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The Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
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Dear Sir

1. The International Consortium on Governmental Financial Management (ICGFM) welcomes the opportunity to respond to the Consultation Paper on Social Benefits.

2. We provide a separate paper setting out our comments and responses.

3. We appreciate the opportunity to comment on this exposure draft and would be pleased to discuss this paper with you at your convenience. If you have questions concerning this letter, please contact Michael Parry at Michael.parry@michaelparry.com or on +44 7525 763381.

Yours faithfully,

Michael Parry

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Cc: Jack Maykoski
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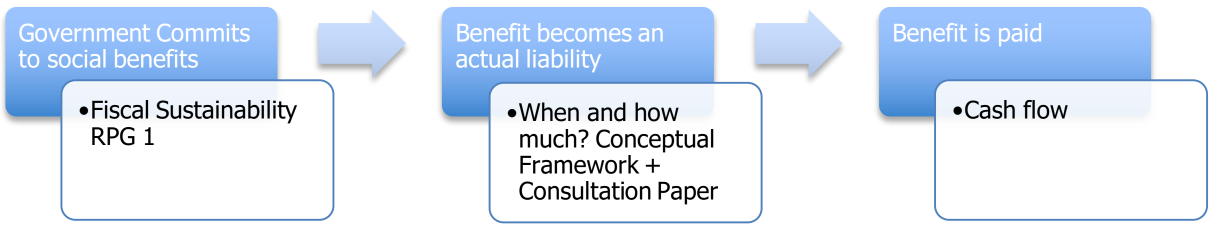
International Consortium on Government Financial Management (ICGFM)

Response to Consultation Paper on Recognition and Measurement of Social Benefits issued July 2015

Overview

1. The Consultation Paper (CP) on the Measurement of Social Benefits raises two fundamental issues:
    a. The recognition as liabilities commitments made by a government to specific groups of citizens – even though there is no contractual obligation requiring future governments to honour such commitments
    b. The inter-generational impact of such commitments – in particular the cost of a state pension payable to all citizens.
2. Governments across the world commit to certain social benefits, e.g.:
    a. Health care benefits
    b. Unemployment benefits
    c. State pension benefits.
3. There is a flow from the commitment through liability to the actual payment of social benefits as illustrated in Figure 1 below.

Figure 1: The flow of social benefit obligations



4. In most countries social benefit commitments made by a current government are honoured by subsequent governments, but such commitments do not amount to legally binding contractual obligations. There are numerous examples where the terms of the social benefit obligation have been retrospectively changed, e.g. raising the age for state pension, reducing the amounts to be paid.

5. These issues are addressed in the IPSAS Conceptual Framework. This identifies when non-legally binding obligations become liabilities in Para 5.24 as follows:

   a. *The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;*

   b. *As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and*

   c. *The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.*

6. The first two conditions are normally part of governments making social benefit commitments. The issue of recognition as a liability is when condition (c) above is met. At some stage social benefits do meet condition (c) and hence become liabilities.

The ICGFM supports the principle of recognising social benefits as liabilities when the three conditions specified in the Conceptual Framework are met

Specific Matters for comment 1 (following Para 3.4)

(a) Scope

7. We consider the scope appropriate, subject to the comments below.

8. The IMF Government Finance Statistics Manual 2014 (GFSM 2014) in Annex 2 identifies two major classes of social protection:

   a. Pensions and other retirement benefits

   b. Non-pension social benefits.

9. Pensions are specifically included in the GFS definition of social benefits (GFS 2014 Para 2.46 and Annex 2). However, the treatment of liabilities for pensions and for other social benefits is potentially different. IPSAS 25 has defined the approach for employment pension liabilities and logically should be the basis for defining the approach for funded state pensions and other retirement benefits.

10. We therefore consider it important that the two categories of social benefits as above are defined so that consideration can be given as to whether they are to be treated differently.

(b) Definitions

11. The use of the GFS definitions is strongly supported. In principle we consider that only in exceptional circumstances should the IPSAS use different terminology or definitions to those used in GFS.

12. Our comments on specific definitions relate to two important issues:

   a. In Europe social benefits would be regarded as citizen entitlements rather than acts of charity. Persons become entitled to social benefits when they meet certain conditions in many cases without regard to their personal circumstances, e.g. disability and related social benefits are paid irrespective of an individual's income or financial status, e.g. in the UK even the richest are entitled to a state pension. Therefore, the definitions should refer to ***entitlement*** rather than need.

b. It is our view that the treatment of funded benefits (social insurance) should be different from the treatment of unfunded payments. Therefore, it is necessary to define what is meant by funded benefits.

Definition of funded schemes (social insurance)

13. It is our view, as indicated below, that schemes that are fully or mainly funded are different in nature, and therefore in accounting treatment, from unfunded schemes. For this purpose, we would define funded schemes quite narrowly, e.g. "*A funded age related or other benefit is one where an individual has over time made payments to a fund represented by specific assets, which assets are administered separately from other government assets through an independent agency, and such agency is able to generate its own balance sheet separate from the balance sheet of general government. Furthermore, the revenues generated from the funds assets are expected mainly or entirely to meet the costs of the anticipated social benefits payable from the fund.*"

14. Such funded schemes create an implied contract between the potential beneficiary and the fund to pay the social benefits. Furthermore, citizens in general may assume that the fund has sufficient resources to make such payments and hence there will be no charge on citizens in general. This makes it important to identify and disclose in the financial reports any fund surplus or deficit on such funded schemes. We would regard the entitlement to benefits under such funded schemes as a **constructive liability** of the government.

2.41 Social benefits[1]

15. For the reason indicated in (a) above the definition should refer to entitlement, i.e. "*Benefits provided to individuals and households, in cash or in kind, when they meet the conditions entitling them to such benefits*."

2.42 Social risks

16. Social risks include events that entitle a person to certain benefits even though there may be no worsening in their financial situation, e.g. pensions are payable in the UK even if a person continues in employment earning a very high income.

17. Therefore, we would prefer a definition that refers to entitlement to benefits rather than making assumptions about an individual's financial circumstances, e.g. *"Events or circumstances that make an individual or household entitled to social benefits*"

2.49 Social assistance

18. Similarly, social assistance should be defined in terms of entitlement to benefit rather than because of an individual need, e.g. "*The provision of social benefits to all persons who are entitled without any formal requirement to participate as evidenced by the payment of contributions*".

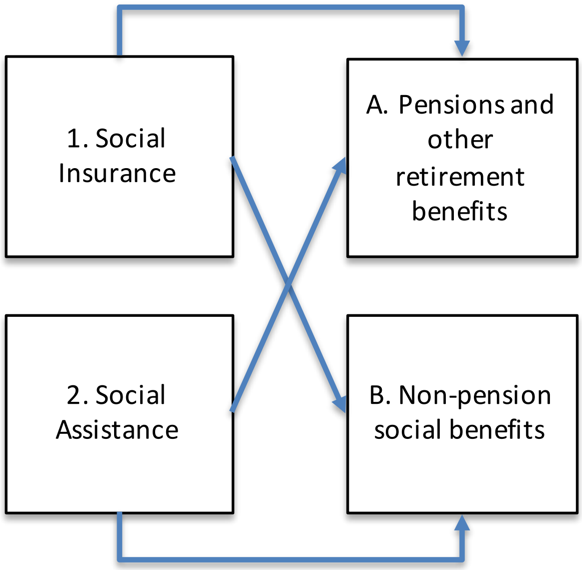
[1] Headings in numbered as in the CP

Specific matters for comment 2 (following Para 3.4)

(a) Supported approach

19. In indicating the approach supported we see four possible combinations of social assistance, social insurance, pension and non-pension benefits as illustrated in Figure 2 below. We further consider that the approach should vary between these options.

Figure 2: Benefit analysis – the four categories



20. We consider each of the above combinations in relation to the suggested approaches to recognition of social benefits. The numbers follow the numbers in the diagram.

1A. Funded pension and other retirement benefits (social insurance)

21. Provided the concept of a funded scheme is defined as above, then the treatment should be based on that described in IPSAS 25 for funded employee pension schemes. We can see no reason for a different treatment.

1B. Social insurance non-pension benefits

22. Provided, as above, the funding is clearly defined as above, we concur with insurance approach as recommended in the Consultation Paper

2A. Social assistance (unfunded) pensions and other retirement benefits

23. We consider the obligating event the most appropriate approach

2B. Social assistance – non-retirement benefits

24. Similarly to 2A, we consider the obligating event approach the most appropriate.

25. We concur that Option 2 Social Contract is not appropriate for identifying the liabilities under an IPSAS on Social Benefits. However, as under that heading discussed, we consider the social contract approach is a useful model to provide supplementary information on inter-generational assets and liabilities.

Specific matters for comment 3

26. We are not aware of any social benefit transactions not discussed in the CP

Option 1: Obligating event approach

27. The fundamental problem is deciding when the obligation meets condition 3 the Conceptual Framework para 24: "The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities."
    a. It could be argued that this stage is never reached for non-contractual social benefit obligations. A recent example that demonstrates this point is Greece, where social benefit payments (including pensions) have been reduced even after beneficiaries have commenced receiving the benefits. In the UK the criteria for disability benefits has been changed so as to exclude some persons who were previously receiving this benefit.
    b. These examples illustrate the point that as a general principle of constitutional law no government can bind its successor. Hence any social benefit obligation can be changed at the whim of the government in power.
    c. Thus it is possible to argue that there should be no recognition of social benefits as a liability since there is only a political obligation to provide the benefit.
28. On the other hand, it may be argued that in reality no government is ever likely to complete renege on an obligation by a previous government to provide social benefits. At most such obligations may be amended or reduced, but never eliminated.
29. Therefore, the argument of substance over form is that there should be some recognition of the liability in advance of actual payment. The question posed by the Consultation Paper is how this point is identified and how the liability should be measured.
30. We regard Obligating Event as the conceptually simplest approach. It also provides "de minimas" approach, in that obligating events can be defined so restrictively that the obligation is undoubtedly a liability.

Specific matters for comment 4 (after Para 4.69)

31. We respond to the four sub-questions as follows:
    a. We consider the obligating event approach appropriate for social assistance (i.e. unfunded) social benefits, both retirement and other.
    b. In such cases we would use a narrow definition of the threshold obligating event, i.e. claim become enforceable. Also this would be year by year basis, i.e. the liability recognised would only be for the current financial year.
    c. We would not allow any variation on this requirement
    d. It is our view that supplementary information should be provided in financial reports using the social contract approach to indicate the inter generational liabilities being created by the commitments. This is further explained below under Option 2: social Contract.

Specific matters for comment 5

32. We have indicated in our response to question 2(a) above above that we support a different treatment for funded schemes. This would only apply where the contributions are used to acquire fund assets as defined above.

Specific matters for comment 6

33. As indicated in our response to question 2(b) above social benefits provided though an exchange transaction, e.g. social insurance, should be accounted through a future IPSAS on social benefits. It is our view that these fall within the definition provided in our response to question 2(b) above.

Specific matters for comment 7

34. Since under our recommended approach the obligating event approach is only applied where there are no clearly identifiable scheme assets, the answer is (c) - never.

Option 2: Social contract approach

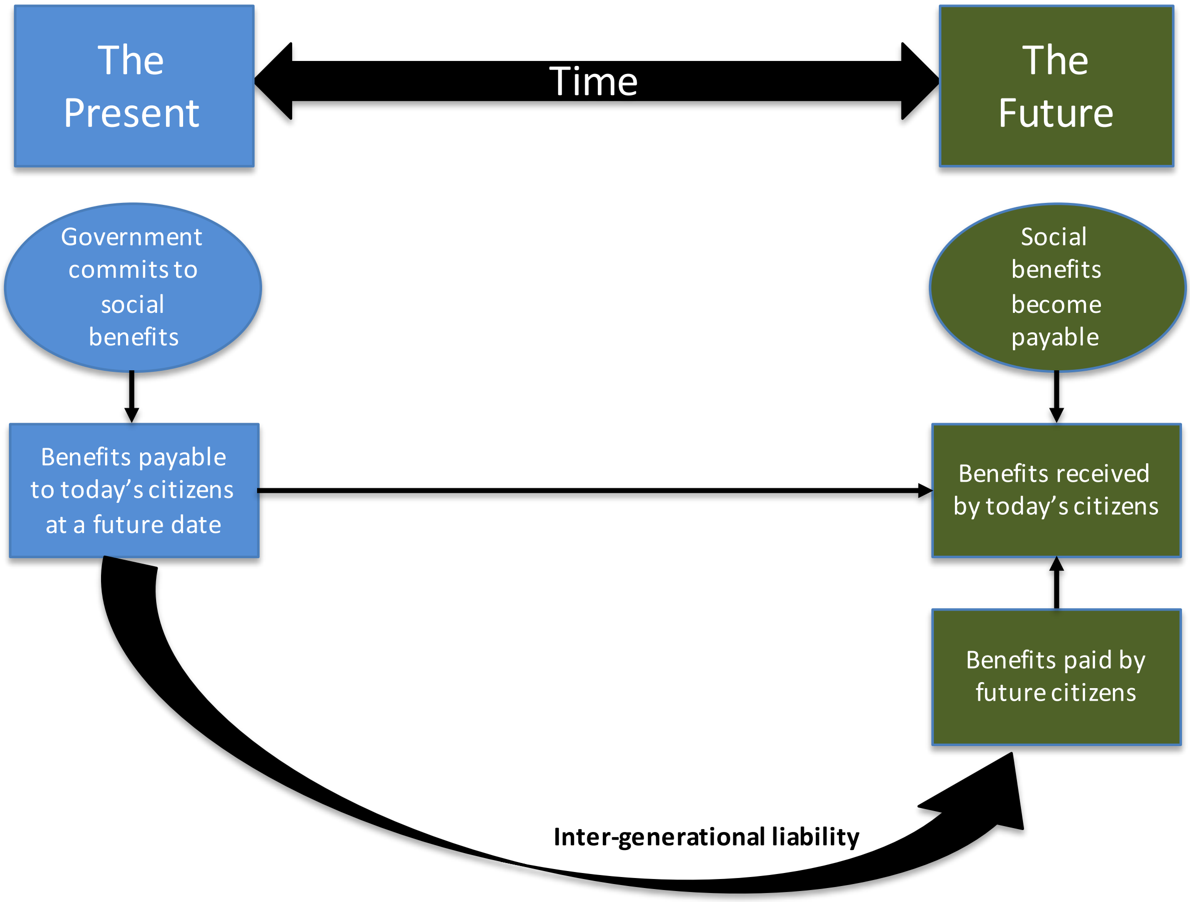
35. It is our view that the CP makes the concept of social contract overly complicated by equating social contract with executory contract. In our view, the concept of social contract is a concept of social philosophy and does not need to be linked executory contracts.

36. The political philosophy approach to the social contract dates back to Socrates and Plato. In essence the concept of the social contract refers to the mutual transferring of rights. This is a definition of social assistance – a transferring of the rights to income from one group of citizens to another group of citizens".

37. A commitment by a government to certain types of social assistance takes this one stage further and transfers rights from future generations of citizens to current generations of citizens when the latter meet certain entitlement conditions, e.g. age, disability.

38. Thus the social contract approach provides a model for recognising the inter-generational impact of commitments to unfunded social benefits.

Figure 3: Intergenerational impact of social benefits



39. Because of the uncertainties attached to such inter-generational liabilities, we do not consider that they should be shown as liabilities within the Statement of Financial Position. However, we do consider that the model could be used to provide supplementary information within the financial reports on the intergenerational impact of todays commitments to pay unfunded social benefits as well as constructive liabilities arising from part funded schemes.

Supplementary statement of inter-generational impact

40. We consider the concept of a supplementary statement of inter-generational impacts could be used to summarise and report a range of decisions taken today which impact on future generations where these are not reported as actual liabilities in the statement of financial position. Such a supplementary statement could also include other potential intergenerational commitments, e.g. long term subsidies of specific industries.

41. A future consultative paper may be required on including in the financial reports such a statement of inter-generational impacts. Issues to be considered would include what would be included in the paper, the extent to which revenue flows should be taken into account (or perhaps the required revenue flows be defined), the use of actuarial data, discount rates, handling of uncertainty, the number of years into the future, and so on.

Specific matters for comment 8 (after Para 5.38)

42. As indicated, we do not consider the social contract appropriate for the inclusion of liabilities in the statement of financial position.

43. However, we do consider that the social contract approach provides a model for providing supplementary information on the inter-generational impact of today's social benefit commitments. It is our view that all governments that have significant unfunded social insurance commitments should be required to provide a supplementary report as part of their financial reports identifying the inter-generational liability.

Option 3: Insurance approach

Specific matters for comment 9 (after Para 6.24)

44. The insurance approach is supported as an appropriate approach for funded social insurance other than pensions and other retirement benefits (see above). This provides a conceptually valid approach for both recognising and measuring the liability.

45. Since this is only applicable to funded schemes, the amount of liability to be recognised would be net of fund assets.

Specific matters for comment 10 (after Para 6.35)

46. We disagree. We can see no reason for treating surpluses and deficits differently. Therefore, the approach in (b) should be applied to a surplus or a deficit.

Specific matters for comment 11 (after Para 6.37)

47. As indicated above we would only apply the insurance approach to social benefits that are mainly funded as defined above. In this case in our view any deficit should be expensed on initial recognition.

Specific matters for comment 12 (after Para 6.43)

48. We find the terminology in the section of CP less than clear, in that different terms are used for what is essentially the same concept, e.g. assumption price, prudentially adjusted liability, cost of fulfilment.

49. In our view the appropriate basis is the risk adjusted cost of fulfilment, referred to as the assumption price.

Specific matters for comment 13 (after Para 6.63)

50. As indicated above, we would propose a narrow definition of a funded (social insurance) scheme. All other schemes would be treated as social assistance.

Specific matters for comment 14 (after Para 6.72)

51. Yes - this is consistent with approaches discussed above

Specific matters for comment 15 (after Para 6.76)

52. Yes – this is consistent with all our other responses as indicated above.