# DRAFT UPDATE ON THE FINANCIAL FRAMEWORK REVIEW

## Informal Consultation

## 21 September 2015

**World Food Programme**
Rome, Italy

## EXECUTIVE SUMMARY

WFP's financial framework consists of the general and financial regulations and rules, financial structures, policies, systems and processes that support operations and provide financial oversight and accountability for stakeholders. It enables WFP to deliver food and nutrition assistance, common services and cluster responsibilities.

WFP has recently adjusted parts of the financial framework to respond to changing operational modalities and to enhance efficiency and effectiveness. Significant changes in the ways in which WFP provides food assistance and related support in changing operational contexts will drive the next phase of the Financial Framework Review (2014–2016), which addresses fundamental aspects of WFP's financial architecture.

To operate with the transparency, efficiency and effectiveness required by Member States, partners, donors and beneficiaries, WFP must establish a financial framework in which resource allocations are clearly accounted for against stated objectives, outcomes and outputs, and in which clear links between financial and operational performance are evident.

During 2015 and 2016, WFP will restructure its financial framework: better alignment between resources and results will improve decision-making, especially at the field level, and will ensure optimum use of resources. This review builds on the Quadrennial Comprehensive Policy Review and the business models of other United Nations organizations.

The Financial Framework Review involves the following workstreams:

- Resource-based planning – standardization of resource-based plans at the country office level to improve planning and performance management;
- Macro advance financing – aggregated budget authority for country offices at the beginning of the financial period to reduce the impact of fragmented funding streams, increase the predictability of resources and enhance efficiency and effectiveness; and
- Budgeting for operational effectiveness – revision of WFP's budget structure to reduce internal fragmentation, simplify processes and maximize transparency and accountability in alignment with the Country Strategic Plan approach.

Part I of this document describes each workstream of the Financial Framework Review, identifies associated risks and gives a timeline and cost estimate to the end of 2016. The Secretariat will discuss all aspects of the review with the Board and other stakeholders. Input from experienced field staff, best practices in other United Nations agencies and donors' requirements will inform the review as it progresses.

Part II describes the results of the review of the Programme Support and Administrative Equalization Account target level. The Secretariat intends to increase the target level to five months of expenditure to support a modest increase in risk associated with less conservative contribution forecasting. It also intends to establish a floor for the account equivalent to two months of expenditure for use solely in the event of a sustained deficit between Programme Support and Administrative expenditures and indirect support cost income. The Financial Framework Review will explore the potential of reducing the opportunity cost of the Programme Support and Administrative Equalization Account balance.

# PART I: OVERVIEW OF THE FINANCIAL FRAMEWORK REVIEW

## Context

1. This section sets out the objectives of the Financial Framework Review (FFR) and provides an overview of each workstream, a timeline and the approaches to be used including pilots.

2. WFP's financial framework was set up in the mid-1990s and has, with minor changes, served its needs and supported the introduction of new tools such as cash-based transfers and advance-financing mechanisms. In accordance with its obligation to provide the performance required by donors, host governments and beneficiaries in terms of transparency and accountability with regard to resource allocation, and demonstrated value for money WFP must upgrade its financial framework to support it to at least 2030.

3. In 2014, the Board approved a reorganization of the Working Capital Financing Facility into three components: an internal project lending facility, a global commodity management facility and corporate services. This increased the size of the advance facilities and improved the support structure by establishing a separate reserve – sized according to the risk level – for each category.[1]

4. At the 2015 Annual Session, WFP introduced the priority areas of the Financial Framework Review and set out the challenges that continue to limit the predictability, flexibility and accountability of WFP's resources for country offices.[2]

5. The review is supported by the Quadrennial Comprehensive Policy Review (QCPR), which aims to harmonize the business practices of United Nations organizations, and by the process of developing the Sustainable Development Goals and the Agenda 2030.

6. Figure 1 outlines the main internal drivers of the FFR,[3] and highlights some structural challenges that the Secretariat must address.

[1] WFP/EB.A/2014/6-D/1.

[2] WFP/EB.A/2015/6-C/1.

[3] WFP/EB.A/2015/6-C/1.

**Figure 1: The case for change**

**Piecemeal and/or fragmented budget authority**

- Fragmented budget authority to incur costs is based on the receipt of contributions or advances, which leads to short-term operational focus and higher transaction costs
- Funding is parcelled out among projects and trust funds, and also among the numerous cost components of any project, which limits ability to optimize resources for medium-term and long-term planning
- Multiple projects in one country create fragmented funding streams and programming, and make it more difficult to link resources to results

**Multiple budget entities at the country level**

- Variation in the duration of entities hinders cohesive fund management
- Time-consuming processes for budget approval, revisions and transfers

**Inflexible budget structure**

- Numerous cost components and inability to shift funding between cost components limits a Country Director's flexibility
- This can result in unspent balances, surpluses and returns of funds to donors
- Input-orientated budget structure does not support linkages to financial and performance information

7. The FFR will address these challenges through more realistic planning, enhanced accountability, streamlined processes and less fragmented internal structures, which will better align WFP's financial and results frameworks to enable improved performance management and reporting. The goals of the review, which were developed in consultation with WFP Country Directors and reviewed by the Board, are:[4]

- Goal 1: increase the predictability of resources so that country offices can optimize operational efficiency and effectiveness;
- Goal 2: increase flexibility with a view to improving responses to operational needs and maintaining discipline in financial management, reporting and analysis;
- Goal 3: enhance accountability by linking resource management responsibilities and outcomes; and
- Goal 4: simplify the resource management framework.

[4] WFP/EB.A/2014/6-D/1. The document was approved, and the Board welcomed further discussion.

**Figure 2: Goals of the Financial Framework Review**


8. The Secretariat has prioritized three workstreams, which will be implemented in parallel to ensure that activities result in stand-alone and collective benefits:

- resource-based planning;
- macro advance financing; and
- budgeting for operational effectiveness in support of Country Strategic Plans.

9. As affirmed at informal consultations, three principles will remain in place: the voluntarily funded nature of WFP, full-cost recovery and contribution-specific expenditure tracking. However, the FFR will examine the application of these principles in consultation with the Board.

## Resource-Based Planning

10. Resource-based planning is not a new concept to WFP. Operational needs consistently surpass the level of contributions, and managers prioritize activities or beneficiary groups and adjust the level or duration of assistance to match the funding received. In response to a Board request, the Secretariat included the first prioritization exercise in the Management Plan (2014–2016) to show how managers planned to adjust programming, and the consequent effects on beneficiaries, if only a portion of operational needs were to be funded. The subsequent Management Plan refined the exercise with funding projections by country to create a provisional prioritized plan of work with analyses of the anticipated effects of unmet needs in terms of reductions in the number of daily rations and food tonnages, the value of cash and vouchers, the duration of assistance and beneficiary caseloads by activity type.

11. This workstream will standardize a realistic planning layer in WFP, and more clearly distinguish between "needs" and "plans". The approach will enable country offices to plan their operations 12 to 18 months in advance on the basis of projected resources.

12. Resource-based plans will not replace needs assessments, which remain the basis for programme design and interventions, but they will enhance accountability and performance management by making it easier to compare operational results against original plans, and will enable WFP to better assess its performance in terms of value for money.

13. The workstream takes into account: i) various approaches and models informally adopted by country offices to align funding with operational implementation; and ii) the development of the provisional prioritized programme of work for the Management Plan and WFP's pipeline management processes. Its will be organized as follows:

- Step 1. Define operational needs by project, activity, beneficiaries, transfer modalities and food types.
- Step 2. Country offices estimate annual projected funding through analysis of past and current funding levels by project and possibly by donor.
- Step 3. Develop plans on the basis of projected resources, prioritizing activities and adjusting beneficiary numbers, ration sizes and duration of assistance.

14. The Secretariat will test resource-based planning in a few countries from September 2015 to June 2016. These pilots will support the macro-advance financing pilot programmes described below.

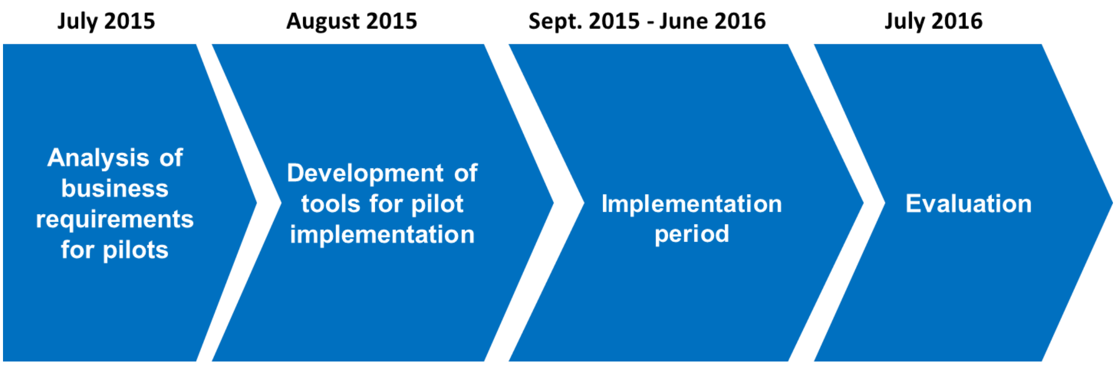
15. The criteria for selecting the pilot countries are: i) a mix of operational sizes; ii) diversity of donors; iii) commitment by country office management; iv) resource management capacity; and v) likelihood of at least minimum funding. The pilots will be supported by a working group at Headquarters.

16. The results of the pilots will be assessed in July 2016, before a standardized platform is rolled out to country offices. Country Directors and project managers will be equipped with tools that combine projected resource levels with information about supply chains and resource management.

17. To mitigate the risk that donors may focus on resourcing particular issues rather than possible shortfalls in needs-based plans, WFP will: i) continue to communicate operational needs and advocate for full funding to meet the requirements of all beneficiaries; ii) develop metrics to link shortfalls with particular outcomes to indicate the effects on beneficiaries; and iii) clarify the distinction between needs and plans in its fundraising.

18. Figure 3 shows the timeline for the resource-based planning workstream.

**Figure 3: Resource-based planning timeline**




## Macro Advance Financing

19. Macro advance financing is intended to give country offices aggregated budget authority to incur costs from, for example, the start of a financial period. This is an extension of the current Internal Project Lending (IPL) facility, which provides loans to projects using forecast contributions as collateral.

20. Macro advance financing will increase the predictability of resourcing at the country office level with aggregated advances to improve operational effectiveness. Removing the uncertainty and irregularity of funding will enable country offices to implement projects with greater efficiency and continuity; they will, for example, be able to enter into contracts for the duration of a financial period rather than on a piecemeal basis.

21. The initial step is to pilot the approach in a few countries with a view to: i) delivering operational value through enhanced efficiency and effectiveness; ii) improving the concept and supporting accountability framework; iii) identifying and quantifying risks; iv) learning lessons for wider application; and v) engaging with donors to maximize operational value through improvements to processes.

22. It is anticipated that the country offices involved will receive an advance and budgetary authority for 2016 on the basis of projected cash funding and other variables. Commitments and expenditures will be made against the advance, and contributions received will be used to repay it in line with donors' conditions.

23. In view of the unique context in which each country office operates, the macro advance financing approach will vary. This will enable the Secretariat to assess its risk appetite at various levels and establish ways of maximizing the operational value of the advances.

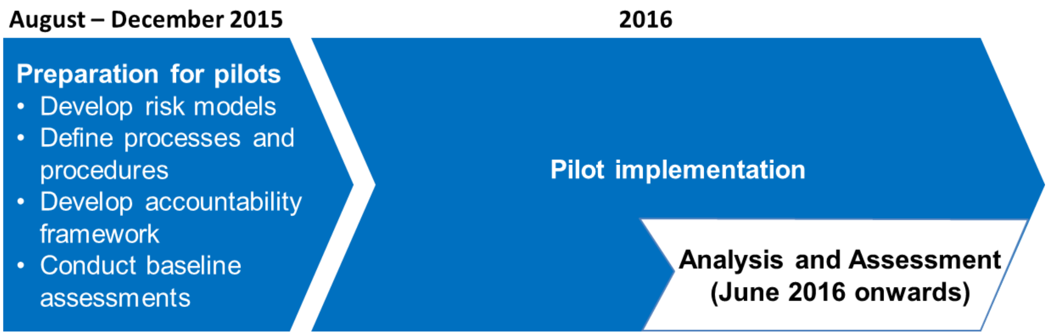
24. After the pilots, the Secretariat will benchmark the gains in efficiency and effectiveness. The pilots will be compared with the current model to demonstrate potential for increased efficiency and improved delivery of assistance to beneficiaries.

25. The Secretariat will manage four or five pilots through the IPL facility, which is backed by the Operational Reserve: USD 150 million to USD 200 million will be set aside from the IPL ceiling of USD 570 million. Macro advances may be allocated in revolving tranches to reduce the total advance balance and minimize the risk.

26. The pilot countries will be selected on the basis of: i) participation in the resource-based planning pilot; ii) relatively predictable past funding; iii) stability in terms of needs and resources; iv) commitment by the Country Director; and v) capacities in the country office. The selected country offices will develop a risk model and a "compact" — a document defining accountabilities for the pilots — as part of their preparation.

27. Figure 4 shows the timeline for the macro advance financing workstream.

**Figure 4: Macro advance financing timeline**



## Budgeting for Operational Effectiveness

28. This workstream will review WFP’s current structure and develop options for an improved structure that maximizes WFP’s ability to respond efficiently and effectively to prioritized operational needs with disciplined financial management, reporting and analysis, and that facilitates fundraising. The work will be carried out in consultation with stakeholders.

29. The revised budget structure is intended to:

- align resources with the results framework to improve transparency;
- enhance reporting to donors and show how individual contribution are used;
- increase the flexibility of resourcing to achieve the Strategic Objectives;
- simplify budgeting at the country level; and
- support rapid mobilization of resources in emergencies.

30. Under the current budget structure country offices manage several project budgets and numerous cost categories in each project. Funding is further fragmented by donor contributions for specific activities. The financial resource management structure is input-oriented and not aligned with the data used for performance reporting. By reducing this fragmentation and enhancing the budget structure, WFP can continue to deliver assistance in emergencies and can benefit from multi-year, results-oriented planning and costing.

31. The workstream will be aligned with the Country Strategic Plan (CSP) approach to ensure consolidation of budget structures in country portfolios, hence reducing fragmentation. The user-oriented approach will consider the views of all stakeholders, encourage dialogue and work toward simpler, less bureaucratic solutions.

32. Phase I – analysis – has already begun: it includes a review of WFP’s current budgeting processes and identification of future requirements, and takes into account the QCPR with a view to defining a financial framework that is, where possible, aligned with those of other United Nations agencies. The work will include a review of the financial architecture of the United Nations Children’s Fund (UNICEF) and Office of the United Nations High Commissioner on Refugees (UNHCR), for example, and some non-governmental organizations will be studied to determine where harmonization or integration is feasible.

33. Phase II focuses on option development and consultation, also in alignment with the CSP initiative. WFP will develop options to create a budget entity that can support all country-level food assistance interventions and modalities in a single budget envelope.

34. Stakeholders will be consulted to determine the initial list of options, which will be refined in Phase III – internal discussion – to determine the options with the greatest potential. These will be tested in country offices to assess their effects and identify associated risks with a view to selecting the preferred option, which will then be presented to the Board for approval.

35. Phase IV involves further refinement and testing of the selected option and development of an implementation plan, subject to the Board’s approval.

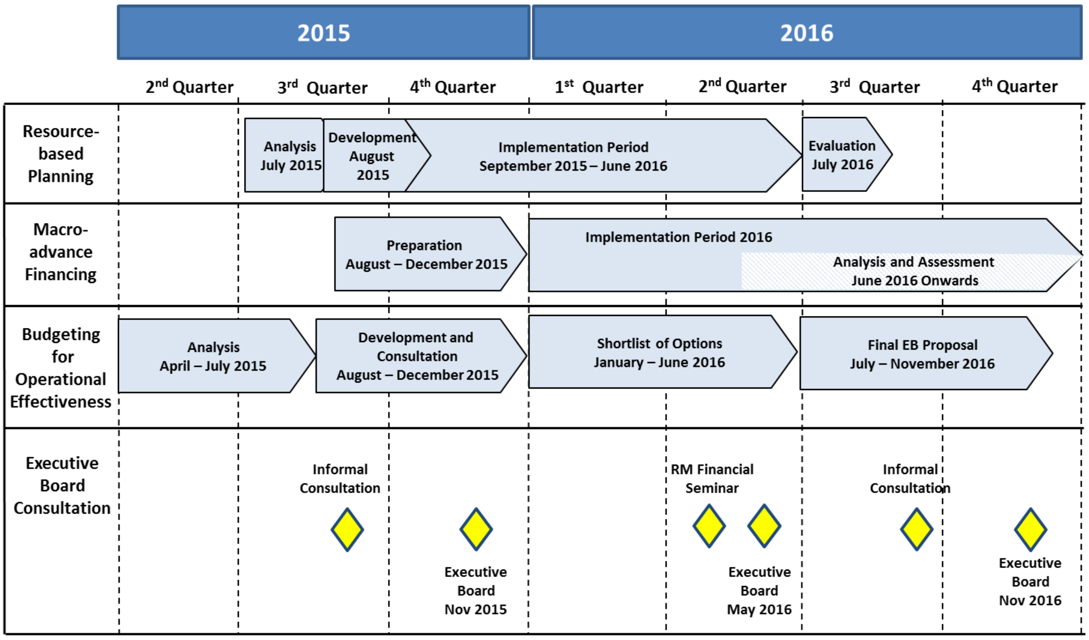
36. Phase I has already identified several risks and mitigation measures. The first risk is insufficient buy-in by country offices, Headquarter divisions, stakeholders or Member States. To address this risk, WFP will consult extensively internally and communicate regularly with the Board and hold bilateral discussions as needed.

## Figure 5: Budgeting for operational effectiveness timeline


## Timeline and Cost Estimates for the Financial Framework Review

37. Figure 6 shows the timeline of the FFR workstreams and consultations until the end of 2016. The Secretariat will work with the Bureau to determine requirements for additional consultations or briefings.

## Figure 6: Consolidated timeline of Financial Framework Review workstreams




38. During the consultation process, Board members requested an overview of the budget for the FFR. Table 1 accordingly provides a breakdown of staff and non-staff costs for the approved 2015 budget and the proposed budget for 2016.

| TABLE 1: FINANCIAL FRAMEWORK REVIEW BUDGET (2015 AND 2016) (*USD million*) | | | |
|---|---|---|---|
| **Cost** | | **2015 approved budget** | **2016 proposed budget** |
| Staff costs | | 1 766 387 | 1 297 740 |
| Other costs | Consultants | 375 000 | 315 000 |
| | Direct operational costs | 251 928 | 427 412 |
| | Information and communications technology | 46 685 | 39 848 |
| | Travel | 200 000 | 180 000 |
| | Training | 60 000 | 80 000 |
| | Other | 400 000 | 160 000 |
| **TOTAL** | | **3 100 000** | **2 500 000** |

39. Table 1 shows an estimate of the investment required to complete the FFR (2015–2016) and place the conclusions and draft decisions before the Board for approval at its 2016 Second Regular Session.

40. Subject to discussions with the Board membership in 2015 and 2016, proposals presented at the 2016 Second Regular Session could involve substantial changes to WFP's financial systems and policies. Options in the Budgeting for Operational Effectiveness workstream, for example, may involve implementing country portfolio budgets and updating Enterprise Resource Management and performance management systems, procedures and training.

41. The Secretariat will consult the Board and stakeholders at all stages of the FFR. Proposals will be accurately costed to provide the Board with all relevant information before it decides which FFR proposals and change-management initiatives should be implemented.

## External Support

42. The Boston Consulting Group is engaged in the FFR, following its 2014 assessment of WFP's financing and lending mechanisms. As part of the Macro Advance Financing workstream, it will conduct the baseline analysis for the pilot and quantify efficiency and effectiveness gains at the end of 2016. It will have an in-country presence to support the Budgeting for Operational Effectiveness workstream.

43. The Boston Consulting Group will also review resource management processes and the cross-functionality of the workstreams at the country office level, working with the Secretariat to identify inefficiencies and develop recommendations for improvements.

# PART II: REVIEW OF THE PSA EQUALIZATION ACCOUNT TARGET LEVEL

## Background of Review

44. In accordance with the Management Plan (2014–2016),[5] the Secretariat reviewed the indirect support cost (ISC) rate issue in consultation with the Board, focusing on the context, drivers and four policy questions that included Programme Support and Administrative (PSA) costs and the use of the PSA Equalization Account as a funding source.

45. The conclusions were presented at the Board's 2014 First Regular Session[6] and Second Regular Session[7] and its 2015 Annual Session.[8] After consultation and consideration of the Secretariat's recommendations, the Board decided that no changes to the ISC policy were required except that a single ISC rate of 10 percent would be applied to private-sector donations.

46. It was agreed that the target level of the PSA Equalization Account should be reviewed to assess WFP's financial resilience to income fluctuation. The target level – currently four months of PSA expenditure – has remained unchanged since 2006. The review included an analysis of best practices in other United Nations organizations and non-governmental organizations.

47. The Secretariat also conducted a "stress test" of various scenarios utilizing varying ISC income levels to estimate the time required to revise the PSA budget and evaluate the effect of reducing staff when ISC income is realized at a level below the Management Plan projections as opposed to maintaining staff to retain WFP's core capacities until contributions are received.

## Overview of PSA Equalization Account

48. Because WFP is a voluntarily funded organization, income fluctuations can quickly undermine its ability to cover indirect costs. The PSA Equalization Account was established in 2002 to manage surpluses and deficits between ISC income and PSA expenditures and so mitigate the risk that ISC income may not materialize at the expected rate. The Secretariat adopted a target level of four months of PSA expenditure for the PSA Equalization Account. The Board approves all uses of the account.

49. At its 2015 Annual Session, the Board endorsed the use – subject to specific approval – of the balance of the PSA Equalization Account for the following purposes:

- to cover any difference between ISC income and approved PSA expenditure;
- as a reserve to underwrite the risk of decreased ISC income or under-funding of the PSA budget;

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

[6] WFP/EB.1/2014/4-B/1.

[7] WFP/EB.2/2014/5-D/1.

[8] WFP/EB.A/2015/6-C/1.

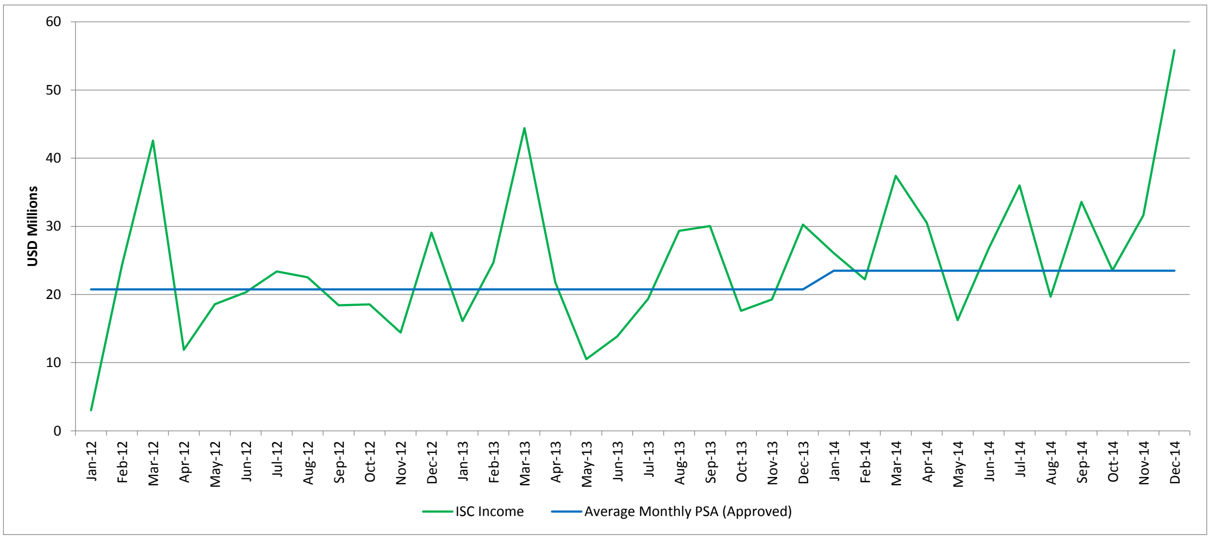
- ➢ for critical corporate initiatives or thematic fund transfers; and
- ➢ for strengthening WFP's reserves.[9]

50. Conservative management of the PSA budget and currently stable ISC income creates periodic surpluses above the target level in the PSA Equalization Account. These enable the PSA Equalization Account to be used, subject to the Board's approval, for decisions on matters such as reserve transfers and corporate priorities, and other pressing requirements for organizational strengthening that would otherwise not be affordable in the regular PSA budget.

## Analysis of WFP's ISC Income and PSA Expenditures

51. The annual budget for PSA expenditure is approved by the Board through the Management Plan; ISC income varies according to the level of voluntary contributions. The PSA Equalization Account is primarily used to bridge funding gaps from one year to another, and also to even out monthly income and expenditure variations. Figure 7 compares monthly ISC income and average monthly PSA expenditure from 2012 to 2014 to highlight the variability of timing and contributions that occur from month to month. During the period the PSA Equalization Account target level was set at four months of PSA expenditure – USD 83.0 million for 2012 and 2013 and USD 93.9 million for 2014.

**Figure 7: Comparison of ISC income and average monthly PSA expenditures, 2012−2014 (*USD millions*)**




52. In 2012, ISC income totalled USD 255.0 million and the PSA budget was approved at USD 249.1 million. Despite an overall surplus of USD 6.5 million, seven months in 2012 had an average income deficit of USD 5.7 million. The largest single month deficit in January 2012 was USD 17.7 million.

53. In 2013, ISC income totalled USD 283.5 million and the PSA budget was approved at USD 249.1 million, giving a surplus of USD 36.6 million in the PSA Equalization Account. Six months in 2013 had an average income deficit of USD 4.6 million, and three consecutive months recorded a total deficit of USD 18.6 million – the largest in the three-year analysis.

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[9] WFP/EB.A/2015/6-C/1.

54. In 2014, ISC income totalled USD 354.7 million and the PSA budget was approved at USD 281.8 million, giving a surplus of USD 76.0 million in the PSA Equalization Account. Only three months ran a deficit, which averaged USD 4.1 million.

55. As these figures show, the PSA Equalization Account balance is used minimally during a calendar year; the current target level is sufficient to cover any temporary deficits between ISC income and PSA expenditure. PSA Equalization Account balances, PSA expenditures and ISC income for 2002 to 2015 are shown in Figure 8 at the end of this document.

## Summary of Results of the Review of Best Practices in other United Nations Organizations and NGOs

56. The desk review of United Nations organizations and NGOs included examination of public documents such as financial statements to determine their reserve policies and levels. The United Nations organizations – the United Nations Development Programme (UNDP), UNHCR, UNICEF and the United Nations Population Fund (UNFPA) – are voluntarily funded and comparable to WFP in size, objectives and geographic scope. The NGOs were Plan International, Care International, World Vision and Save the Children International

57. None of the organizations has a reserve such as the PSA Equalization Account, which was established to mitigate the risk of income fluctuation in covering support costs, but most have a reserve policy to "guarantee ... financial viability and integrity"[10] and mitigate risks such as resource shortfalls and uneven cash flows.

58. The level of reserves varies. Some organizations aim to achieve a year-end balance of regular resources in their reserves equivalent to between three and six months of expenditures.[11] The reserve balances of others are set at a static figure or range, or are calculated as a percentage of net contributions.

59. The desk review showed that WFP's management of the PSA Equalization Account is in line with established practices of three to six months of expenditures.

## Setting a Target Level to Optimize the PSA Equalization Account

60. As part of the recent work to reshape WFP and build capacity in the field, the Secretariat is optimizing PSA budget resources and the use of the PSA Equalization Account to underwrite ISC income. The Secretariat has tended to underestimate contribution forecasts in Management Plans in projecting ISC income and developing the PSA budget (Table 2). A higher PSA Equalization Account target level could, for example, support improved planning for PSA requirements through less conservative income forecasting, but this could also entail a higher level of risk.

[10] UNDP and UNFPA.

[11] DP/2014/20: "… a prudent level of liquidity for UNDP regular resources would be the equivalent of expenditures for three to six months."; E/ICEF/2014/AB/L.5: "… prudent level of liquidity for regular resources defined as the equivalent of expenditure for three to six months."

| TABLE 2: FORECAST AND ACTUAL CONTRIBUTIONS 2008–2014 *(USD million)* | | | | | | | |
|---|---|---|---|---|---|---|---|
| | **2008** | **2009** | **2010** | **2011** | **2012** | **2013** | **2014** |
| Forecast* | 5 200 | | 7 500 | | 3 750 | 3 700 | 4 200 |
| Actual** | 5 038 | 4 205 | 4 130 | 3 597 | 4 044 | 4 380 | 5 381 |

*  Management Plans
** Audited Annual Accounts, Statement of Financial Performance

61. An increased target level would enable the Secretariat to adopt a medium-term approach to the PSA budget in line with the three-year Management Plan. This would enhance PSA stability, avoid short-term staff reductions or restructuring and help to maintain emergency response capacities.

62. An increased target level would also benefit the ISC rate, which is approved annually in the Management Plan; in the short term it cannot be changed in response to fluctuations in income or expenditures, and increases or decreases can only be approved after consultation. Such an increased target level should be sufficient to absorb any changes and reduce the need modify the ISC rate in response to income fluctuations.

63. In view of the foregoing, the Secretariat intends to increase the target level of the PSA Equalization Account by one month to bring it to five months of expenditure.

64. This robust financial safety net will continue to protect PSA-funded support and services from fluctuations in funding. The increased target level will enable the Secretariat to make less conservative income forecasts and improve PSA budget planning to support operations and emergency requirements.

## Stress Test Analysis of the PSA Equalization Account; Establishing a Floor

65. The financial resilience of the PSA Equalization Account was analysed in terms of its first two purposes: i) covering differences between ISC income and approved PSA expenditure; and ii) underwriting the risks of decreased ISC income or underfunding of the PSA budget. The analysis, which was based on the 2015 level of the PSA budget, considered two scenarios: i) income of USD 4,071 million, the average contribution level between 2009 and 2013, excluding the extraordinary income levels in 2008 and 2014; and ii) income of USD 3,597 million, the contribution level in 2011 and the lowest level in recent years.

**Scenario 1**

Income received: USD 4,071 million

ISC income received: USD 262.6 million

Regular PSA budget: USD 281.8 million

Regular PSA would have to be reduced by 7 percent – USD 19.2 million – if the Secretariat decided that PSA expenditure must be matched with the ISC earned from income of USD 4,071 million.

If immediate action were taken to reduce PSA expenditure by 7 percent, it is estimated that this could be achieved over a period of three to six months with minimal one-time costs.[12]

If the Secretariat took no action to reduce PSA costs, for example because the decline in income was regarded as temporary and likely to be reversed the following year, the balance of the PSA Equalization Account would decline annually by the equivalent of 0.8 months of PSA expenditure.

**Scenario 2**

Income received: USD 3,597 million

ISC income received: USD 232.0 million

Regular PSA budget: USD 281.8 million

ISC rate constant at 7 percent

To align the PSA expenditure level with the income level, the Secretariat would have to reduce the regular PSA budget by 18 percent – USD 49.8 million.

If the ISC income level were to decline to this level, it is likely that the minimum immediate action would be to reduce PSA expenditure by 7 percent over a period of three to six months − similar to the level of reduction in Scenario 1.

If the Secretariat took no action to reduce PSA costs, the balance of the PSA Equalization Account would decline by the equivalent of two months of PSA expenditure each year.

If after six months the decline in income was regarded as permanent, further action would be needed to reduce PSA expenditure to the ISC income level of USD 232.0 million. It is likely that this further reduction will take six to twelve months; it could incur one-time costs of up to USD 15 million.

In this scenario, with the two-stage cost reduction actions described, the total cost would be up to USD 47 million. Part of this cost − up to USD 32.0 million, or 1.35 months of PSA expenditure − would be a result of maintaining PSA expenditure above ISC income during the cost-reduction period. The other part − up to USD 15 million, or 0.64 months of PSA expenditure − would be one-time costs.

66. The analysis showed that two months of approved PSA expenditure would be sufficient to cover the differences between ISC income and PSA expenditure resulting from a decline in income, as in either scenario. This takes into account the estimated time and one-time cost involved in adjusting the PSA cost structure.

[12] WFP/EB.A/2006/6-C/1.

67. Two months of PSA expenditure would not be sufficient, however, to support a significant increase in workload or an emergency response, nor would it be enough to support critical corporate initiatives, thematic fund transfers or an increase in WFP's reserves.

68. In view of the foregoing, the Secretariat concludes that two PSA Equalization Account levels are relevant:

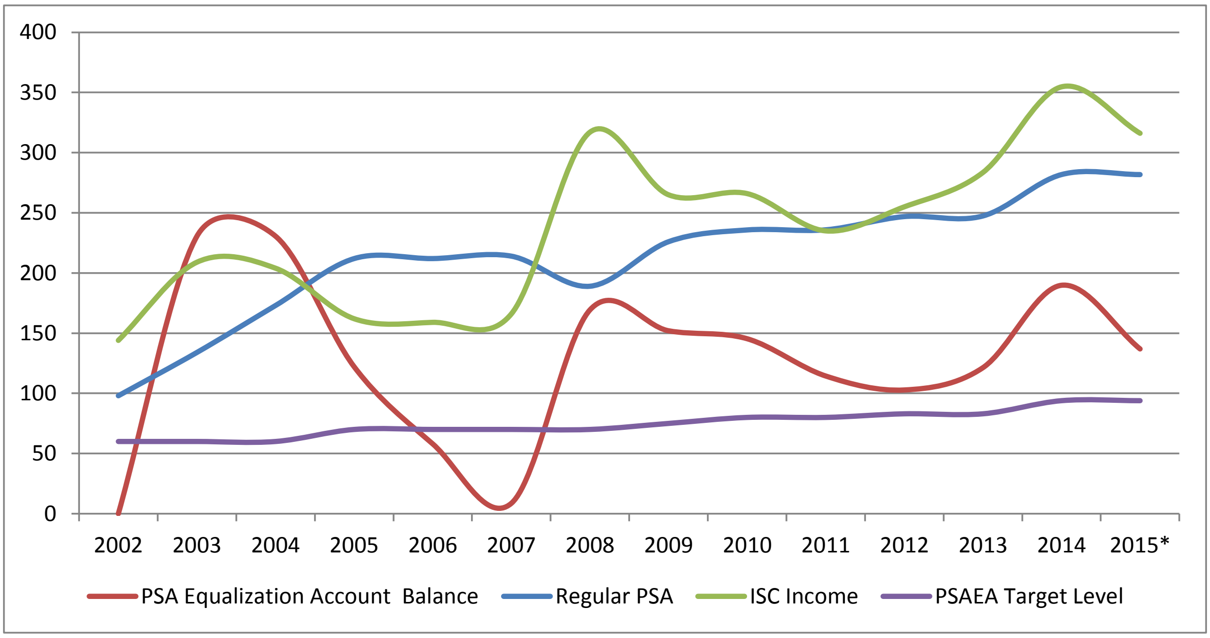
- two months of PSA expenditure – the minimum level required to adjust for differences between ISC income and approved PSA expenditure and to underwrite the risk of decreases in ISC income or underfunding of the PSA budget; and
- five months of PSA expenditure – the target level for providing a more robust financial safety net for the PSA Equalization Account: covering temporary differences between ISC income and approved PSA expenditure, underwriting the risk of decreases in ISC income or underfunding of the PSA budget, and covering critical corporate initiatives, thematic fund transfers and increased reserves.

69. The Secretariat therefore intends to increase the target level of the PSA Equalization Account to five months of PSA expenditure, and to establish a floor within the PSA Equalization Account equivalent to two months of PSA expenditure. The portion of the account below the floor would be used solely in the event of a sustained deficit between PSA expenditures and ISC income.

## Opportunity Cost of the PSA Equalization Account

70. The PSA Equalization Account balance is one element of WFP's risk-management toolbox. Compared to other elements − such as the Immediate Response Account or the Operational Reserve, which are used to facilitate advances to operations − the PSA Equalization Account is quite static. Maintaining the PSA Equalization Account balance in such a way entails an opportunity cost. The FFR will explore ways to reduce this opportunity cost and maximize the value from the PSA Equalization Account.

**Figure 8: PSA Equalization Account balance, PSA expenditures and ISC income, 2002–2015 (*USD millions*)**



## ACRONYMS USED IN THE DOCUMENT

| | |
|---|---|
| CSP | Country Strategic Plan |
| FFR | Financial Framework Review |
| IPL | Internal Project Lending |
| ISC | indirect support cost |
| PSA | Programme Support and Administrative |
| QCPR | Quadrennial Comprehensive Policy Review |
| UNDP | United Nations Development Programme |
| UNFPA | United Nations Population Fund |
| UNHCR | Office of the United Nations High Commissioner on Refugees |
| UNICEF | United Nations Children’s Fund |