

Alliance of the CGIAR Centres

POOLING OF CENTRES RESERVES

Prepared by the Alliance Office for AGM06, November 2006

Preamble

AGM05 requested the Alliance to explore options for system-wide pooling of reserves and report to ExCo. ExCo recommended one amendment, which was implemented (addition in the terms of reference of consultants of: if there are legal impediments to pooling reserves, how could they be overcome). The discussion of the ToR made it clear that before exploring options for pooling reserves, it was essential to determine whether pooling of reserves was legally feasible. The Alliance tabled the reports of the two consultants at ExCo11, and was requested to present the Alliance's analysis of options on pooling reserves to AGM06.

Issues related to what constitutes an appropriate level of reserves for the different centres are being examined separately by the Alliance Deputy Executive-Finance (DDG-Finance) and the Secretariat.

Abstract

Appropriately qualified consultants were chosen – the CG Secretariat were happy with the choice of consultants. Having looked at the problem from all angles their conclusions are that it is not legally possible to pool reserves for purposes of sharing financial risk. The mission of the Alliance is “to enable the Centres to contribute more effectively and efficiently to the mission of the CGIAR by cooperating and pooling their resources whenever and wherever needed”. In the case of Centres reserves held for specific purposes of financial risk management, the Alliance's position is as follows. Since it is legally not possible for Centres to pool such reserves, and since to remove legal impediments all the governing documents of the 15 Centres would have to be amended, which would imply unacceptably high transaction costs, the option of pooling reserves for purposes of sharing financial risk management is neither legally nor pragmatically worth pursuing by the Alliance at this juncture. At the same time, some of the Alliance Centres are currently discussing the option of establishing an investment partnership, for a portion of their reserves.

Selection of consultants

The Alliance developed the following criteria for selecting consultants, in consultation with some donors, the Secretariat and the Director of Internal Audit.

1. Understanding of the funding mechanisms that characterize the CGIAR system, of the requirements associated with restricted and unrestricted funding, and of the international and not for profit nature of the centres;
2. Established international reputation and track record in international legal and financial management issues concerning not for profit entities;
3. No conflict of interest; a totally objective perspective, with no possibility of the consultant being influenced by a past career in the CG or by current linkages to the CGIAR that would offer opportunities for lobbying or bias.

The criteria, approved by a sub-Committee of the Alliance Board (AB) were used to rank nominated consultants (from the Secretariat, some donors, the Director of Internal Audit). A short-list was established and the sub-committee of the AB approved the two

top consultants in the short-list. The Secretariat was invited to give its view, and it had no objections to the choice of the two consultants.

A legal consultant, Ms. Roady, was engaged who is a senior partner at Morgan Lewis. She focuses her practice on tax and governance issues affecting tax-exempt organizations, including charities, foundations, colleges and universities, museums and other nonprofit organizations. Ms. Roady recently served on the Governance Work Group of the Panel on the Nonprofit Sector, which was convened by Independent Sector to provide comments to the Senate Finance Committee of the U.S.A.

A financial consultant was also engaged, Mr. Sumariwalla who is the founder and President of Global Philanthropy and Nonprofits, headquartered in the USA. He has 30 years of experience in the management of non profit organisations. He holds a BA, an MA (U. of Massachusetts) and an LL.M (U. of Virginia).

Legal findings and options

The legal consultant examined:

1. whether the Centres comprising the Alliance have authority to pool their reserves for purposes of sharing financial risks
2. If there are impediments to such pooling, whether they might be removed; and
3. Whether there are opportunities for the pooling of reserves for other purposes than sharing financial risk

On the first question, she examined the Charter of the CGIAR, the governing documents of the Centres and the manner in which they receive their funding. She concluded that Centres do not have authority to pool their reserves for purposes of sharing financial risk. Management of financial risk is one of the ultimate responsibilities of Centre Boards and this responsibility cannot be shared with other Centres.

The Centres are governed by Boards that are charged, under Centres governing documents, with overseeing the activities of the Centres, which are directed to the purposes for which they were created. Centre Boards have fiduciary duties to ensure that the assets of the Centres are applied for the intended purposes. They are also responsible to Centre donors for the use of Centre resources in accordance with donor intent. Each Centre has different donors, and has received contributions based on either specific project descriptions or core budgets that reflect the use of funds to support the Centre's mission and purposes. All the governing documents of the Centres set the type of above limits to Centre Board's discretion over the use of Centre resources and assets.

None of the governing documents of the Centres permits the Centre Board to exercise complete discretion and use centre reserves in a fungible manner with other centres (through reserve pooling) to share financial risk management.

On the second question, the consultant determined that the only way for the Centres to achieve authority to pool their reserves would be through the amendment of their governing documents. This would be a complex and time-consuming process at best. It would require a re-negotiation of all centres governing documents, and obtaining the

express consent of donors whose funding contributed to the accumulation of such reserves. Those centres formed by treaty or agreement among founding organizations and/or governments would also have to assure that any amendments have the approval of the organizations' founders.

On the third question, the consultant found that one legally feasible option for the centres is to pool some of their reserves for investment purposes (instead of for sharing financial risks). Centres and their Boards do have authority to enter into such arrangements; it is actually common for non profit organizations to pool some portion of their reserves for investment purposes, and such arrangements do not involve the sharing of financial risk beyond that inherent in the investment itself.

In view of these legal analysis and findings, the Alliance's view is that:

- (i) **since it is currently legally not possible for Centres to pool their reserves for purposes of sharing financial risks, and**
- (ii) **since the removal of the current legal impediments to pooling reserves for financial risk sharing necessitates significant changes in all the governing documents of the 15 Centres which would imply very high transaction costs,**
- (iii) **the option of pooling reserves for purposes of sharing financial risk management is neither legally not pragmatically worth pursuing by the Alliance at this juncture.**

Creation of a Mutual fund/investment partnership

The fiduciary duties of Centre Boards include overseeing the prudent management of investments, including the selection of competent investment professionals to provide investment management advice, the negotiation of reasonable fees for the services of such investment professionals, and the development of investment guidelines that are aligned with the organizations' needs and investment horizons and that give appropriate attention to the need for diversification. Nonprofit organizations, such as the Centres, do create partnerships that pool funds from multiple partners for purposes of investment.

This option, recommended by both the legal and the financial consultant, **entails establishing an investment partnership mechanism that can be used to manage pooled investments of the Centres**. Under this option, each Centre wishing to participate contributes a portion of its reserves to the partnership in return for a proportionate equity interest that would be shown as an asset on its financial statements. **A number of Centres (8) have indicated their interest in exploring this option**. Other centres have indicated that they do not wish to join in such a mutual fund at this juncture.

The next steps, for the interested centres, include (i) assessing the expected benefits versus the transaction costs of setting up an investment partnership that would have an investment profile congruent with prudent financial management (low risk), (ii) determining the approximate amount of funds to be invested; (iii) preparing a "request for proposal" to be used to identify potential investment managers; (iv) development of appropriate investment guidelines for the pooled investment; (v) selection of jurisdiction

where the investment vehicle will be created; and (vi) preparation of legal documents that will govern the investment vehicle under the laws of the applicable jurisdiction. Discussions among interested centres are on-going on these issues.

APPENDIX: CGIAR CENTRE RESERVES –SOME DEFINITIONS

Financial information and data within the CGIAR are reported on the basis of the International Financial Reporting Standards (IFRS), as issued by the International Accounting Standards Board (IASB). The following definitions are based upon and drawn from the relevant International Financial Reporting Standards.

Reserves - Reserves held by the centres are part of their net assets. To define “**Reserves**” it is necessary to define “**Net Assets**” and to separate out that portion which represents “**Reserves**”.

Net Assets are defined as the residual interest in a Centre’s assets remaining after liabilities are deducted. They are the residual balance of total assets minus total liabilities. The overall change in net assets over a reporting period represents the total gains and losses generated by the Centre’s activities during the period as determined by the particular measurement principles adopted and disclosed in the financial statements.

Classification: There are three classes of net assets. These are:

- **Permanently restricted** – Net assets subject to donor imposed stipulations and required to be maintained permanently by the centre. Generally the donor will permit the centre to use the income on the related investment for general or specific purposes. Permanently restricted net assets do not form part of a centre’s reserves.
- **Temporarily restricted** – Net assets subject to donor imposed stipulations that will be met either by actions of the centre and/or the passage of time. Temporarily restricted net assets do not form part of a centre’s reserves.
- **Unrestricted** – Net assets that are not subject to donor imposed stipulations. Unrestricted net assets are further classified as either undesignated or designated.

(a) Undesignated net assets – represent accumulated surplus of revenue over expenses and which have not been designated by Centre Management for any specific purposes. They are meant to be used to finance working capital and on going cash requirements. These net assets form part of a centre’s reserves.

(b) *Designated net assets* – that part of net assets that has been designated by Centre Management for specific purposes. These include investment in centre owned property and equipment, funds held as a reserve for the future acquisition of property and equipment; and fund specifically identified and internally committed for future program activity. These net assets, to the extent that they have not been invested in fixed assets form part of a centre's reserves.

'Centre Reserves' refer to a centre's unrestricted net assets less the centre's investment in fixed assets.

Uses of Reserves: As noted above reserves form part of a centre's net assets.

'Reserves are used for a combination of purposes. These include:

- **To finance working capital** – Without working capital centres would be unable to maintain operations in both the short and long term. Working capital is used in this context as the day to day liquidity that any entity must maintain in order to meet financial obligations as they fall due.
- **To act as a buffer** - against a **major unexpected shortfall in funding**. Reserves enable centres to continue operations until funding is resumed.
- **To make redundancy payments and meet other downsizing costs** - in the event of a **major permanent reduction in funding**. Reserves enable centres to right size their operations in a rational and orderly manner.
- **To act as a buffer** – in the event of **uninsurable damage to buildings and capital equipment** due to natural disasters or civil strife.
- **To fund strategic research initiatives** - unrestricted funds may be set aside over a multi year period for designated strategic research projects or to provide 'seed money' for proof of concept studies.
- **To finance capital acquisition and replacement** – donors do not normally provide funding directly for fixed asset acquisition and replacement
- **To act as a buffer** – against **political instability** which could result in costs being incurred for staff evacuations and relocations, closure of offices, stations or other facilities and the need to establish temporary or new facilities.
- **To provide for closure costs** – in the event that a centre is being wound up or closed.
- **To smooth out cashflow from Donors** – Donor payments are "lumpy" – they are made in large lump-sums when it suits the donor institution's budget and political cycles and not when required on a month-by-month basis by Centers to undertake the agreed program of work. The Centers therefore need to have reserves of cash which they can draw on to smooth out their cashflow and ensure promised outputs, outcomes and impact is realized in a timely manner. If reserves didn't exist, Centers would have to take out interest bearing bank-loans which would reduce the funds available for research