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Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
277 Wellington Street, 4th Floor
Toronto, ONTARIO
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Dear Sir/Madam:

SUBJECT: Consultation Paper: Recognition and Measurement of Social Benefits

Thank you for the opportunity to comment on the Consultation Paper: *Recognition and Measurement of Social Benefits* issued in July 2015.

The Government of Canada bases its accounting policies on the accounting standards issued by the Public Sector Accounting Board (PSAB) of Chartered Professional Accountants of Canada (CPA Canada). The government of Canada is not required to follow the International Public Sector Accounting Standards (IPSAS), however, IPSAS are regarded as an important secondary source of generally accepted accounting principles.

Our comments with respect to the preliminary views and specific matters for comment in the Consultation Paper (CP) are included in the attached appendix.

We thank you again for providing the opportunity to comment on this Consultation Paper. If you require further information, please do not hesitate to contact either Leona Melamed at leona.melamed@tbs-sct.gc.ca (613-355-2731) or myself at diane.peressini@tbs-sct.gc.ca (613-369-3107)

Yours sincerely,

Diane Peressini
Executive Director,
Government Accounting Policy and Reporting

c.c.: Bill Matthews, Comptroller General of Canada

APPENDIX

Responses to Preliminary Views and Specific Matters for Comment

Scope and Definitions Preliminary View 1 (following paragraph 2.50)
Specific Matter for Comment 1 (following paragraph 2.50)

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 agree that transfers in kind and collective goods and services should be excluded in order to provide a narrower and more defined scope to this standard.

b) We do not agree with all of the definitions provided.

   We disagree that social benefits are all related to financial need. The definitions should reflect that social benefits are paid to those individuals that a government entity determines should receive them; such payments may be made to all individuals that qualify, whether or not they are in financial need. Consequently, we have suggested changes to the definitions of social benefits and social assistance to reflect this.

   In addition, as the benefits provided as a result of an employer-employee relationship arise from an exchange transaction, we believe that such benefits should be excluded from the definitions in this CP. Our suggestion is to remove the definition of social insurance entirely, given that it includes benefits arising as a result of an employer-employee relationship for which guidance is provided in IPSAS 25 *Employee Benefits*, and to modify the definition of social security to combine the relevant elements of social insurance that relate to these benefits.

   Consequently we suggest the following changes to the definitions:

   > **Social benefits**: Benefits provided by a public sector entity (or entities) to individuals and households, in cash or in kind, to mitigate the effect of certain social risks.
   >
   > **Social assistance** is the provision of social benefits to qualifying individuals or households without any formal requirement to participate, as evidenced by the payment of contributions.

> **Social Security** is the provision of social benefits to the community as a whole, or large sections of the community, that is conditional on participation in a scheme imposed and controlled by a public sector entity, as evidenced by way of actual or imputed contributions made by or on behalf of the recipient.
>
> **Social insurance**: remove definition

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) In our view, the obligating event approach is the only one of the three approaches that is consistent with the substance of the underlying transactions and which is aligned with the definitions of elements and the recognition criteria in the conceptual framework. Under this approach, establishing when the obligating event has occurred such that the government entity has little or no discretion to avoid an outflow of resources is critical in ensuring that the financial statements present information that is fair and balanced with respect to the financial position of the entity. Governments have full discretionary power over changes to their social benefit programs, particularly if there will be insufficient future revenues to fund them. Consequently, we believe that the obligating event for recognition of a liability for social benefits arises only when a claim is approved. Please see our detailed response to Specific Matter for Comment 4.

We agree with the statement in Preliminary View 2, that the social contract approach is not consistent with the conceptual framework; however, the rationale for this statement should have been provided in the CP. In our view, given that public sector entities do not recognize the power to tax as an asset, the executory contract model is not supportable, as it requires "net" recognition of the right to receive taxes against the obligation to pay social benefits. As a result we feel that the social contract approach may be more relevant to sustainability reporting, where future tax revenue considerations can be taken into account, rather than financial statement reporting.

Furthermore, in our opinion, the insurance accounting approach is not appropriate for social benefits. The substance of social benefit schemes is very different to that of private sector insurance contracts to be accounted for under proposed IFRS 4, which are undertaken on an exchange basis and establish the same rights and obligations for the insured and the insurer as financial instruments. The funding mechanism for contributory social benefit schemes is a form of taxation, albeit for a specific purpose, and does not result in an enforceable right to an individual participant to the assets of the scheme in the future. As well, the public sector entity does not have an obligation at the inception of the scheme to pay benefits in the future, as this is a non-exchange transaction based on the entity's own legislation. Consequently, the insurance approach is not consistent with the conceptual framework and we do not support its application to social benefit schemes, whether contributory or not. Please see response to Specific Matter for Comment 9.

b) We are not aware of additional approaches that the IPSASB should consider developing.

Specific Matter for Comment 3 (following paragraph 3.4)

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.

We are not aware of any such transactions.

Preliminary View 2 (following paragraph 3.4)

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.

Please see comments in response to Specific Matter for Comment 2.

Specific Matter for Comment 4 (following paragraph 4.69)

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.

In our view, a liability arises for social benefits only when the claim is approved. As stated in paragraph 4.49, this implicitly includes the satisfaction of eligibility criteria on an ongoing basis in order to receive the next benefit.

Although an individual may have an expectation of receiving a benefit in the future, an obligation does not arise until there is an obligating event. The enactment of legislation is not the event that creates a present obligation, as an event or action must occur to trigger the government's liability to an individual recipient. Until this event or action has occurred, the recipient is not entitled to the benefits.

In our view, the obligating event or action that must occur for a liability for social benefits to arise is the approval of the claim (sub-option (d)). Only at this point is a valid expectation created for an individual to receive the benefit that leaves the entity little or no discretion to avoid the outflow of resources.

The key participatory events and threshold eligibility criteria sub-options (a) and (b) do not create a liability as the obligating event has not yet occurred. In sub-option (b), although the threshold criteria have been met, this does not obligate an entity for future periods in which the eligibility criteria may no longer be met. We believe that sub-options (a) and (b) produce financial information that may be useful for long-term sustainability reporting but do not meet the liability recognition criteria in financial statements, as these sub-options involve future obligations rather than present obligations. As noted in paragraphs 4.28 – 4.33 of the Consultation Paper, long-term sustainability reporting is not considered an objective of financial statements. Recognizing future obligations as liabilities does not provide relevant or meaningful information to the user of financial statements, and does not fairly present the financial position of the entity when the future revenues that the government expects to receive to fund the social benefits are not recognized in financial statements.

When an approved claim is required for payment of the next benefit, sub-option (c) does not represent the obligating event for which a liability should be recognized, as the entity still has discretion to avoid payment. However, certain benefits may not require approval of a claim prior to each payment date after the initial claim is approved. Examples of these benefits are entitlement programs, such as an old age security program, which are approved initially when the citizen reaches a certain age; subsequent approval essentially consists of revalidating that the individual continues to meet the eligibility criteria for the payment of the next benefit (e.g. is still alive and a resident of the jurisdiction). For these benefits, the continued meeting of the eligibility criteria for the next benefit payment constitutes the approval process. Consequently, for some entitlement programs, sub-option (c) and (d) may provide the same result.

Sub-option (e), i.e. recognition only at the point the claim becomes enforceable, is not considered the most appropriate recognition point as it does not properly reflect the accrual basis of accounting.

Specific Matter for Comment 5 (following paragraph 4.76

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.

In our opinion, the obligating event does not arise at a different point for contributory schemes. Contributions paid by an individual to gain access to future social benefits do not entitle the individual to receive those benefits until all eligibility criteria have been satisfied for the next benefit and the claim approved. Contributions are part of the satisfaction of the eligibility criteria. Although the payment of contributions may create an expectation by the contributors to receive the future benefits, the contributor does not have an entitlement to those benefits until the past event i.e. the approved claim and meeting of the eligibility criteria, that creates the obligation has occurred.

Specific Matter for Comment 6 (following paragraph 4.80)

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 unable to provide examples of social benefits arising from exchange transactions. We believe that social benefits, by their nature, are non-exchange transactions, even when contributory. As exchange transactions are usually contractual in nature, we believe that other standards such as IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* or IPSAS 25 *Employee Benefits,* would provide relevant guidance as applicable to the nature of the transaction.

Preliminary View 3 (following paragraph 4.91)

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

We agree that the cost of fulfillment represents the most appropriate measurement basis for liabilities for social benefits under the obligating event approach.

Specific Matter for Comment 7 (following paragraph 4.91)

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 scheme assets related to liabilities for contributory social benefit schemes should be included in the presentation when they will be solely used to finance that particular scheme. Assets earmarked from general taxation to be used to fund a scheme should not be included in the presentation of that scheme.

Specific Matter for Comment 8 (following paragraph 5.38)

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?

(b) Measure this liability at the cost of fulfillment? Please explain the reasons for your views.

We believe that the social contract approach is not supportable for the reasons outlined in our response to Specific Matter for Comment 2.

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 do not agree. In our opinion, the insurance approach should not be applied to social benefit schemes. Our views are based on the following observations:

- The proposed IFRS 4 guidance on insurance contracts relates to exchange transactions for individual contracts where each party has rights and obligations under the contract. An insurer recognises those rights and obligations created by an insurance contract when it becomes a party to the contract. Social benefit schemes differ from insurance contracts as follows:
    - Contributions to a scheme do not give the contributor enforceable rights to future benefits.
    - The government entity does not have rights to the future contributions that result in the recognition of an asset under the IPSAS conceptual framework.
    - The government entity controlling a social benefit scheme is not obligated under the terms and conditions of the plan, given that it is established by its own legislation and which the government entity has the right to modify unilaterally.

- The IFRS 4 proposed guidance for recognizing expected profits on a contract applies to individual insurance contracts. It provides a smoothing mechanism for insurers to offset premium revenue with expected payments over the term of the insurance contract, as a private sector insurance contract is usually established by the insurer with the intent of obtaining a profit. It is likely to be rare that an insurer would establish a contract under which a loss expected; this would be considered an onerous contract, with the loss is recognized at the inception of the contract
    - Social benefit schemes are not created with the expectation of being profitable, although they could be profitable or unprofitable when considered for an individual recipient, depending on the individual's risk. However, application of the expected risk associated with a particular benefit scheme would need to be on a collective rather than an individual basis, and would always result in the upfront recognition of losses.
    - Unlike an insurance contract, receipt of benefits under a social security scheme is based on meeting eligibility criteria, and consequently, there is not usually a direct relationship between the amount of the contributions payable by an individual and the benefits to be received.
    - Also, as stated in the CP (paragraph 6.45), contributions may not reflect individual risks and may be influenced by other factors than the risks covered, such as government policy. Again, this does not reflect the intent behind linking premiums for an insurance contract in exchange for the expected payments reflecting the transfer of an individual's risk, which is the premise of insurance accounting.

Based on the differences between social benefit schemes and insurance plans discussed above, we believe that insurance accounting does not reflect the substance of social benefit schemes. Consequently, it is not appropriate to apply the insurance approach to any social benefit schemes, whether contributory or not.

Specific Matter for Comment 10 (following paragraph 6.35)

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.

Please see our response to Specific Matter for Comment 9 as we do not agree with the insurance approach for social benefit programs. Social benefit plans are not designed to generate a profit and are often funded on a pay-as-you-go basis, rather than being fully funded. Consequently, insurance accounting would result in unbalanced and misleading information on an entity's financial position in the financial statements. As well, it is impracticable to evaluate social benefit plans on an individual participant basis, which is the intent behind the proposed IFRS 4 guidance, as there may be profits for some participants and losses for others (for example, on employment insurance plans).

Specific Matter for Comment 11 (following paragraph 6.37)

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.

We do not support the insurance approach. Please see our response to Specific Matters for Comment 9 and 10.

Specific Matter for Comment 12 (following paragraph 6.43)

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.

We do not support the insurance approach. Please see our response to Specific Matters for Comment 9 and 10.

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.*

If you disagree, please specify the criteria that you consider should be used. Please explain the reasons for your views.

We do not support the insurance approach. Please see our response to Specific Matters for Comment 9 and 10.

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.

We do not support the insurance approach. Please see our response to Specific Matters for Comment 9 and 10.

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.

We do not support the insurance approach. Please see our response to Specific Matters for Comment 9 and 10.