

Department of Treasury and Finance

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Mr David Boymal
Chairman
Australian Accounting Standards Board
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Dear Mr Boymal

ITC 15 SOCIAL BENEFITS

The Heads of Treasuries Accounting and Reporting Advisory Committee welcomes the opportunity to provide comments to the AASB's Invitation to Comment 15 *Social Benefits*, which consists of the following papers:

- IPSASB's Exposure Draft 34 *Social Benefits: Disclosure of Cash Transfers to Individuals or Households*; and
- IPSASB's Consultation Paper *Social Benefits: Issues in Recognition and Measurement*.

Please find HoTARAC's comments regarding ITC 15 at Attachments A and B.

The IPSASB's proposals on Social Benefits also include a Project Brief on *Long-Term Fiscal Sustainability Reporting*. Attached for your information, is HoTARAC's comments to the IPSASB on this Project Brief (Attachment C refers).

In summary, HoTARAC:

- does not support ED 34. It is unclear as to how the ED 34 disclosure would fill the government report users information "gap" with regards to social benefits programs. HoTARAC sees little value in reporting information that does not significantly enhance the evaluation of social benefits program performance and financial position, as well as their impact on the overall government fiscal position. HoTARAC suggests that useful information should aim at indicating trends, effectiveness, financing and viability of such programs. This type of information is expected to be covered by the IPSASB's Long-Term Fiscal Sustainability Project;
- reiterates that it strongly disagrees with the proposal to issue a Standard on the recognition and measurement of social benefits that is based on an accounting concept other than "due and payable"; and

- deems that it would be worthwhile for the AASB to issue an Exposure Draft based upon the IPSASB's Social Benefits Long-Term Fiscal Sustainability Project providing that some work has been undertaken to ensure it conforms with Australia's regulatory environment. However, the work done on any adaptation should be appropriately prioritised within the AASB's current public sector work program. In this context, given the number of other issues of potentially higher importance (including extension of AASB 1049 reporting to entities, fair value, service concessions etc), social obligations could be considered a low priority at this time.

In this regard, it is noteworthy to mention that the major fund provider of social programs in Australia is ultimately the Australian Government, and the projected impact of these programs on its fiscal position is already identified in the Intergenerational Report, issued by the Australian Treasury.

If you have any queries regarding HoTARAC's comments, please contact Peter Gibson from the Australian Department of Finance and Deregulation on 02 6215 3551.

Yours sincerely



D W Challen

CHAIR

HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY COMMITTEE

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Encl

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HoTARAC's DETAILED COMMENTS ON EXPOSURE DRAFT 34 SOCIAL BENEFITS – DISCLOSURE OF CASH TRANSFERS TO INDIVIDUALS OR HOUSEHOLDS

General Comments

HoTARAC does not support IPSASB's ED 34, as it recommends reporting prospective information. This does not currently fall within the scope of the Accounting Standards and the proposed disclosures do not significantly enhance the evaluation of social benefits programs.

There is a general consensus that, given the significant size of government social benefits expenditure, there is a need for information that would improve the assessment of the financial position and performance of such programs.

HoTARAC concurs with IPSASB that primary financial statements do not meet all the information needs of government report users on this matter. However, the general purpose financial report is an ex-post financial report that generally reports on past events.

HoTARAC has difficulties in determining how the disclosures outlined in the ED 34 will fill this information "gap".

Clarification is required on why and how the additional data will satisfy users needs and who will be using this information. The proposed disclosure of current and previous year amounts and general information for each program provides very little analysis and/or assessment of social benefits program performance and financial position.

Further, the additional information is unlikely to enable most users to assess future outlays and trends, as most programs in Australia require detailed actuarial assessment, which necessitates a high degree of skilled input.

HoTARAC acknowledges that this is an interim step, but sees little value in reporting information that does not significantly enhance the evaluation of social benefits programs. In HoTARAC's view, useful information on social benefits would aim at indicating trends, effectiveness, financing and viability of such programs. Therefore, HoTARAC believes that the scope of the ED would need to be expanded to include the right to tax, not just social benefits, and the impact on the overall fiscal position of a Government. Disclosure of this type of information is expected to be partly covered by the IPSASB Long-Term Fiscal Sustainability Project.

Other comments are:

- the development of standard disclosures on social benefit programs enhances consistency and credibility of the information provided to the users of government financial reports;
- the usefulness of the information on social benefits is diminished by the fact that proposed disclosure does not mandate reporting on government receipts used to fund those benefits – notably taxes;

- reporting of such disclosure would be more useful at a “whole-of-government” level rather than at an entity level. This is due to the fact that generally governments, and not individual entities, make major decisions on social benefit entitlements and associated allocation of resources. It would also provide a better representation of the complete set of a jurisdiction’s social benefits policies; and
- in the instance that proposed additional information is to be reported in a General Purpose Financial Report:
 - the requirement to disclose the amount of expenses and liabilities recognised in the financial statements, which in Australia is currently based on the “due and payable” approach, would be confusing; and
 - an unnecessary duplication would result from including the entity’s accounting policy for, and amounts of recognised expenses and liability related to, social benefits already reported in the financial statements.

While HoTARAC does not support ED 34, it has provided below detailed comments on specific aspects which may be of assistance to the Board.

Specific Matters for Comment

1. Appropriateness of the scope of ED 34:

- (Australian context only) More clarity is required in relation to the application of ED 34, at entity level, to those entities which administer cash transfers and those entities which control cash transfers, but do not make direct payments to recipients. For the purpose of this submission, HoTARAC considers administered and controlled transactions in the way they are determined in AASB 1050 *Administered Items*.

Arguably, the disclosure of estimated cash transfers in the financial statements of an entity, which administers a social benefits scheme, might send a misleading message to users of its financial statements that the administered entity has the certain degree of control over the scheme and is generating cash inflows to fund the scheme. This is not always true as, in the ordinary course of business, the administered entity has no discretion regarding the distribution of social benefit program payments and associated administered revenues.

- The exclusion from the scope of social benefits provided in the form of goods and services to individuals and households does not provide the full cost/resources required from government for providing social benefits to individuals/households. This exclusion may lead to manipulation of disclosures by converting cash transfer programs into individual goods and services, in order to avoid, or minimise, disclosure.
- In the Government Business Enterprises section, the title should be removed and paragraphs 7 and 8 should be combined together.

2. Definitions:

- Even though some of the terms have already been defined in other IPSAS, it would be useful to have a Glossary of Terms at the end of the Standard.
- The definitions of “Public Sector entities” and “Government Business Enterprises” need to be included or cross referenced.
- The definitions of “Social Benefits” and “Individual goods and services” are not logical, as both refer to each other. HoTARAC proposes the following definition of “Social Benefits”:

“Social Benefits are resources provided by a public sector entity to individuals, households or communities in a non-exchange transaction to protect the entire population, or a particular segment of the population, in any jurisdiction against certain social risks.”

- To be consistent with the definitions of “Collective goods and services” and “Individual goods and services”, the definition of “Cash transfer program” should be as follows:

“...is a program that provides social benefits by way of cash transfers to an individual or household.”

- Proposed amendments are suggested below:
“An eligibility criterion is a requirement that must be satisfied for entitlement to cash transfers, generally enshrined in legislation (regulation / decree etc).”
- The word “welfare” contained in the definition of “social risk” could be interpreted differently between various jurisdictions and thus may need refining.

3. Determination of the amounts expected to be transferred:

- HoTARAC agrees that assumptions should generally be consistent between programs. However, in certain circumstances, there may be some rationale for having different assumptions, for example morbidity rate may be different for programs aimed at youth compared to programs for retirees.
- HoTARAC strongly disagrees with the reference to “market yield” at reporting date for the selection of the discount rate, which in effect is the “spot” rate. The application in Australia of this concept for determining the employee benefits provision under the equivalent of International Accounting Standard 19, has caused “high volatility” of the figure reported, which significantly impairs the assessment of the underlying provision. It is recommended that ED 34 clarifies that the “spot” rate at reporting date would generally not best reflect the time value of money.
- The source of assumptions publicly available applied in calculating the expected amount should be disclosed, for example Consumer Price Index, Gross Domestic Product, unemployment rate and so on.

- Assumptions should also include the probability that the social benefit payments will be claimed by the eligible individuals/households. In practice, there may be a major difference between the number of individuals or households who are eligible to apply for social benefits payments and the number of individuals or households who proceed to claim the social benefits. The amounts should be calculated on the total number of expected claimants to avoid a potential overestimate of future outflows.

4. Appropriateness of disclosure requirements in paragraph 45:

- To be useful, disclosure should, as a minimum, require information about the general nature of government receipts expected to fund the social benefits cash transfer reported.
- A summary table of all the major programs and the aggregated amount for the remaining programs would be useful. This would provide a comparison between the programs as well as reporting the total amount of social benefits for the period.
- For each of the major programs, the disclosure requirement should include the timing of the payments and revalidation points. This would assist comparability and provide useful information on the timing of significant cash outflows. In the instance where earmarked receipts are disclosed, the timing of inflows and outflows would provide useful information as to the government financial position. The absence of this disclosure is one of the major reasons HoTARAC supports long-term sustainability disclosures rather than the principles in ED 34.
- *Paragraph 38:* The standard should state that, generally, assumptions should be consistent, however if circumstances require different assumptions, rationale for this needs to be clear.
- *Paragraphs 46, 48 and 51:* (Australian context only) Consistent with the AASB's policy, the Standard should spell out what is required and should not contain "encouragement for additional items".
- *Paragraph 47:* as well as recent growth, materiality assessment should add the expected future growth to the quantitative factors.
- *Paragraph 49:* the statement referring to IPSASB 1, which is a financial statements requirement, is out of place. Again, this is an unnecessary duplication, if proposed disclosures are incorporated into a GPFR.

5. Verifiability of disclosure requirements in paragraph 45:

- HoTARAC members generally agree with these requirements.
- HoTARAC is however unsure as to whether IPSASB's proposal mandates audit of the additional disclosures.
- HoTARAC is of the view that certain requirements appear to be very subjective and may hinder the audit process. In Australia, some jurisdictions have encountered difficulties in achieving a consensus with their auditors when the use of "best estimate" is open to interpretation.

- In the instance where audit is mandated, authoritative and clear guidance must be issued to ensure consistency, comparability and verifiability of the estimated future cash transfer obligations.
6. Appropriateness of implementation arrangements:
- HoTARAC considers that these arrangements are appropriate.

HoTARAC Comments to IPSASB regarding Consultation Paper - *Social Benefits: Issues in Recognition and Measurement*

HoTARAC's comments are based on the approach taken to the provision of social benefits in Australia.

Australian paragraph Aus26.1 of Australian Accounting Standard AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* states "...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."

In Australia, "cash transfer" programs are funded from general taxation or other revenue. Such programs are not contributory. The rights of citizens to benefits are set out in legislation, but this legislation is frequently modified in ways that alters entitlement to benefits.¹ Rights of citizens to benefits are not codified in the Constitution, not even in general terms.

Some provision of "individual goods and services" requires co-payment by citizens (such as medical services). However, these co-payments are usually required at, or reasonably adjacent to, the time that the benefit is provided, and usually go to the service provider not the government, so in that sense the programs are not contributory. The funding and legislative basis for such programs is similar to that described above for "cash transfer" programs.

It is understood that this system may differ from the situation in other countries where there may be contributory programs that establish legal entitlement rights similar to post-employment benefits under AASB 119/IPSAS 25. Some countries may have provisions in their Constitutions which guarantee citizens certain rights that cannot easily be changed or removed.

General Comments

A fundamental problem of the traditional financial accounting framework is that it does not deal well with government rights and obligations. This is partly because the traditional framework is based on the concept of exchange, whereas many of the government rights and obligations are not based on explicit notions of exchange.

This situation particularly applies to social benefits, principally those provided by programs typical of the Australian context above. It has been argued by some that obligations to provide social benefits in the future; i.e. not just those that are due and payable in the next payment period, represent real liabilities within the current framework (e.g. using IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* or equivalents). However, as noted below in the answer to Question 1, the resulting financial statements prepared on a

¹ The section of the *Social Security Act 1991* (Commonwealth) dealing with subsequent amendments runs to 194 pages.

traditional basis, particularly the Balance Sheet, would in effect be totally meaningless as a measure of financial performance relevant to the current reporting period as it would not recognise the corresponding rights (the right to impose taxation).

Accordingly, HoTARAC reiterates its previous position on the recognition and measurement issue. The Committee strongly disagrees with the proposal to issue a standard on the recognition and measurement of social benefits that is based on any accounting concept other than "due and payable". For social benefit payments, a present obligation only arises when entitlement conditions are satisfied for payment during a particular reporting period. Please refer to HoTARAC's previous submission of July 2004 (Attachment 1 refers).

HoTARAC believes that information about the future obligations of the government to provide social benefits is useful. However, in doing this, it may seek to do so outside the financial accounting framework applied to general purpose financial statements, which excludes prospective information. A long-term sustainability report, effectively a future forecast based on management accounting principles, would appear to be a more appropriate method of providing the information.

Specific Matters for Comment

Question 1 – Do you agree that, within the constraints of the current implied conceptual framework for general purpose financial reporting, current financial statements such as the statement of financial position and the statement of financial performance cannot convey sufficient information by themselves to users about the financial condition of governmental programs providing social benefits? Please state your reasons.

HoTARAC agrees with this statement. Financial statements are based on past events, which can provide useful information for evaluating the financial performance/position of an entity but do not fulfil all needs of users with regards to social benefit programs. Social benefits reporting would be improved with information on the future expenditure and financing of these programs. However, this information should not be included within financial statements.

In HoTARAC's view, the framework would require significant modification to the definition of a liability to allow for the social benefits inclusion. However, inclusion would result in inconsistencies between Balance Sheet items and would impair the understandability and comparability of the financial statements various components. Therefore, it would be of little relevance to users. A practical example of the impact resulting in massive social benefits liabilities being reported and impairing the readability would be the United States Government, which in its 2007 Financial Report, reported an off-Balance Sheet item of Social Insurance Responsibilities in the order of US\$45 trillion, whereas its total recognised liabilities are just under US\$11 trillion.

The IASB Framework (paragraph 13) acknowledges that financial statements do not provide all the information that users may need to make economic decisions since they largely portray the financial effects of past events and do not necessarily provide non-financial information. The financial statements should be read in conjunction with other financial and non-financial information, such as the Annual Report, the Budget, and the long-term sustainability report.

Question 2 – Do you think that a present obligation to individuals or households arises at any time for:

- a) Collective goods and services; and/or**
- b) Individual goods and services?**

If you think a present obligation does arise for either (a) or (b) or both (a) and (b) please indicate when and indicate your reasons.

(a) Collective goods and services

HoTARAC disagrees with the view that a present obligation exists for the future provision of collective goods and services. In Australia, the provision of collective goods and services is not subject to binding obligations. A government public announcement to provide particular collective goods and services is only an intention or promise, and thus, neither a legally binding decision, nor a constructive obligation to the Government.

More specifically, governments typically commit to an obligation to achieve a specific outcome (e.g. affordable housing) and not to make specific payments or to provide specific services in a specific location.

A Government still retains the discretion to avoid the sacrifice of future economic benefits. It can withdraw its promises if it decides that the situation requires it.

(b) Individual goods and services

HoTARAC agrees that a present obligation to individuals or households can arise for individual goods and services once eligibility criteria have been satisfied for the present reporting period. However, HoTARAC does not support recognition of a liability for the provision of individual goods and services in future periods on an accounting concept other than “due and payable”.

Similar to a cash transfer program, HoTARAC asserts that a present obligation exists once eligibility criteria to receive the goods and services entitlement have been satisfied for the present reporting period, giving rise to a valid expectation by the citizen that the government will provide the benefit. However, the obligations are not binding indefinitely, and can be altered by the Government through amending the relevant legislation.

The Committee agrees the provision of goods and services by third parties should be excluded from the scope.

Question 3 – Do you think that a present obligation to individuals or households in respect of cash transfers arises when all eligibility criteria have been satisfied for:

- a) Non-contributory programs; and/or
- b) Contributory programs?

If you think that a present obligation arises at an earlier point for (a) or (b) or both (a) and (b), please indicate that point and give your reasons.

(a) Non-contributory programs

Non-contributory programs – programs largely funded from general taxation that do not require contributions by or on behalf of individuals or households to entitle them to resources.

HoTARAC contends that a present obligation exists, but only on a “due and payable” basis and not for the provision of future benefits. Satisfaction of eligibility criteria creates an expectation from citizens that the Government will provide them with the social benefit. Most entitlements are usually only based on current events, not past events.

(b) Contributory programs

HoTARAC members do not have sufficient experience with contributory programs to answer this in an informed way. However, it is conceivable that such programs may provide citizens with greater certainty as to entitlements. Thus, an obligation may arise that could constitute a liability.

In general, social benefits in Australia are provided through non-contributory programs.

Question 4 – Where a cash transfer program requires individuals or households to revalidate their entitlement to benefits, do you think that revalidation is an attribute that should be taken into account in the measurement of the liability or a recognition criterion? Please state your reasons.

Revalidation – Many programs delivering social benefits require eligible individuals or households to revalidate their eligibility at a future date to maintain their entitlements to benefits.

HoTARAC considers revalidation to be a measurement attribute. Eligibility requirements or contributions are the recognition criteria.

To consider revalidation as a recognition criterion would result in two programs with identical and nearly identical eligibility requirements to have a different liability, because of separate revalidation points. This would provide an opportunity for manipulating the liability amount based on the timing and frequency of the program eligibility revalidation. It also would impair comparability between programs. The timing of the revalidation could be set

shortly after the reporting date, thus artificially limiting the entity's liability and expense.

To determine revalidation as a measurement attribute would better reflect the obligation. Under this treatment, the expected cash flows included in the measurement of a liability for social benefits would take into account the probability that existing beneficiaries will satisfy revalidation criteria at future revalidation points.

Question 5 – Do you think that in developing requirements for recognition and measurement of social benefits the IPSASB should further explore the executory contract accounting model briefly outlined in Key Issue 6. Please state your reasons.

Executory contracts are contracts in which neither party has performed any of its obligations, or where both parties have partially performed their obligations to an equal extent.

Executory Contract Accounting Model: Under this model, (a) governmental obligations to provide goods, services and cash transfers to individuals or households and (b) the rights of individuals or households to receive those benefits, are acknowledged as commitments. Governmental obligations are offset by the ongoing duty of individuals or households to contribute taxes and other sources of finance. Liabilities would arise only when legal entitlements have been established.

US “inter-period equity” measures whether revenues in a particular reporting period are sufficient to pay for the goods and services provided in that period.

Yes, subject to the following. HoTARAC agrees that social benefits are similar in concept to executory contracts, in the sense that the liability for future social benefits is offset by the Government's right to tax. However, an important distinction is that executory contracts are normally reciprocal or exchange transactions while social benefits are not. Obligations under such contracts are generally not recognised as liabilities in the financial statements, as generally a rights and obligations approach is not adopted in the other Accounting Standards (refer IASB Framework, para 91).

It would be useful if IPSASB could provide further information on how the executory model would be applied to social benefits. The discussion provided seems to indicate that the government obligation would be offset by the duty of individuals to contribute taxes, i.e. as individuals will not yet have contributed future taxes, there will not be a need to recognise a liability for most social benefits of the future in present financial statements. This approach does not consider situations where individuals will have no liability to contribute future taxes; situations where non-residents living in the country may pay taxes but not be entitled to the benefits of cash transfer programs; or non-residents living abroad who may not pay taxes but are entitled to the benefits of cash transfer programs (all situations exist in Australia).

Nevertheless, some application of a model derived from executory contract theory may be appropriate if it can further rationalise the recognition on a “due and payable” basis.

The Consultation Paper indicates that the Executory Contract Accounting Model is consistent with the US “inter-period equity” concept. The Committee agrees that “inter-period equity” is a valuable concept for government accountability of social benefits. But this should be considered as part of the Long-Term Fiscal Sustainability Reporting Project rather than the recognition and measurement of social benefits. Australia’s long-term sustainability report, the Intergenerational Report applies the “inter-period equity” concept.

Additional Comments

The Committee notes that the social benefit obligation should reflect the expected payment. In some jurisdictions, such as Australia, the individuals/households must claim the social benefits, effectively confirming their eligibility, before a Government initiates the payment of the entitlement. Therefore, the calculation of the social benefits obligation must take into account not only that the eligibility criteria are met but also the probability that a claim will be received.

(Australian context only) AASB would need to consider the Government Finance Statistics/Generally Accepted Accounting Principles harmonisation implication of the recognition and measurement of social benefits obligation other than on the “due and payable” basis.

This project should progress in conjunction with the IASB projects on liabilities and the Conceptual Framework and the IPSASB project on the Conceptual Framework.

Comments on the International Federation Accounting Committee's Public Sector Committee's Invitation to Comment *Accounting for Social Policies of Governments*

General Comments

HoTARAC acknowledges that this is a difficult but important area of public sector accounting, where it is difficult to prescribe a standard that is both conceptually correct and practical.

The PSC appears to advance two broad approaches in this ITC. Under the first approach, explained by Option 1, liabilities are recognised until the next point in time that eligibility criteria must be satisfied. This is, in effect, a small extension on the current due and payable approach. The second approach, set out in Options 2 and 3, requires recognition of a liability at an earlier stage - either when the criteria are first met or before they are met. This is a significant departure from current practice.

HoTARAC believes that Options 2 and 3 are unworkable. HoTARAC believes these options would dilute the usefulness of financial statements and would be inconsistent with accounting for future tax revenues. These options appear to confuse probable government expenditure, with those expenditures where the government has no realistic alternative.

A majority of HoTARAC members believe that Option 1 is superior to the other options but note that it is subject to a judgement about whether a government has no realistic alternative but to sacrifice future economic benefits. For example, a ten year period between entitlement testing does not necessarily mean that the government will not change the scheme in this period. Therefore, the majority of HoTARAC members prefer the current "due and payable" approach as discussed in the Invitation to Comment.

Governments rarely have obligations to make specific social welfare payments. Rather, they typically commit to an obligation to achieve certain desired outcomes. For example, a Government may make a commitment to provide affordable, accessible health care. In doing so, the Government has not necessarily created an obligation to provide specific services in a specific location. Similarly, an obligation to ensure that citizens with no, or minimal, market based income have an acceptable standard of living does not commit the Government to an ongoing program of support, or to ongoing payments to identified individuals.

A minority of HoTARAC members support Option 1, as it is based on GAAP principles, whereas it is not clear what principles underlie the "due and payable" approach.

Current Australian Practice

In Australia, the Australian Government is responsible for the bulk of welfare payments. State and Territory governments have a greater role in the provision of goods and services to the community.

Governments in Australia essentially use the “due and payable” approach described in Chapter 1 of the ITC. Social benefits that will be paid in the future are not recognised except for those benefits accrued at reporting date but payable in the following reporting period. No liability is recognised for future services to be provided, such as disaster relief, legal aid or defence services.

For example, pensions, unemployment benefits, child support etc are generally paid every two weeks. If the balance date was one week into this period, a liability would be shown for that week, despite the fact the money will not be paid until the next period. This treatment is consistent with other expenses, such as public service wages.

Further information can be found in AAS 31 *Financial Reporting by Governments* at paragraphs 12.1.2 and 12.1.3. (refer to Attachment A)

HoTARAC view on Options provided in Invitation to Comment

Whilst a majority of HoTARAC members do not support any of the options outlined in Chapter 4 of the ITC, Option 1 is preferred to Options 2 or 3.

Option 1 – Satisfy all eligibility criteria

Option 1 assumes that the Government has no realistic obligation but to make payments from the date that the recipient first meets the eligibility criteria, until the date that eligibility is reassessed. However, there is still scope or discretion to avoid the sacrifice of future economic benefits. Where eligibility is reassessed frequently, it may be argued that, in the interim, it is unlikely that the Government would change legislation to avoid making a payment. However, particularly where a long period intervenes between entitlement and final payment, circumstances could change sufficiently that governments would be able to justify a suspension of payments.

Therefore, a majority of HoTARAC members have reservations about Option 1, in that it would still give rise to obligations for social benefit payments in future reporting periods, even where there is no binding obligation and the Government has the discretion to avoid the sacrifice of future economic benefits. Where social benefit payments are not frequently reassessed for eligibility, application of Option 1 will give rise to a similar outcome to Option 2.

Also, some Australian governments produce Consolidated Financial Statements on a monthly basis. For example, if old age pensions were reassessed every two months, the Steering Committee’s majority option would require a full two months expenses relating to old age pensions to be

shown in one month, together along with a liability for the next month. In the following month, the liability would be reduced with no expense recognised. This would create confusion and inconsistency between reporting periods.

As discussed above, a minority of HoTARAC members support Option 1. They consider that, where eligibility criteria are satisfied, a constructive obligation arises. If there is sufficient uncertainty surrounding the payment, making it unlikely that a payment will be made to individuals who satisfy the current eligibility criteria, a measurement issue will arise. It is important to clearly separate measurement issues from principles underlying the definition of a liability.

Option 2 – Satisfy threshold eligibility criteria

Option 2 is not supported. In addition to the issues identified for Option 1 above, Option 2 gives rise to the following problems:

- it relies on the assumption that, when a person reaches the eligibility criteria, they will remain eligible and the eligibility criteria and social benefits arrangements will remain unchanged. This means that a liability is recognised, even though there is discretion to avoid the sacrifice of future economic benefits;
- it relies on recognising all future social obligations up front and would create liabilities and expenses, but there would be no corresponding revenues and assets as future tax revenues are not recognised;
- the Invitation to Comment states that, “financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future.” Governments also produce Budget Papers that are publicly available and which set out future spending; and
- social benefits are not the only obligation that governments have no realistic alternative but to continue to pay. For example, governments could not operate without a public service. Whilst governments may not have a legal obligation for future wages, if a government chooses to reduce the public service it will have a legal obligation to pay termination benefits. However, governments do not show any liability in this regard.

Option 3 – Key participatory events

Option 3 is not supported for the same reasons as Option 2. Indeed, Option 3 would recognise a liability when certain key participatory events have occurred. HoTARAC believes that, apart from the issues raised in Option 2, the determination of an obligating event in Option 3 is too arbitrary. For instance, individuals enter the workforce at different ages and different individuals are entitled to other social benefits apart from old age pensions. It is also not reasonable to commit future governments to the policy of the current government. Whilst it is certain that all future governments will provide some level of social welfare payments, the eligibility criteria may change.

Under Option 3, recognising an expense and a liability for future social obligations would further dilute the usefulness of the Statement of Financial Performance. For example, if old age pensions were expensed at birth and a liability shown, the general journal entry when pensions are paid would simply be to debit liability and credit cash. No expense would be shown for the period to which the expense relates.

HoTARAC views on the appropriate accounting treatment for each class of obligation are at Attachment B.

Specific Matters for Comment

(a) Do you consider that separate Exposure Drafts and IPSASs should be prepared for:

- i) old age and similar pensions; and**
- ii) other social policy obligations?**

A majority of HoTARAC members consider that there is no reason for treating old age pensions separately from other social policy obligations. Old age pensions are similar to other social obligations of government, and a consistent conceptual approach is preferred.

A minority of HoTARAC members support separate Exposure Drafts for old age pensions and similar pensions and other social policy obligations, on the basis that they are both complex areas and should therefore be separated to allow detailed discussions.

(b) Do you consider that unfunded pension plans to provide government employees with benefits as a consequence of their employment, where the pensions are to be paid from government revenues, should be included or excluded from the scope of any forthcoming IPSAS on social policy obligations?

In Australia, most government employees are members of public sector superannuation schemes, covered by other accounting standards. Accounting for government employee superannuation schemes should be no different than the requirements for private sector employees. Therefore, HoTARAC supports the development of an IPSAS based on IAS 19 *Employee Benefits*.

(c) Do you agree that notions of social benefits are well understood and need not be defined in an IPSAS? If you are of the view that it is necessary to define social benefits for inclusion in an IPSAS, please outline the reasons for this view and your proposed definition.

A majority of HoTARAC members support the definition provided in paragraphs 7 and 8 of IPSAS 19 as shown in Figure 2.2 of the ITC. However, a minority of HoTARAC members believe that it would be beneficial to more

clearly define social benefits, based on Government Finance Statistics concepts.

(d) Do you agree that the definition of a liability and the related concepts of a legal and constructive obligation in IPSAS 19 should be applied to non-exchange transactions in the public sector?

HoTARAC agrees that the definition of a liability and the related concepts of a legal and constructive obligation should be applied to non-exchange transactions in the public sector. However, HoTARAC believes that, when these concepts are applied to social benefits, there are a limited number of constructive obligations in the public sector.

HoTARAC agrees with the comments made on pages 38 and 39 of the ITC that “governments frequently change the nature and amount of benefits and rarely provide categorical assurances that current benefits will continue to be provided in future periods. Governments are frequently in power for limited periods and would be unable to give such assurances even if they wanted to.”

Governments do not have obligations to make specific payments, but rather have an obligation to achieve certain desired outcomes. For example, a Government may make a commitment to provide affordable, accessible health care. In doing so, the Government has not necessarily created an obligation to provide specific services in a specific location. Similarly, an obligation to ensure that citizens with no, or minimal market based income have an acceptable standard of living does not commit the Government to a specific program of support, or to specific payments to identified individuals.

A Government would have a present obligation for a particular income support payment or service provision only where:

- it has explicitly accepted responsibility to sacrifice resources for provision of the particular social benefit payment and communicated this to relevant parties;
- the recipients have acted on the Government’s acceptance and would suffer detriment from the promise being withdrawn; and
- the Government intended the recipients to act in a certain way or would have known that the recipients had no realistic alternative but to act in a certain way, such that the Government has little or no discretion to avoid the sacrifice of future economic benefits.

(e) Do you agree with the Steering Committee’s conclusions about the alternate approaches to determine when a constructive obligation arises in Chapter 4. Are you of the view that there are other circumstances in which a constructive obligation may arise?

As stated above, a majority of HoTARAC members prefer Option 1, but do not fully support any of the options put forward in the ITC. Rather, the majority of HoTARAC members support the current approach adopted in AAS 31

Financial Reporting by Governments, which is similar to the “due and payable” approach referred to in the ITC.

In Australia, the onus is on constituents to inform the Government that they are no longer eligible for benefits. Obviously, there are government officials whose responsibility it is to check this, however a person’s eligibility is a day-by-day proposition.

A majority of HoTARAC members believe that satisfying the eligibility criteria is not conclusive as to whether an obligation should be recognised. It might be possible for the Government to cease payments during the period, especially if the recipients would incur no detriment over the remainder of the period from cessation of the payments.

A minority of HoTARAC members support Option 1 and consider it would be very unusual for a Government to cease payment during a period when the eligibility criteria has been satisfied, while it is not clear that, if payment ceased, the recipient would not be worse off than if the payment continued.

Those HoTARAC members believe that, if it is considered likely that payments will cease, the recognition criteria for liabilities would not be satisfied on the basis that the future sacrifice of economic benefits is not likely.

(f) Do you agree with the Steering Committee View in Chapter 5 that a present obligation for the provision of goods or services to constituents does not arise prior to the provision of those goods and services? Do you agree that any costs incurred in acquiring goods and services for delivery in the future should be recognised in accordance with IPSASs or, in the absence of such, other generally accepted accounting practices for dealing with such exchange transactions?

HoTARAC agrees that there is no obligation prior to the provision of the goods and services. Governments often have very broad general obligations, such as to provide adequate public health care to those who cannot afford to pay for it. However, this obligation does not result in a present obligation to provide health services in future periods.

The Government has a number of realistic alternatives, including the power to revise policies, introduce new programs to replace existing services or enact new legislation to revise eligibility criteria.

The determination of whether a liability exists must be assessed for each program on a case-by-case basis in order to ensure the consistent application of the principles. It is agreed that, as a general rule, a liability would not exist in the case of collective goods and services.

HoTARAC agrees that any costs incurred in acquiring goods and services for delivery in future should be recognised in accordance with generally accepted practice for exchange transactions.

- (g) Do you agree that the financial reporting consequences of cash advances provided by a government to allow individuals to purchase specified goods and services as discussed in Chapter 5 differ from cash advances discussed in Chapter 6 which are provided for use at the discretion of the recipient?**

A majority of HoTARAC members support a “due and payable” approach for all categories of social benefits.

For example, the Government may provide constituents with vouchers to purchase goods and services. Upon presentation of the vouchers the businesses providing the goods and services would invoice the Government. The Government would have a liability for the un-presented vouchers as at the reporting date. Measurement of the liability should take into account the possibility that some vouchers will never be claimed. They would also be required to show a liability for invoices unpaid.

Alternatively, if the Government paid the providers up front and then issued vouchers to constituents, the Government could show an asset for the unclaimed vouchers.

If a Government has a stated policy that it will reimburse constituents upon presentation of a receipt for the purchase of that good or service, it would have a liability for the amounts unpaid at reporting date. This is because the constituents have acted upon a policy of the Government and will suffer detriment if the Government does not honour its agreement.

- (h) Do you agree with the Steering Committee View in Chapter 7, that the principles developed in Chapters 5 and 6 also apply to specific events, such as disaster relief, which give rise to obligations which government will satisfy in the future? If you disagree with this view, please identify the factor(s) that make disaster relief and similar specific events different from other benefits as considered in Chapters 5 and 6.**

The same rules will apply to disaster relief principles as other social policy obligations. A Government's commitment only arises when a disaster occurs and entitlement conditions are satisfied for payment during a particular payment period.

- (i) Do you agree with the majority view of the Steering Committee regarding old age pension obligations, the minority view or do you have another view?**

A majority of HoTARAC members support the “due and payable” approach to all categories of social benefits.

While HoTARAC strongly prefers the majority view it does see merit in governments including note disclosure outlining the Government's intention to continue to provide benefits.

- (j) **Do you agree with the Steering Committee View in Chapter 9 that the disclosure requirements in IPSAS 1 *Presentation of Financial Statements* and IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* should apply in respect of social benefits and that additional detailed disclosures of individual social benefits should not generally be required?**

If HoTARAC's majority preference for the "due and payable" approach is adopted, few social benefits would be recognised as liabilities. The disclosure requirements of IPSAS 1 and IPSAS 19 would be appropriate. HoTARAC does not believe that the disclosure of individual social benefits should be required.

HoTARAC also believes that note disclosure, outlining whether the Government intends to continue to provide benefits in accordance with its social policy obligations, may be useful to users of financial reports.

- (k) **Do you agree with the Steering Committee View in Chapter 9 that the PSC should explore the possibility of requiring disclosures about the overall sustainability of a government's social benefits including the assumption that higher level disclosures are more likely to meet users' needs?**

HoTARAC fully supports the PSC reviewing the framework for reporting information about the sustainability of government programs, but outside the general purpose financial report. This issue is also part of a wider issue regarding triple bottom line and sustainability reporting. This type of issue is not confined to government. For this reason, HoTARAC believes that the PSC should review this issue in conjunction with other IASB projects, including its project of "management discussion and analysis".

HoTARAC notes that the preparation of a separate statement as part of the budget is one way of addressing this issue. The Australian Government has been at the forefront of this issue by preparing, as part of the 2002-03 Budget, an intergenerational report looking at the sustainability of government spending for the next 40 years. This report will be produced every five years. Addressing the problem of Australia's aging population, the Australian Treasury this year released a Discussion Paper, "Australia's Demographic Changes."

HoTARAC further believes that the issues raised by the ITC suggest that the current conceptual framework may be deficient. HoTARAC believes that a separate conceptual framework for public sector reporting should be investigated. The current reports of Statement of Financial Performance (Operating Statement), Statement of Financial Position (Balance Sheet) and Statement of Cash Flows may not be sufficient to present the financial operations of the Government.

(I) Do you foresee any audit issues that might arise if “sustainability disclosures” were included in the financial statements?

There is an inherent difficulty in verifying prospective financial information. Auditors tend to limit the scope of their work when reporting on prospective information due to inherent uncertainties regarding the achievement of the projections.

Selected paragraphs of Australian Accounting Standard 31 *Financial Reporting by Governments*

12.1.2 Subject to paragraph 17.1, this Standard requires liabilities to be recognised in the statement of financial position, provided that they meet the recognition criteria set out in paragraph 12.1. Transactions or other events that do not give rise to a present obligation to sacrifice economic benefits to another entity in the future do not meet the definition of liabilities. The intention of a government to make payments to other parties, whether advised in the form of a budget policy, election promise or statement of intent, does not of itself create a present obligation that is binding on the government. A liability would be recognised only when the government 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 by the grant agreement. In such cases, only amounts outstanding in relation to current or previous periods satisfy the definition of liabilities.

12.1.3 Some transactions or events may give rise to legal, social, political or economic consequences that leave a government 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 must be recognised only when the amount of financial aid to be provided can be measured reliably.

View on Each Class of Obligation

Collective Goods and Services

HoTARAC agrees with the Steering Committee View on this issue. No liability should be recognised for collective goods and services to be provided in future periods. Expenses and liabilities should be recorded in accordance with current generally accepted practice, that is, the “due and payable” approach.

Individual Goods and Services

The Steering Committee View is the same as for collective goods and services and is supported by HoTARAC.

Cash transfers to individuals

For the reasons described above in relation to Option 1, the Steering Committee View is not supported by a majority of HoTARAC members. That is, adoption of this approach may result in a liability for social benefit payments that might arise in future reporting periods. This is not supported, because there may be discretion to avoid the sacrifice of future economic benefits.

Disaster Relief

HoTARAC believes the same rules should apply to disaster relief as other social policy obligations. A Government commitment only arises when the disaster occurs and a Government has made a commitment to make payments and the amount to be provided can be measured reliably.

Legal Aid

In Australia, the Australian Government provides funding to State legal aid commissions to fund legal advice for disadvantaged persons.

States and Territories do not show a liability for legal aid services to be provided in the future.

HoTARAC believes that there should not be any change to the current practice, and notes that this is in line with Example 8A of the ITC.

Old Age Pensions

A majority of HoTARAC members believe that old age pensions are part of the general operation of government. As such, they should be treated in the same way as other social benefits, that is, the “due and payable” approach.

HoTARAC's COMMENTS REGARDING IPSASB's PROJECT BRIEF LONG TERM FISCAL SUSTAINABILITY

HoTARAC is of the view that recognition, measurement and disclosure of social benefits in general purpose financial statements is problematic. It considers that information on government long-term fiscal sustainability would better meet report users needs. Thus, HoTARAC strongly supports this Project.

Significant issues identified are as follows:

- the Project scope should be broader. HoTARAC recommends that it should comprise all material government expenditure and receipts, not just social benefit programs. This would assist in revealing overall fiscal pressures, not only those related to social programs. For example, some collective goods and services, such as defence and education, may create financial pressure on a government that seeks to meet its social benefit commitments. Further, additional fiscal pressure may arise from environmental sustainability issues that a number of governments have commitments to address; environmental measures may impact on both on government receipts and expenditures; and
- only whole-of-government reporting would make sense, given that generally the matching of tax receipts and material expenditure would only be possible at that level. Reporting at the level of individual government entities would usually be inappropriate.

In HoTARAC's view, long-term fiscal sustainability information provides:

- enhancement of public sector accountability;
- evaluation of the extent to which future generations of taxpayers will be affected by the fiscal consequences of current policies for the delivery of goods and services;
- assessment of the extent to which service delivery can be maintained at existing levels;
- assessment of the extent to which governmental obligations to citizens under existing legal or policy frameworks can be met from predicted inflows over a pre-determined future period;
- improved government decision-making and development of sustainable and corrective policies; and
- appropriate comparison between governments. This will also assist supra-national bodies to assess government performance appropriately. For example, this analysis may identify that some governments currently perform well but at the expense of long-term sustainability.

As noted, several jurisdictions already publish this type of information. However, to ensure consistency, comparability, unbiased and independent information, the development of a standard/guidance by an international standard-setter such as IPSASB is a valuable initiative. HoTARAC considers that IPSASB is the most appropriate international standard-setting body to develop guidance on this

matter. However, HoTARAC believes it would be appropriate to develop the proposal in conjunction with statistical bodies. This is because:

- statistical bodies are also considering the disclosure of information, particularly about pension schemes. The International Monetary Fund, for example, has already published a “best practice” guide that may be useful to refer to; and
- this would enhance harmonisation between accounting and statistical systems.

We concur with IPSASB that this type of report does not directly link to accrual/traditional financial statements, and fills a significant information “gap” for governmental financial reporting, which cannot be fulfilled by accrual financial statements.

Subject to the initial comments above, HoTARAC supports the scope of the Project.