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FINANCE COMMITTEE

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Comprehensive Financial Framework for Cost Recovery - Update

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

Mr Boyd Haight, Director

Office of Strategy, Planning and Resources Management

Tel: +3906 5705 5324

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EXECUTIVE SUMMARY

- Following on the Finance Committee's endorsement of the cost recovery aims, assumptions and principles, this document presents the final concept of the comprehensive financial framework for cost recovery in terms of the cost recovery model, benefits and implementation considerations.
- The concept moves away from the costs categorization and incremental recovery principles that have been used in the current FAO Support Cost Policy to a proportional full cost recovery model where all costs of delivering the programme of work under all source funds are categorized into three cost categories: Direct Operational Costs; Direct Support Costs; and Indirect Support Costs.
- The concept provides for three main benefits: i) treats extrabudgetary resources as supporting delivery of the Programme of Work in the integrated budget, not as an incremental cost; ii) recognizes more decentralized operations, integration of development and emergency project operations, and more diverse funding sources; iii) through simplicity and transparency, aims to overcome perceptions of FAO partners, management and staff that the current policy and its implementation is complex and inequitable.
- *Direct Operational Costs* and *Direct Support Costs* would be budgeted under the Regular Programme and in all Extrabudgetary projects, following a proportional application. An *Indirect Support Costs (ISC)* rate would be calculated as a proportion (percentage) of total direct costs across all sources of funds (Regular Programme and Extrabudgetary). An ISC rate would be applied on all Extrabudgetary project budgets for recovery. The new model would therefore replace the 18 current PSC (project serving cost) rates and ICRU (Improved Cost Recovery Uplift).
- Based on a preliminary application of this cost categorization to the PWB 2014-15 (Regular Programme and Extrabudgetary) at the aggregate level, the overall average ISC recovery rate is estimated at 7%. There is need for flexibility in applying the ISC rate as recognized by the UNGA guidance to UN funds, programmes and agencies which called for a simple, transparent and harmonized methodology, providing incentives, including through differentiated cost recovery rates.
- The milestones and timeline is presented to develop and agree a new FAO cost recovery policy based on the new model, and to put in place transition and implementation measures.

GUIDANCE SOUGHT FROM THE FINANCE COMMITTEE

- The Finance Committee Committee is invited to comment and provide guidance on the new cost recovery model, benefits and implementation considerations.

Draft Advice

- **The Finance Committee:**
 - **endorses the new model based on proportional cost recovery with attributable support costs;**
 - **notes the estimated ISC rate of 7 per cent and emphasizes the need to consider flexibility in its application;**
 - **requests the Secretariat to prepare a new FAO cost recovery policy for consideration at its next regular session;**
 - **endorses the implementation milestones and requests the Secretariat to present an implementation plan with particular attention to transitional arrangements at its next regular session.**

I. Introduction

1. At its 154th session in May 2014 the Finance Committee examined and welcomed the update on development of a comprehensive financial framework for cost recovery,¹ including the identification of FAO-specific financial, administrative and operational issues and recent developments within the United Nations (UN) system. The Committee endorsed in principle the aim, assumptions and principles of the initiative and looked forward to receiving the final concept and implementation considerations at its next regular session.

2. Since May 2014 the Secretariat has finalized the concept of the comprehensive financial framework for cost recovery in terms of the principles, recovery model, benefits and implementation considerations, as presented in this document for consideration by the Finance Committee. Section II provides an overview of the current FAO support cost policy and issues arising. Section III sets forth the new approach to cost recovery. Section IV describes the benefits and issues addressed, and Section IV provides implementation milestones and timeline.

II. Overview of current FAO support cost policy and issues arising

3. Support cost mechanisms were established in UN organizations during the 1970's. They were based on the principle of sharing support costs among UN system organizations, and between United Nations system organizations and Member States, as an appropriate financial expression of partnership.

4. The current FAO support cost policy was developed in 1999 and endorsed by Council in 2000. The support cost policy has been updated four times and its implementation is reported annually to the Finance Committee and biennially in the Programme Implementation Report.² The current FAO support cost policy is provided in Annex 1 for reference.

5. The scope of the current FAO support cost policy is to recover necessary and inherent *variable indirect costs* associated with providing *administrative and operational support* (AOS) to projects, and the direct cost of *technical support services* (TSS). The current policy is based on the principles of:

- a) *incremental cost recovery*, which assumes that FAO's work is mainly financed by assessed contributions under the Regular Programme, where Regular Programme support to Extrabudgetary projects funded by voluntary contributions is considered as an incremental cost to be recovered;
- b) recovery of only half of *variable indirect costs*, as agreed among UN agencies in 1992 under the partnership principle.

6. The recovery rates of *variable indirect costs* adopted for AOS were based on the original standard rate of 13 percent approved by the UNDP governing body in 1980 and then adopted by almost all UN system organizations.³ The UN Secretariat and most of the specialized agencies continue to apply this rate, with variations.

7. Under the current policy, support costs are categorized and recovered as follows (detailed definitions are provided in Annex 2):

- a) all *variable direct costs* (e.g. project personnel, technical support services, consultants, travel, equipment, supplies, information technology and security services) are charged directly to projects;

¹ FC 154/10

² For example, FC 156/6 and C 2015/8 PIR 2012-13 paragraphs 383-393

³ FC 151/8

- b) 50% of incremental *variable indirect costs*⁴ are recovered through a *project servicing charge (PSC)* with a base rate of 13% and with variances for specific circumstances (see Annex 3);
- c) *fixed costs* (direct and indirect) are entirely excluded from the current cost recovery policy (e.g. fixed costs of general management, general financial accounting, central HR function, auditing, central records, etc.) on account of the principle that only ‘incremental’ costs are recovered.

8. The Conference at its 37th session in June-July 2011 reaffirmed the policy of full cost recovery of administrative and operational support to extrabudgetary projects that had been approved by the Council in November 2000 and directed the Council to implement measures to improve such recoveries from extrabudgetary-funded activities, building on the experience of other UN Agencies. Based on the experience of the World Health Organization, the Secretariat developed and implemented in 2013 and 2014 the Improved Cost Recovery Uplift (ICRU) mechanism to recover costs that had been largely excluded from the cost recovery policy, specifically costs related to information technology, office space occupancy and security. Under ICRU, these costs are recovered as variable direct costs.

9. In recent years, the environment in which FAO operates has evolved to the extent that the current cost recovery model is straining to remain viable. The main changes in FAO’s operating environment that cannot be adequately addressed within the current support cost policy are:

- a) the integrated approach to programming and delivery and the higher level of Extrabudgetary resources compared to the Regular Programme (now 59%:41%), where support costs are no longer incremental to delivery of the approved Programme of Work;
- b) more decentralized operations, integration of development and emergency project operations, and more diverse funding sources;
- c) perceptions of FAO partners, management and staff that the current support cost policy and its implementation is complex and not equitable.

III. New approach to cost recovery

10. The review of the current FAO support cost policy and development of a comprehensive financial framework for cost recovery has been carried out in the context of the developments and issues set out in Section II above and the December 2012 UN General Assembly Resolution A/RES/67/226 (emphasis added) in response to the Quadrennial Comprehensive Policy Review:

“The General Assembly requests the executive boards of the United Nations funds and programmes, and encourages the governing bodies of the specialized agencies to adopt cost recovery frameworks by 2013, with a view to their full implementation in 2014, based on the guiding principle of full cost recovery, proportionally, from core and non-core resources, and a simple, transparent and harmonized methodology, providing incentives, including through differentiated cost recovery rates, and taking into account different volumes and nature of funds to increase core funding and more predictable, flexible and less earmarked non-core contributions that are aligned with the strategic plans adopted by the respective governing bodies.”

3.1. Principles

11. Taking account of issues encountered with the current FAO support cost policy and the guidance provided by the UNGA, the comprehensive financial framework for cost recovery was modelled around the following principles as endorsed by the Finance Committee at its 154th session:

⁴ Recruitment of human resources; procurement and formalization of contracts; preparation of budgets, monitoring of work plans, and control of expenditures; receipt, custody and disbursement of funds; project accounting; financial and other project reporting.

- a) Aim for full cost recovery, proportionally, from Regular Programme and Extrabudgetary resources in an integrated budget.
- b) Support and strengthen FAO's ability to deliver on its mandate, using resources efficiently and supporting the relationship between FAO's normative and development work.
- c) Align with the decentralization policies that enable decision-making and strengthen activities at the country level.
- d) Be simple and provide for transparency, equitability and accountability that is financially and operationally reasonable.
- e) Adopt those existing practices accepted by Member States, donors and governing bodies within the UN system that would support FAO's efforts in implementing its unique mandate.

12. The underlying assumption for the review is that policy frameworks, resource levels, financial and operational aspects of the Organization remain relatively constant.

3.2. The new model: proportional cost recovery with attributable support costs

13. The new model moves away from the costs categorization and incremental recovery principles that have been used in the current FAO support cost policy as described in Section II above.

Definition of cost categories

14. The comprehensive financial framework for cost recovery is based on a proportional full cost recovery model where all costs of delivering the programme of work under all source funds are categorized into three cost categories:

- a) **DOC: Direct Operational Costs** are any costs relating to specific inputs (other than direct support costs) required to deliver an activity. These are the costs, for example, that comprise project budgets (cost of project personnel, FAO technical support, consultants, travel, contracts, equipment, etc.)
- b) **DSC: Direct Support Costs** are the costs of those services that can be attributed to supporting the provision of specific inputs acquired as direct operational costs. These costs include *inter alia* services for human resource management, finance, information technology, security, monitoring and evaluation. These costs relate to the support the Organization has to provide to deliver the specific inputs.
- c) **ISC: Indirect Support Costs** are costs that support the execution of the delivery of activities, but cannot be directly associated to their implementation (e.g. policy, executive direction and management, governance and oversight).

15. The new model therefore a) considers all costs under all funding sources (Regular Programme as well as Extrabudgetary); b) moves away from the distinction of costs between *variable* and *fixed* and thus no longer considers Extrabudgetary resources as *incremental*; and c) moves away from the principle of *partnership* to full cost recovery).

16. In summary the new model uses a simplified cost structure with two types of *direct costs* (Direct Operational Cost and Direct Support Cost), and one type of *indirect costs*. Support costs can be direct (DSC) or indirect (ISC).

Calculation and recovery of support costs

17. The calculation of support costs would change compared with the current policy and would replace the present set of PSC rates and ICRU recoveries.

- a) Direct Support Costs would be identified through the application of the new cost categorization and then budgeted under the Regular Programme and in all Extrabudgetary projects, following a proportional application between sources of funding. The result would determine what would have to be budgeted and recovered from project budgets as direct costs, together with Direct Operational Costs.
- b) Indirect Support Costs would be calculated as a proportion (percentage) of total direct costs (DOC and DSC) across all sources of funds (Regular Programme and

Extrabudgetary), rather than the existing model that is based on the identification of the incremental costs of Extrabudgetary contributions under the Regular Programme. An ISC rate would be calculated as a proportion (percentage) of total direct costs across all sources of funds (Regular Programme and Extrabudgetary) and would be applied as a percentage on all total Extrabudgetary project budgets for recovery.

18. Based on a preliminary application of the above cost categorization to the PWB 2014-15 budgeted level of resources (Regular programme and Extrabudgetary) at the aggregate level, the overall average ISC recovery rate is estimated at 7%. This ISC rate has been derived by classifying all estimated expenditure under all sources of funds into the three main cost categories, and the result is shown in Table 1.

Table 1: Proportional cost recovery

| Type of Cost | FAO cost 2014-15 All sources of Funds (USD million) |
|--|--|
| a) Direct Operational and Support Costs | 2,283 |
| b) Indirect Support Costs | 159 |
| c) Grand Total (NAP 1,005+EB 1,437) | 2,442 |
| d) Estimated ISC proportional rate (b/a) | 7 % |

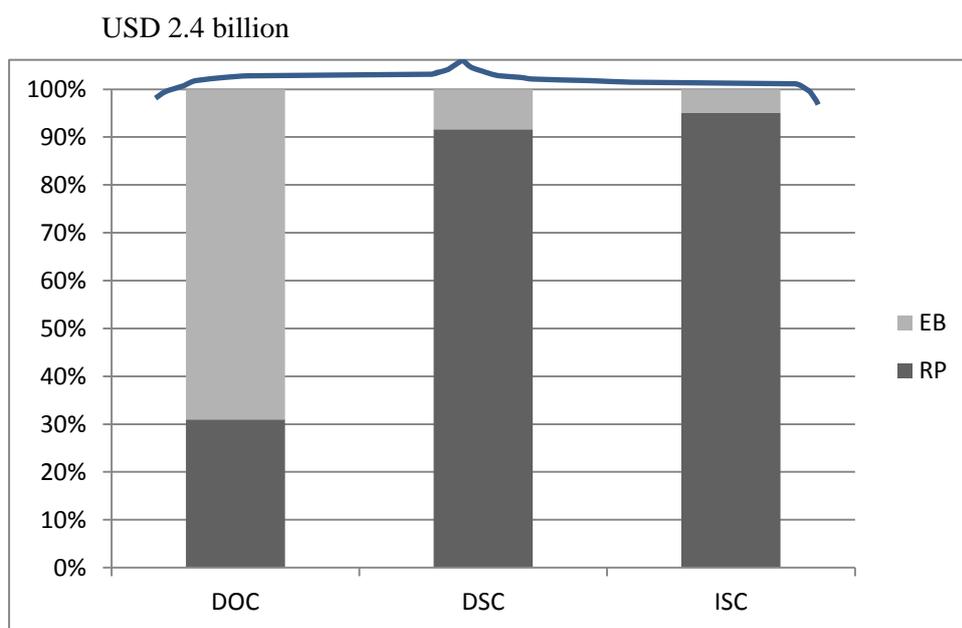
19. The ISC rate would replace the current three standard PSC rates and 15 special PSC rates under the current policy (see Annex 3). Most of the special rates would not be necessary under the new approach, as the 'discount' of costs they represent would be equivalent to what would be recovered through the standard ISC rate and direct costs (DSC and DOC) charged to the project. This would lead to convergence around the estimated 7% ISC rate, which is in line with the prevalent ISC rates being adopted by several UN funds and programmes with some room for flexibility (World Food Programme at 7%; UNDP, UNICEF, UNFPA, UN-Women⁵ at 7% for core contributions, 8% for non-core contributions).

Application of new cost categorization to PWB

20. The application of this new cost categorization to the PWB 2014-15, before the application of the principle of proportionality across all sources of funding, is shown in Figure 1. Since the current cost recovery model recovers only 50% of variable indirect costs and none of the fixed costs from Extrabudgetary projects, a very high percentage of overall DSC and ISC are funded by the Regular Programme (RP) compared to Extrabudgetary (EB) funding, as show in Figure 1.

⁵ UNW/2013/11 paragraphs 4, 5.a and 5.b

Figure 1: Application of new cost categorization to PWB 2014-15 costs, before proportionality



21. The new cost categorization corrects this imbalance under the principle of *full* cost recovery with *proportionality* in direct and indirect support costs attribution. The new model attributes support costs proportionally to both funding streams, driven by the weight of Direct Operational Costs as illustrated in Figure 2.

Figure 2: Illustration of approach to proportional cost attribution

| | Regular Programme | | Extrabudgetary | |
|------------------------|-------------------|-----------------------|----------------|--------------------|
| Direct Support Costs | DSC Total X | DOC Regular Programme | DSC Total X | DOC Extrabudgetary |
| | | DOC Total | | DOC Total |
| Indirect Support Costs | ISC Total X | DOC Regular Programme | ISC Total X | DOC Extrabudgetary |
| | | DOC Total | | DOC Total |

22. Direct Operational Costs therefore represent the driving element for apportioning direct and indirect support costs between funding sources. For example, if the new cost categorization is applied to the PWB 2014-15, the share of DOC Regular Programme is about 31% and the share of DOC Extrabudgetary is about 69%. This demonstrates that Extrabudgetary resources should be funding around 69% of overall DSC and ISC costs. The formula above would therefore provide the indicative elements and amounts that would have to be recovered from Extrabudgetary projects as DSC and ISC to ensure proportionality between Regular Programme and Extrabudgetary resources.

23. In summary, Direct Support Costs would be budgeted in the same manner as they are now. What would change is the attribution of the Direct Support Costs at aggregate level to each funding stream (Regular Programme and Extrabudgetary) based on each funding source’s proportional share of Direct Operational Costs. Indirect Support Costs would likewise be budgeted according to current practices in the PWB but attributed to each funding stream according to the proportional share of Direct Operational Costs. These support costs would then be attributed proportionally to Regular Programme and Extrabudgetary resources for recovery against Extrabudgetary projects. This

proportionality in cost recovery will help to rebalance the funding structure of FAO, so that no funding source will bear a disproportionate level of support costs.

24. The budgeting of Regular Programme and Extrabudgetary resources would not change. With regard to Extrabudgetary projects, the two direct cost categories would be budgeted and charged directly: the DOC category comprises costs that are generally already budgeted in practice; the DSC category comprises costs not currently budgeted in FAO projects in a coherent and consistent manner.

25. Careful project budgeting will be critical under the new cost recovery model, in order to capture all direct costs. Clear guidelines for project budgeting of direct costs - in particular direct support costs (DSC) will be required, to ensure transparency and equitability, as well as developing capacities to implement, through training and support, during project formulation and approval.

3.3. Need for flexibility in applying Indirect Support Cost rates – policy implications

26. There is need for flexibility in applying the ISC rate as recognized by the UNGA guidance to UN funds, programmes and agencies, which called for a simple, transparent and harmonized methodology, providing incentives, including through differentiated cost recovery rates.

27. The current FAO support cost policy contemplates special rates such as a zero percent rate for contributions to cover the travel cost of participants from developing countries to conferences and consultations or contributions to extraordinary capital expenditures for premises.

28. Furthermore, flexibility is needed to be able to adjust to changes in the assumptions, in particular relative to possible needed adjustments to variable levels of operations, considering the unpredictability of Extrabudgetary contributions.

29. Some partners, such as the Global Environment Facility (GEF), have specific requirements for charging direct and indirect costs that will be further analysed.

IV. Benefits and issues addressed

30. There are three main benefits to a proportional cost recovery model using direct operational costs, direct support costs, and indirect support costs categories. In summary, the new model:

- a) treats extrabudgetary resources as supporting delivery of the Programme of Work in the integrated budget, not as an incremental cost, thus helping to rebalance the funding structure of FAO, so that no funding source will bear a disproportionate level of support costs;
- b) recognizes more decentralized operations, integration of development and emergency project operations, and more diverse funding sources;
- c) through simplicity and transparency, aims to overcome perceptions of FAO partners, management and staff that the current policy and its implementation is complex and inequitable, and converging around a common project servicing charge rate for UN funds, programmes and agencies.

31. The table in Annex 4 provides an assessment on the degree to which the CFF model for proportional cost recovery addresses the issues that were identified during the review of the current cost recovery model, and that were reported in FC 154/10.

V. Implementation milestones and timelines

32. The milestones and timeline to develop, agree and implement a new FAO cost recovery policy is presented in the Table 2. The preparation of a detailed implementation plan will include the following elements:

- a) Clear guidelines for project budgeting of direct costs - in particular *direct support costs*.
- b) Internal communication campaign, supported by communication and e-learning tools, and help desk.
- c) Inform and communicate with external resource partners on transition and implementation measures.
- d) In the initial stages of implementation, assess the extent to which the new approach has been understood and implemented and identify corrective action.

Table 2: Implementation milestones and timeline

| Dates | Milestones | Status |
|---|--|-------------------|
| Aug- Dec 2013 | Research 1. Conduct research on history, recent developments, internal working modalities 2. Review history of FAO cost recovery 3. Consult with Finance Committee November | Completed |
| Jan- May 2014 | Concept 1. Conduct internal consultations 2. Develop principles and concept for the Comprehensive Financial Framework concept 3. Update Finance Committee May | Completed |
| Jun- Nov 2014 | Develop Approach 1. Finalize principles and Comprehensive Financial Framework model 2. Identify implementations considerations and modalities 3. Consultation and approval of new approach: Finance Committee November | Ongoing |
| Nov 2014- March 2015 | Formulate new support cost policy and implementation plan 1. Develop policy 2. Prepare implementation plan, including transitional arrangements 3. <i>Consultation and approval of new policy: Finance Committee and Council</i> | Next steps |
| April to Dec 2015 | Implement 1. Finalize and execute implementation plan 2. Phase in new policy and transitional arrangements | Next steps |

ANNEX 1 - CURRENT FAO SUPPORT COSTS POLICY

1. The scope of the current FAO support cost policy is to recover all variable indirect support costs associated with projects funded by voluntary contributions. These are mostly defined as administrative and operational services which are a necessary and inherent part of any project which the Organization agrees to execute, but which, because of their nature, cannot be readily or directly singled out for charging to the project itself.

2. More specifically, FAO has defined variable indirect support costs in MS 250 as follows:

Administrative services may include such items as:

- a) recruitment, briefing and servicing of project personnel;
- b) servicing of fellowships;
- c) procuring supplies and equipment, formalizing contracts;
- d) preparation of budgets and control of project expenditures;
- e) receipt, custody and disbursement of funds, maintenance of project accounts, financial reporting, external and internal audits, etc.;
- f) security monitoring.

Operational services may include such items as:

- a) assembling and submitting proposals to donors;
- b) negotiating agreements and plans of operation with project-sponsoring bodies and recipient governments;
- c) location and recommendation of qualified personnel;
- d) guidance and supervision of the implementation of projects;
- e) preparing, monitoring and revising work plans and budgets;
- f) reporting periodically on projects;
- g) fellowships placement and formulation of study plans;
- h) technical selection of equipment and technical preparation of contracts.

3. It is noted that all of these costs fall under the definition of variable indirect project support costs.

Summary

Table A: Matrix of Activities by Funding Source and Type

| Funding Source | Technical Assistance (TA) | | Emergency Assistance | Normative Programmes and Other RP Activities | |
|-------------------|---|---|----------------------|--|---------------------------|
| | National Funding | Donor Contributions | Donor Contributions | FAO RP Normative Activities inc. Commissions | Jointly Funded Activities |
| Extra-budgetary | 13% ceiling (see text below for exceptions) | 13% ceiling (see text below for exceptions) | 10% ceiling | 13% (see text below for exceptions) | As per MoU |
| Regular Programme | TCP and SPFS: ceiling of 7% | | TCP 7% ceiling | FAO Regular Programme | FAO Regular Programme |

4. The following notes apply these principles to the each of the categories of programme defined in Table A.

EXTRA-BUDGETARY PROGRAMMES

Technical Assistance - Government Cost Sharing

5. These are defined as technical assistance projects in the field which are funded by the Government of the recipient country, including those which are funded through loans from international financing institutions.
6. In principle, such projects should reimburse the variable indirect support costs associated with the project. Standard rates are not to exceed a ceiling rate (currently 13 percent) but can be lowered where appropriate for special circumstances:
- a) high proportions of contracts, supplies and equipment requiring minimal AOS costs (current Manual Section 250 provisions to continue to apply);
 - b) national execution in whole or in part;
 - c) inclusion of project support costs in the project budget as direct project costs;
 - d) other cost sharing or complementary support arrangements; and
 - e) exceptionally large projects when economies of scale apply.

Technical Assistance – Donor Contributions

7. These are defined as technical assistance projects in the field which are funded by a third party other than FAO or the recipient Government.
8. In principle, such projects should reimburse the variable indirect support costs associated with the project. Standard rates are not to exceed a ceiling rate (currently 13 percent) but may be lowered where appropriate for special circumstances:
- a) rates established by inter-governmental bodies of the UN system organizations (including the international financial institutions);
 - b) high proportions of contracts, supplies and equipment requiring minimal AOS costs (current Manual Section 250 provisions to continue to apply);
 - c) Associate Professional Officers (APOs) which are charged a fixed rate of 12 percent;
 - d) inclusion of project support costs in the project budget as direct project costs; and
 - e) exceptionally large projects when economies of scale apply.

Emergency Assistance

9. FAO emergency assistance is defined as a situation where an urgent and exceptional external response is needed in the agriculture sector to address the impact of a particular disaster, natural or man-made. If a project is characterized as an emergency, the request follows the "fast track" and is operationally treated as such. Generally, "prevention" and "preparedness" are not within the meaning of "emergency" for project operational purposes.
10. The ceiling rate for emergency assistance projects is 10 percent. Rates for emergency assistance are to be determined on a case-by-case basis to recover the full variable indirect support cost of the project. When Emergency Operations and Rehabilitation Division (TCE) operates technical assistance projects because of special situations, the reimbursement rates for technical assistance shall apply.

Regular Programme Normative Activities

11. These are defined as voluntary contributions which directly support the implementation of Regular Programme activities. Such activities will generally be normative in nature and be implemented at Headquarters or at a Regional Office rather than directly in the field.
12. A standard PSC rate of 13 percent will apply.
13. Such rates can be lowered to reflect the impact of certain special circumstances:
- a) contributions to cover the travel cost of participants from developing countries to conferences and consultations on matters within FAO's mandate will be exempted from indirect support cost charges;

- b) sponsorship funds in support of awareness raising and/or promotional events will be used to cover the identifiable direct costs of these activities and as such, are not subject to project servicing costs;
- c) contributions to FAO for the refurbishment and improvement of FAO premises (both at Headquarters and in Regional and Subregional Offices) are exempt from PSC charges;
- d) Associate Professional Officers (APOs) which are charged a fixed rate of 12 percent; and
- e) long-term trust fund accounts (e.g. Commissions established under the auspices of FAO) will be subject to a case by case estimate of the actual level of variable indirect support costs and charged accordingly.

Jointly Funded Activities

14. These arrangements cover activities which are part of the Regular Programme and are usually normative in nature. They are defined as partnership arrangements between FAO and other inter-governmental organizations including, in particular, UN system organizations.

15. The special nature of these partnership arrangements will be recognized and translated into an agreement to share direct costs in a manner appropriate to the joint activity's contribution to the Strategic Objectives of the Organization. Variable indirect costs are generally to be funded by the host organization although recognition of this fact should generally be given in the Memorandum of Understanding and related cost sharing formulae.

16. It is noted that the FAO-GEF Agreement foresees a flat reimbursement fee of 10 percent for full size projects for support and supervisory costs. This arrangement is still being evaluated by FAO. GEF-funded PDF Block B projects that have become operational have been granted Project Support Servicing of 6 percent, which seems sufficient to fully recover variable indirect support costs.

REGULAR PROGRAMME

TCP and SPFS

17. Regular Programme funded technical assistance (including emergencies) should, in principle, reimburse the variable indirect support costs incurred by “operating units” or their equivalent associated with the project (i.e. for operational services). This should be based on an average rate (currently 7 percent).

ANNEX 2 - DEFINITION OF COSTS USED IN THE CURRENT FAO SUPPORT COST POLICY

| Cost Accounting Term | Definitions | Examples of Services Provided | Means of Recovery in FAO |
|-----------------------------|--|--|---|
| Direct Costs | Costs that can be directly traced to a product or output. | Project personnel, equipment, premises, travel and any other input necessary to achieve the results and objectives set out in specific activities or projects. | Fully recoverable from extrabudgetary resources. To be directly included in project budget. |
| Indirect Costs | Variable Indirect Costs Costs that are associated with the production of several outputs, but which are not traceable to individual outputs, and which tend to vary indirectly with the volume produced. | Services provided by administrative and operational staff supporting specific activities or projects, which cannot be discretely identified. | Levy PSC as percentage charge against actual expenditures. |
| Fixed Indirect Costs | Costs that is not easily traceable to the production of a single output and which do not vary with the volume of output. | Costs of general management: senior management; general financial accounting; central HR function; auditing; messenger service; central records, etc. | Not to be financed from extrabudgetary resources. |

**ANNEX 3 - LIST OF PSC RATES ALLOWED IN THE CURRENT FAO SUPPORT COST
POLICY
(Standard and non-standard)**

| Type of projects or categories of costs recognized in the current FAO support cost policy | PSC rates |
|---|---|
| TF/APO (Belgium and Netherlands) | 14% |
| Technical Assistance including normative (standard rate) | 13% |
| TF/APO (excluding Belgium and Netherlands) | 12% |
| Emergency Assistance -Trust funds (standard rate) | 10% |
| TCP (standard rate) | 7% |
| Contracts/expendable and non-expendable procurement is over 70% of net project budget | 7% |
| Contracts/expendable and non expendable procurement is between 40% and 70% of net project budget | 7% applied to that budget component and the relevant PSC rate to the rest of the project budget |
| GEF medium and full size project executed by FAO | 6% with balance recovered as direct costs |
| Funds deposited with the Organization to cover the facilities fee and the cost of holding non-FAO sessions on FAO premises | 5% |
| GEF - Project Preparation Grant (covers project formulation costs) | 0% |
| GEF medium- and full-size project not executed by FAO* | 0% |
| Contributions to FAO for the refurbishment and improvement of FAO premises (both at headquarters and in regional and subregional offices) | 0% |
| Contributions to cover the travel cost of participants from developing countries to conferences and consultations on matters within FAO's mandate | 0% |
| Contributions to reimburse Technical Support Services from FAO staff time where funding is entirely or largely for this purpose | 0% |
| Sponsorship funds in support of awareness raising and/or promotional events | 0% |
| Exceptionally large projects when economies of scale apply | Determined on a case-by-case basis |
| Inclusion of project support costs in the project budget as direct project costs** | Determined on a case-by-case basis |
| Article VI and XIV Bodies*** | Determined on a case-by-case basis |

* FAO does not receive a PSC but receives a management fee separate from the project budget that is managed in a separate trust fund

** For EU or UN Joint Programmes funded projects when a PSC rate of 7% is granted to technical assistance/normative projects or emergency projects respectively 6 % and 3 % should be identified as AOS type direct inputs in the projects.

*** See the list of Article VI and XIV bodies and PSC rates in the attachments

ANNEX 4 - DEGREE TO WHICH THE CFF MODEL ADDRESSES IDENTIFIED ISSUES ASSOCIATED WITH THE CURRENT COST RECOVERY MODEL

| Issues associated with the current cost recovery modality ⁶ | Addressed | Manner in which issue is addressed |
|--|-----------|--|
| A. Financial issues | | |
| 1. Current extrabudgetary budgets do not reflect full costs because of support from the Regular Programme and technical departments may not be identifying all work performed for projects. | Yes | Activities will be fully costed, showing Direct Operational, Direct Support and Indirect Support Costs. |
| 2. Some directly attributable costs are recovered through the cost recovery rate rather than being included in direct costs. | Yes | Indirect support costs will not include activities that can be attributable. |
| 3. Multiple support cost rates may affect resourcing as resource partners may direct funds to activities with lower recovery rates. | Yes | An indirect support cost recovery rate will apply to contributions, with flexibility for incentives and requirements of some partners. |
| 4. Financial reporting on extrabudgetary and Regular Programme activities are not comparable at the activity level. | No | Budgeting at activity level will continue. Comparing financial results for disparate activities may have limited value. |
| 5. Reporting on extrabudgetary resources varies by resource partner resulting in time-consuming processes. | Partially | The standard cost categorization for all resources will allow for more standardized reporting across donors, although not entirely. Comparing financial results for disparate activities may have limited value. |
| 6. Costs eligible for recovery, accepted recovery modalities and accepted recovery approaches can vary by donor. | Yes | Full cost recovery policies can be applied to all contributions (some cases require further analysis, such as GEF). |
| 7. The current cost recovery modality does not provide incentives for contributions to core resources or encourage non-traditional donors (private sector, South-South). | Yes | Adopting proportional cost recovery will ensure that Extrabudgetary resources are treated as supporting the delivery of the Programme of Work. |
| B. Administrative issues | | |
| 1. Separate administrative processes, support structures and operating modalities exist to delineate Extrabudgetary costs from Regular Programme activities for budgeting and cost recovery. | Yes | Standard cost categories and aggregate support cost budgeting with proportional cost recovery will mean that separate processes, structures and modalities will not be necessary. |
| 2. Method for calculating recovery rates is complex, time consuming | Yes | The method for calculating the recovery rate will not require the WMS and CMS |

⁶ FC 154/10 paragraph 16.

| Issues associated with the current cost recovery modality⁶ | Addressed | Manner in which issue is addressed |
|--|------------------|---|
| and difficult to communicate internally and externally. | | and will be simplified: the calculation of the indirect support cost rate will be done as a percentage of direct costs. |
| 3. The modality of cost recovery—either through an applied rate or through staff occupancy charges (ICRU)—is complex in application, redistribution of recovered amounts in alignment with work requirements and difficult to communicate. | Yes | Simplified through proportional cost recovery. There will be no need for 18 different rates. ICRU will be discontinued. |
| 4. Assessment of requests—within the approved policy—for rate adjustments pertaining to special circumstances are time consuming and may give the appearance of inequitable treatment among donors. | Yes | Activities are fully costed. Hence there will be no longer the need for the assessment of requests in the current volumes for rate adjustments, there will be greater transparency and equitability of treatment. |
| C. Operating issues | | |
| 1. Resources are not initially linked to specific activities and may come from various separate funding streams—extrabudgetary, Regular Programme, recoveries—and therefore may affect operational effectiveness (by creating uncertainty in timing and sufficiency of necessary funding). | Partially | All costs of work will be funded proportionally at the time of resourcing of projects. |
| 2. Activities with smaller budgets may not include resources necessary for effective implementation since some required inputs may not be readily scalable on a project-by-project basis | Yes | Activities will include attributed costs, which could include non-scalable resources distributed proportionally to the activities they benefit. |
| 3. Operational effectiveness may be hampered and financial efficiency may be reduced due to resource use restrictions. | Yes | Full cost recovery with proportionality should mitigate the risks of changes in delivery and non-scalable costs in the short term. |