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Agenda item 12

For consideration

BUSINESS PROCESS REVIEW: SECOND PROGRESS REPORT ON THE PILOT PROJECTS

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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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EXECUTIVE SUMMARY

In March 2003, the Secretariat began a business process review designed to improve efficiency in WFP. It had two objectives: (i) to maximize the utilization of resources destined to a project, and (ii) to improve on-time availability of food aid. The recommendations arising from this review are now being tested at the field level in a series of pilot projects, the first of which was launched in December 2003.

One of the recommendations of the business process review is to authorize spending against forecast contributions rather than confirmed contributions. Following a series of informal and formal Board consultations, in February 2004 the Board approved the use of the Operational Reserve to finance the pilot projects on the basis of forecast contributions.

Following consultations with the Board in May 2004, and in order to present the latest results of the pilot testing, and to advise on next steps, the Secretariat submits this document to the Board for consideration.

The main results of the pilots include:

- a 44 percent improvement in on-time resource availability in the Democratic Republic of Congo protracted relief and recovery operation; as a result, 700,000 more beneficiaries will be fed on time in the fourth quarter of 2004;
- a 90 percent improvement in on-time resource availability in the Occupied Palestinian Territories emergency operation; as a result, 450,000 needy people are receiving WFP food aid during the first 90 days of the operation; and
- a reduction of US$5.2 million in unutilized balances in a single Project, in the Democratic Republic of Congo.

DRAFT DECISION*

The Board takes note of the information and results presented in the "Business Process Review: Second Progress Report on the Pilot Projects" (WFP/EB.3/2004/12-B/1), including the planned next steps for the Business Process Review.

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

INTRODUCTION

1. In 2003, the Secretariat began a business process review (BPR) designed to improve efficiency in WFP, which has resulted in the development of a new business model that aims to:

   i) maximize the utilization of resources destined to a project; and

   ii) improve on-time availability of food aid in-country.

2. To start applying the new business model in real situations, the Secretariat is implementing a pilot project phase with the following objectives:

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

3. The purposes of this information note are to update the membership on progress in BPR since June, and to outline the way forward. The note contains: (i) a high-level summary of progress in the pilots; (ii) a review of the main business process improvements; (iii) an analysis of the benefits and impact resulting from the improvements so far; (iv) a summary of progress in reducing balances; (v) an outline of what BPR expects from donors to help reach our common objectives and (vi) an outline of the next steps for BPR.

> ***Results so far:***
>
> - a 44 percent improvement in on-time resource availability in the Democratic Republic of Congo (DRC) protracted relief and recovery operation (PRRO); as a result, 700,000 more beneficiaries will be fed on time in the fourth quarter of 2004;
> - a 90 percent improvement in on-time resource availability in the Occupied Palestinian Territories emergency operation (EMOP); as a result, 450,000 needy people are receiving WFP food aid during the first 90 days of the operation; and
> - a US$5.2 million reduction of unutilized balances in the DRC.

I. SUMMARY OF PROGRESS IN THE PILOT PROJECTS

4. Five pilot projects were selected: the DRC PRRO, the Occupied Palestinian Territories EMOP and PRROs in Cambodia, Indonesia and the West Africa Coastal region.

5. The pilot projects in DRC and the Occupied Palestinian Territories are now fully "live" in the new business model. The pilot has been launched in Indonesia. Preparatory work has been completed in Cambodia and West Africa to ensure that they are ready to operate in the new business model as soon as their projects begin (see Annex I).

6. It is important to note that the Secretariat is testing the new business model in an integrated way. For example, it would be relatively easy to grant an operation working-capital financing, or to move quickly to the new flexibility in a single-project

account. But these benefits are based on putting into place important improvements. These "building blocks" are essentially conditions that must be in place before a country office can qualify for working-capital financing to ensure that business is being run as efficiently as possible and that the proper financial controls are in place. As highlighted in previous BPR papers, these building blocks are:

- enhanced needs assessment;
- enhanced project budgeting and approval;
- enhanced project planning, execution and monitoring;[1]
- donation forecasting;
- working-capital financing;
- resource assignment at the country office level with single-project account;
- prioritization of food aid;
- donor reporting;
- timely project closure and resource transfer; and
- augmented regional oversight.

7. For example, enhanced project planning is essential to make full use of the single-project account. Similarly, working-capital financing is considered only after a project has greatly improved its planning, monitoring and execution, and donation forecasting has been improved. These fundamental improvements provide the accountability and rigour in running our business that have to be adopted before we can consider additional flexibility in our programming and funding of projects.

II. PROCESS IMPROVEMENTS IMPLEMENTED TO DATE

8. **Enhanced project budgeting and approval.** After assessing food aid requirements, the next step in the project cycle is setting up the project budget. To prevent over-budgeting – one of the main causes of unspent balances – the BPR team prepared a multiple-scenario budget in DRC and the Occupied Palestinian Territories that can adjust to operational changes based on predefined triggers.

9. The supply-chain and financial-planning tool described below has enabled the country teams to develop project plans and budgets for different operational scenarios, detailing the monthly costs that projects will incur under each. Starting with the expected scenario, we have identified possible events – such as a change from land to air transport – that would trigger shifts from one scenario to another, either the most expensive worst-case or the least expensive best-case. Chart 1 shows the DRC provisional multiple-scenario budget.

10. The BPR team is working on an enhanced approval process incorporating the multiple-scenario budgeting approach.

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

Chart 1

MULTIPLE SCENARIO BUDGETING: TRIGGERS DRIVE ALLOCATION OF RESOURCES

Example DRC Operation

Cost category	Worst	Expected	Best	Triggers
	Monthly costs[1] (US$ million)			
Commodities	2.97	2.79	2.69	• Originating country • Fluctuation in commodity prices
External transport	0.69	0.66	0.64	• Originating country • Fluctuation in sea transport prices
Overland	1.09	0.92	0.86	• Transport mix - rail, road, air • Purchasing location - local, regional, overseas
ITSH[2]	1.75	1.59	1.47	• Transportation mix - rail, road, air • Purchasing location - local, regional, overseas

(1) During first year: distributing 8,854 mt per month
(2) Internal transport, storage and handling

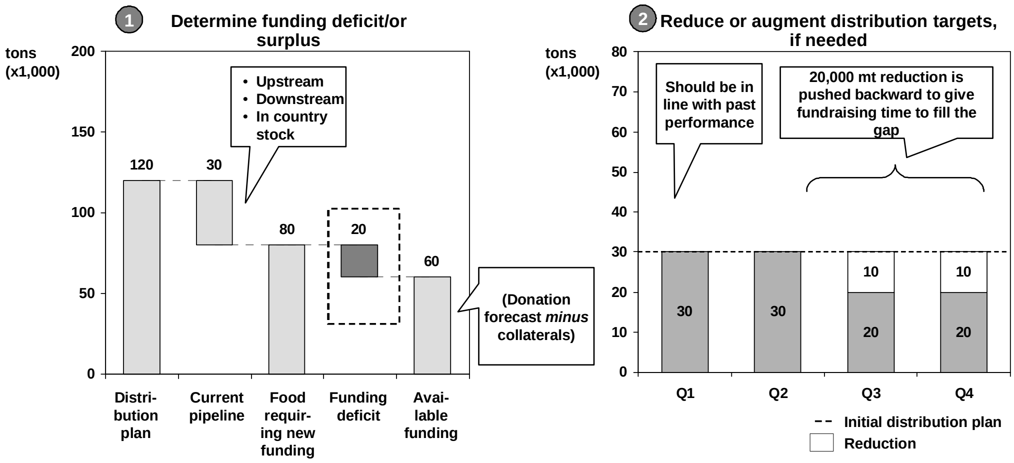
11. **Enhanced project planning, execution and monitoring** are the foundation of the new business model, constituting the prerequisite for working-capital financing and allowing implementation of the single-account approach. This module focuses on developing a project planning tool linking the logistics and cash pipelines, and establishing a monthly planning and review cycle.

12. For the first time, a planning method has been developed linking the logistics and cash pipelines, driven by project requirements and linked to factors including the logistics corridor, commodity and type of financial commitment. The country offices in DRC and the Occupied Palestinian Territories now know precisely what food and cash are needed and when. With this information, the country office is in a position to request working-capital financing or to utilize the flexibility afforded by a single-project account. As a result, project management and financial management have improved significantly, allowing resources to be used to the greatest effect.

13. **How it works**. Using a newly defined expenditure-forecasting methodology, the country office calculates the net requirements based on the forecast shortages. These requirements are compared to the overall forecast income to balance expenditure-plan/distribution targets with the forecast income. For the first time, projected income and project expenditure must equal one another, so that the country office knows what it requires and what it will receive and spends accordingly, thus maximizing resources and on-time availability. In the past, country offices often planned distribution based on limited knowledge of income forecasts and requirements. Chart 2 shows how the new methodology works.

Chart 2

BALANCE EXPENDITURE PLAN WITH DONATION FORECAST



14. The country office updates its expenditure forecast monthly to track potential shortages and the need for working-capital financing. This prototype forecasting system is now in place in DRC, Indonesia and the Occupied Palestinian Territories. So far, DRC has been the most challenging environment for putting this system into place, which is not surprising given its more complex logistics situation based on several corridors.

15. This model of expenditure forecasting provides country offices with appropriate planning information and is an excellent tool for providing fundraising officers with better and more precise information to share with donors. Annex II gives more details about the expenditure and income forecasts in DRC and the Occupied Palestinian Territories.

16. **Donation forecasting.** The new income-forecasting method, which was developed by WFP and the Boston Consulting Group, is now being tested. Donation forecasts have been prepared for Cambodia, DRC, Indonesia, the Occupied Palestinian Territories and the West Africa Coastal operation. The enhanced supply chain and financial planning are the first pillar at the country level and the basis for the expenditure forecast; the donation forecast is the second pillar, serving as the income forecast. It should be borne in mind that in the new business model, projects can operate on the basis of forecast but not yet confirmed contributions.

17. Donation forecasts are prepared monthly; DRC has produced four forecasts since July. The new donation-forecasting method is based on compiling and correlating “hard” and “soft” data for single donors, associated with estimations of the probability that these donors will contribute to the project in question. The hard data include historical information mapping a donor’s contribution record and behaviour; the soft data include information on the global picture of a donor’s attitude towards international assistance, its fiscal and budgetary policies and, most important, assessments from WFP’s donor relations officers.

18. So far, it has been difficult to forecast donations beyond the current calendar year. This appears to be the result of a conservative internal approach by fundraisers and insufficient visibility of donors’ future funding patterns. But it is expected that donation forecasting will improve as fundraisers gain more experience and WFP works even more closely with donors.

19. **Working-capital financing**. As highlighted in previous communications with the Board, there is often a timing mismatch between availability of resources and project needs, even with forecast income projections. Projects often receive resources too late for food to arrive in time. To solve this mismatch, WFP needs to spend against forecast contributions rather than confirmed contributions. In practice, country offices will request working-capital financing against forecast "collaterals".

20. To date, the DRC PRRO and the Occupied Palestinian Territories EMOP have received US$15 million in working-capital financing from the Operational Reserve Account approved by the Executive Board in February 2004. This resulted in significant increased on-time availability of food. The positive impact of working-capital financing is discussed in greater detail in the following section.

21. **Resource assignment at the country office level within a single-project account.** In the old business model, the allocation of directed country-specific contributions was initiated by a centralized group. Contributions were broken down into their cost components such as commodity, transport and landside transport, storage and handling (LTSH). In the new model, the DRC country director is now directly responsible for programming country-specific resources, which is a better reflection of the country director's true project ownership. This increased involvement at the beginning of the supply chain is expected to be an important incentive to improved resource utilization, and should augment project ownership at the country office level. The Occupied Palestinian Territories country team will be trained in this competency in the coming months.

22. **Timely project closure and resource transfer.** This is the last step in the project cycle, carried out immediately before the official start date of the new project. Timely project closure and quick transfer of any leftover resources clearly improve project management by avoiding multiple projects with the same objectives and beneficiaries. These activities also reduce the build-up of balances and in some cases provide critical start-up capital for all follow-on projects.

23. In DRC, transfer of resources from the last phase to the new phase helped to alleviate what would have been almost three months of shortfalls. In the old model, the project would have appealed for additional funds for the new project, even though funds were potentially available for transfer. This quick closure and transfer of resources also delayed the need for working-capital financing.

24. Chart 3 gives an overview of the business process improvements tested in the pilots so far. The BPR team is working on enhanced needs assessment and enhanced budget approval processes and will soon start with augmenting prioritization of food aid and donor reporting.

Chart 3

PROCESS IMPROVEMENTS TESTED SO FAR

Pilot project	Enhanced project planning, execution and monitoring	Donation forecasting	Working-capital Financing	Single-project account	Multiple-scenario budgeting	Resource transfer	Allocation of resources at CO level
DRC PRRO	✓	✓	✓	✓	✓	✓	✓
Occ. Pal. Terr. EMOP	✓	✓	✓	✓	✓	✓	
Indonesia PRRO	✓	✓	Planned for Oct 2004		✓		
Cambodia PRRO	✓	✓	PRRO planned to start in Jan 2005; BPR implementation planned to start Oct 2004				
West Africa Coast PRRO	✓	✓	PRRO planned to start in January 2005; BPR implementation planned for Nov 2004				

25. **More regional oversight added.** In addition to the process improvements mentioned above, WFP has also strengthened the capacity of the regional bureaux by creating new regional financial analyst posts in each bureau. These financial analysts are responsible for (i) monitoring the budgetary performance of operations in the region, (ii) forecasting and analysis and (iii) providing support for the BPR pilots in the region. They will monitor and manage the cash pipeline for all operations in the region and will play a critical role in the eventual roll-out of the new business model.

26. These are several of the tools we have developed to empower country offices and ultimately improve utilization and timeliness of resources.

III. BENEFITS AND IMPACT – PILOT CASE STUDIES

Working Capital Financing

27. Working with the BPR group, the country teams in DRC and the Occupied Palestinian Territories used the project-planning tool described above to define precisely their food and cash requirements. By linking expenditure forecasts with the new donation forecasts, the country teams had a clear picture of forecast pipeline breaks that needed to be financed with interim working capital, as well as of their ability to repay the working-capital loans with forecast contributions.

28. After developing a detailed financial forecast, DRC requested and received working-capital financing of US$5.4 million in June. Through this advance financing, WFP is ensuring that 700,000 refugees in Eastern Congo will receive food aid during the last quarter of 2004. This translates into a 44 percent increase in on-time availability for the operation in this period. This advance was made against contributions expected to be confirmed in the second and third quarters of 2004, but which would have been too late to avoid serious shortfalls later in the year.

29. To date, over half of the working capital loan granted to DRC has already been repaid using contributions confirmed in July and August from EuropAid, France, Finland and Ireland.

30. To reduce risk, the Secretariat is ensuring that any advances are paid back as soon as possible. This rapid payback does not, however, preclude additional loans; indeed, it improves a country's credit-worthiness, because it shows that repayments can be made. Based on its current forecast of needs and donations into 2005, DRC may in fact request additional working capital in October. This will allow the country office to feed beneficiaries on time and puts WFP's cash balances to work as working capital rather than interest income drawn from the bank, as in the past.

31. The forecast donations WFP has used as collateral to secure the working-capital advances in DRC have not had many donor constraints, so working-capital financing and repayment have been relatively smooth. But the addition of even one donor restriction – bag markings, for example, as described below – drastically reduces the efficiency gains of such financing.

32. In the Occupied Palestinian Territories, an analysis of the expenditure and income donation forecast indicated the need for working-capital financing at the beginning of the project, because there were minimal resources left over from the previous project. The donation forecast looked healthy overall, but contributions were not expected to allow the project to start on time. So a total of US$9.6 million was advanced in July, which is ensuring that 90 percent of beneficiaries – 400,000 needy people – received food aid on time during the first quarter of the project.

Impact

33. The impacts were:

- in DRC, 700,000 more beneficiaries will be fed on time – a 44 percent increase in overall on-time availability; and
- in Palestine, 400,000 people will be fed on time – a 90 percent increase in on-time availability.

34. No left-over balances are expected at the end of the pilot project, because commodities will have been purchased and distributed in anticipation of contributions that would have arrived at the end of the project. Under the old business model, the previous DRC PRRO generated 37,000 mt of carry-over stocks – 20 percent of overall resources.

Latest on Financial Risk Management

35. WFP continues to fine-tune its financial risk management in the light of the results of working-capital financing in the various pilots. The fundamental principle is that working-capital financing is risk-free for donors: WFP assumes the risk on the basis of a solid system of income and expenditure forecasting. The risk-management methodology currently under preparation is based on a three-step approach. For each project, the basic objectives are to:

- reduce risk proactively;
- monitor risk; and
- plan for contingencies.

36. WFP expects to have enough data from the pilots – including the impact of business process improvements and more data on the reliability of income and expenditure forecasts – to complete the development of its risk-management methodology and define the size and scope of any working-capital facility and risk reserve by February 2005 (see Annex III).

Single-Project Account

37. In May, the DRC country team utilized its new financial and supply-chain planning tool to identify a temporary deficit in direct support costs (DSC) and other direct operational costs (ODOC) that occurred because DSC and ODOC are often needed early in the project to commit funds for items such as longer-term staff salaries. At the same time, DRC had a positive LTSH balance, because LTSH is needed on average three to four months after commodities have been purchased. US$5.2 million in LTSH funds not immediately needed by the project were used to offset the temporary shortfall in DSC and ODOC by using the single-project account approach (see Chart 4).

Chart 4

US$5.2 MILLION SINGLE PROJECT ACCOUNT ADJUSTMENT SOLVED TEMPORARY DSC AND ODOC DEFICIT

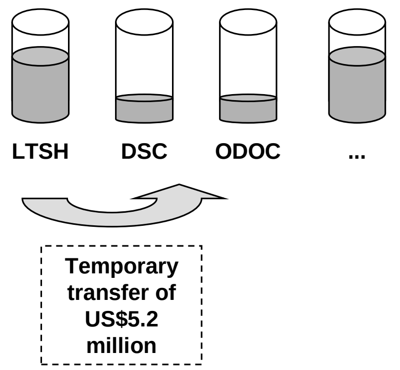
Example DRC Operation

LTSH surplus can offset DSC and ODOC deficit...

Forecast financial surplus and shortfalls

Cost item	jun-04	jul-04	aug-04	sep-04
Commodities	-525,181	-1,398,165	-1,625,469	-3,182,730
Ext. transport	1,190,638	867,924	741,368	239,853
LTSH	8,001,608	8,035,784	8,271,455	6,632,068
ODOC	1,610	-463,173	-830,748	-885,748
DSC	-2,682,944	-4,207,427	-3,806,964	-4,331,619
TOTAL	5,985,731	2,834,943	2,749,641	-1,528,175

... by using single project account



Single project account can only solve temporary deficits since overall actual at end of project need to be within ranges of the multiple scenario budget.

38. The country office avoided almost three months of cash shortfalls and prevented staff reductions without the need to inject new funds. In the past, a common recourse in this situation was to use the DSC advance or to appeal for additional contributions, even when overall funds were available, because country offices spent strictly according to availability of funds in different “pots” of money available at any one time. The single-account approach reduces dependency on additional funds and reduces this structural inefficiency in resource utilization.

Impact

39. The new approach:

- reduced unutilized balance in DRC by US$5.2 million;
- maximized utilization of existing resources; and
- avoided injection of additional funds and an increase in unutilized working capital.

Multiple-scenario Budgeting Approach

40. The introduction of the multiple scenario methodology gave both pilot country offices a tool to prevent balances from building up during the project. Systematically developing multiple scenarios gives greater insight into the factors that trigger costs. In DRC, for example, the main triggers affecting LTSH are (i) the origin of the commodity – local, regional or overseas, and (ii) the supply route – railway, road or air. In the Occupied Palestinian Territories, the main triggers are the country of origin of the commodity and the security situation.

41. Indeed, the LTSH rate will consist of multiple components that depend on the origin of commodities, rather than a single rate per project, in line with this multiple-scenario approach to budgeting. The components that will be applied will depend on whether commodities are sourced locally, regionally or internationally.

42. Introduction of trigger-dependent LTSH rates is having a significant impact in preventing the build up of excess balances, because the variance can be so great in LTSH. Introduction of multiple scenarios has reduced the incentive to over-budget, because the flexibility is already built into the operational budget.

Impact

43. The impacts were:

- build-up of balances prevented; and
- over-budgeting reduced.

Enhanced Project Planning, Execution and Monitoring

44. The project-planning tool has **improved on-time availability**, not only because it laid the foundation for advanced working capital, but because it provided better insight into logistics options to prevent short-term pipeline breaks. In eastern DRC, for example, the country office used the tool first to pinpoint looming shortages and then to identify temporary surpluses elsewhere in the country, which were diverted to prevent shortfalls for the refugees.

45. This planning tool also helps to **maximize the utilization of resources** by accurately forecasting when cash is required for commodities, transport, LTSH, DSC and ODOC. Based on this forecast, DRC was able to determine that their temporary DSC deficit could be covered by their temporary LTSH surplus. In other words, it enabled the country office to reap the benefits of the single-pot approach. Also, improved financial planning will indicate possible cash surpluses towards the end of a project, before they become actual balances. The need for advance financing or infusions of multilateral cash is reduced because the country office can utilize all available cash more efficiently.

46. Finally, enhanced planning helps to focus fundraising efforts. The country office now provides the fundraising department with a detailed extract from the planning tool giving an overview of expected shortages in terms of beneficiaries, corridor, commodity type, month and funds required to prevent pipeline breaks (see Annex II for details of DRC and the Occupied Palestinian Territories).

Impact

47. The impacts were:

- on-time availability improved: in DRC, the supply of 3,300 mt of maize has been expedited to prevent pipeline breaks;
- utilization of resources maximized: temporary deficits in DSC offset with LTSH, and no structural surplus balances going forward; and
- more targeted fundraising enabled.

FIGURE 1: IMPROVEMENTS ARE WORKING!

Initiative	Objective 1: Improve on-time availability	Objective 2: Reduce unspent balances
Working-capital Financing	• DRC - 44% improvement in Q4 • Occupied Palestinian Territories - 90% improvement in Sep-Nov	• DRC and Occupied Palestinian Territories - Its expected no balances will need to be carried over
Single-project account	• N/A	• DRC - Need for Advance Financing was reduced by US$6.8 million - US$5.2 million to prevent DSC and ODOC shortage could be internally financed
Enhanced project planning, monitoring and execution	• DRC - 3,000 mt maizemeal was expedited to prevent pipeline breaks in Q3 - 120 mt sugar was borrowed from Uganda project	DRC and Occupied Palestinian Territories Financial planning indicates there are no *structural* surplus balances
Resource transfer	•DRC - 37,000 mt transferred in January from previous PRRO - 900 mt transferred in July from previous EMOP • Occupied Palestinian Territories - 2,500 mt will be transferred in September from previous EMOP	
Multiple-scenario budgeting	• N/A	• DRC and Occupied Palestinian Territories - At time of programming local, regional or overseas rates are applied

Monitoring Impact

48. A system to monitor progress in achieving the BPR objectives of (i) increasing on-time availability of food aid and (ii) ensuring full utilization of resources is being put in place throughout WFP.

49. On-time availability will be monitored by measuring:

- the percentage of distribution targets reached; and
- the stability of food arrivals in-country.

50. Utilization of resources will be monitored by measuring:

- the surplus, if any, after operational closure;
- the size of balances during the project; and

- cash balances at the corporate level.

51. These targets will eventually be used to evaluate and improve project performance throughout WFP.

IV. Progress on Reducing Balances

52. One of the main objectives of BPR is to maximize utilization of resources, thereby reducing unspent balances. The main focus of the Secretariat has been a long-term, corporate solution – a new business model – that ensures that balances are not accumulated in the first place. Even in this pilot phase, much work has been done to address this issue in the short term.

53. Since 2002, WFP has identified and taken action on US$700 million in unspent balances that have been reprogrammed or refunded, or receivables that have been written off or written down (see Annex IV). This progress is the result of the following short-term initiatives.

- WFP has progressed rapidly in **implementation of procedures for project closure and transfer of any outstanding resources**. It is now closing projects as part of normal business. Until 2000, very few projects were ever financially closed; since then, WFP has closed over 700 projects. This has ended the accumulation of unspent balances residing in older projects. More generally, project closure greatly improves financial management at the country level. This initiative alone has been the biggest contributor to reducing balances in the short-term, because balances are identified for reprogramming or refunding to donors.
- **Monitoring of balances at the country office level, especially LTSH, has been improved** in live projects, ensuring that balances do not accumulate. Management reports have been developed for country offices; procedures have been put in place to monitor the utilization of resources. Over US$60 million in potential surpluses have been identified and reprogrammed into more food aid.
- Procedures for reprogramming and refunding unspent balances have been streamlined.

54. Analysis of the corporate cash situation indicates that the working-capital ratio – that is, the amount of operating cash as a percentage of total revenue – decreased overall from 20 percent in 2000–2001 to 17 percent in 2002–2003. This indicates that WFP is spending contributions directed to projects faster. As of July 2004, the percentage had increased slightly. But it is difficult to draw conclusions in the middle of the year; the increase appears to be mainly the result of faster receipt of donor contributions and the timing of donors' contribution cycles. In any case, WFP is still only maintaining three months' worth of operating cash (see Annex IV).

55. In the longer-term, the Secretariat is implementing BPR and putting into place a new business model that will reduce unspent balances to a minimum. As documented above, BPR will avoid balances by means of several improvements, including (i) the single-pot approach, (ii) advance financing, (iii) multiple-scenario budgeting and (iv) enhanced project planning and monitoring. The primary role of the new regional financial analysts in each bureau, described earlier, is to ensure efficient utilization of project resources and avoid potential surpluses and deficits.

V. EXPECTATIONS FROM THE DONOR COMMUNITY

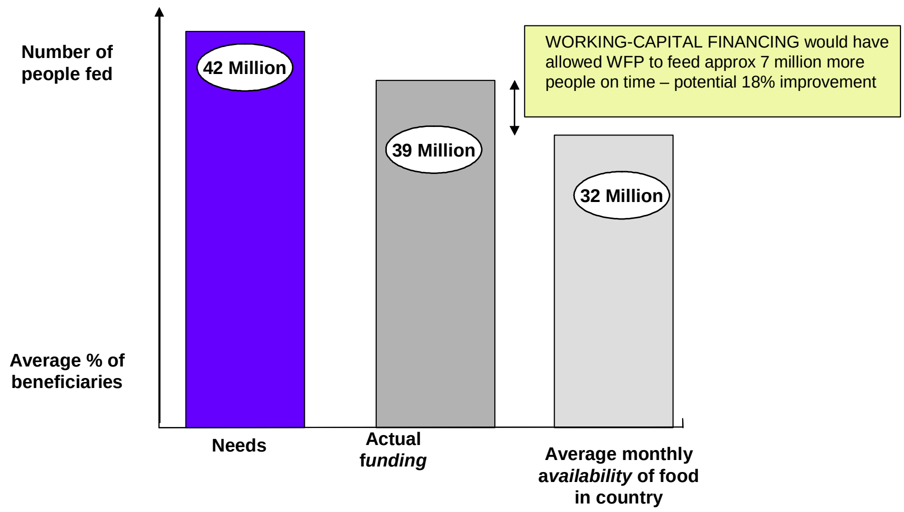
56. As described above, WFP is introducing fundamental improvements to its business in order to make financing really work. But four changes by donors are also necessary to maximize the efficiency gains of this new business model.

Working-Capital Financing and In-Kind Donors

57. As indicated in previous Board papers, the potential benefits of using working capital are significant: an estimated 20 percent increase in on-time availability of food aid to beneficiaries.

Figure 2

PERFORMANCE MEASUREMENT 2003
Based on 9 significant projects



58. These estimates are based on the assumption that all donors, cash and in-kind, support the use of working-capital financing to improve on-time availability. Working-capital financing will only be really effective if WFP can make advances against in-kind contributions, because in-kind contributions represent over half of all contributions.

59. Working-capital financing is not a single-step remedy: it is part of a comprehensive process of improving planning for meeting needs. More important, working-capital financing would only be used as a final option in WFP’s attempts to prevent food shortages. As in the pilot projects, WFP will rely on other available levers first, for example using pre-positioned stock, regional borrowing and resorting to financing only when other options are ineffective.

60. WFP is collaborating with its main in-kind donors on ways to incorporate in-kind contributions into working-capital financing and testing ways to reach the goal of improving the on-time availability of food aid. Possible solutions include increased pre-positioning, streamlining WFP’s project-approval processes and donors’ granting procedures, and pre-purchasing in-kind contributions.

Standard Bag Markings for Financed Contributions

61. Currently, of course, most food aid is distributed in bags indicating the name of the donor. This practice helps to provide visibility, but it greatly reduces the opportunity for repayment because it limits repayment of any working-capital loan to a single donor.

> Analysis indicates that if bag markings were not a constraint, the risk of using working-capital financing would be reduced by 70 percent.

62. WFP would therefore much prefer to use standard WFP bag markings when financing against forecast contributions.

63. To ensure that donors receive visibility, WFP will take alternative measures such as issuing press releases, calling press conferences and placing donor flags at distribution sites.

Support WFP's Improvement in Donation Forecasting

64. Accurate donation forecasting is crucial to leverage the potential of the new working-capital model and other process improvements. WFP needs the help of donors in forecasting into the next calendar year.

65. Over-optimistic forecasts can result in outstanding loans at the end of a project, or early depletion of resources. On the other hand, over-conservative forecasting can result in reduced on-time availability and carry-over at the end of a project. Donor input is crucial: WFP is committed to working even more closely with donors to improve its forecasting ability. WFP's fundraising department plans to set up forecasting workshops with the donor community to share lessons learned so far and to help strengthen its forecasting capacity.

Link Expiry Dates and Other Utilization Limits of Contributions to the Duration of the Project

66. This will help WFP to use resources most efficiently for the projects and the beneficiaries being assisted.

VI. Next Steps

67. Between October 2004 and February 2005, WFP will:

- recalibrate the working-capital model, incorporating the effect of other business process improvements;
- further develop risk-management procedures;
- determine the size of a global working-capital fund, and review the scope of other existing advance facilities;
- determine the size of a reserve fund to cover possible losses incurred through adopting a working-capital approach;
- continue to develop the business process improvements described above; and

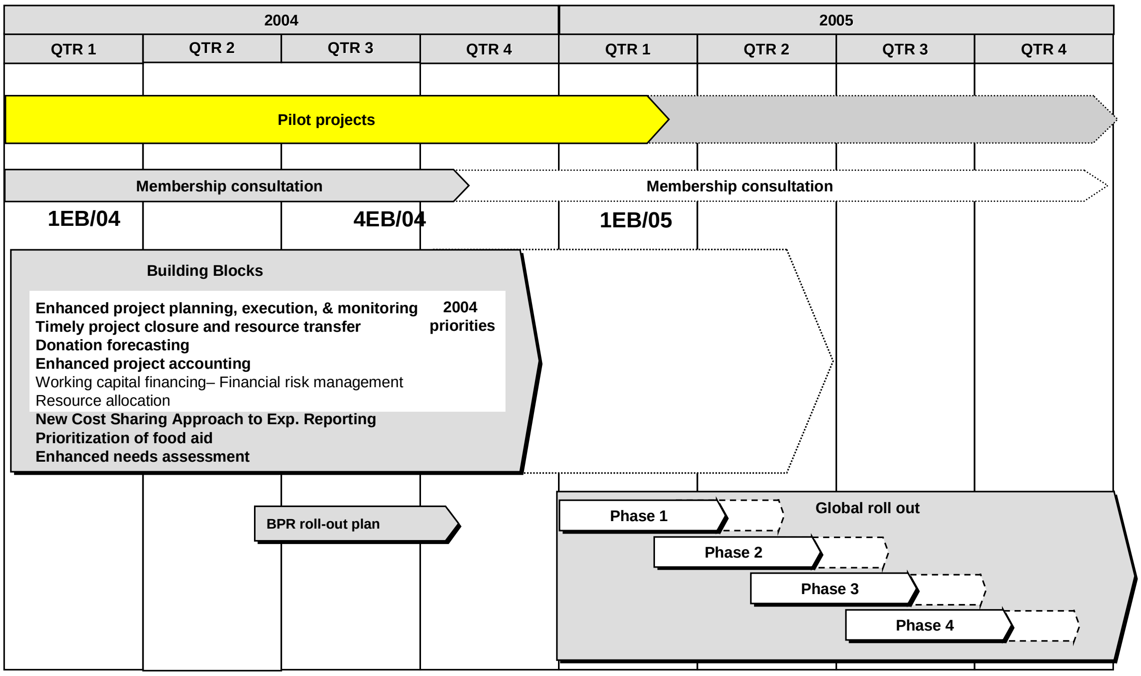
- prepare a global implementation plan to roll out process improvements to major relief operations in 2005; in addition to the current pilot countries, provisionally planned roll-out countries and regions include Afghanistan, Angola, Bangladesh, the Democratic People's Republic of Korea (DPRK), Ethiopia, the Great Lakes, Kenya, southern Africa, the Sudan and Tajikistan – amounting to over 60 percent of WFP activity by volume.

68. Based on progress so far, the Secretariat expects to have completed sufficient testing to place a draft decision on the adoption of a working-capital approach before the Board in February 2005. But this is too important to be rushed: testing will continue if more testing is required to ensure that solutions are provided to the open issues discussed in this paper.

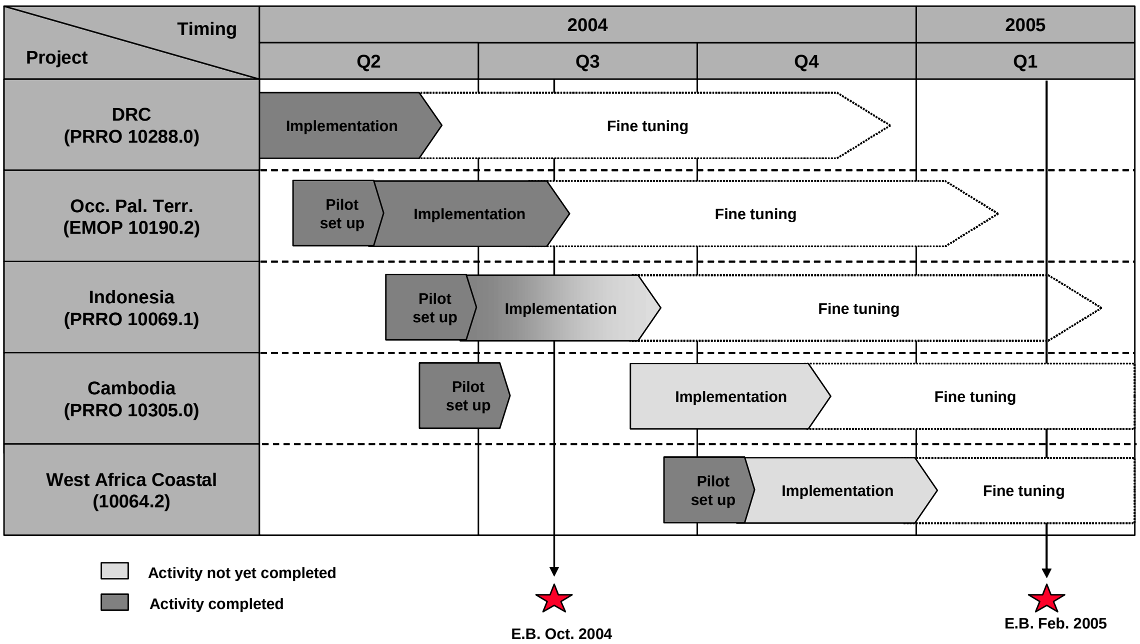
69. The Secretariat will continue to liaise with the Board during this critical pilot phase. WFP tentatively plans an informal consultation with Board members in January 2005 ahead of the February Board session to ensure that members are fully informed of the latest results.

ANNEX I

I. OVERALL BPR PROJECT CALENDAR



II. OVERVIEW OF CURRENT PILOT PROJECTS TIMETABLE



ANNEX II: EXAMPLES OF CURRENT PILOT FINANCIAL FORECASTS

i. Financial Forecast Summary — DRC 10288.0 (as of 4 Sept 2004)

			Income				Loan and repayment			Cumulative surplus/shortfall	
			Donations (US$)		Resource transfer (US$)		External		Internal	US$	mt
Quarter	Cost items	Funding requirement (US$)	CONF.	HIGH PROB.	CONF.	HIGH PROB.	Adv. fin. - loan	Adv. fin. -repayment	Single-pot adjustment - loan/repayment	With conf. and high prob. income	
Opening balance	Commodities	-6.872.530	8.191.221	-	-	-	-	-	-	1.319.000	-
	External transport	-32.666	3.359.802	-	-	-	-	-	-	3.327.000	
	Overland	-	2.633.039	-	-	-	-	-	-	2.633.000	
	ITSH	-1.293.766	4.340.087	-	8.000.000	-	-	-	-	11.046.000	
	ODOC	-17.529	404.898	-	-	-	-	-	-	387.000	
	DSC	-4.108	3.215.634	-	-	-	-	-	-	3.212.000	
Quarter 1 2004	Commodities	-1.414.415	2.356.544	-	-	-	-	-	-	2.261.000	-
	External transport	-3.616.030	925.517	-	-	-	-	-	-	636.000	
	Overland	-	752.470	-	-	-	-	-	-	3.385.000	
	ITSH	-4.693.537	1.256.480	-	-	-	-	-	-	7.609.000	
	ODOC	-24.907	117.220	-	-	-	-	-	-	479.000	
	DSC	-2.309.446	930.944	-	-	-	-	-	-	1.833.498	
Quarter 2 2004	Commodities	-3.836.992	643.561	-	-	-	4.132.160	-	-	3.200.000	-
	External transport	-572.066	192.486	-	-	-	1.267.652	-	-	1.524.000	
	Overland	-	198.110	-	-	-	-	-	-	3.583.000	
	ITSH	-2.488.419	354.693	-	-	-	-	-	-5.200.000	275.000	
	ODOC	-73.899	33.090	-	-	-	-	-	850.000	1.288.000	
	DSC	-1.893.341	262.797	-	-	-	-	-	4.350.000	4.553.000	
Quarter 3 2004	Commodities	-6.773.581	2.582.579	178.502	-	-	-	-3.131.898	-	-3.944.000	-364
	External transport	-916.583	772.437	53.389	-	-	-	-1.267.652	-	166.000	
	Overland	-1.436.703	795.006	54.949	-	-	-	-	-	2.996.000	
	ITSH	-6.801.289	1.423.367	98.380	227.213	1.640.499	-	-	2.600.000	-537.000	
	ODOC	-737.289	132.790	9.178	108.269	24.104	-	-	-425.000	400.000	
	DSC	-3.920.571	1.054.594	72.891	13.437	187.879			-2.175.000	-214.000	
Quarter 4 2004	Commodities	-1.744.717	-	-	-	-	-	-1.000.262	-	-6.689.000	-7.239
	External transport	-611.898	-	-	-	-	-	-	-	-446.000	
	Overland	-157.022	-	-	-	-	-	-	-	2.839.000	
	ITSH	-284.735	-	-	34.414	-	-	-	-	-787.000	
	ODOC	-257.816	-	-	16.370	-	-	-	-	159.000	
	DSC	-1.342.420	-	-	2.061	-	-	-	-	-1.554.000	
Quarter 1 2005	Commodities	-2.966.341	-	87.823	-	-	-	-	-	-9.568.000	-18.457
	External transport	-998.375	-	26.267	-	-	-	-	-	-1.418.000	
	Overland	-761.422	-	27.035	-	-	-	-	-	2.105.000	
	ITSH	-1.127.543	-	48.403	-	-	-	-	2.600.000	734.000	
	ODOC	-271.287	-	4.516	-	-	-	-	-425.000	-533.000	
	DSC	-4.457.005	-	35.862	-	-	-	-	-2.175.000	-8.150.000	
Quarter 2 2005	Commodities	-5.113.717	-	-	-	-	-	-	-	-14.682.000	-35.799
	External transport	-1.543.439	-	-	-	-	-	-	-	-2.961.000	
	Overland	-1.263.376	-	-	-	-	-	-	-	842.000	
	ITSH	-1.839.703	-	-	-	-	-	-	-	-1.106.000	
	ODOC	-107.075	-	-	-	-	-	-	-	-640.000	
	DSC	-1.103.882	-	-	-	-	-	-	-	-9.254.000	
Quarter 3 2005	Commodities	-3.569.747	-	-	-	-	-	-	-	-18.252.000	-47.795
	External transport	-1.067.588	-	-	-	-	-	-	-	-4.029.000	
	Overland	-1.646.711	-	-	-	-	-	-	-	-805.000	
	ITSH	-2.844.089	-	-	-	-	-	-	-	-3.950.000	
	ODOC	-710.337	-	-	-	-	-	-	-	-1.350.000	
	DSC	-1.542.027	-	-	-	-	-	-	-	-10.796.000	
Quarter 4 2005	Commodities	-	-	-	-	-	-	-	-	-18.252.000	-47.795
	External transport	-	-	-	-	-	-	-	-	-4.029.000	
	Overland	-549.468	-	-	-	-	-	-	-	-1.354.000	
	ITSH	-1.967.241	-	-	-	-	-	-	-	-5.917.000	
	ODOC	-	-	-	-	-	-	-	-	-1.350.000	
	DSC	-761.382	-	-	-	-	-	-	-	-11.557.000	
		-90.340.026	36.929.367	697.196	8.401.764	1.852.481	5.399.812	-5.399.812	-	-42.459.000	-47.795

ii. Financial Forecast Summary — Occupied Palestinian Territories EMOP 10190.2 (as of 4 Sept 2004)

			Income				Loan and Repayment			Cumul Surplus/Shortfall	
			Donations (US$)		Resource Transfer (US$)		External		Internal	US$	mt
Quarter	Cost items	Funding requirement (US$)	CONF.	HIGH PROB.	CONF.	HIGH PROB.	Adv. fin. - loan	Adv. fin. - repayment	Single-pot adjustment – Loan repayment	with confirmed and high prob. income (US$)	mt
Quarter 3 2004	Commodities	-9.859.869	5.786.268	3.232.372	-	-	7.035.960	-5.261.035	-	**934.000**	**-**
	External transport	-991.103	1.001.238	559.320	-	-	667.790	-592.139	-	**645.000**	
	Overland	-	-	-	-	-	-	-	-	**-**	
	ITSH	-1.199.734	926.770	517.720	139.652	-	1.179.408	-970.476	-	**593.000**	
	ODOC	-	61.661	34.446	9.272	-	78.514	-64.598	-	**119.000**	
	DSC	-338.092	498.217	278.318	75.056	-	634.054	-521.728	-	**626.000**	
Quarter 4 2004	Commodities	-5.702.246	-	3.496.592	-	-	-	-1.774.925	-	**-3.047.000**	**-**
	External transport	-1.048.686	-	605.040	-	-	-	-75.651	-	**126.000**	
	Overland	-	-	-	-	-	-	-	-	**-**	
	ITSH	-538.804	-	560.039	-	-	-	-208.931	-	**405.000**	
	ODOC	-	-	37.261	-	-	-	-13.916	-	**142.000**	
	DSC	-184.577	-	301.068	-	-	-	-112.326	-	**630.000**	
Quarter 1 2005	Commodities	-4.206.055	-	-	-	-	-	-	-	**-7.253.000**	**-12.062**
	External transport	-726.926	-	-	-	-	-	-	-	**-601.000**	
	Overland	-	-	-	-	-	-	-	-	**-**	
	ITSH	-1.019.264	-	-	-	-	-	-	-	**-614.000**	
	ODOC	-200.000	-	-	-	-	-	-	-	**-58.000**	
	DSC	-1.519.169	-	-	-	-	-	-	-	**-889.000**	
Quarter 2 2005	Commodities	-997.961	-	-	-	-	-	-	-	**-8.251.000**	**-27.327**
	External transport	-172.410	-	-	-	-	-	-	-	**-773.000**	
	Overland	-	-	-	-	-	-	-	-	**-**	
	ITSH	-478.823	-	-	-	-	-	-	-	**-1.093.000**	
	ODOC	-90.000	-	-	-	-	-	-	-	**-148.000**	
	DSC	-193.697	-	-	-	-	-	-	-	**-1.083.000**	
Quarter 3 2005	Commodities	-	-	-	-	-	-	-	-	**-8.251.000**	**-33.070**
	External transport	-	-	-	-	-	-	-	-	**-773.000**	
	Overland	-	-	-	-	-	-	-	-	**-**	
	ITSH	-	-	-	-	-	-	-	-	**-1.093.000**	
	ODOC	-	-	-	-	-	-	-	-	**-148.000**	
	DSC	- 107.632	-	-	-	-	-	-	-	**-1.191.000**	
		-29.575.049	**8.274.154**	**9.622.176**	**223.980**	**-**	**9.595.725**	**-9.595.725**	**-**	**-11.456.000**	

ANNEX III

Update on Risk Management

No Risk for Donors

1. Advance financing creates no risk for donors. WFP bases its decisions on whether to advance working-capital financing on forecast donor contributions, so donors will have no legal obligation to fulfil or confirm forecast contributions.

A Rigorous WFP System to Manage Risk

2. WFP will assume all risks associated with working-capital financing. Risk management is incorporated into every step of the financing process to maximize the number of beneficiaries being fed on time with limited risk. Several risk-management activities are being implemented to prevent early exhaustion of resources and/or deficits at the end of projects. The Secretariat will test and fine-tune the risk-management methodology before the February 2005 Board meeting.

3. Three categories of risk that need to be managed by the working-capital facility are shown in Chart 5.

CHART 5: RISKS RELATED TO WORKING CAPITAL FINANCING
Three risks need to be managed by new risk-management activities

Risk category	Description	Impact
1 Constraints risks	• Risk that forecast contribution cannot be used for repayment because donor constraints are not met	• Outstanding loans at the end of project
2 Forecast risks	• Risk that forecast contributions do not materialize	• Outstanding loans at the end of project • Early depletion of resources
	• Risk that total forecast contributions are too low (too pessimistic donation forecast)	• Beneficiaries not being fed on time • Carry over at project end
3 Process risks	• Risk that contribution is not used for repayment	• Outstanding loans at the end of a project
4 Price risks	• Risk that commodity prices, LTSH rates etc change between purchase order date and donor confirmation date	• Outstanding loans at the end of a project
5 Currency risks	• Risk that exchange rate changes between time of payment of goods and reception of donation	• Outstanding loans at the end of a project

- Price risk is covered by multiple-scenario budget
- Currency risks will be covered by WFP's current activities

Addressed by new risk-management activities (shaded rows 1–3)

Source: BPR team analysis

4. The risk-management methodology currently being tested has three steps:

   i) reduce risk proactively;

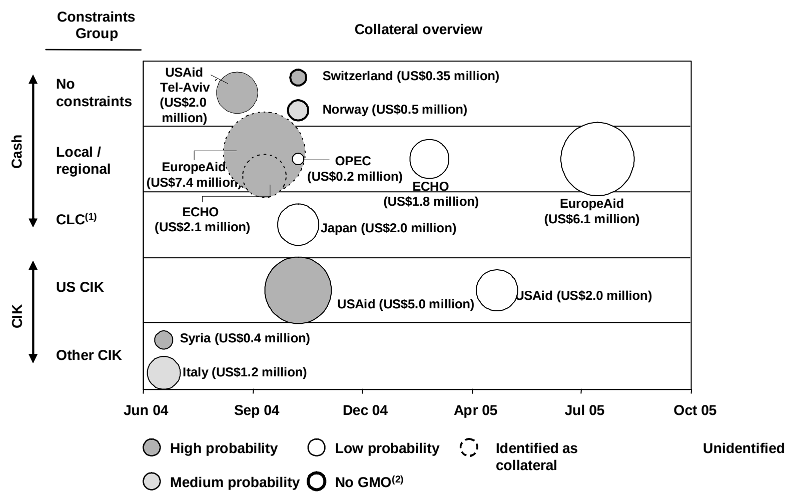
   ii) monitor risk; and

   iii) plan for contingencies.

Reduce Risk Proactively

5. **Limit constraint risk by matching outstanding loans with groups of collaterals.** To maximize repayment, all working capital financing is linked to individual forecast “collaterals”, which are grouped by their main constraints. If possible, a country office links its loans to the constraints group with lowest risk, for example donations with no constraints, local/regional purchasing requirement or a requirement that no genetically modified organisms (GMOs) be included. Chart 6 shows how a country office links its outstanding loans to groups of collaterals and subsequently monitors them.

CHART 6: LIMIT 'CONSTRAINTS RISK' BY MATCHING OUTSTANDING LOANS WITH GROUPS OF COLLATERALS
Example for Occupied Palestinian Territories EMOP 10190.2



Constraints Group	Forecast income (US$ million)	Outstanding loans (US$ million)	Identified collaterals (US$ million)
No constraints	2.9		
Local / regional	17.6	(9.6)	(9.5)
CLC(1)	2.0		
US CIK	7.0		
Other CIK	1.6		
Unidentified			(0.1)
	31.1	(9.6)	(12.1)

(1) Cash in lieu of commodity
(2) Genetically modified organism
Source: FCD; donation forecast for Occupied Palestinian Territories EMOP 10190.2 d.d. July 14, 2004

Limit Forecast Risk by Setting Working-Capital Financing Limits

6. To maximize on-time availability without outstanding loans at the end of a project, every request for working-capital financing has to comply with strict rules before the request can be granted by the financing authority. The most important rules are:

i) Any overall outstanding loan to a project, discounted for the probability that individual contributions materialize, must be smaller than the overall cash contributions to a project.[2]

ii) Advanced funds must be linked to collaterals with a probability of materializing higher than 80 percent, or back-up with similar constraints must be identified. For example, a working-capital financing request can be linked to a single high-probability contribution, or two medium-probability contributions, that require commodities to be purchased regionally or locally. The country office will review its repayment plan every month with the fundraising department, so that at any time all outstanding loans are matched with eligible forecast contributions.

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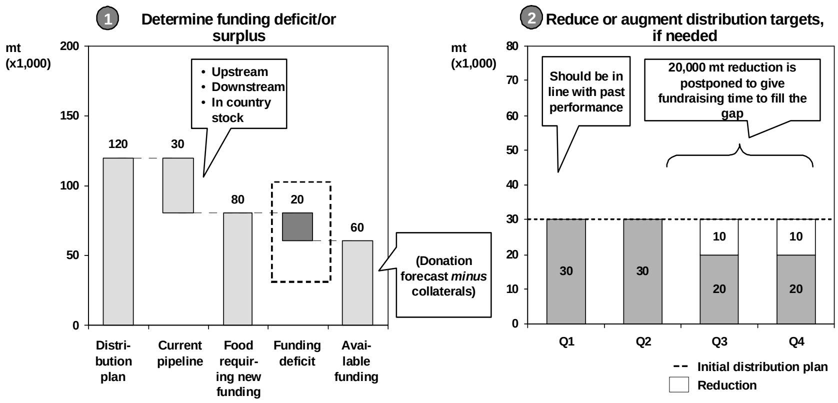
[2] Until working-capital financing of in-kind contributions is implemented.

iii) Working-capital financing requests may not exceed net funding requirements for the next three months, to prevent early depletion of resources. The funding requirements are based on distribution targets after alignment of forecast donations with the expenditure plan, as described below.

7. To prevent early depletion of resources or less-than-maximum on-time availability, a country office regularly balances its distribution targets, and therefore its expenditure plan, with the donation forecast. If distribution targets need to be reduced, the reduction will be postponed as far as possible to give the fundraising department the opportunity to fill the gap and ensure that beneficiaries are not deprived of food aid or reduced rations. Chart 7 shows how expenditures and donation forecasts are balanced.

CHART 7: BALANCE EXPENDITURE PLAN WITH DONATION FORECAST



Implement Levers to Ensure Repayment Process Is Followed

8. Measures to prevent “double spending” of contributions and ensure prompt repayment include:

i) making the process part of corporate systems to ensure that identified collaterals are blocked from being released to a project: and

ii) installing process control, whereby the financing authority monitors whether the repayment process is followed and analyses reasons for failed repayments.

Monitor Risk

9. WFP is setting up a monitoring system in which projects are categorized into three risk levels, based on an algorithm that takes into account outstanding debt, forecast income, identified collaterals, credit history and project phase. A project’s risk level affects the decision for future working-capital financing: high risk levels result in increased control from the financing facility.

10. Besides monitoring the risks of individual projects, WFP constantly monitors its overall risk exposure by tracking the number of projects and outstanding loans per risk level and hence calculating the overall risk by multiplying the outstanding loans with expected losses per risk category. WFP’s overall risk exposure will influence decisions on future working-capital financing requests.

11. Repayment issues are thoroughly evaluated to ensure that they can be prevented in the future. First, each time an identified collateral cannot be used for repayment, the fundraising department gives a written explanation and proposes a solution. Second, projects with outstanding loans at termination will be reviewed by the bank analyst. Both evaluations will be inputs to improve the odds of repayment and refine WFP's risk-management methodology.

Plan for Contingencies

12. Several actions can be taken to prevent a project from running into deficit:

i) an appeal to donors to repay outstanding loans;

ii) allocation of multilateral donations; and

iii) last-minute diversions of shipments, diverting food that has been purchased through working-capital financing to a project in the region that has recently received a confirmed contribution.

13. A last resort would be to draw upon the risk reserve. This is expected to happen in 2 percent of cases. This indicator, which is part of risk monitoring throughout WFP, will be closely monitored.

ANNEX IV

DETAILS OF CASH BALANCES

REDUCTION OF UNSPENT BALANCES IN US$ MILLION (SOURCE: WFP FINANCIAL STATEMENTS JULY 2004)			
	July 2004 YTD*	**Prior period 2002–2003**	**Total**
Reprogramming of unused fund balances	(35,0)	(99,9)	(134,9)
Refund of unused fund balances	(10,4)	(63,4)	(73,8)
Write-off/write-down of contribution receivables	(43,7)	(333,7)	(377,4)
Prior period adjustments	(59,5)	(53,0)	(112,5)
TOTAL	**(148,6)**	**(550,0)**	**(698,6)**

* Year to date.

Comparative financial analysis as at 31 July 2004 **(US$ million)** (source: WFP Financial Statements July 2004)			
Cash balances	**31-Dec-01**	**31-Dec-03**	**31-Jul-04**
Operating cash	391,1	412,9	450,5
Bilaterals and trust funds	80,8	96,9	414,9
Reserves and other accounts	290,4	397,6	391,3
Total cash	**762,3**	**907,4**	**1256,7**
Working capital ratio	**2000–2001**	**2002–2003**	**7-months 2004**
Annualized revenue	1.991,6	2.494,1	1.778,9
Operating cash	391,1	412,9	450,5
Operating cash as % of revenue	**20%**	**17%**	**25%**
Months operating cash	2,4	2,0	3,0
Average annualized revenue per month	166,0	207,8	148,2
Turnover ratios	**2000–2001**	**2002–2003**	**7-months 2004**
Contribution receivable - no. of months outstanding	8,1	7,1	5,7
Accounts payable and outstanding obligations - no. of months outstanding	2,9	2,3	2,8

ACRONYMS USED IN THE DOCUMENT

BPR	business process review
DPRK	Democratic People's Republic of Korea
DRC	Democratic Republic of Congo
DSC	direct support costs
EMOP	emergency operation
GMO	genetically modified organism
ITSH	internal transport, storage and handling
LTSH	landside transport, storage and handling
ODOC	other direct operational costs
PRRO	protracted relief and recovery operation
YTD	year to date