



Federation of European Accountants

Ian Carruthers
Chairman
IPSASB
IFAC
Submitted via website

Brussels, 4 February 2016

Dear Chairman,

Subject: IPSASB Consultation Paper - Recognition and Measurement of Social Benefits

The Federation of European Accountants (FEE) is pleased to provide you with its comments on the above mentioned Consultation Paper (CP).

FEE welcomes the publication of this CP as the IPSASB's latest initiative to drive forward the debate on the appropriate accounting treatment of social benefits. The treatment of social benefits has long been seen as a crucial public sector-specific accounting issue and the lack of an IPSAS dealing with this matter has been held out by some parties as a reason that IPSASs as a whole are not suitable for adoption. Consequently, we believe timely completion of this project is of crucial importance, which is one of the reasons that we support IPSASB's decision to limit the scope of the CP to exclude exchange transactions and collective goods and services.

The provision of social benefits constitutes a significant proportion of government expenditure in most developed countries. The demographics of many developed countries show an ageing population and a decreasing birth rate – this will simultaneously increase the need for many types of social benefit whilst reducing the tax base with which to pay for them. Consequently, FEE regards the proper accounting and disclosure of the ongoing costs of providing social benefits as a vital element in the crucial public debate on the sustainable funding of public sector services.

It is primarily for this reason that FEE does not support the social contract approach outlined as an option in the CP. This approach, where recognition is based on strict legal entitlement and where future payments of benefits are matched to future taxation receipts (even if the obligation arises from past events), would not achieve the objective of making public sector liabilities more transparent. Additionally, the concept of intergenerational solidarity that underpins the social contract approach may not be appropriate for those countries where a falling population is predicted.

We believe that it is important that all public sector bodies properly disclose their financial liabilities arising out of past events – this is crucial information for all stakeholders and will also assist these bodies in their management of resources. For this reason, FEE supports the IPSASB's preliminary view that a combination of the obligating event approach and the insurance approach (for certain contributory schemes) is the best method to meet the objectives of public sector financial reporting.

However, the obligating event approach is not without its complications, particularly in respect of determining the point at which an obligation should be recognised in the financial statements. FEE considers that there may not be one specific point of recognition that is suitable for all types of social benefits. For example, we consider that there are good reasons for recognising liabilities under pension schemes at an earlier point than accident benefit schemes.

Additionally, there are so many national variations in the way that particular types of social benefits (such as state pensions) are administered that it may not be feasible to provide firm rules applicable in all countries. In many cases the accounting treatment will be significantly influenced by the exact legal terms of the scheme, but the IPSASB could provide invaluable assistance by providing a principles-based framework for deciding on the most appropriate point of recognition, backed up by real-world examples.

FEE also considers that the legal form and rules of a social benefit scheme impact on other areas – for example, in the treatment of deficits arising in schemes accounted for under insurance rules that are partially funded by contributions and partly out of tax revenues. In this instance, we are not convinced that the option to write off anticipated losses as an expense at the inception of the scheme will provide the most meaningful information for users of the financial statements, despite being consistent with the treatment of anticipated losses under IPSAS 25.

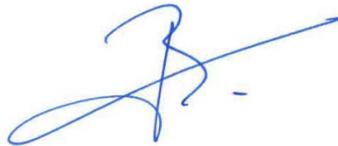
In this case, we believe that it will be necessary to consider in detail the exact legal conditions relating to the scheme in order to ascertain the most suitable treatment of the anticipated losses. In other cases it may even be appropriate to identify the separate components of the scheme when determining the most appropriate accounting treatment – for example, an insurance element that is embedded within a scheme.

For further information on this letter, please contact Paul Gisby, Manager, from the FEE team on +32 2 893 33 70 or via e-mail at paul.gisby@fee.be.

Yours sincerely,



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FEE President



Olivier Boutellis-Taft
FEE Chief Executive

Annex 1 - Detailed responses to questions

Specific Matter for Comment 1(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?

- (1) FEE thinks that the scope of the CP, already having been the subject of considerable debate within the IPSASB, is appropriate. We consider that, in particular, collective goods and services pose different accounting challenges to the provision of the benefits dealt with in this CP and agree that these issues should be dealt with separately. We also welcome the closer alignment to Government Finance Statistics that this restriction of scope brings.
- (2) From a practical point of view, restricting the scope of the project should assist with its more timely conclusion. Concluding the social benefits project in the shortest time possible is especially important at a European level, where it has been argued that the lack of an IPSAS on social benefits reduces the applicability and usefulness of the IPSAS suite of standards as a whole.

Specific Matter for Comment 1(b)

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

- (3) FEE believes that the definitions in Preliminary View 1 do provide an appropriate basis for an IPSAS on social benefits.

Specific Matter for Comment 2(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.

- (4) We support the IPSASB's preliminary view that a mixture of the obligating event approach (option i) and the insurance approach (option iii) will provide the best solution.
- (5) For non-contributory schemes, the obligating event approach seems best to fit with the IPSAS's Conceptual Framework definition of a "present obligation": i.e. "a legally binding obligation or non-legally binding obligation, which an entity has little or no realistic alternative to avoid". It also fits better with IPSAS 19's definition of an "obligating event" as an "event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settle that obligation" and with private sector accounting standards, particularly IAS 37 Provisions, Contingent Liabilities and Contingent Assets.
- (6) When considering the recognition of a liability, the IPSASB takes the approach that it is not dependent upon considerations as to whether the government in question will have adequate funding to settle the liability in the future. In this respect, the obligating event approach appears to be more in keeping with this approach than the social contract approach.

- (7) Regarding schemes with a contributory element, it seems eminently sensible to use well established insurance accounting principles for schemes where the funding is either totally or partially from direct contributions from the recipient households.

Specific Matter for Comment 2(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.

- (8) We are not aware of any additional approaches.

Specific Matter 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.

- (9) FEE is not aware of any other types of social benefits transactions not discussed in the CP and that would not be addressed by one or more of the options set out in the paper.

Specific Matter 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 discussed in this chapter.

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.

- (10) FEE's opinion is that it will be extremely difficult to establish the same recognition criteria for all forms of social benefits and still produce meaningful information. In our opinion, different forms of social benefits will produce different legitimate expectations for the potential beneficiaries, often influenced by the legal form underlying the social benefit in a particular country.
- (11) For example, for a non-contributory basic state pension funded out of tax receipts and subject to no eligibility criteria apart from reaching the age of retirement, it could be argued that the key participatory event is birth. However, where the criteria include a requirement to have worked a certain number of years or the amount received varies by the number of years worked, it may be more appropriate that the key participatory event is the individual's entry into the job market. This is why we believe that the Standard should be flexible enough to allow the preparers to use the most suitable option for each social benefit scheme.

- (12) FEE believes that the recognition criteria for those events that could be regarded as “unplanned”, such as unemployment, sickness, and accidents, are different than for those where benefits can be seen to accumulate over time and where eventual receipt is more probable. Pensions are the best example of these. For “unplanned” events, we gravitate towards recognising a liability at a later stage, such as **“when threshold criteria have been satisfied”** or **“the eligibility criteria to receive the next benefit have been satisfied”**, depending on the unique scheme requirements for the benefit in question.
- (13) For benefits such as accident benefits, it would be possible to recognise a liability when **“key participatory events have occurred”** – i.e. when the individual is born, attains a certain age or has satisfied some other key eligibility requirement for the scheme in question. However, there is a good argument that, there is no past event from which a present obligation arises as the triggering event (the accident) has not yet occurred. Additionally, the calculation of the liability using this eligibility criterion would require the exercise of so many assumptions and estimates that the resulting liability could provide little in the way of meaningful information for the various users of the financial statements. These are the reasons why FEE prefers the application of the **“when threshold criteria have been satisfied”** or **“the eligibility criteria to receive the next benefit have been satisfied”** eligibility criteria for such schemes.
- (14) We will now proceed to discuss each of the options presented in the CP to highlight strengths and weaknesses of each approach.

Key participatory events have occurred (option a)

- (15) In some respects, it could be argued that realising a liability at this point is the best theoretical approach and best conforms to the CF’s definition of a liability. However, there are issues with choosing this threshold.
- (16) One issue with this approach is defining the key participatory event. For unemployment benefits, for example, one could argue that being warned of impending redundancy is the key participatory event. On the other hand, there is also a theoretical argument for saying that entering into the jobs market is the key participatory event because it opens up the possibility of claiming such benefits at some point in the future.
- (17) Another issue regards the large degree of uncertainty present, which would be greater the earlier the key participatory event occurs. Just because the individual has an expectation of receiving a benefit, it does not necessarily mean that all of the necessary criteria will eventually be fulfilled. This would lead to a liability being recognised when no actual obligation exists. Also, recognition at this stage introduces significant issues in measurement – it would probably require many actuarial assumptions and it is debateable in such circumstances whether the information produced would be useful to the users of public sector financial statements.

Threshold eligibility criteria have been satisfied (option b)

- (18) In many circumstances, FEE believes this would be the earliest practical point at which a liability can be recognised reliably. Firstly, this would probably be the first point where the government body in question becomes aware that a claim is probable.

- (19) Secondly, as mentioned above, we have some doubts as to how meaningful provisions primarily based on actuarial assumptions would be. We agree with the comments in para 4.37 that when the eligibility criteria have been met the government no longer has a realistic alternative to avoid the payment. Because there is more certainty, the measurement issues are greatly reduced over option (a), albeit there are still measurement issues that would require actuarial assumptions in respect of benefits that have requirements for periodic reassessment of eligibility, as highlighted in para 4.38.

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

- (20) This option has the advantage of making the measurement of the liability easier, but runs the risk of understating the potential liability as at least some proportion of the population claiming such benefits will continue to satisfy the next periodic assessment of eligibility. This option may be more applicable to schemes where considerable uncertainty exists as to the proportion of claimants likely to satisfy the periodic review criteria, especially if such criteria become more onerous with the effluxion of time.

A claim has been approved (option d)

- (21) FEE believes that, in most circumstances, using this option will result in a liability being recognised too late. In many cases, the difference in timing between this and (b) above is merely due to administrative processes. Depending on the efficiency of the administration involved, the time delay between submission of a claim that meets the eligibility criteria and the approval of the claim can be quite significant and it is quite possible that at least some element of the benefit would be paid in arrears. FEE considers that once it becomes possible that an accounting treatment would result in a liability being recognised (even partly) in arrears then the recognition of the liability is too late.

A claim is enforceable (option e)

- (22) Whilst we appreciate the legal certainty that this sub-criteria would bring, the negative points made in (d) above apply even more keenly under this option so this would not be our preferred option.
- (23) FEE has not identified any other options for recognition in addition to those presented by the IPSASB.

Specific Matter for Comment 5

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

Please explain the reasons for your views.

- (24) In our opinion, adding a contributory element increases the legitimate expectation of the individuals who contribute that a future benefit could or will be received. Consequently, where there is a material level of contribution (i.e. more substantial than an annual subscription or processing charge), we believe that this could justify the recognition point being brought forwards (i.e. more towards (a) above rather than (b)). However, the legal terms of the scheme would need to be considered as they may contain provisions that defer the obligating event even if the scheme member has enhanced (and possibly mistaken) expectations that a benefit could be received.

Specific Matter 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.

- (25) As mentioned under Comment 1(a), FEE agrees with the IPSASB's pragmatic solution of splitting social benefits arising from non-exchange transactions from those arising from exchange transactions, not least to expedite development of the social benefits standard. We also believe that there are good reasons to keep the two types of transactions separate in future IPSASs.
- (26) We believe that social benefits provided through exchange transactions are likely to have an earlier recognition point than with non-exchange transactions as individuals paying contributions will have a greater legitimate expectation of receiving benefits in future. It is also more likely that contributory schemes will be discretely funded or have earmarked assets, thereby changing the focus of the main accounting issues.
- (27) The examples of social benefit schemes provided through exchange transactions that FEE has identified have the characteristics of either a pension scheme or an insurance scheme. For those that have the characteristics of a pension scheme, it would seem appropriate that *IPSAS 25 Employee Benefits* could either be amended to include such schemes or be used as a basis for a separate standard.
- (28) For those schemes with the characteristics of insurance schemes, it would be logical to use the accounting approach detailed in this CP (in chapter 6) as the basis for a separate standard.

Specific Matter 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.

- (29) FEE believes that option (a) ("In all cases") is the most appropriate where there exist separately earmarked assets for a particular scheme – subject to the assets in question fulfilling the recognition criteria. To recognise the liabilities of a scheme without recognising its corresponding assets is not logical and would lead to a misrepresentation of the financial position of the scheme and its potential future costs. In our opinion, such assets and liabilities should be presented separately in the financial statements and not offset.

Specific Matter for Comment 8(a)

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?*

Please explain the reasons for your views.

- (30) Although recognising the argument that future social benefit payments will be paid out of future tax receipts, and also the concept of intergenerational solidarity, FEE does not believe that the social contract approach would enhance either public sector accounting transparency or the management of public sector resources. It appears that the social contract approach's principle function is to provide a conceptual basis for public sector bodies to defer recognising a liability until the last possible moment.
- (31) Many developed economies, including those in the European Union, are facing a future of an ageing and shrinking population, heralding a prospect of funding increasing social benefits costs from a shrinking tax base. These are long term problems that need to be addressed as soon as possible, and FEE believes that appropriately recognising liabilities for social benefit programmes will provide greater transparency and inform the public debate on whether such programmes are fiscally sustainable in the future and how they will be funded.
- (32) On a more technical point, the social contract approach requires that future taxation will cover future benefits payable, which appears to be contradictory with the IPSASB's Conceptual Framework – a point specifically made by the IPSASB in point 5.25 of the ED.
- (33) Therefore, FEE does not support the social contract approach and consequently does not intend to comment on the point at which an obligation should be recognised under this approach.

Specific Matter for Comment 8(b)

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

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

Please explain the reasons for your views.

- (34) Although FEE doesn't intend to comment in detail on the social contract approach, we note that the issue of measurement has not been specifically addressed in respect of the obligating event approach. Consequently, FEE wishes to state that its preferred method for measuring social benefits (unless specifically stated otherwise) is at the cost of fulfilment at the point in time when the liability has to be settled and discounted as appropriate.

Specific Matter for Comment 9

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

Please explain the reasons for your views.

- (35) IPSASB is proposing that the insurance approach is appropriate where there are significant cash contributions from individuals. They emphasise that this approach is not suitable for all social benefit schemes and would only be used in conjunction with another method. FEE agrees with the use of the insurance approach in these circumstances and believes that the IPSASB is correct to limit the scope of this approach to contributory schemes only. In addition, FEE believes that, in some circumstances, it may be appropriate to separately identify an insurance component within a scheme, since the insurance approach should not be misapplied so as to account for non-insurance schemes or components of schemes.
- (36) These conclusions in this ED are in line with current private sector developments in insurance accounting and it seems logical to treat social benefit schemes that have the characteristics of a funded insurance scheme in the same manner.
- (37) It may not always be easy in practice to differentiate the characteristics of a funded insurance scheme, subject to the insurance approach, from those of a general social benefit scheme, dealt with using the obligating event or social contract approach. The IPSASB already provides examples of schemes, together with the accounting implications, in Appendix A. It would be useful if the IPSASB could provide an indication within Appendix A of which of these schemes (or separate components of a scheme) would be dealt with by the insurance approach, by the obligating event approach or by the social contract approach.

Specific Matter for Comment 10

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

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

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

Please explain the reasons for your views.

- (38) FEE was broadly supportive of the IASB's ED 2013/7 and agreed with the proposals contained therein for the recognition of surpluses. The immediate recognition of losses on onerous contracts is in line with current accepted accounting practice. Consequently, FEE also agrees with the treatment described above pertaining to the recognition of expected deficits.

Specific Matter for Comment 11

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

- a) Recognize an expense on initial recognition;*
- b) Recognize the deficit as an expense over the coverage period of the benefit;*
- 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.

- (39) FEE appreciates the arguments in favour of option (a), the immediate recognition of an expected deficit, where a social benefit scheme is not fully funded by contributions. As the CP states, this would ensure consistency of accounting treatments for all deficits with deficits on fully funded schemes and also with more general accounting for deficits, such as those arising from onerous contracts.
- (40) However, there is some debate whether the immediate recognition of the expected deficit would actually provide meaningful information for the users of the accounts, particularly where the scheme is new and no contributions have been paid and no entitlement to benefits has yet arisen. In these circumstances, there is a good argument to be made for recognising the expected deficit on initial recognition and then recognising the deficit over the coverage period (option (b)). This would provide more meaningful information as to the annual costs of operating such schemes.
- (41) However, where this accounting treatment is adopted by a scheme that has already been running for some time, we would recommend the immediate recognition of the expected deficit insofar as it could be identified as arising out of past contributions, with the remaining deficit to be recognised as a cost over the remaining term of the contract.
- (42) FEE also believes that the legal nature and terms of the scheme may be of importance in this question. For example, where the scheme permits contributions to be raised to cover deficits there may not be a liability to be recognised even if a public sector body is required to cover any eventual deficit of the scheme. However, this may not be the case if it becomes apparent that a deficit could not practically be funded by raising contributions, at which point the question of how to treat the deficit becomes critical. Also, the terms of the scheme may permit the cancellation of the scheme or reduction in benefits in certain circumstances, which may allow the public bodies to avoid paying, or reduce the amount of, the deficit.
- (43) FEE does not support Options (c) and (d), not least because they run contrary to the general approach of not recognising an asset until its receipt is virtually certain.

Specific Matter for Comment 12

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.

- (44) In accordance with the view expressed in the response to Comment 8(b) above, FEE's view is that the cost of fulfilment measurement basis is the most appropriate to use in these circumstances. Establishing the assumption price may be very difficult for schemes predominantly run by government bodies as there may be little in the way of an alternative market that is able or is willing to take over the provision of such services.

Specific Matter for Comment 13

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.

- (45) FEE agrees with the criteria stated in the CP.

Specific Matter for Comment 14

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.

- (46) FEE supported the approach to the discount rate incorporated in IPSAS 25, and, in particular, that reference should be made to yields on both government stocks and on high quality corporate bonds. We see no reason to adopt a different approach in this CP.

Specific Matter for Comment 15

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.

- (47) This CP proposes adjustments for relevant decisions on initial measurement:
- At the end of the reporting period, the carrying amount of a social insurance scheme would reflect the future cash flows, measured at that date, and the remaining expected surplus or deficit.
 - The remaining expected surplus (or expected deficit) would be adjusted for changes to future cash flows arising from future coverage.
 - The expected surplus (or expected deficit) would be recognized as revenue (or expense) in the statement of financial performance using a systematic basis that reflects the transfer of benefits provided under the scheme. Benefits payable during the period would be recognized as an expense.
 - The statement of financial performance would also reflect any changes to the discount rate, and the unwinding of the discounted cash flows.
- (48) This is in accordance with the current IASB proposals on insurance contracts and FEE supports the proposals.