
Financing of category 6 and cost recovery mechanisms: current practices and proposed way forward

INTRODUCTION

1. This paper describes WHO's policies for financing indirect administrative and management costs (programme budget category 6, Corporate services/enabling functions), including cost recovery, and contains proposals to strengthen the WHO cost recovery policy framework.
2. WHO's administrative and management costs can be divided into two broad categories: direct and indirect. Direct costs are those that can clearly be attributed, either in whole or in part, to a programme or project; they include costs associated with management and other support functions where a direct link between the cost and project can be identified. Indirect administrative and management costs are those that cannot be traced directly to specific activities, projects or programmes, but which are incurred in support of such activities.
3. WHO's indirect administrative and management costs include the Organization's leadership, oversight, and governance costs. Many of these are "fixed" costs, since they do not tend to vary greatly regardless of the overall workload of the Organization, for example the costs of holding a governing body meeting such as the World Health Assembly, or the costs associated with maintaining WHO principal office locations. These indirect costs are grouped together under category 6 of the WHO programme budget, Corporate services/enabling functions. Category 6 is divided into five components: leadership and governance; strategic planning and resource coordination; strategic communications; accountability, transparency and risk management; and management and administration. The latter represents the largest single component. In 2016, expenses under Category 6 totalled US\$ 373 million, 60% of which was for management and administration, and 40% for the other components (see Annex 1 for further details).
4. Only half of the costs under category 6 can be financed through assessed contributions, which means that a significant component of the management and administration costs above, as well as some of the leadership, governance and oversight components, must be funded through cost-recovery mechanisms.

Cost recovery

5. WHO's Organization-wide cost recovery policies aim to ensure that:
 - administrative and management costs attributable to programme implementation are fully charged to those programmes;

- a fair and transparent method for identifying, budgeting and charging such costs, indirect and direct alike; and
- the total amount recovered is adequate to pay for the services needed.

6. WHO operates three main indirect cost recovery approaches, as described below.

(a) Programme support costs are charged as a percentage of voluntary contributions, at the time of implementation. A range of percentage rates exists – either set through World Health Assembly resolutions such as the standard 13% rate,¹ or established by the Organization in accordance with United Nations system-wide agreements,² or based on special agreements approved by the Director-General.³ These rates do not necessarily reflect the actual indirect costs related to programme implementation, which vary depending on the location, cost-structure, and type of work to be performed. It would not be practical to establish multiple rates for each programme, nor is such an approach likely to be supported by donors. Some US\$ 149 million were generated from programme support costs in 2016. These funds were used mainly for the management and administration component within category 6.

(b) A post occupancy charge was introduced in 2010, as a percentage of salary cost, which currently stands at 9.5% of gross salaries. The main reason for introducing this charge was to address the shortfall between the amount raised for programme support costs and the amount required to finance administrative functions under programme budget category 6, which are needed to run the Organization. In 2016, US\$ 73 million was raised from post occupancy charges; these funds are used mainly for IT, office running costs (such as utilities and maintenance) and management and administration of the Global Service Centre. There is also a 1% allocation from the post occupancy charge to the Real Estate Fund.

(c) Cost recovery also comes from hosted partnerships: a new methodology was introduced in 2016 to ensure full cost recovery and improve the transparency of the approach, linking the amounts recovered more closely to the overall category 6 budget. The total amount charged to hosted partnerships in 2016 was US\$ 6 million.

7. In 2016, the total amount recovered from these three sources was US\$ 228 million, most of which was spent on the category 6 components described above.

Rationale

8. In 2013, WHO conducted a comprehensive review of its management and administrative costs (category 6) to identify potential improvements in the classification and management of those costs, identify efficiencies, and ensure sustainable financing. An external consultant was engaged, and

¹ Standard rate 13%, WHA34.17 (1981), 3% for member state procurement, with 0% in emergency EB33.R44 (1964).

² For example UN CERF 7%, multi donor trust funds 7 or 8%, European Union 7%.

³ For example 7% for Polio and emergencies.

detailed reports were provided to the Health Assembly in 2013, and subsequently discussed, and recommendations issued, by the Executive Board in 2014.¹

9. In respect of financing category 6, and the cost recovery methodology, the consultant recommended four options for consideration. These options were either to increase the existing programme support cost rate, which would then finance all administrative and management costs; introduce a new fee for service approach; continue with the existing funding arrangements, but with greater clarity on the services financed from each source; or implement a blended approach, using a combination of these methods.

10. In assessing these proposed options, the following considerations were noted:

- replacing with a single programme support cost rate would require a rate that would be unacceptably high for voluntary donors; and
- implementation of a combined programme support cost rate with a fee-for-service approach, using a service catalogue and costs recovered based on usage, would be complex and applicable only to a relatively small range of costs under category 6, and would therefore generate insufficient funds.

11. Member States expressed the need for transparency, and for full cost recovery (and avoidance of cross-subsidization), and stated that WHO must continue to look for efficiency improvements, in order to keep category 6 costs under control.

12. After due consideration of the proposed cost recovery options, Member States supported financing of category 6 through a combination of assessed contributions, and cost recovery through the methods described above. This approach ensures simplicity, scalability and transparency. WHO has subsequently implemented improvements to classifications of its management and administration costs, and brought more clarity to the distinction between direct and indirect costs. Category 6 now groups together all indirect administrative and management functions of leadership, governance and oversight, policy-setting, administration, and support services, which are necessary to maintain the ongoing activities of the Organization.

13. In accordance with the consultants' recommendations, there is now a clearer link between each main source of financing, and the services covered (including detailed budgeting of the post occupancy charge against the post-related costs under category 6). Lastly, the Organization has introduced a new cost recovery system for hosted partnerships.

14. All United Nations agencies are under pressure to reduce administrative costs, and ensure fair, transparent cost recovery policies. WHO has been at the forefront of those organizations seeking to reduce costs by offshoring to cheaper locations and outsourcing. Cost recovery at other United Nations agencies tends to follow the same principles, for example direct and indirect cost classifications. Cost recovery (programme support cost) rates do, however, vary within the United Nations system; many use a 7% or 8% rate, and all of WHO's funding received through United Nations system-wide facilities tends to be charged at 7%. A number of other specialized agencies continue to apply a standard rate of 13%. Annex 2 contains information on the cost recovery rates charged by

¹ See document EB134/3.

16 organizations of the United Nations system, following the last United Nations system-wide internal study into cost recovery practices.

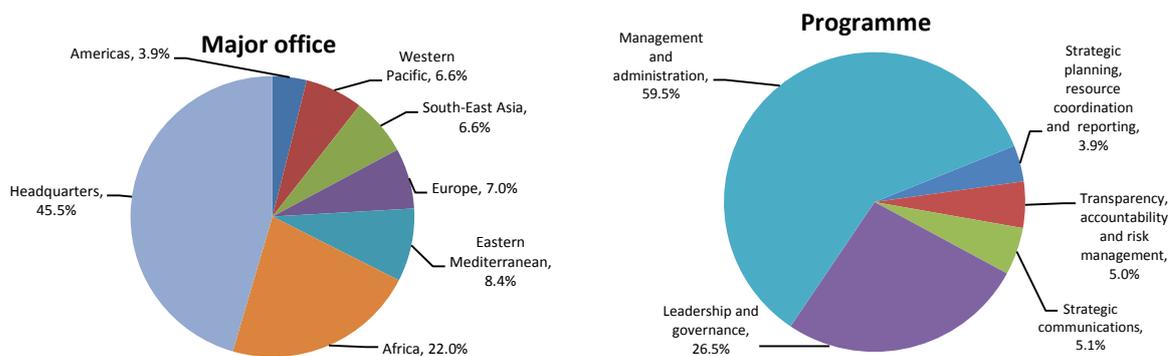
15. The consultant also noted that the different rates do not mean that one agency is more or less efficient than another, rather it is a reflection of the different budget and funding models. WHO has for several years now presented an “integrated” budget to Member States. Most other United Nations entities (funds and programmes and specialized agencies) present “core” and “non-core” (or “extrabudgetary”) budgets, with most or all of the institutional running costs, covered within the core budget. By contrast, at WHO, over half of the amount needed for category 6 is financed through cost recovery, with the balance through assessed contributions. Several studies have been conducted to explore the harmonization of cost recovery rates within the United Nations system, but since cost-structures and financing models remain different, it is likely that the rates will continue to differ, even if the underlying cost recovery policy objectives are harmonized.

Proposed way forward

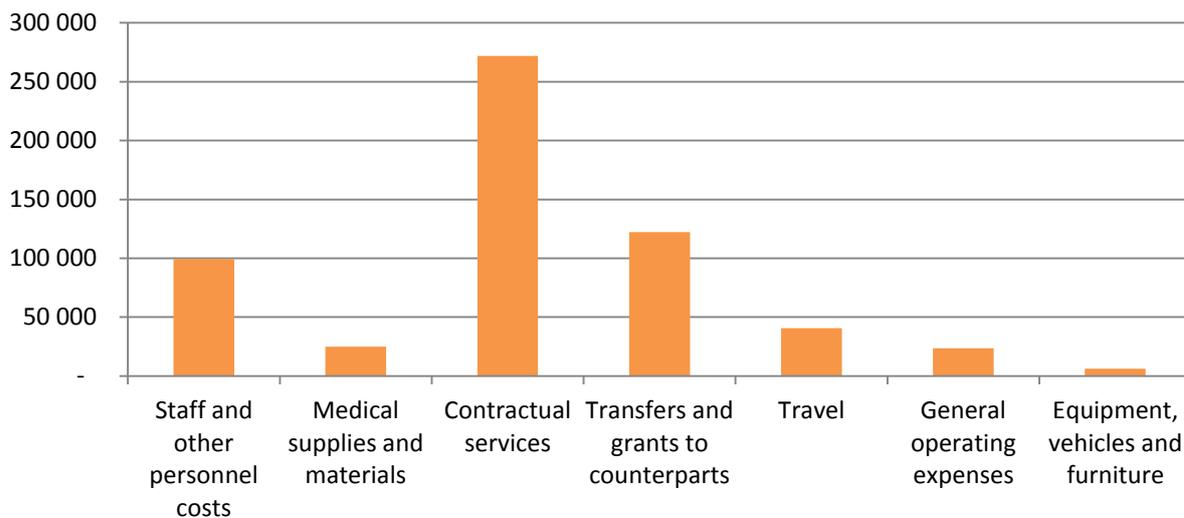
16. It is proposed that the current cost recovery methodology be retained, with further elaboration of which costs are covered by each source of financing for category 6. It is also proposed that the methodology for cost recovery should be formally incorporated into the WHO Financial Regulations and Rules, which at present only refer to the programme support cost. A proposal to that end will be made to the Executive Board in January 2018.

ANNEX 1

CATEGORY 6 EXPENDITURE IN 2016 (AS REPORTED IN DOCUMENT A70/40)



Expenditures by type (US\$ thousands)



ANNEX 2

**COST RECOVERY RATES FOR 16 ORGANIZATIONS OF
THE UNITED NATIONS SYSTEM**

Cost-recovery rates	Single donor, programme or project-specific contributions	Entity-specific (thematic) trust funds	United Nations inter-agency pooled funds	Local government contributions	Other (EC, Private donor)
0%			1		
3 to 5%				4	2
7%	4	7	6	2	2
8%	4	2	4	1	1
10%			1	0	2
13%	5	3		5	
Variable	2	2	4		5
No answer or N/A	1	2	1	4	4

These figures are taken from a survey conducted in mid-2015 for the United Nations Finance and Budget Network and refer to several organizations that apply the specified rates. In all but one case, exceptions to standard rates can be agreed by the Executive head of the Organization.

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