



IOM International Organization for Migration
OIM Organisation Internationale pour les Migrations
OIM Organización Internacional para las Migraciones

**INFORMAL CONSULTATIONS
ON BUDGETARY AND
MANAGEMENT MATTERS
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**SUPPLEMENTARY INFORMATION SUPPORTING THE PROPOSAL
TO SIMPLIFY IOM'S OVERHEAD RATE POLICY**

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1. Further to discussions on the Proposal to Change IOM's Project-Related Overhead Rate Policy¹ at the last informal consultations on budgetary and management matters on 22 June 2005 and as requested at that meeting, the Administration is presenting additional information and further analysis for moving to a five per cent overhead rate on all costs as opposed to the present policy of 12 per cent on staff and office costs.

2. The main rationale for the Administration's proposal to change IOM's overhead policy from 12 per cent overhead calculated on staff and office costs to five per cent overhead calculated on all costs is further elaborated below:

a) **Simplicity and consistency of calculation:** By calculating overhead on total expenditure there is little room left for judgment and interpretation as to what constitutes staff and office versus operational costs. The evolving nature of IOM's operations has resulted in new types of activities that are difficult to categorize as either staff and office or operational (traditional transport type activities held a relatively easy distinction). This ambiguity in classifying costs can lead to time consuming debates with project managers. Examples are as follows:

- The cost of travel to operational sites (refugee camps, IDP camps, project activity centres, etc.). These are normally categorized as staff travel, under office costs, but are directly related to completing the operations in that site;
- Costs of staff on IOM contracts hired directly to undertake operational activities (i.e. truck drivers, IDP camp registration staff, etc.);
- Costs of seminar travel and subsistence. The costs for IOM staff are recorded under staff whereas the costs for non-IOM staff are recorded under operations resulting in the seminar costs being recorded under two separate sections;
- The costs of purchasing or renting vehicles for operational activities.

By using one standard method that is not open to interpretation, overhead calculations will be simplified and transparent. In addition, the coding of expenditure can be driven by activities and not overhead calculations.

b) **Perceptions:** Currently, many other international organizations report a lower rate of overhead than IOM. IOM's overhead rate at 12 per cent on *staff and office costs* appears high to many donors and partners when compared to those rates applied by the United Nations and other agencies who apply a percentage on the *total* expenditure. In fact, IOM's overhead rate is much lower than almost all other organizations if presented on total costs. Therefore, time is spent by IOM reviewing and explaining this principle with donors and other stakeholders.

¹ Document IC/2005/5 – Proposal to Change IOM's Project-Related Overhead Rate Policy

Repeated below is a summary obtained by the Administration of the overhead rates applied by the United Nations and other organizations:

UN:	13 per cent
UNDP:	5 to 7 per cent on total costs
ICRC:	6.5 per cent on total costs
WFP:	7 per cent on total costs
UNHCR:	7 per cent on total costs

The methodology applied by different UN agencies varies, as does the content of the respective programme support costs systems. However, the Administration could find no other Organization that applies an overhead on partial costs. Agencies are gravitating toward an average rate of 7 per cent, with increasing use of additional cost recovery through the charging of certain support functions (reporting, evaluation, supervision missions and staff costs) directly to the project budget.

By moving to an overhead rate of 5 per cent, IOM will not only align its overhead charge with the practice in other organizations, but will also facilitate review and comparisons by stakeholders.

- c) **Regularizing existing practice:** In certain cases IOM has adopted the donors system for charging overhead while at the same time ensuring that the standard 12 per cent overhead on staff and office is covered. This practice usually requires additional work to reconcile the two different methods. For example, funding obtained from two large donors, the European Commission and USAID, is already computed based on all costs, generally at 7 per cent and 5 per cent respectively. As certain projects, funded by those donors, already calculate overhead on total costs, moving to this method for all projects will unify IOM's overhead practice.
3. The Administration believes that a revision and simplification of the overhead policy will be beneficial to IOM. To remain cost effective, finance and administrative processes and structures are in need of revision in line with the changing nature of both internal and external factors influencing the Organization's work. IOM's overhead rate policy is an area requiring a change at this juncture. As with other structural and administrative changes, the Administration proposes to implement the change in overhead rate policy in a gradual and phased manner.
4. Annex 1 summarizes the updated analysis of costs using expenditure information for the first six months of 2005. During this period, total expenditure was USD 563.2 million and total overhead income was USD 10.9 million. To make meaningful projections, expenditure has been adjusted for projects not subject to overhead (principally projects funded by discretionary income) and also for compensation programmes where, in 2005, large payouts skew the expenditure information for overhead projections.
5. Based on the adjusted total expenditure of USD 296.1 million for the first six months of 2005, applying the 5 per cent proposed overhead rate on all project expenditure will result in overhead income of USD 14.8 million. If the overhead rate were 6 per cent, overhead income of USD 17.8 million would be obtained and if the overhead rate were 7 per cent, overhead income of USD 20.7 million (Annex 1, section 1.3).

6. This projected overhead income would only be achievable if all projects converted to the new system and the level of expenditure remained constant. This obviously is not possible since expenditure levels vary from year to year and any revision to IOM's overhead rate will need to be implemented in a gradual and phased manner. If a new overhead rate and method is approved, new projects beginning as from January 2006 should follow the new rate; however, existing projects will not be subject to immediate and automatic application of the new rate. Projects currently in progress and foreseen to end in the near future would remain at the 12 per cent level. Some projects may have the new rate applied over time, while others will require specific renegotiation before the new rate can be applied.
7. The Administration therefore assumes that only a portion of existing projects would adopt the new overhead percentage immediately. Due to the need for a transition period, the new overhead rate will have to be tested for several years (at least through 2008, the final year in the projections in Annex 1) before the level is reviewed.
8. Implementation is estimated at 25 per cent of projects to apply the new overhead system in 2006 (since most projects will be continued from 2005 or would have been negotiated prior to approval of the new overhead method); in 2007, 50 per cent of projects will apply the new overhead and in 2008, 75 per cent.
9. Based on these assumptions and using the first six months of 2005 adjusted expenditure, the projected overhead income for 2006, 2007 and 2008 is summarized in Annex 1, section 1.4, as USD 11.4 million, USD 12.6 million and USD 13.7 million respectively. The estimated overhead income is slightly higher than the current overhead income for the period January to June 2005 of USD 10.9 million; however, given the uncertainty of future expenditure levels, the results are satisfactory.
10. The Administration estimates that out of the total overhead of 5 per cent, 1 per cent will be required to meet the costs of IOM's participation in United Nations Department of Safety and Security (UNDSS) as well as to cover other security costs and 4 per cent to be used to cover the standard IOM overhead. The UNDSS overhead income for the first six months of 2005 was USD 2.1 million. Based on the above assumptions, Annex 1, section 1.4 summarizes UNDSS income for the next three years as USD 2.4 million, USD 2.6 million and USD 2.8 million. This again is reasonable given increased security concerns and related security costs and the uncertainty of future expenditure levels.
11. Beginning immediately, the Administration will approach donors through bilateral discussions to review the effects and possibility of changing to the new overhead calculation. For projects that have low staff and office costs and high operational costs, more overhead will be due making donors less favourable to switch over. For projects that have high staff and office costs and low operational costs, a lower amount of overhead will be payable making donors more favourable toward accepting. Therefore, it is expected that projects that will pay less overhead from the new overhead methodology may more readily convert than those facing increased overhead. A phased implementation is therefore necessary and will allow time for negotiations.
12. Consistent with prior years, the overhead income and expenditure will continue to be reported in both the annual Programme and Budget and the annual Financial Report which is audited by IOM's external auditors (Appendix 3 of MC/2172). In addition, the amount of overhead income earmarked for security will continue to be segregated and reported

separately in the annual Financial Report (Appendix 4 of MC/2172). The key assumptions in all projections are the extent and timing under which projects will apply the 5 per cent overhead combined with the level of expenditure. The Administration will continue to share information on this important subject with Member States as well as with interested donors.

Recommendation

13. The Administration believes that a move to the new overhead policy at a rate of 5 per cent on total costs will enable IOM to remain cost-effective, will simplify calculations and improve the transparency and perception of its cost structure.

Analysis of IOM overhead income based on actual results for January to June 2005

All figures are stated in USD millions

All figures are calculated for one half year (6 months) based on January to June 2005 expenditure

1.1

	Staff and office costs	Operational costs	Total expenditure	Overhead - regular and security (12%)
Total expenditure January to 30 June 2005	104.1	459.1	563.2	10.9 ^{Note 1}
Less:				
Projects not subject to overhead (DI projects)	11.2	1.0	12.2	0.0
GFLCP and HVAP (due to large non-recurring compensation payments)	6.9	248.0	254.9	0.7
Adjusted total expenditure	86.0	210.1	296.1	10.2

Note 1: Overhead obtained for the period January-June 2005 totalled USD 10.9 million from the 12%: USD 8.8 million from the standard overhead (9.5%) and USD 2.1 million from the 2.5% overhead for UNDSS.

1.2

<u>Check on reasonability of adjustments:</u>	<u>Overhead</u>	
Adjusted total staff and office costs at 12%	10.3	(Calculated at USD 86 million at 12%)
Plus non-recurring overhead	0.7	(Overhead for Jan-Jun 2005 summarized above)
Total	11.0	

1.3

<u>Overhead on adjusted total expenditure</u>		
At 5%	14.8	(Calculated at USD 296.1 * 5%)
At 6%	17.8	(Calculated at USD 296.1 * 6%)
At 7%	20.7	(Calculated at USD 296.1 * 7%)

1.4

<u>Total estimated overhead income for 2006 to 2008</u>					
Year	Percentage of projects using old system (at 12% of staff and office costs)	Percentage of projects using new system (at 5% of total costs)	Total estimated overhead (at 12% old and 5% new basis)	Overhead for UNDSS and security costs (at 2.5% old and 1% new basis)	Standard IOM overhead (at 9.5% old and 4% new basis)
2006	75%	25%	11.4	2.4	9.1
2007	50%	50%	12.6	2.6	10.0
2008	25%	75%	13.7	2.8	10.9