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DRAFT INTERIM REPORT OF THE INTERGOVERNMENTAL WORKING GROUP
ON OVERHEAD COSTS

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This report comprises two parts: Part I reflecting the discussions and actions of the intergovernmental Working Group on Overhead Costs at its first session held in January 1978 and Part II covering the discussions and actions of the Group at its second session held in June 1978.

PART I. FIRST SESSION, NEW YORK, JANUARY 1978

[See draft text contained in DP/WGOC/L.1 already circulated.]

PART II. SECOND SESSION, GENEVA, JUNE 1978

[See attached draft text.]

INTRODUCTION

1. The intergovernmental Working Group on Overhead Costs held its second session at the Palais des Nations, Geneva, during the period 5- June 1978. Mr. Sarfraz Khan MALIK (Pakistan), Chairman of the Group, presided and Mr. Peter OSVALD (Sweden) served as Rapporteur.

I. ORGANIZATION OF THE SESSION

Attendance

2. Members of the Governing Council represented at the session of the Working Group, States represented by observers, and organizations and entities in the United Nations system and other intergovernmental bodies which were represented are listed in the annex to the present report.

Agenda and organization of work

3. The Chairman welcomed all participants and expressed the hope that with the active participation of all concerned the Group would be able to present a constructive interim report to the Governing Council at its current session. He recalled the progress made at the first session and the requests for additional information which the Group had made at that time and indicated that practically all of the information requested was now before the Group. At the Chairman's suggestion, the provisional agenda, as contained in document DP/WGOC/23, was accepted as a guide for proceeding with the work of the session.

4. In addition to the agenda (DP/WGOC/23), the Group had before it the following documents:

- (a) Expanded Preliminary Note by the Joint Inspection Unit (JIU) (DP/WGOC/21)
- (b) Statement of the Administrative Committee on Co-ordination (ACC) on the proposals of the Joint Inspection Unit (DP/WGOC/22)
- (c) Information submitted by Executing Agencies (DP/WGOC/19 and Addenda 1-6)
- (d) Information submitted by UNDP (DP/WGOC/20)

II. INTRODUCTORY STATEMENTS

5. The Chairman of the Joint Inspection Unit made a statement introducing document DP/WGOC/21, followed by a statement by the Chairman of the Consultative Committee on Administrative Questions (CCAQ) by way of introduction of document DP/WGOC/22.

6. The Chairman of JIU in his introductory statement indicated that the over-all effect of the new system proposed by the JIU would in all likelihood be some reduction in costs; the reduction would increase in future years. The

differential rates for project components and for methods of project execution would result in somewhat lower payments, while other suggested adjustments were unlikely to affect the total amounts. In suggesting the reimbursement percentages, JIU had been guided both by an analysis of available data and by its conclusions contained in its report on "The Role of Experts in Development Co-operation". While the proposed system might be somewhat more complex than the present global percentage formula, the time required to apply the new system to a normal agency would not be more than three or four days of clerical time a year. As regards the share of total support costs to be borne by the UNDP and the regular budgets of the Agencies, a point to which reference was made in paragraphs 34-35 of document DP/WGOC/21, this was clearly recognized to be a policy question to be decided by the competent intergovernmental bodies.

7. Referring to the ACC statement (DP/WGOC/22), the Chairman of the JIU regretted that the ACC had taken a negative attitude and at the same time had submitted no constructive suggestions of its own. The Chairman of JIU pointed out that in saying that the new system was defective both in concept and in detail, as was suggested in para. 9, the ACC had not taken into account the advantages of the proposal in terms of economy and equity. Also, it was not true to suggest that JIU had not proposed any real economies; the new scheme would provide lower total reimbursements, although the amounts of reduction could not be estimated. Furthermore, the ACC in referring, in paragraph 13 of its comments, to the difficulties of projecting in advance possible amounts of reimbursement for budgeting purposes, had exaggerated the problem; both under the present and the new systems, project expenditures had to be roughly estimated, and so had to be possible movements in Post Adjustments for other budgetary purposes. The Chairman of JIU added, with reference to para. 23 of the ACC comments, that the suggested inclusion of support costs in project budgets would respond directly to the right of Governments to know how support costs were related to and used for delivery of specific projects.

8. In his introductory statement, the Chairman of CCAQ said that notwithstanding the potentially divisive character of some of the JIU recommendations, the ACC had succeeded in presenting a joint statement of comments. The JIU proposal had not dealt with the problem of reducing total support costs, but was explicitly concerned only with reducing and redistributing the amount reimbursed to the Agencies and the consequent additional amounts to be absorbed by the regular budgets of the organizations. ACC fully shared the desire to increase resources going directly to project activities and the organizations had in fact made efforts.

often forced by the pressures of monetary instability and inflation, to reduce support costs. While the present formula had many positive features, the ACC had not approached the JIU proposal with an exclusively "status quo" mentality. It was conceded that the present arrangement was pragmatic rather than scientific, but the multitude of reimbursement rates and adjustments proposed by the JIU reflected judgements which were no more objectively valid than the present rate of 14 per cent. In the view of the ACC, the JIU proposal could not readily be applied to funds-in-trust activities as some of the ex post facto adjustments called for in the proposal would pose difficulties in the negotiations in respect of trust fund contributions.

9. The Chairman of CCAQ added that the ACC saw no justification for reverting to, nor any possibility of obtaining authority and resources to implement recommendations for new cost measurement systems, which were originally made by the JIU in 1974 and then unanimously rejected, especially if those were oriented towards individual projects. As regards Government execution, any support costs charged should be related only to those parts of a project which Governments invite organizations to implement. Even under the present 14 per cent system for Agency execution, most of technical backstopping, the cost of programme planning, and of post-project evaluation and follow-up were absorbed by the organizations' regular budgets and not charged to reimbursement. While welcoming the prospect of special help to the smaller organizations and the recognition of the problems faced by organizations located in high cost areas, the ACC noted that the JIU proposal did not in fact deal with economies of scale as there was no reference to the dollar level of programme delivery at which economies of scale might begin. Finally, the Chairman of CCAQ said that the ACC was particularly opposed to the suggestion that provision for support costs should be included in project budgets; it could not but be detrimental to the whole process of project formulation and project implementation.

10. A member of the JIU, supplementing the remarks of the Chairman of the JIU, referred to the ACC comment that the JIU had not suggested reductions in total support costs and said that a well-conceived new reimbursement formula should lead to better management and be an incentive to increase efficiency and reduce overall costs. Moreover, the Agencies would have to prove that they had done all they could to reduce total costs. The Inspector also said that the 1974 JIU recommendations on cost measurement systems had not been rejected, as mentioned by the Chairman of CCAQ; some had been approved and others were to be subject to further study. The Inspector added that one should not go only for simplicity: simplicity did not lead to improvement, while a degree of complexity might do so.

III. SUMMARY OF DISCUSSION

11. The Chairman, initiating the discussion, pointed out that two differing views had been placed before the Group: one that the JIU proposals were somewhat complex and impractical to apply and might even cost more; the other view was that this position was exaggerated and the proposals were logical and could be applied without much difficulty. However, both the JIU and the ACC seemed to agree on the definition of the term "support costs" and on the JIU proposal for introducing a measure of stability in reimbursement of such costs.
12. Many members reacted positively to the JIU Note and expressed the view either that it could be taken as a basis for further work or that it contained a number of good elements which could prove useful in the further development of a new or modified formula. It was emphasized that the sound and efficient management of technical co-operation activities would require not only realistic, practical and workable policies and procedures but also management oriented information, based on which a rational system of payment for support costs could be built. It was suggested that the JIU proposal met a number of desirable objectives: recognition of the mutually supportive role of regular budget activities and technical co-operation activities, optimization of resources available for project activities, recognition of variations in support costs for different mix of projects, economies of scale, fairness to the Agencies, relative ease of implementation and promotion of standardized accounting systems in the Agencies. The view was also expressed that it would have been helpful to the Group had information been available on the quantitative impact of the application of the JIU proposal, as compared to the present formula, in each Agency.
13. The view was expressed that the ultimate aim of the work of the Group was to try to reduce over-all programme and project support costs; these costs were rapidly reaching significantly large levels. They must therefore be pruned and reduced through good management and continuous vigilance in the interests not only of increasing resources available for project assistance but of ensuring a steadily increasing level of support from member States. Appreciation was expressed for the efforts made in UNDP and the Agencies to contain and reduce support costs and it was hoped that these efforts would continue with even greater vigour. A question was raised in this connexion whether cost reductions which were reported to have been achieved in the Agencies should not be credited proportionately also to support cost payments from UNDP and not totally to the regular budget of those Agencies. Reference was also made by some members to proposals contained in the

JIU report on "The Role of Experts in Development Co-operation" which might result in cost reductions, although it was recognized that these proposals had yet to be considered by the Governing Council.

14. Two main criticisms voiced by a few members against the JIU proposal were, first, that it was not really more scientific than the present formula inasmuch as fine distinctions and calculations based on weak data had exaggerated the over-all weakness of the proposed system, and, second, that it was far too complex and impractical. The ACC statement (DP/WGOC/22) and the statement before the Group by the Chairman of CCAQ had brought these out clearly.

15. As regards the need for a simple formula, it was agreed by several members that to be simple was not synonymous with being good and some complexity was healthy for good management. It was also suggested that the JIU proposal was not really as complicated as it seemed when presented in the abstract; in any event, the issue might be resolved by adjusting or simplifying the proposal as it stood perhaps by limiting the number of variables to be taken into account. By the same token other members, who were somewhat less receptive to the JIU proposal, said that one could start with the present 14 per cent formula which, despite its imperfections, was a better point of departure, and modify it to take account of a limited number of variables, especially economies of scale and component mix of projects.

16. One member, who otherwise gave strong support to the JIU proposal, nevertheless pointed out that the proposal was still based on the "cost plus" principle and thus did not provide any direct incentive to reduce costs. In his view, the only way to do this was to include support costs in the regular budgets which, in his view, was probably not practicable. He added that the JIU proposal to include support costs in project budgets and have them financed from IPF's might provide some incentive. Some other members also supported this latter proposal although one member, while favouring the idea of including support costs in project budgets for presentation purposes was opposed to their incorporation within the IPF system. Still other members were opposed to this idea as a whole.

17. Several members rejected the suggestion of an automatic link between the JIU proposal, even if it involved a reduction of reimbursement, and higher assessed budgets in the Agencies. The aim was a reduction in over-all support costs whether paid by UNDP or the regular budgets and not a redistribution of such costs as between the two sources. In this regard it was recognized that programme

planning and support, technical backstopping and post project evaluation and follow up were inherent to the normal concerns of the organizations and were absorbed by them.

18. As regards the element in the JIU proposal for a measure of stabilization of support payments from year to year, while there was some support for this idea, it was suggested that the JIU's specific proposal might not be an effective cushion. It was also suggested by another member that the stabilization concept should work both ways, that is not only for decreases but also for increases. Yet another member questioned this element of the JIU proposal stating that stability should be sought in planning and programming and not through the instrumentality of support costs.

19. There was some discussion concerning the size of projects as a variable to be taken into account. While it was suggested by one Agency that there should be higher support reimbursements where small projects were involved, it was pointed out that 75 per cent of all UNDP-financed projects during the period 1972-1976 were projects under \$150,000. It was doubtful therefore whether smallness was a significant departure from the norm. More substantively it was argued by one member that UNDP should discourage fragmentation of effort into very small projects and indeed should offer a lower reimbursement in order to act as a disincentive to such projects. The consensus was to leave this question in a neutral stance.

20. While the element of variable cost levels at different headquarters duty stations was recognized as a factor in the situation, doubt was expressed about the feasibility of finding a sufficiently simple way of taking this into account in a reimbursement formula. Two further arguments against making provision for this element were put forward: that it might serve as a disincentive to decentralization of the work to the regional and country levels and that some caution was required before institutionalizing in a system special support to inflation and monetary instability.

21. One member in advocating a continued pragmatic approach to the question of reimbursement of support costs drew attention to the wide variety of services provided to the Agencies by UNDP, especially its field offices, with no reimbursement of related costs. He referred in this regard to the detailed picture of the situation given in the Administrator's annual report for 1977.

22. Another member emphasized the need to correlate any reimbursement system to the quality of implementation of projects by the Agencies. Citing recent examples of seriously delayed and defective implementation of projects in his country by some Agencies, he asked why UNDP should pay at the full established level in respect of such projects.
23. A few members emphasized the usefulness of the project approach to support costs and pointed out that calculation project by project would help to focus insight on various specific cost elements. It was recognized that this approach would require a system of cost measurement for support costs at the project level. Several members spoke in favour of steps being taken which would eventually lead to a cost measurement system. It was suggested that the JIU might be requested to study and outline the elements of a simpler cost measurement system which might lend itself to application by all Agencies. As against this, it was argued that perhaps a better and a more urgent task that might be performed was to review the implementation of the New Dimensions, especially government execution.
24. Agency representatives explained the history of previous cost measurement studies and indicated that while they had provided some useful results, the ACC had concluded, and the Advisory Committee on Administrative and Budgetary Questions had agreed, that continued operation of such systems would not be productive of any new or more reliable results and would be expensive. After prolonged discussion at various stages in the debate it was agreed that this issue, which could cover activities well beyond support activities for UNDP-financed programmes that were the concern of the Working Group, might best be raised in other intergovernmental fora.
25. Responding to an earlier question from a member about the impact of the JIU formula, the representative of FAO said that the application of the formula to a sample of 88 FAO projects showed that reimbursement would be reduced to 11.5 per cent overall. For the FAO-executed UNDP programme as a whole, this would, under certain assumptions, mean a reduction of some \$5 million per biennium, an amount of an order of magnitude which could not be absorbed by the regular budget.
26. One member specifically noted that the ACC in its statement had not commented on more recent data reported by some Agencies on support costs incurred by them as published in document DP/259/Add.2. FAO had reported such costs incurred as 13.8 per cent in 1975 and 13.7 per cent in 1976 as compared with 19.3 per cent in 1973 and 15.9 per cent in 1974.

27. The view was expressed unanimously that a long-term resolution of the question of reimbursement in respect of support costs had to be sought through full and close co-operation among Governments, the Agencies and UNDP. It was at the same time recognized that a final decision, which had to be based on broad policy considerations rather than purely technical factors, must be formulated and approved by Governments. The procedure to be adopted must also respect the role of the Agencies and their legislative bodies and the principle of partnership between UNDP and the Agencies.

28. Towards the close of the formal discussion, the Chairman of the Group gave expression to what he gauged to be an emerging consensus among members. He indicated that while the JIU proposal had much merit, perhaps a less complex approach might be tried taking into account only two or three variables like economies of scale, component mix of projects and mode of execution. Given the positions of the JIU, on the one hand, and the ACC on the other, it might be appropriate to request the Administrator to undertake this further work in close and perhaps separate consultations with the JIU and the Agencies. The Chairman further indicated that he had consulted the Administrator, who had indicated his readiness to accept this task provided that (a) the Group gave him specific guidance and not remit to him the issue in general and comprehensive terms... (b) it was clearly recognized that his report would be recommendatory to the Group, with the responsibility of formulating a recommendation to the Governing Council clearly resting with governments members of the Group, and (c) it was emphasized that the solution would have to be found through full and constructive co-operation among the Agencies and UNDP with the determination to produce a positive recommendation.

29. The Chairman expressed his appreciation to the Administrator and invited the Agencies to extend their full understanding and co-operation to the Administrator in the difficult task ahead. He further indicated that while the Administrator would be guided by the specific guidelines to be provided by the Group, Agencies could feel free to discuss with him all ideas and proposals on the subject. The Chairman also expressed his appreciative confidence that the JIU would be available to the Administrator for consultation.

30. Several members then spoke specifically to lend full support to the Chairman's summation of the emerging consensus. Agency representatives welcomed the Chairman's approach and assured him and the Group that they would work with the Administrator in full and constructive co-operation. One Agency representative emphasized in this regard that any solution reached through this process should be adhered to for 5, 6 or even 10 years thus avoiding further and repetitive expenditure of resources of time and money which might well be otherwise available for the substance of technical co-operation work. Another Agency representative supplemented the offer of full and constructive co-operation with the statement that his Agency could not accept to take into account additional variables beyond the ones mentioned by the Chairman nor would it entertain further requests for cost measurement.

31. At the conclusion of the formal discussions, the Working Group went into a series of informal meetings in order to formulate, on the basis of the Chairman's summation, its decision concerning the further action to be taken.

Decision of the Working Group

32. At a formal meeting held on 9 June 1978, the Working Group adopted by consensus the following decision:

The intergovernmental Working Group on Overhead Costs

Having reviewed, with appreciation, the Expanded Preliminary note submitted by the Joint Inspection Unit (DP/WGOC/21), the statement of the Administrative Committee on Co-ordination on the JIU proposals (DP/WGOC/22) and other documentation submitted to the Working Group at its second session,

Taking into account the comments, observations and suggestions made during the discussion of this question,

Having continued the examination of this question bearing in mind the terms of reference and the criteria laid down by the Governing Council in its decision establishing the Working Group at its 588th meeting on 29 June 1977.

Recalling that, at its first session, in January 1978, the Working Group had broadly endorsed the criteria for the definition of support costs outlined by the JIU in paragraphs 7 - 11 of its first Preliminary Note (DP/WGOC/1),

Recognizing that the present reimbursement formula is a pragmatic and temporary compromise and further that this formula does not fully respond to all the variables in the situation,

Noting that over-all programme and project support costs have reached significantly large levels and the consequent need to make every effort to reduce such costs on the basis of the principles of sound management and in the interests of better programme delivery,

Noting with appreciation the efforts made by UNDP and the Executing Agencies towards support cost reductions and expressing the hope that these efforts will be continued and intensified,

Urging that any new formula for reimbursement should provide an incentive to review and reduce over-all support costs,

Noting that any UNDP funds released by a reduction of support costs would be fully available for additional programmes in developing countries through a corresponding increase in resources available for IPFs,

1. Considers that any new reimbursement formula should be easy to understand, practical to operate and durable,
2. Regards the JIU proposal as one basis for the establishment of a new formula, while recognizing the necessity for modifications with respect to the variables proposed,
3. Considers 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 sub-contracts taking account, in this regard, of the practices already in vogue in many agencies in respect of funds-in-trust and multi-bi 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;

4. Considers 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,

5. Requests the Administrator, on the basis of paragraphs 12 and 13 above, and in consultation with the Executing Agencies and, if possible, with the Administrative Committee on Co-ordination to recommend to the Working Group a modified formula to enable Governments members of the Working Group to formulate an intergovernmental recommendation to the Governing Council,

6. Further requests 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 and submit a report to the Working Group,

7. Invites the Advisory Committee on Administrative and Budgetary Questions and the Joint Inspection Unit to submit their comments and observations on the recommendations prepared by the Administrator in pursuance of paragraphs 14 and 15 above,

8. Also invites the Agencies to submit to the Working Group information on the application of the new formula which would indicate the formula's impact on the level of their support costs,

9. Decides to meet again in New York from ... to ... January 1979.
33. At the same meeting, the Group also decided to recommend to the Governing Council that in the interest of consistent terminology, the name of the Group should be altered to "Intergovernmental Working Group on Support Costs".

[Attendance list will be annexed]