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PROGRAMME OF WORK AND ANNOTATED OUTLINE FOR THE 2003 REVIEW OF RESOURCE AND LONG-TERM FINANCING POLICIES

Note to the Executive Board

This document is submitted for consideration to 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).

Executive Summary

The Executive Board, in outlining its Provisional Biennial Programme of Work for 2003–2004, requested the Secretariat to submit a Programme of Work and Annotated Outline for the 2003 Review of Resources and Long-Term Financing (R&LTF) Policies for the consideration of the Board at its First Regular Session of 2003.

This document complies with this request by describing the elements of the R&LTF, outlining the issues to be covered in the R&LTF review and proposing the stages involved in completing the review.

Draft Decision*

The Executive Board:

a) endorses the Annotated Outline as a conceptual framework and definition of scope for the issues to be covered in the 2003 review of the R&LTF; and

b) endorses the Programme of Work as a description of the process to be followed for the 2003 review of the R&LTF.

* 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.

PART I: BACKGROUND

1. The resource and long-term financing (R&LTF) policies of the World Food Programme were introduced with effect from the 1996–1997 biennium. At that time it was decided that the effectiveness and efficiency of the policies should be reviewed at the end of the first biennium.[1] Thus the R&LTF policies were reviewed by a working group of the Executive Board. This review was completed in 1999,[2] and the revised R&LTF policies took effect from the 2000–2001 biennium.

2. The current review is being undertaken to continue this assessment of the effectiveness and efficiency of the policies and to review the issues and difficulties encountered in their implementation. The review has also been prompted in part by recent decisions of the Executive Board, including the decision on the Provisional Biennial Programme of Work for 2003–2004 (2002/EB.3/43[3]), and the decision on the recent ISC review (2002/EB.3/7[4]). Therefore, the issues raised by the Board and in other fora are also included in this review.

3. This document provides the Annotated Outline and Programme of Work for the R&LTF review as identified in the Provisional Biennial Programme of Work of the Executive Board (2003–2004). It sets out the objectives, scope, methodology and timetable for the review.

4. A draft version of this document was circulated to Executive Board members in December 2002 and discussed at an informal meeting of the Board on 14 January 2003. The comments and feedback received from Board members have been incorporated in this final document.

5. At this informal consultation, many Board members indicated that, because of the extensive scope of the review, its planned completion in time for the May 2003 meeting of the Board would be difficult to achieve. The Annotated Outline sets out both strategic policy issues and specific financial issues.

6. It was generally agreed at the consultation that the Annotated Outline (Part II of this document) would serve as the conceptual framework for the entire review of the R&LTF, but that the issues should be addressed in phases.

7. Therefore, although the current Programme of Work of the Executive Board indicates that the review should be finalized for the May session of the Board, this document proposes that the issues be addressed in two phases:

   a) **initial phase:** issues to be addressed at the Annual Session of the Board in May 2003;

   b) **final phase:** issues to be addressed at the Third Regular Session of the Board in October 2003.

8. The determination of which issues should be addressed in each phase will be done using the following criteria:

   ➢ strategic issues or specific financial issues;

[1] CFA 40/5

[2] WFP/EB.1/99/4-A

[3] WFP/EB.3/2002/14

[4] WFP/EB.3/2002/14

- issues necessary for or related to the *Strategic Plan* and the *Management Plan*, which are due for submission to the Board in May and October 2003, respectively;
- issues required to be addressed in this timeframe by previous *Executive Board decisions*.

9. The remainder of this document comprises two parts:

a) **Part II, Annotated Outline of the Review**: sets out the scope of the review by describing the elements of the R&LTF, by identifying the issues to be covered (arising from Board decisions or from the implementation of the policies by the Secretariat) and by outlining some of the studies to be conducted to resolve these issues.

b) **Part III, Programme of Work:** identifies and describes the stages and steps proposed by the Secretariat to complete the review, together with the key milestones of the review.

10. The overall methodology adopted by the review will be as broad based and inclusive as possible. In addition to extensive internal consultations and consultations with Board members, developments in other United Nations organizations will be examined with a view to benefiting from "lessons learned" and to help ensure the harmonization of policies. The ongoing work of the UNDG Working Group on harmonization—and other harmonization initiatives—will also be incorporated in the review where appropriate.

11. Consultations between the Secretariat and the Board will be done through the Bureau, as outlined in Part III of this document.

12. Therefore, the Executive Director recommends that the Board:

a) endorse the Annotated Outline as a conceptual framework and definition of scope for the issues to be covered in the 2003 review of the R&LTF; and

b) endorse the Programme of Work as a description of the process to be followed for the 2003 review of the R&LTF.

PART II: ANNOTATED OUTLINE OF THE REVIEW

SECTION A: INTRODUCTION

13. This section of the review will briefly describe the evolution of the R&LTF policies, the changes effected, and the recent discussions and decisions of the Executive Board that prompted the current review.

14. The direction and guidance provided by the Bureau during the review, together with the consultation process undertaken for the review, will also be described.

SECTION B: OVERVIEW OF THE R&LTF

15. This section will include a high-level evaluation of the policies, and an identification and assessment of possible alternatives. This will involve an examination of the organization, its mandate and strategies and the broader environment in which it operates, including the evolving priorities of donors, developments in other United Nations organizations and other trends affecting the organization.

16. To ensure a comprehensive review, this section will also describe and examine the original objectives and scope of the R&LTF policies and assess the appropriateness of the term "Resource and Long-Term Financing (R&LTF)" and other terms.

17. The underlying principles and mechanisms currently used to ensure the achievement of these objectives and other issues related to the implementation of the principles, particularly with respect to donors' modalities for remitting and reporting on the use of their contributions to WFP, will also be examined.

Objectives

18. In initiating the R&LTF, the 38th Session of the Committee on Food Aid Policies and Programmes (CFA) "agreed that WFP should have a more sound and predictable resource base, preserving and strengthening WFP's multilateral character".[5]

19. The aim of the policies is "to overcome external constraints, provide more predictable, flexible resources and ensure full cost recovery and at the same time, preserve the multilateral nature of WFP over the long term".[6]

20. The objectives of the R&LTF policies were summarized as follows:[7]

    a) to "bring about, to the extent possible, increased predictability of resource availability and flexibility in their use, taking into account the multilateral character of the Programme [WFP]",

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5 CFA 38/18

6 CFA 40/5

7 Extracted from CFA 38/18

b) to “secure the required level of resources to be provided to WFP and optimise their use”,

c) to “ensure the funding of administrative and other costs”,

d) “WFP’s resource base should be broadened by seeking additional donors” and

e) “the Programme need[s] to ensure it retain[s] the ability to draw on different line items of donor budgets”.

R&LTF Principles and Mechanisms

21. To achieve the above-stated objectives, the Board established the following principles in the implementation of the R&LTF:

a) **Full-cost recovery principle—**requiring each donor to cover all the costs associated with the implementation of its contributions.

b) **Funding windows—**categorizing contributions according to the extent to which they are directed and the level of associated reporting requirements.

c) **Programme categories—**categorizing programmes, projects and activities.

d) **Cost categories—**classifying costs into:

  - direct operational costs (DOC—including commodity costs; ocean transport; landside transport, storage and handling [LTSH]; and other direct operational costs [ODOC]);
  - direct support costs (DSC); and
  - indirect support costs (ISC).

e) **Funding and financing mechanisms—**the Operational Reserve, Immediate Response Account and Direct Support Cost Advance Facility and use of interest income.

22. This part of the review will examine the current definitions for these principles and mechanisms and how they have been implemented, to ascertain whether they are still applicable under present circumstances and the extent to which the present funding and financing mechanisms have facilitated not only the implementation of the R&LTF but also the achievement of the organization's mandate. The discussion will also highlight the general benefits and problems, if any, associated with the R&LTF policies.

SECTION C: FULL-COST RECOVERY PRINCIPLE

23. The principle of full-cost recovery is central to the R&LTF policies. This section will examine the extent to which the full-cost recovery principle has been implemented, the benefits derived by WFP and the problems encountered in applying the principle, including the following issues:

Donors’ Inability to Finance the Associated Costs

24. Some donors are unable to provide the cash requirement for the associated costs, and existing mechanisms available to the Programme to fund such costs are limited. This is particularly the case for certain non-traditional donors, and will be examined under the discussion on donor categorization (see "Application of Full-Cost Recovery for Non-traditional Donors" under Section D).

Legislation Excluding Certain Items

25. National legislation prohibits some donors from contributing towards certain DSC/ODOC items. The review will provide a list of these cost items, by programme category, and will describe the financial impact of these constraints on the overall contribution level to WFP, to ascertain the magnitude of the problem and look for other possible sources to fund these items.

Utilization of Savings and Stock Carry-over

26. Despite improvements in budgeting and the monitoring of resources arising from the implementation of WINGS, balances at the end of projects are still likely to exist. Therefore, the following issues will be reviewed:

- utilization of savings and surpluses: these are either reprogrammed at present (following time-consuming consultations) or refunded; and
- methods of funding and utilizing carry-over stock of commodities (between project phases, projects, programme categories and countries).

Flexibility between Cost Components during Operations

27. As with most organizations, the utilization of resources does not always follow expectations. Some cost components of individual contributions are used more quickly than others. (For example, if external transport costs are lower than expected, a balance may remain in this cost component even after all the food has been transported.)

28. The current implementation of the principle of full-cost recovery makes it difficult to utilize resulting balances in the remaining cost components or to reclassify them to other components that are still needed for the completion of the operation. The possibility of allowing flexibility among some cost components (possibly subject to percentage or absolute limits) will be examined as one potential solution. The review will include an analysis of projects with large surplus balances in one cost component and a deficit in another, to demonstrate this inflexibility.

Small-Value Contributions

29. The R&LTF policies and principles are applied to all contributions regardless of their financial magnitude. The question of the cost-effectiveness of applying the principle to small-value contributions will be examined, and an outline of these small-value contributions will be provided. The review will also describe the administrative and accounting processes involved, to demonstrate the inefficiencies involved in complying with the full-cost recovery principle.

SECTION D: FUNDING WINDOWS AND DONOR CATEGORIZATION

30. This part of the review will focus on three main areas: funding windows, donor categorizations and reporting.

A. Funding Windows

⇨ *Definitions*

31. Within the present R&LTF, contributions to the Programme are provided through three funding windows:[8]

a) **Directed Multilateral—***"a contribution, other than a response to an appeal made by WFP for a specific emergency operation, which a donor requests WFP to direct to a specific activity or activities initiated by WFP or to a specific Country Programme or Country Programmes".*

b) **Multilateral—**where *"WFP determines the Country Programme or WFP activities in which the contribution will be used and how it will be used … and for which the donor will accept reports submitted to the Board as sufficient to meet the requirements of the donor".*

c) **Bilateral—***"directed by the donor to be used to support an activity not initiated by WFP".*

⇨ *Level of Directedness*

32. Access to an adequate level of untied funds that can be used flexibly is critical to WFP's response capability and effectiveness on the ground. The recent review of the audited financial statements and the Budgetary Performance Report for the biennium 2000–2001 showed a continuous increase in the directed multilateral funding windows and a decline in the multilateral funding windows. This trend of increased directedness and conditionality of contributions limits the Programme's ability to optimize the use of resources. It also:

a) places additional constraints on WFP's fulfilling its mandate and on the Programme's ability to ensure that resources are used in the most efficient and cost-effective manner;

b) reduces the Programme's ability to respond quickly to critical needs and delays the implementation of operations;

c) increases the labour-intensiveness and cost-intensiveness of negotiating, programming and reporting contributions;

d) adversely affects operations, for example by creating an uneven timing of the flow of resources;

e) reduces the Programme's capacity to fund less popular, but equally needy, programmes/operations; and

f) in the case of the increased conditionality of *multilateral* contributions, raises the issue of how these are defined, i.e. what types of conditions, if any, are allowable for a contribution still to be considered multilateral.

33. This part of the review of R&LTF will examine the current use of funding windows and will seek a better way to achieve a balance between directed and multilateral contributions. It will examine also the cost—and other—implications associated with managing donor directedness and conditionality.

[8] Financial Regulation definitions.

⇨ *Predictability*

34. As contributions become more directed, with an increasing number of donor conditions, the predictability of resources (and how they might be used) is significantly reduced. This section of the review will examine this issue and the following:

a) Fewer and fewer donors are announcing their tentative pledges for the WFP financial period. This constrains WFP in its planning of global resources utilization.

b) Increased direction and conditionality reduce the predictability of available resources at the activity/project level. This constrains activity/project planning.

⇨ *Bilateral Contributions*

35. Amounts received by the Programme through the bilateral funding window are currently handled on a case-by-case basis. In some instances, some of the provisions applicable to these contributions require additional clarity as to how they are classified and accounted for.

36. One of the major issues to be clarified in this part of the review is related to the support costs to be charged against bilaterals and whether they should be charged as ISC, DSC or both. At present, there are varying rates of ISC levied on these contributions, and income from such levies is credited to the General Fund or directly to the bilaterals.

37. Another issue that will be examined is the increasing opportunities for WFP to provide to recipient countries and to donors bilateral services that may not directly deal with food but may be more in the nature of technical assistance, etc.

B. Donor Categorization

38. The current R&LTF refers to two categories of donor: traditional and non-traditional donors, which include the private sector. A close review of these two categories of donor indicates that, in certain cases, the policies governing their contributions are inadequate, including those regarding the financing of cost components to which some of the non-traditional and private-sector donors are unable to contribute. This part of the review will examine both categories of donor, the extent of their contributions to WFP over the past six years, the difficulties encountered in applying the full-cost recovery principle, and the administrative processes involved in handling each donor category's unique nature.

39. **Traditional donors** are governments that have continuously (either on an annual basis or through appeals) provided donations to WFP since its inception. Their contributions to WFP have usually become part of their budgetary appropriations. Most of these donors have a multi-year framework partnership agreement or a Memorandum of Understanding with WFP that generally governs the way the Programme manages their contributions.

40. **Non-traditional donors** include the private sector and governments that provide donations to WFP on a more ad-hoc basis. WFP executes specific contracts or Memoranda of Understanding for contributions from these donors.

⇨ *Non-Traditional Donors*

41. Contributions from non-traditional donors have been allowed greater flexibility in meeting full-cost recovery through modalities available to the Programme to cover the associated costs that these donors may not be able to provide, such as:

- cash provided by traditional donors;

- monetization (i.e. sale) of commodities;
- waivers for certain cost components; and
- the General Fund.

42. However, a closer look will show that although these mechanisms do exist, the funds available through them are not sufficient to cover the associated costs of certain non-traditional donors. Therefore, while non-traditional donors present a major resourcing opportunity for WFP, cash contributions to cover the associated costs can be problematic, especially for some in-kind contributions and those of larger magnitude.

⇨ *Application of Full-Cost Recovery for Non-Traditional Donors*

43. Current guidelines, rules and procedures for financing the associated costs for non-traditional donor countries are inadequate. Funding the non-food costs of these contributions has become increasingly difficult, with traditional donors reluctant to fund the costs, the levels of resources in the WFP General Fund inadequate, and the use of monetization problematic. This part of the review of R&LTF will explore options for addressing the funding of associated costs and will examine the following options for providing specific policies for handling contributions from these donors:

a) the introduction of eligibility criteria for non-traditional donors;

b) the use of private-sector contributions to cover non-food costs, including in-kind services (transportation, logistics, etc.);

c) the use of the LTSH, ODOC and DSC of the project to which the contribution of the non-traditional donor is directed;

d) the use of interest income;

e) the seeking of additional donor funding and/or other funds to cover these costs;

f) the use of project savings identified during project implementation; and

g) increased monetization of commodities.

⇨ *In-kind Contributions*

44. Not all offers of in-kind contributions from non-traditional donors are accepted by WFP, for example when there is inadequate cash for the associated costs, often resulting in a failure to meet project needs. The specific context and conditions under which the Programme should accept the contributions have not been fully defined. The cost of the administration and handling of such contributions and other requirements for more specific reporting need to be clarified.

⇨ *Unique Nature of Private-Sector Donors*

45. Although private-sector donors fall under the category of non-traditional donors, they are not governments; private-sector donors have different cultures and may also have a different perspective on their partnerships with WFP that affects their behaviour. WFP has limited experience in this area, and specific policies governing the relationship with private-sector donors have yet to be developed.

46. Therefore, this part of the review will establish a policy framework governing WFP's relationship with the private sector, using as a basis the Secretary-General's guidelines for cooperation with the private sector. The experiences of other United Nations organizations in this area will also be drawn upon in formulating the policy.

47. Such a policy will need to take into account the principles for engagement and the unique legal, financial, programming and communications issues that arise. An analysis of the costs and benefits of such an initiative will be presented, and its implications for the overall aim of improving the security of resources and of broadening WFP's donor base will be examined.

SECTION E: PROGRAMME CATEGORIES

48. Programme categories refer to the classification of WFP's operations based on the nature of the projects being implemented, i.e. development, emergency relief, protracted relief, recovery and rehabilitation, and special operations. Although these categories were established with the introduction of the R&LTF in 1996, they were already in existence and being applied in the classification of projects before that time. (The exception to this is the PRRO category, which was a subset of the then regular resources.)

49. This part of the review will be handled in close coordination with the development of the Strategic Plan. However, in order not to delay the R&LTF review, it will be assumed for the review that for funding purposes the current programme categories will be maintained. This assumption will be subject to change depending on the progress of consultations and discussions on the Strategic Plan.

SECTION F: COST CATEGORIES

50. This part of the review will examine the cost categories (their definitions, nature, basis for valuation and charging, and accounting), including their appropriateness for and applicability to achieving the goals of R&LTF. The following paragraphs describe the issues that will be reviewed for each cost category.

A. Operational Costs

⇨ *Definition and Composition*

51. Operational costs are defined in the Financial Regulations as "the costs of:

a) commodities;

b) ocean transportation and related costs;

c) landside transportation, storage and handling (LTSH); and

d) any other input provided by WFP to beneficiaries, the government of the recipient country or other implementing partners [ODOC]."[9]

52. The line items charged to each of these cost categories is attached as Annex I.

[9] Financial Regulation definitions

⇨ Basis for Valuation

53. The valuation placed on each of these at the time the contribution is confirmed is defined in the General Rules as follows:

"(i) commodities: ["a value based on the world market prices, at the Food Aid Convention (FAC) price or at the donor's invoice price as may be applicable[10]"];

(ii) external [11] transport: estimated actual cost;

(iii) landside transportation, storage and handling (LTSH): average per ton rate for the project;

(iv) other direct costs: pro-rata share of the budgeted amount for the project as in force at the time the contribution is made, based on tonnage".

⇨ Basis for Charging

54. The expenditure amounts charged to these line items are as follows:

a) commodities:

- ➢ purchased commodity: actual expenditure amount;
- ➢ in-kind commodity: value based on the world market prices, the FAC price or the donor's invoice price;

b) external transportation and related costs: actual expenditure amount;

c) LTSH: pro-rata share of actual expenditure based on tonnage; and

d) ODOC: pro-rata share of actual expenditure based on tonnage.

⇨ Issues to Review

55. This section of the review will examine the current definition and composition of operational costs, and how equitable are the present modalities for charging these costs to donors. It will also focus on the following issues:

Input or Support

56. Certain costs, currently classified as support costs, are incurred to organize the purchase of commodities, the receipt of in-kind commodities and the transportation (both external and landside) of commodities. One view of these costs is that they can be considered as *input* to the Programme's operations rather than as *support* of the operations. From an accounting perspective, there may be a case for classifying such costs as operational costs. (For example, if the services were outsourced, the cost of that outsourcing could be considered part of the cost of the commodity/transport and would not necessarily classified as a cost of supporting the related operation.)

57. Other considerations (such as donor preferences and transparency) will be examined to determine the viability of any reclassification of such costs.

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[10] General Rule XIII.6

[11] This cost component is described as "external" transport in the General Rules and "ocean" transport in the Financial Regulations. It is proposed that in the Financial Regulations "ocean" be changed to "external", for consistency and to reflect the true content of this cost component (as there are instances when commodities are purchased outside of the country of implementation but are not necessarily transported by sea).

LTSH

58. To ensure a more equitable allocation of LTSH costs among donors of specific projects and operations, an LTSH equalization account was established. The review will look into how well this mechanism is working and the extent to which its objectives have been achieved and may provide recommendations for its use.

ODOC Category

59. Costs of inputs provided by WFP and utilized directly in activities, which were formerly classified as direct support costs (DSC), were reclassified as operational costs (as ODOC), effective from 1 January 2000. The establishment of the ODOC category of costs will be reviewed to determine if the anticipated benefits of establishing the category have been realized.

B. Support Costs

⇨ *Definition and Composition*

60. Support costs are currently classified into two categories, defined in the Financial Regulations as follows:[12]

- **Indirect support cost (ISC):** "a cost which supports the execution of projects and activities but cannot be directly linked with their implementation".
- **Direct support cost (DSC):** "a cost which can be directly linked with the provision of support to an operation and which would not be incurred should that activity cease".

61. ISC currently comprises:

- management and administration (all in Headquarters);
- programme support—Headquarters;
- programme support—regional offices; and
- programme support—country offices: currently a standard configuration for all country offices.

62. All other support costs are classified as DSC. The line items charged to each of these cost categories is attached as Annex II.

⇨ *Basis for Valuation*

63. The valuation placed on each of these at the time the contribution is confirmed is defined in the General Regulations as follows:[13]

- Direct support costs: *"pro-rata share of the budgeted amount for the project as in force at the time the contribution is made, based on tonnage";*
- Indirect support costs: *"percentage of direct costs as determined by the Board"*.

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[12] Financial Regulation definitions

[13] General Rule XIII.4

⇨ *Basis for Charging*

64. The expenditure amounts charged to these line items are as follows:

- DSC: pro-rata share of actual expenditure based on tonnage; and
- ISC: percentage of direct costs using a rate set by the Board.

⇨ *Issues to Review*

65. The current definitions and modalities for valuation and charging support costs will be reviewed in this section. The following issues will also be examined:

Distinction between Direct and Indirect

66. The recent comparative study of the support costs of WFP and other United Nations organizations found that the other organizations examined did not have a cost category equivalent to DSC. This section will examine why this is the case, the benefits and drawbacks of using a DSC cost category and whether or not the current split of support costs between direct and indirect is appropriate.

Reclassification of ISC to DSC

67. As discussed in the recent review of ISC, under the current definitions and policies, there is a strong case for reclassifying any variable component of PSA that is charged as part of ISC that can be directly linked to an operation as DSC. Although this may not require a policy change, it will be examined in this part of the review, and options will be developed for consideration in the context of framing the 2004–2005 budget.

68. The current definitions and policies require DSC to have a "**direct link** with the provision of support to *an operation*"—unless this direct link can be established the costs must be classified as indirect. The following will also be examined:

- implementing new methods and procedures of establishing such a direct link or
- changing the definitions of ISC and DSC, for example to allow support costs that can be linked to *operations* (rather than to a single operation) to be classified as DSC.

Fixed and Variable Support Costs

69. After this examination of ISC and DSC cost classification and definitions, there may remain ISC costs that are variable in nature (i.e. costs that vary *indirectly* with the level of operations). If this is the case, the following further issues arise and will be examined:

a) **Variable ISC:** Should ISC-type costs (PSA) be fully fixed in nature? How will changes in these costs be treated when, in one financial period, significant changes in volume occur? At what levels should such changes be triggered?

b) **Fixed DSC:** The current definition of DSC requires that DSC costs not be "incurred should [the] activity cease". [14] This section will examine the following:

   i) the appropriateness of this definition, i.e. if a cost is fixed in nature, must it be classified as indirect?;

   ii) whether or not this would require certain costs to be reclassified from DSC to ISC; and

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[14] Financial Regulation definitions

iii) in the context of the changing financial position of many United Nations funds and programmes, the ACABQ's comment that "WFP [should] ensure that fixed costs for … DSC contain adequate flexibility to accommodate, at minimum cost, changes in operations and programme delivery".[15]

c) **Country offices:** The current policy of using a standard configuration for PSA in country offices raises the possibility that countries that do not generate sufficient DSC may have insufficient support cost budgets, although they are expected to maintain certain minimum requirements or levels of administration and management, communications and advocacy, technical competencies (vulnerability analysis and mapping [VAM], gender, etc.), governance (UNDAF, inter-agency coordination, etc.), and oversight (monitoring and evaluation, audit). The standard configuration policy will be reviewed in light of this.

d) **Regional bureaux:** The use of a standard configuration for regional bureaux will also be evaluated, as these offices are likewise expected to maintain certain minimum requirements to be able to provide a cost-effective support mechanism for country offices.

Timing of Indirect Support Costs

70. The current policy requires that donors confirm an ISC amount equal to a percentage of their confirmed direct costs. However, if actual direct costs incurred are lower than the confirmed amounts, there is no clear policy on whether or not an ISC refund is due to the donor. In other words, at what point should ISC be appropriately charged to the donor?

Pro-rata DSC (also applies to ODOC and LTSH)

71. The current policy is to charge donors with a pro-rata share of actual DSC, ODOC and LTSH expenditure of a project or activity based on tonnage. This policy needs to be clarified for contributions to a project or activity that have a termination date falling before the end of the activity or project. In this case, it must be decided if the pro-rata share of costs should be:

a) only of those costs incurred up to the termination date (in which case the contribution would not bear the same share of costs as other contributions), or

b) of all costs incurred up to the end of the project (in which case it could be argued that the contribution was bearing a share of costs arising after its termination date).

SECTION G: FUNDING AND FINANCING MECHANISMS

A. Operational Costs

➪ *Background*

72. The application of the above R&LTF policies in isolation would make the implementation of each operation fully dependent on the prior receipt of contributions for that specific operation. However, the nature of WFP's operations demands a degree of flexibility and responsiveness that would be insufficient if this were the case. The R&LTF

[15] Report of the Advisory Committee on Administrative and Budgetary Questions (ACABQ).

policies therefore also outline mechanisms for bridging financing and/or funding in certain circumstances:

a) **Operational Reserve:** This mechanism is used to ensure continuity of operations in the event of a temporary shortfall of cash when an operation has confirmed contributions but cash has not yet been received.

b) **Immediate Response Account (IRA):** This mechanism is used to provide food and the attendant DSC for certain operations that do not yet have confirmed contributions, but for which such contributions can reasonably be expected.

c) **DSC Advance Facility:** This guarantee mechanism is designed to enable the organization to spend DSC monies in advance of confirmed contributions. It is backed by the General Fund.

⇨ *Issues to Review*

73. This section will examine the adequacy, in terms of level and coverage, of these funding and financing mechanisms. It will include a review of the following issues:

Scope

74. The scope of each of the current mechanisms, and linkages between them, will be examined, and any overlap or gaps will be clarified.

Operational Reserve

75. The scope and adequacy of the operational reserve will be reviewed in light of the level of activity of the Programme. This will include an examination of trends in contribution levels and the collection and utilization of this reserve.

Immediate Response Account

76. The composition of WFP activities has changed substantially over the last several years with the dramatic increase in emergency requirements. The IRA target level has, nonetheless, remained unchanged, even as its use has been expanded to PRROs and SOs.

77. The following issues will be examined in this context:

a) The level and scope of the IRA in comparison to the volume of operations—the IRA target level and the nature of projects that may be funded will be reviewed;

b) the level of delegated authority to Country and Regional Directors to approve new IRA EMOPs;

c) criteria and procedures for using the IRA, for example:

   i) inability to use funds when there is a temporary critical break in the pipeline;

   ii) delay in releasing funds due to delays in the EMOP approval process, which is a prerequisite for an IRA allocation;

   iii) unclear procedures for allocating IRA funds for non-food items and the ceiling for expenditures; and

   iv) limited opportunities to revolve the IRA.

Advance Mechanisms

78. The timing of DSC and ODOC requirements in a project is not necessarily linked to that project's food deliveries. It is not unusual for DSC and ODOC to be required before the bulk of the food deliveries. For example, the recent review of DSC found that "relief operations usually *needed* the largest amount of DSC at the beginning of their implementation, while greater amounts are *generated* later on. Thus the timing of the availability of the resources and of the actual need in the country offices differ."

79. In this context, the scope and adequacy of the DSC Advance Facility will be assessed, together with the risks of non-recovery. As this facility cannot be used for ODOC and the same timing issues seem to apply to ODOC as to DSC, this section of the review will also examine the possible need for an ODOC advance facility.

80. To the extent possible this section will include an assessment of the timing difference between requirements and fund availability. It will also review the total level of DSC/ODOC in relation to the advance facility.

Preparedness

81. WFP has no established or adequate mechanisms to finance preparedness activities, such as those involving food needs assessment, except the very limited Project Preparation Fund, which is set aside every year from multilateral contributions to the development programme category.

82. The recent review of DSC in EMOPs and PRROs concluded that "a project preparation funding facility should be developed. Funds for a project could be drawn from the facility at the planning stage, and once a project got approved, the funds would then be returned to the facility. If the project is not approved, there should be a mechanism for funding planning and preparation costs".

83. Options for establishing and funding critical preparedness activities will therefore be examined.

Other Corporate Requirements

84. The funding and financing of other corporate requirements, such as needs assessment, contingency planning, gender initiatives and evaluation and monitoring, will also be reviewed. In particular, the review will examine the treatment of cost items that are initially not directly linked to an operation but that subsequently may be directly linked due to the evolving nature of that operation.

B. Support Costs

⇨ *Background*

Indirect Support Costs (ISC)

85. ISC costs are budgeted under the Programme Support and Administrative (PSA) Budget which is set for a biennium, although the Executive Director currently has the authority to "adjust the PSA component of the budget in accordance with any variation in volume of operations when such variations are more than ten percent from the planned level".[16]

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[16] WFP/EB.3/2001/14

86. ISC costs are funded primarily from ISC recoveries by applying a single recovery rate on all of the organizations contributions, except in specific cases when these costs are waived.

Direct Support Costs (DSC)

87. DSC is budgeted at the project level and funded pro-rata from contributions to the project.

⇨ *Issues to Review*

Uncertain ISC Income Used to Fund Certain PSA Budget

88. The recent ISC review paper[17] highlighted the uncertainty of the current ISC funding mechanism. This uncertainty makes gaps between PSA income and PSA expenditure almost inevitable. The following issues will be examined in this context:

a) available alternatives for funding PSA, including an examination of possible ways of making such funding independent of tonnage while ensuring that all donors continue to bear an equitable share of these costs;

b) available alternatives for setting the PSA level; as noted in the ISC paper, "the PSA budget should not be [set] based only on considerations such as tonnage or a percentage of direct costs"[18];

c) how the PSA equalization account may be used to finance PSA gaps in the long term, including the impact that the full-cost recovery principle may have on the account's use;

d) the possible funding implications of reclassification of ISC to DSC or of DSC to ISC, in terms of funding ISC costs that may be more fixed in nature;

e) in light of discussions of the fixed/variable nature of ISC and any resulting reclassification, the current authority of the Executive Director to adjust the PSA budget (when there is a change in operational level of more than 10 percent);

f) the R&LTF policy stating that the ISC rate would be "determined by applying the approved PSA budget to the projected DOC and DSC of the activities for the biennium". The PSA budgeting process is largely internal, while the ISC rate–setting process relies on many external factors. This means that PSA budget levels have become, to a certain extent, a *result of* rather than a *determinant of* the ISC rate. The largely fixed nature of ISC costs means that applying the ISC rate to expected direct costs may not be the most appropriate way of setting the PSA budget level.

DSC In-Kind Contributions (also applies to ODOC)

89. DSC costs are normally pro-rated to donors based on the commodities contributed to the operation. However in-kind contributions for DSC and ODOC usually do not have any associated commodities. This causes problems in the proration of these costs. This issue will be examined in this section.

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[17] WFP/EB.3/2002/5-C/1

[18] WFP/EB.3/2002/5-C/1

SECTION H: OTHER R&LTF ISSUES

90. This section will examine the treatment of specific, non-standard subjects under the R&LTF policies. It will include:

A. Interest Income[19]

⇨ *Background*

91. Under Financial Regulation 11.2, monies "not required immediately may be invested by the Executive Director, bearing in mind the need for safety, liquidity and profitability".

92. The income generated from such investment (Financial Regulation 11.3) "shall be credited, where applicable, to the related special account, and in all other cases to the General Fund as miscellaneous income". Financial Regulation 4.1 indicates that interest on investments should be treated as miscellaneous income.

⇨ *Issues to Review*

93. The use of any miscellaneous income from the General Fund therefore involves, at least in part, the use of interest income. Certain donors have expressed concern over such use of interest income, citing their legislation restricting the use of interest earned on their funds. Some donors have also requested that WFP remit interest on any unexpended balance of their cash contributions at the end of a project or programme or at regular intervals. If such requests are honoured, it would increase the administrative burden, further reduce the multilateral nature of WFP's resources, and cause the Programme to lose a potential source of additional revenue.

94. The following issues will be examined as part of the review:

a) options for the treatment of interest where donors have legislative restrictions and the steps necessary to optimize use of interest income, with donor legislation taken into consideration;

b) the steps necessary to optimize the use of interest income, with donor legislation taken into consideration;

c) the compatibility of the current Financial Regulations with such legislation;

d) the ownership of interest income (interest earned on unspent balances of completed projects);

e) the determination of the amounts of interest income relating to each donor and the impact of any "negative balances" on this process;

f) the current practice of treating interest income differently from other General Fund resources (in terms of the approval required for its use);

g) practices of other United Nations organizations; and

h) the effect of the new policy of accrual of income on the treatment of interest income.

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[19] Resulting from Executive Board decision 2002/EB.3/7.

B. GCCC[20]

⇨ *Background*

95. The review will also consider the current policies and treatment of Government Cash Counterpart Contributions (GCCC). The issues discussed under this item are related to the implementation of Financial Regulation 4.7 and the problems associated with the modalities of GCCC calculation, recording and collection.

⇨ *Issues to Review*

96. This section will include a review of the following:

a) the definition and scope of GCCC and the effectiveness and validity of Financial Regulation 4.7 in terms of mandatory requirements, adequacy and effectiveness;

b) the significant difficulties in finalizing and implementing the basic agreements with recipient governments as required under Financial Regulation 4.7;

c) the appropriate accounting treatment of GCCC, including alternative ways of recording GCCC (for example as receivables or on a cash basis);

d) the valuation and recording modalities of in-kind GCCC contributions and the impact this may have on the PSA;

e) the relationship between GCCC and the PSA standard configuration in country offices and the non-PSA options for treating GCCC, including:

   i) direct credits to respective country offices;

   ii) as miscellaneous income to the General Fund; and

   iii) within new country office standard configurations, as both PSA and DSC, or as a separate cost element;

f) the difference between donor and host government views on the voluntary nature of these contributions;

g) the modalities used by other United Nations agencies; and

h) the financial rules and criteria to complement the treatment of GCCC.

⇨ *Progress to Date*

97. A comprehensive analysis of these GCCC issues has already been completed and is being reviewed internally by the Secretariat. It was originally intended to present this document to the Board in February. However, to align the timeline of the GCCC review with the remaining R&LTF issues, this document will be presented for consultation with the Bureau and Board members before being presented to the Executive Board in May.

C. ISC Waivers

⇨ *Background*

98. The issue to be discussed under this item relates to the waiver of ISC on in-kind contributions for DSC under WFP General Rule XIII.4, paragraphs (e) and (f).

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[20] Resulting from Executive Board decision 2002/EB.3/7.

⇨ Issues to Review

99. This section will include an examination of the criteria for waiving ISC and the following issues:

a) Waivers of ISC could cause shortfalls in covering PSA.

b) The General Regulations do not address contributions that are ISC in nature.

c) Contributions received by WFP net of ISC (e.g. Friends of WFP) have an impact on ISC income.

d) How significant are in-kind contributions to DSC, and what is their impact on ISC?

e) Should General Rule XIII.4 (f) be extended to cover in-kind LTSH and/or ODOC?

f) Not all in-kind contributions to DSC (e.g. standby agreements) are accounted for. Procedures to document and account for all in-kind DSC contributions will be examined.

D. Locally Generated Funds

⇨ Background

100. The Programme generates funds locally, including from the sale of commodities (commonly referred to as monetization), as provided for in General Rule XI.1 and Financial Regulation 4.6. This part of the review will cover specific financial policies for the accounting and management of these funds.

⇨ Issues to Review

101. This review will assess:

a) policies, procedures and guidelines for different types of locally generated funds;

b) the application of the full-cost recovery principle in such cases;

c) the treatment of ISC/administrative fees related to these funds.

E. Provision of Logistics Services to Third Parties

⇨ Background

102. WFP provides a variety of services to other United Nations agencies and members of the private and voluntary organizations (PVO) community on a short-term (one-off) or long-term basis. These activities are not directly related to food distribution. However, in the process of WFP's implementation of its projects, particularly in transport and logistics, there are opportunities for sharing these kinds of services with other participating organizations. These types of services include:

- United Nations Joint Logistics Centre (UNJLC);
- United Nations Humanitarian Air Service (UNHAS);
- United Nations Humanitarian Response Depot (UNHRD); and
- Technical Agreements with third parties (UNICEF, FAO etc.).

103. There is no current standard for how WFP deals with such activities in its programme structure, nor for how and at what level ISC is attributable to these activities. Currently, inclusion of these activities in project budgets levies the usual ISC. Other mechanisms used include third-party agreements (TPAs) and MOUs where arbitrary rates are added, and in some cases no fees are charged, usually because the entire cost of the operation is included in consolidated appeals.

⇨ *Issues to Review*

104. As the Programme is increasingly being tasked with providing logistics services to third parties, and because of the magnitude of income and expenditures relating to such activities, a standard methodology needs to be established, together with more specific and relevant policies.

105. The following three issues (not an exhaustive list) may require resolution:

a) What is the most appropriate vehicle for managing these types of operations?

b) What is the most appropriate indirect support cost to charge for these activities?

c) Should WFP be the sole vehicle through which donor contributions are channelled to the activity in question?

SECTION I: IMPACT OF OTHER STRATEGIC ISSUES

106. The Programme is considering the following issues, which could raise other issues to be incorporated into the R&LTF review:

- results-based management framework for PSA;
- Management Plan 2004–2005;
- Strategic Plan 2004–2007.

107. Any impact these issues have on the R&LTF policies will be incorporated in the appropriate section of the final review paper as work progresses in these subjects.

SECTION J: CONCLUSIONS AND RECOMMENDATIONS

108. This section will outline the main conclusions and recommendations of the review.

PART III: PROGRAMME OF WORK

109. It is proposed that the 2003 review of the R&LTF be viewed in four separate stages with the following milestones:

- **Stage 1: Produce Annotated Outline and Programme of Work:**
  - Secretariat to circulate draft annotated outline and programme of work: 10 December 2002
  - Informal consultation of the Board on the final EB paper: 14 January 2003
  - FAO Finance Committee review: during the week ended 31 January 2003 (to be confirmed)
  - Review of annotated outline and programme of work by ACABQ: 5 February 2003 (via video)
  - Final annotated outline and programme of work formally presented to the Executive Board: 6–7 February 2003
- **Stage 2: Information Gathering and Bilateral Informal Consultations:**
  - Substantive comments from Board members on issues identified in annotated outline: 14 February 2003
  - Secretariat to produce detailed information relating to the identified issues and results of bilateral informal consultations with group lists: 21 February 2003
  - The Executive Board Bureau, in consultation with the Secretariat, to prioritize issues and identify those that will be included in the initial phase of the review
- **Stage 3: Produce Initial R&LTF Review Document for Executive Board:**
  - Executive Board Bureau to review the priority issues, conclusions, and recommendations: Regular meetings: 5 February, 14 February, 26 or 28 March (all to be confirmed)
  - Secretariat under the direction of the Bureau to produce the initial R&LTF review document setting out the proposed policies: 9 April 2003
  - Initial R&LTF review document to be submitted to REC for processing: 11 April 2003
  - Initial R&LTF document to be issued: 25 April 2003
- **Stage 4: Review of Initial R&LTF Review Document by ACABQ and FAO Finance Committee**
  - FAO Finance Committee review: during week of 5–9 May 2003 (to be confirmed)
  - ACABQ review: 12–13 May (to be confirmed)
  - Executive Board considers proposals from the initial R&LTF review document: 26–30 May 2003

- **Stage 5: Final Phase: Review of Remaining Issues**
  - Issues not covered in the initial review document presented to the May meeting of the Executive Board will be presented to the October meeting of the Board. These issues, and the timetable for their resolution, will be outlined in an annex to the document prepared for the initial phase of the review (see Stage 4).

ANNEX I

CURRENT BREAKDOWN OF OPERATIONAL COSTS

1. Commodities:
   a) In-kind commodities
   b) CLC—cash in lieu of commodities
2. External Transportation:
   a) External transport—ocean freight
   b) External transport—overland freight
   c) External transport—air freight
   d) Loading
   e) Discharge
   f) Storage
   g) Agency fees
   h) Bagging
   i) Transshipment
   j) Fumigation
   k) Insurance
   l) Superintendence
3. Landside transportation, storage and handling (LTSH):
   a) Port operations costs
   b) Landside transport
   c) Air transport
   d) Transhipment costs
   e) EDP operations
   f) Distribution costs
   g) Other LTSH costs
4. Other direct operational costs (ODOC):
   a) Staff-related costs
   b) Recurring costs (rental, utilities, etc.)
   c) Equipment/capital costs
   d) Food transformation costs

ANNEX II

CURRENT BREAKDOWN OF SUPPORT COSTS

1. Indirect support costs:
   a) Staff
   b) Overtime
   c) Consultancy
   d) Travel
   e) Information and publications
   f) Documents and meetings
   g) Training
   h) Communications
   i) Management information systems
   j) Hospitality
   k) Other operating expenses
   l) Services from FAO
   m) Services from other United Nations organizations
   n) Contribution United Nations Reform
2. Direct support costs:
   a) Staff
   b) Consultants
   c) Travel
   d) Communications
   e) Information systems
   f) Other office expenses

ACRONYMS USED IN THE DOCUMENT

ACABQ	Advisory Committee on Administrative and Budgetary Questions
CFA	Committee on Food Aid Policies and Programmes
CO	country office
DOC	direct operational cost
DSC	direct support cost
EMOP	emergency operation
FAC	Food Aid Convention
FAO	Food and Agriculture Organization
GCCC	Government Cash Counterpart Contribution
HQ	headquarters
IRA	Immediate Response Account
ISC	indirect support cost
LGF	locally generated funds
LTSH	landside transport, storage and handling
MOUs	Memoranda of Understanding
ODOC	other direct operational cost
PRRO	protracted relief and recovery operation
PSA	programme support and administrative
PVO	private and voluntary organization
R&LTF	resource and long-term financing policies
TPA	third-party agreements
UNDAF	United Nations Development Assistance Framework
UNDG	United Nations Development Group
UNHAS	United Nations Humanitarian Air Service
UNHRD	United Nations Humanitarian Response Depot
UNICEF	United Nations Children's Fund
UNJLC	United Nations Joint Logistics Centre
VAM	vulnerability analysis and mapping