Australian Government

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CANADA
(Submitted to www.ifac.org)

Dear John

IPSASB Exposure Draft 63 *Social Benefits*

The Australian Accounting Standards Board (AASB) is pleased to provide its comments on Exposure Draft 63 *Social Benefits* (ED 63).

Overall, the AASB supports the Alternative View in ED 63. However, we have some concerns about the recognition of a potentially large liability without also recognising in some way the right to tax that would contribute to funding the liability. Our concerns and alternative suggestions are explained in the Appendix to this letter. The Appendix also includes the AASB's comments on the specific questions in ED 63. The AASB encourages the IPSASB to seek the views of users of financial statements regarding the reporting of social benefits.

ED 63 was issued by the AASB as an Invitation to Comment ITC 38 *Request for Comment on IPSASB Exposure Draft* Social Benefits (November 2017). The AASB received two submissions, which are available on the AASB's website.[1]

If you have any questions regarding this letter, please do not hesitate to contact Janri Pretorius, Senior Project Manager (jpretorius@aasb.gov.au).

Yours sincerely,

K. E. Peach

Kris Peach
Chair

1 http://www.aasb.gov.au/Work-In-Progress/Open-for-comment.aspx?id=2118

APPENDIX

AASB's responses to the Specific Matters for Comment for Respondents to ED 63

The AASB's views on the specific matters for comment in ED 63 are set out below.

Specific Matter for Comment 1:

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

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

The AASB does not agree with the exclusion of universally accessible services from the scope of ED 63.

Some social benefit schemes appear to be similar in nature whether or not they are universally accessible. Therefore, a consistent accounting approach for liability and expense recognition would be appropriate where such transactions have similar characteristics. It might be more appropriate to address the accounting for social benefits, universally accessible services and collective services in a single project to mitigate the creation of diverse accounting treatments for similar transactions.

In addition, Australian Government Finance Statistics (GFS) issued by the Australian Bureau of Statistics (ABS), which is based on the IMF's GFS, places more emphasis on the nature of a transaction and the sector of the recipient as opposed to the eligibility criteria versus universally accessible services distinction. An Australian example of this is Medicare, which provides universal access to healthcare services in Australia. The eligibility criteria are broad and cover all people normally resident in Australia. Payment for services on the Medicare benefit schedule is classified as a social benefit to households in goods and services under ABS GFS. In this case, the exclusion of universally accessible services would not necessarily be consistent with GFS.

We acknowledge the IPSASB decided to adopt a narrower definition of social benefits (as opposed to a broader set of terms) in order to efficiently progress both the social benefits project and the non-exchange expenses project. By limiting the scope of the social benefits project and addressing the broader scope later on, there is a risk of inconsistent accounting treatments leading to diversity. We acknowledge that some government entities may choose to apply the 'narrow scope' social benefits accounting to other items by analogy, such as to universally accessible services. However, this would require bona fides on the part of the preparer and might not result in comparable accounting across entities. Consequently, we think adoption of the broader scope is appropriate.

Specific Matter for Comment 2:

Do you agree with the definitions of social benefits, social risks and universally accessible services that are included in this Exposure Draft?

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

The AASB does not agree with the proposed definitions of 'social benefits' and 'social risks'. We sought to test the definitions by applying them to a range of Australian benefits. They appeared difficult to apply in practice and we are concerned that this may lead to diverse outcomes. This might also create an artificial boundary between arrangements that may be economically similar in substance.

For example, the Australian Government's "Crisis Payment" social benefit is a one-off payment to residents in severe financial hardship and extreme circumstances, such as leaving a violent relationship, getting out of jail or being a refugee. This scheme also includes natural disasters not covered by other specific disaster recovery benefits.

When applying the proposed definitions of ED 63 to this scheme, we note the following:

- the scheme is available to specific individuals/households who meet eligibility criteria;
- it addresses the needs of society as a whole;
- it is not universally accessible services; and
- it covers both social risks (eg refugees and financial hardship) and non-social risks (eg natural disasters).

A strict application of the 'social risks' definition would imply that certain payments of the scheme would be accounted for as social benefit payments under ED 63, whilst other payments under the scheme would fall outside the scope of ED 63. This could lead to a diverse outcome that would not be useful to users trying to understand the nature, characteristics and implications of this scheme.

As noted in the response to SMC 1, the AASB supports expanding the scope of ED 63 by including universally accessible services and collective services. If the scope of ED 63 were to change, we do not think that the definition of 'social risks' would be required.

Specific Matter for Comment 3:

Do you agree that, with respect to the insurance approach:

(a) It should be optional;

(b) The criteria for determining whether the insurance approach may be applied are appropriate;

(c) Directing preparers to follow the relevant international or national accounting standard dealing with insurance contracts (IFRS 17, *Insurance Contracts* and national standards that have adopted substantially the same principles as IFRS 17) is appropriate; and

(d) The additional disclosures required by paragraph 12 of this Exposure Draft are appropriate?

If not, how do you think the insurance approach should be applied?

The AASB is of the view that the insurance approach should be mandatory for social benefit schemes that are similar to insurance (ie 'insurance-like') and that are managed in the same way as insurance schemes to ensure that economically similar transactions are also similarly accounted for. We are particularly concerned where such schemes are fully or partially funded, as recognition of the scheme assets should not occur without appropriate recognition of the related liabilities. The AASB considers that insurance accounting provides the most appropriate recognition and measurement of such liabilities.

The insurance approach would be consistent with the proposals in the AASB Discussion Paper *Australian-specific Insurance Issues – Regulatory Disclosures and Public Sector Entities* (November 2017). The Discussion Paper addresses the issue of whether AASB 17 *Insurance Contracts* (which incorporates IFRS 17) would appropriately capture all schemes with economically similar insurance risk once it is applicable to public sector entities, so that such insurance risk is appropriately reflected in the financial statements of public sector entities. The AASB is proposing in its Discussion Paper that the scope of AASB 17 be expanded to include 'insurance-like' arrangements that are created by statute, in addition to contractual arrangements. Additional guidance on determining whether an arrangement is insurance-like is proposed to be added to AASB 17. However, the Discussion Paper does not limit insurance-like arrangements to those that are fully funded, as neither the IASB Conceptual Framework nor the IPSASB Conceptual Framework defines liabilities based on their funding status. AASB Discussion Paper paragraphs BC19–BC29 provide a more detailed discussion.

The AASB is also of the view that should the IPSASB not want to make an appropriate insurance Standard mandatory, it should require the application of either an appropriate insurance Standard or IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* to social benefits that are similar to insurance. If IPSAS 19 is applied, it is recommended that the disclosures required by IPSAS 19 should be mandatory.

Responses to the specific questions

(a) The insurance approach should be mandatory for social benefit schemes that are managed in the same way as insurance schemes;

(b) the criteria are not appropriate as the IPSASB Conceptual Framework definition of a liability does not depend on the way a liability is funded (refer paragraph 5.25), and economically similar transactions might be accounted for differently under the proposed criteria, depending on their funding arrangements;

(c) directing preparers to apply IFRS 17 or a national equivalent is appropriate; and

(d) we agree that the additional disclosures required by paragraph 12 are appropriate.

Specific Matter for Comment 4:

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

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

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

The AASB generally supports the Alternative View presented in ED 63 (which would reflect a liability when the obligation arises), rather than the Obligating Event approach (which would reflect a liability only when all eligibility criteria, including staying alive, are met). The AASB believes the term 'obligating event approach' is misleading because, in our view, the event that gives rise to an obligation for the entity can occur much earlier than when ED 63 identifies it, based on its condition of all of the eligibility criteria being met.

However, the AASB acknowledges practical concerns in recognising a potentially large liability, without also recognising the right to tax as an asset that would contribute to funding the liability. The AASB considered possible ways of extending the obligating event approach recognition point by recognising the related asset, in order to provide more useful information in the financial statements. The AASB also acknowledges that for many schemes there will still be difficulties in determining an appropriate recognition point for social benefit liabilities (ie it will not always be clear whether the obligation arises upon the birth of an individual or when they satisfy key criteria).

The table below illustrates two possibilities for the recognition and measurement of the liability and the related asset that the AASB thinks could be supported. The underlying illustrative example referred to throughout the table is an age pension paid to citizens of a country who are 65 years or older *and* have passed a periodic means test prescribed under current legislation. A mandatory financial sustainability report is included in each case to provide users with more complete information useful for decision-making purposes that satisfies the qualitative characteristics of general purpose financial statements.

Even though the suggestions in the table are not fully developed models, and there would be a number of practical implementation issues, the AASB hopes that the IPSASB will find them helpful as a potential way forward in addressing the difficulties with both the obligating event approach proposed in ED 63 and the Alternative View.

LIABILITY	ASSET	MANDATORY SUSTAINABILITY REPORT
OPTION 1		
• Current liability for the next 12 months • Past event is the **threshold**, eg all citizens who are 65 years of age or older (irrespective of whether the means test has been passed) • Measured as age pension payments expected to be made for the following 12 months for all citizens **65 years of age and older at reporting date**	• Asset is the *right* to future tax receipts – but recognition only of the current asset for the next 12 months • Past event is the **legislation** establishing income tax payable by taxpayers • Measured as the estimated tax income from all **existing taxpayers at reporting date** for the next 12 months	• Past event is the legislation establishing both the age pension benefit payments and the future income tax receipts • All expected cash flows are included, ie both inflows and outflows for all individuals currently eligible as well as those expected to become eligible during the period of the sustainability report
OPTION 2		
• Current liability for the next 12 months • Past event is the **legislation** establishing the age pension social benefits • Measured as age pension payments expected to be made for all citizens who are **65 years or older at reporting date, as well as all citizens expected to turn 65 during the next 12 months**	• Asset is the *right* to future tax receipts – but recognition only of the current asset for the next 12 months (same as Option 1) • Past event is the **legislation** establishing income tax payable by taxpayers (same as Option 1) • Measured as the estimated tax income from **existing taxpayers at reporting date and those expected to become taxpayers during the 12 months**	Same as Option 1

The Liability

When formulating these options, the AASB has looked beyond the next eligibility assessment date as the basis for the liability. Our underlying view is that the liability is conceptually a very large amount, because it potentially covers everyone alive at the reporting date that is expected to be eligible for the benefit in the future, based on current actuarial assumptions. Such a liability would be subject to significant assumptions, a small change in which could lead to significant volatility in the size of the liability.

The AASB does not believe the recognition of the full conceptual liability is appropriate as it is not likely to constitute useful information, and would not be consistent with the IPSASB Conceptual Framework's Qualitative Characteristics: the underlying assumptions would be very uncertain and subject to significant estimation, and the total liability could be out of scale in comparison with other liabilities. Consequently, a departure from the Conceptual Framework might be warranted in accounting for the liability, resulting in a narrower basis for and smaller measurement of the liability.

In the AASB's view, the basis for the liability as set out in ED 63 (the expected payments up to the next eligibility assessment date) is too narrow.

Option 1 in the table presents a broader current liability measure than that in ED 63. The approach in Option 1 views the obligating event as a citizen reaching the age pension threshold of 65 years of age. The liability therefore would be measured as the expected age pension payments in the next 12 months to those citizens who were aged at least 65 years at

the reporting date. Satisfying the means test is reflected in the measurement of the liability, not when the liability should be recognised, as it is a criterion that is beyond the government's control.

Option 2 extends the basis for the current liability a little further than under Option 1. Option 2 does this by treating the pension legislation as the obligating event. Under this approach, the liability would be measured as the expected age pension payments in the next 12 months, which would therefore relate to citizens aged at least 65 years at the reporting date, but also to citizens aged between 64 and 65 at the reporting date, since they would become 65 (and potentially eligible for pension payments) within the next 12 months. As with Option 1, satisfying the means test is reflected in the measurement of the liability, not when the liability could be recognised.

Option 2 would therefore result in a liability that is broader than under the approach set out in ED 63, but still much narrower than a liability based on citizens alive at the reporting date. Option 2 presents a better view of the current liability for the age pension, but does ignore the non-current liability as a pragmatic response to the difficulties of measurement and scale noted above. It is difficult to find a basis for recognising some portion of the non-current liability, instead of none or all of the potential non-current liability.

The statement of financial position could usefully reflect the current liability in order to support assessments of the short-term liquidity and solvency of the entity providing the age pension. It is highly unlikely that a government could change its major social benefit policies and programs within a 12-month period. A 12-month measurement period would also be reflective of many (but not all) organisations' operating cycles and budgetary periods. Recognising a 12-month current liability would be more useful than measurement between two consecutive payment periods or to the next assessment date, because different countries and schemes may have different payment or assessment periods, which would reduce the comparability of financial statements and impair their understandability. The long-term position might be best presented in sustainability reports, presented with the financial statements, without recognising any non-current liability.

One suggestion for recognising part of the non-current liability would be to recognise and measure the liability for the period up to the issuance of the next long-term sustainability report. The Australian Federal Government typically publishes Intergenerational Reports at least every five years. Even though a social benefit liability for up to the next five years could be reliably estimated, this is still considered an arbitrary basis. The AASB therefore prefers applying the well-established current/non-current split over the use of an arbitrary period. This would be more in line with the qualitative characteristics of the Conceptual Framework and produce information that is relevant, understandable and comparable and overall a better representation of the nature and characteristics of social benefit schemes.

In the event the IPSASB decides to retain the approach proposed in ED 63, the AASB recommends that the IPSASB avoids using the term 'obligating event approach' and indicates that when recognising social benefit liabilities, the measurement of the liability is restricted to meeting the eligibility criteria (including staying alive) rather than stating this is the obligating event point of recognition. We consider this would be more consistent with the Conceptual Framework.

The Asset

The AASB notes that in some instances it is clear which government revenues will be used to fund a social benefit liability, but these schemes are likely to be insurance-like schemes where specific tax is collected to fund a particular scheme. In other cases it is normally not clear at collection for what purpose tax income will be used.

The AASB disagrees with the IPSASB's position in ED 63 paragraph BC13 that the future taxation income used to fund social benefits cannot be recognised as an asset because the entity does not currently control those resources. As stated in paragraph 6 of the Preface to the IPSASB Conceptual Framework, "taxation is a legally mandated, compulsory non-exchange transaction between individuals or entities and the government." Furthermore, existing tax legislation gives governments the sovereign power to tax individuals and entities. Consequently, the government has a **right** to receive the future tax income and this right should be recognised on the statement of financial position as an asset.

Paragraph BC5.18 of the Conceptual Framework states that the IPSASB agrees with the view that "… the power to levy taxes and fees must be converted into a right by legal means, and that such a right must be exercised or exercisable in order for an asset to come into existence … the IPSASB concluded that a government's inherent powers do not give rise to assets until these powers are exercised and the rights exist to receive service potential or economic benefits."

The Conceptual Framework (paragraph 5.13) also states that "… An asset arises when the power is exercised and the rights exist to receive resources." That paragraph distinguishes between the establishment of a power through a statute and exercising the power to create a right, as factors to consider in assessing when an entity's control of rights to resources arises. Although not clear, this could be viewed as indicating that converting a right into statute via legal means does not constitute exercising the power and gaining the right to receive resources from external parties.

The AASB's view, however, is that if a government's general ability to tax has been converted into legislation and is currently in force, then an asset has come into existence. This view is symmetrical to the AASB's view of when a liability arises. The nature of the asset in these circumstances is more akin to an intangible asset, but it is a recognisable asset nonetheless.

For the purposes of illustrating symmetrical proposals, under Option 1, an asset would be recognised, measured as the estimated tax income from all existing taxpayers at the reporting date for the next twelve months. This basis is then broadened under Option 2 by measuring the current asset as the estimated tax income from existing taxpayers at the reporting date as well as from those expected to become taxpayers during the next twelve months.

Again, recognition of this current asset in the statement of financial position would facilitate liquidity and solvency assessments, and the long-term position could be presented in sustainability reports, presented with the financial statements.

As the options in the table above are limited to recognising a current liability, it could be appropriate to also limit the options to recognising a current asset, to facilitate assessment

of the short-term liquidity and solvency of the entity. Under this approach, a non-current asset would not be recognised. If a departure from the Conceptual Framework might be warranted in accounting for the liability, as previously explained, then similarly a departure from the Conceptual Framework might be warranted in accounting for the asset as well.

However, in order to avoid presenting a misleading impression that a government's current liquidity position is indicative of its longer-term liquidity position, an important consideration is whether the measurement of the asset should be restricted or aligned to the current liability in some way (ie in the next 12 months, the social benefit policy could be funded from general tax, however when operating expenses and the long-term nature of the social benefit policy are considered, the policy could not be funded without an increase in taxes etc). For example, the amount of the asset might be restricted to the amount of the liability.

Discussion with users would be necessary to determine which approach would better align with the qualitative characteristics of relevance, understandability and comparability of financial information, resulting in a better representation of the nature and characteristics of the asset.

Executory Contracts

It is also important to consider the existence of executory contracts. Consider an example where an unemployed (yet physically able) person is required to perform certain public service duties (eg removing refuse in parklands) for the government while they are unemployed, in exchange for receiving unemployment benefit payments.

This situation is different from the options illustrated in the table above. In this case, the government has both a liability (ie the payment of the unemployment benefit) and an asset (ie future services the government is going to receive in the form of work performed; this is *different* to the right to future income tax asset). This initially constitutes an executory contract, because the arrangement is equally proportionately unperformed by both parties. An offsetting asset exists along with the liability, but the traditional approach is not to recognise either the asset or the liability in this case. We suggest that the standard should clarify the identification and treatment of executory contracts.

Specific Matter for Comment 5:

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

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

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

(c) For the future cash flows related to from an entity's social benefit schemes (see paragraph 34):

  (i) It is appropriate to disclose the projected future cash flows; and

  (ii) Five years is the appropriate period over which to disclose those future cash flows.

If not, what disclosure requirements should be included?

The AASB agrees the disclosures in paragraphs 31 through 34 are useful, although the AASB does not support the proposed five-year period for the disclosure of the future cash flows. Instead, the AASB supports mandatory disclosures of the long-term impact and sustainability of social benefits as an integral part of a public sector entity's financial reporting.

Specific Matter for Comment 6:

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

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

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 recognised 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 <IR> 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.

Do you think the IPSASB should undertake further work on reporting on long-term fiscal sustainability, and if so, how?

If you think the IPSASB should undertake further work on reporting on long-term fiscal sustainability, what additional new developments or perspectives, if any, have emerged in your environment which you believe would be relevant to the IPSASB's assessment of what work is required?

As noted in the response to SMC 5, the AASB supports mandatory disclosure of the long-term impact and sustainability of social benefits as an integral part of a public sector entity's financial reporting. The AASB does not propose requiring the long-term sustainability report to be included in the financial statements; however, the two separate reports should be clearly linked. This might be achieved by presenting the financial statements and the sustainability report together, by referring in the financial statements to the sustainability report, or by other means.

The AASB notes that even though the long-term sustainability report might not be updated annually, linking the most recent version to the financial statements would still provide the best context for users of the financial statements.

The AASB is of the view that the most useful and comprehensive disclosure would be the combined presentation of projected cash outflows for social benefit schemes and projected cash inflows. This would enable users of the financial statements to gain a better understanding of the government's social benefit schemes, including assessing their long-term sustainability, such as the government's estimated financial position at selected points in the future and potential fiscal challenges.