برنامج الأغذية العالمي
Programme Alimentaire Mondial
World Food Programme
Programa Mundial de Alimentos

Executive Board
Third Regular Session

Rome, 19 - 22 October 1999

FINANCIAL AND BUDGETARY MATTERS

Agenda item 3

For approval

FUNDING OF WFP'S AFTER-SERVICE MEDICAL LIABILITIES

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Distribution: GENERAL
WFP/EB.3/99/3-C
17 August 1999
ORIGINAL: ENGLISH

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This document is submitted for approval by the Executive Board.

The Secretariat invites members of the Board who may have questions of a technical nature with regard to this document, to contact the WFP staff focal point indicated below, preferably well in advance of the Board's meeting.

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INTRODUCTION

1. A proposal for the funding of WFP's after-service medical liabilities was submitted to the Annual Session of the Executive Board in May 1997 (WFP/EB.A/97/4-E). In its decision 1997/EB.A/8, the Board agreed, *inter alia*, that WFP needed to recognize after-service medical liabilities and should develop a detailed plan for their amortization. The Board indicated that more information would be needed before it could make a final decision. The present document provides additional information on the basis of the independent actuarial valuation of after-service medical liabilities and proposes a methodology for funding these liabilities.

ACCOUNTING FOR AFTER-SERVICE MEDICAL LIABILITIES

2. The United Nations Accounting Standards, which are based to a large extent on International Accounting Standards, require that organizations provide for post-retirement benefits in their financial statements or that disclosure be made in the notes to the financial statements and estimated liabilities quantified where possible, showing the base of valuation (UNAS 57). WFP's Audited Biennial Accounts for 1996–97 included a note disclosing the after-service medical liability, in accordance with the above standards. The magnitude of the accrued liability (US$44.8 million at 31 December 1997) suggests that it would be more prudent to provide for these liabilities in the financial statements rather than by way of a disclosure note.

3. The liability for future after-service medical coverage entitlements earned by on-duty staff represents current service costs to be charged to the organization's budget.

4. The recognition of the liabilities for after-service medical costs in the financial statements represents a change in accounting policy in that:

a) accrued liabilities for after-service medical costs would be provided for in the financial statements;

b) current service costs for staff on duty would be recognized as they are earned; and

c) payments of after-service claims in excess of retiree contributions would be charged against accrued liabilities.

ACCRUED LIABILITY AND SERVICE COSTS

5. The projected actuarial valuation undertaken by the external consultants in 1998 on the FAO after-service medical coverage plans, in which WFP participates, showed the following financial liabilities for WFP:

- Accrued liability at 31/12/1997—US$44.8 million;
- Current service cost for 1998—US$1.3 million.

ACCRUAL VALUATION—WFP SPECIFICITY

6. The actuarial valuation of the after-service medical costs used a common set of assumptions for all programmes covered by the FAO after-service benefit plans based on the actuarial model used for the valuation of the United Nations Pension Fund.

7. WFP was concerned that the common set of assumptions may not be valid, as WFP expected to have a higher turnover of staff and consequent lower level of retiree medical benefit liabilities. A further study was commissioned by WFP to determine whether the use of specific rates for WFP would change the share of the cost and liabilities for the after-service medical benefits.

8. The study showed that the withdrawal rates for WFP headquarters staff were indeed higher than expected. However, there were lower than expected rates in the field. The actuarial consultants concluded that the net effect on the service costs and accrued liability of these variations in withdrawal rates was insignificant and that the assumptions made in the actuarial valuation of the FAO plan produced a reasonably close estimate of WFP's actuarial costs.

9. Consequently, the actuarial valuation of the FAO after-service medical coverage plan is used as the basis for determining the accrued liabilities and service costs for WFP.

PROPOSALS FOR FUNDING THE ACCRUED LIABILITY AT 31/12/1997—(US$44.8 MILLION)

Option 1—The accrued liability for after-service medical costs to be provided for in the 1998–1999 biennium against the unearmarked balance of the General Fund

10. In view of the fact that the accrued liability for after-service medical costs is related to prior benefits earned by staff and retirees, the most appropriate methodology would be to provide for the liability as a one-time charge against the unearmarked balance of the General Fund.

11. This approach has the advantage of charging the financial statements with the full accrued liability. Providing for the accrued liability in this way also avoids the need to amortize the accrued liability over future budgetary periods and increase indirect support cost (ISC) rates.

12. The WFP interim financial statements for the 1998–1999 biennium showed an unrestricted balance in the General Fund (net of the Operational Reserve of US$57 million) of US$61.8 million as at 31 December 1998. Of this amount, US$16.6 million was subsequently approved by the Executive Board for the funding of the Financial Management Improvement Programme (FMIP). The current balance in the General Fund, the expected interest earnings and the increases in programme support and administration (PSA) income arising from higher levels of operations in 1998–99 in excess of budgetary estimates—are expected to ensure that adequate resources are available to provide for the accrued liability in full.

13. However, in the unlikely event that the unearmarked balance of the General Fund proves insufficient, at the end of the biennium, to allow for a full funding of the accrued liability, the shortfall could be funded against future budgets or surpluses which may be reasonably anticipated in the General Fund.

Option 2—To amortize the accrual liability over a number of years

14. A second option would be to amortize the accrued liability over a future period. The actuarial valuation report presented the amortization payments over 15 or 30 years (methodology chosen by FAO) using a constant percentage of pensionable remuneration.

15. This methodology, which spreads the past accrued liabilities over future periods, is preferable where the level of current surpluses is inadequate to provide against the liability, either partially or in full. The selection of a fixed percentage of pensionable remuneration has the effect of increasing levels of annual amortization in line with expected increases in pensionable remuneration. The disadvantage of this option is that accounting for the full liability is delayed and past liabilities would be provided for as ISC against future PSA earnings or surpluses.

16. The Annex shows the amortization payments over periods of 15 and 30 years. The increasing amortization payments shown in the Annex could have a negative impact on ISC rates in future years. Under an amortization scheme of 15 years the expense for the first year is US$3.9 million (approximately 4 percent of the PSA budget) and for the last year US$8.3 million. For a 30-year amortization period, the expense is US$2.4 million (approximately 2.5 percent of the PSA budget) and US$11.2 million for the first and last year, respectively.

CURRENT SERVICE COSTS

17. The current service costs for benefits earned by on-duty staff represent a cost to be charged against current budgets and recorded as accrued liabilities. The actuarial valuation of this cost for 1998 is US$1.3 million per annum.

18. Previously the after-service medical claims in excess of retiree contributions were charged against the budget. These will, in future, be disbursed against the accrued liability.

19. For the current 1998–1999 biennium, the budgetary impact of this change in accounting is minimal in that the current service costs for 1998 amount to US$1.3 million and the excess claims payment, US$1.2 million.

ACCOUNTING

20. Under both options, and to take account of the unpaid current service costs, a general ledger account for the After-Service Medical Liability would be established.

RECOMMENDATION

21. As sufficient balances are expected to be available in the General Fund, Option One is recommended by the Executive Director as the most appropriate methodology to recognize the after-service medical liabilities in the financial statements.

22. The following decision is recommended:

The Executive Board

23. Taking note of decision 1997/EB.A/8 that WFP needs to recognize the after-service medical liability in the financial statements and should develop a detailed plan for the amortization of these liabilities, **decides to**:

a) provide for the accrued liabilities for after-service medical costs at 31 December 1997 of US$44.8 million;

b) fund the accrued liabilities from the unearmarked balance of the General Fund; and

c) provide for the current service costs for after-service medical coverage for 1998 and subsequent years from the biennial budget of the organization.

ANNEX

TABLE 1: AMORTIZATION AS A LEVEL PERCENTAGE OF PENSIONABLE SALARY (in million US$)

Amount of Principal	**$44.8**	**Number of years**	**15**
Starting Pensionable Pay	**$72.2**	**Interest rate (%)**	**8.50**
		Salary increases (%)	**5.50**

Year	Unfunded obligation at beginning of year	Amortization payment made at end of year	Unfunded obligation at end of year	Amortization payment as % of principal
1998	44.8	3.9	44.7	5.40
1999	44.7	4.1	44.4	5.40
2000	44.4	4.4	43.8	5.40
2001	43.8	4.6	42.9	5.40
2002	42.9	4.8	41.7	5.40
2003	41.7	5.1	40.1	5.40
2004	40.1	5.4	38.1	5.40
2005	38.1	5.7	35.6	5.40
2006	35.6	6.0	32.7	5.40
2007	32.7	6.3	29.1	5.40
2008	29.1	6.7	24.9	5.40
2009	24.9	7.1	19.9	5.40
2010	19.9	7.4	14.2	5.40
2011	14.2	7.8	7.6	5.40
2012	7.6	8.3	-0.1	5.40

TABLE 2: AMORTIZATION AS A LEVEL PERCENTAGE OF PENSIONABLE SALARY OVER 30 YEARS (in million US$)

Amount of principal	**$44.8**	**Interest rate (%)**	**8.50**
Starting pensionable Pay	**$72.2**	**Salary increases (%)**	**5.50**

Year	Unfunded obligation at beginning of year	Amortization payment made at end of year	Unfunded obligation at end of year	Amortization payment as % of principal
1998	44.8	2.4	46.2	3.36
1999	46.2	2.5	47.6	3.36
2000	47.6	2.6	49.1	3.36
2001	49.1	2.8	50.5	3.36
2002	50.5	2.9	51.8	3.36
2003	51.8	3.1	53.2	3.36
2004	53.2	3.3	54.4	3.36
2005	54.4	3.4	55.6	3.36
2006	55.6	3.6	56.7	3.36
2007	56.7	3.8	57.7	3.36
2008	57.7	4.0	58.6	3.36
2009	58.6	4.3	59.3	3.36
2010	59.3	4.5	59.9	3.36
2011	59.9	4.7	60.3	3.36
2012	60.3	5.0	60.4	3.36
2013	60.4	5.3	60.2	3.36
2014	60.2	5.6	59.7	3.36
2015	59.7	5.9	58.9	3.36
2016	58.9	6.2	57.7	3.36
2017	57.7	6.5	56.1	3.36
2018	56.1	6.9	54.0	3.36
2019	54.0	7.3	51.3	3.36
2020	51.3	7.7	47.9	3.36
2021	47.9	8.1	43.9	3.36
2022	43.9	8.5	39.2	3.36
2023	39.2	9.0	33.5	3.36
2024	33.5	9.5	26.8	3.36
2025	26.8	10.0	19.1	3.36
2026	19.1	10.6	10.1	3.36
2027	10.1	11.2	-0.2	3.36