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COUNCIL
117th session
Agenda item 5(d)

C 117/5(d)
22 November 2016
Original: ENGLISH

RESOURCE MANAGEMENT

(d) Results-Based Budget: Outline of budgetary implications for 2018-2019

Note by the Secretary-General

SUMMARY

Executive summary:	This document sets out the Secretary-General's preliminary budget outline for the 2018-2019 biennium, while a new Strategic Framework is currently being developed for the six-year period of 2018-2023 and apprise the Council of the various factors and externalities that could impact the budget proposals for the next biennium
Strategic direction:	4
High-level action:	4.0.3
Output:	4.0.3.2
Action to be taken:	Paragraph 54
Related documents:	C 117/3 and C 117/5(c)

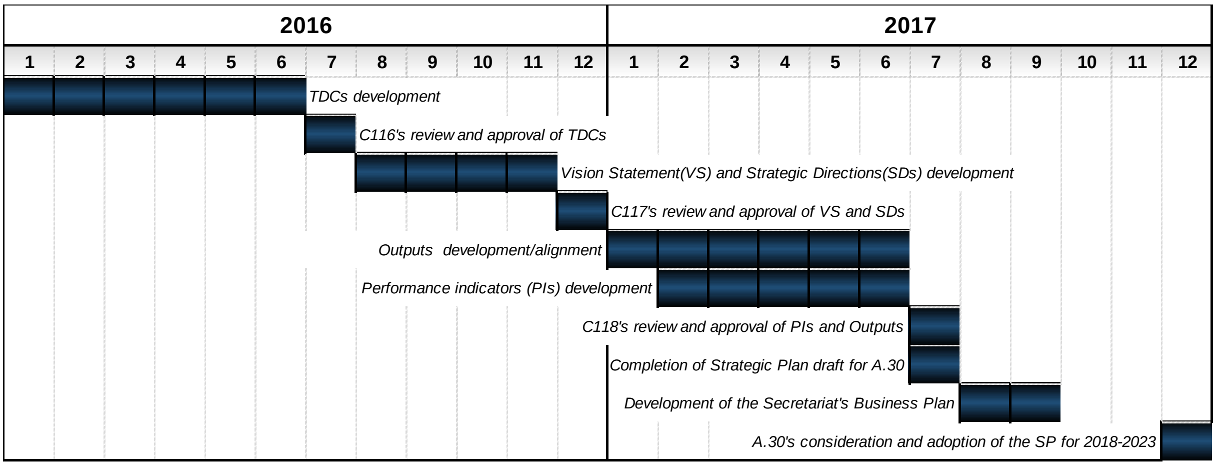
Introduction: Legal framework of the budgeting process

1 In accordance with the IMO Financial Regulations (regulation 3.4), the Secretary-General is required to submit, in the **second year** of the biennium, an **outline** of the budgetary implications of the projected High-level Action Plan for the following biennium to the regular session of the Council prior to the regular session of the Assembly. Following the due process and reflecting the outcome of the Council's consideration, the Secretary-General submits his **detailed budget proposals to the extraordinary session** of the Council, which then forwards to the Assembly its comments and recommendations thereon together with the proposals (regulation 3.5). The proposed budget should contain the resources necessary to meet the requirements of the strategic results derived from the Organization's Strategic Plan and should be structured in such a manner as to provide transparency between the resources required and the results to be achieved (regulation 3.3). The Directors of the Secretariat prepare data on resources required, including work-months, meeting-weeks, travel, consultants and other relevant objects of expenditure. The data is to be supported by divisional business plans linked to the Organization's Strategic and High-level Action Plans

(rule 103.1.2). The Financial Regulations and Financial Rules were amended by the Assembly in resolution A.1017(26) in December 2009 to provide a legal framework, on which the current Strategic and High-level Action Plans approach is based.

2 Currently, the Council is in the process of developing a new Strategic Framework that is expected to be implemented in the 2018-2023 period through its adoption by the thirtieth session of the Assembly in December 2017, in accordance with the timeline as agreed in C 114, which can be summarized as in chart 1 below.

Chart 1
Agreed timeline for the development of a new strategic framework



3 C 116 reviewed the trends, developments and challenges and C 117 is expected to develop a Vision Statement and the Strategic Directions. In this situation, as may be noted in the above chart, the Secretariat's business plan linked to the new Strategic Framework and the accordant resource requirement estimates can only be prepared following the finalization of this work. Hence, the Secretary-General has decided to present this **preliminary** budget outline document to C 117, one session earlier than the session as articulated in the Financial Regulations, to apprise the Council of the issues that should be considered in preparation of his budget proposals for the next biennium. The Secretary-General intends to submit proposals to amend the Financial Regulations and Financial Rules with a view to establishing an appropriate legal framework, which will correspond to the new Strategic Framework that is being developed. In addition, the Secretary-General intends, in case it becomes necessary as a result of the transition to the new Strategic Framework, to submit proposals for addressing the salient issues.

Organization's budget/financial framework

4 The Secretary-General's proposed budget should include budgetary estimates for the income, expenditure and transfer of the regular budget and all of the Funds established by the Assembly and also should reflect the availability of extrabudgetary resources (financial regulation 3.3). The delivery of the Organization's work programmes is currently carried out under a financial structure consisting of seven Funds established by the Assembly and various donor/trust Funds established by the Secretary-General in accordance with the Financial Regulations (regulation 6.7). In the financial accounts of the Organization, all these funds are categorized under four segments, as illustrated in chart 2 below, which also shows the flow of funds among the players and stakeholders of the Organization.

5 The four segments constituting the Organization's financial framework and accounts are:

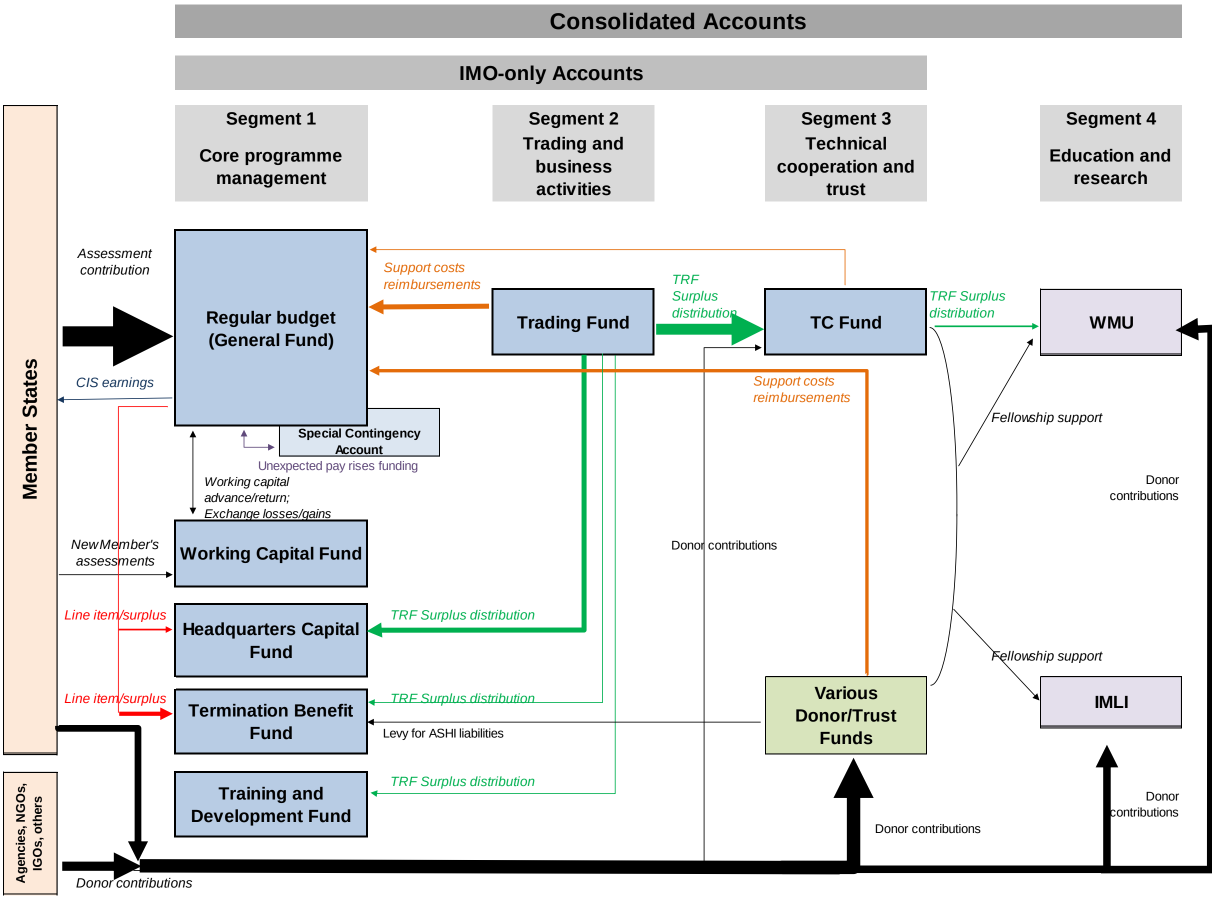
.1 the Core programme management segment, which incorporates the regular budget/General Fund; the Working Capital Fund; the Headquarters Capital Fund; the Termination Benefit Fund and the Training and Development Fund;

.2 the Trading and other commercial business activities segment, which includes publishing and catering;

.3 the Technical cooperation and trust funds segment, which contains the Technical Cooperation Fund and all donor/trust Funds; and

.4 the Education and research segment, which is to present the accounts of the World Maritime University (WMU) and the IMO International Maritime Law Institute (IMLI) in accordance with IPSAS.

Chart 2
Organization's Current Financial Framework



6 The Organization's regular budget activities are mainly funded by assessments on its Member States and Associate Members. The level of assessments is decided by the Assembly after deducting, from annual budgets, any other anticipated income such as:

.1 reimbursements of administrative support costs from the Trading Fund (currently charged at 13% of annual expenditure), the Technical Cooperation Fund (support costs at 5% of expenditure) and various donor/trust Funds (5% to 13% support cost charges, depending on the type and/or source of funding);

.2 available transfers from the surplus of the General Fund and/or other Funds, in particular from the Trading Fund; and

.3 miscellaneous income, including investment returns (interest), subletting income including use of conference facilities, etc.

7 In the General Fund, a Special Contingency Account (SCA) was established on 1 January 2014, as decided by the Assembly in resolution A.1063(28), with an initial funding of £2 million secured from expenditure savings generated in the regular budget in the 2012-2013 biennium. The SCA aims to address unavoidable overruns in the regular budget staff cost driven by the International Civil Service Commission (ICSC) beyond the assumed rates of increase embedded in the appropriation for staff costs.

8 Interest earnings from assessment contributions in the General Fund are returned to Member States in accordance with the Organization's Contribution Incentive Scheme (CIS) and some Member States donate their CIS earnings to Technical Cooperation or other donor/trust Funds.

9 The Working Capital Fund is replenished by assessments on new Members of the Organization (i.e. only the part assessed on Members on 1 January 1976). To avoid currency fluctuations affecting the budget, all US dollar-based expenditure is ring-fenced at the budgetary exchange rate and any gains or losses arising from the difference in the budgetary and actual rates are accounted for under the Working Capital Fund, as approved by the Assembly in resolution A.1039(27).

10 The funding sources of the Headquarters Capital Fund are currently threefold: a line item reflected in the regular budget for replenishment; an allocation (currently 12.5%) of the annual cash surplus of the Trading Fund as stipulated in resolution A.1063(28); and interest accrued on the financial assets of the Fund. There used to be an occasional transfer into the Headquarters Capital Fund from the cash surplus of the General Fund.

11 The Termination Benefit Fund is currently funded by a regular budget line item for replenishment and interest accrued under the Fund. There used to be an allocation (previously 8.5%) of the annual cash surplus of the then Printing Fund, but this ceased when the Printing Fund was expanded to become the Trading Fund in 2010. However, as the Assembly decided, by means of resolution A.1063(28), to centrally account for the post-employment benefits and liabilities of all staff, regardless of their funding source, under the Termination Benefit Fund, 1% of the Trading Fund surplus is now distributed to the Termination Benefit Fund. In addition, to address the post-employment liabilities related to the personnel under the Technical Cooperation Fund or donor/trust Funds, the Assembly decided also that the Organization should set a levy of 7% on the base salaries of staff under those Funds, so that the collected levy can be pooled under the Termination Benefit Fund for their benefit.

12 The funding of the Training and Development Fund is currently made up of an allocation (1.5%) of the annual cash surplus of the Trading Fund, as stipulated in resolution A.1063(28); and interest accrued under the Fund.

13 The Trading Fund is a self-financing entity, the operating expenditure of which is offset by the income generated through publications sales and catering services. However, as some administrative backstopping costs (finance and budget, human resources management, building management and ICT services) are borne by the regular budget, support costs are reimbursed to the regular budget at a 13% rate on actual expenditure incurred. The annual cash surplus of the Fund is distributed to the various Funds of the Organization as decided by the Assembly in resolution A.1063(28).

14 Resources of the Technical Cooperation Fund come mostly from an allocation (currently 80% in gross) of the annual cash surplus of the Trading Fund, as stipulated in resolution A.1063(28), as well as interest accrued under the Fund. Occasionally added are contributions from Member States, in particular, donations of their earnings under the CIS. At the request of the Council, the WMU Board of Governors adopted, in May 2015, a Study on the financial sustainability of WMU, while agreeing to request IMO to consider continuing the contribution for the 2016-2017 biennium. To support the efforts of WMU with respect to building, as a contingency, reserves equal to one-year's operating expenditure, the Assembly also decided, in resolution A.1100(29), to continue during the 2016-2017 biennium contributing to the University, 5% of not less than the 80% of the Trading Fund cash surplus initially allocated to the Technical Cooperation Fund.

15 Various donor/trust Funds have been established to manage monies allocated to the activities of the Integrated Technical Cooperation Programme (ITCP) and other organizational programmes. Such contributions are made by Member States, governmental agencies, intergovernmental bodies and other public, private and non-governmental sources. Support costs income, earned through third party agreements with donors on the technical cooperation activities, provides funding for activities in the regular budget.

Preliminary estimation of resource requirements for the 2018-2023 period

16 The development of a financial resource plan aims to assess the resource requirement to implement the Organization's Strategic Plan, and to explore and set out the measures for its funding. It is often said that the world's best strategic plan will fail if it is not adequately resourced through the budgeting process. Aligning resources to plan validates that initiatives and action plans comprising the strategic plan properly support the strategic objectives. Mindful of the current process for the development of a new Strategic Framework, this document preliminarily examines a range of potential budgetary growth assessments for the forthcoming three biennia (a six-year period from 2018 to 2023) for which the new Strategic Framework is being developed.

17 As it can be seen from the existing budget makeup, the majority of the budget is on a fixed cost base. When considering the programme delivery, activities requiring a substantial change or additional resource mobilization draws incremental costs. Therefore, any change in the programme delivery needs to factor in considerations for resource requirement and its mobilization. However, as the implications of the new Strategic Framework are not yet known, the costing model for the estimation of the funding requirement for the forthcoming six-year period is based on the current resource profile.

18 Table 1 below, which summarizes the resource requirements for the 2018-2023 period, is based on:

.1 assuming no volume and programme change affecting the current staff complement (the number of posts);

.2 recosting the base resources required for 2017 through application of the pay and price parameters prevailing at the time of preparing this document;

.3 reflecting unavoidable statutory increments in the base salary pay for the existing staff in Professional (on average of 2% increase) and General Service (on average of 3.5% increase) categories;

.4 assuming also the take-home pay rise of 2% per annum both for Professional and General Service and the 3.5% adjustment to the Professional pensionable remuneration in every two years from 2018;

.5 anticipating the same 32.8 meeting weeks (comprising 16.8 weeks for 2018 and 16 weeks for 2019) for next biennium's IMO meetings with full interpretation services;

.6 applying annual inflation of 2% in general and exchange rates of $1.25 per pound sterling; and

.7 not considering additional impacts expected from the place-to-place surveys for General Service (due in 2020) and Professional (due in 2021), other than that taken place this year for the Professional category, of which a prospective 5% increase is reflected in the recosting base for 2017.

19 The estimated resource requirement under those assumptions indicates that more than 3.8% of biennial growth is expected during the 2018-2023 period, as shown in table 1 below. For the immediate forthcoming biennium, this means an additional funds' requirement of £3.55 million, compared with that for the current biennium, while, in annual terms, indicating increases of 2.5% (£1.17 million) and 1.7% (£0.83 million) for 2018 and 2019, respectively. The majority of resource requirement rests with the regular budget, which alone accounts for 73% of the total resource requirement for the next biennium, followed by the Trading Fund (12%) and the TC Fund (10%).

Table 1
Preliminary estimation of resource requirements in the 2018-2023 period

Approved Budgets			Estimated resource requirements					
2016	**2017**	**(£'000)**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**
32,618	33,154	Regular budget	34,641	35,583	36,568	37,498	38,508	39,453
5,983	6,067	Trading Fund	5,906	6,056	6,200	6,345	6,492	6,639
1,200	1,179	Headquarters Capital Fund*	1,000	1,018	1,227	1,063	1,083	1,102
1,019	1,103	Termination Benefit Fund	827	839	852	1,075	1,058	1,252
115	117	Training and Development Fund	119	122	124	127	129	132
5,150	4,850	Technical Cooperation Fund	5,150	4,850	5,150	4,850	5,150	4,850
46,085	**46,470**	**Total Annual Expenditure**	**47,643**	**48,468**	**50,121**	**50,958**	**52,420**	**53,428**
(1,296)	385	**YoY resource changes**	1,173	825	1,653	837	1,462	1,008
-2.7%	**0.8%**		**2.5%**	**1.7%**	**3.4%**	**1.7%**	**2.9%**	**1.9%**
	92,555	**Biennial Total**		**96,111**		**101,079**		**105,848**
	598	Biennial resource changes		3,556		4,969		4,769
	0.6%			**3.8%**		**5.2%**		**4.7%**

* The budgets for the Headquarters Capital Fund for the current biennium are the revised ones submitted in document C 117/5(c) to the Council for its approval.

Table 2
Resource requirements for the regular budget for the 2018-2023 period

Approved (£'000) 2016	2017	Regular Budget	Estimated (£'000) 2018	2019	2020	2021	2022	2023
24,362	24,930	Staff costs	26,420	27,282	28,086	28,931	29,753	30,610
1,607	1,568	Other personnel	1,639	1,606	1,672	1,638	1,705	1,671
590	597	Mission travel	597	609	621	634	646	659
5,090	5,179	General operating expenses	5,075	5,177	5,280	5,386	5,493	5,603
970	880	Replenishment to Funds	910	910	910	910	910	910
32,619	**33,154**	**TOTAL**	**34,641**	**35,584**	**36,569**	**37,499**	**38,507**	**39,453**
0	535	**YoY budget estimate changes**	1,487	944	985	930	1,007	947
0.0%	**1.6%**		**4.5%**	**2.7%**	**2.8%**	**2.5%**	**2.7%**	**2.5%**
	65,773	Biennial estimate Total		70,225		74,069		77,960
	0	**Biennial estimate changes**		4,452		3,843		3,891
	0.0%			**6.8%**		**5.5%**		**5.3%**

20 The resource for the regular budget is estimated to require additional £4.45 million (6.8%) for the next biennium, comprising £1.49 million (4.5% increase) for 2018 and £0.94 million (2.7% increase) for 2019, as shown in table 2 above. It may be noted that the increase in resource requirements is mainly due to growth in fixed costs, which account for more than 76% of the total resource estimate for the 2018-2019 biennium. The growth of staff costs simply reflects the assumed pay and price changes (paragraph 18 above) on a full costing basis with consideration of lapse factor of £1.1 million for the biennium, without any accounting for additional posts that may be required in the future.

21 The detailed analysis and explanation by object of expenditure will be provided to the Council next year with further update on any change in the pay and price factors.

Impacts of resource requirements on sustainable funding

22 As may be noted from the Organization's budget and financial framework shown in chart 2 above, the stream of funds is closely interrelated. Thus, it needs a holistic view and approach at a corporate level in order to properly assess the impact of sustainable funding requirements for the implementation of the Organization's work programmes for a certain period. The Secretary-General has undertaken the review of the funding status of all those Funds, other than those of two educational institutions, namely WMU and IMLI, under various scenarios and options, the outcomes of which are presented in subsequent paragraphs 25 to 44.

23 The starting point of the impact analysis of the funding requirement is to assess annual prospective surpluses to be generated from income over expenditure under the Trading Fund. This is because it is the only Fund of the Organization with 100% self-financing commercial activities and has been the major source of funds to other IMO Funds, including the regular budget (General Fund), in accordance with the distribution formula as decided by the Assembly.

24 If the current distribution formula, which was last amended in resolution A.1063(28) by the Assembly in 2012 and maintained in resolution A.1100(29) for the current biennium, is retained for future biennia as well, the prospective funding from the Trading Fund surplus to other IMO Funds would be as shown in table 3 below. The prospective income is based on the current sales fluctuation pattern and cycle with rather conservative outlooks and its operational resource requirements are based on the same assumptions presented in paragraph 18 above. The diminishing surplus estimate is due to an already apparent decrease in the sale of printed publications and the emerging increase in electronic publication sales. Taking into account the scale of funding from the prospective surplus distribution, the ensuing paragraphs 25 to 36

review other sources of funding, assess the funding gap and examine some other funding options and scenarios by each Fund. The impact analysis on the regular budget assessment on the Member States is set out in paragraphs 37 to 39.

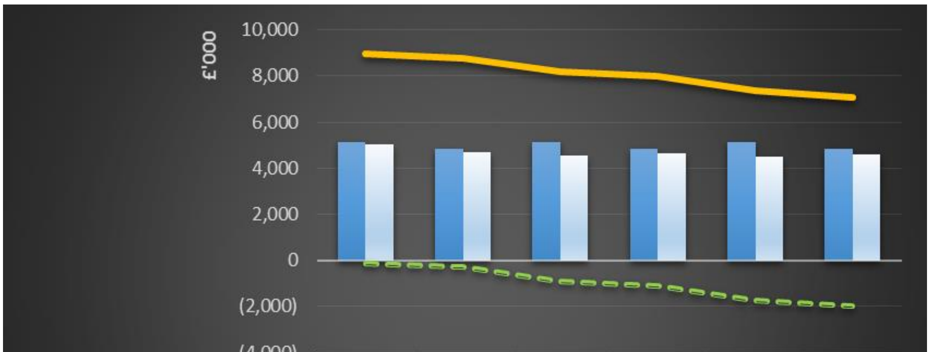
Table 3
Distribution of prospective surpluses of the Trading Fund

Actual 2016	Projection 2017	Profit distribution (Y+1)		Preliminary projection 2018	2019	2020	2021	2022	2023
5,515	5,437	Technical Cooporation Fund	76%	5,015	4,688	4,554	4,643	4,510	4,603
290	286	(WMU)	4%	264	247	240	244	237	242
907	894	Headquaters Capital Fund	12.5%	825	771	749	764	742	757
73	72	Termination Benefit Fund	1%	66	62	60	61	59	61
109	107	Traning & Development Fund	1.5%	99	93	90	92	89	91
363	358	RB (assessment reduction)	5%	330	308	300	305	297	303
7,257	**7,154**	**Total surplus distributed**	**100%**	**6,599**	**6,168**	**5,992**	**6,109**	**5,934**	**6,057**

Assessment of sustainable funding for Technical Cooperation Fund programmes

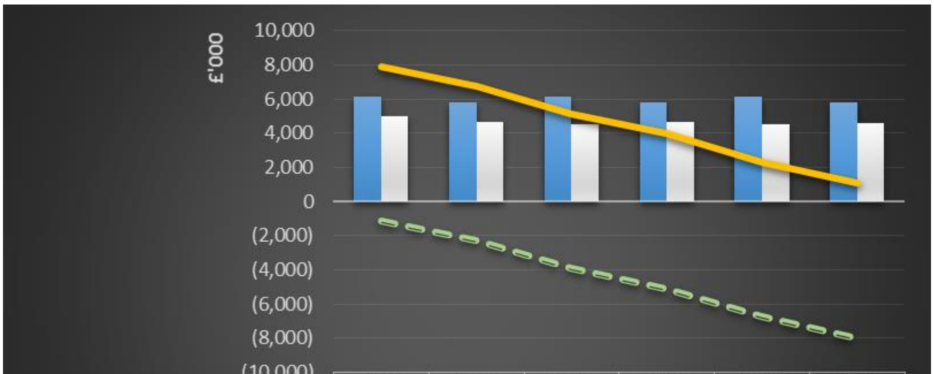
25 In table 1 above, the TC Fund allocation is assumed to remain the same amount as for the current biennium of £10 million, in view of actual delivery levels shown in recent years. As may be noted from chart 3 below, the annual funding requirements could be mostly covered by the Trading Fund surplus distribution. For the 2018-2019 biennium, it may show only small funding gaps of £0.3 million and the funds balance would remain at above £7 million throughout the forecasting six-year period. Any income arising from investments of the monies in the TC Fund may improve the financing capacity of the TC Fund, but under the current economic environment in the United Kingdom economy, the investment return is projected to be marginal at some £30,000 per annum.

Chart 3
Funding assessments for the TC Fund programmes (Scenario A)



	2018	2019	2020	2021	2022	2023
Funding requirement	5,150	4,850	5,150	4,850	5,150	4,850
TRF surplus distribution	5,015	4,688	4,554	4,643	4,510	4,603
Accumulated gap	(135)	(297)	(893)	(1,100)	(1,741)	(1,988)
Year-end reserves	8,944	8,782	8,186	7,979	7,338	7,091

Chart 4
Funding assessments for the TC Fund programmes (Scenario B)



	2018	2019	2020	2021	2022	2023
Funding requirement	6,180	5,820	6,180	5,820	6,180	5,820
TRF surplus distribution	5,015	4,688	4,554	4,643	4,510	4,603
Accumulated gap	(1,165)	(2,297)	(3,923)	(5,100)	(6,771)	(7,988)
Year-end reserves	7,914	6,782	5,156	3,979	2,308	1,091

26 If the same amount is maintained in US dollars for future biennia, the required funding in pound sterling would increase to £12 million for a biennium under the prevailing exchange rate of $1.25 and the reserves of the TC Fund would decrease rapidly, as may be seen in chart 4 above. In this respect, the Council may wish to note that the Technical Cooperation Committee has initiated a review of its 2007 Strategy for the long-term financing of the Integrated Technical Cooperation Programme (ITCP), with the view to completing the revision by the next session of the Assembly. The objective of the review is to take advantage of other funding sources and to reduce the reliance for the delivery of technical assistance on the resources that the Organization may be able to make available. In this regard, the Committee has initiated the process of revising the Assembly resolutions, which set out the principles and guide the IMO's work on technical assistance thus far. The draft new resolutions, which will govern the IMO's work up to 2030, are to be submitted for adoption by the next session of the Assembly. It is already becoming apparent that the 2030 Agenda for Sustainable Development and the Sustainable Development Goals will provide opportunities for funding the IMO's technical assistance work. Furthermore, it is becoming apparent that, as a result of the IMO Member States Audit Scheme, the requests of the Member States for pre- and post-audit technical assistance will continue to increase and in several cases such assistance will be extensive. Thus, discussing further the possible long-term needs of the TC Fund is at this stage premature and doing so will be highly speculative.

Assessment of sustainable funding for Headquarters Capital Fund programmes

27 Currently, there are two major sources, other than the reserves of the Headquarters Capital Fund (HQCF), of funding for the HQCF programmes: the surplus distribution from the Trading Fund; and transfers of the line item provision reflected in the regular budget. The amount from the former, set at 12.5% of the annual surplus of the Trading Fund, was £0.9 million for 2016 and similar amounts are expected for 2017. On the other hand, the funds from the latter source, which once amounted to £0.4 million in 2005, have reduced to £0.12 million for each year of the current biennium. If the same amount of the regular budget line item provision is assumed for future biennia, together with the surplus distribution as set out in table 3 above, the situation of funding to meet the future resource necessity for the HQCF programmes is assessed to deteriorate as shown in chart 5 below.

Chart 5
Funding assessments for the HQCF programmes (Scenario A)

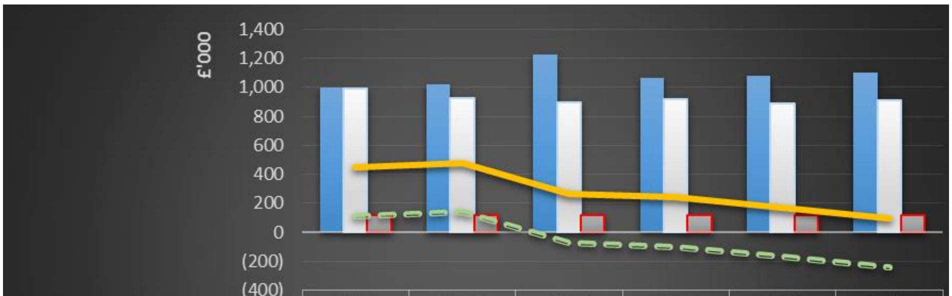
	2018	2019	2020	2021	2022	2023
Funding requirement	1,000	1,018	1,227	1,063	1,083	1,102
TRF surplus distribution	825	771	749	764	742	757
Transfer from RB/GF	120	120	120	120	120	120
Accumulated gap	(56)	(183)	(541)	(721)	(942)	(1,167)
Year-end reserves	284	157	(202)	(381)	(602)	(827)

28 The ad-hoc contribution of £0.8 million from the United Kingdom Government in 2015 partly helped in relieving the funding burden, but this is not a common situation expected in the future. As such, to avoid any funding shortfalls for the vital Headquarters refurbishment and the enhancement of the Organization's overall ICT environment, sustainable funding options need to be explored:

.1 While the Secretary-General continues to carefully review and prioritize the refurbishment and enhancement programmes for the 2018-2019 biennium, the Council should be aware of the possibility of additional funding through the reinstatement of the 15% portion distributed from the Trading Fund surplus, which was the original portion before 2010. By increasing the surplus distribution portion by 2.5% points, which would add some £165,000 per annum to the HQCF, some positive balances may be maintained to address any unexpected disruption in the building and ICT systems for the forthcoming three biennia, as shown in chart 6 below; and

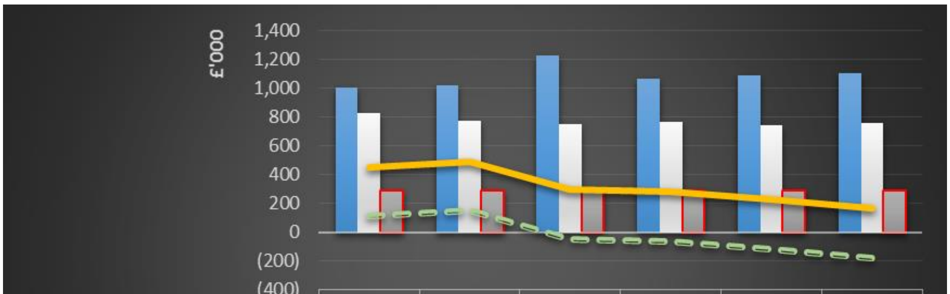
.2 Another optional scenario to be considered, instead of pursuing the change in the surplus distribution formula, is to increase the provision of the regular budget line item by £165,000 to £285,000 for each year of the 2018-2023 period, which will generate similar effects, as shown in chart 7 below, in the prospective year-end reserves of the HQCF. However, the latter approach will result in an increase in the budget and assessment of 0.5% for the next biennium.

Chart 6
Funding assessments for the HQCF programmes (Scenario B)



	2018	2019	2020	2021	2022	2023
Funding requirement	1,000	1,018	1,227	1,063	1,083	1,102
TRF surplus distribution	990	925	899	916	890	908
Transfer from RB/GF	120	120	120	120	120	120
Accumulated gap	109	136	(72)	(99)	(172)	(246)
Year-end reserves	449	476	267	241	168	94

Chart 7
Funding assessments for the HQCF programmes (Scenario C)



	2018	2019	2020	2021	2022	2023
Funding requirement	1,000	1,018	1,227	1,063	1,083	1,102
TRF surplus distribution	825	771	749	764	742	757
Transfer from RB/GF	285	285	285	285	285	285
Accumulated gap	109	147	(46)	(61)	(117)	(177)
Year-end reserves	449	487	293	279	223	163

Assessment of sustainable funding for Termination Benefit Fund programmes

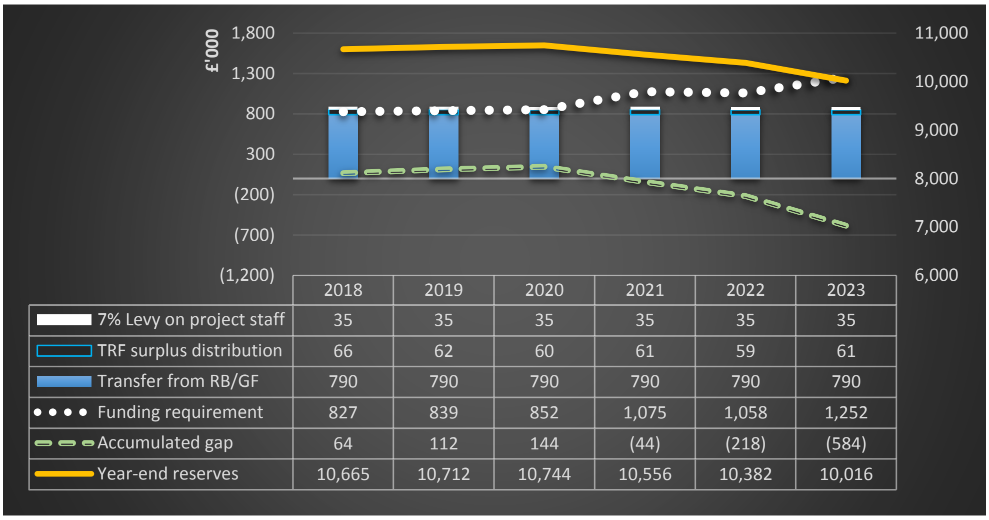
29 In respect of funding under the Termination Benefit Fund (TBF), two aspects should be taken into account: funding for current years' expenditure programmes; and funding for long-term post-employment liabilities accounted for in accordance with the International Public Sector Accounting Standards (IPSAS), which the Organization introduced in 2010.

Funding for current years' programmes

30 Established current regular funding sources of the TBF are three: distribution (1%) from Trading Fund surpluses (see table 3); line item provision in the regular budget; and a levy of 7% on the base salary of new staff members financed from the project funds under the TC and various donor/trust Funds. With the continued provision of the same flat amount of line item together with some small additions from the Trading Fund, it is assessed that, as may be noted from chart 8 below, the reserve of the Fund would not go down below the £10 million

mark by 2023. This is because of the reduced number of mandatory retirees due for the first three years from 2018, when the mandatory age of separation extends to 65 from the current 62 years.

Chart 8
Funding assessments for the TBF programmes



	2018	2019	2020	2021	2022	2023
7% Levy on project staff	35	35	35	35	35	35
TRF surplus distribution	66	62	60	61	59	61
Transfer from RB/GF	790	790	790	790	790	790
Funding requirement	827	839	852	1,075	1,058	1,252
Accumulated gap	64	112	144	(44)	(218)	(584)
Year-end reserves	10,665	10,712	10,744	10,556	10,382	10,016

Funding for post-employment liabilities

31 With regard to post-employment liabilities, including after-service health insurance (ASHI) and repatriation benefits, the Council will recall that the External Auditor indicated (document C 114/4(b)/1) that the Organization could be exposed to the risks of escalated costs that may consequently begin to consume a greater proportion of the annual budget of the Organization. The Auditor accordingly recommended that management should continue to explore feasible funding options that could create an asset base that matches the movement of the said liability. In this context, the Assembly decided by means of resolution A.1100(29), as a follow-up step, to transfer, on 1 January 2016, £6 million of the cash surplus in the General Fund to the Termination Benefit Fund. The cash surplus was accrued from the accumulation of past expenditure savings. The measure was a significant step forward for the Organization to start building up funds to cover the liability, in addition to the Assembly decision in resolution A.1063(28) to charge 7% on the base salary of all project staff recruited under the Technical Cooperation Fund or any donor/trust funds.

32 The Organization's actuarial liability for post-employment benefits accounted for £34.5 million in total as at 31 December 2015. The initial transfer of £6 million has met 17% of the funding requirement and contributed to the increased reserve of the Fund, which is projected to be some £11 million by the year-end of 2016, satisfying 32% of the post-employment liability measured in 2015. However, the long-term liability, which has grown from the £29.8 million reported in the Organization's final accounts for 2012, is inevitably going to rise significantly for 2016, when actuarial valuation is fully undertaken by a professional actuary for the 2016 final accounts. In preliminary discussions, the actuary has indicated that the fall in the discount rate based on long-term bond rates used for the actuarial valuation may result in an increase in the estimated liability of approximately £12 million (35%) to £46.5 million. A discount rate of 4.3% was established for the 2015 actuarial valuation and a fall of 1% in the discount rate has the effect of increasing the estimated value of the liability by approximately £8.1 million.

33 The funding of the post-employment liability is the common issue of the entire United Nations system and, as such, a UN-wide working group on ASHI management has tried to find a common approach. The group recommended, in December 2015, that, for the adequate funding of the liability, organizations build reserves at a minimum to fund the additional cost accrued during current periods, represented by service costs plus the corresponding interest costs. This recommendation would mean a move from the current pay-as-you-go approach to an accrue-as-you-go approach, reflecting the true cost of current operations. In addition, the working group recommended that organizations consider embedding a funding mechanism into the standard staff costs used for budgeting.

34 In this context, the Secretary-General has reviewed the use of part of the expenditure savings, as has been done for 2016, but concluded that this is not a sustainable approach since there is no guarantee of steady expenditure savings and, if any, there are other competing demands. Thus, the Secretary-General has explored various other possible options, taking into account the fund balances and reserves of the various Funds of the Organization, accrued additional costs for post-employment benefits and the restraints in the increase of Member States' assessments in the regular budget. Those options are as follows:

.1 **Option A – Increase in the regular budget line item provision** by another £1.5 million per annum, as an accrual amount, in addition to the flat amount of £0.79 million noted in chart 8. This approach then would still take more than 23 years, even without application of time value, to fill the actuarial funding gap of £35.6 million to be expected at the end of 2016. The additional £3 million for the 2018-2019 biennium has an implication of increases in the regular budget and Member States' contribution assessment of 4.6% and 5%, respectively, over the current biennium.

.2 **Option B – Embedding of 7% on the base salary scales of all existing staff members**: Currently, a 7% levy is imposed on the base salary of all new project staff from 2014 and option C is to expand the 7% charge to the base salaries of those existing staff under the regular budget and Trading Fund. The budgetary impact of the liability-funding levy is assessed to increase by £1.22 million and £69,000 in the regular budget and the Trading Fund, respectively, for the 2018-2019 biennium, which alone would bring 1.9% and 0.6% increases on the corresponding budgets for the current biennium. The biennial impact on the Member States' contribution assessment would be 2% increases for the next biennium.

.3 **Option C – Embedding of 7% on the base salary scales of all new staff members**: This funding option pursues a much longer-term approach while avoiding any immediate budgetary impact but incorporating a steady funding scheme in place. Considering the current vacant positions and staff age profiles, the funding amount based on new recruitments is assessed very marginal, not more than £100,000 per annum for the coming several years, which will affect both the budget and assessment with a biennial increase of 0.3% each for the 2018-2019 biennium.

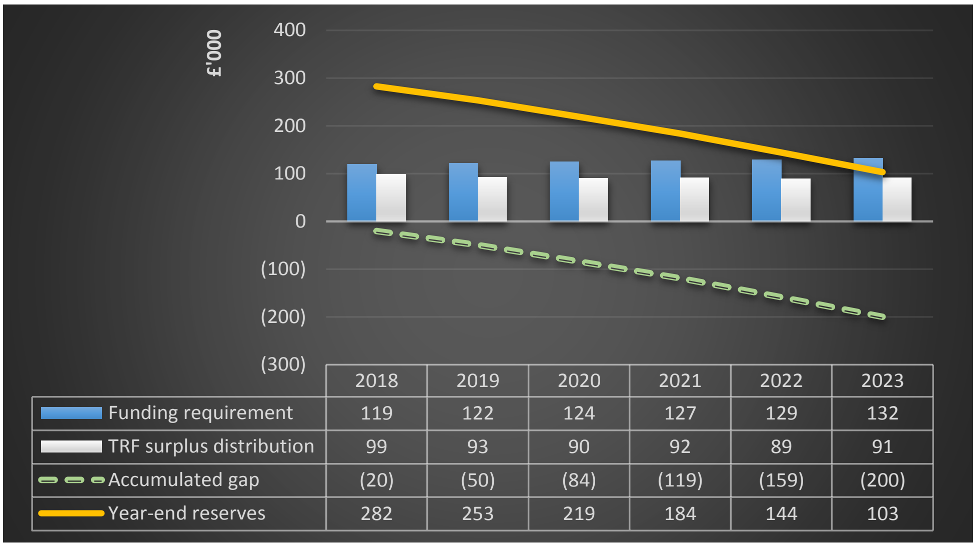
.4 **Option D – Increase in the distributable portion from the Trading Fund surplus**: The established distribution formula sets out a 1% allocation to the TBF and the formula may need to be revisited to consider increasing the portion to the TBF to reduce the funding gap. Although there are other competing resource demands from other Funds of the Organization, a diversion can be made of the eventual 4% distribution to WMU, through which some £0.51 million could be added to the TBF for the next biennium.

Use of the 5% surplus of the Trading Fund, set aside to reduce the Member States' assessed contribution, could be another option to the distribution formula change. However, this will increase the assessment by £0.64 million for the 2018-2019 biennium, representing an increase of 1.1% over the current biennium.

Assessment of sustainable funding for Training and Development Fund programmes

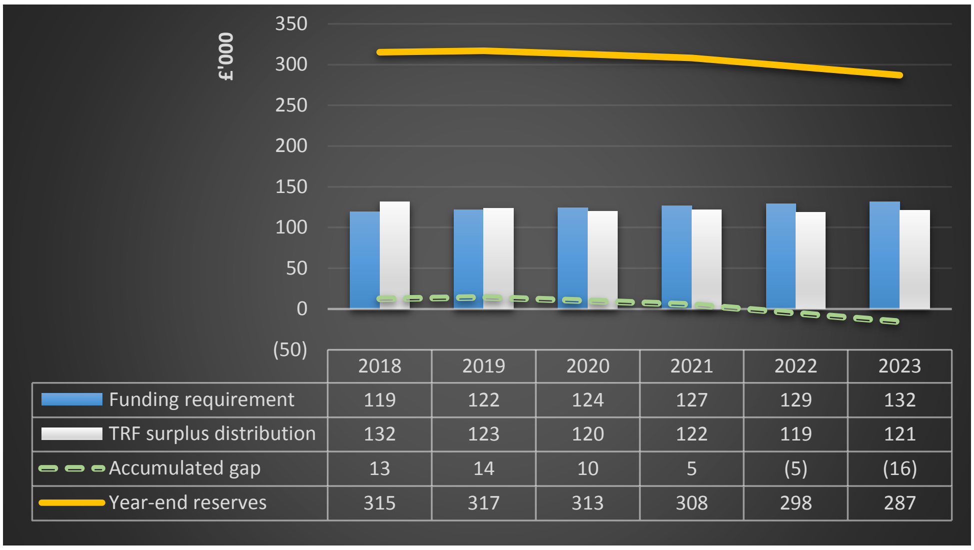
35 The resources of the Training and Development Fund (TDF) are mostly come in recent years from the distribution of Trading Fund surpluses, set at 1.5%. Chart 9 below, which compares the funding requirement with the prospective fund flow, shows that the surplus inflow would not fully meet the annual funding requirement and thus the year-end reserve would diminish year by year over the upcoming six-year period.

Chart 9
Funding assessments for the TDF programmes (Scenario A)



	2018	2019	2020	2021	2022	2023
Funding requirement	119	122	124	127	129	132
TRF surplus distribution	99	93	90	92	89	91
Accumulated gap	(20)	(50)	(84)	(119)	(159)	(200)
Year-end reserves	282	253	219	184	144	103

Chart 10
Funding assessments for the TDF programmes (Scenario B)



	2018	2019	2020	2021	2022	2023
Funding requirement	119	122	124	127	129	132
TRF surplus distribution	132	123	120	122	119	121
Accumulated gap	13	14	10	5	(5)	(16)
Year-end reserves	315	317	313	308	298	287

36 If any prospective volume and programme changes are reflected in the programme, then the reserve will be more rapidly depleted. Therefore, a sustainable funding scheme needs to be placed before the depletion of funds. As the terms of reference of the TDF include the funding through the regular budget, a creation of line item provision allowing for some £30,000 per annum would help maintain the reserve at the current level. Another way to address the matter would be the increase of 0.5% points to 2% in its current portion allocated from Trading Fund surpluses (chart 10 above), while reducing the 5% portion for Member States' assessment to 4.5%. The former approach will result in 0.1% increases in both budget and assessment for the next biennium. On the other hand, the latter's impact is only on the assessment with increases of 0.1% for the biennium.

Assessment of sustainable funding for regular budget programmes

37 As noted in paragraphs 25 to 36 above, funding requirements in other IMO Funds affect the estimation of the regular budget and the accordant assessment on Member States. The funding of regular budget programmes is annually assessed on Member States for their contribution in accordance with the established formula set out by the Assembly in resolution A.726(17). When any net income is anticipated in the General Fund for the budget period in concern, it will offset by that amount the calculation base for assessments. Hence, Member States' assessments for the next biennium are not only dependent on the budget estimate but are also affected by the extent of any anticipated offsetting income, including support costs reimbursements, and the scope for optional transfers to the regular budget from the reserves of any other Funds of the Organization.

Table 10
Anticipated income and the accordant assessment for the 2018-2023 period biennium

Approved (£'000)		Regular Budget	Estimated (£'000)					
2016	2017		2018	2019	2020	2021	2022	2023
32,618	**33,154**	**RB resource requirement**	**34,641**	**35,583**	**36,568**	**37,498**	**38,508**	**39,453**
1,438	1,448	Support costs income	1,446	1,459	1,501	1,513	1,556	1,569
0	672	Trading Fund surplus distribution*	330	308	300	305	297	303
914	768	RB expenditure savings allocation	0	0	0	0	0	0
150	150	Other miscellaneous income	269	269	279	279	289	289
2,502	**3,038**	**Total offsetting income**	**2,045**	**2,036**	**2,080**	**2,097**	**2,142**	**2,161**
30,116	**30,116**	**Required assessments on MS**	**32,596**	**33,547**	**34,488**	**35,401**	**36,366**	**37,292**
0	0	**YoY assessment changes**	2,480	951	941	913	965	926
0.0%	**0.0%**		**8.2%**	**2.9%**	**2.8%**	**2.6%**	**2.7%**	**2.5%**
	60,232	Biennial assessment Total		66,143		69,888		73,658
	0	**Biennial assessment changes**		5,911		3,745		3,769
	0.0%			**9.8%**		**5.7%**		**5.4%**

38 When the regular budget estimate for the coming period is only based on the reflection of changes in the pay and price movements on present expenditure arrangements, as shown in tables 1 and 2 above, total offsetting income anticipated for the next biennium is £4.08 million. The figure does not reflect additional resources as may be required due to volume and programme changes including various needs from other Funds of the Organization. The biennial estimate represents a 36% decrease (£1.46 million) on the amount set for the current biennium of £5.54 million, mainly because of no allocation of expenditure savings expected in the regular budget for the current biennium, as may be seen in table 10 above. For the current biennium, on the other hand, a total of £1.68 million from the expenditure savings was reflected to offset partly the assessment on Member States. Its consequential effect is the transitional assessment rise of 8.2% (£2.48 million) for the first year of the 2018-2019 biennium but the incremental amount for the second year, and even for the years thereafter, is assessed to be in line with the nominal budget estimate increases at below 3% (£1 million).

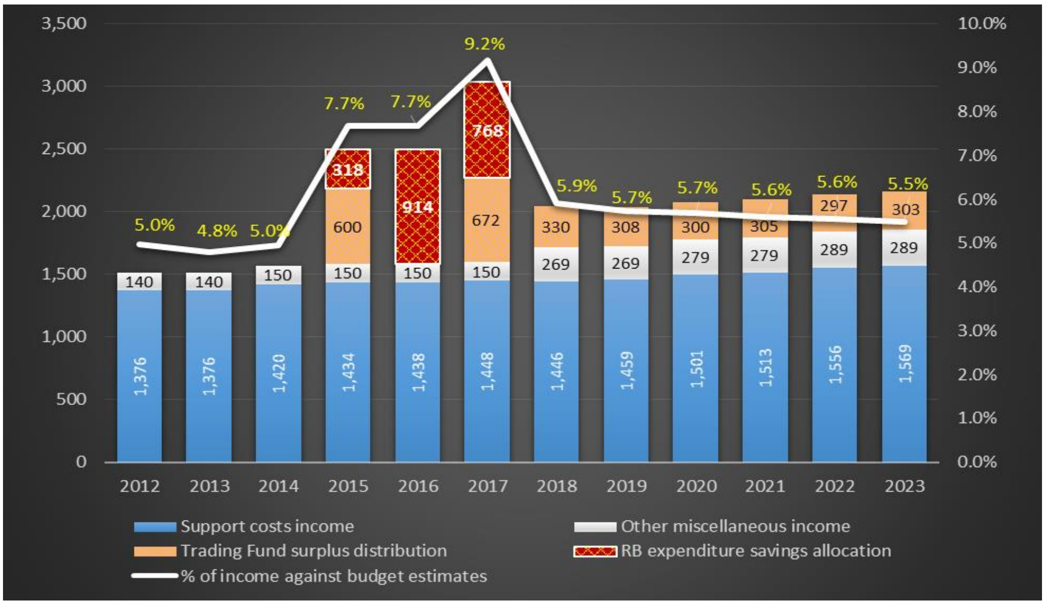
39 The assessment level does not preclude any scheme that the Council or Assembly may wish to further consider, in particular, with respect to the alternative use of the resources available in the other Funds of the Organization and use of expenditure savings in the regular budget. In this regard, the Council will recall that one of the options it considered to reduce the Member States' assessment was to revise the Trading Fund surplus distribution formula thereby a 5% portion being set aside, which was later adopted by the Assembly in resolution A.1063(28). As the Secretary-General is of the view that this approach needs to be maintained for the next biennium, the offsetting income projection in table 10 above includes the same 5% portion but, unlike for the current biennium in which the two-year portions are being used for the second year assessment reduction, the distribution is assumed for each year of the biennium. However, another option to utilize actual and prospective expenditure savings would need a holistic approach in the context of competing demands for sustainable funding of other programmes in the Organization's various Funds, as noted in paragraphs 25 to 36 above.

40 The prospective expenditure saving in the regular budget for 2016 is projected at some £2.1 million (see document C 117/5(c)) but the precise forecast of expenditure savings expected in 2017 remains premature at this stage, because of the uncertainty of the budgetary impact resulting from the outcome of the place-to-place cost-of-living survey, which will be known early next year. If the consequential budgetary impact of the survey result is greater than the 2% pay rise embedded in the staff costs budget for 2017, the Secretary-General will initially make every effort to accommodate the increase within the approved budget through various stringent measures but any overruns will be financed from the Special Contingency Account (SCA) of the Organization. The Council may also wish to note that if the weak value of the pound sterling against the US dollar, which has already shown, compared with the budget rate of $1.5, almost 20% drops in October 2016, continues, the year-end reserves in the Working Capital Fund, in which the currency loss is accounted for, would decline to £1.4 million in 2016, and thus trigger the replenishment threshold of £1.5 million. To address the matter, the Secretary-General has proposed in document C 117/5(c) to replenish the difference to raise the balance to £2 million as of 1 January 2017 from the prospective savings in the regular budget for 2016. In addition, if the sterling weakness continues through out to the end next year, another required fund for replenishment is assessed to be some £0.7 million at the exchange rate of $1.25 on average. Hence, the balance of the expenditure saving in 2016, if materialized and being used for the WCF replenishment, as indicated, would be left at £0.8 million, which is not sufficient to accommodate all other funding requirements. If the priority of using expenditure savings is given to other Funds as shown in the table, rather than to the assessment reduction, it is inevitable to increase the assessment on Member States.

41 In this context, the Secretary-General has reviewed the percentage of offsetting income against the budget estimates and recognized that the Member States usually finance approximately 95% of the regular budget resource requirements, as may be noted for the years of 2012 to 2014 from chart 11 below, when there is only usual income (support costs reimbursement and miscellaneous income). When the Trading Fund surplus distribution and expenditure savings are added to the usual income, which include support costs reimbursements and miscellaneous income such as investment interests and subletting income, offsetting ratios rise to 8%-9% and the accordant funding ratio by Member States through assessment contribution drops to 91%-92% of the budget estimates. When only Trading Fund surplus allocations are added, the Member States' funding ratio is expected at some 94% of resource requirements for the forthcoming period. The Secretary-General, in this regard, considers that **the sustainable funding ratio of the regular budget by assessment on Member States should be set at no less than 94% of the annual budget estimates.** The difference should be secured from: efficient management of support costs reimbursement; improved investment returns after distribution to Member States based on the Contribution Incentive Scheme (CIS); pursuit of active utilization of conference facilities; and part of the

Trading Fund surplus. If the anticipated income is still not enough to fill the funding ratio gap, the optional use of expenditure savings in the regular budget can be explored. With this approach, the additional funding required from the use of expenditure savings is calculated to be £33,000 for 2018 and £99,000 for 2019 on the basis of offsetting income forecast shown in table 10 above. If the funding ratio from usual offsetting income is expected to exceed the 6% threshold, the excess will be planned to transfer to other Funds to address any identified priority matters.

Chart 11
Offsetting income and its ratio against budget estimates



Review of the Trading Fund surplus distribution formula

42 In order to provide steady additional funding required under various Funds' programmes for the upcoming period, the Secretary-General has reviewed the current formula of the Trading Fund surplus distribution. One of the funding options of all other Funds are to increase the share of the surplus allocation from the Trading Fund but, as there are competing demands for the available funds from the Trading Fund, it is necessary to revisit the current distribution formula. An initial review of the formula in the perspective of additional funding requirements of the Funds shows that all but one is in a trade-off situation between the change in the portion and the assessment amount. The increase in the portion of a certain Fund unavoidably needs accordant decreases in the stake of others, which then resorts to the regular budget and accompanying assessments to maintain the sustainable funding base. In this regard, the reinstatement of the portion for the WMU shared out from the allocation to the TC Fund, which is calculated eventually at 4% of the surplus (namely, 5% of the 80% distributed to the TC Fund).

43 The reinstatement depends on whether the provision of funds to WMU will continue beyond 2017. It may be considered in two ways: one is a full reinstatement of 4% with immediate effect from the next biennium; the other is a phased reinstatement in three biennia, starting with 3% for the 2018-2019 biennium and reduced by 1% points per biennium thereafter, ending with 0% for the 2024-2025 biennium. Depending on the ways to be applied, an indicative distribution of reinstated portions would be as in table 11 below, which the Secretary-General will further review for submission to C 118, based on any direction the Council may provide.

Table 11
Indicative surplus distribution of reinstated portions

		TCF	(WMU)	HQCF	TBF	TDF	RB
	Current distribution	76.0%	4.0%	12.5%	1.0%	1.5%	5.0%
Immediate approach	0% WMU for 2018-19	76.0%	**0.0%**	**15.0%**	**2.0%**	**2.0%**	5.0%
Phased approach	3% WMU for 2018-19	76.0%	**3.0%**	**13.0%**	1.0%	**2.0%**	5.0%
	2% WMU for 2020-21	76.0%	**2.0%**	**14.0%**	1.0%	2.0%	5.0%
	1% WMU for 2022-23	76.0%	**1.0%**	**15.0%**	1.0%	2.0%	5.0%
	0% WMU for 2024-25	76.0%	**0.0%**	15.0%	**2.0%**	2.0%	5.0%

Note: ***Bold*** *indicates where there is a change*

44 Among the options to address the funding gap in meeting the post-employment liability (paragraphs 31 to 34 above), those related to using increased portions of the surplus distribution are much limited to expand its portion to a much higher level, due to contending with other priorities. On the other hand, it may also be difficult to increase in the line item provision by further £3 million or to charge of 7% on the base salary scales of all existing staff, due to consequential further rise in assessment on Member States (option A as in paragraph 34.1). Nevertheless, the Secretary-General is of the view that the **7% charge scheme should work out at least with the new staff members** (option C as in paragraph 34.3), as the budgetary impact is marginal at not more than £100,000 for a biennium.

Review of Mixed Zero Growth budget policy

45 The Council may wish to recall that, the budget proposals for the last biennium and again for the current biennium, did establish, as a goal, the delivery of Mixed Zero Growth (MZG), in particular, in the **regular budget**. MZG aimed to deliver Zero Nominal Growth (ZNG) in budget for a year followed by Zero Real Growth (ZRG) in the next, with a return to ZNG thereafter. The approved regular budget under that policy is the increases of 0% and 2.9% for 2014 and 2015, respectively, and 0% and 2.3%, respectively, for each year of the 2016-2017 biennium. The biennial impacts are £2.1 million (3.4%) growth for the last biennium and another £1.5 million (2.3%) top-up for the current biennium. It should, however, be noted that, notwithstanding the budget growth under the MZG approach, the Member States' assessment has not risen at all from £30.1 million for five years since 2012.

Table 12
Comparison of regular budget estimates for the 2018-2019 biennium

Approved (£'000)		Regular Budget	Standard estimates		MZG Amounts		Differences	
2016	2017		2018	2019	2018	2019	2018	2019
32,618	**33,154**	**Total resource requirements**	**34,641**	**35,583**	**33,154**	**33,817**	**(1,487)**	**(1,766)**
0	536	**YoY changes**	1,487	943	0	663	(1,487)	(280)
0.0%	**1.6%**		**4.5%**	**2.7%**	**0.0%**	**2.0%**	**-4.5%p**	**-0.7%p**
	65,772	**Biennial total**		70,224		66,971		(3,253)
	0	**Biennial changes**		4,452		1,199		(3,253)
	0.0%			**6.8%**		**1.8%**		**-5.0%p**

46 The Secretary-General has initially sought the continuance of the MZG budget policy in his contemplation of the budget proposal for the forthcoming 2018-2019 biennium. However, as noted in table 2 above, the mere reflection of pay and price factors based on the current expenditure pattern has an implication of annual budget increases of 4.5%(£1.49 million) for 2018 and 2.7% (additional £0.94 million) for 2019, resulting in a biennial increase of 6.8% (£4.45 million) on the regular budget approved for the current biennium. If the regular budget

is prepared strictly under the MZG policy, it would be no increase for 2018 and a 2% increase (£0.66 million) for 2019, resulting in a biennial effect of 1.8% increases (£1.2 million) on the budget approved for the current biennium. The biennial difference between the two approaches is £3.25 million comprising £1.49 million for 2018 and £1.76 million for 2019, as shown in table 12 above. Therefore, to maintain the MZG approach, there should be ways to reduce such amounts, as long as the pay and price factors are effective as assumed. Moreover, in case there is any additional resource requirements, those costs would also have to be contained within the same budget frame.

47 As noted in paragraph 26 and from table 2 above, the increase in budget estimates for the 2018-2019 biennium is essentially due to the growth of staff costs, which alone account for 76% of the total resource requirement. On the other hand, other non-staff costs estimates drive little growth at the biennial level of budget estimates. Therefore, the issue concerned is whether the major cost driver can be controlled.

48 Staff costs are fixed costs and, once the posts are filled, the costs are very rigid in downward movement but are inclined to grow, even with the reduced volume of work programme, at least for the period of contract, due to statutory increases such as additional costs from annual step increments. The pay factors are not controllable and non-negotiable by the Organization, as changes in the salary and pension scales and various benefits are promulgated by the ICSC as endorsed by the United Nations General Assembly. Post adjustment allowances for each duty station are closely linked with the cost of living in its duty station, which are affected by the country's economy. In this context, to minimize the rising impact of uncontrollable fixed staff costs while maintaining the MZG budget policy, it is inevitable to reduce the number of existing posts, at the same time absorbing any new post requirement by means of redeployment as much as manageable. In this regard, the Council will recall that the number of approved posts for the 2014-2015 biennium was reduced by 33 in the regular budget from 298 to 265 and 8 in the Trading Fund from 36 to 28. The staff complement has remained the same for the current biennium while the new posts required for the provision of machinery to ensure implementation of the mandatory IMO audit scheme and goal-based standards (GBS) have been met through the redeployment and function adjustment of some posts. The preliminary budget estimates presented in tables 1 and 2 are based on the same complement of 265 but with no reflection of any potential post increase.

49 Hence, the Secretary-General is of the view that it may not be viable any more for the Organization to maintain the MZG policy. The crucial point to consider in the preparation of the budget proposal for the next biennium is to assess any prospective changes in the volume of cost elements in addition to movements in the pay and price factors. In view of this, the Secretary-General will further review his preliminary assessment of resource requirements for the next biennium, **taking also into account any prospective volume and programme changes** affecting the staff complement, and submit his updated budget implication outline to C 118, based on the outcome of the Council's deliberation on this matter.

Summary

50 This preliminary budget outline, which is intended to provide a sound ground on which the budget proposal for the 2018-2019 biennium will be prepared, addresses issues affecting the Organization's financial sustainability on a mid-term basis for the forthcoming 2018-2023 period for which a new Strategic Framework is being developed. The Secretary-General has considered future financial requirements based on the current resource and costs profiles, while assessing their impact on the funding sustainability of each Fund of the Organization over future biennia and risk factors, in particular, any prospective funding gaps, have been identified.

51 In estimating the assessments on Member States that are required to meet the funding of regular budget resources, all essential elements, together with the funding requirement in other IMO Funds, have been taken into account as a holistic package at a corporate level.

52 It should, however, be noted that the mid-term forecast involves more uncertainty than anything short-term, because the relevant parameters are not easily predictable and resource estimates are still subject to the uncertainty of volume and programme changes. Nevertheless, based on the identified issues and analysis of financial status of IMO Funds, the Secretary-General has explored possible options and measures to mobilize sustainable funding so that the flow of future funding can be more predictable and reliable.

53 The outline of the Secretary-General's budget proposal for the next biennium is expected to bring a biennial perspective to resource allocations that are necessary for setting realistic boundaries on what the Organization can accomplish and to help direct resources to the programmes with high priorities. In this respect, the next aspect of his budget proposal outline to be submitted to C 118 will be more focused on service delivery under updated parameters and accordant scenarios, which do not simply project the status quo but, rather, take into account a range of prospective volume and programme increases required to meet new demand and challenges. Consequently, the current results-based budgeting (RBB) structure has to be examined to see how the requirements of the RBB and those of the new Strategic Framework might be well aligned.

Action requested of the Council

54 The Council is invited to note the Secretary-General's preliminary budget outline and attendant factors, in particular:

.1 the preliminary estimation of resource requirements for the 2018-2019 biennium;

.2 the assessment of sustainable funding for the 2018-2023 period with various options and scenarios including the amendment to the Trading Fund surplus distribution formula;

.3 the review of the Mixed Zero Growth budget policy and the reason why the policy may not be sustainable for the future budget preparation; and

.4 the Secretary-General's summary and his intention to submit an updated budget outline to C 118, taking into account any direction the Council may provide.

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