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Agenda item 6

For approval

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UPDATE ON THE WFP MANAGEMENT PLAN (2008–2009)

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NOTE TO THE EXECUTIVE BOARD

This document is submitted to the Executive Board for approval.

The Secretariat invites members of the Board who may have questions of a technical nature with regard to this document to contact the WFP staff focal points indicated below, preferably well in advance of the Board's meeting.

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Should you have any questions regarding matters of dispatch of documentation for the Executive Board, please contact Ms C. Panlilio, Administrative Assistant, Conference Servicing Unit (tel.: 066513-2645).

* Finance and Legal Division

** Office of Budget and Financial Planning

DRAFT DECISION*

Having considered "Update on the WFP Management Plan (2008–2009)" (WFP/EB.A/2008/06-C/1) , the Board:

i) approves the policy for hedging the Euro component of Programme Support and Administrative expenses as outlined in this document, with effect from the 2009 budgetary period;

ii) approves the use of US$5 million from the General Fund for the establishment of an Emergency Security Fund; and

iii) approves the use of up to US$7.5 million from the General Fund for WINGS II as follows:

   a. US$5 million project risk contingency allocation to cover unexpected cost overruns; and

   b. US$2.5 million for change requests to allow the project to promptly incorporate high-value opportunities that arise during the realization phase.

* This is a draft decision. For the final decision adopted by the Board, please refer to the Decisions and Recommendations document (WFP/EB.A/2008/16) issued at the end of the session.

INTRODUCTION

1. With the approval of the "WFP Biennial Management Plan (2008–2009)"[1], the Secretariat reaffirmed its commitment to provide updates on the implementation of the Plan during the biennium. This is the second update for the current biennium.

BACKGROUND

2. The Management Plan used a needs-based methodology for programme costs, while the setting of the Programme Support and Administrative (PSA) budget took into consideration the expected level of resources, based on historical funding levels and expected reserves.

3. Recognizing that in a voluntarily funded organization funding required may not be available from donors, the Secretariat continuously reviews WFP's operational level, the expected level of funding and indirect support cost (ISC) income, to ensure the PSA expenditure levels are sustainable.

4. This update provides an overview of the changes in the Programme of Work since the approval of the Management Plan, along with the re-costing of these programmes; an overview of the projected resource level to fund the Programme of Work; and a forecasted opening and closing balance of the PSA equalization account based on the approved PSA appropriations and the General Fund.

5. The note also outlines issues related to the US$/Euro exchange rate and the effect this may have on the PSA budget; and the Secretariat's recommendation to hedge the exchange rate in order to provide greater budgetary certainty. It introduces strategies for dealing with the unfunded staff benefit liabilities recorded in the "Audited Biennial Accounts 2006–2007, Section II".[2] Finally, it includes a proposal for additional funding for WINGS II and an Emergency Security Fund.

WFP'S PROGRAMME OF WORK

6. In the Management Plan, WFP estimated that 7.81 million mt of food would be required for the biennium to address the food needs of 90 million beneficiaries at a cost of US$5.414 billion. In the first update on the Management Plan, presented to the Board in February 2008,[3] the Programme of Work was updated to include US$228 million in additional requirements for new, unforeseen needs and US$734 million in additional costs for original requirements, due mostly to increases in food and fuel prices.

7. Continued increases in prices have necessitated further re-costing of the original Management Plan requirements. In addition, new operational requirements have emerged.

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[1] WFP/EB.2/2007/5-A/1

[2] WFP/EB.A/2008/06-A/1/2

[3] WFP/EB.1/2008/6-D/1

Re-Costing the 2008–2009 Programme of Work

8. Since the finalization of the operational component of the Management Plan in mid-2007, the unprecedented rise in food prices, combined with the continued increase in fuel prices and the devaluation of the US dollar against most currencies, has changed many of the assumptions on which the operational Programme of Work was based.

9. In the February 2008 update on the Management Plan, the Secretariat estimated that it would require US$734 million in additional resources (US$786 including ISC) to implement the original Programme of Work. The update pointed out that commodity markets continued to be volatile and that further increases in prices were expected. The Secretariat undertook to conduct a detailed re-costing of all projects, the results of which are reported below.

10. The original requirements included in the 2008–2009 Programme of Work were re-costed to reflect new market conditions. All other factors – the volume of food, the composition of the food basket and the number of beneficiaries – were kept constant in order to isolate the increases in the budget that were due to cost increases.

11. As a result of the re-costing exercise WFP foresees its operational requirements being revised upwards by US$1.4 billion, a 26 percent overall increase for the biennium. A breakdown by cost component of the additional US$1.4 billion required due to the increase in costs is provided in Table 1.

TABLE 1: RE-COSTED PROGRAMME OF WORK

	Original Programme of Work (as in Management Plan 2008–2009)	Additional resources required due to cost increases (estimated)	Original Programme of Work, re-costed
Operational budget, by cost component *(US$ million)*			
Commodity cost	2 426.9	1 306.5	3 733.4
External transport	593.2	85.3	678.5
LTSH	1 475.8	(22.8) [4]	1 453.0
ODOC	292.1	4.1	296.2
DSC	626.1	46.0	672.1
Total operational budget	**5 414.1**	**1 419.2**	**6 836.8**
Programme of Work(including 7% ISC)	5 793.1	1 518.5	7 311.6

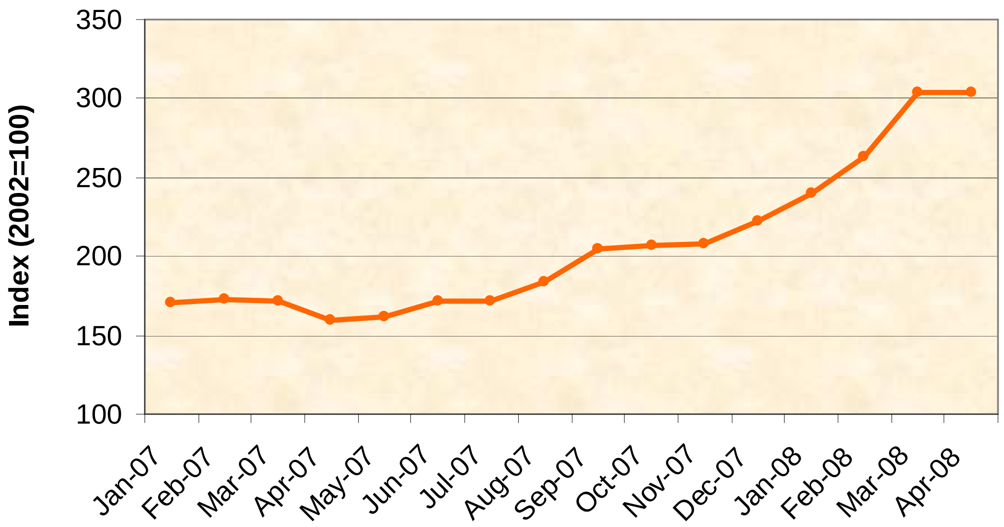
12. Some 92 percent of the overall increase is directly related to the increase in commodity prices. In the February update on the Management Plan, WFP estimated an increase in commodity costs for the biennium of US$519.9 million. As commodity prices continued to rise, the re-costing exercise indicated that WFP would require US$786.6 million over and above that figure, bringing the total increase in commodity costs for the requirements

[4] Includes a significant reduction in LTSH in the Sudan due to pre-positioning of food, enhancements to the transport infrastructure and previous investments in light vehicles.

outlined in the original Management Plan to US$1,306.5 million. The increase in associated costs due to re-costing is US$112.6 million.

13. In order to monitor food prices, WFP has developed a cereal index that tracks the price movements of the four cereals that make up the largest proportion of the WFP food basket: rice, maize, wheat and sorghum, which together represent 42 percent of the value of the food basket. Figure 1 illustrates the dramatic increases in commodity prices since the Management Plan was compiled.

FIGURE 1: WFP Cereal Index 2007-2008



Additional Requirements

14. Since the approval of the Management Plan in October 2007, new requirements have increased the Programme of Work by US$449 million.

15. In the February update on the Management Plan, the new operational requirements totalled $228 million. Since then, US$221.6 million of additional requirements have been identified, as outlined in the below table. The additional requirements consist of:

- new projects (mainly Special Operations (SOs))
- extensions of existing projects; and
- additional unforeseen requirements under existing projects. Additional requirements under existing projects cover the food needs of new beneficiaries, for example in Afghanistan, where WFP will provide food assistance to beneficiaries not previously targeted, to support vulnerable households impacted by the significant increase in wheat prices.

16. Table 2 provides an overview of the additional requirements since the February update on the Management Plan.

TABLE 2: ADDITIONAL REQUIREMENTS *(US$ million)*	
Management Plan original requirements	**5 414.0**
Additional requirements reported in the February update on the Management Plan[5]	228.0
Iraq and Syrian Arab Republic Regional EMOP	71.5
Sudan SO	41.7
Afghanistan PRRO	34.9
Humanitarian Response Depot SO	9.7
Emergency Telecom Cluster SO	6.0
Mozambique SO	3.4
Kenya SO	1.9
Ethiopia SO	1.3
Other adjustments (to 31 projects)	51.2
Revised operational requirements	**5 863.6**

Revised Programme of Work

17. The revised Programme of Work for the biennium 2008–2009 is US$7.792 billion (including ISC), which includes US$1.4 billion in additional costs required to implement the Management Plan 2008–2009 and US$449 million in additional operational requirements.

TABLE 3: REVISED PROGRAMME OF WORK				
	Original Programme of Work (as in Management Plan 2008–2009)	**Additional resources required due to cost increases (estimated)**	**Additional operational requirements**	**Total**
Operational budget, by cost component *(US$ million)*				
Commodity cost	2 426.9	1 306.5	237.2	3 970.6
External transport	593.2	85.3	40.7	719.2
LTSH	1 475.8	(22.8)	9.9	1 462.9
ODOC	292.1	4.1	92.1	388.4
DSC	626.1	46.0	69.7	741.8
Total operational budget	**5 414.1**	**1 419.2**	**449.6**	**7 282.8**
Programme of Work (including 7% ISC)	5 793.1	1 518.5	481.0	7 792.6

[5] WFP/EB.1/2008/6-D/1

18. Within the total estimated revised Programme of Work, US$4.3 billion relates to 2008 requirements and US$3.5 billion to 2009. The Secretariat is working to adjust all operational budgets to reflect the cost increases.

Projected Resource Levels

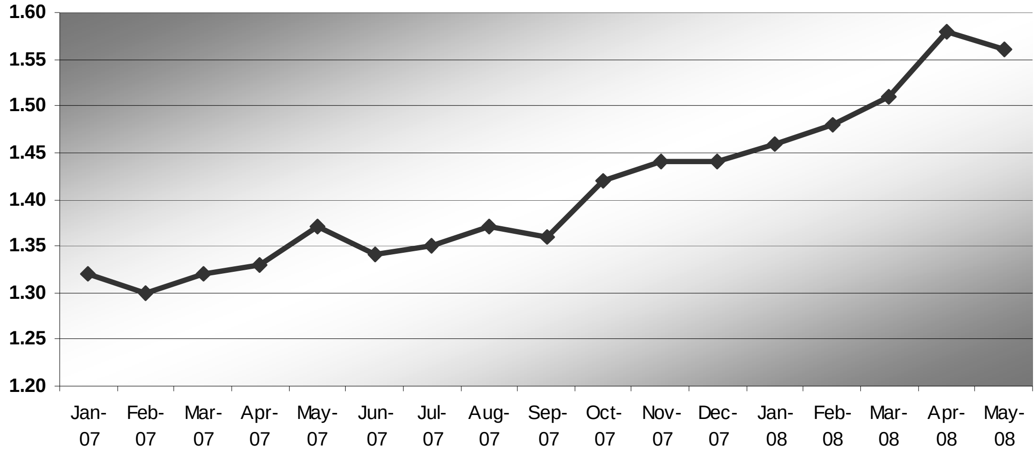
19. The 2008–2009 Management Plan was based on an overall income forecast of US$5.2 billion generating between US$311 and US$340 million of ISC income. This corresponded to a 90 percent funding of the original US$5.8 billion overall requirements.

20. The Secretariat has reviewed its income forecast for the biennium, in light of the large increase in the Programme of Work. Current forecast for the overall contribution income is US$6.4 billion, which would generate between US$385 and US$419 million in ISC income. This forecast will be updated as the response to the appeal to address the impact of higher food prices becomes more certain.

Proposed Hedging Policy

21. As outlined in the Management Plan, the PSA budget appropriation for the biennium was built on the assumption of a US$/Euro exchange rate of 1.33. Since the preparation and approval of the Management Plan, there have been significant changes in the currency markets, as shown in Figure 2. The exchange rate in May 2008 is 1.56, which is 23 cents above the rate embedded in the Management Plan assumptions.

FIGURE 2: Exchange Rate US$/€



22. As explained in the February update on the Management Plan, the Secretariat has calculated that each movement of one cent in the US$/€ exchange rate has an impact of US$1.06 million on the PSA budget. If the exchange rate between the US dollar and the Euro remains at the current level, the PSA budget will cost approximately US$24.4 million more than outlined in the Management Plan.

23. Given the large impact of the US$/€ exchange rate on the PSA budget, the Secretariat proposes that the Board authorize a standing hedging policy that would allow the Secretariat to always hedge the Euro component of the PSA budget for the following budget period.

24. Hedging the Euro expenditure would involve buying the right to purchase a determined amount of Euros at a fixed exchange rate. It is important to note that a hedge can result in either a financial gain or a financial loss. Should the market price of Euros in US$ terms be higher than the price specified in the hedging contract, the hedge would result in a gain, since the Secretariat would be able to buy at the lower contract rate. Should the market price of Euros be lower than the price specified in the hedging contract, the hedge would result in an opportunity loss, since without the hedging contract the Secretariat would be able to buy Euros on the open market for a lower amount of US dollars than specified in the contract.

25. The Secretariat is not in a position to predict market movements and thus the hedging policy serves only to remove one of the uncertainties in PSA planning and not to achieve financial gain. The hedging decision would need to be made six to nine months before the start of the biennium to ensure stability for the full PSA planning process through the inclusion of the hedged Euro/US$ rate in standard position costs and non-staff budgets. The hedging contract would need to be made before the planning process is completed and before the Executive Board has approved the PSA allotment for the period for which the hedge is being made.

26. The Secretariat therefore recommends adopting a policy to hedge the Euro-based parts of PSA expenditures that have predictable cash-flow patterns.[6] If approved, this policy would be applied with effect from the 2009 budgetary period; hedge contracts would be concluded immediately for the predictable Euro-denominated element of the 2009 PSA budget.

27. Such a policy would result in certainty of the US$ value of the Euro-dominated PSA expenditure and therefore greatly benefit the planning process, while the financial impact of the policy over time is expected to be neutral. The Secretariat will present the Board with regular updates on expenditures that are hedged and the financial impacts of such hedging.

Status of the PSA Equalization Account

28. The Management Plan 2008–2009 forecasted a 2007 year-end balance of US$11 million. According to the recently issued Financial Statements, the actual balance was US$8.6 million. However, as indicated above, the ISC income forecast has been revised upwards to reflect the increase in the Programme of Work. The latest forecast for the PSA equalization account is outlined in Table 4.

[6] The largest cost item that is effectively denominated in Euros is staff costs in Headquarters; this will be the focus of the hedging. The Secretariat will examine options for using hedging for some other non-staff costs also denominated in Euros.

TABLE 4: PSA EQUALIZATION ACCOUNT, 2008–2009	
	PSA Equalization Account forecast 2008–2009
1 January 2008 opening balance	8.6
2008–2009 ISC income	385.0
2008–2009 PSA expenditure	(345.0)
Projected foreign exchange impact	(24.4)
Income from unforeseen EMOPs	-
Balance before fund transfer	**24.2**
Transfer of DSCAF[7]	24.1
31 December 2009 forecast	**48.3**

29. The Secretariat recognizes the importance of keeping the PSA Equalization Account balance under review and will continue to monitor ISC income and PSA expenditures. The Executive Board will be updated on the status of this account throughout the biennium.

Status of the General Fund

30. The General Fund is an accounting entity used for recording ISC recoveries from projects and miscellaneous income that is not earmarked for any particular programme activity. The ISC income is recorded in the PSA equalization account, which is a subset of the General Fund. The main income source for the unearmarked portion of the General Fund is interest income; thus, market conditions and interest rates have a large impact on the General Fund. The latest forecast for the unearmarked portion of the General Fund is outlined in Table 5.

[7] EB Decision 2007/EB.2/4, para. iii. Note that this transfer was made on the basis of a lower ISC forecast and to ensure that the PSA equalization account did not go into deficit.

TABLE 5: UNEARMARKED PORTION OF THE GENERAL FUND *(US$ million)*	
	General Fund forecast
31 December 2007 balance	**52.8**
2008–2009 interest income	30.4
2008–2009 General Fund expenditures	
United Nations Department of Safety and Security (EB Decision 2007/EB.2/4, para. vii)	(26.6)
Private-sector fundraising loan (EB Decision 2008/EB.1/4)	(9.0)
Transition fund (EB Decision 2007/EB.2/4, para. vi)	(10.6)
Replenishment of operational reserve (draft decision iii of the Audited Biennial Accounts, Section I para. ii)	(5.9)
WINGS II (draft decision of this document, para. iii)	(7.5)
Security Fund (draft decision of this document, para. ii)	(5.0)
31 December 2009	**18.6**

31. The interest income forecast for the 2008–2009 biennium has been revised downward from US$60 million to US$30.4 million to reflect the reduction in interest rates by the United States Federal Reserve from 5.25 percent to 2.00 percent since September 2007. The credit and financial markets crisis has made it more difficult to predict investment income for the full biennium; the Secretariat will provide regular updates on the General Fund.

32. The opening balance for the General Fund has been revised upwards to US$52.8 million to reflect the information from the Audited Biennial Financial Statements (2006–2007).[2] This is US$34.8 million higher than the US$18 million balance projected in the Management Plan (2008–2009). The difference is largely due to interest income, currency exchange adjustments and miscellaneous income realized during the biennium, which increased favourably compared to income earned during the previous biennium. Interest income alone increased by US$36 million due to relatively high interest rate levels for most of the 2006–2007 biennium.

WINGS II

33. As explained in the document before the 2008 Annual Session of the Board "Update on the WINGS II Project", the WINGS II project is in the realization stage. WINGS II was allocated US$49 million by the Board. A significant proportion of the project expenditures are effectively denominated in Euros. The gradual appreciation of the Euro versus US dollar over the life of the project has put pressure on the WINGS II project budget. In addition, during the building and configuration phase, opportunities have been discovered to incorporate high-value changes that were not apparent during the design stage.

34. Therefore, the Secretariat is seeking two budgetary allotments from the Board for a total of US$7.5 million, comprising:

- US$5 million project risk contingency allocation to the WINGS II Special Account to cover unexpected cost overruns; and
- US$2.5 million allocation to the WINGS II Special Account for change requests (including US$1.5 million for PASport) to allow the project to promptly incorporate high-value opportunities that arise during the realization phase.

Security Upgrade

35. As noted in the document "Information Note on the Implementation of New Security Management Arrangements", a global review of the security arrangements of all duty stations is being undertaken within UNSMS. Although the full funding and cost implications for WFP are not yet known, it is likely to call for significant additional investments in security.

36. The Secretariat requests that the Board authorize the use of US$5 million from the General Fund to begin addressing the most pressing of the security needs described in the security management arrangements document.

Unfunded Staff Benefit Liabilities

⇒ *Background*

37. As reported in the "Audited Biennial Accounts 2006–2007" (EB.A/2008/6-A/1/2), WFP had fully recognized all staff liabilities as at 31 December 2007. The recognition of these staff liabilities was made following a recommendation by the United Nations Controller, recommendations by the External Auditor and the IPSAS requirement that all such liabilities be fully recognized.

38. Although WFP has fully recognized the liabilities, not all of them are funded. This section presents options for achieving full funding.

39. As at 31 December 2007, after-service benefits and other staff benefit liabilities totaled US$219.2 million, of which US$108.4 million was unfunded. Details of these liabilities are shown in Table 6.[8]

[8] "WFP Biennial Financial Statements (2006–2007): Section II", note 12C, page 27.

TABLE 6: STAFF BENEFIT LIABILITIES					
	(US$ thousand)				
	Actuarial valuation	**WFP valuation**	**Total staff liability**	**Funded liability**	**Unfunded liability**
Staff Benefit Funds					
Separation payment scheme	19 683	-	19 683	19 683	-
After-Service Medical Coverage	150 501	-	150 501	90 654	59 847
Compensation Plan Reserve Fund	3 019	-	3 019	539	2 480
	173 203	**-**	**173 203**	**110 876**	**62 327**
Other staff liabilities					
Accrued leave	3 720	16 615	20 335	-	20 335
Death grant	1 537	107	1 644	-	1 644
Repatriation grant	14 829	-	14 829	-	14 829
Education grant	-	4 138	4 138	-	4 138
Home leave travel	-	4 906	4 906	-	4 906
Other field-staff liabilities	-	193	193	-	193
	20 086	**25 959**	**46 045**	-	**46 045**
Total staff liabilities	**193 289**	**25 959**	**219 248**	**110 876**	**108 372**

⇒ *Funding*

40. It should be emphasized that these staff liabilities are related to past service and the full funding of such liabilities is not an issue unique to WFP.[9] The Programme has had to fund such liabilities in the past. However, they were funded on a "pay-as-you-go" basis: the liabilities were paid and charged against projects or PSA as they became payable, as part of the standard salary costs, and funds were not set aside to meet future payments. Neither projects nor PSA were charged with full accrued liability.

41. As it may not be realistic to expect an immediate full funding of all staff liabilities, the Secretariat suggests applying a phased approach to resourcing such liabilities, whereby funding is secured over several biennia.

[9] The United Nations Secretariat, for example, had unfunded liabilities of US$2.073 billion as at 31 December 2005.

42. The following funding options could be explored, either individually or in combination:

(i) the inclusion in management plans over several biennia of an amount for past-service staff liabilities, until the unfunded amount is fully amortized;
(ii) the inclusion of an amount in the standard salary costs for ongoing and future projects or PSA to provide full funding over the amortization period;
(iii) annual allocations from the General Fund;[10] and
(iv) the transfer of unspent project balances to fund past service staff liabilities (subject to donor approval where appropriate).

⇒ *Recommendation*

43. An initial review suggests the most appropriate option would be to fund these liabilities through inclusion of an amortization amount in the Management Plan or in standard staff costs. The Secretariat will examine the options more closely before reverting to the Board with more detailed recommendations.

Staffing issues

44. The update on the Management Plan to be presented in October 2008 will include a realignment of 2009 PSA to reflect the updated WFP strategy, along with progress on the implementation of organizational changes and their impact on staff.

[10] The General Fund was the source of the initial funding of after-service medical liabilities in 1999.

ACRONYMS USED IN THE DOCUMENT

DSC	direct support costs
DSCAF	Direct Support Cost Advance Facility
EMOP	emergency operation
IPSAS	International Public Sector Accounting Standards
ISC	indirect support cost
LTSH	landside transport, storage and handling
ODOC	other direct operational costs
PPRO	protracted relief and recovery operation
PSA	Programme Support and Administrative
SO	Special Operations
SO	special operation
UNSMS	United Nations Security Management System
WINGS II	WFP Information Network and Global System II