AGENCY SUPPORT COSTS

Report of the Administrator

INTRODUCTION

1. The Intergovernmental Working Group on Support Costs (formerly known as the Intergovernmental Working Group on Overhead Costs), at its second session held in Geneva in June 1978, requested the Administrator, in consultation with the Executing Agencies, and, if possible, with the Administrative Committee on Co-ordination (ACC), to recommend to the Working Group a modified formula for reimbursement of support costs to enable Governments members of the Working Group to formulate an inter-governmental recommendation to the Governing Council.

2. The decision of the Working Group specified that "any new reimbursement formula should be easy to understand, practical to operate and durable" and "that any new formula for reimbursement of programme and project support costs should be based as closely as possible on data on the costs incurred and should, to the extent feasible, take account of:

(a) Economies of scale, i.e. the scope for reduced reimbursement rates in respect of project expenditures in a given year beyond a stated total monetary level or levels, together with special provisions for the smaller Agencies;

(b) Nature and component mix of projects: for example, through the application of a lower percentage factor for equipment and subcontracts taking account, in this regard, of the practices already in vogue in many Agencies in respect of funds-in-trust and multibi projects; such lower percentage for equipment should not act as a disincentive to the inclusion of the desirable amount of equipment in projects, the final design and composition of which are the prerogative of the Government concerned;

(c) Method of execution: for example, principally, in cases of Government execution, the associated Agency would be paid support costs only in respect of specific inputs included in the project budget and delivered by the Agency at the request of the Government, the rate of reimbursement being according to the agreed new formula;"
3. The Working Group considered further "that the new formula could take account, but only if a simple way could be found, of variations in cost levels at headquarters of Agencies, of the provision of a measure of stabilization in the year-to-year variations in support cost reimbursements, and of the possible benefits to be derived from adopting a project rather than a programme basis for the calculation of support costs." 4/

4. The Working Group further requested the Administrator, "in consultation with the Executing Agencies and, if possible, with the ACC to review the question of the possible inclusion of support costs in project budgets." 5/

5. In accordance with the decision of the Working Group, the Administrator has held extensive consultations with the Executing Agencies on the items and issues underlined by the Working Group and cited in paragraphs 2 to 4 above. The first round of consultations consisted of asking the Executing Agencies to submit comments on the questions identified by the Working Group for consideration in connexion with a new reimbursement formula, and other relevant information. The views and comments received from the Executing Agencies were analyzed by UNDP and subsequently discussed at the meeting of the Consultative Committee on Administrative Questions (CCAQ) held in Rome in September 1978. It should be recalled that, in accepting the mandate given to him by the Working Group, the Administrator emphasized that he must have, in addition to clear guidelines from Governments, the full cooperation of all parties involved if the Working Group's request was to be met successfully. In this spirit, the Administrator reiterated, in the course of his consultations with the Agencies, that it was imperative that the System collectively evolved a modified long-term arrangement with which the organizations could work and which would be generally acceptable to Governments so that this issue might be put to rest.

6. Taking account of the views and positions expressed in the CCAQ, UNDP prepared a draft of the present report which was the subject of discussion at a special meeting of Agency representatives which was called by UNDP in New York on 3-4 October. At that meeting, the FAO representative expressed objection to the proposal in regard to economies of scale, while the United Nations representative stated reservations to any significant changes in present arrangements. The Administrator submitted his proposals to the ACC at its session held from 30 October to 1 November, together with a covering note which included the texts, agreed with the Agencies concerned, of the objections and reservations respectively of FAO and the United Nations. At the same time, in an effort to respond to the concerns expressed by those two organizations and to facilitate a consensus, the Administrator proposed certain transitional provisions which would substantially mitigate any sudden impact of the modified arrangements on other sources of funding. Extracts from the Administrator's covering note to ACC are given in Annex I to this report.


5/ Ibid., operative para. 6.
7. At the ACC meeting, the Director-General of FAO reiterated his Agency's objection to any adjustments for economies of scale and indicated that, as a matter of principle, FAO could not accept any enlargement of the current subsidy provided by the regular programme without the prior assent of its governing bodies. He further indicated that FAO delivery of UNDP-financed projects could reach $125 million in 1981, and between $150 and $200 million by 1982, and that the impact of the proposed adjustment for economies of scale for FAO could be a reduction of as high as $3 million. The proposed transitional provisions would not adequately meet the problem. The representatives of the United Nations and UNIDO, recalling that actual support costs in these organizations were substantially far in excess of 14 per cent, restated their reservations regarding any changes which would go beyond minor refinements to take account of special features of particular projects. The Administrator indicated that at a $150 million level of project expenditure, the reduction for economies of scale would amount to $1,375,000 against a total reimbursement of $21 million but that, under the suggested transitional arrangements, the $21 million reimbursement would be continued until the new formula itself produced that dollar amount of reimbursement, provided the expenditure level did not go below $150 million. The Administrator stated further that, given the FAO's strong objection to the principle of an adjustment for economies of scale and the fact that economy of scale was one of the criteria specifically set by the Intergovernmental Working Group, he could not see how a consensus could be reached. Other members of the ACC agreed that the views expressed should be reported to the Working Group.

8. With this background, the Administrator presents in this paper his proposals for a modified formula which the Working Group may wish to recommend to the Governing Council. Apart from the objections or reservations indicated above, all other Executing Agencies have indicated that they would go along with these proposals.

I. ANALYSIS OF AGENCY VIEWS ON POINTS IDENTIFIED FOR CONSIDERATION IN ANY NEW REIMBURSEMENT FORMULA

9. An important general consideration affecting the analysis is that numerous factors influence, in different ways and to varying degrees, the situation of the Agencies in regard to support functions for technical co-operation activities and thereby significantly detract from their comparability. Such factors include the size of the Agency's regular activities and budget; the volume of technical co-operation activities as well as the nature, type, size and diversity of projects they comprise; internal organizational structure and related arrangements; nature, extent and style of decentralization in the Agency; the range of disciplines covered by the Agency and the extent of interdisciplinary activities reflected in projects; the extent to which

6/ The new formula would produce $21 million reimbursement for a project expenditure level of $162 million.
projects handled by the Agency fall into clear-cut, specialized or even standard types; currency fluctuations and cost variations at the headquarters and other locations where support functions take place. All these elements affect the discussion of practically every issue or aspect included in this analysis.

Economies of scale

10. On the basis of a preliminary analysis of cost data, of which more will be said below, it was recognized that the proportional relationship between support costs incurred and the size of the programme delivered was not constant for all levels of activity. It was also recognized that, due to a variety of factors, including in particular currency fluctuations and cost variations at the headquarters of the various organizations, the points at which economies of scale, or the reverse, emerged were difficult to determine and therefore any limits below or above which differential scales would apply would have to be set somewhat arbitrarily.

11. For relatively small programmes, the organizations concerned felt that flexibility arrangements should continue to be based on actual incurred cost rather than on a theoretical model. It was also pointed out that for them, as well as others, a major cause of the higher costs incurred was the effects of currency changes at the centres where support work was performed. These organizations therefore preferred to negotiate individual higher levels of reimbursement with UNDP rather than to build positive adjustments into the reimbursement formula. It was suggested that the limit below which the flexibility arrangements would apply, which had been confirmed in 1975 at $10 million of annual project expenditure, should be raised.

12. For the larger programmes, there was general agreement that a formula incorporating the concept of economies of scale, through percentage reductions, once a certain level of delivery had been reached, could be considered if the amount at which the reduction would come into effect was set sufficiently high to ensure that extra support-cost burdens would not be placed suddenly on regular budgets. Agreement was also reached that the amount and formula established would not be subject to revision, save in exceptional circumstances, for at least 10 years. A graduated series of reductions was also envisaged. This approach accords with the recommendation of the Advisory Committee on Administrative and Budgetary Questions in its 1977 report to the Governing Council (DP/284, para. 11) that "the establishment of regressive rates of reimbursement, as suggested by the Administrator in paragraph 28 of his report (DP/259), need not necessarily be ruled out. The Advisory Committee recalls in this connexion that in its report to the Governing Council at its nineteenth session it had referred to the possibility of introducing a graduated rate of reimbursement of overhead costs (DP/77/Add.2, para. 11). The Advisory Committee recommends that the Administrator and the Executing Agencies study the possible introduction of the variable rates and report their conclusions to the Governing Council".

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Nature and component mix of projects

13. There was no consensus among the Executing Agencies on the validity of introducing differential rates of reimbursement according to the nature and component mix of projects. Attention was called to the additional cost accounting and related work that such a system would produce if it were to be related to individual projects. Furthermore, it was suggested that if lower reimbursement rates were to be adopted for some components, the rates for other components would have to be increased since the present 14 per cent formula represented an averaging out of the costs involved. Nevertheless, the organizations wanted to respond positively to the issue addressed by the Working Group, particularly taking account of present practices in many Agencies in regard to funds-in-trust and multibi projects. It was thus suggested that a lower rate could be applied where a project budget consisted primarily or entirely of equipment. The point was made that projects of this type should be excluded in the application of reductions for economies of scale in order to avoid a double adjustment.

Method of execution

14. Nearly all organizations maintained the view that the cost of services provided by the organizations in the context of Government-executed projects should be reimbursed. Specifically, there was a consensus that an Agency would be paid support costs at applicable rates from central UNDP resources only in respect of specific inputs included in the project and delivered by the Agency at the request of the Government. It was also agreed that the provision of technical advice should not be subject to reimbursement unless clearly identified additional costs (for example for consultants, travel, etc.) were incurred; costs in the latter event would be charged to the project budget.

Variations in cost levels at headquarters of Agencies

15. Attention was drawn to the dramatic situation created for a number of organizations, especially those located in Geneva, by the fact that support cost reimbursements in dollars calculated at a fixed per cent of project expenditures, also measured in dollars, have been producing less resources in the currencies of the headquarter stations of those organizations. However, there was no agreement on a simple way to deal with the problem as part of a standard formula. It was also pointed out that any new arrangements would take effect as from 1982 and it was difficult now to speculate on the nature of the problem or its impact at such future dates. For these reasons, the consensus that emerged was that it would be preferable to deal with any really hard problems of this kind through ad hoc arrangements, similar to the flexibility provisions in effect for the smaller programmes. In this connexion, it was recalled that the Governing Council adopted a decision at its twenty-fourth session in June 1977, in relation to the existing flexibility arrangements for support cost reimbursements that "cases of
particular hardship due primarily to currency fluctuation and heavy programme reductions should be dealt with on an ad hoc basis." 7/ A continuation of this arrangement appears to offer the best solution to the particular problems deriving from the high cost levels occasioned for a few Agencies by currency fluctuations at the locations where their support costs were primarily incurred.

Adjustments to promote stability in the level of support cost reimbursements

16. While virtually all Executing Agencies expressed their support in principle for arrangements under which significant declines in the level of support cost reimbursement from one budgetary period to another would be avoided, there was concern that these arrangements might complicate the formula. It was recalled that the proposals, in this regard, of the Joint Inspection Unit, which were supported by ACC, suggested variations of 10 per cent in the level of reimbursements as the maximum permissible from one financial period to the next. Considering all aspects of this matter, a provision of this kind was not regarded as having high priority.

Adoption of a project rather than a programme basis for the calculation of support costs

17. With the exception of the specific category of projects mentioned in paragraph 13 above, there was no support for this idea. It was pointed out that:

(a) So many factors influence the volume and intensity of backstopping and support required for individual projects, and so unpredictably, that no reliable over-all support cost formula could be developed at the project level; and

(b) The nature of non-technical support activities is such that the costs related to individual projects could not be identified.

18. Attention was drawn to certain consequences of attempting to calculate support cost at the project level, as follows:

(a) The timely and efficient establishment of project budgets, as well as project implementation, would be adversely affected;

(b) Considerable additional budgeting and accounting work would have to be undertaken, if at all feasible, and this would substantially increase support cost expenditures with no real benefit;

(c) Elaborate cost measurement systems would have to be installed by all Executing Agencies; geared to the production of data at the project level, such systems, in addition to being very expensive, could not produce anything other than information of doubtful validity and reliability.

Inclusion of support costs in project budgets

19. On this point, interagency consultations confirmed that no organization was in a position to support this idea. Quite obviously, if support costs could not be identified and isolated at the project level, there would be no possibility of including an appropriate amount in the individual project budget. In addition to the arguments put forth in paragraphs 16 and 17 above, it was considered that such a system could lead to protracted negotiations between Governments and Executing Agencies at all stages of the technical co-operation process, from project formulation and approval up to implementation and project revision, so that the efficiency of technical co-operation would be noticeably diminished. The system would be cumbersome to operate and would run counter to the goal of reducing support cost levels to a minimum.

20. As pointed out in paragraph 17 above, with regard to the difficulty in identifying the costs related to individual projects, it should be remembered that over the years, in most Agencies, technical assistance activities have been integrated with regular programme activities. Even in Agencies with separate technical assistance departments, some non-technical support activities, such as computer services, documents reproduction, etc. are performed centrally in other units of the organization. In view of the integration of technical assistance activities with the regular programmes of the Executing Agencies, the ACABQ, in its report on the subject of the proper rate of reimbursement of overhead costs, submitted to the nineteenth session of the General Assembly in 1964, had recommended that "the earlier formula of 'clearly identifiable' additional costs should be replaced by a percentage formula. In making that recommendation, the Advisory Committee recognized that the percentage of reimbursement would have to be based on empirical considerations, and reaffirmed the basic principle that the organizations should continue to provide from within their regular budgets for a substantial portion of the overhead costs of the extrabudgetary programmes (A/5842, para. 41)." (DP/77/Add.2, para. 6.)

II. EVOLUTION OF PRESENT FORMULA

21. It will be recalled from previous documents presented to the Governing Council and the Working Group (primarily DP/259) that the matter before the Working Group today has a history as long as that of UNDP and its predecessor organizations, Expanded Programme of Technical Assistance and the Special Fund. The solutions adopted over the years have been, of necessity, pragmatic rather than scientific, given the nature of the United Nations development assistance system which operates through separate organizations in partnership with Governments and UNDP.

Cost measurement systems

22. Cost measurement studies (CMS) were attempted as the result of growing concern over the years of the need for devising a more rational method of determining the reimbursement of overhead costs. In 1973, FAO, the ILO,
UNIDO, the United Nations and WHO introduced a cost measurement system that had been elaborated by a CCAQ Task Force created for this purpose. The ILO, FAO and UNIDO continued full CMS studies in 1974; WMO established a CMS in 1974. In 1975 and 1976, FAO, UNIDO and WMO continued with CMS. Guided by the initial results of the cost measurement studies carried out in 1973, the Governing Council, at its nineteenth session in January 1975, authorized the present reimbursement rate of 14 per cent for the years 1974-1977. At the time, it was acknowledged that this was a temporary pragmatic solution since CMS studies indicated that the order of magnitude of support costs being incurred by the Executing Agencies showed considerable variations but was substantially higher than 14 per cent.

23. In commenting on the results of the cost measurement studies in 1976, the ACC (DP/207, para. 16) considered "that the cost measurement studies carried out so far have been useful in providing organizations, their governing bodies and the Governing Council of UNDP with information on programme support costs". When discussing the continuation of CMS reports, the ACC stated that "the principal purpose of such reports would be to assist the organizations in improving the management and control of their programmes". It went on to state that "the ACC has difficulty with the continued emphasis in the cost measurement system on the very detailed measurement and analysis of such costs. Such detailed studies might divert human and financial resources of other important areas of management which have been identified by the JIU and are supported by the organizations as directions in which further work should be oriented." (Ibid., para. 17.)

24. In 1978, in commenting on the proposals of the JIU concerning a new system for Agency support costs, the ACC emphasized the position taken by the ACABQ in its review of the second report by the Secretary-General on services provided by the United Nations to activities financed from extra-budgerary 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 conclusions." (DP/WGOC/22, para. 16.)

25. In view of the foregoing, and in light of further consultations with the Executing Agencies and the ACC, the Administrator must proceed on the basis that further elaborate cost measurement studies will not be undertaken and that, therefore, a pragmatic approach, based, to the extent possible, on readily available cost data, is the best way to finding a reasonable means of modifying the present arrangements for the reimbursement of support costs.

8/ UNDP reported to the Governing Council (DP/259/Add.2) the results of the CMS exercise in those Agencies which continued to carry them out.

III. SITUATION PREVAILING TODAY

Organizational structure of the Executing Agencies

26. At its second session, in June 1978, the Administrator transmitted to the Members of the Working Group information describing the organizational and other arrangements which exist in each Agency to provide support to technical co-operation activities of UNDP and other organizations, and information with regard to how each Agency treated the payment of support cost reimbursements in terms of its budget framework (DP/WGOC/19 and Addenda 1-6). It will be recalled from these documents that there is no one way in which technical co-operation activities are handled by the Executing Agencies. In some Agencies the work is integrated with the regular programme of activities of the Agency; in other Agencies, although separate departments of Technical Assistance have been created, certain supporting administrative functions (such as accounting, computer services, legal services, etc.) are performed by other units of the organizations in integrated fashion for all activities. Some Agencies distinguish between technical assistance programmes executed on behalf of UNDP and those from other sources of funds; others do not. Some Agencies have decentralized their support activities to other locations; others have not. Budgetary practices are as varied. Some Agencies consider support cost reimbursements as miscellaneous income to their regular budgets; other Agencies attempt to show programme costs by source of funds, thus showing income from support cost reimbursements against the programme concerned. It is impossible, therefore, to produce a set of comparable cost data for the various Agencies; what is included in one Agency's figures is not necessarily the same information for another. As already pointed out, cost measurement studies tried to cut across these lines but involved such a considerable amount of time, effort and expenditure with results of doubtful value that they have been abandoned in virtually all Agencies.

Available cost information

27. In order to satisfy the Governments, the Agencies and UNDP itself that the modified proposals being made are reasonably consistent with realities, the Administrator asked the Executing Agencies to provide him with the following information for the years 1975, 1976 and 1977 (and 1978, in some cases) in order to determine broad orders of magnitude of costs in relation to programme activity:

(a) Estimated support costs in relation either to the Agency's total technical co-operation activities or specifically to UNDP's technical co-operation programmes to include non-technical backstopping in terms of personnel, fellowships, equipment procurement, subcontracting, finance and accounts, data processing, and project formulation;

(b) Total estimated cost of procurement operations related to the total cost of supplies and equipment purchased;

(c) Total estimated cost of subcontract operations related to total cost of subcontracts.

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28. The Administrator, in keeping to the Working Group's decision that any new formula should be based as closely as possible on cost data, was particularly interested in data which would be relevant to the issues of economies of scale in organizations with large programme deliveries, and special treatment of the equipment and subcontracting components of projects.

29. In view of the caveats pointed out above, particularly the difficulties involved in comparing data from organizations with programmes and practices of such a diverse nature, only broad indications on an over-all and general basis are available regarding total support costs in relation to programme delivery. Some Agencies have attempted to extrapolate, on a sampling basis, the proportion of support costs to all, or in some cases only UNDP, technical assistance activities of the Agencies for the years 1977 and 1978. For the larger Agencies, the figures show ranges from 17.4 per cent to 34-36 per cent with intermediary figures of 20-24 per cent. With respect to smaller Agencies with programmes of at least $1 million, and for which more precise cost data are available due to the requirements of the flexibility provisions, the relationship between total support costs to UNDP delivery ranges from 17 to 23 per cent. It is clear from these figures that for nearly all Agencies, over-all costs of support activities continue to run in excess of the present 14 per cent reimbursement rate. It should be recalled, however, that 1977 and 1978 is a period in which the programme is still recovering from the financial difficulties of earlier years and has not yet returned to its full delivery potential.

IV. ELEMENTS OF A MODIFIED FORMULA

30. After consulting with the Executing Agencies, and despite the absence of a consensus, the Administrator believes that a modified formula for the reimbursement of support costs, reflecting in one way or another the primary elements emphasized in the Working Group's decision as quoted in paragraph 2 of this paper, and which could be applicable, should the appropriate authorities so decide, to technical co-operation activities financed from other extrabudgetary resources as well should be considered. At the same time, the Administrator has concluded, as a result of his discussions with the Agencies, that it would be impractical and speculative to build into a modified formula variations due to currency fluctuations, or to provide for stabilization with regard to the size of support cost reimbursements from one period to another, or to include support costs in project budgets, particularly due to the difficulties of identifying and calculating these costs on a project-by-project basis.

31. Thus the modified arrangements would provide for:

(a) A regressive scale of reimbursements after annual project expenditures in an Agency reach certain specified levels;

(b) Flexibility arrangements for positive adjustments, based on actual costs, for those Agencies handling relatively small programmes;
(c) Application of a lower rate to those projects which comprise primarily or entirely the procurement and administration of equipment and/or subcontracts;

(d) Reimbursement for support costs to an Agency, in respect of Government-executed projects, only in respect of specific inputs included in the project budget and delivered by the Agency at the request of the Government.

Economies of scale

32. In analyzing the data for the years 1975, 1976 and 1977, the Administrator endeavoured to determine to what extent, if any, increases or decreases in the level of programme delivery affected the relative proportion of support costs. No clear-cut pattern of expenditure emerged and it was difficult to measure changes in the relationship between the level of delivery and support costs, due in large part to currency fluctuations and inflation as well as the other variables referred to in paragraph 9 above. Although the Administrator is fully cognizant of the effects of these variables, he considers it impracticable to take all of them into consideration in a simple formula. Nevertheless, there are indications that when the volume of activity increases in an Agency, the proportion of support costs does not increase in the same ratio if other special factors do not significantly distort the situation.

33. Below a certain level of programme delivery, infrastructure costs must be maintained at a defined minimum level regardless of the amount of programme delivery. For this reason, the Governing Council has authorized flexibility provisions for smaller programmes. At the present time, the flexibility arrangements apply to annual programmes under $10 million, a limit which was confirmed by the Governing Council in January 1975. In view of the fact that any modifications to the present arrangements will take effect only in 1982, the Administrator proposes that this limit should be raised to $15 million to account for inflation during the period since 1975. The Administrator would further propose that the Governing Council should continue the delegation to him of the responsibility for negotiating with the Agencies concerned the amounts of reimbursement under the flexibility arrangements which would, in all cases, be based on detailed information with respect to costs incurred, as is now the case, and that the Administrator would inform the Council of the agreements he has reached. In view of the Council's decision to meet annually, this would facilitate planning within the Agencies concerned. Any situation outside of this framework would of course continue to require ad hoc Governing Council consideration and decision.

34. On a purely pragmatic basis, it is reasonable to assume that after a certain level of programme delivery, support costs do not increase in the same proportion as increases in the level of delivery, particularly as Agencies continue to review and improve their procedures. Although, as already pointed out, there is no way to determine the exact point at which
the ratio of the costs incurred to the delivery base decline, it is logical to believe that plateaus are reached above and below which lesser or higher cost ratios are incurred. For example, if a programme above a certain level were doubled, the corresponding support costs incurred, in all likelihood, would not double.

35. A pragmatic approach must be used to establish the plateaus beyond which reduced reimbursements may be contemplated. The Administrator would propose that the present rate of 14 per cent be maintained for programme deliveries up to $50 million, subject to the flexibility arrangements for the smaller Agencies described earlier. At least one Agency with a programme delivery presently around the $15 million level has informed the Administrator that it has continuously "lived within" its overhead reimbursements, and believes that, with a technical co-operation programme steadily increasing in size, the appropriate percentage is about 14 per cent under prevailing conditions. Other small Agencies, especially at higher cost locations, have had to rely on additional support under the flexibility arrangements or by ad hoc decision of the Governing Council. The suggested figure of $50 million for the first plateau allows for a programme more than three times the maximum envisaged for flexibility arrangements; by the $50 million level some decline in proportionate costs should begin to emerge.

36. Beyond $50 million, which is double the present delivery level of several Agencies, the amount of delivery between $50 and $75 million would be subject to only 13.5 per cent reimbursement, the amount between $75 and $100 million subject to 13 per cent reimbursement, and the amount over $100 million subject to 12 per cent reimbursement.

37. Inasmuch as the modified arrangement elaborated in this document provides for a substantially lower rate of reimbursement for projects which consist primarily or entirely of equipment and subcontracts, the monetary value of such projects should be excluded in the determination of the plateau levels in each Agency for purposes of application of the regressive scale.

Component mix of projects

38. As pointed out in paragraph 13 above, there was general agreement that the equipment, and, in some Agencies, the subcontract components, are less costly to administer than are other components. The support operations for these components also may be isolated for the purpose of estimating costs more easily than costs for other support activities. Cost data received from the Agencies appears to bear out this statement. Either on the basis of costs incurred for the procurement of all equipment and supplies for the Agency, or only for technical co-operation activities, the average costs for the period
1975-1977, as reported by the three Agencies with the largest programmes, ranged from 3.3 per cent to 10 per cent. For most other Agencies, costs were in the 6-9 per cent range, with the exception of one Agency which, due to a special situation, reported a higher proportionate cost for this operation.

39. There was general agreement on the suggestion that a lower reimbursement rate could be applied where a project budget consisted primarily or entirely of equipment and/or subcontracts. The Administrator believes this to be a viable and practical suggestion, not only in the light of the cost data supplied, but also because this is already the practice in many Agencies with respect to certain projects executed under funds-in-trust arrangements.

40. The arrangements currently in force in some of the Agencies with regard to the reimbursement for support costs relating to non-UNDP extrabudgetary technical co-operation activities are summarized below:

- United Nations - no exceptions to 14 per cent;
- ILO - generally 14 per cent, but for projects involving primarily the funding of staff at headquarters, 5 per cent;
- FAO - normally applies 14 per cent but exceptions are:
  - Associate Expert Programme - 12 per cent;
  - where the supplies/equipment represents an amount of 70 per cent or more of the net project value - 5 per cent for whole projects;
  - where supplies/equipment component represents an amount between 40-70 per cent - 5 per cent for equipment/supplies, 14 per cent on other components;
- UNESCO - the normal rate charged is equivalent to 14 per cent of total project funds, however, if a project consists exclusively or very largely on the procurement of equipment and supplies, the rate charged is 8 per cent, if a project requires very little direct supervision, the minimum rate charged is 5 per cent;
- WHO - 14 per cent is normally applied to all programmes (for Associate Experts, 12 per cent);
- IBRD - for experts provided by the Bank's Agricultural Development Service in Eastern Africa and at Agricultural Project Management Unit in Western Africa, the Bank charges full direct costs plus 14 per cent; on UNDP programmes, the Bank receives 11 per cent;
ITU - applies 14 per cent to all funds-in-trust programmes except:
  - Associate Expert Programme 12 per cent;
  - in two cases where the equipment represented over 50 per cent of the net project value the percentage applied to the equipment component was reduced to 7 per cent;

ICAO - applies 14 per cent to all funds-in-trust programmes except:
  - Associate Expert Programme 12 per cent;
  - a regressive percentage on major items of equipment in excess of $10,000 purchased under the Civil Aviation Purchasing Service (CAPS), plus additional percentage charges as appropriate to cover such services as inspection of equipment, preparation of detailed specifications, preparation of detailed design for systems, factory progress review, final acceptance of equipment and on-site visits;

WMO - Funds-in-trust are generally at 14 per cent, but in some projects in which large quantities of equipment are purchased or other large expenditures are made without a corresponding increase in administrative action at WMO headquarters, a lump sum to cover support costs is negotiated on a case-by-case basis;

UNIDO - generally 14 per cent - Associated Experts 12 per cent;

For projects financed by it, UNFPA pays 14 per cent to the United Nations, while, for the other Agencies, UNFPA reimburses the administrative and technical costs associated with the implementation of its projects by means of infrastructure support projects, negotiated yearly, rather than overhead payments. On Government-executed and NGO-executed projects, no overhead is charged, but the administrative costs associated with the execution of the projects may be included in the project budget.

41. In the light of the practices generally being followed by the Agencies, as cited above, and in the interest of simplicity and practicability, particularly in the absence of any concrete indications of the support costs involved in administering the other components, the Administrator would propose a flat rate of reimbursement of 7 per cent for projects comprised of 75 per cent or more of the equipment and/or subcontract components. These projects can be isolated easily by computer (or manually in smaller Agencies) or at the time of approval and no extraordinary accounting procedures need to be instituted by the Agencies to cope with them. As stated earlier, the Agency's total delivery would be reduced by the amount of these special projects before applying the adjustments proposed under economies of scale in order to avoid a double adjustment.
42. For Agencies dealing primarily in subcontracting, the experience has been that the negotiation, administration, monitoring and supervision of subcontracts cost substantially higher than support in respect of equipment purchases. It is proposed that the present special arrangement providing for a consolidated, reduced rate of 11 per cent reimbursement should continue in respect of IBRD. The present arrangements for approval by the Governing Council of the annual budget estimates in respect of support services for UNDP/OPE projects should also be continued.

Method of execution

43. With regard to Government-executed projects, the Administrator, in line with the suggestion of the Working Group, proposes that an Agency be paid support costs at applicable rates from central UNDP resources only in respect of specific inputs included in the project and delivered by the Agency at the request of the Government. The provision of technical advice should not be subject to reimbursement unless clearly identified additional costs (for example for consultants, travel, etc.) were incurred; costs in the latter event would be normally charged to the project budget.

Variations in cost levels at headquarters of Agencies

44. In view of the difficulties in finding a simple way to deal with this problem as part of a standard formula, and as any long-term view of the problem of currency fluctuations would be highly speculative, the Administrator proposes that the Governing Council should continue with the ad hoc arrangements currently followed, and that these be extended to all cases of particular and demonstrated hardship due primarily to currency fluctuations. All such cases should be submitted to the Governing Council for consideration and decision, except those Agencies already covered under the small programme flexibility provisions.

V. CONCLUSIONS

45. In the foregoing paragraphs, the Administrator has endeavoured to show how he arrived at the proposals he is making. Extensive consultations were held with the Executing Agencies in a spirit of full co-operation and with an awareness of the integral nature of the objectives of the System as a whole. Agencies recognized the need to respond positively to the concerns expressed by the Governing Council and the Working Group and to reconcile these concerns with those of their own governing bodies. The proposals being made at this time reflect the principal elements contained in the Working Group's decision, to the extent it was possible to obtain a consensus among the Agencies, bearing in mind the impact of these arrangements on their assessed regular budgets. It was noted in this connexion in many Agencies, even under the present reimbursement arrangement, that certain of the total support costs are being met by their regular budgets. In addition, the costs of policy making organs, co-ordination and executive policy management in many Agencies have traditionally been accepted as chargeable to the organizations' regular budgets.
46. To summarize, the main points of the modified formula, which the Administrator is proposing to the Working Group, and which it may wish to recommend to the Governing Council for approval, are as follows:

A. **Flexibility arrangements**

Agencies with annual programme delivery levels below $15 million would be reimbursed in excess of 14 per cent upon presentation of detailed cost information justifying the increased reimbursement. The Administrator would authorize the amount of reimbursement and would inform the Governing Council of this action. Cases of special hardship arising from significant currency fluctuations and not already covered by the foregoing flexibility provisions would be referred, on an ad hoc basis, to the Governing Council.

B. **Economies of scale**

Agencies with annual programme delivery levels between $15 and $50 million would receive, subject to C below, reimbursement at the rate of 14 per cent of programme delivery. For the $25 million portion between $50 and $75 million delivered, the reimbursement rate would be 13.5 per cent; between $75 and $100 million, the reimbursement would be at the rate of 13 per cent; and the amount over $100 million would be reimbursed at 12 per cent.

C. **Nature and component mix of projects**

For projects consisting of 75 per cent or more of equipment and/or subcontract components, the reimbursement rate would be 7 per cent of total project costs. The totality of these projects would be excluded on an Agency-by-Agency basis before reductions were made with respect to economies of scale.

D. **Special arrangements with IBRD and UNDP/OPE**

The present special arrangement providing for a consolidated, reduced rate of 11 per cent reimbursement would continue in respect of IBRD. The present arrangements for approval by the Governing Council of the annual budget estimates in respect of support services for UNDP/OPE projects would also be continued.

E. **Method of execution**

In the case of Government execution, Agencies would be reimbursed 14 per cent of the amount of the project elements they were asked to execute on behalf of the Government unless the services were provided for the procurement of equipment in which case the reimbursement rate would be 7 per cent.

F. **Date of application**

The modified formula would take effect as from January 1982 and would remain in force for the succeeding two IPF cycles, i.e. until 1991. In 1989, the situation would be reviewed and a decision would be taken with respect to the period beyond 1991.
ANNEX

Extracts from the Administrator's covering note submitted to the Administrative Committee on Co-ordination

1. At the meeting held on 3-4 October, there was general recognition that the draft paper properly reflected the broad consensus in the CCAQ discussions in Rome in September in regard to the nature of the modifications proposed in the reimbursement system for support costs.

2. However, as to the specific proposals, the FAO representative expressed strong objections to the proposal to provide for economies of scale, in any case, the proposals in paragraphs 34-35:

   (i) Were based on an erroneous principle in that they did not provide for diseconomies and economies of scale starting from support costs above, say, the first $20 million;

   (ii) Must be viewed against the fact that even at the present rate of reimbursement an unfavourable burden was placed on the regular budget;

   (iii) Gave the impression of being applicable primarily to FAO; and

   (iv) Taking account of delivery trends as of 1982, the proposed date of effecting the changes were not realistic and would place an unreasonable impact on FAO.

The principle of the whole proposal to introduce any economies of scale was not, however, accepted by FAO.

3. The representative of the United Nations also expressed strong reservations with regard to the proposals in connexion with economies of scale on the grounds that the United Nations had no basis so far for any conclusion that its programme delivery had reached a level where economies of scale would begin to take effect. Furthermore, the representative of the United Nations drew attention to the continued position of the Secretary-General that a single rate of reimbursement with such minor modifications as may be agreed upon between the Agencies and UNDP to meet exceptional circumstances is the best solution to the question of support costs. He also pointed out that the Controller of the United Nations was not prepared to commit the Secretary-General to a proposal which would have the effect of imposing additional support costs of technical co-operation activities upon the regular budget of the United Nations. Finally, the United Nations did not consider it appropriate at this time to join in a recommendation of the Administrator since the Secretary-General would be submitting to the thirty-fourth session of the General Assembly any observations or recommendation he might deem appropriate regarding this question.
4. The UNDP representative assured the interagency meeting that the draft proposals had been made in line with the criteria in the Intergovernmental Working Group's decision and the recommendation of the ACABQ in favour of regressive scales of reimbursement. The proposal on economies of scale was based also on the reasoning that if $15 million represented the limit below which special payments might be provided, economies of scale should be recognized at least at three times that level. On the other hand, the regressive scale could not be established in such a way that for most organizations it would produce a higher reimbursement than the 14 per cent. Moreover, by 1982, several organizations would in all likelihood have reached the $50 million plus level. It was also pointed out that the reduction from the current reimbursement level in respect of $100 million of delivery would be only $375,000 against a total reimbursement, at current rates, of $14 million.

5. Representatives of other organizations indicated that they would generally go along with the proposals with some minor modifications which were agreed to at the meeting and are now reflected in the attached draft.

6. The Administrator has reviewed the situation in the light of the position of FAO and the United Nations as indicated above. Recognizing the problems of transition to a modified arrangement, the Administrator is prepared to recommend to the Working Group that, for every Agency, the dollar amount of reimbursement in 1981 under the current formula should be safeguarded, so long as the annual total of project expenditures for that Agency continues to remain at or above the 1981 level, until such time as the application of the modified formula produced the 1981 amount of reimbursement.