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Programme Alimentaire Mondial

World Food Programme

Programa Mundial de Alimentos

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RESOURCE, FINANCIAL AND BUDGETARY MATTERS

Agenda item 5

For approval

BASIS FOR CALCULATION OF INDIRECT SUPPORT COSTS (ISC) ON OCEAN TRANSPORT COSTS

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NOTE TO THE EXECUTIVE BOARD

This document is submitted for approval by 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 point 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).

DRAFT DECISION*

The Board endorses the action taken by the Executive Director to exclude the cargo preference premiums from United States contributions for ocean transport when calculating ISC, with retroactive effect from January 2002, as described in the document WFP/EB.1/2004/5-B/1.

* 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.

SECTION I: BACKGROUND

1. The present document discusses WFP's applicable General and Financial Rules and Regulations governing the full-cost recovery principle in relation to contributions for ocean transport.

2. The document describes the details of an agreement between WFP and its major donor regarding the basis for calculating indirect support costs (ISC) in relation to contributions from the major donor to ocean transport, and the accounting methodology for such contributions, in the light of recent comments received from the WFP External Auditors.

3. The document then considers that such accounting treatment does not impact on ISC and proposes that the Board endorse the methodology, enabling the Secretariat to levy ISC on ocean transport contributions.

SECTION II: FULL-COST RECOVERY PRINCIPLE

4. WFP's Financial Regulations define the principle of full cost recovery as follows: "Full-cost recovery shall mean the recovery of operational costs, direct support costs and indirect support costs in full."

5. Article XIII of WFP's General Regulations and General Rules states: ..."Donors may contribute appropriate commodities, cash and acceptable services in accordance with the general rules made pursuant to these General Regulations. Except as otherwise provided in such general rules in respect of developing countries, countries with economies in transition and other non-traditional donors, or in respect of other exceptional situations, each donor shall provide cash contributions sufficient to cover the full operational and support costs of its contributions."

6. General Rule XIII.4 states: "…(a) Donors contributing food commodities or designated cash, such as cash in lieu of food commodities, shall provide sufficient cash, acceptable services or acceptable non-food items to cover the full operational and support costs related to their commodity contribution, using the following criteria for the calculation of operational and support costs;…..(ii) external transport: estimated actual cost;…" Indirect supports costs are a percentage of direct costs as determined by the Board.

7. In its First Regular Session in 1999, the Board adopted the "Report of the Formal Working Group on the Review of WFP's Resource and Long-term Financing Policies" (WFP/EB.1/99/4-A) and approved the recommendations contained therein.

8. In paragraph 20 of the "Resource and Long-Term Financing Policies (R&LTF)" document, the working group "…..decided to recommend that full cost recovery from each donor should continue to be fundamental to WFP's R&LTF policies…..It considered various categories of existing and potential donors, their particular needs in making different types of contributions. It decided to recommend a degree of flexibility to encourage contributions while safeguarding the full-cost recovery principle."

9. In the same R&LTF document, paragraph 76 states: "One of the recommendations of the Formal Working Group approved by the Committee on Food Aid Policies and Programmes (CFA) at its Fortieth Session stipulated "that WFP renegotiate with donors those agreements which do not fully conform with the new model in order that the principle of full-cost recovery is met by each donor. Recognizing individual donor constraints, the Secretariat should be flexible with donors but fully recover support costs pertaining to the

implementation of operations carried out with their contributions (CFA 40/15, paragraph 22 n).”

SECTION III: TERMS OF CONTRIBUTIONS FOR OCEAN TRANSPORT

10. A standard agreement between the United States Government and WFP governs the contributions made by that government to WFP.

11. The standard provisions for a Title II grant agreement between the United States Government and WFP state that ocean transport of commodities provided under Title II, Public Law 480 shall be procured by WFP in compliance with United States policies on cargo preference requirements, which is that at least 75 percent of tonnage is to be transported on vessels carrying the United States flag.

12. The United States’ cargo preference is defined by the United States Maritime Administration of the Department of Transportation as: “The reservation, by law, for transportation on US-flag vessels of all or a portion of all ocean-borne cargo which moves in international trade either as a direct result of the Federal Government's involvement or indirectly because of the financial sponsorship of a Federal program or guarantee provided by the Federal Government.”

13. The United States Cargo Preference Act of 1954, Public Law 83-664, as amended, requires that at least 50 percent of the gross tonnage of all cargo generated by the United States Government be transported on privately-owned commercial vessels carrying the United States flag to the extent that such vessels are available at fair and reasonable rates. In 1985, the Merchant Marine Act of 1936 was amended to require that the percentage of certain agricultural cargoes to be carried on vessels carrying the United States flag be increased from 50 to 75 percent. For shipments of commodities under Title II and Title III of Public Law 480, the requirement for the use of vessels carrying the United States flag is 75 percent.

14. It is recognized that freight rates on ships carrying the United States flag are generally higher than those on other ships. The requirement to ship at least 75 percent of United States cargo contributions on ships carrying the United States flag limits WFP’s ability to obtain the least expensive freight rates. The cost difference between the estimated freight on a ship that does not carry the United States flag and the actual freight on a ship that does carry the United States flag is called the Cargo Preference Premium.

15. Such premiums were handled in various ways in the past. WFP separately calculated and claimed them until 1991, when there was a strict distinction between commodity and cash contributions. Since 1992, when flexibility between commodity and cash in United States contributions was introduced, such premiums became a part of United States cash contributions. This practice continued until 2001. In August 2001, however, the United States Government informed WFP that ISC should not be levied on the amounts of such premiums.

16. The Executive Director accordingly advised the United States Government that the amount of the premiums would henceforth not constitute a part of the United States contribution, and thus would not be subject to the ISC levy.

17. Therefore, in the agreement between the United States Government and the Secretariat, United States contributions for ocean transport are levied with ISC on the basis of the freight estimates for ships not carrying the United States flag. Such freight estimates were calculated to match world commercial freight rates.

SECTION IV: WFP ACCOUNTING FOR OCEAN TRANSPORT CONTRIBUTIONS

18. With effect from January 2002, income and expenditures were recorded on the basis of the adjusted global freight estimates — actual United States global rates net of United States cargo preference premiums — and recognized, in accordance with WFP's approved income and expenditure basis of accounting. As a service to the United States, however, WFP continued to account for cash receipts and cash disbursements related to United States cargo preference premiums. When received from the United States Agency for International Development (USAID) and the United States Department of Agriculture, the United States cargo preference premium cash amounts were recorded as liabilities; when paid to shipping companies, the liabilities were decreased accordingly.

19. In late 2003, WFP's External Auditors expressed concern over WFP's accounting treatment of the United States cargo preference premiums, noting that these were significant sums which should be reflected in WFP's statement of income and expenditure.

20. The External Auditors strongly recommended that the United States cargo preference premiums be considered a part WFP's income. The full United States cargo preference premiums pledged should be recorded as income, and the corresponding disbursement recorded as expenditure.

SECTION V: IMPACT ON ISC

21. The Executive Director accepts the views of the External Auditor on the accounting issues, but recognizes the distorting element of the United States cargo preference premiums. The Executive Director fully understands the United States Government's stated position that United States cargo preference premiums should not be levied with ISC.

22. The financial forecasts of operational activity included in the 2002–2003 biennial budget and those in the 2004–2005 Management Plan are based on average international ocean freight rates, excluding ships carrying the United States flag, so the United States cargo preference premiums have no budgetary impact on WFP's projected income and expenditures. There is therefore no negative impact on forecast ISC levels.

23. The Executive Director also recognizes that the United States fully covers the ocean transport costs of its contributions and provides ISC on the basis of world commercial freight rates, which are reviewed each biennium.

SECTION VI: RECOMMENDATIONS

24. The Executive Director recommends that the Executive Board endorse his action to exclude the cargo preference premiums from United States contributions for ocean transport when calculating ISC, with retroactive effect from January 2002.