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COMMITTEE OF REPRESENTATIVES OF GOVERNMENTS AND ADMINISTRATIONS
(Noumea, New Caledonia, 28-30 June 2016)

AGENDA ITEM 6: 2016 REVISED BUDGET AND 2017 DRAFT BUDGET

(Paper presented by the secretariat)

Summary

1. This paper presents the revised 2016 budget to CRGA for noting in accordance with SPC's Financial Regulations, which require the Director-General to inform CRGA of revisions of the budget.

2. It also presents the draft 2017 budget for consideration by CRGA.

3. **The revised 2016 budget is a balanced budget**, totalling 101.8 million CFP units, comprising a core budget of 25.4 million CFP units combined with restricted and project funding of 76.4 million CFP units. The 2016 revised income projection represents an increase of 10.9 million CFP units (12%) compared to the original 2016 budget of 91 million CFP units, primarily due to an increase in project funding.

4. **The secretariat is currently projecting a 2017 deficit budget amounting to 5.6 million CFP units**, derived from income of 82.7 million CFP units less expenditure of 88.3 million CFP units. With a projected core budget of 23.5 million CFP units and programme and project funding of 59.2 million CFP units, total income is forecast to amount to 82.7 million CFP units. This is a significant decrease (19.2 million CFP units/18.8%) from the 2016 revised budget and arises primarily from:

   a. a decline of 17.3 million CFP units in restricted and project funding due to ongoing adverse currency movements and a fall in project funding as existing projects are executed, but new project funding cycles have yet to be identified. This context also has an impact on the budget deficits projected for 2018 and 2019;
   b. a decline of 1.2 million CFP units in project management fees (as a direct consequence of the fall in project funding);
   c. programme funding reductions of 0.75 million CFP units due to adverse currency movements.

5. This paper also draws CRGA's attention to **a projected deficit of 9.3 million CFP units in 2018 and 10.8 million CFP units in 2019**.

6. The secretariat presented a balanced 2016 budget to CRGA 45 in November 2016. However, due to a combination of adverse currency movements and additional unfunded priorities, a deficit of 2.1

million CFP units was identified early in the first quarter of this year. This required the secretariat to take severe and immediate action to ensure that the revised 2016 budget was returned to a balanced position. We note that CRGA 45 approved a release of 600,000 CFP units from reserves to fund priority initiatives. However, due to the material nature of projected deficits for 2017 and future years, the secretariat determined that it was not appropriate to draw down reserves in 2016. The measures implemented are detailed in paragraph 27 of this paper.

7. The secretariat is committed to addressing the projected budget deficits for 2017 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 implementation of the sustainable financing initiatives set out in Paper 6.2 over the next three budget cycles is an essential part of the secretariat's strategy to ensure that SPC's financial systems and levels of funding are truly fit for purpose and placed at the service of the priorities on which the organisation will focus.

Recommendations

8. CRGA is invited to:

   i. note the revised 2016 budget and endorse the actions that the secretariat has implemented to ensure adherence to the principle of maintaining balanced budgets;

   ii. note the draft budget for financial year 2017, subject to:
      a. the secretariat presenting a revised 2017 budget that substantively addresses the current forecast deficit;
      b. review by the Audit and Risk Committee;
      c. final submission to the CRGA Strategic Plan Implementation Subcommittee by December 2016 for review and approval;

   iii. note the ongoing serious budgetary situation for 2018 and 2019;

   iv. approve the secretariat's plans to develop and implement a sustainable financing strategy, including cost recovery and priority setting mechanisms, over three budget cycles.

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2016 REVISED BUDGET AND 2017 DRAFT BUDGET

Purpose

9. This paper presents the revised 2016 budget to CRGA for noting in accordance with SPC's Financial Regulations, which require the Director-General to inform CRGA of revisions of the budget.

10. It also presents the proposed budget for financial year 2017 for consideration and endorsement by CRGA with the following considerations:

    a. Given the challenges in finalising a reliable budget for future years due to the decision to bring CRGA forward by 5 months, the secretariat proposes that CRGA note that the proposed 2017 budget is 'indicative' in nature and that a revised budget will be submitted for approval in December 2016;
    b. It is proposed that the revised budget will be submitted for review by the Audit and Risk Committee (ARC) prior to presentation for final review and approval by the CRGA Strategic Plan Implementation Subcommittee.

Introduction

11. *The secretariat advised CRGA 45 that it was committed to addressing the 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 do this, the secretariat has placed a more strategic focus on its finances with particular emphasis on implementing full cost recovery (FCR) across the organisation. The secretariat notes that, beginning with the 2016 revised budget, it has moved its ICT operations to a FCR basis and will implement similar changes to the funding of all its facilities for the 2017 budget year. Further changes to proposal costing will be introduced with the objective of full implementation within three budget cycles. In addition, a dedicated resource mobilisation function has been created. 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. Core and surplus funding will, in future, be allocated according to an objective priority-setting mechanism, so that SPC's finances can be placed at the service of the organisation's strategic objectives rather than simply distributed on a historical basis. The ultimate objective is to have a sustainable financing strategy in place and fully implemented by the end of FY 2018, so that the organisation's financial systems and funding levels are truly 'fit for purpose'.

12. The 2016 revised budget and the proposed 2017 budget are set out in the 'Green Budget Book' which contains details of the income budget and expenditure budget, and also contains a summary of expenditure by budget chapter (i.e. by division).

13. Supporting the income and expenditure budget summary on pages 1 to 4 of the green book is each division's budget by budget chapter, which shows:

    - funding categories – core, restricted and project funding;
    - budget narratives, which describe for each division/programme its goal, objectives and key planned outputs/results to be achieved under core and project funding for FY 2016;
    - budget predictions for FY 2017, 2018 and 2019.

14. The green book also contains a number of annexes with supporting information, such as assessed contributions and host grants, and an early income prediction to 2019 by funding type and by source (member/donor).

15. Funding in the 2016 revised budget and proposed 2017 budget is classified under the headings of *core funding, restricted* 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 management fees, 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 in the future.

   ii. *Restricted 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, including both SPC members and non-members, that are earmarked for specific time-limited activities.

Assessed contributions

16. Assessed contributions for FY 2016, 2017 and 2018–2019 have been projected at the levels agreed on by the 8th Pacific Community Conference in 2013. While the triennial review of assessed contributions is due to be undertaken this year, the current budget projections for assessed contributions have been held constant until such time as this process is completed. Individual members' contributions are shown in Annex 1 of the green book.

17. Metropolitan members contribute 9,167,665 CFP units made up of:

Australia	3,200,000 CFP units
France	2,500,000 CFP units
New Zealand	2,050,000 CFP units
USA	1,417,665 CFP units
Total	9,167,665 CFP units

18. The 22 island members of SPC contribute 2,113,600 CFP units in assessed contributions. Each of these members falls within one of the five categories of membership contributions, as endorsed by the 8th Conference.

19. The 8th Conference also noted the request from Guam to review its capacity to pay an increased assessed contribution of 130,000 CFP units per annum, under category 2. No response has been received from Guam regarding its capacity and willingness to pay the higher level of assessed contribution. Therefore its contribution in the budget has been maintained at the 2014 amount of 69,000 CFP units. Once again, the secretariat would welcome a formal communication from Guam on this matter.

20. The secretariat also draws members' attention to the fact that, as of writing, only 12 member countries and territories have paid their 2016 assessed contribution. Table 1 below details the

payment status of members. There are currently 4.215 million CFP units in outstanding assessed contributions – refer Annex 1. This situation puts further strain on SPC's ability to project its funding and expenditure, together with its capacity to implement the Strategic Plan. The secretariat would be most grateful if members could commit to paying their outstanding contributions, together with any arrears, before the end of 2016.

Table 1: Status of assessed contributions and host country grants.

Members paid in full	**Members with 2016 contribution not fully paid and no significant arrears**	**Members with significant arrears**
Australia Cook Islands Fiji France French Polynesia Kiribati New Zealand Pitcairn Islands Samoa Tokelau Tonga Wallis & Futuna	American Samoa Federated States of Micronesia Guam Marshall Islands Nauru New Caledonia Niue Papua New Guinea Solomon Islands Tuvalu United States of America Vanuatu	Northern Mariana Islands (576,878 CFP units) Palau (208,332 CFP units)
Total: 12	**Total: 12**	**Total: 2**

Host country grants

21. The 8th Conference acknowledged a proposal to increase the total amount of host grants to 3,000,000 CFP units by fiscal years 2015/2016. Given the financial situation of SPC's host countries and the global economic context, the secretariat considered that the proposed amount was unrealistic and therefore proposed a more modest increase that has been the basis for ongoing consultations with host country members. If host countries do agree to make the level of contribution requested, the new amount of host country grants would be as follows:

Host country	**Proposed amount**	**2016 amount**	**2015 amount**
Fiji	400,000 CFP units	40,000 CFP units*	40,000 CFP units
New Caledonia	340,000 CFP units	250,000 CFP units*	60,000 CFP units
FSM	200,000 CFP units	200,000 CFP units	0
Solomon Islands	50,000 CFP units	50,000 CFP units*	50,000 CFP units
TOTAL	**990,000 CFP units**	**540,000 CFP units**	**150,000 CFP units**

* These amounts have already been agreed to by the host countries.

22. The secretariat takes this opportunity to highlight the fact that host country contributions, together with the privileges and immunities granted to SPC under Host Country Agreements, also recognise the significant economic benefits that host countries derive from SPC's presence. As has been noted by previous CRGA meetings, the 2014 Report on Economic Benefits of SPC's Presence to its Host Countries indicated that the total net economic benefits are about USD 29 million per annum

for Fiji, USD 25 million for New Caledonia, USD 2.2 million for the Federated States of Micronesia and USD 0.2 million for Solomon Islands.

23. For FY 2016, host country grants have increased from their previous total level of 150,000 CFP units to 540,000 CFP units. The secretariat does, however, note that this total increased level of host country contribution remains significantly less than the level of economic benefit derived by host countries and is only half the proposed total amount of 990,000 CFP units.

24. This increase is also the result of positive discussions with the Government of New Caledonia, which committed to a significant increase in its host grant from 60,000 CFP units to 250,000 CFP units per annum. The secretariat acknowledges this effort with much appreciation.

25. Discussions are still underway with Fiji to increase its host country contribution from the current annual level of 40,000 CFP units to 400,000 CFP units. Fiji is currently undertaking internal consultations, which the secretariat hopes will allow it to meet this target as soon as possible.

26. The Federated States of Micronesia (FSM), which has hosted the SPC North Pacific Regional Office since January 2006, remains the only SPC host country that does not currently make a host country contribution to the organisation. The secretariat has received a verbal indication that FSM will pay the suggested contribution of 200,000 CFP units per annum and has therefore included this contribution in its 2016 revised budget. However, it is still awaiting formal confirmation that this contribution has been approved by the FSM Congress and that a payment will be processed before year's end. Any further information in this regard from FSM would be greatly appreciated.

Revised 2016 budget overview

27. The revised 2016 budget is a balanced budget totalling 101.8 million CFP units, comprising a core budget of 25.5 million CFP units combined with restricted and project funding of a further 76.4 million CFP units. Overall, the 2016 revised income projection reflects a substantive increase (10.9 million CFP units/approximately 12%) compared to the original budget of 91 million CFP units, primarily due to an increase in available project funding.

28. The secretariat draws CRGA's attention to the fact that, although CRGA 45 approved a balanced budget, adverse factors, both external and internal, have meant that the secretariat has had to deal with a budget deficit amounting to approximately 2.15 million CFP units from the start of 2016. The main factors driving the deficit were:

   a. adverse currency movements which:
      i. increased staff costs by 820,000 CFP units;
      ii. decreased core income by 530,000 CFP units;

   b. additional activities – 800,000 CFP units.

29. To address the deficit, the secretariat implemented the following short-term, remedial actions to reduce 2016 budgeted costs. We note that these actions primarily impacted staff, thereby creating a high level of internal tension. The secretariat remains aware that, due to their short-term nature, these measures do not address any of the longer-term structural issues that are currently driving ongoing deficit forecasts for the 2017–2019 budget years:

   a. The SDR (special drawing rights) rate used to calculate international staff salaries was capped at a rate below the prevailing market rate – 530,000 CFP units.

b. No salary adjustment was processed following the annual staff performance assessment process – 480,000 CFP units.
c. Several vacant positions were frozen – 350,000 CFP units.
d. Certain common services were cut along with a proposed Information Knowledge Management initiative – 360,000 CFP units.
e. ICT was shifted to a full cost recovery basis – 450,000 CFP units.

30. Core income has declined by 1.5 million CFP units due to a corresponding decrease in general income. The main factor in this decline relates to a lower recovery of project management fees, which are forecast to decline by approximately 1 million CFP units.

31. Restricted and project income totals 76.4 million CFP units in the revised 2016 budget – an increase of 12.4 million CFP units from the original budget of 64 million CFP units. The increase is due to a combination of new projects and the carry-over of unspent 2015 project funding.

32. Members contribute 44.6% of the total budget (metropolitan members 41.9%, Pacific Island members 2.7%). Development partners contribute 51.4%, and the remaining 4% comes from other internal income sources.

33. The green book presents a summary of income by type (core funding, programme and project funding).

34. Chapter I – 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, Programming and Learning unit and the Communications and Public Information unit. Together these units account for 4.6% of the total budget.

35. Chapters II–X cover the budgets of all the technical divisions. The Geoscience Division continues to be the largest technical division with 22.7% of the total SPC budget, followed by Land Resources (14.6%), Economic Development (12.4%), Fisheries, Aquaculture and Marine Ecosystems (FAME) (12.5%), Environmental Sustainability (7%), Statistics for Development (4.2%), Social Development (4.2%), Public Health (3.9%), and the Educational Quality and Assessment Programme (3.1%).

36. Chapter XI deals with the Operations and Management Directorate (OMD), which provides support for the work of the organisation across eight broad areas: administration, finance, human resources, legal services, library services, publications, and translation and interpretation. Chapter XI also includes SPC's decentralised offices (the North Pacific Office, the Melanesian Office (including the Solomon Islands country office) and the PIRMCCM[1] secretariat. The areas under Chapter XI represent 10.8% of the total budget.

37. Chapter XII – ICT, Housing Unit and Canteen. With the shift of ICT to a full cost recovery basis, it has been combined, for budget purposes, with the Housing Unit and the Canteen as self-funded operations. Note that ICT has a forecast deficit of 202,000 CFP units for the revised 2016 budget, but this is expected to be covered by year end as transitional issues are resolved. Administratively speaking, ICT, Housing and the Canteen remain part of OMD.

[1] Pacific Islands Regional Multi-Country Coordinating Mechanism.

Proposed 2017 budget overview

38. The secretariat proposes a 2017 budget deficit amounting to 5.6 million CFP units derived from income of 82.7 million CFP units less expenditure of 88.3 million CFP units. With a projected core budget of 23.5 million CFP units, and a restricted and project budget amounting to 59.2 million CFP units, the total income projection of 82.6 million CFP units is a significant decrease (19.2 million CFP units/18.8%) from the 2016 revised budget and arises primarily from:

   a. a decline of 17.2 million CFP units in restricted and project funding:
      i. restricted funding will decline by 291,000 CFP units due to projected adverse currency movements;
      ii. project funding is projected to decline by 16.9 million CFP units due to the end of current project funding cycles and delays in the start of new cycles. This is a significant factor in the budget deficits projected for 2017 and 2018;

   b. a decline of 1.2 million CFP units in project management fees (as a direct consequence of the drop in project funding);

   c. a programme funding reduction of 0.75 million CFP units due to adverse currency movements.

39. In line with SPC's long-standing policy, only assured funding is included in the budget, with prospective funding from pipeline projects not included. The shift of CRGA from November to mid-year is now problematic from a budget preparation perspective as more complete and reliable information on new project funding is not available until later in the year.

Core-funded budget 2017

40. The 2017 core budget deficit is primarily a result of the following negative movements:
   a. A decrease in project management fees arising from the projected 17 million CFP unit decline in project activity – 1.2 million CFP units;
   b. Salary impact of the strengthening SDR – 1.2 million CFP units;
   c. Return of staff performance adjustments – 670,000 CFP units;
   d. Recruitment of key deferred positions – 224,000 CFP units;
   e. Increased ICT investments – 1.1 million CFP units;
   f. Adverse currency movements – 775,000 CFP units.

41. The ongoing decline in the AUD continues to adversely affect core income. The secretariat is concerned at the continuing decline in the relative value of the AUD but equally with the increased volatility of all SPC's operating currencies as this has created significant challenges when managing forward hedging contracts to help minimise the risk of currency losses. For 2016, the AUD/XPF rate has fluctuated between 80 and 74, a variation of 7.5%. We have budgeted at a rate of 75 for 2017 but this may need to be revisited before year end to test its validity.

42. The secretariat is evaluating options to determine whether currency volatility can be better managed by adopting a major international currency (such as the Euro or USD) as SPC's official operating currency.

Project-funded budget 2017

43. Compared to the 2016 revised budget of 68.59 million CFP units, the 2017 project budget is forecast to be significantly lower at 51.63 million CFP units. The green book includes a four-year project income forecast in Annex 3. It also provides further information on project funding by development partner. In 2017, it is forecast that members will contribute 10.9 million CFP units (21.1%) with development partners providing 40.7 million CFP units (78.8%) of project funding. The EU is anticipated to be the single largest project donor with 25.1 million CFP units (48.5%), followed by Australia at 7.45 million CFP units (14.3%).

44. SPC's policy is to include in its budget only projects for which formal approval has been given at the time of budget preparation. The secretariat's forecast of project funding therefore tends to be conservative, and an increase in project income can be expected as pipeline projects progress through appraisal processes.

2018–2019 OUTYEAR BUDGET OVERVIEW

45. In addition to the budget for 2017, the green book includes two additional years, FY 2018 and FY 2019. Budget assumptions remain essentially the same as for the 2017 budget, including continuation of Australia's voluntary contribution.

46. The 2018–2019 core funding budgets are projected to be 9.282 million CFP units and 10.826 million CFP units in deficit. In casting the projections, it is assumed that operating expenditure is generally at 2016 budget levels. This is, therefore, a realistic projection and does not include new initiatives or priority areas that cannot be funded with certainty.

47. Project management fees are shown as falling significantly in both years from 2016 levels: by 2.85 million CFP units in 2018 and 3.5 million CFP units in 2019. This is a direct result of the projected decrease in income from projects that are assured. As only assured funding is included in the budget projections and prospective funding from pipeline projects is not included, an increase in management fees is anticipated as new project funding is secured. Host grants are maintained at 2016 levels in the projections.

48. In light of these projections, SPC will need to continue to control costs internally and implement cost recovery mechanisms. In the short to medium term, the secretariat will also need to significantly increase its resource mobilisation capacity and has therefore allocated initial funding in 2017 and future years to support increased resource mobilisation activities.

Progress on increasing SPC's reserves

49. 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 was endorsed by the 2012 Independent External Review.

50. The secretariat's reserves as per the audited 2014 financial statements amounted to 6.5 million CFP units. However, these will be reduced by approximately 1 million CFP units as a result of the current deficit in the 2015 draft financial statements. Despite the projected 2015 deficit, accumulated reserves will remain within the 3–5 million CFP unit range.

51. This level of reserves is nevertheless significantly less than the proposal made at the 8th Conference of the Pacific Community to proactively build SPC's reserves to a level sufficient to cover 60–90 days of operation. This is equivalent to about 16–25 million CFP units based on an assumed 100 million CFP unit budget. The secretariat remains committed to pursuing this objective as a matter of business continuity and risk management but notes that:

   a. there is currently no feasible mechanism in place to support an increase in reserves;
   b. ongoing project audit risks may have a significant negative impact on existing reserves.

Recommendations

52. CRGA is invited to:

   i. note the revised 2016 budget and endorse the actions that the secretariat has implemented to ensure adherence to the principle of maintaining balanced budgets;

   ii. note the draft budget for financial year 2017, subject to:
      a the secretariat presenting a revised 2017 budget that substantively addresses the current forecast deficit;
      b review by the Audit and Risk Committee;
      c final submission to the CRGA Strategic Plan Implementation Subcommittee by December 2016 for review and approval;

   iii. note the ongoing serious budgetary situation for 2018 and 2019; and

   iv. approve the secretariat's plans to develop and implement a sustainable financing strategy, including cost recovery and priority setting mechanisms, over the next three budget cycles.