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METHOD FOR DETERMINING THE INDIRECT SUPPORT COST RATE FOR WFP



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NOTE TO THE EXECUTIVE BOARD

This document is submitted to the Executive Board for approval.

The Secretariat invites members of the Board who may have questions of a technical nature with regard to this document to contact the WFP staff focal points indicated below, preferably well in advance of the Board's meeting.

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EXECUTIVE SUMMARY

This paper is the second in a series covering the two-phase review of the indirect support cost rate and the Secretariat's consultations with the Board. Phase 1 was presented during the First Regular Session of 2014 with the paper "Method for Calculating the Indirect Support Cost Rate for WFP", which outlined the context and drivers of the review and posed four questions to shape the discussion. This paper – part of phase 2 – draws on informal consultations with the Board and reviews three of those questions:

- WFP is a 100 percent voluntarily funded organization: should core funding or different funding approaches to cover indirect variable costs be considered?
- Should WFP continue with a single indirect support cost recovery rate, or should the rate vary according to the type of intervention?
- Could WFP use variable indirect support cost rates to incentivize resource mobilization, for example through South–South cooperation or host-government contributions?

Regarding the first question, while the Secretariat recognizes that unearmarked, multi-year funding enables WFP to deliver on its mission more efficiently and effectively, it concludes that core funding would be less desirable for WFP than the current model.

Regarding the second question, the Secretariat concludes that introducing variable indirect support cost recovery rates linked to programme categories or activity types would also not be desirable. The current single-rate model is simple and transparent.

Regarding the third question, the Secretariat concludes that modifying the existing arrangements for indirect support cost rates is unlikely to incentivize South–South cooperation or host government contributions. Analysis of contributions received in 2009–2013 indicates that fluctuations in South–South cooperation and host government contributions were not affected by indirect support costs rates, but by factors such as food assistance needs arising from humanitarian crises, and the perceived quality of WFP's programmes. The Secretariat therefore recommends maintaining current practice with respect to indirect support cost rates.

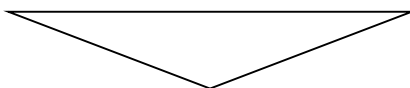
However, under its current approach to private-sector contributions, WFP applies indirect support cost rates ranging from 10 to 20 percent, based on a matrix. A single rate would be more equitable, transparent and efficient, and an appropriate rate would ensure alignment with the principle of full-cost recovery. Given the improved operational efficiency – reflected in lower costs of private-sector fundraising – and higher private-sector contributions since 2012, the Secretariat recommends a single rate of 10 percent for private-sector donors. Consistent with the principle of full-cost recovery endorsed by the Board at its 2013 Annual Session, this rate ensures that private-sector donors provide sufficient cash to cover the management and administrative costs related to their contributions.

The fourth review question is as follows:

- Recognizing that some costs related to support and administration are covered from sources other than the indirect support cost recovery rate, WFP should undertake a detailed analysis of its indirect costs and review the Programme Support and Administrative Equalization Account, which serves as a safety net for unplanned fluctuations in indirect support cost recovery. Should WFP continue to consider multiple sources of funding for costs such as security and non-recurring investments?

Further consultations with the Board are planned in 2015. A final document will be prepared for the 2015 Annual Session addressing question four, summarizing work done on all four questions and proposing a method for determining the indirect support cost rate for WFP for the Board's approval.

DRAFT DECISION*



The Board takes note of “Method for Determining the Indirect Support Cost Rate for WFP” (WFP/EB.2/2014/5-D/1) and looks forward to concluding the review in 2015.

The Board approves the application of a single indirect support cost rate of 10 percent for private-sector donations, in accordance with the principle of full-cost recovery outlined in “WFP Private-Sector Partnerships and Fundraising Strategy (2013–2017)” (WFP/EB.A/2013/5-B).

* This is a draft decision. For the final decision adopted by the Board, please refer to the Decisions and Recommendations document issued at the end of the session.

INTRODUCTION

Rationale for the Review

1. The Management Plan (2014–2016) included a proposal for reviewing the indirect support cost (ISC) rate. Several concerns drove this proposal:
 - a) Financial resilience. As WFP is an entirely voluntary-funded organization with a core mandate to respond to emergencies, income fluctuations can quickly undermine its ability to cover all indirect costs. This calls for periodic validation of WFP’s cost recovery model and financial safety nets.
 - b) Strategic shift. The changing nature of WFP’s activities with the shift from food aid to food assistance since 2008 – such as the growth in cash and voucher activities – may be altering the magnitude and composition of its indirect costs. The expanding range of WFP’s activities also requires better understanding of Programme Support and Administrative (PSA) costs.
 - c) Value for money. The ISC review provides an opportunity to reassure donors that the indirect cost recovery model satisfies concerns about cost containment and value for money.
2. In the Management Plan (2014–2016), the Secretariat proposed a two-phase review that would engage the Board in informal consultations and present conclusions and recommendations in a series of papers. Phase I of the review commenced in early 2014 and posed four questions. Phase II, covering issues raised by each question, commenced in May 2014 with an informal consultation presenting the Secretariat’s initial views on the four questions, asking for guidance on the first two, and mapping subsequent stages of the review.
3. The first phase was presented to the Board in “Method for Calculating the Indirect Support Cost Rate for WFP”,¹ which covered the context and drivers for the review:
 - the 2012 Quadrennial Comprehensive Policy Review (QCPR), calling for harmonization of ISC policy across the United Nations;
 - WFP’s current and future resourcing environment;
 - maximizing value for money – the ISC rate is seen as a proxy for PSA efficiency and a means of optimizing operational efficiency and effectiveness; and
 - WFP’s changing cost and support structures, particularly the increasing use of non-food activities.
4. In line with discussions of core funding, critical mass of core resources and support cost policies in United Nations funds, programmes and specialized agencies, WFP examined alternatives to its current model of ISC recovery. This included reviewing the merits of a core budget with variable and fixed PSA expenditures, and considering alternative models such as core or non-core funding to cover variable or fixed PSA expenditures.

¹ WFP/EB.1/2014/4-B/1.

5. An informal Board consultation in May 2014 addressed the first two review questions:
 - WFP is a 100 percent voluntarily funded organization: should core funding or different funding approaches to cover indirect variable costs be considered?
 - Should WFP continue with a single ISC recovery rate, or should the rate vary according to the type of intervention?
6. A subsequent consultation in September 2014 discussed a third question:
 - Could WFP use variable ISC rates to incentivize resource mobilization, for example through South–South cooperation or host government contributions?
7. This paper summarizes the discussions and conclusions of the informal consultations.²

BASIC ASSUMPTIONS GUIDING THE REVIEW

8. Three principles underpin WFP's funding model: i) 100 percent voluntary funding; ii) full-cost recovery on contributions; and iii) no cross-subsidization. WFP's funding model should also ensure:
 - simple and efficient administration and management;
 - flexibility to adjust to variable operational levels;
 - predictable and transparent funding levels and resources for the PSA budget;
 - equitable treatment of donors; and
 - consistency with United Nations system-wide approaches, particularly those of funds and programmes.
9. WFP's current model of a PSA budget, a PSA Equalization Account and a single ISC recovery rate periodically reviewed by the Board has been a reliable, transparent, easy and efficient way of managing and administering WFP's business environment.
10. WFP recognizes that harmonization towards common positions across agencies is worth pursuing where possible. At the same time, paragraph 50 of the QCPR resolution endorsed by the General Assembly,³ the report of the Advisory Committee on Administrative and Budgetary Questions (ACABQ) on the ISC paper presented to the Board,⁴ and deliberations of the FAO Finance Committee have acknowledged that different business models exist. While harmonization is valuable, these documents and views recognize that: i) there are various business models within the United Nations system; and ii) harmonization may call for changes that are not to the benefit of every organization involved.
11. ISC rates are not a suitable indicator of the efficiency or value for money of an agency's operations mainly because the different mandates across the United Nations call for different cost structures, and organizations that benefit from core funding, for example, cannot be compared with those that rely on full recovery of their PSA budgets through ISC recovery.

² The evolution of WFP's ISC recovery rate policy is summarized in Annex I.

³ A/RES/67/226.

⁴ WFP/EB.1/2014/4(A,B)/2.

OUTCOME OF THE INFORMAL CONSULTATIONS

Question 1: Core Funding Model

12. A review of the advantages and disadvantages of the core funding model⁵ for WFP recognized the benefits of unearmarked, multi-year funding in meeting operational and administrative demands more efficiently and effectively. Areas of work that could benefit from core funding include WFP's humanitarian response in sudden-onset emergencies and its resilience activities. However, consultations with the Board recognized the difficulties in raising core contributions from donors. For the past two decades, despite repeated appeals and resolutions in the Economic and Social Council and the General Assembly, donors have demonstrated limited willingness to increase core funding across the United Nations, as evidenced by the relative stagnation of core funding in relation to the substantial growth of non-core funding.
13. The Secretariat has concluded that WFP's current funding model and financial tools for the PSA budget are effective and perform satisfactorily, provided that the WFP business environment does not change dramatically.
14. Risks and challenges facing the current model include dependence on short-term contributions while institutional capacities – funded in the PSA budget and essential for rapid and efficient response – require a medium- to long-term perspective. The establishment of a Capital Budgeting Facility sought to address this challenge in WFP's funding model. These requirements are also partly addressed through the use of donor contributions for institutional strengthening activities, surpluses in the General Fund and non-recurring investments against the PSA Equalization Account. This will be discussed with the Board in connection with the fourth review question.

Question 2: The Single ISC Rate Model versus Variable ISC Rates to Recover Indirect Support Costs from Different Programmes and Activity Types

15. The May 2014 informal consultation concluded that WFP's current single rate model is the most appropriate for ensuring the principle of full-cost recovery. It is simple and easy to administer; is based on a transparent and straightforward methodology; and focuses discussion on the structure, efficiency and effectiveness of the PSA budget.

⁵ “Core resources are those that are commingled without restrictions and whose use and application are directly linked to the multilateral mandates and strategic plans of the entities, which are approved by the respective governing bodies as part of an intergovernmental process. In contrast and as determined by the contributors, non-core resources are mostly earmarked, as determined by their contributors, and are thus restricted with regard to their use and application.” A/67/94–E/2012/80 “Analysis of funding of operational activities for development of the United Nations System for 2010”.

16. Since 2003, a single ISC recovery rate of 7 percent is applied to contributions for all programme categories: emergency operations, protracted relief and recovery operations, special operations, development projects and country programmes. All public-sector donors are treated equally. The exceptions, which are discussed in following subsections, are a 4 percent rate applied to locally generated, country-specific trust funds, an exemption from ISC for government counterpart cash contributions, and various rates for private-sector contributions, averaging 12 percent and ranging from 10 to 20 percent. In 2013, the 7 percent rate generated 95 percent of total ISC revenues, with the remainder coming from contributions to local trust funds and private-sector contributions.

Question 3: Variable Rates as Incentive for Resource Mobilization

17. The premise for proposing lower ISC rates is that they would encourage additional contributions. However, the effectiveness of lower ISC recovery rates as an incentive for resource mobilization depends on:
- the potential for mobilizing additional resources through different funding channels;
 - the magnitude of the additional resources compared with overall funding levels; and
 - the increased ISC income from the higher funding compared with the ISC income foregone because of the lower recovery rate.
18. Additional factors to consider include:
- cross-subsidization between donors when lower ISC rates are not matched by lower PSA costs;
 - challenges in renegotiating/reversing lower ISC rates when required, such as when expectations regarding their effect have not been met; and
 - activities and investments of partner organizations – United Nations agencies and humanitarian non-governmental organizations (NGOs) working in the same field – that may be seeking access to the same funding channels.

WFP's Sources of Funding, Including Trust Funds

19. Most of WFP's funding is earmarked for programmes or projects. Over the last five years approximately 85 percent of funding has been generated from traditional resourcing partners: donors from the Organisation for Economic Co-operation and Development's Development Assistance Committee (OECD-DAC). Other contributions come from South-South cooperation (SSC), the private sector and host governments.

TABLE 1: CONFIRMED CONTRIBUTIONS BY FUNDING PILLAR,^a FIVE-YEAR TREND (USD MILLION)						
	Pillar	2009	2010	2011	2012	2013
1a	Host governments	82.0	119.8	61.6	167.8	153.4
1b	Unique host governments ^b	63.8	66.7	44.6	138.4	116.7
2a	SSC – BRICS ^c	60.3	62.1	143.2	131.3	85.7
2b	SSC – other streams	6.1	18.2	5.1	5.8	6.5
2c	SSC – Middle East	34.9	106.3	78.8	39.0	99.5
3	Multi-donor funds	217.8	209.0	203.8	223.1	224.9
4&5	OECD-DAC	3 536.6	3 209.9	3 133.8	3 359.5	3 772.2
6	Private donors	103.8	141.5	85.3	65.2	84.7
TOTAL^d		4 023.3	3 813.8	3 694.6	3 962.3	4 390.0
Share of pillars 4 and 5 in total		88%	84%	85%	85%	86%

^a 1 = country-led resources from host governments; 2 = emerging economies and the Gulf; 3 = United Nations, multi-donor and thematic funds; 4 = new channels from OECD donors; 5 = current base of donors with minimized donor conditionality; and 6 = private sector.

^b Unique host governments contribute under one pillar only.

^c BRICS = Brazil, Russian Federation, India, China and South Africa.

^d Total is not equal to the total of individual donor types as some donors are counted in more than one pillar: Algeria, Egypt, India, Iraq, Islamic Republic of Iran, Syrian Arab Republic and Yemen.

20. Multi-partner trust funds and global funds such as the Global Fund to Fight AIDS, Tuberculosis and Malaria and the Global Environment Facility currently provide a small but significant source of funding.

⇒ *The role of trust funds in WFP*

21. Trust funds provide flexibility that enables WFP to carry out activities for which it might be difficult to raise resources through established channels.
22. Corporate trust funds are based at Headquarters for undertaking initiatives in institutional strengthening including implementation of innovations or pilot activities that cannot be or are not funded through the PSA budget. The 7 percent ISC recovery rate is applied to these resources.
23. Country-specific trust funds support country-level projects and programmes. A standard ISC recovery rate of 4 percent is applied when the trust fund activity is planned, resourced, implemented and managed in country. These projects require less support from Headquarters and from the PSA budget. Country-level trust funds enable WFP to provide member countries with capacity development support tailored to the specific needs of the country and often without a food component.

24. Application of a lower ISC recovery rate because the PSA arrangements for country-specific trust funds are streamlined will be validated when WFP addresses the fourth review question by undertaking a more detailed cost analysis of its indirect costs. In the meantime the Secretariat sees no reason to depart from current ISC rate-setting practices for trust funds, which are consistent with the principle of full-cost recovery.

South–South Cooperation, Host Government Contributions and Private-Sector Contributions⁶

⇒ South–South cooperation and host government contributions

25. The United Nations Office for South–South Cooperation defines SSC as “a process whereby two or more developing countries pursue their individual and/or shared national capacity development objectives through exchanges of knowledge, skills, resources and technical know-how, and through regional and inter-regional collective actions, including partnerships involving governments, regional organizations, civil society, academia and the private sector, for their individual and/or mutual benefit within and across regions.” For WFP, SSC usually involves developing country governments donating food or cash from their public budgets to WFP’s programmes. This may be complemented by triangular or twinning arrangements whereby a developing country typically contributes food to support a country-level activity while another willing donor covers the operational and support costs.⁷
26. Host government contributions are those made to WFP by a developing country government to assist the implementation of activities within WFP’s technical mandate in the same country.⁸ Host government contributions include government counterpart cash contributions, which are made in-country to support WFP operations. ISC is not charged on these contributions as they usually cover facility rental and utilities. The scale of host government contributions is currently limited.
27. The current ISC rate has not been an issue in funding negotiations involving South–South or host government contributions. Other factors appear to be more relevant: WFP’s reputation and capacity for delivering food assistance to vulnerable groups reliably, effectively and efficiently; its capacity to manage large and small contributions; its accountability framework and reporting capacity; its capacity to engage with local partners; and the outcomes it delivers. This finding confirms a 2003 study of WFP and NGOs,⁹ which concluded that “most donor decisions that were related to the apportionment of food aid resources between WFP and NGOs, and among NGOs, were made on programmatic and policy grounds rather than being based on a comparison of support costs.”
28. WFP’s General Rules and Regulations provide flexibility to incentivize resource mobilization through SSC, including twinning,¹⁰ provided it does not incur significant additional indirect support costs.

⁶ This section is based on feedback from managers of WFP and other United Nations organizations such as the United Nations Children’s Fund (UNICEF), the United Nations Development Programme (UNDP) and the Office of the United Nations High Commissioner for Refugees (UNHCR).

⁷ Such triangular cooperation can involve one or more developed countries and/or multilateral organizations.

⁸ Some United Nations entities classify such contributions to programme activities as unilateral trust funds.

⁹ “Comparison Study of WFP and Non-Governmental Organizations” (WFP/EB.1/2003/4-D).

¹⁰ WFP General Rule XIII.4.

29. WFP recognizes the increasing importance of SSC, which plays a small but important role in WFP's overall funding, along with host government contributions, including to trust funds. The Secretariat does not recommend any change to the standard ISC rate of 7 percent, or 4 percent for locally generated, country-specific trust funds.

⇒ *The private sector*

30. WFP defines the private sector to include private individuals, independent foundations and corporations and corporate foundations. Policies for private-sector fundraising include the principle of full-cost recovery, with mechanisms that include a private-sector management fee from 2008 to 2013, and the current private-sector donor rates, ranging from 10 to 20 percent. These rates ensure that private-sector donors cover the management and administrative costs related to their contributions.

31. WFP's variable ISC recovery rates for private-sector contributions – approved by the Board in June 2013 and introduced in December – are based on the type of donor and the scale and complexity of the contribution and its management. These rates are set out in Table 2.

Type of donor	Standard rate	Lower rate for large/uncomplicated contributions
Corporations and corporate foundations	20	12
Individuals	15	15
Independent foundations	15	10
Funds raised by country office	12	10

32. There is flexibility to depart from this model under certain circumstances,¹¹ but the rate applied to private-sector contributions cannot be lower than the ISC rate of 7 percent, or 4 percent for trust funds and special accounts.

33. The standard 20 percent rate for corporations has been difficult to justify, especially when corporations are aware of the lower ISC rates charged by other United Nations agencies such as UNICEF, UNHCR and UNDP. A lower rate would make WFP more competitive in fundraising from private-sector corporations. Other United Nations agencies have lower ISC rates, and most have a single rate for all private-sector donations.

34. Application of the model has proved problematic. There is room for interpretation of what constitutes "low complexity" to qualify for a lower ISC rate. Negotiations by donors and WFP units seeking funding to reduce or waive private-sector ISC rates often result in inefficiencies and higher transactional costs that do not add value. Current and prospective private-sector donors say the current model is difficult to understand and apply, and a single rate would facilitate more transparent and efficient administration.

35. WFP's Private-Sector Partnerships and Fundraising Strategy (2013–2017) calls for regular review and adjustment of the rates charged to private-sector donors to reflect costs and market dynamics. Since 2012, private-sector revenue has increased and costs have been reduced. The resulting increase in efficiency makes it possible to receive less ISC from the private sector than the current average level of 12 percent.

¹¹ For large donations with standard reporting requirements and no additional communication needs.

36. The Secretariat proposes a single 10 percent ISC rate for private-sector donations, in line with the Private-Sector Partnerships and Fundraising Strategy (2013–2017). Such a rate would be welcomed by prospective private-sector partners, better aligned with the rates of other organizations and more conducive to efficient implementation and management. It would also be consistent with the principle of full-cost recovery.¹²

NEXT STEPS

37. Based on the review so far and on consultations with Board members, the Secretariat concludes that there is no reason to make any fundamental change to WFP's existing policies or practices. The Secretariat seeks the Board's approval to apply a single ISC recovery rate of 10 percent on private-sector donations, consistent with the principle of full-cost recovery adopted by the Board in June 2013.
38. The analysis contained in this paper pertains to review questions 1, 2 and 3, and provides background for investigation of the fourth – and most significant – question:
- As some costs related to support and administration are covered from sources other than the ISC recovery rate, WFP should undertake a detailed analysis of its indirect costs and review the PSA Equalization Account, which serves as a safety net for unplanned fluctuations in ISC recovery. Should WFP continue to consider multiple sources of funding for costs such as security and non-recurring investments?
39. The cost analysis needed to address this question will start during the last quarter of 2014. It is expected that this work will comprise a detailed examination of WFP's recurring PSA budget and additional budgetary proposals funded from the PSA Equalization Account. Informal consultations with the Board will inform preparation of a paper for approval at the Annual Session in June 2015. The paper will provide conclusions summing up the review of WFP's ISC rates.

¹² WFP/EB.A/2013/5-B paragraph 47.

ANNEX I

EVOLUTION OF WFP'S ISC RECOVERY RATE POLICY

WFP's ISC recovery rate policy has evolved through several stages since 1995.¹

Prior to 1995	<i>Financing of fixed overheads from regular cash contributions, resulting in funding problems, particularly for support costs.</i>
1995	<i>Adoption of full-cost recovery, with contributions received being allocated to a project's actual food and external transport costs and shares of its landside transport, storage and handling, direct support costs and associated ISC. ISC rates were updated annually,² based on cost studies, and differentiated rates were approved for³ emergency operations, protracted relief and recovery operations, development projects and special operations.⁴</i>
1999	<i>Redefinition of certain cost categories, including PSA, and decision to use a single recovery rate regardless of programme category by "applying the approved Programme Support and Administrative budget to the projected [direct operational costs] and [direct support costs] of the activities for the biennium. The single rate principle will be subject to review through the normal budget setting process and be able to be discontinued by decision of the Executive Board."⁵</i>
2002	Review of the ISC rate ⁶ resulting in <i>identification of a PSA gap</i> consisting of the difference for a given period between PSA expenditure and ISC income.
2003	<i>Establishment of the PSA Equalization Account⁷ to record gaps between PSA expenditures and ISC income, and reduction of the ISC rate to 7.0 percent for 2003. The PSA Equalization Account allows ISC income and PSA expenditure to be isolated from the rest of the General Fund, ensuring that ISC income can be used only with Board approval and that it is generally used for PSA expenditure or expenditure of a similar nature, such as on the capital asset fund or capacity building.⁸ The management goal was to maintain the PSA gap at zero, through either structural adjustments to the PSA budget or adjustments to the ISC rate.</i>
2006	<i>Determination of the ISC rate based on actual audited financial results. Although the ISC rate determined by this method was consistently higher, it was retained at 7.0 percent.</i>
2011	Shift from a biennial WFP Management Plan and budget cycle to a three-year Management Plan with an <i>annual budget</i> , approved each year on a rolling basis. ⁹
2014	Integration of private-sector fundraising into the PSA budget to ensure that private-sector donors cover the management and administration costs related to their contributions.

¹ "Method for Calculating the Indirect Support Cost Rate for WFP" (WFP/EB.1/2014/4-B/1).

² In 1997, the Board approved adoption of ISC rates for a biennium rather than a single year.

³ "Review of WFP's Resource and Long-Term Financing Policies" (WFP/EB.2/98/11).

⁴ "Review of ISC Modalities" (WFP/EB.1/2006/6-A/1).

⁵ "Report of the Formal Working Group on the Review of WFP's Resources and Long-Term Financing Policies" (WFP/EB.3/98/4-D).

⁶ An ISC rate is applied to every contribution received as a means of reimbursing WFP for the PSA expenditure incurred when implementing projects, predominantly at Headquarters and the regional bureaux.

⁷ The PSA Equalization Account is treated as part of the General Fund to "record all PSA expenditures and all income applied to fund such expenditures", to improve transparency and facilitate decision-making on ISC rates.

⁸ The only exceptions have been transfers to the Immediate Response Account and the Direct Support Costs Advance Facility.

⁹ "Review of the Management Plan Cycle" (WFP/EB.A/2011/6-B/1).

ACRONYMS USED IN THE DOCUMENT

ISC	indirect support cost
NGO	non-governmental organization
OECD-DAC	Organisation for Economic Co-operation and Development-Development Assistance Committee
PSA	Programme Support and Administrative
QCPR	Quadrennial Comprehensive Policy Review
SSC	South-South cooperation
UNDP	United Nations Development Programme
UNHCR	Office of the United Nations High Commissioner for Refugees