

Program and Budget Committee

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POLICY ON RESERVES AND PRINCIPLES APPLIED IN RESPECT OF THE USE OF RESERVES

document prepared by the Secretariat

1. Having taken due note of the comments made by representatives of Member States at the meetings of the Program and Budget Committee (PBC) and the Assemblies in the course of their respective meetings in September and October 2009 with respect to the policy on the use of the Reserves, the Secretariat committed to preparing a document for consultations for the next regular session of the PBC.
2. Accordingly, this document provides (i) an overview of WIPO's Policy on Reserves, together with (ii) recommendations for consideration by the PBC for the principles and approval mechanism proposed for the use of reserves exceeding the required reserve target levels.
3. *The Program and Budget Committee is invited to recommend to the Assemblies of the Member States of WIPO to take note of WIPO's policy on reserves, and endorse the proposed recommendations for the principles and approval mechanism to be applied for the use of reserves as described in paragraphs 20-23 of the present document.*

[Policy on Reserves follows]

POLICY ON RESERVE AND PRINCIPLES APPLIED IN RESPECT OF THE USE OF RESERVES

I. INTRODUCTION

1. In financial and accounting terms, “reserves” can cover various concepts. For example:
 - “Reserves” can be created as a “special account” – e.g. funds set aside on a separate bank account, with special rules established for their use. Such accounts would be part of liquid assets on the balance sheet of an organization;
 - “Reserves” are also used to reflect provisions for future liabilities on the balance sheet of an organization;
 - “Reserves” can also be seen as part of retained earnings, set aside for a specified purpose and, hence, unavailable for disbursement as dividends; and finally
 - The accounting definition of “reserves” describes these as “Net Assets” or “Net Equity”, which is the difference between an organization’s total assets and total liabilities. In the case of companies, this is also known as owner’s equity, shareholder’s equity or the net worth of the company.
2. In WIPO’s case, Reserve funds are accounted for as the net assets of the Organization, i.e. the difference between total assets and total liabilities. WIPO’s Financial Regulations and Rules (FRR) define the two specific components of the Organization’s Reserves and Working Capital funds (RWCF) as follows:
 - “**Reserve funds**” shall mean funds established by the Assemblies of the Member States and of the Unions, each as far as it is concerned, in which surplus income from fees that exceed the amounts required to finance the program and budget appropriations should be deposited. Reserve funds shall be used in a manner decided by the Assemblies of the Member States and of the Unions, each as far as it is concerned (*Financial Rule 101.3 (n)*); and
 - “**Working capital funds**” shall mean funds established for providing advance financing of appropriations should there be a temporary liquidity shortfall and for such other purposes as the Assemblies of Member States and of the Unions, each as far as it is concerned, shall decide (*Financial Rule 101.3 (q) and Regulation 4.3*).
3. The Financial Regulations and Rules (FRR) of WIPO also reflect the ownership and the authority of the Paris, Berne, Madrid, Hague, IPC, Nice, PCT, Lisbon, Locarno and Vienna Unions in respect of the Organization’s Reserves and Working Capital Funds as follows.
 - If, after the closure of the financial period, any Union shows a surplus of income, such surplus shall be accounted for under the **reserve funds**, unless otherwise decided by the General Assembly or the Assembly of the Union concerned. (*Regulation 4.7*)
 - The **working capital funds** of the Organization and of the Paris, Berne, Madrid, Hague, IPC, Nice, PCT, Lisbon, Locarno and Vienna Unions shall be established in amounts to be determined by the Assemblies of the Member States and of the Unions, each as far as it is concerned. (*Regulation 4.2*)

II. WIPO'S POLICY ON RESERVES

4. In addition to the above, which provides a clear definition of the Organization's RWCF, WIPO has an explicit Policy on Reserves in place, adopted by Member States in the year 2000 (please refer to document A/35/15 and A/35/6), which sets out the level of required RWCF for the Organization, together with a number of other core policy considerations. This policy remains valid and forms a solid and relevant basis for the effective financial management of the Organization.
5. The core elements of the Policy on Reserves, which are further elaborated below, are the following.
 - WIPO maintains a clear separation between the Reserves and Working Capital Funds in accounting terms, while preserving the levels and ownership arrangements for the working capital funds;
 - The level of Reserves, including Working Capital Funds (RWCF), are defined at the level of Unions, on the basis of percentages of estimated biennial expenditure ("PBE factor") for each Union, and presented within the context of the Organization's budgetary process;
 - The requirements set out under Article 8(4) of the Madrid Agreement and Protocol in respect of the distribution of Madrid Union surpluses are to continue to be fully respected; and
 - The Director General retains the prerogative to propose for approval project activities funded from available surpluses.
6. It is noted that WIPO's Policy on Reserves does not explicitly set out any requirements related to liquidity. However, the proposed Policy on Investments (document WO/PBC/15/8) provides an overview of the approach taken in respect of the management of money not needed for immediate requirements. In accordance with Financial Rule 104.10 (b), these investments are to be made "in such a way as to place primary emphasis on minimizing the risk to principal funds while ensuring the liquidity necessary to meet the Organization's cash flow requirements". Information on the value and liquidity of the financial instruments held by the Organization are disclosed in the Financial Statements, in accordance with IPSAS 15¹.
7. The following section addresses each of the core elements of the Policy on Reserves in further detail.

II. (A) Separation of the Working Capital Funds

8. As noted above, the concept of Reserves and Working Capital Funds (RWCF) was introduced while maintaining the separation between reserve funds and working capital funds. Accordingly, the arrangements for the working capital funds continue to be that the assessed contributions through which working capital funds are financed are held in

¹ IPSAS 15 – FINANCIAL INSTRUMENTS: DISCLOSURE AND PRESENTATION: This standard (together with IAS 39 – Financial Instruments: Recognition and Measurement) entails criteria for recognizing financial instruments in the financial statements and the measurement of their carrying value (IAS 39). The Standard also covers information about factors that affect the amount, timing and certainty of future cash flows related to financial instruments; the nature and extent of the use of financial instruments; the financial purposes they serve; the risks associated with those financial instruments; and policies for controlling these risks (IPSAS 15).

trust by WIPO for the Member States of the respective Unions. The level of working capital funds is established by the individual treaty agreements of the respective unions concerned. Adjustments in the overall level of the RWCF are accordingly introduced by amending the level of the reserve funds only, without any adjustment to the level of working capital funds. At the time of their approval of the Policy on Reserves, Member States agreed also to the consolidation of the presentation of the working capital funds for the contribution-financed Unions in the Financial Management Report.

II. (B) Setting the Required (Target) Level of Reserves

9. The reserve and working capital funds serve to minimize the risk of deficits or liquidity problems exercising a negative effect on program delivery, to maximize the probability that the Organization can meet its obligations and to provide financial stability.
10. As noted in document A/35/6 of 2000 (the proposal for the Policy on Reserves), the “issue of financial risk can be elaborated further by distinguishing between income-related and expenditure-related risks. Income-related risks include the non-payment of contributions, lower than anticipated fee-income or exchange rate fluctuations. Expenditure-related risks include, for example, vendor bankruptcy prior to completion of delivery. As it will be demonstrated when examining the requirements for each of the Unions, the most significant risk faced by WIPO is income-related. Essentially, this is the risk that the income which is estimated to be secured during the biennium and which is required to fund the proposed biennial expenditure does not materialize. The proposed biennial expenditure is therefore a good and direct indicator for risk assessment. Hence, it is proposed to express the protection provided by the total amount of RWC funds as a percentage of the estimated biennial expenditure (PBE factor): the higher the PBE factor, the higher the protection. The PBE factor also provides an indication of how long the operation could be funded by drawing exclusively on the RWC funds. For example, a factor of 50% would indicate funding for 12 months and a factor of 25%, funding for six months.”
11. In accordance with the above approach, the target level of RWCF was established as a percentage of estimated biennial expenditure (PBE factor) for the contribution-financed Unions, the PCT Union, the Madrid Union and the Hague Union. The appropriate PBE factor was established at the level of Unions, with the aim of reflecting the risks and liquidity concerns specific to the Union concerned. The level of RWCF for each Union is accordingly calculated as the estimated biennial expenditure multiplied by the Union’s PBE factor.
12. The selection of the PBE factor as the reference point ensures that the level of the RWCF is linked to the level of the proposed program and budget, which, in turn, “ensures that the dynamics of change and the related risk and liquidity concerns are fully reflected”² in the level of RWCF. The approved PBE factor for the contribution-financed Unions is 50%, the PCT Union 15%, the Madrid Union 25% and the Hague Union 15%. The PBE factor can be adjusted by specific decision of the Member States.

²

Document A/35/6 of 2000 (the proposal for the Policy on Reserves)

II. (C) The Madrid Union Surpluses

13. As decided by the Assembly of the Madrid Union, and under Article 8(4) of the Madrid Agreement, the surplus of the Madrid Union's income over expenditure is distributed to Member States. The requirements set out under Article 8(4) of the Madrid Agreement and Protocol in respect of the distribution of the Madrid Union Surpluses specifically state that: "The annual product of the various receipts from international registration, with the exception of the receipts derived from the fees mentioned in paragraph (2)(ii) and (iii), shall be divided equally among the Contracting Parties by the International Bureau, after deduction of the expenses and charges necessitated by the implementation of this Protocol."
14. Accordingly, while the surplus generated under all other Unions will automatically be retained as part of the Organization's RWCF, the surplus related to the Madrid Union is paid out to Member States unless they otherwise decide.

II. (D) The Use of the Reserves

15. Within the context of the proposal for the Policy on Reserves, Member States at their Assemblies in 2000 also considered:
 - A revision to the budget process – this has since been superseded by the mechanism adopted by Member States for their involvement in the budget process³; and
 - A mechanism whereby excess RWCF (above the target level) of one biennium would be used to fund part of the budget of the following biennium (ie a possible deficit budget would be proposed), and any shortfall in the RWCF would represent a resource requirement. This was to be presented within the context of the budget proposal, together with a four-year financial plan annexed to the budget document. This was to provide an opportunity to demonstrate that decisions proposed for the budget period can be sustained during a longer-term period.
 - Within the context of their consideration of the proposal for the Policy on Reserves, Member States approved that "excess or shortfall in resources as compared to the established level of RWC funds are accounted for in the biennial process of each Union, subject, as concerns the Madrid Union, to Article 8(4) of the Madrid Agreement and Protocol". While the decision in principle and practice continues to be fully reflected in the way the Organization accounts for the RWCF, the practice of presenting four-year financial plans annexed to the budget document and considering deficit budgets was discontinued after 2004.
 - In approving the above, Member States formally noted that the "policy on budget surplus does not restrict the prerogative of the Director General to propose for approval by the WIPO General Assembly or the Assembly of the Union concerned, as the case may be, project activities funded from available surplus".

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Annex IV of WO/PBC/10/5, which sets out the timeframes for the budgetary planning cycle, the role of the Member States in the consultation process, and the various milestones of the process over the financial period.

III. PROPOSED PRINCIPLES AND APPROVAL MECHANISM FOR THE USE OF RESERVES

16. In preparing this document, a thorough and careful review was done of the policies and practices already in place. Ten years have passed since the Organization's Policy on Reserves has been approved, and in respect of the elements related to the establishment of the target level of RWCF, the policy in place is seen to remain solid and valid. The Organization has new Financial Regulations and Rules, a revised allocation methodology has been put in place for the allocation of income and expenditure to Unions, and as of 2010 WIPO has committed to be IPSAS compliant and will be audited under these standards. Yet the core elements of the Organization's Policy on Reserves remain a solid foundation for effective financial management.
17. However, with the backdrop of the current economic climate, the global financial crises and operational uncertainties affecting many of even the most significant market players, prudence is seen to be especially important for financial management, and underscores the importance of maintaining healthy reserves⁴, and avoiding planned deficits.
18. The FRR currently sets out the following in respect of the use of the two elements of the RWCF for WIPO. A comparative table is provided in the Annex for information, illustrating the levels and policies for the use of working capital and reserve funds of selected UN system organizations.
- The **working capital funds** shall be used, to the extent possible, as advances to finance budgetary appropriations that are not yet covered by available liquidity and for such other purposes as may be determined by the Assemblies of the Member States and of the Unions, each as far as it is concerned. (*Regulation 4.3*)
 - **Reserve funds** shall be used in a manner decided by the Assemblies of the Member States and of the Unions, each as far as it is concerned. (*Financial Rule 101.3 (n)*) The use, other than for the covering of any deficits, of any of the reserve funds is a matter for the decision of the General Assembly of WIPO or the Assembly of the Union concerned, as the case may be. (*Regulation 4.6*) If, after the closure of the financial period, any Union shows a deficit, not coverable out of reserve funds, the General Assembly of WIPO or the Assemblies of the interested Unions, as the case may be, shall decide upon measures to redress the financial situation. (*Regulation 4.8*)
19. In accordance with the framework provided by the FRR and the Policy on Reserves, the principles and approval mechanism recommended to be followed in the future in respect of proposed reserve appropriations are described below.

⁴ For further information on the status of RWCF and an updated Financial Overview for 2010/11, please see WO/PBC/15/16.

III. (A) Principles Underlying the Proposals for the Use of the Reserves

20. As noted above, the RWCF required target level is established to minimize the risk of deficits or liquidity problems exercising a negative effect on program delivery, to maximize the probability that the Organization can meet its obligations and to provide financial stability. Accordingly, the first principle for the proposals for the use of Reserves is set out below.

PRINCIPLE 1: Proposals for the use of the RWCF should only pertain to the amounts available in the RWCF exceeding the target level required by WIPO's Policy on Reserves. This is applicable both at the level of individual Unions as well as at the level of the Organization as a whole.

21. The Reserves of the Organization, while they may be required to finance a deficit in a given biennium if actual expenditures exceed actual income, should not be used to inflate the funding available for operational and recurring expenditures. Planned deficits instill a false sense of long-term resource availability, and may result in the undertaking of longer term commitments (e.g. staff resources) with short term funding. With special emphasis on the fact that over two-thirds of WIPO's costs are personnel costs, this could represent a significant risk for the Organization. Accordingly, the second principle for the proposals for the use of Reserves is set out below.

PRINCIPLE 2: Proposals for the use of the Reserves should be for extraordinary, one-time expenditures, such as capital expenditures and strategic initiatives under the agreed Strategic Goals, and not for recurring, operational activities of the Organization.

22. Unlike appropriations under the regular budget, which are only available for the biennium for which they were approved, the Reserves of the Organization provide a funding source which can cut across biennia and remains available for spending for the duration of the initiative as approved by Member States. Accordingly, the third principle for the proposals for the use of Reserves is set out below.

PRINCIPLE 3: Proposals for the use of the Reserves may be for projects and initiatives which are outside the biennial financial period of the Organization, and may cut across, or last for, more than one biennia.

III. (B) Approval Mechanism for Proposals for the Use of the Reserves

23. In accordance with WIPO's FRR and its Policy on Reserves, proposals for the use of the Organization's available Reserves may be made by the Director General or Member States to the Assemblies of the Member States and of the Unions, each as far as it is concerned.

APPROVAL MECHANISM: Proposals for the use of the Reserves may be made by the Director General of WIPO or Member States via the PBC to the Assemblies of the Member States and of the Unions, each as far as it is concerned. The proposals are to be accompanied by information on the overall status of the RWCF as of the date the proposal is made. Such information may be presented in the form of a separate document.

In the case of the Madrid Union, where any use of the biennial surplus is subject to Article 8(4) of the Madrid Agreement and Protocol, the proposal for the use of the surplus and/or RWCF in excess of the target level required by the Policy on Reserves is presented by the Director General to the Madrid Union Assembly. Information on the proposed use of these reserves, and their impact on the utilization of the overall RWCF is to be included in the information document presented to the PBC and the Assemblies of the Member States on the overall status of the RWCF.

[Annex follows]

Reserves and Working Capital Funds of Some UN System Organizations

UN System Organization	Approved Budget USD'000	Level of Working Capital Funds USD'000	Percentage of Working Capital Funds to Approved Regular Budget	PURPOSE of WCF	Other Reserves USD'000	PURPOSE of Reserves
United Nations (2008-2009)	4,865,080	150,000	3.08%	- to finance budgetary appropriations; and - to finance unforeseen and extraordinary expenses or other authorized purposes (FREG* 4.2 to 4.4)	224,000 (2006)	to clear up the past financial difficulties and especially to resolve the short-term deficit of the Organization
UNICEF (2006-2007)				UNICEF does not have a formal WCF, but rather a policy specifying maintenance of sufficient liquidity.	ASHI = 150,000; Capital Assets = 27,100; Separation and Termination = 18,300; Procurement Services = 2,000	To ensure the liquidity of UNICEF, the Comptroller shall maintain balances of cash, within the cash resources of the UNICEF Account, from general resources and supplementary funds at the levels approved by the Board (FRULE 110.1). The UNICEF liquidity policy recommends a minimum year-end balance of Regular Resources convertible cash equal to 10% of projected Regular Resources income for the following year. In addition, there are Funds set up for -ASHI; - Capital Assets; - Separation and Termination; and - Procurement Services
UNFPA (2006-2007)				UNFPA, being a voluntary funded organization, does not have a WCF.	in addition to the Operational Reserve, there's Reserve for Field Accommodation for 5,000 (2006), and a Security Reserve which varies from one biennium to another (included in the overall budget proposal)	UNFPA has an operational reserve for regular resources. The purpose of the Operational reserve is to guarantee the financial viability and integrity of UNFPA. The Reserve shall be fully funded and held in irrevocable and promptly available liquid assets. The reserve shall be used for downward fluctuations or shortfalls in resources; uneven cash flows, increases in actual costs as compared to planning estimates or fluctuations in delivery; and other contingencies which result in a loss of resources for which UNFPA has made commitments for programming. The reserve is calculated at 20% of total regular income for the year.
ILO (2006-2007)	594,310	30,702	5.17%	(a) to finance budgetary expenditure pending receipt of contributions or other income; (b) in exceptional circumstances and subject to prior authorization of the GB, to provide advances to meet contingencies and emergencies (FREG 19-21)	875 (2006)	no reserves per se, but a budgetary chapter for Unforeseen Expenditure to finance expenses which may arise under specific circumstances.
FAO (2006-2007)	773,800	25,678	3.32%	To advance moneys to the General Fund in order to (a) finance budgetary expenditure pending receipt of contributions to the budget; (b) finance emergency expenditure not provided for in the current budget; (c) make reimbursable loans for such purposes as the Council may authorize in specific cases (FREG 6.2(a))	SRA = 38,300 Capex = 4,700 authorized appropriation in 2006-07 Security = 0 in 2006-07	FAO has (a) Special Reserve Account (SRA)- authorized up to 5% of subsequent biennium's total budget; (b) Capital Expenditure Account (Capex); and (c) Security Account
UNESCO (2008-2009)	631,000	29,000	4.60%	- to finance budgetary appropriations; and - other purposes to be determined by the General Conference (FREG 6.2 to 6.5)		UNESCO does not operate reserve accounts for meeting unbudgeted expenditure contingencies or emergencies. Such accounts may be established by the DG and if so shall be reported to the Executive Board. Part IV of the regular budget provides for Anticipated Cost Increases, which finances cost increases arising from inflation and statutory factors which are expected to arise during the course of the biennium.
ICAO (2006-2007 portion of 3 year budget 2005-2007)	132,331	6,004 (2006)	4.54%	Advances are made (a) to the General Fund to finance temporary cash deficits as a result of delays in receipt of income; (b) to the relevant Joint Financing Fund for the operation of projects under agreements concluded under Chapter XV of the Convention, to a maximum of \$100,000; (c) in cases where the Council has approved appropriations under FREG 5.2 (b) to the relevant special fund created under FREG 8.4 subject to the limit therein specified (FREG 7.3)		none
UNAIDS (2006-2007)	366,000	35,000	9.56%	UNAIDS has an Operating Reserve Fund in the amount of USD 35 million for 2006. Its primary purpose is to ensure that cash will be available for the financing of the UNAIDS approved biennial budget, pending the receipt of contributions. If in the current financial period, the sum of available carry-over balances (other than those in the Operating Reserve Fund), contributions from donors and miscellaneous income (including interest earned on income), are not sufficient to enable UNAIDS to commit funds within its approved budget, advances may be made from the Operating Reserve Fund under certain conditions.		no other reserves beyond Operating Reserve Fund
ITU (2006-2007)	259,111			ITU does not have a working capital fund.	amount fixed by the Council on the basis of the existing level of the Reserve Account and expected requirements	ITU has a Reserve Account to provide working capital to meet essential expenditure and to maintain sufficient cash reserves to avoid resorting to loans. However, by decision of the Council, withdrawals may be made from the Reserve Account, inter alia, to reduce the amount of the contributory unit to be paid by the member States, to balance the budget of the Union, or to place a limit on the Reserve Account.

UN System Organization	Approved Budget USD'000	Level of Working Capital Funds USD'000	Percentage of Working Capital Funds to Approved Regular Budget	PURPOSE of WCF	Other Reserves USD'000	PURPOSE of Reserves
IMO (2006-2007)	87,028	4,014	4.61%	to finance appropriations pending the receipt of contributions (FREG 5.1). Financial Rules also govern credits made available from the WCF for unforeseen and extraordinary expenses (FRUL 106.1)	Total amount for all Funds is around 20,000 (2006)	IMO has - Trading Fund - to separately account for commercial activities (sales of publications, catering etc) - HQ Capital Fund - to finance the capital expenditure - Termination Benefit Fund - to provide funds for termination, ASHI etc - Training and development fund - to fund the costs for staff training and development - Technical Co-operation Fund - to provide funds for integrated technical cooperation programs
WIPO (2006-2007)	405,343	7,449	1.84%	The WCF shall be used, to the extent possible, as advances to finance budgetary appropriations that are not yet covered by available liquidity and for such other purposes as may be determined by the Assemblies (FREG 4.3)	174,339	FREG 4.7 "If after the approval of the final accounts, any Union shows a surplus of income, such surplus shall be paid into the reserve funds, unless otherwise decided by the General Assembly or the Assembly of the Union concerned." FREG 4.6 "The use, other than for the covering of any deficits, of any of the reserve funds is a matter for the decision of the General Assembly of WIPO or the Assembly of the Union concerned, as the case may be."
IFAD (2007)	91,954			IFAD's budgets are financed from its Regular Resources based on member contributions to replenishments, loan reflows and interest income. There is no specific working capital fund separate from the pool of regular resources. IFAD has a "contingency" of USD 100 000 to the administrative budget.		IFAD has a general reserve, which is accumulated over the years and use thereof is determined by the Governing council through the Executive Board.
UNIDO (2008-2009)**	193,038	10,711	5.55%	To finance (a) budgetary appropriations; (b) unforeseen and extraordinary expenses, excluding expenditure intended to compensate for any loss caused by fluctuation in exchange rates. (FREG 5.4)	Operating Reserve = 4,880 (2008) Exchange rate fluctuation Reserve = 13,080 (2007)	UNIDO has an Operating Reserve and an Exchange rate fluctuation reserve
IAEA (2006)	273,619	18,000	6.58%	Used for advances to the Regular Budget to finance temporarily appropriations and for any other purposes authorized by the General Conference upon recommendation of the Board		IAEA has a Major Capital Investment Fund, sourced from regular budget appropriations
WTO (2008-2009)**	293,680	7,751	2.64%	to finance budgetary appropriations pending receipt of contributions; and in exceptional circumstances and subject to prior authorization of the General Council, to finance commitments relating to extraordinary expenditure	2006: Ministerial OF = 738 Security EOF = 328 Appellate BOF = 738	WTO has - Ministerial Operating Fund - to finance the ministerial Conference - Security Enhancement Operating Fund - to finance the Security Enhancement Plan over several years - Appellate Body Operating Fund - to finance variable dispute settlement expenses

Source:
CEB/2009/HLCM/FB/14 Budgeting Practices in UN System Organizations - 2009 Survey Results
CEB Financial Statistics 2006; 2008

*FREG - Financial Regulations

**UN operational rates of exchange are used to convert WFC and other Reserves amounts in various currencies to USD.

[End of Annex and of document]