



## Working capital reserve

### *Background*

At the forty-sixth session of the Subsidiary Body for Implementation (SBI) Parties requested the secretariat to organize a technical workshop on the margins of SBI 47 to discuss ways to increase the efficiency and transparency of the UNFCCC budget process.<sup>1</sup>

This document, one of five that the secretariat has prepared for the above-mentioned technical workshop, provides information on the level of the working capital reserve

### **I. Executive Summary**

1. UNFCCC maintains a Working Capital Reserve of 8.3 per cent of annual total expenditure representing one month of operating requirements under the Trust Fund for the UNFCCC core budget.
2. The overall level of outstanding indicative contributions to the core budget is increasing, which in turn necessitates the need to draw down on the working capital reserve.
3. With an increasing level of outstanding core contributions, the working capital reserve is insufficient to provide the requisite cover to ensure sound and effective financial management of the secretariat operations.
4. This document highlights the need for urgent consideration by the Parties to increase the level of working capital reserve to 12% of the annual total expenditure in the interim, with a view to increasing the level to 15% in line with most other United Nation organizations.

### **II. Introduction**

5. The principle purpose of the working capital reserve is to guarantee the financial liquidity and integrity of an entity to compensate for uneven cash flows and to meet such other similar requirements as may be decided upon, taking into account the estimated income and expenditures for the following financial period.
6. The UNFCCC has seven separate funds and an established practice for the level of reserves to be maintained.
7. This document focuses on the working capital reserve under the Trust Fund for the Core Budget of the UNFCCC which was established pursuant to paragraph 14 of the financial procedures for the Conference of the Parties to the UNFCCC, its subsidiary bodies and its permanent secretariat as contained in Annex I to decision 15/CP.1, which stipulates: "Within the fund there shall be maintained a working capital reserve to a level to be determined from time to time by the Conference of the Parties by consensus. The purpose of the working capital reserve shall be to ensure continuity

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<sup>1</sup> FCCC/SBI/2017/7, paragraph 129

of operations in the event of a temporary shortfall of cash. Drawdowns from the working capital reserve shall be restored from contributions as soon as possible”.

8. It is important to note that the reserve is used to finance budgetary appropriations pending the receipt of core contributions from the Parties.

9. The level of the working capital reserve in the period 1996–2017 was set and maintained in line with the applicable budget decisions taken by the Conference of the Parties at a rate of 8.3 per cent of annual total expenditure (equivalent to one month of operating requirements). While the rate of 8.3 per cent has been maintained, the absolute amount of the reserve has been adjusted in accordance with the budget approved by the Conference of the Parties (COP) for the biennium. Consequently, the working capital reserve will increase to EUR 2,372,575 per annum for the biennium 2018–2019 from EUR 2,269,518 in 2017.

10. An effective cash flow management system, which is an important determinant of an appropriate reserve level, requires two critical projections:

- (a) Projection of cash requirement in relation to the level of expected expenditure;
- (b) Projection of receipt of cash.

### III. Projection of cash requirement in relation to the level of expected expenditure

11. The secretariat prepares quarterly and ad hoc projections of requirements under the Trust Fund for the UNFCCC core budget. Approximately 70–75 per cent of the core budget consists of staff costs, which are relatively steady in terms of monthly expenditure levels. However, monthly expenditure levels under the core budget vary between 50 per cent above and 35 per cent below the average expenditure level. The expenditure patterns are dependent upon the level of activities taking place at a point in time and seasonal payments for specific staff entitlements. Peak periods of operational activity include meetings of the various governing and constituted UNFCCC bodies.

### IV. Projection of receipt of cash

12. Income to the UNFCCC core budget consists of indicative contributions from all Parties and a special annual contribution by the host government. Indicative contributions are based on a scale for the Convention as approved by the COP and a scale for the Kyoto Protocol as approved by the Conference of the Parties serving as the Meeting of the Parties to the Kyoto Protocol.

13. By 30 September of each year, the secretariat notifies each Party of its indicative contributions for the following year, inviting Parties to note that contributions are due on 1 January of each year in accordance with paragraph 8(b) of the financial procedures. However, past practice indicates that the timing of receipt of indicative contributions is at the discretion of Parties and thus, from an organizational perspective, timing of receipt remains unpredictable as only a small number of Parties actually make their contributions by the deadline provided for in the financial procedures.

14. Table 1 shows the receipt of core contributions as compared to actual core expenditure for the year 2016 for the period September 2015 to December 2016.

Table 1

#### Receipt of core budget contributions in 2016 by month (euros)

<i>Month</i>	<i>Expenditures</i>	<i>Contributions received for 2016</i>	<i>Prior year contributions received</i>
Sept.-Dec. 2015	–	1,522,359	–
January	1,643,072	3,267,311	316,486
February	2,041,111	3,677,875	13,715
March	2,911,905	2,545,382	616,772
April	1,838,427	2,778,058	160,834
May	3,221,723	1,078,707	8,135

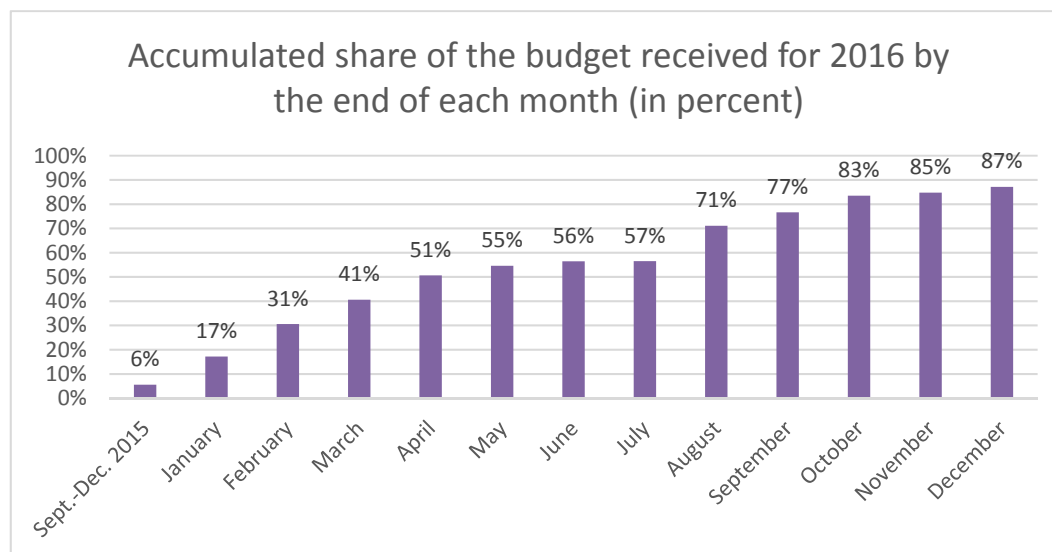
<i>Month</i>	<i>Expenditures</i>	<i>Contributions received for 2016</i>	<i>Prior year contributions received</i>
June	1,975,742	507,419	33,150
July	2,984,220	19,844	39,921
August	3,008,311	4,218,784	314,988
September	2,110,251	1,513,111	62,789
October	1,476,825	1,846,440	71,548
November	1,959,132	198,749	91,103
December	1,819,063	644,224	84,051
<b>TOTAL</b>	<b>26,989,782</b>	<b>23,820,279<sup>a</sup></b>	<b>1,813,492</b>

<sup>a</sup> Total expected core contributions for 2016 was Euro 27,305,158 (approximately 13% outstanding).

15. Figure 1 below, shows the cumulative core budget contributions received for 2016 by the end of each month in percent. Only 6 percent of the budget had been received by the deadline stipulated in the financial procedures i.e. 1 January. By the end of the year 87 % of the total core budget contributions had been received. Late receipt of contributions reduces the flexibility in funds management required for effective and efficient operations and timely delivery of mandated outputs. To safeguard its reputation as a reliable business partner the secretariat needed to manage its resources very cautiously to ensure that payments could be made promptly. This meant, however, that some activities had to be delayed.

Figure 1

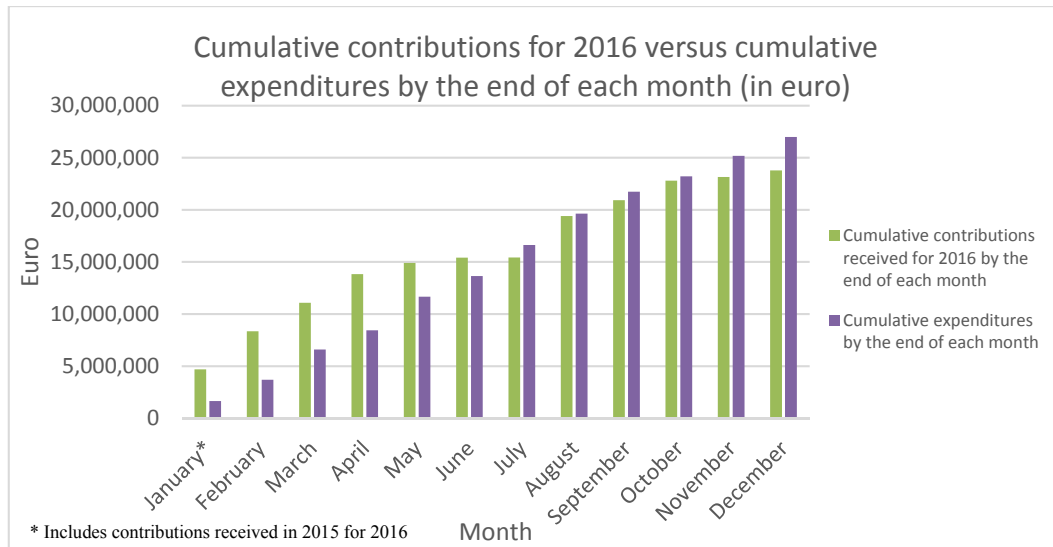
**Cumulative share of the indicative core contributions received for 2016 by the end of each month (in percent)**



16. Figure 2 shows cumulative contributions for 2016 as compared to cumulative expenditure by the end of each month (in euro). Expenditure exceeded contributions throughout the second half of the year. The deficits had to be covered by tapping into the working capital reserve, which was, however, insufficient in December. By the end of the year the deficit amounted to EUR 3.2 million, which exceeded the level of the working capital reserve that was set at EUR 2.3 million.

Figure 2

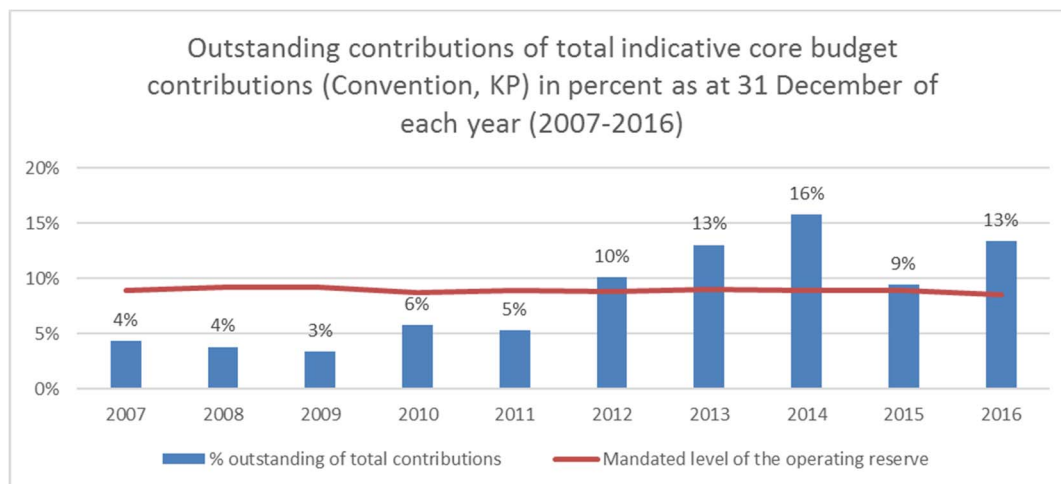
**Cumulative contributions for 2016 as compared to cumulative expenditure by the end of each month (in euro)**



17. Over the last decade, the secretariat has witnessed an increase in the level of contributions that remain outstanding. Figure 3 shows that the proportion of outstanding contributions by the end of each budget year has more than tripled from 4 per cent in 2007 to 13 percent in 2016. Consequently, in the period 2012–2016, the secretariat needed to draw on the working capital reserve to cover the cash requirements.

Figure 3

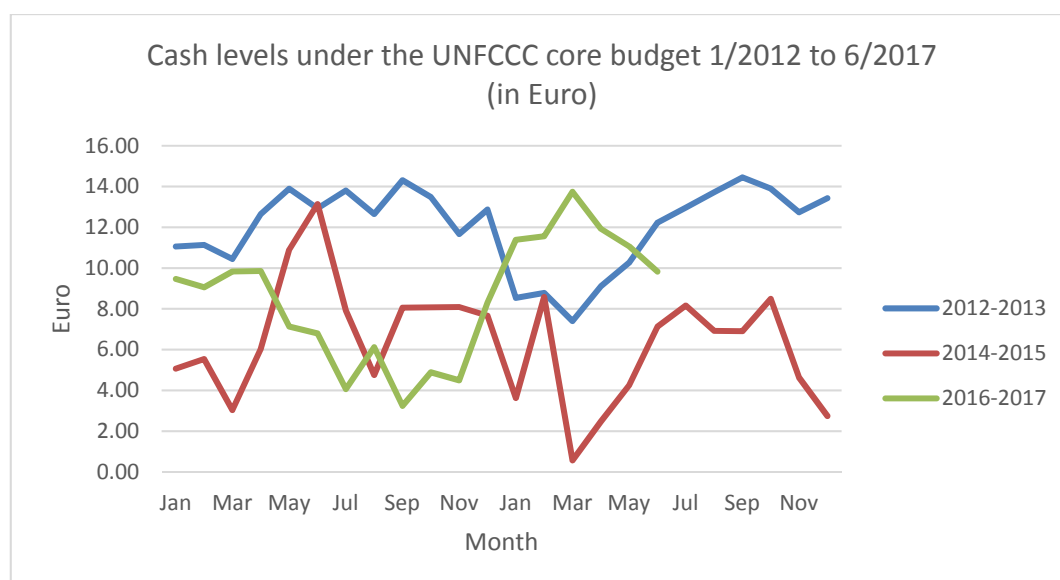
**Outstanding contributions to total indicative core budget contributions**



18. Considering the unpredictability of receiving indicative contributions both in terms of timing and amount, a working capital reserve of only one month’s ‘equivalent expenditure’ does not provide a sufficient buffer to compensate for fluctuations in the cash flow.

## V. Review of cash levels over past biennia – supply side

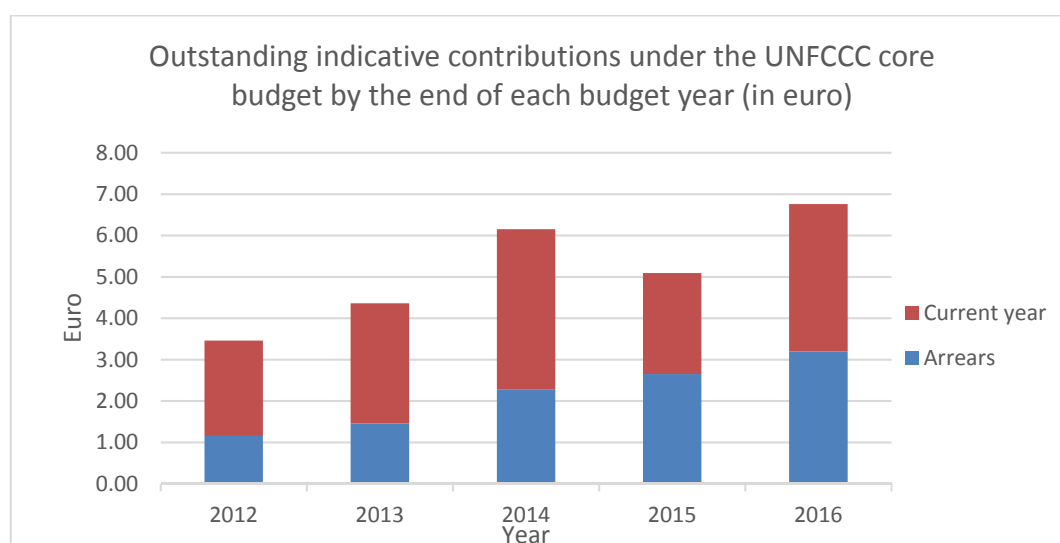
Figure 4  
Cash Levels Core Budget UNFCCC



19. As illustrated in figure 4, the overall cash available in the core budget of the UNFCCC decreased significantly in the period 2012–2016. For the 2017 financial year, the secretariat embarked on an intense outreach exercise to Parties. This resulted in a modest increase in the recovery of outstanding indicative contributions and an increased level of payments at the start of the year. However, the level of outstanding contributions for the current year and from previous years remains high, as shown in figure 3. The secretariat thus risks not having sufficient cash to pay for core-related activities in a timely manner which in turn has the potential to negatively affect the sustainability of the secretariat.

20. While fluctuations in income and expenditure and the respective balance in cash available are very volatile and therefore almost impossible to predict, a constant increase in outstanding contributions has been recorded over the last years, as shown in figure 5.

Figure 3  
Outstanding indicative contributions core



## **VI. Review of cash levels over past biennia – demand side**

21. While the level of outstanding contributions is high, the implementation rate of the core budget is close to 100 per cent.

22. The combination of a high level of outstanding and late contributions with an almost full implementation rate has resulted in a difficult financial situation which negatively impacts programme implementation.

## **VII. Status of the working capital reserve under the UNFCCC core budget**

23. In the biennium 2016-2017 the working capital reserve established under the Trust Fund for the UNFCCC core budget continues is set at 8.3 per cent (one month of operating requirements) amounting to EUR 2,269,782 in 2016 and EUR 2,269,518 in 2017. Since the working capital reserve was fully depleted by the end of 2015, it is imperative that it is replenished in the current biennium.

24. In line with the financial procedures, the replenishment is undertaken by applying cash received by Parties who are in arrears for prior biennia firstly to the working capital reserve.

25. The secretariat has increased the frequency of reminders and now sends them quarterly to all Parties that have contributions outstanding. The current year's replenishment as at 8 September 2017 amounted to EUR 0.91 million.

## **VIII. Way forward**

26. The difficulties in terms of the level of the working capital reserve, available cash and volume of outstanding contributions in conjunction with the increase in implementation rate necessitates urgent attention. In this regard, possible actions to improve the liquidity situation of the secretariat in order to ensure that the secretariat continues meet its obligations and deliver in accordance with the approved budget are as follows:

(a) Increasing the level of the working capital reserve from the current 8.3 per cent of the approved annual budget to 12 per cent in the interim, with a view to increasing it to 15% in line with most other United Nations organizations;

(b) More timely payment of indicative contributions to reduce the need to use the working capital reserve to finance temporary cash shortages;<sup>2</sup>

(c) Parties indicating the timing of the payment of their contributions to enable the secretariat to make a more accurate projection of cash flow;<sup>3</sup>

(d) Establishment of a working group composed of representatives of Parties to analyse and develop proposals for addressing the problem of long-outstanding contributions, bearing in mind the accompanying costs required to support such a working group;

(e) Allowing any interest earned in the current year to be credited to the working capital reserve to enable it to be replenished.

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<sup>2</sup> Refer to the workshop note on outstanding indicative contributions.

<sup>3</sup> In accordance with decision 15/CP.1, annex I, paragraph 8(a)