Cost Recovery Overview

Joint UNDP, UNICEF, UNFPA and UN Women Executive Board informal
3 February 2017

Outline

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Observations

- The four agencies are compliant with the harmonized cost recovery and integrated budget frameworks approved by the Executive Boards
- The four agencies have applied the approved cost recovery framework and the approved cost recovery rates consistently
- The independent consultant's report has positively validated the fundamental principles of the model and the agencies' adherence to it
- Significant challenges remain, as some funding and national government implementing partners are unwilling to include eligible direct costs in programmes
- Some challenges remain, as a few funding and national government implementing partners are unwilling to accept the harmonized cost recovery rate
- Longer-term institutional agreements, including with UN partners, locked into lower cost recovery rates
- The four agencies recognize that differences in business and funding models, as well as relative size, have an impact on comparability

Role and Use of Regular (Core) Resources

- General Assembly Resolution 67-226, section II, stressed that core resources remain **"the bedrock of operational activities for development of the UN System"**
- Core resources provide funding base for each agency's programmes in individual countries, regionally and centrally, and also provide an essential and predictable foundation for responding to the needs of programme countries and supporting the mandate, integrity and resource mobilization platform leading to the results of the agencies' Strategic Plans
- Core resources, per the approved harmonized cost classification categories of the current integrated budget, cover:
  - Programme activities;
  - Development effectiveness activities;
  - UN development coordination activities;
  - Management activities:
    - Critical cross-cutting management functions which are integral to the existence and the advancement of the mandate of the organizations, irrespective of the volume of Programme implementation;
    - Management costs related to the support of core programme delivery*;
  - Comparable special purpose activities (Capital investments); and
  - Agency specific special purpose activities

* For UNDP, transitional measures were approved by the Executive Board for 2014-2017 period

Components of Costs

Total Costs = Indirect costs + Direct costs

Cost recovery refers to the requirement for the organization to ensure that regular resources are not used to subsidize the implementation of programmes funded from other resources.

Indirect costs

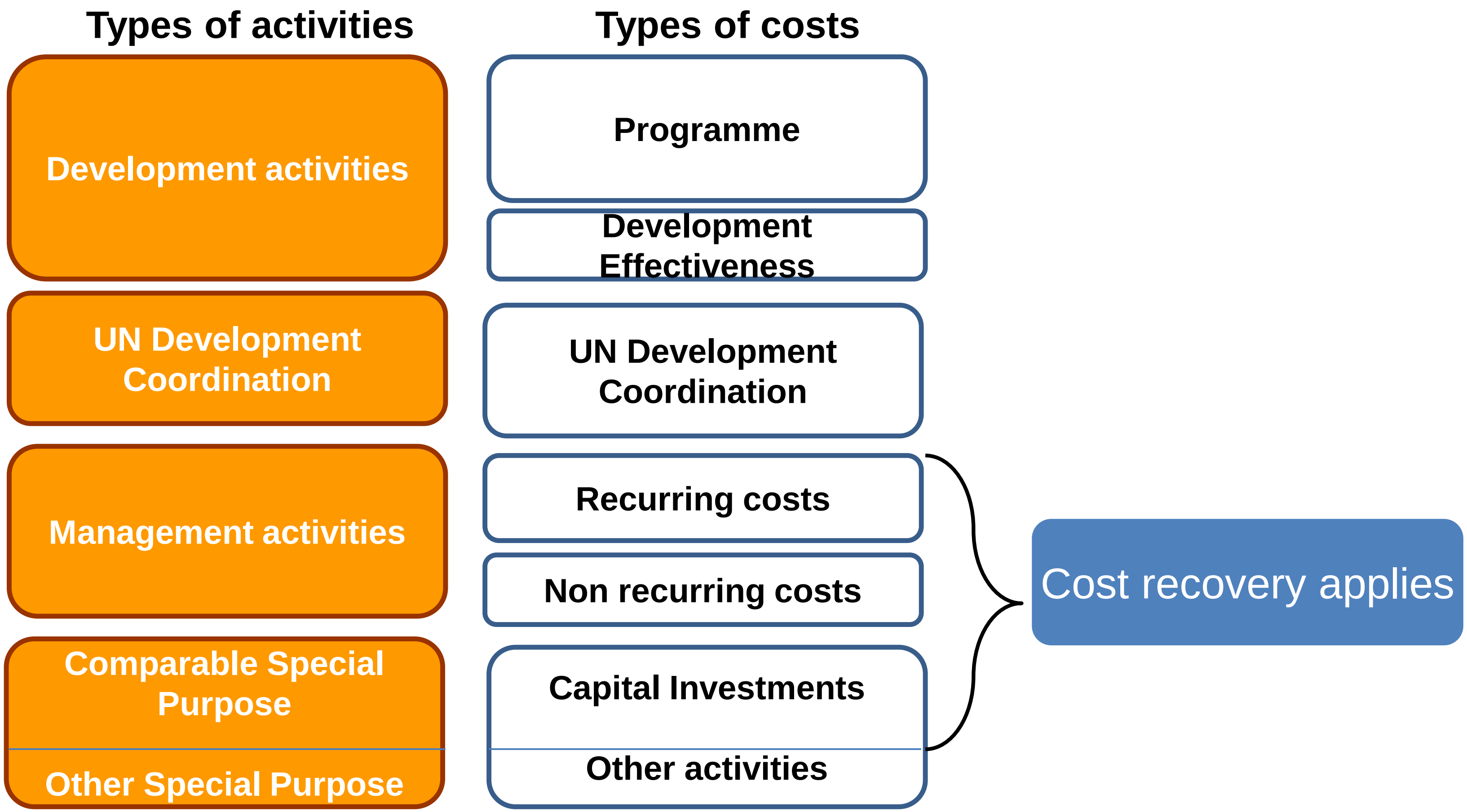
- Costs that are indirectly linked to the delivery of development results are recovered through the cost recovery rate

Direct costs

- Costs that are directly linked to the delivery of development results are directly funded from regular resources or other resources, depending on where the cost originates

As such total costs include both indirect and direct costs incurred by the organizations.

What is the link between cost recovery and cost classification?



Executive Board approved model cost recovery – step by step

Illustrative Example:

Step	Illustrative example	
Proportionate percentage share of RR and OR in the planned use of resources	*Regular resources:*	*$40*
	Other resources:	*$60*
Step 1: Calculate the sum of management and comparable Special Purpose costs and remove costs related to critical, cross-cutting functions	*Inst. Budget:*	*$12.6*
	Development Effectiveness:	*($2)*
	Non-comparable Special Purpose:	*($1)*
	UN Dev. Coordination:	*($1)*
	Critical cross-cutting:	*($1)*
	IB Subject to cost recovery:	***$7.6***
Step 2: Take the amount calculated in step (1) and split it proportionally according to the levels of total planned core and non-core expenditures	*IB proportion OR (7.6*60%) =*	*$4.56*
	*IB proportion RR (7.6*40%)=*	*$3.04*
Step 3: Take the amount calculated in step (2) to be recovered from non-core resources and calculate it as a percent of total planned non-core development expenditures	*IB proportion OR: $4.56 / ($60-$4.56) = 8.2%*	
	IB proportion RR: $3.04 / ($40-$3.04) = 8.2%	
Step 4: The amount in step (3) equals the notional cost-recovery rate on non-core resources	*Result of step 4 = 8.2% established cost recovery rate*	

Executive Board approved model - implications

- The four agencies have applied the approved model using 2014-2015 actuals, per audited financial statements and financial reports
- The analysis confirms that the 8% cost recovery rate is broadly aligned with the Executive Board approved methodology. Details are provided in the Annexes
- However, the effective rate realized is always lower than 8% largely due to the impact of the Executive Board approved differentiated rate structure
- The next slide shows the actual effective rate realized in 2014 and 2015 by each agency

Effective cost recovery rates 2014 and 2015 by agency

The effective rate represents the rate that was realized based on the actual cost recovery vs. the actual OR spending*. These rates were also reported in the independent external consultants' report.

Agency	2014	2015
UNDP	6.1%	6.3%
UNFPA	7.02%	7.03%
UNICEF	6.3%	6.5%
UN Women	7.12%	7.00%

*For UN Women, based on collected revenue

Details for each Agency are presented in the Annexes at the end of this presentation

Number of Waivers – 2014 and 2015

Number of waivers	2014	2015
UNDP	24	9
UNFPA	4	8
UNICEF	1	9
UN Women	1	1

- Per EB decision, "*on an exceptional basis (….) the Administrator (…) and the Executive Director (…) may consider granting a waiver of the cost-recovery rates on a case-by-case basis, (…) and that the Executive Board will be informed of these waivers in the annual financial reports*"
- Total financial impact of the cost recovery waivers in response to partner requests is immaterial (but should continue to be given very exceptionally)
- The waivers granted are reported in the respective agency annual reports

Key Challenges

- Continuously declining core resources negatively impact on:
  - forward-looking and strategic choices and investments;
  - ability to deliver on development results
  - institutional capacity for quality assurance and accountability
- Some funding and national government implementing partners are unwilling to include eligible direct costs in programmes. This, by definition, results in cross-subsidization
- Some funding and national government implementing partners are unwilling to pay the standard cost recovery rates
- Longer-term institutional agreements, including with UN partners, locked into lower cost recovery rates
- Comparability amongst agencies is affected by different business and funding models, and size
- While the cost recovery rate is established based on the planned estimates, the actual performance will by definition be different (i.e. different income and different actual costs)

Recap

- The four agencies are compliant with the harmonized cost recovery and integrated budget frameworks approved by the Executive Boards
- The four agencies have applied the approved cost recovery rate consistently
- The effective rate is by definition lower than the approved 8% rate, taking into account the EB approved differentiated rates; waivers and legacy rates
- Effective rates have generally increased over the years
- It remains a challenge that some funding and national government implementing partners are unwilling to include eligible direct costs in programmes
- The four agencies recognize that differences in business and funding models, as well as relative size, have an impact on comparability

Next steps

- Against the backdrop of GA resolution 71/243 on the QCPR and guidance of the Executive Board:
  - Hold joint informal in April in order to discuss the 2016 information (after financial books are closed)
  - Prepare the next integrated budgets on the basis of the current Executive Board approved cost recovery and integrated budget frameworks
- Continue to monitor and report on actual cost recovery on an annual basis
- Continue to strongly advocate of inclusion of eligible direct costs in programmes/projects.

Q&A

Annex I

Background Executive Board Decisions and summary of notional cost recovery rates for 2014-2015

Background: Approval of cost recovery framework

Executive Board decision on cost recovery (February 2013)

- “Approves the harmonized methodology for calculating cost-recovery rates (…) and welcomes the increased transparency and proportionality in the new harmonized framework”
- “Endorses a general, harmonized cost-recovery rate of 8 per cent for non-core contributions that will be reviewed in 2016, with the possibility of increasing the rate if it is not consistent with the principle of full cost recovery, proportionally from core and noncore funding sources (…)”
- “Requests that an independent and external assessment be performed in 2016 on the consistency and alignment of the new cost-recovery methodology with General Assembly resolution 67/226”

UNDP United Nations Development Programme UNFPA UN WOMEN unicef

Background: Approval of differentiated rates

Executive Board decision on cost recovery (continued)

- “Underscores that the principle of harmonized rates will also apply to differentiated cost recovery rates (…) and further endorses the following differentiated cost-recovery rate structure:

  (a) a harmonized 1 per cent reduction for the thematic contributions at the global, regional and country level in UNDP, UNFPA and UNICEF (8 per cent - 1 per cent = 7 per cent), with the United Nations Entity for Gender Equality and the Empowerment of Women (UN-Women) maintaining the 8 per cent as a temporary arrangement;

  (b) maintaining the existing preferential rates for government cost-sharing, South-South contributions and private-sector contributions”

- “Decides that, on an exceptional basis (….) the Administrator (…) and the Executive Director (…) may consider granting a waiver of the cost-recovery rates on a case-by-case basis, (…) and that the Executive Board will be informed of these waivers in the annual financial reports;

- “Decides that existing agreements will be honored using the previous cost- recovery rates and that new or renewed agreements will comply with the present decision”

Background: Request for further information

Executive Board decision on cost recovery (continued)

- “Requests (…) to include in the midterm review of their integrated budgets, information on the implementation of the approved cost-recovery rates, including the approved underlying calculation methodology and the inclusion of each cost category; their actual cost-recovery rates for the two previous financial years; and an analysis of compliance with the principle of full cost recovery, funded proportionally from core and non-core resources, as mandated in General Assembly resolution 67/226” (Executive Board decision from September 2013)

- “Requests (…) to present in accordance with the Executive Board decision 2013/2, all requested information on cost recovery to the Executive Board in time to be included for the consultations on the strategic plan 2018-2021 and the integrated budget 2018-2019 at its Annual session 2017” (Executive Board decision from September 2016)

Executive Board approved model – calculation of notional rate using 2014 and 2015 actuals

The rates below result from applying the Executive Board approved methodology to 2014 and 2015 actuals:

Agency	2014	2015
UNDP	7.9%	7.0%
UNFPA	7.9%	7.8%
UNICEF	6.2%	6.0%
UN Women	8.3%	8.1%

Details for each Agency are presented in the following Annexes

Annex II

UNFPA specific details

UNFPA Calculation of rate in line with approved formula in documents DP-FPA/2013/1–E/ICEF/2013/8

	Calculation of Rate based on Approved Methodology 2014 and 2015 (in US$ Million) - UNFPA	Actual Expenses	
	Use of resources	**2014**	**2015**
A1	Regular resources (RR)	444.8	449.9
A2	Other resources (OR), gross (A)	515.0	505.3
	Total	959.8	955.2
	1. Calculate the proportionate percentage share of RR and OR in the planned use of resources		
B1	Proportionate share RR	46%	47%
B2	Proportionate share OR (B)	54%	53%
	2. Calculate the sum of management and comparable Special Purpose costs [and remove costs related to critical, cross-cutting functions)		
C	Institututional Budget	141.1	140.3
	Less		
C1	Development Effectiveness Activities	(30.4)	(31.1)
C2	Non-Comparable Special purpose Activities		
C3	UN Development Coordination Activities	(2.0)	(2.1)
C4	Critical cross-cutting management functions based on standard costs	(38.3)	(37.9)
	3. Take the amount calculated in step 2. and split it proportionally according to the levels of total planned core and non-core use of resources		
D=C-(C1:C4)	Institutional Budget Subject to Cost Recovey based on approved methodology	70.5	69.3
E1=B1*D	Regular Resources Proportional Share of IB	32.7	32.6
E2=B2*D	Other Resources Proportional Share of IB	37.8	36.6
F=E2/(A2-E2)	Notional Rate	7.9%	7.8%
G	Cost Recovery actually earned	33.8	33.2
H=G/(A2-G)	Effective Rate	7.02%	7.03%

UNFPA – impact of differentiated rates, legacy and waivers vs. the standard rate

UNFPA Type of agreement	Effective rates		Variance vs. standard rate	
	2014	2015	2014	2015
Standard Rate	8.00%	8.00%	-	-
Thematic Trust Funds	7.00%	7.00%	2,003,189	1,610,350
Various Umbrella Agreements	7.00%	7.00%	626,436	704,370
Country Programme Donor	5.00%	5.00%	448,235	681,793
Joint Programme	7.00%	7.00%	372,727	512,793
Legacy	7.00%	7.00%	762,906	510,362
Exception	5.20%	5.19%	79,532	119,162
Others (small contributions)	6.93%	6.99%	50,601	12,802
Total	**7.02%**	**7.03%**	**4,343,627**	**4,151,633**

Note: Variance vs. the standard rate represents the difference between the effective cost recovery received and the cost recovery that would have been earned using the standard approved rate (8%). Thus the amount is not exactly the same when comparing the effective cost recovey received to the notional rate derived by applying the approved methodology.

Annex III

UNICEF specific details

UNICEF Calculation of rate in line with approved formula in documents DP-FPA/2013/1–E/ICEF/2013/8

	Use of resources	**2014**	**2015**
A1	Regular Resources (RR)	1,124	1,085
A2	Other Resources (OR)	3,680	4,193
	Total	4,804	5,277
	1. Calculate the proportionate percentage share of RR and OR in the planned use of resources		
B1	Proportionate share of RR	23%	21%
B2	Proportionate share of OR	77%	79%
	2. Calculate the sum of management and comparable special purpose costs (and remover costs related to critical, cross-cutting functions)		
C	Institutional Budget	441.50	469.09
	Less		
C1	Development Effectiveness	(113)	(129)
C2	Special Purpose Activities	-	-
C3	UN Development Coordination	(8)	(6)
C4	Critical cross-cutting functions based on standard costs	(38)	(35)
	Net	282	299
	3. Take the amount calculated in step2. and split it proportionally acc to te levels of total planned core and non-core use of resources		
D=C-(C1:C4)	IB subject to Cost Recovery based on approved methodology	282	299
E1=B1*D	RR proportional share of IB	66	61
E2=B2*D	OR proportional share of IB	216	237
F=E2/(A2-E2)	Notional Rate	6.2%	6.0%
G	Cost Recovery Actually Earned	220	257
H=G/(A2-G)	Effective Rate	6.3%	6.5%

Annex IV

UN Women specific details

UN Women Calculation of rate in line with approved formula in documents DP-FPA/2013/1–E/ICEF/2013/8

Calculation of Rate based on Approved Methodology 2014 and 2015 (in US$Million) - UNWOMEN	Actual expenses	
Use of Resources	**2014**	**2015**
Regular resources	143	149
Other resources (OR), Gross (A)	131	169
Total	274	318
1. Calculate the proportionate percentage share of RR and OR in the planned use of resources		
Proportionate share RR	52%	47%
Proportionate share OR (B)	48%	53%

2. Calculate the sum of management and comparable Special Purpose costs [and remove costs related to critical, cross-cutting functions)

	2014	**2015**
Institututional Budget	73.0	82.5
Less		
Development Effectiveness Activities	(21.3)	(23.4)
Non-Comparable Special purpose Activities		
UN Development Coordination Activities	(10.4)	(12.4)
Critical cross-cutting management functions based on standard costs	(18.5)	(21.0)

3. Take the amount calculated in step 2 and split it proportionally according to the levels of total planned core and non-core use of resources

Institutional Budget Subject to Cost Recovery based on approved methodology	22.8	25.7
Regular Resources Proportional share of IB	11.9	12.0
Other Resources Proportional Share of IB	10.9	13.7
Notional rate	8.3%	8.1%
Cost recovery actually earned	10.3	11.5
Effective Rate	7.12	7.00

UN Women Effective indirect cost recovery rates 2014 and 2015

Year	Collected Revenue A	Support cost recorded B	Effective rate B divided by A
2014	146,110,705.37	10,367,460.42	7.10%
2015	165,030,949.79	11,529,076.89	6.99%

Annex V

UNDP specific details

UNDP Calculation of rate in line with approved formula in documents DP-FPA/2013/1–E/ICEF/2013/8

		2014	2015	2014-2015
	Actuals (use of resources) (*)			
A1	Regular resources	835	714	1,548
A2	Other resources	4,191	4,258	8,449
	Total	**5,026**	**4,971**	**9,997**
B1	Proportionate share Regular Resources	17%	14%	15%
B2	Proportionate share Other Resources	83%	86%	85%
	1. Calculate the sum of management & comparable Special Purpose costs (and remove costs related to critical, cross-cutting management functions)			
C	Institutional budget	670	659	1,329
	less			
C1	Development Effectiveness activities	(122)	(148)	(270)
C2	Non-comparable special purpose activities	(67)	(70)	(137)
C3	UN development coordination activities	(73)	(76)	(149)
C4	Critical cross-cutting management functions based on standard costs	(40)	(41)	(81)
D = C + C1..C4	**Total**	**368**	**324**	**692**
	2. Take amount calculated in step (1) and split proportionally according to levels of total core and non-core expenditures			
D = C + C1..C4	**Total Inst. budget (actuals) subject to cost recovery** (i.e. numerators for calculation cost recovery rate on RR and OR)	**368**	**324**	**692**
E1 = B1 * D	Regular Resources proportional share of IB actuals	61	46	107
E2 = B2 * D	Other Resources proportional share of IB actuals	307	277	585
F = E2/[A2-E2] (= E1/[A1-E1])	Calculation of cost recovery rate using EB approved model on 2014 and 2015 actuals (same rate on RR and OR)	7.9%	7.0%	7.4%

(*) Based on data reported in UNDP ARFS for 2014 and 2015 in annexes 1&2, net of GLOC and in-kind contributions

UNDP compliance with cost recovery policy - funding of $692m in IB costs

- In 2014-15, UNDP was in full compliance with the harmonized EB approved cost recovery policy and the integrated budget framework.

- On **'core'** resources, UNDP 'charged' an equivalent of 7.7%, yielding $**80m**.
- Note that 'core' also financed critical cross-cutting management functions ($81m), and transitionary measures ($132.8m) - i.e. measures approved by the EB in the Integrated Budget, due to time required for full implementation of the cost recovery policy (noting that the EB approved cost recovery methodology included differentiated rates, legacy rates, and waivers disclosed to EB).

- On '**non-core**' resources, UNDP charged an actual effective cost recovery rate of 6.1% in 2014 and 6.3% in 2015, yielding **$454.5m** in cost recovery revenue.
- UNDP had indicated to the EB as part of its 2014-2017 integrated budget, that it would require abovementioned transitionary measures (approved with $133m for 2014-2015 and $66m for 2016-2017). Adding **$132.8m** transitionary measures to $454m in cost recovery revenue adds to **$587.3m.**

- When adding the 'core' charge of $80m, this adds to total (core/non-core) funding of **$667m**

$80m **Core (7.7% charge on [$1,124m-$80m]** – see next slide)

$454.5m **Non-core** (6.1% & 6.3% charged in 2014 & 2015, respectively – see next slides)
$132.8m EB approved trans measures
$587.3m **subtotal (see next slide)**

$667m **total** (core/non-core) funding

- Noting that costs were **$692m**, this resulted in a gap of **$25m**, which was financed from prior year accumulated XB reserves. No additional core resources were used to finance these costs in 2014-2015, hence UNDP complied with the cost recovery policy.

- Note that if UNDP would in 2014-2015 have charged a cost recovery rate of 8% on all non-core programme expenses, it would have yielded $570m in cost recovery revenue ($115.5m more than the $454.5m in actual cost recovery revenue yielded in 2014-2015).
- Together with the $80m in core 'charge', this would result in total funding for management activities of $650m, leading, if transitionary measures were excluded, to a gap of $42m (= $692m- $650m)

* Based on financial information reported in UNDP's audited financial statements and annual financial reports for 2014 and 2015.

UNDP United Nations Development Programme UNFPA UN WOMEN unicef

UNDP compliance with cost recovery policy (continued)

		2014 - 2015		2014		2015	
		Core	*Non-core*	*Core*	*Non-core*	*Core*	*Non-core*
A	Delivery (basis for calculation of actual cost recovery charged)	$1,124	$7,688	$587	$3,883	$537	$3,806
B	Actual cost recovery charged (see further slides for details on non-core) *% (=B / [A - B])*	$80 *7.7%*	$455 *6.3%*	$42 *7.7%*	$225 *6.1%*	$38 *7.7%*	$229 *6.3%*
C	EB approved Transitional measures	$133	$133	66	66	66	66
D = B + C	Total actual cost recovery including Transitional measures	$213	$587	$108	$292	$105	$296
E	Critical cross cutting management functions ('CCCM')	$81	-	$40	-	$41	-
F = D + E	**Total (including Transitional measures and CCCM)** ***% of non-core delivery***	**$294**	**$587** ***8.0 %***	**$148**	**$292** ***7.9 %***	**$146**	**$296** ***8.2 %***

Notes:

* Based on financial information reported in UNDP's audited financial statements and annual financial reports for 2014 and 2015.

* $294m in core total expenditure reconciles with total UNDP core expenditure on management activities ($289m) plus capital investments ($5m). (see later slide).

Use of Regular (Core) Resources in UNDP

2012-2013 compared with 2014-2015

Regular resources	2012-2013			2014-2015	
	% of total	*Amount (US$ millions)*		*% of total*	*Amount (US$ millions)*
Programmatic component	58%	$1,058		62%	$958
Institutional component	42%	$757		38%	$586
Total	**100%**	**$1,815**		**100%**	**$1,543**

Institutional component					
Development effectiveness	17%	$128		21%	$119
United Nations coordination	17%	$129		25%	$149
Management	62%	$472		49%	$289
Special purpose - non-comparable (UNV/UNCDF)	4%	$28		4%	$24
Special purpose - comparable (capital investments)	0%	$0		1%	$5
Total	**100%**	**$757**		**100%**	**$586**

KEY CHANGES FROM 2012-2013 to 2014-2015:

Reduction in the proportion of regular resources allocated to the institutional budget in favour of the programmatic component;

Rebalancing of resources within institutional budget :

- Increasing the proportion allocated to development effectiveness activities;
- Maintaining core support for the backbone of United Nations development coordination activities;
- Decreasing the proportion allocated to management

- All information extracted from UNDP audited financial statements, 2012-2015
- 2014-2015 Management expenditure of $289 million includes EB approved transitionary measures of $132.8 million and Critical cross-cutting management functions of $81.3 million

UNDP - Effective average cost recovery rate calculation

with amounts by funding stream in US$ million dollars

Effective average cost recovery rate:	2014	2015
	6.1%	**6.3%**

Funding stream	2014		2015	
	Non-core programme expenses	Cost recovery revenue	Non-core programme expenses	Cost recovery revenue
Third party Cost Sharing	1,293.4	77.6	1,296.5	82.6
European Union	254.7	16.4	347.4	20.8
Programme Country government Cost Sharing	907.1	35.0	918.0	35.5
South-South Contributions	3.1	0.2	2.6	0.2
Thematic Trust Funds	114.7	6.8	107.8	4.4
GEF	350.8	37.1	374.2	41.7
GFATM	474.0	31.2	423.2	28.6
Montreal Protocol	38.0	2.5	37.4	2.4
LOTFA	382.7	14.7	247.4	9.5
Other Trust Funds	64.1	3.7	51.1	3.6
Grand Total	**3,882.8**	**225.2**	**3,805.5**	**229.3**

The effective average cost recovery rate is calculated as follows:

Total Cost recovery revenue

____

(Total non-core programme expenses less Total Cost recovery revenue)

Planning assumption for implementing cost-recovery rate of 8% was that 50 per cent of 3rd party agreements would be in compliance with the cost recovery policy by the end of 2015. However, UNDP exceeded that initially envisaged level by achieving <u>**76**</u> per cent rate of the compliance by the end of 2015.

Notes:

1. All amounts from Atlas GL in line with UNDP audited Financial Statements for 2014 and 2015.
2. Note that in calculation of the effective average cost recovery rate, the denominator is adjusted for $34.3m for 2014 and $38.5m for 2015 to take into account GEF/Montreal Protocol related accounting.
3. Programme country governments also contribute to offset local office costs through cash as well as in-kind contributions.