



**Executive Board of the
United Nations Development
Programme and of the
United Nations Population Fund**

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Financial, budgetary and administrative matters

UNITED NATIONS POPULATION FUND

**REVISION OF UNFPA FINANCIAL REGULATIONS
AND
RECOVERY OF INDIRECT COSTS FOR CO-FINANCING**

Report of the Advisory Committee on Administrative and Budgetary Questions

1. The Advisory Committee on Administrative and Budgetary Questions (ACABQ) has considered the reports of the Executive Director of the United Nations Population Fund on the revision of UNFPA financial regulations (DP/FPA/2005/3) and the recovery of indirect costs for co-financing (DP/FPA/2005/5). During its consideration of the reports, the ACABQ met with the Deputy Executive Director (Management) and her colleagues, who provided additional information.

Revision of UNFPA financial regulations (DP/FPA/2005/3)

2. As indicated in the first paragraph of the report of the Executive Director, revisions to the existing regulations as well as proposed new regulations are proposed for the approval of the Executive Board. The Committee welcomes the presentation, which facilitates identification of the revisions and additions to the text. The Committee was provided as well with a matrix of all proposed changes outlining new or revised text, with justification for the changes.

3. The Committee notes that most of the revisions result from the introduction of the PeopleSoft financial system (Atlas) in January 2004, and reflect the introduction of the multi-year funding framework (MYFF) in 1999, which replaced the previous work plan. The revisions also reflect United Nations simplification and harmonization initiatives. As indicated in paragraph 2, the revisions were approved by the Office of Legal Affairs of the United Nations.

4. The Atlas-induced changes include the replacement of the former “certifying” function by the “committing” function, which establishes the approval to spend against a budget source; the replacement of the former “approving” function by the “verifying” function, which ensures proper controls are in place before disbursing the funds; and the replacement of the “allocation” concept by the “budget” concept, which is used to enable and control expenditures, as summarized in paragraphs 3-5 of the report of the Executive Director.

5. Previous terminology referring to the work plan in the regulations is replaced by “MYFF”, in view of the introduction of the multi-year funding framework mentioned above. Moreover, now that formal authority has been delegated to UNFPA on managerial oversight and financial and personnel services, references to the UNDP Administrator have been removed in the text. The Committee further notes that under the current regulations, all entities spending money in support of UNFPA activities are defined as “executing agencies”. However, under the United Nations Development Assistance Framework and the country programme action plan, the host government and/or UNFPA is now the “executing agency” and the old concept of executing agency or individual partner organization implementing the activity is therefore replaced by “implementing partner” (paragraphs 6-7 of the report). The Committee also notes that in an effort to further harmonize and simplify, UNFPA indirect costs, currently segregated into administrative and operational support costs (AOS) and managerial and support service costs (MSS), will now be labelled “indirect costs” in the regulations.

6. UNFPA is also expanding the definition of “fully funded” contributions in the regulations in order to allow implementation of a project or activity based on cash received or, if needed, a written pledge or signed agreement (paragraph 8 of the report). This will allow UNFPA to programme expenditures up to the 100 per cent level in well-defined cases in which the expectation is to receive 90 per cent cash prior to project completion. The Committee was assured that internal guidelines would be issued to minimize risk.

7. The Advisory Committee recommends that the Executive Board approve the revisions to existing regulations and the new regulations proposed, as contained in the report of the Executive Director (DP/FPA/2005/3).

Recovery of indirect costs for co-financing (DP/FPA/2005/5)

8. UNFPA provides managerial and substantive support to activities financed from co-financing resources, which entail additional managerial and administrative support from UNFPA, regardless of the executing/implementing agency. The Advisory Committee recalls that the issue of cost recovery policy of indirect costs was discussed in 1998 and 2000, and that the Executive Board approved the current rate structure in its decisions 98/22 and 2000/6.

9. The current policy for recovery of indirect costs is as follows:

- (a) Trust fund contributions, regardless of implementing partner, are levied a 5 per cent recovery for MSS;

- (b) Cost sharing contributions implemented by UNFPA are subject to a 5 per cent recovery of AOS costs;
- (c) Trust fund contributions implemented by UNFPA are subject to an AOS of 7.5 per cent;
- (d) Government execution is subject to an AOS of 5 per cent payable to UNFPA for support;
- (e) Partner organizations implementing UNFPA activities can cover their indirect costs up to 12 per cent in the case of non-governmental organizations (NGOs) and up to 7.5 per cent in the case of United Nations agencies.

10. The Committee notes that the basis for the review includes the recommendation of the Joint Inspection Unit (JIU) for all organizations of the United Nations system to review their indirect cost rates in order to harmonize whenever possible (see paragraphs 12-14); the recommendation of the Advisory Committee for a review of the UNFPA cost-recovery methodologies to ensure that no “subsidization” takes place between core and co-financing funds; and the fact that, as part of the simplification and harmonization initiatives under way in the United Nations system, other agencies have reviewed and obtained approval to revise their cost-recovery policies. The Committee was further informed that both donors and country office staff have advised that the system is complicated and difficult to understand, and that as a result of this complexity, donors sometimes request waivers which, when granted, make it difficult to argue that there is no subsidization of restricted contributions by core funds – thus the proposal to simplify the calculation, as indicated in paragraph 8 of the report of the Executive Director.

11. The methodology for arriving at the formulation of the policy on recovery of indirect costs is based on a model suggested by the JIU and used by some other agencies to estimate actual indirect costs as a percentage of expenditures from co-financing (see paragraphs 15-16 of the report of the Executive Director). The Committee notes that, as a first step, the level of fixed indirect costs, which do not increase with the volume of co-financing activity, was determined within the biennial support budget. Variable costs, which are what remains after fixed indirect costs are deducted, were then apportioned based on the respective sizes of contributions in the areas of co-financing, regular resources and procurement services. Part II of the annex to the report of the Executive Director provides the UNFPA structure of fixed and variable costs. Using that model, and based on the calculation of actual recovery rates for the last two bienniums (8.1 per cent for 2000-2001, and 6.5 per cent for 2002-2003), the Executive Director is therefore proposing a unified rate of 7 per cent to be charged on all co-financed activities. Moreover, the Executive Director is of the opinion that the goal of no cross subsidization of co-financing can be attained through the application of a single rate.

12. The Committee notes that in reviewing the cost-recovery rates, UNFPA also reviewed the rates for the reimbursement of costs related to third party procurement services, currently calculated at 5 per cent of the value of the goods procured, and confirmed its appropriateness. The Executive Director is thus proposing to maintain it. The rates determining the level of reimbursement for indirect costs that implementing partners may charge, of up to 12 per cent for NGOs and 7.5 per cent for United Nations agencies, are also proposed to be retained.

13. Based on the above, the Committee agrees that the rate of 7 per cent, proposed to be the one rate to be used to recover indirect costs for co-financed activities, is reasonable. The Committee also agrees that the Executive Director should be allowed to keep the indirect cost-recovery rate under review and make proposals for amendments to avoid cross-subsidization, if necessary.
