

Program and Budget Committee

Twenty-Second Session Geneva, September 1 to 5, 2014

REVIEW OF WIPO'S FINANCIAL SITUATION AND ITS POLICIES RELATED TO RESERVES

Document prepared by the Secretariat

INTRODUCTION

1. This document is presented to facilitate a review of WIPO's Reserves and the related policies by Member States.
2. WIPO derives a high proportion of its income from fees for services that it renders to the global economy. It therefore faces the risk that actual income could fall short of the biennial forecast that forms the basis for the biennial budget. This risk is mitigated by a number of strategies. Foremost among these are: (i) the establishment and use of a reliable and robust forecasting model that provides predictability on the income streams from the PCT, Madrid and Hague Systems, which constitute over 90 per cent of the overall income of the Organization; and (ii) the establishment of financial management policies and processes that enable the continuous monitoring and management of the Organization's financial situation.
3. In financial management, the term "reserves" is used to cover multiple concepts. These could include, for example, funds set aside for special purposes with special rules established for their use, or provisions created to cover future liabilities. In financial accounting, reserves can be defined as the "net assets" of the organization. A financially well-managed Organization would aim to have a "healthy" level of net assets. The level would typically be determined by a number of factors such as the size of the Organization, its financial structure, the nature of its operations and the characteristics of demand for its products and services. In addition to maintaining the reserves, organizations, which do not have access to capital markets and can face liquidity risks in the course of executing their operations, establish working capital funds to mitigate these risks. The approach to planning, managing, use and reporting of the reserves is central to financial management of an Organization.

WIPO'S POLICIES ON RESERVES AND WORKING CAPITAL FUNDS

4. In WIPO's case, Reserves and Working Capital Funds (RWCF) are accounted for as the net assets of the Organization, i.e. the difference between total assets and total liabilities. WIPO's Financial Regulations and Rules (FRR) define the two specific components of the Organization's RWCF as follows:

- “**Reserve funds**” shall mean funds established by the Assemblies of the Member States and of the Unions, each as far as it is concerned, in which surplus income from fees that exceed the amounts required to finance the program and budget appropriations should be deposited. Reserve funds shall be used in a manner decided by the Assemblies of the Member States and of the Unions, each as far as it is concerned (*Financial Rule 101.3(n)*); and
- “**Working capital funds**” shall mean funds established for providing advance financing of appropriations should there be a temporary liquidity shortfall and for such other purposes as the Assemblies of Member States and of the Unions, each as far as it is concerned, shall decide (*Financial Rule 101.3(q) and Regulation 4.3*).

5. Historically, a complex system of reserves and working capital funds had been established for the Unions during the life of WIPO and its predecessor Organizations, as part of the implementation of the international agreements and treaties. As the Unions of WIPO evolved, with differing growth rates, the risks faced by the different Unions were not reflected dynamically in the level of the Union Reserves. Similarly, the Union Working Capital Funds, which were established at the time the Unions came into operation, remained static, not reflecting the changing liquidity requirements.

6. These shortcomings were addressed, in the year 2000, by Member States who considered and approved a proposal to maintain an appropriate (target) level of reserves and working capital funds that better reflected the risk and liquidity concerns specific to each Union. Member States also approved the establishment of a mechanism to adjust the combined level of reserves and working capital funds, by Union, while maintaining the separation between the Reserves and Working Capital Funds. The Working Capital Fund, financed from assessed contributions, remains to this date, and is held in trust by WIPO for the Member States of the respective Unions.

7. The establishment of an appropriate level of RWCF acts as mitigation for the most significant risk, namely, that income estimated for a biennium does not materialize. In this context, the proposed biennial expenditure was considered the most logical indicator for the purpose of estimating the level of protection required against the risk. It was therefore decided to express the total RWCF as a percentage of biennial expenditure (PBE factor) which then provides information on how long an operation could be funded for by drawing on the RWCF.

8. At the time that the decision was taken on RWCF, the volatility of demand and the relatively lower level of maturity in forecasting and planning of income had resulted in unforeseen budget surpluses which, by a prior (in the early nineties) decision of Member States, were being credited to a Special Reserve Fund for Additional Premises and Computerization. While Member States had approved priority projects and activities to be financed by this fund, there were serious concerns that, at a stage when the Organization's capital investment needs were growing (along with the growth in the registration systems), the practice of setting aside funds for long term projects through the separate Special Reserves Fund required the maintenance of high liquidity levels and was inefficient. Therefore, alongside the proposal on the policy on reserves and working capital funds, the Member States also considered and approved a proposal to discontinue the Special Reserve Fund as a result of which surpluses or deficits for each Union would directly augment or reduce the reserves and working capital funds of each Union, instead of being credited to the Special Reserve Fund. Furthermore, the Member States decided to retain the possibility of approving projects and activities to be funded from available surpluses (above the target level for each Union). This was seen as a more

efficient approach to managing the funding of long term capital projects. (Reference: A/35/15, report of the 35th Assemblies)

9. Ten years later, in 2010, after a review of the policies and practices in place, they were assessed as continuing to provide a solid foundation for effective financial management. However, against the backdrop of the economic and financial crisis, the importance of maintaining healthy reserves and the avoidance of deficits underscored the need to ensure that the use of the reserves was subject to clear and well documented criteria and principles and a well-defined approval mechanism. Member States therefore considered and approved the Policy on Reserves and Principles Applied in Respect of the Use of the Reserves (Reference: A/48/15, report of the 48th Assemblies).

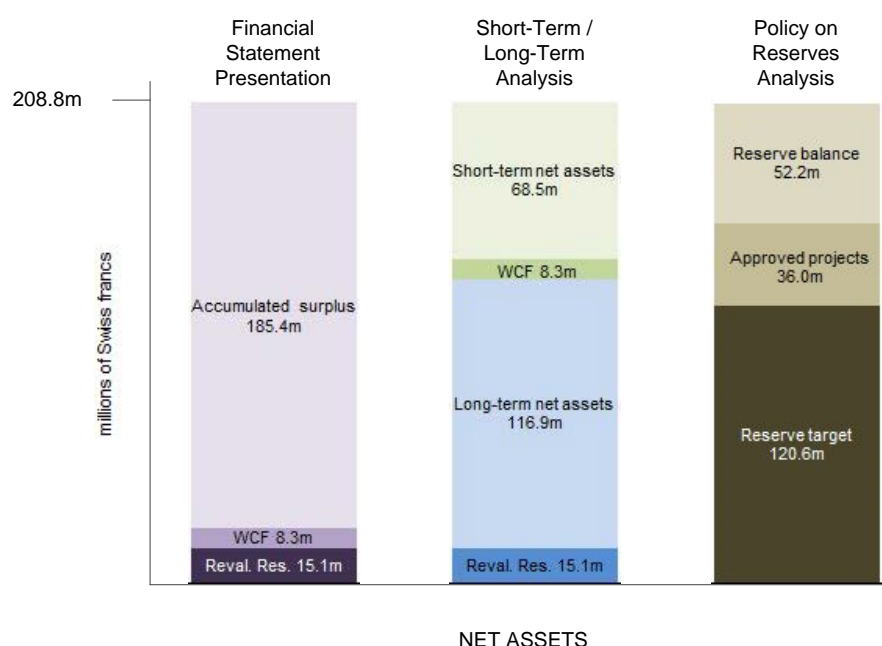
10. The planning, utilization and reporting of the RWCF are now governed by the WIPO treaties, WIPO reserves policies (2000 and 2010) and IPSAS (WIPO's accounting standards). The current practices related to the RWCF faithfully reflect the Organization's policies.

WIPO'S FINANCIAL POSITION (NET ASSETS) 2013

11. The Net Assets at the end of the financial year 2013 were 208.8 million Swiss francs. Of these, 15.1 million Swiss francs are Revaluation Reserves arising out of revaluation (from historic to fair value) of the land owned by the Organization; 8.3 million Swiss francs are the Working Capital Funds; and 185.4 million Swiss francs are accumulated surpluses. In accordance with the Organization's policy, accumulated surplus funds in excess of the target level may be made available to projects, by Assemblies decision.

12. As at December 2013, the balance of accumulated surpluses includes funds which have been approved for special projects in compliance with the policy. This includes 24.8 million Swiss francs for projects underway as at December 31, 2013 and 11.2 million Swiss francs for new projects to be started in 2014 under the Capital Master Plan. There also remains a balance of 23.3 million Swiss francs for the construction projects. These latter projects are not expected to affect the level of net assets as expenditure incurred during the construction phase will be capitalized as work in progress.

13. The following graph provides three different views of the Net Assets (RWCF) as at December 31, 2013, namely, the Financial Statements view, the analytical view providing the long-term vs. current asset components of the Net assets and the Reserves Policy View.



TRANSITION TO IPSAS – IMPACT ON NET ASSETS

14. In 2010, the Organization adopted the International Public Sector Accounting Standards (IPSAS). The principal benefits of IPSAS for the stakeholders and users of financial statements is that they foster greater accountability and transparency and provide more reliable information. The key benefit of the adoption of IPSAS within the UN System of agencies, with regard to governance, is that the assets, liabilities, revenues and expenses are now recognized in a more realistic and complete manner. Furthermore, the standards have ensured greater harmonization, comparability and consistency across organizations.

15. The most significant change from a financial accounting perspective is that IPSAS requires organizations to move to a full accrual basis of accounting. This has meant that transactions and events are recognized when they occur and in the financial statements of the periods to which they relate. Thus expenses for goods and services are recognized in the statements when they are delivered and revenue is earned and recognized when the services are rendered.

16. In WIPO, the most significant changes from the transition to IPSAS are a more complete recognition of land and buildings leading to an increase in assets on the statement of financial position, recognition of the full liability of post-employment benefits leading to significant employee benefit liabilities in the financial statements and the recognition of fee-income as revenue when services are performed leading to significant deferred revenue liabilities in the financial statements. These and other changes have led to a change in the level and composition of the net assets (RWCF) of the Organization when we moved to IPSAS on January 1, 2010. The summary of changes to the Net Assets (RWCF) and the evolution of the Net Assets until December 31, 2013 are provided in Table 1, Table 2 and Table 3 below.

Table 1 – Evolution of Net Assets – Financial Statement Presentation

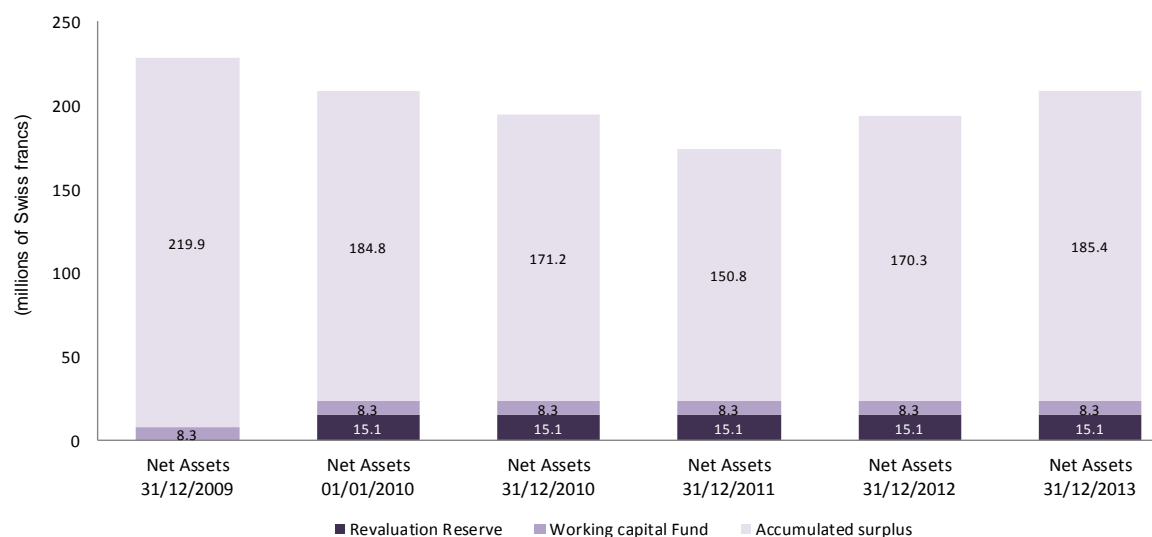


Table 2 – Evolution of Net Assets – Short-Term/Long-Term Analysis

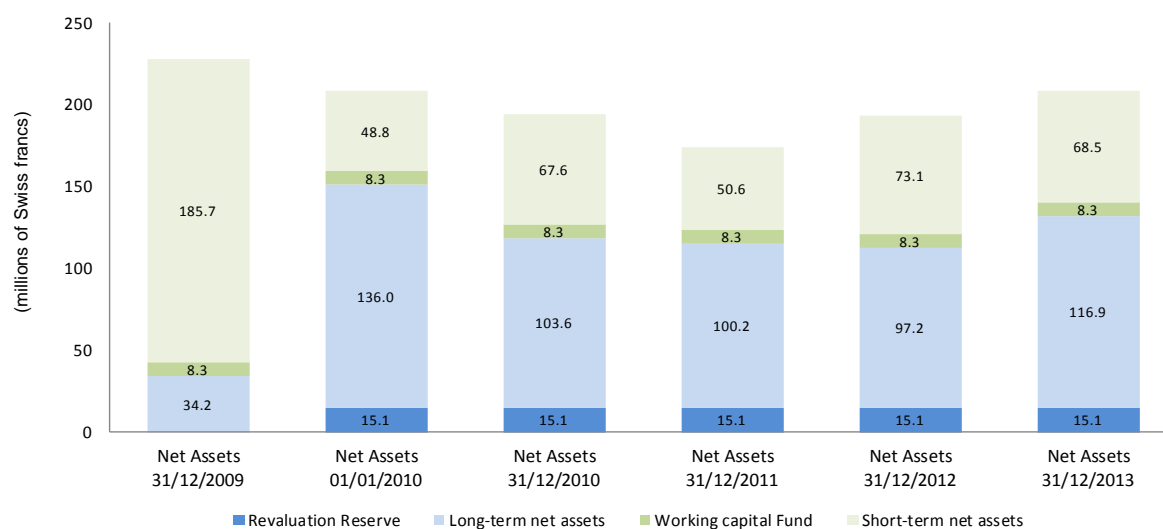
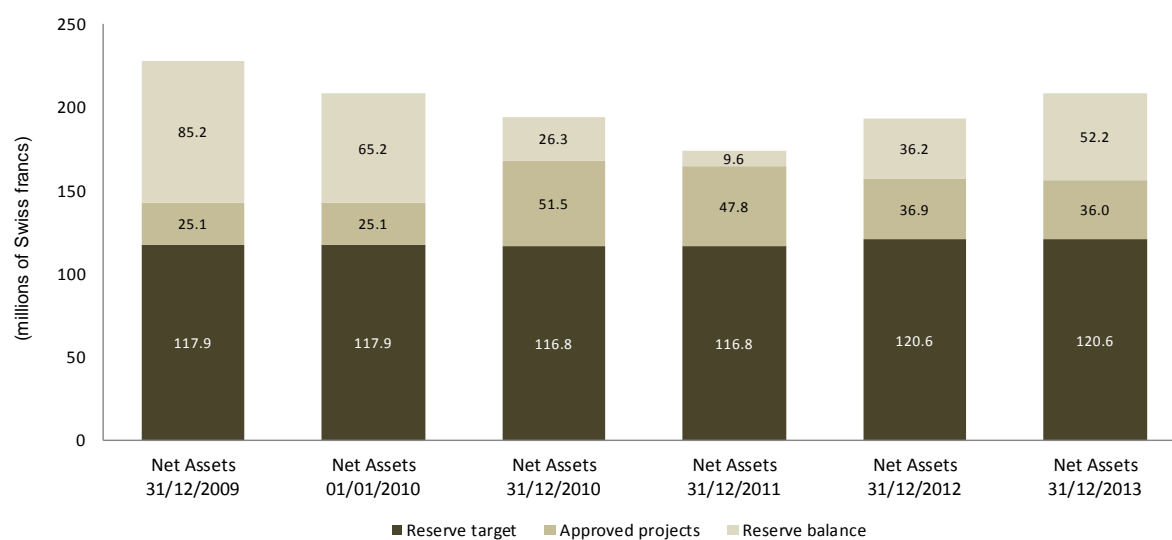


Table 3 – Evolution of Net Assets – Policies on Reserves Analysis



Note: Numbers for 31/12/2011 and 31/12/2012 are based on restated figures following the change in the accounting policy for the recognition of PCT revenue.

17. The Net Assets (RWCF) saw a reduction of 20 million Swiss francs as a result of the transition to IPSAS on January 1, 2010. This reduced level was however above the target RWCF level. The Net Asset level has remained consistently above target levels since. The Annex to this document provides a historical evolution of the Financial Situation of WIPO including the Net Assets (RWCF).

TRANSITION TO IPSAS – IMPACT ON LIQUIDITY ANALYSIS

18. Some standard financial indicators for assessing the liquidity position of an Organization and its ability to meet short-term obligations are the ratios as described briefly below:

(i) Current ratio = Current assets ÷ Current liabilities

A simple guide to the ability of an organization to meet its short-term obligations is to link current assets and liabilities in what is commonly termed the current ratio. The application of this ratio provides a guide to the solvency of an organization at year end, and an indication of the ability to meet short-term creditors without recourse to special borrowing.

(ii) Liquid ratio = Liquid assets ÷ Current liabilities

A stricter approach to the current ratio is to exclude the year-end inventory to arrive at what are called liquid assets – those being cash or near to cash. Inventory is excluded as it may prove difficult to turn quickly into cash. This is seen as a prudent approach to assess the ability of an organization to meet its short term liabilities.

(iii) Cash holding % = Cash ÷ Current assets

Various ratios can be used to gain some indication of the adequacy of an organization's cash position. It is useful to have some idea of what proportion of current assets are being held in the form of cash and short-term investments. One simple ratio is the percentage of cash to total current assets, the more liquid an organization is, the higher the proportion of current assets in cash or near-cash items.

19. The changes in recognition of assets and liabilities following the transition to IPSAS had another important effect – that of providing a more prudent view of the Organization's liquidity position and its ability to meet its short term liabilities. In WIPO's case, while the transition to IPSAS resulted in a 13.0 million Swiss francs increase in current assets, current liabilities increased by 151.3 million Swiss francs. As mentioned previously, the biggest adjustment was for PCT deferred revenue in current liabilities. The changes in these ratios for the transition to IPSAS and their evolution since are set out in the table below:

	<u>Liquidity Ratio Evolution</u>					
	31/12/2009	1/1/2010	31/12/2010	31/12/2011	31/12/2012	31/12/2013
	<i>(in millions of Swiss francs)</i>					
Cash and cash equivalents	366.7	366.7	383.5	379.7	408.1	409.9
Accounts receivable	14.5	25.2	26.7	70.3	76.2	82.5
Inventories	-	2.4	2.5	2.4	2.3	2.1
Total current assets	381.2	394.3	412.7	452.4	486.6	494.5
Total current liabilities	187.2	337.2	336.8	393.5	405.2	417.7
Current ratio	2.036	1.169	1.225	1.150	1.201	1.184
Liquid ratio	2.036	1.162	1.218	1.144	1.195	1.179
Cash holding percentage	96.20%	93.00%	92.92%	83.93%	83.87%	82.89%

Notes:

- (1) Numbers as at 31/12/2009 are presented on an UNSAS basis and include Funds in Trust
- (2) Numbers from 1/1/2010 to 31/12/2013 are presented on an IPSAS basis.
- (3) All cash and cash equivalents balances include amounts considered 'restricted'.
- (4) Numbers for 31/12/2011 and 31/12/2012 are based on restated figures following the change in the accounting policy for the recognition of PCT revenue.

20. The transition to IPSAS on January 1, 2010 resulted in a significant reduction in the Current and Liquid ratios mainly on account of the more complete recognition of current liabilities arising out of PCT fee income deferral. During the period 2010 to 2013 no significant change was observed in the Organization's ability to meet its short term obligations. Cash Holding percentage saw a decline of 10 per cent mainly on account of an increase in accounts receivable due to changing payment patterns of PCT fees.

USE OF THE AVAILABLE RESERVES TO FUND PROJECTS

21. As stated in paragraph 12, WIPO has a number of projects funded from the reserves. In addition, the Member States continue to decide on such projects. The project proposals are developed and approval decisions are taken in full compliance with our policies on RWCF.

22. The most important criterion considered in proposing such projects is the availability of reserves above the target levels established. Projects funded or approved for funding from the reserves must be capital projects or projects with a significant capital component. As a result of undertaking such projects, while there will be a reduction in current assets to the extent they are funded from cash, this reduction will be partially or fully offset by an increase in fixed assets. As a result, the impact on Net Assets is minimal. The funding of projects from reserves however has an impact on the current, liquidity and cash ratios described in paragraph 18.

23. The Organization does not face a liquidity risk exposure at present as it has substantial unrestricted cash resources which are replenished from the results of its operations. Moreover, the Organization's current investment policy has been developed to ensure that its investments are held primarily in liquid short-term deposits. WIPO would, however, in the context of continuously strengthening financial risk management, benefit from undertaking an analysis, including a benchmarking comparison of liquidity ratios for similar Organizations, with a view to determining the target range that should be reached for its current, liquid and cash ratios.

Policy Gap and Way Forward

24. WIPO's Reserves and Working Capital Funds Policies do not explicitly set out any liquidity requirements. This could be considered as a shortfall or gap in the current policy. WIPO's External Auditors have recommended that WIPO may consider that expenditures from reserves be incurred after ascertaining their impact on the liquidity of the Organization. The implementation of this recommendation will need an update to the Policy on the use of the reserves to reflect liquidity considerations. Any proposals for projects to be funded from the reserves would then need to be analyzed for their impact on liquidity targets in addition to that on the level of reserves.

TARGET LEVEL FOR NET ASSETS (RESERVES AND WORKING CAPITAL FUNDS)

25. The overall target for the Net Assets of the Organization remains in accordance with the policies on reserves and working capital funds. The target level of RWCF was established as a percentage of estimated biennial expenditure (PBE factor) for the contribution-financed Unions, the PCT Union, the Madrid Union and the Hague Union. The appropriate PBE factor was established at the level of Unions, with the aim of reflecting the risks and liquidity concerns specific to each respective Union. The level of RWCF for each Union is accordingly calculated as the estimated biennial expenditure multiplied by the Union's PBE factor. The approved PBE factor for the contribution-financed Unions is 50 per cent, the PCT Union 15 per cent, the Madrid Union 25 per cent and the Hague Union 15 per cent. The PBE factor can be adjusted by specific decision of the Member States.

26. The resultant target level of RCWF as a whole, based on the targets by Union, is approximately 18.5 per cent, on the basis of the 2014/15 biennial budget. This corresponds to

around 4 months of projected biennial expenditure. In 2006, the Swiss External Auditor recommended that WIPO raise its RCWF target to 25 per cent i.e. six months of projected biennial expenditure. Furthermore, Member States have raised questions on whether the current target level is adequate. As illustrated by Table 3, the actual levels of RCWF have been consistently above target.

Policy Gap and Way Forward

27. The Reserves and Working Capital targets which were determined in the year 2000 have not been reviewed for over fourteen years. The Organization has successfully navigated through the recent economic and financial crisis with no adverse impact on its financial situation. However, with the high dependence on a single Union (the PCT) and in the context of strengthening risk and financial management of the Organization, WIPO would benefit from examining the possibility of increasing the RWCF target level gradually over two to three biennia.

28. It should be noted that the overall level of RWCF includes the Working Capital Funds component in accordance with the Policy established by Member States in the year 2000. As elaborated earlier, the working capital funds remain funds held in trust by WIPO for Member States. The level of the working capital fund has remained static since 1990. The current amount of 8.3 million Swiss francs does not offer material protection against potential liquidity shortfalls as intended when the WCF was set up. In reviewing the target levels of RWCF, since adjustments would be proposed to the combined level of RWCF, consideration would be given to the need for and relevance of maintaining a separate working capital fund component. Such consideration would include a review of treaty obligations in respect of working capital funds.

MANAGEMENT AND REPORTING OF RESERVES AND WORKING CAPITAL FUNDS

29. Financial reporting at WIPO is governed by IPSAS and the FRR. Reporting on RWCF is currently an integral part of the Financial Statements and the Financial Management Report (FMR). Detailed disclosures are provided in Note 21 of the 2013 Financial Statements, and a breakdown by Union in Table 1 of the 2012/13 FMR. In addition, until 2013, a separate report on reserves utilization had been submitted to Member States. In the current session of the PBC, the report on reserves utilization is included within the FMR (page 8, table 1.3).

30. The Secretariat has also prepared, for this session of the PBC, a proposal to enhance and improve financial and performance reporting. The follow up actions to this proposal, as mandated by Member States, would include a review and improvement to the reporting on the reserves.

31. The External Auditor's report in respect of the 2013 Financial Statements has recommended that WIPO may consider the creation of a separate reserve for financing projects in order to maintain a clear distinction between the target level of accumulated surplus set aside and the reserves allocated to finance special projects and reflect the same separately in the financial statements to provide a better understanding of the transactions related to the utilization of accumulated surplus/reserves.

Policy Implications and Way Forward

32. As stated in paragraph 8, WIPO's Member States decided to discontinue the maintenance of a Separate Reserve for Additional premises and Computerization. WIPO's current policy does not provide for the creation and maintenance of a separate reserve fund for financing projects. The External Auditor's recommendation from the Audit of the 2013 Financial Statements and its implications for liquidity and financial management would need to be fully analyzed and suitable guidelines reflected in the Organization's relevant policies, subject to Member States' approval.

33. The following decision paragraph is proposed.

34. The Program and Budget Committee (PBC), having reviewed the Financial Position (Net assets) of the Organization and its evolution:

(i) recognized the need to undertake a review of the policies on Reserves and Working Capital Funds; and

(ii) requested the Secretariat to submit to the PBC a comprehensive policy proposal that includes target setting for the Net Assets, liquidity considerations and the management, use and reporting of the available surpluses above the target level, taking into consideration the Member States' comments and guidance and the recommendations of Audit and Oversight bodies in this respect.

[Annex follows]

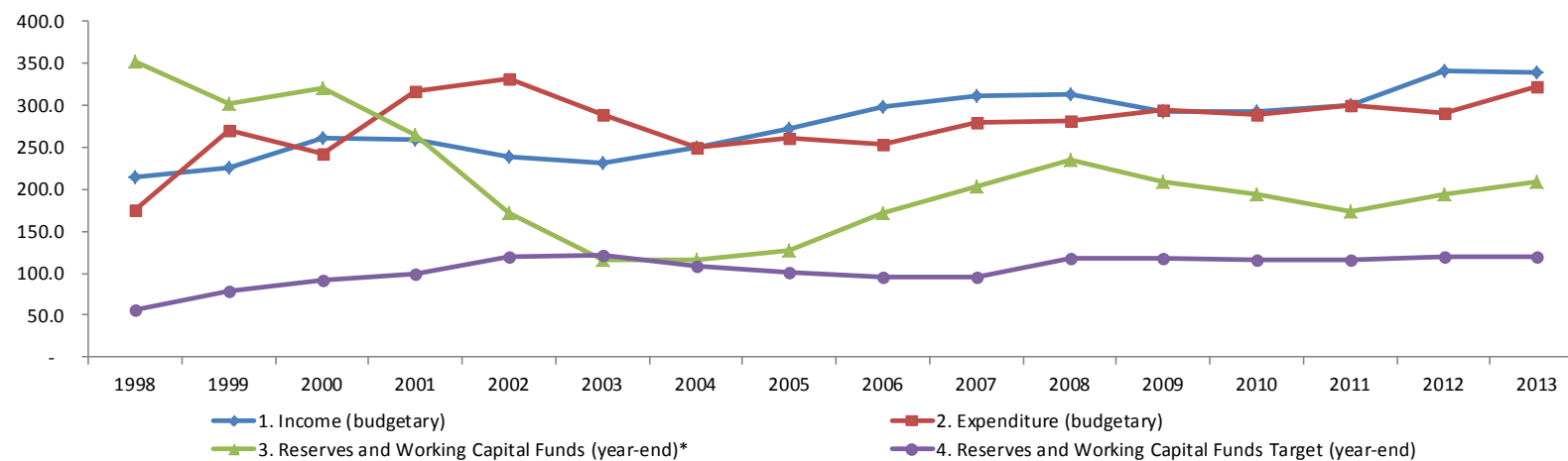
EVOLUTION OF WIPO FINANCIAL SITUATION 1998-2013

EVOLUTION OF BUDGETARY INCOME, BUDGETARY EXPENDITURE AND RESERVES BY YEAR

(in millions of Swiss francs)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
1. Income (budgetary)	214.3	225.1	260.6	260.1	238.6	231.7	250.5	272.2	297.3	312.0	313.9	293.5	292.5	300.3	341.1	339.7
2. Expenditure (budgetary)	175.5	269.7	242.1	316.2	330.8	288.5	249.6	261.6	252.9	279.8	281.7	295.1	289.4	299.5	290.1	321.7
3. Reserves and Working Capital Funds (year-end)*	353.0	302.0	320.6	264.4	172.2	115.4	116.3	126.9	171.4	203.6	235.8	208.3	194.7	174.2	193.7	208.8
4. Reserves and Working Capital Funds Target (year-end)	57.1	79.2	91.1	99.3	119.1	121.7	108.1	100.8	95.9	95.9	117.9	117.9	116.8	116.8	120.6	120.6

*Reserves from 2009 on are on IPSAS basis; the model for revenue recognition for the PCT in accordance with IPSAS was amended in 2013 in order to reflect changes in payment patterns. Since this represents a change in accounting policy it has to be applied retrospectively (2011 and 2012).



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