23 March 2018

Mr John Stanford
The Technical Director
International Public Sector Accounting Standards Board
International Federation of Accountants
529 Fifth Avenue, 6th Floor
New York, NY 10017 United States of America

Dear John

Consultation Paper: Recognition and Measurement of Social Benefits

The New Zealand Treasury welcomes the opportunity to provide comments to the International Public Sector Accounting Standards Board on the ED 63: Social Benefits.

IPSASB is to be commended for its efforts in tackling this project that is a very important aspect of public sector accounting, covering issues that are often contentious.

We have attached our responses to the specified matters for comment.

Yours sincerely

Jayne Winfield
Manager, Fiscal Reporting

Specific Matter for Comment 1:

Do you agree with the scope of this Exposure Draft, and specifically the exclusion of universally accessible services for the reasons given in paragraph BC21(c)?

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

The NZ Treasury continues to have the concerns expressed in our response to the Consultation Draft that the scope of the standard is:

- Insufficiently clear
- Creates boundary issues with other standards (both current and proposed)
- Invites the possibility that transactions with similar economic substance will be treated differently.

We acknowledge that the IPSASB has attempted to address our concerns by clarifying and redefining the social risks element of the definition, and through seeking to make a distinction between benefits to specific individuals and/or households and those that are universally accessible. However these only serve to muddy the waters. For example:

> AG4: "Social benefits are only provided when eligibility criteria are met" will create debate about whether universal payments such as a Universal Basic Income are within scope. It would be a surprising outcome if such payments were outside scope because of the lack of an eligibility criterion.
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> AG5: "The assessment of whether a benefit is provided to mitigate the effect of social risks is made by reference to society as a whole; the benefit does not need to mitigate the effect of social risks for each recipient" that will create debate about whether society benefits or whether the recipients benefit, when in the vast majority of cases both benefit.
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> AG6: "A social benefit that covers a segment of society as part of a wider system of social benefits meets the requirement that it addresses the needs of society as a whole" that will create debate about whether the group of participants receiving the benefit needs to be of a certain size to be considered a "segment of society".
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> AG7: "Excludes universally accessible services" which appears to include in scope services that are not universally accessible. Thus payments for flu jabs for the over-65s would be included but for flu jabs available for the whole population would not?
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> AG8: "Social risks relate to the characteristics of individuals and/or households (and following discussion)" which presumes that an individual's or household's circumstances can be distinguished between those that arise from their own vulnerability, and those that arise from external adverse events, when of course the outcome of a social risk is a function of both.

We remain concerned that the current scope, if it stands, will trap us and our auditors into resource wasting debates as to whether items are in or out of scope, and thus whether the Social Benefit standard applies, in contrast to IPSAS 19, or the standard that results from the non-exchange expense project or some other standard. Not only are such avoidable costs unwelcome, the risk is exacerbated that transactions with similar economic substance will be treated differently and that transactions with dissimilar economic substance will be treated the same, leading to reduced reliability and understandability of the financial statements.

The other risk is that it is likely that the non-exchange expenses project may be overly swayed by the precedent set by the social benefits deliberations.

If the IPSASB is determined to develop a standard on social benefits alone, The NZ Treasury urges it to treat it as Stage 1 of a more complete non-exchange expenses standard. When social benefits are included in a standard on non-exchange revenues, attempts to define and differentiate between factors such as “social risk” “universally accessible” and “social v individual benefit” can be consigned to scrapheap where they belong as they should not impact on how the transaction is measured or recognised.

To enable a cleaner scope in the meantime, the social benefit standard should be limited to non-reciprocated benefits paid in cash, either directly to beneficiaries or through third parties providing specified services to beneficiaries.

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?

The Treasury’s objections to the above definitions will be apparent from our comment to SMC 1.

The distinctions made in the GFS literature (e.g. to respond to social risks or to encourage social benefit, between social assistance and social security, between households and sectors supporting households etc.) are matters of classification of items that have a similar economic impact on the reporting entity. Consistency with the classification system of GFS should certainly be encouraged, but consistency with the classification decisions that statisticians make, should not enable different recognition and measurement of items with similar economic substance.

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?

The Treasury:

(a) Accepts that the insurance approach should be optional at this time, although it is not our preference, and we do not reach this conclusion on the cost-benefit grounds that the IPSASB has documented, as we consider that when a social benefit scheme is intended to be fully funded from contributions and is managed as an insurer manages insurance contracts, then the benefit of an insurance approach clearly outweighs the cost of an inappropriate accounting approach. However, given that the IPSASB has not yet developed an Insurance Accounting Standard, and that the appropriateness of IFRS 17 to social insurance arrangements has not been tested, we agree that it is not appropriate to make the insurance approach compulsory at this stage.

(b) Agrees that the criteria for determining the insurance approach are generally appropriate. However, as they stand they do not allow an on-balance decision where the management and funding intentions are clearly to take an insurance approach, but where the criteria are not fully met, that the insurance approach can be taken. For example, it is quite possible that a contributor population and the claimant population may be similar but not equivalent, which should not disqualify the insurance approach from being used. The insurance approach is in general not an approach to be guarded against, but rather one to be encouraged where appropriate. We suggest some wording changes below to realign the standard in that direction.

(c) Agrees that preparers should 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)

(d) Accepts that the same disclosures about the characteristics of the scheme and any changes to it are as appropriate for schemes using the insurance approach as for schemes using the obligating event approach.

Treasury proposes the following amendments in line with our comments above:

AG12. ~~A social benefit scheme is intended to be fully funded from contributions when~~ In determining whether social benefit scheme is intended to be fully funded from contributions, an entity considers the following indicators:

NB: This proposed revised wording is consistent with AG15

Following AG13: The criteria in AG12 should be significantly met for a social benefit scheme to be considered to be intended to be fully funded from contributions. The criteria in AG12 does not preclude governments or other parties making contributions on behalf of a minority of participants, nor an underwriting loss to be temporarily incurred.

Specific Matter for Comment 4:

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

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

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

The Treasury in general agrees with the recognition point of the majority view, although we think it is relatively clumsily worded, and are concerned that the conceptual argument is not well made.

With most social benefits, there is little discretion to avoid in total the commitment that the government has made in its policy, but there is a great capacity to adjust it. In some cases, projections based on demographic trends might suggest an adjustment, at some point of time, is inevitable. The assumption of no change to government policy therefore is insecure to use as the basis for reporting a liability in the statement of financial position. That assumption is however a useful input to analysis when considering the impact of proposed adjustments to the policy.

The Statement of Financial Position balance of net assets/liabilities shows the net contribution/ obligation that past taxpayers have passed on to the future or alternatively the benefit/obligation that future taxpayers are inheriting from the past. The question then seems at arise then is: What do users want the government's accounts to show about the current calls on future taxes? Should it include the impact of our current policies in the future?

Our conclusion is generally that it shouldn't. The redistributive activity of government is a function of both taxes and social transfers. Decisions about one are not made in isolation from the other. The decision-usefulness of financial statements is not improved if the treatment of social transfers differs from taxes. Nor indeed is the accountability of those making decisions over taxes and social transfers.

The Treasury does see merit in there being public information about the extent of change in government policies, including most particularly taxes and social transfers, needed for government finances to be in equilibrium. However, that would not be achieved by adding piecemeal a liability for social benefits into the government's accounts, while excluding liabilities to provide services, and the resources that will be employed to fund them.

That argument, taken from the core objectives of financial reporting in the Conceptual Framework takes Treasury to the view that the financial statements should report what is currently owing to beneficiaries, rather than what is owed to beneficiaries in the future if current policies are to continue.

Treasury therefore suggests that the obligating event for all benefits where the meeting of eligibility criteria provides an entitlement to the benefit should be the meeting of eligibility criteria. If benefits are only paid to living persons (which may not always be the case) the application guidance should make clear that being alive is one of the eligibility criteria for determining an obligating event.

Treasury does not see the relevance of reference to "the next benefit" – if benefits are settled in instalments, in advance or in arrears, that should not impact on the recognition point and we suggest reference to the next benefit be removed.

Specific Matter for Comment 5:

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

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

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

(c) For the future cash flows related to 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?

(a) The Treasury is cautious about these proposed disclosure requirements. We note that the current focus of standard-setters is generally on reducing disclosures to avoid cluttering the financial statements with unnecessary information. As information about the benefits available, eligibility criteria and recent amendments must be widely known for citizens to be able to make claims, we question the benefit in replicating this information in the financial report.

(b) Paragraphs 32 and 33 are more likely to be relevant if the social benefit is treated as an insurance type arrangement. Where recognition is at the point when the eligibility criteria are met, NZ Treasury sees little point in extensive disclosures and believes the requirements of paragraph 33 are unnecessary.

(c) Financial statements report on the current financial position of the entity. The Treasury notes that this is budget forecast information.

Specific Matter for Comment 6:

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

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

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?

Consistent with our view that public information about the extent of change in government policies, including most particularly taxes and social transfers, needed for government finances to be in equilibrium is valuable we endorse the IPSASB's work on Long Term Fiscal Reporting and its encouragement by national governments.

Treasury suggest that the focus of the IPSASB should at this stage be on outreach and on distilling the lessons from experience.

For example, some in New Zealand have questioned the focus on sustainability in our long term fiscal reports and have suggested a focus on resilience would have more traction. We have defined fiscal sustainability as the ability of the government to meet both current and future obligations, but have been challenged in making statements about such future obligations beyond the implications of demographic changes.

The concept is essentially an idea about intergenerational equity. However that requires that the obligations to and from future generations to be estimated in the present. It requires a prediction of what will last, and it fails to account for interrelationships between time and space, what systems or subsystems we hope to sustain and for how long. This is not possible. At least it is not possible for the preparers of long term fiscal reports to reliably project this over many years. The economic systems are too complex, the constituencies' objectives are too varied, and the policy options are too diverse. Thus our long term projections have failed to gain significant traction in the public discourse.

If sustainability is desired, and future orientation and uncertainty is at the heart of sustainability, then managing for sustainability becomes a matter of risk and opportunity management. If policy making is to develop more comprehensive strategies that combine active management of specific risks with enhancement of generic resilience in the economy, measures of resilience (i.e. measures of absorptive capacity to shocks and stresses and adaptive capacity to rebound from them) are needed. We are forming the view that resilience measures and targets have more traction than sustainability measures, and will be more likely to in fact improve sustainability.

Of course views about the future, about the risks that the nation faces and will face in the future are important, and will inform policy setting on desirable resilience levels such as levels of net debt and borrowing capacity.   In such a setting, the long term fiscal report would be reframed as a risk analysis document rather than a set of projections.

That is the New Zealand experience. The IPSASB would do well to undertake research on this and other countries experiences of long term fiscal reporting, rather than initiating a standard setting or a project to mandate long term reporting at this stage of its development.