



SECOND ITEM ON THE AGENDA

**Review of article 18 of the
Financial Regulations**

1. At its 283rd Session (March 2002), the Governing Body, following its discussion of a paper¹ on the use of the 2000-01 surplus, requested the Director-General to propose amendments to the Financial Regulations which would ensure that surpluses be dealt with in an appropriate manner, taking into account the circumstances under which they had occurred.
2. Article 18.1 of the Financial Regulations defines how the excess (surplus) or shortfall of income over expenditure should be determined for a complete financial period, while article 18.2 stipulates that any surplus shall be used to reduce the contributions of Members. This article also sets out modalities as to how this reduction is to be made.
3. Article 18 should be considered in conjunction with the provisions of article 21 of the Financial Regulations, which address the closely related question of financing expenditure when insufficient contributions have been received.
4. Before considering any possible amendments, it would be appropriate to briefly recall the evolution in recent years of those provisions of the Financial Regulations that govern surpluses or deficits.
5. Under article 21 of the Financial Regulations, the Director-General is authorized to incur expenditure up to the full amount of the approved budget, even if contributions received are insufficient to finance such expenditure. Pending the receipt of contributions, he is authorized to withdraw sums from the Working Capital Fund and, if necessary, to contract loans or advances as well.
6. Up to the end of the 1992-93 biennium, if sums withdrawn from the Working Capital Fund or borrowed to finance budgetary expenditure could not be reimbursed during the same financial period because budgetary income fell short of the total authorized expenditure that was incurred, member States were subject to an additional assessment in the second year of the next financial period so that the outstanding loans or advances could be repaid. Thus all member States could, in accordance with the provisions of the Financial

¹ GB.283/PFA/2/2.

Regulations, be liable to additional assessments to compensate for the non-payment of contributions by any member State.

7. As stated in paragraph 2 above, article 18 of the Regulations provides that any excess of income over expenditure at the end of a financial period should be used to reduce contributions of member States in future years. This was justified, and indeed necessary, when article 21 used to operate as described in paragraph 6 above. When a member State in arrears discharged its financial obligations, the resulting surplus would be credited to all member States, thus compensating them for the additional assessment that had been made in the past. In this manner, over a period of time there would be no additional charge on any member State in respect of the non-payment of contributions by another.
8. Notwithstanding the provisions of article 21 of the Financial Regulations, as described in paragraphs 5 and 6 above, the Director-General never used the authority to fully spend the budget regardless of income shortfalls during the successive financial crises from the mid-1980s to the mid-1990s. The magnitude of the shortfalls and the uncertainty as to the length of the period during which contributions would continue to be withheld called for prudent financial management and fiscal responsibility. The Director-General therefore, in full consultation with the Governing Body, proposed reductions in programmes in order to limit expenditure, to the extent possible, to the expected level of income. Thus, not only did the Organization remain free of all debt, but on no occasion were additional assessments made on member States to make up for the contributions that were not received. Notwithstanding the proposals contained in this document, it is the Director-General's intention to continue the prudent financial management practices of the past.
9. The Governing Body at its 259th Session² (March 1994) as well as its 261st Session³ (November 1994) reviewed the Financial Regulations with a view to introducing greater flexibility for the treatment of future cash surpluses and deficits. The need for this review of the Financial Regulations had been demonstrated by the successive waivers in recent years of the provisions that governed the treatment of both surpluses and deficits. Upon the recommendation of the Governing Body, the International Labour Conference at its 82nd Session (1995), having noted the practical difficulties that had arisen in recent biennia from the non-application of articles 18 and 21.2 of the Financial Regulations, decided, "on a trial basis for the 1994-95, 1996-97 and 1998-99 financial periods only that – notwithstanding the aforementioned articles – sums withdrawn from the Working Capital Fund to finance expenditure pending receipt of contributions in accordance with article 19.1(a) of the Financial Regulations shall, if they cannot be reimbursed from contributions received in the course of the same financial period, be reimbursed from amounts credited in subsequent financial periods against arrears of contributions".⁴ At the end of this trial period, the Governing Body reviewed the impact of this decision⁵ and decided to recommend to the Conference that article 21 of the Financial Regulations be amended so as to put the new arrangements into continuing effect. The International Labour Conference approved the proposed amendments at its 89th Session (June 2001).
10. Essentially, the practical effect of these amendments is that sums withdrawn or borrowed due to shortfalls in income caused by the non-payment of contributions by member States

² GB.259/PFA/3/12.

³ GB.261/PFA/4/1.

⁴ International Labour Conference, 82nd Session (1995), *Record of Proceedings*, p. 21/4.

⁵ GB.279/PFA/4.

are no longer reimbursed through additional assessments on member States but through arrears of contributions received in the following financial period or periods. Member States are therefore no longer subject to such additional assessments.

11. With the benefit of hindsight, it is evident that when the provisions of article 21 were being reviewed and amended, more attention should also have been focused on article 18 as these two articles are closely interlinked. The rationale for the rules governing the distribution of the surplus, that if member States were called upon to pay for shortfalls in income they should be reimbursed any surpluses that arose subsequently, was no longer valid. This linkage was broken when member States were no longer required to pay for income shortfalls by way of additional assessments.

Possible amendments

12. Although all surpluses, irrespective of how they are derived, currently fall under the definition found under Article 18.1 of the Financial Regulations, the following are the distinct sets of circumstances that would give rise to a surplus:
 - (a) Due to underspending of the programme and budget, there may be an excess of budgetary income over budgetary expenditure in any financial period.
 - (b) Due to the receipt of arrears of contributions,⁶ total budgetary income exceeds the approved income budget.
 - (c) A combination of (a) and (b) above.
13. In the first type of surplus, it is considered that no changes are necessary as article 18.2 of the Financial Regulations adequately addresses the treatment of such a surplus by providing for a deduction in the future contributions of member States. Under normal circumstances, it would be logical to return to member States income that was not required to finance the approved programme and budget.
14. As regards the second type of surplus, arising from the receipt of arrears of contributions, a case can be made for the Organization retaining the surplus to finance additional programme activities, rather than distributing it to member States, programme reductions having been made in previous financial periods for the most part to restrict budgetary expenditure to budgetary income.
15. Where the surplus is a composite of an underspending of the budget as well as of income in excess of the approved income budget, the two elements would be separated and treated in the manner described in paragraphs 13 and 14 above.
16. Various alternatives for the treatment of surpluses were considered, such as: the carry forward of unspent balances to the next biennium; partial retention by the Office of the surplus with the balance credited to member States; maintaining the status quo. The Director-General considers that on balance the proposal contained in paragraph 14 is an appropriate, equitable and practical solution.

⁶ Arrears of contributions referred to are, after deducting arrears that may be required to reimburse the Working Capital Fund and other borrowings, in accordance with article 21.2 of the Financial Regulations.

- 17.** If such an approach were acceptable to the Committee, the modalities as to the use of the surplus for programme activities would need to be determined. One course of action might be to transfer the surplus to a Special Programme Fund, the use of which would be subject to the approval of the Governing Body based on proposals made by the Director-General.
- 18.** The above proposals would address the shortcomings of the Financial Regulations as described in this paper and would be simple to interpret and to operate. Although it is not possible to establish precise financial regulations to cover every possible eventuality, the Director-General considers that the proposed changes would provide fair and equitable treatment of surpluses in most circumstances. In extreme cases, a certain degree of judgement may well be necessary in the application of the Regulations.
- 19.** In the light of the guidance given by the Committee, the Director-General will make proposals to the Committee at the 286th Session (March 2003) of the Governing Body which will include draft amendments, as necessary, to the Financial Regulations.

Geneva, 9 October 2002.