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FINANCE COMMITTEE

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Proposals for Revision of FAO's Support Cost Policy

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

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GUIDANCE SOUGHT FROM THE FINANCE COMMITTEE

- The Finance Committee is invited to take note of the outcome of the internal review and progress in putting in place measures to reduce the cost recovery gap of indirect variable costs within the current scope of the FAO policy on support costs. It is also invited to note the proposals outlined by the Secretariat for cost recovery under an enlarged scope, details of which will be provided at a future session.
- The Finance Committee is invited to take note of the financial risk associated with residual deficit balances on Trust Fund projects which occur in the context of the higher volume of voluntary contributions and the intention of the Secretariat to carry out further analysis with a view to presenting proposals to mitigate the risk at a future session of the Finance Committee.

Draft Advice

- **The Finance Committee takes note of the outcome of the internal review and progress in putting in place measures to reduce the cost recovery gap of indirect variable costs within the current scope of the FAO policy on support costs, and it looks forward to receiving details of proposals for cost recovery under an enlarged scope at a future session.**
- **The Finance Committee takes note of the financial risk associated with residual deficit balances on Trust Fund projects which occur in the context of the higher volume of voluntary contributions and the intention of the Secretariat to carry out further analysis with a view to presenting proposals to mitigate the risk at a future session.**

Background

1. The voluntary contributions managed by the Organization in Trust Funds have increased significantly in recent years. During the 2008-09 biennium, Trust Fund expenditures amounted to more than USD 1 billion, and for the first time exceeded Regular Programme expenditures. There are a number of emerging issues and risks presented by this increase in Trust Fund activity, in particular concerning cost recovery of services provided in the delivery of the activities funded by voluntary contributions, and residual deficit balances on Trust Fund projects.

2. The FAO policy for setting project servicing cost (PSC) rates, including for voluntary contributions held in Trust Funds, was endorsed by the Council in November 2000.¹ The policy is based on the principle that there should be a reasonable alignment of charges to the actual costs of providing administrative and operational support (AOS) to projects, taking due regard of existing arrangements, and the need for a simple and transparent approach.

3. The Organization reports regularly on the level of support costs and recoveries.² The Finance Committee at its 123rd session in October 2008 noted with concern the persistent and growing under-recovery of administrative and operational support costs for extra-budgetary activities, as highlighted by the External Auditor and reported in the Programme Implementation Report 2006-07. The recovery gap has closed somewhat in 2008-09.³

4. At the 128th Session of the Finance Committee in July 2009, the Secretariat informed the Committee of the results of the inter-agency study undertaken by the High Level Committee on Management (HLCM) Finance and Budget Network (FBN) Working Group on Support Costs. The study identified a number of cost categories which are not covered by FAO's support cost policy and rates but would qualify for recovery.⁴

5. Pending the finalization of inter-agency consultations, the Secretariat has undertaken an internal review and identified several measures that could: (a) reduce the cost recovery gap of indirect variable costs within the current scope of the FAO Support Cost Policy; and (b) improve the cost recovery of categories of costs that have been previously excluded from recovery by FAO, but are normally recovered by other UN Organizations, under the in-principle enlarged scope of the Support Cost Policy endorsed by the Finance Committee in July 2009.⁵

Improved recovery of indirect variable costs within the scope of the current Support Cost Policy

6. The Secretariat has identified measures which are being taken within the current scope of the support cost policy to improve the recovery of indirect variable costs, where the applicable PSC rate is less than 13 percent, by: centrally charging the costs of programme staff providing operational support to projects in country offices; and, calculating and centrally charging regional, sub-regional, and country offices for the costs of servicing space in premises.

Improved recovery of costs under an enlarged scope of the support cost policy

7. The internal review is further analysing categories of costs that have been until now largely excluded from the FAO policy on support costs, although such costs are normally recovered by other UN Organizations. These would represent an enlargement of the current list of

¹ CL 119/13 Annex II and subsequent refinements in CL 112/4 paragraphs 21-23; CL 128/4 paragraphs 20-25; CL 131/7 paragraphs 49-52.

² FC 135/5

³ C 2011/8 PIR 2008-09 paragraphs 310-314

⁴ FC 128/13

⁵ CL 137/4 paragraph 61

costs to be recovered under the FAO support cost policy, as previously endorsed in principle by the Finance Committee.

Deficit balances on Trust Funds

8. A particular area of financial risk which occurs in the context of the increase in Trust Fund activity is the risk associated with residual deficit balances on Trust Fund projects. Whilst over the years the Organization has minimised the occurrence of such instances, given the increasing volume of Trust Fund activity, it is essential that the risk be recognised and options to deal with the risk be considered.

Update on Proposals

9. The Secretariat will make an oral presentation of the outcome of the internal review and progress in putting in place measures to reduce the cost recovery gap of indirect variable costs within the current scope of the FAO policy on support costs. The Secretariat will also outline proposals for cost recovery under an enlarged scope, details of which will be provided at a future session.

10. The Secretariat will also bring to the attention of the Finance Committee the financial risk associated with residual deficit balances on Trust Fund projects which occur in the context of the increased volume of voluntary contributions and the intention to carry out further analyses of the matter with a view to presenting proposals to mitigate the risk.