed on a biennial basis from: actual cost adjustments that are occurring in the current biennium (biennialization); projected adjustments to unit costs that will take effect in the next biennium (inflation); and, the lapse factor on established posts.
4. Biennialization is the incremental financial effect in 2012-13 of staff cost adjustments that are occurring in the 2010-11 biennium. Biennialization is the consequence of two factors:
 - under- or over-budgeted costs in the current biennium (2010-11), that is, where actual staff costs per work month are at variance from the budgetary estimates prepared two years earlier;
 - current (2010-11) cost adjustments that took or will take effect at some point during the 2010-11 biennium (whether budgeted or not) that have to be applied to a full 24 month period in the 2012-13 biennium.
5. As such, biennialization objectively reflects the financial impact of events that have already taken place or are expected to take place before the implementation of the 2012-13 budget. Most changes in staff costs implemented during the biennium are the result of recommendations by the International Civil Service Commission (ICSC) approved by the General Assembly of the United Nations. The movements of the US dollar against local currencies in Decentralized Offices also contribute to biennialization to the extent that they differ from the previous biennium exchange rates. Accordingly, the financial implications of biennialization are essentially a matter of fact and arithmetic, not conjecture or long-range planning.
6. Inflation represents the cost impact in 2012-13 of those adjustments that are expected to take effect at various points in the next biennium. Inflation estimates for salaries, pension fund contributions and allowances are derived from the latest external forecasts (Consumer Price Index (CPI), Nominal Wage Indexes, exchange rate by location) by the Economist Intelligence Unit (EIU), published data of authoritative bodies such as the ICSC, and independent verification. Inflation estimates for the current service cost of after service benefits are based on the latest results of the actuarial valuation for the staff related liabilities schemes (After Service Medical Coverage, Terminal Payments Fund, Separation Payment Fund, Compensation Fund). The actuarial valuation is carried out jointly by all Rome-based agencies every year.
7. The lapse factor is a reduction of the budgetary provision for the estimated cost of established posts to account for the fact that some of them will be vacant for some time as a result of staff

movements. The lapse factor methodology, approved by the Council at its 107th session¹ following a detailed study by the External Auditor, is based on three factors: i) staff turnover rates; ii) standard recruitment times; and iii) the extent to which separations are foreseen. The lapse factor reduction is applied to the standard rates (unit costs) of staff costs by grade and location for 2012-13. The cost increase calculation captures the change in this reduction factor from one biennium to the next.

B. Practices of other UN agencies

8. The Rome-based agencies collaborate on the definition of cost increase factors. However, due to the differing cost structures of the Rome-based agencies the aggregate cost increases calculated by each agency are not strictly comparable. Variances are caused by factors such as the grade structure, the distribution of posts by location, human resource policies, and the calculation method.

9. A comparative review of the calculation of the cost increases in five UN Organizations (ILO, UN, UNDP, UNESCO and UNICEF) was presented to the Finance Committee at its 113th session in May 2006². It showed that there were no fundamental differences in the methodologies used in the budgeting process and confirmed the common practice of basing staff cost increase projections on past expenditure patterns coupled with estimates from external sources. There were, however, some technical differences in cost elements included in staff costs and the details used to build up staff cost increase estimates for the budget, and in approaches with respect to currency adjustments during implementation.

10. The comparative review revealed an important difference in the funding mechanism available to organizations to handle staff cost variances during implementation. In the UN, the programme budget is 'recosted' three times in the biennial cycle as an established practice to take into account the latest inflation trends, the outcome of salary surveys, and the evolution of the operational rates of exchange. If the recosted UN staff costs exceed the budgeted amount, the cost is passed on to Members in the form of increased assessments during the biennium. In FAO, any variance must be managed within the budgetary appropriation for the biennium, requiring programme adjustments during the implementation cycle to manage these unbudgeted costs, and adjustments are reflected under biennialization for the following biennium.

C. Role of the International Civil Service Commission

11. In 1975 FAO accepted the Statute of the International Civil Service Commission which led to a number of amendments to the General Rules of the Organization (GRO) approved by the Conference. Through this, a number of powers were transferred to the General Assembly of the United Nations acting on the basis of recommendations of the Commission, or to the ICSC itself, and the Organization is no longer competent to intervene on these matters.

12. The question of whether the Council has authority to change, or not to approve, the recommended salary scale has been raised many times, including before the ILO Administrative Tribunal. The position of the ICSC and the organizations of the system has always been that although the salary scale is recommended by the ICSC, the Council is left with no discretion because the salary scale is the result of a methodology and of a survey, and these are within the authority of the ICSC.

13. Under Article 10 of the Statute, "the Commission shall make recommendations to the General Assembly on (...) the scales of salaries and post adjustments for staff in the Professional and higher categories" and it is thus the General Assembly that determines those scales. Furthermore, as regards General Service staff, under Article 12 of the Statute, "at the headquarters duty stations (...) the Commission shall establish the relevant facts for, and make recommendations as to, the salary scales of staff in the General Service and other locally recruited categories". The recommendations to the Organization are submitted for approval by the competent Governing Body; in the case of FAO it is the Council. On the basis of these provisions and practice the ICSC has established a methodology for

¹ C 2009/15 paragraphs 213-218

² FC 113/10

salary surveys and conducted salary surveys in consultation with the Organization and staff representatives as provided for also in Article 12. The surveys are carried out usually - but not always - every four years. The ICSC is a specialized body that has built over the years the expertise and staffing to carry out the functions entrusted to it by the UN system

III. Assumptions, events and forecasts applied in preparing cost increase estimates for 2012-13

A. Overview

14. Anticipated cost increases have always been carefully reviewed by the Governing Bodies of FAO. In the past, there has been a tendency to keep the unit cost projections for the next biennium to the lowest possible level, in full knowledge of the associated risk of under-budgeting staff costs. Indeed, this resulted in significant adverse staff cost variance in the 2004-05 and 2006-07 biennia, and a smaller variance in the 2008-09 biennium.

15. For the 2012-13 biennium, biennialization was calculated based on actual changes in costs in 2010. Inflation estimates were applied systematically based on EIU forecasts, netting off revaluation or devaluation forecasts of currencies, with the main risk area being fluctuation of the US dollar exchange rate against national currencies in Decentralized Office locations.

16. In applying the methodology as elaborated above to the 2010-11 net appropriation budget level of USD 1,000.5 million for illustrative purposes, the cost increases are estimated at USD 42.5 million for 2012-13, which corresponds to a biennial cost increase of 4.2 percent, equivalent to a 2.8 percent annual increase, as summarized in *Table 1*.

17. The cost increase figures presented in this document are based on information available at the time of the preparation of this document. Figures will be updated, as appropriate, based on the final resource plans being prepared for the MTP 2010-13/PWB 2012-13 document. Furthermore, trends and decisions that could impact the estimated cost increases will continue to be monitored in the first half of 2011, including any decisions stemming from the 72nd session of the ICSC from 21 March to 1 April 2011 and the actuarial valuation for the after-service service staff benefit as at 31 December 2010, as explained further below. Any significant changes to the cost increase assumptions and estimates will be reported to the Governing Bodies prior to the Conference in June 2011.

Table 1: Summary of 2012-13 cost increases illustrated at the level of the 2010-11 Net Appropriation at 2010-11 budget rate of exchange (USD million)*

	Illustration of 2012-13 Net Appropriation at 2010-11 costs	Biennialization	Inflation	Lapse Factor Adjustment	Cost increases for 2012- 13	Percent Cost Increase (biennial)	Percent of cost increase attributable to each cost component
Personnel Services							
Salaries, Pension Fund Contributions and Allowances	702.9	(1.5)	29.3	-	27.8	4.0%	66%
After Service Benefits	46.0	2.3	-	-	2.3	5.0%	5%
Lapse Factor Adjustment	-	-	-	1.7	1.7	-	4%
Total Personnel Services	748.9	0.8	29.3	1.7	31.9	4.3%	75%
Total Goods and Services	251.6	-	10.6	-	10.6	4.2%	25%
Budget level for Net Appropriation and additional requirements	1,000.5	0.8	39.9	1.7	42.5	4.2%	100%

* The breakdown of the budget by input category as shown in the column entitled "Illustration of 2012-13 Net Appropriation at 2010-11 Costs" reflects a preliminary input mix for 2012-13 at 2010-11 costs. Figures are rounded to the nearest tenth.

18. USD 31.9 million (or 75 percent of the total) of cost increases are for Personnel Services equivalent to a 4.3 percent increase in the biennium (or 2.8 percent per year). Personnel services comprise all staff costs, including salaries, pension fund contributions, dependency and other allowances, social security and other staff-related entitlements and after-service benefits for both the professional and general service staff categories at the new lapse factor.

19. Total Goods and Services include other human resources, travel, general operating expenses, furniture, equipment, and present an estimated inflation of USD 10.6 million, equivalent to a 4.2 percent increase in the biennium (or 2.8 percent increase per year).

B. Personnel services

20. Details on the assumptions, events and forecasts applied in preparing the cost increase estimates due to biennialization, inflation and the lapse factor for Personnel Services are provided in *Table 2* and described below.

Table 2 – Biennialization and inflation of staff costs by cost category illustrated at the level of the 2010-11 Net Appropriation at 2010-11 budget rate of exchange (USD million)

Cost category	Illustration of 2012-13 Programme Base at 2010-11 Costs	Biennialization for Personnel Services	Inflation	Lapse Factor Adjustment	Total Cost Increases
	I	II	III	IV	V=II+III+IV
Professional Staff Costs					
Salary	347.6	(3.1)	14.5	-	11.4
Pension	67.5	0.1	1.7	-	1.8
Education Grant	25.0	0.8	1.3	-	2.1
Entitlement Travel	16.7	(2.7)	1.1	-	(1.6)
Medical Cost	15.7	(2.6)	1.0	-	(1.6)
Other Allowances	22.8	3.4	1.1	-	4.6
Total – PR	495.2	(4.1)	20.7	-	16.6
General Service Staff Costs					
Salary	152.5	5.7	6.0	-	11.7
Pension	29.9	0.8	1.1	-	2.0
Medical Cost	21.4	(3.9)	1.3	-	(2.6)
Other Allowances	3.8	(0.0)	0.2	-	0.1
Total - GS	207.6	2.6	8.6	-	11.2
Subtotal - PR & GS	702.9	(1.5)	29.3	-	27.8
ASMC	27.6	2.4	-	-	2.4
Termination	6.2	1.0	-	-	1.0
Agreed Termination	4.0	(2.0)	-	-	(2.0)
HQ General Service Staff Separation Scheme	7.8	0.6	-	-	0.6
Compensation	0.4	0.3	-	-	0.3
Subtotal - after service benefit liabilities (current service costs)	46.0	2.3	-	-	2.3
Lapse factor adjustment	-	-	-	1.7	1.7
Total staff costs	748.9	0.8	29.3	1.7	31.9
Non staff costs	251.6	-	10.6	-	10.6
Total	1,000.5	0.8	39.9	1.7	42.5

Figures are rounded to the nearest tenth

21. For reference, Column I illustrates the PWB 2012-13 budget base using the 2010-11 Appropriation of USD 1,000.5 million at 2010-11 costs, broken down between the personnel services cost of USD 748.9 million and Goods and Services costs of USD 251.6 million.

Biennialization – Professional and General Service staff costs

22. The effect of under- or over-budgeted Professional and General Service staff costs estimated for 2010-11 and the effect of all staff cost adjustments that are expected to take place at some point in 2010-11, and that have to be provided for the full duration of the 2012-13 biennium, amounts to a total biennialization adjustment of USD 0.8 million as shown in column II. The main categories of staff cost adjustments contributing to biennialization are explained below.

23. The net salary costs for all locations are the largest items that contribute to biennialization. It reflects an average of factors such as exchange rate effects in Decentralized Offices arising from the

US dollar fluctuations against local currencies and the biennial effect of increases occurred in 2010 and projected in 2011.

24. Headquarters Professional staff costs (not shown separately in table) experienced a negligible increase in 2010 compared to the budgeted increase of 2.0 percent. An increase of 2.5 percent is forecasted for 2011, in line with the budgeted amount and in line with preliminary indications of the results of the recently conducted 2010 Cost-of-Living Survey in Rome. The Advisory Committee on Post Adjustment Questions (ACPAQ) of the ICSC, at its 33rd session from 24 to 31 January 2011, reviewed the results of the 2010 Cost-of-Living surveys held in Headquarters duty stations. The final results and reports following the Place to Place surveys will be submitted to the ICSC at its 72nd session, New York, 21 March to 1 April 2011, for the Commission's endorsement. The final figures for all duty stations will only be available as of 1 April 2011 as there could still be some minor changes due to exchange rates, CPI movements and possible increases in the medical insurance premiums.

25. The increase for the General Service staff at Headquarters was 2.1 percent in 2010, slightly higher than budgeted, and a 2.5 percent increase is projected for 2011 consistent with the budgeted amount. The Working Group to review the General Service salary survey methodologies met from 17 to 21 January 2011 and the outcome of this meeting will be presented to the ICSC at its 72nd session. The 2010 round of salary surveys for the eight Headquarters duty stations has therefore been postponed, presumably to the end of 2011 or 2012.

26. Pensionable remuneration of the Professional category in all locations has been unchanged since 2008 and is forecasted to increase by 2.3 percent in 2011 as budgeted, which is slightly higher than the EIU Average Nominal Wage Index forecast for the USA (2.0 percent). The scale of the pensionable remuneration is revised when the net remuneration of professional staff in New York is updated for the change in the cost-of-living.

27. The basic medical insurance plan cost for Professional and General Service categories were unchanged in 2010 and are to increase by 1.5 percent in 2011. The significantly lower than budgeted increases are mainly attributable to savings arising from various cost containment measures introduced by the Secretariat.

28. Current service costs of the after service staff benefits are forecasted USD 2.3 million higher than budgeted overall in 2010-11, mainly due to the increase arising from the actuarial valuation for the After-service Medical Coverage (ASMC) as at 31 December 2009, which only became available after the finalization of the 2010-11 cost increase figures.

29. Entitlement travel costs in 2010-11 are lower than budgeted due to higher than expected savings arising from the unchanged published air fare and the implementation of a new policy on the lump sum payment effective July 2008.

Inflation – Professional and General Service staff costs

30. Column III quantifies the Professional and General Service staff cost inflation estimate of USD 29.3 million for 2012-13, of which USD 20.7 million is for Professional staff costs and USD 8.6 million is for General Service staff costs, as described below.

31. For Professional and General Service staff salaries at Headquarters, an increase of 2.5 percent is budgeted in both 2012 and 2013, which is in line with the Average Nominal Wage index forecasts for Italy (2.5 and 3.0 percent respectively). Estimated inflationary costs are USD 7.6 million for Professional and USD 3.1 million for General Service staff.

32. Significant inflationary increases are projected for Professional and General Service salaries in decentralized locations (USD 6.9 million for Professional and USD 2.9 million for General Service staff). Various factors including inflation, exchange rate fluctuation and recent past patterns of increases were taken into consideration. EIU CPIs and Average Nominal Indexes forecast increases ranging from 2 to 9 percent per annum for 2012-13 for various regions and locations where FAO has a significant presence. For example, inflation rates in Egypt, where FAO has both a Regional and Sub-regional Office, are forecasted at up to 9.3% for 2012 and 8.1% for 2013.

33. For pensionable remuneration of Professional staff in all locations, increases of 2.6 and 3.6 percent were applied in 2012 and 2013 respectively, in line with the EIU Average Nominal Wage index forecasts for the USA.

34. Medical costs are assumed to increase by 5.0 percent each year, in line with the medical inflation in the actuarial valuation. Savings arising from the new contractual arrangement with the insurer and the claim handling company are expected, however the extent of savings will depend on the performance of the plan.

35. Entitlement travel costs include a 5.0 percent increase per annum, taking into account as an average the increase in the cost of travel forecasted by the travel industry for the next year at 5 to 12 percent due to the consolidation and re-pricing of air fares.

36. An increase of 5.0 percent has been applied to the education grant costs based on the past trend and the revision in the level of education grant and boarding cost recommended by ICSC to the UN General Assembly. A revision is performed every other year.

Inflation – staff benefit schemes

37. A similar level of current service costs is estimated for 2012-13 After Service Medical Coverage (ASMC) and Terminal Payments Fund (TPF), Separation Payment Fund for the General Service category, and Compensation Fund, based on the actuarial valuation of 31 December 2009 which was completed in early 2010 and reviewed by the Finance Committee. The new valuation as at 31 December 2010 will only be available after the preparation of the PWB 2012-13.

Lapse factor

38. The lapse factor consists of a reduction of the budgetary provision for the estimated cost of established posts to account for the fact that some of them will be vacant for some time as a result of staff movements. The lapse factor methodology was approved by the Council at its 107th Session.

39. The lapse factor adjustment of USD 1.7 million (column IV) results from the change in the percentages from 2010-11 to 2012-13 applied to all locations except Country and Liaison Offices (2.41% for Professional and 1.65% for General Service costs in 2010-11 and 2.09% and 1.55% in 2012-13). For the Country and Liaison Offices, the Conference approved in 2009 the removal of the lapse factor adjustment.

C. Goods and services

40. Inflation of USD 10.6 million on goods and services is calculated by applying EIU's forecasted CPI for Italy (1.8 and 2.1 percent for 2012 and 2013, respectively) on Headquarters' expenditures, and by applying EIU's forecasted CPI for the world (3.0 and 3.2 percent for 2012 and 2013, respectively) for non Headquarters' expenditures.

IV. Conclusion

41. The cost increase figure of USD 42.5 million is calculated following the agreed methodology and based on information available at the time of the preparation of the document. Trends and decisions that could impact the estimated cost increases will continue to be monitored in the first half of 2011, and any significant changes to the cost increase assumptions and estimates will be reported to the governing bodies prior to the Conference in June 2011.

42. The Finance Committee is requested to take note of the preliminary anticipated cost increases for 2012-13 and provide any comments or guidance thereon.