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UNDP FINANCIAL, BUDGETARY AND ADMINISTRATIVE MATTERS

UNDP FINANCIAL RISK MANAGEMENT; REVIEW OF OPERATIONAL RESERVE

Report of the Administrator

SUMMARY

The present report provides an assessment of the financial risks faced by the United Nations Development Programme. It includes a summary of the history of the Operational Reserve and presents a review of financial management concepts, including liquidity, working capital and the level of reserves as they pertain to UNDP operations. Finally, the report includes recommendations as to the appropriate levels of liquidity, working capital and reserves that should be maintained under regular and other resources.

The Executive Board may wish to: (a) take note of the report of the Administrator; (b) note the recommended approach to the determination of UNDP liquidity; (c) support the recommendation of the Administrator for the establishment of a reserve for Other Resources activities and the mechanism for its funding; (d) approve the recommended formula for the calculation of the UNDP Operational Reserve, subject to positive review by the Advisory Committee on Administrative and Budgetary Questions (ACABQ); and (e) request the Administrator to report to the Executive Board on the results of the ACABQ review and UNDP action at its second regular session 1999.

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I. INTRODUCTION

1. The present report contains a review of the Operational Reserve and an analysis of the nature of financial risks faced by UNDP. It also defines and discusses the concepts of risk management, liquidity, working capital, the Operational Reserve and other contingency reserves.

2. Terms used in the report to describe Regular Resources and Other Resources of UNDP are those defined in the harmonized budget format (DP/1997/2-E/ICEF/1997/AB/L.3) approved by the Executive Board in its decision 97/6.

II. REVIEW OF THE OPERATIONAL RESERVE

3. The most important existing financial mechanism for UNDP risk management is the Operational Reserve. Established by the Governing Council in the annex to its decision 70/34,[1] the management objective of the Reserve was "... to guarantee under all circumstances the financial liquidity and integrity of the programme, to compensate for uneven cash flows and to meet such other requirements as may be decided upon by the Governing Council at a subsequent stage".

4. The Operational Reserve was created in conjunction with a shift in policy from full funding (i.e., projects undertaken only when funds for their completion were 100 per cent available) to partial funding, as approved by the General Assembly (resolution 2688 (XXV)). Under a partial funding system, UNDP is authorized to approve programme activities against anticipated income and in excess of cash on hand. A primary factor in the success of a partial-funding system is the ability to predict future contribution levels and delivery rates. This change in operating guidelines allowed UNDP to leverage its expected contributions and expand its programming activities. Funds allocated to the Operational Reserve were not intended to be programmed but were set aside to meet uneven cash flow requirements as they arose.

5. The Operational Reserve was initially established at the level of $150 million. At that time, the Reserve was composed of cash and illiquid investments ($90 million) and letters of credit ($60 million).

6. In 1975, UNDP experienced a financial crisis: expenditures exceeded contributions and the Operational Reserve was drawn down. Responding to the crisis, the Governing Council, in its decision 76/34 of 29 June 1976, decided that the level of the Operational Reserve should be built up during the second cycle to a minimum level of $15 million in 1977 and thereafter progressively built up each year to reach a fully funded liquid level of $150 million by the end of 1980.[2] The Council noted the report of the Administrator on the subject (DP/199), in which he recommended that the Operational Reserve should be held exclusively in liquid investments, rather than a combination of investments and letters of credit. The Administrator also noted in his report that UNDP had a clear requirement for working capital relating to the level of cash flows and separate from an Operational Reserve. In its decision 79/31 of 2 July 1979, the

Council approved an increase of the Reserve by $25 million in both 1980 and 1981, thus attaining a level of $200 million by the end of 1981.

7. In his report on the Operational Reserve (DP/469 and Corr.1 and Add.1) submitted to the Governing Council at its twenty-seventh session (1980), the Administrator completed an assessment of risk factors and related the size of the Reserve to the potential occurrence of risks. Risk factors included 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 that result in a loss of resources for which UNDP has made commitments for programming. These factors are cited in Financial Regulation 12.2(a).

8. Taking into account the recommendations of the Administrator, which were based on an analysis of UNDP activities at the time, the Governing Council, in paragraph 3 of its decision 80/50 of 30 June 1980, decided that the elements to be compensated for and covered by it should be limited to:

(a) Downward fluctuations or shortfalls in resources; [14 per cent of anticipated annual pledges, as noted in document DP/469]

(b) Uneven cash flows; [12 per cent of anticipated annual pledges, as noted in document DP/469]

(c) Increase in actual costs or as compared to planning estimates or fluctuations in delivery;

(d) Other contingencies which result in a loss of resources for which UNDP has made commitments for programming. [4 per cent of anticipated annual pledges, as noted in document DP/469]

While the allocations equalled 30 per cent of anticipated annual pledges, it was considered unlikely that all contingencies would occur at the same time. Accordingly, in paragraph 4 of the same decision the Council established the level of the Operational Reserve for each year of the third programming cycle (1982-1986) of 25 per cent of the anticipated 25 per cent of the estimated contributions or expenditures for that year, whichever might be the higher.

9. In its decision 90/44 of 22 June 1990, the Governing Council noted the Administrator's comments on the Operational Reserve, recommending a modified formula by which the Reserve would be set at 20 per cent of expected annual contributions or expenditures, whichever was higher. The reduction in the percentage from 25 per cent to 20 per cent was based on the Administrator's recommendation that improved information systems and operating procedures made quick response to adverse financial circumstances easier. Based on this formula, the Operational Reserve was set at $200 million in 1997. Should the formula be retained, it is calculated at a level of $180 million in 1998 and 1999 based on the forecast presented to the Board in the annual review of the financial situation, 1997 (DP/1998/29).

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III. FINANCIAL MANAGEMENT CONCEPTS

10. There are several generally accepted financial concepts that can be applied to manage current assets on the balance sheet of an organization. They include working capital and contingency reserves, which, taken together are generally referred to as liquidity. These concepts are based on a determination and management of the appropriate amount of current assets that must be held to ensure that the organization can meet its obligations in a way that minimizes uneven cash flows and provides financial stability. As noted in section II, the concepts of working capital and reserves were considered similar in nature and included together in early calculations of the size of the Operational Reserve. However, it is important to understand the differences between working capital, contingency reserves and liquidity.

11. Working capital smooths uneven cash flows. In the case of UNDP, working capital is used to provide advances to executing agents, fund unliquidated obligations and pay ongoing administrative expenses. Working capital is not set aside in the nature of a reserve. It is the residual of cash flows into and out of an organization. Working capital is part of resources available for programming. As specified in Financial Regulation 12.4, working capital is to be provided for from the cash resources of UNDP. UNDP has never formally articulated its requirements for working capital.

12. Contingency reserves are liquid assets that are set aside and available only to meet specified financial risks. Prudent financial management dictates that they are not fungible and not available for use as working capital or for programming. This is particularly true when an organization does not have borrowing authority. The Operational Reserve exists today as a contingency reserve for Regular resources activities. However, UNDP activities have changed substantially since the Operational Reserve was first established in 1971 and since the last modification to the formula was made in 1990.

13. Liquidity is defined as the sum of working capital and reserves at any point in time. From a balance sheet perspective, liquidity is the sum of cash and investments held. Liquidity levels fluctuate as assets are used and replenished in a cycle that provides both working capital for ongoing operations and for reserves.

14. The concept of fiduciary responsibility is fundamental to the role of UNDP as a trustee for the assets of other entities (e.g., trust funds, Governments). It is responsible for the management of working capital and reserves for Other resources activities (e.g., Funds administered by UNDP) and must ensure that proper segregation of assets is maintained. It is not appropriate, for example, for UNDP to use Other resources cash contributions to smooth uneven cash flows that may occur in Regular resources activities.

15. The most significant change in UNDP operations has been the growth in Other resources activities, particularly cost-sharing and trust funds. Over the past few years, Other resources activities have grown to represent a significant portion of UNDP activities. The annual review of the financial situation, 1997 (DP/1998/29) contains additional details on the subject.

16. By definition, the Operational Reserve is limited to providing reserves needed for Regular resources activities. Based on trends observed in the growth of Other resources activities, which, under the provision of the Financial Regulations and Rules, are required to be fully funded, the Administrator believes that a contingency reserve is needed for risks associated with these activities. The Operational Reserve, which is funded from Regular resources, should continue to be a reserve for risks associated solely with Regular resources activities.

IV. UNDP RISK ASSESSMENT

17. Risk management is not a science but rather a blend of management judgment and practical experience. Proper risk management involves the identification of a risk and a prudent judgment about its likelihood of occurrence and any resulting financial implications. While the occurrence of certain contingencies may be deemed unlikely, their potential financial impact may be so great as to require inclusion in a prudent management response plan.

18. The following risk assessment is based on an analysis of the UNDP income statement and balance sheet. Risks can arise from income or expenditure-related activities and from the valuation of assets and liabilities. The process followed by UNDP to refine its knowledge and understanding of these financial risks has progressed in stages over the past two years.

19. As noted in paragraph 30 of document DP/1997/24, UNDP retained an international consulting firm in March 1997 to conduct an assessment of UNDP financial risk and comment on a prudent level of liquidity for UNDP. The review concluded that the current Operational Reserve formula no longer provides a reliable basis for addressing the risks identified. Based on the consultants' knowledge of non-profit organizations, they recommended that UNDP maintain the equivalent of between 6 and 12 months' expenditures as liquidity to meet inevitable fluctuations in cash flows. This benchmark was based on what is considered prudent financial management, particularly for organizations without borrowing capacity. The consulting firm asserted that in the non-profit sector, this level of liquidity is considered to be an indication of financial stability.

20. The assessment of UNDP financial risk also benefited from an exercise conducted in 1997 by the United Nations Office for Project Services (UNOPS) and presented to the Executive Board at its third regular session 1997 (DP/1997/26). The UNOPS study assessed risks faced by the organization and identified four possible responses for addressing risk: limitation; management; transference; or assumption. The study defined a new UNOPS reserve formula based on 4 per cent of the combined administrative and project budget expenditures of the prior year. UNDP followed the UNOPS approach to an assessment of risk based on the four possible responses identified. While recognizing that UNDP faces risks in its operations that are different from those faced by UNOPS, the ability to limit, manage or transfer risk all reduce the chance that UNDP will be required to assume financial loss and draw upon reserves.

21. Taking into consideration the above reviews, the following paragraphs contain an analysis of the most significant financial risks faced by UNDP. Risks associated with Regular resources activities and Other resources activities are presented separately within each category.

A. Income-related risks

22. The most significant financial risks faced by UNDP are income related. Unpredictable fluctuations in contributions pledged from year to year, their value in United States dollar terms in light of exchange rate volatility, and unknown timing of payments of contributions constitute the main risk elements. These risks are further enhanced by the concentration of contributions from a relatively limited number of large donors. For example, the top five donors to UNDP regular resources accounted for some 51 per cent of voluntary contributions over the years 1991-1996.

23. Income-related risks in Other resources activities are substantially mitigated by UNDP Financial Regulations, particularly Regulation 4.15(a), which specifies that all contributions are to be paid in advance of the implementation of planned activities. Some risk remains, however, as donors are often unwilling to advance 100 per cent of a commitment, preferring to effect payment in instalments matched to project budgets and cash requirements. Such practices expose UNDP to a risk of delayed or defaulted payment over the course of project activities.

B. Expenditure-related risks

24. For both Regular resource and Other resource activities, there are a number of risks that are present when making commitments for expenditures. These can occur in resource planning, in the form of over-allocation of resources, or in programme delivery in the form of mismanagement or overexpenditure of allocated resources. Financial risks also arise when making disbursements and include the risks of overpayment, payment to the wrong vendor, fraud or vendor bankruptcy prior to completion or delivery. These risks are present whether UNDP directly manages the activity or is using an agent. In addition, UNDP makes advances for programme and project execution to executing agents and to Governments under national execution. The possibility of fraud or loss exists if an advance is not used for the purpose intended and cannot be recovered. While these risks can be minimized through appropriate internal controls and staff training, they cannot be completely eliminated. With the goal of further minimizing risk, UNDP is reviewing its controls and is implementing an improved expenditure control policy.

C. Asset-related risks

25. UNDP cash and investments assets are also subject to risks. Guidelines are in place that substantially reduce the probability of risk of loss from investment activities by controlling types of investments, minimum credit ratings and exposures to counterparts, etc. In addition, cash management

policies and procedures in place in country offices significantly mitigate the risk of loss from theft or devaluation. Illiquid assets, such as property and equipment, are protected under general property insurance coverage policies. Cash in transit is also protected under a commercial insurance policy.

D. Liability-related risks

26. UNDP is exposed to liabilities from contractual agreements or third parties. Risk exposure in this area is difficult to quantify, but encompasses a variety of legal agreements entered into with donors, Governments, non-governmental organizations, executing agencies and individuals. Costs to UNDP could arise from legal expenses and from management time diverted from other activities to handle problem situations. A number of staff-related liabilities associated with entitlements also exist for which future required funding is not known and may be significant. Examples include post-retirement medical benefits and pension liabilities.

E. Structural risks

27. A category of risk to which UNDP is exposed is similar to one identified by UNOPS: the risk created by business interruption. This risk is magnified by the global structure of UNDP since the size of the country office network increases the chance that there may be civil strife or unrest somewhere in the world that could negatively impact UNDP operations. Similarly, if UNDP were to have its activities interrupted owing to a catastrophic event (e.g., as a result of a major information systems failure), there would be significant costs associated with restoring normal operations.

V. APPLICATION OF FINANCIAL MANAGEMENT CONCEPTS

28. The present chapter defines the basis on which the concepts of liquidity, working capital and reserves should be applied. The application is linked to the financial risk assessment that was performed and to what is considered prudent financial management. Formulas have been reviewed accordingly and are presented below.

A. Reserves

29. UNDP has developed a simplified approach to the calculation of reserves be performed annually based on historical data. A three-year average is recommended for most calculations since that period is the same as the UNDP planning horizon. It should be noted that this represents a change from the current methodology, which is based on estimates rather than on actual data. The Administrator believes that the use of a three-year historical period also provides more perspective on trends and greater objectivity than a forecast.

B. Formula for the Operational Reserve

30. Based on the risk elements presented in chapter IV of the present report, the Administrator recommends that the formula for the calculation of the Operational Reserve be amended in accordance with the following assessment.

Income-related risks

31. In order to protect UNDP from the risk of unexpected downward fluctuations in voluntary contributions, a component of the Operational Reserve is to be calculated as the equivalent of 10 per cent of the average of the voluntary contributions received over the most recent three years, rounded to the nearest $1 million. In 1998, the amount would be $84 million, calculated as follows:

Voluntary contributions received

(Millions of dollars)

1997	761	
1996	848	
1995	900	
Average		836
10 per cent of which		84

The recommendation to use a factor of 10 per cent stems from the study undertaken by the international consultants, which identified the average fluctuation in contributions pledged over a number of years to be 5.8 per cent, and the average fluctuation in exchange rates against the United States dollar over the same period to be 3.7 per cent. Thus, 10 per cent is believed to be a reasonable percentage to set as a reserve against income risks for voluntary contributions.

Expenditure-related risks

32. As a protection against the risks associated with expenditure, a second component of the Operational Reserve would be determined by taking 2 per cent of the average of total expenditures of the three prior years, rounded to the nearest $1 million. The use of a 2 per cent rate is based on UNDP Financial Rule 110.1, which allows for expenditure against project budgets to be exceeded by $20,000 or 4 per cent, whichever is higher, but not more than 2 per cent of the total of an executing agency's total allocations. While this rule does not directly relate to biennial budget expenditure, it is prudent to include administrative expenditure as well. On this basis, this component of the Operational Reserve would amount to $17 million, calculated as follows:

Expenditures

(Millions of dollars)

1997	961	
1996	847	
1995	801	
Three-year average		870
Two per cent reserve		17

Liability-related and structural risks

33. The unknown and unpredictable costs associated with such risks as contractual disputes, unfunded liabilities, business interruption or losses due to civil strife, natural disasters, etc., make it difficult to use a strict formula to determine the protection needed. A lump sum amount for this component of the reserve is necessary. The Administrator recommends that this amount be established as 25 per cent of the sum of the income and expenditure components of the Operational Reserve, rounded to the nearest $1 million. In this way, liability and structural risk protection will be proportional to the growth of the UNDP programme. On this basis, the component relating to liability and structural risks would amount to $25 million, calculated as follows:

	Millions of dollars
Income component of the Reserve	84
Expenditure component of the Reserve	17
Total of these components	101
25 per cent thereof	25

Cash-flow risks

34. Historically, UNDP has experienced significant gaps in its cash flow each year resulting from the mismatch between cash outflow for programme and administrative expenditure and cash inflow from voluntary contributions. While cash outflows have tended to be spread evenly throughout the year, the rate of receipt of voluntary contributions have tended to be more and more towards the end of the calendar year. As UNDP does not have the authority to borrow funds to meet such seasonal cash flow variations, when such variations leave the organization with a temporary need for cash in order to meet its normal obligations, it will have to make use of the Operational Reserve for that purpose.

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35. Based on an analysis of the monthly cash flow position of UNDP over a five-year period, which reveals that gaps of up to 15 per cent between cash inflows and outflows have existed at various points of time, the Administrator believes that a component of the Operational Reserve equal to the cash requirements for one month should be maintained. Given the critical nature of this element of the Reserve, it would be appropriate to calculate the amount on the basis of the most recent full-year expenditure. As 1997 total expenditure for regular resources amounted to $961 million, the one-month equivalent would be $80 million.

36. Under the Administrator's proposed revised formula, the Operational Reserve would equal $206 million in 1998, an increase of $26 million from the $180 million calculated by the current formula (see table 1).

Utilization of the Operational Reserve

37. In accordance with Financial Regulation 12.2, the Administrator will decide as to the need to draw upon the resources of the Operational Reserve. The Administrator will report all such drawdowns to the Executive Board at the subsequent regular session, or between sessions to the members of the Board whenever in the Administrator's opinion, the situation so merits. When notifying the Board of the utilization of Operational Reserve resources, the Administrator will at the same time advise the Board as to the timing and means by which the Operational Reserve will be replenished.

38. The Administrator intends to make use of the resources of the Operational Reserve to minimize the negative effects on programme delivery resulting from any occurrence of the financial risks covered by the Operational Reserve. Drawdowns of resources from the Operational Reserve will be undertaken only when the level of available regular resources has been depleted, and will be effected by a transfer of resources from the Operational Reserve to the regular resources of UNDP, and recorded as such in the financial statements.

C. Formula for the Other resources reserve

39. In accordance with the UNDP Financial Regulations and Rules, Other resources activities are required to be fully funded, meaning that funds must be received in advance of the implementation of planned activities. Therefore, many of the income-related risks associated with Regular resource activities do not apply to Other resource activities. Nevertheless, expenditure-related risks, structural risks, and, to a certain extent, liability risks do exist and prudent financial management suggests that such risks be protected through a financial reserve.

Expenditure-related risks

40. The Administrator recommends that a component of reserve for expenditure-related risks be determined by taking 2 per cent of the average of total expenditures of the three previous years incurred under cost-sharing and trust fund activities, rounded to the nearest $1 million. The use of a 2 per cent rate matches that used for the expenditure-related component of the proposed

formula for the Operational Reserve for Regular resource activities. As an example, if the formula were applied for 1998, the amount of this component would be $19 million, calculated as follows:

Year	Expenditure (Millions of dollars)	
1997	1 139	
1996	925	
1995	733	
Three-year average		932
Two per cent reserve		19

Liability and structural risks

41. Under Other resources, liability-related risks are associated with risks arising from fraud, mismanagement, or poor management of resources held in a fiduciary capacity, and which could therefore result in a claim against UNDP. Structural risks arise from the administrative costs associated with programme activities financed by other resources. Staffing and other administrative costs, such as office accommodation, are financed from the administrative support costs charged to cost-sharing and trust-fund arrangements, and recorded as extrabudgetary income. Should this earned income be disrupted, or even cease owing to circumstances beyond the control of UNDP, significant administrative expenditures would still need to be incurred to meet ongoing obligations.

42. In order to ensure that administrative obligations could be met in a worst-case scenario without utilizing UNDP regular resources, the Administrator believes that funds sufficient to cover such costs for a period of one year would be needed. This amount is currently estimated at $30 million.

43. To cover fully the expenditure, liability, and structural risks described above, the Other Resources Reserve would amount to $49 million for the 1998 financial situation resulting from:

	Millions of dollars
Expenditure component	19
Liability and structural component	30
Total	49

Funding and utilization of the Other Resources Reserve

44. In recognition of the risks relating to the acceptance and management of Other resources by UNDP in those countries in which they have been largely generated, the Administrator has been informally reserving a portion of the extrabudgetary income derived from the fees charged by UNDP. The Administrator now intends to record as a reserve those funds previously reserved for this purpose.

45. The Bureau for Programme and Resources Management (BPRM), is currently reviewing the UNDP cost-recovery policies and mechanisms, including the fee structure. This review will also take into account the need for a reserve for the risks relating to other resources.

D. Formula for liquidity

46. As previously stated, liquidity is defined as the total amount of cash and investments held at any point in time, and may also be expressed as the sum of reserves and working capital. In its assessment of UNDP financial risks, the international consulting firm engaged by the Administrator advised that organizations such as UNDP, which do not have access to the capital markets nor the ability to borrow from banks to cover periodic cash flow needs, should maintain in liquidity the equivalent of 6 to 12 months' expenditure as a prudent level. Based on that assessment, the Administrator believes that UNDP should manage its liquidity to fall within such a range. It is to be noted that (a) the level of liquidity held by UNDP is largely a factor of the timing of the payment of voluntary contributions and (b) the organization must have a sufficient level of working capital to operate effectively. UNDP expends approximately $80 million per month, and should cash resources start to dwindle, the Administrator must have sufficient time to initiate corrective action.

47. The Administrator wishes to emphasize that the indicative amount of liquidity to be held is not intended to be a mandated amount. Liquidity levels will indeed fluctuate for a variety of reasons, many of which may be seasonal in nature. However, if the liquidity level rises above or falls below the indicative range, it is a signal for UNDP to take action. For example, if liquidity falls below the equivalent of four months' expenditure, and if the reasons for the reduced liquidity level warrant it, the Administrator may initiate withdrawal action to accelerate the payment of contributions. Similarly, a rising liquidity level may signal programme delivery problems, which may require remedial actions regarding programming or programme execution.

48. In 1997, programme and administrative expenditures totalled $960 million. Therefore, the indicative liquidity range for 1998 would be from $480 million to $960 million. Liquidity minus reserves represents the working capital available to support the organization's operations. For example, a liquidity of $480 million, less reserves of $206 million calculated under the proposed formula for the Operational Reserve, would leave approximately $274 million of working capital, which is currently approximately 3.5 months of cash outflows. At the time of the preparation of the present report, the actual regular resources liquidity of UNDP amounted to approximately $447 million, or roughly

five and one half months' needs, of which $206 million, or three months' needs, reflects the working capital.

49. It is important to note the distinction between liquidity and the balance of unexpended resources. In document DP/1998/34, the Administrator has projected that the balance of unexpended UNDP resources available for programming would fall to zero by the end of 1999. In such an event, UNDP would nevertheless have a positive level of liquidity, probably at the low end of the range (six months), since it would still have funds of the non-programmable operational reserve, and some amount of working capital relating to undisbursed expenditure.

50. Other resources liquidity. In 1997, Other resources expenditures totalled $1.1 billion. Therefore, the recommended liquidity range for Other resources is from $550 million to $1.1 billion. As noted above, liquidity minus reserves represents the working capital available to support the organization's operations. Liquidity of $550 million, less proposed reserves of $49 million for the Reserve for Other resources, would leave $501 million of working capital. Since fully funded activities by definition require funds to be received prior to commitment, a higher level of working capital should be expected. Indeed, at the time of preparation of the present report, Other resources liquidity amounted to approximately $950 million, or some 9.0 months' of cash flow needs after applying the proposed reserve of $49 million.

51. Liquidity of funds administered by UNDP. The Administrator considers that the concept of maintaining a liquidity range is equally valid for each UNDP-administered fund and should be applied to them individually. The present report does not include an assessment of the risks for funds administered by UNDP. This exercise should be conducted in the future and should take into account the level of liquidity and the reserves deemed necessary for the risks of each particular fund. Some of the funds administered by UNDP have already established contingency reserve levels (e.g., the United Nations Development Fund for Women, the United Nations Capital Development Fund).

52. The application of the formula proposed by UNDP is summarized in tables 1 and 2. The calculation uses 1995 to 1997 financial variables applied in the 1998 context.

Table 1. Summary of components of liquidity - Regular resources, 1998

		6 months	12 months
		(Millions of dollars)	
Liquidity range (6-12 months of programme and administrative expenditures)		480	960
of which:			
Operational Reserve -			
Income component	84		
Expenditure component	17		
Miscellaneous component	25		
Cash-flow component	80	206	206
Working capital range		274	754

Table 2. Summary of components of liquidity - Other resources, 1998

		6 months	12 months
		(Millions of dollars)	
Liquidity range (6-12 months of expenditure)		550	1 100
of which:			
Reserve -			
Expenditure component	19		
Liability and structural component	30	49	49
Working capital range		501	1 051

VI. RECOMMENDED LIQUIDITY, WORKING CAPITAL AND RESERVE LEVELS

53. Based on the foregoing discussion and analysis, the Administrator advises the Executive Board that:

(a) A broad basis for liquidity holdings is an amount equal to between 6 and 12 months of annual expenditure;

(b) Liquidity is defined as the sum of working capital and reserves.

54. The Administrator recommends that:

(a) Liquid assets be set aside for the Operational Reserve based on the formula described in chapter IV. The use of that formula would have set the level of the Operational Reserve at $206 million for 1998.

(b) A reserve for Other resources activities be established based on the formula described in chapter IV and funded through a transfer from the extrabudgetary account in accordance with an appropriate cost-recovery modality. For 1998, the Other Resources Reserve would have been set at $49 million.

VII. EXECUTIVE BOARD ACTION

55. The Executive Board may wish to:

(a) Take note of the report of the Administrator (DP/1999/5);

(b) Note the approach recommended by the Administrator to determine UNDP liquidity;

(c) Support the recommendation of the Administrator for the establishment of a reserve for Other Resources activities and the mechanism for its funding;

(d) Approve the recommended formula for the calculation of the level of the Operational Reserve for regular resources, subject to positive review by the Advisory Committee on Administrative and Budgetary Questions (ACABQ);

(e) Request the Administrator to report to the Executive Board on the results of the ACABQ review and UNDP action at its second regular session 1999.

Notes

[1] Official Records of the Economic and Social Council, Forty-ninth Session, Supplement No. 6A (E/4884/Rev.1), page 39.

[2] Ibid., Sixth-first Session, Supplement No. 2A (E/5846/Rev.1), page 22.
