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FINANCE COMMITTEE

Hundred and Fifteenth Session

Rome, 25 - 29 September 2006

Report on Support Costs Expenditure and Recoveries

Note to the Finance Committee

This document is submitted for discussion to the Finance Committee.

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

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Executive Summary

1. This paper reports on the implementation of FAO's policy on support costs for the period from June 2005 through May 2006, during which time FAO opened 555 Trust Fund projects. The paper provides a categorised distribution of the project servicing cost (PSC) rates applied to these projects in terms of both project numbers and lifetime budgets. It is noted that all projects have been charged at rates which fall within the currently approved policy. The increasing importance of "mixed" trust funds, which provide Direct Support to Regular Programme Activities (so-called "normative" Activities) while also containing "operational" elements, underscores the critical role played by extra-budgetary resources in facilitating the continuum of normative and operational work.
2. The paper also reviews the variable indirect support costs actually incurred by extra-budgetary projects in Direct Support of Regular Programme Activities and finds that these costs exceed the income received under the current policy. Total variable indirect support costs associated with these project activities reached US\$ 7.2 million in 2004 and over US\$ 8 million in 2005, while delivery on such projects was US\$ 57 million in 2004 and US\$ 60 million in 2005. This translates into an average support cost rate incurred of 12.6% in 2004 and of over 13% in 2005 compared with the current standard recovery rate of 6%. The resulting shortfall implies that assessed regular programme contributions are subsidizing such extra-budgetary funded activities, which is inconsistent with the principle endorsed by Council in November 2000 that there should be a reasonable alignment of charges to the actual costs of providing administrative and operational support to projects.
3. A comparative analysis of support costs policies and rates shows that a 13% rate would be in line with practices of the UN and the other main Specialized Agencies (ILO, UNESCO, UNIDO, WHO, WMO). In fact, with the exception of WMO, none of these organizations has a standard reduced rate for extra-budgetary projects directly supporting programmes funded by assessed contributions.

Draft Recommendation

4. The Finance Committee is invited to note the experience in the implementation of the policy on support costs during the period June 2005- May 2006.
5. The Finance Committee is requested to endorse an increase in the PSC rate for projects in Direct Support of Regular Programme Activities from 6% to 13% as a necessary means of ensuring that the PSC rate charged to such projects fully recovers FAO's variable indirect support costs. This will avoid assessed regular budget contributions subsidizing such extra-budgetary funded activities.

I. Introduction

1. This paper reports on the implementation of FAO's policy on support costs for the 12 months from June 2005 through May 2006.
2. The paper also reviews the variable indirect support costs incurred by extra-budgetary projects in Direct Support of Regular Programme Activities (so-called Normative Activities) and finds that these costs now exceed the income received under the current policy. Accordingly, in line with the principle that assessed regular budget contributions should not subsidize extra-budgetary funded activities, the Committee is invited to endorse an increase in the project servicing cost for extra-budgetary projects in Direct Support of Regular Programme Activities from 6% to 13%.

II. Implementation of the Support Cost Reimbursement Regime

3. The FAO policy for setting project servicing cost (PSC) rates was endorsed by the Council in November 2000¹. The policy is established on the principle that there should be a reasonable alignment of charges to the actual costs of providing administrative and operational support to projects, taking due regard of existing arrangements and the need for a simple and transparent approach. Refinements to the application of the policy were made in September 2001, September 2002² and September 2005³.
4. An overall 13% PSC ceiling is applied on Trust Fund projects. The charge may be reduced when the variable indirect support costs on a given project are expected to be lower. The function of appraising variations from standard rates is entrusted to the Office of Programme, Budget and Evaluation. The broad categories of extra-budgetary funded projects to which PSC rates apply are defined as: *Technical Assistance*, where a standard 13% rate is in effect; *Emergency Assistance*, where a ceiling rate of 10% applies; *Direct Support of Regular Programme (RP) Activities* (6%); and *Jointly Funded Activities* (zero to 10%). Within each category and funding source, the circumstances that merit a departure of PSC rates from the applicable ceiling rates are identified.
5. The statistics in the table below cover the period from 1 June 2005 through 31 May 2006, during which time FAO opened 555 Trust Fund projects. The table provides a categorised distribution of the PSC rates applied to these projects in terms of both project numbers and lifetime budgets. It is noted that all projects have been charged at rates which fall within the currently approved policy.
6. The majority of projects in terms of lifetime budgets comprise Emergency Assistance activities. The progressive implementation of the increase in the ceiling rate for Emergency Assistance projects from 6.5% to 10%, approved in November 2005, resulted in a higher level of support cost recoveries. The weighted average of PSC rate applied to emergency projects as of June 2006 was 7.7% and is expected to increase toward 10% in the coming year as projects are approved at the new rate.

¹ CL 119/13 Annex II

² CL 121/4 paragraphs 21-23 and FC 100/5

³ CL 128/4 paragraphs 20-25 and FC 110/4

Distribution of the categories of PSC rates applied to projects opened June 2005 – May 2006

PSC Category		Number of Projects	Lifetime Budget (US\$)	% of Total Budget
1	Projects approved under the rate for Emergency Assistance	150	165,003,584	52.7%
2	Projects approved at their ceiling rates	101	91,328,299	29.2%
3	Projects in Direct Support of Regular Programme (RP) Activities (6% applied)	36	14,365,990	4.6%
4	Partnership with UN system organizations (UNEP at 0% and UNFIP at 5% based on pre-existing arrangements)	1	550,000	0.2%
5	“Mixed” Trust Funds with Direct Support to RP Activities as well as Operational elements (6% to 13% applied)	6	17,676,235	5.6%
6	Decentralized Cooperation Programme (GDPCP)	4	1,071,126	0.3%
7	Global Environmental Facility (GEF)	5	10,458,813	3.3%
8	Technical Support Services (TSS)	9	890,000	0.3%
9	Technical Assistance with a high proportion of contracts, supplies and equipment (Manual Section 250 Annex II applies)	8	8,889,787	2.8%
10	Projects in Direct Support of RP Activities at lower than 6% rate (where particular circumstances in conformity with policy apply - e.g. travel of developing country participants)	5	547,650	0.2%
11	Telefood - zero rate per Conference Resolution 3/97	227	1,624,596	0.5%
12	Contributions to FAO for the refurbishment and improvement of FAO premises (both at HQ and in Regional and Sub-regional Offices)	2	620,983	0.2%
13	Sponsorship Funding	1	23,391	0.0%
Grand Total		555	313,050,454	100%

7. The table demonstrates that the vast majority of projects are charged at their ceiling/recommended rates (i.e. rows 1-4 inclusive account for 87% of cases by value) and therefore that the policy’s flexibility is administered carefully. The remaining projects tabulated in rows 5-13, while resulting in modified rates, do so within the approved policy.

8. It is noted that there has been a drop in the proportion by value of projects approved at their ceiling/recommended rate, from 98% in the previous reporting period to 87%, on account of a change in the overall mix of projects approved. This was mainly due to a shift from projects providing pure Direct Support of RP Activities (row 3) to those mixed with “operational” elements (row 5). The increasing importance of “mixed” trust funds in Direct Support of RP Activities as well as with Operational elements (see row 5 of table in Section II) underscores the critical role played by extra-budgetary resources in facilitating the continuum of normative and operational work⁴. In addition, the value of GEF projects (row 7) increased sharply from US\$ 1.3 million to over US\$ 10 million with approval of the first full scale GEF project grant to

⁴ CL 131/18 Annex II

FAO. GEF project administrative and operational costs will be monitored closely to ensure the Organization recovers its variable indirect costs for such projects.

III. Proposal for Amendment to the Support Cost Policy

Increased PSC rate from 6% to 13% for Projects in Direct Support of FAO RP Activities

9. At its 113th session in May 2006, the Committee “...recalled that adequate external cost recovery for services rendered was an integral element of the efficiency saving measures prescribed by the Council and noted the Secretariat’s ongoing review of the cost recovery rate for projects in support of Regular Programme normative work which was currently 6 per cent. It looked forward to receiving a proposal for adjustment for its review, and the endorsement of the Council.”⁵

10. Projects providing Direct Support to RP Activities (so-called Normative Activities) are implemented at Headquarters or at a Regional Office rather than directly in the field. The type of RP activities supported by extra-budgetary projects varies from financing of posts for activities planned under programme entities (e.g. Implementing Guidelines on the Right to Food) to activities of a global nature but with significant operational components and coordination across locations (e.g. Disposal of Obsolete Pesticides, Strengthening Capacities for Implementing Codex Standards).

11. The current PSC rate of 6% was established on the basis of information dating back to 1998-99 and has not been reviewed since 2000. Following the guidance provided by the Committee in May 2006, the costs incurred by such projects has been analysed based on the latest information and trends, and in the light of practices amongst other United Nations Specialised Agencies.

12. The results of the Cost Measurement Surveys from 2004 and 2005 demonstrate that variable indirect support costs for projects in Direct Support of RP Activities exceed income received at the 6% rate. The cost of delivering such projects is incurred by Headquarters technical divisions and Regional Offices, as well as by central services, operations support and monitoring units. Total variable indirect support costs associated with these project activities reached US\$ 7.2 million in 2004 and over US\$ 8 million in 2005. Meanwhile, delivery on such projects was US\$ 57 million in 2004 and US\$ 60 million in 2005⁶. This translates into an average actual support cost rate incurred of 12.6% in 2004 and of over 13% in 2005.

13. In line with the policy endorsed by Council in November 2000, that there should be a reasonable alignment of charges to the actual costs of providing administrative and operational support to projects the Secretariat therefore recommends for the Committee’s endorsement an increase in the PSC ceiling rate for Projects in Direct Support of RP Activities from 6% to 13%. This is a necessary means of ensuring that the PSC rate charged to such projects fully recovers FAO’s variable indirect support costs and will avoid assessed regular budget contributions subsidizing such extra-budgetary funded activities.

14. The comparative analysis of support costs policies and rates presented to the Committee in last year’s report⁷ shows that a rate of 13% is in line with practices of the UN and the other main Specialized Agencies (ILO, UNESCO, UNIDO, WHO, WMO). In fact, with the exception of WMO, none of these organizations has a standard reduced rate for extra-budgetary projects

⁵ CL 131/9 paragraph 54

⁶ Excluded from the review are projects in this category that attract specific rates under the current policy (12% for APO projects; 0% for travel of developing country participants to conferences and consultations, sponsorship funds in support of awareness raising and/or promotional events, contributions for refurbishment and improvement of FAO premises) and long-term trust fund accounts (e.g. Commissions established under the auspices of FAO).

⁷ FC 110/4 paragraphs 27-37 and Annex

directly supporting programmes funded by assessed contributions. The proposed adjustment in the rate would therefore align FAO's practice with the UN and other Specialised Agencies.