

**FORTY-EIGHTH MEETING OF THE
COMMITTEE OF REPRESENTATIVES OF GOVERNMENTS AND ADMINISTRATIONS**
(26–28 June 2018, Noumea, New Caledonia)

AGENDA ITEM No. 7: 2018 revised budget and 2019 proposed budget

(Paper presented by the Secretariat)

Summary

1. This paper presents the revised 2018 budget to CRGA for noting in accordance with SPC's Financial Regulations, which require the Director-General to inform CRGA of budget revisions.
2. It also presents the draft 2019 budget for consideration by CRGA.
3. The revised 2018 budget was adopted out of session by CRGA in December 2017, based on a detailed review and recommendation by both the Audit and Risk Committee and the CRGA Subcommittee on Strategic Plan Implementation. The Subcommittee *'endorsed the revised 2018 budget and recommended its submission to all CRGA members for comment and out of session adoption'*. The revised 2018 budget, as approved, is essentially a balanced budget with total income of EUR 82.18 million, comprising a core budget of EUR 16.98 million (20.7%) and restricted programme and project funding of EUR 65.2 million (79.3%).
4. The Secretariat is currently projecting a **2019 deficit budget amounting to EUR 2.0 million**, derived from income of EUR 64.9 million less expenditure of EUR 66.9 million. Total income comprises forecast core income of EUR 15.9 million and restricted programme and project funding of EUR 49 million. This is a decrease of EUR 17.27 million (21%) compared to the 2018 revised budget of EUR 82.18 million, primarily as a result of:
 - i. a reduction of EUR 1.04 million in unrestricted core funding, due to a combination of:
 - a. the non-replacement of a material 2018 'one-off' voluntary core contribution;
 - b. ongoing adverse currency fluctuations;
 - c. a reduced level of host country grants;
 - ii. a current decline of EUR 14.99 million in project funding due to the normal cycle of existing projects ending before funding agreements for new projects are finalised. Note that the decline in 2019 is materially greater than in prior budgets due to the expiry of several large, multi-year projects. This context also impacts the budget deficit projected for 2020;
 - iii. a forecast decrease in restricted programme funding of EUR 1.24 million due to a combination of adverse AUD and NZD exchange movements and reduced prior-year carryover. Declines in programme funding are a concern as this source of funding provides flexible funding to programmes that is critical in allowing them to manage the challenges associated with delivering services to members that cannot be funded from either

restricted projects or existing core allocations. The Secretariat is engaged in ongoing negotiations to address the overall decline in this important strategic source of funding.

5. This paper also draws CRGA's attention to a projected deficit of EUR 3.13 million in 2020.
6. The Secretariat is committed to addressing the projected budget deficits for 2019 and future years and to raising the resources necessary to fund initiatives under the Pacific Community Strategic Plan 2016–2020, together with any new or emerging priorities. The sustainable financing initiatives presented at CRGA 46 continue to evolve as efforts to embed the disciplines of full cost recovery (FCR) are strengthened with each budget cycle.

Recommendations

7. CRGA is invited to:
 - i. endorse the 'out-of-session' adoption of the revised 2018 budget;
 - ii. note the draft budget for financial year 2019, subject to:
 - a. the Secretariat presenting a revised 2019 budget that substantively addresses the current forecast deficit;
 - b. review by the Audit and Risk Committee;
 - c. review and endorsement by the CRGA Subcommittee on Strategic Plan Implementation by December 2018;
 - d. out-of-session adoption by all members of CRGA before 31 December 2018;
 - iii. note the ongoing budgetary challenges for future years that stem from SPC's high reliance on cyclical project financing;
 - iv. endorse the Secretariat's proposals that:
 - a. from 1 January 2019, members directly fund their own travel and accommodation costs for participating in all core-funded SPC governance meetings, whether CRGA, Conference, subcommittees, ministerial or heads of sector meetings;
 - b. a detailed review of assessed contributions and host country grants be undertaken, with recommendations to be submitted to CRGA 49.

Purpose

8. This paper presents the revised 2018 budget to CRGA for noting in accordance with SPC's Financial Regulations, which require the Director-General to inform CRGA of budget revisions.
9. It also presents the draft budget for financial year 2019 for review by CRGA subject to the following considerations:
 - i. Given the importance of restricted project funding to the final composition of SPC's budgets, there are challenges in finalising a reliable budget for future years when CRGA is held mid-year. The Secretariat therefore proposes that CRGA note that the draft 2019 budget is 'indicative' in nature and that a revised budget will be submitted for approval by December 2018.
 - ii. The Secretariat proposes the same process as used for approval of the 2017 and 2018 revised budgets, i.e. a final revised 2019 budget will be submitted to the Audit and Risk Committee for review before it is presented to the CRGA Subcommittee on Strategic Plan Implementation for final review and endorsement. The Secretariat will then compile and circulate all comments received to all CRGA members for out-of-session adoption of the revised 2019 budget.

Introduction

10. The Secretariat advised CRGA 45 that it was committed to addressing projected budget deficits and to raising the resources necessary to fund initiatives under the Pacific Community Strategic Plan 2016–2020, together with any new or emerging priorities. To this end, the Secretariat continues to place emphasis on incrementally increasing full cost recovery (FCR) across the organisation. As previously noted, ICT operations were moved to a full cost recovery basis as part of the 2016 revised budget and the Secretariat has continued to refine and learn from this change in 2017.
11. The Secretariat implemented FCR with respect to the funding of its facilities in the 2018 revised budget. This move provided a basis for clear allocation of this major infrastructure cost across all programmes and provided a platform for the formal recovery of these costs from future project proposals.
12. Further development of FCR is being trialled during 2018 and, based on the lessons learned from these trials, an expanded suite of formal cost recovery processes will be reflected in the revised 2019 budget, aimed at increasing the level of project cost recoveries for the following support functions within the Operations and Management Directorate (OMD):
 - i. Publishing
 - ii. Translation and Interpretation
 - iii. Conference support facilities.
13. The need to ensure sustainable financing for SPC in the future will most certainly require the Secretariat and members to revise their approach to work programmes and investment. Significant effort was invested during the last 12 months to develop an objective priority-setting mechanism, which was then tested as part of the allocation criteria for the 2018 internal innovation fund. While declining core funding limits SPC's degree of freedom in creating an increased pool of discretionary core funding, the Secretariat will continue to increase the amount of core funding that can be allocated according to SPC's agreed priorities rather than distributed on a historical basis.

14. The 2018 revised budget and the draft 2019 budget are set out in the 'green book' which contains details of the income budget and expenditure budget, and a summary of expenditure by budget chapter (i.e. by division).
15. Supporting the income and expenditure budget summary are division-specific budgets (budget chapters), which detail:
 - i. funding categories – core, restricted and project funding;
 - ii. budget narratives, which describe for each division/programme its goal, objectives and key planned outputs/results to be achieved under core, restricted programme and project funding for FY 2019;
 - iii. initial budget forecast for FY 2020.
16. The green book also contains annexes with supporting information, such as assessed contributions and host grants, and an early income prediction through to 2020 by funding type and by source (member/donor).
17. Funding in the 2018 revised budget and draft 2019 budget is classified under the headings: *core funding*, *restricted programme* and *project funding*:
 - i. *Core funding* is wholly unrestricted in its use and refers to income received from the following sources: members' assessed contributions, host country grants, and general income (such as bank interest and miscellaneous income). It also includes voluntary contributions from members to fund the Secretariat's core business operations. Core funding is, generally, not time bound and therefore provides a foreseeable source of income for the organisation.
 - ii. *Restricted programme funding* refers to income received from members and donors for use in a broad thematic area or by a specific division, but not tagged to a specific project. There is a degree of flexibility on where such funds can be deployed within the selected area of focus. Such funding is generally time bound.
 - iii. *Project funding* refers to contributions by development partners, both members and non-members, that are earmarked for specific time-limited activities.

Assessed contributions

18. Assessed contributions for FY 2019 and 2020 have been projected at the levels agreed on by the Eighth Conference of the Pacific Community in 2013. While a triennial review of assessed contributions was due to be undertaken in 2016, the current budget projections for assessed contributions have again been held constant. Individual members' contributions are shown in Annex 1 of the green book.
19. Metropolitan members contribute EUR 7.682 million (81%) of assessed contributions as follows:

Australia	2.681
France	2.095
New Zealand	1.718
<u>USA</u>	<u>1.188</u>
Total	EUR 7.682

20. The 22 island members of SPC contribute EUR 1.771 million (19%) in assessed contributions. Each of these members falls within one of the defined categories of membership contributions, as endorsed by the Eighth Conference.
21. The Secretariat also draws members' attention to the fact that, as of 24 May 2018, only 11 member countries and territories have paid their 2018 assessed contribution in full. Table 1 below summarises the general payment status of members. Following an improvement in member payments ahead of Conference in 2017, there has been a significant decline for the 2018 year to date, resulting in a **current unpaid balance of EUR 5.69 million, compared to EUR 2.9 million at the same time last year**. The uncertainty caused by the ongoing arrears situation affects SPC's ability to project its future income base with any degree of certainty, which in turn affects its capacity to implement the Strategic Plan. The Secretariat would be most grateful if all members could commit to paying their outstanding contributions, together with any arrears, before the end of 2018.

Table 1: Status of assessed contributions and host country grants

Members paid in full	Members with 2018 contributions not fully paid	Members with more than 1 year's contributions outstanding	Members with more than 2 years' contributions outstanding	Members with more than 3 years' contributions outstanding
Australia Cook Islands French Polynesia Kiribati New Caledonia New Zealand Palau Pitcairn Islands Samoa Tokelau Wallis and Futuna	Federated States of Micronesia Fiji France Guam Marshall Islands Nauru Niue Tonga Tuvalu United States of America Vanuatu	Papua New Guinea	American Samoa Solomon Islands	Northern Mariana Islands
Total: 11	Total: 11	Total: 1	Total: 2	Total: 1

Host country grants

22. The Eighth Conference agreed to a targeted increase in the total amount of host grants to approximately 3 million CFP units (EUR 2,500,000) by fiscal years 2015/2016. Given the financial situation of SPC's host countries and the global economic context at the time, the Secretariat considered that this would be difficult to achieve and therefore proposed a much reduced amount of approximately 33% (990,000 CFP units/EUR 830,000) of the target figure. Unfortunately, even the reduced target has not been achieved and, of even more concern, some of the gains that were initially made will be again eroded in 2018 and 2019. The current budget projections are:

Host country	Reduced proposal (CFP units)	2018 budget (EUR)	2019 budget (EUR)
Fiji	400,000	33,500	33,500
New Caledonia	340,000	209,500	209,500
FSM	200,000	167,600*	15,000
Solomon Islands	50,000	41,900	41,900
Vanuatu	0	58,700	58,700
TOTAL	990,000	511,200	358,600

** This amount will not be paid for 2018*

23. The Secretariat draws members' attention to the ongoing erosion of core funding, through the dual challenges of reduced voluntary contributions and host country grants, together with the financial uncertainty created by the high level of unpaid assessed contributions.
24. Members will recall the discussions at previous CRGA meetings, on the amount of funding required to pay travel and per diem costs for representatives to SPC's governing body meetings. At the time, members directed that the Secretariat would cover the cost of one person per Island member. However, in light of the aforementioned situation, the Secretariat proposes that, from 1 January 2019, members directly fund their own travel and accommodation costs for participating in all core-funded SPC governance meetings, whether CRGA, Conference, subcommittees, ministerial or heads of sector meetings. This would significantly reduce the burden of travel costs on SPC's reduced core funding and allow the Secretariat to redirect those funds to priority areas or towards any budget deficit.
25. Further, the Secretariat draws members' attention to the fact that assessed contributions have been held constant since 2013, and that the Secretariat made the decision to defer the normal triennial review, which was scheduled to be undertaken in 2016, to avoid increasing pressure on national finances. The Secretariat instead chose to deal with SPC's financing challenges through a series of fiscally responsible internal measures. However, taking into account the five years since the last review, the Secretariat requests CRGA's authorisation to undertake a complete review of assessed contributions and host country grants, and to present a detailed proposal to CRGA and Conference in 2019.

Revised 2018 budget overview

26. The revised 2018 budget was adopted out of session by CRGA in December 2017, following a review by the Audit and Risk Committee and the CRGA Subcommittee on Strategic Plan Implementation.
27. The revised 2018 budget, as approved, remains a balanced budget totalling EUR 82.18 million, comprising a core budget of EUR 16.98 million combined with restricted and project funding of EUR 65.20 million.
28. The 2018 revised income projection represented an increase of EUR 9.5 million (13%) compared to the original 2018 budget of EUR 72.6 million. The increase was due to the following changes:
 - i. Additional project funding of EUR 6.9 million arising from both new project proposals and carry-over of unspent 2017 project funding.
 - ii. Increased restricted programme funding of EUR 1.78 million.
 - iii. A 'one-off' voluntary core contribution of EUR 0.8 million.

Proposed 2019 budget overview

29. The Secretariat has prepared a 2019 budget that presents a deficit amounting to EUR 2.0 million derived from income of EUR 64.9 million less expenditure of EUR 66.9 million. With a projected core budget of EUR 15.94 million, and a restricted and project budget amounting to EUR 48.96 million, the total income projection of EUR 64.9 million is a decrease of EUR 17.2 million (21%) compared to the 2018 revised budget. This decrease is due primarily to the following factors:
- i. A decline of EUR 16.2 million in restricted programme and project funding. The normal funding cycle determines that, at this time of year, there is a decline in available project funding due to existing projects ending before funding agreements for new projects are finalised. It is noted, however, that the projected decline in 2019 is particularly sharp compared to prior years given that several high-value projects are ending in 2018 and the reduction in turnover resulting from this has not yet been offset.
 - ii. A reduction of EUR 1.04 million in unrestricted core funding due to a combination of:
 - a. the non-replacement of the 2018 'one-off' voluntary core contribution;
 - b. ongoing adverse currency fluctuations;
 - c. a reduced level of host country grants.
30. Members contribute 52.7% of SPC's total budget (metropolitan members 49.4%, Pacific Island members 3.3%). Development partners contribute 47.1%, with a small residual amount (0.2%) of income from other internal sources.
31. The green book presents a summary of income by type (core funding, programme and project funding).
32. Chapters I–IX of the green book cover the budgets of all the technical divisions. Following the merger of the Geoscience and Economic Development Divisions, the new Geoscience, Energy and Marine Division (GEM) is the largest technical division, with 28% of the total SPC budget, followed by FAME (23.5%), Climate Change and Environmental Sustainability (8.4%), Public Health (6.9%), Land Resources (5%), Regional Rights Resource Team – RRRT (4.2%), Educational Quality and Assessment Programme (4.1%), Statistics for Development (3.7%), and the Social Development Programme (1.2%).
33. Chapter X – Director-General's Office and Deputy Directors-General – covers the budget of the Director-General's office and the offices of the two Deputy Directors-General. It also includes the Strategy, Performance and Learning unit and Communications and Public Information unit. Together these units account for 8% of the total budget.
34. Chapter XI deals with OMD, which provides support for the work of the organisation across eight broad areas: administration, finance, human resources, legal services, library services, publishing, and translation and interpretation. Chapter XI also includes SPC's decentralised offices (Micronesia Regional Office, and Melanesia Regional Office including the Solomon Islands country office). Expenditure, net of project management fees, for the areas under Chapter XI represents 6.35% of the total budget.
35. Chapter XII covers all FCR and self-funding units, namely ICT, Facilities, Event Management, Housing and Canteen. In terms of administration, all these units remain part of OMD.

Project-funded budget 2019

36. Compared to the 2018 revised budget, 2019 project income is currently forecast to be EUR 15 million lower at EUR 41.9 million. The green book includes a three-year project income forecast (Annex 2). It also provides further information on project funding by development partner. For 2019, it is forecast that members will contribute EUR 12.7 million (30.3%) of project funding, with development partners providing EUR 29.2 million (69.7%) of project funding.
37. While project management fees for the 2019 draft budget are forecast to decrease due to the reduction in project funding, the average recovery rate is forecast to increase from 6.8% to 7.6%. This reflects the benefit of increased rigour in applying full cost recovery to new project proposals.
38. SPC's practice is to include in its budget only projects for which there is a high degree of certainty at the time of budget preparation. The 2019 proposed budget includes proposals to the value of EUR 7.6 million that have yet to be finalised. The majority of this comprises EDF 11¹ projects that are expected to be finalised by September 2018.

2020 Out year budget overview

39. In addition to the budget for 2019, the green book includes a projection for FY 2020. Budget assumptions remain essentially the same as for the 2019 budget.
40. The 2020 budget deficit is currently projected to be EUR 3.13 million. The projection does not include new initiatives or priority areas that cannot be funded with certainty, nor does it reflect any possible re-alignment of resource allocation arising from the ongoing prioritisation process.
41. In light of these projections, SPC will need to continue to control costs internally and further improve FCR mechanisms for all new project proposals being developed and negotiated

Progress on increasing SPC's reserves

42. CRGA 40 approved the Secretariat's proposal to build the organisation's reserves to improve its capacity to deal with temporary funding shortfalls and unforeseeable funding requirements. Target levels were agreed to be achieved by financial year 2015. This decision to increase reserves to between 3 and 5 million CFP units (EUR 2.5 and 4.2 million) was endorsed by the 2012 Independent External Review.
43. The Secretariat's general reserves, as per the audited 2017 financial statements, amount to EUR 11.12 million.
44. Despite the improved level of reserves as at 31 December 2017, they remain less than the proposal made at the Eighth Conference to proactively build SPC's reserves to a level sufficient to cover 60–90 days of operation. This is equivalent to approximately EUR 13–19 million based on total 2017 expenditure of EUR 78.4 million. The Secretariat remains committed to pursuing this objective as a matter of business continuity and risk management but notes that:
 - i. given the ongoing decline in core funding experienced since 2015, establishing a feasible mechanism to support an increase in reserves remains a significant challenge;
 - ii. ongoing project audit risks may have a significant negative impact on existing reserves.

¹ 11th European Development Fund.

Recommendations

45. CRGA is invited to:

- i. endorse the 'out-of-session' adoption of the revised 2018 budget;
- ii. note the draft budget for financial year 2019, subject to:
 - a. the Secretariat presenting a revised 2019 budget that substantively addresses the current forecast deficit;
 - b. review by the Audit and Risk Committee;
 - c. review and endorsement by the CRGA Subcommittee on Strategic Plan Implementation by December 2018;
 - d. out-of-session adoption by all members of CRGA before 31 December 2018;
- iii. note the ongoing budgetary challenges for future years that stem from SPC's high reliance on cyclical project financing;
- iv. endorse the Secretariat's proposals that:
 - a. from 1 January 2019, members directly fund their own travel and accommodation costs for participating in all core-funded SPC governance meetings, whether CRGA, Conference, subcommittees, ministerial or heads of sector meetings;
 - b. a detailed review of assessed contributions and host country grants be undertaken, with recommendations to be submitted to CRGA 49.