



## **Paper on Project Direct and Indirect Costs**

CERF secretariat  
*May 2012*

### **I. INTRODUCTION AND BACKGROUND**

#### **1.1 Purpose and intent**

At the Advisory Group (AG) meeting in October 2011, the sub-granting of CERF funds by UN agencies and IOM to implementing partners (IPs), which usually consist of NGOs, Government and other non-private entities, to deliver humanitarian assistance was discussed. There was a concern that through sub-granting arrangements, implementing partners and their partners (if they further sub-contract to other partners) would each take an amount of project servicing cost (PSC) from the CERF budget, leading to “cumulative” indirect support cost beyond the 7 per cent PSC ceiling and as a result less funds actually go towards the direct benefit of the people assisted.

The Advisory Group therefore requested CERF to provide further information on the amount of PSC and implementing partner indirect costs charged by agencies in the CERF projects.

This paper intends to address this Advisory Group’s request by examining the amount of project indirect support costs in approved CERF grants to ascertain the amount of CERF project funds for direct project implementation. It aims to achieve a twofold purpose:

- 1) Describe the CERF project budget structure in the broader UN budgetary context and define the differences between direct and indirect costs; and
- 2) Present the findings and conclusions from a sample review of implementing partner budgets in recently approved CERF projects.

#### **1.2 UN definitions of project costs**

There are two main categories of project costs, as officially defined in the UN Secretariat as follows:

##### *1. Direct costs*

Direct costs can be clearly attributed, either wholly or in part, to an operation, programme or project financed from voluntary contributions. They include costs associated with providing direct management and other support functions. Direct costs are financed as identifiable components of an operation, programme, or project (i.e. As staff and other personnel costs, travel, contractual services, operational expenses, procurement, or fellowships and grants).

##### *2. Indirect support costs*

Indirect support costs are referred to as Project Servicing Cost (PSC) in the UN Secretariat (also known as programme support costs). These are costs that cannot be traced unequivocally to specific activities,

projects, or programmes. Indirect costs include costs incurred by services providing administrative and other support functions to a range of operations, programmes, and projects financed by a range of voluntary contributions. Indirect costs may be incurred when performing the following functions: the recruitment and servicing of staff, consultants and fellowships, procurement and contracting (usually centralised), budget preparation and control, financial operations, accounts, reporting, and auditing.

The definitions of direct and indirect support costs underpin the review of CERF sub-contracted budgets presented in the following sections of this paper.

## **II. CERF DIRECT AND INDIRECT COSTS**

### **2.1 CERF project servicing costs**

The PSC rate for CERF is 10 per cent<sup>1</sup>. Of the 10 per cent, 3 per cent is retained by the UN Controller to cover UN Secretariat administrative costs – including the budget of the CERF Secretariat – and 7 per cent is passed onto the agencies. This means that CERF allows UN agencies to apply a maximum of 7 per cent of total project direct costs as indirect support cost for project implementation. Examples of costs that characterize the use of PSC for UN agencies are in Annex 1.

Due to the 10 per cent PSC cap and the fact that UN agencies and IOM retain their full 7 per cent (as dictated by their own internal policies), the agencies are not granted indirect support costs in the budgets for their implementing partners. UN agencies and IOM report their NGO and Government partner costs as direct costs in their certified financial statements, including those submitted to the CERF and the UN Secretariat.

The direct costs in the CERF budget are made up of five main budget lines:

- A. Supplies/commodities/equipment/transport
- B. Personnel (staff, consultants, travel)
- C. Training of counterparts
- D. Contracts
- E. Other direct costs

The CERF application budget structure follows the categories in the UNDG format for financial reporting<sup>2</sup>. For detailed descriptions of the types of direct costs under each of the five budget lines, please refer to *Annex 2: CERF budget guidance*.

## **III. AGENCY SUB-CONTRACTING COSTS**

### **3.1 Methodology of agency sub-contracting budget review**

As a way to ascertain that agencies' implementing partners' budgets do not include any indirect support costs, a review was conducted on a random sample of 20 projects from a list of 208 CERF approved

---

<sup>1</sup> The General Assembly set forth a standard PSC rate of 13 per cent in its resolution 35/217 of 17 December 1980. The Controller has the delegation to reduce this rate should the administrative burden of managing the trust fund warrant less than 13 per cent. The PSC rate for CERF was reduced from 13 per cent to 10 per cent by the former Controller in 2006.

<sup>2</sup> Harmonized Financial Reporting to Donors in Joint Programmes: Explanatory Note, September 2006

projects from 1 January to 20 April 2012<sup>3</sup>. The number of sampled projects represents a 10 per cent sample size of total approvals in 2012, and includes the major CERF allocations in 13 countries. No distinction has been made between projects from the rapid response and the underfunded windows in the sample, as both windows follow the same budget structure.

## **IV. MAIN FINDINGS AND CONCLUSIONS**

### **4.1 Main findings of the review**

Of the 20 project budgets sampled, 14 included a contract provision indicating support to an NGO or other implementing partner, while six did not include any proposed funds under the Contracts budget line. The description of contract costs included in the overall agencies' project applications varied in format and clarity. Some agencies described costs by activity (i.e. food distribution per ton; creation of child friendly spaces for protection; supervision and monitoring) while others showed clear breakdowns by financial inputs (i.e. staffing, operations and administration support costs). Based on the descriptions provided, it was found that none of the sampled projects contained any indirect costs in the Contract's category. Please refer to *Annex 3 for the full sampling of contract budgets*.

### **4.2 Limitations in this review**

The main limitation of this desk review is that the cost breakdowns for implementing partners were not always available in sufficient detail or consistent among project proposals, making comparisons between them somewhat challenging. Also, in some cases, the contract amounts were provided as lump sums with general and broad descriptions. Therefore, this sample review can only draw its conclusions based on information available in the approved project budgets.

The CERF secretariat is making steps towards a better understanding of agency sub-contracting requirements. Recently, the CERF secretariat has started to request agencies to provide cost breakdowns for each implementing partner into three categories: (i) staffing; (ii) direct operational costs; and (iii) direct administrative costs. So far, the level of information received regarding funds going to third-party implementing partners still varies. As well, the CERF secretariat exercises some discretion on the level of detail regarding the amount of data on agencies' implementing partners at the time of project application, particularly for rapid response requests during sudden onset emergency situations where time is of the essence. In addition, while an agency may know what needs to be accomplished, they may not have fully worked through all of the budgetary details for each implementing partners' budget at the time of submission, or indeed been able to identify which implementing partners they will use. The CERF secretariat is continuing its efforts to reinforce consistency in budget preparations through CERF trainings at country and regional offices every year, and through the dissemination of budget guidelines, which are applied to every application in the context of the budget reviews.

### **4.3 Conclusions**

Based on the outcomes of the sample budget review, there is no evidence of any agency, either independently or with its implementing partners, requesting indirect costs beyond the seven per cent

---

<sup>3</sup> Project data up to 20 April 2012 extracted from the CERF database.

allowed by CERF. In other words, agencies are adhering to the seven per cent PSC cap when applying for CERF funds, in conformity with CERF budget guidance.

UN agencies and IOM never report more than seven per cent indirect costs on their final CERF financial reports. These financial reports are certified by their own financial controllers before being submitted to the CERF and the UN Secretariat for consolidation and reporting to the legislative bodies.

It is important to note that agencies apply their own internal financial regulations and rules (including auditing limitations) to the management and administration of CERF funds. All costs for implementing partners' services are always expensed and reported to the CERF secretariat as direct costs.

Therefore, once the funds are received by the UN agencies, the CERF secretariat is limited in its ability to discern how exactly the implementing partners' funds have been expensed within the UN agency's system. In this regard, based on the financial reporting we receive, the CERF secretariat is not able to confirm whether or not implementing partners' expenditure reported to the UN agencies and IOM concerning CERF funds is fully in line with the standard definition of direct costs. This responsibility rests with each UN agency and IOM.