ICGFM Ad Hoc Committee on International Accounting Standards: Report On Activities

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Introduction

The Ad Hoc Committee on International Accounting Standards has been established by the ICGFM to review and issue comments on Exposure Drafts and other discussion documents issued by the International Public Sector Accounting Standards (IPSAS) Board. The Committee comprises a group of members of the ICGFM, as listed on the ICGFM website.

All comments submitted by the ICGFM are included in the published comments on the IPSAS Board website[1], but we thought it would be useful to provide an annual summary of the work of the Committee in the Journal.

Membership and How the Committee Works

Members of the Committee have been invited to join, but the Committee welcomes new members if any ICGFM member is interested. We would particularly welcome participation from members in South America, the Caribbean and Asia.

The Committee works entirely through electronic communication. When a new document is issued by the IPSAS Board for comment, members are asked for initial comments. Then a draft response is prepared and circulated for further comments to arrive at an agreed response. The response is circulated to the ICGFM Board before being submitted as a comment from ICGFM on the IPSAS website.

Recent activities

Jesse Hughes, as one of his many contributions to ICGFM, chaired the Committee for a number of years until the end of 2014. During Jesse's Chairmanship the main principles and methods for the Committee were established, along with a Compilation Guide and supporting documents for a staged transition to accrual accounting. Since 2015 Michael Parry has chaired the Committee. This article relates to the Committee's work since 2015.

Since 2015 the IPSAS Board has published six exposure drafts and two Consultative Papers. Comments have been submitted on all of these except the most recent Consultative Paper (on Financial Instruments), on which comments are not due until December 31, 2016.

This article summarises the main features of each of the above documents, ICGFM comments and the outcomes from the IPSAS Board. The full texts of EDs and Consultative Papers have not been repeated as these are available on the IPSAS website. Web links are provided. Submitted comments can be found through the same linked web page.

ED56 Applicability of IPSAS

Summary of ED56

ED56 was issued in July 2015[2]. The proposals represented a fundamental change in the way in which the coverage of IPSAS is defined.

[1] http://www.ipsasb.org

[2] http://www.ifac.org/publications-resources/exposure-draft-56-applicability-ipsass - this reference also leads to the submitted comments

- Previously IPSAS were defined as applying to public sector entities other than Government Business Enterprises (GBEs)
- The proposals in ED56 redefined the applicability of IPSAS by defining the entities to which they do apply, thus removing the requirement to define GBEs

ICGFM comments

Our comments:

- Supported the proposed changes and definitions in ED56
- Recommended that all references to GBEs are removed from all IPSAS and replaced with the term "Public Corporations" used in the IMF Government Finance Statistics (GFS) Manual
- Include the definition of applicability in IPSAS 1 as well as in the Preface to IPSAS.

Outcome

In April 2016 the IPSAS Board issued "The Applicability of IPSAS" and a revised Preface to IPSAS based on the proposals in ED56. Also the paragraph in all IPSAS that refers to their applying "except to GBEs" has been deleted.

However:

- There is now no definition in IPSAS 1 of the applicability of IPSAS – to obtain this definition it is necessary to refer to the Preface to IPSAS
- The term GBE has been replaced with a new term "Commercial Public Sector Entities". Whilst this is an improvement on GBEs this still means that IPSAS and GFS use a different name for the same type of entity. We can see no good reason for this difference and consider this a lost opportunity to better harmonise IPSAS and GFS.

ED57 Impairment of Revalued Assets

Summary of ED57

Issued in October 2015 IPSAS 57 was a relatively minor change to remove what most users considered an anomaly in the treatment of impaired revalued assets. The changes simply bring revalued assets within the scope of IPSAS 21 "Impairment of Non-Cash-Generating Assets" and IPSAS 26 "Impairment of Cash-Generating Assets". The changes also clarify that an impairment to one or more individual assets within a class of property, plant, and equipment does not necessitate a revaluation of the entire class to which the impaired asset belongs.

ICGFM Comments

The ICGFM supported the proposed changes without further comment.

Outcome

In July 2016 the IPSAS Board issued "Impairment of Revalued Assets" which set out the amendments to IPSAS 21 and 26 to implement the proposals in ED57.

ED58 Improvements to IPSAS 2015

Summary of ED58

Issued in January 2016, ED58[3] is a periodic update of EDs on a range of issues. These included

[3] http://www.ifac.org/publications-resources/exposure-draft-58-improvements-ipsass-2015

- Changes and consequential amendments arising from the first four chapters of the IPSASB Conceptual Framework
- Improvements to increase consistency with Government Finance Statistics reporting guidelines
- Improvements to maintain convergence with International Financial Reporting Standards (IFRSs).
- Amendments to adopt the principles set out by the International Accounting Standards Board (IASB) in June 2014 to International Accounting Standards (IAS) 16 and 41 regarding bearer plants.

ICGFM Comments

We supported these relatively minor changes to IPSAS, particularly those converging with IFRS. We also repeated our recommendation on ED56 that the term GBE be replaced with the GFS term "Public Corporations", though as noted above we now know that the IPSAS Board has instead decided to use its own new term ""Commercial Public Sector Entities".

Outcome

The changes as set out in ED58 were adopted in April 2016.

ED59 Employee Benefits

Summary of ED

Issued in January 2016, ED59[4] deals with one of the most complex IPSAS - IPSAS 39 (formerly IPSAS 25) on Employee Benefits. This Standard deals with two major areas:

1. A range of short term and accumulated employee benefits, e.g. bonuses, leave entitlement, etc.
2. Employee pensions

The primary objective of ED59 was to bring the treatment of employee benefits in IPSAS in line with the treatment in IAS 14 as released by the IASB.

ICGFM Comments

Our comments were substantial and in general critical of the approach and organisation of ED59. Because of their length our comments are reproduced in full in Annex 1 to this article. In summary we concluded that:

1. IPSAS 25 as amended by ED59 is not aligned with the issues facing entities in the general government sector (especially sovereign governments) and does not adequately address the requirement for transparency in relation to the inter-generational impact of post-employment benefits.
2. We also recommended that IPSAS 25 should be restructured to clearly segregate the different types of employee benefits. Also the presentation of the IPSAS should be reorganised to improve clarity, and the language used in the IPSAS should be meaningful to persons who are not pension experts.

[4] http://www.ifac.org/publications-resources/exposure-draft-58-improvements-ipsass-2015

Outcome

Some 24 comments were submitted on ED59, including those of the ICGFM. However, none of the other respondents commenting on ED59 indicated the fundamental issues in our comments, and all other comments agreed with the general principles of ED59 though making a number of detailed comments.

Therefore, not surprisingly, IPSAS 39 issued in July 2016 to replace IPSAS 25 substantially incorporates the proposals in ED59. However, we continue to be of the view that ED39 is flawed and requires a fundamental revision:

- To better address the issue of public sector pensions that are completely or substantially unfunded, and also
- To make the Standard better organised and more intelligible.

ED60 Public Sector Combinations

Summary of ED60

Exposure Draft 60 was issued in January 2016[5] as part of the IPSAS Board project on public sector combinations. The objective of this project is to "establish requirements for classifying, recognizing and measuring public sector combinations".

ED60 introduces a number of concepts and makes important proposals for the accounting treatment of combinations.

ICGFM Comments

We made a number of substantial comments on ED60 of which the most important are as follows (the request for comments as set out in ED60 is in italics, followed by our response).

Specific Matter for Comment as set out in ED60

Do you agree with the approach to classifying public sector combinations adopted in this Exposure Draft (see paragraphs 7–14 and AG10–AG50)? If not, how would you change the approach to classifying public sector combinations?

No - ED60 does not adequately recognise the nature and substance of government entity combinations. ED60 distinguishes amalgamations from acquisitions, but in fact there are three potential situations:

Situation 1. An amalgamation of two government entities, for example two government agencies combining into one new agency

Situation 2. A combination of two government entities that that meets the description of an acquisition, but where there is no consideration. An example would be where the two agencies in situation 1 above are combined into one of the agencies.

Situation 3. An acquisition by a government entity of another entity for a consideration. This latter situation would most probably arise when a government acquires a commercial entity, which then becomes a Commercial Public Sector Entity.

For government entities the first two situations differ only in the form of the combination arrangements. Both involve a political decision to reorganise government operations and the substance of the combination remains the same. Therefore, there is no logical reason why the

[5] http://www.ifac.org/publications-resources/exposure-draft-60-public-sector-combinations

accounting treatment should differ as between Situations 1 and 2. On the other hand, situation 3 probably involves the acquisition of a commercial entity and hence the creation of a new, or expansion of an existing, Commercial Public Sector Entity.

Situation 3 has much in common with combinations of commercial entitles, and therefore it is appropriate that it is treated in a similar manner to IFRS 3. On the other hand, Situations 1 and 2 are simply government reorganisations and should both be accounted for in the same manner using the modified pool approach as described in the ED.

Therefore, it is our view that these three situations should be clearly identified and defined, and that the accounting treatment for Situations 1 and 2, as defined above, should be identical applying the modified pool approach.

Conclusions

It is our view that the distinctions between acquisitions and amalgamations as defined in paras 7 and 8 of ED60 lack clarity. The definitions will make it difficult in some circumstances to distinguish acquisitions from amalgamations of government entities. A clearer definition is required.

ED60 appears to have been drafted without adequate consideration of the substance of government entity combinations. In many cases such combinations could meet the definition in the ED of either an "amalgamation" or an "acquisition without consideration". A different accounting treatment for these two situations is inappropriate. Different accounting treatments could unintentionally influence public policy considerations for which the accounting treatment should be irrelevant.

Outcome

The 31 responses from various organisations to ED60 indicated a number of criticisms and proposed changes. However, none of the other responses made the same points as our response. In total the responses have left the public sector combinations project much to consider.

As yet no new standard has been published on public sector combinations.

ED61 Cash Basis Standard

Summary of ED61

Published in February 2016, ED61[6] incorporated most of the recommendations we made in our response to the consultation paper on the Cash Basis IPSAS. These comments were published in the 2015 edition of the International Journal on Government Financial Management[7].

The major changes proposed to the Cash Basis Standard in ED61 include the moving of a number of problem areas to Part 2 of the Standard – Encouraged Additional Disclosures. These include:

- Requirements for consolidation
- Information on external assistance
- Information on third party payments

[6] http://www.ifac.org/publications-resources/exposure-draft-61-amendments-financial-reporting-under-cash-basis-accounting

[7] http://www.icgfm.org/journal/2015/vol1/5.pdf

ICGFM Comments

In general, we were supportive of the proposed changes, which will make the Cash Basis Standard a more realistic goal for countries that do not adopt the full accrual IPSAS. However, we made a number of detailed comments:

- We disagreed with the principle that all countries should be moving to accrual reporting and adoption of the accrual standards
- We recommended that the IPSAS 2 cash flow format should be allowed as an alternative to the traditional Receipts and Payment format. It should be noted that the current Standard allows the IPSAS 2 cash flow format but is not specific as to the format of the financial statements
- We recommended a more structured approach to additional encouraged disclosures in Part 2 of the Standard
- We recommended a requirement that additional information on Part 2 of the Standard should be presented in compliance with any existing accrual IPSAS.

Outcome

Some 17 comments were submitted on ED61. Most supported the reforms, but made a number of suggestions for improvements to the ED before it becomes a standard.

As yet no revised Cash Basis Standard has been published.

Consultative Paper on Social Benefits

Summary of Consultative Paper

The Consultative Paper on Social Benefits[8] addresses fundamental issues that concern the concept and scope of government financial reporting. When governments make legal or policy commitments to pay future social benefits, to what extent should these be recognised as liabilities in the government financial reports? This also raises issues relating to the extent to which non-contractual and inter-generational liabilities should be recognised. It follows on from previous IPSAS Board discussions that did not lead to any published standard or guidance.

The Consultative Paper suggested three options to account for social benefits:

- Option 1: The obligating event approach
- Option 2: The social contract approach
- Option 3: The insurance approach

The Consultative Paper needs to be read in full to better understand the options.

ICGFM Comments

The ICGFM response was a paper on the issue, which is reproduced in Annex 2 to this Article.

Outcome

There were 36 comments on this consultation paper, representing a variety of views. Interesting, there appears to be a general consensus on the principle of recognising social benefits as a liability in the financial statements, though many different views on the scope, definitions and measurement of such a liability.

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[8] https://www.ifac.org/publications-resources/recognition-and-measurement-social-benefits

As yet ICGFM has not published any response or proposed standard on Social Benefits.

Conclusions on the ICGFM Ad Hoc Committee on International Accounting Standards

As is apparent from the above analysis, ICGFM has had some successes on influencing Standards, particularly the Cash Basis Standard. But in other areas our views have not been heard. We shall continue to express our views and seek to ensure they have the maximum impact. Publishing our comments in the International Journal of Government Financial Management is part of the approach to ensure ICGFM's voice is heard.

ANNEX 1: ICGFM RESPONSE ON ED 59 "AMENDMENTS TO IPSAS 25[9]"

Overview

IPSAS 25 is so complex and the methodology descriptions so abstruse that most accountants will be inclined to regard ED59 as raising technical issues best left to those with expertise in the pensions area. This is unfortunate, because pension liabilities for government entities[10] are, in many instances, very large in relation to other figures in the balance sheet[11].

Accounting for pension liabilities is very important, but it is our view that by simply replicating most of IAS 19 the IPSAS Board is not recognising the special nature of pension liabilities of government entities. In consequence the pension liability disclosure requirements for government entities are inadequate.

Comparison of government sector and private sector pension issues

Pension issues for the commercial corporate sector

Commercial entities' pensions are almost invariably intended to be fully funded. If pensions are based on the returns from pension fund assets (defined contribution), then it follows that there is no risk of any further liability to the entity. However, if the pension is one which defines the benefits without direct reference to contributions (defined benefit pension) then there is the risk that the entity may be liable for pension payments not covered by income from pension fund assets – a pension fund liability.

In the latter situation any shortfall will have to be made good from future revenues of the entity, affecting the future profitability, and possibly the solvency, of the entity. The focus of IAS 19 is on identifying such situations, measuring the potential pension fund liability, profit impact and risk to the entity resulting from the pension liability.

Pension issues in the government sector

In contrast, pensions schemes of government entities are commonly unfunded (or only part funded) defined benefit schemes. Therefore, many government entities have large unfunded pension liabilities. However, in the case of sovereign governments this liability is offset by the ability to raise taxes or other revenues – a major difference from commercial entities. This and the inter-generational responsibility of governments should affect the disclosure of pension liabilities.

Until IPSAS 25 (or the application by some governments of national standards) the potential liabilities from pension schemes were not recognised in government entity financial statements. However, since IPSAS 25 all government entities reporting on the accrual basis are required to disclose their unfunded pension liability.

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[9] IPSAS 25 has now been replaced with IPSAS 39

[10] For clarity we use the term "government entities" to describe entities within the General Government Sector and to which IPSAS are applicable. The Corporate Sector refers to commercial entitles, included those owned by government. Using the new IPSAS terminology these latter are referred to as "commercial public sector entities".

11 The UK Whole of Government Accounts 2013/14 estimate the pension liabilities of the UK Government as £1,302 billion (US$1,888 billion) of which 93% is unfunded. This compares to total UK government revenues for the same period of £684.5 billion (US$993 billion)

This has undoubtedly been a step forward in terms of transparency. Where IPSAS 25 has been applied the disclosure of pension liabilities has focused attention on the scale of such potential liabilities[12] to government entities, including sovereign governments.

However, despite the benefits of disclosure, there are arguments for **not** recognising pension liabilities of government sector entities in their financial reports. These arguments against pension liability disclosure are as follows:

- Governments have legal authority to raise revenues. Therefore, governments are in a very different situation to commercial entities. For the latter future revenues depend on success in business. This is a fundamental difference.
- Pensions may be paid from such future revenue flows under the control of the entity, and to show a liability without the corresponding asset of such future revenues is misleading
- Since there is no concept of profit in the public sector the impact of pension liabilities on future profit is irrelevant – it is the impact on future generations of citizens that is important.
- Governments do not cease to exist as a result of insolvency – even if a government defaults on its debts the government continues to exist and is still able to pay future pensions.

These arguments require consideration. At the very least they must influence the design of pension disclosure requirements.

However, there are compelling reasons in favour of recognising pension and other post-employment liabilities for government entities:

1. Unfunded pension liabilities of government entities can be very large (see above) and transparency requires that such liabilities be identified and reported
2. Not all entities within the government sector are guaranteed their future existence or have an automatic right to raise revenues, e.g. educational institutions. For such entities the pension liabilities may threaten their very existence. The need to make good any shortfall may impact, for example, on the fees charged to future students.
3. Pension liabilities represent an inter-generational transfer – to the extent that future pensions cannot be met from employee contributions, they must be met from future revenues, pre-empting the use of such revenues for other purposes.
4. Pension liabilities are a factor taken into account in assessments of credit risk, and may affect the cost of borrowing by the entity.

These arguments are implicitly accepted by IPSAS 25 and are the reasons requiring the disclosure of pension liabilities.

Conclusions on recognising the pension liabilities of entities within the government sector

It is our conclusion that the requirements for transparency require the disclosure of pension and other post-employment liabilities, and particularly the inter-generational impact of such liabilities. Furthermore, we agree that the IPSAS 25 measurement methodology and methodology in IAS 19 is appropriate for calculating a single figure value of such liabilities.

[12] For example, a report on the BBC website on April 16, 2016 on the UK government pension liability emphasised pubic concern with the issue.

However, we consider that the presentation and disclosure requirements of IPSAS 25 are inadequate for government entities.

Identifying and measuring the pension liability

IPSAS 25 sets out a general approach for measuring future pension liabilities that is in essence unchanged by ED 59. This requires an actuarial estimate of future pensions that have accrued from contributions made by employees, discounted to their present value. The liability is reduced by the expected returns from any pension fund assets.

In a funded pension scheme the expectation is that the contributions will enable the pension fund to acquire assets that will generate a sufficient cash flow to pay future pensions. However, it is obvious that calculating the level of pension contributions to achieve this outcome involves forecasts of the future that may prove to be inaccurate. This may lead to a shortfall between the pension fund liability to pensioners and the expected revenues from pension fund assets (it may of course lead to a surplus). The focus of IPSAS 25 is to identify and measure any such funding gap, and then to report this as a single figure pension liability.

The measurement methodology in IPSAS 25/ED 59 is equally valid for commercial or government entities. As indicated above, the difference between commercial and government entitles is that government pensions are often completely, or mainly, unfunded. There may also be other material unfunded post-employment liabilities, for example health care of former employees in the US public sector[13].

Why IPSAS 25 is so complex

There are three reasons why IPSAS 25 is such a complex Standard, as set out below.

1 The mechanics of calculating a single figure for the net pension liability or asset

As indicated above, the mechanics of reducing pension liabilities to a single figure are complex. It requires calculation of the accrued liability for future pension payments (using assumptions for example about life expectancy, survival within an organisation to pension age, interest rates, etc.) and also the anticipated returns from fund assets. It is inevitably difficult to use words to define the calculations.

2. The use of terminology in a manner different from normal usage

Terms are used in both IPSAS 25 and ED 59 with a quite different meaning from normal usage. For example, the term "interest cost" does not refer to an interest payment that will ever actually occur or be paid – it is the amount of the notional interest on the defined benefit liability.

3. Confused presentation of the standard

IPSAS 25 is about employee benefits in general. These include short term benefits and defined contribution pension schemes. None of these issues present any major complexities or differences between the government and corporate sector. Yet the requirements relating to such benefits are interspersed with the more complex requirements relating to defined contribution pensions.

Even within the part of the IPSAS dealing with defined benefit schemes, the Standard does not follow the principle of moving from the general to the particular. For example, the definition

[13] The incidence of government sector pension liabilities in the US is specific to the USA. At the State and Local levels, bonding agencies expect the government to fund 70% of their liabilities. If government does not fund at least 70%, the agency can expect to pay higher interest rates for their municipal bonds. At the federal level, there is no such policy. Health care liabilities are generally unfunded, but are often a substantial cost.

section is immediately followed by a section on schemes with entities under common control, then back to sections on recognition and measurement. This presentation adds to the difficulty of an already complex and long standard.

Proposed changes to IPSAS 25 and ED 59

The basic measurement and valuation principles set out in IPSAS 25, as amended under the proposals in ED 59, are supported as the basis for providing a single figure estimate of unfunded (or part funded) pension liabilities in the government sector. However, this information alone is inadequate, or even misleading, for government entities. A more comprehensive approach is required that:

1. Identifies the unfunded liability for post-employment benefits
2. Identifies and values flows earmarked to meet the cost of such unfunded liabilities
3. Provides an indication of the inter-generational impact of unfunded pension liabilities in future years
4. Makes clear the level of uncertainty in such forecasts and the impact of the more likely variability in the estimates.

These concepts are further expanded below.

1. Amount of any unfunded pension liability

No change is proposed in the calculation methodology set out in IPSAS 25 as amended by ED 59.

2. Funding of pension liabilities

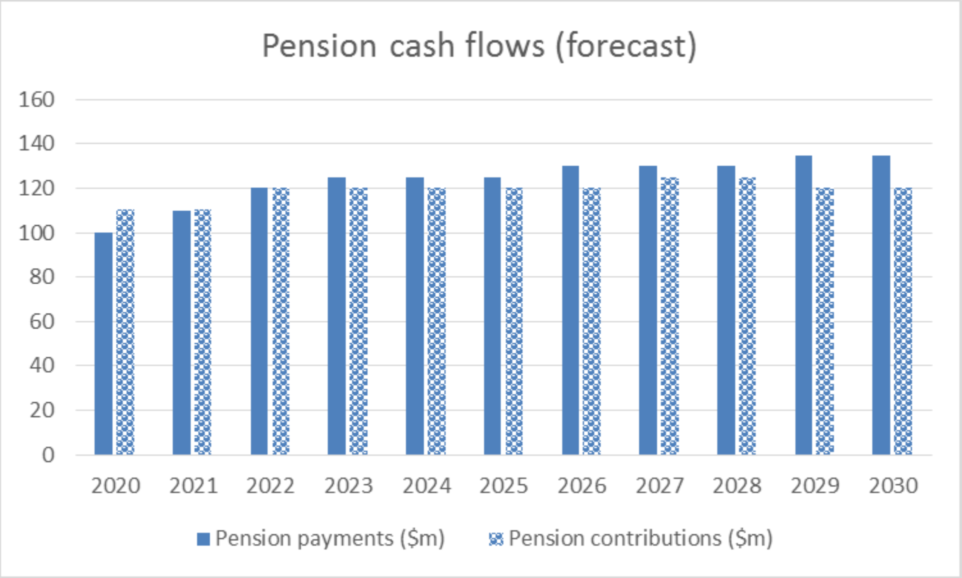
Most government sector entities which have unfunded pension liabilities will (or should) have a plan for funding future pension payments, e.g. future employee and/or employer pension contributions, earmarking of a specific source of revenue, etc. This plan should be described in narrative with a quantification of the anticipated inflows as compared to pension outflows.

Consideration could be given to providing a single figure value of such planned future funding arrangements to be offset against the unfunded pension liability.

3. Future cash flow impact year by year, taking account of any funding plans

Disclosure should involve not just single figure estimates of post-employment benefit liabilities and planned funding flows, but also a year by year estimate of the cash flows. This would clearly indicate the inter-generational impact of employment benefits being incurred by the entity. The information could be presented in a table, possibly also with a graphical representation to make the information clearer as illustrated below.

Figure 1: Example of graphical presentation of pension cash flows over time



4. **Assumptions underlying the above calculations, indicating major uncertainties and possible impact of changed assumptions.**

Some assumptions underlying the calculation of pension liabilities and future cash flows are subject to particular uncertainty, e.g. life expectancy, interest rates. As well as a central estimate, a range of possible outcomes for both single figure estimates and future cash flows should be provided.

Organisation of the IPSAS

In order to improve clarity a revised structure for the IPSAS is proposed:

- Part 1: short term employee benefits
- Part 2: defined contribution pension schemes
- Part 3: defined benefit pension schemes and other unfunded post-employment benefits

Within each section the Standard should be organised to move from the general to the specific, as indicated below for the proposed Section 3:

1. Basic principles and objectives
2. Calculation of defined benefit pension liability – it might be best to define the main principles and use an annex to provide detailed examples
3. Disclosure requirements
4. Special situations and exceptions.

Pension liabilities of commercial public sector entities

The above analysis relates to entities in the general government sector which are required to comply with IPSAS. Commercial public sector entitles are required to apply IFRS. If the more extensive disclosures described above are applied to government entities, this will raise problems when commercial public sector entities are consolidated into whole of government financial reports. For consolidation purposes the more comprehensive information indicated above will be required from all consolidated commercial public sector entities.

Furthermore, pension liabilities of commercial public sector entities may be a contingent liability of the national government. Even if the pension liabilities of a commercial public sector entity are not expressly guaranteed by central government, it would be a brave government which refused to honour such pension commitments.

First time recognition of pension liabilities

Many, indeed most, governments and government sector entities have not as yet recognised in their financial reports unfunded pension and other post-employment liabilities. IPSAS 25 should provide guidance on first time recognition of such liabilities. In particular, guidance is needed whether the first time charge should be taken directly from net equity or charged against surplus/deficit in the Statement of Financial Performance.

Summary and Conclusions

In summary, it is our view that the proposed changes to IPSAS 25 in ED 59 do not go far enough. What is required is a complete redesign of IPSAS 25 so that it requires financial reports to provide information for full transparency on the post-employment benefit liabilities of entities (including sovereign governments) within the general government sector. This information should include information on unfunded liabilities, revenues to meet such liabilities, and forecast future cash inflows and outflows relating to post-employment benefits.

ANNEX 2: RESPONSE TO CONSULTATION PAPER ON RECOGNITION AND MEASUREMENT OF SOCIAL BENEFITS

Overview

1. The Consultation Paper (CP) on the Measurement of Social Benefits raises two fundamental issues:

    a. The recognition as liabilities commitments made by a government to specific groups of citizens – even though there is no contractual obligation requiring future governments to honour such commitments

    b. The inter-generational impact of such commitments – in particular the cost of a state pension payable to all citizens.

2. Governments across the world commit to certain social benefits, e.g.:

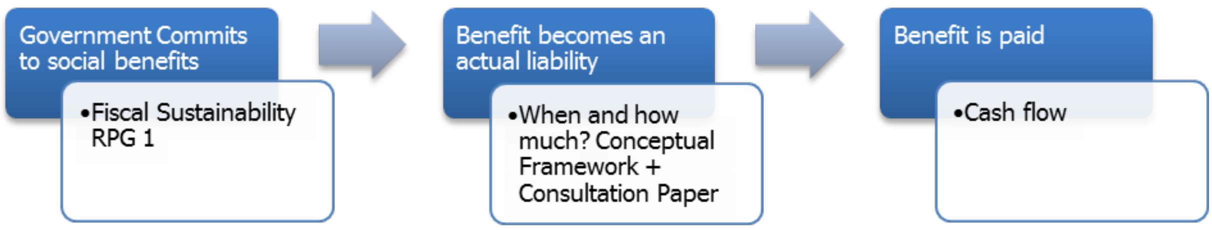
    a. Health care benefits

    b. Unemployment benefits

    c. State pension benefits.

3. There is a flow from the commitment through liability to the actual payment of social benefits as illustrated in Figure 2 below.

Figure 2: The flow of social benefit obligations



4. In most countries social benefit commitments made by a current government are honoured by subsequent governments, but such commitments do not amount to legally binding contractual obligations. There are numerous examples where the terms of the social benefit obligation have been retrospectively changed, e.g. raising the age for state pension, reducing the amounts to be paid.

5. These issues are addressed in the IPSAS Conceptual Framework. This identifies when non-legally binding obligations become liabilities in Para 5.24 as follows:

    a. The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;

    b. As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and

    c. The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.

6. The first two conditions are normally part of governments making social benefit commitments. The issue of recognition as a liability is when condition (c) above is met. At some stage social benefits do meet condition (c) and hence become liabilities.

The ICGFM supports the principle of recognising social benefits as liabilities when the three conditions specified in the Conceptual Framework are met.

Specific Matters for comment 1

In your view:

(a) Is the scope of this CP (i.e., excluding other transfers in kind, collective goods and services, and transactions covered in other IPSASs) appropriate?

(b) Do the definitions in Preliminary View 1 provide an appropriate basis for an IPSAS on social benefits?

Please explain the reasons for your views

(a) Scope

7. We consider the scope appropriate, subject to the comments below.

8. The IMF Government Finance Statistics Manual 2014 (GFSM 2014) in Annex 2 identifies two major classes of social protection:

   a. Pensions and other retirement benefits

   b. Non-pension social benefits.

9. Pensions are specifically included in the GFS definition of social benefits (GFS 2014 Para 2.46 and Annex 2). However, the treatment of liabilities for pensions and for other social benefits is potentially different. IPSAS 25 has defined the approach for employment pension liabilities and logically should be the basis for defining the approach for funded state pensions and other retirement benefits.

10. We therefore consider it important that the two categories of social benefits as above are defined so that consideration can be given as to whether they are to be treated differently.

(b) Definitions

11. The use of the GFS definitions is strongly supported. In principle we consider that only in exceptional circumstances should the IPSAS use different terminology or definitions to those used in GFS.

12. Our comments on specific definitions relate to two important issues:

   a. In Europe social benefits would be regarded as citizen entitlements rather than acts of charity. Persons become entitled to social benefits when they meet certain conditions in many cases without regard to their personal circumstances, e.g. disability and related social benefits are paid irrespective of an individual's income or financial status, e.g. in the UK even the richest are entitled to a state pension. Therefore, the definitions should refer to ***entitlement*** rather than need.

   b. It is our view that the treatment of funded benefits (social insurance) should be different from the treatment of unfunded payments. Therefore, it is necessary to define what is meant by funded benefits.

Definition of funded schemes (social insurance)

13. It is our view, as indicated below, that schemes that are fully or mainly funded are different in nature, and therefore in accounting treatment, from unfunded schemes. For this purpose, we would define funded schemes quite narrowly, e.g. "*A funded age related or other benefit is one where an individual has over time made payments to a fund represented by specific assets, which assets are administered separately from other government assets through an independent agency, and such agency is able to generate its own balance sheet separate from the balance sheet of general government. Furthermore, the revenues generated from the fund's assets are expected mainly or entirely to meet the costs of the anticipated social benefits payable from the fund.*"

14. Such funded schemes create an implied contract between the potential beneficiary and the fund to pay the social benefits. Furthermore, citizens in general may assume that the fund has sufficient resources to make such payments and hence there will be no charge on citizens in general. This makes it important to identify and disclose in the financial reports any fund surplus or deficit on such funded schemes. We would regard the entitlement to benefits under such funded schemes as a **constructive liability** of the government.

2.41 Social benefits[14]

15. For the reason indicated in (a) above the definition should refer to entitlement, i.e. "*Benefits provided to individuals and households, in cash or in kind, when they meet the conditions entitling them to such benefits*."

2.42 Social risks

16. Social risks include events that entitle a person to certain benefits even though there may be no worsening in their financial situation, e.g. pensions are payable in the UK even if a person continues in employment earning a very high income.

17. Therefore, we would prefer a definition that refers to entitlement to benefits rather than making assumptions about an individual's financial circumstances, e.g. "*Events or circumstances that make an individual or household entitled to social benefits*"

2.49 Social assistance

18. Similarly, social assistance should be defined in terms of entitlement to benefit rather than because of an individual need, e.g. "*The provision of social benefits to all persons who are entitled without any formal requirement to participate as evidenced by the payment of contributions*".

Specific matters for comment 2 (following Para 3.4)

(a) Based on your review of Chapters 4 to 6, which approach or approaches do you support?

(i) The obligating event approach;

(ii) The social contract approach;

(iii) The insurance approach

Please provide reasons for your views, including the conceptual merits and weaknesses of each option; the extent to which each option addresses the objectives of financial reporting; and how the different options might provide useful information about the different types of social benefit.

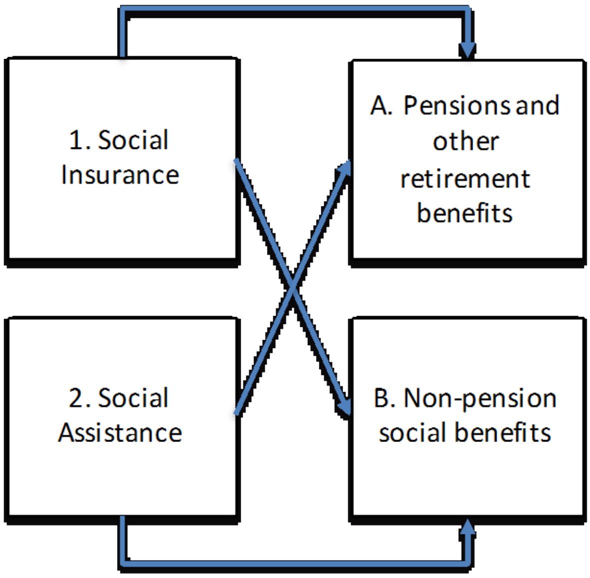
[14] Headings are numbered as in the Consultative Paper

(b) Are you aware of any additional approaches to accounting for social benefits that the IPSASB should consider in developing an IPSAS? If yes, please describe such approach(es) and explain the strengths and weaknesses of each.

(a) Supported approach

19. In indicating the approach supported we see four possible combinations of social assistance, social insurance, pension and non-pension benefits as illustrated in Figure 3 below. We further consider that the approach should vary between these options.

Figure 3: Benefit analysis - the four categories



20. We consider each of the above combinations in relation to the suggested approaches to recognition of social benefits. The numbers follow the numbers in the diagram.

1A. Funded pension and other retirement benefits (social insurance)

21. Provided the concept of a funded scheme is defined as above, then the treatment should be based on that described in IPSAS 25 for funded employee pension schemes. We can see no reason for a different treatment.

1B. Social insurance non-pension benefits

22. Provided, as above, the funding is clearly defined as above, we concur with insurance approach as recommended in the Consultation Paper

2A. Social assistance (unfunded) pensions and other retirement benefits

23. We consider the obligating event the most appropriate approach

2B. Social assistance - non-retirement benefits

24. Similarly, to 2A, we consider the obligating event approach the most appropriate.

25. We concur that Option 2 Social Contract is not appropriate for identifying the liabilities under an IPSAS on Social Benefits. However, as under that heading discussed, we consider the social contract approach is a useful model to provide supplementary information on inter-generational assets and liabilities.

Specific matters for comment 3

Having reviewed the three options in Chapters 4 to 6, are you aware of any social benefits transactions that have not been discussed in the CP, and which could not be addressed by one or more of the options set out in the CP?

If so, please provide details of the social benefit transactions you have identified and explain why the options set out in the CP do not adequately cover these transactions.

26. We are not aware of any social benefit transactions not discussed in the CP

Specific matters for comment 4

In your view, at what point should a future IPSAS specify that an obligating event arises under the obligating event approach? Is this when:

(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;

(e) A claim is enforceable; or

(f) At some other point.

In coming to this conclusion, please explain what you consider to be the relative strengths and weaknesses of each view.

If, in your view, a future IPSAS should consider that an obligating event can arise at different points depending on the nature of the social benefit or the legal framework under which the benefit arises, please provide details.

Please explain the reasons for your views.

Option 1: Obligating event approach

27. The fundamental problem is deciding when the obligation meets condition 3 of the Conceptual Framework para 24: "The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities."

    a. It could be argued that this stage is never reached for non-contractual social benefit obligations. A recent example that demonstrates this point is Greece, where social benefit payments (including pensions) have been reduced even after beneficiaries have commenced receiving the benefits. In the UK the criteria for disability benefits have been changed so as to exclude some persons who were previously receiving this benefit.

    b. These examples illustrate the point that as a general principle of constitutional law no government can bind its successor. Hence any social benefit obligation can be changed by decision of the government in power.

    c. Thus it is possible to argue that there should be no recognition of social benefits as a liability since there is only a political obligation to provide the benefit.

28. On the other hand, it may be argued that in reality no government is ever likely to completely renege on an obligation by a previous government to provide social benefits. At most such obligations may be amended or reduced, but never eliminated.

29. Therefore, the argument of substance over form is that there should be some recognition of the liability in advance of actual payment. The question posed by the Consultation Paper is how this point is identified and how the liability should be measured.

30. We regard Obligating Event as the conceptually simplest approach. It also provides "de minimis" approach, in that obligating events can be defined so restrictively that the obligation is undoubtedly a liability.

Specific matters for comment 4 (after Para 4.69)

31. We respond to the four sub-questions as follows:

    a. We consider the obligating event approach appropriate for social assistance (i.e. unfunded) social benefits, both retirement and other.

    b. In such cases we would use a narrow definition of the threshold obligating event, i.e. claim become enforceable. Also this would be year by year basis, i.e. the liability recognised would only be for the current financial year.

    c. We would not allow any variation on this requirement.

    d. It is our view that supplementary information should be provided in financial reports using the social contract approach to indicate the inter-generational liabilities being created by the commitments. This is further explained below under Option 2: social Contract.

Specific matters for comment 5

In your view, does an obligating event occur earlier for contributory schemes than non-contributory schemes under the obligating event approach?

Please explain the reasons for your views.

32. We have indicated in our response to question 2(a) above that we support a different treatment for funded schemes. This would only apply where the contributions are used to acquire fund assets as defined above.

Specific matters for comment 6

In your view, should a social benefit provided through an exchange transaction be accounted for:

(a) In accordance with a future IPSAS on social benefits; or

(b) In accordance with other IPSASs?

Please provide any examples you may have of social benefits arising from exchange transactions. Please explain the reasons for your views.

33. As indicated in our response to question 2(b) above, social benefits provided through an exchange transaction, e.g. social insurance, should be accounted through a future IPSAS on social benefits. It is our view that these fall within the definition provided in our response to question 2(b) above.

Specific matters for comment 7

In your view, under the obligating event approach, when should scheme assets be included in the presentation of a social benefit scheme:

(a) In all cases;

(b) For contributory schemes;

(c) Never; or

(d) Another approach (please specify)?

Please explain the reasons for your views.

34. Since under our recommended approach the obligating event approach is only applied where there are no clearly identifiable scheme assets, the answer is (c) - never.

Specific Matter for Comment 8

In your view, under the social contract approach, should a public sector entity:

(a) Recognize an obligation in respect of social benefits at the point at which:

(i) A claim becomes enforceable; or

(ii) A claim is approved?

(b) Measure this liability at the cost of fulfilment?

Please explain the reasons for your views.

Option 2: Social contract approach

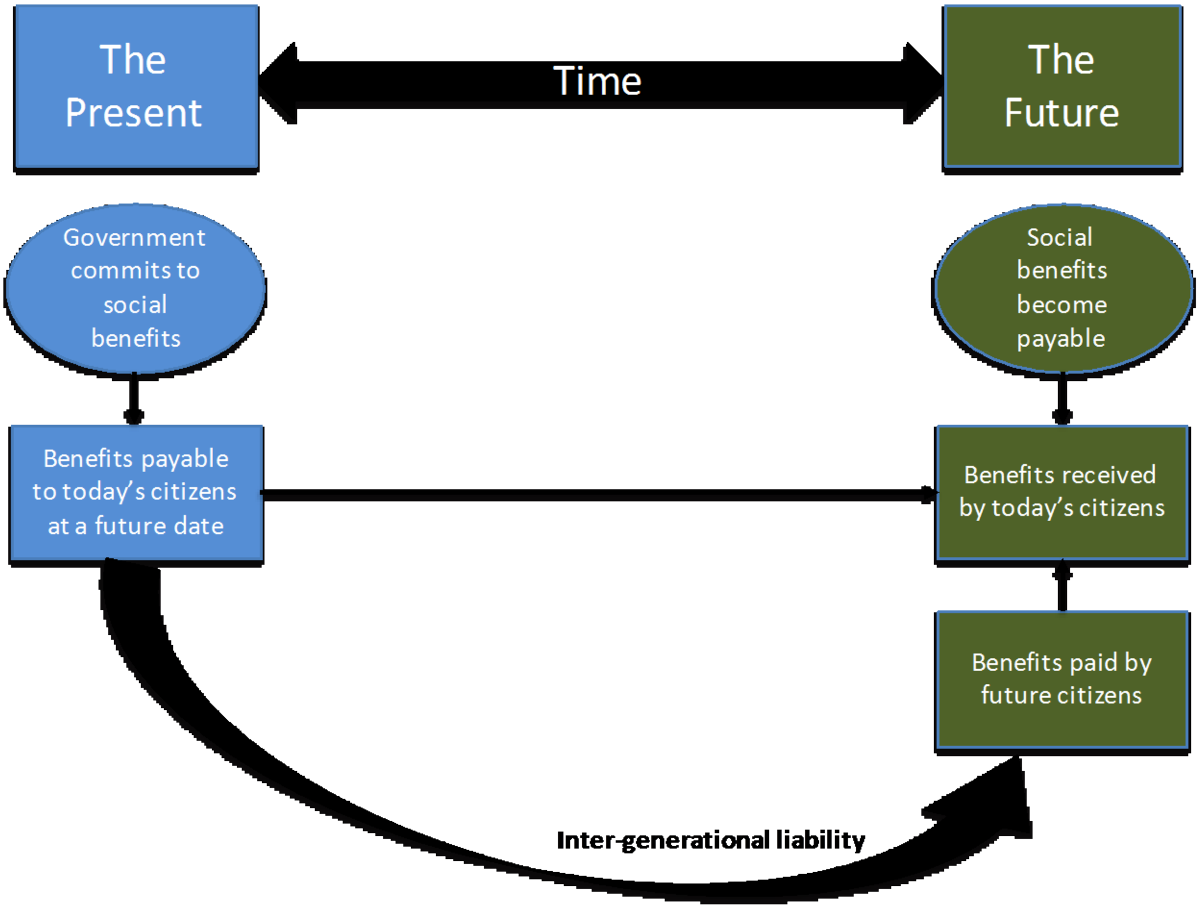
35. It is our view that the CP makes the concept of social contract overly complicated by equating social contract with executory contract. In our view, the concept of social contract is a concept of social philosophy and does not need to be linked to executory contracts.

36. The political philosophy approach to the social contract dates back to Socrates and Plato. In essence the concept of the social contract refers to the mutual transferring of rights. This is a definition of social assistance – a transferring of the rights to income from one group of citizens to another group of citizens.

37. A commitment by a government to certain types of social assistance takes this one stage further and transfers rights from future generations of citizens to current generations of citizens when the latter meet certain entitlement conditions, e.g. age, disability.

38. Thus the social contract approach provides a model for recognising the inter-generational impact of commitments to unfunded social benefits.

Figure 4: Intergenerational impact of social benefits



39. Because of the uncertainties attached to such inter-generational liabilities, we do not consider that they should be shown as liabilities within the Statement of Financial Position. However, we do consider that the model could be used to provide supplementary information within the financial reports on the intergenerational impact of today's commitments to pay unfunded social benefits as well as constructive liabilities arising from part funded schemes.

Supplementary statement of inter-generational impact

40. We consider the concept of a supplementary statement of inter-generational impacts could be used to summarise and report a range of decisions taken today which impact on future generations where these are not reported as actual liabilities in the statement of financial position. Such a supplementary statement could also include other potential inter-generational commitments, e.g. long term subsidies of specific industries.

41. A future consultative paper may be required on including in the financial reports such a statement of inter-generational impacts. Issues to be considered are what would be included in the paper, the extent to which revenue flows should be taken into account (or perhaps the required revenue flows be defined), the use of actuarial data, discount rates, handling of uncertainty, the number of years into the future, and so on.

Specific matters for comment 8 (after Para 5.38)

In your view, under the social contract approach, should a public sector entity:

(a) Recognize an obligation in respect of social benefits at the point at which:

(i) A claim becomes enforceable; or

(ii) A claim is approved?

(b) Measure this liability at the cost of fulfilment?

Please explain the reasons for your views.

42. As indicated, we do not consider the social contract approach appropriate for the inclusion of liabilities in the statement of financial position.

43. However, we do consider that the social contract approach provides a model for providing supplementary information on the inter-generational impact of today's social benefit commitments. It is our view that all governments that have significant unfunded social insurance commitments should be required to provide a supplementary report as part of their financial reports identifying the inter-generational liability.

Option 3: Insurance approach

Specific matters for comment 9 (after Para 6.24)

Do you agree with the IPSASB's conclusions about the applicability of the insurance approach?

Please explain the reasons for your views.

44. The insurance approach is supported as an appropriate approach for funded social insurance other than pensions and other retirement benefits (see above). This provides a conceptually valid approach for both recognising and measuring the liability.

45. Since this is only applicable to funded schemes, the amount of liability to be recognised would be net of fund assets.

Specific matters for comment 10 (after Para 6.35)

Under the insurance approach, do you agree that where a social security scheme is designed to be fully funded from contributions:

(a) Any expected surplus should be recognized over the coverage period of the scheme; and

(b) Any expected deficit should be recognized as an expense on initial recognition?

Please explain the reasons for your views.

46. We disagree. We can see no reason for treating surpluses and deficits differently. Therefore, the approach in (b) should be applied to a surplus or a deficit.

Specific matters for comment 11 (after Para 6.37)

In your view, under the insurance approach, what is the appropriate accounting treatment for the expected deficit of a social security scheme that is not designed to be fully funded from contributions:

(a) Recognize the deficit as an expense on initial recognition;

(b) Recognize the deficit as an expense over the coverage period of the scheme;

(c) Offset the planned subsidy and the liability only where this is to be received as a transfer from another public sector entity;

(d) Offset the planned subsidy and the liability irrespective of whether this is to be received as a transfer from another public sector entity or as an earmarked portion of general taxation; or

(e) Another approach?

Please explain the reasons for your views.

47. As indicated above we would only apply the insurance approach to social benefits that are mainly funded as defined above. In this case in our view any deficit should be expensed on initial recognition.

Specific matters for comment 12 (after Para 6.43)

In your view, under the insurance approach, should an entity use the cost of fulfilment measurement basis or the assumption price measurement basis for measuring liabilities?

Please explain the reasons for your views.

48. We find the terminology in the section of CP less than clear, in that different terms are used for what is essentially the same concept, e.g. assumption price, prudentially adjusted liability, cost of fulfilment.

49. In our view the appropriate basis is the risk-adjusted cost of fulfilment, referred to as the assumption price.

Specific matters for comment 13 (after Para 6.63)

Do you agree that, in those cases where the link between contributions and benefits is not straightforward, the criteria for determining whether the insurance approach is appropriate are:

- *The substance of the scheme is that of a social insurance scheme; and*
- *There is a clear link between the benefits paid by a social security scheme and the revenue that finances the scheme. If you disagree, please specify the criteria that you consider should be used. Please explain the reasons for your views.*

50. As indicated above, we would propose a narrow definition of a funded (social insurance) scheme. All other schemes would be treated as social assistance.

Specific matters for comment 14 (after Para 6.72)

Do you support the proposal that, under the insurance approach, the discount rate used to reflect the time value of money should be determined in the same way as for IPSAS 25?

Please explain the reasons for your views.

51. Yes - this is consistent with approaches discussed above

Specific matters for comment 15 (after Para 6.76)

Under the insurance approach, do you support the proposals for subsequent measurement set out in paragraphs 6.73–6.76?

Please explain the reasons for your views.

52. Yes – this is consistent with all our other responses as indicated above.