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Financial, budgetary and administrative matters

**Progress report towards a harmonized cost-recovery policy**

**Summary**

The present report gives an overview of the current status of the progress made by both the United Nations Entity for Gender Equality and the Empowerment of Women and other United Nations funds and programmes towards achieving a harmonized cost-recovery policy.

It summarizes the findings of the United Nations Development Programme, the United Nations Children’s Fund and the United Nations Population Fund, as presented in their joint paper (DP-FPA/2012/1-E/ICEF/2012/AB/L.6) and presents conclusions on the ongoing approach to be taken.

The Executive Board may wish to review and take note of the conclusions drawn and endorse the formal involvement of the Entity in the inter-agency working group.
I. Background

1. The Executive Board of the United Nations Entity for Gender Equality and the Empowerment of Women (UN-Women), in paragraph 12 of its decision 2011/5 on the biennial institutional budget for the Entity for 2012-2013 (see UNW/2011/13), requests the Under-Secretary-General/Executive Director to submit, for the consideration of the Executive Board at its second regular session of 2012, proposals for the principles, criteria and procedures that should guide the use of cost-recovery income, taking into account the harmonized cost-recovery policies and methodologies used by the United Nations Children’s Fund, the United Nations Development Programme and the United Nations Population Fund.

2. The United Nations Children’s Fund (UNICEF), the United Nations Development Programme (UNDP) and the United Nations Population Fund (UNFPA) undertook a joint review during 2012 of their current cost-recovery principles, policies and approaches. The review recommended a number of fundamental changes to the current methods for calculating and recovering such costs. The entities have prepared a joint report to their respective Executive Boards (see document DP-FPA/2012/1-E/ICEF/2012/AB/L.6). The paper was considered at the second regular session of 2012 of each of their Executive Boards. Major changes have been discussed informally with representatives of the Executive Boards; however, a number of significant issues remain subject to further analysis by the entities. The organizations plan to complete these analyses and hope to obtain final approval for the new approach early in 2013, with implementation commencing in the integrated budgets for 2014-2015.

3. During this time, UN-Women has worked closely with the entities to understand how the proposed changes might affect its existing cost-recovery policy and methodology. Given the major changes expected to occur in cost-recovery methodology, UN-Women cannot at this time present the final set of proposals requested by the Executive Board in its decision 2011/5 if it is to ensure harmonization with the approaches of the three entities, as was also requested.

4. The present document therefore builds on the analysis and conclusions of the joint review paper and contains (a) a brief overview of the current approach of UN-Women in relation to cost recovery; (b) a review of UN-Women alignment with the harmonization process; (c) a summary of the major conclusions and recommendations of the joint review carried out by the three entities and their implications for UN-Women; and (d) the next steps to be taken by UN-Women in developing proposals for the principles, criteria and procedures, in collaboration with the organizations, for cost recovery. The document concludes with a set of proposals for areas in which the Board may wish to give guidance to the Entity.

II. Overview of the current approach of the Entity in relation to cost recovery

5. The cost-recovery approach that UN-Women currently follows has been carried over from the United Nations Development Fund for Women (UNIFEM), which followed an approach based on a harmonized set of principles and cost definitions commonly accepted by United Nations system organizations, as follows:
Harmonized cost-recovery principles

(a) In a multi-funded organization (receiving both regular and other resources), each source of funding should bear all attributable costs relating to the necessary management provided by the organization;

(b) All costs can be classified as direct, fixed indirect or variable indirect costs, based on the mandate and business model of each organization;

(c) While United Nations organizations have agreed on a common definition of cost categories, each organization must match its costs against the categories to make them meaningful. Cost recovery would generally apply to variable indirect costs.

Cost classification: harmonized cost definitions

(a) **Direct costs.** Direct costs are all costs that are incurred for, and can be traced in full to, the activities, projects and programmes of an organization in fulfilment of its mandate. Included are the costs of project personnel, equipment, project premises, travel and any other inputs necessary to achieve the results and objectives established for programmes and projects;

(b) **Fixed indirect costs.** These are all costs incurred by the organization, regardless of the scope and levels of its activities, that cannot be traced unequivocally to specific activities, projects or programmes. These costs typically include the top management of an organization, its corporate costs and statutory bodies not related to service provision.

(c) **Variable indirect costs.** Variable indirect costs are all costs incurred by the organization as a function and in support of its activities, projects and programmes that cannot be traced unequivocally to specific activities, projects or programmes. These costs typically include services and administrative units, as well as their related system and operating costs.

6. In UNIFEM, cost recovery applied to both the variable indirect and direct cost components. With regard to the variable indirect cost, UNIFEM adopted the harmonized cost-recovery methodology and rate of 7 per cent agreed upon by the entities, based on a harmonized calculation methodology as described in annex I. However, the rates calculated by the individual organizations differed, as was expected given their differing sizes and business models. The decision to apply the harmonized rate of 7 per cent was taken to support the notion of harmonization among UNDP, UNFPA and UNICEF and to avoid fostering competition among them based on recovery rates. As a result, the existing policy followed by UN-Women is a single rate of 7 per cent to recover the variable indirect costs of managing projects and/or programmes funded from non-core resources (earmarked funds).

III. Participation of the Entity in the inter-agency harmonization process

7. In response to decision 2011/5 of the Executive Board, UN-Women has joined the entities to participate in the adoption of an integrated budget, starting in 2014. As a result and in accordance with the same decision, the biennial institutional budget for 2012-2013 was prepared and approved on the basis of the harmonized
cost classification and results methodologies approved for UNDP, UNFPA and UNICEF. The cost categories are: development activities, subdivided into programme and development effectiveness; United Nations development coordination activities; management; and special purpose (please refer to annex II for further information). The cost categories are defined as follows:

(a) **Development activities.** The corresponding costs are associated with programmes and development effectiveness activities that contribute to and are essential for the realization of effective development results, as follows:

(i) **Programmes.** Activities and associated costs traced to specific programme components or projects, which contribute to delivery of development results contained in country, regional or global programme documents or other programming arrangements;

(ii) **Development effectiveness.** The costs of activities of a policy and/or advisory nature, and of technical and implementation nature that are needed to achieve the objectives of programmes and projects in the focus areas of the organizations. These inputs are essential to the delivery of development results, and are not included in specific programme components or projects in country, regional or global programme documents;

(b) **Management.** This comprises activities and associated costs whose primary function is the promotion of the identity, direction and well-being of an organization. These activities include executive direction, representation, external relations and partnerships, corporate communications, legal, oversight, audit, corporate evaluation, information technology, finance, administration, security and human resources;

(c) **United Nations development coordination.** This comprises activities and associated costs supporting the coordination of development activities of the United Nations system;

(d) **Special purpose.** This covers activities and associated costs of (i) capital investments; and (ii) services to other United Nations organizations.

8. Over the past few months, UN-Women has reviewed the detailed cost-recovery policies and procedures used by UNIFEM, including the allocation of recovered funds, in the context of current requirements and the evolving new harmonized approach being proposed by UNICEF, UNDP and UNFPA to their Executive Boards. The work done to date will facilitate the preparation of cost-recovery policies and procedures tailored to the organization’s business practices and harmonized with the new approach of the other entities.

**IV. Major conclusions and recommendations of the joint cost-recovery review**

9. The joint review, which was sponsored by the three entities and carried out by a consulting firm, examined the organizations’ business models, benchmarked a number of international organizations and developed proposals for a harmonized framework for defining and attributing organizational costs and a cost-recovery calculation methodology. The conclusions reached and agreed to by the entities were based on and aligned with the harmonized cost classifications previously
approved by their respective Executive Boards and utilized in the institutional budgets for 2012-2013 and were intended to increase simplicity, transparency and comparability.

10. A proposed harmonized conceptual framework has been developed to define and attribute organizational costs in the context of the integrated budget, from 2014 onwards. Details of the proposed harmonized conceptual framework for defining and attributing organizational costs, as excerpted from document DP-FPA/2012/1-E/ICEF/2012/AB/L.6, can be found in annex II.

11. The two most significant changes proposed are (a) that the distinction between fixed and variable indirect costs no longer be used in calculating cost recovery, with the result that all indirect costs be considered in calculating cost recovery and (b) that development effectiveness activities and associated costs be directly funded from core and non-core resources. Therefore, recovered costs would cover a proportional share of management and comparable special purpose costs.

12. The entities also recommend to their Executive Boards that the proposed harmonized cost-recovery rate calculation should factor in an assured level of core resources that would be available to each organization to ensure the funding of those critical, cross-cutting functions and activities that underpin the integrity of their business models and mandates, though there is currently no clear definition of what would be included. Because of the differing business models of the three entities, they further recommend that the funding of development coordination activities and associated costs be addressed in the context of each organization’s integrated budget proposals rather than as part of the harmonized framework.

V. Preliminary analysis of the implications of the proposed harmonized conceptual framework on the cost-recovery methodology of the Entity

13. UN-Women has extensively consulted with the entities and, in addition, has participated in the joint informal sessions of the Executive Boards of UNDP/UNFPA, that were organized to discuss the harmonized cost-recovery methodology in the context of the integrated budget, starting in 2014. The recommendations emanating from the joint review did not lead to the endorsement by the organizations of either a clear cost-recovery methodology or rate. In paragraph 28 of the joint review by UNDP, UNFPA and UNICEF, it is indicated that further analysis and consultations are required to determine whether (a) the current harmonized methodology, from which the existing harmonized rate of 7 per cent is derived, remains appropriate; (b) core donors currently bear an undue share of organizational costs; and (c) the cost-recovery rate for each organization lends itself to harmonization.

14. In conclusion, and based on the findings of the joint review, the entities are seeking further guidance from their respective Executive Boards on the determination of the final cost-recovery rates to be adopted for the period from 2014 to 2017.

15. The potential implications for UN-Women could be significant and result in changes to the current cost-recovery rate. It should be noted, in addition, that a portion of development effectiveness activities, previously funded from the
institutional budget, would need to be directly funded from projects and programmes. This represents $40 million, or 28.3 per cent of the institutional budget for 2012-2013. With regard to the current cost-recovery rate, the Executive Board approved a gross budget while permitting the organization to utilize any cost-recovery resources above the estimated amount to support the institutional budget, on the understanding that a prudent approach was required for the biennium 2012-2013.

16. In addition, it should be noted that the funding for UN-Women is, at present, almost equally split between regular and other resources, although it is clear that this ratio may change as the organization matures.

17. Furthermore, unlike the other entities, UN-Women is also funded from assessed contributions through the regular budget, which represents an approximate annual amount of $7.2 million, and there is a need to determine whether the functions covered under the regular budget should be considered as an integral part of the cost-recovery methodology.

VI. Next steps for the Entity in moving towards a harmonized cost-recovery approach

18. At this juncture, UN-Women is not in a position to put forward a proposal of a harmonized cost-recovery methodology or rate, as had been requested by the Executive Board in its decision 2011/5, in view of the current status of the harmonized cost-recovery approach involving UNDP, UNFPA and UNICEF.

19. In parallel with the other entities involved in developing a harmonized cost-recovery approach, UN-Women will continue to use the current cost-recovery rate and utilization methods for the remainder of the current biennium, with the goal of adopting the new approach for the integrated budget for 2014-2015, subject to approval by the Executive Board.

20. In the short term, UN-Women will continue to work with the entities as they receive additional guidance from their Executive Boards and carry out the analyses necessary to provide the details required to gain approval of the new approach and to permit its implementation in the coming biennium. UN-Women will inform the Board of any major changes to the proposal that are made as a result of the actions of the Executive Boards of the organizations.

21. Given the current expectations of progress by the entities in completing their analyses and support from their Executive Boards, UN-Women intends to present to the Executive Board, at its first regular session of 2013, a proposed set of principles, criteria and procedures to guide the collection and use of cost-recovery income, as harmonized with the approach taken by the three organizations.

VII. Conclusions

22. Based on the discussion above, UN-Women proposes that the Executive Board:

(a) Note that the current cost-recovery approach and methodology used by UN-Women is harmonized with that of UNICEF, UNDP and UNFPA;
(b) Affirm its request that the Under-Secretary-General/Executive Director ensure that all sources of funding bear their fair share of management costs and avoid the subsidization of non-core voluntary resources by core voluntary resources;

(c) Request UN-Women to formally join the inter-agency working group with the objective of arriving at a harmonized cost-recovery framework and methodology;

(d) Request the Under-Secretary-General/Executive Director to submit to the Board, at its first regular session of 2013, proposals for the principles, criteria and procedures that should guide the management of cost-recovery income, in a joint paper produced in conjunction with the entities;

(e) Request that the proposals be accompanied if necessary by a description of the transitional arrangements needed to assure incorporation of the new harmonized approach in the proposals for the integrated budget for 2014-2015.
Annex I

Harmonized calculation for the cost-recovery rate

The analytical approach to developing the existing harmonized cost-recovery rate was calculated as follows:

1. Total the amounts required for the institutional budget.
2. Subtract from this the aggregate fixed indirect costs.
3. The amount in 2. equals the variable indirect costs to be recovered.
4. Take the amount calculated in 3. and split it proportionally, according to the levels of planned core and non-core resources.
5. Take the amount calculated in 4. to be recovered by non-core resources and calculate it as a percentage of planned non-core programme resources.
6. The amount in 5. equals the required non-core cost-recovery rate.
Annex II

Details of the proposed harmonized conceptual framework for defining and attributing organizational costs

The following is an extract from document DP-FPA/2012/1-E/ICEF/2012/AB/L.6 (fig. 1 and paras. 20 to 24).

**Proposed harmonized conceptual framework for defining and attributing organizational costs**

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Total Cost *

Programmes

Development Effectiveness

Management

Special Purpose

Core

Non-Core

Core

Non-Core

Cost Recovery
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Note: * Excludes activities and associated costs of a non-comparable nature, such as those relating to United Nations development coordination activities and special-purpose activities (United Nations Volunteers (UNV) and the United Nations Capital Development Fund).
The proposed harmonized conceptual framework outlined above has the following implications:

(a) In principle, all management activities of the three entities, and such comparable special-purpose activities as capital budgets, would be funded with a level of proportionality through cost recovery. The funding of the activities would be with a level of proportionality shared between core and non-core resources;

(b) Given the unique, ongoing nature of United Nations development coordination activities, and special-purpose activities (United Nations Volunteers (UNV) and the United Nations Capital Development Fund), there continues to be a lack of comparability between the three entities. It is thus proposed that they be excluded from the conceptual framework and addressed separately by each organization within the context of their integrated budget proposals;

(c) In principle, development effectiveness activities and associated costs would need to be directly funded from core and non-core resources. This will require a transition period to ensure that adequate funding mechanisms can be developed and implemented.

The conceptual framework reflects a number of positive elements with respect to cost recovery (harmonization, simplicity and transparency, increased proportionately). But it also has major implications in relation to organizational change and financial aspects, all of which need to be thoroughly considered and planned for in advance. A flexible implementation of the new conceptual framework over a transition period should therefore be considered.

In view of the above, it is proposed that the harmonized cost-recovery rate be calculated as follows:

(a) Calculate the sum of management and comparable special-purpose costs;

(b) Take the amount calculated in step (a) and split it proportionally according to the levels of total planned core and non-core expenditures;

(c) Take the amount calculated in step (b) to be recovered from non-core resources and calculate it as a percentage of total planned non-core development expenditures;

(d) The amount in step (c) equals the notional cost-recovery rate on non-core resources.

The proposed harmonized cost-recovery-rate calculation should also factor in an assured level of core resources that would be available to each organization to ensure the funding of those critical, cross-cutting functions and activities that underpin the integrity of their business models and mandates.

The harmonized conceptual framework and cost-recovery calculation methodology will have an important impact on the extent to which cost-recovery rates can be harmonized and a harmonized proportional attribution of organizational costs between core and non-core resources can be achieved.