

WORKING GROUP ON BUDGET REFORM

27 February 2018

REVISED PROPOSALS TO UPDATE THE REGULATIONS:

OPERATIONAL SUPPORT INCOME RESERVE AND CONTINGENCY RESERVE

REVISED PROPOSALS TO UPDATE THE REGULATIONS: OPERATIONAL SUPPORT INCOME RESERVE AND CONTINGENCY RESERVE

Background

1. At the last meeting of the Working Group on Budget Reform, held on 24 October 2017, the Administration presented document WG/BR/2017/7 containing possible proposals to update IOM budget resolutions and regulations. It was noted that a review of the budget regulations had been foreseen in the Working Group's new terms of reference, and that the Working Group had last updated the regulations five years previously, in a comprehensive review approved in Executive Committee Resolution No. 134 of 3 July 2012 on budget processes and mechanisms. The regulations needed updating to reflect how IOM had evolved and grown, and to provide more flexibility, where possible.

2. During the meeting, proposals for changes to the Operational Support Income (OSI) projection and reserve mechanism and the contingency reserve were discussed. The present document addresses the comments made and provides further information on the OSI reserve and the contingency reserve, and the proposed changes to the texts governing these reserves for consideration by the Working Group. It should be noted that any changes to the regulations would require endorsement by the Standing Committee on Programmes and Finance and approval by the Council.

3. Regarding the OSI reserve, which has a balance of USD 33 million, the Working Group requested clarification on the methodology used to determine the appropriate balance and the criteria proposed to guide the use of the funds. The discussions underlined that any use of the funds should be strategic in nature.

4. The Administration explained that the advantage of establishing the minimum balance as a percentage of the previous year's expenditure instead of a fixed monetary amount was that it would make it possible to adapt to changing dynamics in the operations and management structure of the Organization, which was particularly important in view of the projectized nature of the Organization and the continuous growth experienced in recent years. The proposal suggested the minimum level as the higher amount of either 1 per cent of the total expenses of the previous year or 10 per cent of the core structure, meaning that the level of the reserve would be adjusted as the variables evolved. It was noted that the purpose of the OSI reserve was to mitigate risk, which should be kept in mind when establishing a minimum threshold.

5. The proposal to transfer the balance of the contingency reserve into the OSI reserve was discussed and some delegates requested clarification on whether the objectives of both reserves were similar. It was explained that the contingency reserve, which currently had a balance of USD 1 million, had been established in 1959 to help mitigate risk, but had not been used since its establishment. The Administration observed that its purpose was very similar to that of the OSI reserve.

Operational Support Income reserve

6. The OSI reserve mechanism is described in section VI of Resolution No. 134. The mechanism was established to address the issue of how to ensure the funding of the relatively fixed cost of the core structure using a fluctuating income source, OSI, which is principally derived from the project overhead income. Each year, the budget for the core structure is prepared based on the projected level of OSI. As the precise amount of OSI is not known in advance, care is taken to establish a conservative projection by evaluating the latest costs and trends. As a consequence of the approach taken, the actual income has consistently exceeded the budget and the resultant surplus is added to

the OSI reserve. In a year in which the actual income fell short of the budget, the shortfall would be deducted from the reserve.

7. Section VI of Resolution No. 134 needs to be revised as the conditions described therein are outdated. Specifically, changes are recommended to paragraph 1 and subparagraph 3(g), and it is proposed that new text be added, namely new subparagraph 3(h) and paragraph 4. The complete proposed revision of section VI is set out in Annex I of the present document, and a discussion of the main changes is provided below.

Proposed changes

8. Paragraph 1 describes the methodology for projecting the OSI budget level. The text specifies that the average of the three previous years should be the baseline/starting point for the budget projection. However, this historically based and backward-looking calculation is not suited to the IOM environment, where the financial situation is constantly changing. The calculation obviously could not predict the significant increases in OSI levels which subsequently resulted from the growth of the IOM project portfolio and the decision made by the Council in November 2013 to increase the project overhead rate from 5 to 7 per cent. These events significantly changed circumstances from one year to the next, thus making it impossible to rely upon the trends from the previous three years to project future budget levels. As only the result of the previous year can be considered to have much value in making projections in such a rapidly changing environment, an update to the text of paragraph 1 is being proposed to make the previous year the starting point, with consideration given to current and expected trends, including significant new projects or changes to existing projects, as follows:

Original text (paragraph 1)

1. The Operational Support Income budget level will use as a baseline/starting point the average of the results of the previous three years as derived from the Organization's financial reports and budget documents. The budget level must remain within a 10 percent range of variation in either direction of the three-year average.

Proposed text

1. The Operational Support Income budget level will use as a baseline/starting point the previous year's actual result as derived from the Organization's financial reports and budget documents. Current and expected trends, including significant new projects or changes to existing projects, will be considered in projecting the budgeted level.

9. The proposed change would produce more realistic OSI projections based on transparent considerations of previous year's results and assessment of current trends. While the three-year average offered predictability, it did not take into account the evolving migration trends that have an impact on the work of the Organization. This has led to the accumulation of large balances in the reserve. If approved, the suggested approach would be used to establish the budget level each year, which would be presented, with appropriate justification, to Member States for their approval as part of the budget approval process.

10. In line with the proposal, it is also suggested that references to the "three-year average" be deleted in subparagraphs 3(d) and 3(f) (see Annex I).

11. In subparagraph 3(g), the constraints on the level of the OSI reserve are described. The text specifies that the reserve should not exceed USD 5 million, which, in light of the large increases in the reserve since that text was adopted, is no longer a reflection of the current situation. When the

Working Group first discussed this topic in 2011, the reserve had a balance at the prior year end of just over USD 4 million; however, the balance then rose rapidly until it reached USD 33 million as at 31 December 2016. The increase from 2009 to 2016 is shown below. The closure of the accounts for the financial year 2017 had not been finalized at the time of preparing the present document, but preliminary results indicate that the balance of the reserve will increase with additional surplus.

OSI reserve balance, as at 31 December (in USD)

2009	1 110 742
2010	4 284 999
2011	10 603 441
2012	13 813 770
2013	13 509 971
2014	22 305 616
2015	25 008 537
2016	33 175 898

12. It should be noted that IOM grew significantly over the intervening period as the Organization increased its membership, project activities, staffing and funding. With this expansion comes associated increased financial risks. It is therefore a welcome fact that the reserve has also grown, as the larger balance can help mitigate the risks associated with the Organization's extended global footprint. Given that the Organization can be expected to evolve and expand further in the coming years, the text needs to be revised to remove any constraints based on a fixed amount which could easily become outdated, in favour of a minimum requirement based on a moving scale that can be adjusted according to the evolving size and footprint of the Organization. Thus, the Administration recommends that the text be updated as shown below:

Original text (subparagraph 3(g))

- (g) The level of the Operational Support Income reserve will be maintained at a maximum of USD 5 million. The Administration will put forward proposals to the Member States for the utilization from the reserve that is in excess of USD 5 million;

Proposed text

- (g) The Operational Support Income reserve will be maintained at a level which is above the higher of 1 per cent of the Organization's total expenditures or 10 per cent of the core structure expenditures, as reported for the prior year as at 31 December; the Administration will put forward proposals to the Member States in the annual budget or its revisions for the utilization of funds from the reserve that exceed the figure established by these criteria;

13. As the primary purpose of the OSI reserve is to help ensure the funding of the core structure, the above text proposes that the threshold calculation be a percentage of the annual cost of that core structure. It is also proposed that a measure of the Organization's growth be included in that calculation, either as 1 per cent of total expenditures or 10 per cent of the core structure, whichever is higher, as the capacity of the core structure is heavily influenced by the Organization's total expenditures. In 2016, 1 per cent of total expenditure was USD 16 million and between 2014 and 2016 it averaged USD 15.5 million. In 2016, 10 per cent of the budgeted core structure was USD 11.3 million and the average between 2014 and 2016 was USD 12.3 million. Using these criteria, the minimum balance for the OSI reserve would be USD 16 million. As a starting point, the Administration proposes a minimum balance of USD 16 million, which would be an adequate buffer for the core structure. This balance would be reviewed every three years to establish its adequacy.

14. The original text of subparagraph 3(g), while noting that the Administration could propose uses for the excess reserve balance, did not provide specific guidance on or criteria for such uses. To ensure the funds are used for strategic purposes, it is recommended that some criteria be established. The wording of additional subparagraph 3(h) could be as follows:

Proposed text (subparagraph 3(h))

- (h) Proposals for the use of the excess reserve balance will be strategic in nature, support the Organization's long-term objectives and therefore generally relate to:
- (i) strengthening core functions; (ii) supporting policy, capacity and coordination; or
 - (iii) the acquisition of capital assets, including property;

15. It should be noted that, by inserting the additional subparagraph proposed above, subparagraphs 3(h) and 3(i) of Resolution No. 134 would be renumbered as 3(i) and 3(j), respectively.

16. In light of the above, the Administration proposes that the difference of USD 17 175 898 between the balance of the reserve as at 31 December 2016 and the proposed minimum balance of USD 16 million be used broadly in the areas listed below, in accordance with the provisions of the new subparagraph 3(h) proposed above, and which would be strategic investments in the long-term interests of the Organization. Specific proposals will be presented for consideration by Member States in the following three areas:

- (a) Strengthening the core structure: With the growth of the Organization comes the need to strengthen the core structure to enhance, among other things, institutional coherence, operational capacity, and financial and administrative oversight.
- (b) Supporting policy, capacity and coordination: This relates to enhancing the Organization's long-term objectives, in areas such as knowledge management, policy and coordination capacity, and advocacy.
- (c) Acquisition of capital assets, including property: This relates to, for example, establishing criteria to acquire office buildings, given that rental costs continue to be a significant cost to the Organization, IT system enhancements or other strategic initiatives.

Contingency reserve

17. The contingency reserve is much smaller than the OSI reserve, but has a long history and has been the subject of five Council resolutions, adopted between 1959 and 1967, which are presented in Annex II of the present document. The balance of the contingency reserve has been unchanged since 1967, when the reserve was increased by USD 250,000 to its present level of USD 1 million through Council Resolution No. 413 of 17 November 1967. Resolution No. 413 also contains the most recent text to describe its use. Its operative paragraphs 3 and 4 read as follows:

Original text

- 3. That the Contingency Reserve be maintained as a reserve against unforeseen circumstances and against contingencies arising from the imbalance of movements between those covered adequately by government contributions and those not so covered;
- 4. That the Contingency Reserve may be used on approval of the Council or in case of emergency of the Executive Committee on the understanding that such action shall be reported to the next session of the Council;

Proposed changes

18. While the contingency reserve clearly has some value in mitigating risk, there is no reason for it to be separate from the much larger OSI reserve, which has the same function. Furthermore, the above text is outdated, as it was written well before the present projectized business model for IOM was introduced in 1993, and contains a reference to the now defunct Executive Committee. Therefore, the best and simplest solution would be to fold the contingency reserve into the much larger OSI reserve, thereby eliminating the overlapping purposes of the two reserves, and further increasing the capacity of the OSI reserve to fulfil its function. The contingency reserve, which was set up to address unforeseen contingencies, could be accommodated within the OSI reserve. To achieve this, it is recommended that an additional paragraph be added to the end of section VI of Resolution No. 134, as follows:

Proposed text

4. As the purposes of the Operational Support Income reserve and the contingency reserve overlap, and given that there is no reason for them to remain separate, the contingency reserve will be closed and the balance transferred to the Operational Support Income reserve.

Conclusion and next steps

19. The proposed revised text governing the OSI reserve and the contingency reserve mechanisms is set out in Annex I of the present document, and is presented to the Working Group on Budget Reform for its review and consideration. Following discussion and any additional modifications requested by the Working Group, and should the Working Group so decide, the revised text could be submitted, along with other proposed changes to the regulations to the Standing Committee on Programmes and Finance at its Twenty-second Session, for its review and endorsement.

Annex I

**Proposed revised text based on
section VI of Executive Committee Resolution No. 134 of 3 July 2012**
(proposed changes are underlined/struck)

OPERATIONAL SUPPORT INCOME PROJECTION AND RESERVE MECHANISM

1. The Operational Support Income budget level will use as a baseline/starting point the previous year's actual result as derived from the Organization's financial reports and budget documents. Current and expected trends, including significant new projects or changes to existing projects, will be considered in projecting the budgeted level.
2. If the actual Operational Support Income generated at the end of the Budget year is greater than the projection established, the difference will be applied as follows:
 - (a) The additional Operational Support Income will be applied towards Line 2 of the IOM Development Fund, Staff Security and unforeseen shortfalls;* and
 - (b) Any balance remaining thereafter will be transferred to the Operational Support Income reserve.
3. The following clarifications are intended to operationalize the Reserve Mechanism's implementation:
 - (a) The implementation of the Operational Support Income Projection and Reserve Mechanism will be in conformity with IOM's Financial Regulations and this resolution;
 - (b) Funding for the Staff Security mechanism and the IOM Development Fund will continue to be in line with paragraphs III.5 and IV.2 above, and there will not be any negative impact on the funding for these two items;
 - (c) The reserve will be credited with any surplus Operational Support Income available after:
 - (i) applying the above-mentioned rules for the IOM Development Fund and the Staff Security mechanism, as well as (ii) covering any unforeseen shortfalls during the year;
 - (d) As and when necessary, amounts available in the reserve will be applied to bridge the difference between the projected amount of Operational Support Income ~~using the average of the preceding three years as a baseline~~ and the actual amount generated, if the latter is lower than the projected amount;
 - (e) If the overall financial management of the Organization is hampered as a result of implementing the Reserve Mechanism, the Administration will bring it to the attention of Member States;
 - (f) Conscious that there may be years when the actual Operational Support Income in a given year and the funds in the reserve are not enough to cover the projected amount ~~using the three-year average baseline~~, the Administration will bring to the attention of Member States any potential shortfall, with a view to finding solutions in order to achieve a balanced budget;

* Unforeseen shortfalls include: (a) project deficits and frauds beyond the control of the Administration; (b) bridging funds for staff and office costs; and (c) unforeseen one-time, non-recurrent capital expenditure and other miscellaneous items that need to be covered.

- (g) The Operational Support Income reserve will be maintained at a level which is above the higher of 1 per cent of the Organization's total expenditures or 10 per cent of the core structure expenditures, as reported for the prior year as at 31 December; the Administration will put forward proposals to the Member States in the annual budget or its revisions for the utilization of funds from the reserve that exceed the figure established by these criteria;
 - (h) Proposals for the use of the excess reserve balance will be strategic in nature, support the Organization's long-term objectives and therefore generally relate to: (i) strengthening core functions; (ii) supporting policy, capacity and coordination; or (iii) the acquisition of capital assets, including property;
 - (i) The functioning of the Operational Support Income Projection and Reserve Mechanism will, in principle, be reviewed every three years by the Standing Committee on Programmes and Finance (SCPF) in order to make adjustments, if necessary;
 - (j) As with other reserves and accounts of the Organization, the External Auditors will review and report on the Operational Support Income reserve in the context of the audit of the financial statements of the Organization;
4. As the purposes of the Operational Support Income reserve and the contingency reserve overlap, and given that there is no reason for them to remain separate, the contingency reserve will be closed and the balance transferred to the Operational Support Income reserve.

Annex II

RESOLUTIONS RELATING TO THE CONTINGENCY RESERVE

- Council Resolution No. 195 of 16 November 1959 on use of the contingency reserve
- Council Resolution No. 207 of 11 May 1960 on use of the contingency reserve
- Council Resolution No. 313 of 13 May 1964 on use of the contingency reserve
- Council Resolution No. 314 of 14 May 1964 on resources available in the Far East and Miscellaneous Movements Programmes
- Council Resolution No. 413 of 17 November 1967 on transfer of the working capital for the European Programme of Refugee Movements to the contingency reserve

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ELEVENTH SESSION

RESOLUTION No. 195 (XI)

(Adopted by the Council at its 95th meeting on 16 November 1959)

USE OF THE CONTINGENCY RESERVE

The Council of the Intergovernmental Committee for European Migration,

Considering that in 1956-1957, in adopting the budgets and plans of expenditure for these years, the Council established a Contingency Reserve of \$500,000 for the purpose of meeting contingencies arising from the imbalance of movements between those covered adequately by government contributions and those not so covered, as set forth in paragraph 5 of the Report of the Working Party of December 1955;

and that income for those years was sufficient to enable the Council to set aside such funds, which have since been listed in the annual balance sheets; and

Considering further that the Director has reported to the Council that the situation foreseen by the Council in establishing the Contingency Reserve has arisen in 1959,

Resolves to authorize the Director to utilize the Contingency Reserve for this purpose in 1959 to the extent required and within the limits of the total of the Contingency Reserve.

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TWELFTH SESSION

RESOLUTION No. 207 (XII)

(Adopted by the Council at its 111th meeting on 11 May 1960)

USE OF THE CONTINGENCY RESERVE

The Council of the Intergovernmental Committee for European Migration,

Considering that in 1956-1957, in adopting the budgets and plans of expenditure for those years, the Council established a Contingency Reserve of \$500,000 for the purpose of meeting contingencies arising from a change in the ratio between movements which produce sufficient income to cover their costs and those which do not;

Considering further that under Resolution No. 195 (XI) the purpose of the fund was reiterated and the Director specifically authorized to utilize the Contingency Reserve in 1959 as necessary for the purposes outlined above;

Bearing in mind that the situation foreseen by the Council in establishing the Contingency Reserve may arise in 1960 or any succeeding year and that as a result the Director might not be able to meet expenditures,

Resolves to give the Director continuing authority to use the Contingency Reserve in 1960 and succeeding years to the extent required and within the limits of the funds therein to meet contingencies arising in Sections I, IV and V of the Budget, covering respectively the transport of national migrants, movements under voluntary agencies programmes and the transport of refugees, as a result of changes in the pattern of those movements.

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TWENTY-FIRST SESSION

RESOLUTION No. 313 (XXI)

(Adopted by the Council at its 186th meeting on 13 May 1964)

USE OF THE CONTINGENCY RESERVE

The Council of the Intergovernmental Committee for European Migration,

Noting the Report of the Sub-Committee on Budget and Finance at its Ninth Session (MC/652) and the Report of the Executive Committee at its Twenty-third Session (MC/654/Rev.1) with reference to the Contingency Reserve;

Considering the changes in circumstances affecting movements since the passage of Resolution No. 207 (XII),

Resolves that the Contingency Reserve be maintained as a reserve against unforeseen circumstances to be used to meet such emergencies on approval of the Council or in cases of extreme emergency when time does not permit by the Executive Committee on the understanding that such action shall be reported to the next session of the Council;

And that Resolution No. 207 (XII) be superseded accordingly.

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TWENTY-FIRST SESSION

RESOLUTION No. 314 (XXI)

(Adopted by the Council at its 188th meeting on 14 May 1964)

**RESOURCES AVAILABLE IN THE FAR EAST AND
MISCELLANEOUS MOVEMENTS PROGRAMMES**

The Council of the Intergovernmental Committee for European Migration,

Having examined the Report of the Executive Committee (MC/654/Rev.1);

Considering that under Resolution No. 61 an amount of \$900,000, being the balance of advance payments received from the International Refugee Organization for the transport overseas of a group of refugees from Europe, was transferred in 1957 from the European to the Far East and Miscellaneous Movements Programmes and that the resources presently remaining available for the Far East and Miscellaneous Movements Programmes exceed the requirements as currently estimated for its complete implementation,

Resolves to transfer from the unexpended funds under the Far East and Miscellaneous Movements Programmes the following amounts:

\$250,000 to the Contingency Reserve to be applied in an emergency by the Council or, if time does not permit, by the Executive Committee, to meet the costs of refugee movements exceeding the actual income available for such movements in any year, priority to be given to the requirements of the Far East Programme;

\$250,000 to be used as working capital for the European Programme of refugee movements provided that this amount will always be available at the end of the year to be carried over to the succeeding year.

TWENTY-EIGHTH SESSION

RESOLUTION No. 413 (XXVIII)

(Adopted by the Council at its 249th meeting on 17 November 1967)

**TRANSFER OF THE WORKING CAPITAL FOR THE EUROPEAN PROGRAMME
OF REFUGEE MOVEMENTS TO THE CONTINGENCY RESERVE**

The Council of the Intergovernmental Committee for European Migration,

Having received and considered the recommendations of the Sub-Committee on Budget and Finance (MC/851/Add.1/Rev.1) and of the Executive Committee (MC/857/Rev.1),

Decides:

1. To transfer the Working Capital for the European Programme of Refugee Movements, presently standing at \$250,000, to the Contingency Reserve which will then stand at \$1,000,000;
2. That Resolution No. 313 (XXI) relating to the Contingency Reserve and Resolutions Nos. 314 (XXI), 387 (XXVI) and 401 (XXVII) relating to the Working Capital for the European Programme of Refugee Movements are superseded by the text of the present Resolution;
3. That the Contingency Reserve be maintained as a reserve against unforeseen circumstances and against contingencies arising from the imbalance of movements between those covered adequately by government contributions and those not so covered;
4. That the Contingency Reserve may be used on approval of the Council or in case of emergency of the Executive Committee on the understanding that such action shall be reported to the next session of the Council;
5. That \$500,000 of the Contingency Reserve shall be set aside for use in the refugee programmes of the Committee, including the Far East Programme, the latter up to an amount of \$250,000.