Progress on the Financial Framework Review, including Indirect Support Costs

Informal Consultation

17 March 2015

WFP

World Food Programme

wfp.org

Key upcoming dates

April 1	Informal consultation on the strategic utilization of the WFP Programme Support and Administrative (PSA) Equalization Account
April 27	Advisory Committee on Administrative and Budgetary Questions (ACABQ)
May 4	Informal consultation on Resource Management issues at EB.A/2015; Briefing on the Management Plan (2016-2018)
May 11-13	FAO Finance Committee
May 25-29	Annual Session of the Executive Board

The full schedule can be found on the WFP Executive Board page: http://executiveboard.wfp.org/wfp-calendar.

Agenda

Part 1: Financial Framework Review Update

- Project objective and key goals
- Approved restructuring of the Working Capital Financing Facility
- Challenges in WFP’s financial architecture
- Potential characteristics of a target financial architecture
- Components and priority work streams

Part 2: Progress on the ISC Review

- Background
- Remaining question and analysis
- PSA cost drivers
- Review of PSA Equalization Account and non-recurring investments
- Summary of preliminary conclusions

PART 1: FINANCIAL FRAMEWORK REVIEW UPDATE

Financial Framework ‘Fit for Purpose’

Objective:

Improve financial processes, strengthen the funds management structure and enhance overall accountability of resources for greater operational effectiveness and cost transparency.

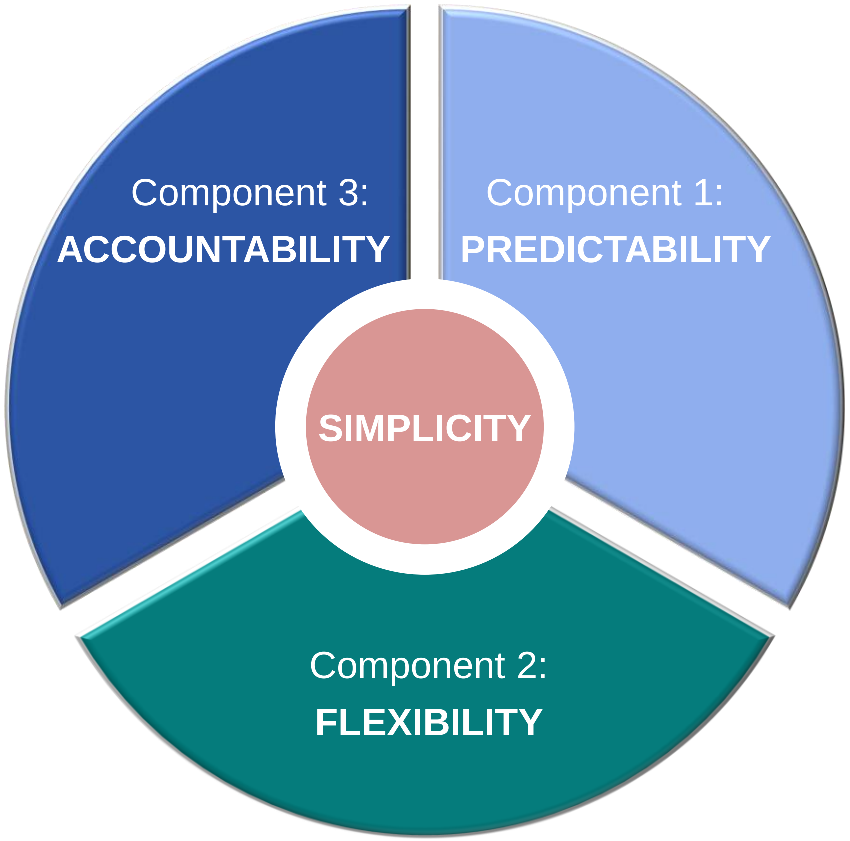
Key goals:

- Improve planning and cost management practices
- Enhance transparency to increase donor confidence
- Enhance accountability for results achieved
- Achieve more predictable and flexible funding
- Create more autonomy over resource usage
- Ensure faster utilization of resources

Internal Financing Tools – Structure Approved EB.A 2014

Mechanisms			*Target/ Ceiling*	*Leverage factor*	*Target/ Reserve*
Advance Financing	**Immediate Response Account (IRA)**	• Immediate assistance in life-saving emergencies; advances sometimes converted to grants	$200M	1:1	$200M
	Internal Project Lending	• Advances to projects with forecasts as collateral	$570M	6:1	$95.2M
Pipeline Management	**Global Commodity Management Facility**	• Food purchasing in advance of requests from projects (previously FPF)	*USD 350 million ceiling* *Reserve target of USD 6 million established*		
Capital Financing	**Corporate Services (CS)**	• Advance financing for Global Vehicle Leasing Programme, Capital Budgeting Facility, & fee-for-service activities	*USD 70 million ceiling* *Risk underwritten by PSAEA*		

Reminder – Financial Framework components



- **Predictability**: achieve greater predictability of funding and planning for country offices to improve operational efficiency and effectiveness
- **Flexibility**: ability to respond efficiently and effectively to prioritized operational needs while maintaining discipline over financial management, reporting and analysis
- **Accountability**: acknowledgment of responsibility for actions … and accountability for resulting consequences
- **…** and **Simplicity**, added as a core objective.

ISC Review and the Financial Framework

- It is recognised that PSA expenditure is a central part of WFP's cost structure and – together with other cost components and funding streams – should be part of a comprehensive review of WFP's costs.

- Given the link between the cost drivers of the PSA and WFP's overall cost structures examined through the Financial Framework Review, the Secretariat is addressing the remaining ISC analysis within the context of the FFR.

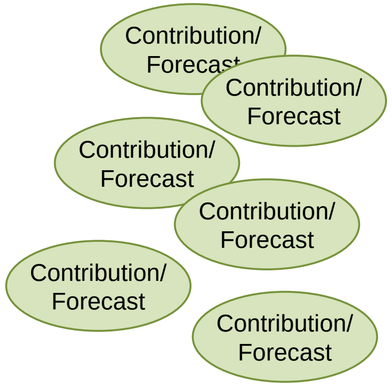
Today's financial architecture

While the current architecture is currently under review, results from Executive Board consultation on both the ISC review and the Financial Framework underscore three underlying principles that should remain in place:

- Voluntary funded nature of WFP
- Principle of full cost recovery (although how it is applied may need to be reviewed)
- Contribution-specific expenditure tracking (although how it is applied may need to be reviewed)

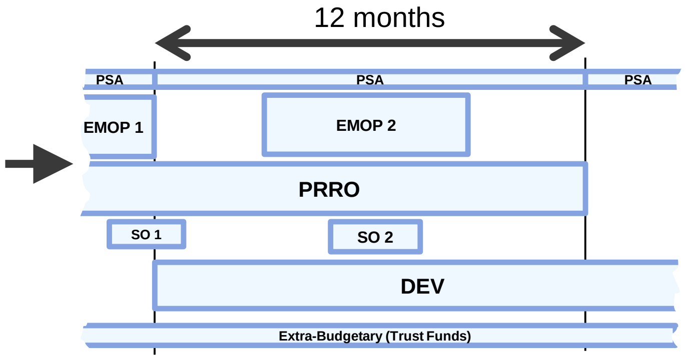
Today’s financial architecture

Budget Authority



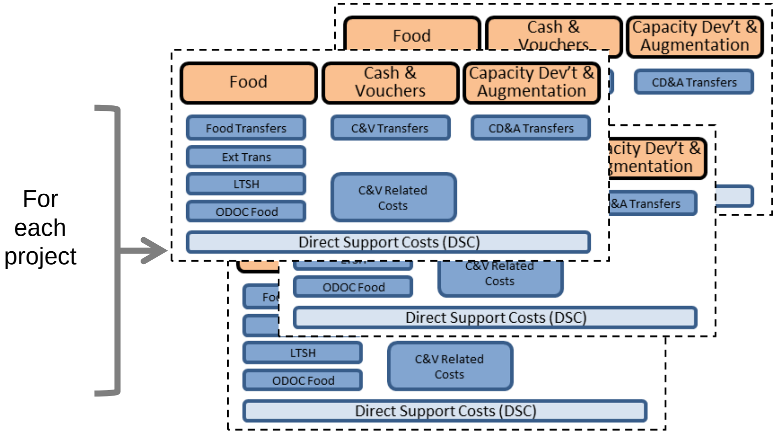
Piecemeal authority to incur costs as contributions (or forecasts) materialize

Budget Entity



Country Office fragmented between projects, PSA and extra budgetary funds

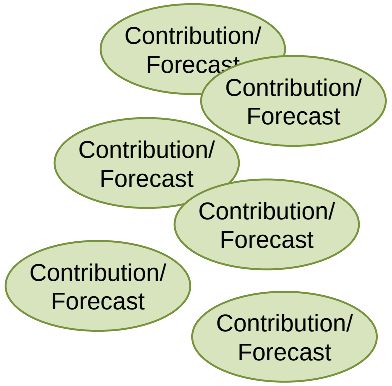
Budget Structure



Further fragmentation of funding into cost components within each project

Today’s financial architecture: Challenges (1)

Budget Authority



Piecemeal authority to incur costs as contributions (or forecasts) materialize

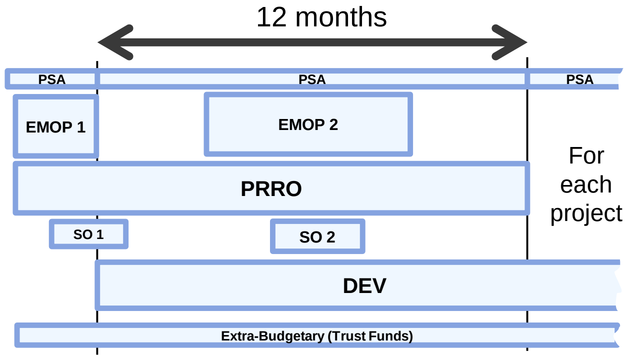
While improvements to resource management instruments including WCFF have extended greater certainty to operations, challenges remain.

Today, piecemeal budgetary authority remains a key challenge given contribution (or forecast) uncertainty, which:

- Inhibits medium and longer term planning;
- Results in higher transaction costs;
- Reduces effectiveness.

Today's financial architecture: Challenges (2)

Budget Entity



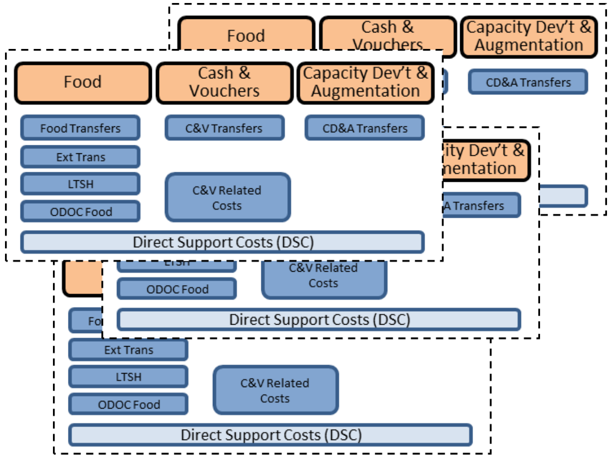
Country Office fragmented between projects, PSA and extra budgetary funds

Today, country-level budgets are fragmented into four programme categories, with additional funds management modalities including trust funds and special accounts. This results in:

- Multiple budget entities with different durations;
- Difficulties in cohesive funds management;
- Short term focus of many activities: planning (and commitments) for medium and longer term activities (and results) are not possible;
- Heavy processes for:
  - ❑Project (budget) approval
  - ❑Project (budget) revision
  - ❑Project resource transfer and closure

Today's financial architecture: Challenges (3)

Budget Structure



Further fragmentation of funding into cost components within each project

Additionally, today's current budget structure for each programme category (project):

- Leads to further fragmentation due to the current application of the principle of Full Cost Recovery within projects;
- Based on input oriented categories;
- Ensures accountability over inputs, but does not link resource accountability to performance management.

Today’s financial architecture: preliminary conclusion

Integration of financial framework with performance management

- Current financial data is input focused, and is fragmented into cost components (Food, C&V, etc.).
- As a consequence, the current structures do not allow financial data to be integrated with performance data - which is output and outcome focused.
- Integration of resources and results frameworks would:
  - ➢ Improve strategic implementation;
  - ➢ Aid performance management;
  - ➢ Enhance cost insights for decision making;
  - ➢ Reinforce accountability for performance.

Potential characteristics of a target financial architecture

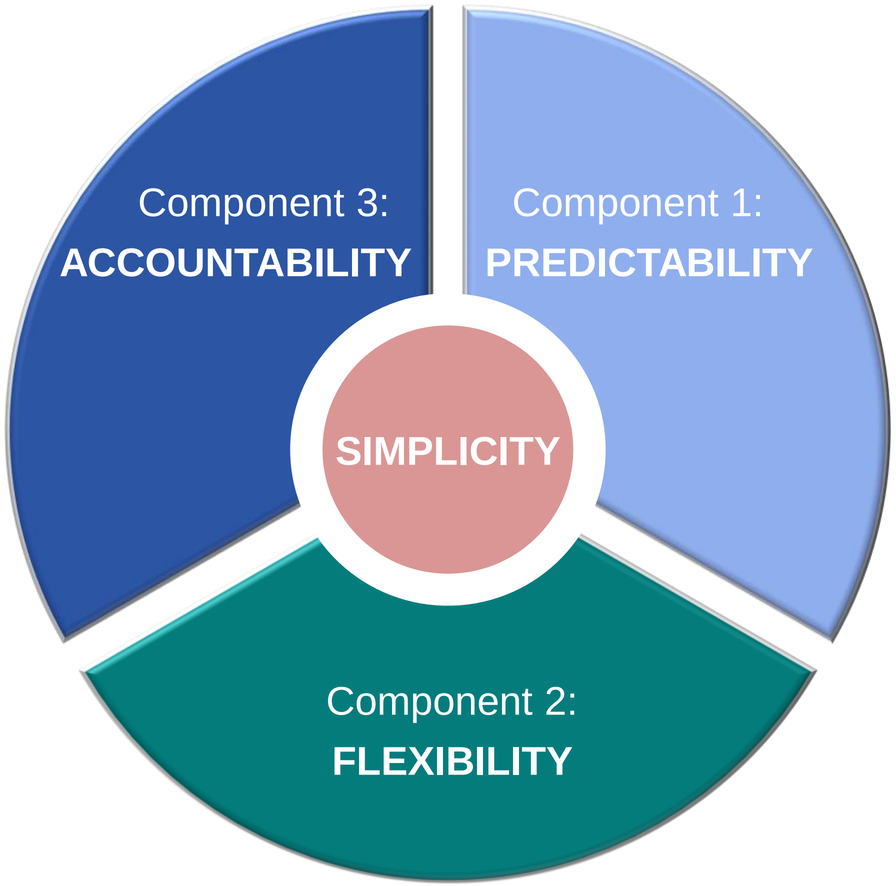
Financial architecture changes could aim to:

- Integrate resources and results frameworks;
- Evolve WFP's financial governance from "input based" to "performance based";
- Provide for multi-year, results-oriented planning – a prerequisite for sustainable nutrition outcomes and achieving Zero Hunger goals;
- Bring greater stability and certainty to our current "core business," improving efficiency and effectiveness;
- Create greater stability for managers, staff and partners over the short and medium term.

Discussion questions for consultation and guidance

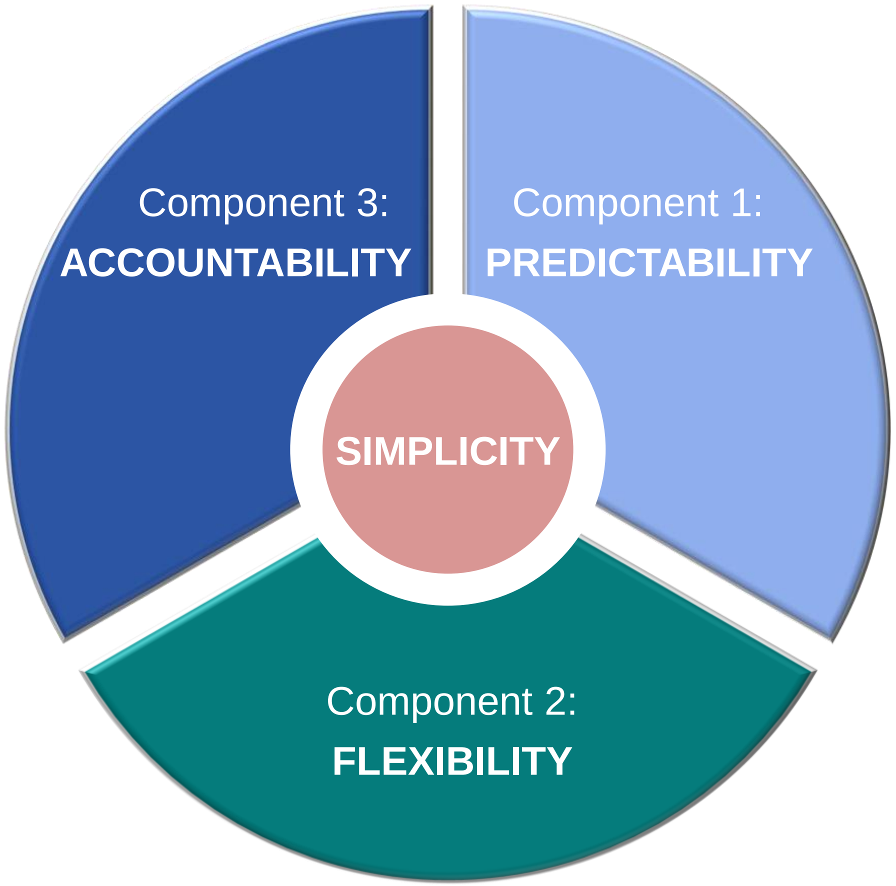
- *From the perspective of the Membership, are there additional challenges in the current financial architecture?*
- *What are the types of changes to be considered to WFP's architecture?*
- *To what extent are changes required from the perspective of the Membership?*

Financial Framework Review: direction and overall approach



- Engage with all areas of the organization including Regional Bureaux and Country Offices;
- Ensure regular consultation with the Executive Board, other appropriate governing structures and external stakeholders;
- Apply a modular and gradual approach to limit overall project risk;
- Prioritize simplification initiatives that will bring immediate benefits to operations while supporting the target financial architecture.

Financial Framework Review Component 1: Predictability



Priority work streams from 2015:

- Macro Advance Financing
- Resource Based Planning

Priority work Stream: Macro Advance Financing

Expansion of Advance Financing mechanisms and levers

- Expand advance financing to more aggregated, earlier authority
- Lessons learned from the non-contribution specific advances review
- Augment underlying risk mitigation mechanisms

Proof of concept through pilots

- Series of pilots
- Quantify efficiency gains through benchmarking of pilots
- Where possible pilot in conjunction with Resource Based Planning work stream
- Show the costs and inefficiencies of the current model

Accountability

- Define 'Compact' with Country Offices for good performance management and funds materializing from the donor
- Provide tools necessary to manage risks

Priority work stream: Resource Based Planning

Resource Based Planning is a prerequisite for expanding the use of advance financing and for an accountability ‘Compact’

- Resource Based Plans will not replace needs based quantification.
- Finalise approach, learning from existing models at CO level.
- Pilot ‘standardised’ approach with a sample of operations, including:
  - Corporate emergencies;
  - Countries with multi-year, results oriented plans (e.g. nutrition);
  - Piloting, where possible, with macro advance financing.
- Roll out the standardised approach to all offices.
- Integrate country level Resource Based Planning with the WFP Prioritized Plan of Work in the Management Plan.

Financial Framework Review Component 2: Flexibility

Priority work stream from 2015:

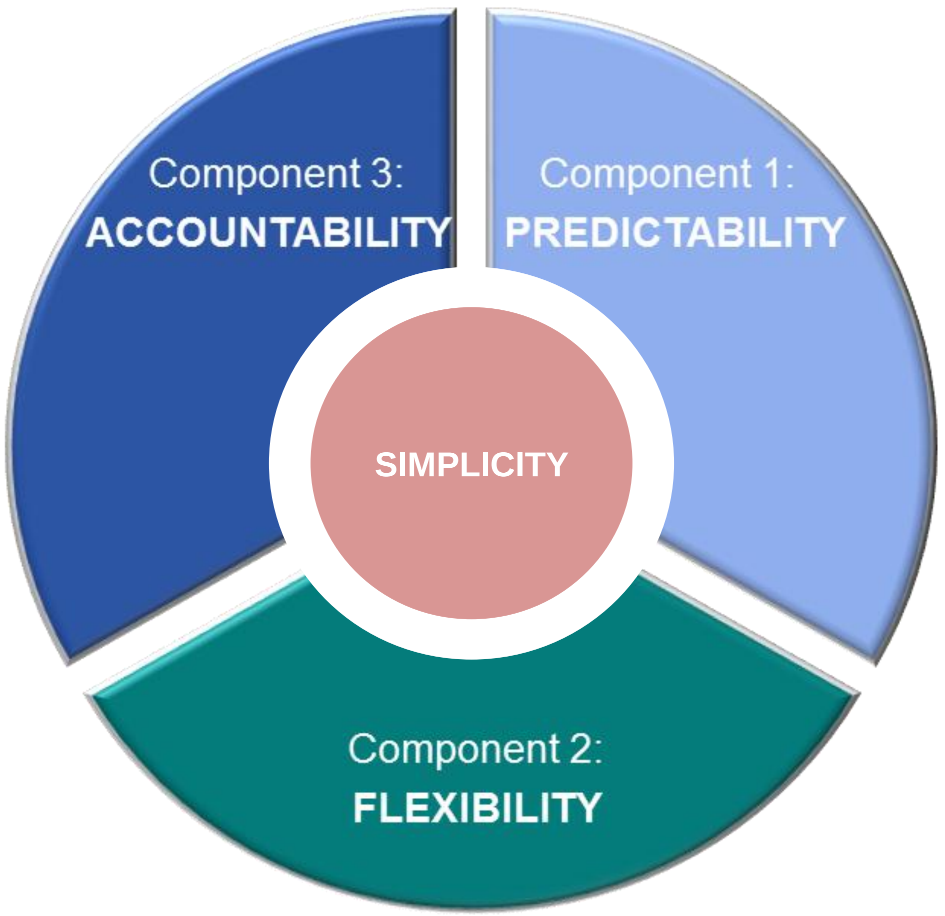
- Review of operational budget structure

Priority work stream: Review of Operational Budget Structure

- The application of WFP's Budget Entities (currently emergency operations, protracted relief and recovery operations, special operations, country programmes, trust funds…) will be reviewed.

- The review must ensure that any proposals to evolve and improve the budget entities provide the following characteristics:
  - Greater focus on the Country Office as the unit/level at which budget is managed and reported;
  - Budgetary control categories that are more closely aligned to results rather than inputs;
  - Improved flexibility, reducing some of the controls on individual associated cost components.

Financial Framework Review Component 3: Accountability



<u>**Priority work streams from 2015:**</u>

- Strengthening accountability over Macro Advance Financing and other resource instruments
- Linking resources to results

Priority work stream: Strengthen accountability to support changes introduced

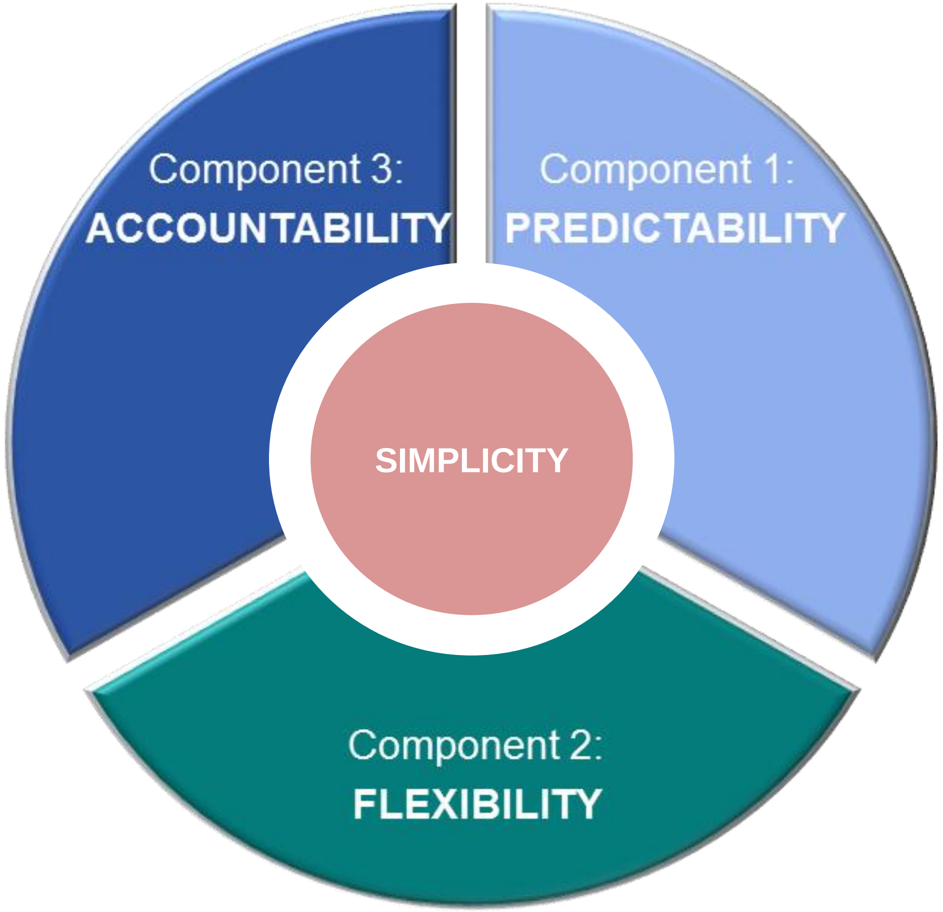
Strengthening accountability over macro advances:

- Define ‘Compact’ with Country Offices for good performance management over funds;
- Provide tools necessary to manage risks.

Linking resources and results

- Strengthening the linkage between resources and results to better understand effectiveness and efficiency of operations, and demonstrate value for money.

Financial Framework Review Component 4: Simplicity



<u>Priority work stream from 2015:</u>

- Simplification initiatives, including in the short term

PART 2: PROGRESS ON THE ISC REVIEW

ISC Review - Background

EB.1/2014

The first phase of the review was presented during the First Regular Session of the Executive Board in 2014 and outlined the context and drivers of the review.

EB.2/2014

A second paper was presented during the 2014 Second Regular Session following informal Board consultations held in May and September 2014. It addressed the first three questions and reached the following conclusions:

- The current voluntary funding model is preferable to a core funding model;
- The current single-rate ISC model is simple and transparent and thus should be maintained;
- Variable ISC rates should be avoided in order to maintain simplicity and transparency;
- Variable ISC rates would be unlikely to incentivize additional contributions through South-South cooperation or host governments;
- A single ISC rate of 10 percent should be applied to private-sector donations.

ISC Review – Question 4

EB.2/2014 (continued)

The fourth question of the ISC review, proposed at the Board's 2014 Second Regular Session, underpins the approach for the finalization of the ISC review and supporting analysis:

"As some costs related to support and administration are covered from sources other than the ISC recovery rate, WFP should undertake a detailed analysis of its indirect costs and review the PSA Equalization Account, which serves as a safety net for unplanned fluctuations in ISC recovery. Should WFP continue to consider multiple sources of funding for costs such as security and non-recurring investment?"

The Secretariat has presented the following analysis in the informal consultation document "*Progress on the Financial Framework Review, Including Indirect Support Costs*." The following slides will summarize the results.

ISC Review – PSA Cost Drivers

The PSA budget is defined as “the portion of the WFP Budget that pertains to providing indirect support to WFP’s activities” (Financial Regulations: I, Definitions).

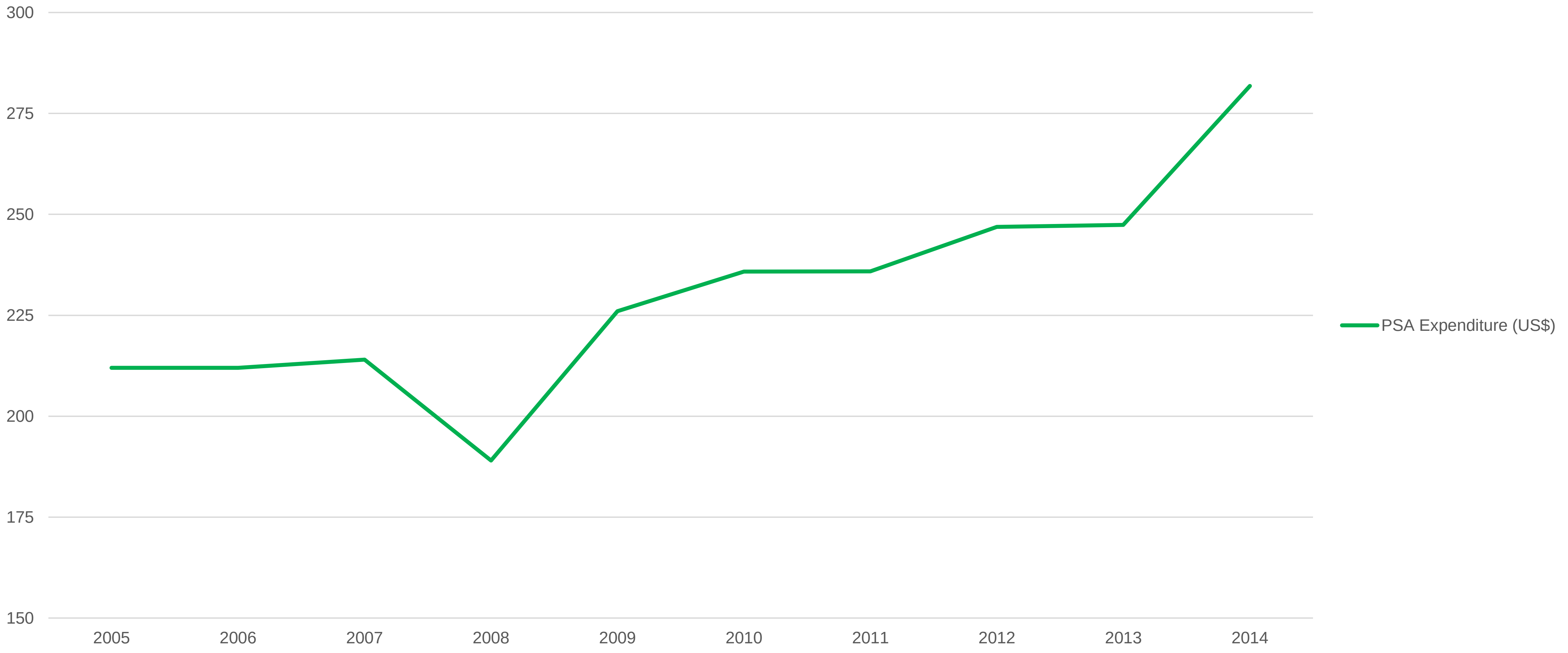
The PSA budget covers the majority of Headquarter and Regional Bureaux costs as well as a core presence in each country. It is subdivided into three appropriation lines:

- Programme support: regional bureaux and country offices;
- Programme support: Headquarters;
- Management and administration.

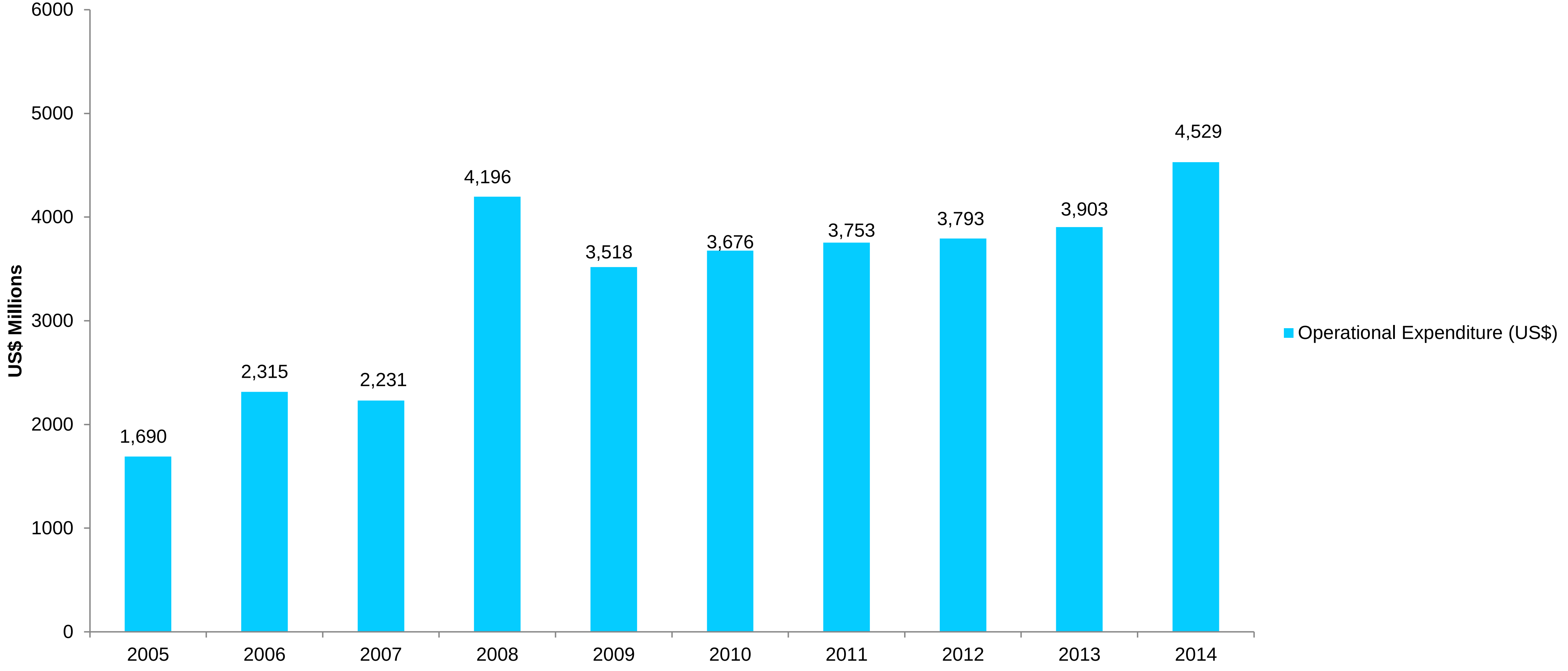
The primary driver of the regular PSA budget is the level of operational implementation. WFP is not a static business and changes to WFP’s operational response is the core basis for PSA expenditure changes.

The following slides show a 10-year trend of operational and PSA expenditures.

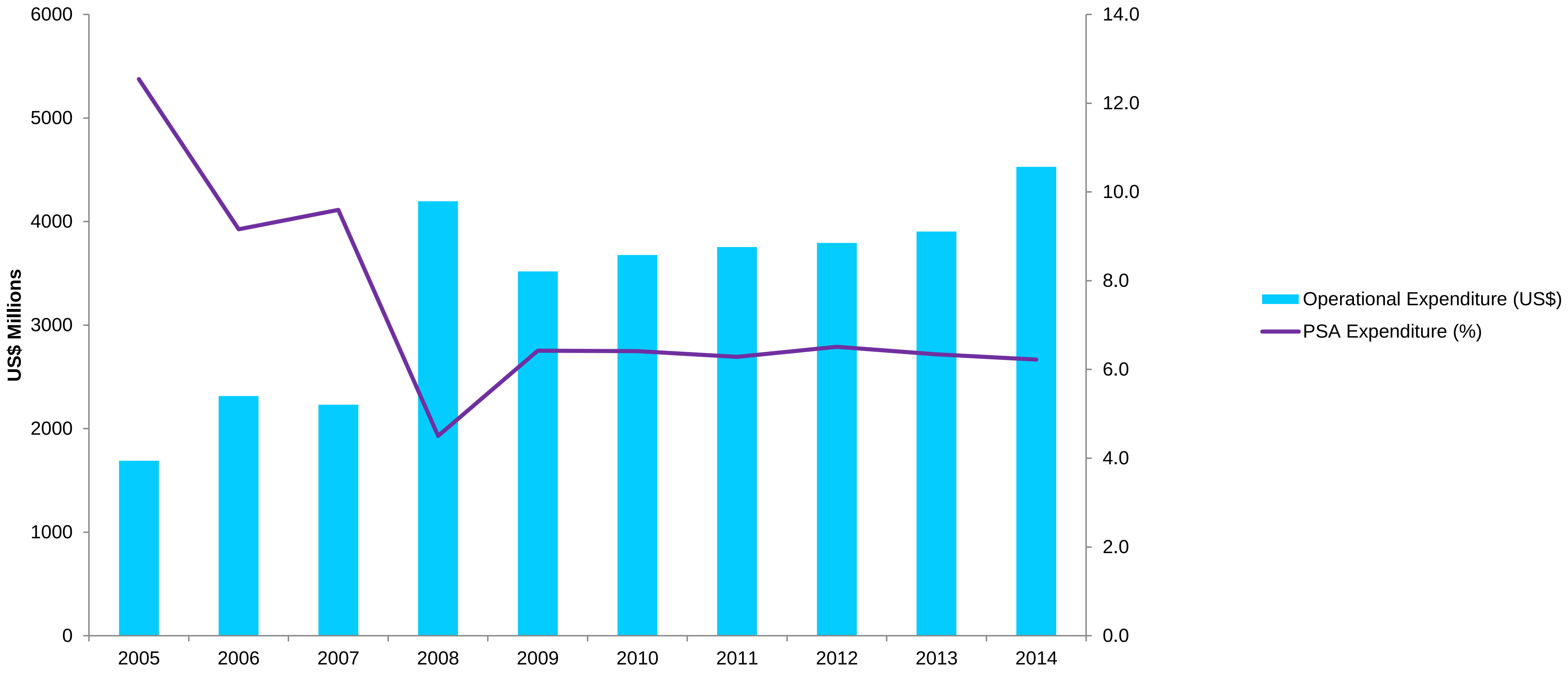
ISC Review – PSA Expenditure (2005-2014)



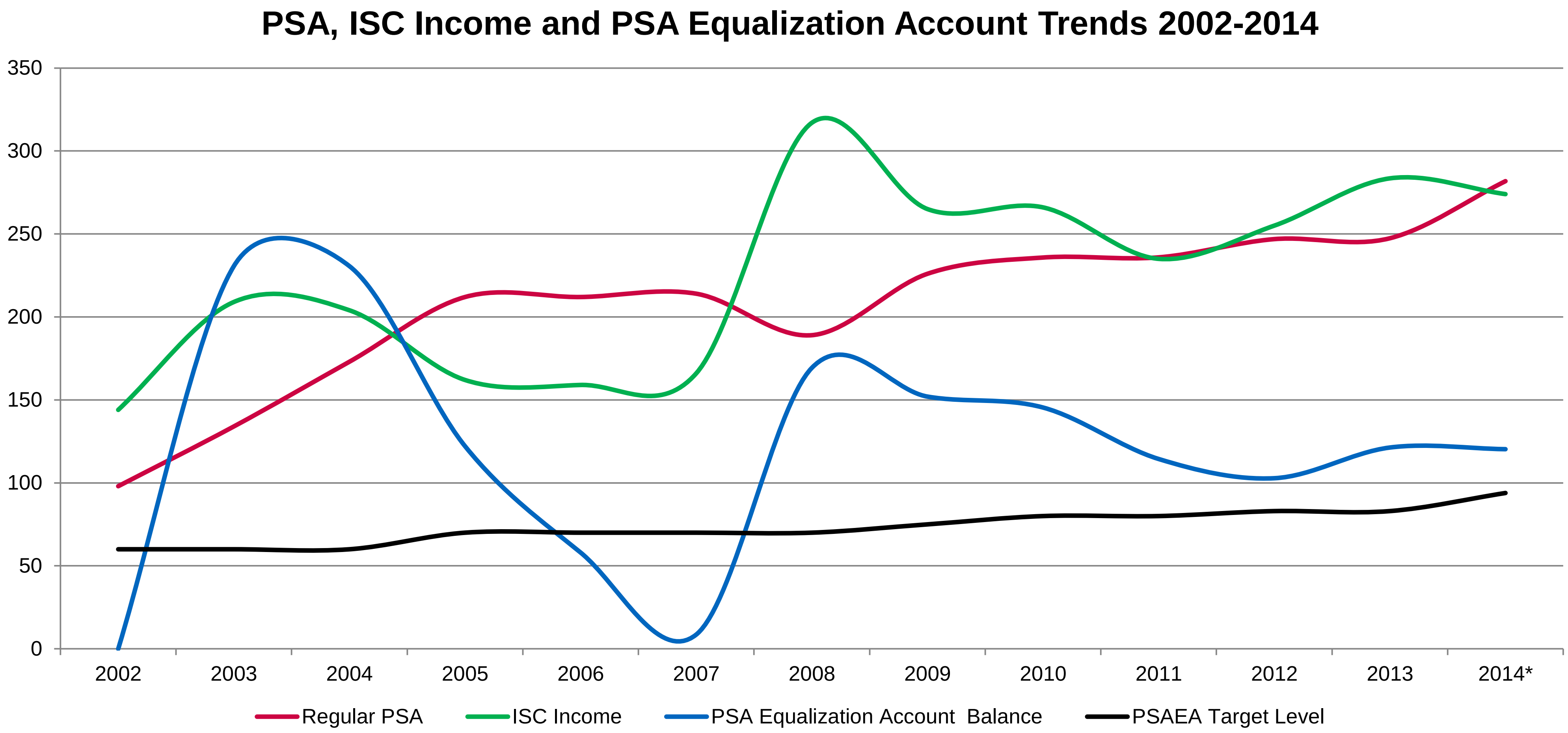
ISC Review – Operational Expenditure (2005-2014)



ISC Review – PSA Expenditure as a % of Operational Expenditure (2005-2014)



PSA Equalization Account – Trends (2002-2014)



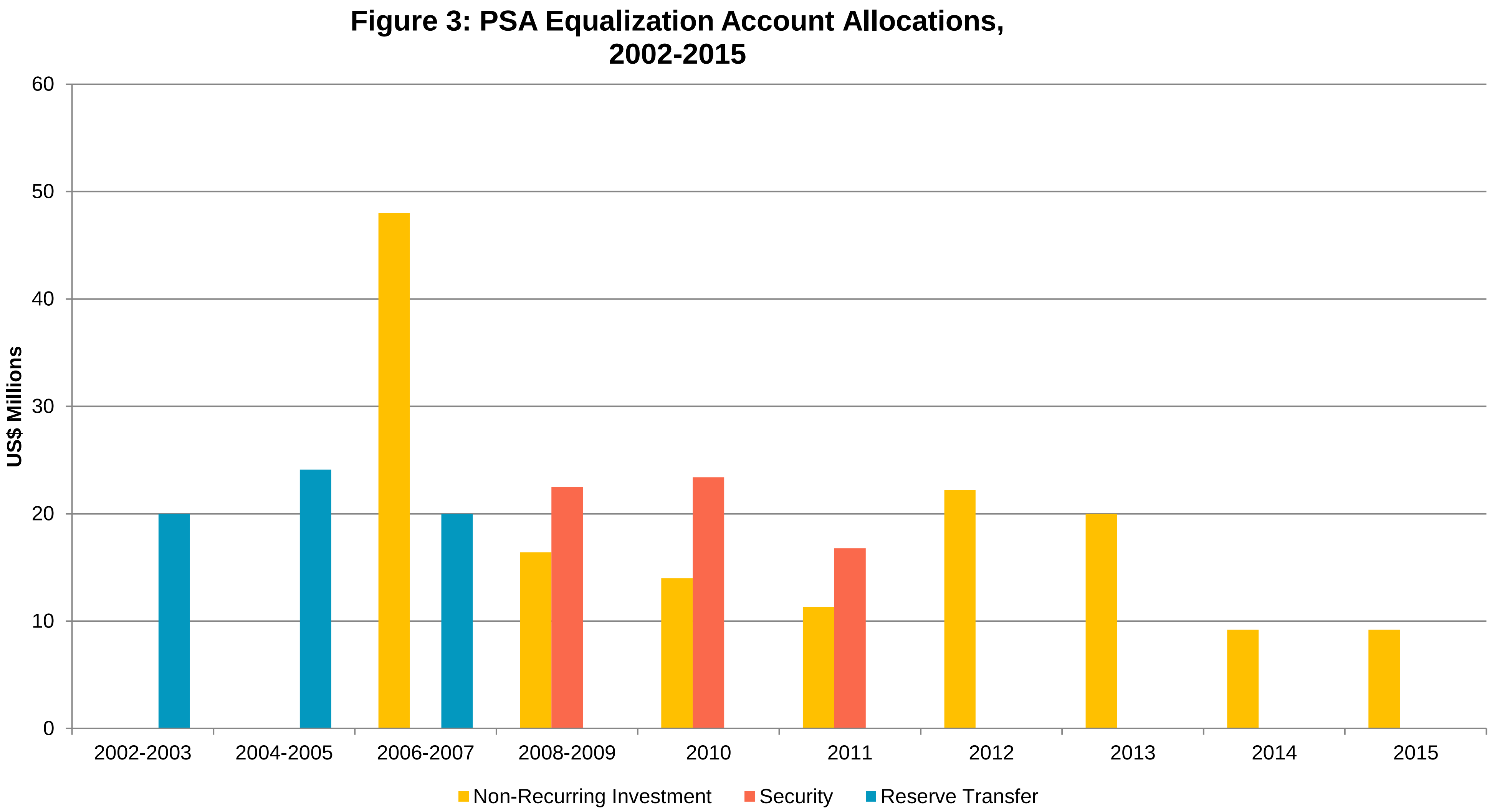
*Figures are preliminary and will be verified and presented in the final document for approval.

PSA Equalization Account

- Since 2002, approximately USD 277 million has been allocated from the PSA Equalization Account by the Executive Board for expenditures outside of the regular PSA budget (reported in the annual financial statements).

- Three key areas of investments have been made using surpluses:
    1. **Non-Recurring Investments** – USD 150.3 million has been allocated for critical corporate initiatives.
    2. **Security** – USD 62.7 million was allocated over a three-year period for field security upgrades and WFP’s cost-share portion toward the UNDSS Security Management System.
    3. **Reserve Transfer** – USD 64.1 million was authorized for transfer to increase the balances of the Immediate Response Account and the DSC Advance Facility (later merged into the Operational Reserve).

PSA Equalization Account



PSA Equalization Account

Examples of non-recurring investments funded by the PSA Equalization Account

- WINGS II (2006-07)
- IPSAS implementation (2006-07)
- IT modernization initiatives (2010-11)
- Strengthening managerial control accountability (SMCA) initiative (2010-11)
- Corporate M&E Tool – COMET (2012)
- Framework for Action (2013)
- People Strategy (2015)

ISC Review – Preliminary conclusions

Falling interest rates in recent years mean that interest income has declined. Furthermore, its unpredictability means it is not a suitable funding source for meeting annual costs for security, IT and other related costs.

Preliminary conclusion 1:

- Interest income, which accrues to the un-earmarked portion of the General Fund, should be used as follows:
    - Firstly, to strengthen the organizations reserves and management of financial risk and
    - Secondly, to fund critical corporate initiatives where there are insufficient funds available in the PSA equalization account.
    - It should only be used to fund recurring costs as a last resort.

ISC Review – Preliminary conclusions

Security expenditures are an essential component in many of WFP's operating environments in order to take steps to provide for the safety and security of WFP staff, premises and inventories.

Preliminary conclusion 2:

- Including security costs that cannot be charged to an individual project in the PSA budget – when no other funding source is available – is in line with the indirect nature of the costs.

ISC Review – Preliminary conclusions

Despite unprecedented funding levels in 2014, WFP remains a voluntarily funded organization with a complex funding landscape. WFP must continue to proactively manage financial risk to ensure that fluctuations in overall funding do not impact the provision of support and services funded through the PSA.

Preliminary conclusion 3:

- Consideration should be given to optimizing the target level of the PSA Equalization Account, on the basis of further analysis, in order to better equip the organization to deal with any sharp decline in funding.

ISC Review – Preliminary conclusions

PSA Equalization Account surpluses beyond the established target levels have historically been used, with Executive Board approval, for reserve transfers and to fund non-recurring investments that are indirect in nature.

These investments have played a critical role in enabling organizational change.

<u>Preliminary conclusion 4:</u>

- The PSA Equalization Account is a suitable source of funding for discrete non-recurring investments that are indirect in nature and provide the highest strategic value for WFP (critical corporate initiatives).

ISC Review – Preliminary conclusions

The review has further revealed inconsistencies in the terminology used to describe priority activities and initiatives that have received allocations from the PSA Equalization Account. The ISC review and the Financial Framework Review present opportunities to improve consistency and transparency.

<u>Preliminary conclusion 5:</u>

- WFP should in future use the term “critical corporate initiatives” for such discrete non-recurring investments from the PSA Equalization Account.

Discussion questions for consultation and guidance

- *What are the views from the Membership on the preliminary conclusions from the ISC review?*

- *Are there additional ISC-related issues to be taken forward as part of the Financial Framework Review?*

Additional comments or questions?

Integration & Support Office (RMX)
Resource Management Department