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RESOURCE, FINANCIAL AND BUDGETARY MATTERS

Agenda item 5

For approval

BUSINESS PROCESS REVIEW: PILOT FINANCING PAPER

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NOTE TO THE EXECUTIVE BOARD

This document is submitted for approval to the Executive Board.

The Secretariat invites members of the Board who may have questions of a technical nature with regard to this document to contact the WFP staff focal points indicated below, preferably well in advance of the Board's meeting.

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Should you have any questions regarding matters of dispatch of documentation for the Executive Board, please contact the Supervisor, Meeting Servicing and Distribution Unit (tel.: 066513-2328).

EXECUTIVE SUMMARY

In March 2003, the Secretariat began a business process review designed to improve efficiency in WFP, primarily to ensure maximum use of resources to meet the needs of the greatest number of beneficiaries. The recommendations made on the basis of the review are now being tested at the field level in a series of pilot projects, the first of which was launched in mid-December 2003.

One of the principal recommendations of the business process review is to authorize spending against forecast contributions rather than confirmed contributions as is currently the case. To test the effectiveness of this, WFP needs to establish a temporary financing mechanism that will remain in effect until a new financing model is decided on at EB/3/2004.

The Secretariat submits this document to the Executive Board for approval, following informal consultations with the membership on 23 September and 20 November 2003 and 14 January 2004 to present the results of the business process review and to state the need for WFP to move to a new financing model, and in the light of the start of pilot testing of the new business model.

DRAFT DECISION*

The Board:

i) takes note that the obligation and commitment for the five pilot projects identified in this document (WFP/EB.1/2004/5-A/1) will commence with the approval of the project by the Executive Board or jointly by the Executive Director and the Director-General of FAO under their delegated authority; and

ii) approves the use of the Operational Reserve to finance the pilot projects on the basis of forecast contributions as an exception to its decision on the use of the Operational Reserve in WFP/EB.A/97/4-D, and takes note of the Executive Director’s decision to allow an exception to Financial Rule 110.1 to allow the use of the Operational Reserve for this purpose.

* 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 March 2003 the Secretariat began a business process review (BPR) to improve efficiency in WFP. The results presented to the membership at informal consultations on 23 September and 20 November 2003 and 14 January 2004 indicate that WFP needs to move to a new financing model.

2. Under existing arrangements, WFP only commits resources when contributions are confirmed by donors. Because donors' timetables are affected by their own needs and because their budget cycles follow an independent process, the present system gives rise to a timing mismatch between food needs and contributions, even if on aggregate sufficient resources for a project are available. Frequent shortfalls of food endanger beneficiaries during projects, and contributions accumulate at the end of projects, resulting in unspent cash balances and undelivered food stocks.

3. The review concluded that solving the mismatch between food needs and donor budget cycles by spending against forecast rather than confirmed contributions would result in a 20 percent increase in on-time availability of food aid at minimal financial risk.

4. At the same time, the review has developed two approaches to increase further the efficiency of WFP food assistance:

   i) multiple-scenario budgeting to avoid over-budgeting; and
   ii) "single-pot" spending authority that allows country directors to overcome timing mismatches between their funding needs and confirmed contributions during a project cycle; this concept was endorsed by the Executive Board in 2003 (WFP/EB.A/2003/6-A/1).

5. Annex I summarizes the BPR analysis and recommendations for the Board's information.

6. In consultation with the membership, WFP has launched or plans to launch five pilot projects to field-test the approaches recommended by BPR. To test the effectiveness of spending against forecast contributions in the pilot projects, WFP needs to establish a temporary financing mechanism; the mechanism proposed here will remain in effect until a new financing model that supersedes it is decided on at EB/3/2004.

7. The BPR estimated WFP financing needs and potential shortfalls resulting from forecasting errors; initial findings from the first pilot project suggest that changing expenditure patterns through the single-pot approach will reduce financing needs and possible shortfalls. Once the pilot projects have generated sufficient data, therefore, the financing model will be recalibrated to account for the impact of changed expenditure patterns. The Secretariat proposed an interim approach to financing the pilot projects before recommending a final decision at EB3/2004 that takes pilot project data into account, because WFP financing needs will determine the nature of possible project financing mechanisms.

8. This paper outlines the need and scope for financing the pilot projects, describes the proposed mechanism in the context of the applicable regulatory framework, and summarizes the approval sought from the Board.

The Need and Scope for Financing BPR Pilot Projects

9. A source is needed to finance the pilot projects in advance of confirmation of contributions. During the pilot phase, WFP will only provide necessary advances based on forecast contributions against such a fund.

10. The Secretariat proposes using the Operational Reserve as a source of financing for the plot projects because its purpose, set out in Financial Regulation 10.5, is to “ensure the continuity of operations in the event of a temporary shortfall of resources”.

Calculation of Financing Requirements

11. Estimated pilot project budgets for 2004 are:

- Democratic Republic of the Congo PRRO: US$86 million;
- West Africa Coastal PRRO: US$74 million;
- Palestinian Territories EMOP: US$16 million;
- Indonesia PRRO: US$19 million; and
- Cambodia PRRO: US$9 million.

12. The approximate total budget for 2004 is US$204 million.

13. The advance financing needs for all pilot projects in 2004 are likely to be between US$14 million and US$49 million, based on the 7 percent to 24 percent financing need estimate based on previous business processes; with the new processes, financing needs should be lower. This is the amount that may have to be set aside from the Operational Reserve over the course of the projects. Only the potential shortfall explained below would be charged against the Operational Reserve on completion of the project.

Calculation of Likely Shortfalls

14. It is estimated that any shortfall when the pilot projects close at the end of 2004 will be substantially less than the amount advanced.

15. The pilot projects in DRC, Cambodia and Indonesia are all multi-year projects. Financing the first year of multi-year projects is virtually risk-free, because any shortfall at the end of the year can be recovered during subsequent years. The West Africa and Palestinian Territories pilots have less than a year remaining; estimating a 7 percent loss for single projects gives an estimated shortfall of approximately US$6 million.

The Proposed Mechanism for Financing Pilots

16. The Secretariat proposes using the Operational Reserve to provide advance financing for the pilot projects. The Operational Reserve would provide the fund against which to commit any advances between US$14 million and US$49 million, as identified above. The potential shortfall of US$6 million could be replenished in accordance with the regulations governing the Operational Reserve.

17. The regulatory framework for this proposal consists of WFP’s *Financial Regulations*, the Board document “Funding and Replenishing the Operational Reserve” (WFP/EB.A/97/4-D) and the applicable Financial Rules.

18. Financial Regulation 8.1 authorizes the Executive Director to expend resources when a project is approved.

> **Financial Regulation 8.1:**
>
> Approval of a Country Programme or project shall constitute authority for the Executive Director to issue allotments, incur obligations and expend resources for the Country Programme or project, subject to the preparation and signature of the Country Programme or project agreement.

19. The *Financial Regulations* therefore permit spending against forecast contributions as proposed by BPR. The present proposal is to allow obligations and commitments on approval of projects in accordance with Financial Regulation 8.1. The applicability of the Operational Reserve for this purpose is contained in Financial Regulation 10.5.

> **Financial Regulation 10.5:**
>
> Within the General Fund, there shall be maintained an Operational Reserve at a level to be determined from time to time by the Board, on the recommendation of the Executive Director and after having considered the advice of the ACABQ and the Finance Committee. ***The purpose of the Operational Reserve shall be to ensure continuity of operations in the event of a temporary shortfall of resources*** (author's italics). The Board shall establish guidelines for the use of the Operational Reserve.

20. The nature of financing against forecast contributions is to anticipate a temporary shortfall of resources in the sense that WFP anticipates resources that have not yet been confirmed by donors. Financing the forecast contributions avoids delays and disruption of operations while waiting for donor confirmation; financing expected contributions in this way ensures the continuity of operations as set out in Financial Regulation 10.5. The mechanism described above would return funds to the Operational Reserve when the contributions are confirmed, meeting the criteria defined in Financial Regulation 10.6.

> **Financial Regulation 10.6:**
>
> Drawdowns from the Operational Reserve shall be restored as soon as possible from the contributions made for the purpose for which the drawdown was made. At the end of each financial period, the Executive Director should determine any such contributions that are uncollectable and for which expenditure was incurred and request the Board to approve the replenishment of the Operational Reserve from the unearmarked portion of the General Fund. Such requests shall be made at the time of the presentation of the audited biennial accounts.

21. In addition to the *Financial Regulations*, the Executive Board has set out guidelines for the use of the Operational Reserve (WFP/EB.A/97/4-D); these are consistent with the financial rules applicable to the Operational Reserve, which stipulate.

Funding and replenishment of the Operational Reserve (WFP/EB.A/97/4-D)

1. The Operational Reserve currently has a maximum level of US$57 million. To the extent that this maximum level is not reached, any surplus of income over expenditure that is at the full disposal of the Programme shall be transferred to the Operational Reserve following approval of the Biennial Audited Financial Statements.
2. The Operational Reserve will be used to:

    i) finance the implementation of approved projects in progress and other continuing multilateral operations (including directed multilateral operations) for which firm pledges have been announced, pending receipt of pledged contributions;

    ii) finance the approved Programme Support and Administrative budget for which firm pledges or other firm sources of income have been identified; and

    iii) make reimbursable advances to other funds as may be established by the Executive Board for which firm pledges or other firm sources of income had been identified, up to a limit of 5 million dollars or not exceeding 10 percent of the Operational Reserve, whichever is less.

Financial Rule 110.1

The Operational Reserve will be used to:

i) finance the implementation of approved projects in progress and other continuing multilateral operations (including directed multilateral operations) for which firm pledges have been announced, pending receipt of pledged contributions;
ii) finance the approved Programme Support and Administrative budget for which firm pledges or other firm sources of income have been identified; and
iii) make reimbursable advances to other funds as may be established by the Executive Board for which firm pledges or other firm sources of income had been identified, up to a limit of 5 million dollars or not exceeding 10 percent of the operational reserve, whichever is less.

The Operational Reserve will be replenished as soon as the relevant contributions are received. Where firm pledges or other firm sources of income are subsequently assessed as not collectable and for which expenditure was incurred, the Executive Director shall request the Executive Board to restore the Operational Reserve to the authorized level by way of replenishment from the unearmarked portion of the General Fund. The reasons for non-collection shall be explained and documented. The request for approval shall be submitted to the Board at the time of the submission of the audited biennial accounts for the relevant financial period. The replenishment of the Operational Reserve shall be effective at the beginning of the ensuing financial period.

22. The guidelines approved by the Executive Board and the Financial Rules subsequently approved by the Executive Director specify that the Operational Reserve is to finance projects for which firm pledges have been announced, pending receipt of pledged contributions. The contribution forecast that would be the basis of financing pilot projects is less certain than the announced or confirmed contribution in Financial Rule 110.1.

23. In order to use the Operational Reserve to fund the financing of pilot projects, the Executive Director, within his authority to amend the Financial Rules, authorized an exception to the Financial Rules for the duration of the pilot projects until superseded by a final Board decision at EB3/2004. This exception authorizes the use of the Operational

Reserve to fund the financing of forecast contributions up to the present level of the Operational Reserve. Board approval of the Executive Director's exception to the Financial Rules is requested, given that the rules reflect its approved guidelines.

SUMMARY AND RECOMMENDATION

24. The use of the Operational Reserve to fund the financing of forecast contributions during the pilot project is an important step towards implementation of the BPR.

25. The Executive Director recommends that:

i) the Board take note that the obligation and commitment for the five pilot projects identified in this document will commence with the approval of the project by the Executive Board or jointly by the Executive Director and the Director-General of FAO under their delegated authority; and

ii) the Board approve the use of the Operational Reserve to finance the pilot projects on the basis of forecast contributions as an exception to its decision on the use of the Operational Reserve in WFP/EB.A/97/4-D, and take note of the Executive Director's decision to allow an exception to Financial Rule 110.1 to allow the use of the Operational Reserve for this purpose.

ANNEX I

Business Process Review (BPR)

Information Note

1. This annex to the Pilot Financing paper presented for approval aims to inform the membership about the business process review (BPR), the conceptual basis for the pilots. BPR is the process through which WFP is updating its business practices and policies to improve its ability to provide more food on time to beneficiaries.

2. BPR is an 18-month project. This information note summarizing work done so far is divided into eight sections:

i) Background and reasons for launching the business process review

ii) Objectives

iii) Main results to date

iv) The new operational model: a framework

v) Pilot projects: objectives, results to date and next steps

vi) Donor expectations

vii) Regulatory and policy issues

viii) Next steps

3. An explanation of risk management in a financing context will be found in Annex II.

SECTION I: BACKGROUND AND REASONS FOR LAUNCHING THE BUSINESS PROCESS REVIEW

4. The BPR initiative has two objectives:

- to improve business processes to ensure full utilization of contributions; and
- to ensure that resources are made available to beneficiaries when needed.

5. These two objectives respond to the rapid change that the Programme has experienced over recent years. A major growth in operations (from US$1.4 billion in 1996 to over US$4.0 billion in 2003), the increased directedness of contributions, the introduction of information management technology (WINGS) and, most important, a shift away from development to emergency and relief operations have changed the way in which WFP works. In emergency operations, the timely delivery of food aid is critical.

6. These changes present other challenges for WFP, including:

- increased transparency and budgetary discipline;
- improved quality and timeliness of reporting on project expenditures;
- better throughput of contributions; and
- elimination of unspent balances.

7. As noted by Executive Board members during discussion of the resources and long-term financing policies review at the Board's first regular session in February 2003, the Programme has yet to absorb these changes fully. Symptoms of WFP's incomplete adaptation to its new environment include rising contribution balances and a mismatch in

timing between beneficiaries’ food needs and the in-country availability of food aid. The Programme can now draw on its new information technology to overcome these problems.

8. In response to these issues and opportunities, the Secretariat introduced a Business Process Review at the February 2003 meeting. Subsequently, the Secretariat held a series of informal consultations with the Executive Board — in September and November 2003, and January 2004 — and with major donors, both in Rome and in their capitals.

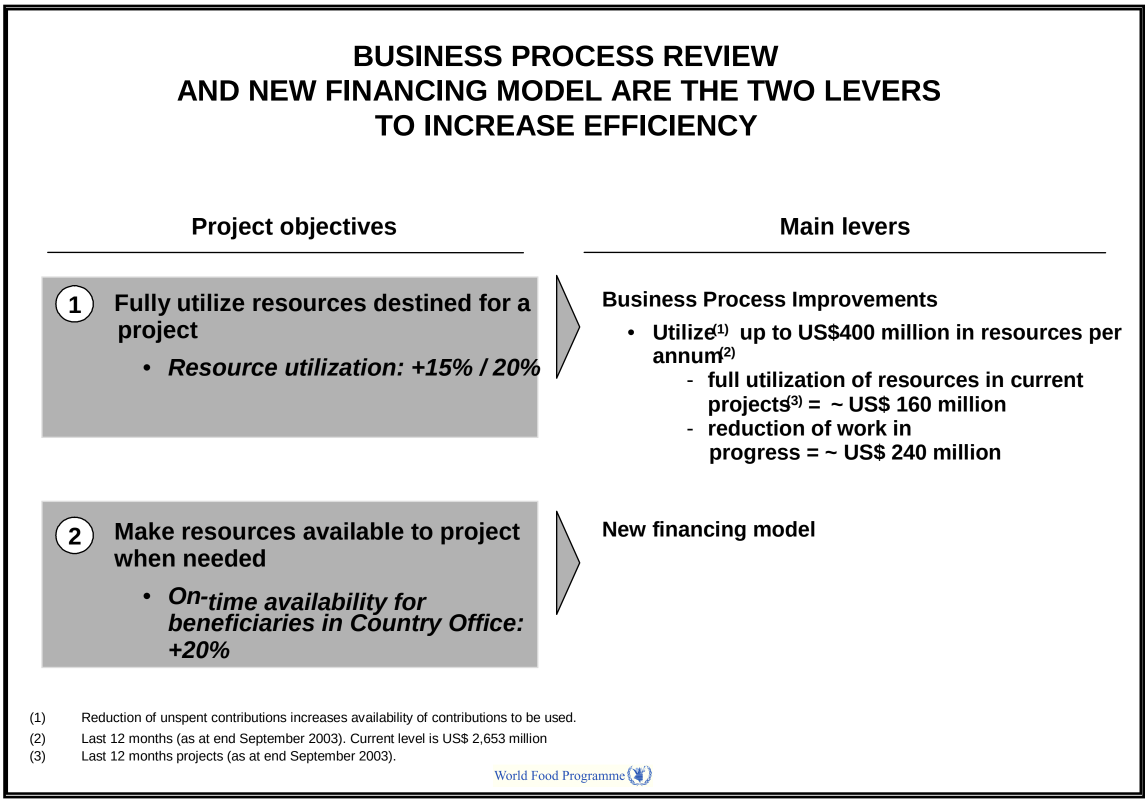
SECTION II: OBJECTIVES

9. The business process review was launched with two major objectives:

- ➢ improve business processes to ensure the full utilization of contributions — the project has identified improvements that if fully implemented would result in a 15 to 20 percent improvement in contribution utilization; and
- ➢ ensure that resources are made available to beneficiaries when needed — the project has designed a new financing model that if fully implemented would lead to a 20 percent improvement in the timeliness of resource availability in beneficiary countries.

10. For an illustration of how these two objectives will functions as levers for improvement, see Figure 1.

Figure 1: How BPR Objectives Act as Levers for Improvement



11. It is important to understand the two types of gain in efficiency introduced by BPR. There are two levers for achieving efficiency gains — process improvements and the financing model — and two types of efficiency gains — increasing the value of

contribution funds and increasing on-time availability. Increasing the value of contributions means that every contribution can now help more beneficiaries: the same amount of money feeds more people, because there will be no unspent balances. Increasing on-time availability means that food is in-country when needed. Business process improvements have had some impact; the new financing model can make up for the remaining difference between levels of resourcing and on-time availability.

12. The BPR team has done a great deal of work on analysing the various components that would combine to make a coherent business process improvement plan, and has identified critical needs that warrant attention in order to lay the basis for such improvement:

- greater flexibility;
- improved planning and implementation; and
- decentralization of authority and responsibility;

13. **Greater flexibility — planning for the unpredictable.** WFP must find ways of adapting its practices to an ever-changing and unpredictable external environment comprising donors, beneficiaries, new emergencies, national governments, international markets, distribution and political factors. Alongside this external framework, WFP must also take into consideration internal factors: results-based management, decentralization, zero-based budgeting, the human resources strategic plan, training for country directors and improving financial management.

14. **Improved planning and implementation — reducing start-to-finish time.** The speed with which WFP operates depends on complex interactions involving forecasting, integration between project approval and project funding, credit supply, commodity management and outsourcing.

15. **Further decentralization of authority and responsibility — clearer accountability.** Operational success is largely the result of (i) clear delegation and demarcation of authority and (ii) responsibility for decision-making, on condition that the performance of people entrusted with such authority and responsibility is regularly monitored to ensure that they meet WFP's expectations. WFP needs to focus programme management at the country director level.

SECTION III: MAIN RESULTS TO DATE

16. BPR has identified reduction and clearance of balances as one of its achievable short-term priorities. A project a task force has been established to focus on these unspent balances. The result of its efforts is shown in Table 1.

TABLE 1: WFP COMPARATIVE FINANCIAL ANALYSIS AS OF 30 NOVEMBER 2003 (US$ MILLION)						
	31/12/2001	**31/12/2002**	**31/03/2003**	**30/06/2003**	**30/09/2003**	**30/11/2003**
Cash balances						
Operating cash	359.5	500.9	535.5	483.2	463.0	482.6
Funds held in trust locally	57.3	47.4	41.7	45.2	53.4	54.0
Reserves and other accounts	402.8	467.1	411.5	512.0	385.8	431.0
Total cash	**819.6**	**1 015.4**	**988.7**	**1 040.4**	**902.2**	**967.6**
Working capital ratio						
Annualized revenue	1 650.8	2 007.7	3 684.0	4 052.0	3 475.1	3 057.8
Operating cash	359.5	500.9	535.5	483.2	463.0	482.6
Operating cash as % of revenue	**22**	**25**	**15**	**12**	**13**	**16**
Months operating cash	2.61	2.99	1.74	1.43	1.60	1.89
Average Annualized Revenue per Month	137.57	167.31	307.00	337.67	289.59	254.82

17. The financial analysis of working capital from 31 December 2001 to 30 November 2003 shows that WFP doubled its revenue in this period but it has reduced operating cash as a percentage of revenue by almost half.

18. Bringing down the operating cash is due, at least in part, to a number of coordinated initiatives:

19. **Improved project closure process.** The closure of projects has a direct impact on contribution balances, because final balances can only be determined after project books have been closed. Timely project closure has therefore become a priority for more effective and efficient management of food aid.

20. In July 2002, WFP embarked on its first major effort to close projects in a timely fashion, and since then has completed four across-the-board exercises, resulting in the operational closure of 584 projects.

21. Through this, the Programme has significantly improved its closure procedures, and more projects are being closed earlier. The gap between operational and financial closure is four months, and a further three to five months are required for the issue of standardized project reports (SPRs) to donors, which form the basis for donor decisions regarding refunding or reprogramming.

22. Detailed guidelines on project closure and resource transfer have been prepared for field offices, highlighting preventive measures that must be implemented to avoid the build-up of large excess cash balances for individual projects. The guidelines are already incorporated in daily activities.

In addition to the acceleration of project closure, most of the contribution balances related to closed projects (US$90 million) had been reprogrammed or refunded in the period June-November 2003. Data up to the end of 2003 are being finalized, but the goal has been to ensure that all savings from projects that ended before 2003 have been reprogrammed or refunded, and the number of financially open projects reduced to less than 200 compared with almost 600 just over two years ago.

23. **Improved 'real time' monitoring of project budgets, and identification of savings.** Project budgets are based on predictions regarding future needs. However, situations can change rapidly, rendering previous predictions obsolete. For example, cheaper than anticipated transport corridors might be secured, or procurement might be made locally rather than internationally. In such cases, posted expenditure will necessarily be less than budgeted, with the result that a project ends up with 'savings' (which is now reported as a 'surplus' at the end of a project).

24. It is therefore essential that country offices continuously monitor the expected income and expenditure of projects in order to identify probable savings *during the life cycle* of a project so that they can be reprogrammed to beneficiaries; it is often too late to reprogramme savings that are identified *at the end of a project*.

25. WINGS and COMPAS (WFP's commodity tracking system) now enable country offices to conduct such improved budget monitoring and real time analysis of fluctuating operational needs. More and more country offices are now monitoring their operational budgets more tightly with a view to identifying potential savings. New reporting tools developed in WINGS and COMPAS are being disseminated to country offices to help them better monitor budgets, and improved policies and procedures have been established to facilitate the speedier reallocation of funds.

It is worth noting that by November 2003, country offices had already identified US$42 million for potential reprogramming. The goal now is to institutionalize quarterly reviews of all operational budgets in order to identify up to US$10 million in savings per quarter throughout 2004. However, the implementation of a new business model (see below) aims to ensure that balances are not accumulated in the first place.

26. **Resources made available more quickly to country offices.** In line with WFP's decentralization initiative, country offices now have earlier access to the support cost portions of contributions programmed to their projects. Technically speaking, this means that a country office can manage all the LTSH, DSC and ODOC related to a contribution immediately after that contribution has been programmed.

27. If country directors have more management control of their resources, they will be able to use those resources more efficiently.

This action has directly improved contribution throughput, and ensured that country offices now have their cash resources on average two months earlier than before. This has resulted in a one-time transfer of more than US$200 million to country offices.

28. **Decentralization of LTSH management.** The management of LTSH — the cash component of contributions that accounts for the largest share of unspent balances — is moving progressively from HQ to field offices. The Transport Division is developing information management tools and conducting training to ensure that country and regional offices are equipped to handle this change.

29. Real management control in the field is expected to be a good incentive for managers to utilize these resources more quickly. At HQ level, the focus is shifting to primarily service centre-type functions — e.g., clearance of LTSH budgets and overall analysis of LTSH costs — to ensure consistency and reduce over-budgeting.

30. Meanwhile, the BPR team has also identified a number of achievable objectives that constitute 12 'building blocks' for business improvement, four of which are key to the introduction of a new financing model (see Figure 2).

Figure 2: Priority Business Process Initiatives

PRIORITY INITIATIVES TO IMPROVE BUSINESS PROCESSES [1]

1 **Project ownership (food and cash pipeline management)**	7 Improve project planning
2 **Improve operational budget set-up, monitoring and revision**	8 Update information systems
3 **Risk management**	9 **Enhance needs assessment**
4 Reduction of business process lead time and increased throughput	1 Establish project closure process and procedures
5 Ensure more targeted, flexible staffing	11 Define re-directing donation system
6 Provide *ad hoc* training	12 Define write-off policies
Key building blocks for the Financing Model	

[1] In terms of organizational changes, stakeholder impact, etc. Costs of implementation are not considered as among the main criteria

Source: BCG analysis.

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SECTION IV: THE NEW OPERATIONAL MODEL: A FRAMEWORK

31. As noted in consultations, the Secretariat has focused on areas that are most likely to result in the most significant improvements in efficiency (measured by the delivery of more food aid on time and better use of resources directed to projects). The basic approach is to empower Country Offices with the tools to enable them to maximize their available resources.

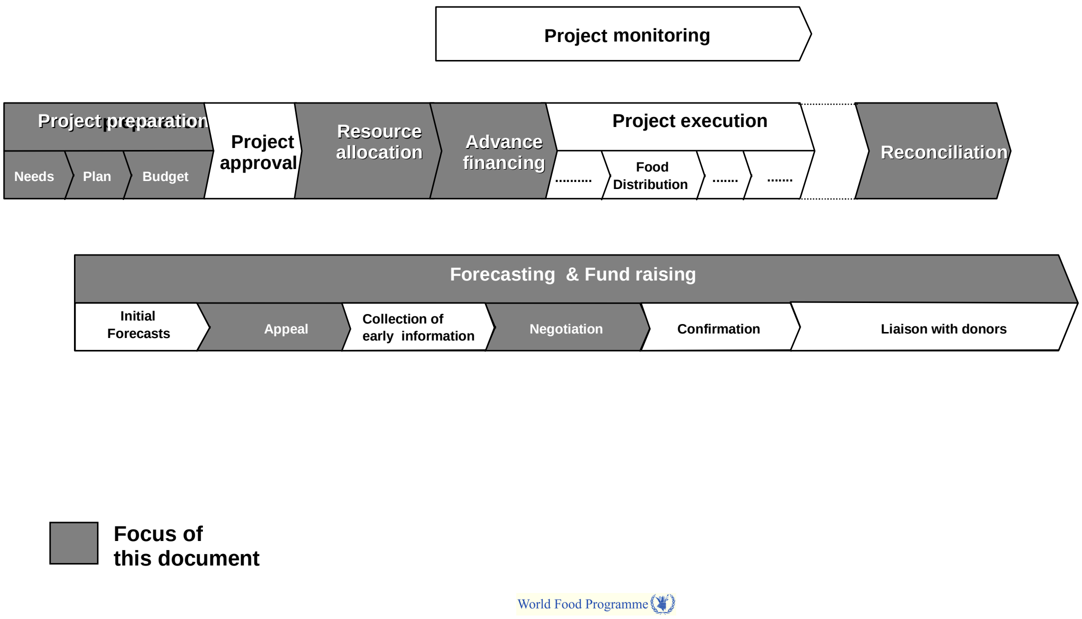
32. To do this, improvements are required in several key areas, including: project preparation, fund-raising, project resource allocation, financing of operations, and reconciliation of project expenditures. This illustration shows only the major changes, and focuses on those processes that most directly relate to donors.

33. The BPR team is currently working on implementation of pilot projects to test and fine-tune the different processes changes that will occur. While this section accurately portrays the Secretariat's views at the beginning of the pilot projects, some adjustments could occur in the coming months, and should be expected.

34. Throughout the text, references are given to the graphic illustrations used to describe the issues in question. Tables comparing the new model with current procedures and describing the benefits of the new model for WFP are placed directly following the issue to which they relate.

Illustration 1

OVERVIEW OF THE MAJOR WFP PROJECT PROCESSES



Project Preparation

⇒ *Needs Assessment*

35. The current process of needs assessment is not expected to undergo major changes as a result of the Business Process Review. Overall, the one significant change will be the compilation of a detailed profile of food aid requirements on a monthly basis, instead of overall needs assessment for an entire project. Monthly needs assessment is a key input to project plans and budgets.

⇒ *Operational Plan and Budget*

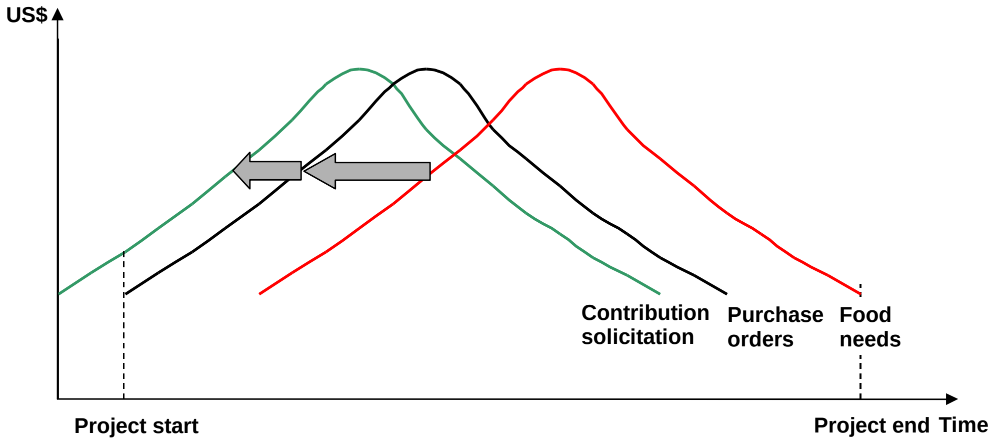
36. At the project planning stage, the BPR introduces two major changes:

- First, a project plan and budget will be prepared on a monthly basis, in order for country offices to plan backwards from an estimated food delivery date (calculated from the monthly needs assessments). This backwards planning captures logistic lead times and clearly identifies when purchase orders should be issued (Illustration 2).

Illustration 2

DELIVERING FOOD WHEN NEEDED REQUIRES

EARLIER CONTRIBUTIONS
Illustrative Example of Current Projects



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37. Under current procedure, project managers only prepare a plan and budget for the entire project, not specifying when the cash will be needed during the life cycle of the project.

PROJECT PREPARATION: PLANNING AND BUDGETING

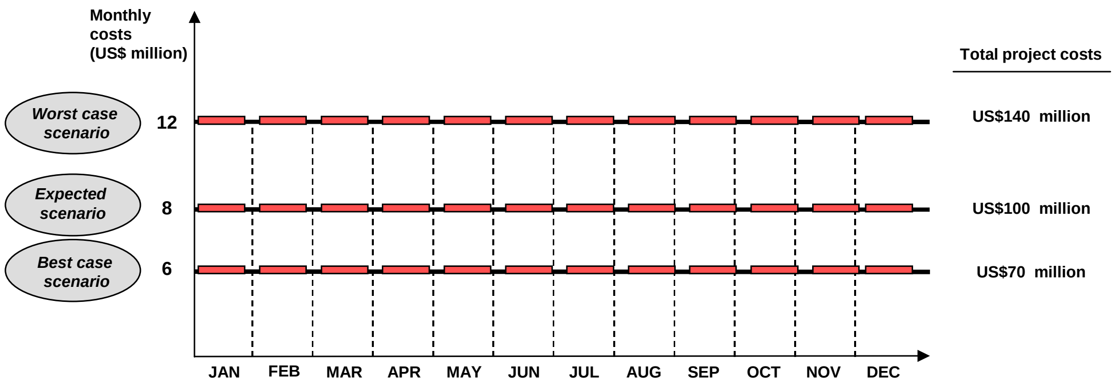
New model	**Current procedures**
Project plans and budgets will be prepared **each month** to facilitate calculation of required lead times and identify the appropriate times for issuing purchase orders.	**One-off** project plans and budgets are prepared for an entire project life cycle, and do not permit systematic identification of when contributions will actually be needed.
Benefits of the new model – Regular monitoring and, if necessary, adjustment. – Facilitates move from one project phase to a new phase. – Facilitates more systematic recording of commitments in WFP's finance system.	

➢ Second, country directors will prepare project plans and related budgets for different operational scenarios, detailing the monthly costs that projects will incur under each (*multiple scenario approach*). Starting from the expected scenario, a country director might identify possible events or other quantifiable parameters that would trigger shifts from an expected scenario to another, either the most expensive ("worst-case") or the least expensive ("best-case"). For a given food aid profile, cost changes refer mainly to increases or decreases in transportation and/or distribution costs (Illustration 3).

Illustration 3

MULTIPLE SCENARIO BUDGETING SHOULD COVER MOST COST VARIATIONS

Every month, project will operate under one of the three approved scenarios



Country Directors are fully accountable for
- Running operations according to approved monthly project plans and budgets
- Shifting scenario when (and only if) identified triggers occur

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38. This multiple scenario approach is critical, because the current approach of using only one fixed rate for the entire project makes it very difficult to adjust to operational changes (only possible through budget revisions, that are complicated and time-consuming) and leads to over-budgeting, one of the main causes of the unspent balances.

PROJECT PREPARATION: MULTIPLE VS SINGLE SCENARIO(S)

New model	Current procedures
Country directors will prepare project plans and related budgets for **different possible scenarios** (indicating estimated monthly costs for each scenario), and identify **triggers that would shift** actual operations **from one scenario to another**.	Projects are based on **one fixed rate for an entire project life cycle**, which can lead to overbudgeting and the creation of unspent balances.

Benefits of the new model

– Adjustment of needs and expenditure during the life cycle of a project.

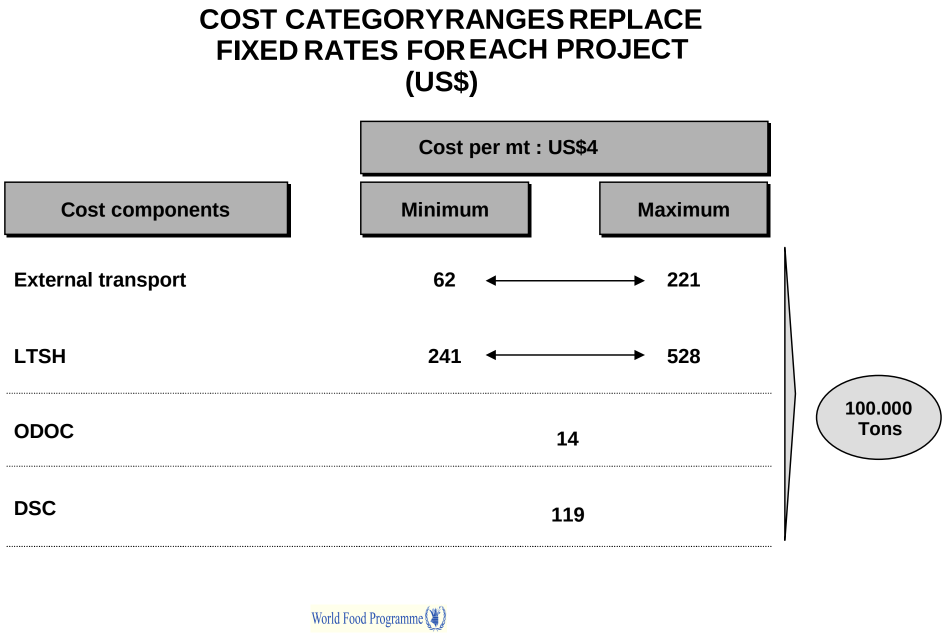
– Increased flexibility at the operational level.

– The identification of 'triggers' will increase the level of responsiveness of projects to the actual situation on the ground at any point during the life cycle of a project.

39. The current model also restricts flexibility since donors are given upfront the exact rates of the different project cost components (external transport, LTSH, ODOC, DSC, etc.) and therefore know exactly how their contribution will be used. This reduced flexibility is another cause of unspent balances and less than optimal throughput to beneficiaries.

40. Under the new model, and since the scenarios have an impact on project cost components, the adoption of the multiple scenario approach means that WFP will not be able to give donors the exact rates of these cost components in advance. Instead, ranges for each of these cost components will be defined upfront, and the final rate, which will be calculated at the end of the project, will be within these ranges (Illustration 4).

Illustration 4



PROJECT PREPARATION: RANGES VS FIXED RATES

New model	**Current procedures**
Ranges for the rates of project components (such as LTSH, ODOC, DSC, etc.) will be defined **in advance** but donors will receive figures for **actual rates** only **at project end** (on condition that these fall within previously approved ranges).	Donors are supplied with **exact rates** for different project components **in advance**, allowing no room for flexibility during a project's life cycle, the potential creation of unspent balances and less than optimal delivery of food aid to targeted beneficiaries.

Benefits of the new model

– Flexibility on when project components are spent during the life cycle of a project.

– Freedom from constraints imposed by working with pre-established rates that are susceptible to change; in the worst case, such constraints could even include sacrificing meeting the needs of beneficiaries.

– WFP will be in a position to cut real costs in situations where component rates drop, or to transfer potential 'savings' in one component to another.

Fund Raising

41. As it does today, the new model envisages WFP preparing an initial appeal on the basis of the project's expected scenario (e.g. overall project value is US$100 million). The main

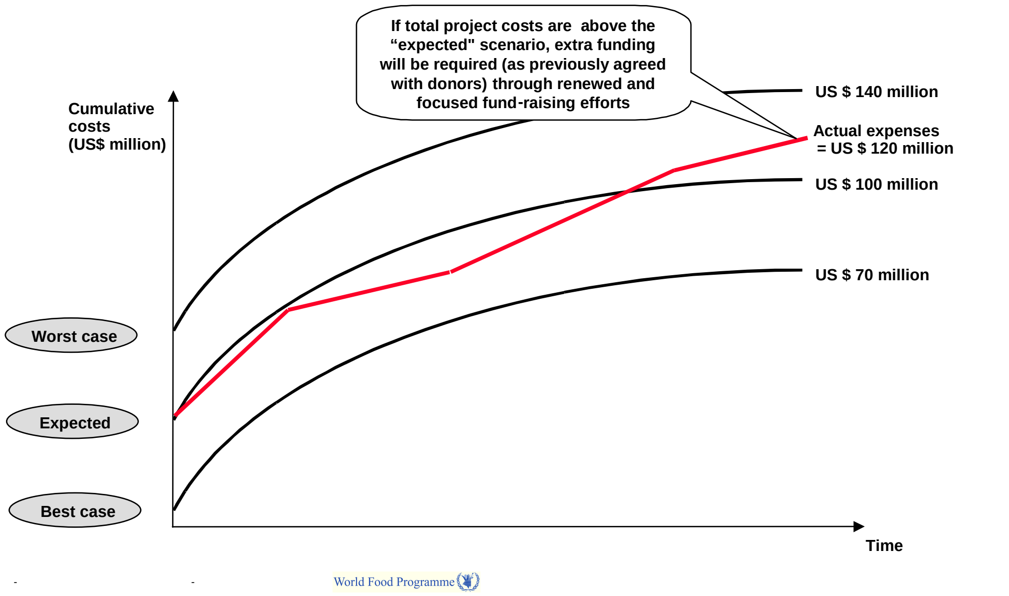
difference to current procedures is that in this initial appeal WFP will specify that requirements might increase to a ‘worst-case’ scenario if conditions deteriorate (i.e. up to the ‘worst-case’ ceiling of US$140 million).

42. Today, and because in the current model this is not needed, WFP does not systematically prepare any project-specific forecasts of donations. In the new model, there will be a need for accurate, timely forecasts of contributions for every project, and the need to prepare a monthly donations report including confirmed and forecast donations (specifying any eventual split between commodity-in-kind (CIK) and cash contributions), and any other available details. Donors will play an important role in this process by making their planned contributions more visible sooner.

43. During a project, if conditions worsen and it is estimated that total cumulative project costs (actual + forecast to project end) will be higher than expected, WFP will have to renew its fund-raising effort for this project through a proactive approach (Illustration 5).

Illustration 5

EXTRA FUNDING SHOULD BE REQUESTED WHEN TOTAL CUMULATIVE COSTS ARE FORECAST TO EXCEED EXPECTED SCENARIO



44. This new approach will be critical to ensure the success of the multiple scenario model.

FUND-RAISING: APPEALS

New model	Current procedures
In its appeals for contributions, **FCD will specify to donors that the originally envisaged scenario may change** during the life cycle of a project to a more negative one.	Appeals for contributions **not systematically prepared on the basis of project-specific donation forecasts**.
There will be a need for **accurate and timely forecasting** of contributions for each single project.	No such procedure exists.
FCD will prepare **monthly donation reports** including, among others, details of confirmed and forecast donations (specifying whether cash or commodity-in-kind).	No such procedure exists.
In the case of projects obliged to switch to a more negative scenario during their implementation, FCD will **renew WFP's fund-raising effort** through a proactive and targeted approach.	**No procedures exist for systematically renewing fund-raising efforts** for already-approved projects.

Benefits of the new model

– Country directors can plan operating activities as well as local fund-raising efforts on the basis of contribution forecasts.

– Contribution forecasts will make it possible to provide advance financing for project resources.

Resource Allocation

45. Once project plans and budgets are approved, country directors or project managers are authorized to spend and are accountable for spending according to the current active scenario, as long as the expected cumulative project costs do not exceed the maximum level of total expected contributions (Illustrations 6 and 7).

Illustration 6

EVERY QUARTER, PROJECT WILL SPEND ACCORDING TO PRE-DEFINED SCENARIOS ...

Appeal for US$ 100 million, expected contributions of US$ 80 million

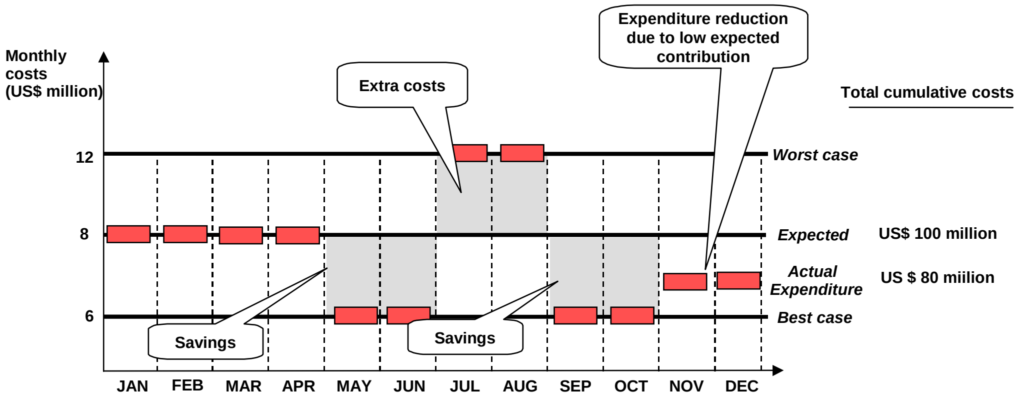


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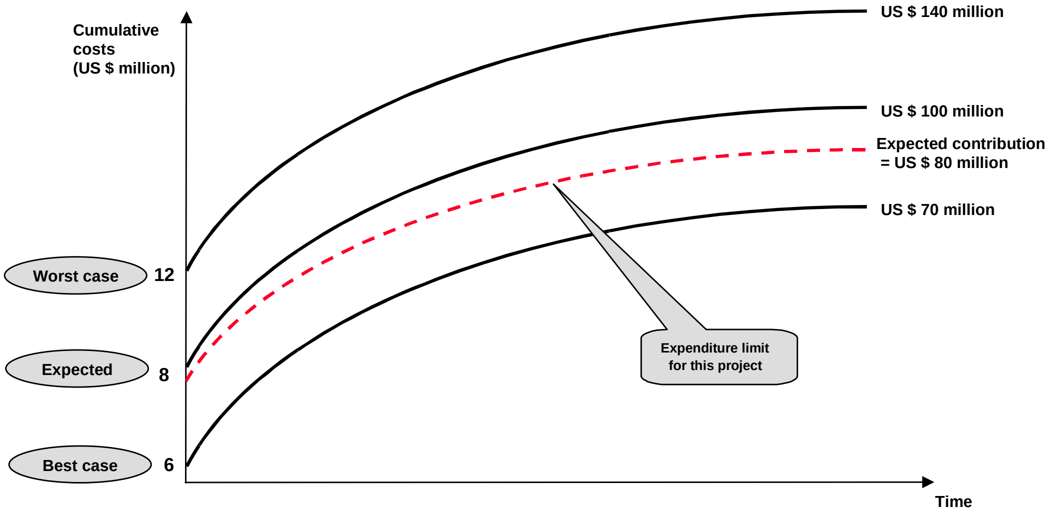
Illustration 7

... BUT LIMITED TO THE TOTAL EXPECTED CONTRIBUTION LEVEL



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46. This is the most significant change from today, because country directors or project managers will spend on the basis of forecasts rather than only after contributions have been confirmed, as is the current practice. During the life cycle of a project, and representing a change to current practice, expenditure will be adjusted according to the total contribution level.

RESOURCE ALLOCATION: AUTHORITY TO SPEND

New model	Current procedures
Country directors (or project managers) may spend — and are accountable for spending — **for any predefined scenario during the life cycle of a project**, on condition that this spending does not exceed the pre-established and agreed ceiling; this involves spending on the basis of forecasts rather than confirmed contributions.	Project spending may only take place once **contributions have been confirmed**.

Benefits of the new model

- A project can start distribution on time without being forced to wait for confirmation of contributions.
- Country directors can plan and spend within their pre-established scenarios and thereby take advantage of the most appropriate and favourable timing for local procurement of commodities and services, among other operational needs.
- Throughput to beneficiaries will increase and timing of distribution will improve.

RESOURCE ALLOCATION: SPENDING ADJUSTMENTS

New model	Current procedures
During the life cycle of a project, spending **may be adjusted** according to the total level of contributions.	**No adjustments** may be made to project spending.

Benefits of the new model

- Monthly monitoring will enable country directors to adjust spending if forecasts change.
- Authorized minimum-maximum spending floors-ceilings will give country directors greater flexibility in adjusting spending levels in project components as the situation on the ground dictates.

47. Scenario changes do not imply that projects will necessarily require a budget revision, and therefore scenario shifts will not require an intervention from the Executive Director/Executive Board or any specific donor. Only if scenarios diverge from what has been planned and approved is a budget revision necessary.

48. The way in which expenditures are committed at project level will also require a change in internal procedures. Today, a project receives from HQ the allotments of contributions divided by each cost category, where they (the contributions) will remain until the end of the project. This translates into situations where projects sometimes have a surplus in some cost 'pots' and a deficit in others, thus being unable to completely meet the needs of beneficiaries.

49. Under the new model, we plan to eliminate this effect by creating a “single pot” at project level. It will then be programmed at the project level into the different cost “pots” according to operational needs. This will allow us to improve throughput to beneficiaries and reduce future unspent balances.

Advance Financing

50. In order to perform the activities described above, it is necessary to solve the mismatch over time between contribution flow and expenditure patterns. This requires that WFP starts financing projects on the basis of expected rather than confirmed contributions.

51. This means that, for example, if a project is expected to receive 80 percent of the resources it needs, WFP can advance up to 80 percent of a project’s first quarter requirements when projects usually receive less than required contributions. Confirmed contributions will later be used to repay the advances from the central cash facility to each project, as shown in Illustration 8.

Illustration 8

OVERVIEW OF PROJECT EVOLUTION IN EXPENDITURE, CONTRIBUTIONS AND CASH POSITIONS

	Qtr–1	Qtr 1	Qtr 2	Qtr 3	Qtr 4	Total
Project budget	5	25	25	25	20	100
Expected contributions	0	0	10	40	30	80
Resources released	4	20	20	20	16	80
Cash position (at the end of QTR)	(- 4)	(- 4) (- 20)	(- 24) (- 20) + 10	(- 34) (- 20) + 40	(- 14) (- 16) + 30	
	(- 4)	(- 24)	(- 34)	(- 14)	0	0

Calculated by multiplying the project budget by the funding expectations

Funding expectations (1): 80%

(1) Expected contributions divided by project budget

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52. Under the current model, and at any given time, WFP is only financing projects up to the level of total confirmed contributions for that project. The management of risk resulting from financing is explained in Annex I.

ADVANCE FINANCING

New model	Current procedures
If it is expected that any given project will receive X percent of the resources it needs, WFP may **advance** up to X percent of requirements in the initial phases when the contribution flow is usually weaker; confirmed contributions will be used on receipt to repay such advances.	WFP **only finances** a given project **up to the level of total confirmed contributions** for that project.
Benefits of the new model – Project activities can be developed at the level of expected contributions well in advance of their confirmation.	

Reconciliation

53. At project end, WFP will reconcile its actual expenses back to donors, providing them with a report on how contributions were actually spent. This will be done *pro rata* across the donor base for each project, up to the point of total project expenditure. This procedure is obviously also different from the current approach of reconciling according to the rates defined upfront in the project funding proposals.

RECONCILIATION

New model	Current procedures
WFP will effect *pro rata* reconciliation at project end and communicate this to the donors concerned; *pro rata* reconciliation will be carried out across the donor base for each project up to the point of total project expenditure. If, despite the new process, unspent balances occur (due to excess contributions or unforeseen project savings), reconciliation will adopt a *'last-in, first-out'* approach for returning or redirecting the last contributions received first.	Expenditure is charged against confirmed contributions, a lengthy and — in many cases — difficult exercise.
Benefits of the new model – *Pro rata* reconciliation will reduce WFP's workload in matching every single item of expenditure to a confirmed contribution.	

54. The following section describes the initial work done in some of these areas as part of the pilot project in the DRC.

SECTION V: PILOT PROJECTS: OBJECTIVES, RESULTS TO DATE AND NEXT STEPS

Objectives

55. To test the applicability of the new business process model in real situations, the Secretariat has planned a pilot project phase based on four general objectives:

- validation of the proposed new business process concepts at the field level;
- review of the feasibility of implementation of the new business processes;

- capacity-building (personnel, tools, methodology) for future implementation; and
- WFP preparation for Programme-wide implementation of the new business process starting in 2005.

56. The objective is to run through the following sectors, which are the foundations of the new business process:

Project Preparation

57. A country office, backed up by support units from its regional bureau and Headquarters, will determine monthly requirements and draw up a possible multiple scenario.

Project Plan Approval

58. The project approval process will be tested with approval of newly-designed project plan formats.

Donation Forecasting

59. The Fund Raising and Communications Department will prepare a forecast of expected contributions for the entire duration of the project concerned through donor contacts and analysis of available information.

Advance Financing and Risk Management

60. WFP will consider advance financing in situations where the requirements of a pilot project country office would not be met by confirmed contributions, and where no alternative exists. The level of such financing will be limited to the income forecast at the time the country office requests advance financing.

Strengthened Country-Level Project Management and Ownership

61. For the pilot projects, WFP will implement a new funding release mechanism: funding will be released immediately to a country office unless advance financing needs to be repaid in a single pot; the country office will be responsible for allocating funding from the single pot.

Project Execution

62. The impact of the new business process model of execution in terms of actual availability of food and where and when it is needed for distribution will be analysed in depth, because adequate and more predictable availability of resources should lead to better planning and execution phases.

Project Monitoring

63. Project monitoring activities will be tested in the areas of project planning, contribution forecasting and project execution.

Reconciliation of Expenses to Donations

64. The reconciliation mechanisms required to reconcile and attribute expenditures to donors will de designed, refined and tested through pilot projects to ensure fair and adequate cost allocation to donor contributions.

Results to Date

65. The BPR is still in the early stages of the DRC pilot, but has already drawn a number of important initial conclusions:

- ➢ Timely and transparent project closure and subsequent transfer of resources are critical for all follow-on projects; these funds provide the start-up capital for the next phase of the operation.
- ➢ Fixed costs should be committed early in the project.
- ➢ There is a need to ensure discipline in planning and monitoring at the country office level.
- ➢ The allocation of resources in a single pot, as opposed to the piecemeal allocation of contributions broken down into cost components such as LTSH, DSC, etc., will greatly enhance resource utilization.

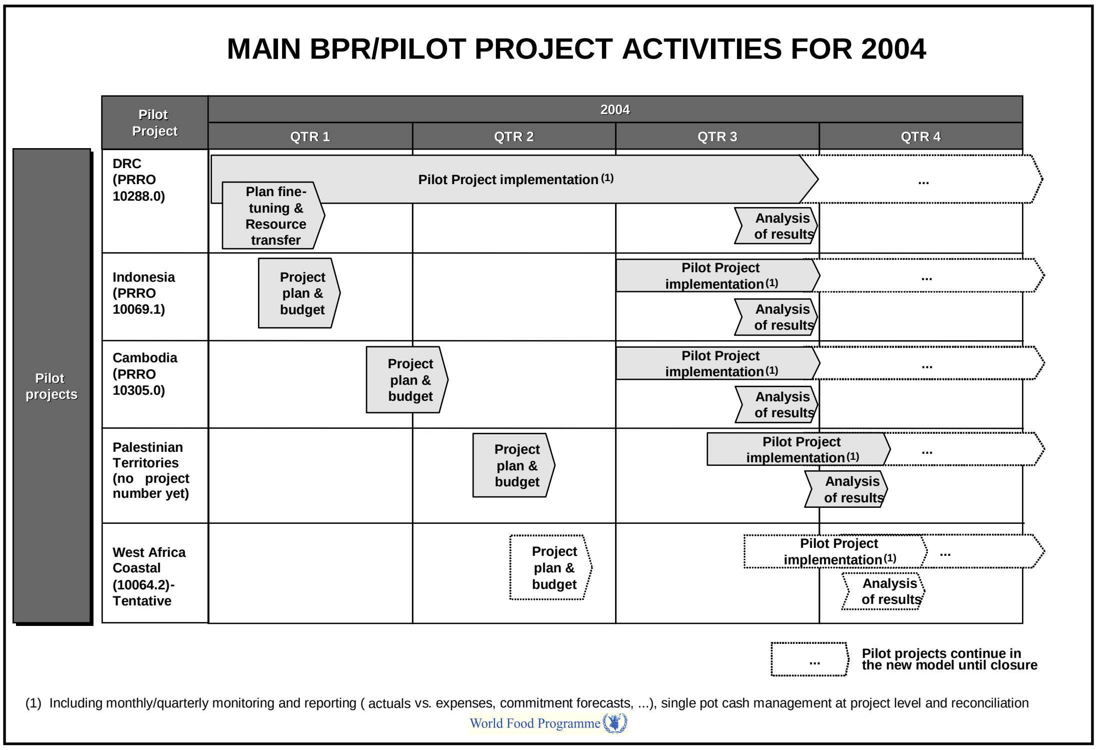
In fact, for the DRC project, the merging of resources into a single pot will ensure that all first quarter requirements are met (food aid and associated support costs); under the old model, there would still be a surplus in some cost components and deficits in others.

Next Steps

66. The first pilot project is under way, following its launch in mid-December 2003. The four other pilots will be carried out in line with the following timetable:

- ➢ Cambodia and Indonesia end-January 2004
- ➢ Palestinian Territories February 2004
- ➢ West Africa Coastal March 2004

Figure 3: Graphic Illustration of Pilot Project Timetable



SECTION VI: DONOR EXPECTATIONS

67. The Secretariat has focused on enhancing its internal processes to improve efficiency since beginning the BPR. We have established initiatives to bring down balances and close projects on time, and have defined the process improvements described above. The priority continues to be improving our own internal processes. In response to queries from the Executive Board, however, the Secretariat has outlined areas in which changes in donor practices would in the course of time significantly enhance the effectiveness of the new business model.

68. **Increase in multilateral donations.** An increase in multilateral donations would certainly improve our operational flexibility and increase on-time availability. The proposed process improvements and new financing model contribute significantly to improving contribution throughput and ensuring that directed resources are utilized as efficiently as possible; these improvements do not, however, address the issue of chronically under-funded operations.

69. **Align contributions with project timeline.** Some contributions expire before the project ends, because the fiscal year ends or because of some donor constraint. This results in less than optimal utilization of donor resources. Country directors should be responsible for spending all resources directed to their projects as efficiently as possible; aligning contribution timeframes with those of projects would greatly help this effort.

70. **Assist in contribution forecasting.** As emphasized above, accurate contribution forecasting is absolutely essential to the new business model. Our Fund Raising and Communications Department will be seeking the assistance of the donor community to determine ways of providing earlier visibility of potential donor contributions.

71. **Endorse the concept of the single-pot allocation and reconciliation of any left over funds on a pro rata basis.** Application of this idea in the DRC has already resulted in dramatic improvements in resource utilization. A situation that would have been a US$5 million resourcing deficit was converted into full resourcing for at least the first quarter of the project. This approach will greatly increase resource utilization and will reduce balances; it will also reduce the need for financing. If funds are left over, they will be returned or reprogrammed on a pro rata basis to ensure fairness among donors.

72. **Support the resource transfer process.** Unless we close projects on time and ensure that any unutilized resources are transferred from one project phase to another, funds will continue to be under-utilized and balances will continue to accumulate. The BPR endeavours to eliminate balances at project end by utilizing resources more efficiently during a project, but the Secretariat recognizes that in the best system there may be unutilized resources that need to be reprogrammed. The BPR team has now developed internal procedures and changes to the information system to speed up the transfer of resources from one project phase to another. Without donor support, however, this effort will not work. The Secretariat strongly urges donors to give their blanket approval to any transfer of resources from one project to another if the project objectives are the same.

SECTION VII: REGULATORY AND POLICY ISSUES

73. The new business processes and financing model will require some regulatory and policy changes. At present the Secretariat does not foresee any changes to the General Regulations, the General Rules or the Financial Regulations; it does, however, foresee changes to the Financial Rules. Currently, the Secretariat anticipates requesting an

extension of the use of the Operational Reserve beyond the pilot projects and a resetting of the level of the Operational Reserve. These changes will be presented to the EB3/2004 in October.

74. WFP's internal project/programme design and management documents will have to be adjusted to reflect the improved processes following field testing of the process improvements in the pilot projects. These modifications will be implemented in the relevant policy documents after the conclusion of the pilots but before the organization-wide rollout.

75. WFP will continue to use multilateral funds to fund projects based on existing prioritization schemes. Proposals in earlier stages of the BPR project to use multilateral funds to reduce possible financial risk resulting from project financing have been abandoned. Once the new financing model is fully developed and field tested, it can be applied to all types of WFP projects — EMOPs, PRROs, SOs, and development projects. Priority will be given to EMOPs, PRROs and SOs in the roll-out to begin in 2005.

SECTION VIII: NEXT STEPS

76. The Secretariat has targeted completion of the business process changes for October 2004 in order to roll out the improvements to EMOPs and PRROs in 2005. Major milestones on the way to a Programme-wide application of the new business and financing model are the pilot projects and Board decisions.

77. As seen in Section II, endorsement of the BPR objectives is too important and the aim of improving throughput to beneficiaries too significant not to get the entire review process right. To ensure a prudent review of the new business model, as well as communicate the details of this model to all stakeholders, the Secretariat has extended the BPR process from the originally targeted date of February 2004 to October 2004.

78. Since the pilot projects are expected to run through 2004, the Secretariat proposes to review their progress with the membership in early May and September 2004. With the data and experience obtained from the pilot projects, the Secretariat validate and recalibrate the financing model for final approval at the October Board. The recalibrated financing model may have an impact on the required level of reserve funds to cover any losses incurred by financing forecasted contributions. Finally, the Secretariat will also propose a method of recovering any costs associated with financing at either the May or October Board meeting, depending on the progress of the pilot projects. For the pilot projects no additional costs are foreseen.

ANNEX II

FINANCIAL RISK MANAGEMENT

1. In response to the information note of November 2003, members requested more information on the proposed financial risk management system.

2. Spending against a forecast of a contribution rather than a confirmed contribution carries the risk that the confirmed contribution will not match the anticipated contribution. In other words, WFP will have spent funds which later fail to materialize. The system WFP proposes to manage this risk has three pillars: (i) iterative income forecasting, (ii) expenditure controls, and (iii) a risk reserve fund.

3. The first step in managing financial risk is accurate income forecasting. For each project, the Resources Department will provide monthly project-to-end income forecasts setting the limit of expenditures a project may commit. If, for example, the income forecast estimates that a project will be funded at 85 percent, the project may spend up to a level corresponding to 85 percent of its budget.

4. The second step is expenditure controls. As described in section IV of Annex I, a project’s budget will be divided into monthly expenditure forecasts that anticipate expenditures four months into the future, based on the average lead time from purchase order to in-country availability; specific average lead times will be estimated for each project. Should the income forecast be revised to show less income than previously anticipated, the project’s future expenditures will be reduced to compensate for the reduced income, thereby enabling the project manager to ensure that the project will not run a deficit.

5. Expenditure controls cannot, however, compensate for forecasting errors on income anticipated in the last four months of a project. Given the lead time, these expenditures will have been committed prior to the period during which the forecasting error would manifest itself, that is, when the contributions are confirmed. Nevertheless, the average distribution of income over the course of a project will keeps this risk small.

6. An analysis of the nine most significant projects in 2002 showed that only about 14 percent of contributions are usually confirmed during the last four months of a project. Assuming a forecasting error of 50 percent on this part of a project’s income, the result would be that 7 percent of the project’s forecast income will materialize. If such an error occurs in about 12.5 percent to 25 percent of projects, then in WFP as a whole the financial risk is about 1-2 percent of contributions — 7 percent divided by 8, to 7 percent divided by 4, rounded up. The financial risk on any single project is accordingly 7 percent; across several projects the risk is 1-2 percent. In the absence of historical data this calculation is obviously based on assumptions; WFP has not attempted to forecast contributions in the past.. Over the course of the pilot projects, the BPR team will validate these assumptions; the point here is to be transparent about the bases of our estimates.

7. The Secretariat proposes covering this risk through a risk reserve. For the purpose of the pilot projects, the Secretariat is proposing Executive Board approval of a rule change authorized by the Executive Director that would permit the use of the Operational Reserve to cover the risks of the pilot projects.

ACRONYMS USED IN THE DOCUMENT

ACABQ	Advisory Committee on Administrative and Budgetary Questions
BPR	business process review
CIK	commodity-in-kind
COMPAS	WFP’s commodity movement tracking and analysis system
DRC	Democratic Republic of the Congo
DSC	direct support cost
EMOP	emergency operation
FAO	Food and Agriculture Organization
FCD	Fundraising and Communications Department
HQ	Headquarters
LTSH	landside transport, storage and handling
ODOC	other direct operational cost
OED	Office of the Executive Director
PRRO	protracted relief and recovery operation
SO	special operation
SPR	standardized project report
WINGS	WFP Information Network and Global System