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Review of the UNICEF cost-recovery policy

Summary

The present report has been prepared in response to Executive Board decision 2003/9, in which the Board requested the Executive Director to review the performance of the recovery policy adopted in 2003.

It is recommended that the Executive Board approve changes in the base recovery rate with the accompanying incentives that enhance thematic funding, private sector fund-raising and UNICEF participation in joint United Nations programmes, based on greater simplification and harmonization with the members of the United Nations Development Group Executive Committee, in order to strengthen the ability of UNICEF to collaborate more effectively with a wide array of development partners in achieving the Millennium Development Goals.

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06-30131 (E) 030506
0630131

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Executive summary: From complexity to simplicity in support of partnerships

1. A principal objective of UNICEF, given its ambitions to help achieve the Millennium Development Goals as articulated in the medium-term strategic plan (MTSP) for 2006-2009 (E/ICEF/2005/11), is to enhance the organization's ability to work with a large array of development partners to leverage resources and results for children. UNICEF is currently conducting an organization-wide review of policies and processes which will include gauging their impact on partnership-building. The review of the recovery policy is timely given the rapidly changing environment in which UNICEF operates, not only with regard to the global consensus around the Millennium Development Goals, but also the implementation of United Nations reforms, as demonstrated in joint programming (see document E/ICEF/2006/13, also being presented to the Board at the annual session of 2006) and the drive for aid effectiveness. The recovery policy has been seen in the past more or less strictly in the context of the financial operations of UNICEF, but the present report goes beyond this specific context into the wider implications for UNICEF.

2. The recovery policy on other resources income, approved by the Executive Board in decision 2003/9 (E/ICEF/2003/9/Rev.1), in many instances has hindered the ability of UNICEF to be an effective partner. It is considered too complex with its 15 different contribution categories and seven distinct recovery rates. UNICEF staff have had to spend inordinate amounts of time clarifying between field offices and headquarters what rates apply in each case, and explaining the policy to donors, many of them at country level (where decisions about contributions are made) and who often are not fully aware of the Board's decision. Particular difficulties in securing other resources contributions have also been encountered with the European Commission, international financial institutions such as the World Bank, and the Global Fund to Fight AIDS, Tuberculosis and Malaria, which are critical partners to UNICEF in advancing children's issues. Difficulties encountered in reaching financial agreements significantly decrease the willingness to enter into substantive collaborative efforts on a broader agenda that can lead to positive results for children.

3. This time spent has given the appearance that UNICEF is a difficult agency to work with, that its recovery rates are higher than those of other United Nations agencies, especially the members of the United Nations Development Group (UNDG) Executive Committee,[1] and that it is also expensive as a programme implementer. Time spent on processing contributions has taken UNICEF staff away from managing the results intended from other resources-funded programmes, and away from enhancing the policy and strategy dialogue with UNICEF development partners that is critical to ensuring that children are given priority in actions aimed at achieving the Millennium Development Goals.

4. Despite the complexity, the resources picture has continued to improve, with increases in both regular and other resources since the current policy was adopted in 2003. Thematic funding has been introduced (reaching 12 per cent of contributions in 2005), decreasing transaction costs and moving UNICEF towards programme

[1] UNICEF, the United Nations Development Programme (UNDP), the United Nations Population Fund (UNFPA) and the World Food Programme (WFP).

support and away from projects, which is a major element in increasing aid effectiveness. Nevertheless, UNICEF is still dependent on small contributions, with over 80 per cent of other resources contributions in 2005 less than $1 million. Incentives in the current policy for larger contributions have not materialized to any significant extent. Into the future, the question needs to be more how to continue to be successful at managing a large number of small contributions in support of programmes rather than expecting a significant change to a smaller number of larger contributions.

5. UNICEF is recommending an adjustment of the base rate of recovery to 7 per cent, with continued incentives for thematic contributions and large contributions. Some flexibility is also required for joint United Nations programmes where agencies share resources. This rate of 7 per cent is used by all UNDG Executive Committee agencies, although UNDP has a range of between 7 and 5 per cent, which UNICEF would also have in the new schedule by recognizing thematic funding.

6. It is estimated that a new base rate with incentives would not fully meet the recovery amount approved in the 2006-2007 support budget, with a $10 million shortfall based on current projected other resources income for the biennium. UNICEF believes that the adjustment would expand the opportunities for receiving additional other resources income beyond the current forecast and thus, based on the new schedule, make up the gap. More importantly, the simplification introduced will enhance UNICEF management of results and, with increased harmonization, make UNICEF a much more engaged partner in development in the drive to meet the Millennium Development Goals, which is the core focus of the MTSP.

I. Introduction: Nearly 40 years of recovery experience

7. The UNICEF recovery policy dates back to 1968 when the first “noted” projects were approved by the Executive Board. Only in 1987 was the first cost-recovery rate on other resources-funded programmes levied, with subsequent changes in 1996, 1998 and 2003.[2]

8. Simply stated, cost recovery is the charge levied on other resources programme expenditures for the estimated incremental costs to UNICEF associated with taking on the responsibility for implementing these programmes (see annexes I, II and III). Cost recovery recognizes that there are specific incremental costs involved in taking in other resources income. UNICEF does not have a limitless capacity to implement other resources-funded programmes. By incorporating recovery into the support budget approved by the Executive Board every two years, UNICEF takes an integrated view of its capacity requirements to achieve the specific targets and results contained in the MTSP, based on the income projections UNICEF has established.

9. The underlying principles of the recovery policy are:

(a) Other resources programmes should be channelled to priority areas approved in the MTSP;

[2] The history of the recovery policy prior to 1998 is detailed in E/ICEF/1998/AB/L.6, Annex I.

(b) Regular resources should not be used to subsidize other resources-funded programmes, to the extent possible;

(c) The recovery policy should be structured to encourage reduction in transaction costs, while keeping the mechanism simple and transparent to administer.

10. The current schedule identifies 15 different categories with seven different percentage rates.[3] The main variables considered are private sector versus other contributions, thematic versus non-thematic contributions, the size of the contribution and whether or not more than 90 per cent of funds are provided up front. The main incentives are towards thematic and large contributions. The main rationale for these incentives has been to reduce transaction costs to the greatest extent possible.

11. The present report responds to the Executive Board's request, in decision 2003/9, for a report on experiences of the cost-recovery policy (see annex IV for the relevant paragraphs of the decision). The Board subsequently agreed to discuss the report at the annual session of 2006.

12. In conducting its review of performance and results of the recovery policy, UNICEF has consulted widely among its field and headquarters offices, other United Nations agencies and National Committees for UNICEF, providing a quantitative and qualitative analysis not just of its impact on income but of how the recovery policy impacts the results UNICEF aims to achieve through other resources-funded programmes, and on its commitment to enhance harmonization with the UNDG Executive Committee agencies.

13. This analysis has prompted UNICEF not just to report to the Executive Board on progress but to request that the Board approve changes in the recovery schedule.

II. Implementation performance: Focus on process rather than results

14. The responses to a survey of country and regional offices and National Committees about the current recovery policy point to some specific areas of concern:

(a) Many country offices forego the inclusion of (sufficient) direct project support costs in project proposals, due to the 'high' recovery rate of indirect costs having a potentially negative impact on implementation rates and on achieving results. For example, the Ethiopia office reported, "It is difficult to negotiate our own programme operations costs and staff salaries over and above a high recovery cost"; and the Viet Nam office said, "Two donors were reluctant to include direct project support costs on the basis that this was inappropriate in addition to their contribution through recovery";

(b) Because of perceived high recovery rates and some ability to modify rate reductions by changing contribution variables,[4] significant time is spent explaining and negotiating contributions with donors on both direct costs and cost-recovery

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[3] E/ICEF/2004/AB/L.5.

[4] Moving contributions to the thematic category or to >90 per cent funds up front are ways recovery rates can be adjusted within the approved schedule; in addition, foregoing (some) identified direct costs can make the recovery more acceptable to donors.

rates, which increases transaction costs, causes delays in seizing opportunities and gives the appearance of “UNICEF being difficult to work with”. The Indonesia office said that the “country office received the money for Aceh but after prolonged negotiation and the donor agreeing to reporting against the CAP [Consolidated Appeal] rather than a separate report”. The Pacific Islands office said, “It took a year to negotiate the agreement with the Principal Recipient and the Secretariat of the Pacific Community for UNICEF to become a sub-recipient of the Global Fund to fight AIDS, Tuberculosis and Malaria and one of the sticking points was the cost-recovery rate”;

(c) Cost-recovery rates can disproportionately affect smaller countries and countries with higher gross national income per capita and low levels of regular resources as they are often offered small contributions at high cost-recovery rates which they are unable to secure and lose to other partners. The Central and Eastern Europe and the Commonwealth of Independent States office said, “The region has lost a total of $12 million in other resources income; another agency with a lower cost-recovery rate has been the preferred partner for donors even in UNICEF priority areas of child protection and HIV/AIDS”;

(d) The current policy weakens the UNICEF position in joint United Nations programmes[5] and can impede UNICEF from participating in joint programmes or can cause protracted negotiations which delay their inception. The Honduras office said, “six United Nations agencies including UNICEF applied to the United Nations Human Security Trust Fund for financing support to a project on preventing violence in children, but with the Trust Fund establishing a cap of 10 per cent on recovery and UNDP taking 1 per cent as ‘pass through’, UNICEF has not been able to agree on 9 per cent recovery when other agencies have adjusted their recovery rate to do so”;

(e) The Financial and Administrative Framework Agreement between the European Commission and the United Nations caps cost recovery at 7 per cent, which significantly constrains the ability of UNICEF to access funding with the current rates that are above 7 per cent;

(f) The time spent on transactional issues with partners has a significant opportunity cost as it reduces the ability of UNICEF to engage in policy and strategy discussions with them and to leverage resources and results for children, again giving the appearance of “UNICEF being a poor partner”;

(g) There are specific examples of lost contribution opportunities to UNICEF from all regions, but many cannot be easily identified because many may have never reached the organization at all. The Democratic Republic of the Congo office said, “Prior to the project submission on orphans and vulnerable children, the Country Coordination Mechanism for the Global Fund agreed that the ceiling recovery rate for the subrecipient would be 5 per cent, as the Principal Recipient already receives 5 per cent, but the UNICEF recovery rate was 11 per cent, losing UNICEF the opportunity to be subrecipient for the project”. The Kosovo (Serbia

[5] Joint programmes are directed by the UNDG Guidance Note on Joint Programming, issued 19 December 2003, and refer to programmes where United Nations organizations collectively support national development partners to prepare, implement, monitor and evaluate activities aimed at achieving the Millennium Development Goals.

and Montenegro) office said the "recovery rate was too high to secure a World Bank grant of $2 million for support to youth programmes" .

15. A critical factor running through implementation is that UNICEF is perceived as a difficult partner, with recovery rates that are considered expensive and with undue time spent on agreements for specific contributions. Cost-recovery rates are not the only impediment to a financial partnership, however. Others include audit stipulations by donors that run counter to United Nations audit principles, use of interest on unspent balances of other resources funds, request for separate accounts and extraordinary reporting requirements.

16. The general direction of the response points to the need for: simplification in the UNICEF cost-recovery schedule to improve efficiency and speed and reduce transaction costs; lower rates that also more closely harmonize with those of other UNDG Executive Committee members to minimize lost opportunities; and flexibility in joint United Nations programmes to enhance joint efforts in the spirit of the reform process.

III. Financial performance: Managing large numbers of small contributions

17. The financial performance of the recovery policy has been far more positive than the implementation performance. Since 2003, regular resources income has increased by 11 per cent and other resources income (excluding emergencies) has increased by 60 per cent, based on 2005 figures. The number of contributions rose from 1,219 in 2003 to 1,715 in 2005, a 40-per-cent increase over two years. The overall average size of contributions increased from $0.8 million in 2003 to $1.1 million in 2005, with $0.9 million for non-thematic and $2.9 million for thematic contributions. There has been no apparent negative effect of the recovery policy on income, or on the number of contributions. Nevertheless, 81 per cent of all contributions in 2005 were still less than $1 million.

18. Thematic contributions have attracted an important segment of other resources income and have proven particularly helpful in emergency situations because of the flexibility they afford in enhancing the organization's ability to respond to evolving requirements as circumstances develop. In the second half of 2003, subsequent to the approval of the recovery policy, there were 16 thematic contributions totalling $29 million. In the biennium 2004-2005, 280 thematic contributions amounted to $750 million.

19. Taking a longer-term view, the figure in annex V shows a clear trend of increases in UNICEF income, from $455 million in 1986 to $2,761 million in 2005. The rate of growth is clearly highest for other resources income, for which Governments and the private sector have increased the ratio of their contributions over regular resources (annex V, table 1). The projected ration for 2006-2007 will be around 40 per cent regular resources and 60 per cent other resources.

20. The actual value of cost recovery has increased from $31 million in the 1998-1999 biennium to $163 million in the 2004-2005 biennium, reducing the level of regular resources used in the support budget from 44 per cent in the 1998-1999 biennium to 35 per cent in the 2004-2005 biennium (annex V, table 2). The actual cost-recovery rate in the 2004-2005 biennium was 7.2 per cent, even with rates

ranging from 12 to 5 per cent. The rate is projected to be 7.0 per cent in the approved support budget for 2006-2007, based on the current schedule.[6]

21. While integration of a recovery target into the support budget provides greater transparency, this process would suggest a logic for adjusting the recovery rate or rates for each biennium. This is clearly undesirable, as adjusting rates every two years would be disruptive and confusing. An alternative approach would be a review every four years, coinciding with the MTSP cycle, when any major structural changes and ensuing modifications in cost structures are most likely to occur. In addition, based on the history of cost recovery, this is a reasonable period to analyze specific trends in other resources income.

22. A summary of experience indicates that:

(a) the general size of contributions is increasing but there continues to be a large number of smaller contributions, demonstrating the diversified origin of contributions;

(b) the reductions in the cost-recovery rate for size of contributions do not appear to have resulted in a noticeable movement to larger contributions but they do recognize the economies of scale for larger contributions;

(c) there is an increase in the number of contributions over $10 million;

(d) thematic contributions have been successful in increasing flexibility and reducing administrative burden, and have been received well as an option by donors;

(e) recovery rates should be reviewed at the end of each MTSP cycle.

23. It is surmised that the continuing positive financial situation facing UNICEF, even in the face of ‘high’ recovery rates, points to recognition by donors that UNICEF, through its wide infrastructure, is able to successfully assume accountabilities for programme results, noticeably in complex situations and often at short notice. This does not, however, lessen the fact that UNICEF faces lost opportunities with its current policy.

IV. Harmonization status: UNICEF still divergent from other agencies

24. The High-Level Committee on Management (HLCM) reviewed the issue of cost recovery at its tenth session in October 2005. A report had been prepared by a working group, led by the United Nations Educational. Scientific and Cultural Organization, that was mandated to draw up common principles for cost recovery which compensate agencies fairly for their backstopping costs and prevents unreasonable competition among agencies.[7]

25. There was consensus among the agencies on terminology and the specific definitions of direct, fixed indirect and variable indirect costs used in assessing cost recovery. There was no consensus, however, on how to recover costs, except that all direct costs should be charged directly to projects, and all variable indirect costs should be recovered, “if possible” as a cost component of the project budget.

[6] E./ICEF/2006/AB/L.1.

[7] CEB/2005/HLCM/R.22.

26. The HLCM encouraged organizations to exchange information on cost-recovery methodologies with the view to the further harmonization of practices. As such, the issue of harmonizing recovery rates was not addressed directly in spite of the fact that the cost-recovery rate is the most visible element of cost recovery and the main cause of competition among agencies.

27. The UNDG Executive Committee agencies, through a specific working group on cost recovery, continue to review the potential harmonization of recovery rates in the context of joint United Nations programmes, especially in the context of multi-donor trust funds. Of the four agencies, UNICEF has the highest range of recovery rates and is furthest from harmonization, at least in terms of rates, and it loses opportunities to other United Nations agencies, including UNDG Executive Committee members.

28. The UNDP cost-recovery policy indicates that the calculations performed in its recovery methodology are similar to those of UNICEF.[8] UNDP identified an 'ideal' cost-recovery rate of 7.6 per cent for the 2004-2005 biennium, and set a recovery rate ranging from 7 to 5 per cent for third party cost-sharing and trust funds. Both UNFPA and WFP have a 7-per-cent recovery rate.

V. The need for schedule change: Freeing up staff time to focus on results

29. The principal need for changing the recovery schedule is that it has already been identified as a factor that is hampering the ability of UNICEF to be a full and effective development partner. This reduces the potential UNICEF contribution to the achievement of the Millennium Development Goals and to the implementation of the United Nations reforms. Opportunities for UNICEF to enhance its partnering to leverage resources for children have been lost with staff time overly concentrated on conducting processes as opposed to managing results. A new recovery schedule will need to be established to achieve a dynamic and effective approach that frees up staff time to concentrate on the broader challenges facing children.

30. More specifically, UNICEF has not been able to fully follow the underlying principles governing cost recovery, mainly due to its complexity and high recovery rates. While other resources programmes have been focused on MTSP priorities and there is a general trend towards reducing the subsidization of other resources programmes by regular resources, the policy has not been simple to operate and has not reduced transaction costs.

31. From the analysis, there are three basic objectives for an enhanced cost-recovery schedule that overcomes the difficulties of the current schedule, which is overly complex, is not fully harmonized, has high transaction costs and causes lost opportunities: (a) simplification, to improve efficiency, reduce transaction costs and free up staff time; (b) harmonization, within the context of the UNDG Executive Committee agencies; (c) fiscal prudence, to ensure that recovery targets are met.

32. The purpose in reviewing changes in the cost-recovery schedule is to optimize all three objectives to the greatest extent possible.

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[8] See DP/2004/35, on UNDP strategic cost management and implications for cost recovery.

VI. New schedule recommendation: One base rate with selective incentives

33. The analysis of cost recovery considered seven different options (detailed in annex VI). Two options reviewed the current model and a modification of it. Three options considered moving to a schedule with one or two percentages. One assessed the potential for moving towards structured fees and another looked at not having any cost recovery at all.

34. The current schedule, in its present or a modified form (options 1 and 2), is projected to meet the recovery target in the 2006-2007 support budget, but does not meet the basic objectives of simplification and harmonization, plus its complexity and high recovery rates would continue to constrain positive partnering. At the other extreme, having no cost recovery (option 7), while putting UNICEF into an advantageous position as a partner, would require a significant restructuring of the support budget and use significant additional regular resources, while at the same time diverging completely from harmonization efforts.

35. Attempting to allocate all costs, both direct and variable indirect, to other resources-funded programmes through a schedule of fees (option 6) does not meet the objective of simplification as a process of allocating all costs would be very complex.

36. Thus, the analysis has focused on re-establishing a base recovery rate (options 3, 4 or 5), with some incentives to sustain the positive features in the current schedule, particularly thematic funding. However, simplification requires a very limited number of exceptions to the base rate, or this objective cannot be not met.

37. Given the objectives of simplification, harmonization and fiscal prudence, together with the performance of recovery in the last four budget cycles and the projection for 7-per cent recovery in the 2006-2007 support budget, it is recommended that a base recovery rate of 7 per cent be set for other resources programmes. Two elements would be retained from the current policy based on their success: (a) thematic contributions would be assessed at 5 per cent; and (b) private sector non-thematic contributions in programme countries (with the private sector supporting UNICEF programmes in its own country) would continue to be assessed at 5 per cent.

38. In addition,: (a) a reduction of 1 per cent would be applied to non-thematic contributions over $40 million subject to the Executive Director being satisfied that economies of scale are applicable, especially in terms of funds management and reporting requirements; and (b) a reduction of 1 per cent would be applied to non-thematic joint United Nations programmes, particularly where another agency or agencies also apply recovery, subject to the Executive Director being satisfied that this will enhance partnership among United Nations agencies.

VII. Implications of the changed schedule: More effective approach with a small financial risk

39. UNICEF considers that the proposed change in schedule: (a) makes the approach simple; (b) reduces transaction costs and frees up staff time; (c) continues the positive momentum of private sector fund-raising; (d) harmonizes with UNDG

Executive Committee members in terms of rates; (e) adapts to the needs of joint United Nations programmes; (f) provides sufficient incentive for thematic funding; and (g) provides incentive for large contributions.

40. Simplification and harmonization will be optimized using one base rate that is common among the UNDG Executive Committee members. In terms of fiscal prudence, there is a slight risk to be considered, especially in terms of continuing the incentive for thematic funding at 5 per cent. This will be mitigated by increased other resources income, as discussed below.

41. Based on the 2004-2005 ratio in the value of thematic and non-thematic income of 19 per cent and 81 per cent, the proposed change would bring a recovery amount of $151 million from projected other resources expenditures of $2,307 million in 2006-2007.

42. Since the projected recovery amount approved in the 2006-2007 support budget is $161 million, there would be a shortfall of approximately $10 million against the projected level of other resources income. To recover this additional $10 million, other resources contributions would have to increase by $165 million, based on the 2004-2005 ratio for thematic and non-thematic contributions.

43. UNICEF believes that with harmonized rates and a simpler overall approach, there will be greater opportunities for obtaining additional other resources contributions. In addition, actual other resources income has consistently been higher than projected in the support budget, as shown in the table below. Both of these factors would indicate that the gap will be met.

Table
Other resources income, projected and actual, 1998-1999 to 2004-2005

Budget	*1998-1999*	*2000-2001*	*2002-2003*	*2004-2005*	*Total*
Projected other resources income	780	886	1 220	1 833	4 719
Actual other resources income	924	1 250	1 702	3 136	7 012
Variation actual over projected	+18%	+41%	+40%	+71%	+49%

44. More importantly, greater simplification will enable UNICEF staff to spend greater time on achieving the results intended from other resources contributions and UNICEF will be a much more collaborative partner in implementing the MTSP in support of the Millennium Development Goals.

45. In conclusion, the analysis of experience with the recovery policy has shown that this policy has to be viewed in a broader organizational context. Even with a continuing positive financial outlook, UNICEF has to continue to ensure that its policies enhance its ability to achieve full and effective working partnerships, both within and outside the United Nations system, for improved results for children. The current policy has caused difficulties for UNICEF in securing many other resources contributions, which has led to some constraints in the broader relationships UNICEF seeks with partners. For this reason, an adaptive recovery policy is recommended.

VIII. Summary and recommendation

46. In light of the above analysis and conclusions, it is recommended that the Executive Board adopt the following draft recommendation:

The Executive Board:

1. *Recognizes* that the UNICEF recovery policy should be assessed within the broader framework of enhancing partnerships to help achieve the Millennium Development Goals for children, within the context of the United Nations reforms currently being implemented, particularly in terms of harmonization with the United Nations Development Group Executive Committee agencies, and with a clear direction of simplification to increase aid effectiveness;

2. *Concurs* with the basic objectives of simplification, harmonization and fiscal prudence guiding the recovery policy;

3. *Decides* that:

(a) A base recovery rate of 7 per cent be adopted for other resources income, with thematic contributions assessed at 5 per cent;

(b) The current rate of 5 per cent for non-thematic funding raised by the private sector in programme countries be maintained;

(c) A 1-per-cent reduction be assessed to joint programmes, where the Executive Director considers this is in the best interests of enhancing the collective efforts of United Nations agencies in the spirit of United Nations reform;

(d) A 1-per-cent reduction be assessed for contributions over $40 million, where the Executive Director is satisfied that economies of scale are met.

Annex I

What is cost recovery and how is it calculated?

1. The cost structure of UNICEF includes both direct and indirect costs, which can be categorized as follows:

(a) *Direct costs* are incurred for and can be traced in full to specific UNICEF programmes in fulfilment of its mandate;

(b) *Fixed indirect costs* are incurred by UNICEF, regardless of the scope and level of its activities and which cannot be traced unequivocally to specific programmes;

(c) *Variable indirect costs* are incurred by UNICEF as a function and in support of its programmes, but cannot be traced unequivocally to specific programmes.

2. Both direct and variable indirect costs are incurred in implementing specific other resources-funded programmes. Direct costs are charged directly to the programmes themselves as specific costs. Variable indirect costs are the subject of the recovery policy as they cannot be traced to specific programmes.

3. The recovery methodology calculates the variable indirect costs associated with supporting other resources programmes in UNICEF, within the context of the support budget approved by the Executive Board on a biennial basis.

4. To determine the required variable indirect costs to be recovered from other resources programmes, the following methodology is used:

Step 1 Define and isolate fixed costs in the support budget.

Step 2 For the remainder of the support budget (not including the fixed costs), determine the proportion of variable indirect costs for regular resources and other resources programmes.

Step 3 Calculate the portion of variable indirect support costs for regular resources and other resources programmes using the proportion in step 2 above.

5. The financial data underlying decision 2003/9 were based on actual 2000-2001 other resources expenditures. Following the recovery methodology, the indirect variable costs proportioned to other resources came to an actual recovery requirement of $132.3 million. This was 12 per cent of total other resources programme expenditures of $1,104.3 million. Therefore, the base rate requirement was 12 per cent. The actual range of rates from 12 to 5 per cent were referenced on this base rate, with incentive reductions for anticipated reduction in transaction costs as well as to accommodate considerations for the private sector and programme countries.

6. The current review is based upon actual other resources expenditures for 2004-2005. Annexes III and IV show the distribution of 2004-2005 support expenditures into fixed costs and variable indirect costs. The latter are further broken down into costs supporting regular resources and other resources-funded programmes based on the percentage defined in accordance with the above description. Those units which support solely the other resources process are fully funded by other resources. The

indirect variable costs amounted to an actual recovery requirement of $199.5 million. This is 8.8 per cent of the total other resources programme expenditures of $2,262.9 million. Therefore, the base rate requirement reduced from 12 to 8.8 per cent, or a reduction of 3.2 per cent, mainly due to the higher level of other resources income.

7. In the 2006-2007 support budget,[9] using the same 8.8 per cent base rate and projected use of other resources of $2,307 million, the actual recovery requirement would be $203 million. The target recovery figure approved for 2006-2007 as part of the support budget was determined based on the estimated other resources expenditure projections for the biennium and the actual average rate of recovery received in the previous biennium. Therefore, there is in-built imprecision with regard to the required cost recovery versus the actual cost recovery. In other words, adjustments to cost-recovery rates will always be based on applying historical performance to projected other resources expenditures.[10]

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[9] E/ICEF/2006/AB/L.1, Table 1, Resource plan.

[10] The use of interest earned on other resources cash-on-hand to offset recovery costs has been raised before by the Advisory Committee on Administrative and Budgetary Questions and the Executive Board. The Advisory Committee has pointed out that in light of potential fluctuations in the pattern of receipts and disbursements of other resources, as well as fluctuations in exchange rates and interest rates, it would not be prudent, as a matter of policy, to rely on interest income to cover shortfalls in support costs recovery (E/ICEF/1998/AB/L.12). Executive Board decision 2003/9 took this recommendation into account.

Annex II

Definition of fixed and variable indirect costs for various divisions and offices

1. For country offices, fixed costs are defined as the minimum core presence in a country office with an approved regular resources programme. These fixed costs are established at $1.226 million for each office for the biennium, covering the costs of one representative, one international Professional, two national Professionals and three General Service staff, plus $150,000 for annual general operating costs and travel. Other staff costs such as termination and after-service insurance are considered fixed costs for all offices. Using actual support expenditures for 2004-2005, the remainder of the support budget for each country office is distributed into separate portions that support regular resources and other resources-funded programmes using the country programme's actual regular resources and other resources expenditures in 2004-2005. Total cumulative programme expenditures for all country offices show a 32/68 split between regular and other resources.

2. Regional offices carry out programme support and oversight functions for their regions. Fixed costs will cover the Regional Director's office, communications, operations, security and emergency, planning, monitoring and evaluation, human resources, information technology officers, support staff and related costs. The same percentage breakdown as for country offices has been used for the variable regular resources and other resources support costs.

3. Several divisions and offices at headquarters dealing with executive management, inter-agency coordination, support to the Executive Board, advocacy, research, partnerships, evaluation and the statutory audit function have been considered as fixed costs (i.e., Office of the Executive Director, Office of the Secretary of the Executive Board, Office of United Nations Affairs and External Relations, Division of Communication, Evaluation Office and Office of Internal Audit). Also considered as fixed costs are the UNICEF contributions for such United Nations bodies as the Joint Inspection Unit, the International Civil Service Commission and the Board of Auditors, as well as centrally shared security and global investment projects.

4. In all divisions, the costs of the director's office, which deals with policy, planning and overall management in the respective functional area, are considered as fixed costs. Except for the functions specifically mentioned, most headquarters offices follow the same work process for regular resources and other resources. In the daily work process, staff do not distinguish between regular resources or other resources, hence, a time-survey study is not done except in the specific cases mentioned. The 32/68 split between regular and other resources as the total proportion of country programme expenditures provides an approximate estimation.

5. Programme Division consists of the Director's Office, technical sections (Health, Nutrition, Education, Child Protection, Water and Sanitation, HIV/AIDS) and an inter-agency/field support section. Programme Division is responsible for designing programme implementation guidelines and indicators for the MTSP focus areas. The Division is also responsible for managing globally-raised funds and allocations to countries. Since the programmes — whether funded from regular resources or other resources — benefit from these functions, in the present report, their support costs, excluding the Director's Office, are attributable to regular resources and other resources programmes according to the 32/68 split.

6. The Division of Policy and Planning provides global policy guidance, strategic information, strategic planning and programme guidance. It plays a critical role in helping to measure results against UNICEF indicators and in articulating the broad UNICEF message around the MTSP focus areas. The costs of the Director's office and the global policy and programme guidance sections are considered fixed, with the rest attributable to regular resources and other resources programmes according to the 32/68 split.

7. Within the Office of Emergency Programmes, the Director's office and the Operations Centre are considered fixed, mandatory costs. The remaining costs are attributable to regular resources and other resources according to the 32/68 split, as most programmes have an emergency preparedness component.

8. For Supply Division, the costs of the Director's Office are considered fixed costs. The remaining costs are attributable to regular resources and other resources according to the 32/68 split.

9. Three divisions are responsible for orchestrating the UNICEF fund-raising strategy: the Programme Funding Office, which is responsible for the relationship of UNICEF with donor Governments and with intergovernmental and international financial institutions and foundations; Private Sector Division (PSD), which is responsible for the relationship of UNICEF with the private sector; and the Regional Office for Europe, which is responsible for the relationship with the National Committees for UNICEF. Because PSD costs are fully funded from the revenue from private sector fund-raising (including card and products sales), it is not covered in this study. For the other two offices, the costs of the Director's Offices and two senior officers who plan, manage and direct the fund-raising strategy are considered fixed costs. Those staff who are dedicated to other resources processing are fully attributed to other resources. The remaining costs are attributable to regular resources and other resources according to the 32/68 split.

10. In the Division of Financial and Administrative Management, a few units that deal only with the other resources process (issuance of allotments, other resources income and receivables recording, and other resources reporting) are 100-per-cent attributable to other resources. The costs of the Comptroller's Office and the units that prepare biennial statutory accounts are fixed costs. The costs of the remaining sections in budget and finance and of the Deputy Directors are fixed, with the remaining costs split into regular resources and other resources according to the 32/68 split. The costs of the headquarters administrative unit will be split between fixed and variable portions in accordance with the ratio for all headquarters divisions. The infrastructure costs of rent, utilities and telecommunications for headquarters are also broken down into fixed and variable portions in the same manner.

11. For the Division of Human Resources, the costs of the Director's office and the policy section are considered as fixed costs. The remaining sections are split into regular resources and other resources according to the 32/68 split.

12. For the Information Technology Division, the costs of the Director's Office and the technical architecture and infrastructure sections have been considered as fixed costs, with the remaining distributed into support costs for regular resources and other resources according to the 32/68 split.

Annex III

Proportioning of support costs (using 2004-2005 actual expenditures)

	Total Support costs	Fixed costs/ core functions		Variable indirect costs	% of variable costs borne by RR	% of variable costs borne by OR	Variable costs borne by RR	Variable costs borne by OR	% of OR support to total OR programme
	(1)	(2)		(3)=1-2	(4)	(5)	(6)=3x4	(7)=3x5	(8)=7/OR prog.
Field offices									
Country offices	**258.9**	**142.9**	**a/**	**116.0**	32%	68%	**37.1**	**78.9**	**3.5%**
Termination/after service insurance	5.3	5.3	a/						
Regional offices	**71.8**	**38.0**	**b/**	**33.8**	32%	68%	**10.8**	**23.0**	**1.0%**
Termination/after service insurance	1.4	1.4	a/						
Central costs - central security and Invest. Proj.	16.9	16.9	c/						
Subtotal, Field offices	**354.3**	**204.5**		**149.8**	**32%**	**68%**	**47.9**	**101.9**	**4.5%**
Headquarters (Programme support)									
Innocenti Research Centre	0.6	0.6	c/						
Programme Division	26.9	5.6	d/	21.3	32%	68%	6.8	14.5	
EMOPS excluding Operations Centre(incl.Geneva)	6.5	1.0	f/	5.5	32%	68%	1.8	3.7	
Division of Policy & Planning - Prog Guidance	2.1	2.1	e						
Operations Centre	2.3	2.3	f/						
Field support systems (ProMS and Cognos)	5.3	0.7	k/	4.6	32%	68%	1.5	3.1	
Investment projects	2.2	2.2	c/						
Supply Division (net of warehouse recovery)	19.8	4.1	g/	15.7	32%	68%	5.0	10.7	
Subtotal, HQ prog. Support	65.7	18.6		47.1	32%	68%	15.1	32.0	
% distribution		28%		72%			23%	49%	
HQ common costs	12.9	3.6	h/	9.3			3.0	6.3	
HQ termination/after service insurance	4.0	4.0	a/						
Subtotal, HQ prog. Support	**82.6**	**26.2**		**56.4**	**32%**	**68%**	**18.0**	**38.3**	**1.7%**

Annex III

Proportioning of support costs (using 2004-2005 actual expenditures) (cont'd)

	Total Support costs	Fixed costs/ core functions	Variable indirect costs	% of variable costs borne by RR	% of variable costs borne by OR	Variable costs borne by RR	Variable costs borne by OR	% of OR support to total OR programme
	(1)	(2)	(3)=1-2	(4)	(5)	(6)=3x4	(7)=3x5	(8)=7/OR prog.
Headquarters Management and administration								
Office of the Executive Director	8.3	8.3 c/						
Office of the Secretary of the Executive Board	2.5	2.5 c/						
Office of UN Affairs and External Relations	2.0	2.0 c/						
Division of Communication	18.2	18.2 c/						
Office of Japan	3.4	3.4 c/						
Evaluation Office	2.5	2.5 c/						
Office of Public Partnerships	1.8	1.8 c/						
Office of Internal Audit	6.1	6.1 c/						
Sharing of UN activities	4.4	4.4 c/						
Division of Policy and Planning	9.1	5.5 e/	3.6	32%	68%	1.2	2.4	
PFO (excluding units solely for OR)	5.6	2.6 i/	3	32%	68%	1.0	2.0	
PFO fund monitoring unit/asst. fund-raising	2.5	i/	2.5		100%		2.5	
GRO	15.1	6.1 i/	9	32%	68%	2.9	6.1	
GRO solely for OR	0.5	i/	0.5		100%		0.5	
DHR	20.2	5.9 j/	14.3	32%	68%	4.6	9.7	
DFAM (excluding units below)	16.7	7.2 h/	9.5	32%	68%	3.0	6.5	
DFAM units solely for OR	2.8	h/	2.8		100%		2.8	
Investment Projects	10.8	10.8 c/						
ITD	39.1	10.0 k/	29.1	32%	68%	9.3	19.8	
subtotal,	**171.6**	**97.3**	**74.3**			**21.9**	**52.4**	
Percentage	100%	57%	43%			13%	31%	
HQ common costs	29.6	16.8 h/	12.8			3.8	9.0	
DFAM - Administrative Services	5.7	3.2 h/	2.5			0.7	1.7	
HQ termination + after service insurance	3.9	3.9 a/						
Total HQ Management and administration	**210.8**	**121.2**	**89.6**	30%	70%	**26.4**	**63.2**	2.8%
Recovered from other sources l/	**-3.9**		**-3.9**				**-3.9**	-0.2%
Global support expenditure,	**643.8**	**351.9**	**291.9**	32%	68%	**92.4**	**199.5**	**8.8%**
Total Programme expenditure (net of recovery)			3,146.9	28%	72%	884.0	2,262.9	

[a] See annex III, para. 1.
[b] See annex II, para. 2.
[c] See annex II, para. 3.
[d] See annex II, para. 5.
[e] See annex II, para. 6.
[f] See annex II, para. 7.
[g] See annex II, para. 8.
[h] See annex II, para. 10.
[i] See annex 2, para. 9.
[j] See annex 2, para. 11.
[k] See annex 2, para. 12.
[l] Includes agency commissions from trust funds and Junior Professional Officers, and government contributions towards local costs.

Annex IV

Excerpts from Executive Board decision 2003/9 related to the review of the recovery policy

9. *Requests* the Executive Director to bring the issue of cost recovery to the attention of the working group on harmonization and simplification of the United Nations Development Group (UNDG) with a view to harmonizing the methodology used by the UNDG members in devising their recovery policies;

10. *Requests* the Executive Director to report to the Executive Board on the experiences of the recovery policy, especially on actual cost recovery achieved and recovery rates applied to projects during this period, on its effects on the regular resources, as well as on the harmonization efforts undertaken, and to submit proposals for further steps towards the elimination of any remaining subsidy of support costs of other resources programmes by regular resources at the second session of the Executive Board in 2005 for a review of this interim policy.

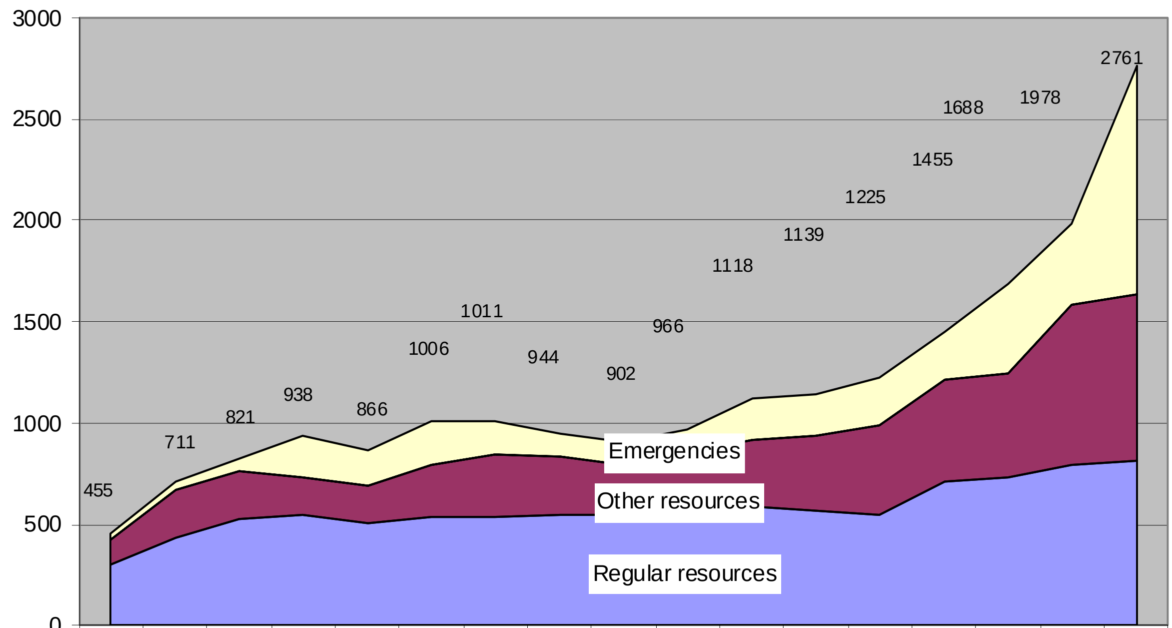
Annex V

Financial Performance

Figure

UNICEF Income, 1986-2005

(In millions of United States dollars)



	1986	1988	1990	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Emergencies	32	39	57	204	170	214	163	106	112	116	197	199	235	241	443	391	1129
Other resources	127	235	233	186	187	257	311	287	243	279	332	377	439	505	513	796	820
Regular resources	296	437	531	548	509	535	537	551	547	571	589	563	551	709	732	791	812

Table 1 — Distribution of income from Governments and the private sector to regular resources and other resources

	1998-1999 (actual)			2000-2001 (actual)			2002-2003 (actual)			2004-2005 (actual)		
	RR	OR a/	Total	RR	OR a/	Total	RR	OR a/	Total	RR	OR a/	Total
Income (In millions of US$)												
Government	688	602	1,290	694	862	1,556	771	1,318	2,089	906	1,904	2,810
Private sector	389	312	701	329	394	723	574	384	958	581	1,232	1,813
Other income	83	10	93	91	-6	85	96		96	116		116
Total	1,160	924	2,084	1,114	1,250	2,364	1,441	1,702	3,143	1,603	3,136	0 4,739
Percentage of RR/OR by sources												
Government	53%	47%	100%	45%	55%	100%	37%	63%	100%	32%	68%	100%
Private sector	55%	45%	100%	46%	54%	100%	60%	40%	100%	32%	68%	100%
Other income	89%	11%	100%	107%	-7%	100%	100%	0%	100%	100%	0%	100%
Total	56%	44%	100%	47%	53%	100%	46%	54%	100%	34%	66%	100%

Table 2 — Regular resources and other resources use in the last four biennial support budgets

	1998-1999 (actual)			2000-2001 (actual)			2002-2003 (actual)			2004-2005 (actual)		
	RR	OR a/	Total	RR	OR a/	Total	RR	OR a/	Total	RR	OR a/	Total
Expenditure												
Programme minus recovery	595	836	1,431	740	1,104	1,844	740	1,458	2,198	884	2,263	3,147
Support	465	31	496	438	53	491	466	72	538	481	163	644
Total	1,060	867	1,927	1,178	1,157	2,335	1,206	1,530	2,736	1,365	2,426	3,791
RR/OR distribution												
Programme	42%	58%	100%	40%	60%	100%	34%	66%	100%	28%	72%	100%
Support	94%	6%	100%	89%	11%	100%	87%	13%	100%	75%	25%	100%
Total	55%	45%	100%	50%	50%	100%	44%	56%	100%	36%	64%	100%
Programme vs. support												
Programme	56%	96%	74%	63%	95%	79%	61%	95%	80%	65%	93%	83%
Support	44%	4%	26%	37%	5%	21%	39%	5%	20%	35%	7%	17%
Total	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%	100%

Annex VI

Recovery options analysed

Options	*Cost recovery*	*Value of cost recovery*	*Impact on partnerships*	*Consistent with UNDG Ex.Com. harmonization*	*Pros*	*Cons*
Option 1 Current model	From 5% to 12%	Achieves $161 million target.	Provides impediments to some partnerships.	Consistent with approach, methodology and intent of the harmonizing position taken by the United Nations.	Follows current policy; Achieves the targeted recovery level; Encourages growth in larger contributions through a reward system.	Is complex as considerable interpretation is required; Better information and explanatory documentation required for staff and donors.
Option 2 Updated current model with addition of 1) a specific partnership rate (6% or 7%), and a lower rate for very large contributions with economies of scale (5%)	From 5% to 10% (Maximum rate could drop from 12% to 10% based on review of results from 2003.)	Achieves $161 million target.	Provides a new rate to support partnering with targeted classes of organizations or groups, and for very large contributions (>$40m).	Consistent with approach, methodology and intent of the harmonizing position taken by the United Nations.	Builds on current model; Responds to the need of most partnerships; Achieves the targeted recovery level; Encourages growth in larger contributions through a reward system.	Adds some further complexity to what is already perceived as a complex model; Better information and explanatory documentation required for staff and donors.
Option 3 Two percentages	7% and 5%	Achieves close to $161 million target.	Reduces higher percentages and simplifies approach which may have a positive impact on partnerships, if the 5% rate is available to targeted partnership opportunities; (Seeking discretionary authority for Executive Director for exceptions could enhance this option).	As long as the presentation is formulated around a cost-based approach as well as a partnership facilitating approach, it would be consistent.	Less complex model; Will achieve close to the targeted cost-recovery value; Closer to other ExCom agency rates; Private sector and recipient countries would support if they get the 5% rate.	Loses the concept of incentives to encourage desired donor behaviour for larger less-earmarked contributions.
Option 4 One fixed percentage based on current average recovery rate	7%	Achieves close to $161 million target.	Reduces higher percentages and would facilitate some partnerships but may not be low enough for all.	As long as the presentation is formulated around a cost-based approach as well as a partnership facilitating approach, it would be consistent.	Very simple model; Will achieve close to the targeted cost recovery; Closer to other ExCom agency rates.	Private sector and recipient countries may resist; Loses the concept of incentives to encourage desired donor behaviour for larger less-earmarked contributions; May not be low enough to address all partnership opportunities unless Executive Director's discretionary authority instituted.
Option 5 One fixed percentage at current lowest rate	5%	Achieves only around $115 million recovery, much lower than the target.	Would have positive impact on partnerships.	As long as the presentation is formulated around a cost-based approach as well as a partnership-facilitating approach, it would be consistent.	Very simple model; Well placed within other Ex Com agency rates; Matches current situation with private sector and recipient countries; Attractive rate for partners.	Loses the concept of incentives to encourage desired donor behaviour for larger less-earmarked contributions; Requires higher percentage of RR for support budget, or restructuring.

Recovery options analysed (cont'd)

Option 6 Structured Fee Approach	Menu of fees for specific services or activities.	Recovery would probably not meet the $161 million target.	Would have positive impact on partnerships.	Could be argued to be consistent with the concept of cost recovery but it would be inconsistent with methodology and approach in the current United Nations harmonized setting.	Appears more business-like; Greater transparency with donors; Scope for negotiation; Possible to achieve unique solutions for individual cases.	Time-consuming and costly to establish and maintain; Significant training required; Loss of standardization; Significant increase in what is categorized as overhead; Requires higher percentage of regular resources for support budget, or restructuring; Increased negotiation time for each agreement; Increased need for re-negotiation of agreements; information technology (IT) system changes required; Accounting treatment changes required.
Option 7 Zero recovery	0%	None	Cost recovery no longer an impediment to partnering.	Diverges from other agencies and distances UNICEF from a harmonized United Nations approach.	Very easy model; Maximum leveraging of resources; Simplifies agreements; Simplifies IT systems; Simplifies accounting; Would encourage income growth and maximize partnership opportunities.	Contrary to Board stated position; Contrary to ACABQ position; Diverges from a harmonized United Nations approach; Requires much higher percentage of regular resources for support budget, or significant restructuring.