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

**INFORMAL CONSULTATIONS ON  
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**PROPOSAL TO CHANGE IOM's PROJECT-RELATED  
OVERHEAD RATE POLICY**

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## **PROPOSAL TO CHANGE IOM's PROJECT-RELATED OVERHEAD RATE POLICY**

### **Introduction**

1. With the expanding range of IOM's activities over the years, experience has shown that the Organization's overhead rate of 12 per cent on **staff and office costs only** appears high to many donors and other partners who are used to the rates of other agencies which apply a percentage on the **total** budget of any given project. In addition, for some activities there is a degree of subjectivity in determining staff and office costs versus those of an operational nature which leads to time-consuming debates with project managers. The Administration believes it would be beneficial for IOM to apply a lower overhead rate on total costs rather than the current rate on staff and office costs only.
2. The Administration is therefore inviting Member States to consider changing the policy on the overhead rate to a percentage of total costs rather than on staff and office costs only.

### **Project-related overhead – the background**

3. Until 1993, much of IOM's staff and office costs were not allocated to project activities and this was the source of structural underfunding for years. In order to rectify the situation, it was decided to projectize staff and office costs directly to specific activities.
4. Consequently, in 1994 IOM adopted a project management system called "projectization" under which each activity was defined as a project and all costs directly related to the implementation of the project were included in the budget. Each project is accounted for separately and has a dedicated project manager to ensure that the income is efficiently used for the intended purpose.
5. In order to cover the indirect administrative support costs, and following a review of the situation, the types of programmes and the level of costs at that time, Member States agreed on an overhead rate of 9.5 per cent to be charged on staff and office costs of all projects.
6. Project-related overhead is a percentage charged to each project to cover indirect administrative costs (such as management, administrative staff and security) at Headquarters and in the Field, necessary for project support, which are not directly related to a specific activity. The percentage is intended to approximate the value of the contribution of indirect costs to each project.
7. An estimate of the project-related overhead is based on an evaluation of: (a) the projected level of staff and office costs; (b) the expected volume of project activity; and (c) trends from prior years' actual results. The overhead percentage charged on projects is reviewed regularly to ensure that it appropriately covers indirect costs associated with project implementation.

### **Evolution of IOM project-related overhead rate**

8. Over the years, IOM has increasingly been engaged in providing services in places where security is of concern, including humanitarian support in emergency and post-conflict situations. This prompted the Organization in 1998 to enter into a security services agreement with the

United Nations Security Coordinator (UNSECOORD). As the security situation around the world worsened and the related costs for participation in the United Nations security mechanism increased, the Administration had to elaborate ways of covering the increased costs of IOM's participation in the UNSECOORD mechanism, now referred to as DSS (Department of Safety and Security), taking into account the unwillingness of Member States to finance staff security costs under the Administrative Part of the Budget.

9. At the Eighty-fourth Session of the Council in December 2002, Member States approved the Administration's proposal to increase the overhead from 9.5 per cent to 12 per cent on staff and office costs, through Resolution No. 1076 (LXXXIV). The income realized from the 2.5 per cent increase is intended to meet the financial requirements of participation in the United Nations Department of Safety and Security and other relevant staff security costs. The change in the overhead rate from 9.5 per cent to 12 per cent on staff and office costs was applied in a phased approach.

10. Project-related overhead currently charged to each IOM project is therefore 12 per cent of staff and office costs incurred (of which 2.5 per cent is used for security costs).

11. Proposals on the use of project-related overhead income are presented yearly to the IOM governing bodies in the Programme and Budget.

### **Considerations for change in overhead rate policy**

12. The present overhead rate policy has been in effect since 1994 and reviewed in 2003 to take into consideration costs of participation in the UNSECOORD. Over this period, activities have significantly changed, for example, there has been a reduction in the proportion of transport-type activities where staff and office costs are a very small proportion, and an increase in activities such as technical cooperation and capacity-building where staff costs constitute the majority of the expenses of a project. Furthermore, there are activities where it is sometimes difficult to clearly differentiate between what constitutes staff and office as opposed to operational costs.

13. For IOM to remain cost-effective, finance and administrative processes and structures need to be revised in line with the changing nature of both internal and external factors influencing the Organization's work. Overhead rate policy is one of those areas requiring a change at this stage. As with other structural and administrative changes, the Administration proposes to implement the change in the overhead rate policy in a gradual and phased manner.

14. The reasons calling for a change, and the desired outcome of the proposed change in IOM's overhead rate policy are as follows:

- transparency of methodology (to avoid any differences in the interpretation of staff and office versus operational costs);
- to align IOM's overhead charge with the practice in other organizations;
- to facilitate review and comparisons by IOM stakeholders;
- to regularize existing practice as in some cases funding is already based on overhead on total costs (United States Agency for International Development (USAID), European Union (EU)), ensuring that the standard 12 per cent on staff and office costs is covered.

**Illustration of the effect of the change in overhead on typical projects**

15. Below is a summary of the different overhead amounts that would result on three typical project scenarios:

	<b>Scenario A</b>	<b>Scenario B</b>	<b>Scenario C</b>
	High staff and office costs (80% of the total budget)	Average staff and office costs (50% of the total budget)	Low staff and office costs (20% of the total budget)
Staff and office costs	320,000	200,000	80,000
Operational costs	80,000	200,000	320,000
Total budgeted costs	400,000	400,000	400,000
Overhead at 12 per cent of staff and office costs	38,400	24,000	9,600
Overhead at 5 per cent of total costs	20,000	20,000	20,000
Difference	18,400 less overhead	4,000 less overhead	10,400 additional overhead

16. For projects with a high proportion of staff and office costs in the total budget, overhead on total costs would reduce the amount of overhead generated on staff and office costs. For projects with a high proportion of operational costs in the total budget, overhead on total costs would increase the amount of overhead.

**Summary of the evolution of IOM overhead income**

17. Below is a summary of the evolution of the project-related overhead income since 2003, including the budget estimate for 2005.

	<b>2005 Budget Revision (MC/EX/665)</b>	<b>2004 (MC/2172) Actual</b>	<b>2003 (MC/2140) Actual</b>
	(USD millions)		
Total staff and office budget/expenditure	180.7	158.9	128.7
Total budget/expenditure	899.2	607.9	413.5
Staff and office as a percentage of total cost	20.1%	26.1%	31.1%
Overhead income (9.5 per cent)	13.1	13.5	10.5
Overhead income (2.5 per cent)	3.0	3.0	1.9
Total Overhead income	16.1	16.5	12.4

### Overhead rates applied by other organizations

18. From information gathered by the Administration, the following overhead rates are applied in the United Nations and other organizations:

<b>United Nations:</b>	13 per cent on total costs
<b>United Nations Development Programme:</b>	5 to 7 per cent on total costs
<b>International Committee of the Red Cross:</b>	6.5 per cent on total costs
<b>World Food Programme:</b>	7 per cent on total costs
<b>United Nations High Commissioner for Refugees:</b>	7 per cent on total costs

19. It should also be noted that the United Nations Finance and Budget Network of the High Level Committee on Management (HLCM) is currently undertaking a study of the "Support costs related to extra budgetary activities" to agree on a common approach for cost recovery, to exchange information and to discuss criteria for support cost distribution. From information available about the review to date, it is obvious that a single rate cannot be determined due to the different nature of the activities that lead to different financial and cost structures of the organizations.

20. The methodology applied by different United Nations agencies varies, as does the actual content of the respective programme support costs systems. However, agencies are gravitating towards an average rate of 7 per cent, with increasing access to additional cost recovery through the charging of certain support functions (reporting, evaluation, supervision of missions and even staff costs) directly to the project budget.

### Recommendation on the level of project-related overhead and proposed implementation process

21. The Administration proposes **an overhead rate of 5 per cent** on total costs, to be split 1 per cent to cover IOM's participation in the UNDSS and other security costs and 4 per cent as standard IOM overhead. As in the past, the amount earmarked for security will continue to be segregated and reported separately.

22. Experience has shown that not all expenditure is subject to overhead. For staff and office costs, the main exemption is for projects funded by Discretionary Income that are not subject to overhead. For operational costs, large payouts under the claims programmes should not be taken into consideration for total overhead calculations. Using 2004 actual expenditures, the Administration estimates that the adjusted base for calculating overhead, after taking into account the above-mentioned factors, on staff and office and total expenditure is USD 142 million and USD 426 million respectively.

23. Given the diversity of IOM projects, any revision to overhead rate will need to be implemented in a gradual and phased manner. If a new overhead rate and method is approved, although new projects beginning as from January 2006 will follow the new rate, existing projects may not be subject to immediate and automatic application of the new rate. Projects currently in progress and foreseen to end in the near future would remain at the 12 per cent level. Some projects may probably have the new rate applied over time, while others will require specific renegotiation before a new rate can be applied.

24. The Administration assumes therefore that only a part of the existing projects would adopt the new overhead percentage immediately. In view of the need for a transition period, the new overhead rate will have to be tested for several years (at least until the end of 2008, the final year in the projections below) before the level is reviewed.

25. The Administration estimates that only 25 per cent of projects will apply the new overhead system in 2006 as most projects will be continued from 2005 or would have been negotiated prior to approval of the new overhead method. The Administration further estimates that in 2007, 50 per cent of projects will apply the new overhead and in 2008, 75 per cent. Based on these assumptions, the following table summarizes total estimated overhead income for the next three years using the estimates from the 2004 expenditure base indicated above in paragraph 22.

	Percentage of projects - old system (12% of staff and office costs) %	Percentage of projects - new system (5% of total costs) %	Overhead for UNDSS and security costs (millions USD)	Standard IOM overhead (millions USD)	Total estimated overhead (millions USD)
2006	75%	25%	3.7	14.4	18.1
2007	50%	50%	3.9	15.3	19.2
2008	25%	75%	4.1	16.1	20.2

26. The Administration estimates that out of the total overhead of 5 per cent, 1 per cent will be required to meet the costs of IOM's participation in UNDSS and other security costs. The above calculations are based on this assumption.

27. As is the current practice, any surpluses and deficits will be carried forward to the following year until the subsequent overhead rate review after 2008. Results will be reported in the IOM annual financial statements, which are audited by IOM's external auditors in order that Member States can assess the current status of the overhead at any time during the transition period.

### **Conclusion**

28. The Administration believes that a move to the new overhead policy and rate of 5 per cent on total costs will enable IOM to remain cost-effective and improve the transparency of its cost structure. The Administration will continue to share information on this important subject with Member States as well as with interested donors to illustrate the effect of the new overhead policy and rate on certain projects so that a comparison between the old and the new system can be made to facilitate the decision-making process of the donors.