

ASSEMBLY - 35TH SESSION

ADMINISTRATIVE COMMISSION

- Agenda Item 41: Financial Questions**
Agenda Item 41.3: Report on the Working Capital Fund

REPORT ON THE WORKING CAPITAL FUND

SUMMARY

This paper reports on the adequacy of the level of the Working Capital Fund, the financial position of the Organization and the financial trends affecting the required level of that Fund. It recommends maintaining the level of the Working Capital Fund at \$ 6.0 million and granting authority to the Council to review and to increase the level of the Working Capital Fund, to a maximum of \$ 8.0 million, if and when an urgent need arises during the next triennium.

Action by the Assembly: Paragraph 5

REFERENCES

Doc 9790, *Assembly Resolutions in Force (as of 5 October 2001)*
Doc 7515/11, *The ICAO Financial Regulations*

1. INTRODUCTION

1.1 Resolving Clause 2 of Assembly Resolution A33-28 specifies that:

- "a) the level of the Working Capital Fund remain at \$ 6.0 million for the years 2002 and 2003;
- b) the Council shall review the level of the Working Capital Fund no later than November 2003 to determine if an increase is needed for the year 2004;
- c) if the Council determines that it is warranted, the level of the Working Capital Fund shall be established at \$ 8.0 million for the year 2004, subject to increases resulting from advances paid by new States becoming members of the Organization after approval of the 2002 scale. The options for financing the increase shall be reviewed by the Council at that time and the Council shall decide on the means of funding;

...

- e) the Council shall report to the next ordinary session of the Assembly:
 - i) on the adequacy of the level of the Working Capital Fund in the light of experience during 2001, 2002 and 2003;
 - ii) whether the financial position of the General Fund and the Working Capital Fund would indicate the need for assessing Contracting States for cash deficits caused by arrears of contributions;
 - iii) on the appropriateness of the level of the borrowing authority;".

1.2 In accordance with Financial Regulation 7.3 b) i), the Working Capital Fund (WCF) is utilized to make advances as necessary to the General Fund to finance budgetary appropriations pending receipt of assessed contributions from Contracting States. The amounts advanced from the WCF are to be reimbursed as soon as funds are available in the General Fund.

1.3 The Council reviewed the level of the Working Capital Fund in November 2003 and determined that the need for the increase in the level was not urgent and immediate for the year 2004. In addition, the Council decided to defer the issue of the future level of the Working Capital Fund for consideration by the Assembly.

2. FLOW OF RECEIPTS AND DISBURSEMENTS

2.1 The need for the use of the WCF is determined by:

- a) the timing of receipt of assessments from Contracting States;
- b) the timing of disbursement against budgeted expenditures; and
- c) the availability of accumulated cash surplus in the General Fund.

2.2 Miscellaneous Income finances about 7 to 8 per cent of the Regular Programme budget appropriations. The balance of 92 to 93 per cent of the budget appropriations are funded by assessments on Contracting States. The regular receipt of assessments is therefore critical to ensure timely disbursements, efficient management of cash and the financial stability of the Organization.

2.3 Staff costs and non-staff costs constitute about 84 per cent and 16 per cent of budgeted expenditures, respectively. Although some expenditures may be incurred periodically and may be skewed towards the end of the year, a very large proportion of the expenditures are disbursed evenly throughout the year. Based on the approved budget, the average monthly disbursements for 2004 are estimated at \$ 4.9 million, of which approximately \$ 4.5 million is funded from assessments on Contracting States or cash surplus. Subject to the level of the budget that will be approved, the average monthly disbursements are likely to increase in the next triennium.

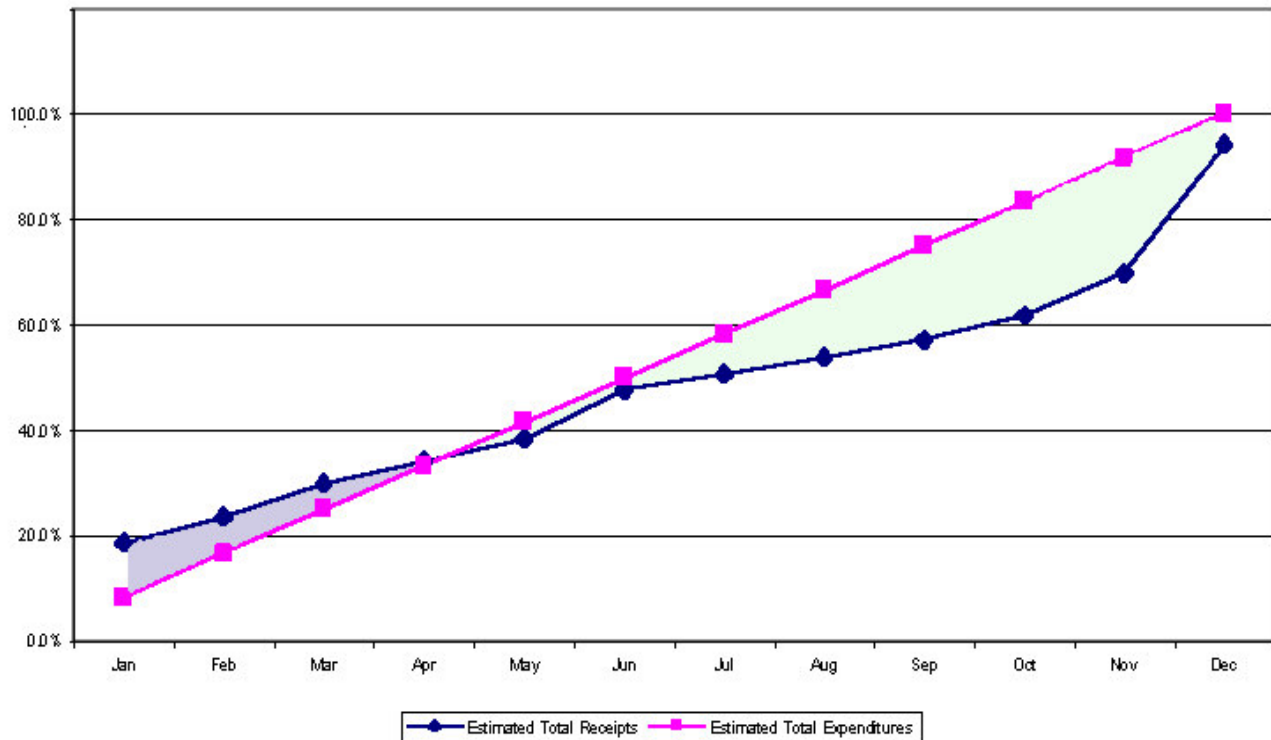
2.4 Table A indicates the cumulative percentage of current year assessments received at the end of each quarter from 1998 to 31 December 2003, and presents the average collection rate for the previous 5 year period compared with the corresponding estimated budgetary expenditure. The difference between the average collections and the estimated disbursements represents a cashflow surplus or cashflow deficit for the year to date. As will be noted in Table A, as at September each year, the cumulative receipt of assessments was short of estimated disbursements by an average of 17.7 per cent.

TABLE A
Cumulative Percentage of Assessments Received
Compared to Disbursements Funded by Assessments

	Percentage of Assessments Received						Past 5 Year Average	Per Cent Estimated Expenditure	Per Cent Cashflow Surplus/(Shortfall)
	1998	1999	2000	2001	2002	2003			
March	33.3	27.3	22.8	34.4	32.3	22.0	30.0	25.0	5.0
June	42.9	55.6	38.8	50.4	51.0	41.1	47.7	50.0	(2.3)
September	52.1	63.1	47.6	63.8	59.6	57.1	57.3	75.0	(17.7)
December	95.3	95.2	93.5	94.5	93.8	95.3	94.5	100.0	(5.5)

2.5 Figure 1 below illustrates the typical pattern of cumulative assessment receipts and the related disbursements funded from assessments for a given financial year, based on past trends experienced by the Organization. It will be noted from the graph that, up until April, receipts are normally sufficient to meet disbursements. From June onwards, the gap between receipts and disbursements widens progressively. Between the months of September to November, the cash shortfall ranges from 18 to 22 per cent of the budget funded by assessments. Assuming a budget at the same level as that for the year 2004, and without cash surplus to supplement assessments, the cashflow shortfall accumulated by the end of September and November would amount to between \$ 7.5 million and \$ 11.3 million, respectively.

FIGURE 1
PATTERN OF RECEIPTS AND DISBURSEMENTS

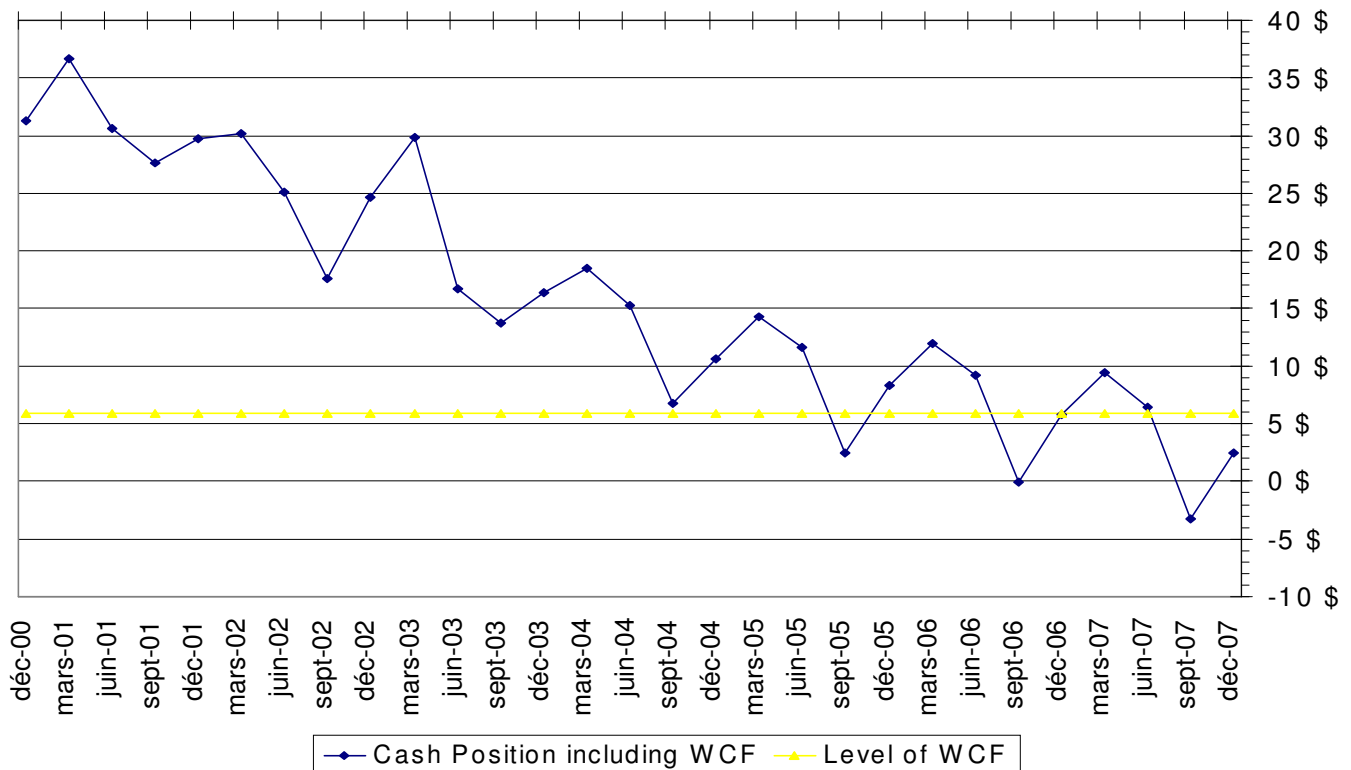


2.6 In previous years, because of the availability of accumulated cash surplus within the General Fund, there was no necessity to draw funds from the WCF. During the financial years 1995 to 1997, the Organization experienced annual cash surpluses resulting in an accumulated cash surplus of \$ 23.6 million by 1998. While part of the accumulated cash surplus was distributed to Contracting States, a larger portion was progressively used to implement new programmes or supplement the Regular Programme Budget so as to reduce the annual assessments on Contracting States.

2.7 It will be noted from the annual accounts that the actual cash balance in the General Fund and the WCF as at 31 December 2002 amounted to \$ 24.7 million. At 31 December 2003, the actual cash balance was \$ 16.3 million, of which \$ 6.0 million pertained to the WCF. In 2004, \$ 5.6 million of the accumulated cash surplus will be used to finance Regular Programme expenditure in accordance with Assembly Resolution A33-23 Resolving Clauses B2 and B3, further reducing the cash available in the General Fund.

2.8 Figure 2 illustrates the cash position of the General Fund, including the WCF, at the end of each quarter from 2000 to 31 December 2003, and the projection to the end of 2007, based on past trends and budget projections. It will be noted from the Figure that the cash position of the Organization is likely to deteriorate progressively, particularly given the present pattern of receipts of assessments. It is estimated that by September 2004, except for the balance of \$ 6.0 million in the Working Capital Fund, all other cash will have been used and the WCF may be the only cash buffer for the Organization's Regular Programme Budget. The cash flow is likely to become more precarious after 2004. If the pattern of receipt of contributions remains unchanged and disbursements occur as planned, the Organization will have to resort to using funds from the WCF to finance its budgeted activities in the third and fourth quarters of the years 2005 to 2007.

FIGURE 2
ACTUAL AND PROJECTED CASH POSITION
(in millions of US dollars)



2.9 The Organization's cashflow problem is caused by the delay in payment of contributions during the year and beyond. Continued avoidance by some Contracting States of their financial obligations is unacceptable and could necessitate an increase in the level of the Working Capital Fund that would negatively impact all Contracting States. Unless payments towards assessments are received from Contracting States on a timely basis, in the year that they are due and in conformity with the Financial Regulations, pressure will be exerted on the finances of the Organization. Other than the WCF, there are no other funds reserved to meet contingencies in 2004 and beyond. It should also be noted from Figure 2 that, in 2007, the current level of the WCF may be inadequate to meet the needs of the Organization, and additional cash resources of up to \$ 4.0 million could be required to supplement the WCF.

3. **BORROWING AUTHORITY**

3.1 The Assembly in 1998 (A32-28) authorized the Secretary General to borrow, if necessary, with the prior approval of the Finance Committee, amounts to finance regular and supplementary appropriations, provided that the outstanding total indebtedness of the Organization at no time exceeds \$ 3.0 million during the triennium. The continuation of the borrowing authority has been provided for in Resolving Clause 2 d) of Assembly Resolution A33-28. It has not been necessary to use this borrowing authority as there were sufficient funds on hand.

3.2 ICAO's only other potential source of funds, excluding commercial borrowing, is surplus of the AOSC or other Special Funds and Accounts. Relying upon the cash of other Funds and Special Accounts in place of securing an appropriate level for the WCF would be flawed in both principle and practice, and does not offer a prudent financial option.

3.3 Although the borrowing authority has not been utilized, in light of uncertainties and the anticipated precarious nature of cash flow in future years, it would be prudent to retain the borrowing authority at the current level for future years. However, this avenue of funding temporary cash deficits, if at all necessary, should be regarded as an avenue of last resort to be exercised under extreme circumstances.

4. **LEVEL OF THE WORKING CAPITAL FUND**

4.1 The current level of the WCF of \$ 6.0 million was established by Assembly Resolution A29-30 and was effected in 1994. The receipt of miscellaneous income has proven fairly stable over time and, therefore, the WCF is needed primarily to finance the monthly expenditure not funded by miscellaneous income. In 1994, the WCF level provided cover for approximately 1.5 months of the budget expenditure financed from assessments, whereas in the year 2004, the WCF is sufficient to cover approximately 1.3 months of such expenditure. A higher level of budget in 2005 and beyond is likely to reduce this ratio further. By comparison, at a level of \$ 8.0 million, the Organization would have sufficient Working Capital to cover 1.7 months of the budget expenditure of the year 2004 that is not funded by miscellaneous income.

4.2 Ideally, the Organization should have a buffer of two months' requirement in the WCF in order to ensure the proper implementation of approved programmes and to make timely payments against commitments. The accumulated cash surplus available in the past has helped the Organization overcome very serious delays in receipt of contributions. However, because the accumulated surplus would have been distributed or used, the Organization may face cash flow problems starting in 2004, and the situation is likely to deteriorate in the next triennium. In this regard, it should be noted that the cash flow projections are based on the assumption that the inflow of assessments will reflect previous trends and disbursements will occur as planned. Any variation from this pattern, particularly unforeseen delays in receipt of assessments, would further aggravate the projected cash position.

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4.3 As explained in paragraph 2.5, the shortfall in cashflow during the months of September to November could range from approximately \$ 7.5 million to \$ 11.3 million, based on an assessed budget with expenditure at the level of the year 2004. An increase in the level of the WCF to \$ 8.0 million would only barely reach the lower level of the estimated shortfall.

4.4 In its review of the level of the Working Capital Fund in November 2003, the Council concluded that the need for the increase in the Fund was not urgent and immediate, and that the level of the Working Capital Fund can remain at the present level of U.S.\$ 6.0 million for the immediate future. However, in the event that some Contracting States continue to delay the payment of their contributions, an increase in the level of the Working Capital Fund may be required during the next triennium. Accordingly, the Council proposes that the Assembly grant the Council the authority to regularly monitor the level of the Working Capital Fund, and to increase the level of the Working Capital Fund to a maximum of U.S.\$ 8.0 million, if and when an urgent need arises during the course of the next triennium. Any adjustment to the level of the Working Capital Fund would be determined on the basis of the scales of assessment for the year for which the increase is approved.

5. ACTION BY THE ASSEMBLY

5.1 The above conclusions and recommendations are summarized in the draft Assembly Resolution in the Appendix, which is recommended by the Council for adoption by the Assembly.

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APPENDIX

DRAFT RESOLUTION FOR ADOPTION BY THE 35TH SESSION OF THE ASSEMBLY

Resolution 41.3/1

Working Capital Fund

The Assembly:

1. *Notes that:*
 - a) in accordance with Resolution A33-28, the Council has reported upon, and the Assembly has considered, the adequacy of the level of the Working Capital Fund and the related borrowing authority;
 - b) in recent years, the accumulation of contributions in arrears has constituted, together with the delays in payment of current year contributions, a growing obstacle to the implementation of the work programme while creating financial uncertainty;
 - c) the relatively long budgetary cycle of ICAO, namely three years, has a bearing on the determination of the prudent level of the Working Capital Fund and borrowing authority, as only the Assembly can levy assessments on Contracting States;
 - d) given the number of permanent staff in ICAO, there is an irreducible minimum which the Organization has to pay out each month to meet the staff costs. This amount is not amenable to short term reduction through adjusting the work programme, since permanent staff remain in post and have to be paid in any event;
 - e) on average, by September of each year, the cumulative receipt of assessments was short of estimated disbursement by an average of 17.7 per cent;
 - f) based on past trends, the average annual cash flow shortfall accumulated by the end of September and November could range between \$ 7.5 million and \$ 11.3 million;
 - g) experience has shown that payments are not made at the beginning of the year when contributions are due and that ICAO cannot rely on contributions being paid even by the end of the year to which they relates and that such unacceptable avoidance of their financial obligations under the Convention by some Contracting States is leading to a grave financial crisis within the Organization that could impact all Contracting States; and
 - h) as long as the cash flow remains uncertain, ICAO would need the Working Capital Fund as a buffer on which it could draw to meet its unavoidable cash commitments;
 - i) the Council reviewed the level of the Working Capital Fund in November 2003 and determined that the need for the increase in the level from \$ 6.0 million to \$ 8.0 million was not urgent and immediate for the year 2004.

2. *Resolves that:*
 - a) the level of the Working Capital Fund remain at \$ 6.0 million;
 - b) the Council shall review the level of the Working Capital Fund each year, and no later than November 2004, 2005, 2006 and 2007, to determine if an increase is urgently needed during that year or for the following year;
 - c) if the Council determines that it is warranted, the level of the Working Capital Fund shall be established at a level no higher than \$ 8.0 million, subject to increases resulting from advances paid by new States becoming members of the Organization after approval of the scales. Such adjustment to the Working Capital Fund will be based on the scales of assessment in effect for the year for which the increase in the level of the Working Capital Fund is approved;
 - d) the Secretary General be authorized, with the prior approval of the Finance Committee of the Council, to finance regular and supplementary appropriations that cannot be financed from the General Fund and the Working Capital Fund, by borrowing externally amounts needed to meet immediate obligations of the Organization, and that the Secretary General be required to repay such amounts as rapidly as possible; the outstanding total of such indebtedness of the Organization at no time to exceed \$ 3.0 million during the triennium;
 - e) the Council shall report to the next ordinary session of the Assembly:
 - i) on the adequacy of the level of the Working Capital Fund in the light of experience during 2004, 2005 and 2006;
 - ii) whether the financial position of the General Fund and the Working Capital Fund would indicate the need for assessing Contracting States for cash deficits caused by arrears of contributions;
 - iii) on the appropriateness of the level of the borrowing authority; and
 - f) Resolution A33-28 is no longer effective and is hereby superseded.
3. *Urges:*
 - a) all Contracting States to pay their assessments as early as possible in the year in which they fall due in order to lessen the likelihood of the Organization having to draw on the Working Capital Fund and resort to external borrowing; and
 - b) the Contracting States in arrears to meet their obligations to the Organization as promptly as possible, as called for by Resolution [].