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Organización  
de las  
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Unidas  
para la  
Agricultura  
y la  
Alimentación

# FINANCE COMMITTEE

## Hundred and Thirteenth Session

Rome, 8 – 12 May 2006

### Actuarial Valuation of the Staff-Related Liabilities

#### I. Introduction

1. Over the last several years, the Committee has examined and proposed various actions in connection with staff-related liabilities. The main documents considered were FC110/16, FC 109/17, FC 108/11a, FC 104/10, FC 97/9, FC 96/12, FC 90/9 and FC 89/14. The main focus of recent Finance Committee meetings has been the determination of the recommended biennial funding of the amortization of the After-Service Medical Coverage scheme (ASMC), for which the Committee requested an interim actuarial valuation of the liability as at 31 December 2004. This was discussed at the September 2005 session (FC 110/16).

2. The Committee noted at its 110<sup>th</sup> Session that a report of the United Nations Secretariat to the General Assembly on the UN after-service health insurance liability (ASHI) had not yet been released. While the UN report would have no impact in terms of FAO's financial obligations for the ASMC liability, some members of the Committee expressed a preference to wait for the UN report in order to consider a consolidated approach to the UN system-wide liability. Therefore, the Committee decided to recommend to Council to continue the ASMC funding for the 2006-07 biennium at the 2004-05 level of US\$14.1 million. The Committee expressed its intention to review the UN report on after service health insurance liability, when available, and further address the funding issue with the objective, if permitted by financial circumstances, to recommend funding at the level prescribed in the latest actuarial valuations in future biennia. The Secretariat presents below the updated information on the staff-related liabilities as at 31 December 2005.

3. After service benefits are the staff members' entitlements which become payable at the end of service. In FAO, these are comprised as follows:

- Separation Payments Scheme (SPS)
- Compensation Plan Reserve Fund (CPRF)
- Termination Payments Fund (TPF)

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- After-service Medical Coverage (ASMC)

## II. Results of the 2005 Valuation

4. An external firm of actuaries has recently completed the actuarial valuation of the staff-related schemes as at 31 December 2005. Financial, demographic and other assumptions were reviewed and updated to reflect the period covered by the 2005 valuation. The main changes from the previous 2003 valuation assumptions applied by the actuaries include:

- an increase in medical cost inflation from a fixed 4.5% to 6.5% in 2006, declining linearly to 4.5% over 10 years;
- a decrease of the discount rate from 5.5% to 4.5%;
- update of US Dollar/Euro exchange rates of the 2004/05 biennium;
- updated mortality rate table, in line with valuations of the UNJSPF;
- use of market value of investments (rather than book value) for funding calculations.

5. The actuarial liability as at 31 December 2005 compared to 2003 comprises the following:

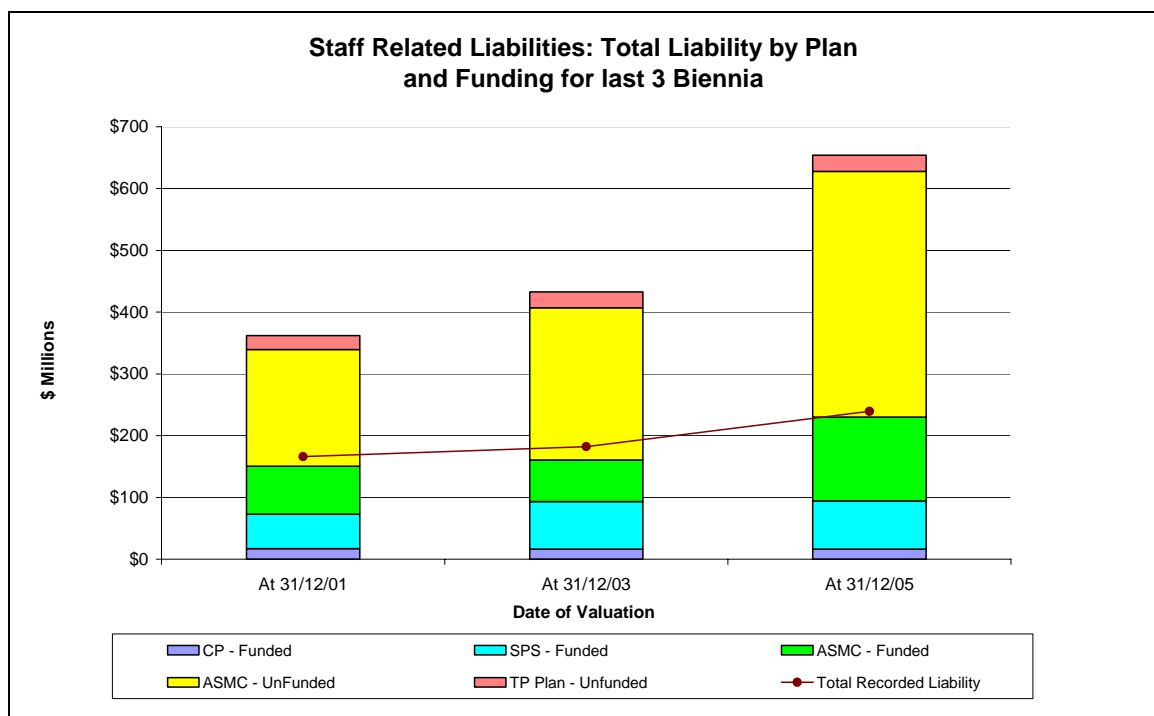
	2005 (US\$million)	2003 (US\$million)
ASMC	533.4	313.8
SPS	77.9	77.0
CPRF	16.6	16.5
TPF	<u>25.9</u>	<u>25.5</u>
Total liability	653.8	432.8

6. The ASMC amortisation for the 2006/07 biennium, using the original 30 year amortisation period which began in 1998, amounts to \$46.5 million compared to \$30 million of the 2003 valuation while the TPF amortisation amounts to \$8.3 million compared to \$6.8 million of the 2003 valuation, using a 15 year amortisation period commencing 1998.

7. The total annual current service cost for 2006 amounts to \$23.4 million compared to a total of \$14.8 million of the 2003 valuation. Current service cost is \$16.1 million for ASMC, \$3.6 million for SPS, \$0.3 million for CPRF and \$3.4 million for TPF.

## III. Current Financial Situation

8. Table 1 shows the funded and unfunded liabilities for each staff-related scheme according to the actuarial valuations, as well as the total recorded liabilities for all schemes at 31 December 2005, compared with the 2000/01 and 2002/03 biennia.

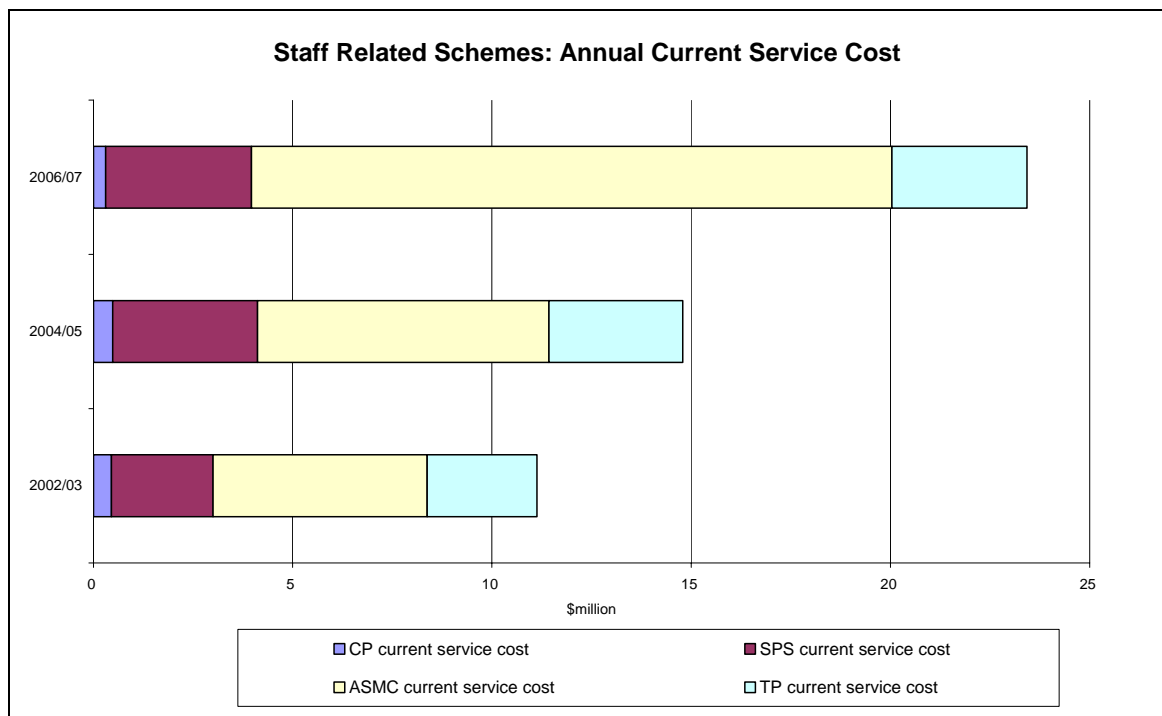
**Table 1**

9. As can be seen from Table 1, the ASMC liability increased significantly in the 2004/05 biennium due mainly to:

- the increase in average US Dollar to Euro exchange rates to US\$1.13 per Euro utilised for the ASMC valuation;
- the increase in medical inflation from 4.5% to 6.5%, declining to 4.5% over the next 10 years;
- the decrease of the discount rate from 5.5% to 4.5%; and
- the use of updated mortality rate table, in line with valuations of the UNJSPF.

It is recalled that the ASMC liability increase from the 2000/01 biennium to the 2002/03 biennium was due to a “one-time” change of basis of apportionment of liability between participants of the ASMC scheme from the pensionable remuneration to “active staff and retiree” headcount methodology in the actuarial valuation (see CL 127/14 (Report of 107<sup>th</sup> FC) paragraphs 14 to 16 and CL 127/15 (Report of 108<sup>th</sup> FC) paragraphs 54 to 61).

10. Table 2 shows the total annual current service cost (ie. accrued cost of active staff liability charged) from the latest 2005 actuarial valuation, to be charged in the 2006/07 biennium, compared with the charges for the 2002/03 and 2004/05 biennia.

**Table 2**

#### **IV. Termination Payments Fund**

11. The TPF comprises the following entitlement elements:

- Repatriation Grant
- Repatriation Travel and Removal
- Termination Indemnity
- Death Grant
- Commutation of Accrued Leave

TPF liabilities in respect of the past service of staff members are being accrued from 1 January 1998 over an amortisation period of 15 years. In addition to the current service cost, the TPF amortisation is also being charged to the regular budget. In recent years however, the actual disbursements of TPF liabilities have exceeded the total of current service cost and amortisation charges.

12. The total TPF liability has increased slightly from \$25.5 million in 2003 to \$25.9 million as at 31 December 2005, due mainly to the decrease in the discount rate offset by favourable changes in other assumptions used for the valuation. In the 2005 valuation, the TPF scheme covered a total of 3,809 active staff members with total annual salaries of \$181.9 million compared to 3,877 active staff members with total annual salaries of \$178.3 million in the 2003 valuation. The breakdown of the TPF liability into the entitlement elements are as follows:

	2005 (US\$million)	2003 (US\$million)
Repatriation grant	6.4	3.6
Repatriation Travel and Removal	2.4	1.8
Termination Indemnity	0.7	1.8
Death Grant	2.7	2.5
Commutation of Accrual Leave	<u>13.7</u>	<u>15.8</u>
Total TPF liability	25.9	25.5

13. The main actuarial assumptions used for the 2005 actuarial valuation of TPF were reviewed based on most recent experience and modified as follows:

- Repatriation grant was increased to 27% of eligible separating staff from 16% of the previous valuation;
- Repatriation travel and removals costs (which fluctuate depending on the mix of staff members regarding dependents and geographic distribution) have decreased to \$9,000 and \$13,255 for single and married staff members respectively;
- Termination indemnity was assumed to be payable to 5% of staff withdrawing from service compared to 12% of the previous valuation;
- the largest component accounting for just over 50% of the TFP liability is the commutation of accrual leave which was revised from 45 days to 36 days of accrued leave, or 14% of final net annual salary.

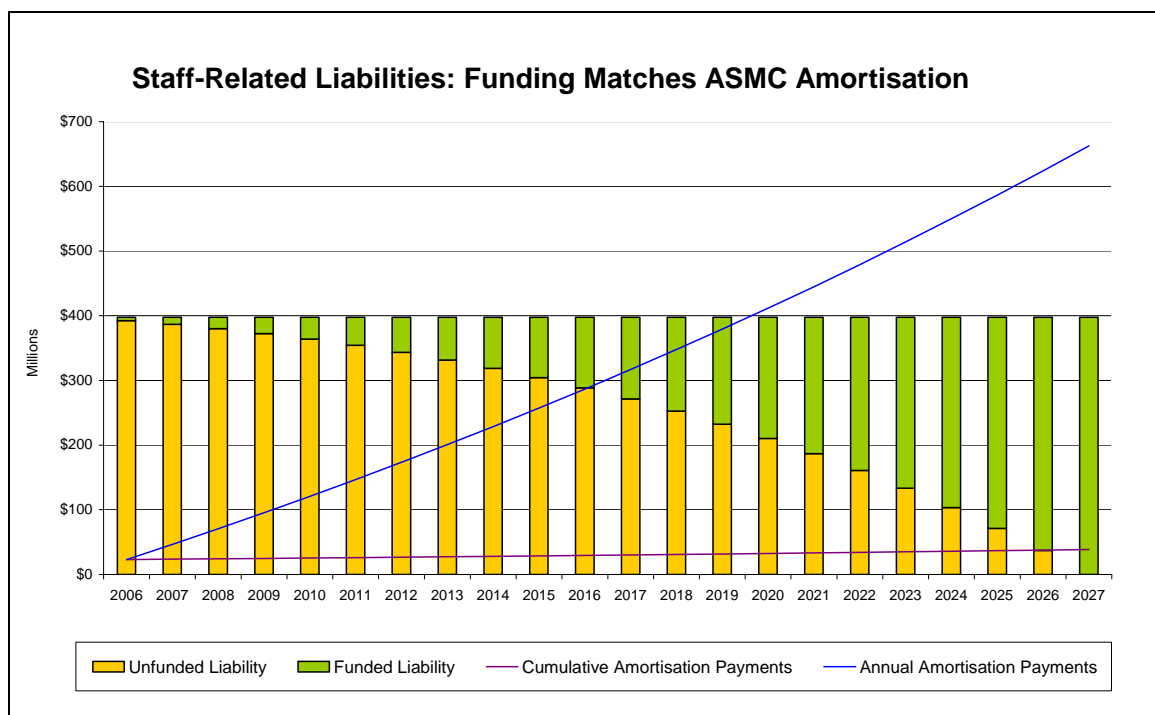
The review of the main TPF assumptions for the 2005 valuation did not alter the TPF liability significantly. The high level of disbursements experienced in recent years is attributable to decreasing staffing levels and the mix of actual entitlements paid to separating staff in the last two biennia.

## V. After-service Medical Coverage

14. Table 3 shows the schedule for the funded and unfunded ASMC liabilities with the annual and cumulative amortisation payments, assuming that funding matches the amortisation for each biennium. The amortisation funding commencing in the 2006/07 biennium is shown to begin with the required amount of \$46.5 million. This approach would aim to assure full funding of the ASMC liability in 22 years, and is the approach envisaged by Council in 2003 when biennial funding was first considered. As stated in paragraph 37 of CL 125/REP:

*“The Council noted that the Finance Committee considered that the current arrangements for funding After-Service Medical Costs (ASMC) liabilities were clearly insufficient and that the issue needed to be addressed as a matter of urgency. The Council endorsed the Finance Committee’s recommendation that the 2004-2005 Budget Resolution include an amount of US\$14.1 million to offset the amount of the liability to be amortized during the biennium, according to the biennial actuarial valuation, and that this amount should be reviewed in each subsequent biennium and adjusted accordingly to reflect the current valuation”.*

Table 3



15. However, funding levels have not been adjusted to match the required ASMC amortisation which has increased substantially from \$14 million in the 2001 valuation to \$46.5 million in the 2005 valuation. Conference decided at the November 2005 session to leave the funding of the amortisation of ASMC unchanged at \$14.1 million for 2006-07. The Finance Committee would continue to review the matter of FAO's liability for ASMC, and consider the UN ASHI report to evaluate the measures and concerns of the UN before deciding on the recommended level of ASMC funding for 2008-09.

## VI. United Nations ASMC Funding Options

16. The long-awaited United Nations paper on ASHI was issued in October 2005<sup>1</sup>. The report disclosed that the estimated actuarial present value of the accrued after-service health insurance liability as at 31 December 2003 for the United Nations and the whole UN common system were \$1,484.9 million and \$4,022.9 million respectively. Action taken by each UN organization with respect to accounting and funding of these liabilities showed that:

- seven organizations including FAO have taken steps to both recognize and fund the actuarial liability from several sources;
- other organizations have not yet made provisions and are generally awaiting the action taken by the United Nations prior to considering how to fund the liabilities.

17. The UN report was originally requested by the Advisory Committee on Administrative and Budgetary Questions in its reviews of the UN's 1998-99 biennium budget. The ACABQ raised the issue concerning the accrued liability for after-service health insurance benefits for the United Nations system and requested that urgent attention be given to the matter, that long-term implications and impact of the growth in the liability upon the UN be addressed on a system-wide basis in a report by the Secretary-General on how the UN intended to address the issue. The

<sup>1</sup> A/60/450

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Board of UN Auditors also emphasized the urgency for all UN organizations to recognize the end-of-service benefit liabilities and to disclose them in the financial statements. General Assembly resolution 58/249 A of 23 December 2003 regarding financial reports and audited financial statements and reports of the Board of Auditors, included a request for the Secretary-General to report to the General Assembly on the full extent of unfunded staff termination and post-service liabilities in the United Nations and its funds and programmes and to propose measures that would ensure progress towards fully funding such liabilities.

18. As acceptable under the United Nations System Accounting Standards, liabilities related to after-service health benefits and other end-of-service entitlements of the UN are currently disclosed in the notes to the financial statements. Other accounting standards promulgated by professional accounting standards boards, such as the International Financial Reporting Standards, prescribe full accrual accounting requiring that liabilities associated with post-retirement benefits be recognized and reported on the balance sheet of financial statements and that the annual accrual of future benefits for active employees be expensed each year until employees become eligible for such benefits.

19. The Secretary-General of the UN emphasized to the General Assembly that health care provided by the after-service health insurance programme is a vital element of social security for retiring staff members since many of them cannot benefit from the national social security schemes of Member States owing to their service with the UN. The UN ASHI report emphasises the high importance to the UN and, therefore, to the viability of its financial base. The short and long-term funding strategies outlined in the report provide a means for funding the programme taking into account the resource constraints of the UN.

20. The UN ASHI report proposed measures for the approval by the General Assembly for funding and accounting of UN ASHI liabilities as follows.

- a) Initial funding of \$350 million by:
  - i) transferring \$250 million from unencumbered balances and savings on, or cancellations of, prior periods' obligations of active peacekeeping missions;
  - ii) transferring \$25 million from the authorized retained surplus in the UN General Fund;
  - iii) transferring \$43 million from the medical and dental reserves;
  - iv) transferring \$32 million from the Compensation Fund.
  
- b) Ongoing funding by:
  - i) continuing biennial appropriations to cover after-service health insurance subsidy payments for current after-service health insurance participants;
  - ii) establishing a charge equivalent to 4% of salary costs to be applied against the budgets to which staff salaries are charged;
  - iii) utilizing unspent budget appropriations in the UN regular budget;
  - iv) transferring any excess of actual over estimated miscellaneous income of the UN General Fund; and
  - v) transferring savings from liquidation of prior years' obligations.
  
- c) Approve changes to the after-service health insurance provisions aimed at reducing future costs of after-service health benefits, recognizing that existing retirees and staff have acquired rights to after-service health insurance participation under current provisions, as follows:
  - i) increase in eligibility requirements for new recruits from 10 to 15 years minimum participation in the UN health insurance plans with a "buy-in" provision after 10 years of participation;

- ii) application of a theoretical pension of a minimum of 25 years of service as the basis of assessing retiree contributions as opposed to using the actual number of years of service when less than 25;
  - iii) introduction of a minimum participation requirement for after-service health insurance eligibility of dependents.
- d) Authorize full recognition of the after-service health insurance liability on the financial statements of the UN.

21. Certain of the UN proposals on funding could be considered as appropriate measures to be taken by FAO as follows:

- a) establish a percentage charge of salary costs to be applied;
- b) utilize unspent appropriation of the FAO Regular Programme budget at the end of the biennium;
- c) transfer any excess of actual over estimated miscellaneous income of the FAO General Fund; and
- d) transfer savings from liquidation of prior years' obligations component of miscellaneous income.

However, such measures have to be viewed in the context of the substantial existing deficit of the General Fund. In addition, the adoption of international accounting standards in the UN system will oblige UN organizations with unfunded and unrecorded after service liabilities to record the full obligation and formally disclose funding plans. The key effort by Member Nations will be to devise and adhere to a long-term commitment to adequately fund the liabilities.

## **VII. Considerations on Common UN Valuation Opportunity**

22. In 2005, the United Nations extended an invitation to FAO and other agencies to join the "UN ASMC" group valuation performed by the UN actuaries, Mercer. The pooling of UN agencies in performing a group ASMC valuation using a set of common UN assumptions would result in savings in terms of the actuary fees for the valuation and would provide consistency over the spectrum of UN agencies participating in the UN ASMC group valuation.

23. However, the financial, demographic or other assumptions used by FAO are likely to be different from those experienced by other UN agencies. Furthermore, the UN group actuarial valuation idea is limited to ASMC and does not extend to the other three staff benefit schemes which are also subject to actuarial valuation in FAO. The Secretariat is evaluating the merits of the UN offer for the ASMC group valuation and a questionnaire was sent to the UN to obtain clarification and further information of the UN ASMC group scheme.