

# ISC REVIEW: RATIONALE & SUGGESTED WAY FORWARD

Informal Consultation - 7 May 2014

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## I. Introduction

- 1) Although WFP's policy on the indirect support cost rate (ISC)<sup>1</sup> was reviewed in 2002 and a method for determining the rate established in 2006, given the significant changes in its operational context since then, as well as developments in the United Nations system, the Management Plan (2014–2016) proposed to engage with the Executive Board on a review of the ISC rate.
- 2) There were two key concerns driving this proposal:
  - a) Financial Resilience: as an entirely voluntary funded organization with a core mandate to respond to emergencies, income fluctuations can quickly undermine WFP's ability to cover all indirect costs. This calls for a periodic validation of the robustness of WFP's cost recovery model and financial safety nets;
  - b) Strategic Shift: the changing nature of WFP's activities from food aid to food assistance since 2008 (e.g. Growth in Cash & Voucher activities) may be altering the magnitude and composition of WFP's indirect costs.
- 3) The shift in the range of WFP's activities is also a key consideration in the Financial Framework Review, which will include an examination of WFP's cost drivers.
- 4) Furthermore, WFP is conscious that at a time of expanding humanitarian need during an economic downturn, cost containment and value for money are prominent in members' minds. The ISC review is an important opportunity to reassure donors that the indirect cost recovery model meets their concerns in this regard.

## II. Approach to the Review

- 5) The approach to the review is, to the extent possible, to sequentially engage with members around the following four critical questions:
  - a) WFP is a 100 per cent voluntarily funded organization: should core funding or different funding approaches to cover indirect variable costs be considered?
  - b) Should WFP continue with a single indirect support cost recovery rate, or should the rate vary according to the type of intervention?
  - c) Could WFP incentivize resource mobilization through preferential or variable ISC rates, for example for South-South cooperation, or Private Sector?
  - d) Recognizing that some costs related to support and administration are covered from sources other than the ISC recovery rate, WFP should

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<sup>1</sup> An indirect support cost rate is applied to every contribution received as a means of reimbursing WFP for Programme Support and Administrative expenditure when implementing projects, which is incurred predominantly at Headquarters and the regional bureaux.

undertake and present a detailed cost analysis of its indirect costs and review the workings of the PSA Equalization Account, which serves as a safety net to cushion unplanned fluctuations in ISC recovery. Should WFP continue to consider multiple sources for funding costs such as security and non-recurring investments?

- 6) The Secretariat recognizes that there may be some interdependencies between the questions. However, the first two questions are largely matters of governance subject to preferences of members and that require limited technical and quantitative analysis. Early guidance from members on these first two areas will accelerate the technical analysis to be undertaken, particularly in connection with the fourth question.

### III. WFP's position

- 7) The Secretariat recognizes that the current ISC recovery model has served WFP, its beneficiaries and members, effectively over the last 16 years, especially due to the simplicity and transparency it affords.
- 8) The Secretariat's position on each of the issues outlined in Para. 5, is that:
- a) WFP's current model recovery offers the organization, its beneficiaries and donors greater transparency and simplicity over the core funding model. While a core funding model may offer greater funding predictability, it must be recognized that there is a weakening appetite in general on the part of donors for core funding, as evidenced by the declining amounts of core funding being allocated to other agencies.
  - b) The application of a single recovery rate to all programme categories is crucial. In addition to the reasons of simplicity and transparency, the single rate avoids the problem of perverse incentives (i.e. temptation to reclassify a project in order to avail of a reduced recovery rate), and reduces the complexities of administering recoveries.
  - c) The Secretariat believes that there is merit in examining ways to encourage more contributions from non-traditional donors as well as private donations. The practices and experience of other organizations, including their application of ISC rates for donations from such sources, merits review. Management believes that where lower ISC rates from certain donors have to be subsidized from ISC recovered from other donations, the subsidy should not be significant. Any proposals to incentivize donor contributions should therefore be supported by a cost analysis.
  - d) With regards to the classification of ISC and the costs that should be funded from it, management believes there is a need for considerable analysis that will require a broad collection of internal and external data, which would be successively and iteratively presented at Informal Consultations. The complexity of the cost analysis would be reduced if members can confirm beforehand that WFP does not seek to establish a core funding model and will continue with a single rate for all programme intervention types.

The analysis would include: i) the impact of the shift to food assistance, and; ii) the total structure of wider overhead costs (ISC, DSC, security costs, costs of innovation, etc.). The work would also seek to establish how WFP might

reduce its dependency on unpredictable funding sources and re-examine the modalities for using the unearmarked portion of the General Fund and PSA Equalization Account surpluses.

- 9) An outline schedule on the way forward is presented in Annex I. Upon completion, WFP's cost recovery policy should be capable of demonstrating financial resilience and value for money. Furthermore, the agreed policy and method should be used in successive Management Plans for setting the appropriate ISC rate and establishing proposals to use the PSAEA and any unearmarked portion of the General Fund.

## Annex I

### Schedule for Way Forward

Following the recommendation of Board members to use the Informal Consultation process to provide guidance and views on the method of reviewing the ISC rate, a tentative outline schedule is set out below.

The aim is to expeditiously conclude discussions on the first two questions outlined in paragraph 5, and to focus on the cost analysis needed for members to have comprehensive discussions on the remaining questions (particularly the fourth question):

- I. May 7<sup>th</sup>: Circulate a review of the rationale for the paper; agree a way forward, and reach a consensus on question 1 and 2 at the Informal Consultation.
- II. June, Annual Session of the Executive Board: Executive Director or CFO to present a verbal update on the discussion and agreements since the First Regular Session in February 2014.
- III. July through September: Continue the discussion with members at the informal consultations on questions 3 and 4, supported by appropriate cost analyses.
- IV. November, Second Regular Session of the Board: present a paper reflecting the status of the review.
- V. 2015: Through further informal consultations, finalise the analysis and prepare a paper for decision to the Board.