Programme Alimentaire Mondial

World Food Programme

Programa Mundial de Alimentos

برنامج الأغذية العالمي

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RESOURCE, FINANCIAL AND BUDGETARY MATTERS

Agenda item 5

For approval

BUSINESS PROCESS REVIEW: WORKING-CAPITAL FINANCING

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NOTE TO THE EXECUTIVE BOARD

This document is submitted for approval by the Executive Board.

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 the Supervisor, Meeting Servicing and Distribution Unit (tel.: 066513-2328).

The following changes arising from the Informal Consultation of 17 January 2005 have been incorporated into the text of this document:

1. Paragraph 24 first sentence ends "… is expected in 2005."
2. Paragraph 56 line 6 contains the expression "…loan of US$6.1 million in October 2004…"
3. In Table 2, the data is "as of end December 2004".
4. Paragraph 65: the sum referred to is US$4.1 million.
5. The heading preceding paragraph 71 is "Multi-Year and Multilateral Funding Commitments".
6. Paragraph 71 ends with the sentence "And of course, increased multilateral funding also greatly increases WFP's flexibility to meet its programme needs."
7. Paragraph 83, last sentence reads "…November 2003 and January and December 2004…"
8. Table 3, column 4, line 2 reads "Potentially non-recourse".
9. Paragraph 110: (i) the second sentence begins "Bearing in mind that the Executive Director would report to the Board periodically on the expenditures incurred during project preparation…"; (ii) the proposed wording of Financial Regulation 8.1 is: "Approval of a Country Programme, project or operation shall normally constitute authority for the Executive Director to issue allotments, incur obligations and expend resources for the Country Programme, project or operation, subject to signature of the Country Programme, project or operation agreement. However, the Executive Director may incur obligations and expend resources during project preparation, if necessary, to fill the food pipeline for the project for the first three months, not exceeding one quarter of total funding requirements."
10. Paragraph 117 includes after "implementation" the wording: "…including the use of working capital to fill the pipeline ahead of project approval. The Secretariat will report on overall 2005 results…"
11. Paragraph 118 point (9) ends "…within their ability to do so".
12. Annex I(a), Financial Regulations, column 2 Proposed Changes: the wording is the same as that given in point 9 above.
13. Annex IV: At the end of the table add: "7 December 2004 Informal Consultation with the Board".

EXECUTIVE SUMMARY

In March 2003, the Secretariat began a business process review designed to improve efficiency in WFP. It had two objectives: (i) to maximize the utilization of resources destined to projects and (ii) to improve on-time availability of food aid. The recommendations arising from this review were tested at the field level in a series of pilot projects starting in January 2004.

One of the recommendations of the business process review was to authorize spending against forecast contributions rather than confirmed contributions to maximize on-time availability of food aid. This working-capital financing of forecast contributions is a key component in achieving the two objectives, but several building blocks had to be put in place as conditions that would ensure prudent business practices to support working-capital financing with an acceptable risk level.

In February 2004, following a series of consultations, the Board approved the use of the Operational Reserve to finance five pilot projects on the basis of forecast contributions. In May and October 2004, the Secretariat updated the Board on the progress of financing, establishment of the building blocks and the pilot projects.

On the basis of progress in implementing business process improvements – the building blocks – and the demonstrated positive impact of working-capital financing in the pilot projects, the Secretariat requests the Board to approve two financial policy changes that will enable WFP to improve on-time availability of food aid.

In view of the positive programme results to date, it is clearly essential that WFP implement the changes identified as soon as possible: without them, as time passes fewer beneficiaries would be fed with the same level of donations.

The results of the pilot testing are clear:

- in five projects, 4.7 million more beneficiaries are being reached on time with the same level of funds; and
- there is a significant reduction in unspent programme balances as a result of better budgeting and planning and use of the single operational account approach at country offices.

DRAFT DECISION*

The Board takes note of the information and recommendations outlined in “Business Process Review: Working-Capital Financing” (WFP/EB.1/2005/5-C), and **approves**:

i. the establishment of a working-capital advance ceiling of US$180 million as per amended Financial Regulation 10.8 to enable the Executive Director to ensure continued financing of projects pending confirmation of forecast contributions within established risk-management parameters;

ii. the relevant changes in Financial Regulation 10.6 to allow the use of the Operational Reserve to cover cases where a working-capital advance is made but the forecast contribution(s) used as collateral for the advance do not materialize; and

iii. revision of Financial Regulation 8.1 to allow expenditures to be incurred during project preparation in order to fill the food pipeline in advance of the start date.

* This is a draft decision. For the final decision adopted by the Board, please refer to the Decisions and Recommendations document issued at the end of the session.

INTRODUCTION

1. In 2003, the Secretariat began a business process review (BPR) designed to improve efficiency in WFP, which has resulted in the development of a new business model that aims to (i) maximize the utilization of resources destined to a project and (ii) improve on-time availability of food aid in-country.

2. To start applying the new business model in real situations, in February 2004 the Secretariat implemented a pilot phase based on the following objectives:

   - validation of the proposed new business process improvements at the field level;
   - capacity-building in terms of personnel, tools and methodology for future implementation; and
   - preparation for implementation of the new business process across WFP, starting in 2005 and extending into 2006.

3. The purposes of this document are (i) to update the Board on the progress of BPR since October, (ii) to request regulatory and policy changes to ensure that WFP can maximize the utilization of resources and reduce balances, and (iii) to outline the next steps, including the plan for rolling out business process improvements to the top ten relief operations in 2005.

OBJECTIVES

4. In the last 15 years, WFP has evolved from a development to an emergency-response organization, but its business practices and processes have not kept pace with the evolution of its logistics and humanitarian-response capabilities. During the 2002 review of WFP's financial policies, it was concluded that a complete assessment of WFP's financial policies could not be completed until an assessment of current financial practices had been made. This resulted in the establishment of BPR in early 2003.

5. The objectives of BPR are (i) to maximize the utilization of resources destined to a project and (ii) to improve on-time availability of food aid in-country.

6. To achieve these, WFP had to update its business practices, which included reshaping several basic "building blocks" and provide "working capital" to operations based on their cash-flow needs.

BUSINESS PROCESS IMPROVEMENTS: BUILDING BLOCKS

7. WFP has identified ten areas in its business processes that require updating to enable on-time delivery of food aid to beneficiaries:

   - enhanced needs assessment;
   - enhanced project budgeting and approval;
   - enhanced project planning, execution and monitoring;[1]
   - donation forecasting;

[1] Includes enhanced financial planning and supply-chain planning.

- working-capital financing;
- resource assignment at the country office level with single-project accounts;
- prioritization of food aid;
- timely project closure and resource transfer;
- enhanced donor reporting; and
- augmented regional oversight.

8. Of these, two are absolute preconditions for future roll-out of working-capital financing, underpinning the new more efficient and proactive approach to managing resources. These are **enhanced project planning**, which results in improved expenditure forecasts, and **enhanced donation forecasting**, which provides the essential income forecast for each project. Without these two building blocks in place at the country level, country offices are not eligible for the additional flexibility of working-capital financing or the single project account.

DESCRIPTION AND STATUS OF BUILDING BLOCKS, IN PROJECT-CYCLE ORDER

9. **Enhanced needs assessment.** Following Board approval in October 2004, the Secretariat embarked on a comprehensive initiative to strengthen needs assessment at the country level. Priorities include (i) ensuring that all emergency operations (EMOPs) will be supported by rigorous assessment documentation to improve accountability and transparency, (ii) strengthening methodologies and guidance, including new and revised assessment handbooks, (iii) improving crisis information for selected emergency-prone priority countries and (iv) augmenting assessment capacities through partnerships and a learning programme. Roll-out is ongoing, with a focus on improving needs assessment in the top ten country operations.

10. **Enhanced project budgeting, preparation and approval.** Assessment of food-aid requirements is followed by establishment of the project budget. To prevent over-budgeting – one of the several causes of unspent balances – the pilot countries have prepared **multiple-scenario budgeting** that can adjust to operational changes based on predefined triggers. On the basis of testing in the pilots, a multiple-scenario budgeting methodology has been refined and is ready for roll-out to the next group of BPR countries.

11. Preparation and approval processes for EMOPs have also been streamlined. WFP has developed a fast-track approach so that donors can respond more quickly to emergencies and help WFP to fill the food-aid pipeline as soon as possible. The country office submits a two-page "EMOP outline" providing preliminary planning assumptions, an outline of the proposed intervention and a summary budget. This is reviewed by a streamlined project review committee prior to normal approval procedures. This approach should significantly reduce the lead times associated with project preparation and approval, and facilitate fundraising and expenditure of contributions.

12. Once the operation is under way, the country office will refine the operational plan and budget and undergo the normal review processes. Timeline: (i) enhanced project budgeting – design completed, implemented in pilot countries, and roll-out to at least the top ten relief operations in 2005; (ii) fast-track approval – completed.

13. **Enhanced project planning and implementation.** This is the foundation of the new business model at the country office level. It forms the prerequisite for working-capital financing and implementation of the single-account approach, and focuses on developing a project-planning tool linking the logistics and cash pipelines and establishing a monthly planning and review capability.

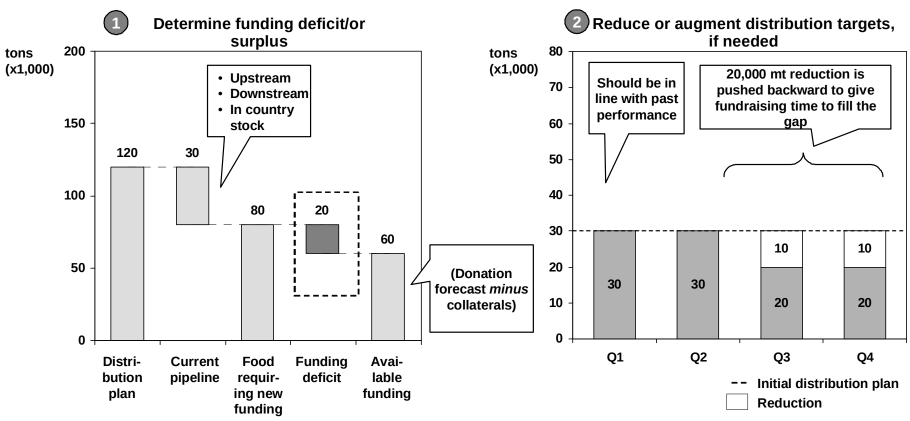
14. For the first time, a planning method linking the logistics and cash pipeline has been developed, driven by project requirements and dependent on the logistics corridor, commodity and type of financial commitment. In all the pilot countries, the country teams now know precisely what is needed and when in terms of food and cash and are thus in a position to request working-capital financing or to utilize the flexibility afforded by a single-project account.

15. For the first time, this planning tool can also provide donors with a fully integrated pipeline and donation schedule that shows monthly project needs. This building block is essential to qualify for financing: a country office must have this new more rigorous system of planning expenditures in place to qualify for a working-capital financing loan. Timeline: design completed, and implemented in pilot countries, and roll-out to the top ten country operations planned in 2005.

16. **Donation forecasting.** The forecasting methodology, developed by WFP and the Boston Consulting Group, has been further refined; donation forecasts have been prepared for all active pilots. The enhanced supply chain and financial planning provide the foundation at the country level and the basis for the expenditure forecast; the **donation forecast** is the second pillar, serving as the income forecast. In the new business model, projects should operate on the basis of forecast – but not confirmed – contributions. Programme expenditures will be sized to correlate exactly with income forecasts (See Graph 1).

Graph 1

BALANCE EXPENDITURE PLAN WITH DONATION FORECAST



17. The forecasts are prepared monthly, which means that the Democratic Republic of Congo (DRC) has already seen six iterations of the forecast since July 2004. The new donation-forecasting methodology is based on compiling and correlating "hard" and "soft" data for individual donors, associated with estimates of the probability that they will contribute to a project. Hard data include historical information mapping a donor's

contribution record; soft data include information on the global picture of a donor's attitude towards international assistance, its fiscal and budget policies and, most important, assessments from WFP's donor-relations officers. Matching spending patterns with income forecasts should eliminate unspent programme balances.

18. Status: Forecasting has improved since the last update in October as the fundraising team at WFP moves up the learning curve and donors become more aware of the importance of forecasting. The first forecasts for DRC, for example, were conservative, especially considering past resourcing history for this operation; recently, however, the level of forecast contributions has risen and much more detail of future income is being reported, which has enabled country offices to utilize working-capital financing to improve on-time availability of food aid.

19. A monthly income forecast must also be in place to qualify for a working-capital financing loan.

20. Timeline: Design and methodology completed and implemented in pilot countries; roll-out to the top ten country operations planned for mid-2005.

21. **Further decentralization: resource assignment at the country office level with single-project accounts.** In the old business model, resources were allocated by Headquarters-based groups; contributions were broken down into cost components such as commodity and transport before they reached the country office. This building block results in two important changes for country offices: first, country teams are responsible for programming their own resources and deciding how to spend their money; second, country offices have the ability to programme their own resources in a single-project account context. Country offices thus have the ability to offset temporary deficits in one area – for example, direct support costs (DSC) – with transport funds, which improves resource utilization and reduces excess balances.

22. This responsibility for allocating resources greatly increases project ownership at the country office level. The pilot countries now have direct control over spending their operational budget and for the first time have more direct access to spending their support costs – landside transport, storage and handling (LTSH), DSC and other direct operational costs (ODOC).

23. This new flexibility is counterbalanced by significantly increased risk management at the field level, including maintenance of more rigorous financial planning and improved regional oversight through the recently appointed regional financial analysts.

24. Design is complete and in place in pilots; a step-by-step roll-out to the top ten country operations is expected in 2005. Roll-out of some aspects across WFP, including decentralization of LTSH management, is also planned for 2005.

25. **Prioritization of food aid.** Once project-driven improvements such as better expenditure forecasting and donation forecasting are in place, WFP will be in a position to improve its global overview and prioritization of food aid worldwide to ensure that supply-chain activities such as procurement and shipping are begun first for operations with the most critical needs. This happens currently, but prioritization can be improved through closer links with the procurement and transport mechanisms of our in-kind donors and by improving WFP's internal supply-chain processes.

26. The recently launched Supply-Chain Optimization project will tackle this building block in 2005.

27. **Timely project closure and transfer of resources.** As reported previously, this is the last step in the life-cycle of a project, carried out just **before** the start date of a new project. When making the transition from one phase to a successive phase, it is imperative to ensure that any unused resources are deployed immediately in the successor programme. Timely project closure and quick transfer of any left-over resources clearly improve project management by avoiding multiple projects with the same objectives and beneficiaries, reduce the build up of balances and in some cases provide critical start-up capital for all follow-on projects. Over the past five years, WFP has averaged carry-over resources of 5 percent to 10 percent.

28. WFP has improved its closure procedures dramatically as part of BPR. Over 300 projects have been closed over the last two years. Since the beginning of last year, when the resource-transfer effort got under way, resources have been transferred to 32 projects, involving 152,000 mt and US$65 million. For the first time, projects are closing on time and millions of dollars are being freed for use in next-phase projects, subject to donor approval of re-programming. In every pilot project, transfer of resources from one phase to the next helped to alleviate months of shortfalls. In the old model, there would have been an appeal for additional funds for the new project, even though funds were potentially available for transfer.

29. Donors' understanding and agreement to allow WFP to transfer resources rapidly from one project phase to the next are critical to the entire effort. Without their agreement, WFP faces pipeline breaks and hungry people sometimes go unfed, even though resources may be available. Elimination of unspent programme balances through more efficient utilization of donor funds by matching programme spending with forecast donor contributions should in the longer term greatly reduce the need to transfer resources.

30. This building block has been completed, and procedures rolled out to all operations.

31. **Working-capital financing.** WFP's financial policies and practices have required it to finance all its work, with minor exceptions provided by the Immediate Response Account (IRA) and the DSC Advance Facility (DSCAF), with **confirmed** rather than **forecast** contributions. These effectively delay delivery of food from one to seven months, depending on whether a donation is cash or commodity-in-kind (CIK) and whether it requires purchase in a particular place, for example, or bag markings. These policies therefore restrict WFP from maximizing its throughput to ensure timely delivery of food to beneficiaries.

32. WFP is recommending several financial policy changes that will provide for adequate working-capital financing of its approved programmes, beginning in 2005 with the top ten EMOPs and protracted relief and recovery operations (PRROs), which are expected to account for 65 percent of its work. This will be covered in more detail in the following sections.

33. Risk analysis has been completed with the assistance of the Boston Consulting Group to minimize unreasonable risks associated with working-capital financing of forecast contributions, as detailed below.

34. The design is complete and tested; roll-out to the top ten EMOPs and PRROs is planned in 2005.

35. **Donor reporting.** As a result of improvements such as working-capital financing and the single-project account, WFP's reporting to donors on project performance will necessarily change, reflecting the more efficient and flexible utilization of resources. This set of activities, which comes at the end of the project, is one of the last building blocks to be completed. It is important that donors support the flexible use of resources, thereby

ensuring more effective pro rata reporting of project costs if WFP is to achieve the two goals set out in BPR. Local donor reporting is also enhanced through the monthly forecast model developed for country office budgeting and planning.

36. The plan is to implement donor reporting changes by mid-2005.

37. **Strengthened regional oversight.** In addition to the process improvements mentioned above, WFP has strengthened the financial oversight capacity of field operations by creating financial analyst posts in each regional bureau, with responsibility for (i) monitoring the budgetary performance of operations, (ii) forecasting and analysis and (iii) providing support for the BPR pilots. The financial analysts will monitor and manage the cash pipeline for all operations, which will be critical in rolling out the new business model.

38. Status: Regional financial analysts have been recruited for all six regional bureaux; five have already been deployed. They are playing a vital role in implementing the pilot projects and developing future roll-out in each region.

39. In summary, WFP is rapidly completing its internal business-process improvements and has put in place the building blocks to support further roll-out of working-capital financing.

Table 1

Process Improvements Implemented

Pilot project	Enhanced project planning, execution & monitoring	Donation forecasting	Working Capital Financing	Multiple scenario budgeting	Resource transfer	Resources Allocation at CO level Incl. single proj.acct	Enhanced Regional Oversight
D.R. Congo PRRO	✓	✓	✓	✓	✓	✓	✓
Palestinian Territories EMOP	✓	✓	✓	✓	✓	✓	✓
Indonesia PRRO	✓	✓	✓	✓	✓	✓	✓
West Africa Coast PRRO	✓	✓	✓	✓	✓	✓	✓
China CP	✓	✓	✓			✓ Planned for early 2005	✓

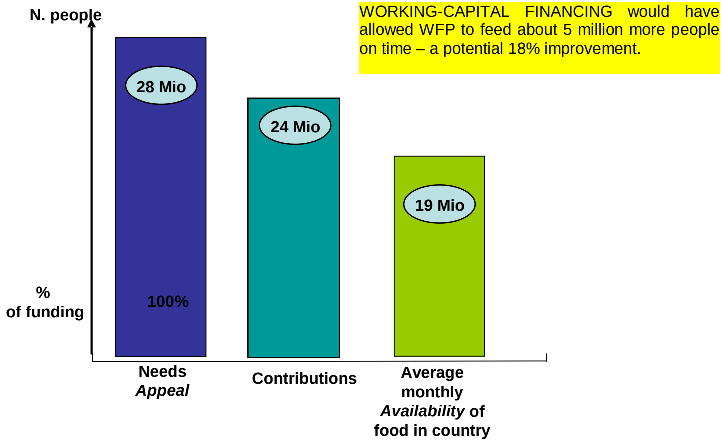
WORKING-CAPITAL FINANCING: BENEFITS AND IMPACT

Overview

40. In 2002, WFP's nine largest programmes targeted 28 million beneficiaries in their budgeted appeals. Donors funded these programmes sufficiently to reach 24 million beneficiaries. But only 19 million beneficiaries were reached on time, which implies a potential improvement of 18 percent, or 5 million beneficiaries, in these projects.

Graph 2

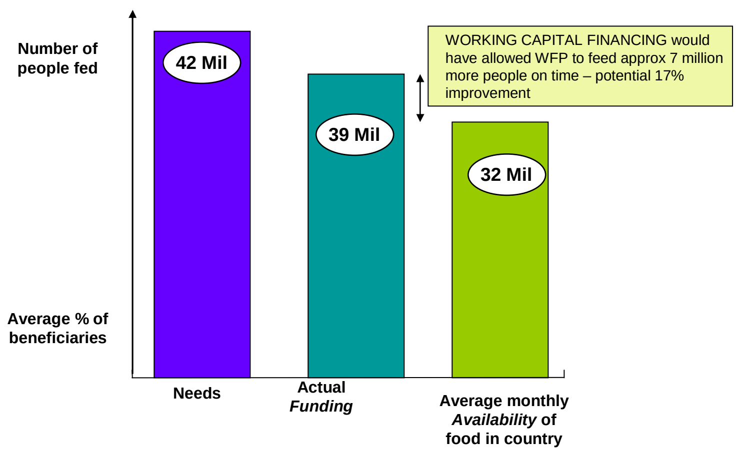
PERFORMANCE MEASUREMENT 2002
Based on 9 significant projects



41. In 2003, WFP’s top nine programmes targeted 42 million beneficiaries in their budgeted appeals. Donors funded these programme sufficiently to reach 39 million beneficiaries. But only 32 million beneficiaries were reached on time, which implies a potential improvement of 17 percent, or 7 million beneficiaries, in these projects.

Graph 3

PERFORMANCE MEASUREMENT 2003
Based on 9 significant projects



42. On the basis of this analysis and further evidence from the pilot projects, implementation of improved business practices – the building blocks – and working-capital financing, including advance purchase of in-kind contributions, will give WFP the potential to feed about 20 percent more people on time with the same resources and will greatly reduce balances through more timely processing of donations and elimination of unspent balances.

43. Time is the essential factor: the longer WFP waits to implement working-capital financing, the fewer needy people will be fed on time. The trade-off for taking managed business risks is the opportunity to feed 20 percent more people with the same level of donations.

Historical Basis of Working Capital Financing: the International Committee of the Red Cross (ICRC)

44. In adopting a model of financing its operations on the basis of forecast contributions, WFP is moving towards an approach that is common in the private sector. But this sort of working-capital financing also has a precedent among humanitarian organizations: over the last five years, ICRC has financed its operations using its existing working capital secured by forecast contributions.

45. WFP has collaborated with ICRC to understand how it could apply a similar approach. The ICRC financing system is based on the following:

- **Expenditure forecasting.** A pre-requisite to financing was a rigorous system of requirement forecasting at the delegation level – equivalent to the country office level. ICRC installed controllers to review forecasts on a regional basis; WFP has established analogous regional financial analysts in each regional bureau.
- **Income forecasting.** ICRC began by forecasting donations project by project; it now forecasts income for its entire portfolio of projects. It has taken ICRC several years to develop sufficiently sophisticated donation-forecasting skills.
- **Risk management.** ICRC manages two main risks. The first is the overall risk of a gap between income and expenditure. Management of this risk begins with the ICRC board setting up a level of acceptable loss for the year when it approves the annual budget, which encourages managers to maximize the utilization of resources. The second is liquidity, which is addressed by maintaining a commercial relationship with a bank. WFP does not have this risk, because its cash-flow situation is positive; it intends to leverage its own working capital as described below. ICRC has also established a comprehensive risk-management system, reducing risks associated with forecasts themselves and its own internal business processes.

46. WFP is grateful for ICRC's support and insights in developing its working-capital financing; both ICRC and WFP continue to share lessons learned.

Results of the Pilot Projects

⇒ *DRC*

47. As reported in October 2004, DRC requested and received working-capital financing of US$5.4 million in June 2004, after developing a rigorous forecast of requirements. Through this mechanism, WFP ensured that 700,000 beneficiaries in Eastern Congo received food aid during the last quarter of 2004, which translates into a 44 percent increase in on-time availability for the operation during the period. The loan was secured

with expected contributions as collateral that were confirmed in the second and third quarters of 2004 but would have been too late to avoid serious shortfalls later in the period on the basis of the current WFP model of matching spending to confirmed contributions.

48. To date, 80 percent of the working-capital loan granted to DRC has been repaid using contributions from various donors.

49. The tight linkage between forecast requirements and forecast income has ensured on-time availability of food aid and more efficient use of food and cash resources. The country office has more precise knowledge of what it needs and when and how much is available, which naturally leads to greater efficiency. No balances are expected at the end of this project.

⇒ *Occupied Palestinian Territories*

50. An analysis of expenditure and forecast income indicated the need for working-capital financing at the beginning of the project, because there were minimal resources left over from the previous project. The contribution forecast looked healthy, but contributions were not expected to allow the project to start on time; US$9.6 million was therefore advanced in July 2004, which ensured that 80 percent of targeted beneficiaries – 480,000 needy people – received food aid on time during the first quarter of the project.

51. WFP's only alternative would have been to advance funds from the IRA, but this would have absorbed 20 percent of available IRA funds that would be better utilized for unforeseen needs rather than as working capital in the normal course of business.

52. As of 15 December, 80 percent of the working-capital loan to the project had been repaid.

⇒ *Indonesia*

53. After project approval in early 2004, Indonesia had few confirmed contributions, insufficient to cover even two months of operational requirements with reduced rations. The programme in Indonesia is a targeted nutritional rehabilitation programme for small children; it has longer than average lead times for procurement of locally produced fortified biscuits and noodles; partial or late funding was not an option. Reliable funding upfront was needed even more than usual.

54. The Indonesia operation is historically well funded; it received a working-capital loan of US$4.8 million after developing detailed income and expenditure forecasts. This resulted in several benefits: (i) 1.6 million needy beneficiaries were fed on time; (ii) implementing partners were able to plan better; and (iii) WFP avoided negative publicity that could have resulted from lack of funding and ensured the Government's continued support for this vital intervention.

⇒ *West Africa Coastal PRRO*

55. This operation, approved in October 2004, was scheduled to begin in January 2005. WFP needs to fill the food aid pipeline three to six months ahead of the start date if distribution is to commence on time. Current financial rules stipulate that no expenditure may be incurred before a project is approved, so WFP was required to delay approval of a working-capital loan for this project until approval in October 2004. Because of this need to fill the food-aid pipeline well before the start date, WFP is recommending a change in the financial rules that will allow it (see paragraphs 106–110).

56. The early contribution forecasts were considerably below the recent resourcing history for this operation, and this initially limited the financing possibilities. Many of the forecast contributions also had conditions such as bag markings that made working-capital financing more difficult. The country team nevertheless put together a rigorous expenditure forecast using the new supply chain and financial planning tools, on the basis of which it received an initial working-capital loan of US$6.1 million in October 2004 to cover commodity and transport costs; in December, an additional US$4.15 million was granted to cover support costs associated with the commodities purchased with the earlier advance. With the working-capital loan, the country team will reach over 600,000 beneficiaries on time in the first quarter of 2005.

⇒ *China*

57. In a recent development, the Secretariat decided to put the Cambodia pilot on hold pending resolution of certain operational issues. China was selected as a replacement for two reasons: (i) it is important to test the impact of the new business model in a development context and to understand how working-capital financing can even out the peaks and valleys frequently associated with development funding and (ii) the selection of China ensures that WFP still has a pilot in the Asia region, which will be important for future roll-out.

58. As with the other pilots, income and expenditure forecasts were established; on the basis of forecast contributions US$4.1 million was granted in December 2004. This enabled WFP to reach 1.3 million beneficiaries on time. A portion of the loan was used to pre-purchase forecast in-kind commodities in Canada.

⇒ *Summary*

- ➢ In the five active pilot projects, 4.7 million more beneficiaries were fed on time.
- ➢ Pilot country offices have a significantly better knowledge of requirements and forecast income and have been able to plan their operations more effectively.
- ➢ There has been better planning not just for WFP, but also for implementing partners who count on WFP to provide food aid and cash resources on time.
- ➢ It is expected that no balances will be left over at the end of the pilot projects because commodities will have been purchased and distributed in anticipation of contributions that would have arrived at the end of the project.
- ➢ Working-capital loan history in the pilots at 15 December 2004 is shown in Table 2.

TABLE 2: DATA AS OF END DECEMBER 2004

Project	Loan (US$)	Date of loan	Repaid	Outstanding
DRC	5 399 812	June 2004	4 096 733	1 303 079
Occ. Palestinian Territories	9 600 000	July 2004	7 665 096	1 934 904
West Africa Coastal	10 250 000	October/ December 2004	0	10 250 000
Indonesia	4 800 000	October 2004	0	4 800 000
China	4 070 089	December 2004	0	4 070 089
Total	**34 119 901**		**11 761 829**	**22 358 072**

59. Almost US$20 million in working-capital loans were granted relatively recently, and all loans are expected to be paid back in full (See Annex II).

Working-Capital Financing and In-Kind Donors

60. The pilot projects show that the benefits of using working capital are significant for beneficiaries. But working-capital financing will only be effective in the long term if WFP can secure working-capital loans against in-kind contributions, because in-kind contributions represent approximately half of all WFP's funding.

61. Working-capital financing is not a single-step remedy: it is part of a comprehensive process of improving planning to meet needs, and is used only as a final option in WFP's attempts to prevent food shortages. As in the pilot projects, WFP will rely on other available levers such as using pre-positioned stock or regional borrowing prior to considering working-capital financing.

62. In recent months, WFP has collaborated with several of its main in-kind donors on ways to incorporate in-kind contributions into working-capital financing and ways to reach the common goal of improving on-time availability of food aid. Possible solutions include increased pre-positioning, streamlining donors' granting procedures and WFP pre-purchasing forecast in-kind contributions at its own risk.

63. Pre-purchasing involves WFP procuring in advance in-kind commodities in the country of origin on the basis of forecast contributions. If the forecast contribution materializes, WFP is reimbursed in cash by the donor, which allows food aid to arrive on time. As with all working-capital loans, if the forecast contribution does not materialize, WFP absorbs the risk.

64. Several in-kind donors have responded positively to exploring this approach. The United States has agreed to a pre-purchasing trial of a significant amount of commodities; WFP is working with several United States government agencies on the details.

65. Canada and Australia have also expressed support for this approach; US$4.1 million in wheat has been pre-purchased in Canada for the China pilot.

Expectations from the Donor Community

66. As described above, WFP is introducing fundamental improvements to its business processes to make financing really work. But several changes by donors are also necessary to maximize the efficiency gains of this new business model.

⇒ *Improving WFP's Forecasting Ability*

67. WFP is implementing internal donation forecasting as part of the business process enhancement. The Fundraising and Communications Department (FD) provides contribution forecasts for country offices, so that they know when their projects can expect to receive revenue and can thus plan better. They will be better equipped to prepare for possible shortfalls, for example by borrowing commodities, intensifying local fundraising or requesting working-capital financing.

68. The full potential of the new working-capital financing model and other process improvements cannot be achieved without reliable donation forecasting, which is why WFP needs the help of donors in forecasting beyond the current fiscal year. If WFP can produce accurate contribution forecasts, country offices will be able to call forward resources as they are needed, which will result in more beneficiaries being fed on time.

69. Donor input is crucial when contribution forecasts are further developed to give country offices all the tools they need to avoid pipeline breaks. It should be noted that over-optimistic forecasts can result in outstanding loans at the end of a project or early depletion of resources. On the other hand, over-conservative forecasting can result in reduced on-time availability and carry-over at the end of a project. The more reliable the forecasts are, the easier it is to guarantee on-time availability of food aid.

70. WFP is thus committed to continue working with donors to improve its forecasting ability. FD plans to set up forecasting workshops with donors to share lessons learned and to strengthen cooperation in forecasting and capacity-development.

⇒ *Multi-Year and Multilateral Funding Commitments*

71. The greatest challenge related to contribution forecasting is to extend forecasting visibility beyond the current calendar or fiscal year. This is particularly difficult, given that so many relief operations are longer than one year. And of course, increased multilateral funding also greatly increases WFP's flexibility to meet its programme needs.

72. At the Board presentation in October 2004, some members proposed support for multi-year donor commitments as well as increased multilateral funding. WFP of course appreciates any budgetary and other difficulties that donors might have, but would welcome such indications of support, which would be invaluable for donation-forecasting and planning purposes.

⇒ *Standard Bag Markings*

73. Currently, most food aid is distributed in bags indicating the name of the donor, which provides visibility for the donor but reduces the effectiveness of working-capital financing. WFP cannot use these contributions as collateral or for repayment of working-capital loans. If WFP accepted as collateral a forecast contribution from a donor that generally requires bag markings and the contribution did not materialize, WFP would either have to find a second donor to repay the loan, even though the first donor was given visibility, or ask the donor for a waiver on a case-by-case basis.

74. A detailed analysis of the contribution forecasts of the BPR pilots shows that most of the forecast contributions are tied to donor's bag markings. In DRC, for example, 80 percent of contributions required bag markings; in Indonesia the figure was 87 percent and in the Occupied Palestinian Territories 72 percent.

75. If bag markings were not a constraint, the risk of using working-capital financing would be reduced by 70 percent, because more contributions could be used as collateral and for repayment.

76. WFP appreciates the restrictions donor governments may have regarding bag markings and will continue to respect them. To minimize risk, WFP will continue to use its standard bag markings whenever commodities are purchased with working-capital financing. To ensure that donors receive visibility, WFP can at the discretion of the donor assist with alternative measures such as issuing press releases, calling press conferences and placing donor flags at distribution sites.

77. The Secretariat would like to express its gratitude to the donors who agreed at EB.3/2004 to the use of standard WFP bag markings; it is hoped that more donors will support this initiative.

⇒ *Shift to Pro Rata Reporting*

78. As reported to the Board, working-capital financing will require some changes in donor reporting, including a shift towards more uniform pro rata reporting on utilization of contributions. If, for example, a donor confirms a contribution of US$10 million to a project that has been funded at US$100 million, the donor will be credited with funding 10 percent of the project.

⇒ *Need to Link Utilization Limits of Contributions to the Duration of a Project*

79. Some contributions are confirmed late in a project and can only be used in a brief time period, which makes it difficult for WFP to use the resources efficiently.

⇒ *Other Donor Conditions*

80. During EB.3/2004, Board members requested a document outlining the major donation constraints and their effects. This data is currently being collected and analysed; a compendium of donor conditions will soon be available for Board review.

Update on Risk Management

81. WFP has developed a risk-management methodology based on a three-step approach. For each project, the objectives are to (i) reduce risk proactively, (ii) monitor risk and (iii) plan for contingencies. The main elements include:

- Reducing forecast risk – the risk that either forecast donations do not materialize or that the forecast is over-conservative, thus jeopardizing on-time food aid availability. In calculating this potential risk, which is the greatest risk when advancing working-capital financing, several factors were assumed (i) the potential risk of lending during the first six months of a project should be zero, because the likelihood of receiving at least some contributions suitable for repayment during the project will be high; and (ii) the maximum outstanding loan in any project is 80 percent of the value of forecast contributions.
- Reducing the risk that donor conditions do not allow for the use of a forecast contribution as collateral or repayment. WFP is collaborating with donors to identify and reduce such conditions, including bag markings, expiry dates and restrictions on purchase.
- Reducing process risk by developing rigorous in-house control systems and uniform repayment schedules.
- Monitoring risk by establishing risk-monitoring activities at Headquarters and adding oversight functions, for example appointing financial analysts in each regional bureau.
- Other forecast risk-management parameters include:
    - Outstanding loans to a project, discounted for the probability that individual contributions materialize, must be less than the overall expected contributions for the next 12 months.
    - In the last nine months of a project, collateral contributions must be classified as high-probability. However, a medium-probability contribution can be used as collateral if another medium-probability contribution is identified as backup, in which case the lower of the two contributions is considered the collateral. Low-probability contributions cannot be used as collateral in the last nine months of a project.

- Working-capital financing requests may not exceed **net funding requirements** for the next three months to prevent early depletion of resources. The funding requirements are based on distribution targets after alignment of contribution forecasts with the expenditure plan.

82. More detail on these activities is provided in Annex III.

Consultations with the Board and Donors

83. Since the Secretariat started BPR in March 2003, it has consulted extensively with Board members and donors to ensure coordination in working towards the common goals of improving on-time availability of food aid and putting working capital to work for beneficiaries. This included informal consultations with the Board in September and November 2003 and January and December 2004, and formal presentations to the Board in February, May and October 2004.

84. The Secretariat has since May 2003 often met major donors bilaterally to consider BPR, including meetings ahead of each Board presentation (see Annex IV).

CONCLUSIONS

85. On the basis of the work done on the pilot projects, WFP and the Boston Consulting Group have recently re-calculated the overall amount of working capital required to solve the timing mismatch between fully committed funding and food-aid requirements. This mismatch is caused by timing differences between project delivery dates and the budget cycles of donor governments. Assuming relief operations worth US$1.6 billion annually and reduced lead times for delivery of food aid as a result of the business process improvements reported above, annual working-capital needs would peak at approximately US$370 million.

86. How was this calculated? WFP studied the funding history of 15 projects of medium and large size, calculating the magnitude and length of temporary funding deficits. On the basis of this, the amount of financing required to even out the peaks and valleys of funding was calculated. This weighted average figure was extrapolated over an annual portfolio of US$1.6 billion, on the basis of which working-capital needs amount to approximately 23 percent of WFP's annual business.

Working Capital Financing Need Reduced by Single Project Account

87. WFP and the Boston Consulting Group then studied the potential impact of the single-pot approach by reviewing the 15 projects cited above and assumed that LTSH, DSC, and ODOC monies were available in a single pot.

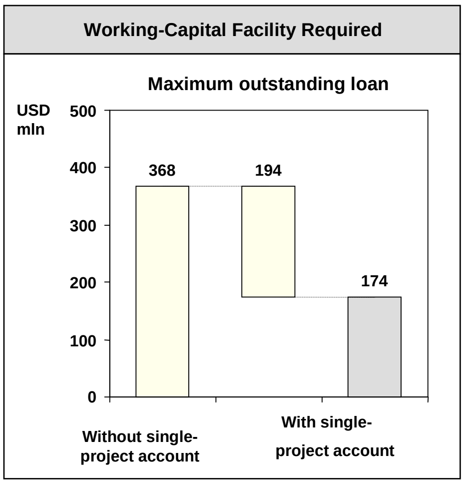
88. It is estimated that the effect of operating in a single-project account will reduce the need for working-capital financing outside confirmed contributions by over 50 percent. This analysis is affirmed by the pilot results: within the first few months of the operation in DRC, use of the single-account approach reduced the need for other financing by over US$5 million.

89. This shows the extent to which the old business model, which mandated spending in strict boxes according to cost components, constrained WFP's ability to manage resources efficiently at the country office level, even with confirmed contributions, because of different lead times for each cash cost component. For example, after commodity costs LTSH is often the largest cost component in value terms, and it takes longest to spend

because it is used late in the contribution cycle to pay costs, including local transporters, warehouse management and handling. The efficiency gains are significant when WFP temporarily uses available but "sleeping" LTSH to commit for other costs.

Graph 4

SINGLE PROJECT ACCOUNT REDUCES NEED FOR WORKING CAPITAL OUTSIDE PROJECT BY ABOUT 55%



90. Approximately US$190 million of working-capital needs can be met by freeing confirmed contributions through the single-project account in each programme. Including the positive impact of moving to a more flexible single-pot approach and improving WFP's business procedures, the net working capital required is reduced to between **US$170 million and US$180 million** from US$370 million, based on a portfolio of US$1.6 billion for relief operations.

Scope of Working-Capital Needs

91. WFP would like to establish a new working-capital financing mechanism with a ceiling of US$180 million, which is well within the balance of WFP's operating cash and reserves.[2] To this end, WFP proposes to amend Financial Regulation 10.8 as follows (addition underlined):

Financial Regulation 10.8: The resources of the WFP Fund shall be used exclusively for the operational and support expenses of WFP. <u>Furthermore, resources of the WFP Fund may be used to advance working capital to projects on the basis of forecast contributions up to a ceiling that will be approved and reviewed periodically by the Board.</u>

92. Once the ceiling for the credit facility is approved by the Board, WFP will be authorized to advance working capital to projects up to the approved limit, based on forecast contributions.

[2] As of 30 November, the value of WFP's reserves was US$270 million.

93. This working-capital financing facility will be secured first against WFP's existing operational reserve – currently US$57 million; the remaining US$123 million will be secured against forecast future contributions, a common business practice. Donations are currently running at over US$1 billion per year, which will ensure that WFP will start leveraging its healthy cash balance and putting its cash to work more effectively to reach more beneficiaries on time.

94. In 2005, WFP proposes to utilize as required working-capital financing in its current pilot projects and ten of its top relief operations in (provisionally) Afghanistan, Bangladesh, the Democratic People's Republic of Korea (DPRK), Ethiopia, the Great Lakes region, Kenya, Southern Africa, Sudan, Tajikistan and Uganda, which account for approximately 60 percent of WFP's food aid annually.

95. WFP will report to the Board periodically on the progress of BPR implementation and particularly on the efficacy of working-capital financing. WFP undertakes to provide an evaluation of 2005 BPR results at EB.A/2006.

Potential Risk

96. Any advance (or loan) will be made on the basis of forecast contributions. The first recourse for repayment of advances will therefore be contributions confirmed for the project to which the advance was made and used as collateral.

97. In exceptional cases where contributions do not materialize to repay the advance – a project default – the Operational Reserve will absorb any write-off of any unpaid working-capital loans, in line with Financial Regulation 10.6. On the basis of a comprehensive risk analysis, it is estimated that such defaults may average US$10- 20 million per year, 0.6 percent to 1.25 percent of assumed annual turnover of US$1.6 billion in relief operations.

98. WFP contends that this minimal level of risk is justified by the potential 20 percent gain in numbers of beneficiaries fed without new donations. WFP's analysis of the risk, made in conjunction with the Boston Consulting Group, emphasizes that there is no financial reason to set up a new risk reserve for working-capital financing of forecast contributions beyond existing reserve levels.

99. In calculating this potential risk, several factors were assumed: (i) the potential risk of lending during the first six months of a project was considered to be zero, assuming donor restrictions are minimized, because the likelihood of receiving at least some contributions suitable for repayment during the lifetime of the project will be very high; (ii) the maximum outstanding loan in any project was assumed to be 80 percent of the value of forecast contributions. If forecasting were more conservative and the maximum loan were set, for example, at 60 percent of forecast contributions, the risk would be even lower; conversely, the more conditions donors retain on contributions, the higher the risk that loans will be defaulted. The impact of donor constraints will be discussed in a later section.

100. The existing policies and procedures for replenishment of the Operational Reserve continue to apply: the Operational Reserve will be replenished from the un-earmarked portion of the General Fund, in accordance with Financial Regulation 10.6.

Relationship to Other Financing Facilities

101. During 2005, as use of working-capital financing is extended to the top ten relief operations, WFP proposes to maintain its other financing facilities – IRA and DSCAF – in their current form.

102. At its current annual target level of US$70 million, **IRA** has often been used as a "non-recourse" lending facility, unlike the working-capital mechanism, which means that IRA loans do not always have to be paid back. The IRA should be a contingency fund for unexpected emergencies and help to start programmes quickly outside the normal course of business. Working-capital loans, on the other hand, are less flexible because all loans are expected to be paid back, but the mechanism aims to even out the timing mismatch between contributions and requirements during the normal course of business.

103. To be eligible for a working-capital loan, a project with an outstanding IRA loan is required either to earmark different donations for repayment or repay the IRA loan. WFP will retain the IRA to ensure that it can react promptly to emergencies.

104. **DSCAF**, currently at US$60 million, was originally used primarily to provide up-front DSC to development programmes. Recently, its scope has been expanded to EMOPs and PRROs. These loans must be repaid from confirmed contributions.

105. For the foreseeable future, WFP will retain DSCAF to ensure advance financing of DSC to projects not covered in the planned roll-out of working-capital financing in 2005. As the business process improvements are rolled out further, the scope of DSCAF will be reviewed again.

TABLE 3: SUMMARY OF FINANCING MODALITIES			
Modality	**Level (US$ million)**	**Purpose**	**Recourse or non-recourse loan?**
IRA	70	React to emergencies	Potentially non-recourse
DSCAF	60	Advance DSC only	Recourse
New working-capital ceiling	180	Respond to working-capital needs as part of normal business	Recourse

Ability to Fill Food-Aid Pipeline during Project Preparation

106. As noted in earlier reports to the Board, working-capital financing is often needed most urgently at the beginning of a project, indeed several months before the start date. To ensure that food aid is available for on-time distribution, commodities must be purchased and shipped many months in advance.

107. Currently, however, WFP's ability to fill the food-aid pipeline is limited. As stated in Financial Regulation 8.1: "…approval of a Country Programme or project shall constitute authority of the Executive Director to issue allotments, incur obligations, and expend resources".

108. Even though WFP is developing a more streamlined, fast-track alternative to project approval, the normal process of preparation and approval can take time as assessments are conducted and analysed and a comprehensive estimate of requirements and costs is carried out.

109. Under the current regulations, this time required for preparation and approval is effectively time lost: WFP cannot readily respond, because no expenditure can take place until project or programme approval.

110. To ensure that WFP responds as quickly as possible, it is proposed that authority be delegated to the Executive Director to incur expenditure necessary to start filling the food pipeline during the preparation phase of a project. Bearing in mind that the Executive Director would report to the Board periodically on the expenditures incurred during project preparation, it is proposed that Financial Regulation 8.1 be amended as follows (additions underlined):

"Approval of a Country Programme, project <u>or operation</u> shall <u>normally</u> constitute authority for the Executive Director to issue allotments, incur obligations and expend resources for the Country Programme, project <u>or operation,</u> subject to signature of the Country Programme, project <u>or operation</u> agreement. <u>However, the Executive Director may incur obligations and expend resources during project preparation, if necessary, to fill the food pipeline for the project for the first three months, not exceeding one quarter of total funding requirements."</u>

Reporting and Monitoring

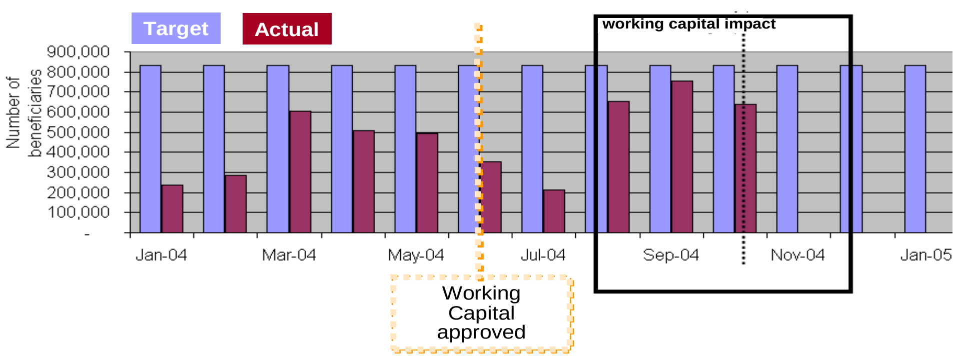
111. WFP has set up a performance-monitoring tool that tracks performance against the BPR objectives. In terms of improving on-time food aid availability, the monitoring tool tracks (i) the number of beneficiaries fed on time compared with targets and (ii) tonnage delivered on-time compared with targets. In terms of improving resource utilization, the monitoring tool tracks (i) fund balances of active projects, which represent confirmed contributions without commitments and which should be used during the operational life of a project, and (ii) fund balances of inactive projects, which should be transferred to new projects.

112. This analysis will be carried out at the operational level and the corporate level. At the country office level, these indicators will be important performance measurements.

113. This monitoring system is already in place in the pilot projects, and will be rolled out to the next set of BPR countries in 2005.

Graph 5

Monitoring Tool:
Democratic Republic of Congo



NEXT STEPS

114. Through the remainder of 2005, WFP intends to roll out the BPR improvements to major relief operations, provisionally in Afghanistan, Bangladesh, DPRK, Ethiopia, the Great Lakes region, Kenya, Southern Africa, Sudan, Tajikistan and Uganda.

115. In each country, implementation of working-capital financing will be contingent on the other building blocks being in place.

116. The Secretariat will adopt a phased approach to implementation, so that the new business model is rolled out first to the largest operations in each region. This will facilitate further roll-out in each region.

117. The Secretariat will continue to report to the Board on the progress of implementation, including the use of working capital to fill the pipeline ahead of project approval. The Secretariat will report on overall 2005 results at the 2006 Annual Session.

RECOMMENDATIONS

118. It is recommended that the Board:

1) **authorize** WFP to advance working capital to approved projects on the basis of forecast contributions from internal cash resources pursuant to the proposed change in Financial Regulation 10.8 (see Annex 1);
2) **approve** the establishment of a working-capital advance ceiling of US$180 million to enable the Executive Director to ensure continued financing of projects, pending confirmation of forecast contributions, within established risk-management parameters (the working-capital ceiling);
3) **approve** the revision of Financial Regulation 10.6 to allow the use of the Operational Reserve to cover cases where a working-capital advance has been made against a forecast contribution but no subsequent contribution is forthcoming to cover expenditures incurred;
4) **take note** of the Executive Director's decision to revise Financial Rule 110.1 to allow the use of the Operational Reserve for this purpose;
5) **approve** the revision of Financial Regulation 8.1 to allow expenditures to be incurred during preparation of a project in order to fill the food pipeline in time to start feeding beneficiaries on the start date;
6) **agree** to review periodically the adequacy and effectiveness of the working-capital credit-advance mechanism, its risks and its ceiling, and **take note** that the Secretariat will present an evaluation report to the Annual Session of the Board in 2006, covering the 2005 results of BPR practices that have been implemented;
7) **take note** of the Secretariat's plan to operate programme budgets on a single-project account basis to improve utilization of resources;
8) **take note** that there will be no deterioration in programme quality with respect to implementation of either the BPR building blocks or working-capital enhancements;
9) **appeal to** donors to continue to help improve WFP's flexibility in responding to programme needs by limiting donor restrictions, within their ability to do so; and
10) **take note** of the mechanisms that WFP has agreed with in-kind commodity donors for pre-purchasing commodities to complement the cash working capital loans.

ANNEX I(a)

RELEVANT EXISTING AND PROPOSED FINANCIAL REGULATIONS

FINANCIAL REGULATIONS	
Existing	**Proposed** (changes underlined)
Financial Regulation 8.1: Approval of a Country Programme or project shall constitute authority for the Executive Director to issue allotments, incur obligations and expend resources for the Country Programme or project, subject to the preparation and signature of the Country Programme or project agreement.	Approval of a Country Programme, project or operation shall normally constitute authority for the Executive Director to issue allotments, incur obligations and expend resources for the Country Programme, project or operation, subject to signature of the Country Programme, project or operation agreement. However, the Executive Director may incur obligations and expend resources during project preparation, if necessary, to fill the food pipeline for the project for the first three months, not exceeding one quarter of total funding requirements.
Financial Regulation 10.6: Drawdowns from the Operational Reserve shall be restored as soon as possible from the contributions made for the purpose for which the drawdown was made. At the end of each financial period, the Executive Director should determine any such contributions that are uncollectible and for which expenditure was incurred and request the Board to approve the replenishment of the Operational Reserve from the unearmarked portion of the General Fund. Such requests shall be made at the time of the presentation of the audited biennial accounts.	Drawdowns from the Operational Reserve shall be restored as soon as possible from the contributions made for the purpose for which the drawdown was made. At the end of each financial period, the Executive Director should determine any such forecast or confirmed contributions that are uncollectible and for which expenditure was incurred and request the Board to approve the replenishment of the Operational Reserve from the unearmarked portion of the General Fund. Such requests shall be made at the time of the presentation of the audited biennial accounts.
Financial Regulation 10.8: The resources of the WFP Fund shall be used exclusively for the operational and support expenses of WFP.	The following additional sentence is proposed: Furthermore, resources of the WFP Fund may be used to advance working capital to projects based on forecasted contributions up to a ceiling which will be approved and reviewed periodically by the Board.

ANNEX I(b)

RELEVANT EXISTING AND PROPOSED FINANCIAL RULES

FINANCIAL RULES	
Existing	**Proposed** (changes <u>underlined</u>)
Financial Rule 110.1 The Operational Reserve will be used to: i) finance the implementation of approved projects in progress and other continuing multilateral operations (including directed multilateral operations) for which firm pledges have been announced, pending receipt of pledged contributions; ii) finance the approved Programme Support and Administrative budget for which firm pledges or other firm sources of income have been identified; and iii) make reimbursable advances to other funds as may be established by the Executive Board for which firm pledges or other firm sources of income had been identified, up to a limit of 5 million dollars or not exceeding 10 percent of the operational reserve, whichever is less. The Operational Reserve will be replenished as soon as the relevant contributions are received. Where firm pledges or other firm sources of income are subsequently assessed as not collectable and for which expenditure was incurred, the Executive Director shall request the Executive Board to restore the Operational Reserve to the authorized level by way of replenishment from the unearmarked portion of the General Fund. The reasons for non-collection shall be explained and documented. The request for approval shall be submitted to the Board at the time of the submission of the audited biennial accounts for the relevant financial period. The replenishment of the Operational Reserve shall be effective at the beginning of the ensuing financial period.	[Note: the arrangements for the BPR pilot projects were an exception to this financial rule (see WFP/EB.1/2004/5-A/1).] The following text is now proposed as a new point (ii) and other points will be renumbered sequentially (new text underlined). No other changes to this rule are proposed: <u>The Operational Reserve will be used to:</u> <u>i) finance and, if required, absorb any unfunded expenditure arising as a result of advances made against confirmed or forecast contributions.</u>

ANNEX II

Details of Pilot Projects

DEMOCRATIC REPUBLIC OF CONGO PRRO 10288.0
(1 Jan 2004 – 31 Dec 2005)

Introduction

During previous operations in DRC, resource availability and food requirements were uneven. Beneficiary needs were not met on time and there were food and cash balances at the end of the project. DRC has four different supply-chain corridors, which makes supply-chain planning difficult. In view of the historical timing mismatch between contributions and requirements and the logistical complexity, it was felt that DRC could reap many of the benefits associated with BPR implementation; it was accordingly chosen as the first pilot.

Resource Transfer

This project received 38,000 mt of food and US$8 million as carry-overs from the previous PRRO and EMOP. These carry-overs were a result of delayed contributions to the previous operations.

Single-Project Account

The single-project account flexibility allowed the country office to maximize existing resources to meet all its LTSH, DSC and ODOC requirements to the end of 2004.

Working-Capital Financing

Refined planning methodology and tools enabled the country office to flag the shortfall in commodities and external transport that were to arise in the fourth quarter of 2004. On 23 June 2004, the project was granted a working-capital loan of US$5.4 million to purchase 15,398 mt of commodities and cover related external transport costs. This working-capital loan ensured on-time availability of food aid to 700,000 beneficiaries in the fourth quarter of 2004; as of 15 December 2004, over 75 percent of the loan had been repaid.

Challenges

⇒ *Contribution Forecasts*

As expected from the first pilot, the contribution forecasts were conservative. This requires the country office to reduce its operational level. These moderate forecasts reduce the likelihood of future working-capital loans. Loans will not be made if repayment prospects appear untenable. In an encouraging development, since July the forecast level has increased from 43 percent to 63 percent of total operational requirements. WFP is endeavouring to bring this forecast into line with historical resourcing levels of 86 percent.

To improve the accuracy of long-term forecasts, WFP appeals to donors to develop joint multi-year forecasting so that unnecessary pipeline breaks are avoided.

Repayment Schedule – Democratic Republic of Congo PRRO 10288.0, as at 16 December 2004 (US$)

Summary	
Working capital	5 399 812
Repaid	4 096 733
Outstanding	1 303 079
Collateral	2 554 819

OCCUPIED PALESTINIAN TERRITORIES EMOP 10190.2
(1 September 2004 – 31 August 2005)

Introduction

The third phase of the Palestinian EMOP was the second pilot. This project was chosen as a pilot to gain an understanding of how BPR enhancements apply to EMOPs.

Resource Transfer

Closure of the previous project resulted in a carry-over of commodities and associated costs totalling US$1.3 million. These were immediately transferred to the new EMOP to minimize the effect of temporary food and cash shortfalls.

Working-Capital Financing

On 27 July 2004, this project was granted a working-capital loan of US$9.6 million to address the timing mismatch between project requirements and available funding. By jump-starting procurement, shipment and distribution of commodities, the country office was able to provide on-time availability of food aid to 480,000 beneficiaries by the end of 2004; as of 15 December 2004, over 80 percent of the loan had been repaid.

Challenges

⇒ *Donor Conditions*

A contribution that the country office wanted to use for repayment of the working-capital loan was tied up with two major conditions: a requirement for donor-specific bag marking and a request for local/regional purchase. WFP cooperated with the donor to address these issues, and thanks to the flexibility of the donor the conditions were waived and the contribution could be used for repayment. As a result, the working-capital loan has been almost fully repaid.

⇒ *Logistical Constraints*

The working-capital loan was granted for the purchase of 21,000 mt and all related costs. Because of complications relating to port capacity, a first-tranche purchase was raised for 70 percent of these commodities. The country office team is now ensuring that the necessary logistics capacities are in place to proceed immediately with procurement. This will ensure maximization of resources within the project and a reduction of unspent balances.

Repayment Schedule – Occupied Palestinian Territories EMOP 10190.2, as at 16 December 2004 (US$)

Summary	
Working capital	9 600 000
Repaid	7 665 096
Outstanding	1 934 904
Collateral	2 150 000

INDONESIA PRRO 10069.1
(1 Jan 2005 – 31 Dec 2007)

Introduction

In January 2005, the Indonesia country office launched the new phase of PRRO 10069.1, which focuses on nutrition rehabilitation activities for a variety of beneficiaries – primary schoolchildren, pregnant and lactating women, children between 1 and 5 and tuberculosis patients living in areas of high malnutrition and poverty. Continued provision of fortified food is essential to assessment of the impact of nutrition activities. Given the Government's commitment to these activities, a break in the pipeline could potentially have damaged WFP's credibility with counterparts.

Resource Transfer

In consultation with donors, the country office will close and transfer approximately US$1.4 million of unspent balances to the current project during the first quarter of 2005.

Working-Capital Financing

Tendering, contract negotiation and production of fortified noodles and biscuits require a lead time of two to three months. To ensure seamless implementation, this project was granted a working-capital loan of US$4.8 million on 29 October 2004, which enabled the country office to purchase locally 9,168 mt to ensure on-time availability of food aid to 1.6 million beneficiaries in the first half of 2005. In view of the recent approval of this loan, there had been no repayment as of 15 December 2004.

Challenges

⇒ *Contribution Forecasts*

The major challenge to this project has been the conservative nature of the contribution forecasts. The previous Indonesia operation was funded at almost 70 percent of operational requirements; the operation prior to that received 93 percent of required funding. Nevertheless, the forecast for this project remains just above 50 percent of operational requirements. FD is working with donors to develop reliable multi-year forecasts, which will be essential for improving the resourcing outlook for the operation and hence maximizing WFP's ability to meet beneficiary needs on time.

⇒ *In-Kind Donations*

The Indonesia country office is expected to receive a large proportion of its contributions in kind. The BPR team is in contact with donors to establish mechanisms to facilitate the use of in-kind donations for working-capital financing. This will be essential for projects such as the Indonesia PRRO to reap the full benefits associated with working-capital financing.

Repayment Schedule – Indonesia PRRO 10069.1, as at 16 December 2004 (US$)

Summary	
Working capital	4 800 000
Repaid	0
Outstanding	4 800 000
Collateral	8 150 000

WEST AFRICA COASTAL PRRO 10064.3
(1 Jan 2005 – 31 Dec 2006)

Introduction

The start date for this project was 1 January 2005. However, the project was approved in October 2004, leaving a very short lead time between approval and start date to call forward commodities. Although there was a significant in-kind contribution confirmed to this project a month before approval, the commodities were not expected in-country until March 2005.

Resource Transfer

Once the previous phase – PRRO 10064.2 – is closed, the country office will carry-over 14,500 mt of commodities and US$3.6 million in associated cash to this project.

Working-Capital Financing

The project was granted a working-capital loan of US$6.1 million on 29 October 2004, which enabled the purchase of 14,314 mt of commodities and related external transport costs. A second working-capital loan of US$4.15 million was granted in December 2004 to cover the associated support costs. This ensured on-time availability of food aid to 600,000 beneficiaries in February and March 2005. In view of the recent approval of these loans, there had been no repayment as of 15 December 2004.

Challenges

⇒ *Contribution Forecasts*

The previous two operations were relatively well funded at 73 percent and 93 percent respectively, but the initial contribution forecast for the West Africa Coastal operation reached only 48 percent of requirements. This low forecast limits financing possibilities, because expenditure and income must be aligned in order to minimize financial risk. By identifying additional contributions and including a level of "unidentified" contributions, FD has gradually increased this forecast to 55 percent of operational requirements.

To improve the accuracy of its long-term forecasts, WFP appeals to donors to develop multi-year forecasting to avoid unnecessary pipeline breaks.

⇒ *Donor Conditions*

As of December 2004, approximately half of the forecast contributions in value terms appeared to require donor-specific bag markings; in addition, 20 percent of the total value will have to be purchased in specific locations, and some contributions are also earmarked for particular countries in the regional operation. These conditions limit WFP's ability to maximize the benefits of working-capital financing. WFP will continue to work with donors in an effort to ease these constraints and thus maximize the efficiency of the working-capital financing facility.

Repayment Schedule – West Africa PRRO 10064.3, as at 16 December 2004 (US$)

Summary	
Working capital	10 250 000
Repaid	0
Outstanding	10 250 000
Collateral	15 005 130

CHINA COUNTRY PROGRAMME 10050.0 ACT 1
(2001 – 2005)

Introduction

WFP's development assistance to China will come to an end on 31 December 2005. It is essential that basic activities are implemented in a timely manner and resourced at an adequate level, and that implementation does not exceed the closing date. The earliest pledge for China is not expected until the end of the first quarter of 2005, however. Taking into account the time for tendering, contract negotiation, delivery at load port, shipping and unloading, commodities would not be available for distribution until the end of June 2005.

Working-Capital Financing

In December 2004, this project was granted a working-capital loan of US$4.1 million, which enabled the country office to purchase 21,750 mt of commodities and to cover related DSC and ODOC. With this working-capital loan, the country office is able to meet the food needs of 1.3 million beneficiaries until the end of May 2005.

Repayment Schedule – China Country Programme 10050.0 ACT 1, as at 16 December 2004 (US$)

Summary	
Working capital	4 070 089
Repaid	0
Outstanding	4 070 089
Collateral	15 000 000

ANNEX III

RISK MANAGEMENT — LATEST DEVELOPMENTS

Working-capital financing allows WFP to incur expenditures based on forecast rather than confirmed contributions. WFP bears 100 percent of the risk associated with this new business model, in view of which it is placing strong emphasis on managing risk while working towards the goal of maximizing on-time availability of food aid to beneficiaries. A comprehensive view of WFP's risk-management activities to date and future initiatives are described in this Annex.

The October 2004 Information Note outlined the following risks associated with working-capital financing.

1. *Constraint Risk*
   The risk that a forecast contribution cannot be used for repayment because of donor conditions such as donor-specific bag marking, specific purchase location or funding proposals and contribution validity dates.
2. *Forecast Risk*
   The risk that forecast contributions do not materialize and, conversely, total forecast contributions are too low.
3. *Process Risk*
   The risk that an identified collateral contribution is not used for repayment as a result of inadequate internal business processes.

The following processes and mechanisms have been established for managing and reducing WFP's risk.

Reducing Constraint Risk

- WFP has conducted an in-depth analysis of constraints by donor. By looking into past practices and contractual stipulations and by communicating with individual donors, WFP has established a more accurate understanding of constraints, which has resulted in more reliable contribution forecasts and improved understanding of which contributions can and cannot be used for working-capital financing.
- In December 2004, the Secretariat held a consultation with donors to explain how donor constraints impact WFP's ability to improve on-time availability of food aid. The consultation has served as a catalyst for further discussions with individual donors on easing such constraints.
- While it is working to ease constraints, WFP continues to take a conservative approach to financing against contributions that have constraints.

Reducing Forecast Risk

- Contribution forecasts, in which each contribution is broken down into high, medium or low probability levels, expected confirmation date and level of contribution, are updated monthly. They have gradually improved in reliability during implementation of the pilot projects.
- Donor-relations officers are in contact with our fund-raising focal points in the field to ensure accurate and up-to-date contribution forecasts.

- Conservative guidelines have been established to keep forecast risk to a minimum. Working-capital loans must:
  - (a) be linked to collaterals with a high probability of materializing and backed up with medium-probability contributions;
  - (b) less than 80 percent of forecast income at any phase of a project; and
  - (c) not exceed net funding requirements for the following three months.
- Analysis of monthly income forecasts:
  - (a) probability fluctuations – the probability of a contribution improving as the expected confirmation date nears;
  - (b) confirmation rate – high probability that contributions have been confirmed as expected;
  - (c) progression of contributions – the changing characteristics of contributions as a project unfolds in terms of value, constraints and expected confirmation date.
- So far, most forecast risk has been mitigated through conservative forecasting. A conservative approach, however, creates the risk that beneficiaries are not being fed on time and that there is carry-over at the end of a project. The Fundraising and Communications Department (FD) is reducing this risk by analysing historical trends and including “unidentified” contributions as part of the contribution forecast. WFP expects to minimize this risk further by working with donors to forecast beyond budget cycles.

Reducing Process Risk

- The Secretariat has developed step-by-step procedures identifying the various roles and responsibilities involved in working-capital financing. This has helped to strengthen our process control, and has greatly mitigated process risk.
- WFP is developing system controls to ensure prompt and accurate repayment of working-capital loans with identified collaterals. This risk is further reduced with the utilization of the Repayment Schedule described below. Although process risk has been kept to a minimum, these system controls will be essential as WFP rolls out working-capital financing to more operations.

Monitoring Risk

- In addition to reducing risk proactively, WFP is monitoring the level of risk on a real-time basis. Two new tools are being utilized for this purpose: the Risk Monitor and the Repayment Schedule.
- The Risk Monitor is an Excel-based tool that categorizes projects into three risk categories, coded red, yellow and green, on the basis of forecast income, identified collaterals, project phase and credit history. In the short term, high risk levels cause increased control of working-capital financing; in the medium term and long term, a project’s ability to repay working capital – its credit history – affects its ability to receive future working-capital loans. This tool also gauges the overall level of WFP’s risk exposure. When the organizational risk level rises, the working-capital financing facility will be conservative in approving loans until the risk level becomes more tenable. The Risk Monitor is being fine-tuned using data from the four pilots and will continue to be refined as it is rolled out to other projects.
- The Repayment Schedule maintained by each country office allows the “bank” (the group at headquarters that manages working-capital loans), the country office and FD to ensure that each working-capital loan is secured with appropriate collateral. When granting a

working-capital loan, the country office and the "bank" agree to a suitable list of expected contributions to serve as collateral. On confirmation, these contributions are used to repay any outstanding portions of the working-capital loan. In some instances, collateral contributions may come in at a lower level or at a later date, or in rare instances they may not come in at all. The monthly updating of the Repayment Schedule is therefore critical for monitoring risk exposure by project.

- The recently appointed regional financial analysts provide another level of risk management and control: they are responsible for overseeing financing risks for all relevant projects in their region.
- The BPR team holds monthly tele-conferences with the country office and relevant units to ensure that expenditure forecasts in the pilot projects are in line with contribution forecasts, and assesses the repayment situation along with any working-capital requests that may be forthcoming.

Future Direction

WFP has been encouraged by donor support, in particular as it relates to easing contribution conditions and improving WFP's forecasting methodologies. WFP will continue to collaborate with donors to reduce these risks and improve its forecasting capacity.

WFP will continue its dialogue with ICRC to draw on their practical experience with contribution forecasting and risk management.

The lessons learned from the pilots and roll-out will further reduce our risk and improve our risk monitoring methodologies, thus maximizing the on-time availability of food aid to beneficiaries.

ANNEX IV

HISTORY OF CONSULTATIONS ON BPR WITH THE EXECUTIVE BOARD AND DONORS	
May 2003	Bilateral consultations with donors on initial BPR concept paper
Aug–-Sept 2003	Bilateral consultations with donors ahead of informal consultation
23 Sept 2003	Informal Consultation with the Board
Nov 2003	Bilateral consultations with donors ahead of informal consultation
20 Nov 2003	Informal Consultation with the Board
Dec 2003–Jan 2004	Bilateral consultations with donors ahead of 2004 informal consultation
14 Jan 2004	Informal Consultation with the Board
Jan–Feb 2004	Bilateral consultations with donors ahead of Board discussion
24 Feb 2004	Executive Board EB.1/2004: Pilot Financing Paper
Apr–May 2004	Bilateral consultations with donors ahead of Board discussion
28 May 2004	Executive Board EB.2/2004: Progress Report of the Business Process Review
Sept–Oct 2004	Bilateral consultations with donors ahead of Board discussion
12 Oct 2004	Executive Board EB.3/2004: Second Progress Report on the Pilot Projects
7 Dec 2004	Informal Consultation with the Board

ACRONYMS USED IN THE DOCUMENT

BPR	business process review
CIK	contribution in kind
DPRK	Democratic People’s Republic of Korea
DRC	Democratic Republic of Congo
DSC	direct support costs
DSCAF	Direct Support Costs Advance Facility
EMOP	emergency operation
FD	Fundraising and Communications Department
ICRC	International Committee of the Red Cross
IRA	Immediate Response Account
LTSH	landside transport, storage and handling
ODOC	other direct operating costs
PRRO	protracted relief and recovery operation

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