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Cost Recovery Update

Joint briefing with the Executive Boards of UNDP, UNFPA, UNICEF, and UN Women
24 January 2018



Outline

1. Background and recap
2. Role of regular resources^(*)
3. Cost recovery models
 - a. 'LEGO' (building block) approach for cost recovery modeling
 - b. High level overview
 - c. Cost recovery rates by agency based on 'LEGO' approach
4. Harmonization
5. EBs guidance and next steps
6. Discussion

Supporting information in Annex

* Also referred to as «core resources»

Background

The Executive Boards in 2017 decided:

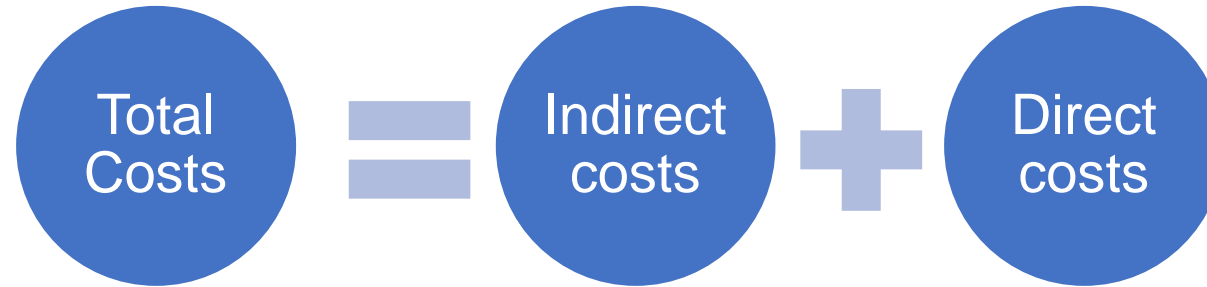
“Acknowledge progress made in cost alignment through implementation of the cost-recovery policy, note further progress should be made, and encourage contributors to adhere to the aspects of the cost-recovery policy approved by the Executive Board in 2013 decision(s).”; and

*“Recall [2013] decisions, in which the Executive Board(s) requested UNDP/UNFPA/UNICEF [later UN Women] to recommend adjustments to the approved cost-recovery rates, as required, to be presented at the 2016 annual session of the Executive Board, note that this process has been delayed, and request [four organizations], to **continue the consultations with Member States** with regard to the cost-recovery policy and to **present evidence-based proposals for harmonized cost-recovery policies** of UNDP, UNFPA, UNICEF and UN-Women, with adjustments, if required, for consideration by the respective Executive Boards no later than their annual sessions in 2018.”*

Progress made

1. The 2018-2021 budgets were prepared on the basis of the current cost recovery policy
2. Improved effective cost recovery on non-core activities (thus reducing the burden on regular resources)
3. Disclosed waivers to policy on an annual basis since 2014
4. Submitted an independent review in September 2016
5. Provided detailed calculations, based on actual expenditure, of effective cost recovery rates for 2014, 2015 and 2016
6. Presented options for possible adjustments to the methodology in 2017
7. Continued engagement with the Executive Boards

Recap: components of costs



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

Indirect costs

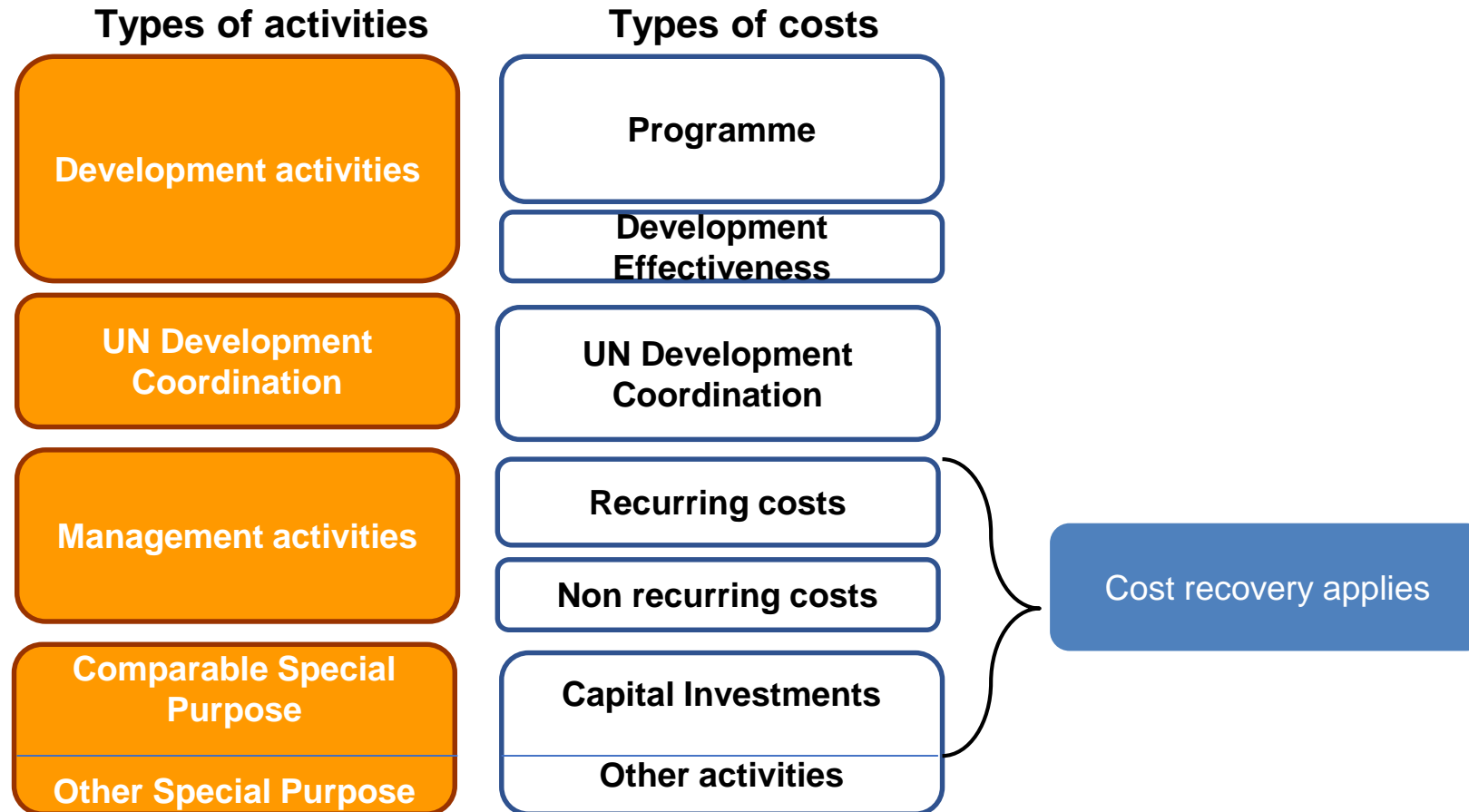
- Costs that are indirectly linked to the delivery of development results are recovered through the cost recovery rate

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.

Recap: What is the link between cost recovery and cost classification?



Recap: Current cost recovery methodology

1. The cost recovery model is designed to recover the designated costs of the Institutional Budget - thus the starting point is the total Institutional Budget
2. The current cost recovery methodology *“takes into account that certain functions that are integral to the existence and the advancement of the mandate of the organizations must be carried out, irrespective of the volume of programme implementation and therefore, their funding must be assured from the regular resources”*
3. Current methodology identifies the following functions to be covered solely from regular resources or directly funded from programmes:
 - a. Development effectiveness activities - directly contribute to the achievement of development results
 - b. UN Development Coordination - largely agency-specific, not-harmonized amongst the four agencies
 - c. Critical cross-cutting management functions - integral to the existence and the advancement of the mandate
 - d. Non-comparable special purpose activities - largely agency-specific, not-harmonized amongst the four agencies
4. The balance is covered by cost recovery, as illustrated in the next slide

Recap: Current Executive Board approved model cost recovery – step by step

Planned **regular** and **other resources funded** expenditure:



Illustrative Example:

Other resources funded expenditure: \$60
Regular resources funded expenditure: \$40

Step 1: Calculate the **IB covered by cost recovery** by taking the total institutional budget and subtracting costs related to Development Effectiveness, Non-comparable Special Purpose, UN Development Coordination and critical, cross-cutting management functions



Total institutional budget (IB): \$12.6
Development Effectiveness: (\$2)
Non-comparable Special Purpose: (\$1)
UN Development Coordination: (\$1)
Critical cross-cutting management functions: (\$1)
IB covered by cost recovery: **\$7.6**

Step 2: Take the amount calculated in step 1 and split it proportionally according to the levels of planned regular and other resources funded expenditures



*IB proportion – other resources : (7.6*60%)* = \$4.56
*IB proportion – regular resources :(7.6*40%)* = \$3.04

Step 3: Take the amount calculated in step (2) to be recovered from other resources and calculate it as a percent of total planned other development expenditures



IB proportion – other resources: \$4.56 / (\$60-\$4.56) = 8.2%
IB proportion – regular resources: \$3.04 / (\$40-\$3.04) = 8.2%

Step 4: The amount in step (3) equals the notional cost-recovery rate on other resources



Result of step 4 = 8.2% established cost recovery rate

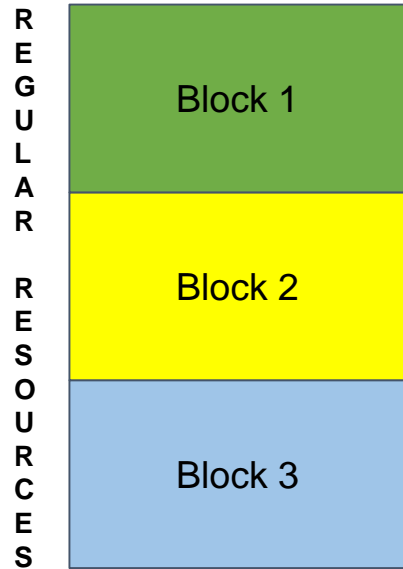
Recap: Key Challenges

1. Continuously declining share of regular resources relative to total resources negatively impact on:
 - a. forward-looking and strategic choices and investments
 - b. ability to deliver on development results
 - c. institutional capacity for quality assurance and accountability
2. Some funding and national government implementing partners are unwilling to include eligible direct costs in programmes. This, by definition, results in cross-subsidization.
3. Some funding and national government implementing partners are unwilling to pay the standard cost recovery rates for indirect costs.
4. Longer-term institutional agreements, including with UN partners, locked into lower cost recovery rates
5. Comparability amongst agencies is affected by different business and funding models, and size
6. While the cost recovery rate is established based on the projected estimates, the actuals will by definition be different (i.e. different income and different actual costs)

Role of Regular Resources

- 1. The QCPR emphasizes two critical concepts that guide the current methodology and the options presented**
 - a. Regular resources form the bedrock of UN operational activities for development, owing to their untied nature
 - b. Regular resources should not subsidize other resources (need for full proportional cost recovery)
- 2. Difference in role of regular and other resources.** The role of regular resources includes support to Member States in the establishment and implementation of UN norms and/or standards to implement strategic plans, as opposed to a project implementation function
- 3. It is critical to ensure a level of regular resources to fund the minimum level of specific essential functions**
- 4. As such, functions funded from regular resources would NOT be covered by cost recovery, and would include:**
 - a. functions mandated to benefit the broader UN development system; and
 - b. functions related to establishing and implementing UN norms and standards across programmatic and institutional areas of work of each agency
- 5. Subsequently, regular resources will be used for funding programmatic activities and the proportional share of the institutional budget. The institutional budget is synergistic and complementary to the programmatic activities**

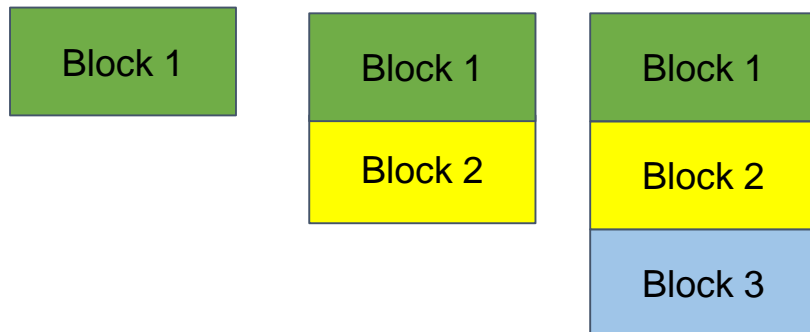
Possible adjustments to cost recovery models – a modular ‘LEGO’ approach



1. The cost recovery model is designed to recover the designated costs of the Institutional Budget - thus the starting point is the total Institutional Budget
2. From this starting point, “blocks” are presented to provide a spectrum of what can be considered as a minimum level of specific, essential functions to be funded from regular resources.
3. These “blocks” would then be solely funded from regular resources and thus excluded from cost recovery
4. The modular “Lego” approach for cost recovery allows for consideration of various options, in line with request of the EBs

Why the “LEGO” approach?

1. Opportunity for EB members to provide direction on **what they see as a critical role of regular resources**
2. LEGO approach - blocks are independent of each other so the final model can be adjusted based on the EB members’ priorities, noting the logical connections among them
3. Thus the indicative rates presented later on, reflect cumulative combinations of the building blocks
4. They are for illustration / guidance and are subject to change depending on the final combination of the chosen LEGO blocks, or elements chosen within the LEGO blocks.

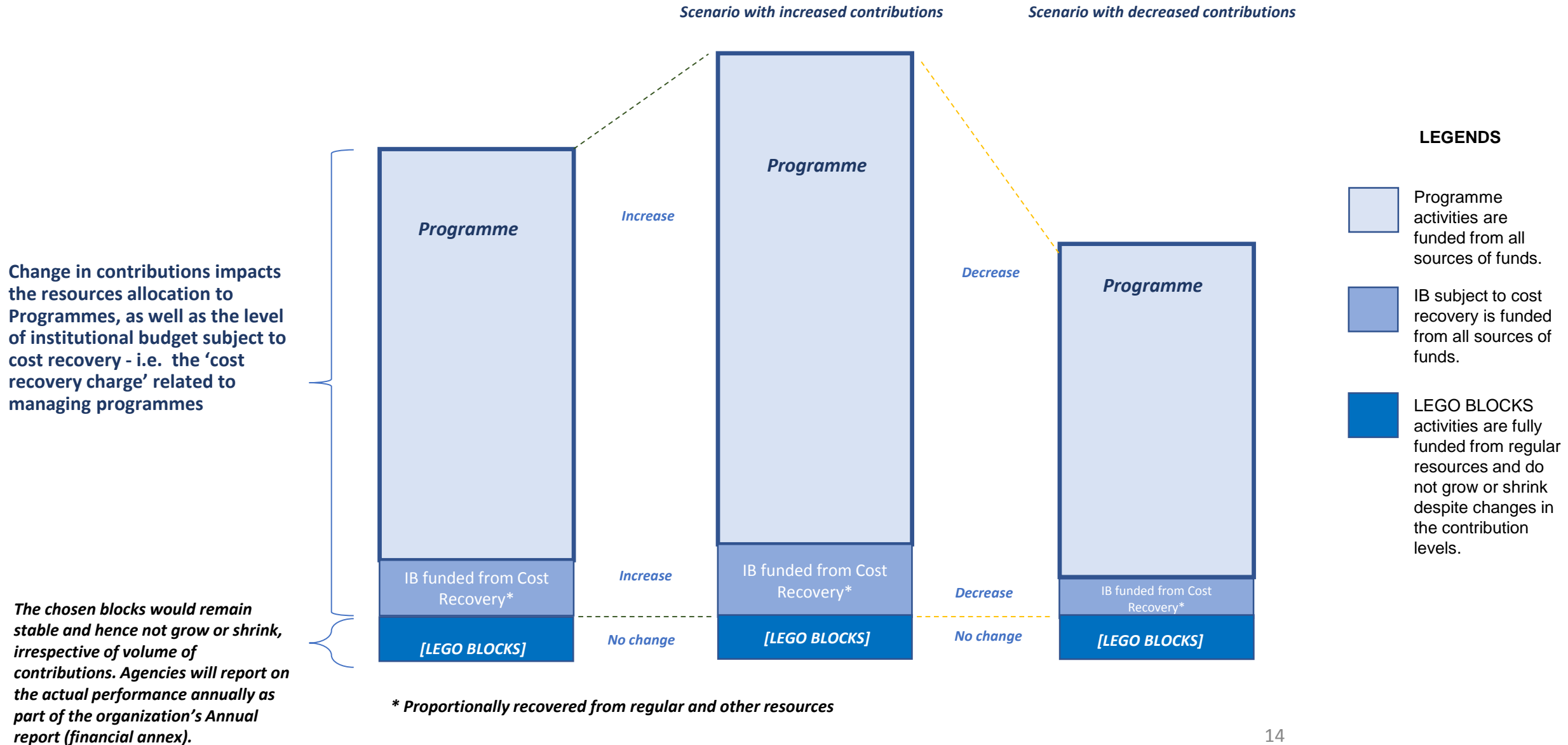


The 'LEGO' approach for activities to be funded from regular resources: three blocks

Block	Description
Block 1: Executive leadership, Country Office leadership, Independent Assurance	Executive Office, Ethics and Ombudsman
	Independent corporate oversight and assurance <ul style="list-style-type: none"> * Internal and external audit and investigation * Evaluation
	Posts of Representative and Deputy Representative (or national equivalent)
	Support to UN Development Coordination
Block 2: Directing advocacy, resource stewardship and technical leadership	Leadership of management functions at HQ and RO levels: Fiduciary, IT, Human Resources, Partnerships and Security management functions
	Leadership of development effectiveness functions at HQ and RO levels: technical leadership, programmatic policy and support for norm setting functions
Block 3: Integrating professional standards, norms and quality assurance	Remaining development effectiveness functions: <ul style="list-style-type: none"> * Integration of professional standards and quality assurance * Programme-policy advisory functions

Green is the minimum. Moving from green to blue, the amount funded from regular resources increases. Remaining institutional budget (including blocks that would not be funded from regular resources) would be covered from cost recovery (proportionally from regular and other resources).

Financial implication of the cost recovery model [regular + other resources]



Overview of costs covered by regular resources vs. cost recovery

	<i>Starting point</i>	<i>Current Model (per decision 2013/9)</i>	Executive leadership, Country Office leadership, Independent Assurance	Previous <i>plus</i> Directing advocacy, resource stewardship and technical leadership	Previous <i>plus</i> Integrating UN norms and standards; and quality assurance
			Block 1 [Green]	Blocks 1 and 2 [Green and Yellow]	Blocks 1, 2 and 3 [Green, Yellow and Blue]
Regular resources covers	<i>Programmes</i>	Programmes <i>Coordination activities; Development Effectiveness activities; Critical cross-cutting management functions</i>	Programmes Coordination activities; Executive and Country Office leadership, Independent assurance;	Programmes Coordination activities; Executive and Country Office leadership, Independent assurance; Directing advocacy, resource stewardship and technical leadership	Programmes Coordination activities; Executive and Country Office leadership, Independent assurance; Directing advocacy and resource stewardship; Professional standards, Quality assurance, normative work and thought leadership
Institutional Budget funded from Cost Recovery (proportionally recovered from regular and other resources)	<i>Full Institutional Budget</i>	Management activities, except abovementioned regular resources funded functions	Management and development effectiveness activities, except abovementioned regular resources funded functions	Management and development effectiveness activities, except abovementioned regular resources funded functions	Management activities, except abovementioned regular resources funded functions

Harmonization - implications

1. Due to different mandates, business models and economies of scale of the four agencies, it is not possible to calculate a **single cost recovery rate** for indirect costs only.
2. There is inherent contradiction between having full cost recovery and having one single harmonized cost recovery rate
3. Where the harmonized standard rate is lower than the required cost recovery rate, the shortfall would be funded from regular resources (or, in the case of UN WOMEN, also from assessed contributions)
4. Nevertheless, the agencies agree that harmonization is beneficial. Harmonization could be achieved across comparable functions or services

Key benefits are presented in the next slide

Harmonization – implications (cont.)

Benefits of continued harmonization

1. The Executive Boards requested agencies to present evidence-based proposals for harmonized cost recovery policies
2. A harmonized rate is an integral dimension to **UN coherence**
3. Provides the right incentives for **Delivering as One** and **Joint programming**
4. This becomes increasingly essential in the context of the call for agencies to work even closer together to help achieve SDGs
5. Reduces the competition among the 4 agencies (not necessarily UN-wide)
6. Simplifies negotiation and reduces the transaction costs

Cost recovery rates comparison by agency – updated based on recently approved budgets

Agency	Starting point (*)	Current Model (per decision 2013/9)	Protected: Executive leadership, Country office leadership, Independent assurance Block 1 [Green]	Protected: Previous plus Directing advocacy, resource stewardship and technical leadership Blocks 1 and 2 [Green and Yellow]	Protected: Previous plus integrating UN norms and professional standards, quality assurance Blocks 1, 2 and 3 [Green, Yellow and Blue]
UNFPA (**)	24.6%	11.3%	13.4%	11.0%	9.3%
UNDP (***)	11.2%	5.9%	7.4%	6.8%	5.8%
UNICEF	11.4%	6.6%	9.1%	8.7%	6.6%
UN Women (****)	30.1%	9.7%	16.9%	12.9%	8.9%

Rates shown cumulatively, for illustration. Final rates will depend on the combination chosen.

The lower the cost recovery rate (due to higher level of protected functions), the greater the draw on regular resources (i.e. less regular resources for programmes)

(*) Starting point is a rate calculated based on equitable funding of an organization’s total Institutional Budget from regular and other resources

(**) UNFPA calculations based on the approved 2018-2021 Integrated Budget, which will be revised in September 2018

(***) UNDP calculations based on the 2018-2019 period.

(****) UN Women executive leadership and much of its normative intergovernmental support is funded from assessed contributions which raises the percentage of the cost recovery rate (see annex)

Next steps

1. Based on today's discussion, and the updated figures provided, continue engagement with the Executive Boards, particularly on:
 - a. Recognizing that it is critical to ensure a level of regular resources to fund the minimum level of specific essential functions
 - b. Preference for either continuing with current methodology, or change based on the LEGO block approach
 - c. Continued use of harmonized rates, based on the presented options, noting the implications on regular resources
2. Prepare a board paper for June 2018
3. EB decision at the annual session 2018



Thank you!
Discussion



Annex – Agency specific details

UNFPA: Comparison current vs. potential adjusted methodology (based on 2018-2021 IB) (in US\$ Million)

Use of resources		Starting point	Current Model (per decision 2013/9)	Executive leadership, Country Office leadership, Independent Assurance	Directing advocacy, resource stewardship and technical leadership	Integrating professional standards, norms and quality assurance
A1	Regular resources (RR)	1,392.3	1,392.3	1,392.3	1,392.3	1,392.3
A2	Other resources (OR), gross (A)	2,194.1	2,194.1	2,194.1	2,194.1	2,194.1
	Total	3,586.4	3,586.4	3,586.4	3,586.4	3,586.4
1. Calculate the proportionate percentage share of RR and OR in the planned use of resources						
B1	UNF	39%	39%	39%	39%	39%
B2	Proportionate share OR (B)	61%	61%	61%	61%	61%
2. Calculate the sum of management and comparable Special Purpose costs [and remove costs related to critical, cross-cutting functions]						
C	Institutional Budget	708.4	708.4	708.4	708.4	708.4
	Less					
C1	Development Effectiveness Activities		(141.0)			
C2	Non-Comparable Special purpose Activities		(20.0)			
C3	UN Development Coordination Activities		(9.4)			
C4	Critical cross-cutting management functions based on standard costs		(174.8)			
C5	Agency specific areas (RC system support, support to other agencies)			(9.4)	(9.4)	(9.4)
	Non-Comparable Special purpose Activities			(20.0)	(20.0)	(20.0)
	Country Office leadership			(183.4)	(183.4)	(183.4)
	Executive leadership			(26.6)	(26.6)	(26.6)
	Independent Assurance			(45.9)	(45.9)	(45.9)
C6	Directing advocacy, resource stewardship and technical leadership				(67.1)	(67.1)
C7	Integrating professional standards, norms and quality assurance					(50.3)
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:C7)	Institutional Budget Subject to Cost Recovery based on approved methodology	708.4	363.2	423.1	356.1	305.8
E1=B1*D	Regular Resources Proportional Share of IB	275.0	141.0	164.3	138.2	118.7
E2=B2*D	Other Resources Proportional Share of IB	433.4	222.2	258.9	217.8	187.1
	F=E2/(A2-E2) Notional Rate	24.6%	11.3%	13.4%	11.0%	9.3%

UNICEF: Comparison current vs. potential adjusted methodology (based on 2018-2021 IB) (in US\$ Million)

Use of resources		Starting point	Current Model (per decision 2013/9)	Executive leadership, Country Office leadership, Independent Assurance	Directing advocacy, resource stewardship and technical leadership	Integrating professional standards, norms and quality assurance
A1	Regular resources (RR)	6,420.3	6,420.3	6,420.3	6,420.3	6,420.3
A2	Other resources (OR), gross (A)	17,550.6	17,550.6	17,550.6	17,550.6	17,550.6
	Total	23,971.0	23,971.0	23,971.0	23,971.0	23,971.0
1. Proportionate percentage share of RR and OR in the planned use of resources						
B1	Proportionate share RR	27%	27%	27%	27%	27%
B2	Proportionate share OR (B)	73%	73%	73%	73%	73%
2. Management and comparable SP costs (net of critical, cross-cutting functions, DE and UNDC)						
C	Institutional Budget	2,455.5	2,455.5	2,455.5	2,455.5	2,455.5
	Less					
C1	Development Effectiveness Activities (incl OR)		(721.9)			
C2	Non-Comparable Special purpose Activities		-			
C3	UN Development Coordination Activities		(49.3)			
C4	Critical cross-cutting management functions based on standard costs		(202.1)			
C5	Agency specific areas (RC system support)			-23.3	-23.3	-23.3
	Country Level Leadership			-339.0	-339.0	-339.0
	Corporate Leadership and Direction			-37.2	-37.2	-37.2
	Corporate Oversight Assurance and Evaluation			-47.8	-47.8	-47.8
C6	HQ and RO leadership for harmonized management functional clusters: Corporate HR, External Relations & Partnership; Security; Finance/ICT; Field Oversight, Managemnt and Support				-53.0	-53.0
C7	Leadership at HQ and RO level for DE functions				-41.0	-41.0
C8	Remaining Development Effectiveness Activities					-433.6
3. Step 2. split proportionally according to the levels of total planned RR and OR use of resources						
D	Institutional Budget Subject to Cost Recovey	2,455.5	1,482.2	2,008.2	1,914.2	1,480.6
E1=B1*D	Regular Resources Proportional Share of IB	657.7	397.0	537.9	512.7	396.6
E2=B2*D	Other Resources Proportional Share of IB	1,797.8	1,085.2	1,470.3	1,401.5	1,084.0
F=E2/(A2-E2)	Notional Rate	11.4%	6.6%	9.1%	8.7%	6.6%

UN WOMEN

UN Women has a formal normative mandate as established by its founding resolution 64/289. Normative leadership positions are funded from Assessed contributions and thus not included in the Institutional Budget unlike the other sister entities. These leadership positions include Executive Director (USG\ED), one of the two Deputy Executive Directors (ASG), Chief of Staff (D2). This alters the basis for comparison (where leadership is paid for by IB by other agencies), leading to a much higher rate for UN Women than other agencies

UN Women: Comparison current vs. potential adjusted methodology (based on 2018-2019 IB) (in US\$ Million)

Use of resources		Starting point (no subsidization)	Current Model (some subsidization)	Executive leadership, Country Office leadership, Independent Assurance	Directing advocacy, resource stewardship and technical leadership	Integrating professional standards, norms and quality assurance
A1	Regular resources (RR)	400.0	400.0	400.0	400.0	400.0
A2	Other resources (OR), gross (A)	480.0	480.0	480.0	480.0	480.0
	Total	880.0	880.0	880.0	880.0	880.0
	1. Calculate the proportionate percentage share of RR and OR in the planned use of resources					
B1	Proportionate share RR	45%	45%	45%	45%	45%
B2	Proportionate share OR (B)	55%	55%	55%	55%	55%
	2. Calculate the sum of management and comparable Special Purpose costs [and remove costs related to critical, cross-cutting functions]					
C	Institutional Budget	203.8	203.8	203.8	203.8	203.8
	Less					
	Development Effectiveness Activities		(50.1)			
	Non-Comparable Special purpose Activities		(3.0)			
	UN Development Coordination Activities		(27.2)			
C1	Critical cross-cutting management functions based on standard costs		(45.9)			
C2	Agency specific areas (RC system support, support to other agencies)			(27.2)	(27.2)	(27.2)
C3	CO leadership			(38.9)	(38.9)	(38.9)
C4	Corp leadership & direction			(10.5)	(10.5)	(10.5)
C5	Corp oversight & assurance					
C6	Non-CO (ie HQ + RO) leadership (D1 & above + 30% goe for harmonized management functional clusters re: Corp HR, Corp External relations & Partnership; Security; Corp Finance/ICT etc; Fiedl Oversight, Managemnt, support)				(14.5)	(14.5)
C7	Leadership at HQ and RO level for DE functions (D1 % above + 30% goe)				-12.30	-12.30
C8	remaining Development Effectiveness at HQ + RO levels					(28.4)
D=C-	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					
(C1:C8)						
E1=B1*	Institutional Budget Subject to Cost Recovey based on approved methodology	203.80	77.65	127.20	100.39	71.97
E2=B2*	Regular Resources Proportional Share of IB	92.64	35.29	57.82	45.63	32.71
F=E2/(A	Other Resources Proportional Share of IB	111.16	42.35	69.38	54.76	39.26
	Notional Rate	30.1%	9.7%	16.9%	12.9%	8.9%

UNDP: Comparison current vs. potential adjusted methodology (based on 2018-2019) (in US\$ Million)

	Use of resources	Starting point	Current Model (per decision 2013/9)	Executive direction and leadership; C.O. leadership; Independent assurance	Previous + Directing Advocacy, Resource stewardship and technical leadership	Previous +integrating norms and professional standards, quality assurance
A1	Regular resources (RR)	1,353	1,353	1,353	1,353	1,353
A2	Other resources (OR), gross (A)	10,320	10,320	10,320	10,320	10,320
	Total	11,673	11,673	11,673	11,673	11,673
	1. Calculate the proportionate percentage share of RR and OR in the planned use of resources					
B1	Proportionate share RR	12%	12%	12%	12%	12%
B2	Proportionate share OR (B)	88%	88%	88%	88%	88%
	2. Calculate the sum of management and comparable Special Purpose costs [and remove costs related to critical, cross-cutting functions]					
C	Institutional Budget	1,286	1,286	1,286	1,286	1,286
	Less					
C1	Development Effectiveness		(248)			
C2 - a	Non-Comparable Special purpose Activities (core funded)		(22)			
C2 - b	Non-Comparable Special purpose Activities (other un agency / external party reimbursable services)	(112)	(112)			
C3	UN Development Coordination Activities		(161)			
C4	Critical cross-cutting management functions based on standard costs		(90)			
	Agency specific area: RC system support			(161)	(161)	(161)
	Agency specific area: reimbursable support to other UN agencies			(112)	(112)	(112)
C5	Agency specific areas: support to UNV/UNCDF			(22)	(22)	(22)
	C.O. leadership (excluding RC which is embedden above)			(122)	(122)	(122)
	Executive leadership			(16)	(16)	(16)
	Independent assurance			(45)	(45)	(45)
C6	Directing advocacy, resource stewardship and technical leadership				(69)	(69)
C7	Integration professional standards, norms and quality assurance					(98)
	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-C8]	Institutional Budget Subject to Cost Recovey based on approved methodology	1,174	654	808	739	642
E1 = B1 * D	Regular Resources Proportional Share of IB	136	76	94	86	74
E2 = B2 * D	Other Resources Proportional Share of IB	1,038	578	714	653	567
F = E2/[A2-E2]	Notional Rate	11.2%	5.9%	7.4%	6.8%	5.8%