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NOTE INFORMING THE CHANGE OF THE FINANCIAL REPORTING OF THE GEF TRUST FUND FROM IFRS TO CASH BASIS

(Prepared by the Trustee)

Note informing the change of the financial reporting of the GEF Trust Fund from IFRS to Cash basis

The purpose of this note is to inform the Council of the change in the basis of financial statement reporting for the GEF Trust Fund (effective for the June 30, 2013 reporting period) from International Financial Reporting Standards (IFRS) to a cash basis reporting.

Background: The GEF Trust Fund is administered by the IBRD as Trustee. The Trust Fund is annually audited by the external auditors of IBRD. Since fiscal year 2007, the GEF Trust Fund financial statements have been prepared in accordance with International Financial Reporting Standards (IFRS) as issued by the International Accounting Standards Board. The financial statements reflect an accrual method of accounting and include the assets, liabilities and cash flows of the Trust Fund. The preparation of financial statements follows prudent approaches related to valuation, discounting of Instruments of Commitments and promissory notes receivables from Contributing Participants (Donors), recognition of grant liabilities and accounting of foreign exchange gains/losses. The accounting and presentation of these components in the financial statements depend on the basis of reporting (i.e.,) IFRS or cash basis.

Reasons for the change: While the financial statements of the GEF Trust Fund are accurately presented in compliance with IFRS, it does not necessarily align well with the underlying nature of business events and activities of the GEF. IFRS application also poses several challenges in the preparation of financial statements, review by external auditors, and for reader usability of financial statements. The following are examples:

- Revenue recognition applicable to Donor contributions: Currently in the GEF Trust Fund financial statements under IFRS, income is recognized at fair value when Donors deposit unqualified Instruments of Commitment. Initial fair value (reflecting the time value of money) is required under IFRS, however, these values are less useful for managing the actual contribution payments and commitment authority of the GEF Trust Fund.

- Allowances and provisions for receivables: Although estimated allowances are required to offset the impact of future receivables, these do not necessarily reflect the actual financial situation and ability or willingness of Donors to meet their obligations.

- Liabilities for projects and fees: The Trustee sets aside GEF resources for Agencies and commits funds based on the CEO approval or CEO Endorsement, as applicable, for the underlying GEF activity (MSP, Full Size project, Enabling activities, etc.). In order to set aside funds, the Trustee performs internal validation. These procedures include verifying the source documents (such as Council approved Work Program), cross verifying details in the PMIS database, and reconciling with the Agency, as needed. Once the validations are met, the Trustee updates the details of CEO approval/endorsement in the Trustee records and issues letters of commitment to the Agencies. Under IFRS, a constructive obligation is recognized based on Council approval and the issuance of CEO endorsement letters, notwithstanding the validations performed by the Trustee, including the funding availability.

- Comparability with Agency financial reporting: All GEF Agencies prepare annual audited financial statements for the funds received from the Trustee on cash basis. It is a challenge to draw parity between the items from Agencies financial statements items with that of the Trustee's which is on an accrual basis under IFRS.

Approach going forward: In order to address several challenges mentioned above, the GEF Trust Funds financial statements will be prepared on a modified cash basis of reporting. Under this method, items appearing in the financial statement would be reported based on cash inflows or outflows during the relevant reporting period. The financials statement is modified to reflect the share in pooled investments on a fair value basis. The primary cash inflows will be cash receipts from Donors for installments and promissory notes encashments which are reported when collected rather than when pledged/earned. Cash transferred to Agencies will be the primary cash outflows which are reported when paid rather than when incurred. In this method, contribution receivable from Donors will not be reflected in the main financial statements, accordingly there will also be no provision for Donor receivables. Similarly, the grant liabilities payable to agencies will not be reflected in the financial statement.

Benefits under Cash basis: In addition to addressing the above-mentioned challenges, GEF Trust Fund financial statements that are prepared under cash basis will have the following benefits:

- GEF Trust Fund financial statements will be simpler and reader friendly.
- Cash inflows and outflows can be more easily tracked and reconciled with the records of Donors and Agencies respectively.
- GEF financial statements and Agency financial statements will be presented on a comparable method of reporting.
- Staff time for preparation of financial statements and coordination with auditors is expected to be less resulting is cost savings.
- Potentially shorter timeframe for audit field work and issuance of audit report.

This change will not affect the business records maintained by the Trustee. The Trustee will continue to track the end-to-end activities related to Donor contributions and GEF project commitments. The Trustee, in its semi-annual report to the GEF Council, will continue to report on the financial situation of the GEF Trust Fund, including the status of Instruments of Commitments, status of installment payments, restricted contributions, liquidity of the Trust Fund, amounts available for programming and decision by the Council/CEO, and the GEF envelope report. The Trustee will continue to provide as much information as possible in the financial statements under cash basis of reporting.