Ken Filewood Consulting

FFA Cost Recovery Review

April 2007

Summary

In this report Ken Filewood Consulting reviews and recommends improvements to cost recovery arrangements at FFA, focusing on the following:

1. The methods FFA uses to determine overhead charges it applies to non-FFA funds.
2. The current funding and cost recovery arrangements for FFA's Vessel Register.

Key findings

FFC59/WP 6.6 FFA Future funding arrangements outlines FFA's current cost recovery policies in broad terms.

- The *guiding principles* shaping the policies[1] represent contemporary public sector management practice.
- With the reservation that there is no explicit consideration of economic incentives, the broad thrust of the policies addresses FFA's needs.
- The most important benefit of cost recovery for FFA is that it increases funds available to provide services to members.

Overhead costs

We strongly endorse the principle of recovering overhead costs to the General Fund, and support the use of staff costs as a basis for apportioning overhead costs to programs.

- After reviewing the rate of overhead cost recoveries based on the 2007-08 budgets, we conclude that a 66% charge on staff costs is appropriate for 2007-08.
- However, the 10% 'administration' charge FFA has previously applied to certain non-staff projects is inappropriate as it involves 'double-counting' of overhead costs.
- In addition, FFA lacks a clear policy framework to ensure consistent and transparent implementation of its cost recovery policies.

US Treaty administration budget

In the past, the US Treaty administration budget has subsidised the FSMA administration budget by paying the full cost of the staff that serves both programs.

- Correcting this would increase transparency and reduce the charge on the US Treaty.
- However, the terms of the FSMA agreement prohibit recovering overhead costs from the FSMA fund.

Vessel register & compliance funding

There appears to be an opportunity to improve funding arrangements for the VMS and Vessel Register.

[1] FFC59/WP 6.6 FFA Future funding arrangements, Attachment A items (i) through (vi).

- Although the MCS working group proposed that FFA dedicate the entire FFA Registration fee to the VMS and Vessel Register, we note that a FFC originally approved part of this fee as a fishery management fee, rather than an administration charge.
- It also appears that the current level of the FFA Registration fee is not based on the long run costs of operating, maintaining and developing the associated infrastructure.
- The VMS is a heavy user of specialised services from FFA's IT unit, and FFA should apply the related costs to the VMS fund.
- There is also an opportunity to simplify and increase transparency in funding compliance activities, in light of FFA's emerging compliance strategy.

Recommendations

General

R1 Develop and document clear cost recovery policy and guidelines for FFA.

Overhead charges

R2 Retain the principle of recovering overhead costs from FFA programs by apportioning the costs based on direct staff costs.

R3 Recalculate the Overhead Charge Rate each year based on a detailed analysis of the current budget, along the lines of the method at Attachment 6.

R4 Apply an overhead charge rate of 66% for the 2007-08 budgets.

R5 Abandon the policy of charging a 10% administration fee on certain projects.

US Treaty & Sub-regional Arrangements

R6 Apportion the staff costs of the Treaties and Sub-regional Arrangements Team between the US Treaty and the FSMA, based on managers' estimates.

R7 Amend the FSMA to permit FFA to recover indirect costs from the FSMA fund, and seek the agreement to apply the charges to the FSMA fund as an interim measure pending ratification of the amendment.

Vessel register

R8 Continue to pay the fishery management fee (60% of the former regional register fee) into the General Fund.

R9 Pay the balance of the regional register fee into the VMS Fund, and fund the integrated FFA Vessel Register from the VMS Fund.

R10 Review the long-run funding requirements of the Vessel Register, including an allowance for long term capital requirements, and adjust the FFA Registration Fee accordingly.

R11 Raise a direct IT services charge on the VMS fund to cover the estimated costs of providing IT project management and advice services to support the VMS.

R12 Make up any short-term cash flow needs of the Vessel Register from the VMS Fund Reserve and/or General Fund.

R13 Review funding options for a consolidated Compliance Fund to collect and disburse all monies involved in carrying out FFA's compliance-related activities.

Introduction

In this report Ken Filewood Consulting reviews and recommends improvements to cost recovery arrangements at FFA, focusing on the following:

1. The methods FFA uses to determine overhead charges it applies to non-FFA funds, such as administration fees applied to the US Treaty.
2. The current funding and cost recovery arrangements for FFA's Vessel Register.

Background

Cost recovery is a broad term covering the processes an organisation uses to recoup the expenses incurred in providing services from the beneficiaries of those services. The difference between cost recovery and other methods of raising revenue is that the main focus is on recouping costs, rather than profit-making.

Effective cost recovery is crucial to enable FFA to achieve its key goals in the areas of fishery management and fishery development.

- It reduces the drain on General Fund and Trust Fund revenues resulting from the need to subsidise non-core activities.
- This maximises the proportion of members' and donors' contributions available for the achieving key goals in FFA's strategic plan.
- Cost recovery also increases transparency and helps identify and eliminate cross-subsidies between different programs.
- It also enables FFA to ensure its compliance activities are adequately funded.

There are many different methods of setting cost recovery charges. But all of them must answer the following questions.

1. What are the services for which costs are to be recovered?
2. Who are the beneficiaries of those services?
3. What activities within the organisation produce the services?
4. How much does it cost to conduct those activities?
5. What proportion of the costs do we wish to recover from the beneficiaries?
6. In what units will beneficiaries purchase the services? (E.g. Annual licences, monthly accommodation, single observer trips, kilowatt hours).

A key step in this process is determining the total cost of the services. There are many different methods of assessing costs, ranging from subjective estimates through to calculations based on very detailed timesheets and financial reports.

- The best method for any organisation is the one which balances the organisation's need for precise cost estimates against the expense of calculating them.

Attachment 1 provides further details on the cost recovery process.

Which of FFA's services are subject to cost recovery?

Table 1 below summarises the cost recovery mechanisms of interest to this review.

- Attachment 2 contains a complete list of FFA's cost recovery mechanisms.

Table 1 – Cost recovery arrangements at FFA

Services	Paying beneficiaries	Mechanism
Compliance information		
Collect, maintain and report VMS data.	FFA vessels	Share of each FFA Vessel Registration fee.
Maintain and report on the FFA vessel register.	FFA vessels	Share of each FFA Vessel Registration fee.
Fishery management		
Deliver fishery management services.	Members	Member contributions.
	FFA Vessels	Share of each FFA Vessel Registration fee.
Treaties & arrangements		
Administer the US Treaty.	US Treaty parties	Payments from US Treaty EDF as per budget approved by FFC.
Administer the FSMA.	FSMA Vessels	Share of FSMA licence fees.
Administer the PNA.	PNA parties	Annual levy from PNA parties.
	FSMA parties	Charge on FSMA fund.
Project management		
Manage projects under contract.	United Nations European Union	Service fees as agreed under each customer contract.

Why review cost recovery at FFA?

FFC 59 approved new funding arrangements for FFA, resulting in important changes to FFA's cost recovery practices. The most important results were as follows.

- Applying overhead charges at the rate of 66% of staff expenses for the VMS, regional register, observer program and US Treaty.
- Applying a 10% 'administration charge' to all non-staff activities funded from the Trust Fund.
- Increases in fees paid by vessels for VMS registration and Regional registration, to allow for the effects of inflation since the fees were originally set.
- In some cases, the new overhead charges replaced pre-existing 'program support' charges, many of which had not been reviewed for several years.

At that time, FFA estimated that altogether the changes would increase revenue by $1.48 million during 2006, resulting in an increase in available funds in the General Fund of $2.076 million.

At their March 2007 meeting, the parties to the US Treaty reviewed the proposed Treaty Administration budget, with the following results.

- The parties expressed concern about the size of the 'program support' fee and questioned the way it was calculated, especially the 66% overhead charge.
- The meeting noted FFC's role in approving the Treaty Administration budget, and requested that FFA brief FFC about the issue.

In April 2007, FFA commissioned Ken Filewood Consulting to review cost recovery practices.

Purpose of the review

The purpose of this review is to help ensure FFA's cost recovery practices meet its needs.

The intended outcomes of the review are as follows.

- FFC is well-informed about cost recovery arrangements in place at FFA, and the rationale for those arrangements.
- Cost recovery policies recover appropriate amounts, especially as regards overhead cost recoveries from the US Treaty EDF.
- FFA is aware of any steps needed to improve cost recovery practices.

Scope

FFA asked Ken Filewood Consulting to focus its review in the following areas.

- Methods FFA uses to recoup FFA's overhead costs from the US Treaty administration budget and other sub-regional arrangements.

- The appropriateness of the 66% overhead charge applied on staff costs.

In the course of the research it became apparent that FFA also needed to clarify cost recovery arrangements for the Vessel Register, and it was agreed to include this topic in the scope of the report.

The following were *outside* the scope of the review.

- Analysing options and possible consequences of economic incentives in the fishery.
- Cost recovery arrangements that recoup part of the costs of overhead activities from sources other than FFA's major programs, i.e. direct charges levied on employees for housing, or service fees paid by other organisations to use office space at FFA.

Attachment 3 contains the full Terms of Reference.

Methodology

Ken Filewood Consulting reviewed FFA's cost recovery practices as follows.

1. Identifying FFA's cost recovery needs in consultation with management.
2. Researching and documenting the current cost recovery process.
3. Analysing the process in terms of its ability to meet FFA's needs.
4. Identifying opportunities for improvement based on the analysis.
5. Developing recommendations to improve the cost recovery process.

The main data sources for the review were interviews with the affected managers and analysis of key documents, including FFC papers, budgets and internal policies.

Findings

The following sections describe the main findings from the above research.

Cost recovery needs

The purpose of cost recovery at FFA is to improve FFA's ability to achieve the goals described in its Strategic Plan.

To do this, FFA needs cost recovery practices that achieve the following outcomes.

1. Provide economic incentives to fishery participants that support FFA's goal of sustainably managing and developing the fishery.
2. Ensure funds are available for its high priority fisheries management and fisheries development programs.
3. Ensure funds are available to maintain and develop key assets such as buildings and information technology infrastructure vital to delivering and improving services.

4. Avoid subsidisation of self-funded activities, such as administration of the US Treaty and the VMS, from member and donor funds.
5. Inform managers and stakeholders of the true costs of delivering each service.
6. Support effective stakeholder relationships.
7. Achieve items 1-6 above in a timely and cost effective manner.

Economic incentives excluded

The scope of this review precludes analysis of economic incentives in the fishery. But some of its recommendations may affect the fees recovered from certain fishers.

- Anecdotal evidence suggests that small fee increases are unlikely to harm members' long-run interests.
- But FFA is better qualified to assess this than the consultant.
- Accordingly we suggest that FFA consider any possible impacts on fishery activity before adopting proposals that alter fishers' economic incentives.

Source of the current policy

FFA's policies in relation to cost recovery are the product of its Financial Regulations, Staff Regulations and FFC decisions dating from at least as far back as the 1980's.

- The key policy document for the current review is <u>FFC59/WP 6.6 FFA Future funding arrangements</u>, at Attachment 4.
- But changing circumstances and ambiguities in the original paper seem to have caused FFA to apply minor variations from the policies FFC 59 endorsed.
- To account for this, we have also considered the draft 2007-08 budgets – which embody current practice – in conducting the following review.

Attachment 5 summarises FFA's current policy, as we understand it from FFC records, the draft budget and interviews with FFA managers.

Summary of the findings

<u>FFC59/WP 6.6 FFA Future funding arrangements</u> outlines FFA's current cost recovery policies in broad terms.

- The *guiding principles* shaping the policies[2] are consistent with FFA's needs and represent contemporary public sector management practice.
- With the reservation that there is no explicit consideration of economic incentives, the broad thrust of the policies addresses FFA's emerging needs
- For example, the policies adopted by FFC59 have increased the General Fund monies available for core fishery development and fishery management activities.

[2] <u>FFC59/WP 6.6 FFA Future funding arrangements</u>, Attachment A items (i) through (vi).

- We strongly endorse the principle of recovering overhead costs to the General Fund, and support the use of staff costs as a basis for apportioning overheads to programs.
- However, the method FFA used to calculate an overhead charge rate of 66% is methodologically invalid.
- And the 10% 'administration' charge FFA has applied to certain projects appears to be inappropriate as it involves 'double-counting' of overhead costs.
- There is also some confusion about the funding of the FFA Vessel Register, which FFA recently established by integrating the former VMS and Regional Register.
- A few other issues remain regarding cross-subsidisation and the funding of the observer program.
- In addition, FFA lacks a clear policy framework to ensure effective development and implementation of its cost recovery policies

The following sections address the most important of these issues in detail.

Governance

While the current cost recovery framework is a great improvement on preceding arrangements, it is not sufficiently clear to enable effective governance.

- <u>FFC59/WP 6.6 FFA Future funding arrangements</u> is the main source of current cost recovery policies.
- However, the paper is ambiguous, neglects some aspects of cost recovered services and addresses matters only at a high level.
- Also, there is a marked lack of internal documents explaining and defining the methods used to calculate costs and set cost recovery amounts.
- As a result, managers lack guidance in applying cost recovery principles and determining appropriate cost recovery charges.
- This appears to have contributed to some minor inconsistencies between the policies intended in <u>FFC59/WP 6.6 FFA Future funding arrangements</u> and their implementation.
- It seems FFA needs to develop and adopt a more detailed cost recovery policy to guide implementation of the broad principles FFC has approved.

Recommendation

R1 Develop and document clear cost recovery policy and guidelines for FFA.

The 66% overhead recovery charge on staff costs

A key element of cost recovery policy is the recovery of overhead costs by a charge on staff costs, initially described in FFC59/WP 6.6.

Table 2 – Existing overhead recovery charge on staff costs

Service/ Activity	**Overhead Charges**
Provide Executive, IT and Corporate support to the: - FFA VMS - Observer program - US Treaty administration - FSMA administration - PNA administration - Donor-funded staff positions in all functions.	66% of staff costs shown in the associated expenditure budgets[3]

General observations

FFA's current approach for recovering overhead costs appears reasonable and desirable, although there are some problems of detail.

- It is highly desirable for the General Fund to recover the costs of providing support services to programs funded from other sources. The main benefits are increasing the quantity of General Funds available to achieve the goals of the strategic plan, and better governance through increased transparency.
- The current policy correctly identifies the Executive, IT Unit and Corporate Services Division as the main sources of support services within FFA.
- However, only part of these costs can be treated as overhead costs, because the same areas also delivery direct services to members.
- Also, some other sources also reimburse part of the overhead costs, for example staff contributions to the Housing Fund.
- So, as the current policy recognises, only part of the costs of the Executive, IT Unit and Corporate Services Division can be properly attributed to overhead costs.
- We also note that the FSMA agreement *prohibits* FFA from recovering overhead costs for the administration of the FSMA.
- Finally, in FFA's case, using staff costs as the basis of apportioning overhead costs appears to offer a reasonable compromise between accuracy and simplicity.

The following sections offer more detailed comments on the policy.

Calculating total overhead costs

The specific figure of 66% FFA presented in FFC59/ WP 6.6 appears to be based on the following estimate of indirect expenses.

[3] FFA defines 'staff costs' as budgeted salary duty travel expenses.

Indirect Expenses = Total Cost of *Overhead Units*[4] x 66%.

This estimate seems to be based on the experience of the then Deputy Director General[5].

- It is fairly easy to refine this estimate by using specific figures from the current year budget, combined with lower-level estimates.
- As a result, it seems preferable to base the overhead charge rate on the current year budget and work program, rather than broad estimates.

Indirect expenses for 2007-08

Attachment 6 shows the proposed calculation of the overhead costs based on the draft 2007-08 budget. The key components of the approach used are as follows.

- The specific services provided by each of the Executive, IT Unit and Corporate Services Division are identified.
- They are classified as support services or core services. Core services include services delivered directly to other beneficiaries, e.g. organising FFC meetings.
- The costs of the core services are estimated using a variety of methods, and deducted from the total costs associated with the units.
- All costs recovered from other sources for providing support services are identified and deducted from the remainder.
- Based on this calculation we estimate that the total recoverable overhead costs for 2007-08 will be $2,247,484.
- We propose that FFA should use the former figure, as it is better documented and almost certainly a more reasonable estimate.

How FFA calculated the 66% overhead charge rate

Although it is not clear, it appears that in FFC59/ WP 6.6 FFA may have calculated the 66% overhead charge rate *on staff costs* as follows[6]:

Overhead Charge Rate = Indirect Expenses / Total Revenue * 2

If so, this method is inappropriate, as it does not take account of the quantity of staff costs over which indirect expenses must be apportioned.

- We note that in this formula, it appears that FFA used *Total Revenue* as a proxy for *Total Expenditure*; this may be acceptable if the budget is balanced, but it would be both clearer and more precise to use the Total Expenditure figure.

---

[4] The Overhead Units are the FFA executive, IT Unit and Corporate Services division

[5] FFC59/ WP 6.6 paragraph 42: 'Around one third of that overhead expenditure is used to provide services that can be regarded as core activities…' i.e. two thirds can be regarded as support services.

[6] FFC59/ WP 6.6 does not state this explicitly. We have inferred it from the text, especially paragraph 42: 'The total 2005 cost of [the overhead units]… represents around 50% of total revenue…'

- The main problem is that this expression calculates the charge rate applicable to *half of total expenditure* (staff plus non-staff costs), *not* the charge rate on *staff costs*.
- It is only a coincidence that the more precise calculation presented below also results in a figure of 66% for the 2007-08 budgets.

Alternative method

A better method of calculating the charge rate on staff costs would be as follows.

Charge Rate = Indirect Expenses / Total Program Staff Costs[7]

We calculated the 2007-08 charge rate by using the figure for Indirect Expenses of $2,247,484 above, and Total Program Staff Costs of $3,411,308 from the 2007-08 budget.

- The result is a 2007-08 overhead charge rate of 66% on staff costs.
- It is only a coincidence that this figure is the same as the rate proposed in 2005.
- As the details of the budget will change from year to year, we suggest that FFA recalculate the charge rate from the budget figures for each year, using a similar model to that at Attachment 6.

Recommendations

R2 Retain the principle of recovering overhead costs from FFA programs by apportioning the costs based on direct staff costs.

R3 Recalculate the Overhead Charge Rate each year based on a detailed analysis of the current budget, along the lines of the method at Attachment 6.

R4 Apply an overhead charge rate of 66% for the 2007-08 budget.

The 10% 'overhead' recovery charge on donor-funded projects

A second important element of FFA's cost recovery policy is the application of a 10% charge on certain projects[8].

Service/ Activity	Charges
Provide Executive, IT and Corporate support to non-staff donor-funded projects	10% on top of the direct project cost.

General observations

[7] By 'Program Staff Costs' we mean the staff costs associated with cost centres *other than* the overhead units, e.g. the Fisheries Management Division, Treaties & Sub-Regional Arrangements Team etc.
[8] Donor-funded staff positions are a source of staff costs and subject to recovery of the overhead charge on staff costs, originally set at 66%. See preceding section.

In FFC59/ WP 6.6 this charge is treated in a section on overhead charges[9].

- While it may be desirable to recover the costs of project management from donor funds, it is inappropriate to treat this as an overhead charge.
- On the other hand, if the charge is intended to recover a part of overhead expenses, it would be double-counting to recover the same expenses through the overhead charge on staff costs.
- So in the latter case, FFA should deduct the total amount raised from the net indirect costs to be apportioned to staff costs.
- But this would simply complicate the process without improving the result.

Applying a 10% project management fee

FFA could reasonably treat the staff costs incurred in employing an officer to manage a project as part of the costs of that project.

- In this case, the proposed rate of 10% would be consistent with general project management practice.
- And since project management is *not* one of FFA's overhead support services, these costs are *not* recovered through the existing charge on staff costs.
- Therefore it would be appropriate to recover them by a separate 'project management' charge on each project.
- However, all project management fees should be reimbursed to the source from which the expense of managing the project was originally paid.
- Where FFA funds the project manager's position from the General Fund, the fees should be paid into the General Fund.
- But where FFA funds the project manager's position from the Trust Fund, FFA should pay the fees into the Trust Fund.
- So wherever FFA proposes to levy a project management fee for a project manager funded from any source except the General Fund, this would create a cross-subsidy.

Recommendations

R5 Abandon the policy of charging a 10% administration fee on certain projects.

US Treaty administration

The FFC 59 decision had the following affects on the US Treaty administration budget.

- Deletion of a former 'program support', formerly set at $160,000 per annum.
- Application of an overhead charge of 66% of staff costs.
- Application of a 10% fee on non-staff projects.

---

[9] FFC59/Wp 6.6 Paragraph 59 (viii) *Overheads*.

- The following table details the current policy.

Policy dimension	Approved policy
Services	Administering the Multilateral Treaty on Fisheries.
Beneficiaries	Treaty parties
Activities	Activities of the Treaties & Sub-regional Arrangements Unit in administering the US Treaty.
Cost of activities	Staff costs of the Treaties & Sub-regional Arrangements unit, plus overhead costs calculated at 66% of staff costs. Direct cost of non-staff projects, plus 10% administration charge.
Unit of Service	Annual administration service fee deducted from US Treaty Economic Development Fund (EDF).

Cross-subsidies

The US Treaty administration budget is currently subsidising the FSMA administration budget and to a lesser extent the PNA administration budget.

- The subsidy arises because FFA charges the full costs of staff in the Treaties and Sub-Regional Arrangements Unit to the US Treaty administration budget.
- But these officers also contribute to the administration of both the FSMA and PNA.
- FFC59/WP 6.6 recognised this issue, and recommended that it be addressed later[10].
- We therefore suggest that FFA adopt measures to eliminate this problem in 2007-08.
- Given the small amounts involved compared with the cost of a time-recording survey, we suggest FFA apply managers' estimates to apportion the team's staff-costs between the three services.
- This would reduce the charge on the US Treaty administration budget, but it would increase the charges on the FSMA and PNA administration budgets.

Recommendations

R6 Apportion the staff costs of the Treaties and Sub-regional Arrangements Team between the US Treaty, FSMA and PNA based on managers' estimates.

FSMA administration

Table 3 below summarises FFA's current practices in relation to the FSMA administration budget.

[10] WCP xxxxx

Table 3 – Cost recovery from the FSMA Administration fund

Policy dimension	**Approved policy**
Services	Administering the FSMA.
Beneficiaries	FSMA parties.
Activities	Work carried out by members of the Treaties and Sub-regional Arrangements Team to administer the FSMA[11]. Non-staff costs of administering the FSMA. Subsidy to the PNA administration budget.
Cost of activities	Non-staff costs, plus administration charge calculated at 10% of value of donor-funded projects.
Unit of Service	Annual service fee deducted from FSMA Administration Fund.

FFA may not recover indirect costs

Current FFA cost recovery policy appears to contradict the terms of the FSMA.

- The policy approved by FFC59 requires FFA to charge for 'overhead costs' (i.e. indirect costs) associated with the FSMA.
- But the FSMA specifies that the administration budget shall 'consist *only of the direct costs* of… providing services in accordance with this arrangement'[12].
- Therefore it appears that FFA is currently obliged to fund the indirect costs of managing the FSMA from the General Fund.
- Alternatively, the parties may wish to consider amending the FSMA to permit the recovery both direct and indirect costs of administering the agreement.

Subsidy to the PNA administration budget

The FSMA administration budget currently subsidises the PNA administration budget by an annual payment of USD 75,000.

- FFA management advises that the same members are parties of the FSMA to the PNA and the FSMA, and that the transfer will continue only until the Vessel Day Scheme is operational.
- Therefore there seems to be no need to adjust the budgets.

[11] Note that this activity is not currently recognised in the Cost of Activities below, as the US Treaty Administration budget bears the full cost of the employees involved; implementing recommendation R6 will introduce staff costs to the FSMA administration budget.
[12] The Federated States of Micronesia Arrangement for Regional Fisheries Access, Article 8 (1) (g). Italics added.

Recommendations

R7 Amend the FSMA to permit FFA to recover indirect costs from the FSMA fund, and seek the agreement to apply the charges to the FSMA fund as an interim measure pending ratification of the amendment.

FFA Vessel Register

The FFA Vessel Register combines the two activities formerly treated separately as the VMS and the Regional Register.

- Table 5 below summarises FFA's current cost recovery practices in relation to the Vessel Register.

Table 5 – Cost recovery from the FFA Vessel Register

Policy dimension	Approved policy
Services	- Process vessels' registration applications. - Develop, maintain and report on FFA's vessel register. - Collect, maintain and provide VMS data. - Assist vessels install and maintain VMS transponders. - Develop the FFA VMS system
Beneficiaries	FFA vessels Members
Activities	- Management and administration. - Assessing applications and determining vessel standing. - Data entry of vessel and registration details. - Preparing and delivering reports from the VMS and register. - Assist vessels install and maintain VMS transponders. - Maintain and develop IT&T systems.
Cost of activities	Direct and indirect costs of the above activities consisting of: - Direct and indirect costs of FFA officers administering the system, including a 66% overhead charge. - A 10% levy on register-funded projects.
Unit of Service	Annual FFA vessel registration fee comprised of: - 100% recovery of VMS system costs, adjusted for inflation. - Nominal recovery of regional register system costs, based on an initial fee of $200 p.a., adjusted for inflation.

- The fee also includes a fishery management fee of $300 p.a., adjusted for inflation.

Structure of the FFA registration fees

The current FFA registration fee results from a change in 2006 that combined the formerly separate fees FFA charged for VMS registration and regional registration.

- The VMS project is fully self-funding, and retains its own VMS fund and reserve.
- Prior to FFC 59, FFA's regional register fee was set at $500 per vessel per annum, to be paid into FFA's General Fund.
- 40% of this fee ($200) was defined as a nominal administration fee; the remainder was defined as a 'fishery management fee'.
- FFC 59 agreed to increase the regional registration fee to allow for inflation.
- We suppose FFC intended the adjusted fee to retain its former structure, i.e. 40% administration fee plus 60% fishery management fee.
- However this intention is not explicit in the meeting records.

Effect of combining the finances of the VMS and the regional register.

The MCS Working Party has recommended that FFA treat 100% of the FFA Registration fee as joint revenue of the VMS and the regional register.

- We assume that the working party intends that the joint operation be self-funding.
- The main motives for this proposal appear to be to simplify administration and ensure that adequate funds are available for needed development of the register.

However, there are some problems with implementing the proposed change in this way.

- Firstly, doing this would have the effect of diverting that part of the FFA registration fee that FFC intends to support *fishery management* away from the General Fund, reducing the funds available for this core activity.
- Secondly, the value of the regional register fee ($500 plus inflation adjustment) was never based on the long run costs of operating the register.
- So applying this amount to the register may over- or under-fund the register in the long term. In the first case, this would make it difficult for FFA to develop the systems underlying the VMS and vessel register to suit members' needs; in the second case the result would be an inefficient use of funds, which could be better used elsewhere.
- A more useful approach might be to pay the amount of the former register administration fee (equal to $200 plus inflation adjustment) into the VMS fund, and manage the joint activity from a single fund.
- Under this arrangement, FFA would continue to pay the former fishery management fee (equal to $300 plus inflation adjustment) into the General Fund.

- This would preserve the status of the fishery management fee and simplify administration of VMS finances.

Long term funding

In the past, neither the VMS fee nor the regional register fee have been based on the long run costs of operating, maintaining and developing the underlying technologies.

- We note that FFA views that the original register administration fee equal to $200 plus inflation adjustment is inadequate to cover the costs of developing the vessel register.
- This is to be expected, since it appears that FFA regarded the original amount of $200 as a nominal amount, rather than an attempt to recover long-run costs.
- Also, in setting the annual level of VMS fees, FFA has tended to recalculate the fee each year based on current year funding requirements.
- The problem with this approach is that by failing to take account of long term capital renewal and development it reduces transparency, discourages forward planning and creates uncertainty for fishers, as the resulting fees vary widely from year to year.
- So it seems it would be helpful to assess the long run funding needs of the joint VMS-regional register operation, and adjust the fee accordingly.

Short term funding

It appears that the cash flow required to fund the register in the short term is almost certainly higher than long run average needs.

- This is because of a combination of factors, including a shortage of monies in the General Fund to maintain the register, failure to make provisions for capital renewal and improvements and the need for a one-off capital expenditure to enable FFA to integrate the former VMS register and the regional register.
- It would be more transparent to provide an explicit subsidy from either the Trust Fund or the General Fund to meet this short term need, than to divert fishery management fees intended for the General Fund.

Future developments

In the longer term, it may be useful to consider replacing FFA's VMS Fund with an industry-funded Compliance Fund.

- The Compliance Fund would receive the proceeds of FFA registration fees and fund the full range of FFA's compliance-related activities, including the VMS, the vessel register and other MCS activities.
- If combined with a coordinated and explicit policy on industry contributions, this would increase transparency, flexibility and administrative efficiency.

Recommendations

R8 Continue to pay the fishery management fee (60% of the former regional register fee) into the General Fund.

R9 Pay the balance of the regional register fee into the VMS Fund, and fund the integrated FFA Vessel Register from the VMS Fund.

R10 Review the long-run funding requirements of the Vessel Register, including an allowance for long term capital requirements, and adjust the FFA Registration Fee accordingly.

R11 Raise a direct IT services charge on the VMS fund to cover the estimated costs of providing IT project management and advice services to support the VMS.

R12 Make up any short-term cash flow needs from the VMS Fund Reserve and/or General Fund.

R13 Review funding options for a consolidated Compliance Fund to collect and disburse all monies involved in carrying out FFA's compliance-related activities.

List of recommendations

The following list contains all of the recommendations scattered throughout the section on Findings, above.

General

R1 Develop and document clear cost recovery policy and guidelines for FFA.

Overhead charges

R2 Retain the principle of recovering overhead costs from FFA programs by apportioning the costs based on direct staff costs.

R3 Recalculate the Overhead Charge Rate each year based on a detailed analysis of the current budget, along the lines of the method at Attachment 6.

R4 Apply an overhead charge rate of 66% for the 2007-08 budgets.

R5 Abandon the policy of charging a 10% administration fee on certain projects.

US Treaty & Sub-regional Arrangements

R6 Apportion the staff costs of the Treaties and Sub-regional Arrangements Team between the US Treaty and the FSMA, based on managers' estimates.

R7 Amend the FSMA to permit FFA to recover indirect costs from the FSMA fund, and seek the agreement to apply the charges to the FSMA fund as an interim measure pending ratification of the amendment.

Vessel register

R8 Continue to pay the fishery management fee (60% of the former regional register fee) into the General Fund.

R9 Pay the balance of the regional register fee into the VMS Fund, and fund the integrated FFA Vessel Register from the VMS Fund.

R10 Review the long-run funding requirements of the Vessel Register, including an allowance for periodic capital renewal and the adoption of new technologies, and adjust the FFA Registration Fee accordingly.

R11 Raise a direct IT services charge on the VMS fund to cover the estimated costs of providing IT project management and advice services to support the VMS.

R12 Make up any short-term cash flow needs of the Vessel Register from the VMS Fund Reserve and/or General Fund.

R13 Review funding options for a consolidated Compliance Fund to collect and disburse all monies involved in carrying out FFA's compliance-related activities.

Attachments

1. Cost recovery: Questions answered
2. FFA's existing cost recovery regime
3. Consultant's Terms of Reference
4. FFC59/WP 6.6 FFA Future funding arrangements
5. Terms of reference
6. 2007-08 Overhead charge rate

Attachment 1

Cost recovery: Questions answered

What is cost recovery?

Cost recovery is a broad term covering the processes an organisation uses to recoup the expenses incurred in providing services from the beneficiaries of those services.

- In principle, an organisation can apply cost recovery to any or all of the goods or services it provides.
- The aim may be to collect part or all of the costs of providing a given service, and different fee structures may be applied to different classes of beneficiary.
- Some organisations practice internal cost recovery, in which departments 'charge' each other for services each provides to other departments.
- The difference between cost recovery and other methods of raising revenue is that the main focus is on recouping costs, rather than profit-making.

Why is cost recovery important for FFA?

Effective cost recovery is crucial to enable FFA to help member countries by achieving its key goals in the areas of fishery management and fishery development.

- It reduces the drain on General Fund and Trust Fund revenues resulting from the need to subsidise non-core activities.
- This maximises the proportion of members' and donors' contributions available for the achieving key goals in FFA's strategic plan.
- Cost recovery also increases transparency and helps identify and eliminate cross-subsidies between different programs.
- Eliminating cross-subsidies is important, as it helps to ensure fair and economically efficient treatment of the beneficiaries of each of FFA's programs.

Cost recovery also enables FFA to maintain and improve its compliance-related activities, by ensuring they are adequately funded. And it can improve governance and cost efficiency by making the true cost of services more visible to FFC.

How can we decide how much to charge for cost recovered services?

There are many different methods of setting cost recovery charges. But all of them must answer the following questions.

1. What are the services for which costs are to be recovered?
2. Who are the beneficiaries of those services?
3. What activities within the organisation produce the services?
4. How much does it cost to conduct those activities?
5. What proportion of the costs do we wish to recover from the beneficiaries?
6. In what units will beneficiaries purchase the services? (E.g. Annual licences, monthly accommodation, single observer trips, kilowatt hours).

With this information it is possible to determine how much to charge each beneficiary for each *unit of service* it uses.

What is the best way to determine the cost of providing a given service?

Organisations use many different methods to determine costs, ranging from subjective estimates through to calculations based on very detailed timesheets and financial reports.

- Some methods are more reliable than others; but the more reliable methods are often more expensive to establish and maintain, as they require more data.
- The best method for any organisation is the one which balances the organisation's need for quality cost estimates against the expense of calculating them.

FFA's existing cost recovery arrangements

Services	Paying beneficiaries	Costs recovered	Mechanism
Vessel Register			
Collect, maintain and report VMS data.	FFA vessels	Current year direct spending, plus indirect costs calculated at 66% of direct staff cost, plus 10% of non-staff project budgets. Direct costs are recovered on a current-year basis, without long-term provisions.	Share of each FFA Vessel Registration fee.
Maintain and report on the FFA vessel register.	FFA vessels Members	Current year direct spending, plus indirect costs calculated at 66% of direct staff cost, plus 10% of non-staff project budgets. Direct costs are recovered on a current-year basis, without long-term provisions.	Share of each FFA Vessel Registration equal to 40% of former Regional Register fee. Payments from FFA's General Fund.
Observer program			
Provide observer services.	US Treaty parties	Current year direct spending, plus indirect	Payments from US Treaty EDF as per

Services	Paying beneficiaries	Costs recovered	Mechanism
- Provide observer placements. - Provide observer data. - Train regional and national observers. - Identified observer projects e.g. crewing project, turtle mitigation project.	US Treaty vessels & fishing industry FSMA vessels Donors	costs calculated at 66% of direct staff cost, plus 10% of non-staff project budgets. Direct costs are recovered on a current-year basis, without long-term provisions.	budget approved by FFC. Observer fees paid by US vessels and US industry under US Treaty. Share of FSMA licence fees. Payments from Trust Fund for some projects.
Fishery management			
Deliver fishery management services e.g. policy advice.	Members FFA Vessels	Fee equivalent to 60% of former Regional Register fee. There is no attempt to recover the full cost of services from industry.	Share of each FFA Vessel Registration fee. Part of member contributions.
Treaties & arrangements			
Administer the US Treaty.	US Treaty parties	Current year direct spending, including full cost of the Treaties & Sub-regional Arrangements Team, plus indirect costs calculated at 66% of	Payments from US Treaty EDF as per budget approved by FFC.

Services	Paying beneficiaries	Costs recovered	Mechanism
		direct staff cost, plus 10% of non-staff project budgets. Direct costs are recovered on a current-year basis, without long-term provisions.	
Administer the FSMA.	FSMA Vessels	Current year direct spending, excluding staff costs, plus 10% of non-staff project budgets. Costs are recovered on a current-year basis, without long-term provisions.	Share of FSMA licence fees.
Administer the PNA.	PNA parties FSMA vessels	Current year direct spending, plus indirect costs calculated at 66% of direct staff cost, plus 10% of non-staff project budgets. Costs are recovered on a current-year basis, without long-term provisions.	Annual levy from PNA parties. Share of FSMA licence fees equal to USD 75,000 p.a.

Services	Paying beneficiaries	Costs recovered	Mechanism
Project management			
Manage projects under contract.	United Nations European Union	Costs are not calculated.	Service fees as agreed under each customer contract.
Facilities management			
Staff housing.	Professional officers	Direct cost of rental payments.	Fortnightly salary deduction equal to 25% of actual or estimated market rent, up SBD 2,000 per month.
Office accommodation	Worldfish Japanese Government	Costs are not calculated.	Quarterly service fee at estimated commercial rate for space used.
Conference facilities.	Non-FFA conference centre customers.	Costs are not calculated.	Fee for service at estimated commercial rate.

Attachment 3

Consultant's Terms of Reference

FFC59/WP 6.6 FFA funding arrangements

2007-08 Overhead Charge Rate

This document shows a proposed method for calculating FFA's annual overhead charge rate on staff costs.

The procedure may be summarised as follows.

Step	Method	Results
1. Identify 'overhead services'	Review the functions of each part of FFA's organisational structure. 'Overhead services' are those services provided by one part of FFA to all other parts to support them in their roles.	The main 'overhead services' are: Supervision, management and controls provided by senior management. Office, transport and ITC facilities used by all employees. Support services such as human resource services, professional advice, travel and accommodation services, records management etc. The providers of these services within FFA are the Executive, Corporate Services Division and IT Unit.
2. Identify activities used in providing the services.	Identify the parts of FFA's organisational structure that provide the services. Identify in activities these work units carry out that do not contribute to providing the services. Review the functions of each part of FFA's organisational structure. 'Overhead services' are those services provided by one part of FFA to all other parts to support them in their roles.	The providers of these services within FFA are the Executive, Corporate Services Division and IT Unit. The activities of these units that do not contribute to the services include those involved in providing a range of other services, including 'core services' provided to FFA members. The main non-overhead activities are those involved in the providing the following services. Policy advice to members. Travel and conference services to members. Library and information services to members. IT project management and advice to the VMS manager. Office accommodation and IT infrastructure provided to other agencies. Conference facilities provided to other agencies.

Step	**Method**	**Results**
3. Determine the costs of the activities.	Estimate the costs of providing non-overhead activities in each work unit providing overhead services. Deduct it from the total amount budgeted for each work unit. Deduct from the budgeted amounts any revenue collected from other sources to recoup the costs.	The table 'Total Indirect Costs 2007-08' below shows this calculation for the draft 2007-08 budgets. **Total Overhead Costs =** **Total Expenses of Overhead Units –** **Cost of Core Services –** **Recoveries from Other Sources**. Note that the table identifies 1) the total cost of each overhead unit; 2) total deductions from this cost, equal to deductions for 'core services' (provided to members) and recoveries (fees collected for other non-overhead services provided to other parties); and 3) a net contribution to overhead for each work unit. The total net overheads for 2007-08 are estimated to be $2,247,484.
4. Determine what proportion of the costs to recover from beneficiaries.	The purpose of overhead recovery is to recover 100% of overhead costs from the activities using the associated services.	100% of the costs are to be recovered.
5. Determine what basis will be used to apportion the costs among the beneficiaries.	Consider what quantity or quantities determine the cost of providing the services (i.e. what drives the costs).	In the case of the overhead services, different factors would drive the amount of effort needed to support each team. For example, the main drivers for recruitment, supervision or payroll processing would probably be the number of employees in each team. But the main drivers for the cost of accountancy services would be the number of purchases made and the number of bank accounts maintained. After considering the options, we have used staff expense (consisting of salary plus duty travel expenses) as the basis for apportioning costs, because: - It is simpler to work with a single cost driver than several. - The number of officers in each area would be a reasonable proxy for many

Step	Method	Results
		other possible drivers, such as total non-staff expenditure or number of projects. - Senior officers (with high associated staff expenses) would tend on average to be heavier users of advice, travel and office services than junior officers (with lower associated staff expenses), and therefore should receive a higher share of costs.
7. Apportion the total overhead costs among the activities receiving the overhead services.	Calculate the Overhead Charge Rate. Use the rate to calculate the Overhead Charge for each work unit.	The calculation is as follows: **Overhead Charge Rate = Total Overhead Cost / Programs Staff Expense** **Unit A Overhead Charge = Unit A's Staff Expense x Overhead Charge Rate** Where: - Total Overhead Cost = $2,247,484, from the above. - Programs Staff Expenses is the sum of the staff expenses of FFA's *program units* (i.e. non-overhead units) - $3,411,308 in this case. - Note that the overhead units are *excluded* in calculating the Total Direct Staff Expenses; if they are included the resulting charge rate will fail to recoup the full value of the overhead costs from the non-overhead units. The second table below shows the results of this calculation for FFA.

Total Indirect Costs 2007-08

Unit/Division	Staff Costs	Non-Staff Costs	Total	Core services	Recoveries	Deductions	Overheads	Overheads	Basis for deductions
Executive	918,106	177,500	1,095,606	372,506	0	372,506	723,100	66%	34% of Total Costs
Corporate Services	827,602	756,785	1,584,387	95,035	98,400	193,435	1,390,952	88%	Cost of Chairman's travel & FFC meeting, plus 25% of travel officers estimated at 8% of Support Staff Costs. Recoveries include miscellaneous revenue, staff housing fund contributions and conference centre fees.
IT Unit	659,251	219,000	878,251	52,149	214,447	266,596	611,655	70%	Core services = 50% of Information Officer & Librarian; Recoveries = Estimated shares of IT Unit personnel.
Overhead Units	**2,404,959**	**1,153,285**	**3,558,244**	**519,690**	**312,847**	**832,537**	**2,725,707**	**77%**	
Vessel Register	743,247	1,964,705	2,707,952	2,707,952	478,223	3,186,175	-478,223	-18%	Recoveries include 60% of register income, estimated at 19% of total register income
MCS other	0	700,500	700,500	700,500		700,500	0	0%	
Observers	157,372	78,000	235,372	235,372		235,372	0	0%	
UST	339,495	270,163	609,658	609,658		609,658	0	0%	
FSM	9,950	361,114	371,064	371,064		371,064	0	0%	
PNA	114,320	33,000	147,320	147,320		147,320	0	0%	
Other Fisheries Operations	**1,364,384**	**3,407,482**	**4,771,866**	**4,771,866**	**478,223**	**5,250,089**	**-478,223**	**-10%**	
Fisheries Management	**1,215,418**	**3,001,926**	**4,217,344**	**4,217,344**	**0**	**4,217,344**	**0**	**0%**	
Fisheries Development	**831,506**	**1,104,214**	**1,935,720**	**1,935,720**	**0**	**1,935,720**	**0**	**0%**	
Program Units	**3,411,308**	**7,513,622**	**10,924,930**	**10,924,930**	**478,223**	**11,403,153**	**-478,223**	**-4%**	
Grand Total	**5,816,267**	**8,666,907**	**14,483,174**	**11,444,620**	**791,070**	**12,235,690**	**2,247,484**	**16%**	

Overhead Recovery Ratio 2007-08

Total Indirect Costs	**2,247,484**	**(A)**
Staff Costs, Program Units	**3,411,308**	**(B)**
Overhead Recovery Ratio	**66%**	**(A)/(B)**

Estimated overhead charges 2007-08

Unit/Division	Staff Costs	Overhead Charge	Non-Staff Costs	Total Budget
Vessel register	743,247	489,676	1,964,705	3,197,628
MCS other	0	0	700,500	700,500
Observers	157,372	103,682	78,000	339,054
UST	339,495	223,671	270,163	833,329
FSM	9,950	6,555	361,114	377,619
PNA	114,320	75,318	33,000	222,638
Other Fisheries Operations	**1,364,384**	**898,902**	**3,407,482**	**2,263,286**
Fisheries Management	**1,215,418**	**0**	**3,001,926**	**4,217,344**
Fisheries Development	**831,506**	**0**	**1,104,214**	**1,935,720**
Total FFA	**3,411,308**	**898,902**	**7,513,622**	**8,416,350**

Overhead Charge = Staff Costs x Overhead Recovery Ratio

Breakdown of 2007-08 IT Unit expenses by beneficiary

The following table shows the assumptions used apportioning the expenses budget of the IT Unit among the following services.

Non-project: Including IT overhead services, such as network maintenance, management and user support. This component contributes to total overhead costs.

FFA projects: Project management and advice services supporting FFA's general IT infrastructure. This component contributes to total overhead costs.

Member services: Library and information services provided directly to members by the IT Unit, including library. This component is a core service; it does not contribute to total overhead costs.

VMS projects: Project management and advice services supporting FFA's general IT infrastructure. This component is a direct service to the VMS program; this review proposes that the costs be recovered from the VMS program.

IT Unit - Contribution to indirect costs

	2007/08 Budget			Proportion					Allocation				
Staff Costs	Gfund Proposed	Tfund Proposed	Total Proposed	Non-project	FFA Projects	Member Services	VMS Projects	Total	Non-project	FFA Projects	Member Services	VMS Projects	Total
Manager Information Tech & Comm	157,315		157,315	80%	4%	0%	16%	100%	125,852	6,293	-	25,170	157,315
Systems Analayst	79,875		79,875	20%	16%	0%	64%	100%	15,975	12,780	-	51,120	79,875
Database Administrator	123,303		123,303	20%	16%	0%	64%	100%	24,661	19,728	-	78,914	123,303
Network Administrator	87,679		87,679	100%	0%	0%	0%	100%	87,679	-	-	-	87,679
Data Quality Officer	92,566		92,566	20%	16%	0%	64%	100%	18,513	14,811	-	59,242	92,566
Information Officer	91,266		91,266	100%	0%	50%	0%	150%	91,266	-	45,633	-	136,899
Helpdesk Officer	14,215		14,215	50%	0%	0%	0%	50%	7,108	-	-	-	7,108
Librarian		13,032	13,032	50%	0%	50%	0%	100%	6,516	-	6,516	-	13,032
Sub-Total	**646,219**	**13,032**	**659,251**						**377,569**	**53,612**	**52,149**	**214,447**	**697,777**
Duty Travel													-
Manager Information Tech & Comm	0		0	80%	4%	0%	16%	100%	-	-	-	-	-
Senior Analayst Programer	0		0	20%	16%	0%	64%	100%	-	-	-	-	-
Database Administrator	0		0	20%	16%	0%	64%	100%	-	-	-	-	-
Network Administrator	0		0	100%	0%	0%	0%	100%	-	-	-	-	-
Data Quality Officer	0		0	20%	16%	0%	64%	100%	-	-	-	-	-
Information Officer	0		0	50%	0%	50%	0%	100%	-	-	-	-	-
			0										
Sub-Total	0	0	0						-	-	-	-	-
Total Staffing	**646,219**	**13,032**	**659,251**						**377,569**	**53,612**	**52,149**	**214,447**	**697,777**