INTERNATIONAL MARITIME ORGANIZATION

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RESULTS-BASED BUDGET FOR 2018-2019

Outline of budgetary implications

Note by the Secretary-General

SUMMARY

Executive summary:	This document sets out the Secretary-General's proposed budget outline for the 2018-2019 biennium. The regular budget is proposed at £70.1 million for the biennium on the basis of Zero Real Growth, with increases of 4.7% for 2018 and 2.1% for 2019. Taking into account other IMO budgetary Funds, the overall resource requirement for the next biennium under all IMO Funds (regular budget plus other IMO Funds) is proposed to be set at £97.7 million, representing an annual increase of 4.5% for 2018 and 1.3% for 2019. The assessment on Member States to finance the estimated regular budget is calculated, taking into account offsetting income projections, at £65.7 million, representing an annual increase of 7.7% for 2018 and 2.6% for 2019.
Strategic direction:	4
High-level action:	4.0.3
Output:	4.0.3.2
Action to be taken:	Paragraph 52
Related documents:	C 117/5(d) and C 118/4(e)

INTRODUCTION

1 The Council will recall that an early outline of the budgetary implications for 2018-2019 was provided to its 117th session in December 2016, in a document which also looked further ahead to the period 2018-2023 to provide a view of the long-term funding situation for the Organization. The budget outline was, at that time, based on an update of the pay and price factors affecting resource requirements.

2 Following that initial review, and taking into account the Council's comments on the matter, this document now reviews the resource requirements for the 2018-2019 biennium, addressing in particular:

- the historical and current context for those resource requirements;
- the impacts of other reform initiatives;
- the Secretary-General's approach to recruitment management;
- the process followed to develop the resource requirements, including in particular the steps taken by the Secretary-General to allocate and prioritize resources as efficiently as possible; and
- the key external cost factors driving the increase in resource requirements.

3 The document then considers the means by which these resource requirements might be funded, setting out:

- the Organization's overall financial position over time and historical funding patterns;
- an outline of the 2018-2019 assessment and in particular the basis for offsetting income used in its calculation; and
- areas where the Council could consider alternatives.

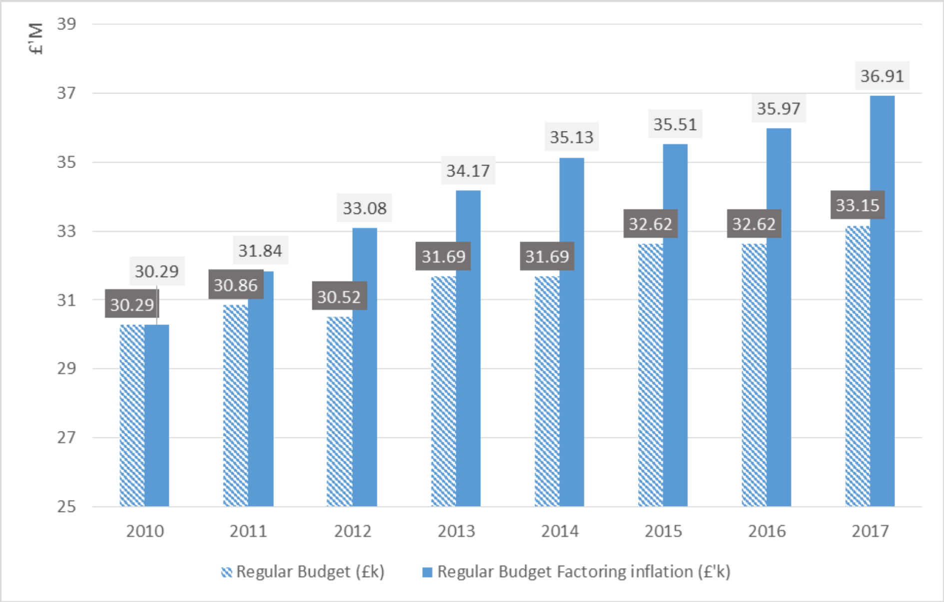
4 Finally the document outlines longer-term funding, budgeting and planning issues which the Secretary-General believes should be addressed during the coming biennium.

HISTORICAL AND CURRENT CONTEXT FOR THE REGULAR BUDGET RESOURCE REQUIREMENTS

5 The regular budget funds the Organization's core regulatory and headquarters work. It covers staff and staff-related costs, travel and general operating expenses, and also provides the primary source of funding for capital purchases through the Headquarters Capital Fund (HQCF) and funding for long-term employee benefits through the Termination Benefit Fund (TBF). Since the global financial crisis began in 2008, the Organization's regular budget has, in common with governmental and non-governmental bodies worldwide, experienced an extended period of austerity.

6 Set at £30.3 million in 2010, the regular budget has increased to £33.2 million in 2017. For comparison purposes, had the regular budget increased since 2010 at the rate of UK inflation, it would now be £36.9 million, the comparison being shown in chart 1. In some ways this understates the degree of budgetary contraction in real terms over that time frame, as during this period the Organization has also absorbed the additional resource requirements of the new mandatory Member State Audit Scheme. This was largely achieved by reallocating existing resources from various Divisions, along with an increase in travel budget for the audit teams through resource reallocation.

Chart 1:
Regular budget increase – actual compared with inflation-only



** Source of UK RPI: Office of National Statistics RPI all Items over 12 months as at May 2017, using January rate.*

7 In order to achieve this low-growth budget over three biennia, a number of creative one-off and short-term measures have been implemented, most notably:

- **review of vacant posts** – for a variety of reasons, vacant posts have been reviewed throughout the period and the number of posts has been significantly reduced due to the constraints in the regular budget increase, as shown in chart 2;

- **increased reliance on temporary staff** – in part as a consequence of the review, many vacant posts have in fact been covered by temporary staff in order to deliver the work, while in other cases fewer Secretariat staff have been covering a broader range of duties;

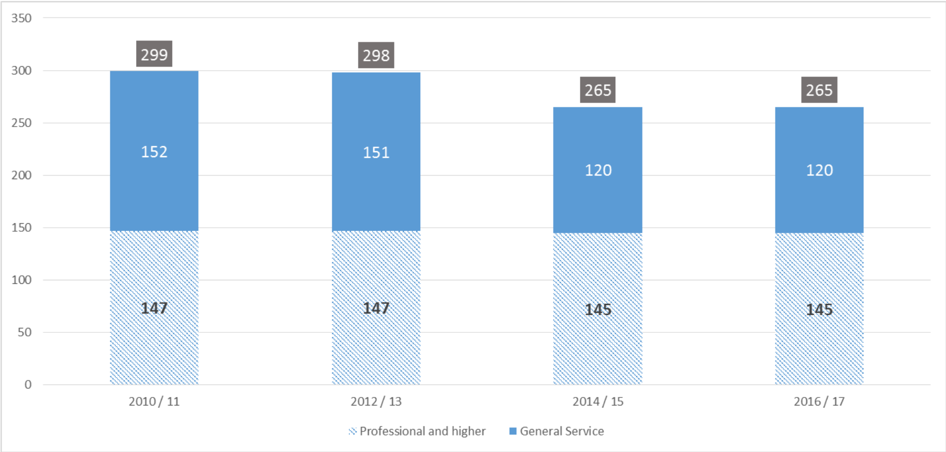
- **reduction in meeting costs** – changes in the approach to printing and documentation, and management of interpreter costs in particular, have reduced the overall direct cost of meetings from £1.28 million in 2010 to £0.96 million in 2016, a 25% reduction;

- **use of the Working Capital Fund (WCF)** – by means of resolution A.1039(27), the Assembly approved that any adverse impact of exchange rate movements could be allocated to the WCF. For 2016, this resulted in an offsetting effect of £420,000; and

- **use of the Trading Fund** – support costs for administrative services provided to the Trading Fund are now reimbursed to the General Fund[1] at a rate of 13% on actual expenditure (approximately £631,000 in 2016).

[1] The Organization's budget/financial framework is described in document C 117/5(d) paragraphs 4 to 15.

Chart 2
Approved regular budget posts by category



8 Whilst these measures have been effective from a budgetary perspective, they have not been without longer-term impacts, most notably:

- **reduced investment in infrastructure and long-term liabilities** – funding provided to the HQCF from the regular budget has totalled only £1 million for the period 2010-2016, while expenditure has totalled £7.2 million. The balance has largely been made up by transfers from the Trading Fund surplus and the use of established reserves in the HQCF itself. In addition, while the Organization's After Service Health Insurance (ASHI) liabilities have been increasing over time, to date a mechanism to fund this liability through the assessment has not been agreed (see paragraph 44);

- **impact on the WCF** – the approach of charging foreign exchange losses to the WCF has effectively softened the impact on the General Fund of recent significant variances, but the WCF has itself been significantly depleted and has recently required replenishment from savings on the regular budget;

- **some loss of institutional knowledge** – the increased level of vacancies, and increased reliance on temporary staff and, to some extent, Junior Professional Officers, who by the nature are not long-term staff members, has inevitably reduced the possibility for a complete handover when long-serving staff retire. The use of temporary staff provides short-term cost savings and flexibility but can produce longer-term issues for institutional memory;

- **reduced time for studying and background work** – as noted by the Secretary-General when responding to the Council at its last session, delivery has been sustained through a more complete focus on immediate priorities. As a result, background research and the maintenance of current technical expertise have not always been possible; and

- **reduced engagement with broader United Nations initiatives** – significant savings have been made in travel costs in recent years, through amendment to the travel policy and reduction in the amount of travel. In the longer term, however, it is difficult to sustain engagement with UN-wide initiatives such as the Sustainable Development Goals (SDGs) without active participation in a range of meetings and networks, and a minimum level of funding is necessary to support this engagement.

9 While in some areas efficiencies have been delivered, more generally service levels, delivery methods and volumes have remained unchanged, the overall effect being that fewer staff have been required to deliver more while working in the same manner as previously, a situation which is not sustainable in the long term. At the same time, some mechanisms used to manage the impact on the assessment are now exhausted, and the flexibility available for future years has been reduced.

10 As set out in document C 118/4(e), while there were significant savings on the regular budget during 2016, largely as a result of unusually high vacancy levels, a number of external factors have arisen during late 2016 and early 2017 which increase the Organization's day-to-day costs. At the same time, action has been taken during 2017 to address the high vacancy levels through a coordinated recruitment plan, which is expected to lower the level of vacancies with which the Secretariat will begin the new biennium. Any underspend for 2017 is therefore likely to be relatively small, and what saving there may be will in large part have arisen from posts which were subsequently filled during the course of 2017. If the projected vacancy situation at the end of 2017 had been in place for the year as a whole, it is projected that the budget would have been overspent.

11 This then reflects a challenge for the 2018-2019 biennium, and it is exacerbated by the UN-wide increase in the mandatory retirement age, from 62 to 65, effective 1 January 2018. A natural consequence of this change is that there will be fewer vacancies arising during the coming biennium, significantly reducing flexibility in managing staff costs.

12 The context for the 2018-2019 budget outline may therefore be summarized as:

- an extended period of austerity during which new functions have been absorbed without the provision of additional resource;

- limited flexibility for further incremental change in working practices due to the Organization's small size and, particularly, the increase in retirement age; and

- significant external price pressures, already impacting in 2017, which are forecast to continue into the coming biennium.

THE BUDGET REQUIREMENT FOR THE 2018-2019 BIENNIUM

13 The Secretary-General is conscious of the budget pressures on Member States, and has taken a number of steps to ensure that the budget outline presented most appropriately reflects the resources required by the Secretariat to deliver the Organization's work.

Strategic Framework and functional review

14 In developing this budget outline, the Secretary-General has initially reviewed the Strategic Framework as it stands to determine whether at this stage any change in resource requirement can be identified. As the Council is considering under agenda item 3, work is continuing on the Organization's Strategic Framework for the period 2018-2023. That Framework will set focus areas for the work of the Organization as a whole for the long term, and once these focus areas are clearly established and agreed, the Secretariat will carefully review the actions, activities and deliverables necessary in order to support their implementation. With the new framework in place, the Secretariat will revise the structure of, and approach to, the Secretariat's Divisional Business Plans, which have historically provided the link between the Strategic Plan and the Results-Based Budget.

15 As the purpose of the Strategic Framework is to focus on key areas of work rather than to add to the mandate of the Organization or the responsibilities of the Secretariat, the Secretary-General anticipates that the actions, activities and deliverables required from the Secretariat can be addressed, from a budget perspective, in a similar way – that is, through reallocation of resource to the areas of focus where necessary. On this basis, the budget outline is prepared on the assumption that the new Strategic Framework will not, in the immediate term, lead to a direct requirement for additional resource. For this biennium, in view of the timing of the development of the Strategic Framework, development of the Divisional Business Plans will take place after this session of the Council in July, but for future biennial budgeting cycles, with the Strategic Framework already in place, it will be possible to develop a more strategic response from the Secretariat to areas the Organization will focus on in the six-year period 2018-2023, and to prepare the budget on that basis.

16 It is also the Secretary-General's intention to undertake a functional review during 2017 and 2018. This recognizes that, during the current period of austerity, a number of short-term and one-off measures have been taken to manage within limited financial resources. In a small organization with a high base of "fixed", particularly staff-related, costs, flexibility is limited without a periodic fundamental review of working practices. The outcome of the functional review will be reported to the Council in due course, along with the budgetary impact, if any.

Staffing management

17 During its discussion on the budgetary outlook for 2016 at its most recent session, the Council requested information on how the current staffing and vacancy levels might be addressed. Since that time, the Secretary-General has taken a number of steps to review and address appropriate staffing levels at IMO, beginning with an analysis of the vacancies themselves. The review shows that during 2016 a total of 20 posts were filled, while 13 posts were newly vacant, with 10 posts being vacant not more than five months, primarily as a result of internal candidates successfully being recruited for other vacancies. The continued high level of vacancies even during periods of active recruitment is in part the result of this "chaining" effect, where an internal candidate is selected, creating a new vacancy at the same time as filling the existing one. The duties of the posts vacated are then performed by temporary staff or contractors until a new recruitment process is completed.

18 Following this analysis and a consideration of the 2017 budget, the Secretary-General developed a recruitment plan for 2017, which aims to significantly reduce the number of vacancies in core posts, with a particular focus on filling vacancies in the technical divisions as a matter of priority. Further, an outline recruitment plan has been developed for the 2018-2019 biennium which is consistent with the budget outline presented in this document. With the increase in retirement age effective 1 January 2018, a much lower level of separations is expected during the coming biennium, and consequently to maintain budgetary flexibility it is necessary to manage recruitment carefully and in an integrated way. The staffing plan, which will require variation during the biennium, not least where vacancies are filled by internal candidates, is based on:

- an understanding of the capacity in Human Resource Services (HRS) to conduct recruitments: even if all posts were identified as an immediate priority, in practical terms the resource is not available to run simultaneous recruitments above a certain level;

- the priority of the posts in question, with emphasis being given to recruiting "front line" posts in the technical divisions; and

- the identification of key posts for which continuity is essential and recruitment has to begin in advance of the departure date of the incumbent.

19 The Secretary-General has also reviewed the approved current staff complement to determine whether further posts could be saved. As noted in chart 2, there was a significant reduction in posts from the 2012-2013 biennium to the 2014-2015 biennium, and the Secretary-General does not believe that a further adjustment is possible at this time, until a more fundamental review of the Secretariat's ways of working is carried out. Hence he has decided to temporarily redeploy an available post within the current staff complement to undertake the new role, requested by the MEPC and endorsed by the Council at its 117th session, to develop and maintain the IMO Ship Fuel Oil Consumption Database and produce an annual report thereon for the MEPC.

Mission travel, meetings and general operating expenses

20 Mission travel expenditure has been reviewed to determine whether the levels of expenditure are appropriate. For the United Nations system as a whole, daily subsistence rates (DSA) are set in United States dollar (USD). With the fall in the value of GBP from June 2016, this component of travel costs has increased. The Secretary-General has decided, however, to contain this cost increase within existing budget levels for the coming biennium through periodic adjustments to priority mission requirements.

21 Meeting costs have also been reviewed to determine whether further efficiency gains may be made. As noted in paragraph 7, meeting costs have reduced significantly in recent years as working practices in servicing meetings have changed. For the coming biennium, no immediate changes in working practices are proposed, but document-management and meeting-support arrangements will be reviewed as part of the functional review. Significant cost savings are not anticipated without a fundamental change in working practices or, particularly, changes in volume or quality of service delivery. It may be possible, however, to more closely link costs to levels of demand by building on reforms already in place. External pressures on rates for interpreters and translators are expected to increase costs overall, so these costs have been reviewed, taking into account projections of the levels of meeting documentation for the coming biennium, and the cost increase is assessed to be contained to the extent possible.

22 The review of general operating expenses shows that a large part of general operating expenses are fixed as they reflect long-term contracts with outsourced service providers, an arrangement which has seen cost reductions over previous biennia. Looking ahead, inflation is expected to increase and will have a direct impact on costs, but a review by the Administrative Division has concluded that some savings to offset this increase may be possible through re-tendering various facilities management-related contracts in a simplified structure. That budget component is therefore presented on a Zero Nominal Growth basis.

Proposed regular budget resource requirements and underlying assumptions

23 Following this review, and a number of budget iterations, the revised regular budget requirement is £34.7 million for 2018 and £35.4 million for 2019, representing a year-on-year increase of 4.7% and 2.1%, respectively, as shown in table 1.

Table 1:
Regular budget requirement for the 2018-2019 biennium

Approved (£'000)		Regular Budget	Forecast (£'000)	
2016	**2017**		**2018**	**2019**
24,362	24,930	Staff costs	26,323	26,960
1,607	1,568	Other personnel	1,800	1,787
590	597	Mission travel	597	609
5,089	5,179	General operating expenditure	5,075	5,176
970	880	Replenishment of Funds (HQCF, TBF)	910	910
32,618	**33,154**	**TOTAL**	**34,705**	**35,442**
0	536	**Year on year budget estimate changes**	1,551	737
0.0%	**1.6%**		**4.7%**	**2.1%**
	65,772	Biennial estimate Total		70,147
		Biennial estimate changes		4,375

24 The budgetary increase is primarily driven by external factors outside of IMO's control, and these are set out in table 2.

Table 2:
Impact of external cost factors on the 2018-2019 regular budget

Biennial Cost Increase analysis	**Biennial (£m)**
• Salary increases as a result of periodic ICSC UN-wide reviews	1.5
• Other staff cost increases – P and above (including annual increments)	0.9
• Salary increases for G staff (including annual increments)	0.3
• Increase in Cigna health insurance premiums	0.3
Staff Cost sub-total	**3.0**
• Impact of exchange rate changes – GBP weakening increases cost of USD-based expenditure, particularly UN Pension Fund contributions	0.8
• Other increases, including other personnel cost increases (translator rates and volumes, temporary staff increase in rates) and inflation	0.6
Overall biennial budgetary increase	**4.4**

25 The Council will recall that for the two most recent biennia, 2014-15 and 2016-17, the regular budget has followed a policy of Mixed Zero Growth (MZG) – that is, an increase of zero in nominal terms in the first year of the biennium and an increase solely in line with external price factors for the second year of the biennium. While the proposed regular budget shown above is slightly below Zero Real Growth (ZRG), the "lapse factor" is higher in 2018 to reflect the projected opening vacancy position and non-staff budget lines have where possible been held to a Zero Nominal Growth level. Nevertheless, as foreshadowed in paragraphs 45-49 of document C 117/5(d), and following the more detailed analysis summarized above, it is no longer possible to achieve a MZG regular budget without delaying recruitment to vacancies, which would weaken the Secretariat's capability to deliver in the short and long term.

26 The key price and cost assumptions used to develop this budget are consistent with those set out in paragraph 18 of document C 117/5, with the exception that:

.1 cost increases which were not anticipated at the time of the previous document are now included, most notably an increase in the costs of the Organization's share of health insurance premiums for staff;

.2 other personnel costs for the translation of documents for meetings have been re-costed based on projected meeting-by-meeting documentation volumes and revised rates for outsourced translation services; and

.3 assumptions on the USD:GBP exchange rate have been adjusted to reflect current market conditions and expectations.

27 The budget is, necessarily, an assessment of future costs of delivery, and with the budget presented in this document covering the period to the end of December 2019 it looks some distance into the future. To assist the Council in considering the key assumptions made when developing the regular budget, and the sensitivity to changes in those assumptions, table 3 sets out the relevant information.

Table 3:
Key budgetary assumptions and sensitivities

<table>
<tr><th>External factor</th><th>Assumed Rate / Measure</th><th>Sensitivity to change</th><th>Comments</th><th>Mitigations</th></tr>
<tr><td colspan="5">Staff costs Assumptions</td></tr>
<tr><td>Statutory increments and take-home pay rises for Professional staff and above</td><td>2%</td><td>±1% approximate annual impact £150,000</td><td>Changes in the costs of Professional staff can arise through changes in the post adjustment, which assesses the cost of living at the duty station, or less frequent changes in the salary scale itself, all of which are determined centrally by the ICSC. This assumption incorporates any results of the periodic place-to-place survey.</td><td rowspan="3">The Special Contingency Account (SCA) established by the Assembly is designed to mitigate increases in salary costs which cannot otherwise be absorbed within the budget. Timing of recruitments for new staff is also a key factor.</td></tr>
<tr><td>Statutory increments and take-home pay rises for General Service staff</td><td>3.5%</td><td>±1% approximate annual impact £55,000</td><td>General Service salary scales are updated annually to reflect local indices, and are periodically reviewed using a salary survey, all determined centrally by the ICSC.</td></tr>
<tr><td>Inflation for other benefits</td><td>2%</td><td>±1% approximate annual impact £47,500</td><td>Other changes to "non-salary" benefits arising under ICSC rules.</td></tr>
<tr><td colspan="5">Foreign exchange rate</td></tr>
<tr><td>Exchange rate</td><td>$1.30</td><td>±$0.1 approximate annual impact £400,000</td><td>The GBP:USD exchange rate impacts the cost of all USD-based expenditure from the regular budget, most notably the Organization's payments to the UN Joint Staff Pension Fund (UNJSPF) and Daily Subsistence Allowance for travel.</td><td>Variances from the budget rate can be absorbed by the Working Capital Fund.</td></tr>
<tr><td colspan="5">Other cost category increases (including other personnel, interpretation and translator costs)</td></tr>
<tr><td>General inflation factors</td><td>2 – 4%</td><td colspan="2">Based on a range of different sub cost categories including other personnel, interpretation, translator costs, building-related business rates, utilities, communication and IT-related costs, local transport, Maritime Knowledge Centre costs etc.</td><td>No specific mitigation other than careful budget management.</td></tr>
</table>

Requirements for other Funds

28 The resource requirements for the Organization's other funds are expected to be in line with those set out in C 117/5(d) with the exception that:

- staff costs have increased for the Trading Fund, driven by the same factors as those set out above for the regular budget;
- a review of the cost allocation formula has been undertaken, which results in an increase in the general costs borne by the Trading Fund. The cost allocation formula was first applied following the building refurbishment in 2007, and has not been reviewed since that time. The revised formula takes account of changes in the factors affecting cost assignment, most notably floor space occupied and headcount employed by each Fund. This review has also factored in the changes arising from the allocation of a part of the first floor to the IOPC Funds. The increase in cost in the Trading Fund results in a corresponding increase in the "Support cost income" line, which reduces the assessment on Member States, as shown in table 6;
- the Termination Benefit Fund expenditure has been adjusted to reflect actual expected separations and, in particular, to take into account the impact of the increased retirement age for IMO staff effective from 1 January 2018; and
- the budgeting process for Trading Fund revenue has been revised to take a "bottom up" approach to sales forecasting, allowing for more accurate projection.

29 With respect to the Headquarters Capital Fund in particular, the Council may wish to note that the Secretariat is working with the Host Government to develop a long-term plan for the building to provide a clearer picture of expected upcoming major works. This will necessarily include a contingency to address urgent issues such as that encountered last year with the upgrade of generators, electrical distribution and related cabling works.

30 The outline budget, including the Organization's other funds, which is presented in table 4, indicates a resource requirement of £48.5 million for 2018 and £49.2 million for 2019, representing a year-on-year increase of 4.5% and 1.3%, respectively.

Table 4:
Budget outline – other budgetary funds

Approved Budgets (£'000)		**Fund (£'000)**	**Estimated resource requirements (£'000)**	
2016	**2017**		**2018**	**2019**
32,618	33,154	Regular budget	34,705	35,442
5,983	6,067	Trading Fund	6,576	6,729
1,200	1,179	Headquarters Capital Fund[2]	1,144	1,167
1,019	1,103	Termination Benefit Fund	859	859
115	117	Training and Development Fund	115	115
5,150	4,850	Technical Cooperation Fund	5,150	4,850
46,085	**46,470**	**Total Annual Expenditure**	**48,549**	**49,162**
0	385	**Year on year resource changes**	2,079	613
0.0%	**0.8%**		**4.5%**	**1.3%**
	92,555	**Biennial Total**		**97,711**
		Biennial resource changes		5,156

[2] Headquarters Capital Fund supplemented as per C 117/5(c).

FUNDING THE ORGANIZATION'S WORK

Context – funding patterns and reserve levels

31 The Organization has three major sources of revenue:

- **Assessment on Member States** – to cover the core work of the Organization, primarily through funding the regular budget along with associated capital expenditure and long-term liabilities;
- **Commercial revenue** – Trading Fund revenue is driven primarily by sales of publications and cafeteria sales, the surplus from which is then available for distribution in accordance with the Assembly's decisions; and
- **Voluntary donor contributions** – bilaterally or through contribution to a Multi-Donor Trust Fund (MDTF), donors contribute towards the delivery of the Organization's activities, primarily through funding the Integrated Technical Cooperation Programme (ITCP) along with funding for other initiatives such as the development of a new Strategic Framework.

32 These are the primary "external" sources of revenue, along with other more minor revenue streams such as investment income and sub-letting of office space. These funds may then be reallocated to meet the resource requirements identified above. Transfers include:

- **the surplus generated by the Trading Fund** – which is redistributed to fund the work of the Organization, the split of funding between aspects being established for each biennium by the Assembly;
- **support cost recovery** – as all delivery relies on administrative and other overhead costs borne by the General Fund, other funds are required to reimburse a "support cost" to cover these charges; and
- **budgetary inter-fund transfers** – funds for capital expenditure and for long-term employee costs including After Service Health Insurance (ASHI) are provided partly through the regular budget, and are then transferred on to the appropriate Fund (HQCF and TBF, respectively).

33 It is, however, important to distinguish between income to the Organization and these "internal" transfers of funds, which represent only a reallocation of existing resources.

34 In looking at the financial health of the Organization, and consequently the most appropriate means of funding its work, it is necessary to look beyond a narrow view of budgetary expenditure and consider the overall financial situation. A key measure is the "reserves" position at the end of each financial period, representing the accumulated surplus or deficit in the Fund(s) over time. Since the adoption of International Public Sector Accounting Standards (IPSAS) in 2010, the Organization has been reporting a complete view of its assets and liabilities, and the trend over time is shown in table 5.

Table 5:
Closing reserve positions 2009-2016 (£'000)

	2009	2010	2011	2012	2013	2014	2015	2016
Core Funds[3]	(7,644)	(6,404)	(11,099)	(12,655)	(12,917)	(11,753)	(9,254)	(14,654)
Trading Fund	3,813	6,873	7,906	8,181	8,140	8,321	9,228	9,417
Technical Cooperation Fund	5,435	4,803	5,168	4,797	5,042	6,493	7,398	7,935

35 In considering these figures and the trends they show, two particular patterns emerge:

- **the overall deficit in the Organization's "Core Funds"**, as a result of the Organization's long-term employee benefit liabilities, for which only a limited amount of funding has been provided to date; and

- **the gradual increase in the reserves held by the Technical Cooperation Fund**. A further £5.7 million (other than the portion to be allocated to the World Maritime University (WMU) of £0.3 million) of the Trading Fund surplus was transferred to the Technical Cooperation Fund in 2017, in accordance with Assembly resolution A.1063(28).

36 The primary reason for the increase in the core Funds deficit is the rise in the Organization's long-term employee benefit liabilities, most notably ASHI. While funds have been set aside to meet these liabilities in the past, most recently £6 million by means of Assembly resolution A.1100(29), this was done through transfer of General Fund reserves rather than the provision of additional funds, and with annual funding being provided on a "pay as you go" basis there is an annual deficit which is unfunded.

Funding 2018-2019 resource requirements – the assessment

37 For 2018-2019, based on the regular budget resource requirement set out above, the proposed assessment on Member States is £32.4 million for 2018 and £33.2 million for 2019, representing an annual increase of 7.7% and 2.6%, respectively, as shown in table 6.

3 Comprising the General Fund, Working Capital Fund, Termination Benefit Fund, Training and Development Fund and the Headquarters Capital Fund.

Table 6:
Outline assessment for the 2018-2019 biennium

Budget (£'000)		Regular Budget	Forecast (£'000)	
2016	**2017**		**2018**	**2019**
32,618	**33,154**	**RB Resource Requirement - (A)**	**34,705**	**35,442**
	536		**1,551**	**737**
	1.6%	**Year on year budget changes**	**4.7%**	**2.1%**
	65,772	Biennial estimate total budget		70,147
		Biennial estimate changes		4,375
1,438	1,448	Support costs from other funds	1,524	1,536
150	150	Other Miscellaneous income	159	156
0	672	Trading Fund surplus distribution[4]	594	495
914	768	Prior year saving allocation	0	0
2,502	**3,038**	**TOTAL offsetting income (B)**	**2,277**	**2,187**
30,116	**30,116**	**Assessment (A - B)**	**32,428**	**33,255**
			2,312	**827**
		Year on year assessment changes	**7.7%**	**2.6%**
	60,232	Biennial estimate total assessment		65,683
		Biennial estimate changes to assessment		5,451

38 For 2018-2019, while an element of the proposed increase in the assessment is a result of the increase in the regular budget set out earlier, a significant factor is the reduction in the overall level of offsetting income used in this budget outline. The Council will recall that in document C 117/5(d), paragraph 41, the Secretary-General noted that, in his view, a sustainable funding ratio of the regular budget by assessment on Member States should be set at 94% of the annual budget estimates, consistent with the Council's views that the core work of the Organization should be funded through the assessment. The assessment shown in table 6 is broadly consistent with a move towards this ratio, and shows an increase in comparison with the previous biennium, primarily as a result of bringing the funding ratio into line with this proposal.

39 The assumptions made for offsetting income in arriving at this outline view of the 2018-2019 assessment are:

- **an increase in the level of support costs received from other funds** arising as a result of the update to the cost allocation formula referenced in paragraph 28, from a total of £2.9 million for the 2016-2017 biennium to £3.1 million for the 2018-2019 biennium; and

- **a formula for distribution of Trading Fund surpluses as shown in table 7**. In considering the distribution formula, the table used is consistent with that presented in paragraph 24 of document C 117/5(d), with the exception of the financial support provided to WMU. WMU has made significant progress in strengthening its financial situation, and while IMO will continue to work closely with the University on a range of matters, and it considered that this direct financial support from IMO is no longer necessary for the coming biennium. As a result, the net proportion transferred to the Technical Cooperation Fund remains the same at 76%, still slightly higher than the level established by the Assembly

4 Trading Fund surplus distribution includes the portion of funds previously distributed to WMU, i.e. applying the "Proposed" distribution formula in table 7.

prior to the introduction of support to WMU. Recognizing that there would otherwise be a significant increase in the assessment, the Secretary-General proposes, in table 7, using the funds previously assigned to WMU to offset the assessment.

Table 7:
Distribution formula for Trading Fund surplus

	TCF	(WMU)	HQCF	TBF	TDF	RB
Current	76.0%	4.0%	12.5%	1.0%	1.5%	5.0%
Proposed	76.0%	0.0%	12.5%	1.0%	1.5%	9.0%

40 The figures in table 6 at present contain **no use of prior year savings** to reduce the assessment, and this is the key to the increase in the outline assessment, as a total of £1.68 million was used to offset the assessment for the 2016-2017 biennium.

Options for further offsetting the assessment

41 Table 8 shows the offsetting income used to reduce the assessment over recent biennia:

Table 8:
Offsetting income – historical trends

	2010	2011	2012	2013	2014	2015	2016	2017
Budget (A)	**30,291**	**30,860**	**30,520**	**31,686**	**31,686**	**32,618**	**32,618**	**33,154**
Reimbursements from TRF	662	673	710	713	670	684	688	698
TC/Donor support costs	300	300	663	663	750	750	750	750
Allocation TRF surpluses					-	600	-	672
Regular budget expenditure savings	1,500	500			-	318	914	768
Miscellaneous income	80	80	140	140	150	150	150	150
Offsetting income total (B)	**2,542**	**1,553**	**1,513**	**1,516**	**1,570**	**2,502**	**2,502**	**3,038**
MS Assessment (C=A-B)	**27,749**	**29,307**	**29,007**	**30,170**	**30,116**	**30,116**	**30,116**	**30,116**
Assessment ratio (B/A)	**92%**	**95%**	**95%**	**95%**	**95%**	**92%**	**92%**	**91%**

42 Over time, the proportion of the regular budget funded by the assessment (the "funding ratio") has been reduced, and the assessment maintained, primarily through the use of expenditure savings from the regular budget, a situation which is unlikely to be sustainable. When considering how best to apply the savings from the current biennium, it is necessary also to consider the funding context and issues set out in paragraphs 34-36: the Organization's core funds have negative reserves, primarily as a result of long-term employee benefit liabilities, and the situation is becoming increasingly grave each year. With this in mind, any short-term measures taken to reduce the assessment will inevitably delay the resolution of IMO's larger funding issues.

43 There were savings of approximately £2.1 million on the regular budget for 2016, of which £0.6 million has already been assigned to replenish the Working Capital Fund in accordance with the decision of the Council at its last session. As presented in document C 118/4(e), the regular budget expenditure savings for 2017 are expected to be significantly lower as a result of a number of adverse external price factors. Nevertheless, it might be

anticipated that **approximately £1 million to £1.5 million** of expenditure savings balance **might be available** for the biennium as a whole, depending on the exchange rate movement (and accompanying requirement for the replenishment of the WCF) and the scale of expenditure savings in 2017. This figure will be reassessed during the course of 2017, and a more accurate forecast will be provided to the Council at its extraordinary session in November.

44 There are two options for the use of these expenditure savings balance for the coming biennium:

- **Option 1 (Assessment reduction)** – Using the regular budget savings to further offset the assessment would minimize the expected increase for Member States in the short term. Applying £1 million as "offsetting income" for the coming biennium with £0.75 million for 2018 and £0.25 million for 2019 would reduce the annual assessment increase to 5.2% and 4.2% respectively; if £1.5 million could be available with a split of £0.9 million for 2018 and £0.6 million for 2019, the annual assessment increase would be 4.7% and 3.6%, respectively (6.6% for the biennium as a whole); or

- **Option 2 (Funding for ASHI)** – the Council will recall that paragraph 34 of document C 117/5(d) set out four options to fund the Organization's ASHI liability. As noted in paragraph 35 of this document, the liability is increasing each year by a substantial amount, from £17 million in 2010 to £36 million at the end of 2016, and urgent action is therefore needed to develop a formal funding plan. As an interim measure, the expected savings balance noted above might be set aside to further build the Organization's reserves in the Termination Benefit Fund and offset the increasing liability, while the matter is considered further.

45 The Council is therefore invited to consider these options and determine the desirability of each, taking into account the Organization's overall financial position and the Secretary-General's view that in order to provide sustainable funding for IMO's core work, a minimum of 94% of the regular budget should be funded through the assessment.

LONG-TERM FUNDING, BUDGETING AND PLANNING CHALLENGES

46 While this document primarily focuses on the budget outline for 2018-2019, there are some longer-term funding issues faced by the Organization which the Council should be aware of, and the response to which will be the focus of the Secretariat during the coming biennium. These are:

- **Review of the Organization's funding and financial governance structure** – the current funding structure has its merits, and provides for clear separation and control of funds provided for different purposes, but it also has issues. Most notably the structure is complex and relies on a number of transfers from one fund to another which can reduce transparency. In addition, the governance and budgetary management structure does not cover the whole of the Organization's activities, most notably those of the large extra-budgetary projects and the Multi-donor trust funds. It is not straightforward to incorporate such funding mechanisms within the overall financial governance of the Organization, and the day-to-day management and auditing of those activities remains strong. Nevertheless there remains an issue to be addressed to ensure that appropriate oversight is in place by the Member States. A further factor will be the completion of the Organization's revised Strategic Framework, and its links to the results-based budget and performance management processes. To address these issues appropriately will require careful review and development of new processes and procedures, and may in due course require amendments to the Organization's Financial Regulations and Financial Rules;

- **Resource mobilization planning –** the Organization's technical cooperation activities are highly dependent on funding provided through the Trading Fund surplus, which increasingly faces competing demands and pressures on the level of surplus that can be generated. More generally, the Secretary-General wishes to bring greater rigour to the Organization's resource mobilization activities. This will inevitably be the start of a journey rather than the end, the intention being to set overall objectives and direction of travel, which will then be incorporated into a holistic, strategic approach to resource mobilization for the long term, and which will also consider in-kind support provision including, for example, the development of a revised strategy for use of Junior Professional Officers, along with revisions to investment management to improve returns on surplus cash;

- **long-term liability management plan** – ASHI funding is an issue for the United Nations system as a whole, as the pay-as-you-go approach significantly understates the full cost of employing staff. The issues surrounding ASHI funding were set out in detail in document C 117/5(d) paragraphs 31-34, and an interim funding measure proposed in paragraph 44 of the present document. Since the issuance of document C 117/5(d), a United Nations working group with participation from across the United Nations system has developed an eight-point plan to address the issue of ASHI liabilities, and we are currently reviewing this report to determine an appropriate response for the Organization. Of the recommendations made, a number are not relevant to IMO, but others require more detailed review and consideration not just of the funding mechanism but of the plan itself. This would then provide the Organization with the time to prepare and provide the Council with a holistic response to the ASHI issue which is consistent with that taken in other United Nations organizations; and

- **capital investment planning** – following the unexpected supplementary budget in the Organization's Headquarters Capital Fund (HQCF) in 2016, as reported to the Council in document C 117/5(c), the Secretary-General has been reviewing the processes and procedures in place to support capital planning and management. While individual plans exist for major expenditure items with respect to facilities management and IT, work is now underway to develop longer-term plans integrated with a broader strategy in each of these areas, to ensure that major maintenance of the building is planned for a five-year period, through discussion with the Host Government, and that IT investment will be integrated with and ready to support the requirements of the new Strategic Framework.

SUMMARY CONCLUSIONS AND ACTION REQUESTED OF THE COUNCIL

Summary of the proposed outline of the budgets

47 In drawing up his budget proposals for the 2018-2019 biennium, the Secretary-General has been mindful of the financial pressures on Member States, and also of the demands placed on the Secretariat through recent austerity measures and significant external factors increasing costs. To support the Secretariat's capability to deliver to the expectations of Member States, and due to external pressures beyond the Organization's control, most notably price increases and the falling value of GBP in relation to the US dollar, a continuation of Mixed Zero Growth is no longer feasible, and a regular budget increase

of 4.7% in 2018 and 2.1% in 2019 is required, a rate slightly below that of Zero Real Growth. When including other IMO funds, the overall resource requirement for the next biennium is proposed to be set at £97.7m, representing an increase of 4.5% for 2018 and 1.3% for 2019.

48 In considering how to fund the Organization for the 2018-2019 biennium, the Secretary-General notes the overall financial situation of the Organization, in particular the increasing negative balances on the core funds as a result of the ASHI liability, and the relatively low proportion of the budget funded by the assessment in recent years. He therefore proposes an assessment on Member States of £32.4 million for 2018 and £33.3 million for 2019, representing an annual increase of 7.7% and 2.6% respectively.

49 In the context of the proposed increase in assessment and the challenges of meeting the Organization's long-term ASHI liability, there is some margin of flexibility to adjust funds for 2018-2019 when considering the regular budget expenditure savings balance. While it is too early to determine the final savings figure for the current biennium, it is estimated that in total there would be between £1 million and £1.5 million available, and Council is invited to consider whether in principle these funds should be:

- applied as further offsetting income to reduce the increase in the assessment; or
- used as an interim measure to further address the Organization's increasing ASHI liability through transfer to the Termination Benefit Fund.

50 The Secretary-General will continue to work in the longer term on a number of areas identified in paragraph 46, with the overall objective of providing further simplicity and transparency in the budgeting and planning process, to reduce the Organization's dependency on the Trading Fund surplus through a broader resource mobilization strategy, and to enhance the integration of long-term planning for assets and liabilities with the budgeting cycle.

51 On the basis of the Council's discussion and conclusions on the Secretary-General's budget outlines provided in this document, along with any changes in assumptions arising from moving external factors, the Secretary-General will submit to the thirtieth regular session of the Assembly (preceded by the twenty-ninth extraordinary session of the Council) his results-based budget proposal containing the Secretariat's business plan for the next biennium and the results-based framework to establish a linkage between the results-based budget and the revised Strategic Framework. A draft Assembly resolution on the budget proposals for the next biennium will also be provided to C/ES.29 for its consideration and forwarding, with its comments and recommendations, to the Assembly.

Action requested of the Council

52 The Secretary-General invites the Council to consider his budget outlines and proposals and note the information provided herein, and in particular to:

.1 endorse the Organization's regular budget staff complement for the 2018-2019 biennium, which remains unchanged from this biennium;

.2 note that the budget outline is set on the basis of 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;

.3 approve in principle the outline regular budget for the 2018-2019 biennium of £70,147,000, comprising an appropriation of £34,705,000 for 2018 and an appropriation of £35,442,000 for 2019, as summarized in table 1;

.4 note the budgetary assumption indicators, the sensitivity of the budget to changes in those assumptions, and the mitigating mechanisms in place where appropriate (table 3), and note that in submitting his detailed results-based budget to the Assembly, these assumptions may be updated to reflect changing circumstances;

.5 endorse the proposed budget plan for the Organization's other Funds (table 4);

.6 agree initially to the financing of the biennial appropriation by assessments upon Member States of £65,683,000, comprising an assessment of £32,428,000 for 2018 and £33,255,000 for 2018, while endorsing the proposal to use, for the reduction of the assessment, offsetting income as shown in table 6;

.7 approve in principle the formula for the distribution of the Trading Fund surplus, and recommend its adoption by the Assembly (table 7);

.8 taking into account the Organization's overall financial situation, decide in principle how the additional funds available from regular budget expenditure savings for the current biennium should be applied, whether to further reduce the assessment or as an interim measure to be applied against the ASHI liability (paragraph 44); and

.9 note that the Secretary-General will provide to C/ES.29, for its consideration, his detailed results-based budget reflecting the conclusions and decisions of C 118, together with a related draft Assembly resolution (paragraph 51).

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