



The Technical Director
International Public Sector Accounting Standards Board
277 Wellington Street West
Toronto, ON M5V 3H2
Canada
29 January 2016
Per e-mail

Dear John

**COMMENTS ON THE CONSULTATION PAPER ON SOCIAL BENEFITS
RECOGNITION AND MEASUREMENT**

Enclosed please find our comments on the IPSASB's Consultation Paper on *Social Benefits Recognition and Measurement*.

We commend the IPSASB for recommencing its work on this important topic. Given the current economic climate, it is important that governments understand the full effect of their social benefit obligations and what this means for their statements of financial position.

Overall, we are generally in support of the proposals in the Consultation Paper, although we do have reservations about the following key issues:

- The scope of the Consultation Paper and the possibility that schemes that are substantially the same may be treated differently because of the way in which the definitions have been crafted.
- There are too many definitions, some of which seem superfluous for accounting and reporting.

Board Members: Ms T Coetzer, Mr B Colyvas, Ms I Lubbe, Mr M Kunene, Mr K Makwetu,
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- The insurance approach may not be the most appropriate or relevant approach to account for schemes in the public sector, even those that may be similar to insurance-type schemes.

Our responses to the IPSASB's Preliminary Views are set out in Annexure A of this letter, while our responses to the Specific Matters for Comment are outlined in Annexure B.

In developing this comment letter, we have consulted a range of stakeholders locally. These stakeholders included audit firms, professional bodies, preparers and users.

Should you wish to discuss any of our comments, please feel free to contact me directly on jeaninep@asb.co.za.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Poggiolini', written in a cursive style.

Jeanine Poggiolini
Technical Director

Annexure A – Responses to preliminary views

Preliminary View 1

Preliminary view 1 outlined a proposed definition of social benefits, along with several related definitions (see paragraph 2.50)

We broadly support the definitions, but have reservations about the following issues:

- the implications for the scope of the project based on the current definition of a social benefit;
- whether all the definitions are needed, particularly those describing social insurance, social security and social assistance;
- what a social risk constitutes and how it should be considered;
- clarity on the application of the definitions of social benefits in cash and in kind; and
- the classification of benefits when they are paid by an agent.

These issues are discussed below.

1. Implication of definition of social benefits on scope of project

Issue 1 – Potential inconsistent treatment of programmes that have the same economic substance

The definition of social benefits makes it clear that only those benefits that are provided to mitigate social risks are in the scope of the Consultation Paper. The Consultation Paper also explains that “universal” benefit programmes, for example, free healthcare or free education provided to all, i.e. individuals or households do not need to meet any eligibility criteria to qualify for the service, are excluded from the scope of the Consultation Paper.

We are concerned that this is going to result in potentially different accounting treatments for benefit programmes that are in substance the same. As a consequence of the definitions and the scope, some jurisdictions may treat these as social benefits in this Consultation Paper, while others will potentially apply the accounting proposed in the IPSASB’s project on non-exchange expenses, yet the substance of the good or service provided is the same. In both instances, government will need to procure the services of employees and the goods necessary to provide these benefits. As a result, there should be no difference in their treatment from an accounting perspective. We also believe that applying different accounting requirements, or even different IPSASs, may be overly complex.

We urge the IPSASB to reconsider the scope to ensure that benefits or programmes that have the same economic substance are not treated differently. We suggest including those programmes that are in substance the same, e.g. healthcare and education, in the non-exchange expenses project.

Issue 2 – Schemes that are both universal in nature and require the satisfaction of eligibility criteria

We have identified a number of schemes where they include both a “universal” component, in that a certain amount of benefits are made freely available to all citizens, and thereafter additional goods and services are provided to eligible participants.

As an example, each resident within a particular municipality is entitled to 6kL of free water per month as access to water is considered a basic human right. If more than 6kL of water is required by a resident, but they cannot afford to pay for the water, they can apply to receive additional water at a substantially subsidised rate. In these instances, residents need to meet certain eligibility criteria to qualify for the subsidised benefits. Where residents do not qualify, they are supplied with water at the applicable tariff charged by the municipality.

It is unclear in these circumstances how the scheme should be classified.

We propose that the IPSASB includes guidance to accompany the definitions to explain that the substance of these arrangements needs to be considered, and whether they are predominantly a universal programme, or a social benefit as defined.

2. Need for all the proposed definitions

While the definitions are generally supported, it is questioned whether all the definitions are necessary. While some of the definitions may be useful in classifying information for statistical purposes in GFS, they do not assist in distinguishing or classifying transactions for accounting purposes. In addition, the number of definitions makes both definitions and scope difficult to understand.

In particular, the definitions of social insurance, social assistance and social security appear to be “umbrella” terms for grouping together certain types of benefits or classifying types of entities. The main distinctions between these terms appear to relate to whether a scheme is contributory or not (social assistance versus social security); and when the scheme is contributory, whether it relates to an employer-employee relationship or not (social insurance).

In our view, whether schemes are contributory may affect the potential accounting, but does not create a distinct feature that requires separate definitions. Likewise, we believe that the scope of any Standard developed could exclude any benefits dealt with in other Standards, such as those arising from employer-employee relationships, negating the need for a separate definition.

As a result, we do not support retaining definitions of social insurance, social security and social assistance in developing an IPSAS. It may however be useful to discuss in the Basis for Conclusions, if an IPSAS is developed, that it is explained that these definitions were used as the starting point for the classification of social benefits in the GFS, and how they were used to derive the formal definitions in the proposed Standard.

3. *Considering “social risks” in identifying social benefits*

If the IPSASB retains the definitions and scope in the Consultation Paper in progressing the project, we have identified an area that requires clarification in relation to the definition of “social benefits”.

One of the key features of the benefits which are within the scope of the Consultation Paper is that beneficiaries must demonstrate the benefits are provided to mitigate a social risk. The concept of a social risk is not well understood in the accounting community, and may lead to a high degree of judgement being applied if an entity needs to assess whether additional demands are being placed on an individual’s or household’s resources.

Paragraph 2.43 explains when benefits might be provided to individuals and households. A core part of this discussion is that an individual or a household needs to be eligible to receive the benefit by meeting certain eligibility criteria. In our view, even a requirement to make contributions to be eligible for a benefit can be seen as a form of eligibility criteria.

There may be merit in using the concept of meeting eligibility criteria to limit the scope of any IPSAS developed in this area, so as to move the focus away from assessing exposure to a social risk (which may be judgemental), to satisfying eligibility criteria (which is more definitive).

We therefore suggest that the IPSASB consider limiting the scope of this IPSAS to only those benefits where eligibility criteria need to be satisfied.

4. *Clarity on the application of the definition “transfers in cash”*

Questions were raised during the consultation process on whether coupons or credits for certain goods and services would be classified as “in cash” or “in kind” transfers. While the Consultation Paper does mention this briefly, it should be clear in the definitions, or the explanatory text to the definitions, whether such items are in cash or in kind benefits.

In addition, the definition of benefits in cash refers to the individuals or households being able to use the cash “indistinguishably” from other forms of cash. It is unclear why this reference is included in the definition, and whether or not it imposes yet another consideration on an entity to assess in distinguishing in kind and in cash benefits.

Some stakeholders indicated that the rationale for separate definitions of in kind and in cash benefits is unclear. We have assumed that these may be necessary as the recognition and measurement approaches are developed, and possibly for presentational purposes. We ask the IPSASB to consider the relevance of these terms as the project progresses and whether they are in fact needed.

It was also observed that the inclusion of a separate definition of reimbursements may be inappropriate as readers may believe it is a separate category of transactions, rather than being part of transfers in kind. We propose deleting the definition of reimbursements, and instead using this as a supplementary description to what is included in transfers in kind.

5. *Classification of benefits when paid by an agent*

The definition of social benefits currently refers to benefits being paid to individuals or households by public sector entities. Frequently, other parties are used as disbursement agents. If read literally, it may imply that the payments are not made to the individuals or households but to another party.

We suggest that a discussion be included in the future IPSAS outlining that agents may be used to disburse or provide benefits, but that this does not mean that they are not social benefits as defined.

Preliminary View 2

The IPSASB considers that a combination of option 1 (obligating event approach) and (for some or all contributory schemes) option 3 (insurance approach) may be required to reflect the different economic circumstances arising in respect of social benefits. The IPSASB does not consider that option 2 (social contract approach) is consistent with the Conceptual Framework. For this reason, the IPSASB has taken the preliminary view that the social contract approach is unlikely to meet the objectives of financial reporting.

We support the IPSASB's preliminary view that:

Option 2 – social contract approach - should not be considered as we do not believe that it is conceptually sound, and will result in governments possibly understating their liabilities as they will only be recognised when the claim is approved. See our response to SMC 2(a)(ii).

We agree that option 1 – obligating event approach - is appropriate and believe that this will provide relevant information to users about government's obligations, as it reflects those circumstances when entities' have no realistic alternative but to fulfill an obligation. See our response to SMC 2 (a)(i). We believe that option 1 is also appropriate for insurance-type schemes.

We believe that option 3 - insurance approach - may be appropriate in certain circumstances. We do however believe that additional work may need to be undertaken to make this approach workable in the public sector. We also note that the IASB has not completed its work on the Insurance project yet, and question how adopting an approach that is not yet final impacts on the work of the IPSASB.

We are however of the view that in progressing the project, it would be appropriate to consider both option 1 and option 3. See our response to SMC 2(a)(iii) and (b).

Preliminary View 3

Under the obligating event approach, liabilities in respect of social benefits should be measured using the cost of fulfilment. The cost of fulfilment should reflect the estimated value of the required benefits.

We agree that the cost of fulfillment is the most appropriate measurement for social benefits as it reflects the cost that government or individual entity will be required to incur to settle the obligation.

Annexure B – Responses to Specific Matters for Comment

Chapter 2 – Scope and Definitions

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.

- (a) We have reservations about the scope of the project, and in particular, that certain schemes that are in substance the same, may be treated differently. See our response to Preliminary View 1 above.
- (b) We believe that the definitions are appropriate, but question the need for all the definitions, and have identified certain definitions that may require amendment or further explanation. See our response to Preliminary View 1.

Although not related to the types of social benefits within the scope of the Consultation Paper, certain aspects of the scope of the accounting and reporting requirements have not been considered in the Consultation Paper. In particular, derecognition is not discussed. Careful consideration will need to be given to the derecognition requirements for social benefit obligations as the project progresses.

Chapter 3 – Identification of Approaches

Specific Matter for Comment 2 (following paragraph 3.4)

- (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.

- (a) Our support or disagreement with the proposals is outlined below:
- (i) We support the obligating event approach as we believe this provides a sound conceptual basis for the recognition and measurement of liabilities related to social benefits. As approach 1 is based on the Conceptual Framework, we believe it will provide relevant information to users of the financial statements in a way, or on a basis, which is well understood.
 - (ii) We do not support the social contract approach as we do not support the notion that government's obligations are equal and/or related to the receipt of taxes. In South Africa, several court cases have indicated that government obligations need to be fulfilled irrespective of whether funding is available to meet those obligations. We also believe that recognising liabilities only when a claim is approved, as explained in the Consultation Paper, will not result in a fair representation of government's obligations. In many instances, we believe that government has no realistic alternative but to provide a particular benefit much earlier than when the claim is approved.
 - (iii) We support, on a limited basis, the insurance approach as we believe it may only be appropriate to specific types of schemes. While we believe that there is merit in considering this approach, we have reservations about whether it is the most appropriate method to use in the public sector. A number of our respondents have highlighted the complexity of applying the insurance approach outlined in the Consultation Paper. These comments are outlined in SMC 9.
- (b) While no additional approaches were identified, we have noted that the IASB's Exposure Draft on Insurance Contracts considered a "simplified" approach to recognising and measuring insurance contracts. This approach is called the "premium allocation" approach. There is merit in exploring this option as it may result in less complexity than the approach discussed in Chapter 6. See our response to SMC 9.

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.

No additional social benefit transactions were identified during our consultation process.

Chapter 4 – Option 1: Obligating Event Approach

Specific Matter for Comment 4

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.

Overall view

General support for approach that acknowledges different recognition points

We are of the view that any future IPSAS on social benefits should acknowledge that an obligating event may arise at different points. We believe that entities should have the ability to decide:

- (a) what the obligating event is that gives rise to the entity having no realistic alternative but to settle an obligation; and
- (b) that this decision should be based on the relevant legislation or other arrangement governing the scheme.

While this may give rise to potential differences in the way that schemes are recognised by jurisdictions, we believe it is conceptually appropriate to allow entities to apply judgement.

A key question to answer in developing a future IPSAS on social benefits is how these points will be used going forward in developing an approach to recognising and measuring social benefits. Subject to our comments below about the acceptability of all the points outlined in (a) to (e), the points should be used to provide guidance to entities about circumstances that may give rise to an obligating event, and in particular when an entity has no realistic alternative but to settle an obligation.

The guidance could include circumstances, or the types of schemes, for which the various points could be used, e.g. key participatory events may be useful for insurance-type schemes, threshold eligibility may be useful for recurring cash transfers, etc. along with appropriate measurement principles.

Concerns about allowing recognition only when claim approved or claim is enforceable

Although we support allowing flexibility, we do have reservations about allowing entities to recognise social benefits only when the claim has been approved, or when the claim is enforceable. In our opinion, this might be too late in the process, and will potentially allow entities to continue to understate liabilities on their statements of financial position.

While we do not support (e) at all, we believe that (d) may need to be used as a “last resort” if there is a significant degree of uncertainty about whether an outflow of resources will occur.

We are unsure whether there is, in all instances, a difference between the “meeting eligibility criteria” and “approved claim” options and believe that it may be ambiguous in certain instances. Our concerns on this issue are outlined below.

Observations on the application of the recognition points

In responding to (a) and (f) above and the appropriateness of the recognition points to social benefits, we consulted a number of affected entities about their social benefits programmes.

(a) Key participatory events

In general, we do not believe that a key participatory event gives rise to an obligating event. In many instances, it may be extremely difficult to even identify what the key participatory event could be, as for many benefits it could be birth within a particular jurisdiction.

We do however believe that for certain insurance-type schemes, using key participatory events is appropriate. We see that there may be a correlation between “key participatory events” and the “beginning of the coverage period” outlined in the insurance approach. As an example, in our unemployment insurance scheme, the key event that gives rise to an expectation that benefits will be provided is the commencement of employment. This coincides with the start of the coverage period under the insurance approach. Using “key participatory events” as the obligating event may result in liabilities being recognised that are analogous to those “Incurred But Not Reported” (IBNR) in terms of ED/2013/7 on Insurance Contracts issued by the IASB.

As a result, we believe that the obligating event approach could accommodate insurance type schemes. A substantial amount of guidance would need to be provided on the recognition and measurement of such liabilities in any future IPSAS developed on social benefits.

(b) Threshold eligibility criteria have been satisfied

We believe that meeting threshold eligibility criteria may give rise to an obligation for certain benefits. Recognising obligations based on meeting threshold eligibility criteria may be particularly appropriate for cash benefits paid, whether over a long or short period.

As an example, in South Africa old age grants are paid to eligible pensioners. We believe that once the pensioner becomes eligible to receive the benefit, this gives rise to an obligating event for the government as it creates a valid expectation that the benefits will continue to be paid until death. Even though pensioners are required to revalidate their eligibility from time-to-time, this is an administrative issue rather than a matter that changes government's obligations.

(c) Eligibility criteria to receive the next benefit have been satisfied

The satisfaction of eligibility criteria may give rise to an obligating event, particularly in the case of in kind benefits that are provided. This point is more relevant for in kind benefits because the benefits are often not recurring (or do not recur as frequently as benefits in cash).

We have reservations about the interpretation of the eligibility criteria that need to be met at this point versus point (d) which requires the claim to have been approved. We believe that in some instances the approval of the claim may be part of determining if an individual is in fact eligible to receive a benefit. As an example, to qualify for benefits under our Road Accident benefit scheme, the entity needs to determine that the claimant was not at fault. Once this has been determined, the individual is eligible and the claim is seen as approved.

As a result, we are not sure that there is always such a clear cut distinction between the claim being approved and the satisfaction of eligibility criteria.

If point (d) is retained, we believe that additional guidance may need to be provided on the difference between the two points.

It is also unclear whether (c) is applicable to all types of benefits. As this approach is dependent on revalidation, it would only be applicable to recurring benefits. It might be important to acknowledge this in this approach if it is used in developing a future IPSAS.

(d) A claim has been approved

Our response on (d) should be read in the context of our response to (c) above and the potential overlap with the idea of satisfying all the eligibility criteria.

As noted above, we believe that only recognising claims when they are approved may result in an understatement of liabilities on the statements of financial position of governments. An example where we believe it may be inappropriate to apply point (d) is as follows:

In our unemployment insurance scheme, an individual qualifies for cover from the date of employment. If unemployed, application is made to the entity and benefits are received. To receive the benefits every month, the individual must verify every month that he/she is still unemployed. The entity will go through a process every month, administratively, of approving the claim as outlined in legislation. This type of approval should not be used as a basis for recognising obligations of government.

(e) A claim is enforceable

We do not support recognising obligations only when they are legally enforceable. This practice is currently applied for our social grant scheme and does not provide meaningful information to users of the financial statements about government's obligations to pay benefits to recipients. Recognition only when claims are enforceable is also not aligned with the concept of accrual accounting which recognises events when they occur.

(f) Any other point

No other points were identified during our consultations. We do however note that, if the points outlined in the Consultation Paper are going to be used to provide guidance to entities (as noted in overall comments on this specific matter for comment), it is arguable that other points may arise and could be used by entities.

Alternative views expressed by constituents

Some of our stakeholders indicated that all 5 points outlined in the Consultation Paper should be permitted in any IPSAS developed on social benefits. They were of the view that entities should be left to apply judgement in deciding how to identify the events that give rise to social benefit obligations.

While we understand that this follows a purely conceptual approach, we believe that without more rigorous guidance, governments may not recognise liabilities on their financial statements as they may well choose to recognise only those obligations that are legally enforceable. This could impair the comparability of financial statements of governments operating similar social security schemes.

Some constituents, albeit a minority, also questioned whether a separate IPSAS is needed, and suggested that IPSAS 19 should be amended to include social benefit obligations. We do however support the development of a separate IPSAS as we believe specific recognition and measurement guidance is needed.

Specific Matter for Comment 5

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 do not believe that an obligating event occurs earlier for contributory benefits than non-contributory benefits as we do not believe that making contributions is the event at which an entity has no realistic alternative but to settle an obligation.

In some instances, an obligation may arise before contributions are made because another event triggers an obligation. We believe that the level of contributions provided is important in measuring obligations, but does not provide information about when the obligating events occur. This view is based on the types of schemes operated in our jurisdiction. A brief overview is provided below.

In South Africa, the only contributory schemes that are operated relate to unemployment insurance scheme, compensation for injuries on duty, and compensation for injury, disability or death as a result of an accident on the country's roads. In most of these schemes, the receipt of contributions is merely a funding mechanism rather than giving rise to a specific obligating event.

There is however a closer link between the contributions received and the benefits incurred for the unemployment insurance scheme. For the unemployment benefits, individuals and their employers contribute 2% of the individual's salary to qualify for the benefits. The period of time worked, as well as the salary earned, determines the amount of the benefits to which the individual is entitled.

Although there is a direct and causal link between the benefits received and the contributions made, the event that gives rise to the obligation is entering employment and the expectation that employment will result in future coverage for unemployment. The value of the liability may depend on the amount of the contributions made, but it does not provide evidence of the point at which government has no realistic alternative but to settle the obligation.

While we currently do not have any schemes where contributions themselves give rise to an obligating event for the entity, we acknowledge that this may need to be assessed for the specific scheme in question. A clear assessment would need to be made of whether making a contribution gives rise to an expectation of benefits for the individual or household making the contribution, such that the entity has no realistic alternative but to settle the obligation.

Specific Matter for Comment 6

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 are of the view that social benefits provided through exchange transactions, as outlined in the scope of the Consultation Paper, should be accounted for in accordance with existing IPSASs. This would include “exchange” social benefits such as those provided in employer-employee relationships (as outlined in IPSAS 25), concessionary loans and guarantees (as outlined in IPSAS 29) which are already addressed in existing Standards of GRAP.

During our discussions on the Consultation Paper, it was questioned whether certain benefits would be classified as exchange or non-exchange. With the introduction of the “insurance approach” in particular, questions were asked about whether, or in what instances, contributory schemes are exchange or non-exchange in nature. We believe that this will need to be considered in the next phase of the project and clear guidance provided.

Specific Matter for Comment 7

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 believe that the answer to this question may depend on whether the contributions provided give rise to an obligation of the entity. Where there is an expectation that contributions entitle an individual or household to certain benefits, it is appropriate to present the scheme assets and obligations on a net basis. However, even if the assets and liabilities are presented on a net basis, a reconciliation should be presented in the notes to the financial statements outlining how the net amount is derived.

In all other circumstances, we are of the view that the assets and liabilities relating to a scheme should be presented on a gross basis.

Chapter 5 – Option 2: Social Contract Approach

Specific Matter for Comment 8

In your view, under the social contract approach, should a public sector entity:

- (a) Recognise 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 fulfilment?

Please explain the reasons for your views.

As noted in SMC 2, we do not support the social contract approach.

Chapter 6 – Option 3: Insurance Approach

Specific Matter for Comment 9

Do you agree with the IPSASB's conclusions about the applicability of the insurance approach? Please explain the reasons for your views.

We do not support the IPSASB's conclusions on when the insurance approach could be applied. The IPSASB concluded that the insurance approach could be applied when there are schemes with:

- Imputed contributions that involve cash transfers.
- A low level of contributions that do not involve cash transfers.
- Contributions that are funded as a general tax where there is a reliable basis for allocating the contributions to the individual schemes.

We believe that the insurance approach is complex to apply, and is premised on the fact that the entity has information available about the revenue it will receive, the claims it will pay, and the period over which the insurance cover is provided. This information is then used at the outset of the contract to determine the profit or loss.

Entities often do not have information about the revenue they are entitled to receive, as the revenue, even if received in the form of specific contributions, is often collected by another agency. As an example, our unemployment insurance scheme receives contributions from individuals and their employers, but this is collected by the Revenue Authority as a tax on payroll. The entity often only has information available on the individuals and contributions at much later periods compared to the period in which the coverage period starts.

We also believe that insurance contracts are designed to ensure that there is a direct correlation between the risks assumed (i.e. benefits to be paid) and the fees charged. In many instances, there is simply no correlation between the revenue and expense streams. Any revenue received is often based on a tax on a specific activity, or a general allocation of revenue to subsidise the scheme. This is different to the basic economic substance of an insurance contract.

While there is merit in applying the liability aspects of the insurance approach, we believe that the revenue aspect of the approach, and in particular the combination of the revenue and expense streams into a single model, is inappropriate in the public sector. The insurance approach, as outlined in the Consultation Paper, may only be relevant to insurance contracts that are undertaken on a commercial basis, rather than those operated in the public sector, or where contributions charged compensate the entity assuming the risks.

As noted in our response in SMC 4 on “key participatory events”, we are of the view that approach 1 could accommodate insurance related schemes, without developing a separate approach which may be complex for entities to apply.

As noted in our response in SMC 2, the Consultation Paper currently only explores one approach outlined in the IASB’s exposure draft on Insurance Contracts. The other approach explored, called the “premium allocation” approach, is a simplified method that is particularly useful for short term insurance contracts. Under this approach, revenue and expenses are not recognised and measured on a net basis. Revenue is recognised when it is earned, while liabilities and expenses are recognised independently of the revenue generated based on the present value of the future risk plus a risk adjustment. As a result, no contract profit or loss is determined and recognised over the period.

We are of the view that there may be merit in exploring this alternative approach if the insurance approach is pursued as it focuses less on the revenue received as part of the scheme. Although this approach is only applicable to short term insurers in the IASB’s ED, it may be relevant for other types of schemes in the public sector.

We also note that, if either of the insurance approaches are followed, the IPSASB would need to consider the revenue recognition implications of adopting such an approach.

Specific Matter for Comment 10

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

Please explain the reasons for your views.

Our response to this specific matter for comment should be read in the context of our limited support for the insurance approach.

If the IPSASB pursues the insurance approach as outlined in the Consultation Paper, we support the proposal that any surplus should be recognised over the period of the benefit, and that any deficit should be recognised immediately. Recognition of the surplus over the period of the contract reflects the period over which the profit is earned. Recognition of the deficit initially reflects the notion that the contract (or arrangement) is onerous.

Specific Matter for Comment 11

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) Recognise an expense on initial recognition;
- (b) Recognise 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.

Our response to this specific matter for comment should be read in the context of our views expressed on the appropriateness of the insurance approach.

Where social benefits are not designed to be fully funded by contributions, we question whether the insurance approach is appropriate. It may be feasible to explore the premium allocation approach as outlined in our earlier response.

If the IPSASB pursues the insurance approach as outlined in the Consultation Paper, then we are of the view that the deficit should be reflected as an expense on initial recognition as this reflects that it is an onerous contract.

Specific Matter for Comment 12

In your view, under the insurance approach, should an entity use the cost of fulfilment measurement basis or the assumption price measurement basis for measuring liabilities? Please explain the reasons for your views.

If an entity is able to charge contributions that adequately compensate it for the risk assumed, the assumption price is appropriate. We note that if an assumption price is used, it may require complex calculations to be undertaken and significant assumptions to be applied. It is also notable that the measurement model in the insurance approach proposed by the IASB also does not fully align with the concept of an assumption price in the Consultation Paper.

However, because many public sector insurance type schemes are not undertaken on this basis, we are of the view that using cost of fulfilment as the measurement basis for liabilities is more appropriate. Cost of fulfilment provides a relevant measure of liabilities as it reflects the cost that the entity will incur to settle the obligation.

Specific Matter for Comment 13

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.

In our response to SMC 9, we indicate that we do not support using the insurance approach in these instances as the accounting approach does not support the economic substance of the arrangement.

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.

Our response to this specific matter for comment is based on the premise that cost of fulfillment rather than an assumption price is used to measure obligations arising from insurance type schemes. If cost of fulfillment is used, then we support the use of a discount rate based on the principles in IPSAS 25 as this reflects a risk free rate.

The discount rate determined in accordance with IPSAS 25 would however be inappropriate if an assumption price measurement basis is used.

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.

If the insurance approach is pursued by the IPSASB, we support the subsequent measurement proposals.