ICAEW

REPRESENTATION 38/18

SOCIAL BENEFITS

Issued 28 March 2018

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MAJOR POINTS

Support for the exposure draft

1. The social benefits standard will arguably be one of the most important financial reporting standards applicable to governments and although this topic has been debated for some time, we commend IPSASB's progress in publishing this exposure draft (ED).

Disagreement with the proposed recognition point for social benefits under the obligating event approach

2. The recognition criteria under the obligating event approach is possibly the most important, and contentious, area of the ED. We refer to our detailed response to Specific Matter for Comment 4 but have highlighted our key arguments below.

3. We do not agree with the ED’s proposal that the past event that gives rise to a liability for a social benefit scheme is the satisfaction by the beneficiary of all eligibility criteria for the next benefit, which includes being alive. Whilst this may hold true for some social benefits, we believe there are other situations where an entity has a present obligation for all future benefits. We regard some long-term social benefits, primarily the state pension, as being similar to an annuity, which should be measured accordingly using actuarial measures, including expected longevity. In other words, the need to be alive to claim a benefit is a measurement issue, not a recognition issue.

4. We believe that in some circumstances the obligating event is likely to occur at the ‘threshold eligibility criteria have been satisfied point’. For example, in the UK, once people reach retirement age and start receiving a state pension, they can expect to do so for the rest of their lives. Government's ability to modify and change social benefits entitlement is without question; however, governments tend to make changes to benefits that affect future claimants, not active recipients.

Relationship of financial statements with fiscal sustainability reporting

5. A broader picture emerges on the topic of social benefits, that is one of intergenerational fairness and how, fundamentally, governments are going to support an ageing population. Whilst some may find it difficult to accept recognition of large liabilities without the asset of corresponding tax revenues also being recognised, the social liabilities facing governments are nevertheless real and the funding of them falls on the younger still-working cohort in most countries.

6. We are very supportive of long term fiscal sustainability reports as they allow readers to understand how future government activity might affect the balance sheet. Furthermore, they present a more complete picture of future liabilities and revenues, all of which, combined with audited financial statements, will increase accountability and provide decision-useful information.

RESPONSES TO SPECIFIC QUESTIONS FOR COMMENT

Specific Matter for Comment 1:

Do you agree with the scope of this Exposure Draft, and specifically the exclusion of universally accessible services for the reasons given in paragraph BC 21(c)?

If not, what changes to the scope would you make?

7. We agree with the scope of the ED. The 2015 consultation paper (CP) Recognition and Measurement of Social Benefits introduced a narrower scope by excluding other transfers in kind (universally accessible services) and collective goods and services. We agreed with this. Furthermore, we agreed with IPSASB's preliminary view 6 in the Revenue and Non-Exchange Expenses consultation paper, which stated that, because there is no obligating event related to non-exchange transactions for universally accessible services and collective services, resources applied for these types of non-exchange transactions should be expensed as services are delivered. Universally accessible services and collective goods and services are, nevertheless, major forms of government expenditure and need to play a prominent part in wider fiscal sustainability reporting.

8. In our response to the 2015 CP, we also commented on the difficulty of distinguishing between some social benefits and non-exchange transactions, which is reflected in BC 20(b) as a concern raised by a number of respondents. We appreciate IPSASB's efforts to maintain a principles-based standard that distinguishes between social benefits and other non-exchange expenses, acknowledging that the lines are blurred and that any differentiation will be somewhat artificial in nature. We agree with BC 21(c) that liabilities and expenses associated with social risks can be measured by reference to an individual's eligibility to receive the social benefit, which would not apply to universally accessible services. Universally accessible services do not necessarily have their eligibility criteria linked to social risks; in many cases they are based on residency and citizenship. However, we believe that BC 21(c) and BC 22 could be expanded to include the reasoning underlying the explanation in IE 9 – IE 11.

9. The comparison of scope between ED 63 and the Government Finance Statistics (GFS) definition in GFSM 2014 (Government Finance Statistics Manual 2014) is an area that needs clarification. Any divergence from GFS needs to be clearly articulated, together with the reasons for diverging. Please refer to paragraph 15 for recommendations, but note that we are content that divergence is always possible due to the different objectives of financial reporting and GFS.

10. BC 22 gives the impression that all universally accessible services are social benefits under GFS, but this is not correct and should be amended. For example, 'public goods' such as policing and defence are universally accessible but do not meet the definition of social benefit under GFS. The sentence 'Universally accessible services such as healthcare services are considered to be social benefits under GFS . . .' should be amended to say 'Some universally accessible services, such as healthcare services, are considered to be social benefits under GFS'.

11. The table in IG 2 (page 47) shows what is in and what is out of scope of the draft IPSAS (x) (ED63) and GFS. We consider that the bracket on the left of the table showing the scope of GFS needs to be more prominent. We also suggest moving the table from IG 2 to sit under BC 22 to help the basis for conclusions reflect the differences between GFS and IPSAS (x) (ED63).

Specific Matter for Comment 2:

Do you agree with the definitions of social benefits, social risks and universally accessible services that are included in this Exposure Draft?

If not, what changes to the definitions would you make?

12. We agree with the definitions of social benefits and social risks in ED 63 but think that it is not clear enough where deviations from GFS guidelines have been made. As already stated above, the rationale for any deviations from GFS needs to be clearly articulated.

13. IPSAS 22 Disclosure of Financial Information about the General Government Sector requires a reconciliation between the General Government Sector and consolidated financial statements. Furthermore, in February 2014, IPSASB issued a policy paper entitled Process for Considering GFS Reporting Guidelines during Development of IPSASs. In this policy paper, paragraph 14 states that a table is to be maintained showing the main differences between IPSASs and GFS reporting guidelines. It would be useful to the reader if BC15 - 22 were preceded by a table showing the definitions in GFS compared with those in the ED, along with explanations of the differences. We recommend that the table be updated for this project and that this table be carried forward to future exposure drafts and consultation papers.

Specific Matter for Comment 3:

Do you agree that, with respect to the insurance approach:

- **a) It should be optional;**
- **b) The criteria for determining whether the insurance approach may be applied are appropriate;**
- **c) Directing preparers to follow the relevant international or national accounting standard dealing with insurance contracts (IFRS 17, Insurance Contracts and national standards that have adopted substantially the same principles as IFRS 17) is appropriate; and**
- **d) The additional disclosures required by paragraph 12 of this Exposure Draft are appropriate?**

If not, how do you think the insurance approach should be applied?

14. Part a). We do not agree with the conclusion reached by IPSASB on making the insurance approach optional. If a social benefit scheme is run as an insurance scheme then one would expect the entity to have all the information available to account for and disclose that information in accordance with the requirements of relevant international or national accounting standards dealing with insurance contracts (such as IFRS 17 Insurance Contracts). We do not believe that cost/benefit comes into the equation for this reason.

15. Part b). We broadly agree with the criteria for determining whether the insurance approach may be applied but question the practicality around ‘intended to be fully funded’. The preceding consultation on social benefits stated, in paragraph 6.21, that

the insurance approach may be appropriate where there are significant cash contributions in respect of the scheme, and where these can be measured reliably. We agreed with this criterion and therefore ask IPSASB to consider whether schemes could still be accounted for using the insurance approach if these were substantially funded, rather than fully funded.

16. Part c). We agree with the ED.

17. Part d). It is not clear how the disclosure in paragraph 12 relates to the disclosures required by IFRS 17. Are the disclosures in paragraph 12 a) and b) additional disclosures over and above the requirements of IFRS 17 or are they clarifications to couch IFRS 17 in terms suitable for social benefits disclosures for the public sector? It may be advisable to include a paragraph similar to other IPSAS disclosures such as:

    If the disclosures required by this Standard, together with disclosures required by other relevant international or national accounting standards, do not meet the objective in paragraph 2, an entity shall disclose whatever additional information is necessary to meet that objective.

Specific Matter for Comment 4:

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

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

18. This question is arguably one of the most important concerning the whole social benefits project. We recognise that this has been debated extensively for quite some time and commend IPSASB's progress in publishing this ED.

19. We do not agree with the recognition criteria proposed in this ED, that under the obligating event approach, the past event that gives rise to a liability for a social benefit scheme is the satisfaction by the beneficiary of all eligibility criteria for the next benefit, which includes being alive. We do not believe that this approach would lead a true and fair financial reporting for social benefits.

20. We feel that AG 19 is too uncompromising by stating that a liability cannot extend beyond the point at which the next social benefit is provided. Whilst this may hold true for some social benefits, we believe there are other situations where an entity has a present obligation for all future benefits. We regard some long-term social benefits, primarily the state pension, as being similar to an annuity and consider it should be measured accordingly using actuarial measures, including expected longevity. In other words, the need to be alive to claim a benefit is a measurement issue, not a recognition issue.

21. We concur with AV 16, that we do not believe that 'being alive' at the point at which the eligibility criteria are satisfied ahead of each payment cycle is an implicit eligibility criterion impacting the liability recognition. Accounting for social benefits should not treat being alive differently to other IPSAS standards such as IPSAS 39 Employee Benefits. Being alive should only impact the measurement through actuarial valuation such as mortality rates.

22. We also agree with AV 15 that a liability may arise from a key participatory event that occurs prior to the eligibility criteria for the next benefit having been satisfied. We therefore believe that in some circumstances the obligating event is likely to occur at the ‘threshold eligibility criteria have been satisfied point’. For example, in the UK, once people reach retirement age and start receiving a state pension, they can expect to do so for the rest of their lives. Government's ability to modify and change social benefits entitlement is without question; however, governments tend to make changes to benefits that effect future claimants, not active recipients.

23. We are mindful that some regard the recognition of potentially very large liabilities without recognising the cash flows that will fund those payments as being misleading and likely to result in financial statements that do not satisfy the qualitative characteristics. We are of the opinion that liabilities should not be on or off balance sheet depending on whether they are funded or unfunded or how they will be paid for. This argument does bring into sharp relief however, the boundary between what should be recognised in financial statements and what should be in long-term fiscal sustainability reports.

24. A broader picture emerges on the topic of social benefits, that is one of intergenerational fairness and how, fundamentally, governments are going to support an ageing population. Whilst some may find it difficult to accept recognition of large liabilities without the assets of corresponding tax revenues also being recognised, the social liabilities facing governments are nevertheless real and the funding of them falls on the younger still-working cohort in most countries.

25. Using definitions of elements from the conceptual framework to argue about liability recognition is clearly not that straightforward for social benefits and some will argue for these to be included within long term fiscal sustainability reports (alongside projected tax revenues). Others will argue for these to be included within the financial statements. We are of the opinion that disclosing social benefit liabilities, even without disclosing the corresponding tax revenue, will provide useful information for decision-making that will also be relevant to society in general.

Specific Matter for Comment 5:

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

- **a) The disclosures about the characteristics of an entity’s social benefit schemes (paragraph 31) are appropriate;**
- **b) The disclosures of the amounts in the financial statements (paragraphs 32-33) are appropriate; and**
- **c) For the future cash flows related to from an entity’s social benefit schemes (see paragraph 34):**
  - **i. It is appropriate to disclose the projected future cash flows: and**
  - **ii. Five years is the appropriate period over which to disclose those future cash flows.**

If not, what disclosure requirements should be included?

26. Part a). The disclosures about the characteristics are designed to provide qualitative information about an entity's social benefits schemes, which we support. We also agree with IPSASB's decision not to provide specific guidance on aggregating the disclosures for social benefits that are not individually material as this guidance is available in IPSAS 1, Presentation of Financial Statements.

27. Parts a) and b). There is a risk that potentially lengthy social benefits disclosures may obfuscate information, therefore a sensible application of materiality to the disclosures will be important.

28. Part c). We consider that future cash flow disclosures would not be necessary if the obligating event approach were applied as we describe in SMC4 since the social benefit liability would not be constrained to receiving the next benefit. However, given the ED's current proposal, having information on future cash outflows in the financial statements would provide decision-useful and relevant information. It would enable users to hold those responsible to account, facilitate analysis of the cost/benefits of social benefit expenditures and encourage people to think about long-term fiscal sustainability. This would be especially true for those governments not producing long-term fiscal sustainability reports or producing them infrequently.

29. We do question why a five-year time horizon has been chosen and query whether this would enable users to properly evaluate the costs of the benefits provided. Longer time horizons would undoubtedly blur the boundary between long-term fiscal sustainability reports and financial statements and could be seen as making long-term fiscal sustainability reporting mandatory through the back door. However, on balance, our view is that including future cash outflow projections beyond five years would be most beneficial to users. These would need to link to fiscal sustainability reports to complement the bigger picture and thus increase understandability.

30. Similar to the point made in paragraph 19 above, the disclosures should include an additional paragraph as follows:

    If the disclosures required by this Standard, together with disclosures required by other IPSASs, do not meet the objective in paragraph 2, an entity shall disclose whatever additional information is necessary to meet that objective.

31. We believe that government financial reporting needs to, in certain aspects, go beyond private sector reporting, given the accountability of public money. In this respect we believe that a future standard on social benefits should also include disclosure requirements in relation to fraud and error. Below are extracts of such disclosure in the financial statements from UK's Department for Work and Pensions (DWP), the body responsible for social benefits. Showing amounts that are under and overpaid as well as fraudulent claims would add to accountability mechanisms.

3. State Pension and disability benefits

	Employment and Support Allowance		Incapacity Benefit		Disability Living Allowance		State Pension	
Overpayments	**2016-17**	**2015-16**	**2016-17**	**2015-16**	**2016-17**	**2015-16**	**2016-17**	**2015-16**
Fraud	2.2%	*1.7%	0.3%	0.3%	0.5%	0.5%	0.0%	0.0%
	£320m	£250m	£0m	£0m	£60m	£60m	£0m	£0m
Claimant error	0.6%	*0.5%	0.9%	0.9%	0.6%	0.6%	0.1%	0.1%
	£90m	£80m	£0m	£0m	£70m	£80m	£80m	£70m
Official error	*1.2%	*0.6%	1.2%	1.2%	0.8%	0.8%	*0.0%	0.0%
	£180m	£80m	£0m	£0m	£90m	£100m	£10m	£30m
Total overpayments	***3.9%**	**2.8%**	**2.4%**	**2.4%**	**1.9%**	**1.9%**	**0.1%**	**0.1%**
	£590m	**£410m**	**£0m**	**£0m**	**£220m**	**£250m**	**£90m**	**£110m**
Total underpayments	**2.8%**	***2.3%**	**0.7%**	**0.7%**	**2.5%**	**2.5%**	**0.1%**	**0.3%**
	£420m	**£340m**	**£0m**	**£0m**	**£290m**	**£330m**	**£60m**	**£260m**
Total expenditure	**£15.0bn**	**£14.5bn**	**£0.0bn**	**£0.1bn**	**£11.5bn**	**£13.3bn**	**£91.6bn**	**£89.4bn**

4. Fraud and error in other benefits

	Carer's Allowance		Interdependencies		Other Unreviewed	
	2016-17	**2015-16**	**2016-17**	**2015-16**	**2016-17**	**2015-16**
Total overpayments	**5.5%**	**5.5%**	**z**	**z**	**1.8%**	**1.7%**
	£150m	**£140m**	**£30m**	**£30m**	**£320m**	**£270m**
Total underpayments	**0.1%**	**0.1%**	**z**	**z**	**1.8%**	**1.8%**
	£0m	**£0m**	**z**	**z**	**£330m**	**£290m**
Total expenditure	**£2.7bn**	**£2.6bn**	**z**	**z**	**£18.0bn**	**£16.2bn**

32. DWP's accounting policy note from the 2016-17 year end:

1.14 Benefit overpayments

We seek to recover all overpayments where we have the legal basis to do so unless it would cause financial hardship or wouldn't be cost-effective. Where recovery isn't cost-effective we write off overpayments – with the exception of fraud cases and direct payments after death.

We recognise receivables in the accounts when there is a legal basis to seek recovery. Benefit receivables are valued at the difference between the amount the customer has been paid and what they should have been paid, less any impairment of these receivables.

We don't recognise certain categories of identified benefit overpayment as receivables, including:

- *those due to official error where there is no statutory right of recovery*
- *cases satisfying Secretary of State waiver policies*
- *where the customer has died and the estate isn't large enough to recover the overpayment.*

We periodically review the quality and consistency of write-off decision making. Our write-off policy has been agreed with HM Treasury.

Specific Matter for Comment 6:

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

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

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

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

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

33. Balance sheets contain useful information on the fiscal consequences of past government activity, including its implications for some future cash flows. But to assess long-term sustainability, readers also need to understand how future government activity might affect the balance sheet. For this reason, we are very supportive of RPG 1 Reporting on the Long-Term Sustainability of an Entity's Finances.

34. At this time, considering the stage of IPSAS development and, more importantly, adoption of these standards by governments around the globe, we would not encourage making any of the RPGs mandatory. It is ‘early days’ yet for IPSASs and we believe that best practice needs to have time to develop on these key areas.

35. Comparing the guidance within RPG 1 and the UK's 2017 fiscal sustainability report (which can be found here), it is noticeable how much additional sensitivity analysis there is compared to the RPG guidance. For example, in the UK's sustainability report a whole chapter is devoted to fiscal gap analysis (fiscal gap is the immediate and permanent change in the primary balance needed to achieve a chosen debt-to-GDP ratio in a given year).

36. Following on from the point made above, RPG 1 does acknowledge in paragraph 8 that it is only outlining minimum information levels. In the future, when best practice has developed sufficiently, reviewing RPG 1 to include guidance on sensitivity analysis would provide users with more insight and depth of analysis of the long-term fiscal sustainability of an entity.