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John Stanford
Acting Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street West, 6th Floor
Toronto, Ontario M5V 3H2, Canada

1 March 2016

Dear Mr. Stanford

Consultation Paper *Recognition and Measurement of Social Benefits*

Ernst & Young Global Limited, the central coordinating entity of the global EY organization, welcomes the opportunity to offer its views on the above consultation.

We are supportive of the IPSASB's project on the accounting for social benefits. The expenditure on social benefit programs is a significant proportion of the budget for governments across jurisdictions and the lack of guidance in the suite of IPSASs has been considered a serious shortcoming of IPSAS. We commend the Board and IPSASB staff on the efforts expended on this difficult topic and believe that the IPSASB is going in the right direction in proposing the use of approaches 1 and 3 - the obligating event approach and insurance approach for the various types of social benefit schemes that we have observed across jurisdictions.

Our main comments are summarised in this cover letter below and our responses to the specific matters for comment are provided in Appendix A.

Scope of the project

We agree with the IPSASB's decision to align as far as possible, the definition of social benefits with the definition used in Government Finance Statistics (GFS). However, further clarifications are needed for social benefit schemes that seem to fall into the scope of this CP and IPSAS 25 *Employment Benefits*. In some jurisdictions, for example Germany and the UK, unemployment benefits (e.g. Job Seeker Allowance in the UK) may be partially funded by an employer and a worker, whilst the worker is in an employment relationship. Whilst we think that it is unclear whether such schemes are in the scope of this project, it would appear that from the discussion in Appendix A60-A70, such schemes are in scope. Further clarifications would be helpful.

Approaches for treatment of social benefits

We think that a combination of the obligating event approach and an approach based on the insurance approach would reflect the different economic circumstances arising in respect of social benefits. We also think that there may be different points of recognition for different social benefit schemes, and that a future IPSAS must consider that an obligating event can arise at different points depending on the nature of the social benefit or the legal framework under which the benefit arises.

We agree with the Board's preliminary view that the social contract approach is inconsistent with the Conceptual Framework and unlikely to meet the objectives of financial reporting. Under this approach, social benefits are generally recognised only when a claim is enforceable or approved which in our view is not recognition of the obligation on a timely basis and hence would not provide users with useful financial information. Therefore we do not think that the Board should devote any more time exploring this option.

Should you wish to discuss the contents of this letter with us, please contact Thomas Müller-Marques Berger at (+49) 711 9881 15844 or via email at thomas.mueller-marques.berger@de.ey.com.

Yours sincerely,

Ernst + Young Global Limited

Appendix A

Specific matter for comment 1

In your view:

- (a) Is the scope of this CP (i.e., excluding other transfers in kind, collective goods and services, and transactions covered in other IPSASs) appropriate?
- (b) Do the definitions in Preliminary View 1 provide an appropriate basis for an IPSAS on social benefits? Please explain the reasons for your views.

EY response to 1(a)

We support the scope of the CP which excludes other transfers in-kind, collective goods and services, and transactions covered in other IPSASs. However, for certain transactions, it is unclear whether they are scoped into this CP. The following are for the IPSASB's consideration:

- We understand that the CP scopes in social security schemes that operate outside an employer-employee relationship (e.g. unemployment benefits) which will usually cover wider groups than employment-related schemes, and the CP specifically scopes out employment-related schemes (Para 2.50, 4.77-4.80). However, for schemes that are partially funded from a previous employment relationship which could be deemed as a partial exchange transaction, it is not clear whether these are scoped into the CP. For example in the UK, the National Insurance (NI) is a system of contributions paid by workers and employers towards the cost of certain state benefits. It is a contributory system of insurance against illness and unemployment, and it also provides retirement pensions and other benefits. Such a scheme would meet the definition of social insurance, but does not seem to meet the definition of social security, defined as "social insurance **that arises outside of an employer-employee relationship**, and provides benefits to the community as a whole, or large sections of the community. Social security is imposed and controlled by a government entity." This definition could be interpreted in two ways. First, regardless of the origin of the contribution, as long as the benefit is administered by the government, the scheme could meet the definition of social insurance. Alternatively, one could take a strict reading of the definition that if the contributions (or some thereof) results from an employer-employee relationship, it could not meet the definition of 'social insurance', hence falls outside the scope of this CP. It would be helpful if the IPSASB could provide further guidance on such schemes and whether an insurance approach would be suitable for such schemes.
- In addition, the discussion in 4.79 - 4.80 are not entirely clear. The discussion seems to suggest that the contributory schemes discussed are in scope, as there is no direct relationship between the financing and the benefits, but 4.80 goes on to say if these services are provided on an exchange basis, then the IPSASB will consider whether these should be treated differently from other exchange transactions. Firstly, it is unclear how, in the absence of a direct relationship between financing and benefits, an exchange transaction would occur, i.e. how should one determine whether there's a 'direct relationship' between financing and benefits. Secondly, what factors or criteria should be considered when determining whether a contributory scheme is an exchange transaction versus one that is non-exchange? It would be helpful for the IPSASB to provide further guidance in these areas.

Response to 1(b)

We agree with the definitions provided in the IPSASB's preliminary view 1 and that these should be consistent with the descriptions given in the *System of National Accounts 2008* (SNA) as far as possible.

Specific Matter for Comment 2

- (a) Based on your review of Chapters 4 to 6, which approach or approaches do you support?
- (i) The obligating event approach;

- (ii) The social contract approach; and
- (iii) The insurance approach.

Please provide reasons for your views, including the conceptual merits and weaknesses of each option; the extent to which each option addresses the objectives of financial reporting; and how the different options might provide useful information about the different types of social benefit.

(b) Are you aware of any additional approaches to accounting for social benefits that the IPSASB should consider in developing an IPSAS? If yes, please describe such approach(es) and explain the strengths and weaknesses of each.

Response to 2(a)

As mentioned in our cover letter, we agree with the IPSASB that a combination of the obligating event approach and insurance approach would be required to reflect the different economic circumstances arising in respect of social benefits. We also think that there may be different points of recognition for different social benefit schemes, and that a future principles-based IPSAS must consider that an obligating event can arise at different points depending on the nature of the social benefit or the legal framework under which the benefit arises.

- (i) In determining the timing of recognition under the obligating event approach, we considered a few different examples and provide our thoughts on when recognition should occur in order for relevant information to be reported in a government's financial statements. The first is the accounting for expenditure arising from an influx of refugees. The point of recognition for a provision would probably be at the earliest when key participatory events have occurred, which in this example is upon the refugees' arrival. A second example is the provision of free tertiary education for citizens. The point of recognition could be the satisfaction of threshold eligibility criteria. Another example we considered is means-tested childcare benefits - an appropriate point of recognition could be upon satisfaction of specified threshold eligibility criteria.
- (ii) As noted on the cover letter, we do not think that the social contract approach is consistent with the Conceptual Framework and it is unlikely to meet the objectives of financial reporting. Under this approach, social benefits are generally recognised only when a claim is enforceable or approved which in our view is not on a sufficiently timely basis in most cases to provide users with useful information. Therefore we do not think that the Board should devote any more time exploring this option.

Insurance approach - We support an approach based on the IASB's proposed insurance model for the treatment of funded social assistance schemes which would be able to capture an entity's exposure to long term and uncertain obligations. However, some preparers and users may see the insurance approach as unnecessarily complex, therefore it may be worth field-testing the obligating event and insurance approaches on funded social assistance schemes for comparison before the IPSASB decides on the direction for accounting for such schemes.

Response to 2(b)

We are not aware of any additional approaches.

Specific Matter for Comment 3

Having reviewed the three options in Chapters 4 to 6, are you aware of any social benefits transactions that have not been discussed in the CP, and which could not be addressed by one or more of the options set out in the CP?

If so, please provide details of the social benefit transactions you have identified and explain why the options set out in the CP do not adequately cover these transactions.

We are not aware of any social benefit transactions that could not be addressed by one of the options set out in the CP. We observe that the types of social benefit transactions identified in Appendix A largely

relate to benefits that are accessible by residents of the country. As discussed in 2(a)(i) above, another social assistance scheme would be funds set aside for the provision of social welfare to asylum seekers or refugees. This type of social benefits is not discussed in the CP but we believe it could be addressed using the obligating event approach.

Specific Matter for Comment 4 (following paragraph 4.69)

In your view, at what point should a future IPSAS specify that an obligating event arises under the obligating event approach? Is this when:

- (a) Key participatory events have occurred ;
- (b) Threshold eligibility criteria have been satisfied ;
- (c) The eligibility criteria to receive the next benefit have been satisfied;
- (d) A claim has been approved;
- (e) A claim is enforceable; or
- (f) At some other point.

In coming to this conclusion, please explain what you consider to be the relative strengths and weaknesses of each view discussed in this chapter.

If, in your view, a future IPSAS should consider that an obligating event can arise at different points depending on the nature of the social benefit or the legal framework under which the benefit arises, please provide details.

Please explain the reasons for your views.

We believe that a future IPSAS should consider that an obligating event can arise at different points depending on the nature of the social benefit or the legal framework under which the benefit arises. In most cases under the definition of a liability, we believe that recognition would occur at points a or b. In addition, recognition should be considered from the perspective of the obligor, and not dependent on the general expectations of the recipient.

Revalidation is a common feature for social benefits schemes such as unemployment benefits. Therefore it is crucial for the Board to carefully consider whether revalidation (or continued eligibility) should be a recognition criterion or a factor affecting measurement. We agree with the Board's observation that there are differing views on the treatment of such schemes, and some have questioned whether factoring the likelihood of continuous eligibility into the measurement on initial recognition would provide users with useful information. Currently, we do not have a preferred approach, however, incorporating the probability of future non-eligibility in the measurement of the liability could give users an indication of the government's expectations of its liabilities.

Specific Matter for Comment 5 (following paragraph 4.76)

In your view, does an obligating event occur earlier for contributory benefits than non-contributory benefits under the obligating event approach?

Please explain the reasons for your views.

We think that the assessment of the timing of recognition should be consistent for both contributory and non-contributory benefits. The obligating event occurs when, from the perspective of the obligor, there is no realistic alternative but to fulfil that obligation. However, for contributory benefits, there may be an increased likelihood that a valid expectation will be created as the recipients start making contributions into the scheme.

Specific Matter for Comment 6 (following paragraph 4.80)

In your view, should a social benefit provided through an exchange transaction be accounted for:

- (a) In accordance with a future IPSAS on social benefits; or
- (b) In accordance with other IPSASs?

Please provide any examples you may have of social benefits arising from exchange transactions.

Please explain the reasons for your views.

We question whether 'social benefits' by definition can be classified as an exchange transaction. Some believe that the nature of social benefits would not result in exchange transactions. A social benefit can be

funded partially by recipients of the benefits themselves, but the benefits rendered by the government is unlikely to be of equal value, and hence most likely to be non-reciprocal in the majority of the cases.

However, if there are benefits/payments that are of an exchange nature, we do not think these should be scoped into this project.

Specific Matter for Comment 7 (following paragraph 4.91)
In your view, under the obligating event approach, when should scheme assets be included in the presentation of a social benefit scheme:

- (a) In all cases;
- (b) For contributory schemes;
- (c) Never; or
- (d) Another approach (please specify)?

Please explain the reasons for your views.

We think that scheme assets should be reflected in all instances, if there are any to account for, as discussed in 4.89 if a separate fund or earmarked assets exists to fund the scheme. We believe that would reflect the true net position, and enhance transparency of a government entity's financial statements.

Specific Matter for Comment 8 (following paragraph 5.38)
In your view, under the social contract approach, should a public sector entity:

- (a) Recognize an obligation in respect of social benefits at the point at which:
 - (i) A claim becomes enforceable; or
 - (ii) A claim is approved?
- (b) Measure this liability at the cost of fulfillment?

Please explain the reasons for your views.

As mentioned in our cover letter, we do not support the use of the social contract approach. We agree with the Board's preliminary view that the social contract approach is inconsistent with the Conceptual Framework and unlikely to meet the objectives of financial reporting. Under this approach, social benefits are generally recognised only when a claim is enforceable or approved which in our view is not on a timely basis and hence would not provide users with useful information.

Specific Matter for Comment 9 (following paragraph 6.24)
Do you agree with the IPSASB's conclusions about the applicability of the insurance approach?
Please explain the reasons for your views.

Specific Matter for Comment 10 (following paragraph 6.35)
Under the insurance approach, do you agree that where a social security benefit is designed to be fully funded from contributions:

- (a) Any expected surplus should be recognized over the coverage period of the benefit; and
- (b) Any expected deficit should be recognized as an expense on initial recognition?

Please explain the reasons for your views.

We think that the Board needs to spend more time determining whether the insurance approach is suitable for social benefits that are of a non-exchange nature. The insurance model developed by the IASB has a similar objective, to account for uncertain liabilities. However, the insurance model is built on the premise of an exchange transaction. We think that the insurance model is a sound starting base for the IPSASB to develop its own model for social benefits, but modifications may need to be made to arrive at an approach suitable for social benefits.

Assuming that the insurance approach is used, we think that the proposed approach is reasonable.

Specific Matter for Comment 11 (following paragraph 6.37)

In your view, under the insurance approach, what is the appropriate accounting treatment for the expected deficit of a social security benefit that is not designed to be fully funded from contributions:

- (a) Recognize an expense on initial recognition;
- (b) Recognize the deficit as an expense over the coverage period of the benefit;
- (c) Offset the planned subsidy and the liability only where this is to be received as a transfer from another public sector entity;
- (d) Offset the planned subsidy and the liability irrespective of whether this is to be received as a transfer from another public sector entity or as an earmarked portion of general taxation; or
- (e) Another approach?

Please explain the reasons for your views.

We question whether Option A, upfront recognition of the expected deficit which may not match the period that actual deficits occur, would result in useful financial information for users. Option B would seem to be a supportable conclusion under the Conceptual Framework. Options C and D are unlikely to be consistent with the Framework as under these options, it's unclear whether the liability is indeed an obligation of the entity or the other entity that is funding the deficit; it is also unclear whether there should be an asset to be recognized for the transfer. Furthermore the planned subsidy and the liability are unlikely to have the right to be offset under the Framework. The IPSASB could consider whether in this situation an exception needs to be made and a departure from the Framework is necessary.

Specific Matter for Comment 12 (following paragraph 6.43)

In your view, under the insurance approach, should an entity use the cost of fulfillment measurement basis or the assumption price measurement basis for measuring liabilities?

Please explain the reasons for your views.

We agree with the use of cost of fulfillment as a government's liability has no 'assumption' price or exit price. And as discussed in 6.41, the main advantage of using the cost of fulfillment measurement basis is that this represents the best estimate of the cost that is expected to be incurred to settle the obligation.

Specific Matter for Comment 13 (following paragraph 6.63)

Do you agree that, in those cases where the link between contributions and benefits is not straightforward, the criteria for determining whether the insurance approach is appropriate are:

- ▶ The substance of the scheme is that of a social insurance scheme; and
- ▶ There is a clear link between the benefits paid by a social security scheme and the revenue that finances the scheme.

If you disagree, please specify the criteria that you consider should be used.

Please explain the reasons for your views.

No further comments.

Specific Matter for Comment 14 (following paragraph 6.72)

Do you support the proposal that, under the insurance approach, the discount rate used to reflect the time value of money should be determined in the same way as for IPSAS 25?

Please explain the reasons for your views.

No further comments.

Specific Matter for Comment 15 (following paragraph 6.76)

Under the insurance approach, do you support the proposals for subsequent measurement set out in paragraphs 6.73-6.76?

Please explain the reasons for your views.

No further comments.