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DIRECT SUPPORT COST ADVANCE FACILITY

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NOTE TO THE EXECUTIVE BOARD

This document contains recommendations for review and approval by the Executive Board.

Pursuant to the decisions taken on the methods of work by the Executive Board at its First Regular Session of 1996, the documentation prepared by the Secretariat for the Board has been kept brief and decision-oriented. The meetings of the Executive Board are to be conducted in a business-like manner, with increased dialogue and exchanges between delegations and the Secretariat. Efforts to promote these guiding principles will continue to be pursued by the Secretariat.

The Secretariat therefore invites members of the Board who may have questions of a technical nature with regard to this document, to contact the WFP staff member(s) listed below, preferably well in advance of the Board's meeting. This procedure is designed to facilitate the Board's consideration of the document in the plenary.

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INTRODUCTION

1. The need for a Facility to pre-fund direct support costs (DSC) was recognized by the Formal Working Group of the Executive Board, established at the Annual Session in 1998 to review WFP's Resource and Long-term Financing (R<F) policies. The Formal Working Group's report recommended, *inter alia*, that the Secretariat provide the Board with options for the creation of a DSC advance facility (WFP/EB.3/98/4-D, Recommendation 3.0).
2. The Board at its Third Regular Session in 1998 deferred formal action on the report until its First Regular Session in 1999. It also decided it would consider the options for a DSC advance facility together with the report (WFP/EB.3/98/13, 1998/EB.3/5).
3. This paper reviews three options for the establishment of a DSC advance facility—i) set up a guarantee mechanism, ii) modify an existing fund, and iii) establish a new fund—and recommends the establishment of a guarantee mechanism.

THE NEED FOR A DSC ADVANCE FACILITY

4. The need for a DSC Advance Facility was recognized as a consequence of the recategorization of costs recommended in the review of the R<F policies. The recategorization to DSC of costs currently covered under the Programme Support and Administrative (PSA) budget is likely to cause difficulties in ensuring continued financing for country office costs moved from PSA to DSC funding, until receipt of confirmed contributions.
5. The review of the R<F policies provided for a change in the structure of the PSA. Under the structure it proposed, the PSA, except in exceptional circumstances, would finance headquarters, regional offices and the basic infrastructure in each country office. The basic infrastructure typically includes the Country Director, up to two national officers and three national support staff. All other country office staff and related costs would be financed through project budgets as DSC.
6. This change in structure involves the recategorization of staff and non-staff costs in country offices from PSA to DSC effective 1 January 2000. Country offices that previously were entirely financed from projects (primarily emergency operations) would now have their Country Director and a maximum of five national staff financed from the PSA. Country office staff and non-staff costs beyond the basic infrastructure would be moved from the PSA to DSC. This change particularly affects the staff in countries with large development programmes.
7. Had the new structure been in effect in the current biennium it is estimated that a net total of \$33 million in costs would have been transferred from the 1998-99 PSA to project budgets. The majority of staff and non-staff costs transferred from the PSA are required for development projects. Most of these costs will be financed through multilateral development resources, which currently provide 13.9% for indirect support costs (ISC). Under the proposals of the R<F Formal Working Group this rate will be reduced significantly (the R<F review used an estimated rate of 7.8 %). The multilateral resources made available by the lower ISC rate will be used in part to fund the staff and non-staff costs transferred from the PSA to project budgets.



8. However, a significant number of the project budgets which must assume the financing of these costs may not be fully funded at the beginning of the biennium. The lack of a facility enabling the Programme to ensure funding for staff and non-staff costs pending the completion of negotiations with donors and receipt of confirmed contributions for the biennium could cause serious disruption and impact negatively on WFP's ability to deliver services, particularly in the first year of a biennium. Based upon the 1998-99 Budget, it is estimated that the maximum total amount that would be required at one time would be \$33 million; being the amount transferred from the PSA to project budgets.
9. Once the change in the structure of the PSA is implemented, there is a small risk that project funding will not be received for certain of the costs incurred. This could affect DSC funding in countries where projects are in their final phases and new projects are scheduled to begin during the biennium. This situation may be compounded by a high level of directed multilateral contributions to the development programme. Based upon the DSC and PSA funding in the 1998-99 biennium, this maximum risk is estimated at \$5 million for a biennium.

PROPOSED GUARANTEE MECHANISM FOR DSC ADVANCE

10. The guarantee mechanism appears to be the DSC advance facility that can most easily be established and offers the most advantages to WFP since:
 - No additional resources would be needed to establish and operate a guarantee mechanism, and resources for the facility would remain available for other operational purposes and not have to be set aside. The General Fund could be used and financing authority made available only as the need arises.
 - DSC expenditure would be recorded at the time it is actually incurred, and an advance account (receivable) and a provision account (liability) would remain reflected in the balance sheet of the financial statements until a contribution is collected, or until the Board determines that resources will not be forthcoming.
 - The use of the General Fund as a DSC guarantee mechanism is within the competence of the Board, after considering the advice of the ACABQ and FAO Finance Committee, and does not require amendments to the General or Financial Regulations.
11. The proposed guarantee mechanism would have the following characteristics:
 - The mechanism would enable WFP to advance sufficient DSC resources for staff contracts to be continued and non-staff commitments to be met before contributions are confirmed, particularly at the beginning of a biennium.
 - The mechanism would advance DSC for projects for which confirmed contributions are reasonably expected but have not yet been received. Projects eligible to receive DSC funding from the Immediate Response Account (IRA) or the Operational Reserve would not qualify for DSC advances under the guarantee mechanism.
 - Allotments authorized from the mechanism would be revolved as contributions are received for the financed activities.
 - The Board would determine to what extent DSC advanced may not be met from donor contributions over the biennium, and may, therefore, require funding from the General Fund. The Board would review the adequacy of the advance level; the amounts not



revolved or collected; and the effectiveness of the mechanism as part of the biennial budget approval process.

TWO OTHER OPTIONS FOR DSC ADVANCE

Modifying an existing fund or reserve

12. Currently, two mechanisms exist to provide advance financing: the IRA and the Operational Reserve. If the IRA were expanded to include DSC financing for development activities, this would create difficulties for some donors who usually fund the IRA from their emergency budget lines. In addition, the portion of the IRA earmarked for the financing of non-food related costs, including DSC, is insufficient for use as a DSC advance facility. The Operational Reserve can be used for development as well as for relief and emergency activities, but only against confirmed contributions.
13. Modifying the Operational Reserve in order to accommodate DSC advances against unconfirmed contributions would be markedly different from creating a guarantee mechanism, in that:
 - The guidelines governing the Operational Reserve (CFA.38/18 paragraphs 37-41 and WFP/EII.A/9714-D) would have to be amended by the Board so that it could be used to advance DSC prior to confirmation of contributions. This would involve a significant extension of the authority granted for the use of the reserve.
 - Additional resources would be required to expand the role of the Operational Reserve to include advancing DSC in the absence of confirmed contributions—potentially \$33 million based upon the 1998-99 Budget. The additional resourcing of the reserve would be either through the allocation of funds from the General Fund or by way of contributions made specifically for this purpose. Replenishment of the portion of the DSC not revolved would be similarly effected through the Executive Board's agreement to transfer funds from the General Fund, or through contributions made specifically for replenishment of the reserve.
 - Additional resources contributed to the Operational Reserve would have to be set aside and could not be used for other operational purposes.
 - The use of the Operational Reserve to advance DSC against unconfirmed contributions would require that WFP record income before the actual receipt of the cash contribution in order to record the DSC expenditure, which is not consistent with the basis of accounting adopted by WFP in accordance with United Nations accounting standards.

Establishing a new fund

14. This is the same as modifying the Operational Reserve with the exception that a reserve to be used for the purpose of DSC advance would be created outside the Operational Reserve. Again, funding would have to be sufficient to cover the maximum potential liability of \$33 million and the resources contributed would have to be set aside



and could not be used for other operational purposes. Also, as in the case of the Operational Reserve, the accounting requirements would not be consistent with United Nations accounting standards nor the basis of accounting adopted by WFP.

15. The current Financial Regulations provide for the creation of reserves, so WFP's regulatory framework would not need to be amended. (Financial Regulation 10:7 The Board may establish other reserves as required). The guidelines governing the use of the new fund would need to be reviewed by the ACABQ and the FAO Finance Committee and their advice provided to the Board.

SUMMARY AND RECOMMENDATIONS

16. The guarantee mechanism has advantages in that it does not require additional resources to be identified, funds would not have to be set aside, and accounting would be in accordance with existing WFP policies and United Nations accounting standards. In addition, it is simple to establish, implement and oversee.
17. The Executive Director, therefore, recommends that the Executive Board:
 - a) Approve the use of the General Fund to advance DSC, as the need arises, up to the limit established by the Board, and that such use be referred to as the "guarantee mechanism";
 - b) Approve the guarantee mechanism be used to enable the Executive Director to ensure continued financing of DSC pending the confirmation of contributions;
 - c) Set the maximum level of the guarantee mechanism and the amount of the provision to cover unfunded DSC advanced under the guarantee mechanism during the biennial budgetary process; and
 - d) Agree to review biennially the adequacy of the level, the amounts not revolved or collected, and the effectiveness of the guarantee mechanism, as shall be shown in WFP's report on budgetary performance and audited accounts.

