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# Secretariat Responds to Concerns About the Indirect Cost Recovery Policy for International NGO PRs

Since the Global Fund's Indirect Cost Recovery (ICR) policy was adopted on 18 April 2011, a number of concerns have been raised about the interpretation and application of the policy. This article describes the concerns and provides responses from the Global Fund Secretariat.

The ICR policy applies to international non-governmental (INGO) principal recipients (PRs) and sub-recipients (SRs) that have certain services provided by their "headquarters" located in a country other than the country where the PR is operating. This can include regional offices of the INGO. The INGO PRs and SRs have to be able to demonstrate strong headquarters involvement in their operations.

According to the policy, for services provided by headquarters, an INGO PR can usually charge an overhead fee of up to 3% of the costs of procuring health products; up to 7% of other costs incurred by the PR directly; and up to 5% of the funds managed by SRs. The policy also sets out what percentage fees INGO SRs can charge.

The ICR policy states that the services provided by headquarters for which a percentage-based overhead fee can be charged include financial accounting, treasury management and reporting support; management support and oversight; human resources administration support; legal support; IT support; internal audit; routine technical assistance and capacity building of in-country staff and structures; and procurement services.

The ICR policy generally excludes national NGOs and UN agencies serving as PRs and SRs – except for one section that states that in exceptional cases, where a national NGO PR is managing multiple programmes and where calculating individual overhead costs is not practical due to the low value of the

Global Fund grant compared to other funding sources, a percentage-based charge may be applied.

Many of the concerns about the ICR policy were expressed by the Civil Society Principal Recipients Network (CSPRN) – see GFO articles here and here. GFO asked the Global Fund Secretariat to respond to some of these concerns. Andrew Hurst, Head of Media and Translations, responded on behalf of the Secretariat.

For the balance of article, we have adopted an ISSUE and RESPONSE format.

ISSUE: PRs say that despite the existence of a policy on ICR, there is a lack of understanding among local fund agents (LFAs) and fund portfolio managers (FPMs) of the concept of ICR and of the application of the policy – regarding, specifically, what expenses are allowed under the ICR policy.

RESPONSE FROM THE SECRETARIAT: The ICR policy was adopted in order to remove the uncertainties in grant agreement negotiations concerning what costs are allowed to be charged to a grant when some work related to the implementation of the grant is done by the head office of a PR in “another” country.

It is true that there are some inconsistencies in interpretation of the ICR policy. This is something we are working on through our quality control initiatives. The inconsistencies appear to be due to the fact that there is an operational policy note that requires that an annual report be prepared listing the overhead costs charged to a grant – i.e.  a report on what constitutes the amounts determined by applying the percentages under the ICR policy. Different actors may have had different interpretations of what this annual report should consist of, with some requesting a detailed breakdown and others just a high level statement.

The Global Fund is naturally cautious about allowing percentage-based unsupported amounts (ICR being the primary example) to be charged to its grants. ICR is seen as a potentially risky area to finance because of the lack of detailed supporting documentation required.

ISSUE: According to the LFA manual, LFAs are not supposed to require PRs to provide detailed breakdowns of ICR, yet this continues to happen.

RESPONSE: A detailed line-by-line cost breakdown supporting the ICR is not required. However, the LFA manual states that the PR needs prepare a narrative to explain the percentage amount in terms of the constituent costs.

When this requirement is combined with the operational policy note, which refers to the need for an annual report on ICR charged to a grant (see previous issue), it is reasonable to assume that the PR should provide at least a breakdown of the main cost types that make up the ICR. This enables the LFA or the Secretariat to make a judgement concerning the value obtained from the investment in ICR.

Some PRs, eager to prove that the ICR represents a reasonable recovery of real costs incurred, provide an annual statement of all institutional costs that are deemed covered by the ICR. They calculate the Global Fund proportion of these costs and compare this with the amount actually recovered. We are not aware of cases where the two sums are significantly different.

ISSUE: Costs that go directly towards strengthening the governance structure of an organisation or increasing office space are questioned by the Fund.

RESPONSE: Every dollar of a grant needs to be directly linked to the objectives of the grant. However, the Global Fund will fund costs that reasonably and directly mitigate risks associated with a grant. Such investments most often also improve the governance of the PR organisation. However, the Fund does not have sufficient resources to support strengthening governance as a separate activity. Across the whole portfolio, this would take funds away from activities directly linked to the fight against the three diseases.

The cost of office space may be covered if the PR can demonstrate that these costs are incremental to the management of the grant – for instance, additional space required to accommodate a larger project management team. If the costs are not incremental and are covered from other sources, they may not be charged against the grant.

ISSUE: There have been contradictory messages from LFAs and FPMs concerning how the ICR policy should be interpreted. For example, there have been instances of direct implementation costs incurred by the headquarters of the PR being treated as indirect headquarters support costs covered by the ICR fees.

RESPONSE: This has happened in some instances. Once a reasonable ICR percentage for INGOs has been agreed, there can be a tendency to be sceptical of additional direct charges. If the PR can demonstrate that they are absolutely essential, these costs may be accepted. This has happened, for example, in some of the very high-risk operating environments where PRs have requested higher-than-normal headquarters support to mitigate risks.

To ensure that there is no duplication or over-recovery of costs which are charged both through the ICR policy and as direct costs, the Global Fund scrutinises closely any additional direct costs requested to be sure that they would not fall under the coverage of the ICR and that they do, in fact, need to be incurred by the PR's headquarters.

ISSUE: The Global Fund is attempting to apply the ICR policy to grants signed before the policy came into effect.

RESPONSE: When the ICR policy was adopted, there may have been cases where it was applied immediately to grants whose agreements were signed prior to when the policy was adopted. If this was done, it would have been to correct a clear case of over-recovery on the part of the PR, and it would not have prejudiced the achievement of the objectives of the grant. Nor would it have prevented the PR recovering the real costs of doing business with the Global Fund.

In other cases involving grants that were already operating when the ICR policy was adopted, there has been a phased reduction of ICR rates over time to reach the rates contained in the policy.

Generally speaking, when the Global Fund issues a new policy that is designed to solve an issue that may have been the cause of a disagreement, it seeks to implement it promptly. If the application of a new policy were to result in a material change to the budget or even a reduction of the grant amount, this would require a change to the grant agreement. However, we are not aware of any instances where a grant agreement had to be changed as a result of the introduction of the ICR policy.

ISSUE: The Global Fund should develop an ICR policy for national NGO implementers.

RESPONSE: The situation of national NGO PRs is quite different from that of INGO PRs. For national NGO PRs, indirect costs are easily verified. This is the main reason why the two types of PRs are handled differently. The ICR policy is not intended to leave the national NGO PR any better or worse off than the INGO PR in terms of cost recovery.

To counter the criticism that the requirement to provide a breakdown of indirect costs is onerous for national NGOs, which may have fewer resources than their international counterparts, the Global Fund does allow some small amounts to be charged on a percentage basis, where the benefits of providing a detailed cost breakdown do not justify the costs. Furthermore, the Global Fund does allow indirect costs to be charged on a line-by-line estimated apportionment basis which, we believe, is not an unreasonable level of detail to demand.

ISSUE: The Global Fund should ensure that LFAs and FPMs correctly and consistently apply the ICR policy.

RESPONSE: In principle, we agree with this. Through our quality control initiatives, we endeavour to improve consistency throughout grant management. That includes the LFA services.

ISSUE: The Global Fund should indicate in its guidelines that reports of annual audits of the PR are sufficient to provide justification for the ICR charges.

RESPONSE: This is a sensible suggestion, provided the auditor's terms of reference specifically cover this issue of cost recovery. However, if the issue is not specifically addressed in the terms of reference for the audit, we do not believe that a standard audit scope of work would be sufficient to deal with the issue.

The Fund's ICR policy is contained in an operational policy note in Section 6.1.5 of "The Global Fund's Operational Policy Manual," available here.

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