



Accounting Standards Board

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Per e-mail

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Dear John

COMMENTS ON ED 63 SOCIAL BENEFITS

We welcome the opportunity to comment on the proposed IPSAS on *Social Benefits*.

The views expressed in this letter are those of the Secretariat and not the Accounting Standards Board (Board). In formulating its comments, the Secretariat consulted with a range of stakeholders including auditors, preparers, professional bodies, and entities in the public sector whose operations are similar to those of insurers.

While we are supportive of the development of guidance on social benefits, we wish to express our concerns on the following issues:

- Obligating event approach – we do not support this approach as we believe it does not provide relevant information to the users of the financial statements about an entity's obligations to provide social benefits.
- Applying the definition of social benefits – a range of issues has been identified in the application of the definition, including how the definition of social risks is applied.
- The definition of universally accessible services – we question the need for this definition, in particular whether a distinction between universally accessible services and collective goods and services is needed.

Our detailed responses to the specific matters for comment and preliminary views are outlined in Annexure A to this letter. Other matters are outlined in Annexure B.

Board Members: Ms T Coetzer (Chair), Mr B Colyvas, Ms I Lubbe, Mr M Kunene, Mr K Makwetu,
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Please feel free to contact me should you have any queries relating to this letter.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Poggiolini', written in a cursive style.

Jeanine Poggiolini

Technical Director

ANNEXURE A – RESPONSES TO SPECIFIC MATTERS FOR COMMENTS

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?

Scope

While we agree with the scope in principle, we have the following comments.

Representing a complete view of social benefits provided

One of the stated objectives of the project is to ensure that users of the financial statements have information to assess the impact of social benefits on an entity's statement of financial position, performance and cash flows.

At present, certain social benefits are dealt with in other Standards, for example, concessionary loans are dealt with in the IPSASs on financial instruments. Considering that, for example, concessionary loans could meet the definition of a social benefit, it is questionable whether excluding these types of benefits from the scope of ED 63 altogether achieves the stated objectives. As there is currently no specific identification or disclosure of "social benefits" in the IPSASs on financial instruments, we are of the view that an incomplete picture of a scheme will be provided to users. A South African specific example is used to illustrate the point:

The government operates a housing scheme where new houses will be provided to qualifying beneficiaries. Depending on the beneficiary's level of income, a house will be provided either entirely free to the beneficiary, or the beneficiary will be granted a subsidised loan to finance the construction of the house. Where the house is granted for free, it will be a social benefit, but where the beneficiary is required to finance the acquisition through a subsidised loan, this will be dealt with in IPSAS 29 *Financial Instruments: Recognition and Measurement*.

We believe that separating the recognition, measurement and disclosure in this way does not provide users of the financial statements with a holistic view of the social benefit scheme. We believe that the IPSASB should reconsider whether the proposed exclusion of certain social benefits from the scope of ED 63 is appropriate and provides a complete picture of the social benefits provided by an entity. At a minimum, entities should be required to comply with the disclosure requirements of ED 63 when social benefits are accounted for in another Standard such as the IPSASs on financial instruments.

Exclusion of insurance contracts from the scope

Paragraph 5(c) of ED 63 indicates that the Standard does not apply to insurance contracts within the scope of the relevant international or national accounting standard on insurance contracts.

It is unclear whether this scope exclusion refers to those contracts within the scope of IFRS 4 or IFRS 17. Explicit mention is made later in ED 63 that the insurance approach refers specifically to IFRS 17. It may be useful to indicate the IPSASB's intention regarding references to international or national standards regarding the scope of the Standard.

It is also unclear whether paragraph 5(c) refers to insurance contracts generally, or whether this relates to those schemes accounted for using the insurance approach outlined in paragraphs 7 to 12. It may be appropriate to include two scope exclusions regarding insurance, i.e. one for pure insurance contracts,

and one indicating that where the insurance approach is applied, only certain parts of ED 63 are relevant.

Exclusion of universally accessible services

We are generally supportive of the idea that benefits that do not meet the definition of a social benefit are excluded from the scope of ED 63. We however have concerns about whether the definition of universally accessible services is needed. In particular, we do not see much distinction between universally accessible services and collective goods and services as these can both be seen as general, ongoing activities of government. We believe that a more general term is needed to reflect the notion that the ongoing activities of government are not social benefits and are therefore excluded from the scope of ED 63.

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?

Social benefits

We support the definition of social benefits, but note concerns on how it may be interpreted and applied in practice given potential issues with the definition of a social risk. If the current definition of universally accessible services is retained, stakeholders indicated that a flow chart may be helpful to guide decisions about the classification of benefits.

General issues

We suggest including explanatory commentary to the definition explaining the position where an intermediary is used to provide social benefits. For example, if a department uses an agency (an entity) to pay social grants to individuals, if an entity had to read the definition as drafted, these benefits may be seen as not meeting the definition of a social benefit as the initial payment is made to an intermediary which is an entity. The actual position is that the intermediary is an agent between the department and the beneficiary rather than a beneficiary of the social benefit.

Addressing the needs of society as a whole

Some stakeholders indicated that the concept of “addressing the needs of the society as a whole” is difficult to understand. If the intention of this aspect of the definition is to distinguish insurance contracts that can be taken out by individuals to cover their specific risks with a defined level of benefits, then we believe AG5 is unhelpful and should be deleted.

Social risks

Concern was expressed amongst our stakeholders about the interpretation of social risks and the impact this has on distinguishing social benefits from universally accessible services. This is particularly the case where a universally accessible service has eligibility criteria but these are not linked to a social risk. Questions were raised about, for example, the risks that arise from a natural disaster. Many of our stakeholders argued that, while the event arises from a geographic risk, the effect of the event gives rise to risks to an individual or household as unemployment or poverty may result from such an event.

A recurring theme of the application issues raised by stakeholders was identifying whether the event that gives rise to the risk is external or internal to an individual’s or household’s circumstances. We believe the reference to an event should be deleted as it creates unnecessary focus on a particular event rather than assessing whether a particular circumstance affects an individual’s or a household’s

welfare. It is suggested that the term “event” is deleted from the definition of a social risk so that the definition reads: “Social risks are ~~events~~ or circumstances...”

We also believe that the reference to disaster relief and that it is always a universally accessible service should be deleted or modified. While we agree that general disaster relief would be a universally accessible service, we believe that if specific benefits are provided to individuals or households who meet certain criteria then this is a social benefit, e.g. rebuilding of homes.

If the reference to an event is retained, we believe it may be useful to provide guidance indicating that if the risk does not arise internally from an individual or a household but arises from external factors, then this may be a key distinction between a social benefit and a universally accessible service.

Universally accessible services

As noted in our response to specific matter for comment 1, we have reservations about the need for a definition of universally accessible services. We have two overarching concerns:

- (a) We do not see a clear reason to define universally accessible services when they are similar to collective goods and services (we appreciate that there is a more direct relationship between a beneficiary and government for universally accessible services than collective goods and services). Both types of benefits can be viewed as the ongoing activities of government, and as a result, one term can be found to deal with these types of benefits instead of two. We also currently do not see a difference in the accounting for universally accessible services and collective goods and services. We also note that this distinction is not needed for statistical reporting.
- (b) In applying the definition, as drafted, it is difficult to understand the difference between universally accessible services and social benefits. This for the most part is due to uncertainty about how the definition of social risk should be applied. This was discussed above.

Applying the definition of universally accessible services

It may not be clear in practice how to determine (a) when a benefit is a universally accessible service with eligibility criteria but those eligibility criteria are not linked to a social risk (this is discussed in the comments to specific matter for comment 2), and (b) whether a scheme is a social benefit or a universally accessible service if it includes eligibility criteria for some benefits and not for others.

In response to (b) above, there are schemes locally that include both social benefits and universally accessible services. For example, local authorities provide a certain amount of free water to all residents within their area of responsibility (as is outlined in the Constitution of the Republic of South Africa), and thereafter free or subsidised water is provided to residents who meet certain eligibility criteria based on their income. The Secretariat deems the “free” component to be a universally accessible service, while any benefit provided thereafter is a social benefit as certain criteria need to be met which arise from social risk (i.e. poverty, unemployment, etc.).

It is unclear from ED 63 how such schemes should be treated. Should an entity:

- Separate the individual components and account for them separately?
- Decide, in substance, whether the scheme is a social benefit or a universally accessible service and apply the appropriate IPSAS to the scheme as a whole?

Guidance on how to deal with these situations would be helpful to preparers.

Changes between classification of benefits as social benefits or universally accessible services

Further to the discussion above, stakeholders indicated that, because of certain circumstances, it may be necessary to reclassify certain benefits from social benefits to universally accessible services, and that guidance may be needed on how to deal with such situations. The example below provides context:

One of our provinces is experiencing a severe drought. Municipalities would provide a level of free water to all, and thereafter subsidised or free water to qualifying residents. As severe water restrictions have been implemented, only a minimal amount of water is provided to each resident, and no eligibility criteria need to be met to receive the allocation of water. As a result, the benefit may have changed from a social benefit to a universally accessible service.

Guidance in ED 63 on when reclassifications may occur and how they should be dealt with from an accounting perspective would be helpful.

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?

Mandatory or optional application of the insurance approach

Entities indicated that, if an entity meets specified criteria, then it should be mandatory for them to apply the insurance approach as this provides relevant information in the financial statements about an entity's social benefit schemes. Applying the obligating event approach when the substance of a scheme is that of insurance, is inappropriate.

Mandatory application will also ensure comparability across similar entities.

Entities indicated that a public sector specific standard, based on IFRS 17, should be developed, or alternatively specific guidance provided on how certain principles should be applied in the public sector, e.g. guidance on estimating revenue, how (or if) to recognise a contractual service margin, and how to deal with transaction costs and what they might represent in the public sector.

Entities noted that specific skills would be required to undertake the valuations in IFRS 17. They noted that these skills may not reside in government, will take some time to develop, and will have cost implications.

Criteria

Issues with current criteria

The criteria in paragraph AG15 seem to focus on the structure of the entity when they should focus on the characteristics of the underlying scheme, as well as the contributions and benefits provided. For

example, indicating that the scheme may be a separate entity or that it may have ring-fenced funding/investments, are not characteristics that are unique to insurers and are therefore unhelpful.

Paragraph AG15(c) indicates that an entity should consider if the legislation that establishes the social benefit give enforceable rights to participants in the event that the social risk occurs. There are two aspects that require further consideration in assessing whether the scheme “looks and feels” like an insurance-like scheme, i.e.:

- While the legislation may give rise to the same rights available to participants in social benefit schemes as insurance schemes, legal enforceability may be stronger in a contract than through legislative means. A beneficiary may need to institute legal action to enforce entitlement to benefits.
- The criterion explains the position in relation to the rights of the participants rather than the position of the entity providing the benefits. Public sector entities are often required to provide benefits irrespective of whether the contribution is received from (or on behalf of) the beneficiary. In a private sector context if a premium is not received it is likely that the coverage, and thus any benefits, would lapse. While the entity would have specific enforcement mechanisms that it could follow to receive payment of the contribution, benefits will still be provided regardless of the receipt of any contributions.

Proposal

We believe that the criteria should focus on the following in developing criteria for the application of the insurance approach:

- (a) Whether there is an arrangement that confers the rights and obligations on parties similar to that of an insurance contract.
- (b) The scheme is intended to be fully funded by contributions, which means:
 - (i) Legislation or equivalent indicates that the scheme should be funded from contributions or levies paid by or on behalf of beneficiaries.
 - (ii) Contribution and/or benefit levels are regularly reviewed and adjusted to ensure the scheme is fully funded.

Application of IFRS 17

While we believe the application of IFRS 17 is appropriate, we do believe that guidance is needed on how to apply IFRS 17 for the types of schemes that are similar to insurance in the public sector.

Additional disclosures required in ED 63

We support the additional disclosures as this will ensure that users have relevant information about the terms of the scheme, as well as why the application of the insurance approach is 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?

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

Obligating event approach

No support for obligating event approach

The obligating event approach as outlined in ED 63 is not supported.

We believe that applying this approach would not result in relevant information to users about government's obligations to provide social benefits. We believe that under this approach the obligations of government would be grossly understated and may in fact have unintended consequences. Where, for example, an entity has investments set aside to fund the benefits provided, a skewed balance sheet position would be presented if the obligating event approach is applied. Where assets exceed the liabilities, beneficiaries and others may come to the conclusion that the contributions are excessive for the current obligations.

In discussing the approach with stakeholders, concerns were expressed about the potential administrative burden that may be imposed by the approach. The explicit satisfaction of criteria would mean that entities need to verify on an ongoing (sometimes on monthly) basis, that all beneficiaries satisfy the criteria. If the criteria have not been satisfied, then no obligation would be recognised. This explicit satisfaction/verification of eligibility criteria is neither practical, nor cost efficient. It is unclear whether this was intended in the approach.

It was also unclear how the approach would be applied in certain instances. For example, municipalities provide schemes where low income earners receive free or subsidised services on a monthly basis. These individuals are required to validate their eligibility to receive these services every three years. We were unsure in these instances which recognition criterion take precedence – the satisfaction of the eligibility criteria, in which case the benefit (and obligation) is for three years; or the explicit criterion of being alive to receive the next benefit, in which case the benefit (and obligation) is for one month.

We believe that the approach introduces a rule that “being alive” is an explicit criterion necessary for the recognition of a liability. For many, if not all schemes locally, verifying that a beneficiary is still alive is an administrative issue rather than being the past event that gives rise to an obligation for the entity.

Support for alternative view

We support the alternative view, in particular that:

- The past event should be identified for each scheme based on its economic characteristics, i.e. a single rule cannot be applied to all schemes. The recognition of an obligation should provide relevant information to users of the financial statements in a way that faithfully represents the economic characteristics of the scheme.
- “Being alive” affects the measurement of a liability rather than the recognition of a liability.

We suggest that the approach be revised along with the following lines:

- The past event is the satisfaction of eligibility criteria, as well as estimating who may be eligible to receive the benefit. Being alive after initial satisfaction of the eligibility criteria is a measurement and not a recognition issue.
- The liability is measured using the period over which the benefits are expected to be provided, and being alive affects measurement.
- The liability should be discounted at a risk free rate.
- The liability should be separated between a current and non-current portion, as this would help budget officials to separate the immediate funding requirements from the longer term obligation.

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 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?

Characteristics of the entity's social benefit schemes

We believe the information will be useful to users of the financial statements.

Disclosure of the amounts in the financial statements

We believe the information will be useful to users of the financial statements. We do however have concerns about the total expense being presented. It is unclear whether the intention is for this total expense line to be labelled "social benefits".

If yes, we are concerned that for in-kind benefits provided, this would:

Require reclassification of goods and services purchased into this line item. This could create an administrative burden, and if the re-allocation is not done correctly, could result in the double counting of expenses.

Potentially be inconsistent with a classification of expenses based on their nature as outlined in IPSAS 1 *Presentation of Financial Statements*.

Disclosure of future cash flows

While we can understand that there is merit in disclosing this information, the five year period is arbitrary. If the obligating event approach is retained, we suggest that the cash flows disclosed should be based on the period over which benefits will be provided in the scheme, e.g. if the scheme indicates that benefits will be provided for 20 years, then 20 year cash flows should be disclosed (segregated into appropriate periods). If there is no period specified, then the 5 year period may be appropriate.

It is also unclear why the cash flows are presented on an undiscounted basis and whether/how this helps achieve the overall objectives of the project.

Specific matter for comment 6

The IPSASB 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 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 is additional information.

In finalising ED 63, the IPSASB discussed the merits of developing mandatory requirements for reporting on the long term 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 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 limited in 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 sustainability reports provide.

Long term sustainability reports will improve accountability and will help support Integrated Reporting <IR> in the public sector. They will also provide useful information to 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, 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?

The preparation of a report on the long-term sustainability of an entity's finances requires a well-developed, sophisticated planning and budgeting process, and officials that are skilled in complex financial modelling. As a result, many governments, including our own, do not formally prepare a report as envisaged in RPG 1.

While there is an acknowledgement that a report of this nature is useful, there is no support locally for the IPSASB to make RPG 1 mandatory. The main concern noted was that, if RPG 1 is made mandatory, the report on long term fiscal sustainability would be required for an entity to assert in its financial statements that it has complied with IPSAS. We do not believe that the preparation of a report on the long term sustainability of an entity's finances should affect the preparation of the financial statements as the reports are intended to achieve different objectives. The financial statements aim to provide information about transactions and events that have occurred using specific recognition and measurement principles, while the sustainability report focuses on prospective information prepared using a different basis to the financial statements.

Stakeholders suggested allowing each jurisdiction to decide how to make the RPG mandatory and to which entities it should apply.

Given that South Africa does not apply RPG 1 at present, there are no issues that have been identified for further consideration by the IPSASB.

Annexure B – Other matters

Insurance approach

Effective date and insurance approach

IFRS 17 is effective for financial years commencing on or after 1 January 2021. Although there is no specific effective date outlined in ED 63, we are aware of the IPSASB's practice of making IPSASs effective approximately 18 months after their approval. We urge the IPSASB to consider the effective date of ED 63 in relation to the application of the insurance approach. We do not believe that the public sector should be applying IFRS 17 before the private sector given its complexity and the time needed to collect data, build appropriate models etc.

Universally accessible services and insurance approach

In applying the definitions in ED 63, we identified schemes that meet the definition of universally accessible services, but would also potentially qualify to apply the insurance approach. While the status and outcomes of the non-exchange expenses project is unclear at present, we urge the IPSASB to consider whether any guidance is needed on applying the insurance approach for schemes that are outside the scope of ED 63.

Obligating event approach

Initial measurement

ED 63 provides guidance to measure the best estimate of the amounts required to settle the social benefit liability. We question the intention of paragraphs 21 and 22.

Paragraph 21 indicates: "An entity's best estimate of the costs that the entity will incur in fulfilling the present obligations represented by the liability take into account the possible effect of subsequent events on the level of benefits to be provided."

It is unclear what subsequent events are being referred to, and how they should be considered in the estimate of the liability.

Paragraph 22 indicates: "When the liability in respect of a social benefit scheme is not expected to be settled wholly before twelve months after the end of the reporting period in which the liability is recognized, the liability shall be discounted using the discount rate specified in paragraph 27." [own emphasis added]

As currently drafted, ED 63 only seems to require discounting if the entire liability is settled after 12 months after the end of the reporting period. It is unclear whether this is intentional, or if an entity should separate the liability into a current and non-current component. Guidance on this issue would be helpful.

Subsequent measurement

Paragraph 24 indicates: "The liability for a social benefit scheme shall be reduced as social benefits are provided. Any difference between the cost of providing social benefits and the carrying amount of the liability in respect of the social benefit scheme is recognized in surplus or deficit, in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*."

In reading this paragraph, it seems to imply that an entity should calculate the cost of providing social benefits, and compare these costs to the carrying amount of the liability. Calculating the cost of the social benefit seems onerous, particularly as it is unclear whether this is done in total, for individual beneficiaries, groups of beneficiaries, etc. It may be clearer to indicate that the liability should be

determined at each reporting date and compared with that already recognised and any difference recognised in the statement of financial performance using IPSAS 3.

We are concerned that ED 63 seems to indicate that a market rate should be used to discount social benefit obligations, i.e. by referring to a financial instrument with the same term and currency. We believe a risk free rate is more appropriate.