Good Humanitarian Donorship

Indirect Support Cost Study: Final Report

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Table of Contents

Development Initiatives is an independent research organisation working on aid, development policy, NGOs and government relations

I. Introduction

The Swedish government has commissioned this study on behalf of the members of the Good Humanitarian Donorship (GHD) initiative. The outcome of the study will be discussed at the GHD meeting on 18th July 2008.

I.1 Why is this study needed?

When an organisation receives funding, including humanitarian funding, it usually applies an overhead or indirect cost charge. With the recent introduction of new financing mechanisms, such as the CERF and Common Humanitarian Funds (CHFs), the layers through which humanitarian funding flows have increased. This has led to donor concern that the subtraction of a charge at each level is reducing the amount of assistance available for beneficiaries. This, in turn, has put pressure on humanitarian organisations to lower their indirect cost charges in order to ensure that more assistance flows to beneficiaries.

Indirect cost charges are often a bone of contention because some donors question whether they represent value for money and seek to reduce them to the bare minimum. This is partly because donors are generally unclear about exactly what costs are covered by these charges. On the other hand, humanitarian organisations and some donors are concerned that the pressure to reduce indirect cost charges is forcing humanitarian organisations to cover these costs from other sources of income and reducing investment in humanitarian response capacity. The lack of documented knowledge about indirect costs makes it difficult to resolve these differences and make a clear case for a fair coverage of costs.

The issue is exacerbated because, within humanitarian organisations, programme staff often do not understand the need for an overhead or indirect cost charge because they do not necessarily know the organisation's cost structure. In some organisations, field staff see the charge as income that is lost to headquarters. This leads to pressure from programme staff to reduce or waive the charge in order to secure funding from donors, often at country level.

Programme staff are tempted to reduce or waive overhead charges because they are aware that many donors regard the indirect cost rate as a measure of an organisation's cost-efficiency and that donors view those charging a lower rate more favourably when making funding decisions. As a result, UN agencies, in particular, have competed to lower rates. However, finance staff know that the rate is shaped by factors such as cost structures, core and/or unrestricted funding and different accounting practices. Due to this, there is no standard practice on what costs to include as indirect support costs (so that one organisation will charge a finance officer in a country office as a direct cost and other will charge it as an indirect cost) and how to calculate the percentage rate (so that some include the value of in-kind contributions and others do not). So the rate does not compare or say anything about cost-effectiveness. This study provides an opportunity to lay out the underlying issues and promote a more nuanced understanding of them.

The study seeks to address the various issues by documenting basic factual information on overhead charges and locating them in the context of the cost structures of the organisations concerned. It relates to GHD principle 10, on supporting the vital role of the UN, the International Red Cross and Red Crescent Movement and NGOs in implementing humanitarian action. This is because, though these costs are contested, they are essential to enable humanitarian organisations to implement programmes and report to donors on how they have used funds. Although the study is framed in the context of humanitarian aid since this is the focus of GHD members, it is about improving the transparency of funding relationships in general and ensuring that aid organisations can operate on the basis of having reasonable costs covered. Most of the organisations in the study are also engaged in development activities and their policies and definitions apply to the full range of activities, not just humanitarian assistance.

I.2 Aims

Given the general lack of information about, and understanding of, indirect cost charges, this study aims to document the different approaches used by humanitarian organisations. This should help to improve the understanding of the issues involved both within humanitarian organisations and amongst donors and lead to more informed debate between them. It also aims to create greater trust and transparency around this issue between donors and recipient organisations so that they can come to some agreement around what constitutes a fair charge for indirect costs.

I.3 Scope

The Terms of Reference (TOR) for the study are attached as Annex I. These show that the study was originally to cover a range of organisations – UN, Red Cross, NGO and private sector. But when DI presented preliminary findings from the study at Montreux VIII on 22nd February 2008, participants expressed an interest in including donor approaches to overheads or indirect costs in the study.

During the discussion that followed the presentation, donors expressed interest in information about how indirect cost charges are applied when funding flows from new pooled humanitarian funds like the CERF and the Common Humanitarian Funds (CHFs) in Sudan and the Democratic Republic of the Congo (DRC) through layers of different organisations.

Therefore, the scope of the study was expanded to include both these issues.

I.4 Methodology

This study has tried to gather facts about the different ways in which humanitarian organisations calculate and apply indirect cost charges and use the income generated. It used data collection methods that included:

- Face-to-face and telephone interviews with staff members from participating organisations (including visits to Geneva and New York to interview UN and Red Cross Movement staff members)
- A review of study reports and documents on overhead charge policies
- Regular feedback to GHD members for their input and
- An email survey.

As per the Terms of Reference, it has covered a broad range of organisations:

- UN agencies (UNICEF, UNHCR, WFP, OCHA and UNDP, including its role as Administrative Agent for Common Humanitarian Funds and Multi-Donor Trust Funds)
- IOM[1]
- ICRC and IFRC
- 2 international NGO families and
- 2 private sector organisations (PSOs) involved in the delivery of humanitarian assistance (one British and the other American).

The TOR stated that the study would cover two international NGOs. But NGOs are varied in their missions, structures and approaches so including only two individual NGOs may not have provided sufficient detail for the study. However, including several NGOs would have been very time consuming because it would have required negotiating separate access and understanding how the organisations worked. So, to maximise the information gathered but stay within a reasonable timeframe, the study has focused on international NGO families or alliances in order to get a sense of whether there are differences in practice within the same family across different countries and also whether there are differences between members

[1] Although the IOM is not a UN agency, it is an intergovernmental organisation with a special relationship with the UN system. Therefore, for the sake of convenience, this report includes IOM in the category of UN agencies when discussing groups of organisations, unless otherwise stated.

of different NGO families in the same country. Even this approach was time-consuming and DI eventually secured the participation of the UK, US, Dutch and Austrian members of the first NGO family and the UK and Irish members of the second NGO family.

Securing the participation of the American private sector organisation was also time-consuming. USAID kindly offered to identify an appropriate study participant and negotiate access. However, this process took around 3 months.

Since the issue of overheads is so contested, the study TOR recognised the potentially sensitive nature of the information involved in this study. Therefore, it was agreed that all organisations participating in the study would be offered the option of remaining anonymous. Due to their distinctive mandates and structures, it would not have been easy to guarantee the anonymity of the UN agencies, IOM, ICRC and IFRC so they waived the right to anonymity. It is easier to grant anonymity to the NGOs and private sector organisations and they preferred to keep information about their approaches to indirect costs confidential so they are simply referred to as NGO A and B and PSO A and B.

The coverage of humanitarian organisations was divided into two phases. The first phase focused on the UN agencies, IOM and the Red Cross Movement. DI presented findings from this part of the study at the Montreux VIII meeting on 22nd February. The second phase focused on the NGOs, PSOs, donors and tracking indirect cost charges.

Following the decision at Montreux to include a survey of donor approaches, DI emailed three questions to 23 members of the GHD initiative. 10 donors responded in time for DI to present their responses in an update on the study at a GHD meeting in Geneva on 10th April. This presentation included preliminary findings from interviews with a couple of NGOs and one private sector organisation. Since the GHD meeting, after a follow-up email, 7 donors have responded so section V is based on responses from a total of 17 GHD members. This represents a 75% response rate, which is very good for an email survey and indicative of the interest that donors have in this study.

It is difficult to track the application of indirect cost charges to funding as it flows through different organisations because humanitarian organisations use different systems to record and report on the information. Therefore, rather than attempt to gather data on funding from the CERF and CHFs at a global level, this study selected the DRC as a focus country because the Pooled Fund Unit already asks UN agencies to report on their onward funding. It tracked 11 projects and the criteria used to select projects were as follows:

- A mixture of CERF and Pooled Fund[2] projects so 7 are CERF projects while the remainder were financed by the Pooled Fund.
- Projects that provided examples of onward funding to different types of implementers - NGOs, government departments, other UN agencies and private contractors.
- A mixture of UN agencies as the first recipients of funding, with a focus on UNICEF and UNHCR since they are participants in the broader study[3]. This was done to provide examples both of a broader range of UN policies and a greater range of recipients of onward funding. DI did not select WFP projects because its indirect support cost policy is quite different to that of other UN agencies.

Section IV.2 reports on the findings from the selected projects.

II. Terminology

This report begins with a discussion of terminology because the original title for the study used the term ‘overheads’ but this is not favoured by study participants. According to a study

[2] In the DRC, the CHF is known as the Pooled Fund.
[3] Of the non-study participants, DI asked WHO to provide information on one project and UNFPA to provide information on two projecs. UNFPA responded promptly but WHO did not reply.

for the IFRC, the term overhead is not defined in a UK dictionary of accounting terms because it requires an arbitrary line to be drawn across the continuum of costs between a beneficiary and a 'head office'[4]. Where the line is drawn depends on the viewpoint of those drawing it so it is open to debate.

As Table 1 below shows, the study participants use a range of different terms to describe their overhead or indirect cost charge. In addition to these terms, NGOs and private sector organisations funded by the American government negotiate an indirect cost rate that is organisation-specific. This is known as the NICRA (Negotiated Indirect Cost Rate Agreement). Section V.3 provides further details.

Organisation	**Term(s) used**
ICRC	Overhead
IOM	Project related overhead
IFRC	Programme Support Costs and Programme Support Recovery (for process of charging costs to programmes)
OCHA	Programme Support Cost
UNHCR	Support Cost
WFP	Indirect Support Cost
UNICEF	Indirect Cost Recovery
UNDP	General Management Support
NGO A	ADRET (Administrative Retention)[5], Shared Cost Recovery, Indirect Cost Recovery, Administrative Cost
NGO B	Administrative costs, PMA (Programme Management and Administration). Other terms vary with donor, e.g. Organisational Management Support (DFID), Indirect Costs (ECHO), Management Support (DEC).
PSO A	Recoverables and non-recoverables[6]
PSO B	Overhead, General and administrative and fringe

Table 1: Terms used by participants describe their "overhead" charge

Given this range of terminology, it would be helpful for the study to adopt a term that is a more accurate reflection of what is in use and to help ensure that donors and funding recipients are talking about the same thing. It is important to note that, even when organisations use very similar words, they may be referring to different things due to the ways in which they classify costs. For example, some organisations refer to programme support costs because the costs are generated by programme activities but others (like NGO B) prefer not to use the word 'programme' when discussing indirect costs because they classify programme support costs (such as financial staff in the field) as direct costs. However, in general, what the terms in Table 1 have in common is that they are referring to the recovery of costs incurred in supporting programme activities, such as staff recruitment and financial reporting, that are over and above the direct costs associated with programme delivery (e.g., transport).

For the purposes of this study, the most appropriate term is "indirect support cost charge". This is defined here as "*a percentage charge applied to an organisation's expenditure for programme-related costs that are not directly attributable to a specific programme*". Programme-related here means costs that would not be incurred unless the organisation was undertaking programme activities (such as financial and narrative programme reporting or monitoring and evaluation).

[4] Pete Ewins – Mango (2007), 'Review of overheads along the Federation value chain and review of Secretariat overhead recovery mechanisms'.
[5] This is used by the US member to describe the charge levied on contributions from private donors.
[6] The organisation uses the term 'recoverables' for overhead costs that can be recovered directly from the contract and 'non-recoverables' for costs that the organisation recoups from the margin or surplus on the contract. The margin is used partly to cover delivery-associated costs and partly as profit.

II.1 UN cost categories

Over the last few years, within the UN system, the Finance and Budget Network of the High Level Committee on Management (HLCM) has done considerable work on cost recovery policies. Importantly, it has achieved consensus on the definition of the following three cost categories:

- Direct costs: Necessary to achieve the results and objectives of programmes and can be traced in full to activities, projects and programmes. E.g., food or transport.
- Variable indirect costs: Incurred in support of an organisation's activities and programmes but which cannot be traced unequivocally to a specific activity or programme. E.g., staff recruitment or financial reporting services.
- Fixed indirect costs**:** Incurred regardless of the scope and level of activities of an organisation. E.g., senior management, head office costs.

A recent HLCM survey of UN agencies found that they classify costs into these groups in different ways but the agreement on the definitions is an important starting point for the harmonisation of financial policies within the UN system.

Although these cost categories are useful for the UN system and applicable to the ICRC and IFRC, they are not directly applicable to NGOs. This is because they are based on the concept of core mandates, organisational structures to support these mandates and core funding. Since the UN agencies, ICRC and IFRC have legal mandates, they would exist with a basic organisational structure even if they did not undertake programme activities in the field and they have core funding to finance this basic organisational structure at least partly[7]. The NGOs and the British PSO, on the other hand, would have little or no reason to exist without their programme activities. There are some costs that the organisation would incur, regardless of whether it had one programme or hundreds, such as the salary of a chief executive, but these are very limited. Therefore, they do not distinguish between fixed costs for a 'core' organisational structure and the rest of the organisation, even at headquarters level.

The American PSO is like the UN agencies in that it does distinguish between variable indirect costs, called overheads and consisting mainly of staff wages, and general and administrative costs, which are fixed costs like rent and office administration that would not increase if its volume of work increased.

In the UK, research on cost recovery by different types of NGOs (working nationally and internationally)[8] has identified four types of costs:

- Direct costs
- Direct support costs (usually incurred in-country, for example, a finance officer in a country office but may include a desk-officer at headquarters)
- Indirect costs (incurred at headquarters level)
- Governance costs (to meet legal requirements such as annual audit of accounts, support to governance body)

This highlights the fact that there is a grey area around in-country support costs because, as with UN agencies, some NGOs choose to charge these as direct costs while others treat them as indirect costs and cover both these and support costs incurred at headquarters level from the indirect support cost charge. Also, though governance costs are identified as a distinct category, the NGOs participating in this study did not separate these out from other administrative costs as they are a very small part of their costs.

[7] WFP is exceptional in that it does not receive core funding but it does have a legal mandate and does distinguish between fixed indirect costs for a core organisational structure and variable indirect costs.
[8] This has been published by the Association of Chief Executives of Voluntary Organisations (ACEVO). See www.acevo.org.uk

The differences between the cost structures of UN agencies and the ICRC and IFRC on one hand, and NGOs and PSOs on the other, highlights the need for donors to agree cost categories with recipient organisations so that there is transparency on which costs have been classified as direct and which as indirect.

III. Characteristics of the Indirect Support Cost (ISC) charge

This section outlines the characteristics of the ISC charge across study participants. It describes how organisations set their rates, their policies for applying the rate and how they use the income from the rate. It provides the factual information that donors can use to understand the differences across humanitarian organisations.

III.1 Who sets indirect support cost rates and how are they reviewed?

Table 2 below lists the body within each organisation that sets the ISC rate and what procedures the organisations have in place for reviewing the rate. It does not list the NGOs or private sector organisations because, as table 3 below demonstrates, unlike the UN agencies and Red Cross Movement, they accept donor rates and do not set their own.

Org/Fund	Rate set by:	Procedures for review
CERF	UN General Assembly (for Secretariat as a whole)	Controller has put together a Working Group to examine reform of Trust Fund management. WG has made some recommendations relating to direct and indirect costs, which were being discussed by the Controller's Office.
ICRC	Assembly	No regular review. Finance department and external resources would provide analysis to Directorate and Assembly for decision.
IFRC	General Assembly	No regular review but IFRC's Finance Commission (comprising a panel of experts nominated by national societies but who are not from national societies themselves) considers issue of rates and proposed changes, then make recommendation to the General Assembly.
IOM	Council	IOM's Administration can put forward proposals to Council for consideration
MDTFs	UN Development Group	Administrative Agent can submit proposals for consideration[9].
OCHA	UN General Assembly (for Secretariat as a whole)	No specific procedure but any proposal to General Assembly to review rates must come from the Controller.
UNDP	Executive Board	Management submits proposal to Board when necessary.
UNHCR	Executive Committee	No specific times for review but Controller needs to make recommendation to Executive Board
UNICEF	Executive Board	Management submits proposal to Board when necessary.
WFP	Executive Board	Each biennium, WFP submits a budget with an ISC rate based on estimated income from direct operational and direct support costs.

Table 2: Setting and reviewing ISC rates

As Table 2 shows, the governance body for each organisation approves the indirect support cost recovery policy and rates. Since donor governments are represented on these bodies (except for the ICRC and IFRC and the UNDG Executive Committee), they are responsible for setting the ISC rates, based on the recommendation of senior management in each organisation.

None of the organisations have procedures to review the ISC rate on a regular basis, except for WFP, so they tend to continue with the same rate unless there is a specific impetus to

[9] UNDG MOU in the 2003 UNDG Joint Programming guidance Note allows the Administrative Agent (AA) to charge a higher rate if the UN organisations agree that the AA's role is unusually complex and if donors agree to pay this higher fee or allow it to be charged as a direct cost in the AA's budget.

change it. IOM, for example, needed to increase the income from its ISC charge to cover a substantial increase in security costs because member states did not want to cover this through their fees. This led to a review of its ISC policy and the organisation decided to charge a lower rate based on its total direct costs instead of a higher rate based on office and staff costs only. Hence, as shown in Table 3 below, some organisations have had the same rate for some time, particularly the UN Secretariat, which has not revised its rates since 1980. This is probably because a change would require consensus in the UN General Assembly.

WFP has a regular review process in place because of its particular funding structure. Since it does not receive core funding, WFP has to cover all its costs from programme funding. Therefore, it has two categories of support costs – direct support costs that are programme-related (e.g., vehicles, communications equipment) and indirect support costs, defined as the cost of staffing and operating WFP headquarters, regional offices and a standard country-office structure. These two categories broadly correspond to the UN's definitions of variable and fixed indirect costs, described in section II.1. However, in some cases, costs in regional offices and headquarters are categorised as direct support costs since they are incurred in support of activities. This is because it is not the nature of a cost that determines how WFP classifies it (so that, e.g., office rental is always an indirect support cost) but whether or not WFP incurs the cost in implementing a project (so, e.g., if WFP has to rent a larger country office to support a large programme, the cost would be classified as a direct support cost, not an indirect cost). WFP has to ensure that it calculates the correct ISC rate so that it generates sufficient income from programmes to cover its indirect support costs (which are essentially fixed costs), and, therefore, reviews it with each biennial budget.

III.2 How, and to what, are ISC rates applied?

Table 3 below assesses whether each organisation has a fixed ISC rate for all types of income or whether it has different policies for different funding sources. Where feasible, it also indicates when the organisation established its current rate policy.

Table 3 demonstrates the wide variation in ISC rate polices among humanitarian organisations. Of those that can set their own rates, some like the ICRC and WFP, apply a single rate to all types of programmes. Others, such as UNICEF, UNDP's MDTF Office and the UN Secretariat (for CERF and OCHA), apply different rates either by type of programme or by size of contribution or according to the amount of administration required.

Org/Fund	Policy on rates	Set in
CERF	UN Secretariat rules apply. Controller has applied low rate applicable for pass-through mechanism, rather than higher rate for trust funds. UN agencies receiving funding are allowed to charge one set ISC rate.	1980
ICRC	One fixed rate applied only to activities in field budget, which is separate from the HQ budget that covers all costs in Geneva, including field support.	Early 1990s
IFRC	Generally one fixed rate but charges donors that require grant-specific reporting 1% more to cover extra costs. Donations from companies and related foundations have 5% deducted upon receipt to cover the costs of relationship management. The remaining 95% of the donation incurs the general ISC rate.	2007
IOM	Generally one rate (applied to total costs) but, for resettlement and return programmes, where international transport costs are a significant part of total costs, a different rate is applied that is calculated on staff and office costs only.	Dec 2005
MDTFs	UNDP used to charge one rate with a minimum charge of $20,000 for MDTFs of less than $2 million and a maximum charge of $100,000 on contributions of over $10 million. In April 2008, UNDG members removed the minimum and maximum ceilings so one flat rate applies to all MDTFs. The UNDG Iraq Trust Fund applies a sliding scale. UN agencies receiving funding usually apply their own financial rules and ISC rates but Iraq Trust Fund has set a specific rate.	2003

OCHA	UN Secretariat rules apply so one rate for normal activities that OCHA executes and a 10% lower rate when OCHA passes funds to others for implementation (as with country-level Emergency Response Funds).	1980
UNDP	UNDP has adopted a more centralised approach to charging ISC. Two rates apply - one for contributions from beneficiary governments and a higher rate for all other contributions.	June 2007
UNHCR	One fixed rate applied to supplementary programmes and new and mandate-related (NAM) activities but not to programmes in the annual budget (though if an annual programme receives CERF funding, the income from the ISC rate is used to cover the costs of posts where the primary function is the development, formulation, delivery and evaluation of programmes).	2000
UNICEF	3 rates. Contributions over $40 million and joint programmes (at discretion of Executive Director) are charged 1% less than general rate because of economies of scale. Thematic funding charged 2% less than general rate because UNICEF has discretion over expenditure and pools funds from different donors. 2% less also applies to income from private sector in programme countries.	June 2006
WFP	WFP has changed its policy of applying different rates to different programme categories and now applies one standard ISC rate to all programmes. Direct support costs are charged on a per tonnage basis.	Reviewed every biennium
NGO A	Variable rate according to what donors allow. US and Austrian members have set a rate that applies to funds raised from the general public.	
NGO B	Variable rate according to what donors allow. UK member does not charge HQ support costs to funds raised from general public for emergency response.	
PSO A	Variable rate according to what client allows.	
PSO B	Based mainly on cost accounting standards stipulated by US government. NICRA means that organisation provides US government with calculation of ISC rate. Rate used is provisional until organisation submits final accounts. Actual rate is then applied retrospectively.	

Table 3: Application of ISC rates

It should be noted that UNHCR does not levy a support cost fee on programmes in its annual budget because the support costs for these are included in the annual budget. But if it receives CERF funding for a programme in the annual budget, it does apply the indirect support cost charge.

Though the NGOs generally accept the rate allowed by donors, they have different policies relating to funds raised from the general public. So, while the US and Austrian members of NGO A have established a rate to cover support costs at headquarters that applies to funds raised from the general public, the UK member of NGO B does not deduct headquarter support costs from public contributions to emergency appeals.

The study participants also have different ways of calculating the ISC rate. Table 4 below summarises the bases for applying the charge.

Org/Fund	Basis for charge
CERF	Actual expenditure. Applies only to grant element of CERF, not the loan element.
ICRC	Actual expenditure. Based on cash and services expenditure in field, i.e., does not apply to in-kind contributions.
IFRC	Actual expenditure. Based on direct costs. Applied to monetary value of in-kind contributions but not to in-kind staff or transport provided by donors or the value of emergency response units supplied by national societies.
IOM	Actual expenditure. Includes staff security costs as these are not covered by membership fees.
MDTFs	Generally applies to expenditure but fee is deducted from contributions to Iraq Trust Fund.
OCHA	Actual expenditure. Applies to OCHA's regular budget (set by UN General Assembly) that covers core activities as well as extra-budgetary resources.

UNDP	Actual expenditure.
UNHCR	Based on budgeted costs and applied to income. Does not apply to annual budget, which has a separate budget for programme support costs.
UNICEF	Actual expenditure.
WFP	The ISC rate is determined by dividing the approved Programme Support and Administration (PSA) budget by the projected Direct Operational Costs (DOC) and Direct Support Costs (DSC) of the activities for the biennium. For example, if the approved PSA is US$100 and the projected activities valued at US$2000, the ISC rate will be 5%. Direct costs includes the monetary value of in-kind contributions.
NGO A	Actual expenditure. Due to USAID rules, US member excludes fundraising costs from NICRA calculation. NICRA is calculated by dividing administration costs by income.
NGO B	Actual expenditure. UK member does not levy charge on in-kind contributions (but, if distributing food for WFP, to cash component covering distribution costs).
PSO A	Actual expenditure. Trying to achieve a margin – part to cover indirect costs and rest as 'profit'. Have costing system to allow allocation of indirect costs to projects and rigorous internal process to ensure that a contract will cover costs (otherwise, unlikely to bid for it).
PSO B	Actual expenditure. 3 elements – overhead (i.e., variable indirect costs, mainly wages), fringe (i.e., social benefits like health insurance and pensions) and general and administrative costs (i.e., fixed costs such as cost of Board of Directors and office rent).

Table 4: Bases for calculating ISC charge

Table 4 above highlights some interesting differences in the bases that study participants have for levying their charges. For example, all the organisations, except UNHCR, levy the charge on actual expenditure. So, if a contribution is not spent in the financial year in which it was received, the indirect support cost rate is only applied to the amount that has been spent or allocated. The remainder is deducted in the next financial year, when the funds are actually spent. This also means that, if the organisation does not spend the entire budget for some reason, it only takes the indirect support costs for the amount spent and the rest is returned to the donor. UNHCR, however, deducts the full amount up-front. In rare cases when the full amount is not spent, it returns the relevant "unspent" component of the support costs as well.

While UNHCR does not levy the charge on its annual budget (only to supplementary programmes and new and mandated activities), OCHA applies its ISC charge to both its annual (or 'regular') budget and its extra-budgetary income.

Also, while organisations such as ICRC and the UK member of NGO B do not apply the ISC charge to in-kind contributions, others such as IFRC and WFP apply it to the monetary value of in-kind contributions.

Since WFP reviews its rate every biennium, it has a simple formula for calculating its ISC rate. This involves taking the budgeted costs for programme support and administration and divided this by the costs budgeted as direct costs and direct support costs. This is similar to the calculation for the NICRA used by USAID to finance NGOs (discussed in more detail in section V.3).

III.3 How is income from the ISC charge used?

This section discusses how the study participants use the income from the ISC charge to cover costs. Table 5 below summarises their approaches.

Org/Fund	Use of income from the indirect support cost charge
CERF	When the CERF was established in 2005, ISC income was used entirely for UN Secretariat's costs. CERF Secretariat costs were charged as a direct cost to contributions. Following negotiations with donors, the Controller has agreed to finance CERF Secretariat costs from ISC income. However, the ISC charge still does not finance the cost of time spent by OCHA field staff

	on CERF administration (perhaps because OCHA field costs financed by extra-budgetary resources (or non-core income).
ICRC	Treated as an expense for field operations and as un-earmarked income for headquarters to support activities in the field and, when possible, build reserves to cover war risk insurance, to pre-finance emergency responses and to ensure that existing operations can continue despite interruptions in donor funding.
IFRC	IFRC has a core budget and a programme budget. Both have a programme support cost component. In-country costs charged as direct costs (programme budget) so ISC income is used to cover programme support costs in regional offices and at headquarters (core budget).
IOM	IOM is a highly projectised organisation since it has very little assessed and un-earmarked income. It uses activity-based costing so staff time is allocated according to the percentage of time spent on each project. It has a management information system that gives each project a unique code and then tracks all income and expenditure against that code.
MDTFs	Income from the Administrative Agent fee is used to cover the costs of the MDTF Office in New York and UNDP staff in field offices who carry out tasks delegated by the MDTF Office. A portion of the fee is transferred to UNDP HQ units such as Treasury, Finance, Legal, Audit, IT etc to cover the costs of UNDP Central Services to the MDTF Office.
OCHA	Income from the ISC charge levied by OCHA is transferred to the UN Secretariat, which pools together ISC charge income from all voluntary contributions. It then uses this to finance activities related to voluntary contributions, e.g., providing financial statements and conducting audits (as outlined in its administrative instruments).
UNDP	Since UNDP is a decentralised organisation, most of the income from the ISC charge is used for country office costs. Income is used to cover general oversight and management functions at both HQ and in-country. These include: Project identification, formulation, and appraisal; determination of execution modality and local capacity assessment, briefing and de-briefing of project staff and consultants, general oversight and monitoring, including participation in project reviews; receipt, allocation and reporting to the donor of financial resources, thematic and technical backstopping through Bureaus, Systems, IT infrastructure, branding, knowledge transfer.
UNHCR	Treated as un-earmarked income and used to cover costs not covered by earmarked funding.
UNICEF	Income contributes to financing the organisational support budget that covers functions like finance, administration and fundraising at headquarters and administration, finance and human resources at field level. It also covers costs such as utilities and the post of representative and deputy representative in the field.
WFP	Since WFP does not get core funding, it uses income from the ISC charge to finance its core organisational costs (i.e., fixed indirect costs). These include a certain structure for field offices.
NGO A	Treated as un-earmarked income to finance headquarters costs only. All members have adopted the policy of using ISC income for headquarters only and charging support costs at field level as direct costs to each programme.
NGO B	UK member treats ISC income as un-earmarked income and uses it to finance annual budget approved by Trustees. Since ISC income is combined with other sources of un-earmarked income, it can be used to finance range of management costs or contribute to a fund that enables organisation to pre-finance emergency response.
PSO A	ISC income termed 'margin'. Mainly used to cover indirect costs but the rest is profit.
PSO B	Organisation informs US government of which costs are included in each of its 3 categories of overhead, fringe and general and administrative. It cannot change these categories without the government's permission. Funding provided for each category has to be used for costs within that category. In-country costs are charged as direct costs to extent possible so indirect costs are mainly those incurred at headquarters.

Table 5: Use of income from ISC charge

Table 5 demonstrates that humanitarian organisations use income from the ISC charge in very different ways. For example, some organisations such as UNHCR and most of the NGOs combine ISC income with other forms of un-earmarked income and then use the money to finance an overall operational or administration budget. As a result, they do not make a direct link ISC income and indirect support costs. IOM, the Austrian member of NGO

A and PSO A, on the other hand, use time-sheets and management information systems to allocate indirect costs to projects.

The table also shows that most participants use the ISC income to finance a mixture of headquarters and field-level costs. NGO A is one exception. All member of NGO A have adopted a policy of funding only headquarters costs through the ISC rate and charging in-country support costs directly to programmes. The US member argued that this is because, without programmes, the NGO would not have country offices. However, it may also be because the NGO family has an arrangement whereby a country office is operated by one member but other members can raise funds for it. In such cases, the member raising the funds keeps the income from the ISC rate for its headquarters costs and the implementing members costs in-country need to be financed directly by the programme.

The UN Secretariat also funds only the headquarters costs of managing CERF grants though OCHA field staff are involved in administrative tasks (e.g., in the DRC, where CERF and Pooled Fund grants are managed by the same team). This is in contrast to UNDP-managed MDTFs. Since the MDTF Office delegates certain tasks to UNDP field offices, a portion of the ISC income goes to cover their costs.

III.4 Why is there so much variation in ISC policies?

As the previous three sections (particularly tables 3, 4 and 5) have shown, humanitarian organisations have a wide range of policies around their indirect support costs, whether this is in the way they apply ISC rates or the ways in which they use the income from the indirect support cost charge. There are a number of factors that contribute to this variation.

BOX 1: Why are ISC rates not comparable?

Given the wide variation in cost structures and accounting policies across humanitarian organisations, even within the UN system or within the Red Cross Movement, an indirect support cost **rate** is not comparable across humanitarian organisations for the following reasons:

- Same percentages apply to different things: Even two organisations that are similar in purpose and charge the same rate, like the IFRC and the ICRC, have different ways of calculating the charge (the ICRC does not include in-kind expenditure but the IFRC does).
- A lower rate does not mean lower costs: When IOM reduced its indirect support cost rate by 7% in 2005, it changed the basis for calculating the rate. Instead of charging it on field office and staff costs only, it applied the new lower rate to total programme costs. According to its 2006 annual report, its income from the rate was higher than anticipated, despite this reduction in the rate. Also, since NGO A charges in-country costs directly to programmes, its ISC rate (which is for headquarters costs only) may be lower than that of NGOs including both field and headquarters costs. But this does not mean that its total costs are higher or lower than that of other NGOs – only a detailed comparison of costs could determine that (see example 2 in Annex II).
- A percentage rate does not indicate revenue raised: Due to differences in income, an organisation charging 7% on $1 million will generate $70,000 in income while another charging 13% on $250,000 will generate $32,500. So, a lower rate does not mean that an organisation has lower overall costs.

USAID recognises that indirect cost rates are not comparable so its best practice guidelines on the NICRA warn against using rates to judge an organisation's cost-effectiveness. It provides an example to show that a lower ISC rate does not mean lower costs. This is shown as example 1 in Annex II.

To avoid an undue focus on rates, given that they are not comparable, this study has adopted a policy of not stating the indirect support cost rates used by any participant.

One reason is that the organisations have different cost structures. So, some organisations, such as UNICEF and WFP, include the cost of a basic structure in field offices in one central support budget, but NGO A only covers headquarters costs from the ISC income. In some cases, the cost structure is determined by function. For example, the IFRC distinguishes between a core budget and a programme budget because it undertakes two separate functions – providing membership services and implementing programmes. Also, as outlined in the previous section, NGO A separates headquarters and field costs because the member raising funds is not always the member operating the country office and implementing programmes. In other cases, funding determines an organisation's cost structure. Since the ICRC gets substantial core funding for its headquarters costs, it has separate headquarters and field budgets. WFP, on the other hand, does not receive core funding so it has developed two categories of indirect costs that it recovers from programme funding.

Another reason is that organisations apply different accounting standards. General accounting principles in the US are fairly prescriptive so organisations (whether NGOs or PSOs) have less leeway when preparing their accounts. The general accounting principles in other countries, such as the UK, allow organisations more flexibility in defining cost categories and reporting. This means that NGO accounts are more comparable in the US than in other countries.

Historical factors are also a key determinant of variations in ISC policies. For example, accounting policies and procedures within the UN system have developed very differently over time and this is proving to be a real challenge to the attempts of UN organisations to harmonise their financial policies. For example, even with something apparently straightforward like staff costs, one UN organisation may include termination and other costs such as health in one salary cost while another may charge these separately. In the case of UN organisations and the Red Cross Movement, historical factors have also determined the level of an organisation's core and un-earmarked funding. As discussed in the next section, this has a significant impact in shaping an organisation's ISC policies.

III.5 Is income from the ISC charge adequate to cover support costs?

Two concerns around indirect support cost charges underlie this study – while donors are intent on lowering ISC rates to get value-for-money, humanitarian organisations are concerned that, by reducing ISC rates, donors are forcing them to subsidise these costs from other sources of income. Since many organisations combine income from the ISC charge with other sources of income and use the total to finance overall support costs and the UN Secretariat does not use cost-based accounting, it is not easy to provide a clear answer to the question of whether donors are providing adequate funding to cover the indirect support costs of the programmes they finance. However, this section lays out available evidence.

Box 2: Terms for core and non-core income

UN agencies use different terms to distinguish core funding from other income.

- UNICEF uses 'regular resources' to describe its core funding and 'other resources' for other income. This is divided into other resources regular (ORR) and other resources emergency (ORE).
- The UN Secretariat uses the terms 'assessed' and 'voluntary' contributions for its core and other funding.
- UNHCR uses the terms 'regular' and 'supplementary' or 'extra-budgetary' income.

To avoid confusion, this study uses the terms core and non-core funding or income.

Except for WFP, all the UN agencies in the study, IOM, the ICRC and IFRC receive some amount of core funding and this influences the amount of indirect costs that they need to recover through the indirect support cost charge. This is because, if an organisation has substantial core and un-earmarked funding, it can cover some variable indirect costs from this so it has less need for income from the ISC charge. These organisations have found that non-core income has increased substantially in the last few years while core funding has remained stagnant or declined slightly. This has raised concerns within the organisations about whether non-core funding is covering the additional costs generated by the programmes or activities for which it is intended adequately or whether core income is subsidising the true cost of programme delivery.

The ICRC is a case in point. It uses income from the support cost charge as a contribution towards costs at headquarters. Currently, this income covers about 30% of headquarters costs, while the rest is financed by core funding. However, there is a sense within the organisation that, if it was to undertake a detailed cost analysis exercise, it would find that variable indirect costs constitute around 50% of its headquarters costs. So, it is not covering the full extent of its indirect costs through its support cost charge and core funding is making up the shortfall.

An examination of IFRC's budget for 2008/9 provides more concrete evidence of the shortfall. The core budget has a provision of CHF 22 million for programme support costs. Of this, CHF 18 million will be financed by income from the ISC charge and the remaining CHF 4 million is to be covered by direct government contributions to IFRC's core budget. This situation would be worse if the IFRC had not instated a policy that, if a national society in a donor country raises funds from its government for an IFRC-implemented programme, it must cover the IFRC's full indirect support cost charge. If the donor government only allows a lower ISC rate, the national society has to make up the difference from other sources of income.

Box 3: Should core funding cover indirect support costs?

If most UN agencies have core funding, would it make sense for donors to increase their core funding to cover variable indirect costs (i.e., programme-related costs) as well as fixed costs (for the core organisation)? In reality, the two sources of income are covering two different types of costs. Core funding is a set amount that finances costs that are fairly steady or 'fixed' from year to year. Variable indirect costs change with an organisation's activity level so it is more appropriate for them to be financed by a source of income that also varies with activity levels.

WFP is an interesting example of what happens when there is only one type of income. Since it has no core funding, WFP has to cover all its organisational costs, including the cost of its basic organisational structure such as its head and regional offices and its core staffing costs from programme funding. This means that WFP has to use a source of income that varies from year to year to finance costs that are fixed so that there is usually some degree of mismatch between its income from the support cost charge and its core costs. This shows that core funding and support cost charges are complementary.

The issue is slightly different for NGOs because they exist to implement programmes so they would not have a core organisational structure without programme funding. In general, NGOs rely on a mix of continuing funding from the general public and governments to maintain their operational level but this can be a juggling act. The Dutch member of NGO A has had to reduce staff numbers in years when it has received less government funding and take staff on when funding has increased. Due to flexible labour laws in the Netherlands, it has not incurred heavy contract termination costs but it has borne additional recruitment costs.

UNICEF's administrative and support expenditure is divided into three elements:

- Programme support (which is further divided into two - country and regional offices and headquarters)
- Management and administration
- Security

The table below summarises data for 2006 (the most recent year for which UNICEF has financial information available publicly). It shows that UNICEF uses income from the ISC charge to cover both programme support (variable indirect costs in the UN's terminology) and management and administration costs (fixed variable costs). There are no strict rules about whether an organisation classifies a particular cost as a fixed or variable indirect cost but the following analysis focuses on programme support costs (variable indirect costs) because organisations that receive core funding have expressed concern that this is being used to subsidise indirect support costs instead of covering core organisational costs alone.

Administrative element	**Expenditure**	**ISC charge income** (supplementary projects)	**ISC charge income** (emergency projects)	**Total ISC income**
Programme support	$228 million	$43 million	$31 million	$74 million
Management & administration	$110 million	$20 million	$15 million	$35 million
Security	$11 million			
Total	**$349 million**	**$63 million**	**$46 million**	**$109 million**

UNICEF spent $228 million on programme support, which is about 65% of its total administrative expenditure. It received $74 million in income from ISC charges to cover its programme support expenditure. In other words, approximately one-third of its programme support expenditure was covered by income from the ISC charge. UNICEF covered the remaining two-thirds of its programme support costs from core income and other resources. Although income from the ISC charge only covered around one-third of its total programme support costs, in June 2006, UNICEF reduced its ISC charge by 9%. It will be useful to examine the impact of this reduction once its income and expenditure data for 2007 become available.

NGOs do not have core funding so they have to cover all costs from programme income. As highlighted by table 5, NGOs combine income from the ISC charge with other un-earmarked income such as funds raised from the general public, investment income and income from trading activities. They then use this to cover all administrative expenses. This means that it is difficult to link income from the ISC charge and indirect support costs. But the NGOs have some evidence that the income from the ISC rates that donors allow is insufficient to cover the related indirect support costs and the gap in funding has to be covered by other sources of un-earmarked income. This can be problematic when NGOs have to use money raised from the general public because the public wants the funding to go directly to beneficiaries.

Unlike other NGOs in the study, the Austrian member of NGO A has a system to track how much time staff members spend on different projects to track indirect support costs. In 2007, funding from the EU accounted for 68.5% of its total income and it received €809,055 in ISC income. This ISC income covered 54.8% of the organisation's total headquarters expenses of €1,476,244. If the EU was covering its fair share of costs, the ISC income would have covered 68.5% of the NGO's headquarters costs. Instead, the NGO had to cover the shortfall with private fundraising.

The Dutch member of NGO A has estimated that its indirect support costs (calculated by taking total headquarters costs and dividing this by total income) are usually 1-2% more than the rate that the EC allows NGOs to charge. Although this seems like a small percentage difference, since the organisation receives over 90% of its income from official donors, variations in programme income can lead to fluctuations in income to cover administrative costs. In its 2006 financial year, the organisation's actual administrative and support costs exceeded ISC income by €186,053. The following year, ISC income was €71,994 higher than administrative and support costs. Due to these fluctuations and occasional shortfalls in its indirect support cost income, the organisation has found that it cannot invest in staff training and organisational development. Thus, if donors cut back on the ISC rate, they risk undermining the long-term capacity and professionalism of NGOs. It should be noted that NGOs that are newly established or growing rapidly are more likely to be affected by the lack of predictability of programme income than large, well-established NGOs that have been able to secure more predictable sources of income.

Interviewees from NGO A pointed out that donors do not always understand that all the members have a policy of charging only headquarters costs as indirect costs and in-country support costs as direct costs. This means a lower ISC rate (particularly for the US member's NICRA as compared to other US NGOs) but higher direct costs.

Private sector organisations also have to recover all their costs from contracts but they need to make a certain margin or profit in addition. Therefore, if a donor does not allow them to charge indirect costs as a percentage of project costs for any reason, they charge them as direct costs. Also, as noted in table 4, PSO A has a rigorous internal process to decide whether to bid for a contract or not. However, cost is not the sole determining factor in this process. The organisation will accept a contract on which it will make no profit or even lose money if it will position the company to attract other, more profitable, business in the future or if it brings other types of benefits. This is on the understanding that the profit from the organisation's other contracts will cover the costs.

While the private sector organisations have the systems in place to track project-related indirect costs, IOM and the Austrian member of NGO A are the only other organisations to have them. This may be because there are factors that militate against humanitarian organisations tracking costs in detail. One of these is organisational culture. In organisations that are dedicated to providing humanitarian assistance and support, it is difficult to convince staff to spend time on keeping a detailed, quantitative breakdown of support costs. This is even more so if staff members perceive the systems as a way for management to police their time. Due to this, the Dutch member of NGO A encountered some resistance when it recently introduction a time-sheet system, even though staff understood the need for it. Without staff commitment, though, management information systems cannot operate effectively. This is because, as one interviewee pointed out, they become "garbage in, garbage out" systems.

The other factor is the cost-benefit ratio of investing in management information systems that can track and categorise expenditure. If an organisation has reasonable core funding, it has less incentive to invest in systems that may be expensive and time-consuming. NGOs, on the other hand, may not have the spare resources to invest in management systems unless they can clearly see the financial benefits.

IV. ISC charges in funding flows

One of the issues that prompted this study was donor concern about how indirect support cost charges are levied as humanitarian funding flows through layers of organisations, particularly since the introduction of pooled funding mechanisms like the CERF and the Common Humanitarian Funds has added an extra layer to the system. This section begins by examining what ISC charges the study participants allow when making onward grants or sub-contracting organisations. The section then focuses on specific projects in the Democratic Republic of the Congo, financed by the CERF or the Pooled Fund (as the Common Humanitarian Fund is known).

IV.1 What ISC charges can sub-grantees or sub-contractors charge?

All the organisations participating in the study implement programmes with local partners to some extent. In the case of the ICRC and IFRC, these are mainly national societies. Table 6 below summarises what the organisations and fund allow implementing partners to charge to cover indirect support costs.

Org/Fund	ISC charges allowed to grant recipients or sub-contractors
CERF	UN agencies are allowed to charge 7%
ICRC	If a national society implements, it is not treated as a separate entity so all costs are shown as ICRC costs. There is no set fee for other implementing organisations. If NGOs undertake distribution of goods, ICRC covers relevant distribution costs but does not pay an administrative fee since it does not charge a service fee for implementation (e.g. distribution of WFP food).
IFRC	IFRC implements either directly or through national societies. It finances the actual expenses of national societies rather than paying a percentage rate. One exception is when the Secretariat agrees a flat rate as a fee for the distribution of relief items. With its HIV/AIDS programme in Southern Africa, the IFRC has allocated 10% for indirect costs but implementing partners must justify this with actual expenses.
IOM	No set rate. NGOs and other implementing partners usually allowed to charge up to 5%
MDTFs	UN agencies are generally allowed to charge their usual rates but Iraq Trust Fund has set limit of 5-9%, with an expected average of 7%. From 2004-2008, the rate was about 6%. In 2008, UNDG Organisations agreed to a standard rate of 7% for indirect costs, with all other costs incurred charged as direct costs.
OCHA	Does not implement programmes so does not sub-contract. Provides grants when managing funds like ERFs. Rates NGOs allowed to charge set by advisory boards in-country.
UNDP	No set rate. UNDP's cost recovery policy encourages implementing partners to charge direct costs in project budgets.
UNHCR	Used to allow NGOs to charge a 5% overhead fee but increased this to 7% in 2007. This should cover in-country costs of partners and, under certain conditions, some international HQ costs. If the project is a large one with a lot of procurement, UNHCR removes procurement costs from the calculation of the overhead charge. There is a cap on expat staff salaries of INGO partners.
UNICEF	Under Project Cooperation Agreement (for amounts over $10,000), when NGO selected as implementing partner, recipient can charge up to 25% of total funds received. This is to be used to resource requirements within the country of assistance and not for the development of elements of the NGO located outside the country of assistance. Applies for maximum of 2 consecutive years. Special Service Agreement used when NGO selected as sub-contractor by competitive bidding – ISC rate should be competitive.
WFP	Allows a standard management service charge of 5%, which is a contribution towards the implementing organisation's headquarters overheads.
NGO A	Will allow partners to claim overheads if these are included in project budget and financed by donor.
NGO B	Partner costs are agreed on a case-by-case basis.
PSO A	Negotiated on a case-by-case basis.
PSO B	Subcontractors are allowed to recover indirect costs if they are an established part of their accounting policies.

Table 6: What ISC charges are implementing partners allowed to levy?

Table 6 demonstrates that study participants have a wide variety of policies on what sub-grantees or sub-contractors are allowed to charge by way of overheads. Since UN agencies usually have international and local NGOs as implementing partners, their policies have implications for the viability of the organisations, particularly local NGOs that cannot easily cover indirect costs from other sources. The coverage of local NGOs and community groups was beyond the scope of this study but, since international organisations often claim to be building the capacity of local partners, it would be helpful to examine whether their policies on indirect support cost charges support this.

As mentioned earlier, members of NGO A often raise funds which are transferred to other members that have country offices and implement programmes. In these cases, the member raising funds retains the indirect support cost income and the implementing member recovers in-country costs as direct costs. Members of NGO B may also raise funds for other members. Since NGO B members have a different cost structure from NGO A, they tend to split the indirect support cost income equally.

IV.2 Tracking ISC charges in CERF and CHF funding flows

Sections I.3 and I.4 explained that, due to donor concerns, the study TOR were extended to examine what ISC charges organisations levy when funding flows from pooled funds like the CERF and CHFs through layers of organisations. It was more practical to do this through a country case-study than globally so the study selected the DRC. This section presents findings from 11 projects – 7 CERF and 4 Pooled Fund projects. 3 UN agencies were the first recipients of funding for these projects – UNICEF, UNFPA and UNHCR.

Table 7 below shows how much each UN agency received for the project, how much it charged for indirect support costs and then the organisations that it funded as implementing organisations. The DRC offices provided the data. The amount retained by the UN agency for its activities is calculated by subtracting all indirect costs and contributions to partners from the project amount. In some cases, the international organisations or government departments listed in the table may have funded local NGOs or PSOs but, within the timeframe available for the study, it has not been possible to check if this is the case and what, if any, indirect support costs the local organisations were allowed to charge.

Table 7: Tracking ISC charges through funding flows					
Project 1: Pooled Fund financed UNICEF project					
Project Amount	1,803,809	UNICEF ISC charge	117,969		
Save the Children UK	1,086,326	ISC charge	92,216		
Bureau Int'l Catholique de l'Enfance	90,452	ISC charge	0		
COOPI	119,093	ISC charge	19,692		
Total to partners	**1,295,871**	**Total ISC charge**	**229,877**		
Total to UNICEF	**278,061**		**Total ISC rate for project**		**17.7%**
Project 2: Pooled Fund financed UNICEF project					
Project Amount	1,485,554	UNICEF ISC charge	97,155		
Govt Departments (Inspections Medicales Provinciales)	157,903	ISC charge	0		
Total to partners	**157,903**	**Total ISC charge**	**97,155**		
Total to UNICEF	**1,230,496**		**Total ISC rate for project**		**6.5%**
Project 3: CERF financed UNICEF project					
Project Amount	4,044,600	UNICEF ISC charge	264,517		
Catholic relief Services (CRS)	100,000	ISC charge	0		
ACF Equateur	300,000	ISC charge	26,893		

Tear Fund	14,533	ISC charge	0		
ACF Bukavu	428,810	ISC charge	18,466		
OXFAM GB/Goma	319,389	ISC charge	32,574		
AVSI	54,544	ISC charge	0		
Action Development Integral Kivu	109,561	ISC charge	0		
Antenna Technologies Grands Lacs	19,570	ISC charge	0		
MERLIN	200,000	ISC charge	17,229		
ACF Lubumbashi	334,000	ISC charge	32,095		
Total to partners	**1,880,407**	**Total ISC charge**	**391,774**		
Total to UNICEF	**1,772,419**		**Total ISC rate for project**		**9.7%**
Project 4: CERF financed UNICEF project					
Project Amount	1,642,450	UNICEF ISC charge	117,416		
Save The Children UK	337,944	ISC charge	16,463		
Croix Rouge Belgique	151,893	ISC charge	7,595		
IFESH	281,374	ISC charge	14,069		
SIMAMA Development Bas-Congo	46,375	ISC charge	0		
Les Aiglons Equateur	6,912	ISC charge	0		
CARITAS Molegbe Equateur	20,000	ISC charge	0		
Min. Affaires Sociales/ Direction Etudes & Planification	34,052	ISC charge	0		
Bureau Volontaires Service Enfance / BVES Sud Kivu	59,745	ISC charge	0		
CAJED Nord Kivu	83,094	ISC charge	0		
Govt Dept/Division Info & Presse Nord-Kivu	1,920	ISC charge	0		
Total to partners	**1,023,309**	**Total ISC charge**	**155,543**		
Total to UNICEF	**463,598**		**Total ISC rate for project**		**9.5%**
Project 5: CERF financed UNICEF project					
Project Amount	1,332,150	UNICEF ISC charge	87,123		
AVSI	526,844	ISC charge	0		
Govt Dept/Division Provinciale EPSP North Kivu	70,134	ISC charge	0		
World Vision	380,499	ISC charge	0		
Save The Chidren UK	141,270	ISC charge	7,064		
Total to partners	**1,118,747**	**Total ISC charge**	**94,186**		
Total to UNICEF	**119,217**		**Total ISC rate for project**		**7.1%**
Project 6: Pooled Fund financed UNFPA project					
Project Amount	428,535	UNFPA ISC charge	29,997		
NGO Synergie provinciale	8,592	ISC charge	0		
Government	7,500	ISC charge	0		
Total to partners	**16,092**	**Total ISC charge**	**29,997**		
Total to UNFPA	**382,446**		**Total ISC rate for project**		**7%**

Project 7: CERF financed UNFPA project					
Project Amount	684,465	UNFPA ISC charge	44,778		
Government	192,500	ISC charge	0		
PSO Ets Me Luboya	150,000	ISC charge	0		
Total to partners	**342,500**	**Total ISC charge**	**44,778**		
Total to UNFPA	**297,187**		**Total ISC rate for project**		**6.5%**
Project 8: Pooled Fund financed UNHCR project					
Project Amount	1,300,000	UNHCR ISC charge	85,047		
ACTED Equateur	277,956	ISC charge	17,609		
ACTED Katanga	581,114	ISC charge	14,971		
CARITAS Uvira	147,915	ISC charge	0		
CARITAS Kalemie	128,660	ISC charge	0		
AIDES	46,728	ISC charge	0		
Total to partners	**1,182,373**	**Total ISC charge**	**117,627**		
Total to UNHCR	**0**		**Total ISC rate for project**		**9.0%**
Project 9: CERF financed UNHCR project					
Project Amount	2,343,887	UNHCR ISC charge	153,338		
ADSSE	200,587	ISC charge	0		
ATLAS/HI	547,106		20,232		
IOM	229,998		17,312		
GTZ	327,746		29,592		
ACTED	75,203		5,660		
Total to partners	**1,380,640**	**Total ISC charge**	**226,133**		
Total to UNHCR	**737,114**		**Total ISC rate for project**		**9.6%**
Project 10: CERF financed UNHCR project					
Project Amount	3,251,654	UNHCR ISC charge	212,725		
Women for Women	470,211	ISC charge	19,592		
Arche d'Alliance	259,147	ISC charge	0		
Search for Common Ground	402,278	ISC charge	24,473		
Save the Children	386,199	ISC charge	0		
Centre for Victims of Torture	120,504	ISC charge	10,728		
ASADHO	175,256	ISC charge	0		
NRC	494,971	ISC charge	30,045		
Total to partners	**2,308,566**	**Total ISC charge**	**297,562**		
Total to UNHCR	**645,526**		**Total ISC rate for project**		**9.2%**
Project 11: CERF financed UNHCR project					
Project Amount	1,626,709	UNHCR ISC charge	106,420		
GNK	29,447		0		
VSF	65,261		4,568		
Mercy Corps	194,514		13,617		
SLAO	249,831		17,460		
CARE International	24,094		1,687		
Total to partners	**563,147**	**Total ISC charge**	**143,751**		
Total to UNHCR	**919,810**		**Total ISC rate for project**		**8.8%**

The table does not show the first ISC charge against a donor’s contribution, made by the pooled fund itself. As noted in table 3, the UN Secretariat levies the rate for a pass-through mechanism for the CERF. Similarly, as Administrative Agent for the Pooled Fund, UNDP charges its standard fee for UN participating organisations. For grants to NGOs, it charge 4% more because it remains financially responsible for the grant and is not simply passing funds on to NGOs.

It should be noted that UNFPA did not pay indirect support costs to the NGO listed under project 6 because UNFPA covers its management costs. The PSO listed under project 7 also did not charge for indirect costs separately because the organisation is a construction company that included all its costs as direct costs. UNHCR, too, did not pay the local NGO AIDES for indirect costs for project 8.

More generally, table 7 highlights the following points:

- UN agencies levy their indirect support cost charge on the total grant that they receive, not just the funds that they retain for their own actions. This is because they remain financially liable for the total amount and are responsible for managing grants made to implementing organisations.
- Government departments do not levy a charge for indirect costs.
- Contrary to expectations, in some cases, UNICEF and UNHCR did not pay international NGOs for indirect support costs. In UNICEF's case, this may be because it does not finance support costs outside the country of assistance (table 6).
- The fact that not every implementing partner charges for indirect support costs means that the total indirect support costs charged for each project are lower than might be expected (with the exception of project 1, total indirect costs for the projects reviewed were less than 10%).
- The indirect support cost rate that UNICEF allows international NGOs to charge varies across projects. For example, though Save the Children UK was able to charge just over 8% for project 1, it received just under 5% for project 4 (which is in line with what the other NGOs charged for project 4).

V. Donor approaches to ISC charges

As described in section I.4, DI emailed a survey of three questions to 23 GHD members. Of these, 17 responded and this section provides a summary of and analysis of their answers. The complete answers are presented in a table in Annex III.

V.1 Do donors distinguish between direct and indirect costs?

The first question that the survey asked was whether donors used the terminology of direct and indirect costs. The aim was to understand whether the UN's categories of direct, variable indirect and fixed indirect costs is useful for donors and whether donors could use an adapted version of this classification for all humanitarian organisations.

Donors were fairly equally divided on this question. 9 either have official definitions of direct and indirect costs or are familiar with the terminology while 8 do not use these terms or did not respond to the question. Of the 9 that do use the terms, France applies them only to NGOs (not the UN) and Switzerland has 4 categories of costs: a) salaries b) running costs c) projects costs d) contributions to partners.

Amongst the donors that use the direct/indirect cost terminology, definitions vary slightly but there is a general understanding that direct costs are deliverables and other costs without which a project cannot be implemented while indirect costs are those that cannot be attributed specifically to one project but are necessary for the organisation to operate.

V.2 How do donors finance the administrative costs of their humanitarian aid sections?

This question was raised by a participant at the Montreux VIII meeting, who wanted to know if donors finance their own administrative costs from the overseas aid budget or from separate government budget lines. Some donors were also interested to know if practice was consistent across GHD members.

One donor did not respond to this question but, of the 16 that did, 9 finance the administrative costs of the humanitarian aid section from overseas development assistance (ODA). This is consistent with DAC rules. 4 donors have separate budget lines for this and three donors use ODA to cover some costs of the humanitarian aid section. So, ECHO finances the costs of technical assistance in the field from the operational humanitarian budget but its other administrative costs are covered by a separate budget line. Germany uses ODA to finance (rare) official trips by members of the humanitarian aid section to evaluate aid projects funded by the government. All other administrative costs are covered by other budget lines of the Federal Foreign Office. Switzerland covers about 90% of salaries for the humanitarian aid section from ODA.

V.3 Do donors have policies on the indirect costs that fund recipients can charge?

One of the aims of GHD members in commissioning this study was to achieve greater harmonisation around indirect support costs in the humanitarian aid field. As table 3 showed, the UN agencies, IOM, ICRC and IFRC set their own rates but NGOs accept what donors allow. Therefore, as a starting point, this study has sought to establish what ISC charge policies donors already have in place for NGOs.

All 17 donors responded to this question. Of them, 5 do not have any set policies about what NGOs can charge as indirect support costs although Ireland generally pays around 7%. Of the remaining 12 donors, 8 donors set a specific rate. These can range from 3-15% although most donors set their rates at 5-7%. Belgium applies a sliding scale of charges, with maximum amounts, based on the size of the grant. So, for example, NGOs with projects of over €495,787 can apply a 10% ISC charge up to a maximum of €74,368 (see Annex III for full details). Norway generally allows NGOs that are directly implementing projects to charge 5% but NGOs that are raising funds for others to implement (as might be the case with NGO A) can charge 3% for projects of up to NOK 5 million and 1% for projects over this limit.

Of the 12 donors that have ISC charge policies, 6 provide an indication of what costs are eligible as direct or indirect costs. These are listed in the table in Annex III. ECHO provides some indication of eligible direct costs in the general conditions for its Framework Partnership Agreement. However, one member of NGO A argued that it would be helpful if ECHO specified more clearly what can and cannot be charged as indirect costs. This is because the interpretation of rules varies across individual staff members and also between Brussels and the field.

The US has a very different approach to indirect support cost charges for NGOs and private sector organisations since it uses the NICRA. Recognising that aid agencies have different cost structures and accounting policies, the US government has adopted a customised system. The government department that has the largest dollar volume of contracts with the recipient organisation negotiates the rate and the rest of the government accepts it. The US government expects the recipient organisation to calculate the rate and provide documentation to justify this rate (including audit reports). It then investigates before agreeing the rate. Organisations calculate the rate by taking administrative costs and dividing this by programme income. Some costs, such as the cost of fundraising from the general public, are not eligible. But the rate remains fair because income from the general public is also excluded from the denominator. The rate is reviewed annually so that each organisation initially uses a provisional rate. At the end of the financial year, the government establishes a final rate, based on the organisation's financial status. This is then applied retrospectively to all government contracts in the preceding financial year. Revising the rate annually may be a time-consuming process but organisations with NICRAs believe it is a fair system.

This section has demonstrated that there is a lot of variation in donors' approaches to indirect support costs, particularly in the charges that NGOs are allowed to apply. This suggests that this is one area where GHD members could harmonise their practice.

VI. Conclusions and Recommendations

This section briefly outlines the key findings from the study and lists recommendations under each finding. It makes the point that it is more appropriate for donors to use clear and harmonised cost classifications to assess whether indirect costs are justifiable than to use percentage rates. Donors still need to take a view on whether the costs in each category are reasonably budgeted but standard, uniformly applied definitions and cost categorisations can lead to greater transparency and give them a better base for comparing cost-effectiveness.

One question underlying this study that needs to be made more explicit is – who is responsible for financing indirect support costs? This section is based on the assumption that donors are willing to fund fully their fair share of indirect costs, i.e. to cover the costs associated with the programmes they finance. By their very nature, indirect support costs cannot be linked to a specific programme but it is possible to allocate the costs across a range of programmes. So, for example, if donor X finances 25% of an organisation's programmes, it might be expected to cover 25% of the organisation's indirect support costs. At present there is limited evidence that donors do not always cover their fair share of costs (the case of NGO A in section III.5) so that funding recipients subsidise the costs generated by donor-funded programmes from other income sources. This is probably because donors are unclear about what costs they are being charged for and recipient organisations do not analyse their costs so as to be able to make a clear case to donors.

If, for whatever reason, donors do not expect to cover fully their share of indirect costs (for example, because they expect recipient organisations to make a contribution from own resources), this will limit progress on the recommendations below because donors and recipients will be operating according to different expectations. Therefore, donors and humanitarian organisations should make their expectations clear. If there is agreement that some donors will not cover their share of costs in full, other donors can compensate by providing more generous funding or recipients can make provision to cover the costs from other sources of income. While it is important for humanitarian organisations to cover their costs, predictability (knowing who will cover what) is also important.

Key finding 1: A percentage rate does not provide a true picture of indirect costs (Box 1). An ISC charge is the product of an organisation's cost structure and other factors such as levels of core or unrestricted funding, not an indication of its performance on delivery or its cost-effectiveness. Donor pressure to reduce the rate does not necessarily cause humanitarian organisations to lower costs. Instead, it may lead to less transparency because the organisations will look for other ways to cover existing costs. In the past, organisations have lowered their rates by changing the way in which they calculate the rate or reclassifying indirect costs as direct costs but they have not decreased income from the ISC rate.

Recommendation 1: Donors need to have a much more thorough understanding of the cost structures of humanitarian organisations so that they can assess their cost-effectiveness more accurately. Humanitarian organisations have a reciprocal responsibility to make it clear what costs they are including as indirect costs so that donors can make a more informed judgement.

Key finding 2: There is considerable variation in the terminology that humanitarian organisations use to describe their indirect support costs (section II). While it would be helpful to narrow down the range of terms used within the humanitarian aid field, the UN system has found that agreeing the names and definitions of different categories of costs is insufficient. This is because organisations continue to classify costs into these categories in different ways. Under the auspices of the UN's Finance and Budget Network, efforts are already under way to reach agreement on harmonising practice.

Recommendation 2: Donors should encourage the UN system to come to an agreement on the definitions of indirect support costs and what expenditures should be included as soon as possible and to adapt its accounting policies and practices accordingly. This will give donors a much clearer idea of how UN agency costs compare.

Key finding 3: Table 5 on the use of income from the ISC charge shows that some organisations, such as the UN Secretariat, UNHCR, the ICRC and some NGOs, do not have a separate calculation of indirect support costs because they combine ISC income with other types of income and use this as a contribution towards total administrative costs. At present, for the reasons outlined in section III.5, they do not have an obvious incentive to track indirect costs.

Recommendation 3: Donors need to make it clear to humanitarian organisations that they understand that ISC rates are not comparable and they will not use the ISC rate as a major factor in assessing an organisation's performance or eligibility for funding. However, donors clearly need a system for assessing whether an ISC charge is reasonable so humanitarian organisations need to reciprocate by analysing their costs more explicitly and making the case for their indirect cost charges.

Donors could promote greater clarity in cost analysis by adopting a more harmonised approach to the types of costs that qualify as direct and those that qualify as indirect. Very specific lists of costs would reduce the flexibility of humanitarian organisations but, if donors can reach agreement on sub-categories of costs and get humanitarian organisations to indicate what costs they are claiming, this would give donors better information and a clearer base for comparison across organisations. Some donors already have lists of eligible costs and these could be the starting point for discussions (Annex IV provides a comparative table of these lists). Even if all donors do not eventually adopt their own definitions of direct and indirect costs, they need to understand how organisations are classifying costs into these two categories.

Key finding 4: There are a much larger number of NGOs than UN agencies involved in humanitarian assistance, most with different cost structures, working to different national accounting standards and in different national legal frameworks. This means that it is likely to be even more difficult to achieve standard cost classifications for NGOs. Also, the fact that NGO A classifies in-country costs as direct costs while NGO B classifies some in-country costs as indirect costs makes it clear that one flat ISC rate does not work for all NGOs.

This suggests that a flexible approach, as taken by the US with the NICRA (see section V.3), is more appropriate. This also has the advantage of applying to all grants within a year so, where donors do not specify a rate, there is no need to negotiate the rate for each project. The drawback of the NICRA is that it can be time-consuming if donors review the rate annually. However, it is possible to adapt this approach if donors are willing to coordinate. So, each donor could negotiate a rate with its own NGOs, based on common principles, and other donors could agree to accept this rate. Also, instead of reviewing the rate annually, donors could review the rate every 2-3 years as long as NGOs provided audited accounts to justify the continued use of the rate.

Recommendation 4: Donors should explore the feasibility of a more flexible approach to financing the indirect support costs of NGOs, that takes account of their different cost structures and accounting standards, such as an adapted version of the NICRA. If donors find that adopting an approach like the NICRA is not possible, they should explore the option of allowing NGOs to charge within a percentage range. They could also consider applying a sliding scale based on the size of a project, as the Belgian government does.

Key finding 5: Organisations with core funding have different needs to recover indirect support costs, depending on the level of core funding (section III.5). Since the relationship between core and non-core income differs across UN and Red Cross organisations, it does not make sense to talk about a standard support cost charge.

Recommendation 5: Donors should not apply pressure on UN and Red Cross organisations to achieve one standard rate because this will penalise some and favour others. However, they can use their position on the boards of UN agencies to better understand cost structures and push for greater clarity in cost analysis. Agencies should show clearly what costs are already covered by core funding and what costs are eligible for funding from ISC income.

Key finding 6: The evidence from ICRC, IFRC and some of the NGOs shows that they have to supplement income from the ISC charge with other sources of unrestricted income in order to cover their costs fully (section III.5). This poses a problem for NGOs because the general public wants its contributions to assist beneficiaries directly rather than to be used to cover the costs of supporting government programmes.

The UK Treasury has argued that government bodies financing NGOs "must recognise that it is legitimate for third sector organisations to recover the appropriate level of overhead costs associated with the provision of a particular service"[10]. In fact, in 2002, the Treasury recommended that all statutory donors should implement full cost recovery by April 2006 and accept "a legitimate portion of overheads"[11].

Recommendation 6: GHD members may want to consider the pros and cons of making a commitment to full cost recovery as statutory donors in the UK have done.

Key finding 7: Contrary to expectations, table 7 showed that when funding flows from pooled funding mechanisms through different organisations, not all of them charge for indirect costs and this lowers the overall indirect cost rate for projects (to less than 10% in almost all the projects reviewed above). Due to time constraints, it was not possible for the study to track funding to the next level down to examine what international NGOs who used local implementing partners paid them for indirect support costs.

Recommendation 7: Donors may want to consider tracking further the indirect costs paid to international and local NGOs when funding flows from pooled funding mechanisms in order to examine the impact on their income and organisational capacity. This would add valuable information because it would track the humanitarian dollar through from donor to beneficiary.

[10] HM Treasury (2006) "Improving Financial Relationships with the Third Sector: Guidance to Funders and Purchasers". Available from: http://www.hm-treasury.gov.uk/spending_review/spend_ccr/spend_ccr_guidance.cfm

[11] HM Treasury (2002) The Role of the Voluntary and Community Sector in Service Delivery - A Cross Cutting Review. Available from: http://www.hm-treasury.gov.uk/spending_review/spend_ccr/spend_ccr_voluntary/ccr_voluntary_report.cfm

Annex I: Terms of Reference

Study on overhead charges in humanitarian assistance
For
Ministry of Foreign Affairs, Sweden

Terms of Reference 21 November 2007

Why do we need a study on overheads?

Humanitarian aid flows through a number of layers on its way from donor to recipient – bilateral donors disburse funds to UN agencies, the Red Cross and Red Crescent Movement, NGOs and commercial service providers. Recently humanitarian reform has resulted in increased pooling of funding through the CERF and various country-level mechanisms. In effect this creates an additional layer through which funding is filtered.

When funding flows through an organisation it is often subject to an overhead charge. These charges are often contested: some stakeholders question the value for money arising from the charges and seek to reduce them to the bare minimum; others see overheads as a way of financing the basic capacity needed for humanitarian response in the absence of other resources to finance core organisational needs.

Because of the lack of documented knowledge about overheads it is difficult to resolve these differences.

This study will seek out and document basic information on overhead charges in the context of the cost structures of the organisations concerned. Based on the data gathered, it will review the implications of the current approach to overheads and identify possible recommendations for consideration by the Good Humanitarian Donorship Initiative.

Process and approach

Because overheads are such a contested issue, it will be extremely important to ensure that the study is, and is perceived to be, independent and objective.

Secondly, we anticipate that much of the literature on overheads will be in the form of internal, confidential reports and that the detail of setting, applying and managing overheads will be complicated and differ between agencies. We will therefore need to work closely with finance managers and they will need to be confident in the value and objectivity of the study and that confidentiality will be respected.

Therefore the first stage of the study should be dialogue with the IASC and a series of one-to-one meetings with UN agencies and other international organisations to brief them on the purpose of the study and to get their input. This will mean that the study should be prepared to adapt the terms of reference if necessary.

Scope

The study should address a limited number of organisations. We propose that this includes:

UN OCHA (including the CERF, and country level pooled funds)
UNDP (including country level pooled funds and, as far as possible within the time available, Multi-Donor Trust Funds)
UNICEF
UNHCR

WFP
IOM
ICRC
IFRC
2 NGOs
2 private sector organisations
1 foundation
Selected donors and funders

What issues will it seek to analyse?

Based on the data gathered above, the study will review the implications of overhead charges, focusing, among other things, on issues like

1. Comparisons of overhead charges between different categories of organisation: multilateral and international organisations, NGOs and private sector
2. Analysis of the relationship between overhead charges and core funding – exploring the extent to which overhead charges finance humanitarian capacity
3. The extent to which overhead charges reflect administrative or other transaction costs
4. The process for review of overhead charges to reflect, for instance, changes in technology or other ways of working

Some of the newer financing mechanisms such as the CERF and Common Humanitarian Funds add a level of overhead to the funding flows. The study will comment on the extent to which this is related to the benefits and efficiencies of such harmonised funding, recognising however that the benefits are difficult to measure in concrete terms.

The purpose of this study is to develop an information base on overhead polices that will help to build trust and transparency between donors and agencies. This will provide a foundation for consensus on recommendations for policies that are acceptable to both donors and agencies.

Following this review, DI will seek to draw out recommendations for consideration by GHD donors, agencies and other stakeholders. These recommendations will try to identify areas where improvements can be made in the short and medium term and map out possible ways of moving forward.

Timing

The work needs to start on 1 January 2008.

An interim report, documenting the basic information on overheads, along with bullet points on the implications of current approaches, will be presented at the Montreux meeting on 22 February 2008.

A final report, including recommendations and options for ways forward will be submitted on 25 April 2008 and discussed at the July 2008 GHD Meeting.

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Annex II: Cost Rate Comparisons

Example 1: From USAID best practice guidelines on the NICRA

Cost Elements	Organisation ABC	Organisation XYZ
Direct Labour	$100,000	$100,000
Fringe Benefits	$ 25,000	$ 25,000
Subtotal	$125,000	$125,000
Travel/Per Diem	$ 80,000	$ 80,000
Other Direct Cost	$200,000	$200,000
Equipment	$ 40,000	$ 40,000
Subcontracts	$ 50,000	$ 50,000
Total Direct Program Cost	$495,000	$495,000
Indirect Cost		
at 75%	$ 75,000	
at 25%		$123,750
Total Cost	$570,000	$618,750

Organisation ABC's rate applies to direct labour only
Organisation XYZ's rate applies to total direct costs

Example 2: Comparison of rates based on different direct and indirect costs

Cost Elements	Organisation ABC	Organisation XYZ
Programme deliverables	$100,000	$100,000
Transport costs	$ 50,000	$ 50,000
Other direct costs	$ 50,000	$ 35,000
ISC rate	**5%** ($10,000)	**13.5%** ($25,000)
Total Programme Costs	**$210,000**	**$210,000**

Organisation ABC charges more in-country costs as direct costs than Organisation XYZ but a lower indirect cost rate
Organisation XYZ charges fewer in-country costs as direct costs than Organisation ABC but a higher indirect cost rate
Both organisations have the same total costs, just different ways of classifying costs and different ISC rates.

Annex III: Details of donor approaches to indirect support costs

The table below lists the responses from the 17 GHD donors. The names of those that did not respond have been left in the table in case they want to provide information when the report is circulated to GHD members for the 18th July meeting.

Donor	Direct/Indirect costs	Administrative cost funding	Policies on recipient support cost charges
Austria (response from Humanitarian Aid Section of the Austrian Development Agency)	**Direct costs** are the costs of the project/ intervention itself and **indirect costs** are the costs reimbursed to the executing agency for its services in implementing, monitoring, etc. the intervention	The budget for operative measures is budget line 7421 under 1/20096. The ADA humanitarian aid section's personnel and general administrative costs are financed from a separate budget line - 7420 under 1/20096.	In the case of emergency projects or projects 1 year or more in duration, indirect costs must not exceed 10% of the direct project costs financed by the Austrian Development Cooperation (based on actual expenditure) or the maximum amount of EUR 160,000. The list of eligible indirect costs is in Annex IV.
Australia			
Belgium		The administrative costs of the humanitarian aid section are financed by the overseas aid budget line (the section is part of the overseas aid administration)	15% of the operational cost, with a maximum of 37,184 euros, for operations for which the total cost does not exceed 297,472 euros; - 12.5% of the operational cost, with a maximum of 49,578 euros, for operations with a total cost between 297,472 euros and 495,787 euros; - 10% of the operational cost, with a maximum of 74,368 euros, for operations for which the total cost exceeds 495,787 euros
Canada	**Direct program/project costs:** Direct program/project costs are those costs, which are actually disbursed and are directly related and considered a necessary expenditure in executing the program/project. **Indirect/overhead costs:** Indirect costs are those costs that cannot be obviously traced to a specific program/project. This means all indirect costs associated with the organization's Canadian office(s)	Administrative costs included in ODA (based on 1979 DAC agreement)	Humanitarian Assistance, Peace and Security (HAPS) Directorate will approve up to 7.5% of total cost of project for HQ admin costs for international humanitarian assistance projects. No cap on local admin costs. Applicable to NGOs. The list of possible direct and indirect costs is in Annex IV.
Denmark		Administrative costs financed by the overseas aid budget.	Flat rate administrative fee of 5% of total actual expenditure (including administration) to cover administrative expenses. NGOs need not specify how they have

			utilised the administration fee, either in the budget or in the auditing phase. The list of eligible expenses is in Annex IV.
EC	Direct Costs: any expenditure directly linked to the implementation of the Project Indirect Costs: costs necessary for the functioning of the organisation which cannot be directly linked to the implementation of the Project.	Only costs for the Technical Assistance in the field are financed by the operational humanitarian aid budget. Administrative costs of DG ECHO's headquarters are financed by the separate budget line 23 01.	According to ECHO's terminology "support costs" are direct costs incurred when carrying out humanitarian aid operations by supporting activities linked to the specific results (e.g. transport costs linked to the distribution of food, depreciation costs of a car used by the implementing partner for monitoring a nutrition programme). The criteria for eligibility of these costs are detailed in articles 18.1 to 18.5 and 18.8 of the General Conditions applicable to the Grant Agreement that are part of the Framework Partnership Agreement with Humanitarian Organisations (see: http://ec.europa.eu/echo/partners/fpa_en.htm). Regarding "indirect costs", a percentage of direct eligible costs of the Project, not exceeding 7%, may be claimed as indirect costs (see article 18.7 of the General Conditions of the FPA)
Finland	Do not have written definitions but do examine project proposals to see how costs apportioned.		No specific policy or guidelines.
France	No definition applied to UN agencies but, for NGO projects, direct costs are for items going to beneficiaries and all others (salaries, administration, rent) are indirect costs.	Administrative costs of humanitarian section financed from separate budget line.	No specific policy – rates set on a case-by-case basis, depending on the nature of the project.
Germany	Direct costs are those that are inextricably linked to the implementation of the measure. For example, costs that arise when purchasing items such as food or non-food items which are then distributed to the beneficiaries. Similarly, if personnel is hired specifically and	Administrative costs of the humanitarian aid section are generally financed from other budget lines which assure the daily operations of the headquarter of the Federal Foreign Office. The only costs financed by the overseas aid budget are such of (rare) official trips abroad by	Generally, the German government does not pay for indirect costs, although exceptions are possible, for example in the case of international organisations.

	exclusively for the purposes of implementing a particular project. **Indirect** (i.e. "Administrative" or "support") costs are those that arise independently of the implementation of a specific project, for example headquarter costs or the costs of establishing or running field offices (unless caused by a particular project).	members of the humanitarian aid section with the intention of evaluating the progress of aid projects funded by Germany	
Greece			
Ireland		Administration costs financed by ODA.	No specific guidelines on what recipients can charge. No set programme support costs rate but, in practice, allow 7%. If an organisation requests a higher level, it will only be accepted if there is very good justification. Ireland has guidelines on things that it won't cover (primarily international travel and insurance) but these are not very extensive and it does not set out what it will cover as an administrative cost.
Italy			
Japan			
Luxembourg			
Netherlands	No actual definition but direct costs are project costs which actually have to be made to execute a project. Indirect costs are support/ administrative costs	We do not have a separate budget line for administrative costs as such. Administrative costs and direct programme costs come from the same budget line for humanitarian assistance. This budget line is part of the overseas aid budget. Non-ODA costs are financed from the non-ODA part of the MFA's budget	At the moment applying organisations receive 3% over the actual project costs to cover indirect support costs. Since the executing organisation(s) also incorporate indirect costs into their budgets, the Netherlands is now reviewing the current system to prevent duplication of indirect costs. It is also considering an increase from 3% to 6% or 8%. Organisations that qualify for a contribution agreement are not eligible for full compensation of their administrative costs but only for an allowance towards them.
New Zealand	NZAID does not differentiate between direct and indirect costs either in its core	NZAID finances all humanitarian aid out of the New Zealand Government ODA	While we have no specific policy on the rate/level of support costs humanitarian agencies charge, we are interested to see some consistency

	contributions to agencies or through its responses to emergency appeals. Funding is provided untagged so that it can be used by agencies to meet their priority needs (which may include support costs).	allocation. The overall ODA allocation is split into 2 budget lines - that which funds actual programming (crown budget) and that which supports programming/admin costs (departmental budget).	across the UN and are in favour of agencies setting rates which are transparent, cost effective, and mainstreamed to support the effective and efficient functioning of the agency.
Norway	No distinction between direct and indirect costs	Administrative costs of the humanitarian aid section are financed by the overseas aid budget	NGOs and private partners directly implementing projects can charge 5%. Other organisations (e.g., those raising funds for others to implement) can usually charge 3% for projects up to NOK 5 million and 1% on projects over NOK 5 million.
Portugal	Direct costs are the costs directly spent on the project. Indirect costs are the associated costs that contribute to the implementation of a project. Example 1: Donation of equipment – the direct cost is the price of the equipment, the indirect cost is the amount spent in transportation, border taxes, etc. Example 2: A technical cooperation project that implies the presence of experts in the beneficiary country (TC mission). The direct costs are the journey price (plane ticket), accommodation and the per diem. The indirect cost is the expert's wage during the mission time. The administrative costs - administrative budget of the central aid agency and of the executing ministries concerned with ODA delivery – are also called indirect costs.	Administrative costs of the humanitarian aid section are financed by the overseas aid budget	No specific rules for humanitarian projects.
Spain			
Sweden	Terminology of direct and indirect costs not used.	Administrative costs of humanitarian section covered by separate budget line.	SIDA guidelines on funding to NGOs for humanitarian activities provide examples of eligible direct costs. These are listed in Annex IV.

Switzerland	Total costs of overseas aid are divided into 4 categories: a) salaries, b) running costs, c) projects costs, d) contributions to partners	The administrative costs of the humanitarian aid Department are financed partially (salaries only) by the overseas aid budget. Total salaries constitute around 10% of yearly total overseas aid budget. Of this 10 %, 90 % are paid by the overseas aid budget and 10 % are paid by the general budget of the Ministry for Foreign Affairs.	Swiss NGOs can use 10 % of SDC contributions for their administrative costs. Guidelines on this issue are in place. Non-Swiss NGOs should inform SDC about their administrative costs.
UK	DFID does not use the terminology of direct and indirect costs in the management of its own programmes and projects. But it recognises that these costs, as variously defined by different organisations, may be reimbursable.	Development and administration budgets are completely separate.	The rate is set by recipient organisations but is subject to negotiation. NGOs can charge 'Organisation Management Support' costs, which should not normally exceed 7%.
US	Indirect costs are those which cannot be directly identified with a single contract or grant. Indirect costs are applied equitably across all of the business activities of the organization, according to the benefits each gains from them. Examples: office space rental, utilities, and clerical and managerial staff salaries. To the extent that indirect costs are reasonable, allowable and allocable they are a legitimate cost of doing business payable under a U.S. Government contract or grant		Responsibility for negotiating indirect cost rates with organizations doing business with the U.S. Government is specifically assigned. Each organization negotiates its indirect cost rates with one government agency which has been assigned cognizance. Usually the cognizant government agency is that agency which has the largest dollar volume of contracts with the firm or organization. The resulting Negotiated Indirect Cost Rate Agreement (NICRA) is binding on the entire government. The NICRA contains both final rates for past periods and provisional (billing rates) for current and future periods. The responsibility for the issuance of NICRAs for non-U.S. based organizations rests with the mission providing the preponderance of funding. An indirect cost rate by itself has very little meaning so indirect costs must be compared at the cost level. The use of allocation bases is not uniform and varies greatly among organizations. Thus, it is not possible to compare

			indirect costs at the rate level between any two vendors, unless their allocation bases are the same, which is rare. Indirect cost rates should not be considered in award decisions or negotiations since indirect cost rates do not compare across organizations, given the diverse accounting practices and methods for determining rates. For example: one company may have a large labour overhead ratio to direct labour because it includes vacation and sick leave along with other types of overhead costs directly related to labour, while another organization will have a lower ratio because they direct charge vacation and sick leave. Neither practice is preferred over the other and both are equally acceptable. They are merely different.

Annex IV: Donor lists of eligible costs

To make it easier to compare the lists of eligible direct and/or indirect costs that some donors provide, this table contains the lists provided by 5 of the 17 donors that responded to the indirect support costs survey. Donors can use this as the starting point for a discussion of a more harmonised approach to categorising eligible indirect costs.

Austria	Canada	Denmark	Netherlands	Sweden
Indirect costs by activity: Project Supervision • Drawing up contracts with partners • Monitoring visits (project travels) • Control mechanisms • TORs for internal and external audits • Preparation and post-implementation activities of evaluations (internal or external) • Organisation, networking and exchange of expertise • Day-to-day supervision of the organisation Financial Project Management • Payments to project partner(s) • Bi-annual financial reports • Requests for budget revisions • (External) audits Personnel Placement, Consultancies, etc. • Staff selection	List of eligible indirect costs: 1. Advertising and promotion (non-program/project specific) 2. Amortization/ depreciation 3. Bank charges (non-program/project specific) 4. Board activities 5. Business development activities 6. Capital taxes 7. Communication - excluding long distance calls that are related to the execution of the program/project 8. Computer maintenance expenses 9. Financing costs such as interest expenses and costs to obtain irrevocable letters of credit 10. General staff training 11. Insurance (e.g. office, board of directors, liability) 12. Internal or external audits of the organization 13. Memberships and subscriptions 14. Office supplies and equipment 15. Organization restructuring costs 16. Professional fees relating to the	The following general administrative expenses are covered by the administration fee: • The expenses of the NGO's main office and country offices (rent, cleaning, office expenses, transport, electricity and water, support staff and other normal running costs) • Expenses for staff at the main office and, if applicable, country offices, who perform normal administrative tasks, for example: o Drawing up applications and other proposals o Travel expenses not connected with project-specific monitoring, etc. o Recruitment and selection of non-project-specific staff o Attendance at meetings and contact with the	The following components should be included as indirect costs. A. Project Preparation -Identification and project formulation (including mission identification and formulation). -Hire by managing organisations of the implementing organisations and all additional costs. -Preparation of project proposal and budget. -Rewriting the project proposals and the budget in accordance with the guidelines laid down by the Ministry/Mission. B. Project Implementation *Technical and administrative assistance during project implementation* -Proper monitoring of the project (e.g. assessment of progress reports). -Where necessary, advice on the project as a whole or parts of it. -Project visits for monitoring purposes. Management and control -Checks on proper and clear records	Eligible project (direct) costs: Training: Grants for training of local personnel in relevant fields, such as the Advanced Training Programme on Humanitarian Action (ATHA) training course. However, the training should mostly take place in the partner country or an adjacent country. Investments: After a special review, grants can be awarded for rental of office premises, vehicles, communications equipment and other equipment that requires capital, on condition that such investments are relevant to the project and that they are not the main purpose of the project. A list is to be enclosed showing how the equipment is to be used and disposed of at the end of the project. In general, grants are not approved for purchasing land or property. Personnel: Grants for

and preparation • Negotiating TORs with partners • Drawing up the placement contract • (Annual) discussions between employers and employees • Supervision of staff during assignment Reporting and Communication with the ADA • Preliminary coordination with the ADA • Planning in detail, drawing up a grant application • Bi-annual reports • Final report Procurement Obtaining tenders; indirect procurement, transport and insurance costs	administration of the organization (e.g.. legal, accounting, etc.), 17. Proposal preparation activities 18. Rent and utilities 19. Repairs and maintenance expenses 20. Review and negotiation of agreements 21. Salaries and fringe benefits relating to the administration of the organization 22. Staff recruitment 23. Strategic planning activities 24. Travel (non-program/project specific) 25. Workstations, including computers 26. Other indirect/overhead type of expenditures relating to the organization's office(s) in Canada Eligible direct costs include: 1. Program/project salaries actually paid by the organization to their personnel (Canadian, local, or in any other country as accepted by CIDA) and related fringe benefits allowed under the agreement. 2. Consultants/ subcontractors fees. 3. Program/project	Ministry of Foreign Affairs o Reporting tasks o Budgetary and accounting tasks o Governance costs (i.e. secretary general/director and members of the board/executive committee). In addition, NGOs are allowed to charge expenses for 'technical project-specific consultancy services' and project monitoring undertaken by permanent staff (at the main office and any country offices). These expenses are charged as project activity costs and are based on individual (depending on length of service) hourly rates with an overhead of up to 80 %. The following activities are deemed to fall within the scope of project-specific consultancy services: • Technical consultancy, support and capacity building	and efficient internal monitoring of the projects 1) -Checks on the timeliness, accuracy and quality of activity and financial reports from the implementing organisation, and where necessary, visits for monitoring purposes. -Reports to DGIS on how this has been agreed in accordance with the contract. -Checks on regularity and efficiency of expenditure, the accuracy of financial reports and any engagement of competent accountants (at BUZA's request and if laid down in the contract, this item may be included as project costs). Functioning of the head office and (permanent) field office -Accommodation and furnishings and fittings. -Staff support (general monitoring, financial and administrative support). -Financial and administrative apparatus. Maintenance and external contacts 1) If it can be shown that extra support is needed	personnel employed locally or internationally who are working within the framework of a project. Participation of international personnel must be justified. The applicant organisation, or the organisation implementing a project, is responsible for recruitment and training, and employer obligations relating to all personnel. Follow-up Grants to cover costs of following up ongoing projects. The costs of follow up must be in reasonable proportion to the budget for the project. All forms of follow-up are to be documented and must be made available to Sida. Quality Issues In certain cases, grants can be awarded for development of methods, participation in international networks relating to humanitarian issues, work on policies, and other quality-enhancing measures, even if these are not directly linked to a specific project. Grants can also be given for national and international lobbying on matters

	travel, accommodation, per diem, and incidentals (actuals not to exceed Treasury Board's *Travel Directive* and *Special Travel Authorities*). 4. Overseas costs deemed by CIDA to be required for the execution of the program/project (e.g. rent, leasehold improvements, utilities, office expenses, office computer, general maintenance). 5. Bank transfer fees related to the execution of the program/project. 6. Costs associated with program/project reporting and production of reading material (e.g. reproduction, translation). 7. Long distance communications, mail, and courier costs related to the execution of the program/project. 8. Technical assistance and meeting costs specifically related to the execution of the program/project, except those relating to flow through. 9. Procurement of goods specifically required for the execution of the program/project and related shipping costs (e.g. packaging,	of local partners • Technical support to the partner's administration and book-keeping • Monitoring of ongoing projects, include inspection visits • Reviews of ongoing projects • Evaluations in connection with the completion of projects • Recruitment of project-specific staff • Project-related information activities • Development of project-specific policies, strategies and guidelines Coordination of project activities with external actors	for project implementation and internal monitoring by the managing organisation, in the form of missions providing advice, technical support and support for internal monitoring, these activities can be entered separately in the project budget. These activities should, however, form part of the project proposal.	impacting the situation of people in humanitarian crises. Evaluation Grants for evaluation of major projects. Evaluation entails a more detailed analysis of, for example, implementation, results, attainment of goals, efficiency and deviation. Evaluation can be carried out at various points in time, but is generally conducted at the end of the project. An evaluation can be initiated by the organisation itself, the local cooperation partner or Sida. Needs analysis Sida can also award grants to organisations for needs analyses in a humanitarian crisis. The needs analyses are not necessarily conducted by the organisations that later conduct the project. Unforeseen expenses Sida may award a grant in situations where the organisation's risk analysis indicates justification for a separate budget item for unforeseen expenses. However, the organisation must get Sida's approval if these funds are

	containers, freight, freight insurance). 10. Construction costs (i.e. material, equipment, and construction-related labour) whereby the organization is assuming, under the terms of the contribution agreement, the performance risk of construction, and where the total of the construction costs is normally less than 20% of CIDA's contribution to the project. 11. Benefits and allowable expenses for personnel on a long-term field assignment and personnel on a short-term relocation, not exceeding those stipulated in CIDA's *Technical Assistance Handbook*. 12. Costs allowed under the manual entitled *Management of Students and Trainees in Canada*. Any other direct costs that are necessary to implement the program/project that are auditable. Prior written approval must be obtained from CIDA's project management for the cost to be eligible			used in a way that changes the main focus of the project, or if it results in major changes to the budget. See Sida's standard agreement for grants to NGOs.