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REPORT OF THE ADVISORY COMMMITTEE ON ADMINISTRATIVE AND BUDGETARY QUESTIONS (ACABQ)

The Executive Director is pleased to submit herewith the report of the ACABQ pertaining to WFP. The report covers the following agenda items:

- Financial Framework Review: Working Capital Financing (WFP/EB.1/2014/4-A/1)
- Method for Calculating the Indirect Support Cost Rate for WFP (WFP/EB.1/2014/4-B/1)

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Advisory Committee on Administrative
and Budgetary Questions

7 February 2014

Dear Ms. Cousin,

Please find attached a copy of the report of the Advisory Committee on your submissions for consideration concerning:

- Financial Framework Review: Working Capital Financing (WFP/EB.1/2014/4-A/1)
- Method for Calculating the Indirect Support Cost Rate for WFP (WFP/EB.1/2014/4-B/1)

I should be grateful if you could arrange for the Committee's report to be placed before the Executive Board at its forthcoming session, as a complete and separate document. I would appreciate it if a printed version of the document could be provided to the Advisory Committee at the earliest possible opportunity.

Yours sincerely,

Carlos G. Ruiz Massieu
Chairman

Encl.

WORLD FOOD PROGRAMME

Resource, Financial and Budgetary Matters

Report of the Advisory Committee on Administrative and Budgetary Questions

I. Introduction

1. The Advisory Committee on Administrative and Budgetary Questions has considered the reports of the World Food Programme (WFP) on the Financial Framework Review: Working Capital Financing (WFP/EB.1/2014/4-A/1) and on the Method for calculating the indirect support cost rate for WFP (WFP/EB.1/2014/4-B/1), which are submitted to the Executive Board of WFP for consideration.

2. During its consideration of the reports, the Advisory Committee met with the Assistant Executive Director, Resource Management and Accountability Department, Chief Financial Officer; the Director of the Budgeting and Programming Division; and the acting Director, Finance and Treasury Division, who provided additional information and clarification concluding with written responses received on 3 February 2014.

3. In addition, the Advisory Committee was provided, upon request, with the report of the Finance Committee of the Food and Agriculture Organization (FAO), which contains its observations and recommendations concerning the WFP reports on the Financial Framework Review: Working Capital Financing and on the Method for calculating the indirect support cost rate (CL 149/3).

II. Financial Framework Review: Working Capital Financing Facility

4. As indicated in the Executive Director's report, WFP intends to undertake a review of its working capital financing and to evaluate ways of expanding its advance financing mechanism in order to increase the stability of funding for country operations, while taking account of the mechanisms for managing associated risks. The WFP Secretariat will continue its review of the financial framework during 2014, in line with Fit for Purpose and the Strategic Plan (2014–2017). The financial framework review will include consultation with Board membership and donors, and the submission of additional documents to the Board.

5. Paragraphs 10-18 of the report provide the rationale and objectives for the review of WFP's financial framework, which is intended to: (i) stabilize funding for country offices by improving the predictability of funding, so that operations can be planned with greater certainty; (ii) optimize the use of resources by reducing funding fragmentation, standardizing resource-based planning and improving the utilization of multilateral/multi-year contributions to expand advance financing capabilities; and (iii) enhance transparency in costing by increasing the visibility of cost drivers, improving cost management and increasing the autonomy of country offices with regard to resource usage (see WFP/EB.1/2014/4-A/1, para 14). The Advisory Committee notes that as the review of WFP's financial framework progresses, the WFP Secretariat will update the Board and submit documents proposing changes to the financial framework, and that any changes needed in WFP's Financial Rules and Regulations will be submitted to the Board for approval (ibid, para.18).

6. Paragraphs 19-30 of the report provide the background on the advance financing mechanisms in WFP. The Working Capital Financing Facility currently provides up to USD 607 million in advance financing, and is underpinned by an operational reserve of USD 101.2 million. The Working Capital Financing Facility comprises the Forward

Purchasing Facility, totalling USD 350 million, and traditional advance financing and corporate services, totalling USD 257 million. The Forward Purchasing Facility is administered through a special account with funding allocated from the Working Capital Financing Facility and direct donor contributions to enable the purchase of food in advance of requests from projects (ibid, para. 24). The traditional advance financing component of the Working Capital Financing Facility enables projects to access funding to ensure continuation pending the confirmation of anticipated contributions, and, once an anticipated contribution is confirmed, the advance is recovered from the project (ibid, para. 23). In addition, there is an immediate response account of USD 70 million, which is a revolving multilateral funding mechanism that enables WFP to provide funding to projects for emergency needs and emergency preparedness activities.

7. The Advisory Committee notes from figure 2 of the Executive Director's report that the total resources available under the Working Capital Financing Facility have increased significantly from a total of USD 180 million in 2005 to a total of USD 557 million in 2010, and that a total of USD 607 million was approved beginning in the year 2013. The level of the Forward Purchasing Facility has been increased from total of USD 60 million in 2005 to USD 150 million in 2010, and was subsequently increased to USD 300 million in 2012 and to the current total of USD 350 million in 2013. The level of the traditional advance financing facility has been increased from USD 120 million in 2005 to USD 407 million in 2010, and was subsequently reduced to its current level of USD 257 million in 2012. In this connection, the FAO Finance Committee noted that the current utilisation rate of the Working Capital Financing Facility was 90 percent in January 2014, with the advances to projects from the traditional advance financing facility being constrained by the current limit of USD 257 million (see CL 149/3, para. 18).

8. According to information contained in table 1 of the Executive Director's report, actual and projected expenditure in the period 2010-2014 has averaged USD 4 billion per annum, and expenditure is projected to amount to USD 4.2 billion in 2014. The Advisory Committee notes that this table indicates a significant decline in the availability of working capital, net of the Forward Purchasing Facility, as a percentage of the funded programme of work in the period 2010-2014, from a high of 11.3 percent in 2011 to the current level of 6.1 percent. **The Advisory Committee notes that if the entirety of the Working Capital Financing Facility is taken into account, the level of availability of working capital as a percentage of expenditure remains relatively constant over the same period 2010-2014 (see table 1 below)**.

TABLE 1: WCFF CEILING AS A PERCENTAGE OF THE FUNDED PROGRAMME OF WORK

	Funded programme of work (*USD million*)	**Available financing (WCFF ceiling minus FPF allocation) (*USD million*)**	**Working capital (excluding FPF) availability as a percentage of funded programme of work**	**Available financing (inclusive of FPF allocation) (*USD million*)**	**Working capital (including FPF) availability as a percentage of funded programme of work**
2010	4 129	407	9.9%	557	13.5%
2011	3 597	407	11.3%	557	15.5%
2012	4 044	407	10.1%	557	13.8%
2013	4 000	257	6.4%	607	15.2%
2014	4 200	257	6.1%	607	14.5%

9. The Advisory Committee was provided, upon enquiry, with information on the monthly status of expenditures and the receipt of voluntary contributions in the period from 1 January 2012 to 30 November 2013 (see table 2 below). **The Committee notes that in most months in the period 1 January 2012 to 30 November 2013, the income from voluntary contributions was consistently higher than expenditure, and that voluntary contributions exceeded expenditure by a total of USD 417 million in the twenty-three month period**.

TABLE 2 : VOLUNTARY CONTRIBUTIONS AND EXPENDITURE IN WFP, 2012-2013
(USD million)

Year	Month	Contributions	Expenditures	Surplus/(shortfall)	Cumulative balance
Opening balance[1]					**1 656**
2012	1	303	264	39	1 695
	2	338	318	20	1 715
	3	665	385	280	1 995
	4	269	299	-30	1 965
	5	283	375	-92	1 873
	6	286	400	-114	1 759
	7	337	315	22	1 781
	8	296	272	24	1 805
	9	365	387	-22	1 783
	10	316	283	33	1 816
	11	230	309	-79	1 737
	12	445	454	-9	1 728
2013	1	269	219	50	1 778
	2	308	357	-49	1 729
	3	766	365	401	2 130
	4	330	327	3	2 133
	5	235	372	-137	1 996
	6	181	368	-187	1 809
	7	381	284	97	1 906
	8	360	361	-1	1 905
	9	547	402	145	2 050
	10	357	274	83	2 133
	11	270	330	-60	2 073
	Average	354	336		
	TOTAL	**8 137**	**7 720**	**417**	

[1] Cash and short-term investments, WFP/EB.A/2013/6-A/1 Annual Audited Accounts 2012, note 7.1

10. **Based on the data provided, the Advisory Committee considers that the need for an increase in the level of the Working Capital Financing Facility has not been sufficiently justified, and it encourages the WFP Secretariat to strengthen and enhance its analysis in its review of the Financing Framework.**

11. Paragraphs 31-67 of the report consider the current level of working capital financing and put forward three options, to be implemented individually or together, which are intended to increase the availability of working capital, while taking into account the risks involved.

⇒ *Proposal 1: Increase the size of the Operational Reserve*

12. The Operational Reserve is maintained as an account within the General Fund at an approved level of USD 101.2 million. According the Executive Director's report, the options for expanding the size of the Operational Reserve include (i) an appeal to donors for direct contributions to the Operational Reserve, and (ii) finding a donor or entity willing to guarantee certain types of advance financing, thereby limiting recourse to the Operational Reserve and allowing for more lending through the Working Capital Financing Facility.

⇒ *Proposal 2: Adjustment of leverage ratios to reflect different levels of risk*

13. In the Executive Director's report, the advance financing tools are examined to show their risk profiles, to assess risk mitigation actions and to propose leverage ratios based on experience and WFP's overall risk tolerance (paras. 40-57). With regard to the immediate response account (IRA), which is maintained separately from the Working Capital Financing Facility and enables WFP to react immediately to an emergency, the Executive Director does not propose to revise the current one-to-one leverage ratio, in view of the relatively high level of risk associated with the emergency operations financed from the account.

14. With regard to the component for traditional advance financing for projects and corporate services, loans are provided to projects utilizing as collateral high-probability or medium-probability anticipated contributions or cost-recovery schemes. According to the report, WFP mitigates the associated risk through an oversight process for the approval of advances, including a review of the purpose of the loan, the risk factors for WFP, the suitability of the anticipated contributions as collateral, the impact on beneficiaries and improvements in delivery times. WFP assesses the risks of advance financing for any project as low or medium on the basis of established risk-mitigation actions and the record of repayment, and it considers that such controls may warrant an increase in the leverage factor above the current 6 to a factor of 10 (ibid, para. 53).

15. Under the Forward Purchasing Facility, WFP's approach relies on the development of an aggregated demand plan to manage risk. According to the report, the risk relating to the Forward Purchasing Facility is considered medium, based on global or regional forecasts of contributions and the successful track record of Forward Purchasing Facility purchases and sales to projects, and an increase in the leverage ratio from a factor of 6 to 8 would be supported with identified risk-mitigation processes and would ensure further mainstreaming of forward purchasing in WFP's supply chain.

⇒ *Proposal 3: Pooled advance financing*

16. It is indicated in the report that pooled advance financing would allow for lending against a country office's annual overall contribution forecast as collateral, rather than against project-specific anticipated contributions. Country offices would be granted advance funding to cover a proportion of the anticipated contributions for operations. The WFP Secretariat recognizes that advances based on overall contribution forecasts would carry higher levels of risk than the established advance financing tools. The Advisory Committee

notes that pooled advance financing would be limited to country offices that have a track record of contributions and which, on the basis of house-wide analysis of country-specific funding trends, are likely to achieve their annual contribution forecasts (ibid, para. 60).

17. The Advisory Committee was informed, however, that voluntary contributions earmarked for specific projects may need to be excluded from the total anticipated contributions for operations when determining the amounts advanced for country offices under the proposal for pooled advanced funding. **The Committee requests that the WFP Secretariat fully elaborate the proposal for pooled advanced funding in the context of the review, taking into account the advantages, disadvantages and the associated risks. The Committee encourages WFP to consider the application of a transparent formula to determine the maximum level of pooled advances made on the basis of a country office's annual overall contribution forecast**.

18. According to the Executive Director's report, the WFP Secretariat has compared the soundness of its advance financing mechanisms using the capital adequacy standards of the Basel Capital Accords from the Bank of International Settlements. The current Working Capital Financing Facility ceiling of USD 607 million implies that the leverage ratio is 6:1, which is equivalent to a capital ratio of 16.7 percent. An increase in the leverage ratio to 10:1 would therefore decrease the capital ratio to 10 percent, which is still conservative compared with the capital ratio requirements for banks, which range from 5 percent to 8 percent. **The Advisory Committee is not convinced that the Basel banking supervision accords, which are a set of recommendations for regulations in the banking industry, are relevant benchmarks for the situation of WFP.**

19. While it is indicated in the Executive Director's report that the three proposals could, individually or together, significantly improve WFP's operational effectiveness and benefit those most in need (ibid, para. 63), the Advisory Committee notes that the FAO Finance Committee, in its report on the Financial Framework Review, was informed that the three proposals for expansion of the Working Capital Financing Facility (WCFF) were mutually exclusive (see CL 149/3, para. 15). **The Advisory Committee cautions against the combination of the proposed mechanisms without due consideration of the potential associated risk**.

20. The Advisory Committee notes that the FAO Finance Committee was informed that further consultation was planned before the Annual Session in June 2014 with the provision of more detailed analysis of the three proposals, with support from an external review by a consultancy firm. **The Committee notes that the separate review by the external consultant may result in further modification of the proposals, or the addition of alternative approaches, to be considered by the Board at the conclusion of the review.**

21. **The Advisory Committee acknowledges the stated objective of WFP in the review of its financial framework to increase the stability of funding for country operations, while taking account of the mechanisms for managing associated risks. Taking into consideration its views in the present report, the Committee expects that the analysis of the proposed financial framework will be undertaken in a comprehensive manner and that a proposed increase, if any, in the overall level of the facility will be fully justified and substantiated.**

III. Method for calculating the indirect support cost rate

22. The Executive Director's report proposes a two-phased review of the methodology to calculate and apply indirect support costs in WFP. The first phase is the submission of the report on the method for calculating the indirect support cost rate, which will elicit the Board's guidance to frame informal discussions, and the second phase is to submit proposals for the Board for its consideration in the Annual session in 2014. The Advisory Committee notes that the FAO Finance Committee, in its related report, cautioned about the ambitious timeline for the review, but recognized that the scope of the analysis was dependent upon feedback by the Executive Board (see para. 12, CL 149/3).

23. Paragraphs 6-15 of the report summarize the current policies, practices and specific issues regarding indirect support costs in WFP. According to the report, the current indirect support cost rate of 7 percent appears to be insufficient to cover all support and administration-related costs (WFP/EB.1/2014/4-B/1, para.12). The report recalls that a review of the indirect support cost rate submitted to the Board's 2002 Third Regular Session, considered the gap between Programme Support and Administrative (PSA) expenditures and indirect support costs income, and compared WFP's approach with those of United Nations and non-governmental organizations. The Board approved the establishment of the (PSA) Equalization Account to record gaps between PSA expenditures and indirect support costs income, and the reduction of the single indirect support cost rate to 7 percent, which has been in effect from 2003. The Advisory Committee was informed that there is variability in WFP's indirect support cost rate, which range from zero to 20 percent, with greater flexibility under trust funds. Exceptions are made for country-specific trust funds (4 percent) and private sector partnerships (12 percent, on average). Trust funds administered by the regional bureaux or Headquarters for activities such as internal capacity development typically have an indirect support cost rate of 7 percent (ibid, para. 13). It is indicated in the report that some contributions such as government counterpart cash contributions do not involve any indirect support cost recovery (ibid, para. 14)

24. Paragraphs 16-27 of the report discuss the main drivers for the indirect support cost rate review:

  i) the 2012-2016 Quadrennial Comprehensive Policy Framework and Harmonization, which requests Boards of Funds to adopt a cost-recovery framework in 2014;

  ii) mobilizing resources, and the examination of other UN organizations to see whether the indirect support cost rate is used to encourage unearmarked or multi-year contributions, or contributions from certain donors;

  iii) maximizing value for money; and

  iv) adapting to WFP's changing business and financial framework, from food aid to food assistance.

25. The Executive Director's report provides information on the practices regarding the recovery of indirect support costs in other United Nations organizations. The World Health Organization and the Food and Agriculture Organization of the United Nations (FAO) have differentiated indirect support costs rates (10 percent for emergency projects and 13 percent for development activities) and also apply a "cost recovery uplift" mechanism on staff costs to recover certain costs related to support and administration. The United Nations Development Programme, the United Nations Population Fund, the United Nations Children's Fund and UN-Women have reviewed cost definitions and classification of activities and adopted a common cost-recovery rate of 8 percent (ibid, para 19). The

Committee notes that the United Nations Secretariat charges 13 percent for the recovery of programme support provided to extrabudgetary activities.

26. The Advisory Committee recalls from its report on the WFP Management Plans that, while the Executive Board of the United Nations Development Programme, the United Nations Population Fund and the United Nations Office for Project Services, in its decision 2013/9, set the harmonized cost recovery rate of 8 percent for non-core funding sources, the Board maintained the rate of 7 percent for core funding sources. In addition, WFP will recover separately those costs that can be directly linked with the provision of support to an operation, at an average rate of 11.9 percent in 2014 (see WFP/EB.2/2013/5(A,B)/2, para. 14).

27. The Advisory Committee recalls General Assembly resolution 67/226, in which the Assembly requested, *inter alia*, the executive boards of the United Nations funds and programmes to adopt cost recovery frameworks by 2013, with a view to their full implementation in 2014, based on the guiding principle of full cost recovery, proportionally, from core and non-core resources, and a simple, transparent and harmonized methodology, providing incentives, including through differentiated cost recovery rates, and taking into account different volumes and nature of funds to increase core funding and more predictable, flexible and less earmarked non-core contributions that are aligned with the strategic plans adopted by the respective governing bodies. **The Committee notes that the methodology for the determination of the recovery rates for programme support costs is not uniform among United Nations system organizations, and that the requirement for overall programme support costs varies according to the mandates and the nature and scope of operational activities undertaken. For example, organizations engaging primarily in logistical and administrative support activities will have support needs that will differ significantly from those that are more substantive in nature. The Committee considers that the determination of the recovery rate for programme support costs in the United Nations system may benefit from a cross-cutting analysis of current practice and the development of the simple, transparent and harmonized methodology requested in General Assembly resolution 67/226, which should analyse the levels of support costs and reimbursements, by function, in International Organizations . In the case of WFP, the Committee expects that the indirect support cost recovery rate resulting from the review will be commensurate with the actual requirements for the reimbursement of programme support and administrative costs attributable to the implementation of projects.**

28. According to the Executive Director's report, in view of current discussions of core funding, critical mass and support cost policies in specialized agencies, alternative models would be examined. Phase 2 of the analysis will include the examination of the merits of a core budget; variable and fixed PSA expenditures; and consideration of alternative models such as core or non-core funding to cover variable or fixed PSA expenditures. The Advisory Committee notes that some support and administration related costs at WFP, including for security, capital costs and innovations, are covered from other sources, such as the PSA Equalization Account, the General Fund and trust funds (WFP/EB.1/2014/4-B/1, para. 33). **The Committee cautions against the cross-subsidizing of projects in recovering such costs and requests WFP to identify an appropriate way of financing support and administrative requirements.**

29. The PSA Equalization Account enables WFP to balance the difference between PSA expenditure and indirect support cost income to reduce the risk of insufficient resources should indirect support cost income fail to materialize at the expected rate (ibid, para. 39). T**he Advisory Committee notes the important role of the PSA Equalization Account in meeting temporary shortfalls in indirect support cost income, and it notes that the review by WFP will consider the appropriateness of the current level of the PSA Equalization Account**.