RESOURCE AND FINANCIAL MATTERS

Agenda item 4 e)

FUNDING OF WFP’S AFTER-SERVICE MEDICAL LIABILITIES
NOTE TO THE EXECUTIVE BOARD

This document contains recommendations for review and approval by the Executive Board.

Pursuant to the decisions taken on the methods of work by the Executive Board at its First Regular Session of 1996, the documentation prepared by the Secretariat for the Board has been kept brief and decision-oriented. The meetings of the Executive Board are to be conducted in a business-like manner, with increased dialogue and exchanges between delegations and the Secretariat. Efforts to promote these guiding principles will continue to be pursued by the Secretariat.

The Secretariat therefore invites members of the Board who may have questions of a technical nature with regard to this document, to contact the WFP staff member(s) listed below, preferably well in advance of the Board's meeting. This procedure is designed to facilitate the Board's consideration of the document in the plenary.

The WFP focal point for this document is:

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Should you have any questions regarding matters of dispatch of documentation for the Executive Board, please contact the Documentation and Meetings Clerk (tel.: 5228-2641).
INTRODUCTION

1. Retirees who are entitled to after-service medical benefits currently make contributions that are below the value of their claims. There is a liability to meet the balance, and this is currently borne by active staff members and WFP. In the future, it is expected that this liability will increase.

2. Assessing and disclosing these liabilities (which can be calculated using actuarial methods) are now mandatory. At its Third Regular Session of 1996, the Executive Board “requested the Secretariat to develop a long term plan to finance the after-service medical accrued liabilities” (WFP/EB 3/96/14/item 2 f).

3. Making provisions for financing these liabilities is the subject of this paper.

WHY ASSESSMENT AND DISCLOSURE ARE NECESSARY

4. Several factors have led to changes in International Accounting Standards:
   • The rising cost of medical care
   • The increase in the ratio of retirees to active employees
   • The need to protect shareholders’ rights to financial information
   • The need to protect retirees’ entitlements
   • Other economic factors

5. The recently approved United Nations accounting standards specify that: “Liabilities for end-of-service benefits (and post-retirement benefits) should be provided for in the accounts to the extent required by the financial policies of the organization. In so far as such liabilities are not fully provided for, appropriate disclosure should be made in the notes to the financial statements and the total estimated liabilities quantified where possible.”

HOW AFTER-SERVICE MEDICAL BENEFITS ARE CURRENTLY FUNDED

6. FAO insures medical risks for a group that comprises mainly FAO, WFP and IFAD with a private company. In 1995, this group contained around 6,000 active staff members and 3,000 entitled retirees. Entitlement to after-service medical benefits depends on a number of conditions—mainly retirement from an organization covered by the policy and 10 years of service. The medical insurance coverage is compulsory for active staff members and optional for retirees.

7. The premium is calculated to cover the expected claims and administrative costs, and is adjusted every year. Roughly half the premium is paid by the organizations (in WFP’s case, from Indirect Support Costs), with the other half being paid by the staff members or

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1 Hereafter, “retirees” will refer to entitled retirees.
retirees. Each individual’s contribution depends only on the number of beneficiaries covered through her/him.

8. Analysis has shown that retirees’ claims and associated costs are consistently higher than their premiums. This means that, with their premiums, active staff members are in effect subsidizing the premiums of the retirees.

9. The following schematic diagram shows how retirees’ claims exceed their level of premiums:

![Retiree claims vs. contributions and liability](chart1)

10. The following schematic diagram shows, on the other hand, how staff members’ claims are below their level of contributions:

![Staff members’ contributions vs. claims and "subsidy"](chart2)

11. Hence, the excess of retirees’ claims over their contributions is currently being funded by staff members’ and organizations’ premium, and future expected costs are not being funded at all.

12. The obligation to meet these costs in the future creates liabilities on WFP’s part—the after-service medical liabilities.

13. FAO commissioned an actuarial study to quantify the after-service medical liabilities at the end of 1993. It commissioned another for the end of 1995, but the report arrived after the last 1996 session of the Executive Board—too late for any action to be taken in the 1994-95 biennial accounts.
ASSUMPTIONS MADE BY THE ACTUARIES

14. A number of assumptions need to be made when calculating after-service medical liabilities.

- The actuaries adopted the assumptions used for the valuations of the United Nations Joint Staff Pension Fund (UNJSPF), which include assumptions for staff turnover, age at death, increases in pensionable remuneration and so on, with some modifications to reflect the particular demographic nature and experience of the whole group insured.

- They assumed that the rate of increase of medical claims would be two percent higher than general inflation.

- Retirees’ future claims include those made by currently active staff (when they become retirees) and already-retired staff. However, currently active staff have worked only a portion of their career and an assumption is to be made on the portion of the ultimate benefits they have effectively earned. The actuaries considered that the benefits were earned over the entire working career of the employees, even though they may be fully eligible for those benefits before then (staff members are currently eligible after only 10 years). The actuaries point out that if they were to apply Federal Accounting Standard 106 of the US GAAP (Generally Accepted Accounting Principles)—which considers benefits to be fully earned when employees become eligible, rather than on retirement—this would result in a much higher accrued liability.

- Whenever the actuaries apportion costs and liabilities between the various organizations participating in the medical insurance, they do it according to pensionable remuneration, and not according to family status, as the calculation is currently made. The actuaries’ figures are used in this working paper, but it should be noted that this method leads to WFP having a share of 17.8 percent of the costs and liabilities, rather than the 16.6 percent currently borne.

- The rates of exchange for January 1996 were used in all the calculations.

PRESENT VALUE OF LIABILITIES AND SERVICE COST

Present Value

15. The after-service medical liabilities are equal to the value of future after-service medical claims minus that of the retirees’ future contributions. As we are dealing with future claims and contributions over a period of years, the payments are discounted to give a present value.

16. Under the assumption that benefits are earned over the entire working career of the staff member, the present value of after-service medical benefits can be analysed in an accrued liability of 212.5 million dollars\(^1\) and a liability to accrue of 81.6 million dollars. Of this, WFP’s share would be 37.75 and 14.5 million dollars, respectively.

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\(^1\) All monetary values are expressed in United States dollars.
Service Cost

17. After-service medical liabilities are not frozen in time. Each year, active staff (including new entrants) are considered to earn a further portion of their after-service medical entitlements. The present value of the amount accrued each year (net of their future contributions as retirees) is called the service cost.

18. The actuaries estimate this service cost at 8.4 million dollars a year—1.5 million dollars for WFP’s share. It should be considered independently from accrued after-service medical liabilities.

19. In addition to the service cost, actual experience will always differ from that assumed under an actuarial valuation model: actuarial gains or losses will occur that will be reflected in the next valuation. These will lead to changes in the liabilities to be disclosed or recognized.

OPTIONS FOR WFP

20. Several questions arise as a result of the actuaries’ study:

Is it Necessary to Fund Accrued After-Service Medical Liabilities?

21. The United Nations accounting standards do allow for after-service medical liabilities not to be funded, provided they are disclosed (this is what the United Nations itself does).

22. With regard to organizations deviating from International Accounting Standards, the United Nations accounting standards (paragraph 1) state:

“The accounting standards agreed for application in organizations of the United Nations system are based to a large extent on relevant International Accounting Standards … Where differences … exist, it is mainly because of the essentially non-commercial nature of the organizations’ activities.”

23. Although United Nations organizations can depart from the International Accounting Standards if necessary (that is, not funding after-service medical liabilities), it is not clear that WFP should do so in this case.

There are three main reasons why WFP should fund after-service medical liabilities:

- **The burden on Indirect Support Costs**
  For other United Nations organizations funded by Assessed Contributions, transferring past liabilities to the future has little impact. For a voluntarily-funded organization such as WFP, this results in increasing future costs that are not directly linked to specific operations—the Indirect Support Costs, which the Executive Board and donors have consistently requested to keep as low as possible.

- **The burden on active staff members**
  The actuarial study shows that the liability arising from retirees (hence the burden for active staff) will increase much more than the pensionable remuneration of active staff—from 0.6 percent to 1.1 percent of their pensionable remuneration during the next 15 years. This means that active staff will have to pay increasing amounts to subsidize retirees’ medical claims.
• **The burden on Assessed Contributions of FAO**

It should be noted that after-service medical liabilities also accrue for staff paid from trust funds and other activities which are not of a permanent nature (for example, bilateral agreements for specific projects). All WFP’s activities are voluntarily funded. Not funding the liabilities now would mean that the burden of funding would be transferred to whatever funding sources are available at the time of disbursement.

24. If other funding sources are not available, the last recourse would be to include them in the Assessed Contributions of FAO. Although such transfers have been implicit in the existing mechanism and have surely taken place (in both directions) so far, it is difficult to assume that FAO contracting States would be willing to subsidize the after-service medical liabilities generated by staff funded by trust funds and voluntary funding.

25. In addition, it should be noted that if accrued after-service medical liabilities are to be funded, funding should include the service cost.

**Could the Accrued After-Service Medical Liabilities be Amortized?**

26. The actuaries indicate that:

   “International Accounting Standard 19 indicates that unfunded obligations should be amortized over the future working life of the active participants. We understand however that the organization has retained the right to adopt a different standard if it believes this to be more appropriate given the circumstances. The alternatives here might include a fixed amortization of principal and interest over a period of years, amortization as a level percentage of pensionable remuneration for the current actives, and amortization as a level percentage of pensionable remuneration including that for future new entrants.”

27. Of these three alternatives, the actuaries made calculations for the first and the third (the second is not calculated by the UNJSPF). Thus, the accrued liabilities can be amortized by:

   • Equal instalments of:
     - 25.6 million dollars (WFP share 4.5 million dollars) over 15 years; or
     - 19.8 million dollars (WFP share 3.5 million dollars) over 30 years

   • Or a fixed percentage of the pensionable remuneration (including that of future new entrants) of:
     - 5.12 percent over 15 years. The yearly amounts would increase from 18.6 million dollars (WFP share 3.3 million dollars) in the first year to 39.3 million dollars (WFP share seven million dollars) in the last one; or
     - 3.09 percent over 30 years. The yearly amounts would increase from 11.2 million dollars (WFP share two million dollars) in the first year to 52.9 million dollars in the last year (WFP share 9.4 million dollars).

28. One should question whether the amortization period should take into consideration the future working life of the currently active participants (as done in the US-based international organizations which recognize costs when they accrue) or even a longer period.
29. Thus, amortization would lead to an increase in Indirect Support Costs—if done over 30 years, the costs range from two million dollars in the first year, to 9.4 million dollars in the last. To this should be added the 1.5 million dollars a year service cost.

What is the Incremental Cost of Funding Accrued After-Service Medical Liabilities?

30. Moving from the current practice of recognizing after-service medical liabilities when they are disbursed (by “subsidizing” retirees’ claims) to a new method of recognizing the liabilities as they accrue has an incremental cost.

31. The new method’s costs were calculated by adding the amortization of the accrued liability and the service cost. The actuaries compared this to the current costs (including subsidy). The difference is the incremental cost:

- If amortization is done over 15 years, the incremental cost goes from 5.3 percent of pensionable remuneration in the first year, to 4.2 percent in the 15th year.
- If amortization is done over 30 years, the incremental cost goes from 3.3 percent of pensionable remuneration in the first year to 2.2 percent in the 15th year.

OUTSTANDING ISSUES

Differences between WFP and FAO

32. WFP is funded by voluntary contributions and the percentage of a given donor may vary significantly from one year to the next. FAO is mainly funded by assessed contributions with a fairly stable distribution between Member Nations.

33. As mentioned above, the UNJSPF assumptions used for the actuarial study have been adapted for the particular demographics and experience of the group of organizations covered. WFP’s population may not be typical of the whole group. For instance, the group includes 20.9 percent of field General Service staff, but they are only 0.9 percent of WFP’s beneficiaries as our General Service staff are administered by UNDP. There may be other differences, such as the age pyramid and the percentage of active staff who will become entitled to after-service medical benefits as WFP employs a large number of project staff for less than 10 years.

34. Assessing the extent of the differences, and the effect that these differences would have on WFP’s share of accrued liability and liability to accrue requires a specific study. In the meantime WFP will use the figures arising from the actuarial study commissioned by FAO.

Where Should the Funding Come From?

35. WFP could provide for the after-service medical liabilities by:

- recourse to surpluses;
- a transfer from the Operational Reserve; or
- amortization.

Option b) would mean that surpluses would have to be used to bring the Operational Reserve back up to its maximum level again; hence, it is ultimately little different from option a).
Option c) implies an increase in Indirect Support Costs, which donors and the Executive Board have consistently requested to keep as low as possible.

36. These costs could be excluded from the PSA as long as there is a surplus to fund them; thus, option a) is considered the best option.

A Gradual Approach

37. Current surpluses may not cover WFP’s after-service medical liabilities in one biennium—a gradual approach is needed.

38. Given that not recognizing after-service medical liabilities is acceptable (provided their amount is disclosed), it should be all the more acceptable to recognize them partially by devoting to them such surplus that is available—gradually building up the funding for the liabilities. In this case, the amount that is not recognized should be disclosed, as stipulated by the United Nations accounting standards.

RECOMMENDATIONS

39. The cash-based system adopted so far (recognizing costs when they are disbursed) results in transferring after-service medical liabilities to future staff and future donors and, eventually, to other organizations belonging to the same insurance group.

40. Accordingly, the following decision is recommended:

The Executive Board

Noting that

• United Nations accounting standards recognize that providing for after-service medical liabilities is a matter of financial policy of the organization, and when such liabilities are not fully provided for these standards request appropriate disclosure in the financial statements; and indirect support costs would be significantly increased by fully providing for those liabilities,

Decides to:

• recognize after-service medical liabilities;
• have a special provision set up for that purpose; and
• fund this provision from future surpluses, provided such surpluses are not needed to replenish the Operational Reserve.