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AGENCY OVERHEAD COSTS

Views of the Joint Inspection Unit

Note by the Administrator

At the request of the President of the Governing Council, the Administrator transmits herewith to the intergovernmental Working Group on Overhead Costs the text of a letter dated 7 November 1977 from the Chairman of the Joint Inspection Unit (JIU), together with the attachment containing views of the JIU on the subject of Agency Overhead Costs.

Communication from the Chairman of the
Joint Inspection Unit to the Administrator of UNDP
dated 7 November 1977

In reply to your letter of 21 September, I have pleasure in attaching a note containing the views of the Joint Inspection Unit on the question of overhead costs. This note is for submission to the President of the Governing Council for the attention of the intergovernmental Working Group.

These views should be regarded at this stage as preliminary since JIU will deal further with the issue of overhead costs as part of its study on the role of experts in development cooperation.

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Views of the Joint Inspection Unit on
Overhead Costs

1. This document is a response by the JIU to the request of the Governing Council to provide for the intergovernmental Working Group on Overhead Costs "views on the question of overheads including, inter alia, a clearer definition of the term 'overheads' and the cost elements involved" (E/6013/Rev.1, para. 348).
2. JIU confirms its previously stated view that the question of whether overheads should be reimbursed by UNDP or provided from the regular budgets of the Agencies is a policy question which can only be decided by the competent governing bodies in the light of decisions of the General Assembly. The views expressed herein are without prejudice to any decisions regarding this policy question.
3. The organizations of the United Nations system, each in its field, have over the years accumulated knowledge and experience which should permit them to make a unique contribution to technical co-operation. In addition, by their participation in technical co-operation, each Agency acquires practical experience which enhances its regular programme and thus its competence to advise developing countries on technical questions. Therefore, JIU believes that the United Nations organizations should continue to play a major role in technical co-operation and that in the future their substantive contribution should be reinforced.
4. There is no doubt that in order to play this role effectively the organizations require resources additional to those which are available in their regular budgets. However, in its report, under preparation, on the role of experts in development co-operation, JIU will suggest measures which could permit economies in both project and overhead costs aimed at increased cost effectiveness without detriment to the technical contributions of Agencies.
5. The existing formula for the reimbursement of overhead costs to Agencies, based on 14 per cent of project costs, represents a pragmatic compromise, and though in existence for some time it has no scientific basis. While having the merit of simplicity, even under traditional project execution, where a United Nations Agency provides all the international project inputs, this formula has defects. It provides the same percentage reimbursement for all projects regardless of the mix of project components. As a result, a project consisting largely of equipment or subcontracts for which Agency support is less costly may have the same overhead reimbursement as a project where experts predominate and for which Agency support is more costly. The deficiencies of the existing formula, for obvious reasons, will be accentuated if new dimensions providing greater variety in the methods of project execution, and particularly Government execution of projects, become a reality.

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6. Therefore, the time has come to devise a new formula for overhead costs. An outline of such a formula is presented below. Although it was devised for UNDP it could be adapted by each Agency for use in other technical co-operation work. As the work of JIU on the study on the role of experts in development co-operation proceeds with, in particular, the identification of innovative and alternative approaches to project execution, JIU might be later on in a position to make more detailed suggestions.

A. Definition of overhead costs

7. The Inspectors are aware of various definitions that have been suggested for overhead costs but note that the Governing Council feels that a clearer definition with cost elements is required. The dictionary definition of 'overhead costs' as "those the costs due to office expenses, management, interest on capital, and other general needs of a business" (Concise Oxford Dictionary) indicates that the term 'overhead costs' is not wholly appropriate in the context of reimbursement to Executing Agencies. It implies that these expenses are mainly administrative and non-technical. This is far from being true. The value of the United Nations Agencies involvement in UNDP rests upon their recognized technical competence and their contribution is both specific in relation to a particular project and broad as regards sectoral planning. Functions of the headquarters or regional offices of the Agencies are essential for the technical success of a project.

8. Other factors to be considered regarding overhead costs are:

8.1 A purely business relationship between UNDP and another organization of the United Nations family in fulfilment of their joint responsibilities under which there would be full reimbursement of costs, would be hardly appropriate.

8.2 Technical wisdom does not flow in one direction from Agencies to projects. The Agencies do not only give, they also receive. The involvement of the Agencies with projects gives them invaluable practical experience, the feedback from which increases their technical competence both to carry out their regular programmes and their role in technical co-operation.

9. Viewed in this perspective it would be fair to state that Agencies should be reimbursed more fully for expenditures directly related to the execution of projects and much less for their contributions to the programme as a whole. Furthermore, while they should be given funds needed for their role in technical co-operation they should also contribute from their own resources.

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10. In the light of the above analysis, the term "overhead costs" should be replaced by "support costs". Support costs may be defined as the sum total of expenses of a United Nations Agency incurred as a result of its participation in technical co-operation programmes. Support costs should be divided into two categories:

10.1 Programme support costs may be defined as that part of support costs devoted to functions of technical co-operation which are not directly related to specific projects but arise from the inherent competence and capacity of an organization in its particular field. See paragraph 11.1 for the components of programme support costs 1/.

10.2 Project support costs may be defined as that part of support costs directly related to specific projects. See paragraph 11.2 for the components of project support costs.

B. Components of support costs

11. The broad component of support costs as identified by JIU are listed below. Those marked by an asterisk (*) would be fully absorbed by an Agency; others could be subject to partial reimbursement in accordance with the system outlined in Part C.

11.1 Programme support costs

- * (a) Over-all direction, management and legal services;
- (b) Participation in programme planning; country programming, sectoral studies, etc.;
- * (c) Research in development questions;
- * (d) Technical documentation services;
- * (e) Participation in intergovernmental and interagency meetings on technical co-operation activities;
- * (f) Writing, translating and printing of documents not related to specific projects;
- (g) Over-all budgeting and accounting work for UNDP;
- * (h) Public information on technical co-operation activities;
- * (i) Office space, furniture, equipment, supplies, utilities.

1/ JIU notes that in many United Nations documents the term "programme support costs" has been used to mean all of the costs associated with support to UNDP.

* To be absorbed fully by Agencies.

11.2 Project support costs

(a) Technical project support

- (i) Participating in project planning;
- (ii) Technical support and supervision of experts and consultants;
- (iii) Advice on training programmes;
- (iv) Advice on equipment specifications;
- (v) Technical negotiation and supervision of subcontractors;
- (vi) Technical reporting, including preparation of reports;
- (vii) Participating in project evaluation, revision and planning of follow-up.

(b) Administrative project support

- (i) Recruitment of experts and consultants;
- (ii) Personnel administration of experts and consultants;
- (iii) Equipment purchase and inventories;
- (iv) Training and fellowship administration;
- (v) Administration of subcontracting;
- (vi) Project budgeting and accounting;
- (vii) Administration of miscellaneous component.

C. Outline of a new system for support costs

12. Programme support costs would comprise three elements:

- 12.1 A uniform, but small, reimbursement expressed as a percentage of total project costs for each Agency to partially compensate for work on country programming and related sectoral studies and for over-all budgeting and accounting work.
- 12.2 A special compensation for the smaller Agencies which do not benefit from economies of scale.

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12.3 Partial compensation to Agencies whose headquarters are located in high cost-of-living areas.

Although all organizations now receive the same percentage of project costs for their support activities, this income can buy more services in low cost-of-living duty stations. When the cost-of-living of the duty station is high, the support costs provided by UNDP fall short of meeting requirements. Therefore, a formula is required, based on the post adjustment system, to equalize the purchasing power of income from support costs between Agencies. The application of this formula would give a plus or minus adjustment to each Agency, depending on the post adjustment at its headquarters. The net effect of applying this formula would not increase costs.

13. Project support costs would be calculated for each project and the amounts of reimbursement would vary with the mix of project components and the type of execution (traditional or Government).

14. Support costs are used by Agencies to equip their headquarters and regional establishments for participation in UNDP. This requires the maintenance of an adequate level of capability at all times for supporting UNDP activities. Any rapid downward fluctuation in support cost income would create financial and organizational crises which could only disrupt the functioning of Agencies. To avoid this it is proposed that support costs reimbursed by UNDP should not, as a rule, decline by more than 10 per cent from one year to the next.

15. If a system such as that proposed above is adopted it would be expressed in a simple table which would be used to calculate support costs. The format is given in the attached table.

16. Reimbursement percentages are omitted from the table for the time being. They could be inserted later when information JIU is seeking from Agencies is obtained and analyzed.

17. The Inspectors stress that recommendations for decentralization made in many JIU reports would have the effect of reducing support costs. This aspect will be covered again by JIU in its report on the role of experts in development co-operation.

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Table for Calculation of Agency Support Costs

(Percentage figures to be inserted at a later date)

<u>Components of support costs</u>	<u>Percentage reimbursement</u>		of	<u>Project costs of part thereof</u>
	(a) Under traditional project execution	(b) Under Government execution		
I. <u>Programme support costs</u>				
(a) Participating in programme planning and over-all budgeting and finance	_____ %	_____ %	of	Project costs for all projects
(b) Smaller Agency compensation	Special formula			
(c) High cost-of-living compensation	Special formula			
II. <u>Project support costs</u>				
(a) Technical support <u>a/</u>	_____ %	_____ %	of	Total project costs
(b) Admin. support				
(i) Recruitment	_____ %	_____ %	of	Expert and Consultant component
(ii) Personnel admin.	_____ %	_____ %	of	" " "
(iii) Equipment procurement	_____ %	_____ %	of	Equipment component
(iv) Training and fellowship admin.	_____ %	_____ %	of	Training component
(v) Subcontract admin.	_____ %	_____ %	of	Subcontracting component
(vi) Budgeting and accounting	_____ %	_____ %	of	Total project costs
(vii) Miscellaneous	_____ %	_____ %	of	Miscellaneous component

a/ Includes estimates for items listed in para. 11.2(b).
