



Social Benefits – The Swedish National Audit Office comments

First of all we would like to congratulate the IPSASB for taking on this project and taking steps forward a more transparent reporting on social benefits in the public sector.

The Swedish National Audit Office (Swedish NAO) does not have a standard-setting role as regards accounting. Our role as Supreme Audit Institution is to audit financial statements and promote transparency as well as create conditions for accountability. Public sector financial reporting constitutes an important basis for decision-making and accountability. We consider that investigating the possibilities of accounting for financial commitments to a greater extent than is the case today to be very positive. It is also a commendable ambition to create common conditions for a higher degree of consistency within and between states to a greater extent than is the case today. The financial and debt crises that have arisen have demonstrated deficiencies in public sector financial reporting and this work may contribute to more adequate accounting for public commitments.

We share the objective and purpose of the IPSASB concerning the need to make existing public commitments visible. It is also important to clarify that financial statements cannot take care of complete sustainability reporting of various social security schemes. We propose that the IPSASB clarifies these components in the future work.

The Swedish NAO wishes to highlight the need to consider the incentives this type of proposal may conceivably trigger. For example there may be a risk that governments create structures in which these social benefits are placed in Funds that lie outside the remit of public sector accounting and auditing. This would affect decision-making, transparency and the ability to require accountability.

Accounting for social benefits is a complex area and we note a quantity of different forms and structures both for different types of support within a country as well as in an international comparison. An international standard should be principles-based and allow some degree of flexibility for accounting for social benefits, so as best to capture the various designs that exist. Too detailed standards increase the risk that the standard will not be globally applicable. Thus it may be appropriate to use different models for the social benefits that exist in a country. However, it is extremely important that the financial statements show which model has been selected, how the commitments are measured as well as disclosing the reliability of the data and assessing any uncertainties.

The premises for our position are:

- Transparency in the Government's financial statements – in accordance with ISSAI 12, we as a Supreme Audit Institution must promote increased transparency and opportunities for accountability
- Auditability – in other words the audit aspects of the IPSASB's proposals and whether they can affect our ability to comply with generally accepted auditing standards (in accordance with the ISSAIs)

We do not intend to submit comments of a technical nature at the detailed level. Our response is based more on a discussion of principles proceeding from the two points mentioned above.

Definition of social benefits

There are both advantages and disadvantages to adopting the same definition in IPSAS as in Government Financial Statistics (GFS). The advantage is an increase in comparability between statistical reporting and the financial statements, which was a problem. However, this should not be at the expense of reducing the value of the financial statements. In this case we do not consider that such a risk exists. The definition in the GFS, which is what the IPSASB proposes, seems to be reasonable.

However, it is a matter of interpretation when a particular benefit is considered to constitute a "social risk". Every country has its unique form of transfers to households to address social risks and in some countries it may be the case that a larger proportion is dealt with through employment, for example as in the USA. A standard should be

principles-based so that it can be adapted to various conditions prevalent in these countries and our assessment is that the proposed definition allows this. Since all countries report their statistical outcome, which is based on the common definition in GFS, in all likelihood this should facilitate definition and interpretation of what is a social benefit. The proposal to exclude general central government commitments, such as defence, infrastructure, education, health etc. seems reasonable, as well as social benefits regulated through employment.

Approach for accounting for social benefits

The IPSASB proposes three different methods for recognition and measurement of social benefits:

- The Obligating Event Approach
- The Social Contract Approach
- The Insurance approach.

The Swedish NAO agrees with the IPSASB's preliminary position that the Obligating Event Approach and the Insurance Approach seem to be the most relevant. However, we wish to emphasise that explanations and background to the Social contract were vaguely described, which has in part entailed some difficulties in discerning the major differences between the Social Contract Approach and the Obligating Event Approach. The main reason for our assuming that the Social Contract Approach is probably not relevant is that it is strictly based on both parties, that is the State and citizens, having obligations that are on an equal footing, such as the State providing support in the form of social benefits as long as citizens meet their obligations in the form of paying tax. Our assessment is that this is a weak link and the question of whether the State can renounce its obligations if citizens do not pay their taxes is not sufficiently investigated. The State probably has a greater responsibility in purely legal terms. The Obligating Event is based on the existence of legislation as grounds for the commitment, which in purely legal and judicial terms are more fixed. However, essentially it is difficult to see the actual difference between these two models.

The point at which an obligation arises

From our perspective as an audit institution we would mainly like to highlight the importance of clarifying when an obligation can be considered to arise (the point in time) and the criteria that must be met when it is to be reported as a memorandum item in the balance sheet.

The Swedish NAO's point of departure is that the obligations reported in the balance sheet must meet the requirements of generally accepted accounting principles and that an audit must be possible to conduct in accordance with generally accepted auditing standards. Under the Obligating Event Approach the IPSASB presents five different points in time (a-e below) for when an obligation may arise. Under the Social Contract Approach two alternatives are presented. These two coincide with (d) and (e) below.

- a) Key participatory events occur
Assumes that a regulatory framework exists stipulating that citizens can expect payment in various situations such as when they fall ill or become unemployed. The obligation (liability or provision) is then to be recorded on the basis of what the Government can "expect" in the form of payments in coming years. We consider that this option is not clearly described and it is difficult to derive the exact point in time for when an obligation arises. It appears as though this option means that agencies must estimate outgoing payments based on historical data and future forecasts of probable outcome.
- b) Eligibility criteria initially met
Assumes that a liability/provision arises when a person becomes unemployed (the event as such), retires, reports sick etc. without having applied for payment of any benefit. This requires the Government to make an assessment of a recipient's expected longevity. The liability/provision is based on the number of citizens (in the current situation) who with some degree of certainty can expect payment based on historical payment trends and provisions established in laws/ordinances.
- c) Eligibility criteria met to receive next benefit
Assumes that a liability/provision arises when criteria for receiving the next benefit payment are met (seen over time). This means that the liability is only

recognised until it is time for the next payment. This requires regular revaluation of the liability.

- d) Claim approved
Assumes that the liability/provision is established when the application for benefit has been received and approved.

- e) Payment date arrived
Assumes that the liability/provision is established when there is a payment decision and the date of the payment has arrived.

The information in a balance sheet must be considered to be *timely, relevant, faithfully presented, understandable and verifiable*¹ and at the same time must be weighed against the information needs that exist for accountability. Relevant and material information of a financial nature that may influence decision-making may not be withheld from citizens and other stakeholders. However, it is of very great importance that this information is reliable, verifiable and can be audited by an independent external auditor.

Whether an obligation exists or not is mainly dependent on the certainty/probability existing in the underlying event/requirement. The strength/certainty determines the time and also whether the obligation should be classified as a liability or a provision. This means that the options listed above a)-e) may all be relevant, depending on the circumstances in the respective countries, but also the circumstances relating to the structure of a particular benefit.

We would like to highlight three parameters that may be relevant to take into consideration in future development of criteria for when an obligation should be identified and reported as a memorandum item:

1. *Political stability*

For an obligation to be classified as a liability/provision there must be some degree of certainty in the obligation. Whether the party bearing the potential liability/provision (in this case the Government/State) can withdraw from the obligation is thus one of the decisive factors. The argument used by the IPSASB in the CP assumes that there is

¹ Conceptual Framework IPSAS

certain stability in the public administration and that there is an implied commitment/obligation on the part of the State to offer social support (in certain given situations) as well as an expectation on the part of the citizens of receiving support. This is generally true. The premise is that the clearer it is established in laws and ordinances the lower the probability of the Government being able to withdraw from such a commitment, which we also consider reasonable. However, it is the case that there is currently a major element of turbulence in the economy, which means that changes in the social insurance systems may be made on an annual basis. One example is the refugee flows in the EU that may entail rapid measures and changes in the systems throughout the entire EU area and there is also turbulence in other parts of the world. Any future standard should allow for the possibility of political turbulence and that the Government's ability to withdraw from obligations may increase. Major changes in the systems mean that governments/states will find it "more difficult" to proceed from historical data as a basis for relevant estimates of obligations as well as that promised obligations will not be paid. In more turbulent economies the point of time options e) or d) be more relevant.

2. *Financing form*

In the situations in which a social benefit is fully or partly financed through fees that can clearly be traced to individual level, there is probably a higher degree of certainty in the obligation. This means that it is possible to recognise the obligation at an earlier stage than for d) and e).

3. *Design and terms*

In the cases where social benefits are designed on the basis of an insurance-like model (or accumulated funds) that is self-financed, it would appear more probable to be able to establish liability for future payments at an earlier stage and estimate future payment flows for payments in coming years.

A liability should be confirmed when the degree of certainty is sufficiently high. The standard should allow a number of alternative proposals of appropriate times and where the reporting entity makes an estimate of the most appropriate time, taking into account certainty/probability and verifiability. From an auditing perspective it is decisive that the data and accounts presented are transparent, verifiable and reliable, which in principle means that a person other than the person who prepared the accounts should with a

relatively high degree of probability, be able to arrive at the same conclusions. The greater the uncertainty factor in the accounting the more extensive and clearer requirements should be made of the party preparing the accounts to clearly report assumptions and underlying material.

Specific comments on the IPSASB's option regarding the time at which an obligating event should be considered to arise and be recognised:

Option a) appears to be the most unclear and there is greater uncertainty as to the reliability of underlying data for the accounts. In our opinion the option is not compatible with requirements of the Conceptual Framework concerning qualitative characteristics (relevance, verifiability etc).

Option b) it is not clear to us where the great difference is between options a) and b).

Options c), d) and e) all three may be relevant depending on what type of benefit and degree of basic certainty of the benefit structure (i.e. if it is based on laws, ordinances, contracts, eligibility for payments and for receiving the benefit).

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