XRB EXTERNAL REPORTING BOARD
Te Kāwai Ārahi Pūrongo Mōwaho
NZ ACCOUNTING STANDARDS BOARD

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CANADA
Submitted to: www.ifac.org

Dear John

ED 63 *Social Benefits*

Thank you for the opportunity to comment on ED 63 *Social Benefits* (ED 63). The ED has been exposed in New Zealand and some New Zealand constituents may comment directly to you.

We have begun by outlining the key points in our comment letter.

We consider that there are no significant conceptual differences between the types of transactions that would fall within the scope of Exposure Draft 63 *Social Benefits* and universally accessible services and collective services. In our opinion where expense transactions such as social benefits, collective services and universally accessible services have similar characteristics, a consistent approach for liability and expense recognition is required. Our preferred option is that a standard on social benefits would cover both cash benefits and services provided to beneficiaries. However, we acknowledge that from a standard-setting perspective, the IPSASB may wish concentrate on a subset of transactions.

If the IPSASB proceeds on the basis of the proposed scope in ED 63 we would encourage the IPSASB to consider how any decisions made in the development of standards-level requirements for social benefits would impact the development of an approach for recognising other expenses and liabilities arising from similar types of transactions, such as universally accessible services and collective services. Our ultimate aim would be for a consistent and coherent approach to accounting for social benefits, regardless of their form. We have also put forward a suggestion to simplify the scope requirements.

We support the application of the insurance approach to insurance-like activities. We have some suggestions to refine the criteria for application of this approach and have asked the IPSASB to consider the appropriateness of the risk adjustment requirements in IFRS 17 for public sector entities. In our view the obligating event approach is not appropriate for insurance-like activities. These liabilities should be recognised either in accordance with IFRS 17 *Insurance Contracts* or using guidance based on the requirements in IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*.

Regarding the proposals in ED 63 on the obligating event approach, our overall view is that to meet the objectives of general purpose financial reporting in accordance with the qualitative characteristics and pervasive constraints discussed in *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*, it is necessary to consider how obligations for future benefits are managed. In the case of schemes which are managed in the same way as an insurer would manage its insurance contracts and which are substantially fully funded, we consider that it is appropriate to report both the assets and liabilities associated with that activity. In the case of other benefits which are not managed in this way and which are to be funded through future taxes, the recognition of large liabilities for social benefits, without the recognition of future cash flows that will fund those benefits, is unlikely to result in financial statements that meet the objectives of general purpose financial reporting and satisfy the qualitative characteristics.

We are broadly supportive of the proposed disclosure requirements in ED 63. However, we do not support the requirement to disclose five years of projected cash outflows. We ask that the IPSASB reconsider whether this requirement satisfies the objective of the disclosures, as outlined in the IPSASB's Basis for Conclusions. We also have concerns that some of the proposed requirements will increase the length of financial statements. We support the recent focus on trying to limit the length of financial statements and keep disclosures understandable and accessible and have therefore made some suggestions about ways to manage the extra information being considered by the IPSASB.

We consider that RPG 1 *Reporting on the Long-Term Sustainability of an Entity's Finances* is serving a useful role, but should remain as guidance at this time.

Our recommendations and responses to the Specific Matters for Comment are set out in Appendix 1 to this letter. If you have any queries or require clarification of any matters in this letter, please contact Lisa Kelsey (Lisa.Kelsey@xrb.govt.nz) or me.

Yours sincerely

Kimberley Crook
Chair – New Zealand Accounting Standards Board

Appendix 1: Responses to Specific Questions for Comment

Specific Matter for Comment 1: Do you agree with the scope of this Exposure Draft, and specifically the exclusion of universally accessible services for the reasons given in paragraph BC21(c)? If not, what changes to the scope would you make?

Definition of a social benefit

We acknowledge that the definition of a "social benefit" is a key determinant of what is in or out of the scope of ED 63. We have found the definition problematic to apply in practice and have commented on the proposed definition under SMC2 below.

Universally accessible services

We do not agree with the exclusion of universally accessible services from the scope of the ED.

We have recently commented on the IPSASB's Consultation Paper *Accounting for Revenue and Non-Exchange Expenses* (the CP). In that comment letter we noted that the determination of an obligating event for social benefit schemes is not substantively different from the determination of an obligating event for general obligations to provide services to the public, including collective services and universally accessible services.

Similar issues arise in respect of these general obligations to provide services to the public as are being considered in ED 63. In many cases, the beneficiaries of these services have existing rights that have been established through legislation, policy announcements, or other government actions. For example, in New Zealand, the Government's obligations to provide universal superannuation to people aged over 65 (a social benefit) and to provide free education for children aged between 5 and 19 (a universally accessible service), are both established through legislation. In our view, there is no substantive difference between obligations for benefits to be provided in the form of money (for example, national superannuation) or in the form of services (for examples, education services). Accordingly, issues being discussed in ED 63 relating to determining the point when, and the extent to which, the government concerned has a present obligation to provide those benefits also arise in the context of universally accessible services and collective services.

Therefore, we consider that where expense transactions such as social benefits, collective services and universally accessible services have similar characteristics, a consistent approach for liability and expense recognition is required. Our preferred option is that a standard on social benefits would cover both cash benefits and services provided to beneficiaries. However, we acknowledge that from a standard-setting perspective, the IPSASB may wish concentrate on a subset of transactions at this stage. If the IPSASB proceeds with the proposed scope in ED 63 we would encourage the IPSASB to consider how any decisions made in the development of standards-level requirements for social benefits would impact the development of an approach for recognising other expenses and liabilities arising from similar types of transactions, such as universally accessible services and collective services.

Social risks and other risks

We disagree with the argument in paragraph BC21(b) that social risks and other risks (for example, earthquakes and flooding) are different. Governments do react to specific disasters, but they may also have standing benefits available for natural disasters. For example, New Zealand farmers affected by an adverse event (for example, flood or drought) which is classed as medium or large-scale by the Minister for Primary Industries, may qualify for a Rural Assistance Payment. Although the severity of the adverse event has to be assessed, the benefit is a standing benefit to deal with the social risks resulting from the adverse event.

Artificial boundary

The IPSASB has acknowledged in paragraph BC21(c) that social benefits and non-exchange expenses fall along a continuum, and that any boundary between these two categories of expenses will, to some extent, be artificial. In creating separate standards for the spectrum of public sector expenses, we are concerned that there may be a risk that some schemes might have multiple components, only some of which fall within the scope of ED 63.

Transaction versus scheme

We note that the scope paragraph (paragraph 5) refers to a transaction but the rest of the [draft] standard establishes requirements for schemes. The [draft] standard does not define a scheme. We do not think that this is a major issue, but some acknowledgment of the fact that social benefits are frequently administered, or referred to, as schemes, or some discussion of what is meant by a scheme would be helpful.

Suggested changes to scope

While we would prefer that the standard on social benefits dealt with social benefits in their entirety (including universally accessible services), we acknowledge that the IPSASB may wish to deal with a subset of social benefits (that is, those that are paid directly to beneficiaries).

We suggest that if the IPSASB wish to deal with a subset of social benefits then the scope of the standard should be limited to those social benefits that are paid directly to eligible beneficiaries.

IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*

We note that the IPSASB will need to ensure that the current scope exemption for provisions and contingent liabilities arising from social benefits in IPSAS 19 will work with the final standard on social benefits. At present IPSAS 19 has a fairly wide scope exclusion in relation to social benefits. It appears that only some of these social benefits will fall within the scope of a standard on social benefits. In order to maintain the status quo, IPSAS 19 will still need to exclude those social benefits not covered by a standard on social benefits.

Specific Matter for Comment 2:
Do you agree with the definitions of social benefits, social risks and universally accessible services that are included in this Exposure Draft?
If not, what changes to the definitions would you make?

<u>*Definitions*</u>

We have found the definitions contained in ED 63 problematic to apply in practice. We are still not convinced that consistency with the classification system used by GFS is the best driver for establishing the scope of an IPSAS. In particular, we have struggled with applying the concept of 'social risk' and why some risks are social risks and others are not. The concept of social risk is not well understood by the accounting community in all jurisdictions and the interpretation of this term could lead to diversity in practice. Some of the questions or issues we have faced in trying to apply the definitions to particular benefits are as follows.

- The diagram under IG2 says universal education does not mitigate the effect of social risk. However, we are of the view that free education reduces the risk of unemployment and note that employment status is considered a social risk. We also note that having to pay for education would impose additional demands on household resources.
- Paragraph AG7 states that "Where benefits in kind are universally accessible, for example a universal healthcare service, these do not meet the definition of a social benefit for the purposes of this [draft] standard." This is open to interpretation because, in order to meet the current definition in ED 63 for universally accessible services, the eligibility criteria cannot be related to social risk. Poor health is a social risk and an individual would have to have a health issue to be eligible to access the universal healthcare services.
- We are not clear what is meant by "address the needs of society as a whole" in the social benefits definition.
- We do not see the rationale for distinguishing between aid provided immediately after an earthquake and the subsequent unemployment benefits or housing benefits paid to people who have lost their jobs or home because of an earthquake (see paragraph AG10).

If the IPSASB were to change the scope as we have suggested in SMC1 above (see *Suggested changes to scope*) we do not think any of these definitions would be required.

Specific Matter for Comment 3:
Do you agree that, with respect to the insurance approach:
(a) It should be optional;
(b) The criteria for determining whether the insurance approach may be applied are appropriate;
(c) Directing preparers to follow the relevant international or national accounting standard dealing with insurance contracts (IFRS 17, *Insurance Contracts* and national standards that have adopted substantially the same principles as IFRS 17) is appropriate; and
(d) The additional disclosures required by paragraph 12 of this Exposure Draft are appropriate?
If not, how do you think the insurance approach should be applied?

Response to SMC3(a)

SMC3(a) Do you agree that, with respect to the insurance approach, it should be optional?

We do not agree that the insurance approach should be optional. We support the use of the insurance approach for schemes that are managed in the same way as insurance obligations, as the insurance approach aligns the reporting with the management of such schemes. If such schemes were permitted to use the obligating event approach this would result in material understatement of an entity's liabilities.

The obligating events approach and the insurance approach are almost at opposite ends of the spectrum in terms of the liabilities that would be recognised. In the case of a scheme which pays for long-term injury treatment following an accident, the insurance approach would require recognition of a liability for treatment over the remainder of a person's life, but the obligating event approach would require the recognition of a liability up until the next revalidation point only. The difference in the amounts recognised under each approach could be material for both the entity and any whole of government statements into which the entity is consolidated.

Entities that manage large social benefit schemes often want to benchmark their performance against similar international schemes. Consistent accounting is necessary for benchmarking to be possible.

The arguments considered by the IPSASB in deciding to make the insurance approach optional are set out in paragraphs BC35 to BC41 of ED 63. Although the IPSASB has considered arguments both for and against making the insurance approach optional, cost seems to have been the main reason for deciding that it should be optional, with the difficulty of applying the criteria a secondary consideration. We do not agree that the cost of applying the insurance approach should be used to justify making this approach optional. Significant liabilities and significant risks should be accounted for appropriately.

The arguments considered by the IPSASB in deciding to propose the use of the obligating events approach for social benefits in general are set out in paragraphs BC59 to BC89. One of the key factors that seemed to influence the IPSASB's thinking was the difficulty of determining that there has been a past event that has given rise to a liability. In the case of obligations for benefits that would meet the criteria to be accounted for using the insurance approach this argument is not relevant. In the case of such liabilities there is general agreement that there has been a past event that has given rise to a liability.

In our view, entities with insurance-like liabilities should be required to recognise such liabilities, either in accordance with IFRS 17 (our preference) or a simplified approach developed by the IPSASB. We explain this in more detail in the next paragraph.

If, after considering responses on ED 63, the IPSASB remains concerned about the cost of mandatory application of IFRS 17 requirements, it could include simplified insurance approach requirements directly in a social benefits standard. These requirements could be based on the requirements for the recognition of provisions in IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*. This approach would result in some differences compared to the application of IFRS 17, but we consider that such differences would be more justifiable than permitting non-recognition of liabilities that are generally agreed to be liabilities. We have identified the following differences that would need to be considered if the IPSASB were to develop such requirements.

(a) IFRS 17 requires outstanding claims to be measured as the central estimate of the present value of expected future payments with an additional risk adjustment. The additional risk adjustment is the compensation an entity requires for bearing the uncertainty about the amount and timing of future cash flows arising from non-financial risk as the entity fulfils insurance contracts. IPSAS 19 does not require a risk adjustment for inherent uncertainty.

(b) The discount rate requirements differ. IFRS 17 requires that the discount rates applied to the estimate of cash flows shall: (a) reflect the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts; (b) be consistent with observable market prices of those financial instruments whose cash flow characteristics are consistent with those of the insurance contracts; and (c) exclude the effect of factors that influence such observable market prices but do not affect the future cash flows of the insurance contracts. IPSAS 19 requires the use of a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the liability.

(c) IFRS 17 includes presentation and disclosure requirements designed specifically to cater for insurance activities, such as disclosures around claim development. IPSAS 19 does not.

<u>Response to SMC3(b)</u>

SMC3(b) Do you agree that, with respect to the insurance approach, the criteria for determining whether the insurance approach may be applied are appropriate?

We support the criterion in paragraph 9(b) that the entity must manage the scheme in the same way as an insurer would manage its insurance contracts. Our view is that entities engaged in insurance-like activities should report on them in the same way as insurers.

We do not support the criterion in paragraph 9(a) that the social benefit scheme is *intended to be* fully funded from contributions. Although we agree that this would be a desirable characteristic of schemes (and in most cases the criterion would be satisfied by an entity wanting to use the insurance approach), we consider that how the entity manages the scheme is more important than whether or not it is fully funded.

We note that the Australian Accounting Standards Board (AASB) has recently considered similar issues in developing its Discussion Paper *Australian-specific Insurance Issues – Regulatory Disclosures* *and Public Sector Entities* (November 2017).[1] The AASB considered and rejected full funding as a scope criterion. The AASB noted that this would not be consistent with other accounting standards or its Conceptual Framework as these pronouncements do not treat the ability to fund a liability as the determinant or limiter on whether a liability is recognised. We concur with this point.

We also think there could be practical difficulties in applying the fully funded criterion in paragraph 9(a). For example, most components of a scheme may be fully funded, but one or more components may not. Paragraphs 9 and A13 talk about "a scheme", but do not indicate whether the assessment is carried out with respect to an entire scheme including all its components, or for each individual component. We assume that schemes which are intended to be fully funded from a certain date would meet the criterion.

In relation to the examples we have considered in New Zealand, the Accident Compensation Corporation, which currently applies insurance accounting, has one component which is not fully funded. This component has been accounted for consistently with the other components and the assessment of future levies for this component is based in part on the liabilities recognised in the financial statements. If the accounting for this component were to change from an insurance approach to the obligating event approach it would have a dramatic impact on the amount of the liability recognised in the financial statements and could send the wrong signals about future funding requirements.

As a way forward, we suggest that the IPSASB consider:

(a) changing the order of paragraphs 9(a) and 9(b) to highlight the importance of how a scheme is managed; and

(b) rephrasing what is currently paragraph 9(a) so that it refers to social benefit schemes which are <u>substantively</u> fully funded from contributions.

In making this suggestion we have thought about how any components of a scheme that will not be fully funded would be accounted for under IFRS 17. IFRS 17 (paragraph 47) states that "An insurance contract is onerous at the date of initial recognition if the fulfilment cash flows allocated to the contract, any previously recognised acquisition cash flows and any cash flows arising from the contract at the date of initial recognition in total are a net outflow." IFRS 17 requires that an entity identify onerous contracts at initial recognition. The entity is required to recognise losses on onerous contracts immediately in profit or loss. The entity does not recognise any contractual service margin on the balance sheet on initial recognition of an onerous contract. We are of the view that the onerous contracts requirements in IFRS 17 would result in appropriate accounting for such components.

1 The AASB issued this Discussion Paper in November 2017. The AASB is seeking feedback on proposals to modify AASB 17 *Insurance Contracts* to lead to more consistent reporting of public sector insurance liabilities.

Response to SMC3(c)

SMC3(c) Do you agree that, with respect to the insurance approach, directing preparers to follow the relevant international or national accounting standard dealing with insurance contracts (IFRS 17, Insurance Contracts *and national standards that have adopted substantially the same principles as IFRS 17) is appropriate?*

We are broadly in agreement with the IPSASB's proposal to direct entities to IFRS 17 or national equivalents. Our main concern is whether the risk adjustment requirements in IFRS 17 are appropriate for public sector entities. The Basis for Conclusions that accompanies ED 63 (paragraphs BC51 to BC54) outlines the IPSASB's consideration of whether or not entities applying the insurance approach should be required to include a risk adjustment. The Basis for Conclusions acknowledged that there have been differing views about the appropriateness of a risk adjustment in the context of social benefits.

Although entities applying NZ IFRS 4 *Insurance Contracts* and PBE IFRS 4 *Insurance Contracts* have applied a risk margin[2] as required by those standards, there has been debate about whether this is appropriate, particularly when the determination of future contributions is based on figures that exclude the risk margin.

The AASB has also considered this issue in Discussion Paper *Australian-specific Insurance Issues – Regulatory Disclosures and Public Sector Entities* (November 2017). The AASB has proposed to include some additional guidance on determining the risk adjustment factor for non-financial risk (see extract below). The AASB concludes that although the risk adjustment might differ from a for-profit private sector entity, it is unlikely to be nil (see extracts from the AASB's Basis for Conclusions below). The AASB has sought feedback on whether there might ever be a risk adjustment factor of zero. We encourage the IPSASB to liaise with the AASB about the responses it receives on this matter.

Extract from AASB DP (November 2017)

Risk adjustment for non-financial risk

E18 Paragraph 37 of this Standard requires an entity to incorporate a risk adjustment in the measurement of insurance contracts. A public sector entity shall include a risk adjustment when measuring rights and obligations arising from insurance-like arrangements.

E19 The risk adjustment shall reflect the amount that the public sector entity requires for bearing uncertainty about the amount and timing of the cash flows that arises from non-financial risk related to insurance-like arrangements. As for issuers of insurance contracts, a public sector entity will reflect the degree of diversification arising from insurance-like arrangements and the public sector entity's risk aversion (risk appetite).

E20 A public sector entity shall consider the extent of diversification in its portfolio, the entity's risk appetite and required return on capital in determining this amount in the same was as private sector issuers of insurance contracts.

2 Those standards refer to a risk margin although IFRS 17 refers to a risk adjustment. Prior to IFRS 17, the insurance accounting standards in Australia and New Zealand require an explicit risk margin in determining outstanding claims liabilities. The standards do not prescribe a fixed margin or the level of adequacy required, but state that risk margins adopted for regulatory purposes may be appropriate for the purposes of the standard, or as a starting point in determining such margins. Insurers must however disclose the probability of adequacy intended to be achieved by their adopted margin. For public sector entities in New Zealand this is typically expressed as "a risk margin to ensure the accrued liability is sufficient to meet all the costs of future claim payments 75% of the time."

….

BC9 In relation to risk adjustments, the Board acknowledges that public sector entities can take a view extending beyond current insurance arrangements and, over the long-term, the best estimate liability is the appropriate total amount to recognise. That is, there is no need for a risk adjustment. This view is often supported on the basis that:

(a) public sector insurers usually have the benefit of a government guarantee underpinned by taxing powers, which could potentially be called upon for support and sustain them in bad times; and/or

(b) some public sector entities enjoy monopoly status and have the power to recover cost overruns in any given period by increasing premiums or levies in following years.

BC10 In relation to the support that might be applied by government to a particular entity, the Board considers the uncertainties associated with outstanding claims cash flows in respect of past transactions, that would be reflected in a risk adjustment, to be a characteristic of the claims liability. In relation to the impact of an entity's monopoly status, the Board considers that, in respect of the current (usually annual coverage) transactions, the entity is bearing risk for that period. Any potential to pass that risk back to external parties relates to possible future transactions that are not the subject of financial reporting for the current period. Accordingly, the risk adjustment might differ from a for-profit private sector entity, however, is unlikely to be nil.

BC11 AASB 17 appendix A defines 'risk adjustment' as "the compensation that an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise as the entity fulfils the insurance contract".

BC12 AASB 17 paragraph B88 comments that:

"Because the measurement of the risk adjustment reflects the compensation that the entity would require for bearing the non-financial risk arising from uncertain amounts and timing of the cash flows, the risk adjustment for non-financial risk also reflects:

(a) the degree of diversification benefit that the entity considers when determining the compensation it requires for bearing that risk; and

(b) both favourable and unfavourable outcomes in a way that reflects the entity's degree of risk aversion."

BC13 The Board notes that public sector entities with the benefit of a government guarantee supported by taxing powers and which may also have the benefit of monopoly status might have a less risk averse approach to its activities than entities without these characteristics. Consequently, public sector entities may have a different risk adjustment to an equivalent private sector entity which did not have such characteristics.

We can understand the IPSASB's reasons for not wanting to establish alternative requirements to those in IFRS 17, as this would take time and resources. However, we think the IPSASB does need to form a view about whether public sector entities should be required to include a risk adjustment and the matters entities should consider in determining that risk adjustment. This might be done by developing guidance or sharing information about the ways in which various public sector entities have approached this issue. We note that similar issues are likely to be encountered when IFRS 17 is incorporated into the UK Financial Reporting Manual. There may also be an opportunity to build on any material developed to assist private sector entities applying IFRS 17 as surveys have indicated that the determination of the risk adjustment is a key area of uncertainty for such entities. Regardless of how the IPSASB chooses to provide guidance, we think that it is an area that requires attention.

We note that the words "by analogy" have been used throughout the standard. We assume that this is because the IPSASB is of the view that the liabilities arising from social benefit schemes would not fall within the scope of IFRS 17 and that the requirements in IFRS 17 would be applied to such obligations "as if they were insurance contracts". We think it would be helpful for the BC to explain why the IPSASB has used the words "by analogy".

As we already have an insurance standard for public sector and not-for-profit entities in New Zealand, and are considering whether or not to develop an equivalent of IFRS 17 for such entities, we would need to carefully consider the scope of any social benefit standard and the IFRS 17 equivalent, and the transitional arrangements. We make this point not because we expect the IPSASB to consider the circumstances of each jurisdiction, but because this might be a more widespread issue. Jurisdictions looking to pick up the insurance approach in ED 63 for social benefits would need to consider how entities in that jurisdiction have previously been accounting for such social benefits and develop appropriate transition requirements. In the absence of an IPSAS on insurance contracts practice is likely to vary.

<u>Response to SMC3(d)</u>

SMC3(d) Do you agree that, with respect to the insurance approach, the additional disclosures required by paragraph 12 of this Exposure Draft are appropriate?

We agree that the additional disclosures required by paragraph 12 are appropriate. Paragraph 12(a) is fairly clear that it requires a summary of the key features of the social benefit scheme as it also requires that the entity explain how additional information about the scheme can be obtained. Paragraph 12(b) which requires disclosure of significant amendments to the scheme during the reporting period also seems to have a high-level focus.

We agree that the standard should require disclosure of summary information about benefits and changes to them. However, in the case of schemes which manage many different benefits we wonder if this information needs to be included in the financial statements or could be provided elsewhere. If such information is readily available in other reports we think the standard could permit cross referencing to such other documents. This could be in relation to the information required by paragraph 12, but it could also be in relation to other disclosure requirements.

Specific Matter for Comment 4:

Do you agree that, under the obligating event approach, the past event that gives rise to a liability for a social benefit scheme is the satisfaction by the beneficiary of all eligibility criteria for the next benefit, which includes being alive (whether this is explicitly stated or implicit in the scheme provisions)?

If not, what past event should give rise to a liability for a social benefit?

This Exposure Draft includes an Alternative View where some IPSASB Members propose a different approach to recognition and measurement.

<u>Response to SMC4</u>

We support the *outcome* of how the IPSASB has applied the obligating event approach to social benefit schemes that are intended to be funded through future taxes, but do not agree with the *rationale* provided by the IPSASB for the proposals in ED64 (including disagreeing with the IPSASB's views on 'being alive'). We support the outcome on the grounds that the recognition of large liabilities for social benefits, without the recognition of future cash flows that will fund those benefits, is unlikely to result in financial statements that meet the objectives of general purpose financial reporting and satisfy the qualitative characteristics. However, we disagree with the rationale provided and aspects of the obligating event approach in the ED, and therefore propose some changes.

More specifically, we do not support the way in which the IPSASB has set up the proposed liability recognition requirements for the obligating event approach in ED 63. Determining the relevant past event for a particular social benefit obligation and the existence of a present obligation that meets the definition of a liability and recognition criteria in the Conceptual Framework is difficult and involves significant judgement. This is evidenced by the IPSASB's discussions over many years and the fact that ED 63 includes an Alternative View. We think that ED 63 makes unnecessary assertions about the past event – they are unnecessary in the sense that the IPSASB could establish standards-level recognition and measurement requirements without making such sweeping assertions.

To explain the above points, we set out below our consideration of the identified past event (including the alternative view) and then propose a way forward.

What is the relevant past event and what are the implications?

We acknowledge that getting agreement about the relevant past event and the corresponding implications of basing the recognition and measurement of liabilities for social benefits on that event is difficult. The NZASB has had a number of discussions over the last few years about the point at which the New Zealand Government has, or might have, a present obligation for particular types of social benefits. There are some benefits where we could easily agree that the recognition of a liability for the next benefit payment only is appropriate. There are other benefits such as New Zealand Superannuation (a benefit paid to most citizens over 65 years and which is not means tested) where we have had a range of views, including those expressed in the Alternative View about the possibility of key participatory events giving rise to a liability. Some would argue that upon reaching the age of 65 and satisfying the other eligibility criteria, most citizens will have a valid expectation that they will receive National Superannuation payments for the rest of their lives, not just the next payment. Although governments can and do change entitlements to old age benefits, in New Zealand this has generally been by raising the age of entitlement or lowering benefits for future recipients – not by changing entitlements to those that have already met the threshold eligibility criteria. We are also aware that the nature of a government's promise to potential recipients and the strength of the recipients' expectations is likely to differ between types of benefits and between jurisdictions.

These discussions have led us to think hard about what it is most useful to report in general purpose financial statements, whether there are conceptual arguments to support the obligating event approach in ED 63 and whether it is conceptually consistent to support the obligating event approach for certain benefits and the insurance approach for others.

Going back to concepts

Our overall view is that to meet the objectives of general purpose financial reporting in accordance with the qualitative characteristics and pervasive constraints discussed in the Conceptual Framework, it is necessary to consider how obligations for future benefits are managed. In the case of schemes which are managed in the same way as an insurer would manage its insurance contracts and which are substantially fully funded, we consider that it is appropriate to report both the assets and liabilities associated with that activity. In the case of other benefits which are not managed in this way and which are to be funded through future taxes, the recognition of large liabilities for social benefits, without the recognition of future cash flows that will fund those benefits, is unlikely to result in financial statements that meet the objectives of general purpose financial reporting and satisfy the qualitative characteristics.

We have thought about how this view can be reconciled with the Conceptual Framework, bearing in mind that the parts of the Conceptual Framework which deal with the definition of a liability and the recognition of liabilities do not discuss an entity's business model or sources of funding.

The topic of social benefits calls into question the boundary between what should be included in financial statements and what should be included in long-term fiscal sustainability reports. Generally we think the definitions of assets and liabilities and the recognition criteria serve us well in drawing appropriate boundaries around what is recognised in financial statements. In the case of social benefit liabilities we think that it is necessary to go back to the qualitative characteristics. The difficulty that we have encountered is that Chapter 3 of the Conceptual Framework is written with general purpose financial reports (not just financial statements) in mind. We consider that the focus of Chapter 3 of the Conceptual Framework is appropriate, but it does not help us in considering the application of the qualitative characteristics to these two different forms of reporting.

Relevance and understandability are the two qualitative characteristics that we think would be most pertinent to the consideration of whether information is most usefully reported in financial statements or long-term fiscal sustainability reports. We acknowledge that the relevance and understandability of information is influenced by users' education, experience and expectations and that it is difficult to draw conclusions about user needs when there are diverse groups of users. We do not consider that the recognition of all social benefit liabilities in financial statements would meet the needs of users of financial statements.

As noted in the UK *Fiscal Sustainability Report* (January 2017), in analysing the stocks and flows of a government, there is a trade-off between completeness and certainty. To quote from that report: "Balance sheets provide reasonably reliable estimates of assets and liabilities related to past activity (though even here there are a number of difficulties with estimation and data availability). But they are incomplete, as they do not account for many elements of future activity. Long-term projections paint a fuller picture, but are extremely uncertain."

In our view social benefit liabilities sit on the cusp of the dividing line between completeness and certainty. Without information on social benefit obligations it could be argued that the financial statements are incomplete. But it could also be argued that, even if liabilities for social benefit obligations were to be included, they would still be incomplete in the sense that information about future taxes would not be included. The existence and amount of potential long-term social benefit liabilities would also be subject to considerable uncertainty.

The Alternative View and being alive

Although we support much of the discussion in the Alternative View, we think that it would be difficult to operationalise this view into an international standard. Even if one accepts the possibility of key participatory events giving rise to a liability for all future benefits, this is likely to be the case for certain benefits in certain jurisdictions only. It is also likely that there would be differing views within a jurisdiction about which benefits a liability should be recognised for. In addition, we do not think the Alternative View has gone far enough. It has not considered whether the recognition of very large liabilities would be consistent with the objectives of general purpose financial reporting, the role of financial statements and the application of the qualitative characteristics.

The Alternative View (paragraphs AV16 to AV21) has also been helpful in prompting discussion about whether, in cases where an entity has a present binding obligation in respect of future social benefits, "being alive" is relevant to measurement rather than relevant to the recognition of the liability. We concur with the comments in paragraph AV18 that, *taking a population as a whole*, measurement of long-term liabilities is possible and we note that actuarial assessments are already used to support the measurement of a number of long-term liabilities.

However, it is possible to argue that being alive is not, in itself, a specific eligibility criterion and is not, therefore, relevant to determining the recognition point.

Generally, being alive is necessary, but not sufficient, for determining eligibility. Although being alive may be inseparable from the specified eligibility criteria (for example, in the case of an old age pension that starts at age 65, the individual cannot get the pension unless he or she is alive at age 65), the purpose of each type of benefit to individuals is to support people in particular circumstances (for example, an old age pension supports people after a certain age and an unemployment benefit supports people that are unemployed). Being alive applies in all these cases, so it is not part of the specific eligibility criteria for any particular benefit.

Having met the specific eligibility criteria for a particular benefit, staying alive does impact on how long the individual continues to receive that benefit, so it does become part of measurement of the benefit payable to eligible individuals. We would therefore prefer that the obligating event approach focus on the nature of the promise, the eligibility criteria for that benefit, and the ongoing requirements for revalidation, rather than relying on being alive as an eligibility criterion. In this regard, we also note that benefits may sometimes be paid to the estate of a deceased person, so being alive is not always necessary to be eligible to receive a particular type of benefit.

We suggest that, rather than focusing solely on the definitions of elements and the recognition criteria, the IPSASB should focus on where users would find information on social benefit liabilities most useful. We think that the characteristics of some large social benefit liabilities means that information on them would be more useful in the context of long-term projections where the implications of continuing current social benefit policies can be considered along with all other projected spending and the options for dealing with the inevitable fiscal challenges. In responding to SMC6 we have noted the usefulness of long-term fiscal sustainability reporting for providing a more complete picture of a government's projected inflows and outflows over a longer-term horizon.

Way forward

We disagree with the way in which the IPSASB has set up the proposed liability recognition requirements for the obligating event approach in ED 63. We think that some paragraphs, such as paragraphs 16 and 20, go further than they need to and invite unnecessary arguments. We think that the body of the standard should be limited to identifying the recognition requirements, and that this could be achieved without making assertions about the past event. This could be done is by omitting paragraphs 13 to 16 and redrafting paragraphs 17 and 18 to deal with the recognition of both a liability and an expense. We think that the Basis for Conclusions is the appropriate place for the IPSASB to explain all of the arguments that it considered in developing the standards-level requirements.

The arguments used to support the proposed obligating event approach (paragraphs 16 and 20) and the arguments in the Alternative View have been established as competing views. This has been useful for prompting debate on the exposure draft, but we would encourage the IPSASB to think about how it can draw on both views in finalising a standard and explaining its conclusions. We suggest that the IPSASB develop a rationale for the obligating event approach based on the objectives of general purpose financial reporting and the qualitative characteristics.

Specific Matter for Comment 5:

Regarding the disclosure requirements for the obligating event approach, do you agree that:

(a) The disclosures about the characteristics of an entity's social benefit schemes (paragraph 31) are appropriate;

(b) The disclosures of the amounts in the financial statements (paragraphs 32–33) are appropriate; and

(c) For the future cash flows related to an entity's social benefit schemes (see paragraph 34):

 (i) It is appropriate to disclose the projected future cash flows; and

 (ii) Five years is the appropriate period over which to disclose those future cash flows.

If not, what disclosure requirements should be included?

<u>Response to SMC5(a)</u>

Regarding the disclosure requirements for the obligating event approach, do you agree that the disclosures about the characteristics of an entity's social benefit schemes (paragraph 31) are appropriate?

We have received feedback from our constituents that disclosure of information on how the scheme is funded is important for users to understand the sustainability of such schemes. We note that the IPSASB has included a requirement to disclose information about how the scheme is funded in paragraph 31(a)(iii) and we agree with this requirement.

We acknowledge that the remainder of the information required to be disclosed by paragraph 31 would be useful to readers of the financial statements. However, we do have concerns that it would add considerable length to the financial statements. We would be concerned that this increased length could obscure other useful information. We would like the IPSASB to consider whether the financial statements are the most appropriate place for this information.

A better option might be to allow cross-referencing to other documents or sources of information. We note that paragraph 31(a)(ii) requires a statement about how additional information about the scheme can be obtained and paragraph 31(a)(iii) a permits a cross-reference to the location of information on social contributions. We suggest that the IPSASB allow the more general use of cross-referencing in meeting the disclosure requirements of the proposed standard. There would also need to be some requirements regarding the use of cross-referencing.

We note that the NZASB has recently issued a domestic standard on reporting service performance information. An extract from PBE FRS 48 *Service Performance Reporting* in relation to the use of cross-referencing is shown below.

Extract from PBE FRS 48 *Service Performance Reporting*

32. An entity may cross-reference the service performance information and the financial statements so that users can assess the service performance information within the context of the financial statements.

33. In presenting service performance information in accordance with this Standard an entity may incorporate, by cross-reference, information outside the general purpose financial report. The use of cross-referencing is permitted subject to the following requirements.
    (a) It is still possible to identify the complete set of service performance information presented in accordance with this Standard.
    (b) Locating the information elsewhere enhances the understandability of the general purpose financial report as a whole and the service performance information remains understandable and fairly presented.
    (c) The cross-referenced information is available to users of the service performance information on the same terms as the general purpose financial report and at the same time.

34. Incorporating service performance information by cross-reference enhances the understandability of the service performance information if it:
    (a) Links related information together so that the relationships between items of information are clear; and/or
    (b) Reduces duplication of information.

35. If an entity applies cross-referencing in accordance with paragraph 33, it shall:
    (a) Disclose, together with the statement of compliance in accordance with paragraph 28 of PBE IPSAS 1 *Presentation of Financial Reports*, a list of cross-referenced information that forms part of a complete set of service performance information in accordance with this Standard;
    (b) Depict cross-referenced information as being information prepared in accordance with this Standard (and audited if applicable);
    (c) Make the cross-referencing direct and precise as to what it relates to; and
    (d) Ensure cross-referenced information remains unchanged and available over time at the cross-referenced location.

We have considered the discussion in ED 63's Basis for Conclusions on whether the IPSASB should provide guidance on aggregating the disclosures for social benefit schemes that are not individually material. In developing ED 63 the IPSASB noted that IPSAS 1 *Presentation of Financial Statements* contains guidance on materiality and aggregation and concluded that no further guidance was required. Materiality is well-established as a concept in relation to recognition and measurement, but is less well-established in relation to disclosure. We believe that this signals a need for specific guidance on making judgements on materiality in relation to disclosures.

We note that the illustrative examples in ED 63 are for the reconciliation required by paragraph 33 and expected cash outflows required by paragraph 34. ED 63 does not have an illustrative example on the characteristics of social benefit schemes. Such an example could be used to provide guidance on materiality and aggregation.

Response to SMC5(b)

Regarding the disclosure requirements for the obligating event approach, do you agree that the disclosures of the amounts in the financial statements (paragraphs 32–33) are appropriate?

We note that these disclosures are in respect of the obligating event approach (which limits the liability to the point at which the social benefit will NEXT be provided). Under the proposed obligating event approach in the ED these liabilities will be constrained. Entities will have to consider materiality in deciding whether they have to make these disclosures. Even if an entity decides it does not have to make the disclosures or can aggregate disclosures, it will still incur costs in making that assessment.

We do not agree that the an entity should provide a reconciliation from the opening balance to the closing balance of the liability for each social benefit scheme (paragraph 33). Given that users can get most of this information from an analysis of the financial statements, we do not think that the benefit of the reconciliation outweighs the cost of preparation.

Response to SMC5(c)

Regarding the disclosure requirements for the obligating event approach, do you agree that for the future cash flows related to an entity's social benefit schemes (see paragraph 34):
(i) It is appropriate to disclose the projected future cash flows; and
(ii) Five years is the appropriate period over which to disclose those future cash flows?
If not, what disclosure requirements should be included?

Although this SMC refers to "future cash flows", paragraph 34 requires an entity to disclose its best estimate of cash ***outflows*** for a period of five years. We disagree that, taken in isolation, the provision of cash outflows provides useful information for users. This is because it will be difficult for users to make assessments of matters such as liquidity and sustainability without information on the bigger picture. Projections of outflows are best considered together with projections of inflows and are most useful when they are comprehensive, rather than focusing on a single social benefit scheme. In most cases, it would not be possible to project cash inflows for a single social benefit scheme as the majority of these schemes will be funded from the general tax take.

In making the above points, we noted the arguments considered by the IPSASB in deciding to require an entity to disclose its best estimate of projected cash outflows, as set out in paragraphs BC97 to BC100. In light of the IPSASB's objective for these disclosures, we reiterate our comments made in SMC 4 and SMC 6 on the importance of long-term fiscal sustainability reporting for providing a more complete picture of a government's projected inflows and outflows over a longer-term horizon. In the case of governments that already publish long-term fiscal information, or individual entities that already publish long-term information about particular schemes, we would like the IPSASB to require that entities refer, in their financial statements, to such reports. We are not, however, suggesting that long-term fiscal sustainability information be presented as an integral part of the financial statements.

We acknowledge that early adopters of IPSAS Standards and accrual accounting are likely to require some time before they are in a position to produce a long-term fiscal sustainability report. From our own experience in New Zealand there was a significant time lag between the adoption of accrual accounting and the issue of the first long-term fiscal sustainability report at a whole-of-government level.

We would like the IPSASB to do some more thinking about the objectives of the additional disclosures in ED 63, and the most cost-effective way of achieving those objectives for jurisdictions which are not currently in a position to produce long-term fiscal sustainability reports.

We recognise that identifying a suitable alternative is not an easy task. Nevertheless, we remain unconvinced that disclosure of five-year cash outflows will meet the stated objectives of this disclosure.

Other comments

If such disclosures were to be required, we think that the standard would need to consider how to deal with the duplication of information in whole-of-government consolidated reports. Would both the entity administering the scheme and the whole of government be required to present the disclosures or would there be the possibility of cross-referencing information already available in another report? These considerations are particularly important given the recent focus on trying to limit the length of financial statements and keep disclosures understandable and accessible.

Constituent outreach in New Zealand highlighted that government spending is often presented as a percentage of GDP. The presentation of spending as a share of total public expenditures or per capita is also used to compare spending between countries and over time. We therefore considered whether it would be appropriate for an IPSAS to permit or mandate disclosure of future cash flows as a percentage of GDP or total spending. In our view the IPSASB should not preclude such presentation but nor should it mandate a particular form of presentation. Some readers may prefer to see spending displayed in the relevant currency. In any case, if percentages or per capita figures are used, readers should always be able to access the underlying figures.

Specific Matter for Comment 6:

The IPSASB has previously acknowledged in its Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities, that the financial statements cannot satisfy all users' information needs on social benefits, and that further information about the long-term fiscal sustainability of these schemes is required. RPG 1, *Reporting on the Long-Term Sustainability of an Entity's Finances*, was developed to provide guidance on presenting this additional information.

In finalizing ED 63, the IPSASB discussed the merits of developing mandatory requirements for reporting on the long-term financial sustainability of an entity's finances, which includes social benefits. The IPSASB identified the following advantages and disadvantages of developing such requirements at present:

Advantages	Disadvantages
Long-term financial sustainability reports provide additional useful information for users for both accountability and decision making, and that governments should therefore be providing. This especially applies to information about the sustainability of the funding of social benefits given the limited predictive value of the amounts recognized in the financial statements.	The extent and nature of an entity's long-term financial reports are likely to vary significantly depending on its activities and sources of funding. It would therefore be difficult to develop a mandatory standard.
Social benefits are only one source of future outflows. Supplementary disclosures (as proposed in the ED) on social benefits flows in isolation are therefore of limited use in assessing an entity's long-term sustainability, as they do not include the complete information on all of an entity's future inflows and outflows that long-term financial sustainability reports provide.	The nature of the information required for reporting on the long-term sustainability of an entity's finances, in particular, its forward-looking perspective, could preclude its inclusion in General Purpose Financial Statements. Given the scope and challenges involved in its preparation and audit considerations, some question whether it would be appropriate to make information in a General Purpose Financial Report mandatory.
Long-term financial sustainability reports will improve accountability and will help support Integrated Reporting <IR> in the public sector. They will also provide useful information for users, in particular for evaluations of intergenerational equity.	RPG 1 was only issued in 2013, so it may be too soon to assess whether requirements developed from those in RPG 1 should be mandatory.

Do you think the IPSASB should undertake further work on reporting on long-term fiscal sustainability, and if so, how?

If you think the IPSASB should undertake further work on reporting on long-term fiscal sustainability, what additional new developments or perspectives, if any, have emerged in your environment which you believe would be relevant to the IPSASB's assessment of what work is required?

On balance, our view is that long-term fiscal reporting should continue to be optional. We agree that the IPSASB has identified the main arguments for and against developing mandatory reporting requirements on long-term fiscal sustainability and consider that the points identified as disadvantages of mandatory long-term reporting are so important that they should be given more weight than the points identified as advantages of mandatory long-term reporting. We comment further on some of these points later in this response.

In SMC4 we disagreed with the arguments used by the IPSASB to justify its obligating event approach proposals (although we agreed that the resulting accounting might be appropriate) and stressed the role of long-term fiscal sustainability reports in providing information about long-term future outflows and inflows. The advantages of long-term reports are that they provide information about outflows for current and future beneficiaries and they allow future outflows to be considered alongside future inflows from taxes. Long-term fiscal sustainability reports encourage jurisdictions to consider long-term fiscal challenges and the options for dealing with those challenges. It informs governments and constituents about how current policies will affect a government's future financial position. For all these reasons we support the provision of comprehensive information in long-term fiscal reports.

The importance of long-term information has been acknowledged in New Zealand with a legislative requirement to prepare such reports. The Public Finance Act 1989 (section 26N) requires that, at least every four years, the New Zealand Treasury publish a statement on the long-term position of the Government for the next 40 years. The most recent such report, *He Tirohanga Mokopuna: 2016 Statement on New Zealand's Long-term Fiscal Position*, was published in November 2016.

Although we acknowledge the importance of long-term information, we do not think that it would be appropriate for the IPSASB to develop mandatory standards-level requirements at this time. In addition to the arguments identified by the IPSASB we note the following.

(a) For governments looking to adopt accrual IPSAS Standards, additional requirements could be regarded as a disincentive to adoption.

(b) Jurisdictional differences, including legislative reporting requirements, would make it difficult to establish mandatory requirements. Legislative differences would mean that any standard would need to have an even higher-level focus than RPG 1.

(c) This field of reporting is continuing to evolve and it would be difficult to establish mandatory requirements in such an environment. The 2017 OECD report *Rationalising Government Fiscal Reporting – Lessons learned from Australia, Canada, France and the United Kingdom on how to better address users' needs* shows that fiscal reporting, of which long term sustainability reporting forms a part, is continuing to evolve and outlines developments in those jurisdictions. This evolution is also occurring in New Zealand. The November 2016 projections not only identified long-term fiscal challenges and some of the options for managing those pressures, it also considered how improving social outcomes might provide fiscal benefits and improve living standards.

SMC6 asks what further work the IPSASB should undertake in this area. We have two suggestions.

(a) Although an increasing number of countries are now producing long-term fiscal sustainability reports, we have not identified any that assert compliance with RPG 1. The IPSASB could investigate the main reasons for this. For example, do jurisdictions consider that such assertions are not necessary, or are there conflicts between RPG 1 and legislative requirements?

(b) We think that the IPSASB has a role to play in continuing to emphasise the importance of reports on long-term fiscal sustainability and stressing the importance of good financial reporting as a precursor to good long-term reporting. As per our response to SMC 5(c), we suggest that the IPSASB require that entities refer, in their financial statements, to any published long-term fiscal sustainability reports.

Other comments

First-time Adoption

ED 63 proposes to give a three-year relief period for the recognition and/or measurement of social benefits for first-time adopters. Although we understand that one of the roles of IPSAS 33 *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* is to encourage the adoption of IPSAS Standards, we do not agree with granting a three-year exemption from application of the standard.

Our reasons for disagreeing with this proposal are as follows.

(a) We are not supportive of three-year exemptions in general.

(b) Social benefits are a fundamental aspect of a government's activities. If a government cannot report on its social benefits in accordance with ED 63, we think that it should delay the adoption of IPSAS until it is in a position to do so.

(c) An entity should have the information required to report in accordance with the obligating event proposals in ED 63 (although we have commented on compliance costs associated with the proposed disclosures).

(d) An entity that is already managing a scheme as an insurance scheme and that intends to apply insurance accounting should have good information about its liabilities.

Editorial comments

We have identified some editorial matters for consideration if the paragraphs identified are carried forward into the final standard.

Paragraph	Comment
13	(b) … and takes account of the <u>pervasive</u> constraints on information in general purpose financial reports. Although paragraph 13(b) is consistent with the wording in paragraph 6.2 of the Conceptual Framework, anyone reading paragraph 6.2 in the Conceptual Framework will be aware that the constraints are referred to as pervasive constraints. Reading this statement in a different context readers may not get this message. We therefore suggest adding the word pervasive.
30 and 34	Paragraph 30 refers to future cash flows that "may" arise from an entity's social benefit schemes and refers to paragraph 34. Paragraph 34 refers to projected cash flows that "will" arise from a scheme.
	Amendments to other IPSAS Standards
IPSAS 19	Paragraph 1 lists scope exclusions. ED 63 is proposing to replace the current social benefit exclusion in paragraph 1(a) with the words "Social benefits within the scope of [draft] IPSAS [X] (ED 63). Because IPSAS 19 paragraph 1(e) already excludes provisions, contingent liabilities and contingent assets "covered by another IPSAS" we do not think that the proposed exclusion in paragraph 1(a) is required. However, ED 63 is not proposing to deal with all of the social benefits that are currently excluded from the scope of IPSAS 19. As noted in our response on SMC1 there may still need to be a scope exclusion for those social benefits that are currently excluded from the scope of IPSAS 19 but which are not being addressed in ED 63.
IPSAS 19	We think paragraph 111G should be paragraph 111H.
IPSAS 28	We think paragraph 60E should be paragraph 60F.
IPSAS 33	We think paragraph 157 should be paragraph 158 (if paragraphs are numbered sequentially from paragraph 154).
	Illustrative Examples
IE26–IE31	*Example 8* Paragraph IE26 states that the pensions are paid at the end of each month. It isn't clear from the example whether (i) there is a benefit payment at the end of December and the accrual relates to the benefits to be paid at the end of January or (ii) December benefits are paid early in January.
IE32–IE41	*Example 9* Paragraph IE34 states that the pensions are paid at the end of each month. It would be helpful if the example clarified whether there is a benefit payment at the end of December, or whether the December benefits are paid in early January.
IE42–IE52	*Example 10* Paragraph IE42 "unemployment pension" should read "unemployment benefit''. We think (from reading paragraph IE46) that the amounts paid on the 15^{th} of each month relate to the month ending on the 15^{th}, but it would be helpful if the example made this clear.