Australian Government
Australian Accounting Standards Board

Staff Paper

Project:	**Social Benefits**	**Meeting**	AASB February 2018 (M162)
Topic:	**Initial Briefing on IPSASB ED 63**	**Agenda Item:**	9.1
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Introduction and objective of this paper

1 The objective of this paper is to provide the AASB with an overview of Exposure Draft (ED) 63 *Social Benefits* issued by the International Public Sector Accounting Standards Board (IPSASB) to facilitate an initial discussion. Staff are requesting the AASB to consider their initial responses to the specific matters for comment.

2 This paper is structured as follows:

(a) Why the IPSASB is undertaking this project

(b) Why ED 63 is important to the AASB

(c) Definitions in ED 63

(d) Scope of ED 63

(e) What does ED 63 propose?

(f) Specific matters for comment in ED 63

(g) Appendix – Extracts from relevant pronouncements

Link to Exposure Draft 63

3 There is no expectation for AASB members to read the entire document in detail, but given the complexity of the topic, it is suggested they peruse it to the extent needed to obtain a reasonable overview of the topic and the issues.
https://www.ifac.org/system/files/publications/files/ED-63-Social-Benefits.pdf

Why the IPSASB is undertaking this project

4 The delivery of social benefits to the public is a primary objective of most governments and accounts for a large proportion of their expenditure. Existing International Public Sector Accounting Standards do not provide requirements and guidance on how to account for social benefits. As a result, public sector entities are required to develop their own accounting policies for social benefits. This lead to widespread inconsistency and lack of comparability in how social benefits are reported by public sector entities. The IPSASB undertook this project to establish the recognition and measurement requirements for social benefits. The IPSASB believes a Standard on social benefits would enhance accountability and transparency and improve decision-making, which are in the public interest.

5 The IPSASB did some work on this topic years ago, circa 2004-2008, and issued consultation papers and an exposure draft. They decided not to proceed with the exposure draft as there were different views about what 'obligation' means and when a present obligation arise. The IPSASB also decided to prioritise work on the development of Recommended Practice Guideline (RPG) 1 *Reporting on the Long-term Sustainability of an Entity's Finances* (issued in 2013) and their Conceptual Framework (issued in 2014) rather than continuing work on the social benefits project.

6 The IPSASB restarted its work on social benefits in 2014 and decided to adopt a narrower definition of social benefits. A consultation paper, *Recognition and Measurement of Social Benefits* was issued in July 2015. This paper built on the IPSASB's previous work on social benefits and was influenced by more recent developments such as the IPSASB's *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* and the updated *Government Finance Statistics Manual* (GFS).

7 ED 63 was issued by the IPSASB in October 2017 and proposes requirements for the recognition and measurement of social benefit schemes. It also provides a definition of a social benefit and proposes disclosure requirements to enable financial report users to evaluate the effect of social benefits on a government's finances. ED 63 is open for public comment until 31 March 2018. ED 63 is also being exposed locally for comment to the AASB as ITC 38 *Request for Comment on IPSASB Exposure Draft Social Benefits*, with comments requested by 15 February 2018. The AASB has previously decided to submit a comment letter on ED 63 to the IPSASB.

Why ED 63 is important to the AASB

8 No specific guidance for social benefits currently exists in Australian Accounting Standards, except for two Australian-specific modifications to AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*. Paragraphs Aus26.1 and Aus26.2 were added to AASB 137 to address the recognition of liabilities arising from government policies, election promises and statements of intent. (The text of the paragraphs is set out in the appendix to this paper.) The guidance in AASB 137 is not sufficient to establish a complete accounting framework for social benefit schemes.

9 Commonwealth entities currently report a liability only until the next payment date where eligibility criteria are met. This is similar to cash basis accounting and reflects the smallest possible liability. The most important issue for the AASB to consider is whether this treatment is appropriate in faithfully representing the characteristics of a

social benefit scheme. For example, the AASB should consider whether it would be more appropriate to measure the social benefit liability at the current present value of **future** social benefit payments that the entity is expected to pay. The approaches included in ED 63 explore these concepts.

10 Participating in the due process of ED 63 is in line with the AASB's strategy to actively influence IPSASB's Standards. At the same time, outreach is being conducted for both the IPSASB and the AASB. This provides an opportunity for the AASB to understand the views of IPSASB respondents and also of the IPSASB when the AASB is considering how to develop its own social benefits project. For example, the AASB could decide to adopt a resulting IPSASB Standard or to develop it further through a domestic exposure process.

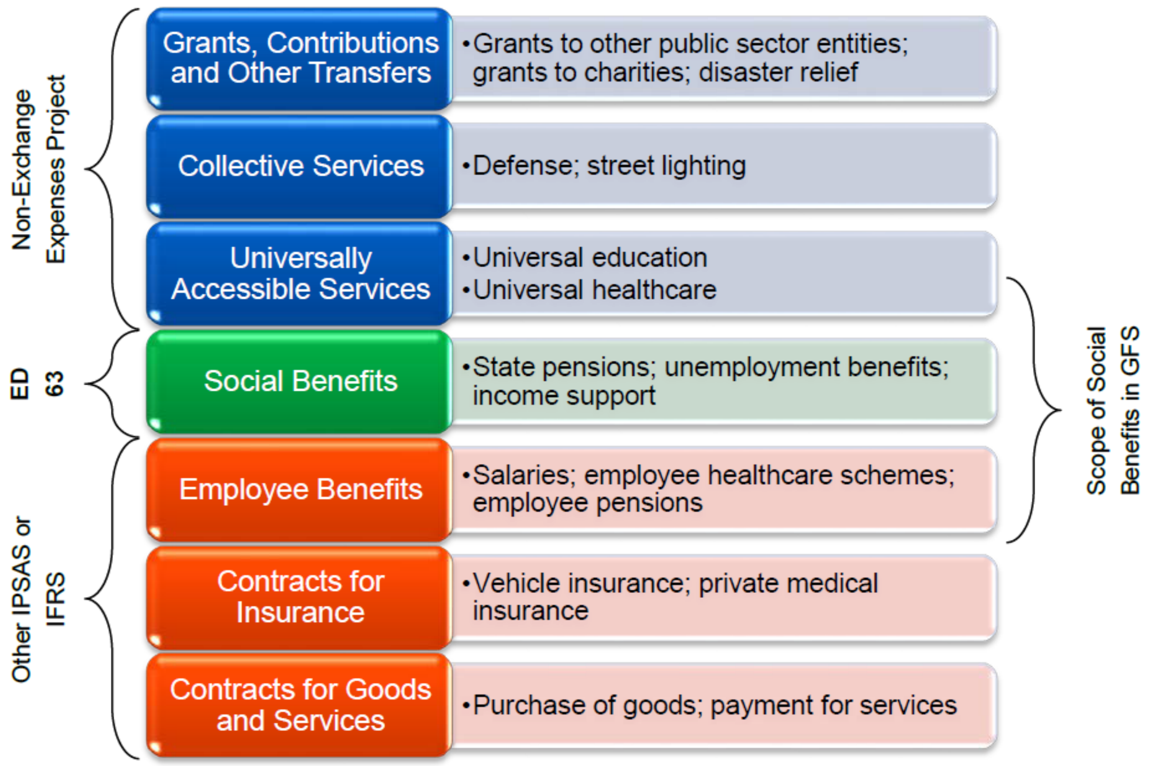
Definitions in ED 63

Social Benefits	Social Risks	Universally Accessible Services
Provided to: a) specific individuals and/or households who meet eligibility criteria; b) mitigate the effect of social risks; and c) address the needs of society as a whole; but d) are **not** universally accessible services. Paragraphs AG4-AG7 provide additional guidance.	Events or circumstances that: a) relate to the characteristics of individuals/households – for example, age, health, poverty and employment status; and b) may adversely affect the welfare of individuals and/or households, either by imposing additional demands on their resources or by reducing their income. Paragraphs AG8-AG10 provide additional guidance.	Those services that are made available by a government entity for all individuals/households to access, and where eligibility criteria (if any) are not related to social risk.

<u>Which benefits are Social Benefits under ED 63?</u>

Benefit	**Social Benefit under ED 63?**
Retirement Benefits (Government Employees)	No – Does not address the needs of society as a whole
State Retirement Pensions	Yes – Paid to all those over a certain age as a means of ensuring those in need are covered
Universal Healthcare Services	No – Meets the definition of universally accessible services
Disability Pensions	Yes – Meets the definition of a social benefit – addresses social risk, paid when criteria met
Unemployment Benefits	Yes – Meets the definition of a social benefit – addresses social risk, paid when criteria met
Disaster Relief	No – Mitigates the effects of a geographical risk rather than a social risk
Defence Services	No – Services are not provided to specific individuals but are collective services

Scope of ED 63



Source: IPSASB ED 63 "At a Glance" Summary, page 3

What does ED 63 propose?

11 ED 63 proposes two approaches for recognising and measuring social benefit liabilities:

(a) Insurance Approach (an optional approach applying IFRS 17 *Insurance Contracts* or corresponding national Standards); and

(b) Obligating Event Approach (resulting in short-term liabilities until the next payment date).

ED 63 also includes an Alternate View, which is essentially a dissenting view on the proposed approaches for recognising and measuring social benefit liabilities. The Alternative View supports a broader view of an obligation, and would result in earlier recognition of liabilities and larger liabilities.

<u>Summary of the Insurance Approach</u>

12 ED 63 permits (but does **not** require) entities to apply the insurance accounting model of IFRS 17 to social benefit schemes where:

(a) the scheme is intended to be fully funded from contributions; and

(b) it is evident that the entity manages the scheme in the same way as an issuer of insurance contracts, including regular assessment and management of the financial performance and positon of the scheme.

13 The AASB has previously considered the IPSASB's insurance approach in detail during the development of the AASB Discussion Paper *Australian-specific Insurance Issues – Regulatory Disclosures and Public Sector Entities* (November 2017). The Basis for Conclusions to the Discussion Paper states that whilst the AASB expected the IPSASB's insurance approach would set a reasonable boundary for capturing public sector 'insurance-like' arrangements, the AASB was not in favour of the insurance approach because:

(a) the AASB observed that the definitions of social benefit and social risk could be difficult to apply, and may require further modification or guidance. The AASB also noted that the definitions were based on International Monetary Fund definitions used for GFS reporting and were controversial with some (but not all) IPSASB stakeholders;

(b) constituent feedback noted in AASB 1058 *Income of Not-for-Profit Entities* paragraph BC14 indicated challenges in identifying a transaction as a reciprocal/non-reciprocal transaction, and concerns that the consequential accounting did not reflect the true underlying financial performance of the entity. The AASB also noted that:

(i) the exchange/non-exchange distinction could result in arrangements with similar economic substance being accounted for differently purely on the basis of the funding mechanism for the arrangement, as the proposed IPSASB criteria to determine an insurance exchange transaction is that the arrangement is fully funded by contributions from policyholders;

(ii) the exchange/non-exchange distinction is difficult to determine in practice;

(iii) AASB 1058 adopted a performance obligation approach which is more aligned to how constituents think of their liabilities; and

(iv) the AASB *Framework for the Preparation and Presentation of Financial Statements* definition of a liability does not depend on the way in which the liability is funded.

14 Staff are of the view that, consistent with the proposals of the Discussion Paper, the insurance approach should be mandatory for those transactions that in substance are insurance contracts.

<u>Summary of the Obligating Event Approach</u>

15 ED 63 proposes a single recognition point for all social benefits. The IPSASB's Conceptual Framework paragraph 5.14 defines a liability[1] as "*a present obligation of*

[1] http://html5.epaperflip.com/?docid=9c3c49a0-9d06-49e1-b666-a5600137e9a9#page=1

the entity for an outflow of resources that results from a past event". The key factor in determining when a liability for a social benefit arises is identifying the past event. ED 63 proposes that the past event that gives rise to the social benefit liability is the satisfaction by the beneficiary of all eligibility criteria for the provision of the **next** social benefit. ED 63 also proposes that **being alive** at the point at which the eligibility criteria are required to be satisfied is an **eligibility criterion**, whether implicitly or explicitly stated.

16 Under ED 63 the social benefit liability is measured at the best estimate of the costs that the entity will incur in fulfilling the present obligations. The liability cannot extend beyond the point at which eligibility criteria are next required to be satisfied (which could be the date of the next social benefit payment), hence it will usually be a short-term obligation.

<u>Summary of the Alternative View</u>

17 Three of eighteen IPSASB members did not agree with the proposals of ED 63. They propose that the obligating event should be dependent on the **economic substance** of the social benefit scheme. These members consider that social benefit schemes may be designed differently and can give rise to different expectations. Consequently, the accounting treatment for these varying schemes should be aligned with their economic substance in order to provide users with relevant information pertaining to a specific scheme – a 'one-size-fits-all' approach would not be appropriate. For this reason, those members do not consider the Obligating Event Approach to be in line with the IPSASB's Conceptual Framework.

18 The dissenting members do not consider that **being alive** at the point at which the eligibility criteria are satisfied ahead of each payment cycle is an implicit eligibility criterion that should affect the recognition of the liability. They note that, whilst it cannot be certain that a specific individual who meets the eligibility criteria at the reporting date will be alive when the next provision of social benefit is due, a measurable number of individual beneficiaries will be alive into the future. Therefore, the entity can have a present obligation at the reporting date in respect of the provision of the social benefit beyond the next benefit payment date.

<u>Contrasting the underlying concepts of the Obligating Event Approach and the Alternative View</u>

19 Under the Obligating Event approach in ED 63, there is an ongoing requirement to demonstrate that the eligibility criteria has been met, including staying alive, before a present obligation can exist. Whilst this may be true for some short-term social benefit schemes, Project Staff are of the view that it is possible for an entity under certain circumstances to have a present obligation for future social benefits to be paid to a person.

20 An example would be an aged pension when an Australian citizen reaches the age of say 65. When such persons (assuming they meet all eligibility criteria) turn 65 they will receive the Australian aged pension and they have a reasonable expectation that

they will continue to receive such a pension until they expire. Governments have sovereign power to change legislation related to such pension schemes from a specific point forward, but they usually do not significantly change existing recipients' entitlements for which they have been previously eligible. In this case, Project Staff is of the opinion that the Government has a present constructive obligation for the expected future aged pension payments until the person is no longer alive. This situation is akin to a political necessity leading to a liability arising from a non-legally binding obligation as described in the IPSASB Conceptual Framework paragraph 5.26. Furthermore, it is also related to the AASB Conceptual Framework paragraph 61 describing an obligation arising from the economic consequences of failing to honour an obligation (constructive in nature in this context) leaving the entity with little, if any, discretion to avoid the outflow of resources.

21 Consequently, the liability should be recognised and measured at the discounted present value of the expected **future** pension payments. In this case, the probability of **future** events that is not within the control of the government (e.g. the ageing of a country's citizens) is included in the quantification of the liability by means of actuarial assumptions and calculations. This supports Project Staff's view that "staying alive" relates to measurement of a liability, rather than being a recognition criterion. The notion of including future events in the measurement of the liability is consistent with the accounting for employee benefits such as long service leave provisions under IPSAS 39 *Employee Benefits* paragraphs 155-150 and AASB 119 *Employee Benefits* paragraphs 153-157. Consequently, Project Staff have a preference for supporting the Alternative View in ED 63.

22 When taking such a broader view of an obligation as explained above, it is inevitable that the quantum of the recognised liabilities will increase significantly. However, the future taxation (or other) revenue that the entity (or Government as per the aged pension example) could reasonably expect to receive in future years to fund the social benefit liabilities is not recognised as an asset in the balance sheet because the entity does not have control over these future receivables. This leads to an unbalanced outcome that would make entities very hesitant to support recognition of such large liabilities on their balance sheet, which might significantly diminish their net assets. Project Staff believe this outcome does not provide useful information and is not aligned with the general objectives of financial reporting.

23 The IPSASB considered making its RPG 1 on long-term sustainability a mandatory requirement, to mitigate the effects of this outcome, but decided on balance not to propose that approach in ED 63 (see SMC 6).

Specific matters for comment in ED 63

24 The following table presents the IPSASB's specific matters for comment (SMCs) in ED 63 for the AASB's consideration. For particular SMCs, Staff have noted their initial thoughts for the AASB's consideration. Responses to each SMC will be drafted for the AASB's consideration at the March meeting, and will incorporate further Staff research, constituent feedback and AASB comments from this meeting.

SMC 1 Do you agree with the scope of this Exposure Draft, and specifically the exclusion of universally accessible services for the reasons given in paragraph BC21(c)? If not, what scope changes would you make?	**Staff comments** Staff observed that some schemes appear to be similar in nature whether universally accessible or not. It may be preferable to combine social benefits and non-exchange expenses project. Do AASB members have any comments?
SMC 2 Do you agree with the definitions of social benefits, social risks and universally accessible services that are included in this Exposure Draft? If not, what changes would you make?	**Staff comments** Staff observed that it was difficult applying the definitions to a small sample of the many different Australian social benefits. Do AASB members have any comments?
SMC 3 Do you agree that, with respect to the insurance approach: (a) It should be optional; (b) The criteria for determining whether the insurance approach may be applied are appropriate; (c) Directing preparers to follow the relevant international or national accounting standard dealing with insurance contracts (IFRS 17, *Insurance Contracts* and national standards that have adopted substantially the same principles as IFRS 17) is appropriate; and (d) The additional disclosures required by paragraph 12 of this Exposure Draft are appropriate? If not, how do you think the insurance approach should be applied?	**Staff comments** Staff consider that the response to SMC 3 should align with the Basis for Conclusions to the AASB Discussion Paper *Australian-specific Insurance Issues – Regulatory Disclosures and Public Sector Entities*. In summary, the response would be as follows: (a) the approach should not be optional (b) the criteria are not appropriate as the Conceptual Framework definition of a liability does not depend on the way a liability is funded, and economically similar transactions may be accounted for differently depending on their funding arrangements; (c) directing preparers to use IFRS 17 or equivalent is appropriate; and (d) No Staff view as yet. Do AASB members agree to respond to this question consistent with the Discussion Paper? Additional disclosures to be considered further.
SMC 4 Do you agree that, under the obligating event approach, the past event that gives rise to a liability for a social benefit scheme is the satisfaction by the beneficiary of all eligibility criteria for the next benefit, which includes being alive (whether this is explicitly stated or implicit in the scheme provisions)? If not, what past event should give rise to a liability for a social benefit? *This Exposure Draft includes an Alternative View where some IPSASB Members propose a different*	**Staff comments** Staff would support responding consistent with the discussion in paragraphs 15-22 of this paper, subject to constituent feedback to ITC 38 and discussion by the AASB. Do AASB members have any comments?

approach to recognition and measurement.	
SMC 5 Regarding the disclosure requirements for the obligating event approach, do you agree that: (a) The disclosures about the characteristics of an entity's social benefit schemes (paragraph 31) are appropriate; (b) The disclosures of the amounts in the financial statements (paragraphs 32–33) are appropriate; and (c) For the future cash flows related to an entity's social benefit schemes (see paragraph 34): (i) It is appropriate to disclose the projected future cash flows; and (ii) Five years is the appropriate period over which to disclose those future cash flows.	Do AASB members have any comments on the issues identified in this SMC?
SMC 6 The IPSASB has previously acknowledged in its *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*, that the financial statements cannot satisfy all users' information needs on social benefits, and that further information about the long-term fiscal sustainability of these schemes is required. RPG 1, *Reporting on the Long Term Sustainability of an Entity's Finances*, was developed to provide guidance on presenting this additional information. In finalizing ED 63, the IPSASB discussed the merits of developing mandatory requirements for reporting on the long-term financial sustainability of an entity's finances, which includes social benefits. The IPSASB identified some advantages and disadvantages of developing such requirements (refer to the Appendix). **Question:** Do you think the IPSASB should undertake further work on reporting on long-term fiscal sustainability, and if so, how?	Does the AASB have any comments on the issues identified in this SMC?

Appendix – Extracts from relevant pronouncements

The below extracts from various pronouncements are referenced in the Staff Paper. Extra details of SMC 6 are also included.

AASB 137

Aus26.1 "This paragraph and paragraph Aus26.2 relate to the recognition by a local government, government department or government of a liability arising from a local government or government existing public policy, budget policy, election promise or statement of intent. The intention to make payments to other parties, whether advised in the form of a local government or government budget policy, election promise or statement of intent, does not of itself create a present obligation which is binding. A liability would be recognised only when the entity is committed in the sense that it has little or no discretion to avoid the sacrifice of future economic benefits. For example, a government does not have a present obligation to sacrifice future economic benefits for social welfare payments that might arise in future reporting periods. A present obligation for social welfare payments arises only when entitlement conditions are satisfied for payment during a particular payment period. Similarly, a government does not have a present obligation to sacrifice future economic benefits under multi-year public policy agreements until the grantee meets conditions such as grant eligibility criteria, or has provided the services or facilities required under the grant agreement. In such cases, only amounts outstanding in relation to current or previous periods satisfy the definition of liabilities."

Aus26.2 Some such transactions or events may give rise to legal, social, political or economic consequences which leave little, if any, discretion to avoid a sacrifice of future economic benefits. In such circumstances, the definition of a liability is satisfied. An example of such an event is the occurrence of a disaster, where a government has a clear and formal policy to provide financial aid to victims of such disasters. In this circumstance, the government has little discretion to avoid the sacrifice of future economic benefits. However, the liability is recognised only when the amount of financial aid to be provided can be measured reliably.

IPSASB Conceptual Framework

5.26 "Economic coercion", "political necessity" or other circumstances may give rise to situations where, although the public sector entity is not legally obliged to incur an outflow of resources, the economic or political consequences of refusing to do so are such that the entity may have little or no realistic alternative to avoid an outflow of resources. Economic coercion, political necessity or other circumstances may lead to a liability arising from a non-legally binding obligation."

ED 63

13. “**An entity shall recognize a liability for a social benefit scheme when:**

a) **The entity has a present obligation for an outflow of resources that results from a past event; and**
b) **The present obligation can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in general purpose financial reports.**”

16. “The past event that gives rise to a liability for a social benefit scheme is the satisfaction by the beneficiary of all eligibility criteria for the next benefit, which includes being alive (whether this is explicitly stated or implicit in the scheme provisions).

Paragraphs AG16-AG19 provide additional guidance.”

19. “**An entity shall measure the liability for a social benefit scheme at the best estimate of the costs that the entity will incur in fulfilling the present obligations represented by the liability.**”

20. “Being alive is an eligibility criterion for social benefit schemes. Consequently, the maximum amount to be recognized as a liability is the costs that the entity will incur in fulfilling the present obligations represented by the liability until the next point at which eligibility criteria are required to be satisfied.”

AG18 “Where a beneficiary has previously satisfied the eligibility criteria, and there has been no break in satisfying those criteria, a liability for future social benefits is recognized each time the criteria are satisfied. This will be the point at which a social benefit is provided.”

AG19 “Being alive at the point at which the eligibility criteria are satisfied is an eligibility criterion, whether explicitly stated or implicit. Consequently, a liability cannot extend beyond the point at which the next social benefit will be provided.”

AASB Conceptual Framework

49(b) “A liability as a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.”

60. “An essential characteristic of a liability is that the entity has a present obligation. An obligation is a duty or responsibility to act or perform in a certain way. Obligations may be legally enforceable as a consequence of a binding contract or statutory requirement. This is normally the case, for example, with amounts payable for goods and services received. Obligations also arise, however, from normal business practice, custom and a desire to maintain good business relations or act in an equitable manner. If, for example, an entity decides as a matter of policy to rectify faults in its products

even when these become apparent after the warranty period has expired, the amounts that are expected to be expended in respect of goods already sold are liabilities."

61. "A distinction needs to be drawn between a present obligation and a future commitment. A decision by the management of an entity to acquire assets in the future does not, of itself, give rise to a present obligation. An obligation normally arises only when the asset is delivered or the entity enters into an irrevocable agreement to acquire the asset. In the latter case, the irrevocable nature of the agreement means that the economic consequences of failing to honour the obligation, for example, because of the existence of a substantial penalty, leave the entity with little, if any, discretion to avoid the outflow of resources to another party."

64. "Some liabilities can be measured only by using a substantial degree of estimation. Some entities describe these liabilities as provisions. In some countries, such provisions are not regarded as liabilities because the concept of a liability is defined narrowly so as to include only amounts that can be established without the need to make estimates. The definition of a liability in paragraph 49 follows a broader approach. Thus, when a provision involves a present obligation and satisfies the rest of the definition, it is a liability even if the amount has to be estimated. Examples include provisions for payments to be made under existing warranties and provisions to cover pension obligations."

91. "A liability is recognised in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably. In practice, obligations under contracts that are equally proportionately unperformed (for example, liabilities for inventory ordered but not yet received) are generally not recognised as liabilities in the financial statements. However, such obligations may meet the definition of liabilities and, provided the recognition criteria are met in the particular circumstances, may qualify for recognition. In such circumstances, recognition of liabilities entails recognition of related assets or expenses."

ED 63 Specific matter for comment 6

Advantages:

Long-term financial sustainability reports provide additional useful information for users for both accountability and decision making, and that governments should therefore be providing. This especially applies to information about the sustainability of the funding of social benefits given the limited predictive value of the amounts recognized in the financial statements.

Social benefits are only one source of future outflows. Supplementary disclosures (as proposed in the ED) on social benefits flows in isolation are therefore of limited use in assessing an entity's long-term sustainability, as they do not include the complete information on all of an entity's future inflows and outflows that long-term financial sustainability reports provide.

Long-term financial sustainability reports will improve accountability and will help support Integrated Reporting in the public sector. They will also provide useful information for users, in particular for evaluations of intergenerational equity.

Disadvantages:

The extent and nature of an entity's long-term financial reports are likely to vary significantly depending on its activities and sources of funding. It would therefore be difficult to develop a mandatory standard.

The nature of the information required for reporting on the long-term sustainability of an entity's finances, in particular, its forward-looking perspective, could preclude its inclusion in General Purpose Financial Statements. Given the scope and challenges involved in its preparation and audit considerations, some question whether it would be appropriate to make information in a General Purpose Financial Report mandatory.

RPG 1 was only issued in 2013, so it may be too soon to assess whether requirements developed from those in RPG 1 should be mandatory.