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FINANCE COMMITTEE

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FAO Cost Recovery Policy

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EXECUTIVE SUMMARY

- At its 154th session in May 2014 the Finance Committee endorsed the aim, assumptions and guiding principles for the development of a Comprehensive Financial Framework (CFF) cost recovery model, which would provide the basis for preparing a more transparent and equitable cost recovery policy that treated extra-budgetary resources as supporting FAO's programme of work in an integrated budget.
- At its 156th session in November 2014 the Finance Committee examined and endorsed a CFF cost recovery model proposed by the Secretariat based on full proportional cost recovery with attributable support costs, and the new categories of Direct Operational Costs (DOC), Direct Support Costs (DSC), and Indirect Support Costs (ISC).
- This document presents a draft FAO cost recovery policy, based on the CFF model of full proportional cost recovery, and an implementation plan and timeline including transition arrangements.

GUIDANCE SOUGHT FROM THE FINANCE COMMITTEE

- The Finance Committee is invited to review and provide comments on the draft FAO cost recovery policy and implementation plan with a view to recommending their adoption to the Council.

Draft Advice

The Finance Committee:

- **Reviewed and provided its comments on the proposed new FAO cost recovery policy and implementation plan;**
- **Recommends endorsement by Council.**

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 (CFF) 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 the aim, assumptions and guiding principles for the development of a CFF cost recovery model, which would provide the basis for preparing a more transparent and equitable cost recovery policy that treated extra-budgetary resources as supporting FAO's programme of work in an integrated budget.

2. At its 156th session in November 2014 the Finance Committee examined and endorsed a CFF cost recovery model proposed by the Secretariat based on full proportional cost recovery with attributable support costs, and the new categories of Direct Operational Costs (DOC), Direct Support Costs (DSC), and Indirect Support Costs (ISC).²

3. As requested by the Finance Committee, this paper presents a draft FAO cost recovery policy based on the CFF model, which would replace the current FAO support cost policy, and an implementation plan and timeline including transition arrangements, for review and endorsement.

II. Draft FAO Cost Recovery Policy

4. The draft FAO cost recovery policy based on the CFF model is provided in Annex 1. The policy defines the scope and principles, the new cost categories, the cost recovery modalities including criteria for implementation and guidelines for flexible application of the ISC rate, and monitoring and reporting requirements.

III. Implementation plan and transition measures

5. As outlined in November 2014, the preparation of a detailed implementation plan will include four main elements:

- a) Prepare clear guidelines for project budgeting of direct and indirect costs;
- b) Design and execute an internal communication plan;
- c) Inform and communicate with external resource partners on transition and implementation measures; and
- d) Assess and address implementation issues, including through proposed adjustments to the policy if required.

6. The Secretariat has determined that full implementation of the new cost recovery policy will require some complex changes in budgeting and accounting processes and procedures. It is proposed to implement the new policy through transitional arrangements from 1 January 2016. The milestones leading to implementation and the transitional arrangements are set out in the table below.

¹ FC 154/10

² FC 156/7, CL 150/4 paragraphs 17-18

Timeframe	Milestone
April-May 2015	1. Set up implementation team.
May-July 2015	2. Apply the new cost categorization to all FAO costs and to FAO ongoing projects, and analyse the results to provide insights and identify possible patterns of costs under the new categorization by type.
May-November 2015	3. Identify and address budgeting, accounting and financial reporting implications, and formulate functional requirements. 4. Develop budgeting and financial reporting guidelines for applying the policy.
October-May 2016	5. Update corporate systems (GRMS, FPMIS, PIREs) for budgeting, accounting and financial reporting.
November-January 2016	6. Develop and roll out internal training and communication campaign. 7. Inform main resource partners, including on transitional arrangements.
From January 2016	8. Start phased implementation with transitional arrangements. - All new projects in early formulation stage fully apply new policy; - Ongoing projects use current policy until end-date, unless partners agree to modify project budgets.

Annex I - Draft FAO Policy on full cost recovery

Scope and principles

1. The scope of the FAO cost recovery policy is full proportional cost recovery from regular programme and extra-budgetary resources, under the FAO Programme of Work under an integrated budget, as encouraged by the UN General Assembly in resolution A/RES/67/226.
2. The policy will:
 - a) 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.
 - b) Align with the decentralization policies that enable decision-making and strengthen activities at the country level.
 - c) Be simple and provide for transparency, equitability and accountability that is financially and operationally reasonable.
 - d) 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.

Definition of cost categories for cost recovery

3. The FAO cost recovery policy makes use of a simplified cost structure with two types of direct costs (Direct Operational Cost and Direct Support Cost), and one type of indirect costs (Indirect Support Cost or ISC). Support costs can be direct (DSC) or indirect (ISC).
4. All the costs of delivering the programme of work under all source of 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).

Cost Recovery modalities

5. The cost recovery policy is based on full Direct Costs recovery, full proportional recovery with attributable Direct Support Costs and the application of an Indirect Support Cost percentage rate to voluntary contributions.

a) Direct Operational and Support Costs

6. All direct costs associated with programmes, projects or activities financed by voluntary contributions will be budgeted and recovered in full from projects.
7. All Direct Operational Costs required for the delivery of activities funded by voluntary contributions will be budgeted. FAO Technical Support is an integral part of Direct Operational Costs.

8. Direct Support Costs will be budgeted and recovered following a proportional application between sources of funding, based on relevant Direct Operational Costs budgeted in the project. Direct Support Costs are attributable to Direct Operational Costs.³

b) The Indirect Support Cost Rate (ISC rate)

9. Indirect Support Costs (ISC) are recovered through the application of a percentage rate.

10. The ISC rate is determined by applying the new cost categorization to the Programme of Work and Budget budgeted level of resources both for regular programme and extrabudgetary delivery, and by calculating the proportion of ISC costs against total direct costs.

11. The ISC rate has been calculated and set at 7%, assuming the current policy frameworks, resource levels financial and operational aspects remain relatively constant.

12. All projects are charged the ISC rate at 7%, with the flexibility as defined in next section.

Flexibility in the application of the ISC rate

13. Flexibility in applying the ISC rate where appropriate, for special circumstances, can be implemented as part of the FAO full cost recovery policy in the following cases:

a) Rates established by inter-governmental bodies of the UN system organizations (including international financing institutions and funding mechanisms, e.g. GEF);

b) Existing long terms trust fund accounts where specific support cost arrangements have been included in the statutes and funding agreements (e.g. Commissions, committees, conventions established under Article XIV or VI of the FAO Constitution);

c) Extra-budgetary contributions with particular partnerships with cost-sharing or complementary support arrangements, e.g. South South Cooperation;

d) New Operational Modalities (NOM) for national execution in whole or in part, and funds transfer as Administrative or Managing Agent (AA or MA);

e) Complex arrangements or major changes in conditions of resource partnership relationship⁴ for which the implications would have to be carefully monitored and analysed.

Are exempt from the application of the ISC rate those contributions for:

f) Travel costs of participants from developing countries to conferences and consultations on matters within FAO's mandate;

g) Refurbishment and improvement of FAO premises (both at Headquarters and in Regional and Sub Regional offices);

h) Sponsorship funds in support of awareness raising and/or promotional events;

i) Telefood Projects.

14. In case of significant changes in context and assumptions, in particular relative to adjustments to variable levels of operations, considering the unpredictability of voluntary contributions funding, the ISC rate would be adjusted.

Monitoring and reporting requirements of the policy.

15. The FAO cost recovery policy implementation will be monitored and reported annually to the Finance Committee.

16. The ISC rate will be reviewed every two years, to assess changes in context and assumptions. The review of the cases requiring some flexibility and the overall context of the application of the ISC

³ Attributable means that costs relate to, but are not univocally traceable to, the specific Direct Operational Costs of the activities funded by voluntary contributions.

⁴ Currently the EU is revising the terms and conditions for multilateral funding.

rate will be monitored by the Secretariat and arising adjustments reported to the attention of the Finance Committee.

17. The ISC rate and the DSC proportional recovery through attribution will replace the current three standard PSC rates and 15 special PSC rates under the current policy⁵ and the ICRU, from 1 January 2016, taking into account transitional arrangements for existing projects.

⁵ See FC 156/7 Annex 3