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**Executive Board
Annual Session**

Rome, 20–23 May 2002

FINANCIAL AND BUDGETARY MATTERS

Agenda item 6



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REPORT OF THE ADVISORY COMMITTEE 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 different agenda items as follows:

- Item 6 a)—Preliminary Review of the Indirect Support Cost Rate
- Item 6 c)—Report of the Executive Director on the Utilization of Contributions and Waivers of Costs (General Rules XII.4 and XIII.4 (g))

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Advisory Committee on
Administrative and Budgetary Questions

16 May 2002

Dear Mr. Morris,

Please find attached a copy of the report of the Advisory Committee on Administrative and Budgetary Questions on the reports entitled “Preliminary Review of the Indirect Support Cost Rate” (WFP/EB.A/2002/6-A/1) and “Report of the Executive Director on the Utilization of Contributions and Waivers of Costs (General Rules XII.4 and XIII.4 (g)) (WFP/EB.A/2002/6-C/1).

I should be grateful if you could arrange for the report to be reproduced *in verbatim* and placed before the Executive Board at its forthcoming session as a complete and separate document. A printed version of the document, in all languages, should be provided to the Advisory Committee at the earliest possible opportunity.

Yours sincerely,

(Signed) C.S.M. Mselle

Chairman

Mr. James T. Morris
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WORLD FOOD PROGRAMME

Financial and Budgetary Matters

Report of the Advisory Committee for Administrative and Budgetary Questions

1. The Advisory Committee has considered the World Food Programme (WFP) reports entitled "Preliminary Review of the Indirect Support Cost Rate" (WFP/EB.A/2002/6-A/1) and "Report of the Executive Director on the Utilization of Contributions and Waivers of Costs (General Rules XII.4 and XIII.4 (g)) (WFP/EB.A/2002/6-C/1). During its consideration of the reports, the Advisory Committee met with representatives of the Executive Director, who provided additional information and clarifications.
2. The Committee notes that the report (WFP/EB.A/2002/6-A/1) is submitted in response to the request made by the Executive Board, at its Third Regular Session in October 2001, for a preliminary review of the analysis of indirect support cost (ISC) rates and its recommendation made in the context of its the review of the WFP's Resource and Long Term Financing (R<F) Policies, during the First Regular Session of January 1999.
3. The report provides a chronology of the evolution of ISC recovery, as a mechanism for funding the PSA budget, along with an analysis of the 2000-2001 PSA budget, comparing budgeted and actual level of expenditure, in addition to PSA expenditure and actual volume of operations for the past three biennia. A review of the difference between income generated from ISC recovery and actual PSA expenditures is also included, and issues related to PSA and ISC recovery, including ways to fund eventual gaps.
4. The Committee notes, however, that this preliminary review, as indicated in the document, is limited to the methodology of charging and calculating indirect support costs (ISC) to fund the programme support and administrative (PSA) budget and meet full recovery. The issue of the appropriate level and cost-effectiveness of PSA is to be addressed in the second part of the analysis, which will be submitted to the Executive Board at its Third Regular Session to take place in October 2002.
5. As discussed during its hearings, three main issues or themes emerge from this preliminary review or analysis on the indirect support cost rate. Firstly, a large portion of PSA costs remain fixed and do not increase or decrease in direct linear proportion with changes in operational activity or operational cost, as can be seen from the analysis in paragraphs 43-50 of the preliminary report. Moreover, when operational costs deviate from the budget estimates, so does ISC income, while PSA expenditure remains at the same level. As stated in paragraph 50 of the report, the Executive Director intends to explore the possibility of introducing the concept of a marginal ISC rate, based on a second level or extra volume of operations. This would reflect marginal changes when operational activity would exceed or fall short of budgeted levels.
6. The second issue concerns the accounting policies of the programme, which, as indicated in paragraphs 52-59 of the report, relates particularly to income recognition. The Committee notes that, at present, expenditure is recorded on an accrual basis, while income is recorded on a cash basis. The comparison between costs and income over given financial periods could be more transparent and simple if they were both recorded on the basis of the same accounting principles. The merit of this option should be examined with a view to proposing it for immediate implementation.



7. As to the third issue, which concerns the appropriate level of PSA, the Committee notes the indications contained in paragraphs 71-77 of the report, which would involve a longer term analysis, in view of the early stages of decentralization of WFP and implementation of the new corporate information system (WINGS).
8. On the basis of the preliminary observations and analysis made in the report, a number of “next steps”, to be taken in order to complete the analysis, are set out in paragraph 78 of the report. These would allow for the preparation of the final report on the review of the ISC rate to be presented to the Board in the fall of 2002.
9. The Advisory Committee welcomes the work completed to date and recognizes the need to focus on the “next steps” identified in paragraph 78 of the Executive Director’s report. The Committee will make more detailed comments when it takes up the report to be presented in the fall 2002. In the meantime, the Committee recommends an incremental phased approach in the implementation of the “next steps”. In view of the need to carry out a thorough review of the matter, the Executive Director should in the first instance identify those elements that could be analysed and the results implemented without delay leaving the more intractable aspects for further analysis in the next period.
10. As a matter of priority, for example, concrete proposals for recording income and expenditure on the same basis, over given financial periods, should be explored. As to the comparative studies of the funding and costs with comparable organizations indicated in 78 (d), the Committee recommends a pragmatic approach, in order to ensure that whatever the results, these are not too costly or cumbersome to implement. The Committee welcomes the inclusion of some large non-governmental organizations in these comparative studies, as communicated to the Committee by the representatives of the Executive Director during its hearings.
11. The Committee also recommends that the alternative of increasing the single rate, even if just marginally, be taken into account in the analysis of the PSA rates. This could prove more cost effective to implement than the introduction of additional rates. In analysing the PSA cost structure, consideration should be given to decreasing the ratio of fixed to variable costs, as recommended in the past by the Committee, by establishing mechanisms by which the programme would react to changes in volume of operation, for example, through the use of contractual arrangements that allow for a decrease in staffing costs.
12. The Advisory Committee recommends that the Board take note of the information in document WFP/EB.A/2002/6-C/1, presented in accordance with General rules XII.4 and XIII.4, on the use of unrestricted cash resources to purchase commodities and on the contributions for commodities or services and waivers of indirect support costs.

