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8 -10 October 2012

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STUDY OF COSTS GENERATED BY THE EXECUTION OF EXTERNALLY FUNDED PROJECTS - REV 1

San Jose, Costa Rica
October 2012

MOSLEY & ASSOCIATES

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June 9, 2012

Dr. Victor M. Villalobos, Director General
Inter American Institute for Cooperation on Agriculture
Apartado 55-2200 San Isidro de Coronado
San Jose, Costa Rica 11101

Dear Dr. Villalobos:

In accordance with our Contract for the Delivery of Professional Consulting Services, please find attached the results of our review of Inter-American Institute for Cooperation on Agriculture (IICA's) Institutional Net Rate - *Study of the Institutional Net Rate*.

Our study, conducted at the request of IICA, was completed in response to IICA *Resolution No. 541* approved by IICA's Executive Committee at its Thirty-first Regular Meeting, July 13, 2011.

The study had two main objectives:

- To review IICA's costs for implementing externally funded projects and IICA's methodology and process for recovering its additional costs for implementing those projects and make any necessary recommendations to IICA to allow for the fair recovery of the additional costs associated with implementing externally funded projects; and,
- To review the international technical cooperation market with respect to agriculture, in order to validate or suggest modifications to IICA's internal policy regarding the recovery of costs associated with the administration of projects financed with external resources.

We found that IICA's approach for recovering the additional costs for implementing externally funded projects is fair, supported by IICA's accounting system, and consistent with the practices of other international organizations and recognized methodology. **Based on IICA's final revenue and expenditure data for calendar year 2011, IICA's INR**

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should be 8.1%, which is within a similar range charged by the other international organizations whose institutional net rate policies we analyzed as part of our review.

A primary conclusion of our study is that IICA's ability to maintain its high quality technical and administrative support to implement project activity could be imperiled unless a fair INR is implemented and maintained.

We make a number of recommendations in the report. However, a primary recommendation is that IICA, in conjunction with its annual study of the additional costs for the management of external resources that is utilized in the calculation of the INR, also utilize the methodology we have in this study to determine if any adjustment to the INR is necessary to remain current, allowing for inflation and other impacts on the additional costs necessary to execute externally funded project activity in the future.

We would be happy to answer any questions you may have regarding the Study. We would like to extend our thanks to everyone at IICA who we worked with during our analysis. The courtesies and cooperation extended by everyone at IICA Headquarters, in the IICA Country Offices we were privileged to visit, and by those IICA Country Offices we held telephone conferences with, was outstanding.

We enjoyed working with IICA, and look forward to future opportunities.

Sincerely,

Everett L. Mosley

Everett L. Mosley, CEO

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June 9, 2012

Inter-American Institute for Cooperation on Agriculture

San Jose, Costa Rica

Study of the Institutional Net Rate

Study of Costs Generated by the Execution of Externally Funded Projects

Table of Contents

Results of the Study

I. Executive Summary

The INR rate

We have completed a study of the additional costs the Inter-American Institute for Cooperation on Agriculture (IICA) incurs as a result of implementing projects funded by external resources and the methodology IICA utilizes to recover those additional costs. IICA's approach is "net neutral" in that IICA's goal is to recover only the fair and true costs for implementing externally funded projects, beyond those costs IICA incurs which are paid for through its regular fund budget. IICA applies an Institutional Net Rate (INR) to externally funded project activity to recover the additional costs related to externally funded projects.

To reach our conclusions, we completed work at IICA headquarters in San Jose, Costa Rica, visited five IICA member Country offices, including Trinidad and Tobago, El Salvador, Peru, Argentina, and the IICA Country office in Costa Rica. We also conducted conference meetings (via Skype) with six additional Member Country offices, including Mexico, Brazil, Uruguay, Ecuador, Haiti, and Honduras.

We found that IICA's approach for recovering the additional costs for implementing externally funded projects is fair, supported by IICA's accounting system, and consistent with the practices of other international organizations. **Based on IICA's final revenue and expenditure data for calendar year 2011, IICA's INR should be 8.1%.**

Study Methodology

We focused specifically on revenue and expenditures in both the IICA Regular and External funds for calendar year 2011. At IICA Headquarters, we worked directly with the Financial Management Division and the Programming, Budgeting, and Control Division to identify the specific expenditure data from which the INR is developed.

During our visits and our telephone conferences with IICA Country Offices, we used a structured questionnaire to guide our discussions so that we understood the work performed at each country office and funding available to the Country office.

We sought the input of the Country Office officials regarding the INR and the development of the INR that might have concerned them. A comprehensive discussion of our study methodology is included in Section III of this report.

Country Offices provided critical information contributing to the success of this study.

Comparative Analysis of Other Organizations INR Rates

We completed a comparative analysis of other international organizations doing work in IICA member Countries and reviewed their methodologies by which they recover their costs for work they perform in support of their externally funded project activity. We found that in many ways, IICA's methodologies and those of the other international organizations we reviewed were similar. Complete results of the comparative analysis are included in Section IX of this report.

Study Conclusion

The complete details and analytical results of our study are included below. However, a primary conclusion of our study is that **IICA's ability to maintain its high quality technical and administrative support to implement project activity, could be imperiled unless a fair INR is implemented and maintained.**

II. Background

The Inter-American Institute for Cooperation on Agriculture (IICA) contracted with EAM, Inc. / Mosley & Associates to perform a study of the costs resulting from the implementation of externally funded projects. Mosley & Associates[1] is highly qualified to perform this review as we have conducted similar reviews in a number of other organizations that, like IICA, need to recover from the funding source organization costs associated with the implementation of projects. Additionally, the Project Manager for Mosley & Associates for this effort has previous experience working with IICA as a member and former Chairman of IICA's Audit Review Committee.

A. IICA Executive Committee *Resolution No. 541*

At its Thirty-first Regular Meeting, IICA's Executive Committee issued Resolution No. 541 (July 13, 2011), *"Full Recovery of Costs Incurred in Administering Externally Funded Projects"*. The Resolution requested the Director General to retain the services of an external consulting firm for the purpose of preparing a study that will provide criteria for defining a policy aimed at recovering the costs the Institute incurs in administering externally funded projects (Institutional Net Rate-INR).

IICA's goal is to ensure that the INR is commensurate with the actual costs of administering external resources.
13 July 2011

B. INR Study Objectives

In line with the objectives of Executive Committee Resolution No 541, the objectives of the study included:

[1] Visit our website at http://www.mosleyandassoc.com/

- To review IICA's costs for implementing externally funded projects and IICA's methodology and process for recovering its additional costs for implementing those projects and make any necessary recommendations to IICA to allow for the fair recovery of the additional costs associated with implementing externally funded projects.
- A review of the international technical cooperation market with respect to agriculture, in order to validate or suggest modifications to IICA's internal policy regarding the recovery of costs associated with the administration of projects financed with external resources.

C. IICA Funding Sources

IICA primary funding source is the Regular Fund, and IICA also executes projects with funding from External Resources.

The Regular Fund is composed of the annual quotas paid by IICA's 34 Member States and miscellaneous income. The purpose of the Fund is to finance the regular operations of the Institute, including administration and management of activities. The Regular Fund resources are used by IICA to pay for projects and activities outlined by the Governing Bodies of IICA, the Inter-American Board of Agriculture and the Executive Committee, in IICA's "*Medium Term Plan*".

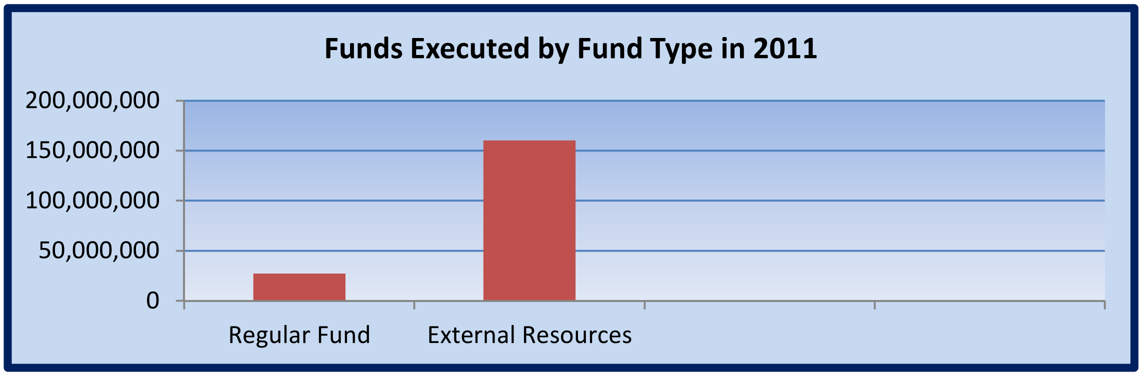
External Resources are made up of voluntary contributions for specific programs and projects, beyond those financed by the Regular Fund, that Member States or other financing or cooperation organizations wish to have IICA implement. IICA's policy on projects financed by External Resources is that these projects should be aligned with and complementary of the goals and objectives of IICA's *Medium Term Plan***.**

Table 1 shows the amount of money in each fund for the years 2008 through 2011. Figure 1 shows a graphic display of Funds Executed by type for 2011.

Table 1: Amounts Executed by Fund Type 2008-2011 (US Dollars)

Year	Regular Fund	External Resources Administered
2008	$31,423,812	$206,313,881
2009	$30,989,158	$154,379,675
2010	$33,228,007	$143,143,313
2011	$32,032,568	$165,578,508

Figure 1: Funds Executed by IICA in 2011



D. IICA's Financial Statements and Accounting Practices

Beginning in 2010, IICA's financial statements have been prepared in accordance with the accounting principles generally accepted in the United States of America (USGAAP), and are presented according to the American Institute of Certified Public Accountants (AICPA)'s fund accounting policies for not-for-profit organizations. In performing this study, we were guided by these accounting principles and international accounting standards applicable to organizations like IICA.

E. IICA's Treatment of Direct and Indirect Costs

It is the policy of IICA that costs that are clearly identifiable as supporting a specific project financed by external resources are direct costs and should be charged to that project and funded by the external resources supporting that project. Similarly, costs that are clearly identifiable as supporting a specific project financed by the Regular Fund are direct costs and should be directly charged to that project and funded by the Regular Fund.

Costs for labor, fixed assets, information technology, utilities and other expenses that support both Regular Fund projects and projects funded with external resources, that cannot be clearly associated with a specific project are indirect costs and are recovered through the Institutional Net Rate (INR).[2]

[2] IICA central office costs for accounting, budgeting and information technology systems are prime examples of labor and fixed asset expenses that support both projects funded by the Regular Fund and with External Resources and are indirect costs. These costs are recovered through the INR.

F. Statement of IICA Intent with Respect to Fair Cost Recovery of Expenses - A Net Neutral Approach

IICA's Executive Order No. 31, June 25, 2008, establishes *Policies and Procedures for Identifying, Negotiating, Approving, Executing, Closing Out and Reporting on the External Resources Mobilized by IICA.* Section III, Part 10 of the Executive Order provides that *the external funding source must reimburse IICA for direct and indirect costs it incurs* for implementation of the specific project financed by the external funding source. Proper application of the policy means that *100% of the costs* (both direct and indirect costs) *of externally funded cooperation instruments must be covered by the external fund.*

IICA wants to recover only the additional costs resulting from work related to externally funded projects, beyond those costs which are paid with regular funds.

IICA's goal in establishing the INR is to recover in a fair manner, only the additional costs beyond those costs which are paid with Regular funds and that result from managing technical cooperation activities that are financed with externally funded resources. IICA's goal is a **net neutral approach**; in other words, only the fair and true costs beyond those in support of Regular Fund activities and associated with managing externally funded resources would be recovered.

G. IICA's Current Recovery Process

To recover the costs for implementing projects funded by external resources, IICA currently uses a methodology and cost recovery process based on the Institutional Net Rate (INR), which is the percentage of external resources IICA believes is necessary to pay for the costs of implementing projects financed by external resources.

IICA's current policy for establishing the Institutional Net Rate (the INR) is included in Chapter III of the Financial Rules, Section 3.5, and in guidance provided by IICA's Secretariat of Corporate Services, Programming, Budgeting and Control Division, to IICA Offices in the Member States for preparation of Annual Action Plans. The Programming, Budgeting and Control Division, also prepares a calculation of additional costs for the management of external resources that is utilized in the calculation of the INR.

During the course of our study, we reviewed this policy guidance and the calculation by the Programming, Budgeting and Control Division of additional costs related to externally funded activities. Since IICA does not have a time keeping system that shows actual time[3] reported by IICA staff working on both regular fund and external fund

[3] We believe that implementing a time keeping system for staff supporting both regular and externally funded activities is not cost beneficial for IICA.

activities, the calculations performed by IICA's Programming, Budgeting and Control Division, which are based on average costs over the four-year period (2007 thru 2010 and updated annually), provides the best data available to determine the amount of time and labor charges applicable to externally funded activities. We found these calculations to be correct and a fair means by which IICA allocates costs to externally funded projects. This is discussed in more detail in **Section V** of the report.

H. IICA's Current and Past INR's

Established INR (rates) 2001 thru the Present
Table 2 below shows the INR rates IICA has established during the periods indicated.

Table 2: IICA INR Rates 2001 thru Present

Year (s)	INR
2001 - 2002	6%
2003-2009	4.5%
2010 *-Present	8%

*Established May 20, 2010

Average INR actually Collected 2001 thru the Present
Table 3 below shows the average INR rate **actually** collected during the periods indicated.

Table 3: INR Actual Rates based on Collections 2001 thru December 2011

Year (s)	INR
2001 - 2002	5.4%
2003-2009	5.6%
2010 -2011	6.1%

Note: The **average** INR actually collected is sometimes more or less than the established rate because of a variety of reasons including the timing of the agreement, and other factors considered at the time the agreements were negotiated. Also, in his Memorandum dated May 20, 2010[4], the DG provided that "*In exceptional cases, due to extraordinary circumstances in a given Member State, or because the Institute is particularly interested in the subject matter of the project, the Director General may authorize an INR of not less than 6%, preferably, in keeping with the procedures currently in place. In such cases, it is necessary to ensure that the budget of the project includes all management, follow-up, technical assistance, administrative support and other costs needed for the Institute to execute the project effectively.*"

Recognizing the possibility of extraordinary circumstances occurring, or the possibility of legislative barriers that exist and impact the percentage of INR a donor may be allowed to pay on an externally funded project, we believe that **the flexibility outlined in the DG's**

[4] No: SC/DG-422 Execution Of Externally Funded Projects (INR)

May 20, 2010 Memorandum is a critical aspect of the implementation of any INR policy. But at the same time, we believe that **the goal of recovering the additional costs for implementing projects funded by external resources is critical to IICA's short and long term success.**

III. Methodology for Conducting this Study

A. Scope of the Study

The DG was clear in indicating that the input of IICA country offices was a critical part of this study.

We focused specifically on revenue and expenditures in both the IICA Regular and External funds for calendar year 2011. At IICA Headquarters, we worked directly with the Financial Management Division and the Programming, Budgeting, and Control Division to identify the specific expenditure data from which the INR is developed.

B. IICA Country Office Visits and Conference Calls

To conduct the study, we visited IICA's Headquarters Office and five Country Offices. We also held teleconferences with 6 additional IICA Country Offices.

To begin our work, we held a telephone conference call on September 21, 2011 with Director General, Victor Villalobos, Secretary of Corporate Services, Carlos O'Farrill, and, Director of Financial Management, Karen Kleinheinz. The Director General (DG) and Secretary O'Farrill expressed the importance of the study to IICA and to its Member States. The DG indicated that the Institutional Net Rate is critical to IICA operations and to performing work funded by external resources on behalf of IICA's Member States.

During the call, we discussed in general terms the country offices we would visit to perform our work, as well as the country offices with which we would hold conference calls as part of the study. The DG was clear in indicating that the input of IICA country offices was a critical part of this study and he along with Secretary O'Farrill and Director Kleinheinz indicated they would help in any way they could to help make this study a success.

C. Basic Study Framework

The basic framework of our study methodology included visits and interviews with Directors and key IICA officials at the IICA Central Office in San Jose, Costa Rica, and five IICA Country Offices including Trinidad and Tobago, El Salvador, Peru, Argentina, and the Country office in Costa Rica office which is on the main campus of IICA's headquarters facility.

We also held telephone conference calls with six additional IICA Country offices including Honduras, Haiti, Mexico, Brazil, Ecuador and Uruguay.

We also interviewed IICA's Internal Auditor to learn about any issues and get input from the Auditor regarding matters related to the INR.

Structured Questionnaire for Interviews

During our visits and conference calls, we used a structured questionnaire to guide our discussions which focused on:

- the work performed at each country office
- funding available to the Country office during 2011 and the source of the funds either regular funds or external funds
- what projects the country office staff worked on and the source of the funding for the activity
- how the labor and related project expenditures for the activities carried out by the Country Office were charged, either to the regular fund, or direct to the external fund

These discussions were critical to our understanding of how the offices work and keep track of time related to projects, and in gauging their understanding of IICA's policies for charging time directly to the regular fund or to the external fund as dictated by the activities that they actually work on and for which they were hired.

Country Offices provided critical information contributing to the success of this study.

During our discussions, **we found that IICA officials and staff had a clear understanding of when to charge expenditures to the regular fund and when to charge expenditures direct to externally funded projects.** If the activity clearly and exclusively was in direct support of the externally funded project, that is the fund to which the expenditure should be charged.

We also sought the input of the Country Office officials regarding the INR, and what issues about the INR or the development of the INR that might have concerned them. We also asked them about their knowledge of concerns expressed by external funding sources about the INR, or their knowledge about specific Country policies or legislation that may have had an impact on the INR that funders were allowed to pay. This is discussed in more detail in **Section VII** of this report.

D. Comparative Analysis of INR Rates for Entities Similar to IICA

Finally, as part of our study, we performed a comparative analysis of entities that like IICA perform work on behalf of external funding sources and like IICA, need to recover the costs for performing that work. This part of the study was designed to understand to the extent possible where IICA stands in comparison to similar kinds of organizations relative to the INR charged by other organizations and the methodologies employed by other organizations in developing an INR. The results of this portion of our analysis are included in **Section VIII** of this report.

IV. IICA's Financial Rules for Establishing the INR

IICA Country Office officials had a clear understanding of which expenditures should be charged to the regular fund and to the external fund.

IICA's Financial Rules, Chapter III, Section B, 3.5 implement IICA's policy for establishing the INR. The rules say in part that the Institute shall charge an INR to cover the Institute's costs of participation in externally funded projects. The rules provide that an annual study shall be done to ensure that the Institute's INR is commensurate with the actual costs of administering external resources.

The financial information that forms the basis for the study is reviewed by the external auditors. Such a review of the costs associated with the INR was conducted most recently in the independent auditor's report issued to the Inter American Board of Agriculture (IABA) on June 16, 2011[5] for the years 2010 and 2009. This requirement is carried out annually by the external auditor with the next report due with the IICA financial statement audit presently underway for 2011 operations.

V. IICA's Annual Study Used to Calculate the INR

A. Basics of the Annual INR Study

To understand the importance of the annual study supporting the INR, you need to understand the basic philosophy of IICA regarding the INR. There are several points to consider:

[5] Deloitte & Touche, S.A. San Jose, Costa Rica

1. IICA's goal is full recovery of costs incurred in administering externally funded projects (IICA Executive Committee Resolution No. 541).
2. Labor and other related expenditures for IICA staff who work exclusively on projects externally funded are charged directly to the externally funded project.
3. The incremental or additional costs for salaries and other expenditures related to externally funded projects for IICA staff who work on activities funded both by the regular fund and by external funds are included in the annual study supporting the INR and are recovered through the INR process.
4. At IICA Headquarters, only the **Complementary Structures** of Headquarters units involved in the management of externally funded projects are included in the costs for the annual study supporting the INR and recovered through the INR including complementary costs for the following IICA units:
    - Office of the Director General
    - Directorate of Technical Cooperation
        - Projects Unit
    - Directorate of Management and Regional Integration
    - Secretariat of Planning and Evaluation
    - Secretariat of Corporate Services
        - Human Talent Management Division
        - Financial Management Division
        - Services and Administrative Support Division
        - Programming, Budgeting and Control Division
    - Internal Audit
    - Social Communication Unit
    - Legal Services Unit
5. Other institutional costs that are not included in the annual study and that are paid fully by the regular fund include:
    - IICA Governing Bodies
    - Secretariat of External Relations
    - Center for Strategic Analysis for Agriculture
    - General Costs and Provisions (Insurance, Pensions, External Audit, OAS Administrative Tribunal, Emergency Assistance Program)

B. The INR Study in 2011

IICA's Secretariat of Corporate Services, Programming, Budgeting and Control Division is responsible for the preparation of the Annual Study on the INR. The annual study, conducted on information compiled through March 2011 and supporting the current INR, utilizes average expenditure data (the data reviewed by IICA's independent auditor) for the years 2007 through 2010 to recover the incremental costs for the execution of externally funded projects for IICA units included in points 3 and 4 presented above. Expenditures in point 2 are recovered by direct charge to the externally funded project, and expenditures in point 5 are paid for by direct charge to IICA's regular fund.

Our study results show that the annual study supporting the INR conducted by IICA is a fair way to determine the amount of costs that should be allocated to the regular fund and to external funds[6]. The study identifies the amount of incremental expenditures (the additional costs required to implement externally funded projects) in a fair, efficient, and cost effective manner.

IICA's Annual Study of Costs Associated with the development of the INR is fair and consistent.

As noted earlier in the report, IICA does not currently have a labor time reporting system that would allow employees who work on activities benefitting both the regular fund and external funds to report their hours worked by project specific category. IICA does not have the necessary systems in place at all of their Country Offices that would allow for this type of recording. **Therefore, it is our belief, that the annual study compilation of additional costs for supporting externally funded activity provides the best way and a fair and supportable way to identify these additional costs.**[7]

VI. IICA's Institutional Net Rate (INR)

A. IICA's INR Based on 2011 Operations

Using the data from the annual INR study discussed immediately above, and with financial expenditure data **from calendar year 2011** provided by the Secretariat of Corporate Services, Financial Management and Programming Budgeting and Control Divisions, **we calculated the INR to be 8.1%. (See Exhibit A for the actual calculation of the INR.)**

This rate allows for a fair recovery of the additional costs IICA experienced resulting from the implementation of externally funded projects.

We determined that the INR should be 8.1% which would have resulted in an increase of US$2,515,111 in INR in 2011.

[6] Another way to determine time spent on each activity is a strict time keeping system implemented IICA wide. But, as noted on page 6 of this report, we believe that implementing a time keeping system for staff supporting both regular and externally funded activities is not cost beneficial for IICA.

[7] Recognized methodology on compilations of costs associated with an activity provides that costs be reasonable, conform to any limitations of the funding agreement, be consistent with policies and procedures, be accorded consistent treatment, be determined in accordance with GAAP, and be adequately documented.

B. Actual INR Recovered for 2011 versus Potential Recoveries

During 2011, IICA recovered $ 9,859,023 through the INR process in effect on agreements during that period. **If the 8.1%, INR had been in effect** on agreements during 2011, collections through the **INR would have been $12,374,134** or a net increase of $2,515,111. This effect is produced by the lower rates on projects which were in the process of execution and the legislative and policy restrictions that existed for other agreements.

C. Need to Update the INR on an Annual Basis

Typically, in any system dependent on the recovery of additional costs resulting from implementing externally funded projects, the INR is reviewed and determined on a recurring annual basis and the INR in future periods may have to be adjusted accordingly depending on the results of the annual study.

D. We therefore recommend that IICA:

1. Complete the INR study on an annual basis.
2. Adjust the INR in accordance with the study results.

VII. Observations Regarding the INR and Important Issues Raised during Country Office Discussions

A. IICA is in financial danger if it recovers less than the actual additional costs necessary for external projects.

As shown on Page 8 of this report, IICA during a number of periods has actually recovered less than the INR percentage amounts established for the period. As a result, some expenses that apply to externally funded projects, are actually paid through IICA's regular fund.

*IICA's **ability to maintain its** high quality technical and administrative support to project execution, could be imperiled, if a fair INR is not implemented.*

When this happens, the regular fund that IICA's governing bodies have approved for use to implement IICA's Medium Term Plan is directly impacted, negatively. Less money is available from the regular fund to implement the Medium Term Plan because it is diverted to pay for the additional costs of externally funded projects. When coupled with the fact that IICA's regular fund, which comes from Member Country quota payments, has been frozen for a number of years, this means that actual monies in the regular fund to implement the Medium Term Plan are effectively reduced.

Additionally, if the regular fund declines as the result of not recovering the full costs of implementing externally funded projects, **IICA's ability to maintain its high quality technical and administrative support to implement project activity, could be imperiled.**

B. Country Issues Impacting the INR

During our country office visits or our teleconferences with other IICA offices, a number of important points or issues impacting the INR were brought to our attention. The observations and comments we received from Country Office Oficials show that in many instances, these officials have a keen understanding of the INR, but in a number of instances, the comments also show a misunderstanding of how the INR is developed, what costs are included in the INR calculation, and what the INR is designed to pay for. To remedy this, IICA would benefit overall from some general training and discussion both in Headquarters and at Country Offices on the INR, how it is developed and what costs it is designed to pay for. Some of these areas include:

1) **Transparency** – Every IICA official or staff member we talked with emphasized that the most critical issue for IICA and the INR was that the process be transparent; that the INR rate established was based on official accounting data from IICA's accounting system and records; that the process for establishing the INR was fully documented; and that both the methodology and the calculations resulting in the INR were fully disclosed.

   We completely agree with these comments and believe that IICA is committed to assuring they are fully implemented.

   Recommendation: IICA should periodically review it's policies and procedures for establishing the INR to assure that full transparency is being achieved. IICA needs to provide training both in headquarters and in the field to assure that IICA officials and staff involved with the INR understand IICA's philosophy, policies and the methodology for development of the INR.

2) **Some Countries Provide In-Kind Contributions or Contribute More than the INR established by IICA** – We noted this in several of the IICA offices we visited or talked with. In the case of In-kind Contributions, we noted that some Government Ministries or other donors provide office space, or pay rent on behalf of IICA, or in some instances provide staffing for project activity. In at least one case, we noted that the in-kind costs associated with providing office space did in fact benefit IICA and the Regular Fund directly as the office space housed the IICA staff funded by the Regular fund. However, in other instances, the in-kind contributions were in fact directly benefitting the project activities funded by

External Resources (and not the Regular Fund activities) and should have been paid directly by the external resources. While it was an in-kind contribution, it benefited the externally funded project and not IICA directly.

Recommendation: While In-kind contributions are important to project activity, the impact on the INR must be carefully considered in every instance and a determination made and an understanding obtained by IICA and the external funding source as to what project activity benefits from the in-kind contribution. If the benefit is directly to the project activity funded by the external resource, it would not be considered as an "additional contribution" to IICA that would in any way reduce the INR on the externally funded project activity.

3) **Small Projects versus Large Projects** – Some IICA officials felt that there should be different INR rates for smaller projects or for larger projects. Reasons given were that IICA fixed costs for smaller projects may actually require a higher INR rate and that the actual gross INR recovery on larger projects may be very large, with the implication being that it was too much.

We believe that both assumptions are wrong. In an organization like IICA it is virtually impossible to establish different INR rates for different kinds of or levels of project activity. The INR methodology IICA uses and which we recommend IICA continue to use is based on the additional costs for the execution of externally funded project activity throughout IICA, beyond the normal costs paid for through the Regular fund, and calculates the INR necessary to recover those additional costs across all externally funded project activity. This is the most reasonable way to recover the additional costs and is similar to the methods used by the organizations included in our comparative analysis.

Recommendation: IICA needs to provide training to staff on how the INR is developed and what it pays for.

4) **Negotiation Process** – A number of IICA officials in headquarters and in the field talked to us about the negotiation process for the INR. Some IICA officials in the field felt that more involvement from headquarters would be beneficial, or that perhaps a "centralized negotiating unit" within IICA might be helpful and bring consistency to negotiations.

Recommendation: While there is benefit from a standard set of procedures as well as strong IICA headquarters involvement in the on-going negotiation process for the INR, we believe it is important that IICA Country officials (and regional officials) are fully involved and in the lead on negotiations. To make this most effective, IICA needs to provide training to staff involved in negotiations so that they understand the INR, what it pays for, how it is developed, and the impact of issues such as in-kind contributions as noted above.

5) **<u>IICA's Competitiveness -</u>** A number of IICA officials talked to us about IICA's overall competitiveness with other organizations providing services similar to IICA. In some instances they felt IICA had lost opportunities because IICA's INR rate was "too high". When we asked those who raised this point if they could name specific activities they had lost, they said they really could not, but felt that they had lost opportunities. Some officials also felt that IICA may not be as competitive as private sector organizations; the concern expressed was that private sector organizations are able to pay higher salaries, and that in the long run, IICA may not be able to compete with the private sector for staff.

   <u>Recommendation:</u> In Section IX of this report, we report on our comparative analysis of IICA's INR with international organizations providing services similar to IICA. Our conclusions shown there are that IICA is within a similar range of these organizations of the INR charged. We do not believe that the results show that IICA is at any serious competitive disadvantage for the types of activities and services IICA performs. The point regarding competition with the private sector is a valid one and one that IICA will have to monitor and address should it become a significant factor in being able to provide services.

6) **<u>Involvement of the IABA</u>** – Some IICA officials felt that the IABA needs to be more involved in the INR and if they were, the negotiation process would be better.

   <u>Recommendation:</u> We believe that there is benefit to this comment, particularly since the IABA and IICA's Executive Committee frequently changes individual members. There is a continuing need for IICA to educate the IABA and the Executive Committee on the INR. These governing bodies need to understand that the INR is what is required to cover the costs for implementing project activity funded by external resources, and if agreements are signed with an INR rate less than the extablished rate, that IICA will be in financial danger as an on-going organization.

7) **<u>Financing of IICA's Indirect Costs</u>** –A number of Country officials did not understand how the INR resources generated are used. In fact, there is a fair amount of mis-understanding of this in IICA, and what it shows is that there is not a common understanding of what the INR is designed to pay for.

   IICA as an organization has fixed costs for salaries, planning and budgeting, accounting and oversight, infrastructure and information technology and a number of other activities provided both at headquarters and at Country offices that are utilized when projects paid for with external resources are executed. The INR is designed to recover those costs, beyond those normally paid for by the Regular fund, that are required to execute external projects. The Secretariat for Corporate Services, when conducting the annual INR study, determines overall what the INR rate is, and where the expenses have been incurred in support of projects executed with external resources. The Studies have shown that the use of the INR has generally been reflective of where costs resulting from the execution of externally funded projects have occurred.

Recommendation: As part of IICA's training on the INR, a segment should be included explaining how the INR is developed, where costs are incurred, and how IICA headquarters supports externally funded project activity.

VIII. Legislative or Policy Barriers Impacting the INR

During our review, we were made aware of specific legislation or policy issues existing in some IICA Member or donor Countries and Organizations that "limit" the amount of INR they are allowed to pay IICA on externally funded project activity. Such situations represent a dilemma for IICA in that accepting these projects at rates less than the established INR causes IICA to not meet its "net neutral" policy for costs associated with external projects, while at the same time, such projects further the overall goals of IICA as outlined in its Medium Term Plan.

When IICA accepts projects at INR rates of less than its established INR, which is the rate necessary for IICA to recover the additional costs for implementing externally funded project activity, it means that IICA as an organization has not accomplished one of its goals, which is recovering all of the additional costs associated with implementing externally funded project activity. When this happens, the result is that the additional costs not recovered thru INR, are paid for with IICA's regular fund, or essentially with **Member Country Quotas**. In other words, all IICA Member Countries pay that portion of the additional funds not recovered because of the reduced INR associated with such projects.

Examples of these legislation or policy limitations include:

- One country has legislation which sets a maximum rate of 5% for INR.
- One country has a policy which sets a maximum rate of 6% for INR.
- One donor Organization, has set a policy maximum of 7% for INR.

Recommendation: IICA needs to have a full discussion with the Executive Committee and the IABA regarding the impact of these kinds of legislative barriers and come to a common understanding of how it will proceed under these circumstances.

IX. How Does IICA's INR Compare with Similar Kinds of Organizations?

A. Other Organizations Policies and Methodologies

As part of our study, we conducted research to determine and compare the Institutional Net Rate (INR) practices, policies and methodologies used by other organizations operating within the International Technical Cooperation Market, to the extent that such information was available, with the policies of IICA. Our goal was to determine how IICA compared to similar organizations, to understand other organizations methodologies, and to compare IICA's actual INR to other organizations actual INR's. Included in our study and comparison (in addition to IICA) were the following eight international organizations: (More detail on the policies and methodologies of the eight entities included in our study is included in **Exhibit B** of this report.) Table 4 below shows the INR rates of the reviewed entities in comparison to IICA.

Entities Included in our Comparative Analysis

- FAO – Food and Agriculture Organization
- OAS – Organization of American States
- UNDP – United Nations Development Programme
- UNICEF – United Nations Children's Fund
- UNIFEM – United Nations Development Fund for Women
- UNESCO – United Nations Educational, Scientific and Cultural Organization
- UNCDF – United Nations Capital Development Fund
- CGIAR – Consultative Group on International Agricultural Research

Table 4: Institutional Net Rate or Indirect Cost Rates Established by the Entities Reviewed[8]

Entity	INR
IICA	8%
FAO	10-13%
OAS	12-20%
UNDP	5-7%
UNICEF	5-12%
UNIFEM	7%
UNESCO	7 -13%
UNCDF	7%
CGIAR	12-13%

B. Summary of Significant Aspects of Cost Recovery Policies and Practices of Organizations We Reviewed

The following highlights significant aspects of cost recovery policies and practices of the eight organizations we reviewed:

- All eight organizations have a policy on recovering indirect costs. **IICA has such a policy in its Executive Order No. 31, June 25, 2008.**

- There is a range of efforts by the eight organizations to recover the costs of implementing projects funded by external resources from using a flat rate or INR approach **like IICA**, to the more sophisticated approach being adopted by CIGIAR which is an "Activity-Based Costing" (ABC) approach.

- In most cases, the eight organizations apply their flat rate (INR) to the direct expenditures for externally funded project activity to recover the additional costs for implementing projects funded by external funds. **This is how IICA applies its INR.**

- Indirect cost rates for the eight organizations we reviewed ranged from 5 percent to 20 percent depending on the type of activity. **In another study done by OAS in 2006, OAS reported similar INRs as noted above, and also reported on two organizations for which we could not obtain current information. In 2006, OAS reported INRs for PAHO and PADF as follows:**

  - PAHO - Pan American Health Organization 6 – 21 percent

[8] Rates Established and reported at the time of our Review – February, 2012. Also, these rates are further explained in Attachment C of this report.

- PADF - Pan American Development Foundation 16 percent

- At least six of the organizations that we studied (FAO, OAS, UNDP, UNIFEM, UNESCO, and CGIAR) **allow for waivers or exceptions to their indirect cost recovery rate**.

- Some organizations (FAO, UNICEF, UNIFEM, and UNESCO) try and separate indirect costs into fixed and variable indirect costs. These organizations defined <u>indirect fixed costs</u> as cost incurred by the organization regardless of the scope or level of its activities and cannot be traced directly to a specific project. These costs include costs of top management not related to the service provision. Fixed indirect costs are considered not volume dependent, cannot be traced to specific activities and projects, and these organizations do not attempt to recover these costs through an indirect cost rate. **This position is similar to IICA's position as noted in this report, Section V, IICA's Annual Study Used to Calculate the INR, point 5.**

- Six of the organizations we reviewed detailed the type of costs to be included in their indirect cost pool**. (The examples shown here are identical to the type of costs that IICA includes in the calculation of its INR.)** Examples include:
  - Staffing of administrative functions;
  - Procurement of goods and services;
  - Setup and management of accounts;
  - Internal and external audit coordination;
  - Resource mobilization;
  - Facilities and utilities;
  - General use of equipment and supplies;
  - Financial reporting;
  - Planning, monitoring, review and evaluation.

C. United Nations Report on the *Policies and Procedures for the Administration of Trust Funds in the United Nations System Organizations*

In 2010, the United Nations Joint Inspection Unit issued a report[9] that reviewed the policies, rules and regulations in force in connection with the management and administration of trust funds. **As part of the review, the inspection unit reviewed the cost recovery policies and principles related to activities financed from extra-budgetary resources, including trust funds.** (The report uses the term "programme support cost" (PSC) to refer to its cost recovery mechanism, which is similar to IICA's INR terminology.)

[9] Joint Inspection Unit, Geneva 2010, report titled "Policies and Procedures for the Administration of Trust Funds in the United Nations System Organizations"; JIU/REP/2010/7

With respect to cost recovery policies, the inspection report noted that given the steadily growing volume of extra-budgetary resources in their overall budgets, most UN system organizations have started **to apply a full cost recovery policy in order to enable recovery of all the administrative and support costs related to activities financed by extra-budgetary resources.**

Highlights of the report include:

- The review found that programme support cost (PSC) recovery differs from one organization to the other in certain aspects and, in particular, UN system organizations apply different PSC rates (from 7-13%).

- According to the report, **deviation and exception from the standard rate** for certain types of activities exist in all the organizations **or may be approved by the executive head** and/or the Controller of the relevant organization in certain cases such as for emergency programmes or programmes with a high level of procurement.

- An important finding of the inspection unit was that in several organizations the **current PSC rates are not enough to cover all actual costs,** and in some cases there is **"cross subsidizing" from the regular budget.**

- The inspection unit believed that **"if UN organizations continue to apply lower PSC rates,** the organizations could come out at the **losing end,** in particular **if they take on a burden that cannot be financed in the long term from regular resources".**

Attachment A

Inter-American Institute for Cooperation on Agriculture
Institutional Net Rate[10] (US Dollars)

Description	Total Resources	Quotas	Miscellaneous Resources	INR[11]	External Resources[12]
Direct Costs					
1.1 Offices	$ 169,613,367	14,447,551	3,298,293		151,867,523[13]
1.2 Regional	$ 3,582,366	3,582,366			
1.3 DTC*	$ 4,466,633	2,883,732	771,079		811,822[14]
1.4 CSAA*	$ 485,053	361,773	35,533		87,747
1.5 CATIE*	$ 976,300	976,300			
1.6 Other	$				[15]
Total Direct Costs	**$ 179,123,719**	**22,251,722**	**4,104,905**		**152,767,092**
Indirect Costs					
2.1 Offices	$ 4,551,214			4,551,214	
2.2 Regional					
2.3 DTC/CSAA*	$ 38,269			38,269	
2.4 Headquarters	$ 7,972,946	3,660,462	632,005	3,680,478	
2.5 General	$ 1,048,993	1,044,526	4,467		
2.6 Other	$ 877,201	334,482		542,719	
Total Indirect Costs	**$ 14,488,623**	**5,039,470**	**636,472**	**8,812,680**	

Institutional Net Rate = Indirect Costs divided by Direct Costs[16] = 8.1%

$14,488,623/ $179,123,719 = 8.089% (8.1%)

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[10] Based on final revenue and expenditure data for calendar year 2011 – December 31, 2011.

[11] This amount includes $8,737,025 of INR and $75, 657 of special contributions for Complementary Structures of the Offices.

[12] Includes only direct costs (total amount executed less amount of INR generated).

[13] Total external Resources $154,676,352 less $1,161,563 exempt from INR, less $1,647,265 country contributions to cooperative projects or projects in support of integration = $151,867,523.

[14] Total external resources $870,197 less $58,374 exempt from INR = $811,822.

[15] External Resources of $9,533 in this category not subject to INR.

[16] To recover the "Indirect costs" associated with the execution of external resources, you divide Total Indirect Costs by Total Direct Costs to obtain the percentage factor (the INR rate of 8.1%) to be applied to the Total External Resources Executed in order to recover the additional costs incurred resulting from the execution of external resources.

*Notes for Acronyms for Attachment A:
1.3 DTC - Directorate of Technical Cooperation
1.4 CSAA - Center for Strategic Analysis of Agriculture
1.5 CATIE - Tropical Agriculture Research and Higher Education Center
2.3 DTC/CSAA - Directorate of Technical Cooperation and CSAA

Attachment B

Cost Recovery Policies of Entities Included in Our Study

Organization	Cost Recovery Policy	How Applied	Rate Used	Comments
FAO	"…There should be a reasonable alignment of charges to the actual costs of providing administrative and operational support to projects, taking due regard of existing arrangements, and the need for a simple and transparent approach." FAO is trying to reduce the cost recovery gap of variable indirect costs within the current scope of FAO Support Cost Policy.	Variable indirect costs are recovered through the levy of a percentage rate applied to expenditures.	Ceiling of 13% for non-emergency projects; 10% for emergency projects.	Tries to separate indirect costs by fixed and variable.
OAS	General standards require specific fund contributions to include a provision for ICR, with the exception of emergency, humanitarian and contributions under $100K. Secretariat has authority to negotiate ICR rate. Full recovery of indirect costs cannot be expected, but a reasonable recovery should be attained.	Will enforce policy that all budgets for eligible Specific Fund projects include ICR. Will exclude the following contributions from ICR: disaster relief, conferences and meetings co-financed and contributions for feasibility studies.	12% for Partnership 15% for Executing Agency 20% for "Flow-through" (funds passed from a donor to a project through the OAS for which OAS provides administrative oversight.)	Significant increases in ICR rate based on internal study. Some donors do not include a provision to cover indirect costs, while others provide up to 30%. Some donors have required that ICR be directed exclusively to technical areas managing the projects and do not take into consideration the impact of these projects on the other areas of the Secretariat. A number of Secretariat costs are currently charged as indirect, when they should be included as direct costs.
UNDP	Other resources need to cover the full cost of the services being provided to Other Resources funded programmes as well as to contribute to the overall costs of UNDP's operations. The costs associated with the	Indirect costs are referred to as General Management Support (GMS). For programmes funded wholly or partially from Other Resources, the	**For Trust Funds (TF) and Third-Party Cost-Sharing (TPCS):** The level of fee is to be set so	For all types of programmes, UNDP determined how the fee charged will be distributed. For example, of the 5-7% charged for TF and TPCS, depending on the type of project, the UNDP Country Office

Organization	Cost Recovery Policy	How Applied	Rate Used	Comments
	delivery of services to programmes above the base structure shall be borne by the relevant funding sources (Regular & Other Resources) with each programme. There are two categories of services provided to programmes: the first includes general oversight, management, and quality control; while the second category includes direct services in the context of implementation. Other Resources-funded programmes benefit from UNDP's global operations (which include strategic initiatives, policy development and corporate systems) and should contribute to them.	recovery for these services, which are not directly attributable to project inputs or activities, is through a percentage fee.	that it covers costs arising both at the Country Office and HQ Level—usually in range of 5-7%. **For Programme Country Cost-Sharing (PCCS):** Average fee is 3%.	could get everything above 2%, the Regional Bureau 0.67%, Central Services 0.33% and Global Operations 1%.
UNICEF	Follows UN principles and modalities of cost recovery. Cost recovery principle requires the direct recovery from projects of the variable indirect costs incurred.		For 2004-2005, policy was to use recovery rate of 7% for regular and other resources and 5% for thematic funds. For 2006-2007, recovery amt projected at $161 million. The base recovery rate needed was estimated at 8.8%. Actual variable indirect costs for period represented 6.2% of the direct program expenditures funded from other resources; actual recovery was 7.2%. Cost recovery	Actual cost recovery exceeded both the planned recovery rate and actual expenditures for 2006-2007. Reason for higher recovery was an increase in 2006-2007 in income from other resources.

Organization	Cost Recovery Policy	How Applied	Rate Used	Comments
			rates charged ranged between 5% and 12%.	
UNIFEM	Ensure activities "linked to the management of other resources are adequately funded without undue subsidization by regular resources." Divides indirect costs into fixed and variable. Costs associated with maintaining the "minimum core capacity" are considered as fixed indirect costs. These costs are not volume dependent, cannot be directly traced to UNIFEM activities and projects, are charged to management costs, and are not recoverable. Variable portion of indirect costs are considered incremental cost incurred beyond the maintenance of minimum core capacity and are volume dependent; they are related to service provision, and each funding source is responsible for covering attributable indirect costs.	Analyzed actual data for 2004-2005 and 2006-2007. Divided indirect costs between fixed and variable. For 2004/2005 to fully recover variable costs should use 7.37%. For 2005/2006 rate should be 7.26%. These rates are w/I range of the effective recovery rates of 7.8% for 2004, 7.5% for 2005, and 8.3% for 2006. Although standard rate of 7% appears to be slightly lower than both implicit recovery rates and effective rates, it was regarded as reasonable.	Using a standard rate of 7%.	UNIFEM is applying gradual approach in application of standard 7% rate. Seems to be recovering indirect costs. Exceptions allowed to the flat 7% rate. Uses 5% rate to program countries cost sharing contributions.
UNESCO	All costs needed for the proper implementation of an extra-budgetary project should be budgeted for and charged to that project; and, in cases where regular program resources are used for a project's implementation, such costs should be reimbursed.	Applies Programme Support Cost (PSC) rate (i.e., a percentage of the project's total expenditure).	Standard rates are: 13% - std. rate 8% - equipment 10% - donor-funded special accts 7% - Delivering as one pilot, multi-donor trust funds and UN Joint Programmes. Minimum flat fee: $6,500 for small projects ($50K or less).	Standard rate can be waived or modified under certain conditions: --provide evidence of the need for derogation --provide evidence to BB that the support costs which would have normally been covered via the PSC rates are budgeted as direct costs to the project .

Organization	Cost Recovery Policy	How Applied	Rate Used	Comments
UNCDF	Cost recovery approach based on three principles: (1) alignment with UNDP cost recovery and harmonization with the cost recovery principles of the United Nations Development Group; (2) proportional burden-sharing of management costs from regular and extra-budgetary resources; and (3) strategic allocation of extra-budgetary resources to ensure effective program delivery.	Cost recovery income is generated from two sources: (1) donor contributions to other resources (non-core fund); and (2) technical advisory services to UN organizations and other institutions.	7%	The actual average general management support rate for contributions received to UNCDF other resources during 2006-2007 was 6.7%. In 2008, the rate was 7%.
CIGIAR	Long encouraged a policy of full cost recovery for both direct and indirect costs in regard to research projects funded by restricted grants. All projects should bear a fair share of costs of the organization's "services" and "institutional expenses." Such costs should be allocated using an appropriate allocation method. Adopting an approach using **activity-based costing (ABC)** principles starting in 2010.	ABC is methodology for assigning costs to projects based on services (activities) they acquire. ABC seeks to identify cause and effect relationships to objectively and fairly assign costs as direct costs where that is possible. Even with ABC some operating costs are difficult or impractical to assign to projects. This group of costs must nevertheless be absorbed by contributions from the projects, as a percentage of expenditures, but under ABC they should be a relatively small percentage of the total cost of any project.	Years ago average "overhead recovery" rate was 11%. Recovery rate still hovers around the same level it was 20 years ago. Trends are clear: management costs as a share of total budgeting is declining. Expect indirect cost rate generally to continue to decline and stabilize at about 12-13%.	ABC is the most sophisticated system being used by organizations reviewed for this study. Small grants-developing separate cost recovery policy. Not realistic to comply with full cost recovery policy. Implementing 2% recovery of systems costs. (Some IT expenses will be charged direct to the user, e.g. depreciation of accounting software gets charged directly to finance department. And if some departments require large amounts of storage space (some research experiments use incredible amounts) a supplementary charge could be levied.) cost.

Attachment C

Sources of Information Consulted for our Comparison Study

Organization	Sources of Information
FAO	1. Finance Committee: Rome, 21 – 25 March 2100; Measures to Improve Implementation of the Organization's Support Cost Policy (FC 138/7) 2. Finance Committee: Rome, 6 – 10 October 2008; Annual Report on Support Costs Expenditure and Recoveries (FC 123/11) 3. Finance Committee: Rome, 19 – 23 September 2005; Report on Support Costs Expenditure and Recoveries (FC 110/4)
OAS	Power Point Presentation: December 11, 2006; New OAS Indirect Cost Recovery (ICR) Policy
UNDP	Policy on Cost Recovery from Regular and Other Resources; 02-June-2003; Bureau of Management/Office of Budget Resources
UNICEF	Economic and Social Council: 12 November 2009; Report on the implementation of the UNICEF cost recovery policy (E/ICEF/2010/AB/L.3)
UNIFEM	Background note on cost structure and cost recovery policy; Rev. 12-6-08.
UNESCO	Guidelines on the Cost Recovery Policy and Budgetary Aspects of Extra-budgetary Projects; Bureau of the Budget, October 2008.
UNCDF	Executive Board of the United Nations Development Programme and of the United Nations Population Fund; Implementation of the UNCDF cost recovery policy; 24 November 2009.
CGIAR	CGIAR Cost Allocation Guidelines: Financial Guidelines Services, No. 5; Revised December 2008.

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September 3, 2012

Dr. Víctor M. Villalobos
Director General
Inter-American Institute for Cooperation on Agriculture
Apartado 55-2200 San Isidro de Coronado
San Jose, Costa Rica 11101

Dear Dr. Villalobos:

In accordance with our Contract for the Delivery of Professional Consulting Services, we issued the results of our review of IICA's Institutional Net Rate, *Study of the Institutional Net Rate*, on June 9, 2012.

At the Special Advisory Commission on Management Issues (SACMI) held at IICA Headquarters on July 12, 2012, the SACMI asked IICA to provide some clarification on some issues that were discussed, and also asked IICA to explore and suggest additional ways that would allow IICA to remain financially strong and competitive in Technical Cooperation throughout the Hemisphere.

IICA officials prepared the attached Supplement to our Study as an addendum to our report in response to the requests made by the delegates attending the SACMI meeting. We have reviewed the clarifications in the addendum, and are in agreement with the clarifications presented.

In response to the delegates' request at the SACMI meeting to explore and suggest ways to remain financially strong and competitive, maintaining its high level of quality in the technical cooperation market, in the addendum, IICA officials also present suggestions that would further this stated goal. We have also reviewed those suggestions and agree that they will in fact help IICA achieve the goal of a stronger financial position going forward and assist in helping IICA to remain competitive with similar organizations. In fact, each year when IICA reviews the INR, IICA should be including in its calculations, known increases in costs for staff and other operational costs. This would be consistent with other organizations which recognize increases in costs for staff and operations.
A final clarification requested by the delegates at the SACMI relating to our June 9, 2012 report has to do with information from the annual study conducted by IICA Officials to review the INR. That study is mandated by IICA's Financial Rules, Chapter III, B, 3.5. In our report, the annual study is referred to beginning on Page 11 of the document. In their report, IICA has developed an approach used to determine the indirect costs associated with the implementation of all projects funded by external resources.

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We reviewed the IICA information and found the indirect costs identified to be reasonable, consistent with IICA policies and procedures, supportable, well documented, and determined in accordance with Generally Accepted Accounting Principles. We verified through interviews with IICA officials at Headquarters and the Offices the consistent treatment of costs, and additionally that the indirect costs determined through the procedures are based upon the costs expended which are audited each year by the external auditors.

We were very confident that the IICA approach to identifying and accounting for this information resulted in the compilation of the indirect costs that we could then use in our methodology for determining the Institutional Net Rate (INR). Additionally, the IICA procedure is the only way IICA has of determining the indirect costs used in support of project activity funded by external resources.

In our report Attachment A, page 23, we used the indirect costs developed and accounted for through the IICA procedures as one piece of the cost data in our formula and methodology to determine the INR.

We hope the additional information presented in this letter and IICA's Supplement to the INR Study respond to the requests of the SACMI and will allow you and IICA Member States to better understand our Report and findings for your review of the Institute's INR policy. Once again, we would like to extend our thanks to everyone at IICA who we worked with during our analysis.

Sincerely,

Everett L. Mosley

Everett L. Mosley, CEO

Attachment: IICA Supplement to the INR Study

Addendum

SUPPLEMENT TO THE INR STUDY

I. INTRODUCTION

Background

At its Thirty-first Regular Meeting, the Executive Committee issued Resolution No. 541 of July 13, 2011, in which it instructed the Director General to retain the services of an external consulting firm for the purpose of preparing a study to provide criteria for defining a policy aimed at recovering the costs incurred in administering externally funded projects (Institutional Net Rate – INR).

Pursuant to that resolution, the Director General hired the consulting firm of Mosley & Associates, which prepared and presented to the 2012 Regular Meeting of the Special Advisory Commission on Management Issues (SACMI), the document entitled “Study of the Institutional Net Rate (INR).”

The SACMI analyzed the study and, after a lengthy discussion, recommended that some aspects of the document be clarified or looked at in greater depth, especially with regard to the:

- INR concept used by the Institute
- Methodology used to calculate the rate for the INR policy
- Proportional burden-sharing approach to the financing of indirect costs, based on the amount of direct costs of the external and Regular Fund resources
- Treatment of in-kind contributions
- Legal and policy barriers to the acceptance of IICA’s INR by some Member States and funding agencies
- Institutional policy concerning exceptions and reductions in the INR
- Construction of a scenario to recover or improve the Institute’s competitiveness

Acting on these recommendations made by the SACMI, the Director General instructed the corresponding units to prepare this supplementary document. This document was studied with the consultant, who endorsed the methodology used.

Methodology

The methodology defined by the consultant was used to calculate the rate for the INR policy, applying it in the study presented to the Institute. This methodology consists of determining the indirect costs as a percentage of the Institute’s total direct expenses, including all sources of financing.

To determine the amount of direct and indirect costs, the consulting firm analyzed and validated the procedures defined by IICA's General Directorate, based on the audited financial information for 2011, and considered them ***"correct … and a fair means by which IICA allocates costs to externally funded projects."***

Structure of the Document

This document designed to supplement the INR study is divided into the following sections:

- INR concept, in which the idea, origin, and net neutral approach of the policy applied by the Institute are described
- An analysis of the Institute's ***competitiveness*** as a result of the financial situation created by the freezing of quotas, the fall in miscellaneous income, and the financing of indirect costs, which should be financed proportionately with INR resources: concept of ***proportionality*** in the financing of indirect costs
- Treatment of in-kind contributions as part of the costs of externally funded projects
- Legal and policy barriers to the acceptance of IICA's INR by some Member States and funding agencies
- Policy on exceptions and reductions in relation to the INR applied
- Method used to calculate the rate for the INR policy, including the criteria for determining the Institute's direct and indirect costs in 2011, based on the audited financial information for that period. The information is used to calculate the rate for the INR policy under the following two scenarios:
    - Audited financial information related to direct and indirect costs for 2011, in accordance with the INR study prepared by the consultant, which concluded that the rate should be 8.1%
    - Audited financial information related to direct and indirect costs for 2011, in accordance with the INR study prepared by the consultant contained in the document presented to the SACMI, adjusted to include the criteria for ***Proportionality and Competitiveness***, which gives a rate of at least 8.9% for the INR policy

II. THE INR CONCEPT

Context

IICA provides cooperation services to its Member States in compliance with its mandate, 2010-2020 Strategic Plan, 2010-2014 Medium-Term Plan, technical cooperation strategies at the hemispheric, regional and national levels as well as rules and procedures.

This cooperation is financed with the Institute's own resources, the Regular Fund, consisting of the quotas paid by the Member States and any miscellaneous income generated. As part of its external relations policy, IICA seeks to establish and consolidate agreements and effective strategic partnerships, based on a corporate approach. This is aimed at the technical strengthening of the Institute, given that in order to make significant contributions, it is essential to expand and deepen collaboration among partners.

The Institute's rules and regulations, as well as the resolutions of its Governing Bodies, stipulate that IICA may sign agreements to execute external resources, provided they are for activities that are in line with the Institute's objectives.

The external resources to be executed by IICA must cover the direct and indirect costs of the projects they are intended to finance.

The Institutional Net Rate (INR) Policy

The Rules of Procedure of the General Directorate call for the existence of an Institutional Net Rate Fund, consisting of reimbursements from the administration of contracts with other institutions. The purpose of this fund is to finance the costs incurred by the Institute in the execution of these contracts and to contribute to institutional pre-investment activities. Therefore, the main objective in applying a rate for the administration of external resources is to cover the **indirect** costs incurred by IICA in their execution. These costs are incurred in the Units or Offices responsible for implementing externally funded agreements and in the technical and administrative support units.

The Institutional Net Rate is the percentage the Institute applies to all the direct costs of externally funded projects and reflects the baseline percentage rate necessary to recover the indirect costs. The INR resources received by the Institute for executing external resources are intended to cover the indirect costs it incurs in implementing the cooperation instruments. These indirect costs are, among others:

- The support and technical and administrative supervisory services provided by the Offices and Headquarters, such as financial, accounting, human resource, programming, budgeting, auditing, technical support, external relations and other services.
- The costs of operating, maintaining and updating the basic structure of the Institute, which enables it to implement cooperation instruments. The costs are incurred at Headquarters and in the Offices in the Member States.

- The pre-investment costs required to ensure the mobilization of the external resources, such as the establishment of partnerships, preparation of proposals, informational material, negotiations, preparation of legal and technical instruments, approval processes and preparations for the start-up of the projects.

In addition, the resources generated by the application of the INR must be sufficient to cover cost increases, thus ensuring that the Institute can continue to manage the external funds throughout the life of the project from both a technical and administrative point of view. This requirement is necessary, given that most externally funded projects are medium-term undertakings.

The Net Neutral Approach of the INR Policy

In all cases, externally funded projects must cover all their direct costs and a fair share (a net neutral share) of the indirect costs. The goal of the Institute's INR policy is to ensure that the proportion of the indirect costs for which the externally funded projects are responsible are covered with the income generated via application of the INR.

The proportion of the indirect costs to be covered with the income generated via application of the INR is determined by the funding structure of IICA technical cooperation projects: on the one hand, projects financed with resources of the Regular Fund, and on the other, externally funded projects.

The Institute has a basic technical and administrative structure of direct and indirect costs for implementing its Medium-Term Plan. As more and more externally funded projects have been implemented, it has become necessary for them to finance, proportionally, their indirect costs.

The INR resources generated by implementing externally funded projects are used to finance the "Complementary Structures," which are indirect costs necessary so that IICA has the technical and operating capacity required for the execution of external projects. In other words, in the Institute's operating units there are "Basic Structures" of costs which are financed with resources of the Regular Fund, and "Complementary Structures" which are the indirect costs of the externally funded technical cooperation projects, which are financed with INR resources.

Under this approach, the INR resources are not a "surplus" or "profit" for IICA since they are used only to cover the proportion of indirect costs corresponding to externally funded projects. If the amount of INR resources generated is insufficient to cover the indirect costs for which the externally funded projects are responsible, the Regular Fund must be charged to offset the difference. This means that the Regular Fund, which all member countries finance and which is to be used to implement IICA's Medium-Term plan, is used to benefit the externally funded projects. This affects the economic structure of the Institute and threatens the ability of the Institute to carry out its own long-term strategy of technical cooperation activities due to a lack of technical and administrative capacity.

The net neutral approach, which seeks to generate only those resources required to cover proportional indirect costs, cannot be seen as and is not a solution to the problem of the declining value of the Regular Fund, caused by frozen quotas and a drop in the receipt of miscellaneous income, because it generates only enough resources to pay for the indirect or "complementary costs" of implementing externally funded projects. The solution to this problem lies in some mechanism other than the INR policy.

III. COMPETITIVENESS OF THE CAPACITIES OF THE INSTITUTE

The calculation of the INR on the basis of the audited financial information for 2011 assumes a certain level of competitiveness on the part of the Institute, which, given a scenario of zero growth of external resources and the Regular Fund, would lead to a gradual loss of competitiveness due to normal cost increases and inflation from cost centers such as utilities and technical and physical infrastructure, and at the same time to the deterioration of staff salaries and loss of human talent and expertise caused by staff turnover rates when staff leave for better paying opportunities. The status quo leads to the obsolescence of the physical and technical infrastructure, and a steadily declining operating capacity.

In addition, because the INR in the last several years has generated less income than that required to cover the proportional indirect costs for which externally funded projects are responsible, there are indirect costs which are being covered by the Regular Fund but should be covered with INR resources.

This means that the Institute is losing its installed capacity to fulfill the mandates and priorities of the Medium-Term Plan approved by the Governing Bodies. This situation is caused, at present, by three factors:

- A decline in the real value of Member State quotas, frozen since 1995 (17 years)
- A decline in the receipt of miscellaneous income due to a drop in financial yields and policies in some Member States regarding the return of financial yields
- The financing of externally funded projects that do not cover all the indirect costs for which they are responsible

Given this situation, IICA must recover, on average, the INR as calculated on the basis of information from the previous year, and include in the INR a factor related to preserving and enhancing the Institute's competitiveness, reflected in:

- Better salaries, to begin to recover competitiveness again on labor markets and be able to attract and keep the qualified human talent required to respond to the technical and administrative requests received by IICA
- Greater investment in technological and physical infrastructure to maintain and improve the provision of technical cooperation

- A proper balance between personnel and operating costs that makes it possible to effectively carry out the Institute's management and technical cooperation work

Assuming a partial recovery of the loss of value of salaries, of 10%, (without reaching salaries equivalent to those on the international labor market, which would require a salary increase of more than 40%), and a similar increase of 10% in investments in physical and technological infrastructure and in operating costs, and making the necessary adjustments for each source to finance its indirect costs proportionally, the INR to be applied should be at least 8.9%. This would make it possible to cover the costs involved in beginning the process of making the Institute more competitive and for the externally funded projects to assume coverage of the proportion of the indirect costs corresponding to externally funded projects. (See **Table 4**.)

IV. IN-KIND CONTRIBUTIONS FOR EXTERNALLY FUNDED PROJECTS

In some cases, the source of financing for an externally funded project covers a portion of the direct and indirect costs with in-kind contributions such as technical and administrative personnel, facilities, vehicles, payment of utilities, consultants, etc.

In the case of in-kind contributions intended to cover the direct costs of a project, the contribution is for the exclusive use of the project, and may not be considered as part of the INR.

If the in-kind contributions do not cover the direct costs of a project, but rather a portion of the structure of indirect costs, they may be considered as part of the INR applicable to the project, and will be applied in determining the INR that the project will be charged.

Of course, some permanent special contributions from some Member States, both cash and in-kind (offices, cash contributions, personnel, utilities at no cost to IICA) should be viewed as a complement to their quota contribution, and do not replace the payment of the INR as part of the cost of the project. These resources help enable the Institute to finance a basic structure in the Member States, despite the freezing of quotas and a decline in the receipt of miscellaneous income.

V. LEGAL AND POLICY BARRIERS TO THE PAYMENT OF THE INR

In some Member States and funding organizations, there are legal or policy limitations on the payment of the INR applied by IICA, which means that other States or funding organizations must offset this loss by accepting higher rates than the one defined by the Institute, and to the direct benefit of the Member State with the limiting legislative or policy barrier.

To address this situation it is necessary to engage in negotiations aimed at changing the policy applied to IICA by some Member States and funding organizations.

In the case of legal hurdles, in-kind contributions or the funding of specific indirect costs may be accepted in lieu of the INR charged by the Institute, in order to cover the INR defined by the institutional policy.

VI. EXCEPTIONS

In exceptional situations, the Director General can waive or lower payment of the INR:

- Mobilization of resources from the Member States in response to emergencies or natural disasters
- Special and specific contributions from the Member States to shore up the core budget of the Institute
- Quotas the Member States pay to fund cooperative or integration programs and projects such as the PROCIs, or regional agricultural integration bodies such as the regional integration councils
- Special and specific contributions from the Member States to improve the infrastructure of the Institute

In addition, the Director General may approve a special INR for a given project or funding source only when it is in the Institute's interest, in which case the funding source must guarantee payment of all direct costs of the project.

VII. BASES FOR CALCULATING THE INR POLICY RATE

1. Type of Resources

The INR is calculated by determining the percentage of the total direct costs of the Institute that the total indirect costs represent; in other words, the percentage of indirect costs. To determine this, the direct and indirect costs of the Institute's two sources of funding must be identified:

a. **The Regular Fund:** The Fund comprises the quotas that the Member States contribute on an annual basis, the amounts of which are established by the Inter-American Board of Agriculture (IABA), in accordance with the system for calculating quotas of the Organization of American States (OAS), as well as miscellaneous resources, which is income received by the Institute from interest payments, and the sale of equipment and services.

b. **External Resources:** These resources are received for the execution of contracts and agreements signed with institutions of the Member States, financing and cooperation organizations and other partner institutions. The INR is applied to these resources.

2. Structure of the Report: Direct and Indirect Costs by Funding Source

a. **Direct Costs:** These costs can be directly attributed to the core activity of the Institute, the provision of technical cooperation services. They are incurred when technical cooperation is provided through cooperation projects or activities included in the annual plans and the projects of the Competitive Fund for Technical Cooperation. The budget items included under the direct costs heading include international and local personnel; technical and training events; international and local travel; purchase of books and journals, publications and document reproduction; materials and supplies for projects; repairs and maintenance; telecommunications; public utilities; fuel; messenger service; customs charges; maintenance and repair of offices, machinery, equipment and furniture, vehicles and computer equipment; as well as rental of office space, equipment and vehicles, utensils and computer and multimedia equipment.

   The sources of direct costs are:

   - IICA technical cooperation projects and activities financed with resources of the **Regular Fund**, the costs of which are programmed in the IICA Offices in the Member States, the Directorate of Technical Cooperation and the Center for Strategic Analysis for Agriculture (CSAA)
   - Projects financed with **external resources**, the costs of which are programmed within the IICA Offices in the Member States, the Directorate of Technical Cooperation and the Center for Strategic Analysis for Agriculture (CSAA)
   - Contributions to CATIE

b. **Indirect Costs:** These costs are necessary for the operation of the Institute and essential to the provision of quality and timely services, but cannot be attributed directly to a specific technical cooperation project or activity. These costs are related to the strategic management of the Institute, the coordination of technical cooperation, external relations, institutional image, legal advisory services, services related to human resources, finance, accounting, programming and budgeting, auditing, and logistics (physical plant, technology infrastructure, security, janitorial, grounds keeping, public utilities, official hospitality, etc.).

   The sources of indirect costs are:

   - The "Complementary Technical and Administrative Structures" in the IICA Offices in the Member States, funded with INR resources
   - The Management, Technical Support and Corporate Services Units located at Headquarters, financed with Regular Fund and INR resources
   - General costs and provisions, such as the Governing Bodies, insurance, pensions of former Directors, contribution to the OAS Administrative Tribunal, External Audit; and other costs covered with quota, miscellaneous and INR resources for the SAP Financial System, and the housing allowance for International Professional Personnel

In sum, direct and indirect costs, calculated on the basis of the 2011 audited financial information, are shown in **Table 1**:

TABLE 1

Description	Total Resources	Regular Fund (quota and miscellaneous)	INR	External Resources
Total Direct Costs US$	**179,123,718**	**26,356,626**	**-**	**152,767,092**
%	**100.0%**	**14.7%**	**0.0%**	**85.3%**
Total Indirect Costs US$	**14,488,623**	**5,675,942**	**8,812,680**	**-**
%	**100.0%**	**39.2%**	**60.8%**	

c. **Determination of the Institutional Net Rate**

- Based on the audited financial data for 2011, the total indirect costs of the Institute are equivalent to 8.1% of the total direct costs of the Institute, as shown in **Table 2**. This rate does not take into consideration adjustments for loss of competitiveness and proportionality in the funding of the indirect costs, which is explained later in this text.

TABLE 2

Total Indirect Costs US$	**14,488,623**	**= 8.1%**
Total Direct Costs US$	**179,123,718**	

Table 3 shows this calculation in detail, based on the audited 2011 financial data.

TABLE 3

Inter-American Institute for Cooperation on Agriculture Institutional Net Rate[1]

Based on 2011 Audited Financial Data (without adjustments for competitiveness and proportionality) (US$)

Description	Total Resources	Quotas	Miscellaneous Resources	INR[2]	External Resources[3]
Direct Costs					
1.1 Offices	$ 169,613,367	14,447,551	3,298,293		151,867,523[4]
1.2 Regional	$ 3,582,366	3,582,366			
1.3 DTC*	$ 4,466,633	2,883,732	771,079		811,822[5]
1.4 CSAA*	$ 485,053	361,773	35,533		87,747
1.5 CATIE*	$ 976,300	976,300			
1.6 Other	$				[6]
Total Direct Costs	**$ 179,123,719**	**22,251,722**	**4,104,905**		**152,767,092**
Indirect Costs					
2.1 Offices	$ 4,551,214			4,551,214	
2.2 Regional					
2.3 DTC/CSAA*	$ 38,269			38,269	
2.4 Headquarters	$ 7,972,946	3,660,462	632,005	3,680,478	
2.5 General Costs	$ 1,048,993	1,044,526	4,467		
2.6 Other	$ 877,201	334,482		542,719	
Total Indirect Costs	**$ 14,488,623**	**5,039,470**	**636,472**	**8,812,680**	

Institutional Net Rate = Indirect Costs divided by Direct Costs:[7]

$14,488,622/ $179,123,719 = 8.089% (8.1%)

Institutional Net Rate: 8.1%

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[1] Based on final revenue and expenditure data for calendar year 2011 – December 31, 2011.
[2] This amount includes $8,737,023 of INR and $75, 657 of special contributions for Complementary Structures of the Offices.
[3]Includes only direct costs (total amount executed less amount of INR generated).
[4] Total external resources $154,676,352 less $1,161,563 exempt from INR, less $1,647,265 country contributions to cooperative projects or projects in support of integration = $151,867,523.
[5] Total external resources $870,197 less $58,374 exempt from INR = $811,822.
[6] External resources of $9,533 in this category not subject to INR.
[7] To recover the "Indirect costs" associated with the execution of external resources, you divide Total Indirect Costs by Total Direct Costs to obtain the percentage factor (the INR rate of 8.1%) to be applied to the Total External Resources Executed in order to recover the additional costs incurred resulting from the execution of external resources.

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*Notes for Acronyms:
1.3 DTC - Directorate of Technical Cooperation
1.4 CSAA - Center for Strategic Analysis of Agriculture
1.5 CATIE - Tropical Agriculture Research and Higher Education Center
2.3 DTC/CSAA - Directorate of Technical Cooperation / Center for Strategic Analysis of Agriculture

3. Calculation of the INR with Adjustments for Competitiveness and Proportionality

a. **Table 1** shows that 60.8% of indirect costs are financed with INR, while at the same time the percentage of direct costs related to external funds is 85.3%. This indicates that the Regular Fund is covering indirect costs in the amount of US$ 3.5 million which should be covered by the INR, determined as follows:

- INR should be generated at a rate of 8.1%: US$ 152,767,092 x 8.1% = US$12,374,134
- INR used in 2011 to finance indirect costs: US$ 8,812,680
- Amount in which the Regular Fund is financing indirect costs which should be financed by INR: US$ 12,374,134 (-) 8,812,680 = US$ 3,561,454

b. In addition, to regain competitiveness a 10% increase is included in indirect costs, financing with INR the corresponding proportion (85.3%) with INR. These calculations are performed as follows:

- A 10% increase is applied to total indirect costs (US$ 14,488,623), resulting in US$ 15,937,485 (US$14,488,623 x 1.1).
- The financing of the total indirect costs with the additional 10% (US$ 15,937,485) is divided proportionally between the Regular Fund (14.7%, US$ 2,345,074) and INR resources (85.3%, US$13,592,411).
- Thus, INR resources finance a further US$ 4,779,731 of indirect costs (US$13,592,411 (-) US$ 8,812,680).
- The financing of indirect costs in greater proportion with INR resources would free up US$3,330,868 in the Regular Fund. These resources, assuming the recovery of INR at the new rate is achieved, would be used to finance direct costs of the Institute's own technical cooperation, as well as covering the necessary increases in the direct costs of the Regular Fund to maintain or improve competitiveness.

c. Accordingly, the INR policy rate would be 8.9%, which is calculated as follows:

- Total indirect costs with 10% increase to maintain competitiveness (US$ 15,937,485) divided by the total direct costs (US$ 179,123,718), which amounts to 8.9%.
- An increase is not included in direct costs of externally funded projects, because these correspond to agreements and contracts for agreed upon amounts budgeted based on current costs.
- The direct cost increases in the Regular Fund are financed in the short term with the resources released from having to finance indirect costs, since the indirect costs would be financed in greater measure by INR funds as a result of proportionality.

Table 4 shows this calculation in detail, based on the audited 2011 financial information and the adjustments for proportionality and competitiveness.

TABLE 4

Inter-American Institute for Cooperation on Agriculture
Institutional Net Rate

Based on 2011 Audited Financial Data adjusted for Proportionality and Competitiveness

Description	Total Resources	Regular Fund (quotas and miscellaneous)	INR	External Resources
A. UNADJUSTED (Summary of Table 3)				
1. Total Direct Costs US$	179,123,718	26,356,626		152,767,092
%	100.0%	14.7%		85.3%
2. Total Indirect Costs US$	14,488,622	5,675,942	8,812,680	
%	100.0%	39.2%	60.8%	
3. Total Costs US$	193,612,340	32,032,568	8,812,680	152,767,092
B. ADJUSTED FOR PROPORTIONALITY AND COMPETITIVENESS				
4. Total Indirect Costs US$ with 10% Increase	15,937,484			
5. Proportional Financing of Indirect Costs with 10% Increase	15,937,484	2,345,074	13,592,411	
	100.0%	14.7%	85.3%	
6. Increase (Decrease) in Financing of Indirect Costs by Source of Funding	1,448,862	(3,330,868)	4,779,731	
7. Resources freed up from the Regular Fund and used/available to cover Direct Costs US$		3,330,868		
8. INR: Total Indirect Costs with 10% Increase (US$15,937,484) divided by Total Direct Costs (US$179,123,718) =				**8.9%**

Notes:

1. From Table 3.
2. From Table 3.
3. Sum of lines (1) and (2).
4. Total Indirect Costs from line (2) with an increase of 10% (for competitiveness).
5. Financing of Total Indirect Costs distributed in accordance with the proportion of Direct Costs of the Regular Fund and of External Resources, 14.7% to the Regular Fund and 85.3% to INR.
6. Variation in financing of Indirect Costs by the Regular Fund and with INR. Result of subtracting Line (2) from line (5).
7. Corresponds to the Indirect Costs to be financed with INR (as per line 5), which were previously financed by the Regular Fund (see line 2).
8. Total Indirect Costs with 10% increase to maintain competitiveness of line (5) (US$15,937,484) divided by the total of Direct Costs line (1) (US$179,123,718), which results in 8.9%.