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Organisation internationale pour les migrations (OIM)  
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**WORKING GROUP ON BUDGET REFORM**

**REVIEW OF THE DISCRETIONARY INCOME PROJECTION**

**AND RESERVE MECHANISM**

## **REVIEW OF THE DISCRETIONARY INCOME PROJECTION AND RESERVE MECHANISM**

### **Background**

1. The Organization's core structure is funded by Member States' assessed contributions and also by Discretionary Income, which is composed of project-related overhead and miscellaneous income. While the assessed contributions of Member States have been relatively static, Discretionary Income has increased significantly with the growth of the Organization and now supports over 50 per cent of the core structure. Unlike assessed contributions, Discretionary Income is by its nature a fluctuating amount, affected heavily by the level of operational activities which in turn determines the amount of project-related overhead. Given its fluctuating nature and its importance to the sustainability of the core structure, considerable effort has been devoted to predicting and estimating the level of Discretionary Income to be used in setting the annual budget.
2. In 2009, Member States endorsed the Discretionary Income projection and reserve mechanism (hereinafter referred to as "the mechanism") in an effort to enhance the predictability and transparency of estimating the level of Discretionary Income. The mechanism mandated that the budget would be based on an average of the three previous years' Discretionary Income. To the extent future budgets underestimated the actual level of Discretionary Income, the resultant surpluses would be set aside in a reserve up to a maximum of USD 10 million. Conversely, if future budgets overestimated the actual Discretionary Income, the reserve would be drawn upon to cover any budget shortfall. The mechanism would be reviewed after the first three years of operation when there would be an opportunity to modify the model if the financial management of IOM were hampered.
3. As 2012 is the appointed time for the three-year review, and within the framework of the ongoing budget reform discussions, the Administration seeks an examination of the provisions of the mechanism with a view to making its application more flexible and practical. The Administration believes that the mechanism can be modified to provide greater flexibility in the use of Discretionary Income, which would assist the Organization in addressing its core budgetary needs without increasing the financial burden on Member States.
4. At the 7 March 2012 meeting of the Working Group on Budget Reform, the need for a review of the mechanism was acknowledged. It was agreed that the Administration would submit a document summarizing its recommendations at the next Working Group meeting.
5. The Administration presented its review and recommendations at the subsequent meeting of the Working Group on Budget Reform on 18 April. There was a discussion on various aspects of the mechanism, and the Administration responded to a number of questions. One question was raised about the extent to which the annual budget should be allowed to vary from the three-year average formula, and it was agreed that the annual budget would remain within a 10 per cent range of variation in either direction of the three-year average. In response to questions about the proposed reduction in the reserve, the Administration explained that the proposed reduction in the reserve from 10 to 5 million would be accomplished gradually in stages over a period of up to four years as described in paragraph 17. One delegation suggested that the review and recommendations be shared with the external auditors for comment, and the Administration undertook to do so. Also, some further descriptive wording was agreed to be included in paragraph 18. Subject to these modifications, the review of the mechanism was

endorsed by the Working Group, and it was agreed that the document including the recommendations be submitted to the SCPF in May 2012.

6. Subsequent to the 18 April meeting of the Working Group, the Administration received the requested feedback from the External Auditors, who noted that the recommendations included in this paper, including the adjustments to the three-year average formula and the proposed reserve reduction, seemed reasonable.

7. This document represents the original review of the Discretionary Income and Reserve Mechanism as prepared by the Administration, and then subsequently modified to include the changes agreed at the Working Group meeting on 18 April. The recommendations proposed in this paper under paragraph 14 have been incorporated in section VI of the “Resolution on Budget Processes and Mechanisms” included in SCPF/83, “Proposed Revision and Consolidation of Resolutions and Mechanisms guiding the Budget Process”.

### **Analysis of the mechanism’s three-year history**

8. The financial results of the mechanism over the past three years from 2009 through 2011 are outlined in the annex. During this period, the budget significantly underestimated the actual level of Discretionary Income. Consistent with the Organization’s growth, which generated significant increases in project-related overhead income, the actual Discretionary Income grew rapidly over the period, far exceeding the mechanism’s historically based budget estimates which were based on a previous and therefore lower Discretionary Income level. This resulted in large surpluses, which, as per the mechanism’s rules, were set aside until the reserve balance reached USD 10 million. As of December 2011, the reserve balance was USD 10,603,441, slightly above the mandated USD 10 million and representing the cumulative sum of the unused surpluses.

9. While the mechanism’s historically based budget estimates were effective in rapidly building the reserve, they had a detrimental effect on the Organization’s core structure. Given the mechanism’s exclusive reliance on past history, it was not able to take into account IOM’s growth over the intervening period, causing the budget to severely lag behind the increase in the Organization’s size and level of activities. Owing to the lagging budget, the core structure was constrained at a time when it needed to be strengthened to support the demands of the expanding programme base. Unable to draw on additional resources, support units found themselves challenged by the increase in operations, often suffering lapses in service. To cite one example, the Office of Legal Affairs became overwhelmed with a large backlog of contracts, substantially delaying the implementation of key projects. The only alternative, other than additional resources, would be to reduce the number of contracts that are subject to legal review, thereby avoiding delays, but increasing the financial risk faced by the Organization. There are similar problems in a number of other units, affecting various aspects of programme delivery and management.

10. Some of the delays and inefficiencies could have been avoided if the Organization had been able to set the budget at a higher and more realistic level rather than accumulating unused surpluses in the reserve. While a reserve of over USD 10 million was accumulated in only three years’ time, this came at a price, which was to limit the capacity of the core structure to keep pace with the growth of the Organization. The rapid build-up of the reserve at the expense of the core structure had a negative impact on the Organization’s ability to respond to growing migration demands and Member States’ needs.

## **Improving the mechanism**

11. The Administration proposes to improve the mechanism to better support the Organization's core structure, while maintaining a modest reserve to address budget shortfalls. Specifically, it is proposed that the mechanism be refined to produce a more consistent and reliable budget projection, thus substantially reducing the likelihood of a future deficit, and hence the need for such a large reserve. IOM has had success in this regard, as during the decade before the inception of the mechanism in 2009, which was also a growth period, the Organization incurred no deficits without maintaining any reserve.

12. To better project the level of Discretionary Income and the level of activities, the annual budget should be set using the mechanism's three-year average formula as a baseline/starting point, but should additionally take into account the following considerations:

- (a) Trend analysis: Rather than relying on a simple three-year average, budget estimates should analyse current trends and their influence on future projections. For example, during a growth trend, or conversely during a downtrend, greater weight should be given to the most recent year or period, as it offers a closer reflection of the work currently being undertaken by the Organization, as well as the core structure needed to support it.
- (b) Major programme changes: Major programme changes have a significant effect on budget estimates and should be taken into account in establishing the budget level. Budget estimates should be increased for large new projects, and then reduced when large projects come to a close.
- (c) General economic environment: Changes in the global economic environment should be considered, as a number of IOM's programmes are influenced by these conditions. A number of donors have indicated that their level of voluntary contributions fluctuates based on the general economic conditions in their countries.
- (d) Inputs from the Field Office network: As the Organization's annual budget is developed using a bottom-up approach with data and inputs from every Country Office, indications from the network of Field Offices during the yearly budget exercise should be taken into account.
- (e) Current migration patterns: Changes in migration patterns may potentially affect certain areas of the Organization's work, and should be factored into the projections.
- (f) Possibility of a mid-year adjustment: The Organization reviews progress versus budget on an ongoing basis during the year and submits a mid-year budget revision to the Standing Committee on Programmes and Finance each May. In the rare event of a sudden change in circumstances, it is therefore possible to make a mid-year adjustment to further mitigate the risk of a wide budget variation or deficit.

The above factors, if applied as supplementary review considerations to the baseline three-year average, would significantly reduce the possibility of a budget shortfall, and consequently the need for a large reserve. We believe the reserve could be safely reduced from USD 10 million to USD 5 million.

## **Proposed revisions to the mechanism**

13. As recommended by the Drafting Group on Budget Reform, it is proposed that the terminology for "Discretionary Income" be changed to "operational support income", and the

mechanism's title to "the operational support income projection and reserve mechanism", to reflect the use of these funds to support the core structure.

14. To facilitate the management of the mechanism and assist with core funding needs, the Administration sees two areas where increased flexibility would be beneficial:

- (a) The annual Discretionary Income budget level should be set using the mechanism's three-year average formula as a "baseline/starting point" and adjusted according to the considerations under paragraph 12 in order to establish a more realistic estimate. As subsequently agreed at the Working Group meeting on 18 April 2012, the Administration further agreed that the annual budget level would remain within a 10 per cent range of variation in either direction of the three-year average.
- (b) If paragraph 14(a) above is implemented, then the reserve balance can be safely reduced from USD 10 million to USD 5 million, which the Administration believes would be sufficient to finance any budget shortfall.

15. These changes would enable the Organization to strengthen services critical to the efficient running of the Organization, while retaining the transparency afforded by the mechanism. Any surpluses in actual operational support income would continue to be reported to Member States while maintaining the reserve balance of USD 5 million. Through the annual budget exercise, the Administration would submit for the approval of Member States proposals on the use of surpluses in excess of USD 5 million.

16. As the reserve is presently at a level of USD 10,603,441 (at December 2011), if these changes to the mechanism are accepted, it will be necessary to propose a use for the current excess over USD 5 million, which is USD 5,603,441. As these funds would have been used to strengthen the core structure had they been available when needed, we recommend that they be used for that purpose going forward.

17. Regarding the USD 5,603,441, the Administration proposes to identify a number of needed posts and other related costs in the functions and services most affected by the Organization's growth, and to use this amount to fund these expenditures for a period of up to four years until they can be covered from other funding sources, such as future budget increases resulting from assessed contributions from new Member States. We believe the drawdown of these funds in stages over a multi-year period will address immediate needs, while ensuring an appropriate level of sustainability. The funds will remain in the reserve until such time as they are utilized, resulting in a gradual decline in the reserve balance over a multi-year period.

18. The Administration has highlighted over the years in the annual Programme and Budget that key areas in the Organization need strengthening, including important functions in both the headquarters and field. If the proposed changes to the mechanism are approved at the Standing Committee on Programmes and Finance in May 2012, concrete proposals on the use of the USD 5,603,441 over a multi-year period would be presented to Member States for their consideration on an annual basis commencing with the 2013 Programme and Budget to be presented in the fall of 2012.

19. The proposed changes are in line with the initial thinking behind the establishment of the mechanism, and would ensure a good balance between the original purpose of the mechanism to promote greater predictability and transparency in budget preparation and the need to preserve and maintain a viable core structure.

<b>Annex: Analysis of Discretionary Income from 2009 to 2011 – Budget versus actual, and tracking the reserve balance</b>									
	<b>2009</b>			<b>2010</b>			<b>2011</b>		
	<b>Budget USD</b>	<b>Actuals USD</b>	<b>Variance USD</b>	<b>Budget USD</b>	<b>Actuals USD</b>	<b>Variance USD</b>	<b>Budget USD</b>	<b>Actuals USD</b>	<b>Variance USD</b>
<b>Sources</b>									
General overhead	25 031 000	29 304 156	(4 273 156)	26 700 000	36 844 420	(10 144 420)	28 600 000	39 893 952	(11 293 952)
Overhead to cover staff security	6 300 000	7 224 221	(924 221)	6 300 000	8 793 237	(2 493 237)	6 800 000	9 816 621	(3 016 621)
Unearmarked contributions	2 669 000	2 344 000	325 000	2 821 000	2 290 480	530 520	2 729 000	2 167 022	561 978
Interest income and other	5 000 000	5 443 937	(443 937)	5 179 000	4 199 469	979 531	5 571 000	5 979 538	(408 538)
Brought forward from previous year	2 000 000	2 000 000							
<b>Total income</b>	<b>41 000 000</b>	<b>46 316 314</b>	<b>(5 316 314)</b>	<b>41 000 000</b>	<b>52 127 606</b>	<b>(11 127 606)</b>	<b>43 700 000</b>	<b>57 857 133</b>	<b>(14 157 133)</b>
<b>Application</b>									
Staff security	6 300 000	7 224 221	(924 221)	6 300 000	8 793 237	(2 493 237)	6 800 000	9 816 621	(3 016 621)
IOM Development Fund – Line 1	1 400 000	1 400 000		1 400 000	1 400 000		1 400 000	1 400 000	
IOM Development Fund – Line 2	3 050 000	4 148 023	(1 098 023)	3 550 000	5 089 949	(1 539 949)	4 100 000	6 746 560	(2 646 560)
Unbudgeted activities and structures	500 000	1 584 166	(1 084 166)	600 000	3 373 296	(2 773 296)	500 000	1 624 298	(1 124 298)
Core structure	29 750 000	30 950 624	(1 200 624)	29 150 000	30 296 867	(1 146 867)	30 900 000	31 951 212	(1 051 212)
<b>Total expenditure</b>	<b>41 000 000</b>	<b>45 307 034</b>	<b>(4 307 034)</b>	<b>41 000 000</b>	<b>48 953 349</b>	<b>(7 953 349)</b>	<b>43 700 000</b>	<b>51 538 691</b>	<b>(7 838 691)</b>
<b>Increase in Discretionary Income reserve</b>	<b>(a) – (b)</b>	<b>1 009 280</b>	<b>(1 009 280)</b>	<b>3 174 257</b>	<b>(3 174 257)</b>		<b>6 318 442</b>	<b>(6 318 442)</b>	
Discretionary income reserve brought forward			(101 462)		(1 110 742)			(4 284 999)	
<b>Total Discretionary Income reserve</b>			<b>(1 110 742)</b>		<b>(4 284 999)</b>			<b>(10 603 441)</b>	