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FINANCIAL FRAMEWORK REVIEW: WORKING CAPITAL FINANCING

NOTE TO THE EXECUTIVE BOARD

This document is submitted to the Executive Board for consideration.

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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EXECUTIVE SUMMARY

The World Food Programme is a voluntarily funded organization. This means that all expenditure for direct operational costs and indirect support costs must be met through donor contributions. The voluntary funding model requires WFP to focus on its operations and to be responsive to beneficiary needs and donors' priorities. But the inherent uncertainty of the model can lead to poor value for money, for example if managers are forced to take decisions based on short-term funding expectations.

For these reasons, WFP has introduced risk-based financial mechanisms such as advance financing in order to make its operations more economical, efficient and effective.

The advance financing mechanisms such as the Forward Purchase Facility and loans to individual projects have enabled WFP to reduce supply lead-times[1] significantly and improve on-time delivery of food to beneficiaries.

The Working Capital Financing Facility has grown significantly since it was introduced in 2005. As of November 2013, 82 percent of the total available working capital was being utilized.

Nonetheless, the uncertainty of funding continues to make it difficult for country offices to plan and effectively implement operations. And the amount of available working capital has not grown in line with WFP's increasing programme of work.

The Secretariat will continue its review of the financial framework during 2014, in line with Fit for Purpose and the shift from food aid to food assistance. More stable funding will enable country offices to plan ahead, manage costs and render services, and will provide greater transparency for stakeholders. It will also enable Country Directors to be more certain as to the provision of services.

This document explains the rationale for the review. It gives information about the financial tools at WFP's disposal and the principles involved, and provides an update on the utilization of working capital. It also gives information about the main areas for further work so that the Board can consider them at an early stage.

[1] Supply lead-time is the time between the start of the purchasing process and release of the food assistance by the country office.

WFP will evaluate ways of expanding its advance financing mechanism in order to increase the stability of funding for country operations, taking account of the mechanisms for managing associated risks. The following approaches will be explored:

i) increasing the size of the Operational Reserve;

ii) adjusting the leverage factor for individual financing tools on the basis of underlying risk; and/or

iii) introducing the concept of advance financing for projects based on more cumulative country office resourcing trends and forecasts.

As the review progresses, the Secretariat will seek Board approval of recommended changes to WFP's financial framework.

DRAFT DECISION*

The Board takes note of "Financial Framework Review: Working Capital Financing" (WFP/EB.1/2014/4-A/1), the objectives and timeline for further review of WFP's financial framework in 2014, and the current utilization of advance financing. It welcomes further proposals for expanding the Working Capital Financing Facility.

* 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. WFP is entirely funded by voluntary contributions. Its annual programme of work comprises projected operational requirements and indirect support costs (ISC), reflecting the resources needed to deliver food assistance to beneficiaries.

2. In the absence of assessed contributions or core resources, WFP must seek contributions to implement its programme of work. The level of operations depends entirely on the level of contributions received. The principle of full cost recovery is applied to all contributions to ensure that all operational, direct support and indirect support costs are covered, in line with General Rule XIII.4.[2]

3. The voluntary funding model requires WFP to be operationally focused and responsive to beneficiary needs and donor priorities. But the inherent uncertainty of the model can also lead to poor value for money, for example if managers are forced to take decisions on the basis of short-term funding expectations.

4. For these reasons, WFP has upgraded its financial framework to include risk-based financial mechanisms such as advance financing with a view to making its operations more economical, efficient and effective.

5. Nonetheless, the uncertainty of funding makes it difficult for country offices to plan operations for more than a few weeks, months or a year ahead. And the amount of available working capital has not grown in line with WFP's increasing programme of work. Currently, 82 percent of the available working capital is being utilized for financial advances to individual projects, the Forward Purchase Facility (FPF) for corporate food stocks, and funding for corporate services.

6. The Secretariat will continue its review of the financial framework during 2014, in line with Fit for Purpose and the Strategic Plan (2014–2017), with a view to enhancing value for money by increasing the stability of funding for country operations.

7. The review will include consultation with Board membership and donors, and the submission of additional documents. This paper is presented to the Board for consideration.

8. The Management Plan (2014–2016)[3] draws attention to proposals such as expanding the availability of working capital, given the relative overall stability of funding at the corporate level, to enable WFP to keep pace with the growing demand from projects for advance financing. This paper proposes a new method for advance financing for projects based on an analysis of cumulative country office resourcing trends and forecasts.

9. This will entail a re-evaluation of WFP's approach to managing the risks associated with advance financing. The Secretariat's risk-management processes for advance financing have been so effective that since 2004 only one Working Capital Financing Facility (WCFF) loan, which was made during the pilot phase, has not been recovered. The Secretariat is considering proposals to increase the availability of working capital and the modalities of its use on the basis of its proven risk-management measures (see Section III).

[2] Exceptions to the full cost recovery principle are outlined under General Rule XIII.4(e) and (f), and are reported to Annual Sessions of the Board.

[3] WFP/EB.2/2013/5-A/1.

SECTION I: FINANCIAL FRAMEWORK REVIEW

10. This section provides the rationale and objectives for further review of WFP's financial framework.

11. Since the early 1990s, WFP's financial framework has been upgraded to address the inefficiencies of the voluntary funding model and mitigate the impact on beneficiaries. The actions include:

   i) implementation of the "cumulative funds" system to manage associated costs more efficiently;[4]
   ii) creation of the Programme Support and Administrative (PSA) Equalization Account to balance the fluctuation between ISC income and PSA expenditure;
   iii) internal advance financing mechanisms such as the Immediate Response Account (IRA) and WCFF to provide funding for projects in advance of confirmed contributions;
   iv) creation of the FPF to reduce supply lead-times by procuring food in advance of requests from projects;
   v) expansion of cost components under the financial framework to accommodate new types of non-food interventions such as cash and vouchers, and capacity development and augmentation, to improve transparency; and
   vi) modification of the direct support cost funding recovery model to a percentage of direct operational costs rather than a rate per metric ton.

12. Despite these improvements, the voluntary funding model and its supporting financial systems continue to hamper the implementation of operations and the new food-assistance tools. Funding is typically received piecemeal, with little or no flexibility. Such fragmentation undermines operational planning, particularly with respect to country offices; and the aggregation of costs reduces transparency and makes it more difficult to identify cost drivers, benchmark and improve cost management.

13. Further work is needed to address these challenges and encourage more stable financial flows. Further review of WFP's financial framework in 2014 through informal and formal consultation with the membership will identify the actions required to improve operational efficiency and enhance the stability of funding with a view to maximizing WFP's impact on beneficiaries.

14. The objectives of the financial framework review are to:

- stabilize funding for country offices by improving the predictability of funding, so that operations can be planned with greater certainty;
- optimize the use of resources by reducing funding fragmentation, standardizing resource-based planning and improving the utilization of multilateral/multi-year contributions to expand advance financing capabilities; and
- enhance transparency in costing by increasing the visibility of cost drivers, improving cost management and increasing the autonomy of country offices with regard to resource usage.

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[4] Associated costs comprise landside transport, storage and handling costs, direct support costs and other direct operational costs. The "cumulative funds" system allows these components to be aggregated so that they can be programmed, obligated and spent against the cumulative amounts.

15. The review will include analysis of the current funding model and of the associated risks, costs and benefits of the proposed model. The aim is to increase decentralization with a view to enabling timely decision-making closer to the point of implementation, in line with WFP's ongoing organizational reform.

16. The review will not seek wholesale change. Initiatives identified during the review will be recommended, approved and adopted on the basis of their value, the associated risks and the system changes required.

17. The following three priorities will be addressed in Board documents:

- Working capital expansion. Three proposals are to be made for increasing the availability of working capital financing, given the relative stability of funding at the corporate level and the risk profiles of current advance finance mechanisms. A new method of advance financing is also to be introduced for Board consideration, in addition to advances provided on the basis of donor-specific high- and medium-probability project-specific forecasts: it would provide operations with advance funding based on country-level resourcing trends and forecasts.
- Single project account. This will propose the consolidation of current funding categories such as landside transport, storage and handling, direct support costs and other direct operational costs into a single budget-control mechanism. The aim will be to increase flexibility and enhance accountability and decision-making at the country office level with regard to actual fund usage, while adhering to donors' reporting requirements.
- Review of the efficiency of the current funding model. An external assessment of the current funding model will be undertaken during the first half of 2014. An internal review will survey WFP's country offices and other United Nations organizations to identify areas for improvement.

18. As the review progresses, the Secretariat will update the Board and submit documents proposing changes to the financial framework. Any changes needed in WFP's Financial Rules and Regulations will be submitted to the Board for approval.

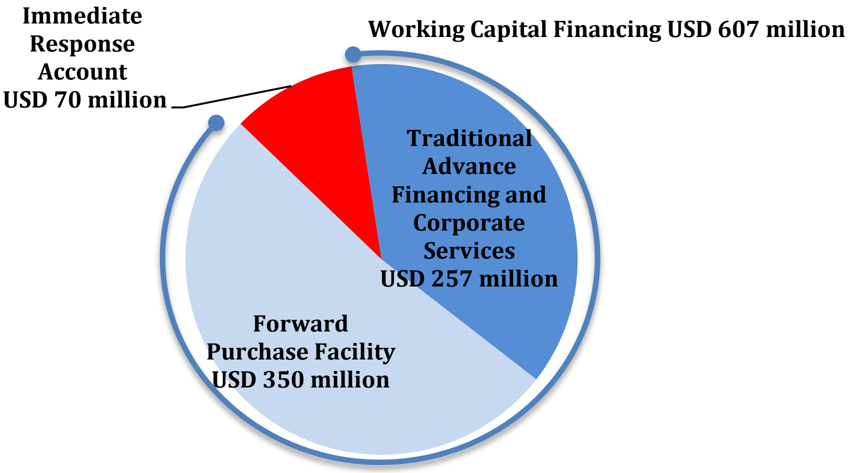
SECTION II: CURRENT UTILIZATION OF WORKING CAPITAL

19. This section reports on the use of advance financing in WFP, and the associated benefits.

Advance Financing Background

20. Advance financing has improved the planning and implementation of projects by providing greater stability and predictability, resulting in significantly increased efficiency. It enables WFP to provide funds in advance of contributions to ensure immediate response to the needs of beneficiaries, and is critical in emergency responses. The primary mechanisms are shown in Figure 1 and described in the following paragraphs.

Figure 1: Advance Financing Mechanisms



⇒ *Immediate Response Account*

21. The IRA is a flexible, replenishable, revolving multilateral funding mechanism that enables WFP to provide funding to projects for emergency needs and emergency preparedness activities. Advances from the IRA are given without any collateral and can be converted into grants. The current target level is USD 70 million**.**

⇒ *Working Capital Financing Facility*

22. The WCFF was approved in 2005[5] following a one-year pilot of advance financing. Its approved ceiling is currently USD 607 million, and it is backed by the Operational Reserve of USD 101.2 million to manage associated risks; this reflects a leverage factor of one sixth of the WCFF ceiling.

Traditional advance financing and corporate services

23. The traditional advance financing component of the WCFF enables projects to access funding to ensure continuation pending confirmation of forecast contributions. Once a forecast contribution is confirmed, the project repays the advance. Country offices can thus reduce the time between a donor's expression of interest in contributing to an operation and the delivery of food and services to beneficiaries. This component of the WCFF also provides advance financing for corporate services such as the Global Vehicle Leasing Pool and the new Capital Budgeting Facility (CBF).

Forward Purchase Facility

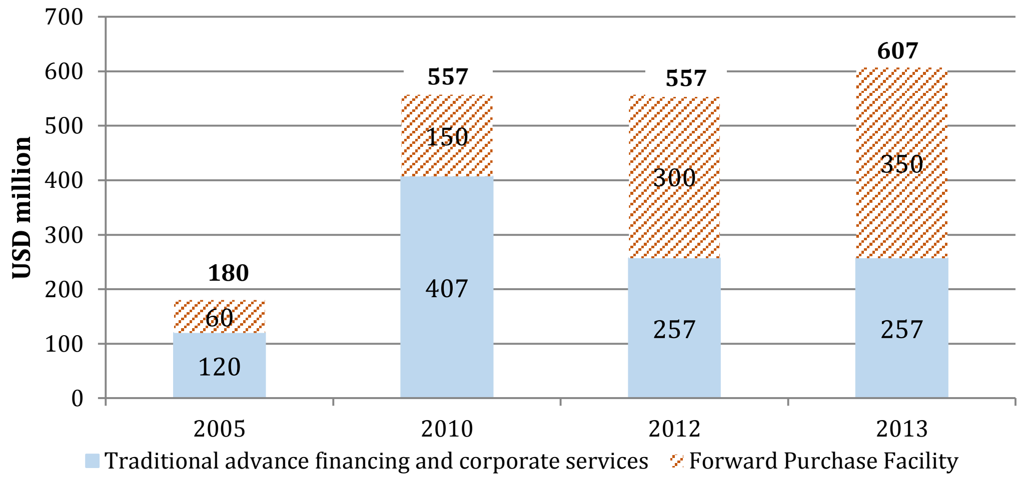
24. The FPF is administered through a special account with funding allocated from the WCFF and direct donor contributions to enable the purchase of food in advance of requests from projects. WFP maintains food inventories in continuous supply lines for pre-determined geographic zones to reduce delivery lead times; the stocks are replenished in the light of aggregate demand, projected shortfalls and resource projections. Food is released to projects on receipt of confirmed contributions or advances from the WCFF or IRA. Since its inception in 2008, the approved level of the FPF has steadily increased from USD 60 million

[5] WFP/EB.1/2005/5-C.

to USD 350 million as the geographic coverage of operations has increased and non-cereal foods were included. WFP has now embedded the process in its supply chains and risk-management systems.

25. Figure 2 provides a timeline of increases to the WCFF and the corresponding Board papers.

Figure 2: Working Capital Financing Ceiling



2005: WFP/EB.1/2005/5-C

2010: WFP/EB.2/2010/5-B/1

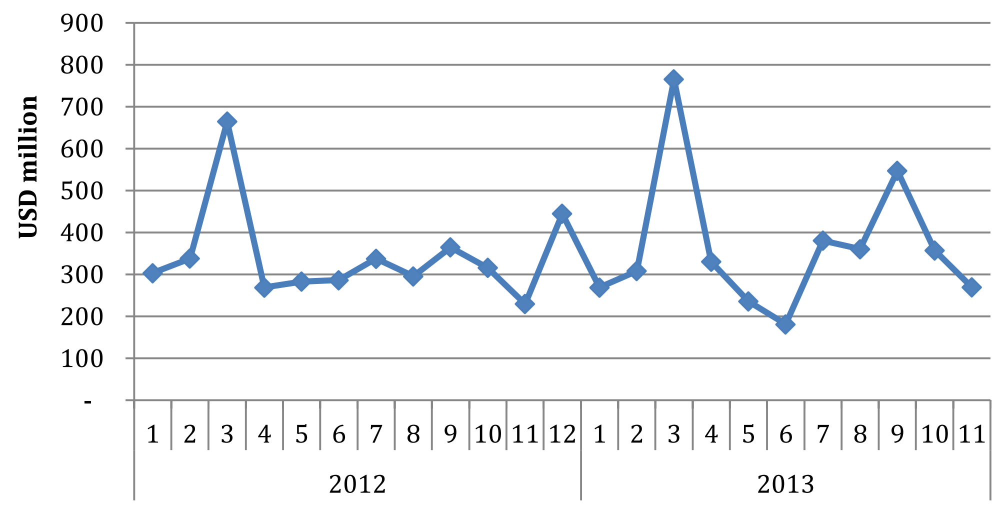
2012: WFP/EB.A/2012/6-B/1

2013: WFP/EB.2/2013/5-A/1

Benefits of Working Capital Financing

26. The level and timing of contributions to WFP vary from year to year and from month to month, as shown in Figure 3. The WCFF and advance financing help to stabilize funding for country offices, thereby enabling them to avert pipeline breaks and continue to implement their operations.

Figure 3: Contributions to WFP
January 2012 – November 2013
(by registration date)



27. Advance financing enables WFP to pre-position food in areas where access may be limited to ensure that critical needs are met. In view of the significant expansion of the FPF to its current USD 350 million, the Secretariat will consolidate the progress made in 2014 by improving processes and capacities and mainstream the 2014 systems upgrade.

28. As noted in the Annual Performance Report for 2012, traditional advance financing for individual projects reduced the average lead time – which typically ranges from 100 days to 120 days – by 37 percent. Use of the FPF reduced food delivery lead times by an average two and a half months – 75 percent – compared with traditional financing methods. The use of advance financing and forward purchasing together reduces the standard 106-day lead time for food procurement by 85 percent. If advance financing or forward purchasing were hampered by lack of working capital, WFP would face significant delays in responding to needs in an emergency.

29. The WCFF provides advance financing for corporate services such as the Global Vehicle Leasing Pool, field security, the food security cluster, telecommunications services and the new CBF. Advance financing increases the cost-effectiveness and efficiency of these services by ensuring business continuity and improving budget planning and management.

30. Further information about traditional advance financing, corporate services and the FPF is provided in the Annex.

SECTION III: EXPANSION OF WORKING CAPITAL FINANCING AND DIFFERENTIATION OF RISK PROFILES

31. This section considers the current level of working capital financing and three options for increasing the amount of finance available.

Constraints on the Current Level of Working Capital Financing

32. Operational requirements of USD 5.9 billion net of ISC are projected for 2014, an 18 percent increase over the corresponding 2013 planning figures. This does not take into account unforeseen requirements that arise during the year. The degree of project implementation will depend on the level of resources received. WFP forecasts contributions of USD 4.2 billion in 2014.

33. The use of the WCFF for FPF and the anticipated full utilization of the FPF allocation of USD 350 million limit the availability of working capital for other purposes. Table 1 shows that the non-FPF working capital available will fall to its lowest level in five years, given the current ceiling of the WCFF and the forecast contributions.

TABLE 1: WCFF CEILING AS PERCENTAGE OF THE FUNDED PROGRAMME OF WORK			
	Funded programme of work ***(USD million)***	**Available financing (WCFF ceiling minus FPF allocation)** ***(USD million)***	**Working capital availability as % of programme of work**
2010	4 129	407	9.9
2011	3 597	407	11.3
2012	4 044	407	10.1
2013	4 000	257	6.4
2014	4 200	257	6.1

Note: the 2010–2012 figures are based on total contribution income as reported in the Financial Statements; the 2013 figures are as estimated in the Management Plan (2014–2016); the 2014 figures are forecasts.

Proposals for Expanding Working Capital Financing

34. The Secretariat has a track record of managing the risks related to advance financing conservatively, and the use of working capital has resulted in improved operational efficiency and effectiveness. The WCFF is an effective instrument for taking advantage of the relative stability of WFP's annual corporate funding to reduce the instability and fragmentation of funding at the project level.

35. The following proposals, implemented individually or together, are intended to increase the availability of working capital while taking into account the risks involved:

i) increase the size of the Operational Reserve, which backs the WCFF and serves as a last recourse for any write-off of an advance;

ii) change the leverage factor for individual advance financing tools on the basis of the underlying risk in each case; and

iii) introduce a new method of advance financing to provide advance funding for operations on the basis of country-level resourcing trends and forecasts.

⇒ *Proposal 1: Increase the size of the Operational Reserve*

36. The Operational Reserve is maintained as an account within the General Fund at an approved level of USD 101.2 million. WFP currently applies a leverage ratio of 6:1 against the Operational Reserve to provide USD 607 million in working capital.

37. Options for expanding the size of the Operational Reserve include:

- appealing to donors for direct contributions to the Operational Reserve: every dollar received would increase the WCFF by six dollars, which would be continuously revolved to provide more timely food assistance for beneficiaries; and
- finding a donor or entity willing to guarantee certain types of advance financing, thereby limiting recourse to the Operational Reserve and allowing for more lending through the WCFF.

38. This type of contribution would not involve support costs, in line with General Rule XIII.4 (e) which states that "… cash contributions which are not designated in any way or are designated to the Immediate Response Account or to Programme Support and Administrative or related activities shall not be required to provide additional cash or

services to cover the full operational and support costs related to their contribution, provided that such contributions do not result in any additional reporting burden to the Programme".

39. As required by Financial Regulation 10.5, the Operational Reserve would be maintained at an agreed minimum level, overseen by the Board, the United Nations Advisory Committee on Administrative and Budgetary Questions and the Finance Committee of the Food and Agriculture Organization of the United Nations.

⇒ *Proposal 2: Adjustment of leverage ratios to reflect different levels of risk*

40. WFP's advance financing tools are designed to maximize the operational efficiency of projects. The tools are used in alignment with WFP's risk-management strategy and supported by specified risk-mitigation actions.

41. WFP recognizes the need to re-evaluate the leverage ratios in light of the associated risks and risk-mitigation actions. The following paragraphs examine the advance financing tools to show their risk profiles, to assess risk mitigation actions and to propose leverage ratios based on experience and WFP's overall risk tolerance.

Immediate Response Account

42. The IRA enables WFP to react immediately to an emergency and is maintained separately from the WCFF. IRA grants or loans are typically available only for the initial three months of an emergency operation. Under very exceptional circumstances, an IRA grant or loan may be used to meet urgent increased food requirements in an ongoing relief operation. The Secretariat has adopted policies governing application criteria, eligible activities and delegated authorities.

43. Country offices seeking grants or loans from the IRA do not need to provide collateral. The risk associated with the IRA is therefore high. This high risk is balanced by not disbursing more than the available IRA balance, which means that IRA funds are not leveraged to make additional loans: a leverage factor of 1 is maintained against the available IRA balance.

44. The Strategic Resource Allocation Committee receives periodic updates on the level and usage of the IRA. The Board is updated in an information paper submitted at each Annual Session covering the previous calendar year.

Traditional advance financing for projects and corporate services

45. WCFF loans to projects presently utilize high-probability or medium-probability forecast contributions or cost-recovery schemes as collateral.[6] Since 2004, nearly USD 3.0 billion has been advanced; the only write-off was USD 5.9 million in 2005 against a protracted relief and recovery operation in the Democratic Republic of the Congo. This successful record of advances and project repayments reflects the strength of WFP's business processes and risk-mitigation policies, but also justifies a higher risk tolerance to enable more operations to access working capital.

46. The risks associated with advance financing include:

i) forecast contributions not materializing or being less than forecast;
ii) contributions being unusable for repayment; and
iii) adverse changes in exchange rates between the commitment to purchase and receipt of a donation.

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[6] For corporate services cost-recovery estimates are used as collateral.

47. WFP acknowledges that some risk is unavoidable. To mitigate the associated risk, WFP has a sound oversight process for the approval of advances: this includes review of the purpose of the loan, the risk factors for WFP, the suitability of the forecast contributions as collateral, the impact on beneficiaries and improvements in delivery times.

48. Lending to projects is based on the probability of forecast contributions: for example, 75 percent of the value of a high-probability contribution or 50 percent of a medium-probability contribution can be advanced. Low-probability forecasts may not be used as collateral. All advance financing requests above the current threshold of USD 10 million require the endorsement of the Strategic Resource Allocation Committee.

49. Internal lending to corporate services such as security, IT and the food-security cluster constitutes a low risk to WFP because the loans are recovered through contributions or cost-recovery schemes.

50. WFP continues to encourage donors to make multi-year, multilateral contributions and to improve its forecasting of contributions with a view to supporting the advance financing process and hence operational stability.

51. The WCFF is backed by the Operational Reserve. If an advance cannot be recovered following the financial closure of a project after every avenue of recovery has been explored, the last recourse is for the Operational Reserve to absorb the write-off, in line with Financial Regulation 10.6.

52. A report on the utilization of advance financing mechanisms is provided for information at each Annual Session of the Board, complementing the Annual Performance Report.

53. WFP assesses the risks of advance financing for any project as “low” or “medium” on the basis of established risk-mitigation actions and the record of repayment. This may warrant an increase in the leverage factor above the current 6 to a factor of 10.

54. There may in future be opportunities to use advance financing to invest in priority areas such as nutrition with a view to covering country office expenditure in advance of the receipt of contributions. But the use of advance financing for such funding could constitute a higher risk. As a risk-mitigation measure it would probably have to be secured at first with donor funds that are pledged for this purpose until a track record has been established.

Forward Purchase Facility

55. The forward planning and purchasing approach relies on the development of an aggregated demand plan to manage risk. This process includes historical demand, distributions, procurement, resourcing trends, projections and needs, and projections of shortfalls by country offices.

56. Identified risks and their mitigation actions are outlined below.[7]

- Risk: Prices may decline after purchase.
  - ◊ Market opportunities, trends and other factors are analysed before purchases are made through the FPF.
  - ◊ Available FPF stocks are prioritized over purchases of similar foods.

[7] As outlined in WFP/EB.A/2012/6-B/1.

- Risk: Funding may not materialize.
  - ◊ Historical trends and forecast contributions with high or medium probability of materializing are taken into account when measuring risk.
  - ◊ The type of food purchased may be distributed in many countries.
  - ◊ Purchases may be redirected to alternative supply lines.
- Risk: Food may be damaged, spoiled or lost.
  - ◊ Food is insured.
  - ◊ Demand planning and strict management of corporate stocks ensures that food is transferred to operations well before its expiry date.
- Risk: Donor conditions such as bag marking, purchase location or contribution validity dates restrict the use of the FPF and increase associated costs.
  - ◊ Tagging is adapted to give donors visibility.
  - ◊ Constraints are communicated to donors and solutions are developed.

57. The risk relating to the FPF is considered medium. This is based on global or regional forecasts of contributions and the successful track record of FPF purchases and sales to projects. An increase in leverage ratio from 6:1 to 8:1, for example, would be supported with identified risk-mitigation processes and would ensure further mainstreaming of forward purchasing in WFP's supply chain. Increased leverage ratio for the FPF could increase the WCFF ceiling and enable FPF authorizations linked to projected food costs.

⇒ *Proposal 3: Pooled advance financing*

58. This proposal focuses on a new and different way of assessing collateral for advance financing. Pooled advance financing would allow for lending against a country office's annual overall contribution forecast as collateral rather than project-specific, validated medium- and high-probability donor contributions. Country offices would be granted advance funding to cover a proportion of the anticipated contributions for operations.

59. In the absence of core funding for country office activities, the benefits of this new method of advance financing include increased funding and operational stability. This could reduce pipeline breaks and maintain continuity of service.

60. The Secretariat recognizes that advances based on overall contribution forecasts would carry higher levels of risk than the established advance financing tools. But such advance financing would be limited to country offices that have a track record of contributions and which, on the basis of house-wide analysis of country-specific funding trends, are likely to achieve their annual contribution forecasts. Risk would also be managed by granting only a small proportion of anticipated contributions to prevent pipeline breaks. The leverage ratio for this new concept would therefore be lower than the ratio for other WCFF advances.

⇒ *Summary of risk profile differentiation for proposals 2 and 3*

61. Table 2 shows the identified risk levels and associated leverage factors.

TABLE 2: OVERVIEW OF RISK PROFILES AND LEVERAGE FACTORS			
Advance financing mechanism	**Risk level**	**Current leverage factor**	**Possible future leverage factors**
IRA	High	1:1	1:1
Pooled advance financing	Medium/high	N/A	5:1
FPF	Medium	6:1	8:1
Project advance financing	Low/medium	6:1	10:1
Corporate services	Low/medium	6:1	10:1

62. The application of these different leverage factors would lead to an increase in available working capital[8] and would ensure that WFP has the capacity and resources to respond rapidly to urgent operational needs or to lend to corporate priority areas.

63. The three proposals could, individually or together, significantly improve WFP's operational effectiveness and benefit those most in need.

Comparing the Leverage of WFP's Advance Financing Mechanisms with International Norms

64. WFP has a full understanding of the financial standing of its "clients" – which are its projects, and internal to it. This must be borne in mind when comparing WCFF leverage ratios with those applied by banks making loans to external customers.

65. In line with the 2010 working capital review (WFP/EB.2/2010/5-B/1), the Secretariat has compared the soundness of its advance financing mechanisms using the "capital adequacy" standards of the Basel Capital Accords from the Bank of International Settlements.

66. The Third Basel Accord – Basel III, a voluntary regulatory standard for bank capital adequacy, stress testing and market liquidity risk – was agreed by the Basel Committee on Banking Supervision in 2011 and will be introduced by 31 March 2018. In line with Basel III, the United States Federal Reserve has announced new minimum requirements for Tier 1 capital of 6.0 percent, and the European Central Bank (ECB) is likely to require a minimum capital ratio of 8.0 percent.

67. Table 3 shows that the WCFF is backed by the Operational Reserve of USD 101.2 million. The current WCFF ceiling of USD 607 million means that the leverage ratio is 6:1 which is equivalent to a capital ratio of 16.7 percent. An increase in the leverage ratio to 10:1 would decrease the capital ratio to 10 percent, which is still conservative compared with the capital ratio requirements for banks, which range from 5.0 percent to 8.0 percent.

[8] The amount of working capital available would depend on the mix of different advances.

TABLE 3: APPROXIMATION TO A CAPITAL RATIO OF THE ADVANCE FINANCING MECHANISM

	WFP current level	WFP proposed maximum level	US Federal Reserve (SIFI*)	US Federal Reserve (bank holding companies)	2014 ECB AQR**	Basel III***
Leverage ratio	6.0	10.0	16.7	20.0	12.5	14.3
Capital ratio *(%)*****	16.7	10.0	6.0	5.0	8.0	7.0

* Systemically important financial institutions.

** Asset-quality review standard

*** Includes a capital-conservation buffer

**** Tier 1 capital

CONCLUSION

68. This paper examines WFP's financial framework with a view to improving the efficiency and effectiveness of its interventions by making project funding more predictable and manageable. Board members are invited to consider the proposals, and the Secretariat looks forward to develop them for approval at the Board's 2014 Annual Session.

ANNEX

This annex provides background on the levels of traditional advance financing, the financing of corporate services and the FPF.

TRADITIONAL ADVANCE FINANCING

1. In 2012, 120 advances totalling USD 636.1 million were made from the WCFF (see WFP/EB.A/2013/6-K/1, paragraphs 9–16), of which 79 percent constituted advances to individual operations and 3 percent advances to corporate services; the remaining 18 percent was allocated to the FPF in connection with the increase to the FPF ceiling from USD 150 million to USD 300 million in June 2012.

2. Table 1 shows that WFP has advanced USD 3.0 billion since the WCFF was established in 2004. Greater utilization of advance financing can be attributed to improved contribution forecasts, greater donor flexibility and familiarity with the approval process for advances. Projects receiving advances reduced average delivery times by 37 percent, thus improving their efficiency and effectiveness.

TABLE 1: ADVANCE FINANCING LOANS (2004–2012)

Year	No. of loans	Total advanced *(USD million)*	Average amount *(USD million)*
2004	5	27.1	5.4
2005	10	154.5	15.5
2006	4	36.8	9.2
2007	21	157.3	7.5
2008	58	324.6	5.6
2009	35	227.1	6.5
2010	62	418.8	6.8
2011	64	439.1	6.9
2012	120	636.1	5.3
2013*	109	549.6	4.9
TOTAL	**488**	**2 971.0**	**6.1**

* As at 30 September 2013.

CORPORATE SERVICES

3. The Management Plan (2014–2016) recognizes the limitations of financing capital investments in the absence of a viable long-term funding source. WFP established the CBF with advances from the WCFF up to a ceiling of USD 20 million to make it possible to undertake capital projects that require a significant short-term outlay to achieve medium-term or long-term benefits. Projects will replenish the facility for repayment of the advances to the WCFF.

4. The Management Plan (2014–2016) proposed the use of the CBF pilot to advance capital to the Logistics Execution Support System. The advance will be repaid through a tonnage-based landside transport, storage and handling charge once the system is established and the savings realized. All CBF-supported initiatives will be subject to review and approval, and will be reported in each Management Plan.

FORWARD PURCHASE FACILITY

5. The FPF was piloted in 2008 to purchase food in advance of requests from projects. Its current level is USD 350 million. The objectives are to:

- reduce supply lead-times to accelerate food deliveries;
- enable procurement of food at advantageous times, in developing countries where possible;
- support emergency responses with strategically located food inventories that are rapidly accessible for delivery;
- help farmers to maximize production by upgrading their equipment and their capacity to deliver processed foods such as vegetable oil, corn-soya blend and ready-to-use supplementary food; and
- explore cost-savings through economies of scale.

6. At its 2012 Annual Session, the Board approved a WCFF allocation of USD 300 million to the FPF, double that approved in 2010, on the basis of the efficiency gains evident in the emergency responses in the Horn of Africa and the Sahel and WFP's forward purchasing targets for 2013. The increase enabled WFP to continue mainstreaming advance purchasing approaches in its supply chains, and to establish rolling food stocks to reduce lead times with minimal financial risk.

7. By mid-2013, WFP was utilizing nearly all of the USD 300 million – calculated in terms of food value and associated costs – to operate continuous FPF supply lines to eastern, western and southern Africa, Central America and the Middle East. But this left no room for any unforeseen large-scale response: in view of this, in November 2013 the Board approved an increase in the WCFF ceiling from USD 557 million to USD 607 million, to be achieved by increasing the Operational Reserve by USD 8.3 million. This will enable a USD 50 million increase for FPF to respond to unforeseen requirements.

8. Figures 1 and 2 show a timeline of the increases in the FPF and their utilization.

Figure 1: Forward Purchase Facility authority timeline

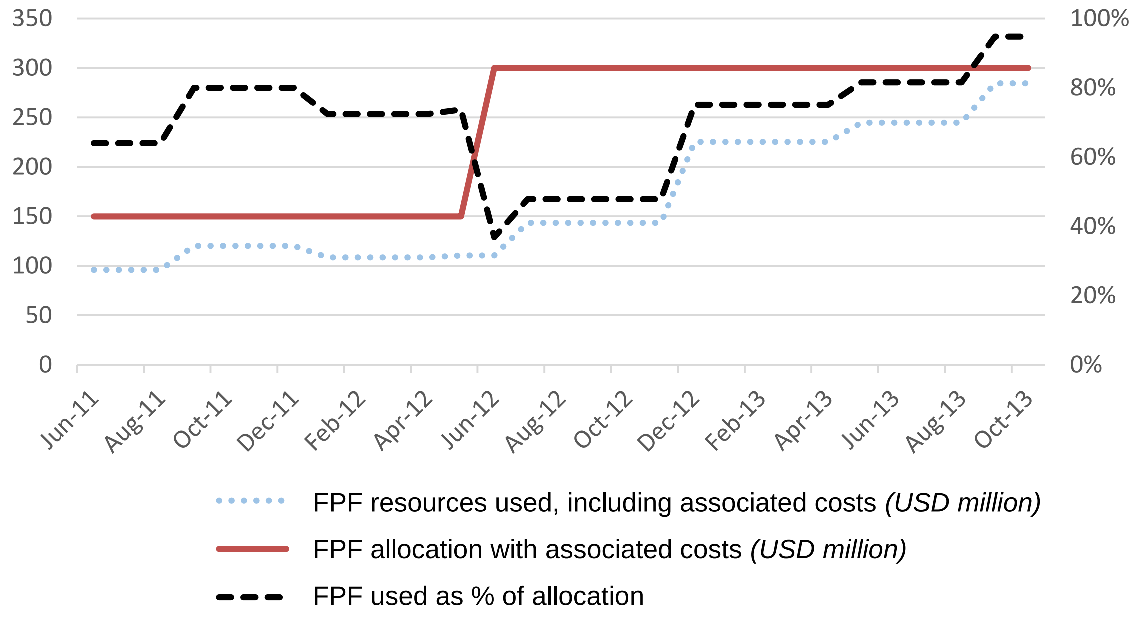
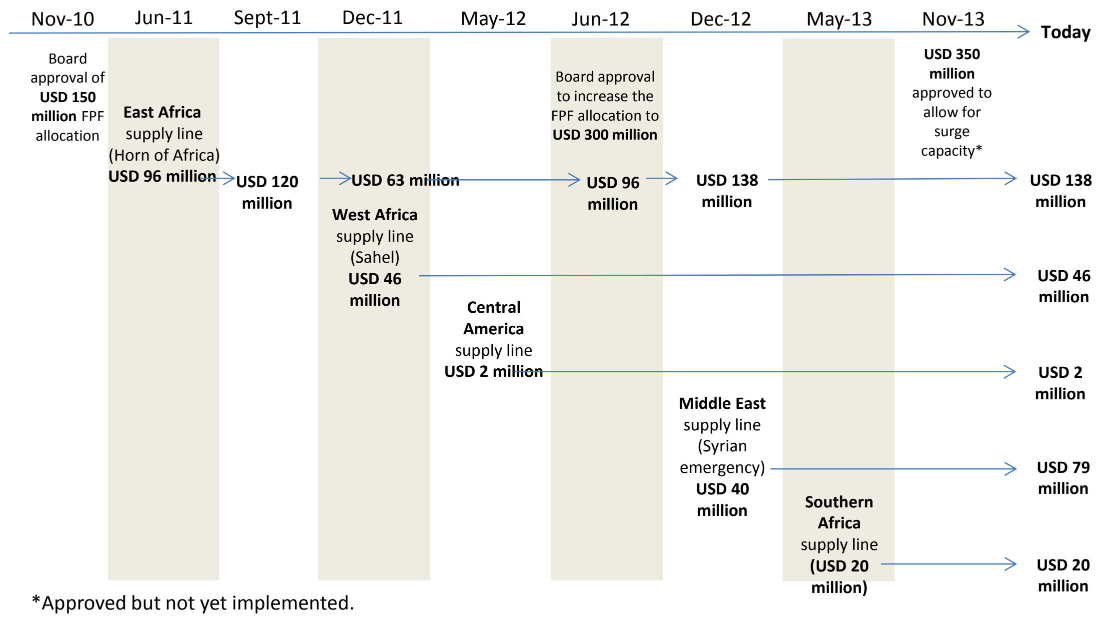


Figure 2: Launch of supply lines and purchasing authority levels[1]



9. Since the launch of the FPF in July 2011, 2.1 million mt of food valued at USD 1 billion has been purchased. FPF purchases amounting to 870,000 mt were made between 1 January and 30 November 2013, of which country offices procured 814,000 mt. Table 2 shows the 2013 performance indicators for high-volume supply lines to large operations.

[1] Purchasing authority levels refer to food value only. Associated costs typically average 20 percent of food value and are included under the FPF approved level.

TABLE 2: 2013 KEY PERFORMANCE INDICATORS FOR ACTIVE SUPPLY LINES (as of 30 November 2013)

Indicator	Unit	East Africa	West Africa	Middle East	Southern Africa*
Lead-time with conventional supply line	days	108	104	68	120
Lead-time with FPF supply line	days	20	20	25	39
Total FPF purchases	mt	412 000	137 000	255 000	65 000
Total sales to country offices	mt	439 000**	127 000	197 000	51 000
Average supply line	mt	240 000	48 000	38 000	25 000
Funded demand coverage	months	5	5	3	4
Capital utilized	USD mln	181	84	177	25
Capital revolved	USD mln	196	88	150	22
Capital rotation	rotation/year	2.0	3.2	5.2	2.5

* From July 2013

** Some sales were revolved against 2012 purchases.

10. The FPF has unquestionably improved WFP's operational efficiency, as noted in external assessments and the indicators in successive Annual Performance Reports. The Secretariat will enhance the relevant capacities in 2014 and mainstream the systems upgrade implemented mid-2013 with a view to optimizing the forward purchasing approach; new food procurement contracts will be considered, and supply-chain management will be improved to make optimum use of the FPF allocation. The FPF will be reviewed periodically to align with the level of projected food commodity purchases, and any required adjustments will be proposed in future Management Plans.

ACRONYMS USED IN THE DOCUMENT

CBF	Capital Budgeting Facility
ECB	European Central Bank
FPF	Forward Purchase Facility
IRA	Immediate Response Account
ISC	indirect support costs
PSA	Programme Support and Administrative
WCFF	Working Capital Financing Facility