

Program and Budget Committee

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REVISED POLICY ON RESERVES

Document prepared by the Secretariat

Following the approval of the Capital Master Plan Project Proposals (document A/65/8), the Revised Policy on Reserves (Annex I to this document) has been updated to reflect the decisions taken at the 23rd PBC session (document WO/PBC/23/9), and the 37th PBC session (paragraph 21 document WO/PBC/37/11 Rev).

[Annex follows]

REVISED POLICY ON RESERVES

I. INTRODUCTION AND DEFINITIONS

1. WIPO's Reserves serve to minimize the impact of income shortfalls and maximize the probability that the Organization can meet its obligations in the short term and maintain financial stability. The reserves are accounted for as the net assets of the Organization, i.e. the difference between total assets and total liabilities. WIPO's Reserves consist of its reserves and its working capital funds and are referred to as Reserves and Working Capital Funds (RWCF).

2. WIPO's Financial Regulations and Rules (FRR) define the two specific components of the Organization's RWCF as follows:

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

3. The Financial Regulations and Rules (FRR) of WIPO also reflect the ownership and the authority of the Paris, Berne, Madrid, Hague, IPC, Nice, PCT, Lisbon, Locarno and Vienna Unions in respect of the Organization's Reserves and Working Capital Funds as follows:

- (i) If, after the closure of the financial period, any Union shows a surplus of income, such surplus shall be accounted for under the **reserve funds**, unless otherwise decided by the General Assembly or the Assembly of the Union concerned. (*Regulation 4.7*)
- (ii) As decided by the Assembly of the Madrid Union, and under Article 8(4) of the Madrid Agreement, the surplus of the Madrid Union's income over expenditure is distributed to Member States. The requirements set out under Article 8(4) of the Madrid Agreement and Protocol in respect of the distribution of the Madrid Union Surpluses specifically state that: "The annual product of the various receipts from international registration, with the exception of the receipts derived from the fees mentioned in [paragraph \(2\)\(ii\)](#) and [\(iii\)](#), shall be divided equally among the Contracting Parties by the International Bureau, after deduction of the expenses and charges necessitated by the implementation of this Protocol."
- (iii) Accordingly, while the surplus generated under all other Unions will automatically be retained as part of the Organization's RWCF, the surplus related to the Madrid Union is paid out to Member States unless they otherwise decide.
- (iv) If, after the closure of the financial period, any Union shows a deficit, not coverable out of reserve funds, the General Assembly of WIPO or the Assemblies of the interested Unions, as the case may be, shall decide upon measures to redress the financial situation (*Regulation 4.8*).

- (v) The **working capital funds** of the Organization and of the Paris, Berne, Madrid, Hague, IPC, Nice, PCT, Lisbon, Locarno and Vienna Unions shall be established in amounts to be determined by the Assemblies of the Member States and of the Unions, each as far as it is concerned. (*Regulation 4.2*).

II. WIPO'S POLICY ON RESERVES

4. In addition to the above, which provides a clear definition of the Organization's RWCF, WIPO had an explicit Policy on Reserves in place, adopted by Member States in the year 2000 (please refer to document A/35/15 and A/35/6), which set out the level of required RWCF for the Organization, together with a number of other core policy considerations. While this policy remained valid and formed a solid and relevant basis for the effective financial management of the Organization, the 22nd session of the Program and Budget Committee (PBC), held in September 2014, reviewed WIPO's Financial Situation and its Policies related to Reserves and requested the Secretariat to submit to the PBC a comprehensive policy proposal on the reserves that includes target setting, liquidity considerations and the management, use and reporting of the available surpluses above the target level, taking into consideration the Member States' guidance and the recommendations of the Audit and Oversight bodies. The preparation of this document has been based on the discussions held with the Member States during the 22nd session of the PBC on the basis of document WO/PBC/22/28.

5. The core elements of the Revised Policy on Reserves, which are further elaborated below, are the following.

- (i) WIPO maintains a clear separation between the reserves and the working capital components of the RWCF in accounting terms, while preserving the ownership arrangements for the working capital funds;
- (ii) The target level of Reserves, including Working Capital Funds, are defined at the level of Unions, on the basis of percentages of estimated biennial expenditure ("PBE factor") for each Union, and presented within the context of the Organization's budgetary process;
- (iii) The target level of Reserves, including Working Capital Funds will be held to the extent possible in cash or in investments that can be liquidated in the short term, at low or no cost, and which are in accordance with the investment policy in force;
- (iv) The Member States and the Director General may propose for approval project activities funded from available surpluses. The calculation of available surpluses will exclude the amounts of the Revaluation Reserve Surplus (which results from the revaluation of the land on which the new building has been constructed) and of the Working Capital Funds (which have been established through member State contributions by decisions of the Assemblies of the Unions and which are funds held in trust by WIPO).

6. The following section addresses each of the core elements of the Revised Policy on Reserves in further detail.

II. (A) Separation of the Working Capital Funds

7. As noted above, the concept of RWCF was introduced while maintaining the separation between reserve funds and working capital funds in accounting and reporting terms. Accordingly, the arrangements for the working capital funds continue to be that the contributions, through which working capital funds are financed, are held in trust by WIPO for the Member States of the respective Unions. The level of the Working Capital Funds is established by the individual treaty agreements of the respective unions concerned. The amount of Working Capital Funds has remained static since 1990. Adjustments in the overall level of the RWCF are accordingly introduced by amending the level of the reserve funds only, without any adjustment to the level of Working Capital Funds. At the time of their approval of the Policy on Reserves in 2000, Member States had also agreed to the consolidation of the presentation of the working capital funds for the Contribution-financed Unions. This is reflected in the Financial Statements and in the Financial Management Report (FMR).

II. (B) Setting the Required (Target) Level of Reserves

8. The RWCF serve to minimize the risk of deficits or liquidity problems exercising a negative effect on program delivery, to maximize the probability that the Organization can meet its obligations and to provide financial stability. The issue of financial risk can be elaborated further by distinguishing between income-related and expenditure-related risks. Income-related risks include the non-payment of contributions, lower than anticipated fee income or exchange rate fluctuations. Expenditure-related risks include, for example, vendor bankruptcy prior to completion of delivery.

9. WIPO is primarily a fee-funded Organization deriving nearly 95 per cent of its income from fees for services. The most significant risk faced by WIPO is therefore income-related. Essentially, this is the risk that the income which is estimated to be secured during the biennium and which is required to fund the proposed biennial expenditure does not materialize. The proposed biennial expenditure is therefore a good and direct indicator for risk assessment. Hence, WIPO's Policy on Reserves expresses the protection provided by the total amount of RWCF as a percentage of the estimated biennial expenditure (PBE factor): the higher the PBE factor, the higher the protection. The PBE factor provides an indication of how long the operation could be funded by drawing exclusively on the Reserve funds. For example, a factor of 50 per cent would indicate funding for 12 months and a factor of 25 per cent, funding for six months.

10. In accordance with the above approach, the target level of RWCF was established as a percentage of estimated biennial expenditure (PBE factor) for the contribution-financed Unions, the PCT Union, the Madrid Union and the Hague Union. The appropriate PBE factor was established at the level of Unions, with the aim of reflecting the risks and liquidity concerns specific to the Union concerned. The level of RWCF for each Union is accordingly calculated as the estimated biennial expenditure multiplied by the Union's PBE factor. The selection of the PBE factor as the reference point ensures that the level of the RWCF is linked to the level of the proposed program and budget, which, in turn, "ensures that the dynamics of change and the related risk and liquidity concerns are fully reflected"¹ in the level of RWCF.

11. Following a review of the evolution of the income, expenditure and actual RWCF of the Organization and each Union, it is proposed that the PBE factor for the PCT Union be increased, to take into account the significant increase in the scale of PCT operations and the increased dependence of the Organization on PCT income since 2000. The increased level of

¹ Document A/35/6 of 2000 (the proposal for the Policy on Reserves)

RWCF for the PCT Union will provide greater financial stability for the Organization's financially most significant Global IP System. The PBE factor for the PCT Union is proposed to be increased from 15 per cent to 20 per cent. The PBE factors for the contribution-financed Unions remain 50 per cent, the Madrid Union 25 per cent and the Hague Union 15 per cent. The Lisbon Union has no RWCF target set for it currently. The evolution of the Lisbon System would need to be monitored carefully to determine the appropriate timing for the introduction of an RWCF target and its level.

12. While the PBE factors are defined by Union, in practice, the Organization works on the basis of a single Program and Budget established by Program (since the late 90s) and by Expected Result (since 2012/13). In the context of the Organization's Budget, the above PBE factors by Union translate into an equivalent Organizational PBE factor of approximately 22 per cent. This would be the equivalent of over 5 months of projected biennial expenditure and an increase from the current level of 18.5 per cent which equates to approximately four months of projected biennial expenditure for the Organization. The increase in the target level of the Reserves will serve to strengthen financial risk management. Furthermore, the proposed increase is in accordance with Member States' preference that the increase in the target Reserves be gradually implemented. The increased Reserves level of 22 per cent is also more aligned to the Swiss External Auditor's recommendation of 2006 which recommended that the Reserves target be set at 25 per cent of Projected Biennial Expenditure i.e. the equivalent of six months of biennial expenditure.

13. WIPO does not face a liquidity risk exposure at present as it has substantial unrestricted cash resources which are replenished as a result of its operations. However, one of the objectives of maintaining a target RWCF is to ensure that the Organization retains its ability to fulfil its obligations in the short term. The target level of RWCF will therefore be held to the extent possible in cash or in investments, which can be liquidated in the short term at low or no cost, and which are in accordance with the investment policy in force. The extent to which the Reserves target could be maintained in cash or other liquid assets will be determined by the negative interest rates, the thresholds which the banking institutions are able to accord to WIPO (up to which our deposits will not attract negative rates) and the investment policy.

II. (C) Reporting on the Reserves

14. The RWCF are central to financial planning and management of WIPO and their reporting is an integral component of the biennial Program and Budget, the Financial Statements and the FMR.

15. WIPO's biennial Program and Budget provides a scenario on the income, expenditure and results by Union.

16. WIPO's Reserves (Net Assets) are reported in the Financial Statements of the Organization in Statement I, which is the Statement of Financial Position, and in the accompanying Notes. WIPO's Net Assets as per the Financial Statements include its Reserves (Accumulated Surpluses and Revaluation Reserve Surplus) and Working Capital Funds. The Working Capital Funds, which were established by the individual treaty agreements of each of the Unions, remain funds created by way of contributions and are held in trust by WIPO for the Member States of the different Unions. They remain available for appropriation, by the decision of the Assemblies of the Unions, should there be a temporary liquidity shortfall.

17. Following audit recommendations received from the External Auditor concerning the creation of a separate reserve for the financing of projects, it is proposed to enhance the reporting of WIPO's Reserves. The enhancements will appear on both the Statement of

Financial Position and within the notes themselves, namely within the note which is currently Note 21. The proposal is to create a separate reserve, entitled Special Projects Reserve which would contain the appropriations to projects financed by reserves, less accumulated expenditure. The balance of the reserve would reflect amounts still to be used for projects already approved. Capitalized amounts in respect of the projects would be credited to accumulated surpluses/(deficits).

18. Table 1 below shows how Note 21 would have looked within the Financial Statements for 2014 had the Special Projects Reserve been created in 2014.

Table 1

Note 21: Reserves and Fund Balance

| | December 31, 2013 | Program and Budget Surplus for the Year (before IPSAS adjustments) | Special Accounts Surplus for the Year (before IPSAS adjustments) | Projects Financed from Reserves (before IPSAS adjustments) | Appropriation or Adjustment to SPECIAL PROJECTS RESERVE | IPSAS adjustments for the year | IPSAS Transfer to Accumulated surpluses | December 31, 2014 |
|--|----------------------|---|---|---|--|--------------------------------------|--|----------------------|
| (in millions of Swiss francs) | | | | | | | | |
| Program and Budget surplus/(deficit) for the year | - | 69.9 | - | - | - | -26.8 | -43.1 | - |
| Special Accounts surplus/(deficit) for the year | - | - | 0.8 | - | - | -0.8 | - | - |
| Accumulated surpluses/(deficits) | 123.1 | - | - | - | -0.1 | - | 72.2 | 195.2 |
| SPECIAL PROJECTS RESERVE | 62.3 | - | - | -35.2 | 0.1 | 29.1 | -29.1 | 27.2 |
| Working capital funds | 8.3 | - | - | - | - | - | - | 8.3 |
| Revaluation surplus | 15.1 | - | - | - | - | - | - | 15.1 |
| Net Assets | 208.8 | 69.9 | 0.8 | -35.2 | - | 1.5 | 0.0 | 245.8 |

19. This table clearly shows the balance of the amounts appropriated to projects at the end of December 2013 and the related expenditure (35.2 million Swiss francs) on those projects during the year 2014. Part of this expenditure has been capitalized in accordance with IPSAS (29.1 million Swiss francs) and this amount is credited to accumulated surpluses. The balance of 27.2 million Swiss francs at the end of 2014 represents the amounts still to be used for projects already approved.

20. The Special Projects Reserve will also be disclosed in the Statement of Financial Position, as illustrated in Table 2 which shows how the reserve would have been disclosed in the 2014 Financial Statements.

Table 2

Extract of Statement 1: Statement of Financial Position

| | December 31, 2014 | December 31, 2013 |
|--------------------------|---------------------------------------|-------------------|
| | <u>(in thousands of Swiss francs)</u> | |
| Accumulated surplus | 195,195 | 123,140 |
| Special Projects Reserve | 27,210 | 62,291 |
| Working Capital Funds | 8,342 | 8,342 |
| Revaluation surplus | 15,046 | 15,046 |
| | <u>245,793</u> | <u>208,819</u> |

21. Reporting on the progress related to projects financed from the Reserves will be carried out in accordance with decisions taken by the Assemblies of the Member States at the time of approving such projects. In respect of financial reporting, the proposal is for the Financial Statements to reflect within the Statement of Financial Position and in the note *Reserves and Fund Balance* (currently Note 21), the balance on the Special Projects Reserve and movements against the reserve during the year, as outlined above, with effect from December 31, 2015. This proposal has been discussed in detail with the External Auditors.

22. The Financial Statements also provide a Report on Revenue, Expenses and Reserves by Segments, which in the case of WIPO are its Unions. WIPO's assets and liabilities are owned by the Organization as a whole and do not belong to individual Unions except for the investment property owned by the Madrid Union. Therefore only Net Assets which include working capital and reserves are shown by segment or Union. WIPO's Financial Management Report provides a comprehensive summary of financial performance for each biennium by Union in the section entitled "Summary of Results by Union". This summary includes the RWCF as at the end of the biennium.

II. (D) The Use of the Reserves – Principles and Approval Mechanism

23. The Use of the Reserves shall firstly be governed by the principles set out in WIPO's Financial Regulations and Rules (FRR).

24. In accordance with WIPO's Regulatory Framework, the revised set of principles to be applied for the use of the reserves is presented below. The revisions are motivated by the principles of financial risk management and financial sustainability and strong calls from several Member States on the need to strictly limit the use of the reserves to one-time and extraordinary expenditures. The proposed revisions establish:

- (i) A stricter definition of the available reserves;
- (ii) A stricter and clearer definition of the types and categories of projects that may be proposed for financing from the reserves; and
- (iii) Clearer guidance on the key parameters to be included in proposals for the use of the reserves including a more comprehensive consideration of project costs that not

only include full project life-cycle costs but also a clear view of the recurring expenditure to which the Organization will be committed as a result of completion of the project. This is also in accordance with observations and recommendations made by the External Auditors.

25. The primary use of the target level of Reserves of the Organization remains the financing of deficits in a given biennium should income drop to such an extent as to result in actual expenditure exceeding actual income. WIPO Reserves and Working Capital Funds have consistently remained above the target level (see chart “Evolution of WIPO Financial Situation 1998-2014” below).

26. In 2000, it was decided that the Director General or the Member States may propose for approval by the WIPO General Assembly or the Assembly of the Union concerned, as the case may be, project activities to be funded from available surplus. In 2010, the Member States approved a set of principles for the use of the Reserves (See WO/PBC/15/7/REV). The following paragraphs set out the revised principles that will guide the use of the reserves.

27. In making proposals for the use of the reserves, the Organization must ensure that such use does not result in the RWCF falling below the target level. Accordingly, the first principle is set out below.

PRINCIPLE 1: Proposals for the use of the RWCF should only pertain to the amounts available in the RWCF exceeding the target level required by WIPO’s Policy on Reserves. This is applicable both at the level of individual Unions as well as at the level of the Organization as a whole.

28. The calculation of the available amounts that exceed the target level must be clear, transparent and prudent. Accordingly, the second principle for the use of the reserves that provides a clear and more prudent approach to the calculation of the available reserves is set out below.

PRINCIPLE 2: The calculation of the available reserves will be based on the information on the RWCF levels contained in the most recent financial statements and must take into due consideration the actual, committed and planned expenditures from reserves for the financial period(s) during which the proposed project will be implemented. The Revaluation Reserve Surplus (which arises from the revaluation of the land on which the new building has been constructed) and the Working Capital Funds (which were established through Member States contributions) will be excluded from the calculation of the amounts available in excess of the RWCF target.

29. The Reserves of the Organization may be required to finance a deficit in a given biennium if actual expenditures exceed actual income, and therefore should not be used to inflate the funding available for operational and recurring expenditures. Planned deficits instill a false sense of long-term resource availability, and may result in the undertaking of longer term commitments (e.g. staff resources) with short term or extra-ordinary funding. With special emphasis on the fact that approximately two-thirds of WIPO’s costs are personnel costs, this could represent a significant risk for the Organization. Accordingly, the third principle for the proposals for the use of Reserves is set out below.

PRINCIPLE 3: Proposals for the use of available reserves should be limited and for one-time projects for capital improvements and exceptional circumstances, as decided upon by the Assemblies of the Member States and of the Unions, each as far as it and its available reserves are concerned. Capital projects would typically be identified in a long-term capital master plan and may be defined as projects related to construction/refurbishment and Information and Communication Technology that are needed to keep an Organization's facilities and systems fit-for-purpose through significant expansion or additions.

Projects should be of a strategic and special nature (versus routine maintenance projects which should be financed from the regular budget). In cases where a project is considered strategic and special in nature, the project is transformative, the cost is extra-ordinary and requires a unique investment. Such investments could, for example, be in core platforms, and major renovations of buildings. These projects, for example, improve access to services for both internal and external customers, introduce automation and improve ICT platforms/processes. IT projects should conform with WIPO's technical standards and ICT policies and duly consider how it would fit with the existing WIPO technology and strategy stack.

30. Projects financed from the reserves may adversely impact the liquidity levels of the Reserves. Additionally, such projects, once completed, will result in a certain level of recurring resource requirements on an on-going basis. Member States' decisions on the use of the Reserves would need to be taken on the basis of comprehensive information and a full understanding of the impact of their decisions on the financial management of the Organization. Accordingly, the fourth principle for the proposals on the use of the reserves is:

PRINCIPLE 4: Proposals for the use of the Reserves should be prepared in a comprehensive manner with information on full life cycle costs of the projects, estimated benefits (which may be both financial and qualitative in nature), recurring expenditures that the Organization will be committed to budgeting for as part of the regular budget in subsequent biennia, and the impact on cash flows and liquidity levels of the Reserves. A preparatory/feasibility study or technical assessment is a pre-requisite for submitting a project proposal. The cost of such studies/assessments should be covered from the regular budget. Where applicable the cost of a project should be benchmarked against similar projects outside of WIPO.

31. Unlike projects and activities under the regular budget, for which appropriations are only available for the biennium for which they were approved, projects financed from the Reserves of the Organization, as described in principle 4 above, may cut across biennia and care must be taken to ensure that funding for approved projects remains available for the duration of the project/initiative as approved by Member States. This would ensure that approved projects are effectively completed. Accordingly, the fifth principle for the proposals for the use of Reserves is set out below.

PRINCIPLE 5: Proposals for the use of the Reserves may be for projects and initiatives which are outside the biennial financial period of the Organization, and may cut across, or last for, more than one biennium. Each project should be contained to a maximum of two phases and should normally be for a minimum budget of three million Swiss francs. If a project is proposed to be implemented in two phases, the budget for each phase should exceed three million.

IV. (B) Approval Mechanism for Proposals for the Use of the Reserves

32. Proposals for the use of the Organization's available Reserves may be made by the Director General or Member States to the Assemblies of the Member States and of the Unions, each as far as it is concerned.

APPROVAL MECHANISM:

Proposals for the use of the Reserves may be made by the Director General of WIPO or Member States via the PBC to the Assemblies of the Member States and of the Unions, each as far as it is concerned. The proposals must be prepared in accordance with the principles set out for the use of the reserves.

In the case of the Madrid Union, where any use of the biennial surplus is subject to Article 8(4) of the Madrid Agreement and Protocol, the proposal for the use of the surplus and/or RWCF in excess of the target level required by the Policy on Reserves is presented by the Director General to the Madrid Union Assembly.

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