

Group of “Friends of the Chair” of FAO Council
Programme of Work and Budget 2010-11
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Anticipated cost increases for 2010-11 and how they have been calculated¹

1. Introduction

1. Cost increases for 2010-11 represent the incremental cost of personnel services and other goods and services arising from the recosting of these inputs at 2010-11 values compared with the 2008-09 Net Appropriation. The cost increases on the proposed Net Appropriation of USD 945.9 million for 2010-11 have been calculated at USD 49.9 million, which corresponds to a biennial cost increase of 5.3 percent, equivalent to a 3.5 percent annual increase.

2. This note elaborates on the methodology used by FAO to calculate cost increases on the Net Appropriation and provides additional information on the assumptions, events and forecasts applied in preparing the cost increase estimates in the full PWB 2010-11, in particular for staff costs.

2. Methodology for calculating cost increases

2.1 FAO’s methodology

3. The methodology for calculating cost increases in the PWB 2010-11 follows the approach previously approved by the Finance Committee, Council and Conference. The cost increase estimates cover the recosting of regular programme inputs from 2008-09 to 2010-11 levels to deliver the programme of work, namely for personnel services, goods and services. The cost increase estimates are developed on a biennial basis from: actual cost adjustments that are occurring in the current biennium (**biennialization**); projected adjustments to unit costs that will take effect in the next biennium (**inflation**); and, the **lapse factor** on established posts.

4. **Biennialization** is the incremental financial effect in 2010-2011 of staff cost adjustments that are occurring in the 2008-09 biennium. Biennialization is the consequence of two factors:

- *under-budgeted or over-budgeted costs in the current biennium (2008-09)*, that is, where actual staff costs per work month are at variance from the budgetary estimates prepared two years earlier;
- *current (2008-09) cost adjustments* that took effect at some point during the 2008-09 biennium (whether budgeted or not) that have to be applied to a full 24 month period in the 2010-11 biennium.

5. As such, biennialization objectively reflects the financial impact of events that have already taken place before the implementation of the 2010-11 budget. Most changes in staff costs implemented during the biennium are the result of recommendations by the International Civil Service Commission (ICSC) approved by the General Assembly of the United Nations. The movements of the US dollar against local currencies in decentralized offices also contribute to biennialization to the extent that they differ from the previous biennium

¹ C 2009/15 paragraphs 197 to 223

exchange rates. Accordingly, the financial implications of biennialization are essentially a matter of fact and arithmetic, not conjecture or long-range planning.

6. **Inflation** represents the cost impact in 2010-11 of those adjustments that are expected to take effect at various points in the next biennium. Inflation estimates for salaries, pension fund contributions and allowances are derived from the latest external forecasts by the Economist Intelligence Unit (CPI, Nominal Wage Indexes, exchange rate by location), published data of authoritative bodies such as the ICSC, and independent verification. Inflation estimates for the current service cost of after service benefits are based on the latest results of the actuarial valuation for the staff related liabilities schemes (After Service Medical Coverage, Terminal Payments Fund, Separation Payment Fund, Compensation Fund). The actuarial valuation is carried out jointly by all Rome-based agencies every year.

7. The **lapse factor** is a reduction of the budgetary provision for the estimated cost of established posts to account for the fact that some of them will be vacant for some time as a result of staff movements. The lapse factor methodology, approved by the Council at its 107th session² following a detailed study by the External Auditor, is based on three factors: i) staff turnover rates; ii) standard recruitment times; and iii) the extent to which separations are foreseen. The lapse factor reduction is applied to the standard rates (unit costs) of staff costs by grade and location for 2010-11. The cost increase calculation captures the change in this reduction factor from one biennium to the next.

2.2 Practical application of methodology

8. Anticipated cost increases have always been carefully reviewed by the governing bodies of FAO. In the past, there has been a tendency to keep the unit cost projections for the next biennium to the lowest possible level, in full knowledge of the associated risk of under-budgeting staff costs. Indeed, this resulted in significant negative staff cost variance in the 2004-05 and 2006-07 biennia, while a smaller negative staff cost variance is also anticipated for 2008-09.

9. For the 2010-11 biennium, biennialization was calculated based on actual changes in costs in 2008 and 2009. Inflation estimates were applied systematically based on EIU forecasts, netting off revaluation or devaluation forecasts of currencies, with the main risk area being fluctuation of the US dollar exchange rate against national currencies in decentralized office locations.

2.3 Practices of other UN agencies

10. The Rome-based agencies collaborate on the definition of cost increase factors. FAO and IFAD apply the same sources of information by category of costs, and the information is exchanged with WFP. These consultations ensure the collection and consistent use of the most up-to-date information in a cost effective manner, an improved understanding of the differences in costs structures and risks for each agency, and a coherent approach to cost increases for those costs categories that are similar among the agencies.

11. However, due to the differing cost structures of the Rome-based agencies the aggregate cost increases calculated by each agency are not strictly comparable. Variances are caused by

² C 2009/15 paragraphs 213-218

factors such as the grade structure, the distribution of posts by location, human resource policies, and the calculation method. For example: IFAD estimates *annual* standard cost rates calculated on the mid-point salary scale for each grade and actual costs for other entitlements, and includes as a personnel cost any reimbursements of income tax; WFP has a mandatory rotation policy with associated higher costs than FAO and IFAD.

12. A comparative review of the calculation of the cost increases in five UN Organizations (ILO, UN, UNDP, UNESCO and UNICEF) was presented to the Finance Committee at its 113th session in May 2006³. It showed that there were no fundamental differences in the methodologies used in the budgeting process and confirmed the common practice of basing staff cost increase projections on past expenditure patterns coupled with estimates from external sources. There were, however, some technical differences in cost elements included in staff costs and the details used to build up staff costs increase estimates for the budget, and in approaches with respect to currency adjustments during implementation.

13. The comparative review revealed an important difference in the funding mechanism available to organizations to handle staff cost variances during implementation. In the UN, the programme budget is 'recosted' three times in the biennial cycle as an established practice to take into account the latest inflation trends, the outcome of salary surveys, and the evolution of the operational rates of exchange. If the recosted UN staff costs exceed the budgeted amount, the cost is passed on to Members in the form of increased assessments during the biennium. In FAO, any variance must be managed within the budgetary appropriation for the biennium, requiring programme adjustments during the implementation cycle to manage these unbudgeted costs, and adjustments are reflected under biennialization for the following biennium.

2.4 Role of the International Civil Service Commission

14. In 1975 FAO accepted the Statute of the International Civil Service Commission which led to a number of amendments to the General Rules of the Organization (GRO) approved by the Conference. Through this, a number of powers were transferred to the General Assembly of the United Nations acting on the basis of recommendations of the Commission, or to the ICSC itself, and the Organization is no longer competent to intervene on these matters ⁴.

15. The question of whether the Council has authority to change or not to approve the recommended salary scale has been raised many times, including before the ILO Administrative Tribunal. The position of the ICSC and the organizations of the system has always been that although the salary scale is recommended by the ICSC, the Council is left with no discretion because the salary scale is the result of a methodology and of a survey, and these are within the authority of the ICSC.

³ FC 113/10

⁴ As regards General Service staff, under Article 12 of the Statute, "*at the headquarters duty stations (...) the Commission shall establish the relevant facts for, and make recommendations as to, the salary scales of staff in the General Service and other locally recruited categories*". The recommendations to the Organization are submitted for approval by the competent governing body; in the case of FAO it is the Council. On the basis of these provisions and practice the ICSC has established a methodology for salary surveys and conducted salary surveys in consultation with the Organization and staff representatives as provided for also in Article 12. The surveys are carried out usually – but not always - every four years. The ICSC is a highly specialized body that has built over the years the expertise and staffing to carry out the functions entrusted to it by the UN system.

3. Assumptions, events and forecasts applied in preparing cost increase estimates for 2010-11

3.1 Overview

16. In applying the methodology as elaborated above, cost increases on the Net Appropriation are estimated at USD 49.9 million for 2010-2011, which corresponds to a biennial cost increase of 5.3 percent, equivalent to a 3.5 percent annual increase, as summarized in Table 1.

Table 1⁵: Summary of cost increases under the Net Appropriation in 2010-11 at 2008-09 lapsed rates (USD million)*

	PWB 2010-11 proposed Net Appropriation at 2008-09 costs	Biennialization	Inflation	Lapse Factor Adjustment	Cost increases for 2010-11	Percent Cost Increase (biennial)	Percent of cost increase attributable to each cost component
Personnel Services							
Salaries, Pension Fund Contributions and Allowances	654.2	16.3	19.4	-	35.7	5.5%	72%
After Service Benefits	37.4	-	4.6	-	4.6	12.3%	9%
Agreed Termination	4.0	-	-	-	-	0.0%	0%
Lapse Factor Adjustment	-	-	-	2.6	2.6	-	5%
Total Personnel Services	695.6	16.3	24.0	2.6	42.9	6.2%	86%
Total Goods and Services	250.2	-	7.0	-	7.0	2.8%	14%
Budget level for Net Appropriation and additional requirements	945.9	16.3	31.0	2.6	49.9	5.3%	100%

* The breakdown of the budget by input category as shown in the column entitled PWB 2010-11 Proposed Net Appropriation at 2008-09 Costs reflects the proposed input mix of the 2010-11 proposal at 2008-09 costs.

17. USD 42.9 million (or 86 percent of the total) of cost increases are for **Personnel Services** equivalent to a 6.2 percent increase in the biennium (or 4.1 percent per year). Personnel services comprise all staff costs, including salaries, pension fund contributions, dependency and other allowances, social security and other staff-related entitlements and after-service benefits for both the Professional and General Service staff categories at the new lapse factor.

18. Total **Goods and Services** include other human resources, travel, general operating expenses, furniture, equipment, and present an estimated inflation of USD 7 million, equivalent to a 2.8 percent increase in the biennium (or 1.9 percent increase per year).

3.2 Personnel services

19. Details on the assumptions, events and forecasts applied in preparing the cost increase estimates due to biennialization, inflation and the lapse factor for personnel services are provided in Table 2 and described below.

⁵ C 2009/15 Table 6

Table 2 – Biennialization and inflation of staff costs by cost category for PWB 2010-11 at 2008-09 lapsed rates (USD million)

Cost category	PWB 2010-11 Programme Base at 2008-09 Costs I	Biennialization			Inflation V	Lapse Factor Adjustment VI	Total Cost Increases VII = IV+V+VI
		Under-/Over-budgeted costs in 2008-09 to reach actual 2008-09 levels II	2008-09 cost adjustments applied to 24 months in 2010-11 III	Total Biennialization for Personnel Services IV = II+III			
Professional Staff Costs							
Salary	324.3	3.2	6.0	9.2	10.2	-	19.4
Pension	66.9	(0.3)	0.0	(0.3)	1.0	-	0.6
Education Grant	25.1	(0.6)	(0.4)	(1.0)	0.6	-	(0.3)
Entitlement Travel	16.8	(1.3)	0.0	(1.3)	1.0	-	(0.2)
Medical Cost	12.8	0.5	1.0	1.5	1.3	-	2.8
Other Allowances	19.4	1.5	1.7	3.2	0.4	-	3.6
Total - PR	465.3	3.0	8.3	11.3	14.6	-	26.0
General Service Staff Costs							
Salary	141.2	0.9	1.4	2.3	2.5	-	4.8
Pension	27.2	0.4	0.6	1.0	0.5	-	1.4
Medical Cost	17.4	0.5	0.8	1.3	1.7	-	3.1
Other Allowances	3.1	0.2	0.2	0.4	0.1	-	0.5
Total - GS	188.9	2.0	3.0	5.0	4.8	-	9.8
Subtotal - PR & GS	654.2	5.0	11.3	16.3	19.4	-	35.7
ASMC	23.9	-	-	-	3.7	-	3.7
Termination	9.0	-	-	-	1.2	-	1.2
HQ General Service Staff Separation Scheme	8.0	-	-	-	(0.2)	-	(0.2)
Compensation	0.5	-	-	-	(0.1)	-	(0.1)
Subtotal - after service benefit liabilities (current service costs)	41.4	-	-	-	4.6	-	4.6
Lapse factor adjustment	-	-	-	-	-	2.6	2.6
Total staff costs	695.6	5.0	11.3	16.3	24.0	2.6	42.9
Non staff costs	250.2	-	-	-	7.0	-	7.0
Total	945.9	5.0	11.3	16.3	31.0	2.6	49.9

20. Column I presents the budget in the PWB 2010-11 of USD 945.9 million at 2008-09 costs, broken down between the personnel services cost of USD 695.6 million and goods and services costs of USD 250.2 million.

3.2.1 Biennialization – Professional and General Service staff costs

21. Column II quantifies the effect of under-budgeted or over-budgeted Professional and General Service staff costs incurred in 2008-09, amounting to USD 5.0 million. Column III quantifies the effect of all over-budgeted, under-budgeted and budgeted staff cost adjustments that took place at some point in 2008-09 and that have to be provided for the full duration of the 2010-2011 biennium, amounting to USD 11.3 million. The sum of these two effects is the

total biennialization adjustment of USD 16.3 million shown in column IV. The main categories of staff cost adjustments contributing to biennialization are explained below.

- The Professional staff salary cost for all locations is the largest item under biennialization. It is due to higher than budgeted increases at headquarters and exchange rate effects in decentralized offices. In April 2009 the ICSC promulgated an increase of 6.2 percent in Euro (or 6.6 percent in US dollars compared with a budgeted cost increase of 3.0 percent in April 2009). In non-Euro-based decentralized locations, the impact of devaluation of the US dollar against local currencies in 2008 resulted in increases in actual costs in the range of 3 to 7.5 percent.
- Entitlement Travel costs declined in 2008-2009 under biennialization, where efficiency savings due to the change in the entitlement calculation have been factored.
- Medical Cost for Professional and General Service category is under-budgeted in 2008-09, and thus the cost adjustment to 24 months, mainly due to the strengthening of the Euro.
- Increases in Other Allowances are mainly due to changes in dependency allowances as promulgated by the ICSC and effective January 2009 following the UNGA approval.
- General Service salary and pension costs have increased in headquarters as budgeted (3.03 percent in 2008 and forecast for 2.8 percent in 2009), while GS salary and pension costs in decentralized offices, including dependency and language allowances, increased due to the impact of the devaluation of the US dollar against local currencies in decentralized offices⁶.

3.2.2. Inflation – Professional and General Service staff costs

22. Column V quantifies the Professional and General Service staff cost inflation estimate of USD 19.4 million for 2010-11, of which USD 14.6 million is for Professional staff costs and USD 4.8 million is for General Service staff costs, as described below.

- For headquarters Professional and General Service staff salaries, an increase of 2 percent in 2010 and 2.5 percent in 2011 is foreseen, slightly higher than the EIU Average Nominal Wages Index forecasts for Italy for 2010 (1.7 percent) and for 2011 (2.3 percent), taking into consideration that the official wage index for Italy in 2009 was 2.8 percent and will be used by the ICSC to determine the salary scales for GS staff in Italy and influence the cost of living for Professional staff.
- The other area of significant inflationary increase is for Professional and General Service salaries in decentralized locations where numerous factors including inflation indexes (e.g. Nominal Wage Index forecast to increase around 8 percent p.a. in several decentralized locations where FAO has a significant presence), exchange rate forecasts and recent patterns of increases were considered to forecast staff costs. The forecasted inflation rates range between 1 percent and 8 percent.
- For Pensionable Remuneration of Professional staff in all locations an increase of 2.4 percent in 2010 and 2.3 percent in 2011 was applied equal to the EIU forecast of the Nominal Wage Index for the USA. The ICSC bases the revisions in Pensionable Remuneration scales on the cost of living in New York. The same estimated increases have been used by IFAD for their staff costs for next year's budget.
- For Education Grant an increase of 2 percent for 2010 and 2.7 percent for 2011 was applied in line with the CPI World index; Entitlement Travel inflation applied is 5

⁶ This risk was identified in the PWB 2008-09 paragraph 243

percent per year as an average to factor the increase in the cost of travel forecasted by the travel industry for the next year at 7-12 percent due to the re-pricing of fares.

- For Medical Cost, the same medical inflation rate of 6.5 percent per year was used as in the actuarial valuation.

3.2.3 Inflation – staff benefit schemes

23. An increase of USD 3.7 million is foreseen for current service costs of After Service Medical Coverage (ASMC) and a further USD 0.9 million for Terminal Payments Fund (TPF), Separation Payment Fund for the General Service category, and Compensation Fund based on the actuarial valuations of 31 December 2007 and 31 December 2008, which was completed in early 2009. The actuarial valuations were reviewed by the Finance Committee⁷.

3.2.4 Lapse factor

24. The majority of the Lapse factor adjustment of USD 2.6 million (Column V) results from not applying the lapse factor to Country and Liaison Offices as explained below.

25. In the past, budgeting at standard rates adjusted for the lapse factor has often created unfunded costs in offices with a low number of budgeted vacancies, such as the Country and Liaison Offices, which are not able to “absorb” the lapse factor and, therefore, generally require resources beyond their established budgets. In many instances, the difference in costs between the lapsed rate and the unexpired rate for filled posts had to be funded centrally, through reprogramming of resources from other areas.

26. One approach to closing this deficit would be to do away with the lapse factor adjustment, as recommended by the IEE. The CoC-IEE and the Finance Committee have agreed to eliminate the lapse factor adjustment for all budgeted posts in the network of FAO Representations. Management proposes to extend this measure to include all budgeted posts in the Liaison Offices, which suffer from similar constraints. Therefore, in the proposed 2010-11 Net Appropriation after cost increases, FAOR and Liaison Offices are budgeted at unexpired rates for the biennium. This adds USD 2.1 million to staff costs (USD 1.8 million for FAORs and USD 0.3 million for Liaison Offices).

3.3 Goods and services

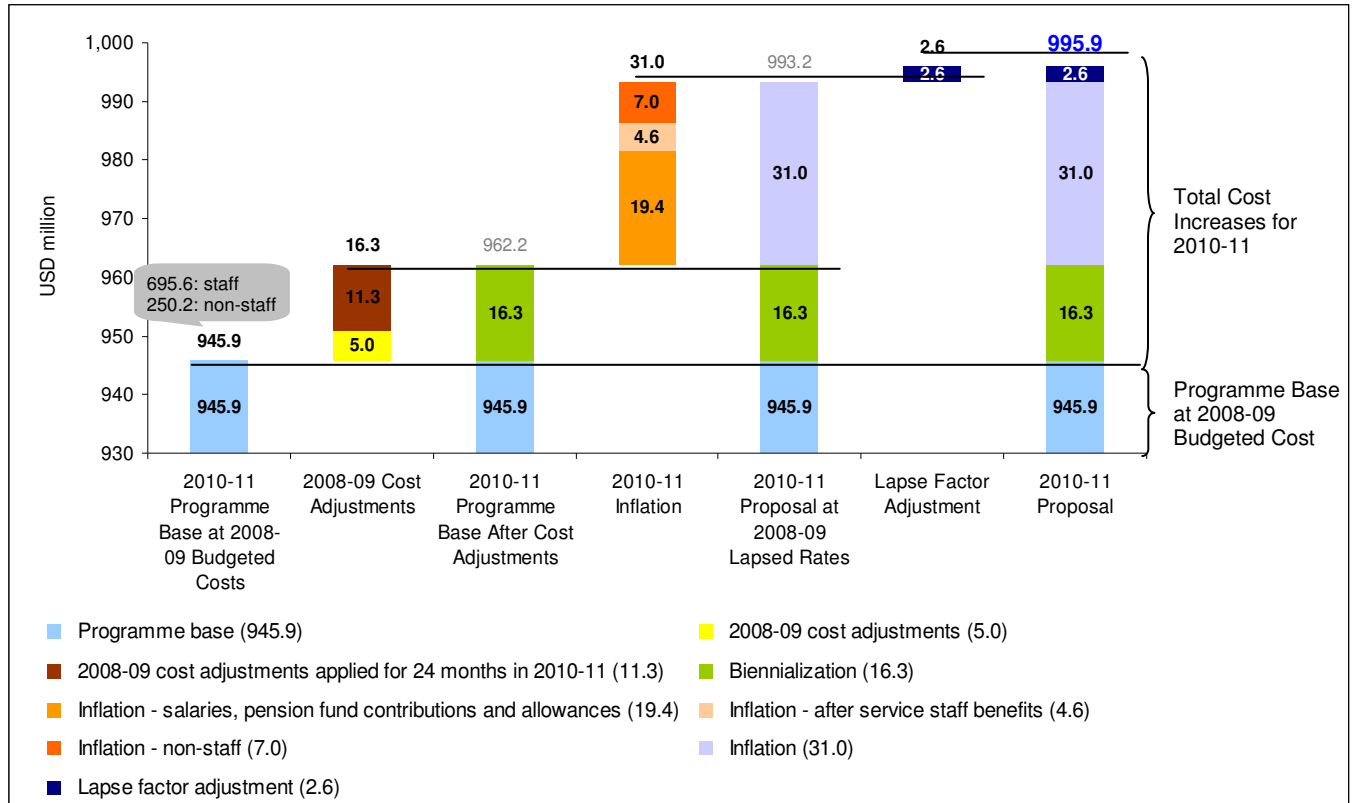
27. Inflation of USD 7 million on goods and services is calculated by applying a combination of the EIU CPI June for Italy of 0.9 percent for 2010 and 1.8 percent for 2011 for the headquarters and Europe-based expenditures, and of 0.9 percent in 2010 and 2 percent in 2011 (lower than CPI September for World of 2.1 percent in 2010 and 2.6 percent in 2011) for the non-headquarters and non-Europe based expenditures. IFAD proposed to their Board in September a composite overall annual increase for 2010 of 1.5 percent.

4. Conclusion

28. Using the data quantified above, the combined effect of the factors that comprise biennialization and inflation of personnel services, goods and services and the lapse factor is graphically illustrated below.

⁷ FC 126/8

Graphical illustration of breakdown of 2010-11 cost increases



29. The first bar identifies the amount of staff and non-staff costs elements that make up the 2010-11 programme base calculated at the 2008-09 costs (USD 945.9 million);

30. The second and third bar extrapolate how the 2008-09 actual costs levels impact the 2010-11 biennium, adding to a total of USD 16.3 million:

- the costs adjustments arising from 2008-09 biennium actual costs in terms of recurrent net under-budgeted/over-budgeted Professional and General Service staff costs incurred in 2008-09 of USD 5 million; and
- those increases that occurred at some point in the 2008-09 biennium that would require additional financial provision for 2010-11 so that they can be met for the entire 24 month period in 2010-11, amounting to USD 11.3 million.

31. The fourth and fifth bar represent the USD 31 million in cost increases that would unfold at some point of the 2010-2011 biennium due to inflation, and comprise:

- USD 19.4 million for Professional and General Service staff costs;
- USD 4.6 million for current service cost of after service staff benefit schemes, in accordance with an actuarial valuation; and
- USD 7 million for goods and services.

32. The sixth bar shows the effect of the lapse factor calculation, which increases staff cost by USD 2.6 million.

33. The seventh and last bar is the summary of all of the above and shows the composition of the PWB 2010-2011 budget level proposal of USD 995.9 million from a cost structure perspective: programme base at 2008-09 budgeted cost of USD 945.9 million and total cost increases for 2010-11 of USD 49.9 million.