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AGENCY OVERHEAD COSTS

Statement by the Administrative Committee on Co-ordination
on the proposals of the Joint Inspection Unit concerning a
new system for agency support costs (DP/WGOC/21)

Note by the Administrator

The Administrator transmits herewith the statement by the Administrative Committee on Co-ordination (ACC) on the proposals of the Joint Inspection Unit concerning a new system for agency support costs (DP/WGOC/21).

Statement by the Administrative Committee on Co-ordination
on the proposals of the Joint Inspection Unit concerning a
new system for agency support costs

1. At its first meeting, held in January 1978, the Intergovernmental Working Group on Overhead Costs of the UNDP Governing Council formulated a series of requests for information and comments which it wished to consider at its second session, beginning on 5 June 1978. In particular it requested the executive heads of the organizations executing UNDP-financed projects to provide comments on a preliminary note of the Joint Inspection Unit on overhead costs, 1/ on the expanded note which was to be prepared by the Unit on the same subject, 2/ and on the Unit's forthcoming report on the role of experts in development co-operation. 3/
2. In connexion with this request ACC wishes to draw attention in the first instance to the general statement of policy on the financing of support costs for extrabudgetary activities which it included in its annual report for 1973-1974. 4/ It considers this statement to be still valid.
3. ACC welcomes the invitation addressed to its members by the Intergovernmental Working Group. It wishes, in view of its long-standing interest in the support costs question, to address itself collectively to the observations and recommendations of the Joint Inspection Unit in such a way that its views may be considered by the Intergovernmental Working Group and by the Governing Council before any decisions are taken. The present statement is addressed primarily to the expanded preliminary note on a new system for agency support costs (JIU/NOTE/78/1), which appears to supersede the previous preliminary note, and to the support cost aspects of the Unit's report on the role of experts (JIU/REP/78/3). In spite of the short time available, efforts have been made to ensure that ACC's comments would be ready in time for consideration by the Intergovernmental Working Group at its June 1978 session as requested.
4. ACC notes, as regards the United Nations, that the General Assembly has before it two comprehensive reports by the Secretary-General 5/ on services provided by the United Nations to activities funded from extrabudgetary resources. On the recommendation of the Secretary-General, supported by the Advisory Committee

1/ DP/WGOC/1

2/ Now issued as JIU/NOTE/78/1.

3/ Now issued as JIU/REP/78/3.

4/ E/5488, paras. 177-185.

5/ A/C.5/31/33 and Corr.1; A/C.5/32/29 and Corr.1.

on Administrative and Budgetary Questions, the General Assembly has deferred dealing with the question of reimbursement of support costs for extrabudgetary activities to its thirty-fourth session, pending receipt of the reports and recommendations expected from the Governing Council and the Economic and Social Council. The question of reimbursement of support costs will be dealt with by the General Assembly, as parent body of the Governing Council, and by the governing bodies of the other organizations, in the context of the broader question of the extent to which the organizations' regular budgets should bear the cost of support of extrabudgetary activities.

5. In the first of the two reports mentioned above, the Secretary-General indicated that he shared the view of the Advisory Committee on Administrative and Budgetary Questions and the Joint Inspection Unit that "the quantum, both as regards the level of reimbursement and the categories of costs it is designed to cover, is for decision by the legislative bodies". 1/ This is also the view of ACC. In addition, ACC fully subscribes to the position taken by the Advisory Committee on Administrative and Budgetary Questions in its review of the second of the Secretary-General's reports, that "any recommendation to modify the present arrangements for the reimbursement of overhead costs (which call, with certain variations, for the payment to the executing agencies of 14 per cent of the cost of the projects delivered by them) would need to take fully into account the position of the executing agencies". 2/ The Advisory Committee on Administrative and Budgetary Questions also stated that "the funding agencies could not assume that the executing agencies would be prepared automatically to bear any extra cost of the services they provided in support of technical co-operation programmes". 3/

1/ A/C.5/31/33, Annex A, para. 68.

2/ Official Records of the General Assembly, Thirty-second session, Supplement No. 8 (A/32/8/Add.9, para. 13).

3/ Ibid., para. 12.

I. General comments

6. As indicated in its annual report for 1973-74, ACC is aware of the general desire, which it shares, "to devote the maximum proportion of assistance resources to project activities and of the consequent necessity of keeping programme support costs to a minimum." 1/ In recent years organizations of the United Nations system have intensified their efforts to reduce costs, including operating costs, as a means of maintaining regular programme priorities while compensating for the effects of inflation and monetary instability. Support costs for extrabudgetary activities have been a primary target for such economy measures. This is mainly because inflation in project costs, on which support cost reimbursement is based, has been more than outweighed by the combined effects of inflation and monetary instability at the centres where support costs are chiefly incurred: this has put increasing pressure on the provisions of complementary support costs in regular budgets. According to the approximate estimates reported to the Advisory Committee on Administrative and Budgetary Questions, and published by it in its 1977 report on administrative and budgetary co-ordination of the United Nations with the specialized agencies and the International Atomic Energy Agency, the amount of regular budget subsidies to the cost of support of the extrabudgetary programmes of these organizations in 1977 was over \$40 million.2/

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7. The present formula for the reimbursement of support costs provides for reimbursement to organizations executing technical co-operation projects of the cost of project formulation and non-technical backstopping. The formula envisages that technical backstopping costs shall be regarded as part of the normal services of the organizations to their Member States, except where unusually large costs are involved, and that the cost of programme planning and of post-project evaluation and follow-up shall also be absorbed by the organizations. The formula is based on a weighted average of the support costs incurred by various organizations, as identified by the cost measurement system developed under ACC auspices. Accordingly, differences in support costs as between different projects and different organizations are automatically taken into account (if differential reimbursement rates were established to reflect these differences separately, some rates would have to be higher and some lower than the weighted average).

8. The main advantages of the present formula are that:

- (a) It is readily understood and simple to administer.
- (b) It reflects a direct relationship between support cost reimbursement and project costs and facilitates budgetary and organizational planning.

1/ E/5488, para. 184.

2/ Official Records of the General Assembly, Thirty-second Session, Supplement No. 315 (A/32/315, Chap. II, table C).

- (c) It sets a standard which permits both the organizations and UNDP to deal with the question of support costs for programmes financed from other extrabudgetary sources.
- (d) It embodies a sharing of support costs between the funding body and executing agencies.
- (e) It provides some flexibility to meet the special situation of some of the smaller organizations.

9. ACC believes that the situation of the smaller organizations, which have particular difficulties in absorbing the additional costs involved in the support of extrabudgetary programmes, continues to deserve special consideration. It would also welcome measures to alleviate the burden of those organizations whose support operations are performed at centres where, in dollar terms, costs are significantly above the average level reflected in project budgets and therefore in support cost reimbursements. In addition, consideration should be given to special arrangements in favour of organizations where support costs are increased because of the special characteristics of projects in their field of competence. However, ACC feels unable to support the measures by which such problems would be handled according to the Joint Inspection Unit's proposals on these points, since the proposed system appears to ACC defective both in concept and in detail.

10. The proposed system provides for adjustments in support cost payments taking account of economies of scale in the organizations' UNDP programmes, of the nature and size of the projects implemented, of the methods used for project execution, of variations in cost as between the headquarters locations of different organizations, and of the need for stability in the reimbursement of support costs to individual organizations from one period to another (paras. 14-33 of the note). These are important issues, and ACC has examined them as carefully as possible in the time available. In doing so it has been mindful of the opinion of the Advisory Committee on Administrative and Budgetary Questions that the Administrator of UNDP and the organizations should study the introduction of variable rates of reimbursement and report their conclusions to the Governing Council.^{1/}

11. Although the note frequently refers (e.g. in para. 5) to cost reduction, it does not propose any real economies in support costs as such. Application of the system recommended would involve transferring part of the burden of meeting support costs from one organization to another and from the States voluntarily contributing to UNDP resources to those financing the assessed regular budgets. To the extent that there are differences in membership of the organizations, and differences between the percentage assessment of Members for regular budgets and their respective percentage contributions to UNDP, the transfers would represent a shifting of financial burdens from some countries to some others.

^{1/} DP/77/Add.2, para. 11, DP/284, para. 11, and Official Records of the General Assembly, Thirty-second Session, Supplement No. 8 (A/32/8/Add.9, para. 15).

12. The Joint Inspection Unit remarks (paras. 6 and 52 of the note) that the present formula has no scientific basis. The system proposed is considerably more complicated, but not more "scientific". Both are based on the same cost measurement figures, supplemented by other data. The proposals introduce a multitude of reimbursement rates and adjustments (paras. 14-31; para. 41), but the rates and adjustments reflect judgements which are no more objectively valid than the choice of the present average rate of 14 per cent. Indeed, as indicated in the note, the rates proposed could be modified at will (para. 35).

13. Under the proposed system it would be extremely difficult both for the organizations and for UNDP to estimate in advance the amounts of the support costs that would be reimbursed, since many of the factors that would determine these amounts could not be predicted. This would be of particular concern in planning, programming and budgeting: among other things, in preparing regular budget estimates it is necessary to take account of estimated expenditures financed from all sources of funds, and governing bodies expect to receive information on such expenditures in the budget proposals submitted for their approval. For example, the proposed system would scarcely make it possible to foresee several years in advance, as would be necessary in drawing up the budget estimates, the effects for each organization of the formula calling for adjustments between the organizations. This is because this formula would among other things require a specially calculated average of post adjustments, "weighted by project costs", for all the headquarters duty stations. Other problems would result from the difficulty of estimating over the same period the types and project components of new projects or the effects of revisions in existing projects. No final calculations or adjustments of support cost reimbursements could actually be completed until all project accounts had been closed and audited. This process might take several years and the sums involved might be considerable. Furthermore, the complexity of the system, and the fact that two of its main features involve inter-organization transfers of support cost reimbursements, would make it impossible to apply the same arrangements to support costs for technical co-operation activities financed from other extrabudgetary sources of funds, particularly where only one donor and one organization are involved.

14. Among the differential rates of support cost reimbursement proposed is a series of special rates for application in the case of government execution of projects and execution of projects through co-operation agreements (paras. 24-26 and 41.2 of the note; passim in parts IV and V of the report on the role of experts). ACC firmly supports the principle that the organizations should give all necessary assistance to their Member States in the framework of such "new dimensions" of technical co-operation. It does not think that a complicated system of differential support cost rates can now be established in respect of the organizations' technical inputs, or that it need be even at a later stage, when enough experience has been gained to judge what the rates might be: in line with the thinking reflected in the present reimbursement formula, the general rule should be that technical inputs are provided free of charge. On the other hand, it is felt that a charge for support costs should be made as at present for any part of a project scheduled for government execution which an organization is in practice invited to implement.

15. In paragraphs 43-51 of the note the Joint Inspection Unit reverts to recommendations put forward in 1974 in its report on cost measurement systems in the organizations of the United Nations family and the possibility of developing them into cost-benefit systems integrated into comprehensive management systems (JIU/REP/74/7). One of the essential conclusions is that "cost measurement systems should be oriented towards individual projects" (para. 46). While various cost measurement systems are now being operated by some of the organizations, they could not in fact be adapted to provide measurement of support costs by project. Nor would the attempt to introduce any such system of measurement in all organizations be economically feasible or justified in cost-benefit terms.

16. ACC wishes to emphasize the position taken by the Advisory Committee on Administrative and Budgetary Questions in its review of the second report by the Secretary-General on services provided by the United Nations to activities financed from extrabudgetary resources:

In paragraph 22(a) of his report (A/C.5/32/29) the Secretary-General expresses the view that no satisfactory formula has been derived from detailed technical studies, exhaustive cost measurement exercises or indirect mathematical calculations and it is therefore highly unlikely that further technical studies would be productive. Determination of the level of reimbursement involves the exercise of political judgement by Member States; for this reason the Advisory Committee agrees with the Secretary-General's conclusion.^{1/}

^{1/} Official Records of the General Assembly, Thirty-second Session, Supplement No. 8 (A/32/8/Add.9, para. 14).

II. Comments on specific questions

Definition of support costs (paras. 8-12 of the note)

17. ACC accepts the proposed definitions of "programme support costs" and "project support costs" (para. 11), which are in line with the terminology already adopted by most of the organizations. As regards the listing of components of programme and project support costs (para. 12), a more detailed list of cost groups was developed by the Task Force on a Cost Measurement System established under ACC auspices, through close analysis of support operations. The indications concerning the cost components that would be absorbed by the organizations represent a departure from the thinking reflected in the present reimbursement formula (cf. para. 7 above), for reasons that are not explained. The approach to be taken in this matter would be a question for decision by the governing bodies.

Special features to be included in the new system (paras. 13-33 of the note)

18. Adjustment for economies of scale (paras. 14-18) - The Task Force on a Cost Measurement System recognized that "the total size of programmes administered had considerable bearing on the total cost of support. Economies of scale are achieved by agencies with larger programmes; a support service does not normally grow in cost proportionately to the value of the funds administered." The Task Force considered, however, that such economies of scale were "impossible to quantify", 1/ and there is no doubt that they are very difficult to isolate from other factors that affect the level of support cost expenditures. The Joint Inspection Unit correlates such economies with the organizations' relative shares of the UNDP programme, which might remain the same even if the UNDP programme greatly changed, rather than with the absolute scale of operations at which economies may in fact begin to appear. A solution to the problem of economies of scale would require a different approach. One factor that would need to be taken into account is the question of fixed and variable costs, with reference to the size of individual organizations. It would also be necessary to examine how far different types of support operations are susceptible to economies of scale. Further considerations would be the characteristics of the organization's field of specialization, the relative level of development of recipient countries, the involvement of administrations in project formulation and organizational arrangements for field operations.

19. Adjustment for nature and size of projects (paras. 19-23) - The Joint Inspection Unit proposes a formula under which projects of smaller than average size would receive proportionately higher support costs than the larger projects. ACC agrees that the size of projects influences the amount of support costs required and welcomes the Joint Inspection Unit's recognition of this problem, which is critical for those organizations which carry out a large number of small projects. ACC believes that a solution to the problem can be developed after due consideration of all its elements, including the difficulties of quantification and the demarcation between large and small projects.

20. Adjustment for method of project execution (paras. 24-26) - ACC has commented on this subject in paragraph 14 above.

21. Adjustment for variations in cost at agency headquarters (paras. 27-31) - As it has said above, ACC would welcome arrangements that would alleviate the problems caused by the declining purchasing power of support cost reimbursements at centres where support costs are chiefly incurred. In some organizations, for example, it has been estimated that the dollar cost of their professional and general service category support staff combined increased by approximately 180 per cent between 1970 and 1977, while the average cost of one expert man-year in the project budgets on which support cost reimbursements are based increased by approximately 90 per cent over the same period. Regular budget appropriations have had to meet such differences. The Joint Inspection Unit's complex formula would merely redistribute the sums reimbursed, to the distinct disadvantage of some organizations. ACC considers that a simpler formula, without this and other drawbacks, should be sought.

22. Stability of reimbursement of support costs (paras. 32-33) - Several organizations have suffered from sharp losses of support cost income owing to decreases in the size of their extrabudgetary programmes. An arrangement along the lines suggested, under which support cost reimbursements would not decline by more than 10 per cent from one budget period to the next, would be desirable whatever the reimbursement system adopted.

Calculation of support costs (paras. 34-51 of the note)

23. Project support costs as a part of project budgets (para. 42) - A practice under which provisions for support costs would be included in project budgets could be detrimental to the quality of projects and the efficiency of project implementation, in that it could encourage, as a major aim in project formulation, the maximizing or minimizing of support cost charges to IPFs.

24. Evolution of cost measurement systems (paras. 43-53) - The cost measurement systems recommended by the Joint Inspection Unit would be oriented towards individual projects and designed to produce cost information on such factors as the nature and size of projects, the mix of project components and the method of project execution (para. 46). To obtain such information it would be necessary to install new systems, much more elaborate than those operated so far by the organizations. In doing so it would be necessary to consider the interactions with information systems now in operation or in course of development, such as the Inter-Organization Project Register (CORE) project of the Inter-Organization Board for Information Systems and Related Activities and the Integrated Systems Improvement Project being carried out under UNDP auspices, as well as the programme and management and administrative systems of the various organizations.

25. On the basis of the present cost levels (the total cost of one professional plus one general service man-year at a high-cost duty station is currently about \$100,000), the total cost of installation and operation for one year of the kind of cost measurement systems envisaged could be of the order of several million dollars for the United Nations system. The funds would have to be provided out of the regular budgets of the organizations concerned, and allocated to cost measurement in preference to programme priorities, at a time when severe economy

measures, including staff cuts, have been put into effect in a number of organizations, when there is strong pressure to limit budget growth, and when means have to be found to meet sharply increased costs due to monetary instability and inflation.

26. The Joint Inspection Unit's proposals regarding the use of cost measurement systems as a management tool for improving the cost-effectiveness of operations were first put forward by it in 1974. The features of the proposals which are now under discussion were not endorsed by the governing bodies concerned, among other things because of the complexity involved in the development of methodologies for programme planning, implementation and evaluation, which depend on a wide variety of technical and social criteria, and the need to avoid over-elaborate and expensive cost measurement systems, the cost-benefit ratio of which might well prove to be unacceptable. The organizations have in the meantime turned their attention to other means of improving cost-effectiveness better adapted to their needs, and particularly to the development of information systems and evaluation. These have been considered to have a greater claim on the limited resources available at the present time.
