

AIDE-MEMOIRE

BUDGET AND FUNDING ISSUES

1. At the 29th meeting of the Standing Committee in March 2004, under the agenda item "Programmes, Budgets and Funding", some delegations asked for clarification on a number of issues, including the impact of exchange rate fluctuations and the evolution of administrative costs. Subsequently, at the consultation held on 1 April, delegations raised additional questions on the modalities of the pilot mechanism embodied in the Operational Reserve, Category II. As some questions could not be entirely resolved at the time, this *Aide-Mémoire* seeks to provide the remaining clarifications.

A. Carry-over from 2003 to 2004

2. The total carry-over from 2003 to 2004 under the Unified Budget (Annual [AB] and Supplementary programme [SB] budgets combined) was USD 98.0 million, compared to a carry-over of USD 49.5 million from 2002 to 2003. AB carry-over was USD 48.5 million (compared to USD 31.1 million in 2003) of which USD 19.7 million was earmarked. SB carry-over was USD 49.5 million (compared to USD 18.3 million in 2002), of which USD 41.3 million was due to operational constraints in Afghanistan and Iraq related to the worsening security situation in the fourth quarter of the year.

3. This increase in the size of reserve and fund balances was greater than in past years. In 2003, total income for the Unified Budget reached USD 967.3 million, exceeding total expenditure by some USD 19.9 million. The rest of the increase in the carry-over is accounted for by various adjustments, including the cancellation of prior years' obligations, adjustments to prior years' expenditure and adjustments to prior years' contributions.

4. Tight cost controls were an important, underlying factor in 2003. These controls included a partial freeze of the Operational Reserve and reduced levels of budgetary allocations (particularly for administrative costs) at the beginning of 2003. While subsequent cost pressures were significant due to the weakening of the US dollar (particularly in European countries), all offices in the region made great efforts to remain within the initial budgetary allocations.

5. Unexpectedly large gains on exchange rates also played an important role, especially during the last quarter of 2003, as explained in the following section.

B. Gains on exchange rates

6. In 2003, currency exchange gains under the Unified Budget amounted to USD 41.5 million (AB: USD 39.9m, SB: 1.6m), compared to a net gain of USD 32.2 million in 2002 and a loss of USD 14.0 million in 2001. The significant increase was the result of a weaker US dollar against the Euro and other donor currencies in the last quarter of 2003.

7. Gains or losses on exchange rates are the result of several factors in addition to the actual fluctuations in international monetary markets and the corresponding changes in the applicable UN exchange rates. The additional factors include the amount and timing of main pledges, the timing of payment of the pledged amounts, the differences in the UN exchange rates between the time of pledge and receipt, as well as the UN exchange rates applicable at the closure of the accounts.

8. Projection of gains or losses is therefore a complex task. At the beginning of 2003, no exchange gains were projected. By the end of the second quarter, a gain of some USD 20 million was projected, reflecting the market trend. In the third quarter, some USD 280 million were pledged and much of this amount was paid in the last quarter, during which the Euro, for example, appreciated by more than 9 per cent against the US dollar. In November, projected exchange gains were adjusted upwards to USD 30 million. At the end of December 2003, the re-valuation of outstanding contributions receivable generated another USD 8 million in gains on exchange, due to the differences between the UN exchange rates at the beginning and at the end of December, respectively. Therefore, while it was clear by late 2003 that significant exchange gains would be posted, it was too late to apply these gains to 2003 programmes. Instead, the exchange gains served partly to compensate the effect of increased costs, expressed in dollars, in some countries, as well as being used for 2004 programmes, thus alleviating projected funding shortfalls in 2004.

9. UNHCR cannot control the foreign exchange markets, but it can seek to make projections as precisely and as early as possible, and to take appropriate measures. One lesson learned from the experience of 2003 is that the effects of exchange rate fluctuations on costs, in the context of a declining dollar exchange rate, can be mitigated, provided that donors maintain their contributions in national currencies (e.g. the Euro) at the same level. Conversely, when the US dollar appreciates, significant losses on exchange can be expected (as in 2001), which may be only partly compensated by reduced costs, expressed in dollars, in some countries. Management will continue assessing market risks and taking appropriate measures.

C. Trends in administrative costs

10. In accordance with the general decision on administrative, programme and financial matters adopted by the Executive Committee at its 54th session,¹ UNHCR's management has taken various measures to contain administrative costs, such as reducing budgetary allocations proportionally for ABODs much more than for Operations, and keeping post creations for administrative and support functions to a minimum. The table below reflects the results of such efforts. For the Unified Budget (AB and SBs), the percentage share of administrative costs (Management and Administration plus Programme Support) has remained relatively stable over the last four years.

¹ A/AC.96/987, para. 24(c)

Year	2000	2001	2002	2003
Management and Administration	5%	4%	4%	5%
Programme Support	23%	24%	22%	23%
Programme	72%	72%	74%	72%
Total	100%	100%	100%	100%

11. However, such efforts have created notable strains throughout the Office, both in the field and at HQ. Furthermore, some investment for better management, such as investment in modern information technology and provision for staff security, are essential for the future of the Office as part of the cost of doing better business.

D. 2003 Supplementary Programmes

12. In 2003, expenditures for the Supplementary Programmes budget were USD 232.6 million compared to USD 200.1 million in 2002, an increase of USD 32.5 million or 16 per cent. The significant increase in Supplementary Programme expenditures is due primarily to the large-scale emergency operations in Afghanistan and Iraq. These two operations accounted for approximately 70 per cent of the Supplementary Programme expenditures in 2003. The carry-over of USD 49.5 million remaining at the end of 2003 has been incorporated into the 2004 AB under the respective country activities.

13. Some important supplementary programmes, first created in the latter half of 2003, are continuing under SBs in 2004:

(a) The SB for Emergency Assistance to Sudanese Refugees in Eastern Chad established in September 2003 with a budget of USD 20.8 million for the period 1 September 2003 to 31 December 2004.

(b) The SB for Repatriation and Reintegration of Liberian Refugees, established in November 2003 with a budget of USD 39.2 million for the period 1 January to 31 December 2004. This SB is part of the UN Consolidated Inter-Agency Appeal for Liberia.

(c) The SB for the Repatriation and Reintegration of Sudanese Refugees, established in December 2003 with a budget of USD 8.8 million for the period 1 January to 31 December 2004. This SB is part of the UN Consolidated Inter-Agency Appeal for the Sudan Assistance Programme.

Any further activities will be mainstreamed into the AB as of 2005.

14. The SB for the Iraq Emergency Operation (Phase I) was closed on 30 June 2003 with a budget of USD 37.1 million. As of 1 July 2003 an SB for the Iraq Repatriation and Reintegration Operation (Phase II) was established with a budget of USD 47.8 million. In March 2004 this was further increased and extended to USD 74 million for the full 12 month period.

E. Rationale and criteria for the Operational Reserve - Category II (OR II)

15. The basic rationale of OR II is that, as long as UNHCR's Annual Programme Budget does not cover the totality of identified needs (due to funding constraints), some desirable activities will not be retained in the Annual Programme Budget. The absence of such activities from the Annual Programme Budget represents a gap between needs and available resources. However, once the Annual Programme Budget is adopted, there may be changes in the funding outlook. There have been cases in the past where offers of additional contributions have been turned down due to lack of budgetary provisions.

16. OR II is a mechanism to allow certain activities to be added to the Annual Programme Budget after the latter has been approved by ExCom. As a necessary condition, such activities should always be fully funded by additional contributions, i.e. contributions which have not already been included in the projected total annual contribution by the donor(s) in question. Through Category II, UNHCR hopes to access funds which would not otherwise become available to the Office. Private sector donors are a particularly appropriate, but not exclusive, source under this approach.

17. As an additional criterion, the decision to use the OR II mechanism depends on the nature of the proposed activity and the benefits accruing to refugees in terms of protection and/or assistance. The nature of activities to be funded by OR II allocations should not be fundamentally different from those normally covered under the AB. Detailed guidelines and conditions for accessing the OR II mechanism have been provided to UNHCR field offices, and the existing Operational Review Board (ORB) control process is applied.

18. An important consideration for the application of OR II is whether the activity helps in addressing real needs, e.g. whether it helps in reaching minimum standards or in closing the gap between minimum standards and desirable higher standards. In this sense, the OR II mechanism is a step forward towards needs-based programming and budgeting, and complements the Partnerships initiative aimed at strengthening collaboration in the budgetary and funding process with operational partners.

19. Other features of the OR II are:

(a) Since the OR II is an integral part of the Annual Programme Budget (AB), and as the latter is part of the Unified Budget, UNHCR's unified budget structure remains fully intact.

(b) The OR II mechanism adds flexibility to the Unified Budget in that it provides appropriations for possible funding of additional activities not already in the Annual Programme Budget.

(c) As OR II is part of the AB, it is not envisaged to charge it with support costs, as it is the case for SBs.

(d) An activity agreed under Category II may continue in the following year(s) under the same category if additional funding is obtained. Alternatively, it may be decided that the respective activity should be mainstreamed into the AB in the following years.

(e) Additional funding for additional activities under Category II is by definition an earmarked contribution.

20. The main differences between OR I, OR II and SBs may be summarized in the following manner:

	OR Category I	OR Category II	SB
Purpose	Mainly emergency needs	Non-emergency additional needs	Emergency needs
Amount	Up to USD 10 million per case, total 7.5% of programmed activities.	Total USD 50 million	Above USD 10 million per case.
Approval and oversight	ExCom approved AB + ORB		High Commissioner + ORB
Support costs	None		7%
Mainstreaming into AB	Possible		Possible. If the SB is mainstreamed into the AB, funding carry-overs are applied to the corresponding part of the new AB.
Reporting	Standing Committee and ExCom		