INTERNATIONAL FEDERATION
OF ACCOUNTANTS

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DATE:	28 OCTOBER 2005
MEMO TO:	MEMBERS OF THE IPSASB
FROM:	PAUL SUTCLIFFE & JOHN STANFORD
SUBJECT:	SOCIAL SECURITY PENSIONS AND EMPLOYEE BENEFITS PENSIONS ACCOUNTING

ACTION REQUIRED

The IPSASB is asked to:

- **Review** the extracts from a draft ED on the Basic Welfare pension and provide further directions for development of a full draft ED;
- **Note** the summary of current requirements in the SNA and GFSM and proposals for changes to the SNA in relation to pensions ; and
- **Consider** the issues raised in the Issues Paper at Item 10.5 and confirm staff views or give staff alternative directions.

AGENDA MATERIAL

DRAFT ED ON BASIC/WELFARE PENSIONS

Agenda Item 10.2 is a revised draft of the extracts of an ED on the basic/welfare pension. The revisions reflect the direction given made in respect of both the basic/welfare Pension and general social policy obligations at the July meeting of the IPSASB: that an obligating event arises when all eligibility criteria have been satisfied and that "staying alive"/"continuing existence" is a recognition criterion rather than a measurement attribute. The draft has also been amended to reflect the point made in New York in July 2005 that, generally, the basic/welfare pension does not involve contributions from individuals or employers.

The Staff memorandum at Agenda Item 9.1 highlighted the view of Staff that it is appropriate to segregate the basic/welfare pension and age-related social benefits from general social benefits and to proceed with a separate ED on the latter.

As indicated above, Item 10.2 is not prepared as a separate ED, so matters like a black letter set of exclusions from the Scope are not included. Paragraphs 3 and 4 will need to be amended if this extract is part of a broader ED dealing with all non-exchange pensions.

Members are requested to:

(a) Confirm the proposed approach (that these extracts are components of a general pensions ED); and
(b) Confirm the substance of the extracts as they apply to the basic/welfare pension or provide directions for change.

SUMMARY OF PROPOSALS FOR CHANGES IN THE SNA

Agenda Item 10.3 briefly outlines some of the key requirements in relation to pensions in the current System of National Accounts (SNA). In July members noted that the SNA has different objectives to accrual reporting in the general purpose financial statements, but considered that it is important to monitor developments as input to the IPSASB's deliberations.

The paper highlights proposals being developed by the Task Force on Employers' Retirement Schemes. Item 10.4 is a more detailed formal report on the last meeting of the Task Force in September 2005, which IPSASB member Ron Points attended. The proposals of that Task Force will go forward for consideration to a review group in February 2006. In particular it is noted that there are no proposals to modify the current approach in the SNA to the basic/welfare pension whereby liabilities are not recorded in the core accounts. However, it highlights proposals to record liabilities arising from funded and unfunded employer pension plans including government employer plans and to record liabilities in relation to government employees in general social security schemes. Staff will continue to monitor the development of these proposals. Members are asked to note these developments.

ISSUES PAPER ON FUTURE APPROACH TO PENSIONS AND DEVELOPMENT OF IPSAS BASED ON IAS 19

IAS 19, *Employee Benefits* was one of the 22 standards in the first phase of the Standards Program of the IPSASB (then the Public Sector Committee (PSC)). In July 2002 the PSC decided to implement a two-track project on IAS 19 with the first phase addressing employee benefits other than post-employment benefits and the second part dealing with post-employment benefits. An early draft ED on employee benefits was presented to the October 2002 meeting of the PSC. However, a decision was taken at that meeting to defer the first phase of the project. This was because the PSC took the view that, in addition to the impact on post-employment benefits, prospective changes to IAS 19 were likely to affect other long-term employee benefits such as long-term compensated absences, long-term disability benefits and jubilee or other long service benefits and not just post-employment benefits. Subsequently it was clarified that post-employment benefits were outside the scope of the ITC, *Accounting for the Social Policy Obligations of Government,* because they were exchange transactions.

In July 2005 the IPSASB directed Staff, subject to resource availability, to prepare for consideration at the November/December 2005 meeting initial materials considering the applicability of IAS 19 to public sector entities.

The Issues Paper at Agenda Item 10.5 fulfills this direction by providing background on IAS 19 and addressing a number of key issues related to the development of a public sector Standard based on IAS 19. In particular, it provides a staff view that liabilities arising from government contributions to general social security schemes in respect of government employees are within the scope of IAS 19 and that this approach is not inconsistent with proposals for modification to the SNA. Members are asked to provide confirmation of the Staff views on the issues highlighted in the Issues Paper or to provide alternative directions on those issues and to highlight any further issues.

Accounting for Basic Pension Arrangements

(and other age related social benefits)

Extracts for consideration for inclusion in Proposed International Public Sector Accounting Standard

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD IPSAS XX

Accounting for Basic Pension Arrangements (and Other Age Related Social Benefits)

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Objective

1. The objective of this Standard/extract of Standard is to establish requirements for accounting for pension arrangements where there is no relationship between the amounts of the pension benefits and the amount of contributions made by either an individual or his/her employer. It also deals with certain other social benefits of government provided in non-exchange transactions only to recipients that have reached a specified pensionable age laid down in legislation. Such benefits are provided by governments and other public sector entities to address a number of age related social risks facing individuals.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for:**

   (a) Basic/welfare aged pensions;

   (b) Age related cash transfers; and

   ***(c)* Age related individual goods and services.**

(*Staff Note: This paragraph is only needed if this is a stand alone ED.).*

3. Many jurisdictions have policies to provide benefits for individuals who have reached a specified age. Such benefits are often cash transfers, which enable an individual to supplement their own resources or resources from post-employment benefits to which they have an entitlement as a result of their previous employment. Such cash transfers are commonly known as pensions. Benefits under pension arrangements may be dependent upon the amount of contributions paid over a recipient's working life and may be linked to an individual's remuneration in employment over their working life. Such pension arrangements are outside the scope of the extract of this Standard.

4. In some cases certain cash transfers may be referred to as pensions although entitlement does not depend on reaching the specified pensionable age laid down in legislation, for example disability pensions payable to individuals who are considered no longer capable of working due to injury or certain medical conditions. This extract of a Standard does not apply to such cash transfers.

5. Age related social benefits also include individual goods and services such as health care and ancillary cash transfers that are restricted to individuals that have reached pensionable age. For example, in some jurisdictions there may be forms of housing benefit or income support that are only available to those who have reached pensionable age. In jurisdictions with cold winter climates there may be programs to subsidize the utility bills of individuals who have reached a specified age. Such programs reflect the increased vulnerability of the aged to hypothermia and the fact that utility bills are likely to consume a larger proportion of an individual's income than for an individual still in the workforce. Transactions relating to such programs are within the scope of this Standard if the value of the resources transferred is not dependant on the amount of any contributions made by recipients.

6. This Standard does not apply to employee benefits, including post-employment benefits provided to government employees and other employees in exchange for their services as employees. Such benefits are exchange transactions. Requirements in respect of employment benefits should be accounted for in accordance with the relevant international or national standard dealing with employee benefits.

7. In some jurisdictions the government or other public sector entity acts as the guarantor of last resort for all or part of the benefits payable under defined benefit or defined contribution plans where a private sector entity is unable to meet obligations under such plans. In order to meet such guarantees government may operate a fund financed by contributions levied on some or all defined benefit or defined contribution plans operating in a jurisdiction. Alternatively, such guarantees, where called upon, may be financed from general taxation. Such guarantees may give rise to provisions or contingent liabilities. However, they are not basic/welfare aged pensions or age related cash transfers and are not within the scope of this Standard.

Government Business Enterprises

(*Staff Note: Usual exclusion will be included if this is a stand alone ED)*

Definitions

8. **The following terms are used in this Standard with the meanings specified:** ***(Staff Note: Additional definitions will be added as needed if this becomes a stand alone ED)***

<u>Age related cash transfers other than a pension</u> are cash transfers to individuals who have reached pensionable age where the amount of the transfer is not dependant upon contributions made by the recipient.

<u>Age related individual goods and services</u> are goods and services provided for individual consumption to protect individuals who have reached pensionable age against certain social risks, where the amount of the resources transferred is not dependant upon contributions made by the recipient.

A <u>basic/welfare aged pension</u> is a cash transfer payable only to individuals who have reached pensionable age where the amount of the transfer is not related to the amount of any contributions made by or on behalf of the beneficiary or to a beneficiary's remuneration as an employee.

A cash transfer is a payment in cash or a reduction in a tax liability, to protect individuals against certain social risks where use of the cash payment is at the discretion of the individual.

An eligibility criterion is a requirement that an applicant must meet for entitlement to individual goods and services and cash transfers.

A general/contributory aged pension is a cash transfer payable only to individuals who have reached pensionable age where the amount of the transfer is dependant on the amount of any contributions made by or on behalf of the beneficiary or to a beneficiary's remuneration as an employee.

Liabilities are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.

Pensionable age is an age specified in legislation at which an individual becomes eligible for individual social benefits and cash transfers not otherwise provided.

A social risk is an event or circumstance that may adversely affect the welfare of individuals or households either by imposing additional demands on their resources or by reducing their incomes.

Terms defined in other International Public Sector Accounting Standards are used in this Standard with the same meaning as in those other Standards and are reproduced in the Glossary of Defined Terms published separately.

Aged Pensions

9. Many jurisdictions provide cash transfers known as pensions to those who have reached a specified age laid down in legislation referred to in this Standard as the pensionable age. A basic/welfare pension is a cash transfer that is intended to address a social risk by providing or contributing towards the provision of a minimum standard of living to individuals that

have reached pensionable age. It may also be known by other terms such as a distress or social security pension.

10. Arrangements for the basic/welfare pension vary significantly in different jurisdictions. In many jurisdictions basic/welfare pension programs will not require any contributions by individuals. However, in some jurisdictions individuals may be required to make contributions. The key characteristics of the basic/welfare pension as defined in this Standard are that the cash transfers payable are only available to those who have reached pensionable age, and are not dependant on the amount of any contributions made by or on behalf of an individual or on an individual's earnings.

11. In some jurisdictions eligibility criteria may need to be satisfied for the basic/welfare aged pension additional to the criterion that individuals have reached pensionable age. Worldwide there is very significant variation in both the eligibility criteria and the way these criteria operate. For example, criteria may include the period for which an individual has been a taxpayer. Where an individual has only recently established residency in a jurisdiction or because a continuous period of residency was interrupted, there may be reductions in entitlement levels.

12. The regulations governing the basic/welfare pension program in some jurisdictions may require an individual to have a record of making contributions over a specified minimum period in order to be eligible for a full entitlement. An abatement from the full entitlement applies where an individual's contribution period is less than that minimum period. However, such a condition is in the nature of a threshold requirement and the benefits payable are not related to the amount of those contributions.

13. In some jurisdictions the basic/welfare state pension is means-tested. For example, individuals whose annual income and/or assets are above a specified threshold may forfeit eligibility completely or may be subject to a reduction from the full entitlement.

14. In some jurisdictions the basic/welfare aged pension may be provided as part of a composite social security scheme that includes the general/contributory scheme. In other

jurisdictions, the basic/welfare aged pension is administered separately from any general/contributory scheme.

15. Typically under general/contributory schemes individuals make contributions during their working lives and receive benefits related to either the amount of those contributions or earnings. These general/contributory programs may include a basic/welfare component. Such a component may act as a "safety net", by providing a minimum amount for those who otherwise have no entitlement under the general/contributory scheme or whose entitlements are minimal. Where transfers under the "safety net" component are not dependant upon the amount of contributions they are treated as a basic/welfare pension for the purposes of this Standard.

16. Where a scheme includes both a basic/welfare component and additional benefits related to contributions made, only the basic/welfare component is within the scope of this Standard.

Age-Related Cash Transfers

17. Certain programs, other than the basic/welfare pension, involve cash transfers which are payable only to those who have reached pensionable age. In some cases such programs may be linked to the basic/welfare program. For example, in some jurisdictions further cash transfers may be payable to those who have not qualified for the full entitlement of the main program.

18. The key characteristic of the basic/welfare pension and age-related cash transfers is that the purposes for which the cash transfer may be used is at the discretion of the recipient. If a recipient has to validate that the cash has been used for a specified purpose the transaction is a reimbursement rather than a cash transfer and is to be treated as an individual good or service.

Age Related Individual Goods and Services

(Staff note: If this is a separate Standard, paragraphs are likely to be added dealing with:

- **Obligating Events and Present Obligations,**
- **Legal Obligations and Constructive Obligations,**
- **Contingent Liabilities**
- **Initial Recognition: Liabilities**

These paras will be similar to those in the general SPO ED at paragraphs 12-14 and 21-37 of Item 9.2.

Basic/Welfare Pension, Age Related Cash Transfers and Age Related Individual Goods and Services

19. **A present obligation for the basic/welfare pension, age-related cash transfers and age-related individual goods and services arises when eligibility criteria have been satisfied. When a present obligation arises it shall be recognized as a liability in accordance with the requirements …………. (equivalent to paragraph 30 in Item 9.2).**

20. This Standard requires an entity to recognize a liability for the basic/welfare pension and age-related cash transfers and individual goods and services when an individual satisfies all eligibility criteria. Eligibility criteria include both those laid down explicitly in governing legislation and regulations and the additional implicit criterion that applicants must "stay alive" in order to receive individual goods and services and cash transfers. This is because where eligibility criteria have been satisfied an entity may have no realistic alternative but to settle its obligations to transfer resources until the eligibility criteria have to be next validated. Recipients may be required to repeatedly satisfy all eligibility criteria in future periods for the receipt of further benefits in those periods. A present obligation

for the provision of those additional benefits does not arise until the recipients satisfy those eligibility criteria in future periods

21. The assessment of whether a government has no realistic alternative but to settle an obligation is made within the framework of existing legislation. Whilst, governments can modify explicit eligibility criteria it is unlikely that such changes will be retrospective. This Standard takes the view that it should not pre-empt that legislative changes will occur, or what those changes may be. Changes in present obligations arising from legislative change are therefore made only when such changes have been enacted or are virtually certain to be enacted**.** This Standard therefore reflects the view that a government has no realistic alternative but to provide to eligible recipients basic/welfare pensions they are presently entitled to as a consequence of satisfying eligibility criteria.

Basic Welfare Pension and Age-Related Cash Transfers

22. The present obligation in relation to the basic/welfare pension and age-related cash transfers is for amounts to which explicit and implicit eligibility criteria have been satisfied. This will be for amounts “due and payable” to the reporting date. There my be rare circumstances where, under the legislation or regulations governing the basic/welfare pension or age related cash transfer program, the relatives or estate of a beneficiary may be entitled to amounts payable up to the next date at which the explicit eligibility criteria have to be validated even though the beneficiary may have died prior to that revalidation point. In such cases the present obligation will be up to that revalidation point.

Age-Related Goods and Services

23. For age-related individual goods and services the way in which the implicit eligibility criterion of “staying alive” operates will depend upon the character of the program, the nature of the goods and services and the ability of relatives and the estate of the recipient of the recipient to benefit from the resources.

24. For the large majority of programs involving the delivery of age-related goods and services there is no obligation on the entity providing individual goods and services to sacrifice

resources prior to delivery of those goods and services to the individual or individual household that has satisfied the explicit eligibility criteria. For example, an individual who has satisfied the explicit eligibility criteria for nursing care has still to remain alive and present themselves at the relevant service delivery point, such as a nursing home, in order to benefit from the care. If the individual were to die prior to entering the nursing home there is very unlikely to be a provision for the transfer of that entitlement to nursing care to the beneficiary's relatives or estate and no present obligation leading to the recognition of a liability on the part of government would therefore arise.

25. There may be a very limited number of cases where an individual satisfies the implicit eligibility criterion of staying alive at the same time that the explicit eligibility criteria are satisfied. In such cases there may be a present obligation leading to the recognition of a liability on the part of government even though that recipient dies before the goods and services to which eligibility has been established have been delivered.

26. Where an individual purchases goods and services and seeks reimbursement from a public sector entity a present obligation will arise at the point at which the goods and services are provided to the individual, provided it can be demonstrated that the individual had a prior authorization to purchase the goods and services and had met all eligibility criteria and the entity providing the reimbursement has sufficient information to measure the amount outstanding reliably. Under such circumstances the individual is, in substance, acting as an agent of the public sector entity and is incurring expenditure on behalf of that entity.

27. Under the requirements of this Standard a liability will not be recognized for age related individual goods and services to be provided in future periods. There are likely to be expectations that the government will continue with many activities designed to provide benefits to those who have reached pensionable age into the foreseeable future. However, the expectation that goods or services will be provided in the future does not give rise to a present obligation arising from a past event that results in the government having no realistic alternative but to settle.

28. An entity may have contracts with third parties for the supply of goods and services needed to provide age related individual benefits on an ongoing basis, including into the future. When the goods or services are provided a present obligation will arise in respect of the service provider – the past event that gives rise to the present obligation is the provision of the goods and services. Expenses and liabilities in relation to such contractual arrangements to supply goods and services will be recognized as for other executory contracts in accordance with IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets.* Similarly, contingent liabilities associated with agreements with suppliers are disclosed in accordance with IPSAS 19.

29. If individual goods and services are provided directly by government entities using the government's employees, present obligations arise as a result of contracts with those employees. The entity accounts for such transactions in the same way as for other employment contracts. The fact that the reporting entity has entered into employment contracts with employees involved in the provision of individual goods and services for future periods does not create a present obligation in relation to citizens prior to delivery of those services. Rather, a present obligation to employees arises as those employees provide the services in accordance with the employment contract.

30. Where the entity has entered into commitments for the acquisition of property, plant and equipment needed to provide individuals goods and services in the future-for example. a new hospital or clinic- those commitments should be disclosed in accordance with IPSAS 17, *Property, Plant and Equipment.*

Contingent Liabilities

(Staff Note: Requirements and commentary relating to Contingent Liabilities will mirror those in SPO ED at paragraph 50 of ED at Item 9.2)

Measurement

31. **The amount recognized as a liability shall be the best estimate of the expenditure required to settle the present obligation at the reporting date.**

32. The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the reporting date or to transfer it to a third party at that time. The estimates of outcome and financial effect are determined by the judgment of the management of the entity, supplemented by experience of similar transactions and, in some cases, reports from independent experts. The evidence considered includes any additional evidence provided by events after the reporting date.

Basic/Welfare Pension and Age-Related Cash Transfers

33. The amount of any liability recognized in respect of the basic/welfare pension and age-related cash transfers will be benefits that are due and payable. That liability is for the benefits to be provided to the individual until the reporting date, unless the legislation or regulations governing the program allow the estate or relative of a recipient who dies between the reporting date and the date at which eligibility has next to be revalidated to benefit from the cash transfer up to the date of formal revalidation. In that case the liability will be for the full amount payable up to the next validation point.

Age-Related Individual Goods and Services

34. A liability in respect of individual goods and services is recognized only in the circumstances outlined in paragraph 25, where a program requires the transfer of resources to the relatives or estate of a beneficiary even though the individual is no longer alive. It is for entities to determine the best estimate of the amount required to settle the present obligation at the reporting date. The amount recognized as a liability will depend upon whether the transferring entity already controls the asset to be transferred or whether it has to acquire the asset for transfer. In the former case the amount required to settle the present obligation at the reporting date will be the carrying value of the asset. In the latter case the amount required to settle the present obligation at the reporting date will be the fair value of the asset that has to be acquired. This Standard does not provide an exhaustive analysis of all the potential amounts at which a liability in relation to present obligations in respect of individual goods and services might be measured.

Staff Note: If standalone ED, sections will be necessary on:

Disclosures

(Staff Note: Detail of disclosures will be considered when requirements for pensions are agreed and members can assess the "package".)

Effective Date

(Staff Note: To be considered when approach determined)

CURRENT DEVELOPMENTS IN PENSION ACCOUNTING: SNA & GFSM

Introduction

The purpose of the paper is to:

- outline current requirements for pensions accounting in SNA 1993 and GFSM 2001;
- highlight modifications to current SNA requirements which are likely to be adopted in SNA 2008;
- consider whether proposals for the modification of requirements in SNA and GFSM are consistent with the view on obligating events and present obligations for the basic/welfare pension and the preliminary views in relation to general/contributory pensions, expressed at the New York meeting in July 2005; and
- highlight the relationship between proposals for change in SNA and an IPSAS based on IAS 19, "*Employee Benefits*" .

The Paper cross-refers to the report of the meeting of the Task Force on Employers' Retirement Schemes, which is included as at Agenda Item 10.4. It should be read in conjunction with that report.

Members are asked to bear in mind that the objectives of statistical accounting differ from those of accrual accounting and that the scope of the SNA is much broader than that of IPSASs. The primary purpose of financial information prepared in accordance with statistical reporting bases is to provide information suitable for analyzing and evaluating fiscal policy. Statistical accounting has particular concern with fiscal aggregates and with flows between sectors.

Current Requirements in SNA 93

SNA 93 differentiates social security schemes run by the government for the general population and social insurance schemes. Social insurance schemes are schemes which involve contributions and include pension schemes operated by employers (including government as an employer) on behalf of their employees. Currently no liabilities are recorded for contributory social security schemes.

SNA 93 distinguishes funded and unfunded employer pension schemes. An unfunded scheme is defined as "one where there are no identifiable reserves assigned for the payment of benefits. In such cases, benefits are paid from the receipts of contributions with any surplus or deficit going into, or being drawn, from the scheme manager's other resources".

Funded schemes are differentiated between "autonomous funds" and "non-autonomous" funds. Autonomous schemes constitute separate institutional units operating on their own behalf in contrast to schemes in which "the funds are segregated from the rest of the employers' own funds (but) are not autonomous". The distinction in the current SNA between autonomous and non-autonomous funds is important for statistical purposes for sector analysis, because it dictates the sector into which the scheme is classified and the accounting entries and flows are recorded. Autonomous schemes are classified within the insurance corporations and pensions fund sector, whereas non-autonomous schemes fall within the sector of the employer responsible for the scheme; a public sector defined benefit scheme would therefore be within the general government sector. Autonomous schemes are dealt with in the same way as pension schemes run by insurance corporations. In the view of

Staff the distinction between autonomous and non-autonomous schemes is not relevant for accrual reporting purposes.

From the perspective of the IPSASB the most significant aspect of the current SNA requirements is that no pension liabilities are recorded in the core accounts for unfunded schemes. Whilst the SNA recommends the recording of unfunded pension liabilities as memorandum items there seems some doubt whether this has been done consistently in practice. Atypically, Australia has recorded the unfunded pension liabilities of government since its adoption of SNA 1993 in 1998.

There are a number of reasons for the approach in the current SNA. In the context of government schemes the main rationale appears to be a view that, in some countries, government can take steps to modify any pension obligation arising from an unfunded scheme at any time and that therefore any obligation cannot give rise to a liability in "a strict sense". More generally, those sceptical of recording liabilities related to unfunded schemes have also suggested that there are a number of technical difficulties principally related to measurement, including the robustness and availability of actuarial data and the determination of discount rates. These technical challenges do not seem materially different to those facing unfunded public sector schemes adopting the accrual requirements of IAS 19 or similar standards in relation to post-employment benefits.

Current requirements in GFSM

In common with SNA, GFSM 2001 does not require the recording of liabilities related to social security schemes. However, GFSM recommends that "transactions in unfunded government employer retirement schemes are considered…………to involve a contractual liability for government to its employees. As a result, the receipt of retirement benefits is considered to be a reduction of the same liability." Therefore, currently GFSM goes further than SNA in its treatment of public sector defined benefit pension plans.

Developments in SNA

As most members will be aware work is underway to revise SNA with effect from 2008. Francois Lequiller highlighted the main proposals of different participants formulating proposals for pensions in a paper, which was included at item 9.6 of the agenda items for the July 2005 IPSASB meeting. In broad summary these proposals were:

(a) recording liabilities relating to all unfunded employer pension schemes in core national accounts, but not changing the approach in the current SNA whereby no liabilities are recorded for contributory social security schemes.

(b) maintaining the approach in the current SNA of not recording liabilities relating to unfunded employer schemes in the core national accounts, and also not changing the approach to contributory social security schemes. These alternative views proposed recording transactions relating to unfunded employer schemes and social security in supplementary information.

The OECD put forward a third set of "compromise proposals". The OECD approach favoured the recognition of liabilities related to unfunded employers' schemes. Whilst accepting the general principle of non-recording of liabilities relating to the contributory social security scheme in the core national accounts, the OECD proposed recognizing pension liabilities in relation to pension obligations for government employees covered by the contributory social security system in the core accounts. Members should refer to Francois' paper for further detail. A copy of that Paper is available from Staff on request.

The current proposals for change arise from the deliberations of the Task Force on Employers' Retirement Schemes, which met in Washington in late September 2005. These proposals will go forward for ratification to a meeting of the Advisory Expert Group (AEG) in February 2006. Whilst it may be anticipated that these proposals will flow through to full adoption they are at present provisional. The most significant are:

- incorporation of liabilities related to government employer pension schemes in the core national accounts, regardless of whether funded or not;
- recognizing pension liabilities in relation to pension obligations for government employees covered by a social security system in the core accounts;
- excluding liabilities from social security schemes from the core accounts **except for** government pension obligations in relation to government employees (see below);and
- recognizing liabilities related to contributory social security schemes in a separate supplementary set of accounts **but not** in the core national accounts (see below in relation to government employees); and

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The proposal to recognize liabilities related to the general contributory social security scheme in respect of government employees by far the most radical. The main justification is that the boundary between social security systems and pension plans established by government for general government employees is often arbitrary and, in substance, there is no difference in the government's obligation regardless of whether it arises from contributions made by government and government entities in respect of government employees to a stand-alone employer scheme or to the general social security system.

This proposal also raises the issue of the treatment of possible contractual obligations on government arising from non-government employees covered by general contributory social security schemes. The report of the Task Force reflects a view that such schemes combine the basic social security function with what is effectively a multi-employer pension scheme and that the criteria for distinguishing basic social security from employer related pension schemes need to be reviewed as a matter of urgency. This may suggest that the SNA is moving towards a recording of a liability in relation to non-government employees covered by contributory social security schemes. Obviously the issue of whether such liabilities are within the scope of IAS 19 is less of a concern to statistical accountants than to accrual accountants.

Implications of the proposals for IPSASB

It should again be stressed that the proposals highlighted above in relation to the SNA are provisional and that any analysis of the implications of such proposals on IPSASB's development work on pensions is subject to final decisions made on the SNA.

At the July 2005 meeting IPSASB confirmed its view that for the basic/welfare pension the obligating event occurs when all key eligibility criteria have been satisfied and that "staying alive"/"continuing existence" is a recognition criterion; practically this means that accounting for the basic/welfare scheme is on a "due and payable" basis. Currently there is no recording of a liability in relation to non-contributory social security schemes in the SNA or GFSM and there are no Task Force proposals to change this approach. Whilst the IPSASB approach does not fully mirror the approach in SNA it is the Staff view that the current IPSASB approach to determining liabilities for the basic/welfare pension is close to the approach in SNA and GFSM and that it is unlikely that differences arising from the different approaches will be material.

At the July IPSASB meeting in NewYork there was a short preliminary discussion about obligating events in relation to general/contributory pension schemes. Whilst no firm decision was taken Staff sensed a view emerging form some members that, again, the obligating event arises when all key eligibility criteria are satisfied. Such a view is not inconsistent with the current approach in the SNA. Of course IPSASB has not considered the requirements for disclosures in relation to the general/contributory scheme.

IPSASB has not yet addressed IAS 19, *Employee Benefits*. An issues paper covering a number of aspects of IAS 19 and related pensions issues is included at Agenda Item 10.5. The issue of whether unfunded defined benefit pension schemes are within the scope of an IPSAS based on IAS 19 is addressed in that Paper. It is the firm view of Staff that a defined benefit plan would not be outside the scope of such a Standard just because there are no plan assets and the plan is therefore unfunded. Therefore the SNA proposal to recognize liabilities in respect of unfunded employer schemes is likely to be consistent with IAS 19 and therefore with an IPSAS based on IAS 19. In the view of Staff there is no doubt that non-government employees covered by contributory social security schemes are not within the scope of IAS 19. This is because non-government employees are not employees of the public sector reporting entity.

Staff wishes to highlight an issue related to the measurement of liabilities in the Report on the Meeting of the Task Force. The report discusses different approaches for measuring liabilities and contrasts the projected benefit obligation (PBO) and the accrued benefit obligation (ABO). The main difference between the two methods is that PBO involves a projection of future salary increases, whereas ABO is based on years of service to the date of the actuarial calculation. The Task Force view is that ABO is more appropriate for statistical accounting purposes. Obviously because ABO is underpinned by a set of actuarial assumptions that do not include projected salary increases, liabilities determined by this method will be materially lower than those determined by the project unit method in IAS 19. The Report further includes an observation that “international accounting standards are also likely to move to the use of the ABO valuation on the balance sheet in the future”. Staff are unaware of any explicit proposals either in the public domain or under development by IASB to adopt an ABO style approach rather than the projected unit method. The IASB Observer has confirmed that there are no current proposals to amend this aspect of IAS 19, although of course a broader review of IAS 19 may be possible in the future.

The Task Force proposals on discounting are fairly terse. However, the conclusion that the discount rate will be based on high quality bonds appears consistent with IAS 19.

Conclusion

In summary Staff views many of the proposals for modifications to the SNA made by the Task Force in respect of pensions to be consistent with, or convergent to, approaches currently being formulated by the IPSASB. In particular the current and projected approach in SNA and GFSM to liabilities arising from the basic/welfare pension is consistent with the “due and payable” approach agreed by members at the July meeting of the IPSAS. The Task Force proposal that liabilities relating to funded and unfunded employer pension schemes should be recorded will, if adopted, bring statistical accounting treatments closer to IAS 19, although, as highlighted above, there is some ambiguity about the extent to which the measurement approach might differ from that in IAS 19.

IPSASB will also have to consider the impact of the SNA proposal, highlighted above, to recognize pension liabilities in relation to pension obligations for government employees covered by a social security system in the core accounts. This issue has been identified as a major issue in IAS 19 and is further discussed at Item 10.5. At this stage Staff proposes to monitor this development and report further to the March meeting of IPSASB. The possibility that then SNA may move towards a recording of a liability in relation to non-government employees covered by contributory social security schemes will also create an issue for the IPSASB.

Report on the Meeting of the Task Force on Employers' Retirement Schemes[1]

September 21-23, 2005

Introduction

The task force was established at the suggestion of the Advisory Expert Group on National Accounts and the meeting was sponsored jointly by the International Monetary Fund and the U.S. Bureau of Economic Analysis. The meeting was chaired by Messrs. Adriaan Bloem (IMF) and John Ruser (BEA).

Accounting in full for pension liabilities

A discussion paper on this topic was presented by Anne Harrison (OECD). Anne explained the background behind the *1993 SNA* treatment of pension schemes, and summarized the main features of that treatment:

1) Output is measured separately for autonomous private pension schemes, and other life insurance;
2) Output for non-autonomous pension schemes is not recorded separately and is treated as ancillary to the employer's main output;
3) Employer's contributions (part of compensation of employees) are measured as the actual contributions to funded pension and social security schemes;
4) Employer's contributions are imputed for unfunded pension schemes – while the *1993 SNA* recognizes that this imputation should be based on actuarial considerations, in practice it suggests that it be based on benefits paid in the current period;
5) Actual employee contributions are recognized for all pension (and social security schemes);
6) Property income attributed to beneficiaries, and therefore supplementary contributions, is only recorded for funded pension and life insurance schemes, and is measured as the investment returns on the fund assets (the insurance technical reserves). The investment returns include interest and dividends but not holding gains from securities, which means that two funds similar except one has interest bearing and one non-interest bearing investments are shown having different amounts of premium supplements and thus output.

For non-autonomous funds, the treatment of output as ancillary to the main activity of the employer is not in line with the economic nature of this activity, which provides services to the beneficiaries rather than to the employer. Therefore, this activity should be

[1] Based on a draft prepared by Mr. Brian Donaghue (expert).

considered as a secondary activity of the employer, and the costs borne by the household sector.

Considering the economic nature of pension contributions:

1) The contributions by employers and employees should be at least equal to the increase in future benefits, discounted to present value, resulting from work done by the employee in the current period;
2) The difference between this amount and the actual contributions should be used to derive the imputed value of employer contributions to unfunded pension schemes;
3) Supplementary contributions, which are paid out of property income redistributed to future beneficiaries, should be at least equal to the increase in future benefits due to service provided in previous periods that results from the decrease in the discount period;
4) No change is required in the recording of employee's contributions.

The *1993 SNA* distinguishes funded from unfunded schemes but makes not mention of the fact that some "funded" schemes may be under or over funded. The calculations described in 1 and 2 above should apply also to determine an imputed contribution (additional to actual contributions) by the employer in the case of an under-funded scheme and an imputed transfer from the schemes to the employer in the case of an over-funded scheme.

The CMFB/Eurostat view, while accepting the general approach outlined above, is that an important distinction remains between funded and unfunded pension schemes. There are a number of characteristics backing up this position, described in a section below, which lead to the proposal to record stocks and flows relating to unfunded pension schemes in a asset of supplementary accounts rather than in the core accounts.

The consensus of the task force discussion was that economic analysis would be better served if analysis of pension schemes shifted from the current focus on the assets of pension schemes to their liabilities, and took account of the contractual nature of employer-employee relationship. This entails an actuarial approach to defined benefit schemes. The funding arrangements, and fund assets, are important but do not define the pension benefit to the household. This change would provide a more consistent treatment of (particularly) government schemes, which have different funding arrangements but essentially the same economic effect. This change would improve the present recording of employer balance sheets, and also reflect the asset situation of households who behave as if they have an asset for all these schemes.

Peter Harper (Australian Bureau of Statistics) outlined the treatment of defined benefit pension schemes in the Australian National Accounts. Australia has recorded the unfunded pension liabilities of governments and the counterpart unfunded pension assets of households since the introduction of the *1993 SNA* in 1998. The treatment is broadly consistent with that outlined in the issues paper *The Statistical Treatment of Employers'*

Pension Schemes prepared by the IMF and discussed by the AEG at its December 2004 meeting.

Defined benefit schemes in Australia are mainly operated by governments, and comprise funded, unfunded, and partly funded schemes. The treatment adopted in the Australian national accounts reflects the view of Australian economic accountants of the economic nature of these schemes, the need to maintain consistent treatment of pension schemes between the Commonwealth (Federal) and various State and Territory governments, and the fact that liabilities for these schemes are already recorded in the balance sheets of all governments, irrespective of the degree of funding. Non-government defined benefit and mixed defined benefit/defined contribution schemes follow mainly cash-based accounting conventions, but are relatively unimportant compared with government pension schemes.

The starting point in compiling data for these schemes is the actuarially based estimate of the net present value of the employer liability and household asset associated with promised retirement benefits. The change in the liability position from one period to the next is decomposed into the following components:

- Imputed employer contributions for new and existing employees for service provided in the current period;
- Plus imputed property income on the outstanding liability to provide retirement benefits (property income attributed to insurance policyholders) arising from the reduction in the discount period;
- Plus revaluations;
- Plus revisions due to changes in actuarial assumptions and the extent of the benefits payable under the scheme;
- Less benefits payable.

The recording in the accounts is as follows:

- Defined benefit pension obligations are recorded as a liability on the balance sheet of the general government sector, and as an asset on the balance sheet of the household sector;
- Imputed employer contributions are recorded as compensation of employees in the income accounts of the general government and household sectors;
- Imputed property income attributed to insurance policyholders is recorded in the income accounts of the general government and household sectors;
- Changes in technical reserves due to transactions (imputed employer contributions plus imputed property income less benefits payable) are recorded as the incurrence of a liability in the financial account of general government and an acquisition of a financial asset in the financial account of households;
- Revaluations and changes in actuarial assumptions and/or defined benefits are recorded in the other changes in assets accounts.

Defining output of defined benefit pension schemes

The Australian view is that the output of pension schemes (both autonomous and non-autonomous) should be based on the cost of managing these schemes (including capital costs) and that the cost should be attributed to the beneficiaries (households). Conceptually the service charge should be classified as part of compensation of employees, including an amount to cover the service provided after retirement, but in practice simply recording the funding as compensation of employees in the period in which the service is provided might be a more practicable alternative.

Defined benefit schemes can be either over or under-funded, and the difference between fund assets and the actuarially determined liability should be recorded as an asset (if over funded) or liability (if under funded) of the employer or other sponsor of the scheme. The defined benefit scheme itself should have zero net worth.

The institutional sector and industry to which the imputed output is classified is also an issue that requires clarification. If the activity is recorded in the sector and industry of the employer then it could result in a number of industries producing life insurance and pension fund products. The Australian preference would be if possible to establish the non-autonomous fund as a quasi-corporation classified to the financial corporations sector and financial services industry.

Peter van de Ven (Statistics Netherlands) described the problems that the recording of output of autonomous pension schemes has raised for the Netherlands because investment income from transactions (interest, dividends) is treated as property income but holding gains or losses are not. The Netherlands has a number of large autonomous defined benefit schemes which are responsible for very substantial holdings of assets. The calculation of output following the *1993 SNA* is derived as: actual premiums earned plus premium supplements minus benefits due minus change in insurance technical reserves due to transactions. Because a large part of the investment income of autonomous pension schemes in the Netherlands derives from holding gains and losses of securities, which are in fact held for that purpose, the application of this formula has resulted in volatile and sometimes even negative measures of output for these schemes.

Examination of the operating process of these schemes indicates that during the process of determining the level of contributions a service charge is calculated explicitly, and charged to the policy holder as an implicit part of total contributions. To approximate this service charge, two mutually consistent indirect methods can be applied:

- Output = costs + (expected) profits
- Output = contributions (ex ante) + (expected) investment income – (expected) benefits – (expected) change in insurance technical reserves.

The first formulation comes from the production account. The second from consolidating all the entries in the current accounts but because the “expected” elements cancel out, it reduces to the first.

The expected holding gains and losses should be included in these calculations because the insurer does not differentiate between sources of receipts in setting the level of contributions and thus of the service charge. However, the question arises whether all income and profits should be included in calculating the service charge, or only funds allocated to the underwriting function.

Task force discussion on this topic reached the conclusion that it is appropriate to use expected transactions and expected holding gains and losses to explain the service charge, and that use of expected holding gains and losses in this way does not contravene the *1993 SNA* rules on the treatment of holding gains and losses because it is merely a way to determine the actual service charge. However, only funds used in the underwriting function should be included in this calculation, or in other words, investment income from own funds should continue to be excluded.

The question was raised whether the cost of providing non-autonomous pension benefits requires imputation or could remain as ancillary activity of the employer. It was agreed that conceptually the managing of non-autonomous pension schemes was secondary rather than ancillary activity, but that where the cost is minor an ancillary treatment could still be used. Where possible, the pension fund should be classified as a quasi-corporation operating in the financial corporations sector and deemed to be providing market services. It was further agreed that the output of non-autonomous pension schemes should be valued at cost, and that the output is consumed by the household sector.

It was agreed that in general the service flows corresponding to output should be recorded as a deduction from property income attributed to policyholders. If the whole of the property income is imputed, then an addition to it to cover the service cost needs to be made.

Developing actuarial estimates

Peter Harper provided a brief description of the process involved in compiling data for unfunded pension schemes in the Australian national accounts. In the case of Australia the compilation process is greatly facilitated by the fact that data is already included in government accounts.

Task force discussion centered on whether compilation of these data would be feasible, and whether they would be reliable, even if they were not included in government accounts. Peter Harper noted that the data are compiled without evident problems even for small Australian governments, and that the process should be reliable if done by professional actuaries following international best practice. He also noted that while revisions are inevitable following actuarial reviews, in practice the reviews have usually changed the liabilities by about 2 percent, and that because this change is included in the other economic flows category it does not affect the main economic aggregates. Some task force members suggested that the Australian experience might be an exception and that most governments are still in the process of developing actuarial data, but the contrary view was also put forward that appropriate data is anyway required for the internal management of pension schemes and might therefore be available even if it is not yet published in the accounts.

Joe Wilkinson (Statistics Canada) commented that it would be very difficult to compile consistent data for Canada under the current cash-based *SNA* treatment because unfunded pension schemes are migrating to a funded basis and therefore the proportion of funded versus unfunded stocks and flows is continually changing. Also, given that governments are recording these data in there own accounts it would seem “bizarre” to exclude them from the national accounts.

A description of the process of developing actuarial estimates for defined benefit pension schemes in the United States was given by Tonya Manning (Aon Consulting). Tonya outlined the types of pension plan sponsors[2] and types of pension plans found in the US and then provided more detailed information on the data required to carry out actuarial studies for defined benefit pension schemes, and the typical processes involved in those calculations.

Defined benefit pension plans are found in both the private and public sectors and cover both plans designed for a single employer and plans covering multiple employers. Plans can be traditional defined benefit or hybrid defined contribution plus defined benefit, and can be funded or unfunded.

The input data relating to the employees (e. g. age, gender, period of employment, current wage or salary rate, expected time until retirement) and plan details (e. g. retirement benefit formula(s), early retirement provisions, pension plan history) are provided by the employer (or sponsor) and are combined with external data such as various bond rates and life expectancy tables. The data and methodology used are required to adhere to standards set out by legislation and actuarial standards, although some discretion is given to the employer in the use of economic data and to the actuary’s professional judgment. The actuarial estimates are usually derived individually for each employee and then combined to give an overall result, although it is possible to use relatively homogeneous employee/beneficiary categories to develop more approximate estimates. Actuarial estimates inevitable involve a number of assumptions and changes in those assumptions will change the results of the calculation, sometimes substantially. In particular, changes in the discount rate used to discount future benefits to current value can substantially affect the present value of pension liabilities.[3] The standards require that the discount rate should be based on high quality bond rates relevant to the employer and with a time to maturity appropriate to the discount period.

[2] Either the employer or autonomous fund manager.
[3] E. g. Increasing the discount rate by 1 percent can reduce liabilities by around 10 percent for a mature plan, or 20 percent for a plan with mostly young employees.

A number of different valuations (i. e. using different sets of assumptions in the actuarial calculations) can be provided for various purposes, but the two most important for accounting purposes are:

a) the projected benefit obligation (PBO); and
b) the accrued benefit obligation (ABO).

The PBO is calculated by first estimating the total pension benefits the employee will earn during his entire career with the employer, allocating this equally to his years of service and then calculating the amount attributed to his years to date. The ABO is calculated only for the years of service to date using current wage and salary rates. The PBO is consistently higher than the ABO during the employment period with a large difference in early years slowly decreasing towards the retirement date when their values coincide. The task force consensus was that the ABO would be the more appropriate valuation to use for national accounting purposes. The accounting standards generally currently prescribe use of the PBO valuation in the balance sheet, with the ABO valuation being provided in the notes to the accounts. However the task force was informed that international accounting standards are also likely to move to the use of the ABO valuation on the balance sheet in the future.

There was a discussion about how discount rates are chosen. This is a matter of some choice between the employer, the accountant and the actuary but the usual outcome is to choose the rate of high quality bonds relevant for the employer in question.

The case of multi-employer schemes was also discussed. In these a single pension fund takes on the responsibility for managing the assets of the fund and administering the payout of benefits. The fund may take over the responsibility for ensuring the adequacy of the fund to meet its liabilities in which case the employer has no further liability. (Future employer contributions being routed through households.) The pension fund in this case is operating on an insurance basis, hoping to generate more than sufficient investment income to cover future benefits.

Tonya indicated that the cost of preparing actuarial estimates, given adequate data sources, was of the order of half a staff year, and around one staff month per year would be required for an annual update.

Borderline between employer pension schemes and social security schemes

Bo Bergman (Statistics Sweden) described the Swedish pension system and its current treatment in the Swedish national accounts.

The current national Swedish pension system was instituted in 1994 and consists of three parts. The major part, with contributions of 16 percent of wages and salaries[4], is a notional defined contribution (NDC) pay-as-you-go (PAYG) system (titled Inkomstpension). The Inkomstpension is supplemented by a funded defined contribution

[4] Up to a specified ceiling.

(FDC) scheme with contributions set at 2.5% of wages and salaries, and an unfunded non-employer related basic pension. The pension system is compulsory, and covers the whole population. There are also ‘private’ (i. e. negotiated employer-employee contracts), mainly defined contribution schemes, which complement the national pension system, and which are similar for both private and public sector employees. Most of these schemes are funded, but unfunded or partly unfunded schemes still exist for civil servants.

The classification of the FDC was discussed before the new pension arrangements were introduced and it was obvious at that time that the SNA/ESA framework did not provide satisfactory guidance. The FDC was initially classified to the social security sector, but this classification was reviewed in 2002 and in 2004 Eurostat decided that the FDC should be split from the rest of the pension system and classified to the insurance corporation sector.

The basic pension is clearly within the ambit of social security, but the Inkomstpension is more difficult to classify. This scheme is classified as defined contribution because the benefits that will be provided are strictly related to the contributions, there is no lateral (i. e. between current beneficiaries) redistribution of income involved. The scheme is titled a notional defined contribution because there are no funds held to provide the future benefits. Current contributions are used to provide current benefits, and future benefits will be provided from future contributions. A link between contributions and benefits is recorded in individual beneficiary accounts. The pension benefits in these accounts are indexed to the growth in average income, less 1.6 per cent, and the average annual benefit for each beneficiary is calculated by dividing the notional balance in the account by age specific unisex life expectancy.

There is also an automatic ‘balancing’ mechanism. This mechanism increases or reduces the value of the notional assets in the fund to keep them in line with contributions. Therefore the ‘return’ on the contributions made by or on behalf of beneficiaries reflects, amongst other things, the level of contributions received in later periods. This clearly adds an element of longitudinal (i. e. between generations) redistribution of income to the Inkomstpension. In principle, there is no recourse to government to provide future benefits, beyond the need for government to maintain the Inkomstpension system itself – that is, the individual bears the whole financial risk.

The Inkomstpension is currently classified as a social security scheme, which means that as it is now in its growth phase net general government ‘revenue’ is recorded, which gives a misleading view of the government’s financial sustainability. The liability associated with this system is calculated (about 135 percent of GDP) and published by the Social Insurance Office, but is not recorded in the national accounts.

The task force agreed that this arrangement has elements of both a multi-employer pension scheme and a social security scheme, and is difficult to classify using current *SNA/ESA* guidelines.

The Swedish pension arrangements have been seen as a model by a number of other European countries, particularly in Eastern Europe , who have also introduced “notional defined contribution schemes.”

Recording of defined benefit pension schemes

Brian Donaghue (consultant, IMF) presented proposals for changes to the recording of defined benefit schemes, based on an analysis of the consistency and coherence of the treatment currently adopted for these schemes in the *1993 SNA*.

In the *1993 SNA*, a social insurance scheme is regarded as being funded only if reserve assets actually exist. When they do, these are assumed to belong to the future beneficiaries of the scheme. There is no discussion of the actuarial liabilities of the scheme and, in consequence, of the possibility of a scheme not being exactly funded. Any scheme without reserves is regarded as being unfunded. Although in the case of a defined contribution scheme future benefits directly depend upon the pension fund reserves, strictly the beneficiaries have a claim on the fund rather than ownership of the fund’s assets. For defined benefit schemes, a liability exists depending on an actuarial assessment of the benefits that the employer (or sponsor) will eventually be obliged to provide as a result of service provided to the current date. These benefits, which comprise the employer (sponsor) liability and beneficiary (household) asset do not logically depend on the value of the assets held as pension fund reserves, or indeed whether any reserve assets are held at all.

The reliability of defined benefit obligations ultimately depends on the viability of the employer (or sponsoring organization), so that unfunded defined benefit obligations incurred by a government may well be more reliable than funded obligations incurred by a private sector employer. The liabilities of defined benefit schemes are regularly estimated by actuaries following well established procedures, and therefore there is also no reason in principle why such liabilities cannot be estimated reliably. Therefore pension obligations meet the accounting criteria for recognition as liabilities. That is:

- They represent a claim on the employer (sponsor) that will result in the future outflow of economic resources;
- It is probable that the outflow of resources represented by the claim will eventually occur;
- The value of the outflow can be reliably measured.

The *1993 SNA* approach is inconsistent in that it does not follow the underlying principle of the *SNA* that similar economic events should be treated similarly. The liabilities of funded and unfunded defined benefit schemes both arise from contractual agreements, and the nature of the benefits, eligibility criteria, and valuation of the liability do not depend on the source of funding. There is no economic reason why unfunded schemes (or the unfunded parts of partially funded schemes) should be treated differently from funded schemes.

The *1993 SNA* treatment of defined benefit schemes is also not consistent with that adopted by the *Government Finance Statistics Manual 2001*, or by international accounting standards.

Reimund Mink (Directorate General Statistics, European Central Bank) and Dieter Glatzel (Eurostat) provided an alternate view of the appropriate treatment of pension schemes, based on a recommendation from the Committee on Monetary, Financial and Balance of Payments statistics (CMFB) in July 2005. That recommendation was:

1. to leave the core accounts unchanged;
2. to adopt a treatment for unfunded employer pension schemes and social security schemes, identical to that for funded schemes but to be recorded in a set of supplementary accounts.

The rationale behind the CMFB/Eurostat recommendation is:

- There are significant measurement problems in establishing the value of the liabilities of the fund. One factor giving unease is that, as confirmed by the actuaries in the meeting, that changes in the discount rate used can cause very significant changes in the estimated liabilities. This in turn significantly affects the figures for government debt both in absolute levels and as far as the movement over time is concerned;
- There is also unease that the derivation of liabilities is determined by a model rather than observation;
- In a number of large EU countries, it is difficult to draw the boundary line between unfunded employer pension schemes many of which refer to the government as employer and social security schemes. Both are funded on a PAYG basis and thus from the point of view of government may be seen to be close substitutes;
- Recent experience in Europe is that both social security and employee pension benefits may be altered unilaterally and with retrospective effect at any time;
- The size of social security liabilities is much greater than that for employer pension schemes. The EDG moderators recognize this and thus do not propose including liabilities for these schemes. By contrast, and given the difficulties of distinguishing the borderline between the schemes, the EU suggestion is to include both sets of liabilities but in supplementary accounts;
- From an analytical point of view, the behavior of households and governments differ under funded and pay as you go schemes, otherwise why introduce funded schemes;
- The current treatment aligns with statistical recording in financial statistics, because funded schemes effectively carry out financial investments, which is not the case for unfunded schemes.

The task force majority view was that while there was understanding of the concerns behind the preferred CMFB/Eurostat the rationale given for their preferred approach was not felt to be convincing, for the following reasons:

- Unfunded pension schemes and social security schemes are not always seen as close substitutes; unfunded pension schemes may be a closer substitute for funded pension schemes;
- Governments can, and sometimes do, abrogate their liabilities, including loan liabilities, but those liabilities are still recorded in the accounts;
- Measurement problems have not prevented unfunded pension schemes being recorded for many corporations and governments; such measurement is required under accrual accounting standards which have already been adopted by several governments and are expected to be adopted by most OECD (and some non-OECD) countries in the near future. The 1993 SNA should be forward looking and not limited by possible temporary difficulties in obtaining suitable data. Actuarial estimates are needed for the pension contributions component of compensation of employees and these use exactly the same modeling as would be used for unfunded schemes;
- Revisions due to changes in actuarial assumptions (including changes to discount rates) can be accommodated in the system via other economic flows
- The 1993 SNA treatment imposes a ‘penalty’ on the debt of governments; operating funded pension schemes versus those with unfunded schemes, because only funded schemes show pension liabilities;
- It is not obvious that the behavior of households and governments differ under funded and unfunded pension schemes; households appear to treat their pension asset interchangeability regardless of whether it is funded or not;
- It was suggested that an alternative to having a set of supplementary accounts could be to provide sufficient detail in the core accounts to permit the exclusion of flows and stocks relating to unfunded schemes to be removed for analytical purposes.

Francois Lequiller put forward for task force consideration a possible compromise approach to recognizing liabilities for both employer pension schemes and social security schemes. He expressed concern that a possible divergent approach among OECD on the treatment of these important entities in the national accounts, could seriously disrupt the process of developing international comparisons.

He noted that the position of the EDG moderators was to recognize liabilities of all employer pension schemes (especially general government as an employer) even if such schemes were unfunded, but not to change the *1993 SNA* treatment of social security schemes. In contrast the position favored by the CMFB and Eurostat is to report all unfunded pension liabilities (employer schemes and social security), but as supplementary, rather than core, accounts. The split between OECD countries on these issues reflects real differences between countries in the ways in which pension schemes are organized.

The approach favored by the moderators has the merits that it:

- Follows the trend in business accounting;
- Is in line with future public finance standards;
- Avoids changes to economic statistics resulting from changes from PAYG to funded schemes.

But the demerits are that it:

- Does not allow for a separate category of liability when a pension scheme, as distinct from social security, is unfunded;
- Does not treat the case where government employee pensions are covered by a social security scheme;
- Does not explain what happens when pension liabilities move from employer systems to social security systems, or the reverse.

The approach favored by the CMFB/Eurostat has the merits that it:

- Provides the maximum amount of information to users;
- Takes into account the gradation of the << strength>> of liabilities associated with different schemes;
- Takes into account the difficulties in estimating liabilities of unfunded schemes.

But the demerits are that it:

- Does not resolve the explicit exchanges of liabilities between different types of pension schemes (France Telecom, and other cases);
- Is not clear on the inclusion in the cost of labor of actuarial based contributions to unfunded defined benefit schemes;
- Could undermine the accuracy of the measure of profitability in the SNA.

The proposed OECD compromise is:

- *In agreement with the EDG moderators' position* to incorporate the liabilities of unfunded employer pension schemes in the core accounts;
- *In agreement with the CMFB/Eurostat position* to treat the stocks and flows of unfunded pension schemes as a separate category, leading to alternative balancing items;
- *In agreement with the EDG moderators' position* to keep the flows and stocks relating to social security outside the core accounts;
- *In agreement with the CMFB/Eurostat position* to include an estimate of contributory social security liabilities in a supplementary set of accounts.

An important additional OECD recommendation is:

- To record systematically the pension liabilities associated with government employees in the core accounts regardless of whether or not they are labeled <<social security;>>
- The rationale of this recommendation is that government is the sponsor whether labeled <<employer>> or <<social security.>>

In addition the OECD recommends investigation of mixed systems (Sweden, Poland, Hungary, and Chile) to determine the appropriate treatment of the associated stocks and flows

Task force discussion confirmed that a proposal on the treatment of pension funds needs to be found which will satisfy both those who wish to include imputed liabilities for unfunded schemes and those who wish to adhere to liabilities for funded schemes only. There was, though, much more support for including all elements in the core accounts allowing removal of some items for analytical purposes than the alternative of having separate accounts which could optionally be aggregated for analysis.

It was noted that a comparability problem already exists between governments which have funded versus unfunded employer pension schemes, and that this problem of comparability is compounded by the fact that the border between social security and government employer pension systems varies from country to country according to institutional arrangements. It is a matter of some importance to clarify the simple definition of social security in the *1993 SNA* to allow the economic distinctions between employer schemes and social security schemes to be applied. The essential distinction was agreed to hinge on whether the benefits are tied to the employer-employer relationship (and are therefore contractual in nature) or are provided by a more general scheme targeting income distribution.

Developing country issues concerning pension schemes

Ramesh Kolli (Central Statistical Organization, India) presented information on the impact on the national accounts of recording pension schemes for developing countries, with the main focus on India.

India does not have a pension scheme covering the entire population of the country. Employer pension schemes mainly cover government employees, and the formal private sector employees. The pension scheme for government consists of an unfunded defined benefit scheme, providing an annual pension together with a lump sum payment, and a defined contribution provident fund. A new defined contribution pension scheme was introduced in January 2004, and applies to all new employees after that date. Formal private sector employees are covered under the Employee Pension Scheme which is a defined contribution pension scheme.

The main problem for the Indian national accounts arises from adopting the 1993 SNA recommendation to use benefits paid as a proxy for contributions payable. The problems arise because:

- There is an abnormally high dependency ratio for the Indian civil service leading to an over estimation of compensation of employees, and GDP;
- Because pension liabilities continue to be paid by the Indian government even after entities have been privatized, the consumption is incorrectly shown against the general government sector;
- Similarly, where States have been reorganized the parent state continues to pay pensions and incurs the consumption cost;
- Following a revision of retirement age, pension payments were lower for two years, with resulting lower compensation of employees, and lower GDP;
- With the introduction of the new defined contribution scheme the real cost of the old defined benefit scheme will gradually fall, but will be still be high as measured by the benefits paid;
- The pension benefits are changed in accordance with pay revisions for existing employees, and this leads to volatility in GDP estimates.

Therefore an exercise has been carried out to develop an improved methodology to estimate employer contributions to unfunded pension schemes in India. The method used in the exercise uses rates of pension contribution by employees on foreign service. These rates are based on actuarial calculations, and imply that the government is contributing indirectly that amount as an imputed contribution.

Summary information was also provided on SNA recording issues for other important developing countries:

- Indonesia and South Korea
    - ❖ These countries nominally have defined contribution schemes, but they are under funded because of unforeseen changes in the number of new retirees and in pension benefits;
    - ❖ This results in problems in recording transfers made to these schemes by the governments, and in recording the granting of new rights.
- Philippines
    - ❖ The Government Service Insurance System is a contributory defined benefit scheme which attained a surplus in 2004. As a result it made a one billion pesos payment to general government, and also made additional one-off pension payments to households. It is not clear how these payments should be classified.
- Malaysia
    - ❖ The pension system is similar to India; government employees are covered by an unfunded defined benefit scheme.

Allocation of net assets of pension schemes

Peter van de Ven lead a brief discussion of the allocation of net assets associated with the under or over funding of autonomous defined benefit pension funds. This is particularly an issue for the Netherlands, where defined benefit schemes are required to hold ‘buffer’ funds of the order of 30 percent of their current liabilities. Also, because some of the fund assets are held as equity, stock market fluctuations can cause the degree of over-funding to be very volatile. It is also an issue for some developing countries, particularly where formally autonomous pension schemes are under funded.

Two situations were identified, the first where the autonomous fund has recourse to the employer to make up under-funding, or conversely the employer can take advantage of over funding to reduce its normal funding for a period, and the second where no such recourse is permitted (at least formally).

In the first case the consensus was that the pension fund would always have zero net worth, with the difference between the actuarially determined liability and the fund assets being an accounts receivable from the employer (if fund assets < liability) or accounts payable (if fund assets > liability).

In the second case the solution is less obvious. If the scheme is under funded with no recourse to the sponsor, it could be considered to have negative net worth. However, if the under funding persists, ultimately the household will get fewer benefits, and therefore perhaps there should be a write down (other changes in the volume) of assets for the household sector· Although there may be no formal agreement to make up the difference, the government may in fact provide the additional funding, as can be seen to have happened in the cases of Indonesia and South Korea. If such payments are ex gratia they would be classified as transfers. However, if the government were seen to have a constructive obligation to supplement under funding, then there would be a government liability to the fund, and a corresponding asset held by the fund.

If the fund is over funded (the Netherlands, Philippines) it could be considered to have a positive net worth, but once again the consequences are likely to be felt ultimately by either, or both, the employer or the beneficiaries. If the surplus results in a payment back to the employer, the employer benefits from the over funding. If additional payments are made to the beneficiaries the household sector receives the benefit. As can be seen above both these events occurred in the case of the Philippines.

The task force was not able to reach a consensus on this issue in the time available. More information should be sought from the international accounting debates on the attribution of ownership of any surplus or deficit on the pension fund reserves.[5]

[5] Brian Donaghue notes: *Although I do not think we reached this conclusion at the meeting, the neatest solution would be to assign a positive or negative net worth to the pension fund, and classify the transactions or other flows when they occur as the under or over funding is unwound.*

Conclusions of the Meeting

1) Output of non-autonomous pension schemes
   - In contrast to *1993 SNA* conventions, output for non-autonomous pension funds should be recognized;
   - Output of non-autonomous pension funds should be measured at cost (which might include the cost of involving an insurance company);
   - This output is consumed by the beneficiaries of the funds (i. e. households).
2) Property income for non-autonomous pension schemes
   - In contrast to *1993 SNA* conventions, for unfunded schemes an income should be imputed to the policyholders. This income should be equal to the property income due to the reduction in the discount period (see conclusion 3.2) plus the service charge.
3) Output of autonomous pension funds
   - Further work is needed on whether the definition of output of autonomous pension funds as actual contributions plus premium supplements less benefits less changes in actuarial reserves should be changed to specify expected premium supplements and expected benefits;
   - The value of property income redistributed to the beneficiaries (used as contribution supplements) should represent the expected property income on the accumulated value of benefits, due to the unwinding of the discount factor applied to the value of these benefits. The fact that some of this property income may be funded by holding gains is not a reason to deduct this amount from the redistribution.
4) Actuarial estimates
   - The accumulated value of benefits should be calculated only on service to date (ABO) and not take projected future levels of wages and salaries into account (PBO);
   - The actuarial basis for calculating the value of the asset to the household is consistent with the employer’s liability to provide future retirement benefits due to service provided to the current date.
5) Actuarial and accounting standards
   - Professional practice confirms the consistency of actuarial estimates and accounting conventions;
   - Accounting conventions are likely to move from the inclusion of PBO to ABO based estimates in the balance sheet, but PBO based estimates are expected to continue to be available.
6) Discount rate
   - An acceptable discount rate would be the interest rate on high quality securities relevant to the sponsor of the pension scheme.
7) Multi-employer schemes
   - A multi-employer defined benefit pension scheme typically assumes liabilities for all employees within the scope of the scheme; in that case an individual participating employer does not incur any further liabilities

once he has joined the scheme, apart from the regular contributions to the scheme, until he withdraws from the scheme.

8) Pension schemes
- Pension schemes are schemes set up to provide retirement benefits to participants, based on an employer-employee relationship;
- They include funded, unfunded, and partly funded schemes;
- They may or may not be mandated by government;
- They can be autonomous or non-autonomous;
- Autonomous schemes are included in the pension subsector of the financial corporations sector;
- Non-autonomous schemes are included in the sector of the sponsor, unless quasi-corporations can be established for the pension funds, in which case they are included in the pension subsector of the financial corporations sector.

9) Recording of pensions
- A clear majority of the task force recommended that all pension liabilities of employers should be recognized, irrespective of the degree to which the schemes are funded;
- They also recommended that a comprehensive recording of the stocks and flows of all pension schemes should be recorded in the core accounts;
- Specific guidance needs to be given to so-called “notional defined contribution” schemes;
- However, recognizing practical problems and user needs, a majority also recommended separately identifying the flows and stocks components of unfunded schemes.

10) Social security schemes
- Basic social security is essentially a redistributive process where benefits provided are not directly linked to the size of contributions;
- Some governments operate a scheme (composite social security) which combines this basic social security function with what is effectively a multi-employer pension scheme;
- The criteria for distinguishing basic social security from employer related pension schemes need to be reviewed as a matter of urgency.

ISSUES PAPER: APPLICABILITY OF IAS 19 TO PUBLIC SECTOR ENTITIES

Introduction

At the New York meeting in July 2005 the IPSASB directed Staff, subject to resource availability, to prepare for consideration at the November/December 2005 meeting initial materials relating to the applicability of IAS 19, *Employee Benefits* to public sector entities.

This Paper provides brief background on the development of IAS 19. It then considers a number of key issues related to the development of an IPSAS based on IAS 19 where directions need to be given before detailed work can commence on developing an ED of an IPSAS. It also considers whether there is a need for an IPSAS based on IAS 26, *Accounting and Reporting by Retirement Benefit Plans.* The paper addresses the following issues:

(a) Scope of IAS 19
(b) Unfunded Defined Benefit Pension Plans
(c) The Boundary Between General/Contributory Schemes and Employer Benefit Plans
(d) Discount rates
(e) Treatment of actuarial gains and losses
(f) IAS 26, *Accounting and Reporting by Retirement Benefit Plans*

Background to IAS 19

IAS 19, Employee Benefits, was first published in 1998. It superseded IAS 19 "Retirement Benefit Costs" which had been published in 1993 and itself was the successor to an earlier IAS 19 published in 1983. As its name implies, the 1998 version of IAS 19 was significantly broader in scope than its predecessors.

IAS 19 was amended in 2000 to provide a revised definition of defined benefit plan assets. IAS 19 was further amended in 2002 to place a limit on the recognition of an asset related to expected refunds or expected reductions in future contributions, solely as a result of the deferred recognition of past service costs and actuarial losses. A further amendment in 2004 was effected on:

- Application of defined benefit principles/accounting for multi-employer defined benefit plans
- Application of defined benefit principles/accounting in a group defined benefit plan
- Creation of an additional option for the recognition of actuarial gains and losses
- Additional disclosures

The amendment on the application of defined benefit principles/accounting for multi-employer defined benefit plans had the objective of clarifying and tightening accounting requirements for entities participating in a defined benefit multi-employer plan.

The amendment on application of defined benefit accounting in a group defined benefit plan had a similar objective for entities participating in group defined benefit plans. It particularly sought to dispel the misapprehension that, in their individual financial statements, entities participating in a group scheme should have an unqualified exemption from defined benefit accounting or should be able to treat a group plan as a multi-employer plan. Both amendments addressed the appropriate method of recognition of assets and liabilities.

The creation of the additional option for the recognition of actuarial gains and losses is discussed further below at (f).

The additional disclosures introduced by the December 2004 amendment related to:
- Reconciliations showing the changes in plan assets and defined benefit obligations;
- Further information about plan assets ;
- Information about the sensitivity of a defined benefit plan to changes in medical cost rates where material;
- Information about trends in financial characteristics of the pan, such as assets, liabilities, surplus/deficit;
- Information about contributions to the plan; and
- Further information about the nature of the plan.

Issues for consideration in determining whether development of an IPSAS based on IAS 19 to the public sector should be actioned.

(a) The Scope of IAS 19

IAS 19 includes within its scope:
- Post-employments benefits;
- Short-term employee benefits;
- Other long term benefits; and
- Termination benefits.

Post-employment benefits

The areas of IAS 19, which are the most technically complex and have proved most controversial are those relating to post-employment benefits. Post-employment benefits principally include retirement benefits, such as pensions, but also post-employment medical benefits and post-retirement life assurance. The latter components are not commonplace in the public sector in most jurisdictions, but are likely to be a feature of public sector terms and conditions in some jurisdictions.

The distinction in IAS 19 between defined contribution schemes and defined benefit schemes is axiomatic in dictating accounting treatments.

Defined contribution plans (often referred to as money purchase plans) are plans in which contributions are paid by the employer in respect of each employee who is a member (and often by the member) and the benefits payable on retirement are dependent upon the investment performance achieved by those contributions. In defined contribution plans the risk of the employer does not extend beyond the contributions made to the plan in respect of the employees. There is no “promise” that a particular level of benefits will be paid. Accounting for defined contribution schemes is relatively straightforward-the annual contribution payable is expensed and the liability at the reporting date will be limited to contributions due and payable to the plan. An asset will be recognized if there is a pre-payment of contributions by the employer to the plan.

Defined benefit plans (known in some jurisdictions as final salary schemes) are defined in IAS 19 as post-employment plans other than defined contribution plans. Under such schemes contributions are paid by the employer in respect of each employee who is a member (and often by the member) and benefits are specified, and are typically linked to final or average salary and years of service.

Defined benefit plans may be funded or unfunded. Funded plans are plans where assets are accumulated and earmarked in order to meet liabilities. Unfunded plans are plans where no such asset base exists and benefits are met directly by employing entities, normally on a pay-as-you-go basis. Even when funded, defined benefit plans expose employers to the downside risk that plan assets might be insufficient to meet plan liabilities.

IAS 19 requires that the financial statements reflect a liability for benefits that are to be provided in the future in exchange for employee services that have already been provided (or an asset when appropriate). In broad terms, the expense to be recognized in the operating statement is determined by reference to changes in the amount of the liabilities (subject to some options. IAS 19 also specifies some presentation requirements.

In respect of defined benefit plans, IAS 19 requires plan assets to be measured at fair value and plan liabilities to be measured on an actuarial basis and discounted to present value (see (d) below for a discussion of discount rates).

Issue
Should an IPSAS on accounting for employee pensions based on IAS 19 be initiated?

Staff View
The Staff view is that defined contribution plans and defined benefit plans are features of employee benefit packages in the public sector in many jurisdictions and that the IPSASB should develop an IPSAS based on the post employment requirements of IAS 19, to the extent that those requirements are applicable to the public sector. Members are asked to confirm the Staff view.

Other Employee Benefits within the Scope of IAS 19
The scope of IAS 19 is much broader than pensions and post-employment retirement benefits. IAS 19 applies to all employee benefits, except those within the scope of IFRS 2, *Share-based Payment*. IAS 19 therefore also includes:

- Short-term benefits payable during employment such" as wages, salaries and social security contributions, recreation/holiday leave, sick leave, profit-shares and annual bonuses payable within 12 months of the reporting date. It also includes non-monetary benefits such as housing, cars and free or subsidized goods and services;
- Other-long term employment benefits such as: long-term compensated absence, long-term disability benefits, long-service awards and profit-shares and bonuses payable more than 12 months after the reporting date; and
- Termination benefits such as redundancy benefits.

Public sector entities provide benefits to employees in exchange for their services that are within the above categories. In most instances the arrangements differ little from the private sector, although profit-shares are likely to be rare, certainly outside GBEs. Bonus schemes may also be less common than in the private sector and, rather than overall profitability, may be linked to service accomplishments and adherence to budgetary targets. They are also likely to be known by other terms, such as performance related pay. Nevertheless, whilst the detail of public sector arrangements may differ from the private sector, the principles that govern the treatment of short-term benefits and other-long term benefits are likely to be relevant for public sector entities.

Termination benefits arise either from:

- An employer's decision to terminate an employee's employment before the normal retirement date; or
- An employee's decision to accept voluntary redundancy in exchange for those benefits.

Whilst the demarcation line between termination benefits and post-employment benefits can be blurred there can be no doubt that termination benefits arising from both the above circumstances are commonplace in the public sector in many jurisdictions.

Issue
Should an IPSAS address all employee benefits covered by IAS 19 as one project or should the post-employment benefits aspects of IAS 19 be separated from the other aspects of IAS 19 and considered separately?

Staff View
The relationship between general/contributory schemes and employee benefit plans may be complex. Therefore, there is a case for dealing with employee pensions and other the post-employment components of IAS 19 separately. The technical challenges of the components of IAS 19 dealing with Short-Term Employee Benefits, Termination Benefits and Other Long-Term Benefits should not be underestimated. However, they are relatively minor in comparison with the Post-Employment Benefits component and, arguably, do not give rise to a large number of public sector specific issues.

Therefore, the Staff view is that there is merit in developing a Standard in one phase that will address all components of IAS 19. Such an approach will also demonstrate the IPSASB's commitment to the second of its strategic priorities-convergence with IFRS. Members are asked to confirm this view or provide alternative directions.

(b) Unfunded Pension Plans

In the public sector it is common for defined benefit plans to be unfunded; that is to say there are no plan assets to offset gross pension obligations. Agenda Item 10.3 highlighted that, in an SNA context, some statistical accountants have argued in the past that, for unfunded plans, the lack of actuarial calculations for data on fund liabilities has militated against recording liabilities in the core national accounts. In addition, inconsistencies between the bases of actuarial approaches between plans, has been a further reason against recording liabilities in the core national accounts. It may well be the case that many unfunded public sector employee plans do not have up-to-date actuarial data on plan liabilities. However, Agenda Item 10.3 also highlighted that, for the SNA, there is a recommendation going forward to record liabilities in respect of all employer plans regardless of whether they are funded or unfunded.

IAS 19 makes it clear that unfunded schemes are within its scope. Paragraph IN 6 of the Introduction to IAS 19 states that "defined benefit plans may be unfunded, or they may be partly or wholly funded".

Issue
Should unfunded employee pension plans be within the scope of an IPSAS based on the principles in IAS 19?

Staff View
Staff is of the view that there is no public sector rationale for an unfunded employee pension plan to be excluded from the scope of an IPSAS based on IAS 19 just because there are no plan assets and the plan is therefore unfunded.

Members are asked to confirm these Staff views.

(c) The Boundary between General/Contributory Schemes and Employer Benefit Plans

General Government Employees in Contributory Social Security Schemes

There is an issue as to how general government employees covered by contributory social security schemes rather than stand alone public sector employee defined benefit plans should be addressed in an IPSAS based on IAS 19. Item 10.3 has pointed out that recommendations for the development of the SNA are moving towards recording a liability in respect of the government obligation to such employees.

Paragraphs of IAS 19 dealing with scope include employee benefits provided "under legislative requirements, or through industry arrangements, whereby entities are required to contribute to national, state, industry or other multi-employer plans".

Issue
Should the scope of the IPSAS include government employees covered by contributory social security schemes?

Staff View
Staff are of the view that, an IPSAS based on IAS 19, should encompass employees of the reporting entity covered by contributory social security schemes for whom the reporting entity makes contributions would be within the scope.

Members are asked to confirm this view.

Paragraphs 36-38 of IAS 19 specify requirements in relation to state plans. State plans are not defined in IAS 19, but commentary notes that "state plans are established by legislation to cover all entities (or all entities in a particular category, for example, a specific industry) and are operated by national or local government or by another body (for example, an autonomous agency created specifically for this purpose)." Paragraph 38 of IAS 19 concludes that state plans are normally defined contribution plans, but that, in the rare cases that a state plan is a defined benefit plan, an entity will account for it as a multi-employer plan. This means that the decision whether to account for it as a defined benefit plan will depend on whether sufficient information is available to use defined benefit accounting. This will depend upon the reporting entity and the circumstances of particular schemes.

Issue
Does the terminology and focus of IAS 19 in respect of these matters need to be modified for application in the public sector?

Staff View
The Staff view is that it is likely that there will need to be some refocusing of these aspects of IAS 19. In particular, the extent to which defined benefit accounting principles will be applicable for public sector entities with employees covered by composite social security schemes.

Members are asked to confirm this analysis or provide an alternative approach.

Non-government employees in Contributory Social Security Schemes
Item 10.3 also highlighted that SNA is moving towards the recording of a liability in relation to non-government employees covered by contributory social security schemes.

Issue
Should non-government employees be included within the proposed IPSAS based on IAS 19?

Staff View
Staff are of the view that non-government employees are not within the scope of an IPSAS based on IAS 19 because they are not employees of the public sector reporting entity. Members are asked to confirm this view.

(d) Discount rates

IAS 19 requires that "the rate used to discount post-employment pension obligations (both funded and unfunded) shall be determined by reference to market yields at the balance sheet date on high quality corporate bonds." There is a fall back that, where there is no deep market in such bonds, government bonds should be used. The Basis for Conclusions in IAS 19 explains the rationale for the requirements on the discounting of scheme liabilities. The main features of the Board's conclusions are:

- The discount rate should be the risk free rate – that is, not risk adjusted to reflect the nature of the obligation;
- The discount rate should be determined by market yields at the balance sheet date rather than the long-term average date; and
- The discount rate should reflect market yields on high quality bonds with an expected term consistent with the expected rate of the obligations.

Issue
Should a Standard addressing the post-employment benefits of public sector employees follow the discounting requirements of IAS 19?

Staff View
The rationale underpinning the discounting requirements of IAS 19 are amongst the most complex parts of the Standard. Decisions taken on discounting will be very significant because relatively small variations in discount rates can have very material impacts on the carrying vales of liabilities. If a decision is taken to develop an IPSAS based on IAS 19 it may be appropriate to commission some expert opinion on discounting. Staff is of the view that a risk free rate for public sector entities is likely to be related to the yield on government bonds rather than high quality corporate bonds.

(e) Treatment of Actuarial Gains and Losses

One of the most controversial areas of IAS 19 in recent years has been the treatment of actuarial gains and losses. IAS 19 defines actuarial gains and losses as:

- The effects of differences between the previous actuarial assumptions and what has actually occurred (known as experience adjustments);
- The effects of changes in the actuarial assumptions themselves, for example the discount rate; and
- The difference between the expected and actual return on plan assets.

Following amendments approved in December 2004 a number of approaches to the treatment of actuarial gains and losses are now permitted by IAS 19:
- The corridor approach – that is, recognition of actuarial gains and losses outside parameters specified in IAS 19;
- Any systematic method that results in a faster recognition of actuarial gains and losses than the minimum for entities using the corridor;
- Full recognition of actuarial gains and losses in profit and loss; and
- Full recognition of actuarial gains and losses in a separate statement, the Statement of Recognized Income and Expense (permitted following the December 2004 amendment).

In broad terms the corridor approach allows entities to defer recognition of actuarial gains and losses that do not exceed specified parameters, known as the corridor. The rationale for this is that, first, in the long-term actuarial gains and losses may offset each other and, second, that if the actuarial gains and losses are within the corridor, it is an indication that actuarial assumptions are acceptably reliable for reporting purposes.

The corridor limit must be determined and applied separately for each defined benefit plan in which the reporting entity has employees and therefore makes contributions. A multi-functional public sector entity with employees in a number of defined benefit plans will therefore have to make a number of separate determinations of the corridor parameters.

The corridor is the greater of 10% of the present value of the defined benefit obligation and 10% of the fair value of the plan assets at the end of the previous reporting period. Where the cumulative actuarial gains and losses exceed the corridor limit the portion of the actuarial gains and losses above the limit are to be recognized by dividing the excess by the expected average working lives of the employees participating in the plan.

There has been much criticism of the corridor approach on the conceptual grounds that it permits entities not to recognize transactions that meet the definitions of revenue and expenses. More contentiously it has also been suggested that it can distort financial performance by providing entities with a perverse incentive to make over-optimistic assumptions in the knowledge that, at most, only a proportion of resultant actuarial losses will have to recognized. Conversely proponents of the corridor have argued that it reduces volatility which can have a distorting effect on the performance statement.

Issue
Should an IPSAS on accounting for employee benefits in the public sector retain the IAS 19 "corridor" option?

Staff View
Staff is of the view that, whilst the conceptual deficiencies of the corridor are acknowledged, there is no compelling public sector specific reason to deviate from IAS 19 in this area. In fact, retention of the corridor partially responds to one of the criticisms made of the GAAP accounting approach to retirement pensions by some statistical accountants-that GAAP accounting approaches lead to unnecessary volatility in the recording of pension liabilities. Members are asked to confirm the Staff view on retention of the current approach in IAS 19 to the treatment of actuarial gains and losses or provide alternative directions.

(f) IAS 26, Accounting and Reporting by Retirement Benefit Plans

IAS 19 applies to employing entities in accounting for all employee benefits (except those to which IFRS 2 applies). IAS 19 does not apply to the financial statements of retirement benefit plans. A separate standard, IAS 26, Accounting and Reporting by *Retirement Benefit Plans* governs requirements for the financial statements of retirement plans. At the New York meeting in July 2005 some members expressed concerns about the financial reporting of public sector pension plans, noting that some plans that had been established appeared to be outside the scope of IAS 26 and were not controlled by public sector entities.

Issue
Should an IPSAS based on IAS 26 be developed for application to public sector pension plans?

Staff View
In the view of Staff development of a public sector Standard based on IAS 26 would complement IAS 19. Staff therefore considers that IAS 26 should be added to the IPSASB's long term work program to be implemented as staff resources permit. Members are asked to confirm Staff's view.