ICAEW REPRESENTATION
40/16

Consultation Paper – Recognition and Measurement of Social Benefits

ICAEW welcomes the opportunity to comment on the *Recognition and Measurement of Social Benefits* consultation paper published by the International Public Sector Accounting Standards Board (IPSASB) in July 2015, a copy of which is available from this link.

This response of 12 February 2016 has been prepared on behalf of ICAEW by the Financial Reporting Faculty. Recognised internationally as a leading authority on financial reporting, the Faculty, through its Financial Reporting Committee, is responsible for formulating ICAEW policy on financial reporting issues and makes submissions to standard setters and other external bodies on behalf of ICAEW. Comments on public sector financial reporting are prepared with the assistance of the Faculty's Public Sector Development Committee .The Faculty provides an extensive range of services to its members including providing practical assistance with common financial reporting problems.

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MAJOR POINTS

Importance of the project

1. ICAEW supports the work of IPSASB and the board's vision of high quality global public sector accounting standards. The development of an accounting standard for social benefits will make an important contribution to the realisation of this vision. It deals with a public sector accounting and financial reporting topic of crucial importance.

2. Governments are naturally wary of adopting accounting standards that will result in the recognition of significant liabilities. It is therefore particularly important to reach a consensus about which accounting solutions are reasonable, cost effective and capable of being applied consistently to the myriad of social benefit schemes in place across the world.

A principles-based social benefits standard

3. Given the very wide range of circumstances to which the standard will need to apply, any future standard on social benefits must, above all, be principles-based. A rules-based approach would not be a workable solution. The new standard also needs to be underpinned firmly by IPSASB's conceptual framework (CF) to allow for successful implementation.

More detailed empirical evidence is needed

4. The complexity of the issues underlying accounting for social benefits should not be underestimated. IPSASB has made a good start, but we strongly recommend that the board now gathers further detailed empirical analysis regarding the following aspects:

- The different benefits available from governments and how these are administered;
- The degree of clarity of the link between the benefits paid by a social security scheme and the revenue that finances the scheme;
- The materiality of benefits that are fully funded;
- Specific laws and regulations that will impact on the recognition criteria for social benefits;
- The scope of the benefits to be covered. Empirical evidence will help with the scoping of the standard.

5. The empirical analysis should be further developed along the lines of Appendix A of the current consultation paper (CP), to include a reasonable spread of countries and types of social benefits. The empirical evidence may be difficult to obtain in some instances. It could take some time to accumulate and will require assistance from national authorities and other key stakeholders. But this is a crucial step to facilitate international acceptance of a new standard, as well as for ensuring a good quality end product.

6. We therefore recommend that IPSASB carry out field analysis for all the options outlined in the CP, to allow both preparers and users of the accounts to gain an appreciation of how the accounting and financial reporting would work in practice. This might be achieved through a questionnaire approach to accountancy institutes or other parties in a range of jurisdictions, which could be fairly limited in number as long as it was reasonably representative of the breadth of types of social benefit that a new standard might cover. This could also form the basis for any future attempt at cost: benefit analysis, which should be based on real world data with good coverage, both in terms of different types of benefits and different funding mechanisms. The empirical evidence gathered will be the core data to underpin this analysis.

7. It would help IPSASB if the sample of countries selected included those where some work has already been done on these issues, to determine the social benefit disclosure when the three options outlined in the CP are applied. Exploring the impact by applying the five different obligating event points for the obligating event approach option, for example, would inform the debate on the suitability of the various trigger points, and indeed the option as a whole.

8. ICAEW would be pleased to offer IPSASB assistance in liaising with relevant UK institutions should this course be followed, and assuming that the UK is one of the countries analysed.

RESPONSES TO SPECIFIC QUESTIONS

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?

Please explain the reasons for your views.

9. The scope of the CP is reasonable. The relatively narrow definition of social benefits should facilitate a timely conclusion to this important project and capture the essence of what social benefits entail.

10. The definition in the CP makes no distinction between social benefits that are exchange transactions and those that are non-exchange transactions (with the exception of employee benefits), although those benefits provided through exchange transactions are more likely to be covered by other standards. The final standard should be explicit as to whether it only relates to non-exchange transactions or to both (as made clear in the original 2008 definition (2.8)). If exchange transactions are included, the issue of whether they should be dealt with by this or another standard will need to be considered. It will therefore be of the upmost importance for IPSASB to complete the work it is doing on the standards on exchange and non-exchange transactions to ensure that the suite of standards meets the financial reporting needs of government entities.

11. The gathering of empirical evidence and the carrying out of detailed case studies as described above will inform decisions about the scope and definitions to be applied to the new standard. The detailed case studies should apply different scope criteria to assess the varying impact that social benefit liabilities have on the statement of financial position.

Specific Matter for Comment 1(b)

Do the definitions in Preliminary View 1 provide an appropriate basis for an IPSAS on social benefits?

12. The definitions are an appropriate basis for an IPSAS on social benefits, although as noted above, it is not very clear in the CP whether the proposed IPSAS on social benefits relates to social benefits that are purely non-exchange. For example, the definition of social benefits would include employee benefits (which are exchange transactions), but these are only excluded from scope as they are covered by another standard. Whether exchange transactions are included or not, and if they are, the basis on which they are dealt with by other standards rather than this standard (or vice versa) should be clarified.

Specific Matter for Comment 2(a)

Based on your review of Chapters 4 to 6, which approach or approaches do you support?

(i) The obligating event approach;

(ii) The social contract approach; and

(iii) The insurance approach.

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

13. We note that the IPSASB's preliminary view is that a combination of Option 1 (the obligating event approach) and Option 3 (the insurance approach) would provide the most useful financial reporting.

14. At this stage in the standard's development we do not believe that there is sufficient information to favour one approach over another, at least not definitively. As noted above, it would be highly desirable for the board to carry out more empirical research on the different social benefits available and their funding mechanisms, to enable stakeholders in different jurisdictions to assess the impacts the various options may have on a jurisdiction's financial statements.

15. We therefore encourage IPSASB to carry out a detailed case study for a fairly small sample of countries to assess the impact of the three options outlined in the CP. The information provided on the social benefit landscape in various countries in Appendix A of the CP is very helpful, but we would like to see more detailed analysis in order to facilitate the debate.

16. We have set out below a number of observations for each of the options. While we are not yet able to draw firm conclusions at this stage of the debate about the relative merits of any single option or multiple options, we hope that these observations will be useful to the further development of this project.

Obligating Event Approach

17. The obligating event approach is consistent with the definition in the CF of a 'present obligation', which is 'a legally binding obligation or non-legally binding obligation which an entity has little or no realistic alternative to avoid'. The approach would be more easily understood by users and easier for preparers to apply than the insurance approach, whilst meeting the qualitative characteristics of the CF. However, the difficulty of articulating when an obligating event arises in the case of government bodies that have wide-ranging rights to amend social benefit promises at will, or at least through a statutory mechanism controlled by them, should not be underestimated.

18. We agree with paragraphs 4.89 and 4.90 of the CP that separately identifying scheme assets would potentially increase the usefulness of social benefits disclosure by allowing users to assess the financial health of certain benefits. It would be interesting to know how many benefits in practice are underpinned by earmarked assets or are supported by a separate fund; we are not aware of any in the UK, but other examples may be found which might be illuminating. We note that future contributions receivable do not meet the definition of an asset and cannot therefore be recognised as an asset.

19. It is perhaps worth noting that state pensions in the UK appear to be hypothecated, but in reality are not underpinned by a fund. National insurance contributions which fund the state pension are paid into the same pool alongside other taxation such as income tax. As such, some benefits may appear to be funded or supported by assets when in fact they are not.

20. If early recognition criteria are adopted, government accounts would contain very large liabilities which might be difficult to measure due to the inherent uncertainty surrounding the recognition of an obligating event and all of the assumptions required to underpin the calculations, although for some obligations, such as state pensions, the portfolio effect and actuarial input may give some reasonable basis for estimation. Some numbers, however, may be rendered somewhat meaningless, with large year on year movements which will be difficult to explain or understand. Governments will of course be placed under political pressure to justify such large obligations even if such obligations will be funded from future revenues, so disclosures and explanations will be key.

21. Finally, we recognise that the obligating event approach will involve the exercise of a high degree of judgement (for early obligating events such as *key participatory events have occurred* and *threshold eligibility criteria have been satisfied*), making international comparisons potentially problematic.

Social Contract Approach

22. The social contract approach appears logical in that many citizens pay taxes and in return are entitled to receive social benefits, although the social contract means some citizens may benefit while never paying in to the system. It is important however, that recognising social benefit liabilities (and unfunded pension liabilities) is potentially one-sided and hence misleading without recognising the government's right to levy taxes on future income to meet these obligations. The social contract approach takes that consideration into account.

23. Under the social contract model, liabilities will not arise until claims for social benefits become enforceable or are approved. This concept would be more easily understood by users of the accounts and will reduce uncertainty with regards to recognition and measurement. Furthermore, this option could probably be applied to most benefits and be fairly quickly implemented, although it will tend to understate liabilities that are expected to be paid on the basis of historical data and reasonable estimations of the future.

24. The social contract approach is based on the concept that governments and individuals are engaged in an executory contract under which the state recognises present obligations when entitlements are established and individuals discharge their performance obligations to contribute taxes and other sources of finance which allow governments to meet these obligations. The question is whether the extent of connection or disjunction between social benefits and funding them makes any difference: many social benefits are merely funded from the proceeds of general taxation, which may bring into question the rationale for the executory contract approach. Many citizens claim benefits without having paid taxes to pay for them. However, the extent of hypothecation may not be particularly relevant to the outcome.

The Insurance Approach

25. We agree with the view expressed in paragraph 6.21 that social benefits may be accounted for under the insurance approach if they possess the characteristics of an insurance contract and, very importantly, where the contributions form a substantial part of the benefit and can be reliably measured.

26. The insurance approach requires a well-defined contractual boundary, meaning that guidance would be needed to determine the start and end dates for the contract, how this approach could be applied to aggregate groups of people and on what benefits would meet the eligibility criteria. It would be most helpful to find some examples to assess the types of benefits that would be suitable for this approach.

27. The insurance method could lead to meaningful disclosures, where users can assess the funding levels of different benefits, including any shortfalls, making financial reporting more transparent. The insurance concept would work for those countries that have designated welfare funds earmarked for specific benefits, or a small pool of benefits, to which the funding could be allocated in a meaningful way. The concept would also work for those countries that provide insurance products that are mandatory, such as accident or medical insurance.

28. We note that, where successive governments change the allocation of funds depending on their policies, some benefits may oscillate between being sufficiently funded to allow the insurance approach to be applied to being insufficiently funded not to allow that approach.

29. We also have some concerns that this approach could end up being too complicated to apply in practice, once all the nuances of specific benefits are analysed. It will be interesting to see whether the outcome of the IASB's IFRS 4 Phase II project has a bearing on this question.

Other issues

30. Finally in this context, we have two more general observations. Firstly, whatever approach is adopted, given the very wide range of circumstances to which it will need to apply, any future standard on social benefits must be principles-based and firmly rooted in the CF. Secondly, it should be noted that obligations which do not meet the recognition criteria are captured in the Statement of Long-Term Fiscal Sustainability. The effect that differing recognition points have on this statement should also be taken into consideration.

Specific Matter for Comment 2(b)

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

31. We are not aware of any additional approaches to accounting for social benefits. However, we think that an important element of any of the approaches will be a disclosure framework to accompany the primary information. Disclosures should be seen as part of the overall package to aid users' understanding of the financial statements.

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.

32. We are not aware of any further transactions that have not been discussed in the CP.

33. As set out in paragraphs 4 to 8, we think it would be helpful to use a small number of jurisdictions to carry out case study examples to see how each of the proposed approaches would operate in practice. This will help to inform the debate as the standard is developed and may help to give constituents insight into how the proposals would affect their own social benefit arrangements.

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

34. Social benefits are not contractual, and so a great deal of the conceptual debate on this issue would seem closely connected with the view one takes of constructive obligations, as defined by IFRS, in a public sector context and as an overlay to the effect of legal obligations. As we have seen, the interpretation of IAS 37 in the private sector has led to some difficulties and counter-intuitive outcomes, for example around levies, and for this reason the development of an accounting approach for non-exchange expenses is necessary, including social benefit transactions. This is less significant in relation to the private sector, which does not generally have many transactions which have the characteristics of non-exchange transactions.

a) Key participatory events have occurred

35. This option ostensibly fits with the CF guidance on the definition of a liability, although there is a debate to be had as to whether in all circumstances it genuinely reflects the point at which an obligation arises, unless a very wide view is taken of constructive obligations. It does not, in any case, appear to be sufficiently practical or desirable for the following reasons:

- Recognising a liability at early participatory events such as birth or entry to the job market does not necessarily mean that a liability will materialise, possibly resulting in the recording of a liability where there is none. This may be a unit of account measurement issue rather than a recognition issue, as it may be possible to take a broader portfolio approach, recognising (based probably on historical data) that only a certain proportion of potential recipients will actually be in a position to claim their entitlement.

- Recognition of liabilities for such early participatory events increases the uncertainty around measurement: actuarial assumptions become central in the determination, increasing the cost of the exercise and making it difficult to explain to users of the accounts.

- The extent of estimation will also potentially affect the comparability between jurisdictions if historical data does not exist or there is insufficient expertise to produce actuarial assumptions and apply them correctly.

36. For these reasons, it seems more likely that key participatory events are more appropriately reflected in the Statement of Long-Term Fiscal Sustainability, which includes projected inflows and outflows related to the provision of goods and services and programmes providing social benefits using current policy assumptions over a specified time horizon.

37. It is also worth bearing in mind that IPSASs operate in a highly political environment, and choosing this option would mean the earliest possible recognition of a liability. Liabilities would potentially be very large and countries would be likely to find it very unpalatable to have to recognise such obligations, particularly under conditions of austerity. If it is pursued, therefore, it will need to be very clearly demonstrated that it is the best approach. We are not convinced at this stage that is evident.

b) Threshold eligibility criteria have been satisfied

38. This option will have a recognition point that is most consistent with the CF. The CP states that once eligibility criteria have been met, a government no longer has a realistic alternative to avoid an outflow of resources (see paragraph 4.37). Political inertia will support the concept of constructive obligations, yet these remain difficult to define and as recent events in Greece have demonstrated, do not always stand the test of time.

39. Measurement will be easier than in option (a) above, but a number of assumptions will be required to assess the recipient's ongoing eligibility. This point is made in paragraph 4.38. Our main concern with this option relates to recognition, since a highly detailed level of information is required. People that are technically eligible to receive benefits do not always choose to do so, or there could be a large time lag. We feel that in practice this approach may be difficult to implement with any degree of accuracy unless highly-developed real-time information systems are available.

c) The eligibility criteria to receive the next benefit have been satisfied

40. This option is similar to (b), in the sense that threshold eligibility criteria have to be met but the provision is restricted until the next assessment for eligibility. This has the advantage of being easier to measure, and reduced liabilities may make adoption of IPSASs more appealing to governments. However, many claimants would continue to be eligible for benefits and thus there is a distinct risk that liabilities under this option would be understated.

41. The option may be applicable for some benefits under circumstances where there is large uncertainty as to future eligibility, such as phasing out of a benefit or significantly changing the terms of conditions of existing benefits. More meaningful information may be presented under this option than under other options where estimation of future eligibility is too onerous.

d) A claim has been approved

42. Although this option has the benefit of certainty and verifiability, the liabilities recorded would be an underestimate of total obligations.

43. The gap between this option and option (b) above is in effect the administrative process of handling the claim. It infers, however, that entitlement is not a given unless and until approved by the payer (i.e. the government), but this is not in line with the CF and would not meet the qualitative characteristics therein.

e) A claim is enforceable

44. The same issues apply as in (d) above, but are amplified

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

45. Yes, we think the obligating event could arise at different times because the legal specifications will differ in each jurisdiction, but so will expectations and circumstances leading to constructive obligations. The relationship between current legal obligations and future potential obligations that could be argued to be constructive obligations is a complex one, as noted above. Given the need to account for a vast array of jurisdiction-dependent scenarios, it is as discussed above imperative that any future standard is principles-based.

46. On the legal side for example, one country may have a non-contributory state pension scheme that is available to all who reach pensionable age. In this case, one could argue that birth is the obligating event. But if a government has the right to terminate or vary the prospective benefit, does the obligating event depend more on whether a constructive obligation exists? Most countries will have some eligibility criteria, such as a minimum amount of years worked, in which case entering the work force may be a suitable recognition point. But if there is a history of changing the point at which entitlement begins, is there really an obligation? This example perhaps shows that IPSASB may not be able to find a 'one size fits all' solution and that the focus should be on developing high level, principle-based standards, underpinned by a wide range of real life examples.

47. The determination of the obligating event is critical, but other factors may come into play in working out what would be most viable for public sector reporting. We feel that there are some key criteria that can be used in evaluating each approach to assess the relative merits against accuracy, practicality and usability:

- **Accuracy**: identification of the obligating event and subsequent measurement are crucially important; while in general we support a principles-based approach and the exercise of professional judgement, the more assumptions and professional judgement are needed in this area, the greater the risk that faithful representation will not be achieved. It should also be noted that due to different local laws and administrative arrangements, outcomes will be different and may affect comparability on an international basis, and the extent of variability of outcome dependent on local factors may have a substantial impact on users' views of the benefits of the information.

- **Practicality**: the development of the benefits standard must take practical issues in consideration, especially with regards to costs of producing the financial statements, system requirements and political impacts.

- **Usability**: how useful and understandable will the benefits figures and disclosures be under each option? We feel that calculating an amount for the future provision of social benefits should just be the starting point for disclosure purposes, with more emphasis on the disclosure of assumptions and sustainability management, where governments indicate their expectations on how they will fund commitments made. Therefore, much more emphasis should be given to the Statement of Long-Term Fiscal Sustainability and how it relates to the amounts recognised in the financial statements.

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

48. We agree with paragraph 4.73 that states that existence of an obligation is not affected by the funding of that obligation. Individual benefits would need to be reviewed to determine the recognition point. We would be reluctant to generalise and say that contributory benefits have an earlier obligating event than non-contributory benefits. The specific terms and conditions would need to be taken into account when making the decisions of when an obligating event takes place.

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.

49. As discussed in paragraphs 4.78 and 4.79, there appear to be two broad types of exchange benefits: pension schemes and social insurance schemes. Social benefits that have the characteristics of employee benefit schemes (even though they do not relate to employees) should be accounted for as per IPSAS 25.

50. In general, we believe that social benefits could be split into two types, those that are contractual in nature and those that are not. Contractual social benefits that display characteristics such as contributions that are linked to specific benefits could then be accounted for using the insurance approach, with all other types of social benefits accounted for using either the obligating event or social contract approach.

51. We would welcome clarification from IPSASB regarding the definition of exchange transactions, especially in the context of social benefits. The 2008 definition of social benefits (2.8, p20) clearly stated that social benefits were non-exchange transactions, yet 4.78 states that the definition of social benefits in this CP does include benefits arising from exchange transactions.

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.

52. The wording in paragraph 4.90 leads us to assume that scheme assets are already recognised in the financial statements but, at present, they are not necessarily separately identified. However, assets should only be separately identified as scheme assets where they are clearly earmarked and assigned to individual schemes. Therefore we would support option (a), in all cases.

53. To recognise liabilities without separately identifying assets that are clearly earmarked and assigned to individual schemes could give a misleading picture. Furthermore, from a political perspective, showing the assets in relation to the liability would reflect the funding position of the scheme. The question would nevertheless arise as to whether a gross or net presentation is appropriate.

54. Scheme assets will apply mainly in the context of contributory schemes, where the contribution can be accurately apportioned to a specific benefit or where non-contributory schemes have earmarked assets.

Specific Matter for Comment 8(a)

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

- **a) Recognize an obligation in respect of social benefits at the point at which:**
  - **i) A claim becomes enforceable; or**
  - **ii) A claim is approved?**

Please explain the reasons for your views.

55. We believe that this approach has some merit. The main advantages are that users of the accounts would be able to more easily understand this concept, and its relative ease of application. This approach could potentially apply to a large number of benefits and be implemented more quickly than the other options.

56. We do however acknowledge the arguments made against this approach. Our concerns are that this approach would not recognise a liability until very late in the process, potentially under-reporting liabilities. Furthermore, this may mask the funding gap between benefits payable and taxation receivable to fund those benefits, which would not assist governments in managing their long term obligations effectively. Nor would it allow meaningful scrutiny by users of the accounts.

57. As described in paragraph 38, we believe that the recognition point – *threshold eligibility criteria have been met* – most fits with the CF. We believe that the social contract approach, as described in the CP, has recognition criteria that are not in line with the definition of a liability. In answer to this question, we would opt for the earliest recognition point, a claim is approved, but remain sceptical that this would lead to high quality financial reporting.

Specific Matter for Comment 8(b)

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

- **b) Measure this liability at the cost of fulfilment?**

Please explain the reasons for your views.

58. Our preferred method for measuring social benefits, unless specifically stated otherwise, is the cost of fulfilment, discounted as appropriate.

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.

59. We agree with the points made in paragraphs 6.21, 6.22, 6.23 and 6.24 regarding the applicability of the insurance approach.

60. We believe that there will be some social benefits that will meet the criteria to be accounted for using an insurance approach. In the UK it is less obvious that this methodology could be easily applied since the links between benefits and the taxation to pay for them are tenuous. We would welcome more empirical research in this area to ascertain the usefulness of insurance accounting for social benefits. In particular we have concerns surrounding the boundary of insurance contracts, such as the identification of start and end dates of the contract and its application to aggregate groups of people, as highlighted in 6.31.

61. We agree with the CP that not all benefits would be suitable to be accounted for using the insurance approach and that a combination of approaches will most likely be the best overall solution.

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 recognized over the coverage period of the benefit; and

b) Any expected deficit should be recognized as an expense on initial recognition?

Please explain the reasons for your views.

62. The above accounting treatment for fully funded social benefits would follow current accepted accounting standards, and we agree with this treatment.

63. The potential difficulty in defining the start and end date for an insurance contract would impact the calculation for cash flows, which in turn would influence the profitability of the contract. Furthermore, a key part of revenue recognition of insurance products is the amortisation of the contractual service margin, which is open to many judgements. The fact that IASB's revised insurance standard has not yet been finalised will not help in the formulation of the social benefits insurance approach and IPSASB may wish to consider what effect IFRS 4 phase II could have on the development of this approach.

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.

64. We believe that the insurance approach will only be applicable in those circumstances where social benefits meet the criteria of an insurance-type benefit which includes the need for the benefit to be fully funded.

65. As we stipulate throughout this response, we would like to see more examples of application to the various types of existing social benefits and related administrative arrangements, in order to come to a firm view as to the most appropriate accounting treatment.

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.

66. See the response to comment 8(b). We support the cost of fulfilment as the measuring basis for social benefit liabilities; the assumption price may be difficult to determine in the absence of an alternative market.

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.

67. We agree with the above criteria but we have concerns about how often there is a clearly defined link between contributions and benefits paid and therefore consider that these schemes are not prevalent. The question itself is probably symptomatic of the real world whereby in those cases where the link between contributions and benefits is not straightforward, the insurance approach would not apply.

68. It would help to see relevant examples, to assess how such benefits (especially significant benefits as a state pension) are funded from a clearly defined and visible funding stream and the consequential impact on the accounting.

69. Other key criteria in determining whether the insurance approach is appropriate include the following:

- Cash flows are within the boundary of the insurance contract, ie the government can compel the recipient to pay the premiums, and the government has a substantive obligation to provide the recipient with benefits;
- Start and end dates need to be reliably identifiable;
- It must be possible to apply an aggregated approach; and
- Estimates of future cash flows must be adjusted for time value of money, using discount rates that reflect the characteristics of the cash flows.

There will need to be a lot more guidance surrounding these issues.

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?

Please explain the reasons for your views.

70. We support the proposal above that discount rates should be determined in the same way as for IPSAS 25.

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?

Please explain the reasons for your views.

71. The CP proposes the following requirements for subsequent measurement that are based on IASB's proposals for insurance contracts:

- At the end of the reporting period, the carrying amount of a social insurance scheme would reflect the future cash flows, measured at that date, and the remaining expected surplus.
- The remaining expected surplus (or expected deficit) would be adjusted for changes to future cash flows arising from future coverage.
- The expected surplus (or expected deficit) would be recognized as revenue (or expense) in the statement of financial performance using a systematic basis that reflects the transfer of benefits provided under the scheme. Benefits payable during the period would be recognized as an expense.
- The statement of financial performance would also reflect any changes to the discount rate, and the unwinding of the discounted cash flows.

As the above subsequent measurements are in accordance with IASB proposals, we support them in order in the interests of IPSAS and IFRS alignment.

72. New terms and conditions may be put in place for new entrants, in which case the CP proposes to account for these arrangements as two separate schemes (6.75, p.66). This seems sensible, but could potentially make the allocation of funding to the schemes even more onerous.