STATE OF ISRAEL
MINISTRY OF FINANCE

31 January 2016

The International Public Sector Accounting Standards Board

Consultation Paper: *Recognition and Measurement of Social Benefits*

Dear Sir/Madam,

We appreciate the opportunity to respond to the International Public Sector Accounting Standards Board's (hereinafter: **"IPSASB"** or **"Board"**) Consultation Paper *Recognition and Measurement of Social Benefits* (hereinafter: **"CP"**). We strongly support the IPSASB's efforts to advance the discussion on the possible accounting treatments for social benefits.

We acknowledge that this response does not follow the guidance for respondents provided in the CP. Nevertheless, we wanted to share our views as a general paper because of the importance of this project.

The CP identifies three approaches for the recognition and measurement of social benefits. Based on these approaches, we recognize that the Board's intention is to bring social benefits on-balance, while today a significant portion of the social obligations is reported as a stand-alone report.

Our comments on the approaches discussed in the CP are provide below:

1. The obligating event approach
   Under the obligating event approach, a liability is recognize in the financial statements as the obligating event occurs, without recognition of any asset representing the future tax revenues.
   In our view, the overall effect of recognizing the future deficit without the recognition of the future tax revenues, might contradict the objectives of financial reporting by public sector entities and might result in a misleading presentation. Particularly, we cast doubts on whether this approach satisfies the faithful representation criteria as a qualitative characteristic of information set out in the Conceptual Framework, which forms the basis of the obligating event approach.
   In addition, we believe that recognizing a liability for all future benefits, as required under the first and the second sub-options (i.e. key participatory events and threshold eligibility criteria sub-options) might create practical difficulties in measuring the liability and will be subject to a significant uncertainty. This raises

the question whether the recognition criteria set out in the Conceptual Framework is satisfied for those liabilities.

Moreover, as the government has the ability to avoid paying the benefits by modifying the relevant legislation, it appears that only the fourth and the fifth sub-options (i.e. the approved claim and the enforceable claim sub-options) will satisfy the recognition criteria.

2. Social Contract Approach

In our view, the underlying model of the social contract approach, under which there is kind of an executory contract between the government and its citizens (i.e. the government provides social benefits to the citizens and the citizens provide the government taxes and other resources of finance, effectively offsets the government's obligations), is an appropriate model, reflecting the current economic reality. Under the social contract approach, by applying analogy to the executory contract accounting model, the government will recognize no liability for social benefits (unless the contract has become onerous), until an enforceable (or approved) claim in respect of the benefits exists.

We believe that the accounting treatment for social benefits under the social contract approach faithfully represents the economic circumstances arising in respect of social benefits, as that approach reflects the fact that the benefits are effectively financed/subsided by tax receivables, and that the payment of benefits by the government is highly dependent on taxes paid by the citizens. In other words, we believe that the government's obligation to provide benefits and the sources effectively finance this obligation (taxes) should not be regarded as separate elements, and therefore our view is that measuring the liability at zero (unless the contract is onerous) is the most appropriate approach. This accounting treatment is appropriate also because the government has the ability to avoid paying the benefits (for example, by modifying legislation).

Regarding the approaches considered by the board in respect of when the liability should be recognized (i.e. when a claim for social benefits becomes enforceable or when the claim is approved) – it should be noted that we support the second approach (when the claim is approved). This is because, in our view, that approach results in a better matching between cost (social benefits) and revenue (taxes), and is more consistent with the guidance of IPSAS 23 *Non-Exchange Transactions (Taxes and Transfers)*, under which revenue from taxation should be recognized when the taxable event occurs (and not at the legal date of receipt).

3. Insurance Approach

Under the insurance approach, it appears[1] that for fully funded schemes, the government should recognize an expected surplus or deficit only for the period in which the legislation cannot be revised. Any expected deficit should be recognized immediately as an expense. Any expected surplus should be recognized over the coverage period of the scheme.

Complexity might arise for schemes not designed to be fully funded from contributions (i.e. subsidized through taxation) – the CP identifies three approaches regarding the recognition of the unsubsidized portion as an expense.

Considering the fact that the insurance approach provides a partial solution only (i.e. that approach does not provide an extensive solution for all social benefits) and the significant complexity that might arise under this approach, we don't support the insurance approach. Particularly, as the Israeli government has the ability to revise the relevant legislation at any time, it appears that the insurance contract is not relevant under these specific circumstances. Considering that the board's objective is to develop an extensive accounting model for social benefits, covering a wide variety of benefits and schemes, it is possible that the insurance approach is not/less relevant for other countries also, where the circumstances are similar to the circumstances in Israel, as mentioned above.

In light of the above, our view is that the social contract approach is the most appropriate approach to recognizing and measuring social benefits. In any case, we believe that adoption of any one of the approaches might be a long process, since the variety of social benefits and the expected social and accounting complexities associated with such adoption.

Regards,

Uzi Sher
Senior Deputy to the Accountant General
Chief Accountant

[1] This can be concluded from the example included in the CP.