

Information Note no. 1 – March 2015

Cost increase assumptions and estimates – additional information and update

In its technical review of the PWB 2016-17 proposals, the Finance Committee considered the anticipated cost increases and welcomed the additional information provided by the Secretariat, which it requested be made available to all Members.¹ This note provides: i) an overview of the published cost increase estimates for 2016-17 and further information on inflation factors and breakdown of personnel services and goods and services so as to facilitate a more detailed review of the cost increase figures as presented in the PWB 2016-17; ii) an update to the cost increase estimates arising from the impact of the final 2014 actuarial valuation of staff-related liabilities related to the after-service benefit plans, and from a possible freeze of the net remuneration for professional staff during 2016.

Section I: Cost increase assumptions and estimates – additional information

1. The document C 2015/3 MTP 2014-17 (reviewed)/PWB 2016-17 includes an estimate of **USD 34.3 million** for cost increases in 2016-17 based on information available up to January 2015. The cost increase estimates result from the recosting of Regular Programme inputs (personnel, goods and services) from 2014-15 to 2016-17 levels to preserve the purchasing power of the net appropriation. The published estimated cost increases for 2016-17 comprise **USD 24.2 million** for personnel services and **USD 10.2 million** for goods and services.

2. The cost increase estimates are developed on a biennial basis from actual cost adjustments that are occurring in the current biennium (*biennialization*), and projected adjustments to unit costs that will take effect in the next biennium (*inflation*).

- a) *Biennialization*, estimated at **USD 3.6 million**, is the incremental financial effect in 2016-17 of staff cost adjustments that are occurring in the 2014-15 biennium.
- b) *Inflation* represents the cost impact in 2016-17 of those adjustments that are expected to take effect from January 2016 through December 2017, estimated at **USD 30.8 million (USD 20.6 million** for personnel services and **USD 10.2 million** for goods and services).

3. This section elaborates on the information in the PWB 2016-17 relating to anticipated cost increases, in particular the inflation factors for *personnel services* and for *goods and services* shown in Table 4 and paragraph 149, including a breakdown of estimated inflation by expenditure category.

Personnel Services – inflation factors

4. *Personnel services* comprise all staff costs, including salaries, pension fund contributions, dependency allowances, social security and other staff-related entitlements and after-service benefits for both the professional and general service staff categories. The increases in personnel services costs derive from decisions regarding the UN common system, as reviewed by the International Civil Service Commission (ICSC) and approved by the UN General Assembly, and other external factors such as prevailing market exchange rates. This last element is particularly relevant for staff costs in those decentralized offices where local currencies strengthen against the US dollar. The ICSC increases apply by location and staff category when they occur.

5. As described in paragraph 149 of the PWB 2016-17, an inflationary cost increase of USD 20.6 million is foreseen for personnel services based on estimates for the various components, including:

- a) Various levels of inflationary increases projected for professional and general service salaries in decentralized locations, taking into account factors such as inflation, exchange rate

¹ CL 151/3 Report of the 157th Session of the Finance Committee (9-13 March 2015)



fluctuation and recent past patterns of increases. The EIU Consumer Price Index (CPI) forecasts range from a low of 2 percent increase for Liaison Offices and Europe non-headquarters locations to a high of 8 percent increase in Africa and Near East region in both 2016 and 2017, in line with the CPI for the countries where FAO has a significant presence. For example, inflation rates in Ghana, where FAO has a regional office, are forecasted at up to 13.7 percent for 2016 and 10.8 percent for 2017.

- b) A slight increase of 0.2 percent and 0.9 percent applied to professional staff salaries at headquarters in 2016 and 2017 respectively, in line with the EIU CPI forecasts for Italy.
- c) No increase for general service staff at headquarters applied for 2016, and a 1 percent increase for 2017, well below the EIU Average Nominal Wage Index currently at 1.2 percent in 2016 and 1.4 percent in 2017 and CPI in Italy.
- d) No increase applied for the cost of the basic medical insurance plan, taking account of the medical insurance contract. This is a particular area of risk that will be closely monitored.
- e) No increase applied for education grant costs in 2016, and a 2 percent increase applied for 2017.
- f) An annual increase of 2 percent is projected for entitlement travel costs, taking into account as an average the increase in the CPI for various duty stations, and the exchange rate fluctuation.
- g) No increase is anticipated for the current service cost of after-service staff benefits in the future actuarial valuations. The estimates in the final actuarial valuation reports as at 31 December 2015 and 2016 will be the base for 2016-17 expenditures. This remains a high-risk area to be managed during implementation.

6. Table 1 provides a breakdown of the inflation factors used to arrive at the inflation cost increase of USD 20.6 million for personnel services in the professional and general service staff categories. The inflation factors are provided by staff cost element and where appropriate by location in columns (f) and (g). They are derived from external forecasts by the Economist Intelligence Unit (EIU), such as Consumer Price Index (CPI), Average Nominal Wage Indexes (ANW), and exchange rates by location; published data of authoritative bodies such as the ICSC; and independent verification, as indicated in column (g).

Goods and Services – inflation factors and expenditure breakdown

7. *Goods and services* include other non-staff human resources (i.e. consultants), travel, general operating expenses, contracts and other (e.g. furniture and equipment). In developing the cost increase estimates for goods and services, an analysis was undertaken of likely expenditure patterns by cost category based on actual 2014 expenditure. The expenditure pattern in 2016-17 for goods and services is assumed to be similar.

8. Table 1 provides information on the inflation factors used to arrive at the inflationary cost increase of USD 10.2 million for goods and services by cost category. The estimates are derived from the EIU CPI and independent verification from other sources. The average of CPI World (3.1 and 3.3 percent for 2016 and 2017, respectively) and CPI Italy (0.2 percent and 0.9 percent for 2016 and 2017) are applied to the costs of all locations to budget the total cost increase. The presumed breakdown of the cost increases by six expenditure categories is also shown.

Table 1: Breakdown of total cost increases by cost element and location (USD million)
(Elaboration of Table 4 of C 2015/3)

Element	PWB 2016-17 (C 2015/3)						Reference / Source Inflation for 2016-17
	Proposed NAP at 2014-15 cost a	Biennializ ation b	Inflation c	Total Cost Increases d = b+c	Percent cost increase (biennial) e=d/a	Annual Inflation for 2016 & 2017 f	
Personnel services							
Professional staff							
Salary (Headquarters)	229.7	(2.8)	1.2	(1.6)		0.2% 0.9%	HQ: EIU CPI Italy 0.2%, -0.4%, 0.2%, 0.9%
Salary (non-Headquarters duty stations)	135.5	(10.5)	11.6	1.1		2-8% 2-8%	Non-HQ: EIU CPI <ul style="list-style-type: none"> • Europe (non-HQ): Euro Area 0.6%, 1.1%, 1.4%, 1.5%, Hungary 0.0%, 1.9%, 2.5%, 2.2%; Turkey 8.9%, 7.9%, 6.3%, 4.9% • Africa & Near East Region: Egypt 10.7%, 10.9%, 8.3%, 8.3%; Tunisia 5.7%, 5.2%, 4.4%, 4.2%; Ghana 15.0%, 14.2%, 13.7%, 10.8% • Asia & Pacific Region: Asia and Australasia excl. Japan 4.0%, 4.2%, 4.2%, 4.3%; ASEAN 4.4%, 5.3%, 5.7%, 5.4%; Thailand 2.1%, 3.2%, 4.0%, 4.7%; South Asia 7.9%, 7.7%, 6.9%, 6.5% • Latin America and Caribbean: Latin America 10.4%, 9.0%, 7.6%, 7.0%; Mercosur 17.8%, 15.0%, 12.0%, 10.7%; Andean Community 3.4%, 3.5%, 3.6%, 3.5%; Chile 4.3%, 3.7%, 3.1%, 3.0% • Liaison Offices: USA 1.8%, 2.1%, 2.2%, 2.3%
Pension	72.5	(2.1)	1.0	(1.1)		1.0% 1.0%	EIU CPI USA 1.7%, 1.5%, 2.1%, 2.3% Effective date: 1 February each year
Education Grant	27.0	3.2	0.3	3.5		0.0% 2.0%	
Entitlement Travel	13.2	0.8	0.4	1.2		2.0% 2.0%	EIU CPI World 3.0%, 2.8%, 3.1%, 3.3%
Medical Cost	15.1	(2.2)	0.0	(2.2)		0.0% 0.0%	New contractual agreement for 2015-17.
Other Allowances - Recruitment and transfer allowances - Rental subsidy - Danger pay - Dependency allowance - Representation allowance	28.4	4.8	1.2	6.1		Various	EIU CPI World each year except for dependency allowance and representation allowance (increase in base salary) EIU CPI World 3.1%, 3.2%, 3.2%, 3.3%
Total - professional staff	521.4	(8.8)	15.7	7.0	1.3%		
General Service staff							
Salary (Headquarters)	81.4	0.0	0.4	0.4		0.0% 1.0%	HQ: Primary salary scale unchanged effective 1 November, 2010 EIU Average Nominal Wage Italy: 1.4%, 0.9%, 1.2%, 1.4%
Salary (non-Headquarters duty stations)	44.4	(0.1)	3.5	3.4		2-8% 2-8%	Non-HQ: In addition to CPI, Average Nominal Wage index used where available. EIU ANW Hungary 3.0%, 4.7%, 4.5%, 4.6%; Turkey 9.5%, 8.5%, 7.3%, 6.5%; Egypt 10.3%, 10.6%, 9.0%, 9.4%; Tunisia 3.4%, 3.8%, 4.0%, 4.2%;

PWB 2016-17 (C 2015/3)							
Element	Proposed NAP at 2014-15 cost a	Biennialization b	Inflation c	Total Cost Increases d = b+c	Percent cost increase (biennial) e=d/a	Annual Inflation for 2016 & 2017 f	Reference / Source Inflation for 2016-17 g
							Thailand 4.0%, 5.0%, 6.5%, 7.0%; Chile 5.6%, 5.7%, 5.9%, 5.8%
Pension	24.8	0.0	0.8	0.8		2-8% 2-8%	Same increases as salary applied.
Medical Cost	17.3	(1.4)	0.0	(1.4)		0.0% 0.0%	New contractual agreement for 2015-17.
Other Allowances - Dependency allowance - Danger pay - Language allowance	2.8	(0.3)	0.1	(0.2)		3.2% 3.3%	Various EIU CPI World 3.1%, 3.2%, 3.2%, 3.3% Same increase as salary applied to dependency allowance
Total – general service staff	170.7	(1.8)	4.9	3.1	1.8%		
Personnel services	692.1	(10.5)	20.6	10.1	1.5%		
After service benefits	62.4	14.1	-	14.1	22.6%	0%	End-2013 actuarial valuation and a preliminary estimated increase for end-2014 valuation
Total personnel services	754.4	3.6	20.6	24.2	3.2%		
Goods and services							
Consultant	113.2	-	2.8	2.8		1.5%	EIU CPI Italy 0.2%, -0.4%, 0.2%, 0.9%
General Operating Expenses	133.7	-	3.3	3.3		2.0%	EIU CPI World 3.0%, 2.8%, 3.1%, 3.3%
Contract	58.5	-	1.5	1.5			
Travel	70.5	-	1.8	1.8			
Non-Expendable Procurement	15.5	-	0.4	0.4			
Supplies and Materials	14.9	-	0.4	0.4			
Total goods and services	406.3	0.0	10.2	10.2	2.5%		
Corporate Income and Cost Recoveries (net)	(54.0)	-	-	-			
Other Income	(95.0)	-	-	-			
Total Income	(149.0)	0.0	0.0	0.0			
Grand total	1,011.7	3.6	30.8	34.3	3.4%		

Section II: Cost increase assumptions and estimates – updated information

9. The cost increases in 2016-17 were calculated based on information available up to January 2015. Since then two sets of information have become available which could change the cost increase estimates.

A. Final 2014 Actuarial Valuation of Staff-related Liabilities

10. The Organization annually obtains from an external actuarial firm a valuation of all the staff-related after-service benefit plans, which enables the Organization to determine its overall liabilities associated with plans and establish the annual related expenses. The results of the final 2014 Actuarial Valuation,² made available mid-February, update the assumptions made in preparing the estimated cost increases concerning After-Service Benefits³ of staff, as follows:

- a) In preparing the published PWB 2016-17 in January 2015, the biennial cost of the current service cost of After-Service Benefits was estimated at USD 76.4 million based on the 2013 Actuarial Valuation and a preliminary increase estimated during preparation of the 2014 Actuarial Valuation as shown in Table 2, row c⁴.
- b) Based on the final 2014 Actuarial Valuation that became available in mid-February, the current service cost of After-Service Benefits for 2016-17 has been revised downwards to USD 75.6 million for the biennium, as shown in Table 2, row f.

11. The valuation of the biennial current service cost of After Service Benefits as at end-2014 affects these costs in 2015 (managed within the 2014-15 appropriation) and the biennialization of these costs in the 2016-17 estimated cost increases. For 2016-17, the biennialized cost of After-Service Benefits is reduced by USD 0.8 million, from USD 14.1 million (Table 2, row b) to USD 13.2 million increase (Table 2, row e).

Table 2: Current service costs of after service staff benefits for Regular Programme (USD million)

C 2015/3 preparation (January 2015)		
PWB 2014-15 ⁵	a	62.4
PWB 2016-17 cost increases (biennialization)	b	14.1
PWB 2016-17 total amount after cost increases	c = a + b	76.4
Update based on 2014 valuation (February 2015)		
PWB 2014-15	d	62.4
PWB 2016-17 revised cost increases (biennialization)	e	13.2
PWB 2016-17 revised total amount after cost increases	f = d + e	75.6
Total amount after cost increases		
C 2015/3 preparation (January 2015)	g = c	76.4
Updated (February 2015)	h = f	75.6
Update based on 2014 actuarial valuation	i = h - g	(0.8)

12. As highlighted in the cost increase assumptions,⁶ the cost increase calculations assume that there will be no further increase in After-Service Benefits in the next two annual actuarial valuations (end-2015 and end-2016). Thus inflation for After-Service Benefits in 2016-17 remains at zero, as shown in Table 1 column (f). Any variance from this assumption in the next two annual actuarial valuations would affect actual expenditure during 2016-17 and would need to be managed within the

² FC 157/6

³ After-service Medical Coverage (ASMC), Terminal Payments Fund (TPF), Separation Payment Scheme (SPS), and Compensation Fund (CPRF)

⁴ C 2015/3 paragraphs 143 and 148c)

⁵ C 2013/3 Information Note 1 based on 2012 actuarial valuation

⁶ C 2015/3 paragraphs 149g) and 151

budgetary appropriation for the 2016-17 biennium and reflected under biennialization for the following biennium.

B. Potential Freeze of Net Remuneration for Professional Staff in 2016

13. The cost increase estimates assumed that the freeze of net remuneration for professional staff in effect during 2014-15 would be lifted in 2016 on conclusion of the ICSC review of the compensation package, without prejudging the outcome of these deliberations. If the freeze were to be continued in 2016, on which official communication is awaited, the estimated inflation of 0.2% on professional staff salaries at headquarters (Table 1, column f) would not eventuate. The estimated cost increase on this element would be reduced by USD 0.5 million (from USD 1.2 million to USD 0.7 million).

14. Concerning the cost of professional staff in non-headquarters locations, the cost of living is reviewed by the ICSC every four months. The majority of countries where FAO has a significant presence have relatively high CPIs relative to the comparator (New York) as shown in Table 1, which will result in professional staff cost increases in these locations.

C. Impact of updated cost increases on proposed level of Net Appropriation

15. Table 3 below reproduces the cost increase table presented in the PWB document (Table 4) with the revised figures based on the final 2014 actuarial valuation of After-Service Benefits and the possible freeze of net remuneration for professional staff in 2016. Row 2 column (c) reflects the updated inflation factor for salaries, and Row 3 column (b) reflects the new biennialization figure for after-service benefits.

Table 3: Summary of possible revisions to cost increases under the Net Appropriation in 2016-17 at 2014-15 budget rate of exchange (revision to Table 4 of C 2015/3)

(USD millions)						
	PWB 2016-17 Proposed Net Appropriation at 2014-15 costs	Biennialization	Inflation	Cost increases for 2016-17	Percent cost increase (biennial)	Percent of cost increase attributable to each cost component
	a	b	c	d = b + c	e = d / a	f
1. Personnel Services						
2. Salaries, Pension Fund Contributions and Allowances	692.0	(10.5)	20.1	9.6	1.4%	29%
3. After-service Benefits	62.4	13.2	-	13.2	21.2%	40%
4. Total Personnel Services	754.4	2.7	20.1	22.8	3.0%	69%
5. Total Goods and Services	406.3	-	10.2	10.2	2.5%	31%
6. Corporate and Other Income	(149.0)	-	-	-	0.0%	0%
7. Budget level for Net Appropriation and additional requirements	1,011.7	2.7	30.3	33.0	3.3%	100%

16. In summary, due to the downward revision of the biennialized cost of After-Service Benefits for 2016-17 and the possible freeze of net remuneration for professional staff:

- a) overall cost increase estimates would be revised downwards by USD 1.3 million from USD 34.3 million to USD 33.0 million as restated in Table 3 above.
- b) the proposed net budgetary appropriation (with cost increases) for the 2016-17 biennium would be revised downwards from USD 1,046.1 million to USD 1,044.8 million (at the 2014-15 budget rate of exchange).