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Executive Board
Third Regular Session

Rome, 21–25 October 2002

FINANCIAL AND BUDGETARY MATTERS

Agenda item 5

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:

- Audited Biennial Accounts (2000–2001) (WFP/EB.3/2002/5-A/1/1–5);
- Report on Budgetary Performance, 2000–2001 (WFP/EB.3/2002/5-B/1);
- Final Report on the Analysis of the Indirect Support Cost (ISC) Rate (WFP/EB.3/2002/5-C/1);
- WFP's Cash Balances: Composition and Appropriate Levels of Cash (WFP/EB.3/2002/5-D/1); and
- Final Report on Balances of Projects Closed Prior to 2001 and Migrated to WINGS (WFP/EB.3/2002/5-E/1).

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Advisory Committee on
Administrative and Budgetary Questions

3 October 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 “Final Report on the Analysis of the Indirect Support Cost (ISC) Rate” (WFP/EB.3/2002/5-C/1), “Report on budgetary performance, 2000-2001” (WFP/EB.3/2002/5-B/1/Corr.1), “WFP’s cash balances” (WFP/EB.3/2002/5-D/1), “Final report on balances of projects closed prior to 2001 and migrated to Wings” (WFP/EB.3/2002/5-E/1 and “Audited biennial accounts (2000-2001)”, Sections I-5 (WFP/EB.3/2002/5-A/1/1 through 5).

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 to be held 21-25 October 2002, as a complete and separate document. A printed version (in all languages) of the document 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 “Final Report on the Analysis of the Indirect Support Cost (ISC) Rate” (WFP/EB.3/2002/5-C/1), “Report on budgetary performance, 2000-2001” (WFP/EB.3/2002/5-B/1/Corr.1), “WFP’s cash balances” (WFP/EB.3/2002/5-D/1), “Final report on balances of projects closed prior to 2001 and migrated to Wings” (WFP/EB.3/2002/5-E/1 and “Audited biennial accounts (2000-2001)”, Sections I-5 (WFP/EB.3/2002/5-A/1/1 through 5. During its consideration of the reports, the Advisory Committee met with representatives of the Executive Director, who provided additional information and clarifications.

2. Owing to problems encountered in delivering the necessary documentation to United Nations Headquarters, the Committee had only a very limited time to properly prepare for its consideration of these matters. The Committee requests that steps be taken to avert such delays in future.

Final Report on the Analysis of the Indirect Support Cost (ISC) Rate

3. The report (WFP/EB.3/2002/5-C/1) concludes the analysis of the ISC rate, initiated in the Preliminary Review of the ISC Rate report submitted to the Board in May 2002 (WFP/EB.A/2002/6-A/1) along with the comments and observations of the Advisory Committee (WFP/EB.A/2002/6(A,C)/2). It addresses the “steps” set out by WFP’s Secretariat and approved by the Board in its decision 2002/EB.A/7with a view towards establishing an appropriate ISC rate.

4. One of the steps approved by the Board included that WFP embark on a comparative study of the funding and costs for administrative and support budgets of comparable NGOs and United Nations organizations. In this regard, the Committee notes the information regarding United Nations organizations in section 9 and annex VII of the report. The results of the NGO comparison study, as indicated in paragraph 134-135 of the report will be presented to the Board in February 2003. The Committee looks forward to this report.

5. As a result of this analysis of the ISC rate, the Executive Director proposes several measures, some of which are recommended for approval by the Executive Board (see the draft decision contained in the report or paragraph 173). The Executive Board may wish to consider the proposals of the Executive Director, as set out in the draft decision, in light of the observations of the Advisory Committee in the paragraphs below.

6. The Executive Director proposes an ISC rate of 7 per cent for 2003, rather than the current 7.8 per cent. This constitutes a reduction of 10 per cent. In addition, the Executive Director also proposes a 10 percent reduction in PSA expenditure from 1 January 2003 (see paragraph 74) of the report.

7. In paragraphs 66-74 of the report, the Executive Director, using the current ISC rate of 7.8 per cent and the tonnage at the approved budgeted level of 5.471 million mt, concludes that for 2002-2003 the potential PSA shortfall would amount to $30 million. To fund this shortfall, an ISC rate of 9.1 per cent would be required. By reducing the ISC rate to 7 per cent, effective January 2003, the shortfall would amount to $39 million. Reducing the rate

to 7 per cent and PSA by ten percent, effective as of the same date, would give rise to a shortfall of $28.5 million (see conclusion 15 and paragraph 167).

8. In paragraph 168, the Executive Director states, "these potential shortfalls could be offset by an increase in volume." In this connection, the Advisory Committee notes that the proposed rate reduction is based on the assumption of an expected revised contribution of 6.4 million mt at an average direct cost of $417 per metric ton (see table 13). Upon enquiry, the Committee was informed that as of 31 August 2002, the level had reached 6.2 million mt based on pledges for Afghanistan and the Southern Africa region. However, in the opinion of the Advisory Committee, this increase in volume, which is attributable to specific situations, may not be a reliable indication of future volume over the long term.

9. In paragraph 168, the Executive Director states that shortfalls could also be partially offset by the reclassification of the variable elements of PSA expenditure to DSC that can be linked directly to an operation. Upon enquiry, the representatives of the Executive Director informed the Committee that the reclassification of the variable elements of PSA would be applied in the context of the preparation and implementation of the PSA budget for 2004-2005, but not for the 2003 portion of the 2002-2003 budget. In this connection, the Committee recommends that, in the context of the preparation of the 2004-2005 PSA budget on a zero basis, a rigorous examination be made with a view towards setting clear criteria for determining elements for PSA expenditure in field offices.

10. The Advisory Committee notes that the Executive Director is proposing to use accrued interest income to fund the shortfall of $40.1 million shown for the biennium 2000-2001 (see table 1). The Advisory Committee cautions that interest income in future bienniums may not be of sufficient magnitude to significantly offset future shortfalls.

11. On the basis of the information contained in the report of the Executive Director, and the testimony of his representatives, the Committee has concluded that the proposed reduction of the ISC rate is not based on the outcome of the analysis. The analysis has not determined that the rate of 7.8 per cent has produced more income than is needed to finance the PSA. Indeed, the information in the report shows that, traditionally, ISC rates have led to shortfalls in income. (See conclusion 9.) Over the last three biennia this shortfall has in fact accumulated to $92.1 million, including the $40.1 million for the audited accounts for 2000-2001 (see table 8). These shortfalls would not be eliminated even by changing from cash to accrual income recognition since, as the study indicates, PSA shortfall would continue as a result of changes in volume of commodity and related prices. Moreover, the comments of the Advisory Committee in paragraphs 8 and 10 above underline the inherent uncertainties of volume and income projections.

12. The management of PSA shortfalls is dealt with in paragraphs 76-88 of the report. The Executive Director proposes the establishment of an equalization account and the use of interest income to address the shortfalls. The Committee was informed that the equalization account would operate starting with the biennium 2002-2003. The Committee recommends that, in the forthcoming discussion of resource and long term financing (R&LTF) policies for WFP, the merits and implications of using miscellaneous income, PSA surpluses and/or interest income to eliminate shortfalls or reduce proposed ISC rates be fully explored, with a view towards establishing formal definitive guidelines on these matters.

13. Upon enquiry, the representatives of the Executive Director informed the Committee that the donor community had been made aware and did not object to the proposed rate and PSA reductions. In this connection, the Committee draws attention to the fact that the concept of full support cost recovery has underlined the discussion of resource and long term financing policies for WFP for several years. The Committee is of the view that this

concept should cover income, not only to finance direct support costs, but also income to finance PSA. This should also be taken into account in the discussion referred to in paragraph 12 above.

14. Furthermore, in order to address the current problems, government counterpart cash contributions (GCCC) could be treated as miscellaneous income and attempts should be made to provide the value of contribution in kind using appropriate criteria. To this end, the Committee recommends that the experience of the United Nations Secretariat be explored (See also part IX and annex V of the Advisory Committee's report A/52/860).

15. After its recent review of several external audit reports of the United Nations and other funds and programmes, the Committee is aware of the changing financial position of many of the latter. In the opinion of the Committee, the increase in pledges for 2003, referred to in paragraph 8 above, may or may not be replicated in the forthcoming biennium. The Committee recommends, therefore, that WFP ensure that "fixed" costs budgeted for PSA and DSC field offices, including contractual arrangements for staff costs, contain adequate flexibility to accommodate, at minimum cost, changes in operations and programme delivery. The Committee requests that the Executive Director include information on this matter in his proposed budget for 2004-2005.

Audited Biennial Accounts (2000-2001)

16. The Committee notes that the submission regarding the audited biennial accounts for the biennium 2000-2001 is presented in five documents or sections (WFP/EB.3/2002/5-A/1/1 to 5). Their late receipt, as mentioned in paragraph 2 above, hindered the adequate examination by the Committee of these reports. In order to facilitate future review, the Committee recommends that, subject to the prerogative of the external auditor to determine the content and form of his report to the Executive Board, consideration be given by the external auditor and the WFP administration to streamlining the presentation of these reports. In the first place, the Executive Director should consider combining the information contained in section I (the report of the Executive Director) with that in section V (the progress report on implementation of the recommendations made by the External Auditor). To this end, the Committee is of the view, consistent with the principle of separation of responsibilities and roles, that the Executive Director should avoid summarizing the content of the Board's report and related opinion (see for example Section I).

17. The Committee is of the opinion that the external auditor may wish to consider eliminating from his long-form report (Section III) much of the material related to the process by which findings and recommendations have been arrived at. The opinion of the External Auditor (contained in Section II) could be integrated into the latter.

18. The Advisory Committee notes that External Auditor has rendered an unqualified opinion on the financial statements and related notes, setting out the financial position of the Programme and the results of operations for the biennium ended 31 December 2001. The Committee commends the external auditor for the recommendations he has submitted and for the priorities and timelines he has specified. Moreover, the Committee trusts that the format in table 1 (Section III) would facilitate the evaluation by the external auditor, of action taken to implement these recommendations. In this connection, the Committee notes that some of the recommendations, such as that in paragraph 64, on income recognition, and paragraphs 65-71, on PSA expenditure and the recovery rate of 7.8 per cent, are addressed in the Executive Director's report on the analysis of the ISC rate (WFP/EB.3/2002/5-C/1). See also the Committee's comments in paragraphs 8-15 above.

19. The Committee notes, from paragraph 67 of the External Auditor's report, that some country offices "had no choice other than to charge some of their PSA related expenses like rental and utilities to direct support costs or other direct operational costs". It emphasizes the importance of the observation of the external auditor for WFP to "define in a more precise and realistic manner, the expenditures that are of PSA nature" (see paragraph 68 of the report).

20. The Committee also notes the comments by the External Auditor, in paragraphs 24 and 27, as to the little progress achieved towards an efficient and effective management of government counterpart cash contributions (GCCC), and its constituting a minor source of funding to the PSA budget. As indicated in paragraph 56, an amount of $3 million was generated from GCCC for the biennium 2000-2001. Moreover, in kind contributions by host governments are not at present accounted for and contributions in cash are recorded as income only upon actual receipt. The Committee is of the view that a different approach should be adopted in the treatment of this income in order to avoid incurring costs not commensurate with the level of amounts collected (see paragraphs 14-15 above).

21. The Committee expresses concern at the delay in evaluating the decentralization process, initially planned for mid-2001 (paragraph 208) and now rescheduled for May 2003 (paragraph 210). Upon enquiry, the Committee was informed that the three African bureaus in Kampala, Yaounde and Dakar would be reconfigured. In view of this, the Committee recommends expediting the evaluation.

22. In the opinion of the external auditor, WFP has achieved its original objective of improving its overall financial management by successfully deploying WFP's Information Network and Global System (WINGS). The deployment of WINGS has resulted in changes in such areas as programming, procurement, transport, LTSH, resource mobilization, human resources, payroll, financial and accounting, while providing such benefits as greater transparency, accountability, and access to managers to real time information, thus facilitating decision making (see also paras. 4-6 of Annex III of WFP/EB.3/2002/5-B/1).

23. The Committee notes from paragraph 260 and table 11 of Section III of the Audited Biennial Accounts reports that the overall costs of the Financial Management and Improvement Programme (FMIP) would amount to $46.9 million, compared to the initial $28.5 million ceiling. The bulk of overall costs is represented by the WINGS component, which amounted to $32.5 million or 70 per cent of the total. Upon enquiry, the Committee was informed that, as of June 2002, WINGS had been deployed in 12 offices accounting for 60 per cent of WFP's operations.

24. The Committee trusts that steps will be taken to deploy WINGS to more country offices in order for WFP to maximize management and operational efficiencies that could facilitate considerably such activities as evaluation of decentralization, preparation of PSA budgets on zero basis, results measurement and a more accurate determination of elements that are more appropriate for PSA and DSC expenditure. To this end, the Committee emphasizes the importance of staff training, adequate help-desk support, provision of appropriate resources for maintenance and for regular upgrading of the system, in keeping with changes in technology. The Committee recommends that information on these matters be provided in the context of the PSA budget proposals for 2004-2005.

Balances of Closed Projects

WFP's Cash Balances

25. The report on the balances of closed projects (WFP/EB.3/2002/5-E/1) completes the review and establishes the financial balances of closed projects migrated to WINGS in January 2001 and presents the steps undertaken to facilitate the operational and financial closures of those projects with completion dates in 1999, 2000 and 2001. The Committee takes note of the information provided and looks forward to the submission of the final outcome of these exercises.

26. The Committee notes that WFP's aggregate cash balances, for the period 1996-2001, total $905 million (see table 1 of WFP/EB.3/2002/5-D/1). Of this total, $579.3 million correspond to cash relating to projects: cash collected for the different programme categories, bilateral operations and trust funds. An amount of $325.7 million corresponds to non-project related cash: long term loans, staff benefits fund, monetization funds held in country offices, outstanding obligations and accounts payable, unearmaked surplus of the General Fund, and special accounts. The breakdown of these balances is shown in tables 2 and 3.

27. According to the Executive Director, the cash balances not relating to projects "should always be kept on hand for specific purposes and not for direct operational requirements unless subsequently reprogrammed by the Executive Director or the donor concerned" (see Executive Summary). For operational purposes, the Executive Director indicates that at least three months' disbursement of $253 million is required.

28. The Committee is of the opinion that the above operational balances appear excessive and may point, inter alia, to problems related to planning, programming, implementation and monitoring, including timely consultation with donors on the disposition of project balances. The Committee notes the action proposed by the Executive Director and trusts that, with the deployment of WINGS, it will be possible for WFP to increase operational efficiency and to monitor more accurately income and expenditure. The Committee requests that the results of the action taken be reported in the context of the proposed budget for 2004-2005, including proposals on the most realistic cash balances for operational activities.

Report on Budgetary Performance

29. The Committee welcomes the inclusion of the recommendations made by the Advisory Committee in its report on WFP's Report on Budgetary Performance, 1998-1999 and WFP's Biennial Budget, 2002-2003.

30. The Committee notes from tables 2 and 3 that the actual volume delivered by the Programme in 2000-2001 amounted to 7.031 million tons, representing an increase of 36.1 per cent compared to the original budget and of 13.7 per cent over actual deliveries in 1998-1999. As indicated in paragraph 10 of the report, this was due to a large donation of commodities, not included in the original projections, from the largest donor. The EMOP category (Emergency Operations Programme) registered the highest level of operation and number of beneficiaries, with most of the tonnage delivered to Africa and Asia. The value of operations amounted to US$ 3,190 million, representing an increase of 16.3 per cent over the original budget estimates and 9.3 per cent over the 1998-1999 actual expenditure level.

31. Total support costs amounted to $606.5 million, of which $235.9 million was for PSA expenditure, including $6.3 million for FMIP, and $370.6 million for DSC expenditures. The Committee notes that with the revision of the level of operations, the biennial PSA budget was adjusted to $244.7 million – an increase of 27.6 per cent compared to the recosted budget of $191.7 million. The 37.5 per cent increase in DSC, compared with the biennium 1998-1999, is mostly due to the shifting of country office costs from PSA to DSC, with the implementation of RLTF. The PSA gap between income and expenditures amounts to $40.1 million (see paragraph 8 above).

32. The Advisory Committee recommends that the Executive Board take note of the Executive Director's report on budgetary performance for the biennium 2000-2001 (WFP/EB.3/2002/5-B/1/Corr.1).