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AGENCY OVERHEAD COSTS

Resume of the background of the question of agency overheads

Note by the Administrator

RESUME OF THE BACKGROUND OF THE QUESTION OF AGENCY OVERHEADS

1. The UNDP and its predecessor organizations, the Expanded Programme of Technical Assistance (EPTA) and the Special Fund, have been seized nearly since their inception with the question of a suitable definition of overhead, and of finding an equitable formula for the reimbursement of the costs involved.

EPTA

2. The 1949 resolution establishing the Expanded Programme of Technical Assistance (EPTA) in 1950, ECOSOC 222 (IX) endorsed by General Assembly resolution 304 (IV) contains the first reference to what was to become the overhead question in paragraph 8 which refers to the setting up of a special account for the credit and transfer of funds to be used for the technical assistance programme covered by the resolution and "for administrative expenses connected therewith." These "administrative expenses" were not defined but Annex I of the resolution goes on to refer to the principle that "...the work undertaken by the participating organizations under the Expanded Programme of Technical Assistance should be such as to be suitable for integration with their normal work", and that "...within the wide range of activities envisaged the participating organizations should practise, especially in the initial stages of their programmes, concentration of effort and economy. The participating organizations should also ensure the fullest use of any existing facilities".

3. This broad guideline was subsequently interpreted by the Technical Assistance Board, in October 1950 (TAB/R.50/Rev.1) as meaning "chargeable expenditures should be limited to those direct additional and exclusive costs" although the Board did not establish any criteria for calculating these costs.

4. By 1952, there was recognition that the administrative costs associated with EPTA activities warranted scrutiny. General Assembly resolution 594 (VI) provides, inter alia, that "...the administrative part of the technical assistance programme financed by voluntary contributions and executed by the United Nations shall be subject to the same scrutiny on the part of the Advisory Committee on Administrative and Budgetary Questions as that applied to expenses proposed under the regular budget". It was in this manner that ACABQ came to be responsible for studying and reporting to the General Assembly on the administrative practices and expenses of EPTA and other operational programmes financed by voluntary contributions. In 1954, in its report to the General Assembly (A/2661, para. 22) the Advisory Committee suggested the figure of 12 to 14 percent of project costs as a reasonable one for calculating the amounts payable from the voluntary funds towards "support costs". This recommendation was based upon the knowledge that Agency support costs at that time averaged some 16 percent which the Committee suggested should be reduced by introducing economies and improving efficiency, thus bringing these costs down to the level of reimbursement recommended.

In 1959, ECOSOC resolution 737 (XXVIII) set the limit for the reimbursement for administrative and operational service costs of the participating organizations at 12 percent of project allocations, including local cost assessments. It was recognized at the time that this was an interim solution of the problem.

Special Fund

5. General Assembly resolution 1240 (XII) of 1958, which created the Special Fund, did not clarify the question of overheads. Paragraph 29 of part B of this resolution states:

"For other services, the Managing Director shall rely as far as possible on the existing facilities of the United Nations, the Specialized Agencies, the International Atomic Energy Agency, and the Technical Assistance Board. These facilities should be made available to the Special Fund without charge except where clearly identifiable additional expenses are involved..."

6. In endeavouring to determine the amount of "clearly identifiable additional expenses" to be reimbursed to the executing agencies in connexion with the execution of projects, and in recognition of the nature of Special Fund projects, a "rule of thumb" formula emerged under which costs were reimbursed in the amount of 2 percent of purchase cost for equipment and supplies and 10 percent of all other project costs (E/3398 and SF/L.119) except those related to the use of sub-contractors where ad hoc rates of reimbursement were negotiated by the Managing Director with the Executing Agencies.

7. In 1963, the Governing Council of the Special Fund approved an increase in the formula of up to 3 percent of the cost of equipment and supplies, and up to 11 percent for other costs including the retroactive application of the liberalized formula to all earlier programmes (E/3789, paras. 66-68). The question of the level of reimbursement was to be re-examined not later than 31 December 1965. At its 14th Session, in 1965, the Governing Council decided to authorize the reimbursement of overhead costs by the Special Fund at the rate of 11 percent of total project costs commencing with the June 1965 programme (E/5185/Rev.1) pursuant to recommendations of the Advisory Committee on Administrative and Budgetary Questions contained in its twenty-second report to the nineteenth session of the General Assembly (A/5842). This rate was still considered inadequate by the Agencies. The report also recommended an increase in the rate for reimbursement of overhead costs with respect to EPTA to 13 percent of project costs for 1965, and for subsequent years to 14 percent. The ACABQ recognized the difficulty in identifying overhead costs and expressed the view that "...the original formula (through which these costs were billed to the funding agency) in so far as it relates only to additional costs which are 'clearly identifiable' is no longer appropriate as a result of the integration of the overall activities undertaken by the Organization" (A/5842, para. 41a). Furthermore, ACABQ also

felt that "...the basic principle that the organizations should continue to provide from within their regular budget for a substantial portion of the overhead costs of the extrabudgetary programmes remains valid" (Ibid. para. 41b).

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8. In the twentieth session of the General Assembly, held in 1965, by resolution 2029 (XX), the United Nations Development Programme was created through the consolidation of the Special Fund and the Expanded Programme of Technical Assistance. Paragraph 2 of the resolution "Reaffirms the principles, procedures and provisions governing the Expanded Programme of Technical Assistance and the Special Fund not inconsistent with the present resolution and declares that they shall continue to apply to relevant activities within the UNDP". The resolution did not deal specifically or anew with the question of overheads and the separate components of the consolidated programme continued to reimburse overhead costs according to the 1965 formula, i.e. up to 14 percent for the EPTA component and 11 percent for the Special Fund. The Consensus, adopted by the General Assembly in resolution 2688 (XXV), in addition to erasing the distinction between EPTA and the Special Fund did instruct the Administrator, in consultation with the participating and executing agencies and the ACABQ, to take steps to establish new methods for reimbursing agencies for their overhead costs (para. 33 of the Consensus refers).

9. In response to the foregoing decision, the Administrator recommended to the Governing Council at its twelfth session a single composite rate of 12 percent to apply as from 1 January 1972. The Council adopted this as a standard figure initially for the years 1972 and 1973, and at the same time approved a temporary addition of one percent. Based on findings from the cost measurement system which showed that agency support costs averaged some 23 percent (see para. 11 below), the Governing Council at its nineteenth session held in January 1975 (E/5646, para. 353), authorized the "reimbursement of agency overhead costs incurred by the agencies for the years 1974-1977 at the rate of 14 percent of actual project costs" but recommended that the cost measurement study be continued in order to find a better reimbursement formula. 1/

Cost Measurement System

10. The cost measurement study was the result of growing concern over the years of the need for devising a less arbitrary method of determining the reimbursement of overhead costs. In 1969 (JIU/REP/69/2), The Joint Inspection Unit pointed out that "...the problem of arriving

1/ At its 24th session (June 1977) the Council decided to establish an intergovernmental Working Group on Overhead Costs to examine comprehensively all aspects of this overheads question and report back to the June 1979 session; it also decided to continue the existing reimbursement arrangements for the years 1978 and 1979. (E/6013/Rev.1, para. 348).

at an average rate to be used in the reimbursement of overhead costs for support to operational activities is insoluble in the absence of an itemized cost accounting system or some other system of measurement which would provide the necessary information upon which to base the determination of such reimbursement rates".

11. The report was followed up in 1971 with a study group in which representatives of UNESCO and WHO participated. The group's recommendations led to the creation in 1972 of a CCAQ Task Force under the auspices of ACC dedicated to the development and introduction of a cost measurement system which could be used for management decisions and cost control purposes. The task force consisted of members from the larger participating organizations, supplemented from time to time by officials from other agencies. It established functions, or stages, of carrying out technical co-operation activities and defined the major kinds of support costs, technical and non-technical, and developed measuring devices for each cost element. The system was developed and introduced in 1973 in FAO, ILO, UNIDO, UN and WHO.

12. The report of the Task Force, with the results of the study undertaken by the agencies in 1973, together with the comments of the ACABQ, the Joint Inspection Unit and FAO, was submitted to the Governing Council at its nineteenth session (DP/77 and Add.1 and Corr.1 and Add.2-5). The report showed that, for the organizations participating in the study, the average cost of technical and non-technical support to UNDP-financed projects represented 23.3 percent of project costs (see DP/259/Add.2 for further details).

13. As indicated in paragraph 9 above, the Governing Council, guided by the results of the cost measurement study and the underlying rationale that not all of the elements analyzed represented "clearly identifiable additional costs", decided to increase the rate of reimbursement of overhead costs to 14 percent for the period 1974-1977. This figure represents the average cost for reimbursement of 2 percent for project formulation and 12 percent for non-technical backstopping. The Council also approved a flexibility proviso for smaller agencies whose programmes do not exceed \$10 million; under this arrangement, the Administrator may negotiate additional lump-sum overhead reimbursements for these agencies.

14. However, it should be noted also that in commenting on the basic question of the rate of overhead cost reimbursement to be used by UNDP, ACC noted "that the Joint Inspection Unit inter alia considers the choice of methods for such reimbursement a political decision insofar as it determines the amount involved, and that no preference can be expressed by the Unit for any of the various possible formulas developed by CCAQ".

15. Agency legislative bodies have from time to time expressed views on the question of overhead costs. Generally, they have taken the position that while technical co-operation activities funded by UNDP (and other sources) should be integrated, to the maximum extent possible, with their normal activities, the additional support costs involved should be met from the respective extrabudgetary sources.

16. There has also been a conscious recognition by legislative bodies of the Agencies concerned that, in many cases, the reimbursement formula approved by the Governing Council of the UNDP resulted in certain amounts of overhead support costs, which vary from agency to agency, being absorbed within their regular budgets. In the case of the United Nations, the principle has been endorsed by the General Assembly that a certain amount of the cost of support of extrabudgetary activities should be borne by the regular budget. The Secretary-General has indicated that he shares the view of ACABQ and JIU that the quantum, both as regards the level for reimbursement and the categories of costs it is designed to cover, is for decision by the legislative bodies. 2/

2/ A/C.5/31/33, Annex A, para. 68. See also A/C.5/32/29.