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**Executive Board
Annual Session**

Rome, 28–30 May 2003

RESOURCE, FINANCIAL AND BUDGETARY MATTERS

Agenda item 6



Distribution: GENERAL

WFP/EB.A/2003/6(A,B,C)/3

22 May 2003

ORIGINAL: ENGLISH

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:

- Issues on Financial Policies (WFP/EB.A/2003/6-A/1);
- Comprehensive Financial Report (WFP/EB.A/2003/6-B/1);
- Amendments to WFP Financial Regulations (WFP/EB.A/2003/6-C/1); and
- Programme of Work of the External Auditor for the 2002–2003 Biennium (WFP/EB.1/2003/5-B/1).

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CL 124/20

May 2003



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para la
Agricultura
y la
Alimentación

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COUNCIL

Hundred and twenty-fourth Session

Rome, 23–28 June 2003

**Report of the Hundred and third Session of the Finance Committee Rome,
19–20 May 2003**

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REPORT OF THE HUNDRED AND THIRD SESSION OF THE FINANCE COMMITTEE

19–20 May 2003

Introduction

1. The Finance Committee submitted to the Council the following report of its Hundred and third Session.
2. The following representatives were present:
Vice-Chairperson: Mr Anthony Beattie (United Kingdom)
Members: Mr Antonio A. Plaza Jiménez (Chile)
Ms Lamy Al Saqqaf (Kuwait)
Mr Adnan Bashir Khan (Pakistan)
Mr Alassane Wele (Senegal)
Ms Ryuko Inoue (Japan)
Mr Lothar Caviezel (Switzerland)
Ms Perpetua M. S. Hingi (United Republic of Tanzania)
Mr Timothy Lavelle (United States of America)
3. The Vice-Chairperson informed the Committee that Mr Humberto Molina Reyes (Chile), Chairperson of the Finance Committee, would regretfully be unable to attend the session. The Committee noted that the Vice-Chairperson would act as Chairperson for this session and that Mr Antonio A. Plaza Jiménez had been designated to represent Chile in the absence of Mr Molina Reyes. The Committee further noted that Mr Timothy Lavelle had been designated to represent the United States of America at the session.
4. The Chairperson advised the Committee that the report of the United Nations Advisory Committee on Administrative and Budgetary Questions (ACABQ), covering some of the items on the agenda, was available for information purposes.

Adoption of the Agenda and Timetable

5. The Chairperson introduced the agenda items and noted that agenda items 5 and 6¹ had already been presented to the Executive Board of WFP and that consequently no discussion of these two items was proposed.
6. However, after consultation, the committee agreed that it would be beneficial to have a presentation from the External Auditor on agenda item 6. The agenda was adopted on this basis.

Issues on Financial Policies

7. The Committee welcomed the document WFP/EB.A/2003/6-A/1 and expressed its view that it was very useful and comprehensive. The Committee endorsed the twelve conclusions contained in the document.

¹ documents WFP/EB.1/2003/5-A/1—Programme of Work and Annotated Outline for the 2003 Review of Resource and Long-Term Financing Policies and WFP/EB.1/2003/5-B/1—Programme of Work of the External Auditor for the 2002–2003 Biennium, respectively refer.



8. The Committee noted that the review of the Financial Policy Framework (FPF) was an ongoing exercise, that the current document was work in progress, and that additional information and conclusions would be presented to the Committee and the WFP Executive Board as part of the 2004–2007 Strategic Plan and the 2004–2005 Management Plan.

9. The Committee looked forward to the incorporation of the review of the Financial Policy Framework issues into the strategic and management planning processes, both in the forthcoming 2004–2007 Strategic Plan and the 2004–2005 Management Plan, and in future strategic and management plans as outlined in the first three conclusions of the document².

10. This incorporation of financial policy review in the planning processes of the organization would also help ensure that the policies reflected the strategic objectives of the organization as outlined in conclusion 4³.

11. The paragraphs dealing with the harmonization of policies with other organizations (paras. 12–19) were also noted by the Committee. Progress on the harmonization of policies was felt to be very satisfactory, but the scope of harmonization was inevitably constrained by WFP's unique financial structure. In particular, the Programme's financial policies rested on the fact that the principal resource consisted of commodities.

12. In discussing conclusion 5 of the document⁴, the Committee noted the impact that donor legislative conditions could have on the anticipated flexibility of the Programme through the change proposed. More aggressive monitoring of budgets and quicker negotiations with donors could reduce the impact of such conditions.

13. The Secretariat pointed out that the Programme's processes had to be able to cater for complex conditionality in certain cases. This did not mean that all contributions should be treated in the same manner. The Secretariat agreed that the Programme must improve its budget monitoring and noted that the forthcoming Business Process Review would look at both of those issues.

14. The Committee recalled that flexibility was one of the original objectives of WFP's financial policies. It was being constrained by increased donor directedness as multilateral funding diminished as a percentage of total funding. The Committee pointed out that the more confidence and trust donors had in the Programme, the more flexibility that could be expected in the use of contributions.

15. Paragraphs 33 to 42 of the paper, which outlined the policies relating to emerging donors and the private sector, were also discussed. The problem of funding associated costs for some emerging donors was highlighted as a key difficulty in broadening the donor base. The Committee supported WFP's efforts to broaden its donor base and the alternatives outlined in the document to fund these

² **Conclusion 1:** "The current review of these policies will be completed in tandem with the 2004–2007 Strategic Plan and the 2004–2005 Management Plan."

Conclusion 2: "It is proposed that in future these policies be reviewed on an ongoing basis as part of the strategic and management planning processes."

Conclusion 3: "The term 'Financial Policy Framework' will be used to refer to the policies created as a result of the R<F initiative and all associated policies."

³ **Conclusion 4:** "Although these objectives reflected the prevailing priorities when the policies were first developed in the mid-1990s, they are generally still relevant and are reflected in the current strategy of WFP as outlined in the discussions on the 2004–2007 Strategic Plan. Any changes to the current policies will be evaluated in the light of WFP's strategic objectives, as outlined in the Strategic Plan."

⁴ **Conclusion 5:** "An examination of the policies reveals that the present method of implementing them is not the only option. To increase the flexibility of resource use under the existing policies, the following approach will be adopted:

- FCR will be applied to the contribution at the time it is confirmed, using the calculation criteria outlined in General Rule XIII.4, (which states that "donors shall provide sufficient [resources] to cover the full operational and support costs related to their contribution, using the following [defined] criteria for the calculation of operational and support costs");
- subsequently, each individual contribution will be controlled at the project level rather than the individual cost component level, unless there is an overriding donor legislative restriction; and
- the changing requirements of the project will be used to determine the breakdown of the contribution among the cost components."



costs and looked forward to the establishment of a funding mechanism for these costs as outlined in paragraph 39 (c). The Committee also suggested that regional resource mobilization efforts would be helpful in broadening the donor base.

16. The Committee also looked forward to the completion of the work outlined in conclusions 7, 8 and 9⁵, as part of the forthcoming zero-based budgeting exercise for the preparation of the 2004–2005 Management Plan. The Secretariat said that significant progress had been made on this exercise and that the use of a "zero base" for the preparation of the 2004–2005 budget would result in a more complete review of all costs and would also help provide an answer to the question of what constituted an appropriate level of programme support and administrative (PSA) costs for WFP.

17. Conclusion 10⁶, dealing with the review of the Programme's funding and financing mechanisms, was supported by the Committee. The principle of "risk transference" was felt to be important, but the mechanisms would need careful review.

18. Government Counterpart Cash Contributions (GCCC), which were the subject of conclusion 11⁷, had long been a problematic issue. While it was generally agreed that the return from GCCC was disappointing, there were differing views as to the reasons for this. Some Committee members expressed the view that this source of funding had been neglected by the Programme, while others pointed out that other United Nations programmes also had problems in collecting these contributions and that considerable effort had been expended by the Secretariat to do so.

19. In relation to this, and to conclusion 12⁸, the Committee agreed that increasing the recognition of in-kind contributions from recipient governments would encourage further contributions and help broaden the donor base.

⁵ **Conclusion 7:** "The forthcoming zero-based budgeting exercise for preparation of the 2004–2005 Management Plan will identify support costs that are fixed and those that are variable."

Conclusion 8: "This reclassification will be accomplished during the preparation of the 2004–2005 Management Plan by examining those costs currently considered indirect (PSA) to establish whether they can be directly linked to an operation. While this exercise may reveal that some of these costs can be directly linked to an operation and should therefore be considered DSC, it is unlikely that *all* variable ISC costs can be directly linked to an operation: under the current policies there will probably always remain ISC costs that are both variable and indirect in nature."

Conclusion 9: "To identify appropriate levels of support costs throughout the organization, the zero based initiative will be applied across all areas – Headquarters, regional offices and country offices. Such an approach will also address the external auditor's concerns regarding the 'inconsistency in the recognition and application of direct support costs and programme and administrative costs' that are inherent in the current standard configuration of PSA in country offices."

⁶ **Conclusion 10:** "The review of these mechanisms will continue in the light of the above and any conclusions or proposals arising from this will be presented in the 2004–2005 Management Plan or at subsequent Executive Board meetings as appropriate."

⁷ **Conclusion 11:** "In line with the above and the emphasis on emerging donors in the consultations on the Strategic Plan, it is proposed that these contributions be treated as far as possible in the same way as all other contributions to WFP. This would involve the following:

- The Programme would issue an annual request to the government of the recipient country for a contribution towards the PSA costs of the WFP country office. These requests would emphasize the expectation that the recipient government contribute a significant portion of these costs but would be similar in nature to an appeal for contributions to a project.
- Following negotiations between the Programme and the government, an agreement would be reached on the amount to be contributed. These agreements would:
 - follow as far as possible the same format as agreements for other contributions;
 - be accounted for in the same manner as other confirmed contributions;
 - be in line with Financial Regulation 4.7, which requires an agreement to record the extent of these contributions.
- The accounting treatment for these contributions would be the same as for all other contributions; recipient governments would be given recognition in the same manner as other donors.
- The Secretariat will develop additional procedures for the utilization of these contributions."

⁸ **Conclusion 12:** "The issue of recognizing the in-kind element of recipient country contributions to PSA will be examined as part of the broader issue of recognizing in-kind contributions from recipient governments."



Comprehensive Financial Report

20. The Secretariat informed the Committee that the report⁹ covered a number of financial items, which in the past were reported in separate documents. The intention now was to prepare a single financial report each year covering a range of financial issues from the prior year. That report would be either an interim financial report for the first year of the biennium, as now, or would be part of the biennial financial report. The report also contained some "one off" items that would not be included in future reports. The annual interim reports were complemented by internal monthly financial reports prepared for management and as part of the financial management training currently being provided to WFP managers.

21. In introducing the first section of the report, the Secretariat highlighted three aspects of the report:

- a) the change in accounting policy for income from a cash basis to an accrual basis, in line with the policy on expenditure recognition;
- b) the financial level of WFP operations for 2002 reflected in the income levels of US\$2.1 billion and expenditure levels of US\$1.7 billion;
- c) the balance sheet presenting the major financial balances at the end of 2002.

22. The Chairperson suggested that WFP could benefit from reviewing the Financial Highlights documents of the Food and Agriculture Organization (FAO) and the International Fund for Agricultural Development (IFAD) in terms of presentation and content.

23. The Secretariat explained the key items in the balance sheet in Table A2. Of the assets, the most important items were cash and contribution receivables. Cash balances should be at reasonable levels with sufficient working capital without being excessive. The cash and contribution receivables represented asset inventory, whose turnover should be maximized in the interests of effective programme delivery.

24. The levels of revenues and fund balances of US\$1.8 billion were expected to grow as the operating activity levels increased. The appropriate level of reserves (Operational Reserve [OR], Immediate Response Account [IRA] and Direct Support Cost Advance Facility [DSCAF]) needed to be reviewed in light of the substantially increased levels of operational activity. The Secretariat was working to reduce both cash balances and contribution receivables in proportionate terms, but with the increasing operational activity, it was possible that these accounts would remain at or close to current absolute levels in the short-term.

25. It was noted by the Committee that approximately 50 percent of the 2002 expenditures were for commodities, with the remaining 50 percent being for external and internal transport, storage, handling and other operational costs, direct support costs and indirect support costs, which were less than 7 percent.

26. The Secretariat explained that "deferred income" reflected contributions confirmed in the current accounting period but pertaining to future periods; and that interest income was low in 2002 due to the lower interest rates in the United States.

27. The Secretariat introduced the section of the report on Cash and Investment Management and explained the composition of the balances and the action taken by the Secretariat to ensure that the funds were properly invested. The Committee noted that the continuation of large cash balances in the hands of WFP created a problem for donors and that WFP needed to reduce these to a defensible level.

⁹ doc. WFP/EB.A/2003/6-B/1 refers.



28. The Secretariat explained that it was acting on both cash balances and contribution receivables. Over the medium term, cash balances should decrease, but it was important to relate them to the level of operational activity that had increased in 2003, in particular because of Iraq. The expectation was that cash levels would be marginally lower by the end of 2003.

29. The Committee asked whether WFP had sufficient expertise to manage its cash and short-term investments. The Secretariat said that this was an area that needed to be strengthened.

30. In its discussion of the sections of the report covering the Balances of Closed Projects, the Utilization of Funds for Reprogramming, and the Utilization of Resources and Waivers, the Committee noted that the reprogramming exercise had been very successful; that the delivery of SPRs had improved in 2002; that the new policy of recognizing income on an accrual basis made the financial data much easier to understand; and that the benefits of the WFP Information Network and Global System (WINGS) were still emerging.

31. The Secretariat said that 58 country offices would have full use of the WINGS by the end of 2003, and that all countries would have WINGS in some form. The Committee stressed the importance of having WINGS in all WFP country offices, noting however that it might not be cost-effective to have full functionality in small offices.

32. The Committee noted the description of procedures for the Capital Asset Fund (CAF) contained in section F of the paper. It would pay close attention to the application of those procedures in considering the draft Management Plan in September.

33. The Committee suggested that the Secretariat familiarize itself with the initiative under way at FAO to establish a capital asset fund.

34. The Committee noted the report on the procedures for the PSA Equalization Account, (section G of the document) and welcomed the explanation of how the account would be managed.

35. In summary, the Committee:

- welcomed the new style of consolidated annual financial reporting and looked forward to receiving mid-biennium reports in addition to the biennial financial reports;
- welcomed the shift to accounting for income on an accrual basis;
- welcomed the suggestion by WFP to provide financial management training to members of the Committee and as part of the induction of new members of the Executive Board;
- stressed the importance of managing cash balances and building capacity and in WFP's taking steps to reduce the levels of cash balances by year end 2003, at least as a percentage of total business activity, if not in absolute terms;
- welcomed the progress made in reprogramming closed projects and other balances;
- welcomed the improved performances on completing SPRs on a timely basis;
- noted the importance of WINGS to the sound financial management of country offices;
- noted that the Capital Asset Fund proposals would be fully developed as part of the Management Plan;
- noted that the PSA Equalization Account had been established in accordance with the Executive Board decision and that proposals for use of the account would be included in future Management Plans.

Amendments to the WFP Financial Regulations

36. The Committee endorsed the proposed Amendments to the WFP Financial Regulations¹⁰, which reflected changes required as a result of previous governance decisions of the Executive Board.

¹⁰ doc. WFP/EB.A/2003/6-C/1 refers



Programme of Work of the External Auditor for the 2002–2003 Biennium

37. The Committee invited the External Auditor of WFP, the National Audit Office of the United Kingdom, to give a presentation of its 2002–2003 Programme of Work¹¹, and an update on the progress so far.

38. The Representative of the External Auditor observed that the presentation of the Programme of Work to the Executive Board was a new initiative of External Audit. Since the handing-over from the Cour des Comptes of France, the former External Auditor of WFP, the NAO had spent three months in planning its work for the 2002–2003 biennium. The NAO had visited the regional office in Cairo and country offices in Pakistan and Afghanistan before preparing its programme of work. The NAO would be responsible for both Financial and Management Audits ("value for money"), and would focus on perceived risks.

39. One of the areas of review by External Audit included the change in the income recognition policy to an accrual methodology. Likewise, some of the themes emerging from field visits made so far included the issue of cross-subsidization in the use of funds from closed projects, a need for a consistent application of PSA and direct support costs (DSC), and the use of WINGS in country offices. The NAO had already issued eight management letters, and another six were imminent. Key themes and issues from these management letters would form a part of the audit report to be submitted to the Executive Board in June 2004.

40. The NAO had prioritized four issues for in-depth management audits during the biennium. These were human resource management, management of air operations, corporate governance of WFP, and the application of needs assessment in operational programming. The NAO planned to submit the management report on human resource management to the October session of the Executive Board. The NAO would be considering a number of other areas for management audit, including procurement.

41. The Committee appreciated the opportunity to hear from the External Auditor. It expected to draw extensively on the advice and comments of the External Auditor, as it had with the Cour des Comptes, in dealing with its business.

Date and Place of the Hundred and fourth Session

42. The Committee was informed that the 104th Session was provisionally scheduled for 15–19 September 2003. It was noted that the expected high volume of work for both FAO and WFP for that session might make it impractical to complete the work of the Committee in one week. It was felt that a separate session for WFP might be needed.

43. The Vice-Chairperson of the Committee would consult with the Chairperson about the handling of the September session. Among other issues, the discussion would cover the question of whether a separate session for WFP business could be held at WFP. The Chairperson would then revert to the Committee.

Any Other Matters

44. It was agreed that legal advice should be sought on the question of whether staffing and personnel issues as, for example, in the document entitled "WFP Policy on Staff Recruitment and Geographical Representation of Member States" (WFP/EB.A/2003/8-B) fell within the terms of reference of advice of the Finance Committee in relation to WFP business.

¹¹ doc. WFP/EB.1/2003/5-B/1 refers