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Dear Stephanie,

COMMENTS ON SOCIAL BENEFITS

We welcome the opportunity to provide comments on:

- Exposure Draft 34 on *Social Benefits: Disclosure of Cash Transfers to Individuals or Households (ED 34)*;
- Consultation Paper on *Social Benefits: Issues in Recognition and Measurement;* and
- A project brief on *Long-Term Fiscal Sustainability*.

While we understand the dynamics of requiring the recognition of potentially significant long-term obligations on government's and public sector entity's financial statements, we would encourage the development of a Standard that deals comprehensively with the accounting for social benefits i.e. recognition, measurement, presentation and disclosure.

We do however support the interim proposal in ED 34 as this would most certainly prepare entities for a more comprehensive basis of accounting for social benefits in the future.

We propose that the disclosure of social benefits be considered as part of the review of the cash basis of accounting.

Our comments to you are set out in four parts:

- Part A responds to the specific matters for comment included ED 34 along with any additional comment on ED 34.
- Part B responds to the specific matters for comment included in the Consultation Paper.
- Part C includes our comment on the Long-Term Fiscal Sustainability project brief.
- Part D provides an outline of the types of social benefits found in the South African public sector, along with their current accounting treatment.

Please do not hesitate to contact me should you require any clarification on our comment provided.

Yours sincerely

Erna Swart

Chief Executive Officer

PART A - ED 34 ON *SOCIAL BENEFITS: DISCLOSURE OF CASH TRANSFERS TO INDIVIDUALS OR HOUSEHOLDS*

SPECIFIC MATTERS FOR COMMENT

1. The scope of this ED is appropriate (paragraphs 2–8). If you do not think that the scope is appropriate please detail how you would modify the scope. Please state your reasons.

1.1 Disclosure of cash transfers only versus disclosure of cash transfers and individual goods and services

The Board is of the view that an obligation arises for cash transfers and individual goods and services at the same point (see our response to question 2 under Part B).

As a result, the scope of ED 34 should require the disclosure of obligations relating to both cash transfer programmes as well as programmes for the provision of individual goods and services.

Currently, any expenditure incurred on providing social benefits is included in the statement of financial performance, based on the classification of expenses either by nature or function. The Board proposes that paragraph 45 of ED 34 require entities to disclose, in the notes to the financial statements, what portion of expenditure incurred in a reporting period relates to the provision of social benefits. For example, in South Africa, municipalities provide X free kilolitres of water per household and X free kilowatts of electricity per household. Users of the financial statements would find it useful to know what percentage of the water or electricity purchases included in the statement of financial performance were provided at no charge to consumers as part of a municipality's social policies. This information would be invaluable in assessing the quantum of social benefits provided by individual entities and across government.

1.2 Threshold eligibility criteria versus eligibility criteria

ED 34 defines threshold eligibility criteria as "all the criteria that an individual or household must satisfy when applying for a social benefit for the first time, or when reapplying for a social benefit after a period of ineligibility, in order to be entitled to individual goods and services or cash transfers".

In the South African scenario, the threshold eligibility criteria would include the application process, i.e. completing an application form for a specific social benefit and it being approved by the relevant entity.

The Board is of the view that only disclosing obligations for those individuals that have met the threshold eligibility criteria is inappropriate as many individuals may have in fact met all the other eligibility criteria, but may not have necessarily applied for social benefits. The Board is of the view that satisfying eligibility criteria rather than threshold eligibility criteria, is the past event that gives rise to an obligation for social benefits. Whether those individuals who have only satisfied eligibility criteria ever apply for social benefits, is a measurement issue.

The Board thus proposes that:

- Obligations (for both cash transfer programmes and programmes that provide individual goods and services) should be disclosed based on those individuals who have satisfied the eligibility criteria of a particular programme at the reporting date.
- The obligation should be measured at the best estimate of the present value expected to be transferred to individuals, which would include an estimate of how many individuals will in fact submit an application to receive social benefits in future. For example, based on past history, an entity may be able to estimate that X% of individuals who qualify for particular social benefits never apply for those benefits because they do not want to be dependent on state welfare.
- The estimate of the obligation should also consider the expected timing of the application by individuals for social benefits.
- To the extent that the obligation relating to the portion of individuals who have satisfied eligibility criteria cannot be measured reliably, no obligation is disclosed.
- The Board also proposes that the obligation be separated between those individuals that have satisfied threshold eligibility, and those that have satisfied eligibility criteria. Given that this might be onerous, this separation is only encouraged.

1.3 Exchange transactions - Insurance contracts

Paragraph 5 states the following: “Certain cash transfer programs may also require contributions by or on behalf of individuals. Such programs are within the scope of this Standard provided that the amount of the contributions is not approximately equal to the economic benefits transferred by the government or public sector entity. This Standard does not deal with the disclosure of such contributions. IPSAS 23, “Revenue from Non-Exchange Transactions (Taxes and Transfers)” provides guidance on distinguishing exchange and non-exchange transactions.”

In the South African public sector, many contributory programmes exist to provide benefits to individuals based on contributions paid, but the substance of these contributions and benefits paid is that they qualify as insurance contracts rather than as a social benefit or another type of exchange transaction.

Insurance contracts are defined in International Financial Reporting Standard 4 on Insurance Contracts (IFRS 4) as: “A contract under which one party (the insurer) accepts significant risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.”

When contributions and benefits paid by entities to individuals meet the definition of an insurance contract, as defined in IFRS 4, the Board is of the view that IFRS 4 should be applied. For purposes of application in South Africa, the Board has extended the definition of a ‘contract’ in the definition in IFRS 4 to include ‘legislation or similar means’.

Paragraph 5 currently does not provide guidance on how entities should account for exchange transactions that are in substance insurance contracts. The Board proposes that paragraph 5 be amended as follows:

"Certain cash transfer programs may also require contributions by or on behalf of individuals. Such programs are within the scope of this Standard provided that the amount of the contributions is not approximately equal to the economic benefits transferred by the government or public sector entity. <u>Where the substance of the contributions and benefits paid to individuals under cash transfer programs are insurance contracts, the international or national accounting standard dealing with insurance contracts shall be applied</u>. IPSAS 23, "Revenue from Non-Exchange Transactions (Taxes and Transfers)" provides guidance on distinguishing exchange and non-exchange transactions."

1.4 Transactions with exchange and non-exchange components

The last sentence of paragraph 5 states that: "IPSAS 23, "Revenue from Non-Exchange Transactions (Taxes and Transfers)" provides guidance on distinguishing exchange and non-exchange transactions."

Paragraph 10 of IPSAS 23 states: "There is further group of non-exchange transactions where the entity may provide some consideration directly in return for the resources received, but that consideration does not approximate the fair value of the resources received. In these cases the entity determines whether there is a combination of exchange and non-exchange transactions, each component of which is recognized separately".

It is unclear whether this requirement from IPSAS 23 should be applied to social benefit transactions. ED 34 should clarify in paragraph 5 that the non-exchange component of social benefit transactions are within the scope of this proposed Standard, while the exchange component is within the scope of other Standards.

2. The new definitions in this ED at paragraph 10 are sufficiently clear and comprehensive. If you disagree, please indicate (a) how these definitions should be modified and (b) which new terms should be defined. Please state your reasons.

The definitions are appropriate and comprehensive, and are appropriate as they are aligned to the Government Financial Statistics classification.

The standard wording included after the definitions section of each standard, should be added to ED 34, i.e. "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".

As part of the Board's financial instruments project, it has been considering the accounting treatment for the 'off market' portion of concessionary loans, which is determined as the difference between the present value of the inflows and present value of the outflows, using a market related rate at the date the loan is granted. The Board proposed in its Discussion Paper on Financial Instruments that the issuer of a concessionary loan should treat this shortfall as a subsidy cost.

The Board has been considering to what extent that 'subsidy cost' is within the scope of social benefits. ED 34 defines a cash transfer to an individual or household as "a social benefit, which is either provided directly in cash, or is an expense paid through the tax system, to protect individuals or households against certain social risks where use of the resources transferred is at the discretion of the individual or household".

The Board believes that this 'subsidy cost' would be within the definition of a cash transfer, but only to the extent that concessionary loans have been granted to an individual or household, and assuming that the transfers are discretionary (if the loans are not discretionary, the definition of individual goods and services should be considered). To the extent that concessionary loans are granted to other entities, they would not be deemed to be a social benefit.

It would be appropriate for the IPSASB to clarify either as part of paragraph 5 or as a separate paragraph, whether the disclosure of these types of transactions is included in the scope of ED 34 or if they will be excluded until such time as the IPSASB has considered the accounting treatment for financial instruments in the public sector.

The Board suggests that these types of transactions should be excluded from the scope of ED 34 until the IPSASB determines the appropriate measurement requirements for such transactions, along with the appropriate disclosures.

If these transactions are however included in the scope of ED 34, the IPSASB should clarify that for concessionary loans:

- the 'off market' portion of the loan is deemed to be a non-exchange transaction, and to the extent that they have been granted to individuals or households, they are within the scope of social benefits;
- the portion of the loan that is to repaid based on prevailing market conditions and rates is an exchange transaction and accounted for as a financial instrument;
- clarify the measurement basis to be used (as applying the principles in paragraphs 30–44 to concessionary loans would be inappropriate) and amend the disclosure requirements accordingly.

3. The requirements for the determination of amounts expected to be transferred to eligible individuals or households are appropriate (paragraphs 30–44). If you do not think that they are appropriate please indicate what those requirements should be. Please state your reasons.

The proposals in paragraph 30 to 44 are appropriate, and are consistent with other IPSASs that prescribe the measurement basis for long-lived actuarial provisions, for example, IPSAS 25 on *Employee Benefits*.

4. The disclosure requirements in paragraph 45 are appropriate. If you think that they are unduly onerous, which disclosures should not be required? Conversely, if you think that the disclosures are inadequate, what further disclosures would you include? Please state your reasons.

The Board does not believe that any of the disclosures listed in paragraph 45 are too onerous.

Paragraph 45(e) refers to 'the basis on which benefits will be increased in future'. The Board proposes that a similar requirement be added for the decrease of benefits (similar to a curtailment of a defined benefit plan under IPSAS 25 on *Employee Benefits*), by either adding a separate requirement or by modifying 45(e) as follows: "The basis on which benefits will be increased <u>or decreased</u> in future'.

Paragraph 45(g) refers to the use of a 'qualified actuary'. In the South African context, it was debated whether only an actuary could be used, or whether another 'professional valuer' could be used. It was argued that the calculation of the obligation required a quantification of social, political and economic factors, and that an actuary would not be able to make these projections on his or her own without the use of, for example, experts in the area of government policy.

The Board proposes to amend paragraph 45(g) as follows: Whether an ~~qualified actuary~~ expert or professional valuer has been used in the determination of the principal assumptions and, if so, whether that expert or professional valuer ~~actuary~~ is an employee of the reporting entity or an external engagement.

This aspect of the measurement of cash transfers for the purposes of ED 34 should also be considered when developing guidance on the recognition and measurement of social benefits.

5. The disclosure requirements in paragraph 45 are going to provide information that is verifiable. If you think that the disclosure requirements are not going to provide information that is verifiable, please identify the specific disclosures and state what those implications are.

The Board believes that the disclosures in paragraph 45 are verifiable. It does not however believe that some of the disclosures in paragraph 46 are verifiable.

Paragraph 46 states the following: "An entity is also encouraged to disclose broader assessments of the projected inflows and outflows associated with particular programs, so as to enhance the ability of users to assess the sustainability of those programs in the future. Where an entity discloses projections of outflows and inflows in relation to programs providing social benefits that exceed the requirements in this Standard, the entity is required to identify separately the information required by this Standard."

Based on discussions with auditors in our jurisdiction, it would be preferable that information about inflows and outflows associated with a particular programme not be included in the financial statements but presented elsewhere in the annual report. They did not believe that this information should form part of the statutory audit of the financial statements, and did not believe that this information was verifiable. As these disclosures form part of the long-term fiscal sustainability project, the Board proposes that this particular disclosure be deleted from ED 34.

The last sentence of paragraph 46 requires entities to distinguish 'required' from 'encouraged' disclosures in relation to the projected inflows and outflows of cash transfer programs. It is not customary to distinguish 'required' and 'encouraged' disclosures in the financial statements, and would not provide any value to users of the financial statements. The Board proposes that the disclosures not be separated into 'required' and 'encouraged' disclosures.

Refer to our response in 1.1 and 1.2 of Part A for potential additional disclosures related to individual goods and services and, threshold eligibility criteria and eligibility criteria.

6. The implementation arrangements are appropriate (paragraphs 50–53). If the implementation arrangements are inappropriate, please specify how you would change them. Please state your reasons.

Based on the input from preparers of the financial statements, at least two reporting periods are required to collate and verify data before the disclosure of such information is required in the financial statements. By making the Standard effective for at least two reporting periods after the date of issue, sufficient time would have been allowed.

PART B - CONSULTATION PAPER ON *SOCIAL BENEFITS: ISSUES IN RECOGNITION AND MEASUREMENT*

SPECIFIC MATTERS FOR COMMENT

1. Do you agree that, within the constraints of the current implied conceptual framework for general purpose financial reporting, current financial statements such as the statement of financial position and the statement of financial performance cannot convey sufficient information by themselves to users about the financial condition of governmental programs providing social benefits? Please state your reasons.

The Board agrees that additional information relating to social benefit programmes is required as part of general purpose financial reporting, as there are limitations to the types of transactions and events that can be included in general purpose financial statements.

The framework governing financial statements is particularly limiting in the following areas:

- The current definition of a liability states that a liability can only be recognised based on a past event occurring, which will result in the probable outflow of resources. It would be useful for users of the financial statements to obtain an understanding of the projections for a social benefit programme based on more than just, for example, those participants which have currently satisfied eligibility criteria. It would be useful to understand the impact of other demographic factors on social benefit obligations, such as population growth. These demographic factors cannot be considered currently in determining a social benefit obligation for financial statement purposes as it a prospective rather than a historical assessment.
- The right of government to levy taxes would not meet the current definition of an asset. As a result, entities recognise obligations to provide certain social benefits on an ongoing basis, but do not recognise a corresponding asset for the right to levy future taxes. Entities may, in terms of IPSAS 23 have an asset for taxes to be received, but this asset will be limited to those taxes that are receivable as a result of a taxable event having occurred during a particular reporting period. In making social policy decisions, it is important to understand how social benefit programmes will be funded not only in the current reporting period, but also into the future.
- It is therefore important to understand the full extent of both inflows and outflows related to social benefit programmes, determined on an economic basis rather than within the current limits of the implied conceptual framework for financial statements. This information would assist in assessing the adequacy of the revenue base to sustain social benefit programmes into the future.

2. Do you think that a present obligation to individuals or households arises at any time for:

a) Collective goods and services; and/or

b) Individual goods and services?

If you think a present obligation does arise for either (a) or (b) or both (a) and (b) please indicate when and indicate your reasons.

(a) The Board does not believe that an obligation arises for collective goods and services as the provision of these goods and services are deemed to be part of the ongoing operations of government. Recognising an obligation for collective goods and services would be akin to recognising future operating expenses, and thus inappropriate.

(b) The Board is of the view that an obligation for individual goods and services arises at the same point as for cash transfer programmes to individuals and households i.e. when all eligibility criteria have been satisfied. The Board is of the view that once all eligibility criteria have been satisfied, a valid expectation has been created that certain benefits will be provided, the settlement of which will require an outflow of resources. The manner of settlement, whether through the provision of cash or goods and services, is irrelevant.

It is inappropriate to assume that an obligation does not exist because legislation may change in future. At the point that legislation changes and depending on the nature of changes, an entity may determine that an obligation no longer exists.

The example below illustrates the point at which an obligation is deemed to arise.

<u>Example</u>

Free or subsidised medical care is provided to patients who satisfy a 'means test' based on their monthly income and the value of any assets owned, and who are diagnosed with a medical condition.

Once patients have satisfied both the eligibility criteria above, an obligation exists as the patient has a valid expectation that he or she will receive free or subsidised healthcare from the state.

3. Do you think that a present obligation to individuals or households in respect of cash transfers arises when all eligibility criteria have been satisfied for:

a) Non-contributory programs; and/or

b) Contributory programs?

If you think that a present obligation arises at an earlier point for (a) or (b) or both (a) and (b), please indicate that point and give your reasons.

(a) The Board agrees with the approach that an obligation arises for non-contributory cash transfer programmes once all eligibility criteria have been satisfied, rather than when all threshold eligibility have been satisfied (as described in our response to question 1 of ED 34). See our response to question 1 of Part A.

(b) The Board is of the view that a present obligation for contributory programmes arises when all eligibility criteria have been satisfied, to the extent that the contributions paid are not refundable prior to the satisfaction of those eligibility or do not form part of a 'defined contribution fund' i.e. the contributions paid by individuals or households are not exchange transactions.

The Board is of the view that contributions paid by individuals or households to gain access to future social benefits do not give rise to an obligation prior to the individual or households satisfying all the relevant eligibility criteria. In these instances, the contributions required to be made are merely one of the eligibility criteria to be satisfied.

Given the various types of contributory schemes that may exist in practice, each scheme should be analysed and accounted for on the merits of that scheme, using the principles of the implied conceptual framework.

4. ***Where a cash transfer program requires individuals or households to revalidate their entitlement to benefits, do you think that revalidation is an attribute that should be taken into account in the measurement of the liability or a recognition criterion? Please state your reasons.***

The Board is of the view that revalidating entitlement to benefits is a measurement attribute and not a recognition criterion. A similar approach is adopted for measuring obligations arising from employee benefits.

The Board is of the view that an individual or household only need satisfy the initial criteria for entitlement to benefits to establish that an ongoing obligation to provide benefits. Whether those benefits are provided, and the value of the benefits provided are measurement issues.

5. ***Do you think that in developing requirements for recognition and measurement of social benefits the IPSASB should further explore the executory contract accounting model briefly outlined in Key Issue 6. Please state your reasons.***

The Board does not believe that the executory contract accounting model is appropriate. In South Africa for example, the state has been taken to court on numerous occasions in relation to the execution of government functions, including the provision of certain social benefits. The state has in certain instances, used the defence that government services only need be provided to the extent that appropriate funding is obtained. The courts have determined that there is a realistic expectation that funding will be raised through appropriate means (taxes or raising debt), and thus government services should be provided.

These rulings contradict the notion of the executory contract accounting model outlined in issue 6 which requires that taxes be received by government before government provides services.

PART C – LONG-TERM FISCAL SUSTAINABILITY

Overall, the Board supports the development of guidance on sustainability reporting because of the limitations on recognising certain transactions and events in the financial statements.

The Board's overall comments in relation to developing guidance on long-term fiscal sustainability are as follows:

- Status and nature of outputs - Any guidance developed on fiscal sustainability should not require entities to prepare fiscal sustainability reports. However, where fiscal sustainability reports are prepared by an entity, they should be required to apply the guidance issued by the IPSASB on long-term fiscal sustainability (where those entities' financial statements are prepared in accordance with IPSASs).
- Reporting entity versus long-term fiscal sustainability – The Board has decided that it may be appropriate for some entities to prepare long-term fiscal sustainability reports, especially those that are able to raise there own revenue from taxes (for example), and are not wholly dependent on transfers from central government. For entities that are budget dependent, it may be appropriate to prepare a sustainability report at a whole-of-government level.
- Time horizons – The time horizon used may be a jurisdictional issue and may depend on socio-economic factors prevalent in a particular country. For example, using a certain timeframe in a developed country may not be appropriate for a developing country as developing countries may be impacted more severely by environmental factors such as drought and disease.
- Regularity of reporting - Annual fiscal sustainability reporting would not be appropriate, especially given that political conditions and the policies of government are only likely to change with a change in government. Fiscal sustainability reporting should be undertaken on a periodic basis, or when there has been a material change in government policies.
- Assumptions and sensitivity of assumptions – The Board agrees that both demographic and economic assumptions should be considered, and consider a sensitivity analysis to be a critical component of an analysis of fiscal sustainability.

PART D – OVERVIEW OF SOCIAL BENEFITS IN THE SOUTH AFRICAN PUBLIC SECTOR

The table below provides an outline of some of the social benefits provided in South Africa. This is not a comprehensive analysis as it merely highlights some of the more significant social benefits provided in South Africa.

Type of social benefit	Nature of social benefit	Eligibility criteria	Current and/or proposed accounting (where applicable)
Cash transfers	Cash grants for: • Old age • Disability • War veterans • Care dependency • Foster child • Child support • Grant-in-aid Paid monthly.	Broad eligibility criteria: • Reaching a specified age; • SA citizen; • 13 digit identification number; • Currently resides in SA; • Satisfy means test; • May or may not be the recipient of another grant (depending on the grants applied for). Proof of life annually.	Currently, these grants are accounting for on a modified cash basis of accounting, which means that the payouts during the year are accounted for when paid, but to the extent that amounts are outstanding at year end, an accrual is recognised. The amount of the accrual is merely 1 months' payment. Propose to use ED 34 for disclosure purposes.
	Composite social security programme – retirement benefits	The government recently published a white paper outlining the proposed implementation of a composite social security programme. The terms and conditions of this programme are currently being negotiated.	Plan not yet implemented.

Individual goods and services	Free or subsidised healthcare	Outcome of a means test prescribes the level of contribution required. Many primary healthcare facilities provide free medical care, with no eligibility criteria.	Currently, state hospitals which fall within national and provincial government, apply a modified cash basis of accounting. Expenses for the day-to-day operation of the hospitals are accounted for when the expenses are paid (with certain accruals being made at year end). The Board would however propose that an obligation be recognised for those patients who are awaiting medical treatment and have satisfied all the relevant eligibility criteria. Municipalities that operate primary healthcare facilities such as clinics also merely account for these benefits as part of their day-to-day operating costs.
	Provision of houses	Houses are provided to no or low-income individuals • Income of less than R3500 per month • Must be SA citizen or permanent resident • Must have not have benefited from other housing programmes (specific exemptions)	The department of housing currently applies a modified cash basis of accounting. Expenses are recognised as and when they are paid (with specific period end accruals). The Board would however propose that an obligation be recognised for those individuals who are awaiting a house and have satisfied all the relevant eligibility criteria. The Board however needs to consider the co-contribution made by individuals in some instances towards the construction of their houses.
	Vouchers	Food, clothing and other vouchers made available to individuals in distress, for example, the breadwinner of the household is recently deceased or imprisoned.	Currently appears in the financial statements as a ‘grant-in-aid’. Propose improved disclosure of these types of benefits provided as part of the notes to the financial statements, as these types of expenses are classified according to nature or function in the statement of financial performance.

	Provision of water or electricity	Municipalities provide: • X free kilolitres of water and X free kilowatts of electricity for free to each consumer in their jurisdiction. • Individuals that are regarded to be 'indigent' in line with the municipality's policies may have their debts for water, electricity and rates written off or reduced.	Currently, these expenses are accounted for on an accrual basis, but are included within expenses in the statement of financial performance. Proposed improved disclosure of these social benefits provided by way of note disclosure in the financial statements.
	Land redistribution	The following persons may apply for land restitution: (a) the claimant was dispossessed • of a right in land; • after 19 June 1913; • as a result of past racially discriminatory laws or practices; (b) the claimant was not paid just and equitable compensation; and (c) the claim was lodged not later than 31 December 1998. Land restitution and redistribution may sometimes consist of land being distributed to affected individuals, but may also consist of assets and or businesses on the land e.g. an entire farming operation.	

Certain benefits provided in the South African public sector may qualify as insurance contracts rather than social benefits. Some examples include:

- Unemployment benefits.
- Benefits paid to individuals as a result of motor vehicle accidents.