GAO
Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

August 11, 2008

Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto Ontario Canada M5V 3H2

Subject: International Public Sector Accounting Standards Board (IPSASB)

March 2008, Exposure Draft: 34, *Social Benefits: Disclosure of Cash Transfers to Individuals or Households*

This letter provides the U.S. Government Accountability Office's (GAO) comments on the IPSASB proposed International Standard on *Social Benefits: Disclosure of Cash Transfers to Individuals or Households.* Overall, we support the IPSASB efforts to disclose additional information on the cash transfers to individuals and households as a step towards increasing transparency and providing information to users about the implications of long-term fiscal challenges relating to social benefits. However, as drafted, we believe that the potentially significant costs associated with gathering data and preparing these estimates could outweigh the benefits of disclosing such information, particularly given that we believe that IPSASB's fiscal sustainability project will provide more relevant and complete information about future social benefit cash transfers. Also, it may take some governments a number of years to develop the information that is needed to comply with the disclosure requirements.

While we recognize the value of including prospective estimates of the cost of social benefits in the general purpose financial statements, we believe that estimates for future social benefits and the cost of other government programs as well as future receipts would be more appropriately reported as part of the long-term fiscal sustainability reporting. We strongly endorse the inclusion of a statement of fiscal sustainability as a primary financial statement, along with annual changes therein. Moreover, a statement of fiscal sustainability would provide users with important prospective financial information that would assist them in obtaining a comprehensive perspective of the government's financial condition and its ability to meet its obligations as they become due. Simply stated, we believe that putting efforts to develop and implement a statement of fiscal sustainability will be more cost effective and provide more comprehensive information for users on the government's financial condition.

The Board has asked respondents to answer specific questions and to comment on other matters in the exposure draft. We provide the requested answers and comments in the related attachment.

Request for Specific Comments
The IPSASB would value comment on whether you agree that:

Question 1.
The scope of this ED is appropriate (paragraphs 2-8). If you do not think that the scope is appropriate please detail how you modify the scope. Please state your reasons.

Response/Comment:
We agree that efforts to establish standards that require disclosures of future cash transfers to individuals or households are important for providing greater transparency and more useful information to the readers of the general purpose financial statements. However, we recognize that sustainability information about social benefits included in the context of broader fiscal sustainability reporting would better enhance accountability and transparency of the fiscal condition of the government and provide users with information needed to make tough and timely decisions about the government's ability to sustain social benefits and other government programs in the long-term.

Question 2.
The new definitions in this ED at paragraph 10 are sufficiently clear and comprehensive. If you disagree, please indicate (a) how these definitions should be modified and (b) which new terms should be defined. Please state your reasons.

Response/Comment:
We identified no significant issues with the definitions in paragraph 10. However, see our response to question 3 below with respect to threshold eligibility.

Question 3.
The requirements for the determination of amounts expected to be transferred to eligible individuals or households are appropriate (paragraphs 30–44). If you do not think that they are appropriate please indicate what those requirements should be. Please state your reasons.

Response/Comment:
It is our view that estimates of future cash transfers should be reported in a statement of fiscal sustainability. Such reporting would include transfers over a projection period sufficient to illustrate long-term sustainability. Adopting a general purpose financial reporting model and developing a conceptual framework that includes a statement of fiscal sustainability can provide readers and policy-makers with better information to formulate policy and understand the effects of current policy decisions on the financial condition and position of the government and the degree of its sustainability —information that is vital for effectively understanding the

consequences and financial, social, and political implications of current government policies for social benefits in the context of all government revenues and program costs.

Also, we have concerns about whether there is sufficient utility in reporting social benefit obligations based on threshold eligibility to financial statement users. A government typically has significant discretion in determining whether to continue or to modify social benefits. Therefore, presenting disclosures based on threshold eligibility and continuous entitlement might not represent a likely or even reasonable policy option for policymakers or users to consider. Also, the proposed disclosures would not include dedicated revenues (which might be useful for assessing sustainability), and reported programs would likely have significantly different time horizons for the cash transfers (some short, some significantly long). However, dedicated revenues and consistent time horizons should be considered in long-term fiscal sustainability reporting.

Question 4.
The disclosure requirements in paragraph 45 are appropriate. If you think that they are unduly onerous, which disclosures should not be required? Conversely, if you think that the disclosures are inadequate, what further disclosures would you include? Please state your reasons.

Response/Comment:
We believe that the disclosure requirements in paragraph 45 will require a significant undertaking for governments to develop the capacity to collect and analyze the required data and acquire technological resources to facilitate this analysis. Accordingly, some governments may not be able to comply with the disclosure requirements for a number of years. Further, developments in the conceptual framework and long-term fiscal sustainability reporting projects could very well make the information included in the disclosures less relevant.

Also, the requirements in paragraph 45 include that the entity shall disclose the required data for each cash transfer program—no matter how small the program budget--which adds to our concerns about the cost-benefit of the proposed standard.

Question 5.
The disclosure requirements in paragraph 45 are going to provide information that is verifiable. If you think that the disclosure requirements are not going to provide information that is verifiable, please identify the specific disclosures and state what those implications are.

Response/Comment:
Government officials are responsible for preparing the general purpose financial statements including, if applicable, the disclosure requirements in paragraph 45 in conformity with the International Public Sector Accounting Standards. As such, the information provided must be able to be verified by government officials. These officials are responsible for the accuracy and completeness of this information.

Auditors will conduct tests of the general purpose financial statements including information that is disclosed--as they deem appropriate. Our view is that the information can be audited by auditors to the extent that management provides them the evidence to support their estimates. For the 2007 Financial Report of the U.S. Government, GAO provided an unqualified opinion on the Statements of Social Insurance, which presents long-term projected receipts and benefits for social insurance programs. In that regard, the American Institute of Certified Public Accountants issued Statement of Position 04-1, *Auditing the Statement of Social Insurance,* which provides related audit guidance.

Sincerely yours,

McCoy Williams

McCoy Williams
Managing Director
Financial Management and Assurance Team

GAO
Accountability * Integrity * Reliability

United States Government Accountability Office
Washington, DC 20548

August 11, 2008

Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West
Toronto Ontario Canada M5V 3H2

Subject: International Public Sector Accounting Standards Board (IPSASB) March 2008, Consultation Paper: Social Benefits: Issues in Recognition and Measurement

This letter provides the U.S. Government Accountability Office's (GAO) comments on the IPSASB Consultation Paper on *Social Benefits: Issues in Recognition and Measurement.* Overall, we support recognition of a liability for social benefits for cash transfers when all eligibility requirements are met and for goods and services, when the goods or services are provided. We believe that estimated spending for future social benefits should be reported, in the context of all government receipts and spending, as part of long-term fiscal sustainability reporting. As a result, we strongly endorse a statement of fiscal sustainability as a primary financial statement along with annual changes therein. Moreover, it is our view that a statement of fiscal sustainability would provide users with important prospective financial information and key demographic data that will assist them in obtaining a comprehensive perspective of the government's financial condition and its ability to meet its obligations as they become due.

In addition, we believe that it is premature for the Board to address the recognition and measurement of social benefit obligations before it completes its deliberations on Exposure Draft 34 *Social Benefits: Disclosure of Cash Transfers to Individuals or Households* and its current conceptual framework and long-term fiscal sustainability projects. These projects will provide additional insights into the nature of financial reporting of liabilities. For example, the conceptual framework project should yield a common framework for recognition and measurement of all liabilities and ensure that the treatment for non-exchange social benefits is consistent with the framework. When issued, the conceptual framework and the long-term fiscal sustainability reporting standard may provide additional information and guidance that might be relevant to our response. Our responses herein are based on a consideration of current standards.

The Board has asked respondents to answer specific questions and to comment on other matters in the exposure draft. We provide the requested answers and comments in this letter.

Request for Specific Comments

The IPSASB would value comment on whether you agree that:

Question 1:
Do you agree that, within the constraints of the current implied conceptual framework for general purpose financial reporting, current financial statements such as the statement of financial position and the statement of financial performance cannot convey sufficient information by themselves to users about the financial condition of governmental programs providing social benefits? Please state your reasons.

Response/Comment 1:
We agree that within the constraints of the current implied conceptual framework for general purpose financial reporting, the current financial statements cannot convey sufficient information by themselves for assessing the financial condition of the government--including governmental programs that provide social benefits. The current financial statements provide certain meaningful information that:

- assists users in making and evaluating decisions about the allocation of resources;
- demonstrates the accountability of the resources entrusted to the government by the public;
- provide users with financial information to evaluate the government's ability to finance its current activities; and
- evaluate short-term performance in terms of the cost of individual and collective goods and services provided for social benefits.

The current financial statements convey information primarily about an entity's past transactions but do not convey information that is prospective in nature—information that is crucial for assessing the financial condition of government programs. It is our view that the current financial statements should be supplemented with a statement of fiscal sustainability as a primary financial statement so that users can assess the extent to which governmental obligations for social benefits under existing legal frameworks can be met in the future—information that is needed to appropriately assess the government's financial condition. Our comments are discussed in further detail in the paragraphs that follow.

The current statements of financial position and of financial performance provide information to assess the cost of providing goods and services during the period. Since a government generally has little exchange revenue and no profit motive, but has instead the goal of providing services that are collectively chosen to improve the well-being of citizens, government costs should be matched year by year with the delivery of such services. Thus, costs can be matched with program delivery and analyzed in relation to outputs, outcomes, and relevant performance measures. These measures could assist in improving:

- resource allocation and program management;
- the effectiveness and efficiency in which services are delivered; and
- the accountability to citizens for service delivery.

The intent of the current financial statements is to convey information primarily about an entity's past transactions and prior economic events. As a result, the financial statements were not designed to provide information that is prospective in nature and crucial for assessing the long-term financial condition of government programs. It is our view that "financial condition" is a forward-looking indicator that should provide predictive information about a government's long-term capacity to sustain and finance its current programs including social benefits— information that is not conveyed in the current financial statements. For example, current financial statements do not reflect an asset for the government's right to tax. Consideration of future taxes and other receipts is critical to assessing financial condition. In addition, the current financial statements do not provide sufficient information for users to assess the extent that financial burdens have or will be passed on by current year taxpayers to future taxpayers without related benefits. Many countries face long-term challenges including demographic and socio-economic change with rapid increases in the old-age dependency ratio that will impact the future fiscal health, level of spending for goods and services, and level of future receipts. Consequently, it is critical that the future impact of these challenges be considered when making a comprehensive assessment of a government's financial condition.

Towards that end, we support a statement of fiscal sustainability as a primary financial statement along with annual changes therein. A statement of fiscal sustainability would report the results and analysis of comprehensive long-term fiscal projections of government receipts and spending for all programs which would help users assess whether future government receipts will likely be sufficient to sustain public services and benefits and to meet obligations as they become due — information that can not be obtained from either the statements of financial position or financial performance. IPSAS 1 —*Presentation of Financial Statements*— recognizes the value of such a statement. According to IPSAS 1, general purpose financial statements can also have a predictive or prospective role, providing information that is useful in predicting the level of resources required for continued operations, the resources that may be generated by continued operations, and the associated risks and uncertainties. A statement of fiscal sustainability provides information that is multi-dimensional and useful for:

- determining the cost of providing social benefits and other goods and services in future years at the current level;
- identifying associated risks and uncertainties;

- determining whether the current tax/revenue policy is likely to produce future budgetary resources sufficient to sustain the current levels of public services and to meet obligations as they become due; and,
- projecting deficits, or surpluses and debt under alternative scenarios.

In addition, a presentation of the changes in fiscal sustainability that occurred during the year can provide a clear and comprehensive measure of the extent to which the government's financial condition improved or deteriorated and will reflect the effect of policy changes enacted during the year.

Fiscal sustainability reporting would provide projections of future spending for social benefits and all other government programs. These spending projections can provide users with an alternative perspective of the financial impact of continuing the current policies on a long-term basis. For example, in the United States, long-term projections of social insurance are calculated based upon current benefit formulas. Payments of Social Security and Medicare Part A benefits are limited to the amounts that are held in the respective "trust funds." The projections illustrate that over the long-term, recipients would not receive the current level of benefits because the trust funds would not have sufficient resources to provide them. Fiscal sustainability reporting contemplates future outcomes, can disclose the projected financial impact of multiple scenarios, and can provide a clear and comprehensive analysis of the extent to which future budgetary resources would be sufficient or insufficient to sustain public services and meet obligations as they become due.

In conclusion, the current financial statements and a statement of fiscal sustainability and annual changes therein provide complementary but unique information to assess a government's finances. The combination of current reporting and long-term fiscal sustainability reporting would provide several key measures of the federal government's financial condition and changes therein including:

- end of year measures such as statements of financial position and fiscal sustainability; and
- annual measures such as a statement of financial performance, budget results, and changes in fiscal sustainability.

We believe that adopting a general purpose financial reporting model and developing a conceptual framework that includes a statement of fiscal sustainability would provide readers and policymakers with better information to formulate policy and understand the effects of current policy decisions on the financial condition of the government and the degree of its sustainability —information that is vital for effectively understanding the consequences and financial, social, and political implications of current government policies for social benefits. We support the Board's new project to develop fiscal sustainability reporting and strongly believe that it should be prioritized over any further work on social insurance reporting.

Question 2:
Do you think that a present obligation to individuals or households arises at any time for:

a) Collective goods and services; and/or
b) Individual goods and services?

If you think a present obligation does arise for either (a) or (b), or both (a) and (b), please indicate when and indicate your reasons.

Response/Comment 2:
It is our view that only amounts for individual and collective goods and services that have been provided to beneficiaries during the reporting period, but have not been paid (including those incurred but not reported) should be recognized in the statement of financial position as liabilities. More specifically, we believe that liabilities for individual and collective goods and services and other non-exchange transactions, should be recognized only for legal obligations, as defined in IPSAS 19—*Provision, Contingent Liabilities and Contingent Assets.* IPSAS 19 defines legal obligations as an obligation that derives from a contract, legislation or other operation of law. IPSAS 19 also states that liabilities are present obligations of the entity arising from past events--the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential. The advantage of recognizing only legal obligations is that the point at which they arise is more objectively identifiable, and therefore subject to less ambiguity.

On the other hand, we do not believe that it is appropriate to recognize <u>future</u> social benefits for collective and individual goods and services as liabilities or present obligations in the current reporting period. First, while a government may have historically provided goods and services to recipients, it does not have a contractual or legal obligation to continue to provide these benefits prospectively. Second, the financial statements should embody the principle of matching the cost of government operations during a reporting period with the goods and services or transfers provided to the recipients. If liabilities for goods and services provided in the future were to be recognized in the statement of financial position, the financial statements would be contrary to this matching concept and significant liabilities would be recognized without the benefit of recognizing future assets expected from cash inflows. This approach would severely diminish the usefulness of the statement of financial position.

For these reasons, we do not believe that it is prudent to recognize, in the financial statements, <u>future</u> individual and collective goods and services that have yet to be delivered. As we discussed in our response to question 1, we believe that the inclusion of a statement of fiscal sustainability with estimates of future benefits of individual and collective goods and services and estimates of future cash inflows would be an appropriate solution for matching costs with resources to help obtain a comprehensive perspective of the government's financial condition and its ability to continue to provide and finance individual and collective goods and services to beneficiaries in the form of social benefits.

Question 3:

Do you think that a present obligation to individuals or households in respect of cash transfers arises when all eligibility criteria have been satisfied for:

a) Non-contributory programs; and/or
b) Contributory programs?

If you think that a present obligation arises at an earlier point for (a) or (b), or both (a) and (b), please indicate that point and give your reasons.

Response/Comment 3:

For cash transfer benefits for non-contributory and contributory programs, we hold the view that present obligations can only occur when each and every individual requirement of the eligibility criteria has been satisfied and the government has an obligation to pay cash transfer benefits. If the beneficiary fails to meet any of the eligibility criteria, the beneficiary would not be entitled to receive a benefit. In the United States, for example, one of the eligibility criteria for receiving monthly social security payments is the continued existence of the recipient. If the deceased was receiving Social Security benefits, the decedent's estate must return the benefits received for the month of death or any later months. For example, if the person dies in July, any benefit paid in August or later must be returned. Certain government programs may provide benefits upon the death of a covered participant (e.g. burial benefits, survivor benefits.) In these instances, the death of a covered participant is an eligibility requirement for the beneficiary to receive a cash transfer.

Social benefits differ from employer provided benefit plans which are exchange transactions in that they do not represent an exchange of current service for deferred compensation and the benefits do not vest. Under a typical non-exchange "pay as you go" social benefit program, the individual does not exchange his or her labor for a benefit from their employer, the recipient of his or her labor; rather, collectively the citizenry pays benefits to those who have worked before. Accordingly, the compulsory payment of taxes by an individual and the subsequent receipt of social benefits by that same individual in a typical "pay as you go" program constitute separate non-exchange transactions. For example, in the United States, the compulsory payment of social security taxes does not entitle an individual to a benefit in a legal, contractual sense and benefits paid to an individual are not directly based upon taxes paid or employment services rendered. Therefore, in those programs, the U.S. government has a legal liability only for benefits that are "due and payable." In addition, Medicaid and food stamps are currently recognized only on a "due and payable" basis as well.

It is our view that the creation and recognition of a liability for future benefits <u>does not</u> reflect the true nature of social benefit programs, the extent of the government's responsibilities for these and other programs, nor the government's ability to revise these responsibilities. Just as future government spending on programs such as defense or education, which are relatively certain to continue, is not a present obligation of the government, future social insurance spending is not a present obligation. Moreover, the balance sheet, which shows what governments own and owe as a result of past operations, should include as liabilities only those items that are present obligations of the governments.

Further, social benefit programs, as currently structured, may be clearly unsustainable (as are Social Security and Medicare in the United States) and social insurance reforms are a near certainty. However, it is not possible to predict what specific actions the government will undertake to modify or change future benefits. Consequently, the inherent uncertainty surrounding agreement and settlement for amounts projected for social insurance benefits, outside of what is currently "due and payable," does not lend itself to recognizing a liability and expense for future benefits. As noted earlier, a statement of fiscal sustainability would show benefits under the current benefit formula which would assist in determining whether projected receipts will be sufficient to pay for such benefits and for the cost of other government programs.

We believe that the financial statements should embody the principle of matching the cost of government operations during a reporting period with the transfers or services provided as we stated in Question 1. However, we recognize the importance of reporting information concerning the sustainability of all government programs, recognizing that social policy obligations are a significant factor affecting sustainability in most countries. A statement of fiscal sustainability to communicate the long-term financial condition of the government including the long-term sustainability of its programs, intergenerational equity issues, projected annual cash flows that would include future receipts and spending for governments would provide increased transparency and provide users with critical information about the government's ability to continue its present course.

In conclusion, governments establish eligibility criteria for determining whether and when an individual is entitled to receive a benefit. According, a liability is not established and recognized until the beneficiary meets all of the eligibility criteria. In addition, it is our view that a liability should be recognized at the reporting date only for the amount of the benefit payment that is "due and payable" that is, legally owed to the beneficiary but was unpaid as of the reporting date. We do not consider estimates for future benefits to be recognized as present obligations because these future benefits have not been established by the government as legal obligations and can be modified or eliminated by the government if it so chooses. Moreover, recognition of future social benefits as a liability may result in a substantial mismatch between costs and delivery of services to the public.

Question 4.
Where a cash transfer program requires individuals or households to revalidate their entitlement to benefits, do you think that revalidation is an attribute that should be taken into account in the measurement of the liability or a recognition criterion? Please state your reasons.

Response/Comment 4:
As we stated in Question 3, we hold the view that a liability should be recognized when every individual requirement of the eligibility criteria has been satisfied and when the government has an obligation to pay cash transfer benefits. Because there may be several types of revalidation requirements for the numerous government programs that provide cash transfers as social benefits, the recognition and measurement would depend on the specific nature of the revalidation requirement. In our experience, revalidation in cash transfer programs is considered an internal control process or mechanism that assists a government in determining whether or not beneficiaries have satisfied all eligibility criteria through the entire period leading up to the revalidation date and were entitled to receive the benefits. In this scenario, the periodic revalidation is one of several eligibility requirements that must be met by the beneficiary to be entitled to continue to receive cash benefits and, consequently, a present obligation for the provision of benefits in future periods does not arise until the recipients satisfy, in each future period, all eligibility criteria.

Question 5.
Do you think that in developing requirements for recognition and measurement of social benefits the IPSASB should further explore the executory contract accounting model briefly outlined in Key Issue 6. Please state your reasons.

Response/Comment 5:
Not at this time. As discussed in our responses to the preceding questions, we believe that there are sufficient and compelling reasons for recording a liability for social benefits only when all eligibility requirements are met and a legal obligation exists. In essence, the current financial statements should reflect liabilities for social benefits provided during the accounting period. On the other hand, long-term fiscal sustainability reporting should reflect long-term social benefit spending in the context of future receipts and the future spending for other programs.
We support the board's current efforts to complete the IPSASB's Conceptual Framework that was initiated in 2006 and its work on long-term fiscal sustainability reporting. We believe that completing these projects will provide an appropriate foundation for developing standards for recognizing and measuring liabilities arising from social benefit programs. The completion of these important projects will enhance policy makers and users ability to effectively understand the consequences and financial, social and political implications of current government policies so that appropriate actions can be taken in a timely manner. The board has several important ongoing projects and has identified other key projects that are presently in

the initial stages with some yet to be started. Each project is very complex and most are expected to utilize a significant number of IPSAS staff and member resources to help ensure a reasonable completion date.

Sincerely yours,

McCoy Williams
Managing Director
Financial Management and Assurance