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Agenda item 5

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REPORT OF THE FAO FINANCE COMMITTEE

The Executive Director is pleased to submit herewith the report of the FAO Finance Committee pertaining to WFP. The report covers different agenda items as follows:

- Audited Biennial Accounts (2000–2001) (WFP/EB.3/2002/5-A/1/1–5);
- Report on Budgetary Performance, 2000–2001 (WFP/EB.3/2002/5-B/1);
- Final Report on the Analysis of the Indirect Support Cost (ISC) Rate (WFP/EB.3/2002/5-C/1);
- WFP's Cash Balances: Composition and Appropriate Levels of Cash (WFP/EB.3/2002/5-D/1); and
- Final Report on Balances of Projects Closed Prior to 2001 and Migrated to WINGS (WFP/EB.3/2002/5-E/1).

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October 2002



منظمة الأغذية
والزراعة
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y la
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COUNCIL

Hundred-and-twenty-third Session

Rome, 28 October – 2 November 2002

Report of the Hundred-and-first Session of the Finance Committee Rome,
7 and 8 October 2002

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REPORT OF THE HUNDRED-AND-FIRST SESSION OF THE FINANCE COMMITTEE

7 and 8 October 2002

INTRODUCTION

1. The Committee submitted to the Council the following report of its Hundred-and-first Session.
2. The following representatives were present:
Vice-Chairperson: Mr Anthony Beattie (United Kingdom)
Members: Mr Antonio A. Plaza Jiménez (Chile)
Mr Fumihiro Kabuta (Japan)
Ms Fatimah Hasan J. Hayat (Kuwait)
Mr Adnan Bashir Khan (Pakistan)
Mr Alassane Wele (Senegal)
Mr Rolf Gerber (Switzerland)
Ms Perpetua M. Simon Hingi (Tanzania)
Ms Carolee Heileman (United States of America)
3. The Committee noted that Mr Alassane Wele had been designated to complete Senegal's term on the Finance Committee.
4. The Vice-Chairperson informed the Committee that both Mr Humberto Molina Reyes (Chile), Chairperson of the Finance Committee, and Mr Eiji Suzuki (Japan) would regretfully be unable to attend the session. The Committee noted that Mr Antonio A. Plaza Jiménez had been designated to represent Chile in the absence of Mr Molina Reyes and that Mr Fumihiro Kabuta had been designated to represent Japan in the absence of Mr Suzuki.
5. In adopting its agenda, the Committee recalled that at its last session the World Food Programme (WFP) had not provided the necessary documentation in all the required languages for the items related to WFP. Accordingly, the Committee had decided to convene this special session of the Finance Committee in order to give appropriate consideration to those items prior to the next session of the WFP Executive Board. It also recalled that WFP would bear the costs of this special session.

ADOPTION OF THE AGENDA AND TIMETABLE (docs. FC 101/1 and FC 101/INF/1)

6. The Chairperson opened the meeting by reminding the Committee of its role as provided for in paragraph 4, Article XIV of WFP's General Regulations: "In all matters relating to the financial administration of WFP, the Board shall draw on the advice of the United Nations Advisory Committee on Administrative and Budgetary Questions (ACABQ) and the Finance Committee of FAO".



REPORT ON BUDGETARY PERFORMANCE (2000-2001)
(doc. WFP/EB.3/2002/5-B/1)

7. The Committee reviewed and took note of the Budgetary Performance Report (BPR), 2000–2001 (WFP/EB.3/2002/5-B/1), submitted to it for discussion and for recommendations to the Executive Board, and expressed its appreciation for the report's clear and transparent presentation. The Committee noted that, in future, this report would form part of the Annual Management Report.

8. Following an introduction by the Assistant Executive Director for Administration (AED), the Committee sought and the Secretariat provided clarification on the following issues:

- a) **The difference between the BPR and the Report of the Executive Director of the Audited Biennial Accounts and the basis for the preparation of these reports:** The Secretariat advised that these two reports were required to be submitted to the Board. The BPR, which used to be submitted on an annual basis, was now being submitted on a biennial basis as required under General Regulation Article VI.2 (b)(iii). The Report of the Executive Director was part of the submission of the Audited Biennial Accounts, as required in General Regulation Article XIV.6(b). The Report of the Executive Director, which was voluntary, summarized all of the operational highlights in the financial administration of the Programme and consolidated recommendations on financial issues covered by the other financial documents being presented to the Board.
- b) **Use of economies of scale in ocean transport to ensure lower costs and savings:** The Secretariat pointed out that WFP continued to manage costs of transport and tried to achieve cost efficiencies and take advantage of economies of scale wherever possible. For example, in all shipping and transport activities, small shipments were combined in order to cut and reduce costs.
- c) **Robustness of budgetary figures at the formulation and revision stages:** The Secretariat explained that the formulation of the overall operational budgets for each programme category was done at the global level at the time of the submission of the original budget. This was revised at the end of 2000 based on actual data for the first year of the biennium and on estimates for the second year and was then updated accordingly. However, at the project level there were more active and real-time budget revisions. The Secretariat agreed that there was room for improvement in this area, for example, in the timely monitoring and revision of the budgets, and explained that this would now be possible with the WFP Information Network and Global System (WINGS).
- d) **Philosophy and justification for additional programme support and administrative (PSA) resources:**
 - i) **Linkage between use of additional PSA resources and level of operations:**
The proposal for the use of additional PSA had been presented to the Board during submission of the 2002–2003 biennial budget. About 50 percent of the additional PSA could be linked to the increase in the level of operations, for example, staff, vulnerability analysis and mapping (VAM), emergency response, baseline studies and communications. The other 50 percent, primarily for systems improvement and staff security, was indirectly linked



to the increase in the level of operations, but these would result in better monitoring of project expenditures.

- ii) **Estimation of availability of additional income prior to PSA increases:**
The Secretariat explained that the additional PSA was approved by the Executive Director on the basis of estimated income, which, however, was received only after the end of the biennium.

9. The Committee noted the continuing decline in contributions for development. This was a point of special concern to some members. Among other consequences, it was felt to have an important bearing on the overall mission and strategy of WFP. More generally, it raised the issue of potential risks for the future of the Programme.

10. The Committee concluded that there was a need to rationalize the presentation of financial information to the Executive Board.

H. AUDITED BIENNIAL ACCOUNTS (2000-2001) (doc. WFP/EB.3/2002/5-A/1/1-5)

11. The representative of the External Auditor recalled that the President of the Cour des Comptes had presented the audit report (Section II: Opinion of the External Auditor on the Audited Financial Statements for 2000-2001, and Section III: Long-form Report of the External Auditor) to the Committee at its Hundredth session and had highlighted the following points:

- a) The External Auditor had rendered an unqualified opinion on the WFP financial statements.
- b) The long-form report included 36 recommendations and an annex on the results of the survey on the review of the decentralization process.
- c) Recommendations were classified by topics, i.e. Financial Matters (12), Treasury Management (12), Decentralization Process (5), and Implementation of the Financial Management Improvement Programme (FMIP) (7).
- d) The recommendations were also classified as to their priority and deadline for implementation.

12. The AED commented as follows on the main issues identified by the President of the Cour des Comptes to the Committee at its previous session:

- a) On the treasury operations, the President indicated that the cash resources donated and/or entrusted to the Programme had been prudently managed and that progress had been made in improving treasury management and activities, including in particular the steps undertaken by the Secretariat to strengthen the monitoring of the performance of investment managers and the costs of investing. For this purpose, the Executive Director had established a post of Investment Officer, for which confirmation by the Board was being sought.
- b) The Secretariat agreed with the comments of the President on FMIP, in particular on the need to continue the work on outstanding migration issues.
- c) On the decentralization process, the Secretariat agreed with the President that proper comparative studies needed to be undertaken prior to the establishment or reconfiguration of bureaux and that the cost benefit analysis of the decentralization needed to be expedited. The Secretariat also agreed that further work was necessary on Government Counterpart Cash Contributions (GCCC).



13. In concluding the presentation, the Secretariat extended its appreciation to the *Premier President de la Cour des Comptes de la République Française* and thanked the Director of External Audit and the members of her team for the extensive and comprehensive work they had done throughout the years.

14. The External Auditor expressed general satisfaction with the response of the Secretariat to the recommendations made in the 2000–2001 audit report, and in the follow-up on the recommendations contained on 1998–1999 audit report, with the exception of the treatment of the GCCC and the cost benefit analysis of decentralization.

15. While discussing the report of the External Auditor, the Committee noted the delay in the preparation of the management paper regarding agreements with host governments on GCCC, and the explanation of the Secretariat that a lot of underlying work was being done in the meantime and that the issue of GCCC would be part of the review of the resource and long-term financing (R<F) policies as indicated in the paper on indirect support costs (ISC) (doc. WFP/EB.3/2002/5-C/1. The Secretariat informed the Committee that the cost benefit analysis of the decentralization was being undertaken for presentation to the Executive Board in 2003.

16. The Committee noted the increased cost of FMIP compared with the original estimate and the Secretariat's explanation that these costs were in line with industry benchmarks and were a result of the expansion in scope, including the Human Resource/Payroll modules, which were not in the original plan.

17. In the discussion on the management and investment of WFP funds, the Committee raised questions on and the Secretariat explained the selection process for investment managers, the source of advice for the WFP's Investment Committee and the United Nations Joint Staff Pension Fund (UNJSPF), and sought the views of the External Auditor on WFP's management of investments. The External Auditor explained that the Secretariat's approach was a cautious one in which yields might not be so strong but with which investments nevertheless came up with good results in 2000–2001. The Committee enquired about WFP's policy on the membership of its internal investment committee. The Secretariat explained that benefits were derived from having representatives from other United Nations organizations on its internal investment committee by way of sharing lessons learned and exploring opportunities for other possible areas of collaboration.

18. In considering the recommendations put forward by the Executive Director in paragraph 84 of the document (WFP/EB.3/2002/5-A/1/1), the Committee referred to other parts of the Audited Biennial Accounts and the other financial documents (on cash balances, closed projects and the ISC rate). The Committee sought and received clarification on the following matters:

- a) **Capital Asset Fund (paragraph 84e):** The Secretariat clarified that the capital asset fund was intended to finance assets and system developments that would last more than one biennium and were continuing or non-recurring in nature. Projects would be charged over time and these amounts would be set aside for the fund. The authority to establish the fund and decisions taken on its use rested with the Board, as provided for in the Financial Regulations.
- b) **Surplus of Prior-1996 funds with unidentifiable donors of US\$13.5 million (paragraph 84g):** The Secretariat explained the nature of this surplus and confirmed that under the new system the previous situation in which fund balances could not be attributed to donors would no longer occur.



- c) **The basis used in the formulation of the Expenditure Plan proposed by the Executive Director (Table 13, paragraph 81):** The Secretariat explained that out of US\$200.25 million planned expenditure, projects and programmes accounted for US\$180 million, of which US\$20 million would be used for repayment of the Central Emergency Revolving Fund (CERF). The main criteria governing the proposed allocation among programme categories were the urgency of expenditures and the identification of underfunded projects. The Secretariat further explained that the timing of actual expenditure was dependent on the approval of reprogramming by the donors concerned. The other major component of the expenditures, although not related directly to projects, was essential for supporting and monitoring effective implementation of projects.
- d) **Ex post facto approvals:** The Committee drew attention to the need for having an appropriate instrument in seeking ex post facto approval and confirmation by the Board of specific expenditures. It suggested that this matter be considered by the WFP governance project.

19. The outgoing External Auditor identified the following main risks faced by the Programme:

- a) In recent years, the Programme had faced a number of external challenges and undergone several major changes, notably the remarkable increase in resources, the implementation of FMIP, the introduction of the R<F policies, and the decentralization of operations. There was a risk regarding consolidation of these changes and maintenance of stability in operations that would require a new approach. The Programme would need to adapt to this new situation.
- b) In terms of cash flow, the Programme was in a strong financial position. It might however need to adapt to an era of declining resources. There was therefore a greater need to project revenues more accurately, taking into account similarities with other United Nations organizations.
- c) Certain systems projects had yet to be concluded, notably the HR/Payroll component of WINGS. Other United Nations agencies might well have an interest in these system developments.

20. In a discussion of the risks faced by the Programme, the Committee noted the decline in resources for development activities; the increased emphasis on emergency operations; the risks faced by staff in hardship duty stations in terms of burnout and the human toll taken on them and their families. The increased complexities in countries with no viable government or infrastructure complicated operations and could affect costs and strategies. The Secretariat briefly explained that an extensive review of staff policies had been completed and would be considered by the Executive staff during their October meeting.

21. The Committee suggested that in view of the various challenges faced by the Programme, the Executive Board might wish to commission an early review of these risks and ways of handling them.

22. After completing discussions on the other documents and related recommendations, the Committee considered the recommendations of the Executive Director contained in paragraph 84 of Section I of the Audited Biennial Accounts and agreed to advise the Executive Board to take note or approve these, as appropriate, except for item f, where the Committee recommended that the Board “approve” instead of “confirm” the funding of the PSA expenditure shortfall of US\$40.7 million.



FINAL REPORT ON WFP'S CASH BALANCES
(doc. WFP/EB.3/2002/5-D/1)

23. The AED for Administration presented the final report on cash balances as a follow-up report on WFP's level and policy of investment that was reviewed by the Committee and the Executive Board in February of this year. The Programme's cash balance as at 31 December 2001 amounted to US\$905 million, of which US\$325.7 million was cash not relating to projects and US\$579.3 million pertained to cash relating to projects.

24. In its analysis of the current cash level and review of the Secretariat's receipts and disbursement patterns, the appropriate level of cash was established to be the aggregate of three months' operating requirements plus the reserves, amounting to US\$360.3 million. When compared with the cash balance relating to projects as at 31 December 2001, there was excess cash of US\$219 million, which was attributed largely to unspent cash balances of US\$77.6 million from closed and completed projects being proposed for reprogramming or refunding and US\$161.8 million of cash available for programming and allotment.

25. The Secretariat agreed with the External Auditor's recommendation to improve cash forecasting. The cash forecast presented was based primarily on past trends, but there were also efforts to project future disbursements and action was currently being undertaken to implement the functionality in WINGS that was developed for cash forecasting. The Secretariat indicated that some of these balances emanated from the closed and completed projects and that the immediate disposition of these balances would reduce the cash balance of the Programme. However, the Secretariat emphasized that this would depend primarily on the decision of the donor concerned and the related timing.

26. After these discussions, the Committee decided to recommend to the Board to adopt the draft decision as proposed, but expressed its keen interest in monitoring progress achieved in reducing the cash balances and speeding up project implementation.

FINAL REPORT ON PROJECTS CLOSED PRIOR TO 2001 AND MIGRATED TO
WINGS (doc. WFP/EB.3/2002/5-E/1)

27. The Assistant Executive Director of Administration introduced the item and highlighted the main issues contained in the document. Strategies and procedures were being implemented to ensure that projects were closed in accordance with the prescribed completion dates. The implementation of these WINGS-based strategies, together with a more intense review by senior management, would prevent any future build-up of closed project balances, which had an impact on the levels of cash balances in the Programme.

28. At the request of the Committee, the Director of External Audit explained that the improved processes for closing projects would affect the cash balances held, owing to the time required for consultation with donors on reprogramming and for utilizing reprogrammed funds. She further indicated that closed project balances reflected both negative and positive aspects relating to excess budgeting and cost savings achieved in implementation and that the Secretariat would need to address this in the future.

29. Some members expressed the view that the closed project balances might provide a window of opportunity for reprogramming to unfunded development activities and urged the donors concerned to expedite their consideration of such activities. Other members commented on the possibilities of exploring alternative concepts, nomenclature or classification for the development programme category.



30. The Committee recommended that the Executive Board adopt the draft decision contained in paragraph 37 of document WFP/EB.3/2002/5-E/1.

FINAL REPORT ON THE ANALYSIS OF THE INDIRECT SUPPORT COST (ISC) RATE (doc. WFP/EB.3/2002/5-C/1)

31. The Secretariat presented the Final Report on the Analysis of the Indirect Support Cost (ISC) Rate (WFP/EB.3/2002/5-C/1) and related documents using a Powerpoint presentation, which was based primarily on the “Next Steps” as decided by the Executive Board in the preliminary review of ISC in May (document WFP/EB.A/2002/6-A/1).

32. The Committee reviewed the recommendations of the Executive Director as set out in paragraph 173 of the paper and highlighted the following issues for the consideration of the Executive Board:

Interest Income: The Committee took note of the trend analysis of the recent PSA shortfalls and of how interest income was used to fund these shortfalls in addition to other activities such as FMIP and After-Service Medical Liabilities. It further noted the two recommendations (b and d) involving the use of interest income to fund the shortfall in 2000–2001 and the potential continuation of using interest income for any future shortfalls. The Committee noted that recommendation b could be adopted, as it was a continuation of previous practice, but that recommendation d should not be taken as a permanent solution. Hence the Committee recommended that the phrase “including the continuation of the practice of using interest income for any shortfalls” be deleted from the proposed decision.

The Committee also recommended that the issue of the use of interest income to fund PSA shortfalls be included in the forthcoming review of the R<F policies.

Accounting Policy Change: The Committee agreed with the proposed change to the accounting policy on income recognition.

PSA Equalization Account: The External Auditor said that the establishment of the equalization account was also a welcome development, but that such an account should be considered a reserve account and consequently be established by the Executive Board rather than by the Executive Director. The Secretariat pointed out that the equalization account could be established by the Executive Director as part of normal accounting procedures to improve the monitoring, reporting and managing of these gaps. However, the disposition of the balance of this account at the end of a period would require an Executive Board decision.

Reclassification of Variable Programme Support and Administrative Costs (PSA) to Direct Support Costs (DSC): The Committee discussed and requested clarification on the modalities for implementation of the proposed reclassification of the variable element of PSA to DSC. It also noted the External Auditor’s comments that the reclassification should be undertaken in conjunction with the zero-based approach to the 2004–2005 budget preparation and that seeking approval for this proposal at this stage would be premature. It noted also the ACABQ recommendation that a clear set of criteria for the reclassification be set. The Secretariat responded that this review of ISC established a strong case for such a reclassification. If direction on this issue were received from the Executive Board, then the Secretariat would be in a position to incorporate this in the strategy on the application of a zero-based approach to the preparation of the 2004–2005 budget. The Committee recommended that the



Board instruct the Secretariat to review the reclassification of expenditures and develop options for consideration in the context of framing the 2004–2005 budget.

Reduction of ISC Rate to 7.0 Percent for 2003: The Committee took note of the 2002–2003 analysis and of the various scenarios showing the results of a reduction of ISC to 7.0 percent and the reduction in PSA expenditure by 10 percent for 2003. It observed that all scenarios presented resulted in a shortfall. Expressing concern regarding the risks associated with these recommendations, the Committee stressed that the recommendations should be defended only on the basis of projections and sensitivity analysis.

The Secretariat explained that the recommendation was indeed based on projections and analysis of actual costs. The shortfalls referred to in the paper were arrived at using the actual rate of 2000–2001 of US\$417 per metric ton (mt) with an estimated volume of 5.5 million mt. The latest average actual rate for 2002 of US\$434 per ton and the projected volume of 6.2 million mt for the biennium had raised the confidence of the Secretariat that such a shortfall would not occur.

The Secretariat further explained that the shortfall for 2000–2001 was due primarily to the accounting convention for income recognition and that if the accrual basis had been adopted, there would have been no shortfall. Changing the accounting convention would establish the true impact of factors such as “price” and “volume” on the PSA gap in a real-time manner.

The External Auditor also expressed the view that it was preferable not to change the ISC rate mid-biennium. The Committee noted that recommendation 2.4 under paragraph 14 of the document on R<F, approved by the Board in January 1999, provided that “The single ISC rate will be fixed for a biennium, but may be revised on an annual basis should the situation so warrant.”

Ten-Percent Reduction of 2003 PSA Budget: The External Auditor commented that the revision of the PSA budget was the prerogative of the Board except when it related to a volume change in excess of 10 percent. Therefore, this could not be decided by the Executive Director. However the Secretariat indicated its understanding that the Executive Director had the authority to reduce PSA expenditure as part of his responsibility for the stewardship of WFP funds. This reduction was being made as one of the mechanisms to address the recommended decrease in the ISC rate.

Study of Comparative Costs of Other United Nations Organizations

The Committee considered the comparative study with other United Nations organizations as very informative and relevant to the discussions on ISC and expressed hope that members of the Board would benefit from the outcome of the study, in particular how WFP compared with other organizations in terms of support costs.

The Committee looked forward to the further study of comparative costs of non-governmental organizations (NGOs), the report of which would be presented in February 2003.



ANY OTHER BUSINESS

33. The Chairperson, on behalf of the Committee, echoed the Secretariat's earlier appreciative remarks and thanked the outgoing External Auditor, the Cour des Comptes of France, for their work and valued contributions to the Committee, and to WFP and FAO, over the last eight-year period.

34. The Chairperson welcomed the incoming External Auditor, the National Audit Office (NAO) of the United Kingdom of Great Britain and Northern Ireland. The Chairperson commented that, in addition to looking forward to NAO's contribution to and comments on the work of the Committee, an issue to be addressed would be how to streamline the presentation and submission of audit reports to the Board, i.e. to present them more frequently rather than once every biennium. The Chairperson further informed the Committee that the NAO would make a presentation to the Board on its audit strategy for WFP in February 2003 session.

