# Task force IRSPM A&A SIG, CIGAR Network, EGPA PSG XII

*March 21, 2018*

## Acknowledgement and Disclaimer

The IPSAS ED63 asked several questions in its REQUEST FOR COMMENTS. The responses prepared by the Task Force IRSPM A&A SIG, CIGAR Network and EGPA PSG XII are presented hereafter.

The IRSPM A&A SIG, CIGAR Network and EGPA PSG XII are three research networks that focus on Public Sector Accounting. The Task Force is made up of 15 researchers from these networks. The responses being presented are based on an analysis of the Consultation Paper, the IPSASB Conceptual Framework, relevant IPSAS, and various published research papers on the subject. Following various meetings and discussions, the members of the Task Force have reached the following common conclusions and suggestions.

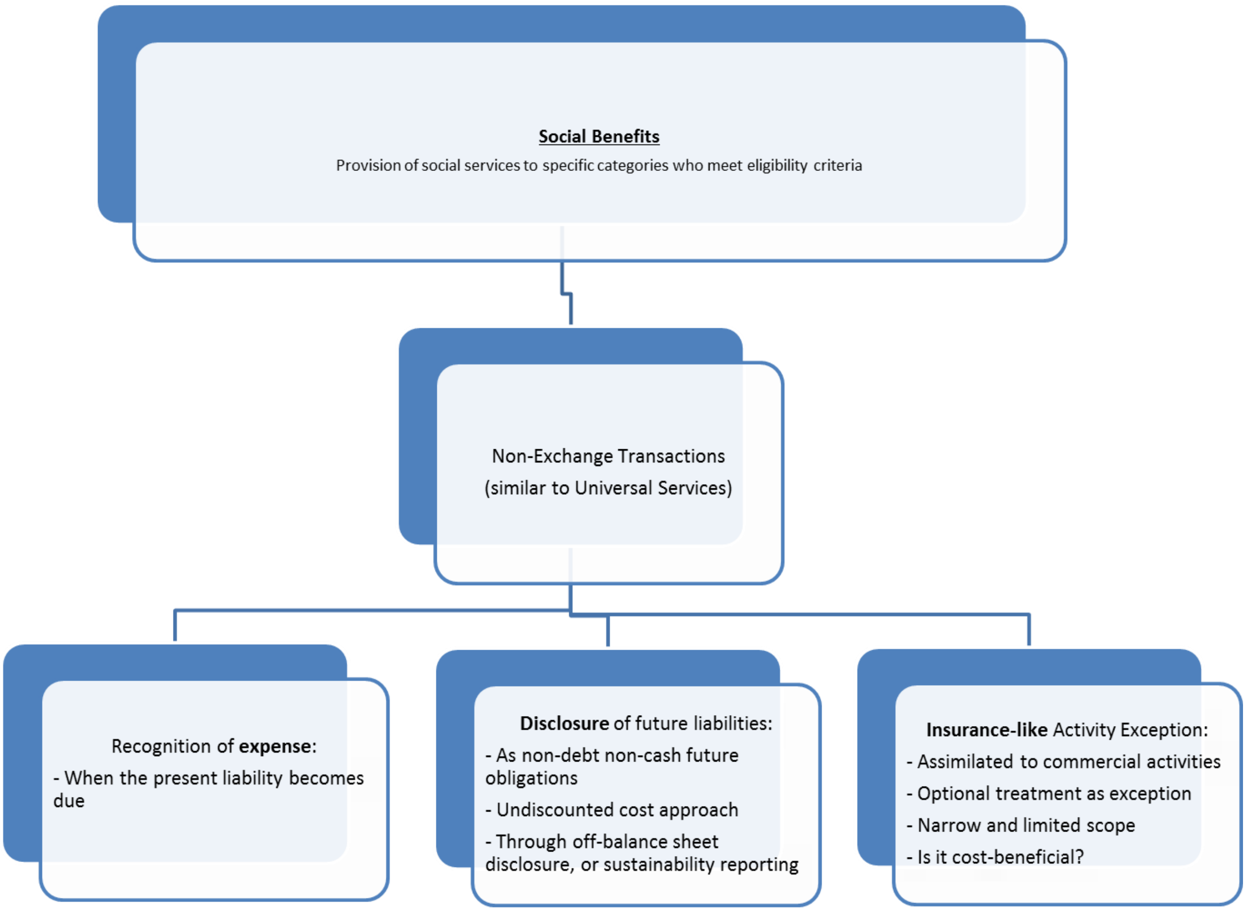
The views expressed in this document represent those of the members of the Task Force and not of the whole research community represented by the networks, and neither of the Institutions/Universities with which they are affiliated.

The following response on the IPSAS ED 63 on social benefits comprises two sections: the first section provides general remarks and suggestions; while the second one provides specific comments on requested matters.

## General Comment on IPSAS Exposure Draft 63 (Social Benefits, October 2017)

This section provides a rationale to better comprehend the comments and suggestions developed by this response. It comprises: an overview; a general comment on recognition; a general comment on measurement; and some concluding remarks and general recommendation.

This rationale is visualised by the following chart:




**Overview**

In July 2015, the IPSASB issued the Consultation Paper on Recognition and Measurement of Social Benefits, followed by the Exposure Draft 63 on Social Benefits in October 2017. The objective of this IPSASB project is to establish the recognition and measurement requirements for social benefits.

Social benefits were previously considered by IPSAS19 on provisions, contingent liabilities and contingent assets. IPSAS19 excludes provisions related to social benefits from its scope when provided in non-exchange transactions.

The Exposure Draft 63 (ED63 hereafter) aims to recognise and measure social benefits as a current liability, with initial recognition and subsequent changes to be reported directly through the income statement as expenses.

The ED63 defines social benefits (ED63, #6) as an insurance-like activity aimed to (b) mitigate the effect of social risks on (a) specific categories who meet eligibility criteria, in view to (c) address the needs of society as a whole, while (d) differing from universally accessible services.

Drawing upon this definition as an insurance-like activity, the ED63 provides two accounting options:

A) The insurance approach permits, but does not require, adherence to IFRS17 (insurance contracts) or equivalent national standards, when the social benefit scheme is fully funded from contributions and managed as an issuer of commercial insurance contracts. The insurance approach involves recognising and measuring the liability at the present value of estimated future cash flows.

B) The obligating event approach recognises the liability for the present obligation on the nearest next benefits which are estimated to be paid to current beneficiaries who do already meet all eligibility criteria at the reporting date.

**General comment on matters of recognition**

Social benefits refer to goods, services and financial transfers provided in the pursuit of the social policy objectives of a government. Their provision does not therefore constitute an exchange transaction with its beneficiaries. These benefits may include the delivery of health, education, housing, transport and other social services to beneficiaries without exchange consideration, as well as payments of benefits to families, the aged, the disabled, the unemployed, veterans, and other social categories.

Provision of social benefits relates to specific mandates and/or missions of the public sector, where it performs specific economic functions of redistribution and spending. The management of social policy objectives targeting specific social categories may generate the provision of an ongoing flow of benefits through time and circumstances.

This provision depends on the ongoing specific policies run by governments, which are decided by fiat and may evolve over time. Incumbent beneficiaries may hold reasonable expectations to receive future benefits as long as they meet eligibility criteria, but future benefits do not constitute a commercial promise or current obligation by governments. In particular, eligibility criteria and other terms and conditions may be amended in due course. Therefore, the provision of social benefits should be assimilated to that of universal services. Both may then be treated as non-exchange transactions which involve current expenses by governments which provide them.

**From this general perspective, it is questionable that a new and specific standard is required to account for social benefits.**

**Instead, illustrative and interpretative guidelines may be included in the standard for non-exchange expenses.**

The ED 63 especially focuses on the possible recognition of a liability related to the flow of social benefits. At one point of time (i.e., the reporting date), a part of this ongoing flow constitutes a current liability when expense is incurred and payment is due, while the remaining part refers to future liabilities – incurred in the future or from past events - which may become due in future periods (Heald and Georgiou 2011, page 450-1 and figure 1; see also ED63, BC12). The current liability relates to the current expense that is incurred to provide the current period social benefits (ED63, BC59, points d and e). On the contrary, the future liabilities neither involve a current cash outflow to be paid, nor involve a past cash inflow to be repaid to a financial creditor. Until they become due, these future liabilities constitute non-debt non-cash obligations for the reporting entity. When they become due, their payment may be covered by contributions, general taxation, and public debt issuance proceedings (Biondi and Boisseau-Sierra 2017a).

One of the critical issues raised during the debate on the Consultation Paper (CP) and now the ED63, has been the identification of the specific point when future social benefits become a present obligation which triggers the measurement of a current liability (ED63, BC59). The dissenting opinion summarised by the Alternative View in the ED63 insists that no universal recognition point may be established for all social benefit schemes. We recommend recognising the current liability when payment becomes due (ED63, BC59, points d and e), at the same time when the expense is incurred. This reliable and easily identifiable criterion reduces uncertainty and complexity concerning the universal recognition point. It also makes financial reporting more compatible with budgetary accounting.

The definition of social benefits as an insurance-like activity points to the mitigation of social risks (ED63, #6 and #BC20). Risk occurrence is an occasional event. When the triggering event occurs, the risk materialises and the insurance is paid to mitigate the negative effects of that risk. Some social benefits, such as unemployment transfers, may fit this definition. However, other social benefits such as state pensions are regular events, triggered by social conditions. When beneficiaries meet the eligibility criteria (such as passing the age threshold), they shall receive the benefits from that particular social benefit scheme. Ageing is not as much a risk as a condition that is regularly met when time goes by and eligibility criteria are satisfied.

From this perspective, the insurance-like definition does identify a narrow subset of social benefit policies (see also ED63, #BC44), while failing to provide a general definition and a consistent distinction from universally accessible services, such as healthcare systems and financial assistance to access them. Universally accessible services are certainly provided for the benefit of society as a whole; they may be limited to some categories (not for all) and access to them may be subject to eligibility criteria and non-commercial consideration (not for free) (comp. with ED63, #6 and AG7). For instance, primary school level is made accessible for free when the age threshold is triggered; while higher school levels are provided against non-commercial consideration and may involve some admission tests and other eligibility criteria. Moreover, universal healthcare services may be made accessible through some financial aid scheme that enables access for those who are unable to afford the required consideration. Therefore, we recommend assimilating social benefits to universal services, treating both consistently.

For the sake of this specific standard focusing on social benefit liability, our recommended treatment of social benefits as universal services makes it easier to account for provisions in kind and in cash. When a social benefit is generally provided in kind, it may be assimilated to the production of a universal service. When a social benefit is generally provided in cash, the recognition of a specific liability occurs when the payment becomes due, making its specific expense similar to other current expenses for universal service provision.

**General comment on matters of measurement**

Concerning measurement, the insurance approach accounting option introduced by ED63 requires applying accounting for insurance contracts as established by IFRS17 or equivalent national standards. In this context, the ED63 may better clarify the distinction between life-insurance (pensions) and non-life insurance. Non-life insurance transactions should not be set forward as a reference for social benefits because non-life insurance amounts to be paid are only recognised when they become due.

The alternative option develops measurement requirements for the obligating event approach. As a general principle (ED63, #17, #19, #22), this latter approach requires estimating the present discounted value of the future fulfilment costs that will be incurred for current beneficiaries until the next period at which eligibility criteria are required to be satisfied. This value is then recognised as a liability, which is immediately passed through the income statement as an expense. Over time, the unwinding of discounting is also passed through it as an interest expense (ED63, #25).

However, the application guidance (ED63, #AG21, #AG22) clarifies that the liability cannot extend beyond the point at which eligibility criteria will be next satisfied and is therefore expected to be short-term and settled within twelve months of the reporting date. The time value of money will be therefore not material. Consequently, the recognised amount will be generally not discounted, and this accounting option ends up applying a cost approach to the liability measurement. From this perspective, to avoid any possible misunderstanding, the standard may be more clear-cut and simple treating the liability measurement straightforwardly as a short-term liability.

Accordingly, information provided under the two accounting options – the insurance approach and the obligating event approach – are generally incomparable with each other.

The disclosure requirements for the obligating event approach option establish another measurement method which refers to the best estimate of undiscounted estimated cash outflows related to current and future beneficiaries in the next five reporting periods (ED63, #34). This latter method promises to respond to longer-term information needs without having recourse to discounting. Discounting of expected long-term cash flows raises major conceptual and application difficulties and requires systematic updates, exposing reported information to hazardous fluctuations and structuring opportunities (Biondi and Sierra 2017 and 2017b).

The retained measurement of the social benefit liability raises general concerns for public debt management and reporting. As such, this liability constitutes a non-debt obligation which should be distinguished from debt obligations which are generally issued as marketable financial securities. In particular, the non-cash amount derived from its discount unwinding should be distinguished from the cash amounts to be paid for debt service (interest charges and debt instalments).

Moreover, its initial measurement requires the whole liability to be expensed at injection through the income statement (ED63, #17). While this may be a minor issue if the liability is short-term, the retained accounting method should be made more consistent with the flow of time in splitting the liability progression between current and future periods. The fact that a liability is a present obligation for future costs does not imply it to become a full expense at the time of its recognition.

Last but not least, since users risk mingling together debt and non-debt obligations under a single liability class, off-balance sheet disclosure should be preferred. At the present, the IPSAS1 (#88) does not include a specific class for these non-debt non-cash obligations which differ from provisions and financial instruments.

In conclusion, <u>we do recommend excluding social benefit future obligations from balance sheet recognition</u>. Off-balance sheet information may be based upon estimation of future undiscounted cash outflows, in line with the disclosure requirements for the obligating event approach in the ED63. This disclosure may be included either in the notes to financial statements, or in specific sustainability reporting statements to be developed.

**Concluding remarks and general recommendation**

The ED63 aims to provide a single standard for recognition and measurement of social benefit liabilities.

Its insurance-like definition of social benefit schemes enables the application of IFRS17 or equivalent national standards to those schemes, but points to a limited subset of them, failing to provide a general and consistent approach to social benefits in general.

The standard may become more useful for users and more consistent with the economic substance by focusing on a working definition of non-exchange transactions and related expenses incurred to provide regular social services over time and circumstances, including social benefits. This focus would make their definition closer to the scope of social benefits in GFS, which includes social benefits with employee benefits and universally accessible services. In this context, social benefits may be provided both in kind and in cash and are assimilated to universal services.

The measurement of future obligations related to social benefits may exclude the recourse to discounting, in line with the alternative method introduced for disclosure requirements under the obligating event approach by the ED63.

These non-debt future obligations for social benefits should be clearly distinguished from debt obligations owed by public sector entities.

Since users risk mingling debt and non-debt obligations under a single liability class, off-balance sheet disclosure should be preferred, in line with the ESA2010 on employee benefits.

The passing through the income statement should be submitted to a restrictive test, limiting the expense to the part of the liability which has become due, in line with GFS.

## Requested Comments by Exposure Draft 63 (Social Benefits, October 2017)

This section addresses the specific matters for comment requested by the ED63.

**Specific Matter for Comment 1:**

Do you agree with the scope of this Exposure Draft, and specifically the exclusion of universally accessible services for the reasons given in paragraph BC21(c)?

If not, what changes to the scope would you make?

We recommend assimilating social benefits to the provision of universal services. Both are non-exchange transactions and involve non-exchange expenses. Social benefits may then be assimilated to universal services triggered by specific conditions (eligibility criteria). From this perspective, it is questionable that a different standard specific to social benefits is necessary or suitable.

The IPSAS Board itself seems to be aware that the distinction between social benefits and universal services is functionally and substantially inconsistent (ED 63, BC 20, c): "… social benefits and non-exchange expenses form a continuum, and […] any boundary will, to some extent, be artificial". Both perform social policy objectives by governments.

The reference to the individual's eligibility seems appropriate to identify both the current expense and the future obligations associated with these activities. This criterion may characterise social benefits as non-exchange transactions providing social services that target eligible individuals.

On the contrary, the notion of social risks seems too narrow and difficult to apply (ED63, BC20), since some eligibility criteria are not triggered risks but social conditions such as ageing.

In sum, universal services are not substantially different from social benefits since the former are not necessarily for all and for free (see also response to comment 2).

**Specific Matter for Comment 2:**

Do you agree with the definitions of social benefits, social risks and universally accessible services that are included in this Exposure Draft?

If not, what changes to the definitions would you make?

We disagree with the definition of social benefits as an insurance-like activity targeting mitigation of social risks. Risk is an occasional event possibly triggered in some circumstances. When that event occurs, the risk materialises and the insurance benefit is paid to mitigate its negative effects.

On the contrary, social benefits are non-exchange transactions with beneficiaries. They accomplish social policy objectives of a government. They respond to specific eligibility criteria which are not necessarily risks, but social conditions such as ageing, poverty, disability or unemployment.

The retained distinction with universally accessible services is weak, since the latter may involve non-commercial consideration payments (not for free) and conditions equivalent to eligibility criteria for access (not for all).

Therefore, we do recommend assimilating social benefits to universal services, treating both consistently. Both may be provided in cash (consistent with social benefit payments) and in kind (consistent with production of regular social services, including to specific categories).

**Specific Matter for Comment 3:**

Do you agree that, with respect to the insurance approach:

(a) It should be optional;

(b) The criteria for determining whether the insurance approach may be applied are appropriate;

(c) Directing preparers to follow the relevant international or national accounting standard dealing with insurance contracts (IFRS 17, *Insurance Contracts* and national standards that have adopted substantially the same principles as IFRS 17) is appropriate; and

(d) The additional disclosures required by paragraph 12 of this Exposure Draft are appropriate?

If not, how do you think the insurance approach should be applied?

We do agree that the insurance approach should be optional, and the retained application criteria do clearly identify the key characteristics of fully funded schemes that are managed as commercial insurance activities. Additional disclosures are consistent with this identification.

However, the reference to IFRS17 or equivalent national standards may be too narrow. Since the economic substance of these schemes is identified as a commercial insurance activity, national standards on insurance may be acceptable.

Although appropriate, this insurance approach targets a narrow subset of social benefit schemes, with a very limited scope of application (ED63, #BC33 and#BC44). Its burdensome application may overweigh its benefits.

From this perspective, this subset may be treated as an exception to the general application of the accounting for non-exchange expenses.

**Specific Matter for Comment 4:**

Do you agree that, under the obligating event approach, the past event that gives rise to a liability for a social benefit scheme is the satisfaction by the beneficiary of all eligibility criteria for the next benefit, which includes being alive (whether this is explicitly stated or implicit in the scheme provisions)?

If not, what past event should give rise to a liability for a social benefit?

*This Exposure Draft includes an Alternative View where some IPSASB Members propose a different approach to recognition and measurement.*

The dissenting opinion expressed by the Alternative View clearly expresses the difficulties raised by choosing one universal point of time when future obligations trigger a current liability. Moreover, this choice may raise distorting incentives, inducing behaviours which seek to reduce the time span of social benefits to avoid recognition of bigger liabilities and bigger related expenses.

More generally speaking, although incumbent beneficiaries may develop reasonable expectations to receive future social benefits as long as they meet the eligibility criteria, the eventual provision depends on social policy decisions by governments, which are taken by fiat and may evolve over time.

Therefore, the satisfaction by the individual beneficiary of all eligibility criteria for the next benefit is not an appropriate criterion to identify the short-term part of the social benefit future obligations that is expected to become due in the next period. The recognition of the current liability for social benefits should occur when the current expense is incurred and its payment is due (ED63, BC59, points d and e).

A different approach may be based upon the alternative accounting method introduced by the disclosure requirements under the obligating event approach (ED63, #34). This approach is based upon the passage of time and subject to eligibility conditions. It should clearly distinguish between the current liability which is due, and the future obligations that may become due in future periods, while the non-debt non-cash nature of the latter is clearly acknowledged.

The impact on the income statement should be consistent with the incurrence of expense related to social benefits, imposing a restrictive test on whether (and which part of) the current liability has become payable (ED63, BC59, points d and e).

Since users risk mingling debt and non-debt obligations under a single liability class, off-balance sheet disclosure should be preferred.

Therefore, information about the future obligations related to social benefits may be disclosed by off-balance sheet notes to financial statements, or by sustainability reporting statements to be developed.

**Specific Matter for Comment 5:**

Regarding the disclosure requirements for the obligating event approach, do you agree that:

(a) The disclosures about the characteristics of an entity's social benefit schemes (paragraph 31) are appropriate;

(b) The disclosures of the amounts in the financial statements (paragraphs 32–33) are appropriate; and

(c) For the future cash flows related to from an entity's social benefit schemes (see paragraph 34):

(i) It is appropriate to disclose the projected future cash flows; and

(ii) Five years is the appropriate period over which to disclose those future cash flows.

If not, what disclosure requirements should be included?

We agree on the disclosure requirements, although a clear distinction should be made between these future obligations which do not involve past or present cash flows, and the cash liability related to public debt obligations.

In this context, five years may offer a conventional time horizon, although the most appropriate time horizon depends on the economic substance of each and every social benefit scheme with reference to current and/or future beneficiaries.

**Specific Matter for Comment 6:**

The IPSASB has previously acknowledged in its *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*, that the financial statements cannot satisfy all users' information needs on social benefits, and that further information about the long-term fiscal sustainability of these schemes is required. RPG 1, *Reporting on the Long Term Sustainability of an Entity's Finances*, was developed to provide guidance on presenting this additional information.

In finalizing ED 63, the IPSASB discussed the merits of developing mandatory requirements for reporting on the long-term financial sustainability of an entity's finances, which includes social benefits. The IPSASB identified the following advantages and disadvantages of developing such requirements at present:

| **Advantages** | **Disadvantages** |
| --- | --- |
| Long-term financial sustainability reports provide additional useful information for users for both accountability and decision making, and that governments should therefore be providing.<br><br>This especially applies to information about the sustainability of the funding of social benefits given the limited predictive value of the amounts recognized in the financial statements. | The extent and nature of an entity's long-term financial reports are likely to vary significantly depending on its activities and sources of funding. It would therefore be difficult to develop a mandatory standard. |
| Social benefits are only one source of future outflows. Supplementary disclosures (as proposed in the ED) on social benefits flows in isolation are therefore of limited use in assessing an entity's long-term sustainability, as they do not include the complete information on all of an entity's future inflows and outflows that long-term financial sustainability reports provide. | The nature of the information required for reporting on the long-term sustainability of an entity's finances, in particular, its forward-looking perspective, could preclude its inclusion in General Purpose Financial Statements.<br><br>Given the scope and challenges involved in its preparation and audit considerations, some question whether it would be appropriate to make information in a General Purpose Financial Report mandatory. |
| Long-term financial sustainability reports will improve accountability and will help support Integrated Reporting <IR> in the public sector. They will also provide useful information for users, in particular for evaluations of intergenerational equity. | RPG 1 was only issued in 2013, so it may be too soon to assess whether requirements developed from those in RPG 1 should be mandatory. |

Do you think the IPSASB should undertake further work on reporting on long-term fiscal sustainability, and if so, how?

If you think the IPSASB should undertake further work on reporting on long-term fiscal sustainability, what additional new developments or perspectives, if any, have emerged in your environment which you believe would be relevant to the IPSASB's assessment of what work is required?

We agree that the IPSASB should undertake further work on reporting on long-term financial sustainability of public sector entities.

Special attention should be paid to the overall economic functions of redistribution and spending; the public sector specific recourse to non-debt obligations; and the public sector specific use of public debt management in deficit-spending mechanisms.

The ongoing evolution of future obligations may then be covered through such a specific report on financial sustainability, while being scoped out from financial reporting. A summary of this report may be disclosed in off-balance sheet notes to financial reporting statements when relevant.

**References**

Biondi, Y. and Boisseau-Sierra, M. (2017a) Financial Sustainability and Public Debt Management in Central Government. In: Rodríguez Bolívar M. (ed) Financial Sustainability in Public Administration. Palgrave Macmillan, Cham. DOI: 10.1007/978-3-319-57962-7_7

Biondi, Y. and Sierra, M. (2017) Pension Management between Financial Market Development and Intergenerational Solidarity: A Socio-Economic Analysis and a Comprehensive Model. Socio-Economic Review (24 April 2017). DOI: 10.1093/ser/mwx015

Biondi, Y. and Boisseau-Sierra, M. (2017b) Pension Obligations in the European Union: A Case Study for Accounting Policy. Accounting, Economics, and Law: A Convivium, 7(3). DOI:10.1515/ael-2017-0027

Heald, D. and Georgiou, G. (2011) The Macro-Fiscal Role of the U.K. Whole of Government Account. Abacus, 47: 446–476. DOI:10.1111/j.1467-6281.2011.00348.x

Signed: **Task force IRSPM A&A SIG, CIGAR Network, EGPA PSG XII**

| | | | |
|---|---|---|---|
| Aggestam | Caroline | Associate Professor | Department of Accounting and Auditing, Copenhagen Business School, Copenhagen, Denmark |
| Anessi Pessina | Eugenio | Professor of Public Management | Università Cattolica del Sacro Cuore, Milan, Italy |
| Biondi | Yuri | Senior Tenured Research Fellow of the CNRS (IRISSO, University Paris Dauphine PSL), France | Research Director, Laboratory of Excellence on Financial Regulation (Labex ReFI), Paris, France |
| Bisogno | Marco | Associate Professor of Accounting | University of Salerno, Italy |
| Brusca | Isabel | Professor of Accounting and Finance | University of Zaragoza, Spain |
| Caperchione | Eugenio | Professor of Public Management | Department of Economics "Marco Biagi", Modena and Reggio Emilia University, Italy |
| Caruana | Josette | FCCA, FIA, CPA, MA (Fin. Services), PhD | Lecturer, Department of Accountancy, University of Malta, Malta |
| Christiaens | Johan | CPA, Public Sector EY | Professor Public Sector Accounting, Ghent University, Belgium |
| Cohen | Sandra | Associate Professor of Accounting | Department of Business Administration, Athens University of Economics and Business, Greece |
| Dabbicco | Giovanna | Researcher, PhD at Parthenope University of Naples | ISTAT, Italy |
| Hodges | Ron | Emeritus Professor of Accounting | Birmingham Business School, University of Birmingham, U.K. |
| Jorge | Susana | Assistant Professor with accreditation | Faculty of Economics, University of Coimbra, Portugal |
| Manes Rossi | Francesca | Associate Professor of Accounting, CPA, co-chair of EGPA PSG XII | University of Salerno, Italy |
| Sicilia | Mariafrancesca | Associate Professor of Public Sector Management and Accounting | Department of Management, Economics and Quantitative Methods, University of Bergamo, Italy |
| Steccolini | Ileana | Professor of Accounting & Finance | Newcastle University London |