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FINANCIAL AND BUDGETARY MATTERS

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PROPOSAL ON USE OF INTEREST INCOME

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NOTE TO THE EXECUTIVE BOARD

This document contains recommendations for review and approval by the Executive Board.

Pursuant to the decisions taken on the methods of work by the Executive Board at its First Regular Session of 1996, the documentation prepared by the Secretariat for the Board has been kept brief and decision-oriented. The meetings of the Executive Board are to be conducted in a business-like manner, with increased dialogue and exchanges between delegations and the Secretariat. Efforts to promote these guiding principles will continue to be pursued by the Secretariat.

The Secretariat therefore invites members of the Board who may have questions of a technical nature with regard to this document, to contact the WFP staff member(s) listed below, preferably well in advance of the Board's meeting. This procedure is designed to facilitate the Board's consideration of the document in the plenary.

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INTRODUCTION

1. At its Annual Session of 1997, the Executive Board requested the Secretariat to make proposals on the use of interest income for its consideration. The request was made because some donors indicated that with the implementation of new resource and long-term financing policies, the programme support and administrative (PSA) budget should be fully covered from indirect support cost (ISC) recoveries, and not partially through the use of interest income as this appeared to counter the principle of full cost recovery.
2. The objectives of this paper are:
 - a) to explain that structural financing gaps for the PSA occur within a financial period, notwithstanding the principle of full cost recovery, and to demonstrate that the use of interest income is a mechanism to equalize those gaps; and
 - b) to propose modalities on the use and allocation of interest income.

BACKGROUND

3. WFP's proposed Financial Regulations 11.2 and 11.3 state that, "*Monies not required immediately may be invested by the Executive Director, bearing in mind the need for safety, liquidity and profitability. Income from investments shall, where applicable, be credited to the relevant special account, and in all other cases to the General Fund as miscellaneous income. Unless otherwise authorized by the Executive Director, interest accrued on donor funds administered by the Programme for bilateral services shall also be credited to the IRA.*"
4. Funds contributed to WFP are placed in interest-bearing and fixed-term accounts until disbursed. Under WFP's current Financial Regulations, WFP interest earnings are accrued as miscellaneous income under the General Fund. Such income, as administered by the Executive Director, is used exclusively for WFP's operational and support expenses, including the PSA component. The figure below shows the interest income earned by WFP over the five-year period 1992 to 1996.

INTEREST INCOME DURING THE PERIOD 1992-1996 (in US\$ million)

Financial period	Cash balance	Total	Interest income	
			WFP	Bilateral donors
1992-93	499.3	66.3	58.4	7.9
1994-95	616.9	54.3	44.6	9.7
1996	752.3	30.5	30.7	4.8

Note: Total interest includes interest credited to: a) WFP's miscellaneous income; and b) bilateral donors.



5. WFP interest income is generated from cash contributions received but not immediately disbursed. This is mainly attributed to:
 - a) contributions received for large operations where expenditure will be incurred over their duration; and
 - b) where operational obligations have been incurred on receipt of contributions, but actual disbursements against these obligations are made over a longer time period.
6. WFP interest income is reflected in the Financial Statements as miscellaneous income under the General Fund. Prior to the implementation of the new resource and long-term financing policies, interest income was credited to the Regular Resources surplus and mainly used to provide up-front financing for relief operations where donor funding was not readily available. However, in recent years, a portion of interest income was used to help fund the PSA budget since the volume of non-relief contributions, the primary source of funding for PSA, has been steadily declining.

STRUCTURAL FINANCING GAPS OF THE PSA

7. The adoption of new resource and long-term financing policies in January 1996 led to the implementation of the principle of full cost recovery. With this principle, donors would be expected to meet the full cost of operations, including ISC, to fund the biennial PSA budget. In theory, while ISC recovery should generate enough revenue to fully fund the PSA, this is not the case for the reasons described below.
 - a) The PSA expenditure does not vary to the same extent as operational expenditure, because part of the PSA costs are not variable. The level of an approved PSA budget is not adjusted in cases where a change in the volume of operations falls within a range of 10 percent; and
 - b) changes in the ratio of operations between programme categories result in generating different amounts of ISC, because of the application of different ISC rates for the programme categories. Alterations in the variable cost component of ISC could lead to gaps or excesses between resource availability and the funding needs of an approved PSA budget, which is estimated at the beginning of the biennium based on an assumed level of operation in each programme category.
8. Consequently, there is a need for a mechanism to address imbalances between PSA budget costs and the recoveries actually achieved.

MODALITIES FOR THE USE AND ALLOCATION OF INTEREST INCOME

9. Miscellaneous income and the accumulated General Fund surplus are the only funding mechanisms available to WFP to use as an equalization mechanism. Interest is by far the main element of miscellaneous income. The use of interest for this purpose directly helps relieve the burden for financing support costs in two ways.
 - a) **PSA shortfalls during the same period:** The use of interest income avoids the need to resort to appeals for additional funding from donors in a subsequent financial period.



- b) **Using the available surplus in a subsequent period:** The availability of this funding for the PSA could be considered in establishing the ISC rates to be applicable in the subsequent year, thus achieving a decrease in these rates, or in a manner to be decided by the Board on the basis of recommendations made by the Executive Director.

CONCLUSION

10. As provided in WFP's current and proposed Financial Regulations, interest income earned from multilateral and directed multilateral cash balances should continue to be credited as miscellaneous income in the WFP General Fund. Interest earnings, as miscellaneous income, should be used as an equalization mechanism for any imbalances between ISC recoveries and approved PSA budgets. After balancing an approved PSA budget, any remaining interest earnings from a completed financial period could be brought forward to the ensuing financial period as a mechanism to reduce support cost recovery rates, or used in a manner to be decided by the Board on the basis of a recommendation made by the Executive Director.

RECOMMENDATIONS

11. The Executive Director recommends the following to the Executive Board:
- all interest income earned from multilateral and directed multilateral contributions should continue to be credited and treated as miscellaneous income in the WFP General Fund;
 - interest earned during a current financial period should be applied to meet any shortfalls due to structural imbalances between an approved PSA budget and the level of indirect support cost recovery;
 - after meeting imbalances in support cost recoveries during a current financial period, any remaining interest income earned during a current financial period should be applied in the next financial period to reduce support cost recovery rates, or in a manner to be decided by the Executive Board on the basis of a recommendation made by the Executive Director; and
 - the Executive Director will report to the Board through the Budgetary Performance Report on how interest income has been used in the preceding period.

