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The Technical Director
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International Federation of Accountants
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31 January 2016

Dear Sir/Madam

COMMENT ON CONSULTATION PAPER: Recognition and Measurement of Social Benefits

We welcome the opportunity to comment on Consultation Paper: *Recognition and Measurement of Social Benefits.*

The IPSAS Board (IPSASB) has prepared a Consultation Paper (CP) which highlights the possible accounting treatments for social benefits. The CP identifies three broad approaches to accounting for social benefits. The approaches are summarized below:

Option 1: The obligating event approach considers social benefits by reference to the definition of a liability in the Conceptual Framework. Obligations to pay social benefits are seen as other obligations (in principle). The key issue of this approach is to determine when a present obligation arises. A present obligation only arises at either one of the five recognition points:

- Key participatory events, whereby some but not all of the eligibility criteria are met;
- Threshold eligibility criteria;
- Eligibility criteria to receive benefit is met;
- Claim to receive next benefit is approved; or
- Claim to receive next benefit is approved and payment date has arrived.

Option 2: The social contract approach, previously referred to as the executory contract accounting model. This approach highlights the obligation of the Public Sector entity to provide goods, services and cash transfers to individuals/households; and the corresponding rights of such individuals/households to receive those benefits. A present obligation only arise once claims for social benefits become enforceable or are approved.

Option 3: Insurance approach is a new approach which recognises and measures social benefits based on insurance accounting. The approach also recognizes a right to future receipts resulting from the provision of that coverage. Complex issues arise under this approach in respect of partially subsidised schemes and significant changes to the terms of schemes.

The preliminary view of the IPSASB is that of a combination of Option 1 (Obligating event approach) and Option 3 (Insurance approach) in respect of social benefits. The IPSASB is of the view that Option 2 (Social contract approach) is unlikely to meet the objectives of financial reporting.

The detailed comments to the matters highlighted in the CP are discussed in the Annexure below.

Please feel free to contact me should you have any queries relating to this letter.

Yours sincerely

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ANNEXURE A – DETAILED RESPONSES

CHAPTER 2: SCOPE AND DEFINITIONS

Social Benefits are benefits provided to individuals and households, in cash or in kind, to mitigate the effect of social risks

The other key definitions are as follows:

Social risks are events or circumstances that may adversely affect the welfare of individuals and households either by imposing additional demands on their resources or by reducing their income.

Social benefits are provided to mitigate social risks.

Social Benefits in Cash are social benefits paid in cash, by or on behalf of a public sector entity, that allow individuals and households to use this cash indistinguishably from income from other sources. Social benefits in cash do not include reimbursements.

Social Benefits in Kind are goods and services provided as social benefits to individuals and households by or on behalf of a public sector entity, and all reimbursements for the costs incurred by individuals and households in obtaining such goods and services.

Reimbursements are cash payments made as a social benefit by or on behalf of a public sector entity to compensate a service provider or an individual or household for all or part of the expense

Social Insurance is the provision of social benefits where the benefits received are conditional on participation in a scheme, evidenced by way of actual or imputed contributions made by or on behalf of the recipient. Social insurance may form part of an employer-employee relationship (employment-related social insurance) or may arise outside an employer-employee relationship (social security).

Social Security is 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.

Social Assistance is the provision of social benefits to all persons who are in need without any formal requirement to participate as evidenced by the payment of contributions

Specific matter for Comment 1

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?**

In our view, we agree with the scope of the CP. We agree that collective goods need to be excluded from the scope of social benefits as they relate to goods and services provided to the entire population or a segment of the population such as national defense, fire protection etc. To add on, collective goods and services are consumed automatically by all or part of the population and are not normally subject to the satisfaction of the eligibility criteria.

We also agree with the abovementioned definitions.

CHAPTER 3: IDENTIFICATION OF APPROACHES

Preliminary view

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.

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.**

We favor the obligating event approach because it supports the view that a present obligation needs to exist before a social benefit is recognized. This approach is also consistent to that of the Exposure Draft ED/2015/3: *Conceptual Framework for Financial Reporting* published by the International Accounting Standards Board (IASB). The ED/2015/3 defines a liability as a present obligation of the entity to transfer an economic resource as a result of past events. To add on, in our view, the recognition point of a social benefit should occur when the **eligibility criteria is met**. The recognition points whereby the **key participatory events are identified and when not all of the eligibility criteria are met** or **the threshold eligibility criteria** are not ideal as this could lead to premature recognition of social benefits. On the other hand, the points

whereby the **claim to receive next benefit is approved and payment date has arrived** could also result in the late recognition of social benefits.
This obligating event approach is also consistent to that of the ED/2015/3 which states that an entity has a present obligation to transfer an economic resource if it has no practical ability to avoid the transfer and the obligation has arisen from past events.

In our view, the social contract approach is not ideal because it states that a present obligation only arises once claims for social benefits become enforceable or are approved. It ignores instances whereby obligations are not legally enforceable as a consequence of a contract or legislation. This is not consistent to the ED/2015/3 which states that obligations can also arise as a result of customary practices, published policies or specific statements that require the transfer of an economic resource.

We also do not favour the insurance approach which recognises and measures social benefits based on insurance accounting as it could be complex to grasp. It is also our understanding that the IASB is in the process of replacing the standard on insurance accounting. Therefore, it might not be a feasible exercise for the IPSASB to adopt the insurance approach as the principles therefore could differ according to the guidance that will be provided by the IASB.

Specific matter for Comment 3

a. **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?**

No we are not aware of any social benefits transactions that have not been addressed by this CP.

Specific matter for Comment 4

a. **In your view, at what point should a future IPSAS specify that an obligating event arises under the obligating event approach?**

Refer to our responses to comment 2 where we explain the appropriate point to recognise an Obligating event.

Specific matter for Comment 5

a. **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 agree that an obligating event occurs earlier for contributory events than non-contributory benefits under the obligating approach because we accept the view that the payment of a specified number, or amount, of contributions creates a valid expectation that an individual or household will receive benefits based on those contributions. Such expectations are stronger than for non-contributory schemes that are primarily funded from general taxation.

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?**

We are of the opinion that a social benefit provided through an exchange transaction should be accounted for with other IPSASs as the scope of the IPSAS on social benefits will only cater for social benefits provided through a non-exchange transaction.

Preliminary view

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)?**

In our view, the scheme assets should be included in the presentation of a social benefit for contributory schemes because the scheme is financed by contributions.

Chapter 5 – Option 2: Social Contract Approach

Specific matter for Comment 8

In your view, under the 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?**

In our view, under the social contract approach, a public sector entity should recognise an obligation when the claim becomes enforceable because an obligation can be recognized earlier than when the claim is approved.

To add on the liability should be measured at the cost of fulfillment as the historical cost and fair value might not be determined easily.

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.

We agree with the IPSASB's conclusions that the insurance approach is not appropriate for all social benefits and would have to be used in conjunction with another approach due to the different characteristics of social benefits.

In our view, it would be inappropriate to combine the revenue and expense streams into a single measurement model in the public sector.

Specific Matter for Comment 10
Under the insurance approach, do you agree that where a social security scheme is designed to be fully funded from contributions:

a. **Any expected surplus should be recognized over the coverage period of the scheme; and**
b. **Any expected deficit should be recognized as an expense on initial recognition?**

Should the IPSASB pursue the insurance approach, we agree that any surplus should be recognized over the coverage period of the scheme, and that any deficit should be recognized immediately.

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. **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.

Should the IPSASB pursue the insurance approach, we recommend that a deficit of a social security benefit that is not designed to be fully funded from contributions, be recognized as an expense on initial recognition (this reflects an onerous contract).

Specific Matter for Comment 12
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.

In our view, the cost of fulfillment measurement basis should be used as it reflects the cost that the entity will have to incur to settle the obligation. The assumption price measurement basis is more applicable to insurance type schemes where the entity is able to charge contributions that compensate for its risks.

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.**

We do not recommend 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
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?

Yes we support this proposal because using the same discount rate as the one determined in IPSAS 25 allows consistency with statistical reporting and reflects a risk free rate.

Specific Matter for Comment 15
Under the insurance approach, do you support the proposals for subsequent measurement set out in paragraphs 6.73–6.76?

Should the insurance approach be pursued, we agree with the proposals for subsequent measurement.