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FINANCE COMMITTEE

Hundred and Fifty-third Session

Rome, 12 - 14 May 2014

Financial Framework Review

Queries on the substantive content of this document may be addressed to:

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EXECUTIVE SUMMARY

- Following the implementation of the previous phase of the Financial Framework Review in November 2013, WFP's financial structure now supports the range of food assistance tools implemented by the organization: food, cash and voucher transfers, and capacity development. The next phase of the Financial Framework Review (2014–2016) is a continuation of WFP's efforts to shape financial systems that are 'Fit for Purpose' and aligned to WFP's operational requirements. The review will focus on three components that seek to: i) increase predictability of resources; ii) improve flexibility through a review of WFP's funds management structure; and iii) improve accountability of planning and cost management.
- In connection with the first component of the Financial Framework Review, the document reviews the current structure of the Working Capital Financing Facility. This was established in 2005 to advance funds to operations on the basis of forecasted contributions and reduce the time for food assistance to reach beneficiaries. Over the years, the scope of the Working Capital Financing Facility has been expanded, and it currently supports three distinct financing instruments: i) internal lending for project operations through Traditional Advance Financing; ii) Global Commodity Management through the Forward Purchase Facility; and iii) corporate services financing.
- The current ceiling of the Working Capital Financing Facility is USD 607 million, and to mitigate risks it is backed by the operational reserve of USD 101 million (i.e. through a leverage factor of 6 to 1). As such, Traditional Advance Financing for projects and corporate services currently have a combined ceiling of USD 257 million, while the Forward Purchase Facility has a ceiling of USD 350 million.
- High demand for operational advances presents additional urgency for the review and proposed restructuring of WFP's Working Capital Financing Facility. During the past 12 months, WFP had responded to multiple Level 3 Corporate Emergencies, including the Syrian crisis, the Philippines typhoon response, and emergency relief for conflict-affected populations in South Sudan and Central African Republic. The current structure fails to provide the sufficient flexibility required for WFP to respond efficiently and effectively to new emergencies and other operations within the annual programme of work.
- In order to maximize the utilization and efficiency of advance financing instruments, the Secretariat proposes to separate the Forward Purchase Facility (to be renamed Global Commodity Management Facility) and advances for corporate services from the Working Capital Financing Facility. Moreover, funds used for forward purchase of commodities involve minimal risk as the action entails an asset swap from cash to food commodities. Corporate services financing is also backed by assets or utilizes a repayment scheme and has minimal associated risks. The Secretariat proposes that a small reserve be established to manage unforeseen losses from forward purchasing which cannot be covered by insurance, and to use the Programme Support and Administrative Equalization Account as a safety net of last resort for extraordinary losses incurred through corporate services financing.
- Segregation of these instruments will preserve WFP's low-risk approach to working capital management. Proposed revisions to the Working Capital Financing Facility and the operational reserve will also increase the level of transparency of each of the underlying financial instruments, and increase the organization's capabilities to extend project lending.

GUIDANCE SOUGHT FROM THE FINANCE COMMITTEE

- The Finance Committee is requested to take note of WFP's Financial Framework Review document and recommend it for approval by the Executive Board.

Draft Advice

- **In accordance with Article XIV of the General Regulations of WFP, the FAO Finance Committee advises the WFP Executive Board to approve the draft decisions as outlined in the document "Financial Framework Review".**

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FINANCIAL FRAMEWORK REVIEW

**Restructuring of the Working Capital
Financing Facility**

NOTE TO THE EXECUTIVE BOARD

This document is submitted to the Executive Board for approval.

The Secretariat invites members of the Board who may have questions of a technical nature with regard to this document to contact the WFP staff focal points indicated below, preferably well in advance of the Board's meeting.

Assistant Executive Director and Chief Financial Officer, RM*: Mr M. Juneja tel.: 066513-2885

Acting Director, RMF**: Mr R. van der Zee tel.: 066513-2544

Should you have any questions regarding availability of documentation for the Executive Board, please contact the Conference Servicing Unit (tel.: 066513-2645).

* Resource Management and Accountability Department

** Finance and Treasury Division

EXECUTIVE SUMMARY

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In connection with the first component of the Financial Framework Review, the document reviews the current structure of the Working Capital Financing Facility. This was established in 2005 to advance funds to operations on the basis of forecasted contributions and reduce the time for food assistance to reach beneficiaries. Over the years, the scope of the Working Capital Financing Facility has been expanded, and it currently supports three distinct financing instruments: i) internal lending for project operations through Traditional Advance Financing; ii) Global Commodity Management through the Forward Purchase Facility; and iii) corporate services financing.

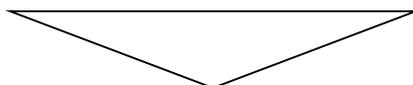
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High demand for operational advances presents additional urgency for the review and proposed restructuring of WFP's Working Capital Financing Facility. During the past 12 months, WFP had responded to multiple Level 3 Corporate Emergencies, including the Syrian crisis, the Philippines typhoon response, and emergency relief for conflict-affected populations in South Sudan and Central African Republic. The current structure fails to provide the sufficient flexibility required for WFP to respond efficiently and effectively to new emergencies and other operations within the annual programme of work.

In order to maximize the utilization and efficiency of advance financing instruments, the Secretariat proposes to separate the Forward Purchase Facility (to be renamed Global Commodity Management Facility) and advances for corporate services from the Working Capital Financing Facility. Moreover, funds used for forward purchase of commodities involve minimal risk as the action entails an asset swap from cash to food commodities. Corporate services financing is also backed by assets or utilizes a repayment scheme and has minimal associated risks. The Secretariat proposes that a small reserve be established to manage unforeseen losses from forward purchasing which cannot be covered by insurance, and to use the Programme Support and Administrative Equalization Account as a safety net of last resort for extraordinary losses incurred through corporate services financing.

Segregation of these instruments will preserve WFP's low-risk approach to working capital management. Proposed revisions to the Working Capital Financing Facility and the operational reserve will also increase the level of transparency of each of the underlying financial instruments, and increase the organization's capabilities to extend project lending.

DRAFT DECISION*



The Board takes note of “Financial Framework Review” (WFP/EB.A/2014/6-D/1) building upon the findings of the external review of WFP's Working Capital Financing Facility and the consultative process on the way forward with the Secretariat. The Board:

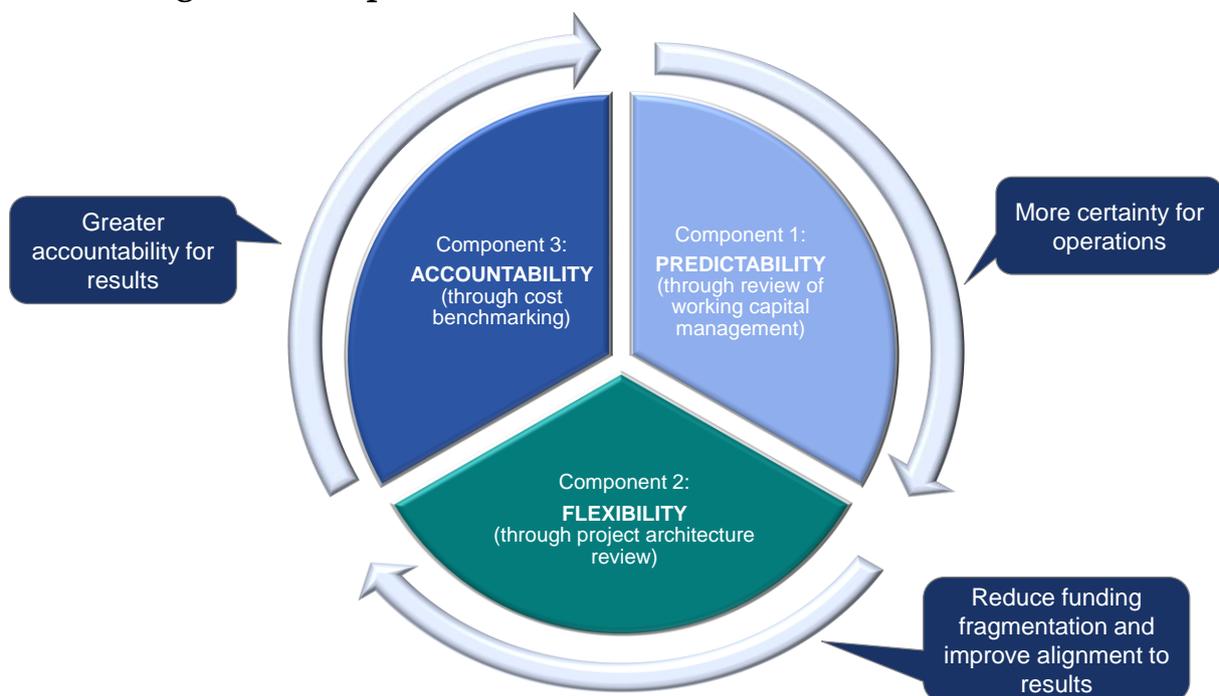
- i) welcomes the comprehensive approach to the financial framework review;
- ii) approves the separation of the Forward Purchase Facility and corporate services advances from the Working Capital Financing Facility;
- iii) approves the establishment of a reserve for the Global Commodity Management Facility and the transfer of USD 6 million from the operational reserve to the newly established Global Commodity Management Facility Reserve;
- iv) approves the ceiling of USD 570 million for the Working Capital Financing Facility to be used for internal lending for project operations;
- v) approves a ceiling of USD 350 million for the Global Commodity Management Facility;
- vi) approves a ceiling of USD 70 million for corporate services advances for 2014 and looks forward to reviewing this regularly as part of future Management Plans;
- vii) takes note of the intent to use the Programme Support and Administrative Equalization Account as a reserve of last resort for corporate services advances; and
- viii) looks forward to further discussions on the Financial Framework Review as outlined in this document.

* This is a draft decision. For the final decision adopted by the Board, please refer to the Decisions and Recommendations document issued at the end of the session.

INTRODUCTION

1. The previous phase of the Financial Framework Review was undertaken with the support of the Board¹ to ensure that WFP's financial architecture fully supported current and future Strategic Plans, including new operational modalities such as cash and voucher transfers and targeted capacity development activities. This phase was implemented by the end of 2013 and updated WFP's project structure and direct support costs (DSC) funding model. This facilitates planning, management and expending of WFP's food assistance operations using three high-level categories: food, cash and voucher transfers, and capacity development. This will help make WFP more transparent in its financial management, and serve as the foundation for giving staff the tools needed to manage operations with greater accountability.
2. The next phase of the Financial Framework Review continues WFP's efforts to provide financial systems that are 'Fit for Purpose' in line with the Executive Director's organizational strengthening initiative. The review is comprised of the following three components:
 - Component 1: Increasing predictability in resources for country offices;
 - Component 2: Improving flexibility by reviewing and refining WFP's funds management structure;
 - Component 3: Improving accountability of planning and cost management through the development of a country office cost benchmarking framework and tool kit.

Figure 1: Components of the Financial Framework Review



¹ "Financial Framework Review Options" WFP/EB.A/2010/6-E/1

3. WFP will seek to improve the overall management and efficiency of WFP's resources through the various components of the review. Proposed activities include:
 - Within Component 1 (predictability), review of WFP's Working Capital Financing Facility (WCFF) with a view to achieve greater predictability in resources for WFP country offices to improve planning and efficiency.
 - Within Component 2 (flexibility), conduct a comprehensive review of WFP's funds management structure to:
 - i) identify gaps and challenges within the current framework;
 - ii) assess opportunities to increase flexibility of resource management; and
 - iii) implement solutions that improve operational planning and resource management, while strengthening WFP's integrated platforms for financial management, reporting and analysis.
 - Within Component 3 (accountability), develop a country cost benchmarking framework to provide WFP country offices with data analysis tools and key performance indicators to enhance accountability in the management of operations and provide the basis for improving data quality and accuracy; development of management dashboards, building upon existing corporate platforms, to improve planning and accountability of resources.
4. The Financial Framework Review will continue to strengthen and align WFP's financial structure with operational requirements with a view to maximize WFP's resource accountability. The review is also a platform for WFP to seek to improve cost comparability among United Nations agencies in conjunction with the project architecture review and in line with the Quadrennial Comprehensive Policy Review (QCPR) recommendations to identify opportunities for cost harmonization.
5. This document will focus on the first component and will seek to ensure that WFP's WCFF is adapted and utilized efficiently and effectively to support WFP's operations. Additional components of the Financial Framework Review outlined above will be presented at a later stage and are subject to resource availability.

OVERVIEW OF WFP'S WORKING CAPITAL FINANCING FACILITY

6. The WCFF was established in 2005² to advance funds to operations on the basis of forecasted contributions. The facility is used to reduce the time for food assistance to reach beneficiaries. Over the years, the scope of the WCFF has been expanded, and it currently supports: i) internal lending for project operations through Traditional Advance Financing; ii) global commodity management through the Forward Purchase Facility; and iii) corporate services financing.
7. The current ceiling of the WCFF is USD 607 million, and to mitigate risks it is backed by the operational reserve of USD 101 million (i.e. through a leverage factor of 6 to 1). As such, Traditional Advance Financing for projects and corporate services currently has a combined ceiling of USD 257 million, while the Forward Purchase Facility (FPF) has a ceiling of USD 350 million.

² WFP/EB.1/2005/5-C

8. At the First Regular Session of the Executive Board and during informal consultations in 2014, proposals for maximizing the efficiencies of the WCFF were discussed as part of an ongoing consultative process to increase value for money through increased funding certainty for WFP's operations. The Board expressed its overall support for the review, and requested additional information including on associated risks.
9. To support management response to the Board's request for further elaboration and analysis of the WCFF and proposals for the way forward, an external assessment of the WCFF was conducted by the Boston Consulting Group on a pro-bono basis. The review underscored that the current advance financing model serves three distinct financing requirements: internal project lending, global commodity management and corporate services financing, each with distinct and unrelated risks. Figure 2 outlines WFP's current advance financing framework through the WCFF and the Immediate Response Account.

Figure 2: WFP's current internal financing framework

Mechanisms		Benefits	Ceiling USD million	Leverage factor	Reserve USD million
Project Lending	Immediate Response Account (IRA)	<ul style="list-style-type: none"> Immediate assistance in life-saving situations 	Up to 70	1:1	Up to 70
	Traditional Advance Financing (TAF)	<ul style="list-style-type: none"> Loans to projects with forecasted contributions as collateral 	607	6:1	101
Global Commodity Management	Forward Purchase Facility (FPF)	<ul style="list-style-type: none"> Food purchasing in advance of requests from projects 			
Corporate Services Financing	Corporate Services (CS)	<ul style="list-style-type: none"> Advance financing for corporate services such as vehicle purchases 			

10. The current ceiling of the WCFF is USD 607 million. At present, Traditional Advance Financing and corporate services utilize USD 257 million of the WCFF, with USD 350 million earmarked for the FPF. The Secretariat proposes the following modifications to the structure of the Working Capital Financing Facility:

- Removal of the FPF and corporate services tools from the WCFF;
- Allocation of USD 6 million from the operational reserve, currently USD 101 million, for the creation of a dedicated FPF reserve (to be entitled Global Commodity Management Facility Reserve) to mitigate food commodity losses;
- Establish a ceiling of USD 350 million for the FPF which would be renamed to Global Commodity Management Facility;
- Establish a ceiling of USD 70 million for corporate services financing to be reviewed annually as part of the Management Plan;

- Establish an internal project lending ceiling for operations of USD 570 million, to be backed by the USD 95 million remaining in the operational reserve (i.e. maintaining the current leverage factor of 6:1).
11. The following sections synthesize the findings of management and the Boston Consulting Group's review of the WCFF. They provide additional analysis and a verification of the risks associated with each tool, as well as the mitigation measures in place to support the implementation of the draft decisions to maximize the efficiency and effectiveness of these instruments for WFP's operations.

REVIEW OF INTERNAL PROJECT LENDING FOR WFP OPERATIONS

Overview

12. WFP's internal financing tools are fundamental for addressing the challenges WFP faces as a voluntarily funded organization. Traditional Advance Financing within the WCFF provides WFP operations with enhanced predictability for resource management by facilitating lending to projects in advance of confirmed contributions from donors. As contributions are received by the organization, operational advances are recovered and revolved. Advances are guaranteed by the operational reserve, which is the safety net of last resort in case an operational advance cannot be recovered from donor contributions.
13. Forecasts are categorized as high, medium or low probability depending on informal and formal announcements from donors, political developments within countries and on donor trends. Currently only forecasts that are considered as medium probability or high probability can qualify as collateral for advance financing. Once a forecast is classified and approved for financing, advance requests may be authorized at 50 percent for medium probability forecasts or 75 percent for high probability forecasts upon receipt and scrutiny of the advance request. An operational advance is repaid when a contribution is confirmed.
14. The current ceiling for Traditional Advance Financing stands at USD 207 million, an amount that is some 45 percent below the available ceiling before 2010. The main reason for the reduction was the USD 150 million earmarked from the WCFF in 2010 to provide for the expansion of the FPF. Since 2005, approximately USD 3 billion has been advanced.
15. From mid-2013 to mid-2014, high levels of demand for internal project lending have strained WFP's capability to provide Traditional Advance Financing to projects. With the current WCFF structure, the unused balance for project lending has rarely exceeded USD 50 million over this period. During this period, WFP had responded to multiple Level 3 Corporate Emergencies, including the Syrian crisis, the Philippines typhoon, and emergency relief for conflict-affected populations in South Sudan and Central African Republic. The current structure of the WCFF fails to provide the flexibility required for WFP to respond efficiently and effectively to new emergencies and support to other operations within the annual programme of work.

Risk Management

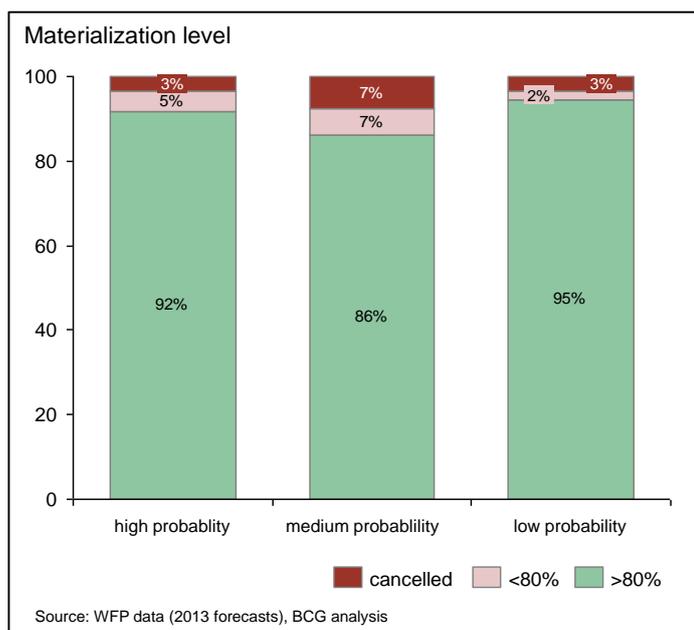
16. The key risk associated with Traditional Advance Financing is the reduction in value or the non-realization of a forecasted contribution.
17. WFP has a thorough approval process for project lending to ensure financial risks are minimized. Each forecast is prudently developed in order to classify the possible contribution as low, medium, or high probability.

18. In the case where a forecasted contribution did not materialize or is only partially realized, clear lines of defence are in place. New materialized forecasts can be used to recover the advance to the project.
19. As a last resort, funds can be drawn from the operational reserve in order to repay an operational advance.

WFP's Low-Risk Approach to Project Lending

20. A thorough assessment of WFP's financing mechanisms was undertaken by The Boston Consulting Group (BCG) to evaluate WFP's current project lending practices. It concluded that current lending has extremely low risk. Only one default of USD 5.9 million has been observed since the mechanism was established in 2004.³
21. An analysis of 2013 forecasted contributions was undertaken to better understand the rate and value of materialized contributions. Most forecasted contributions materialize at a rate above 80 percent (Figure 3), irrespective of whether they are high, medium or low probability forecasts. The analysis further reveals that 2–7 percent of all forecasted contributions materialize at a value of less than 80 percent of the original forecast value, while 3–7 percent of all forecasted contributions do not materialize.

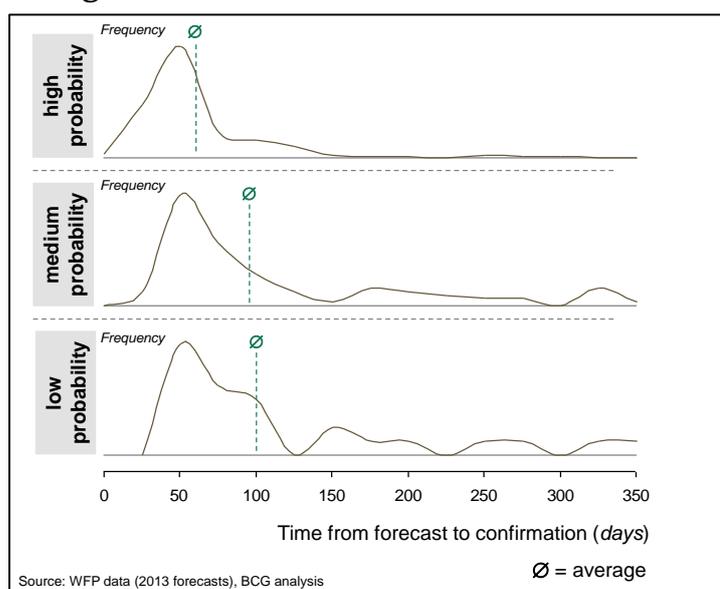
Figure 3: Materialization of forecasted contributions



22. The principal distinction between the forecasts is that high probability contributions materialize an average of 58 days from the time the forecast is recorded (Figure 4). Medium and low probability contributions are realized over a longer period, approximately 100 days from the time the forecast is recorded.

³ Project lending in the amount of USD 5.9 million was not recovered from a protracted relief and recovery operation in the Democratic Republic of the Congo in 2005.

Figure 4: Average time from forecast to confirmation (in days)



23. In 2013, approximately 43 percent of WFP's total contributions were forecasted as high (20 percent), medium (15 percent) or low (8 percent), with other contributions such as in-kind support, multilateral undirected and non-forecasted contributions totalling 57 percent. With 75 percent and 50 percent of high- and medium- probability forecasts (respectively) available for project lending, approximately 22 percent⁴ of 2013 contributions were available for advances ahead of formal confirmation of donor contributions.
24. The Boston Consulting Group further noted WFP's conservative approach to leveraging the operational reserve. The analysis has determined that the current leverage factor of 6:1 could be increased to 10:1. However, management has concluded that a more conservative leverage factor and correspondingly higher operational reserve, consistent with the current leverage factor of 6:1, would provide, for the time being, a more prudent safety net for internal project lending for operations.
25. Given the nature of low, medium and high probability forecasts as described above, the external review recommends, and management agrees, that project lending could be further extended by initially increasing lending against forecasts up to an average of 80 percent of all categories of forecasted contributions.
26. While the external review recommends an internal lending ceiling of USD 600 million will more fully meet project needs for more predictable funding, management has concluded that a more conservative ceiling of USD 570 million will, for the time being, optimize, on the one hand, effectiveness of operations and, on the other hand, risk management of the facility. Management further recommends that such internal lending could be backed by an operational reserve of USD 95.2 million (i.e. consistent with the current leverage factor of 6:1). Management will continue to pursue more dynamic risk management measures and improved forecasting mechanisms to expand the scope and amount of internal project lending to The Boston Consulting Group's recommended levels.

⁴ Approximately 10 percent of forecasted contributions are ineligible for traditional advance financing due to donor restrictions.

REVIEW OF GLOBAL COMMODITY MANAGEMENT

Overview

27. WFP's global commodity management tool, the Forward Purchase Facility, was established within the WCFF as a special account to enable food purchases in advance of requests from projects.⁵ WFP maintains food inventories in continuous supply lines for pre-determined geographic zones to reduce delivery lead times. Inventories are replenished based on aggregate historical demand trends and resource projections. The use of FPF commodities has, on average in 2013, reduced food delivery response times by about two and a half months, or nearly 75 percent of total lead time.
28. In 2013, approximately 955,000 mt of food was purchased using this approach. More than 30 country offices purchased 873,000 mt from the FPF inventory and an average supply line of about 342,000 mt was maintained throughout the year.

Risk Management

29. The external review identified the financial risks associated with the global commodity management component of the WCFF. The two key risks identified were:
- risk of purchased quantities exceeding demand; and
 - other operational factors, including risk of damage/expiry, adverse weather conditions, infestation, inadequate quality, etc.
30. The review noted that WFP's demand forecasting and planning has improved in recent years due to the implementation of refined global pipeline management tools and the implementation of an industry-standard forecasting and planning system incorporated into the WFP Information Network and Global System II (WINGS II) (SAP). Due to these improvements and consultations with industry experts, WFP has maintained advance commodity purchases aligned with actual demand. WFP's demand forecasting, which is done at an aggregated level, further compensates for variations in food requirements or funding at specific country office project level.
31. Regarding operational risks, The Boston Consulting Group found that minimal operational losses can be achieved as a result of good warehouse conditions, comprehensive transport guidelines and quality assurances embedded in food procurement contracts.
32. Food losses of FPF stock due to operational risks are a small percentage of total FPF purchases from 2011–2014. Over this period, total insured food losses within FPF have been less than 0.1 percent per year or 2,055 mt. Uninsured losses are less than 0.3 percent or 6,033 mt.
33. No FPF food commodity losses were incurred due to poor demand planning over this same period. The Boston Consulting Group found that good demand management practices are in place in WFP, including accurate demand planning based on global pipeline management tools and resources.
34. WFP also uses a self-insurance scheme to protect against food losses from damaged, losses (spoiled food) or theft up to the point of entry into a country. Most FPF risks due to operational factors are therefore covered by self-insurance. The review recommended that WFP's self-insurance for FPF stocks be extended, facilitating full coverage of commodities

⁵ As outlined in WFP/EB.1/2014/4-A/1

and mitigating all risk associated with this working capital management tool. This would ensure that commodities are covered in all instances either through external (supplier, transporter) or self-insured schemes, thus obviating the need for any reserve to cover rendered losses.

35. WFP is currently undergoing a global self-insurance policy review. This comprehensive review is aimed at streamlining all self-insurance policies throughout WFP operations to strengthen risk mitigation and will also include a review of the self-insurance policy for FPF.
36. Purchase of FPF commodities entails an asset swap of cash balances for food commodities. Purchases are made using WFP's available corporate resources (cash), which are transferred for a tangible asset until food is "sold" to a country office. Following the "sale" to a project, cash is replenished and funds revolve.
37. The Secretariat agrees with The Boston Consulting Group's conclusions that the FPF entails negligible issues as a result of sufficient risk mitigation mechanisms in place. However, self-insurance does not yet cover all potential losses. The Secretariat therefore proposes to separate the FPF from the WCFE and create a dedicated Global Commodity Management Facility reserve of USD 6 million serve as an additional safety net for losses that may fall outside the insurance coverage. The dedicated reserve will be funded by the operational reserve.
38. The ceiling of the Global Commodity Management Facility will be maintained at USD 350 million and reviewed regularly in line with operational requirements and in consultation with the Board.

REVIEW OF CORPORATE SERVICES FINANCING

Overview

39. The corporate services financing mechanism within the WCFE enables WFP to implement corporate initiatives of larger scale that improve efficiencies and realize cost savings over a period of time. The investments are repaid to the corporate services financing allocation through the use of the service, where cost recovery or service fee is implemented for purposes of repayment.
40. Within corporate services there are presently three different types of financing:
 - i) the Global Vehicle Leasing Programme (GVLP), which is essentially a revolving credit line;
 - ii) the Capital Budgeting Facility that provides for large long-term investments such as the Logistics Execution Support System (LESS); and
 - iii) fee-for-service activities, including advances paid for information technology (IT) services and staff security, which are normally recovered within the year.

Risk Management

41. The identified risks associated with advance financing for corporate services include:
 - loss of assets;
 - long-term benefits fail to materialize; and
 - limited funding at project level results in inability to satisfy cost-recovery schemes.

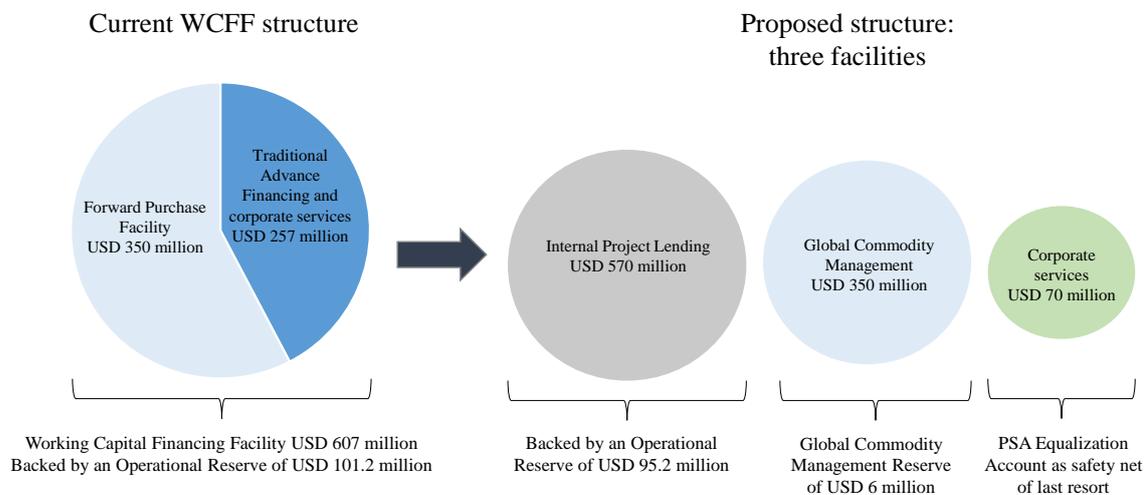
42. The risk factor of corporate service projects is low as all current uses have cost-recovery schemes in place. WFP alleviates risk for GVLP through a Self-Insurance Scheme (SIS). When any vehicle is leased from GVLP by a country office, an SIS invoice is automatically issued for insurance. The SIS premiums are used to pay out claims for damaged vehicles and cover administrative costs.
43. As part of the Capital Budgeting Facility, future benefits of all long-term investments advanced are carefully reviewed and an appropriate cost-recovery methodology is established. This newly established facility presently has USD 6.7 million outstanding, with a cost-recovery system in place to begin recovering funds in the near future.
44. Advances given to other special accounts are also repaid through quarterly and annual cost-recovery schemes and have a similar repayment model as that applied to the Capital Budgeting Facility. To date, WFP has not defaulted on advances paid for IT and staff security.
45. Corporate Services Financing activities are guaranteed by corporate assets or cost-recovery schemes, and given the low-risk nature of corporate services, the external review noted that a dedicated reserve is not required for this instrument.
46. The Secretariat therefore proposes that the corporate services financing activities be separated from the WCFE with an established ceiling of USD 70 million, based on the current scope of the three types of corporate services, to be reviewed annually. Close monitoring of repayment performance is established and is proposed to be included as part of the Management Plan process in consultation with the Board.
47. In the unlikely event that expenditures incurred for corporate services cannot be repaid, the Programme Support and Administrative Equalization Account (PSAEA), which is the reserve available to fund activities as directed by the Board,⁶ is proposed as a safety net of last resort. This would be considered an extraordinary case and the Secretariat would seek the authorization of the Board for this type of repayment.

Conclusions

48. Drawing upon the findings of the external review, the Secretariat proposes the adoption of the draft decision to improve the efficiency, effectiveness and transparency of its advance financing and working capital instruments, ensuring in particular that project lending capabilities are maximized to provide timely and sufficient resources for WFP's operations in advance of a confirmed contribution. The proposed structure is summarized in Figure 5 below.

⁶ As outlined in WFP/EB.A/2006/6-C/1 and updated in WFP/EB.A/2011/6-A/1, the PSA budget consists of indirect support costs (ISC) revenue received from operations for approved PSA expenses. At the end of the year, the surplus of ISC revenue over PSA expenses is transferred to the PSA Equalization Account in order to establish a reserve to fund activities approved by the Executive Board. Uses of the PSA Equalization Account reserve are generally limited to support costs, including capital and capacity development costs, or transfers to the Immediate Response Account.

Figure 5: Current and proposed structures of WFP's working capital instruments



49. The Secretariat, in consultation and coordination with the Board, will seek to maintain a conservative approach to project lending and the management of its internal project lending and corporate commodity management instruments.
50. The Secretariat will continue to consult with the Board and provide formal and informal updates on the progress of the Financial Framework Review.

ANNEX**FINANCIAL FRAMEWORK REVIEW (2014–2016)****Background and Current Challenges**

1. The voluntary nature of resourcing for country operations is a fundamental aspect underpinning WFP's efforts to maximize the efficiency, effectiveness and transparency of WFP's financial architecture. Limitations on the predictability of available resources and the flexibility of funds management impact the delivery of food assistance activities to beneficiaries and operational planning in many country offices. This can result in uncertainties in budgeting and incurred expenditures, and further impact the delivery of assistance for the beneficiaries WFP serves.
2. In order to ensure WFP's financial architecture remains updated and supports the evolving requirements of humanitarian and development operations globally, WFP with the support of its Board conducted a number of reviews of its financial framework in recent years. The reviews have led to several important changes that have increased operational flexibility and transparency in managing resources. Key changes include adjustments to WFP's cost-recovery model, establishment and expansion of internal lending mechanisms to facilitate immediate emergency response, among others. In 2013, WFP updated the financial structure of operations to facilitate more detailed project planning and management of operations by segregating commodity and non-commodity interventions within the project structure. This has helped to increase transparency and accountability of resource utilization.
3. While these initiatives have greatly improved WFP's effectiveness and transparency during WFP's transition from food aid to food assistance, additional work is needed in order to ensure that WFP's financial framework is 'Fit for Purpose' and can support evolving operational and donor requirements. As WFP continues to update and improve its tool kit for emergency, recovery and development activities, the organization's financial architecture must also be refined to update and refine finance policy, integrate corporate systems and support country offices in the implementation of operations.

Overall Objectives

4. The next phase of the Financial Framework Review continues WFP's efforts to provide financial systems that are in line with the Executive Director's organizational strengthening initiative. The review will seek to update WFP's financial architecture and is comprised of the following three components:
 - Component 1: Increasing predictability in resources for country offices;
 - Component 2: Improving flexibility by reviewing and refining WFP's funds management structure;
 - Component 3: Improving accountability of planning and cost management through the development of a country office cost benchmarking framework and tool kit.

Harmonization of Financial Tools with Corporate Information Systems

5. In recent years, WFP has implemented a number of changes to embed accountability and transparency into the organization. Some key changes include:
 - Expansion of Cost Components: The cost components used to plan, monitor and report on costs were recently expanded to include the type of intervention (food, cash and

vouchers, or capacity development and augmentation), improving the transparency and accuracy of costing data.

- Modification of the direct support cost funding recovery model: The direct support cost funding recovery model was recently modified to use a percentage of direct operational costs rather than rate per metric ton, helping to improve the transparency and comparability of support costs.
 - Logistics Execution Support System (LESS): LESS is a tool for supply-chain management, inventory accounting and real-time tracking. It is already being used in Sierra Leone and Liberia and will be rolled out to additional offices, replacing the legacy COMPAS system and improving integration between the inventory tracking and financial data.
 - Country Office Monitoring and Evaluation Tool (COMET): The implementation module of COMET is currently being piloted and will help country offices to plan food assistance and beneficiary coverage with partners, track progress and report on actual outputs and outcomes. It will help to strengthen the link between resources and results.
6. As part of the Financial Framework Review, WFP will continue to align its financial systems and underlying policy frameworks to meet operational requirements. Linkages with corporate information platforms including data warehouses will be identified and strengthened in coordination with WFP management and the Board in order to define organizational priorities for costing operational aspects to improve performance measurement and management results.

Component 1: Increasing Predictability in Resources for Country Offices

7. In anticipation of Board approval of the restructuring of WFP's Working Capital Financing Facility, the Secretariat will continue to work towards refining business processes, guidelines and systems solutions to facilitate the management of these tools. WFP will also continue to update the Board on the utilization of each mechanism and further proposed enhancements to WFP's advance financing and working capital management instruments through established consultative channels.

Component 2: Improving Flexibility by Reviewing and Refining WFP's Funds Management Structure

8. WFP is also working to identify ways in which to improve the management of WFP's resources. Currently, operational resources are managed at the project level, with many countries implementing multiple projects. The review will assess WFP's current funds management structure and seek to identify ways in which the management and utilization of resources can be improved, while providing increased flexibility to country offices.
9. Outcomes of the funds management review will seek to provide:
- increased decision-making authority to country offices over operational budgets;
 - increased flexibility in utilization of available funds, improving timing of expenditures and reducing unspent balances;
 - improved transparency through enhanced tracking of implementation costs;
 - integration of WFP's financial architecture with ongoing corporate initiatives to improve performance management, commodity accounting, business continuity management and the enhanced integration of WFP's food assistance tool kit; and

- standardization/harmonization of funds management practices.
10. Changes to the structure that require Board decision will be presented for consideration and approval following a comprehensive consultation process.

Component 3: Improving Accountability of Planning and Cost Management through the Development of a Country Office Cost Benchmarking Framework and Tool Kit.

11. As part of this component, WFP will examine a country cost benchmarking framework in order to better understand the cost drivers throughout the operational life-cycle and to strengthen accountability over funds' usage, in particular over costs. It is anticipated that the framework will:
- improve the transparency of programme support and delivery costs;
 - strengthen the link between resources and results;
 - facilitate where possible the replication of successful cost control measures; and
 - strengthen accountability over resources at country office level.
12. The primary focus of the framework is to improve WFP's internal cost accountability. It is further recognized that comparability among United Nations agencies is important, and in conjunction with Component 2, the cost benchmarking methodology will include a review of QCPR recommendations on cost harmonization to consider opportunities to make WFP more comparable with other agencies, funds and programmes. Further, WFP's cost benchmarking framework will be developed in close coordination with activities of Component 2 (flexibility) to ensure that any proposals to increase flexibility are linked to greater cost accountability.

Country Office Consultation

13. An important part of the scoping and development of each component will include consultation with stakeholders, particularly country offices, to provide technical and programmatic input to the Financial Framework Review process. Consultation with functional areas and regional bureaux will also seek to address current challenges in WFP's financial architecture that are faced regularly in the implementation of operations and oversight capacities.

Expected Results

14. The Financial Framework Review is expected to increase the efficiency and cost transparency of WFP's work by improving financial processes, strengthening the funds management structure and enhancing overall accountability of resources. Through a comprehensive review of financial policy, procedures and supporting corporate systems, WFP will:
- increase the efficiency and effectiveness of internal lending, capital financing and pipeline management instruments to strengthen the level of resource predictability at country office level to support operational response;
 - improve resource management and utilization with the implementation of an enhanced operational structure that supports evolving operational and donor requirements while aiming to provide flexibility to country offices; and

- increase visibility of costs at country office level to identify efficiency gaps, monitor performance and implement cost-saving measures to improve accountability and maximize value for money.
15. Progress on the components of the Financial Framework Review will be consulted and presented to the Board, including on related proposals to improve resource, financial and budgetary frameworks under Board authority, as well as proposed amendments to the WFP General Regulations and General Rules, Financial Regulations, and Financial Rules as applicable.
 16. WFP will also consult with donors throughout the project with a view to incorporate feedback and best practices in funds management to guide the work of the review. Extra-budgetary resources required to implement activities will also be presented.

ACRONYMS USED IN THE DOCUMENT

BCG	The Boston Consulting Group
FPF	Forward Purchase Facility
GVL	Global Vehicle Leasing Programme
ISC	indirect support costs
IT	information technology
LESS	Logistics Execution Support System
PSA	Programme Support and Administrative
PSAEA	PSA Equalization Account
QCPR	Quadrennial Comprehensive Policy Review
SIS	Self-Insurance Scheme
WCFF	Working Capital Financing Facility
WINGS II	WFP Information Network and Global System II