



IFAD
INTERNATIONAL FUND FOR AGRICULTURAL DEVELOPMENT

Executive Board — Sixty-Fifth Session

Rome, 2-3 December 1998

GENERAL RESERVE — A REVIEW OF ADEQUACY
PROVISION FOR UNFUNDED LIABILITIES

General Reserve - A Review of Adequacy

1. The Audit Committee, at its December 1998 meeting, began its review of the adequacy of the General Reserve with discussion on a proposal to increase the ceiling of the General Reserve from USD 100 million, approved by the Governing Council at its Fourth Session in December 1980, to USD 130 million. The Committee also discussed the transfer of USD 5 million to the General Reserve from the Accumulated Surplus of IFAD's Resources for 1999, which would bring the amount in the General Reserve approved by the Executive Board to USD 100 million. As further discussion will be required, the Committee has included this item on the agenda of its April 1999 meeting. The Audit Committee noted that any Executive Board recommendation to increase the General Reserve ceiling would require Governing Council approval. The Committee felt it would not be desirable to leave the matter in abeyance until the Governing Council meets during the first quarter of 2000, and accordingly recommended that the Governing Council, at its Twenty-Second Session in February 1999, delegate authority to the Executive Board to amend the ceiling of the General Reserve.

Provision for Unfunded Liabilities

2. At its same meeting, the Audit Committee discussed a proposal to make an annual transfer of USD 2.6 million from the Accumulated Surplus of IFAD's Resources in each of the five consecutive years commencing with 1999, so as to build up a provision of USD 13 million to fund the After Service Medical Scheme actuarial deficit.

3. IFAD prepares its financial statements in accordance with International Accounting Standards (IAS). Executive Board Directors will recall that, with documents EB 97/62/R.5 and EB 98/64/R.5, management drew the attention of the Executive Board to the actuarial deficit associated with after-service medical coverage (ASMC).

4. A revised IAS 19, dealing with employee benefits, has been issued. The IAS requires an entity to recognize :



- (a) a liability when an employee has provided service in exchange for employee benefits to be paid in the future; and
- (b) an expense when the enterprise consumes the economic benefit arising from service provided by an employee in exchange for employee benefits.

5. In accordance with revised IAS 19, employee benefits cover post-employment medical care. In the Rome-based United Nations organizations, this is known as ASMC.

6. In 1969, the Food and Agriculture Organization of the United Nations (FAO) introduced ASMC both for staff receiving a UN pension and for eligible former staff, on the basis of shared costs. In 1972, the Basic Medical Insurance Plan (BMIP) and the Major Medical Benefits Plan were introduced, and non-contributory coverage was extended to retired staff and their dependants after 10 years of service.

7. Medical costs, which had been relatively low until that time, began to escalate rapidly and the proportion of total after-service medical claims rose from 3.6% in 1975 to 27% in 1985. Cost comparisons showed that, at the end of 1985, the per capita claim cost for a retiree was 65% greater than that for an active staff member. As of 1 November 1989, retirees were obliged to pay BMIP contributions.

8. In December 1977, an FAO/IFAD cooperation agreement was signed, under which, *inter alia*, FAO agreed to “make its administrative services and other facilities available to the Fund”. This was meant to cover participation in various social security plans, including the medical plan. The FAO medical plan is a multi-employer plan covering the Rome-based UN organizations (World Food Programme, IFAD, the International Centre for the Study of the Conservation and Restoration of Cultural Property, and the UN Information Centre) and the Rome office of the United Nations Development Programme. Like all other UN agency schemes, the FAO medical plan operates on a pay-as-you-go basis, yearly costs being met from annual budgets and current staff contributions. It is now evident that demographic trends and escalating medical costs have rendered the pay-as-you-go system unsustainable over the long term.

9. The introduction of Common Accounting Standards within the UN system, as endorsed by the General Assembly, will require organizations to recognize the costs incurred but not-yet-paid-for post-retirement benefits on the basis of an actuarial valuation. For IFIs such as IFAD, the IAS requires that the cost of providing employee benefits should be recognized both as a liability and as an expense. The revised IAS 19 stipulates that an actuarial valuation should be used to make a reliable estimate of the amount of benefits that employees have earned in return for their service in the current and prior years.

10. In recognizing the problem associated with the current pay-as-you-go system and in an effort to comply with stringent accounting standards on the cost of providing post-retirement benefits, FAO decided to engage a consulting actuary experienced in both the medical plan and the UN Joint Staff Pension Fund to compute such costs. The actuary, Buck Consultants, determined that, as of 1 January 1996, there was an unfunded, accrued liability for active staff and retirees of USD 215.5 million, of which IFAD’s share was USD 10.8 million based on the number of active staff. FAO and the participating agencies requested the actuary to update the results of the last formal valuation of ASMC to 31 December 1997. The draft results show a moderate increase in deficit (from USD 212.5 million to USD 229.3 million), of which IFAD’s share increased from USD 10.8 million to USD 12.9 million.



11. In line with FAO, as of 1 January 1998, IFAD decided to make provision for the full annual service cost, as indicated in document EB 97/62/R.5. The annual service cost included in the 1999 Programme of Work and Budget takes account of the revised actuarial estimate.

12. FAO (whose financial statements are produced under the less stringent UN Common Accounting Standards) decided to amortize the unfunded actuarial deficit over a 30-year period. However, IFAD is obliged to comply with the requirements of the IAS. The latter, which takes effect with accounting periods beginning 1 January 1999, provides two alternatives to deal with the actuarial deficit. The first is to recognize the deficit immediately, that is, to make provision for the USD 13 million against the opening balances of the accumulated surplus. The second alternative is to treat the deficit as an expense on a straight-line basis over a five-year period from the date of adoption (paragraph 155 of revised IAS 19).

13. Given that immediate recognition of such liability would have an adverse impact on IFAD's resources available for commitment, the Audit Committee recommends that the second alternative be adopted, that is, amortization on a straight-line basis over a five-year period starting in 1999. In other words, it would be preferable to provide approximately USD 2.6 million from the accumulated surplus over a five-year period starting in 1999.

Recommendation

14. The Executive Board is invited to: (i) recommend to the Governing Council that the latter adopt the draft Resolution attached hereto, authorizing the Executive Board to amend the ceiling of the General Reserve (see paragraph 1 above); and (ii) authorize annual transfers of USD 2.6 million from the Accumulated Surplus of IFAD's Resources in each of the five consecutive years commencing with 1999 so as to build up a provision to fund the After-Service Medical Scheme actuarial deficit (see paragraph 13 above).



**DRAFT RESOLUTION ON THE AMENDMENT OF RESOLUTION 16/IV
ON THE ESTABLISHMENT OF A GENERAL RESERVE**

Resolution ..XXII

Amendment of Resolution 16/IV on the Establishment of a General Reserve

The Governing Council of IFAD,

Noting its Resolution 16/IV on the Establishment of a General Reserve, adopted on 11 December 1980, and document GC 22/L...;

Recognizing the need to continue to provide cover for the Fund against the following risks:

- (i) potential overcommitment of the Fund as a result of a diminution in the value of assets caused by exchange rate fluctuations;
- (ii) possible delinquencies in receipt by the Fund of loan service payments;
- (iii) possible delinquencies in the recovery of amounts due to the Fund from the investment of its liquid assets; and
- (iv) potential overcommitment as a result of a diminution in the value of assets caused by fluctuations in the market value of investments;

Further recognizing that there may be a need to revise the ceiling of the General Reserve from time to time so as to realistically cover the above-mentioned risks;

Decides to amend paragraph 2(iv) of Resolution 16/IV to read as follows:

“that, subject to the above, the ceiling of the General Reserve may be amended from time to time by the Executive Board;”.