AT A GLANCE
July 2015

IPSASB

Consultation Paper Summary—Recognition and Measurement of Social Benefits

This summary provides an overview of the Consultation Paper (CP), *Recognition and Measurement of Social Benefits.*

Project objectives:	The objective of this project is to establish the recognition and measurement requirements for social benefits. This Consultation Paper is the first step in determining these requirements.
The project and stage:	The IPSASB issued this Consultation Paper in July 2015.
Next steps:	The IPSASB seeks feedback to guide it in further developing the principles of recognition and measurement for social benefits.
Comment deadline:	The Consultation Paper is open for public comment until January 31, 2016.

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Why is the IPSASB Undertaking this Project?

The purpose of the IPSASB's project on social benefits is to initiate a discussion about matters such as the definition and classification of social benefits; and the approaches to the recognition and measurement of social benefits.

The delivery of social benefits to the public is the primary objective of most governments and accounts for a large proportion of their expenditure. Existing IPSASs do not provide requirements and guidance on how to account for social benefits.

IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, excludes provisions related to social benefits in non-exchange transactions from its scope. Some social benefits provided through exchange transactions such as employee benefits may be addressed in other IPSASs.

There is an opportunity for the IPSASB to improve its suite of standards by developing a new IPSAS on social benefits. An IPSAS on social benefits will enhance accountability and transparency and improve decision making, which are in the public interest.

This CP is an important step in determining the appropriate reporting of social benefits.

As well as building on the previous work of the IPSASB on social benefits, the CP has been influenced by more recent developments in the IPSASB's literature:

- *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*
- Recommended Practice Guideline 1, *Reporting on the Long-Term Sustainability of an Entity's Finances*
- Policy Paper, *Process for Considering GFS Reporting Guidelines during Development of IPSASs*

The CP proposes the following objective for an IPSAS on social benefits:

IPSASs shall require an entity to provide information that helps users of its general purpose financial reports to assess:

(a) The nature of social benefits provided by the entity, and the key features of the operation of the scheme; and

(b) The impact of social benefits provided on the entity's financial performance and financial position

Alignment with Government Finance Statistics (GFS) Reporting Guidelines

The IPSASB considers it important to reduce differences with the statistical basis of reporting where appropriate. This led the IPSASB to publish the policy paper, *Process for Considering GFS Reporting Guidelines during Development of IPSASs* in February 2014.

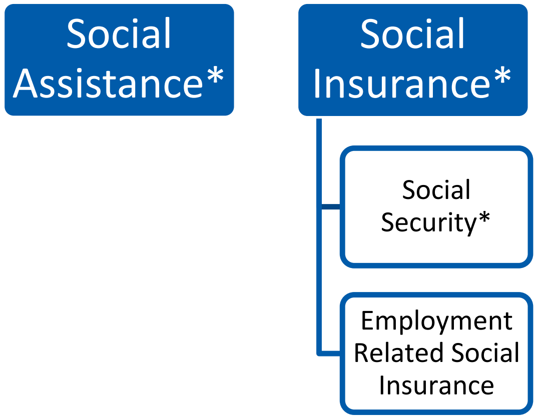
The IPSASB decided to align, as far as possible, the definitions in the CP with those in GFS. This is intended to provide clearer definitions that demarcate transactions and events which are, in substance dissimilar.

Reasons for alignment with GFS reporting guidelines

GFS provides a system for describing and classifying social benefits. The classification approach within GFS reflects the different economic consequences of the different types of social benefit transactions. The IPSASB considers that the economic consequences will be similar in GFS and in a future IPSAS.

Therefore, adopting the same classification approach is appropriate.

Figure 1: GFS Classification of Social Benefits



* See definitions on next page

Rationale for classification approach within GFS

According to GFS, social protection is the systematic intervention intended to relieve households and individuals of the burden of a defined set of social risks. Individual social benefits are part of the system of social protection.

Social risks are defined as “events or circumstances that may adversely affect the welfare of individuals and households either by imposing additional demands on their resources or by reducing their income.” In other words, social risks are risks that impact an individual or household’s budget.

Significant government expenditures for goods and services provided to individuals and households fall outside the GFS definition of social benefits. This is because such expenditures do not address social risks, i.e., they do not affect the budget of an individual or household.

A major example of government expenditure that would not be included in the GFS definition of a social benefit is the provision of universal health and education services.

Definitions

The key definitions for determining the scope of the project are :

Social Benefits are benefits provided to individuals and households, in cash or in kind, to mitigate the effect of social risks.

Social risks are events or circumstances that may adversely affect the welfare of individuals and households either by imposing additional demands on their resources or by reducing their income.

Other terms defined in the CP are:

Social Benefits in Cash are social benefits paid in cash, by or on behalf of a public sector entity, that allow individuals and households to use this cash indistinguishably from income from other sources. Social benefits in cash do not include reimbursements.

Social Benefits in Kind are goods and services provided as social benefits to individuals and households by or on behalf of a public sector entity, and all reimbursements for the costs incurred by individuals and households in obtaining such goods and services.

Reimbursements are cash payments made as a social benefit by or on behalf of a public sector entity to compensate a service provider or an individual or household for all or part of the expense incurred or to be incurred by that individual or household in accessing specific services.

Social Insurance is the provision of social benefits where the benefits received are conditional on participation in a scheme, evidenced by way of actual or imputed contributions made by or on behalf of the recipient. Social insurance may form part of an employer-employee relationship (employment-related social insurance) or may arise outside an employer-employee relationship (social security).

Social Security is social insurance that arises outside of an employer-employee relationship, and provides benefits to the community as a whole, or large sections of the community. Social security is imposed and controlled by a government entity.

Social Assistance is the provision of social benefits to all persons who are in need without any formal requirement to participate as evidenced by the payment of contributions.

Other terms are used in the CP when describing the scope of the project, but are not formally defined:

The term **"other transfers in kind"** is used to describe goods and services provided to individuals and households by government entities, other than to protect against a social risk. This term includes the universal provision of services such as health and education.

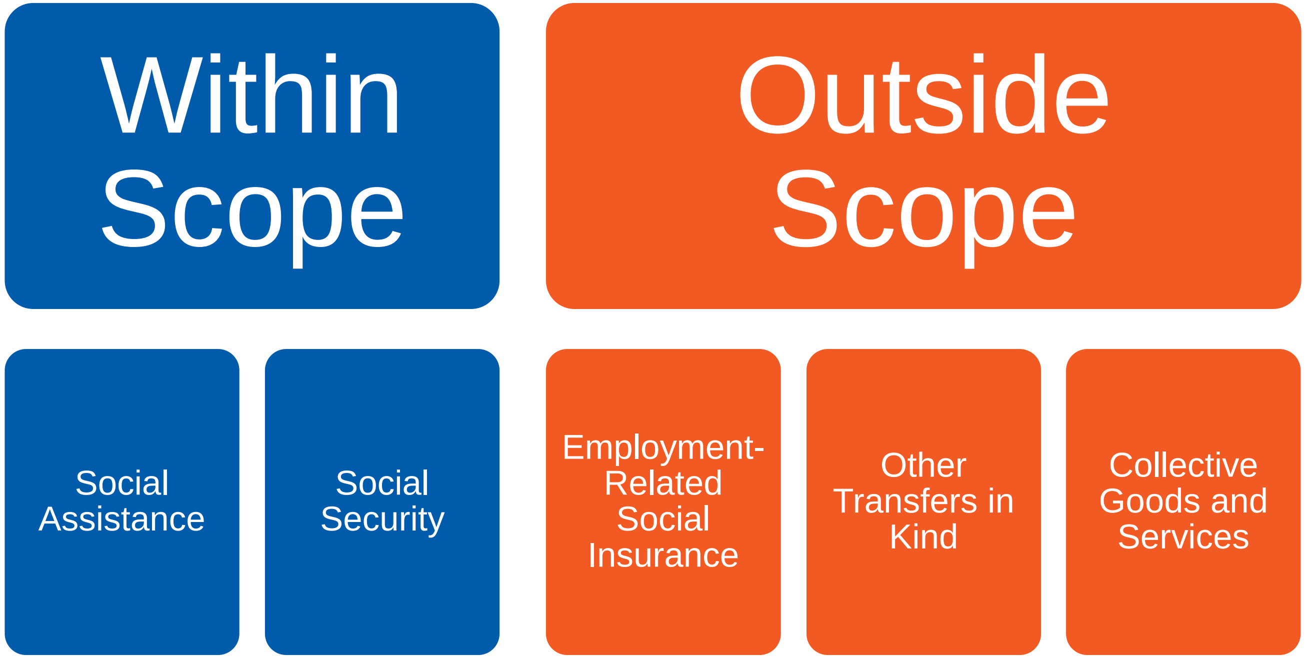
"Collective goods and services" refers to services such as defense and public order which are delivered simultaneously to each member of the community. The provision of a collective service to one individual does not reduce the amount available to others. Individuals cannot be excluded from the benefits of collective goods and services.

Scope

The scope of the project is aligned, as far as possible, with the scope of social benefits within GFS.

The scope of the project includes social assistance and social security, but excludes employment-related social insurance, other transfers in kind and collective goods and services.

Figure 2: Summary of the Scope of the Project



Employment-related social insurance is excluded from the scope of the project. Although employment-related social insurance meets the definition of a social benefit, IPSAS 25, *Employee Benefits* already provides requirements for accounting for employment-related social insurance.

Other transfers in kind and collective goods and services are excluded from the scope of the project because they do not meet the definition of a social benefit. Guidance on accounting for these transactions will be provided in a separate project on non-exchange expenses. Work on this project has already begun.

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Identification of Options

The IPSASB has identified three broad options for the recognition and measurement of social benefits.

The IPSASB is seeking views as to the relative conceptual merits and weaknesses of the three approaches.

The three options are summarized on this page, with further details provided on the following pages.

The IPSASB has expressed a preliminary view that a combination of the obligating event approach and the insurance approach may be required to reflect social benefits' differing economic circumstances.

Option 1: Obligating event approach

This approach considers social benefits by reference to the definition of a liability in the Conceptual Framework. The key issue is when a present obligation arises.

The CP identifies five distinct points at which a case can be made for recognizing an obligation in the financial statements:

(a) Key participatory events have occurred;

(b) Threshold eligibility criteria have been satisfied;

(c) The eligibility criteria to receive the next benefit have been satisfied;

(d) A claim has been approved; or

(e) A claim is enforceable.

Option 2: Social contract approach

This approach acknowledges, as commitments, both:

(a) Public sector obligations to provide goods, services and cash transfers to individuals or households; and

(b) The rights of individuals or households to receive those benefits.

These obligations are offset by the ongoing duty of individuals and households to contribute taxes and other sources of finance.

There is an imputed social contract between the state and the citizens under which citizens agree to pay taxes to enable the state to provide social benefits. This is analogous to an executory contract.

Obligations are recognized when they become enforceable (or when claims are approved).

Option 3: Insurance approach

This approach considers that some social benefits are similar in practice to insurance contracts. It uses an insurance accounting model to measure these social benefit schemes at the net present value of their cash inflows and outflows.

The insurance approach recognizes a present obligation to pay benefits at the point that coverage begins. The approach also recognizes a right to future receipts resulting from the provision of that coverage. The insurance approach is, therefore, only suited to contributory benefits.

Consequently, it may be appropriate to adopt the insurance approach for some or all contributory benefits, and another approach for the remaining benefits.

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Option 1: Obligating Event Approach

The CP identifies five scenarios in which a present obligation for social benefits may arise.

Two sub-options consider that satisfying future eligibility criteria (including revalidation) is only taken into account when considering the measurement of a liability, not when considering the recognition of a liability.

(a) Key participatory events have occurred

In the absence of a legal obligation, a present obligation arises when key participatory events have occurred that give rise to a reasonable expectation of satisfying eligibility criteria for a benefit and, as a result, the individual has relied on that expectation over a period of time leaving the government with no realistic alternative but to settle the obligation in the future. Examples include entering the workplace, starting school or even being born.

The present obligation is for all benefits to be provided to the individual in future periods regardless of whether the individual is required to satisfy eligibility criteria again in future periods.

(b) Threshold eligibility criteria have been satisfied

In the absence of a legal obligation, a past event giving rise to a present obligation occurs when an individual meets the eligibility criteria for the first time (the threshold criteria).

The present obligation is for all benefits to be provided to the individual in future periods regardless of whether the individual is required to satisfy eligibility criteria again in future periods.

Revalidation is the process performed by the entity to determine whether a beneficiary remains eligible to receive a social benefit, based on information provided by or on behalf of that beneficiary. Requirements to satisfy eligibility criteria (including revalidation) on an ongoing basis are treated differently under the different sub options.

Under all the sub-options, a liability is initially recognized when the relevant obligating event (which varies from sub-option to sub-option) occurs.

A requirement to satisfy ongoing eligibility criteria (including revalidation) does not affect the recognition of the liability under the key participatory events and threshold eligibility criteria sub-options. The liability at initial recognition is for all future benefits. The likelihood of an individual continuing to meet eligibility criteria in the future is taken into account when measuring the liability, but does not affect the recognition of the liability.

A requirement to satisfy ongoing eligibility criteria (including revalidation) affects both the recognition and measurement of the liability under the remaining sub-options. The liability at initial recognition is for benefits receivable only until the next revalidation point. When a recipient meets the eligibility criteria and revalidates their entitlement at a future dates, further liabilities are recognized as the criteria are met. The likelihood of an individual continuing to meet eligibility criteria up to the next validation point is still taken into account when measuring the liability in these circumstances.

Option 1: Obligating Event Approach

The CP identifies five scenarios in which a present obligation for social benefits may arise.

Three sub-options consider that satisfying future eligibility criteria (including revalidation) is taken into account when considering the recognition of a liability, as well as the measurement of that liability.

(c) The eligibility criteria to receive the next benefit have been satisfied

This sub-option considers that all eligibility criteria must have been met for an obligating event to have occurred. Until an individual or household has satisfied all the eligibility criteria, there is no claim on an entity's resources.

(d) A claim has been approved

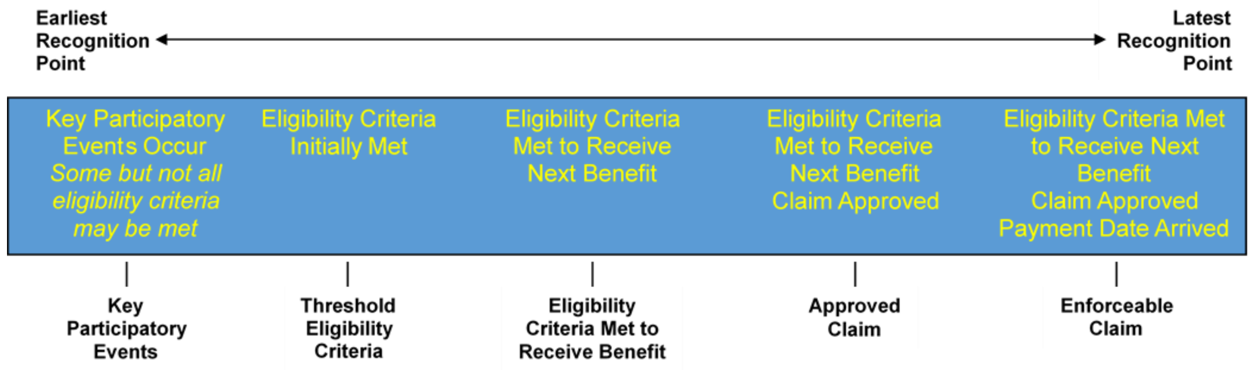
Under this sub-option, benefits relating to the period for which a claim has been approved are recognized as an expense. Unpaid amounts are recognized as a liability. A liability is not recognized under this sub-option until a claim is received and approved.

(e) A claim is enforceable

Under this sub-option, public sector entities should only recognize legal obligations in respect of social benefits. Until a legal obligation exists, a claim is unenforceable. A government always has the ability to avoid settling such an obligation, for example by amending legislation, prior to this point.

As a result, the entity does have a realistic alternative to an outflow of resources. This may also negate the creation of a valid expectation of benefits being paid in the future.

Figure 3: The five points at which an obligating event may give rise to amounts being recognized in the financial statements



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Option 2: Social Contract Approach

The social contract approach considers the provision of social benefits as analogous to an executory contract.

The CP discusses the issues that this analogy raises:

- Who should be considered as the counterparty (or counterparties)?
- What are the obligations to be performed by the counterparty?
- What is the appropriate accounting treatment?

Counterparty

The IPSASB previously identified the counterparties as individuals or households. This could refer to individuals or households collectively or individually.

The CP considers that the social contract approach applies collectively, as individuals or households who receive social benefits may not, individually, provide any matching performance (such as paying direct taxes).

The CP also notes that in some jurisdictions, a significant proportion of taxes and other sources of finance is provided by corporate entities rather than by individuals and households.

Consequently, the CP concludes that the counterparty should be identified as society as a whole, as only at this level can matching performance be anticipated.

Obligations to be performed

The IPSASB's earlier work on the social contract approach considered that the obligations to be performed by the counterparty are to contribute taxes and other sources of finance.

It may be possible to identify other obligations. Where individuals perform activities that enable a public sector entity to achieve its objectives, this could be viewed as fulfilling an obligation.

However, these activities rarely amount to independent performance; they are often linked to the actions of the entity, such as a patient taking medication provided by that entity.

The IPSASB has currently taken the view that the performance obligation relates to the contribution of taxes and other sources of funding.

Accounting treatment

Unless an executory contract is considered onerous, the net asset or liability is usually measured at zero.

Using the executory contract analogy, an entity only recognizes a liability for social benefits when performance is due. This is generally taken to mean when an individual or household can enforce a claim for the provision of social benefits against the entity.

An alternative approach, which the CP also explores, is that performance falls due when a claim is approved. This approach may more closely match that in IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers*). IPSAS 23 requires revenue from taxation to be recognized when the taxable event occurs rather than on the legal date for receipt.

Option 3: Insurance Approach

The insurance approach uses an insurance accounting model, based on the principles set out in the International Accounting Standards Board's proposals in Exposure Draft ED/2013/7, *Insurance Contracts*.

As the approach is based on net cash flows, the CP does not consider the insurance approach is suitable for social assistance, i.e., non-contributory schemes.

Recognition and measurement issues are more complex where a scheme is not fully funded through contributions, but is partially subsidized through general taxation.

Initial recognition

The CP proposes that social security schemes would be recognized at the earlier of the beginning of the coverage period or the date on which the first contribution from or on behalf of the participant becomes due.

Schemes fully funded through contributions (unsubsidized schemes)

For social security schemes fully funded through contributions (i.e., without tax subsidies) the statement of financial position would show at initial recognition the expected surplus (if any) from the scheme, and a current estimate of the amount of future cash flows in respect of the scheme, discounted to reflect the timing of those cash flows.

Any expected surplus would be recognized over the coverage period of the scheme. Any expected deficit would be recognized immediately as an expense.

Schemes not fully funded through contributions (subsidized schemes)

For social security schemes not designed to be fully funded from contributions (i.e., subsidized through taxation) the CP is seeking the views of respondents as to how the expected deficit should be treated.

The IPSASB has identified the following approaches:

- The entity should recognize a liability and an expense on initial recognition. This matches the treatment of unsubsidized schemes.
- The entity should recognize the expected deficit as a liability on initial recognition, and subsequently recognize the deficit as an expense over the coverage period. The accounting treatment for a deficit would mirror the treatment for a surplus.

  and
- The entity should adjust the obligation determined from the future cash flows to reflect the planned subsidy, either when the subsidy is received as a transfer from another entity; or in all cases.

Further matters

Other matters discussed in the CP are:

- The need for a risk adjustment;
- Determining the coverage period;
- Relationship between contributions and benefits;
- The discount rate to be applied; and
- Subsequent measurement.

Next Steps

The deadline for comments is January 31, 2016.

During the comment period, IPSASB members are available to discuss the proposals with a wide range of parties.

How can I comment on the proposals?

The CP requests comments on the Preliminary Views of the IPSASB and the Specific Matters for Comment.

Respondents may choose to provide comments and answers on all the Preliminary Views and all Specific Matters for Comment or just selected views or matters for comment. They are also welcome to comment on any other matter they think the IPSASB should consider in forming its views.

Respondents are asked to submit their comments electronically through the IPSASB website, using the "Submit a Comment" link. Please submit comments in both a PDF and Word file.

All comments will be considered a matter of public record and will be posted on the IPSASB website.

The IPSASB will carefully consider all feedback and discuss responses at its public meetings after the comment period has ended.

Stay informed

The IPSASB's website will indicate the meetings at which feedback on the CP will be discussed. The dates, and, where known, the locations of 2016 meetings are available at:

http://www.ipsasb.org/meetings

To stay up to date about the project, please visit:

http://www.ipsasb.org/projects/social-benefits