Recognition and Measurement of Social Benefits (ED 132)

ITC on the IPSASB’s Consultation Paper

Accounting Standards Board

Disclaimer

The views and opinions expressed in this presentation are those of the individual. Official positions of the ASB on accounting matters are determined only after extensive due process and deliberation.

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- Proposed accounting for social benefits

Background and purpose

Background & purpose

- Social benefits
  - benefits payable to individuals & households, in cash or in-kind to mitigate effect of social risks
- Social risks
  - events/circumstances
  - adversely affecting welfare by imposing additional demands on household’s resources or reducing income
  - e.g. unemployment, disability, healthcare, education, etc.

Background & purpose

- Significant portion of public sector expenditure used to provide social benefits
- Potential to result in large liabilities recognised in entity’s F/S
- Important to account for and report on for decision-making
- No guidance in IPSASs or GRAP
- Need to develop guidance

Background & purpose

- IPSASB issued CP on *Recognition & Measurement of Social Benefits*
- Concurrent ED 132 issued
  - IPSASs used to develop Standards of GRAP
  - assess impact of proposals locally
- Comment deadline 20 January 2016
- Feedback used in drafting comment letter to IPSASB

Scope and definitions

Scope

- Scope inclusion
  - benefits meeting definition of social benefits
- Scope exclusion
  - other transfers in-kind and collective goods/services
  - social benefits in other Standards
    - employee related benefits (IPSAS 25)
    - some concessionary loans (IPSAS 29)
    - guarantees (IPSAS 19, IPSAS 29)
    - benefits provided by entities outside public sector

Scope

Inside Scope

Social Assistance

- Social Benefits in Cash
- Social Benefits in Kind

Social Security

- Social Benefits in Cash
- Social Benefits in Kind

Outside Scope

Employ-ment Related Social Insurance

- Parts of IPSAS 25 e.g. post employment benefits

Other Transfers In Kind

- Non-Exchange Expenses Project

Collective Goods and Services

- Non-Exchange Expenses Project

Definitions

- Social benefits
  - benefits payable to individuals & households,
  - in cash or in-kind,
  - to mitigate effect of social risks
- Social risks
  - events/circumstances
  - that may adversely affect welfare of individuals & households
  - by imposing additional demands on their resources or reducing income
  - e.g. unemployment, disability, healthcare, education, etc.

Definitions

- Social benefits are paid to mitigate social risks when households receive benefits
  - on meeting eligibility criteria from a social risk without making contributions
  - when a specified social risk occurs and contributions are made
  - by making contributions to a scheme to accumulate future entitlements to benefits, with benefits being paid on occurrence of specified social risk

Definitions

- Social benefits in cash
  - social benefits paid in cash
  - individuals & households use cash indistinguishably from other income sources
  - does not include reimbursements
- Social benefits in kind
  - goods and services provided as social benefits to individuals & households
  - by or on behalf of another public sector entity, and
  - all reimbursements for the costs incurred by individuals & households in obtaining such goods and services

Definitions

- Reimbursements
  - social benefits paid in cash by a public sector entity
  - to compensate a service provider or individual or household
  - for all or part of the expense incurred or to be incurred
  - by that individual or household in accessing specific services

Definitions

- Social insurance programmes
  - provides social benefits where benefits are conditional on participation in programme
  - actual or imputed contributions made by or on behalf of recipient
  - programmes may
    - form part of employer-employee relationship (employment related social insurance), or
    - arise outside employer-employee relationship (social security)

Definitions

- Social security programmes
  - social insurance programmes arising outside employer-employee relationship and
  - provides benefits to community as a whole, or large sections of the community
  - programmes imposed and controlled by government entity
- Social assistance programmes
  - programmes providing social benefits to all persons who are in need
  - without any formal requirement to participate as evidenced by payment of contributions

SMC 1

(a) Is the scope of this CP (i.e. excluding other transfers in kind, collective goods and services, and transactions covered in other IPSASs) appropriate?

(b) Are the definitions an appropriate basis for an IPSAS on social benefits?

Please explain reasons for your views.

Proposed accounting for social benefits

Proposed accounting

IPSASB considered three approaches to account for social benefits

- Option 1 : The obligating event approach
- Option 2 : The social contract approach
- Option 3 : The insurance approach

Option 1: The obligating event approach

Accounting for Obligating Event Approach

Recognition

Obligating event approach

- Considers reference to definition of a liability in Conceptual Framework
- Liability
  - present obligation of the entity for an outflow of resources that results from a past event
- Present obligation
  - legally binding obligation (legal obligation) or non-legally binding
  - entity has little or no realistic alternative to avoid
- Obligating event
  - event that creates a present obligation

Obligating event approach

When does an obligating event arise?

- Legally binding obligations
  - point at which individual or household could take legal action to enforce settlement of their entitled benefit
- Non-legally binding obligations
  - an indication to others that entity will accept certain responsibilities
  - creation of a valid expectation
  - little or no realistic alternative to avoid an outflow of resources
  - consider cumulatively & apply judgement

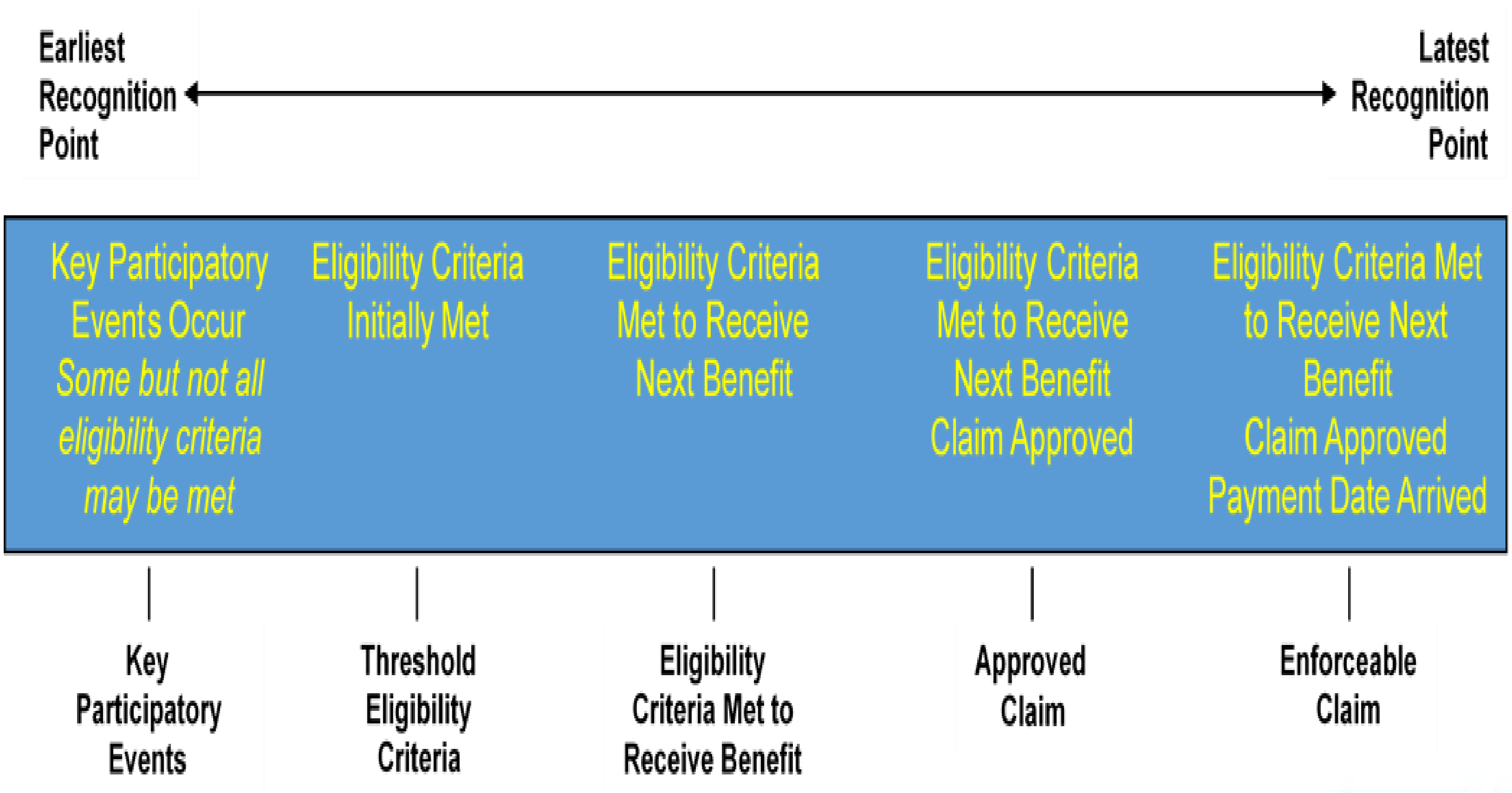
Obligating event approach

Obligating events could arise at the following points:

1. Key Participatory Events
2. Threshold Eligibility Criteria
3. Claim
4. Approved Claim
5. Enforceable Claim

Obligating event approach

- Points in the social benefit process



Key Participatory Events

Key Participatory Events

- Liability occurs when
  - individual has reasonable expectation of satisfying eligibility criteria for a benefit, and
  - has relied on that expectation over a period of time
  - leaving govt with no realistic alternative but to settle obligation in future
- Occurs before individual meets threshold eligibility criteria (where applicable)
- Not required to satisfy eligibility criteria again in future periods

Threshold Eligibility Criteria

Threshold eligibility criteria

- Occurs after key participatory event
- Eligibility criteria
  - specifies criteria to assess if beneficiary entitled to social benefit
- Liability when threshold eligibility criteria first met
  - e.g. reaches pensionable age or unemployed
- Future benefits recognised as liability on meeting initial eligibility criteria
  - assessment of recipient’s longevity for measurement purposes

Claim on an entity's resources exists

Claim on resource

- Liability recognised when eligibility (incl revalidation) criteria met
  - but only until next social benefit provided
  - beneficiary must meet eligibility criteria again
- Validation
  - process performed by entity to assess if beneficiary eligible to receive benefit
  - based on information provided by, or on behalf of beneficiary
  - could be periodic
- Benefits applied for do not require approval

Approved claim on an entity's resources exists

Approved claims

- Liability recognised when eligibility (incl revalidation) criteria met and claim approved
  - until next approval of claim
  - beneficiary must meet eligibility criteria again
- Validation
  - process performed by entity to assess if beneficiary eligible to receive benefit
  - based on information provided by, or on behalf of beneficiary
- Approved claim does not require claim to be enforceable

Enforceable claim on an entity's resources exists

Enforceable claims

- Liability recognised when eligibility (incl revalidation) criteria <u>met</u>, claim <u>approved</u> and <u>enforceable</u>
  - until next payment date
  - beneficiary must meet eligibility criteria again
- Enforceability
  - requires legal obligation to exist and payment date to have arrived

SMC 4

At what point should a future IPSAS specify that an obligating event arises under the obligating event approach? Is this when?

(a) Key participatory events have occurred;

(b) Threshold eligibility criteria have been satisfied;

(c) An approved claim on an entity's resources exists;

(d) An enforceable claim on entity's resources exists; or

(e) At some other point.

Contributory schemes

- Some view that obligating event is sooner as expectation that benefits will be received are stronger
  - payment of contributions into a fund
  - communication of personal details of estimated future benefits
  - unrealistic for govt to avoid paying benefits, even if in future
- Some view that existence of obligation should not depend by its funding
- Some view it to be quasi-exchange transactions & accounting for in IPSAS 25

SMC 5

Does an obligating event occur earlier for contributory programmes than non-contributory programmes under the obligating event approach?

Social benefits from exchange transactions

- CP includes social benefits from exchange transactions, excludes employee benefits
- Employee benefits covered in IPSAS 25
- Are there other social benefits arising from exchange transactions?
  - e.g. compulsory accident insurance (often subsidised by govt hence non-exchange)
- Social benefits from non-exchange transactions excluded from IPSAS 19

SMC 6

Should a social benefit provided through an exchange transaction be accounted for:

(a) In accordance with a future IPSAS on social benefits; or

(b) In accordance with other IPSASs?

Please provide examples you may have of social benefits arising from exchange transactions.

Measurement

Measurement

- Historical cost
- Market value
- Cost of release
  - amount third party charges to accept liability
- Assumption price
  - amount entity willing to accept in exchange for assuming an existing liability
- Cost of fulfilment
  - cost to fulfil obligations in least costly manner
  - preferred approach in CP

Measurement

- Cost of fulfilment may
  - depend on uncertain future events, all possible outcomes estimated
  - be for extended period, discount cash flows
- Guidance provided in IPSAS 29 and IPSAS 19
- Contributory social programmes
  - may be appropriate to consider IPSAS 25
  - account for programme assets and liabilities
  - provide useful information
  - should it be gross or net?

Measurement

- IPSAS 25
  - assets and liabilities shown gross
  - measured separately using different discount rates
- IAS 19
  - net liability or net asset shown
  - net amount using single discount rate
  - if net liability, interest expense reported
  - if net asset, interest income reported

SMC 7

Under the obligating event approach, when should programme assets be included in the presentation of a social benefit programme

(a) In all cases;

(b) For contributory programmes;

(c) Never; or

(d) Another approach, please specify?

Should assets an liabilities be reported net (IAS 19 approach) or gross (IPSAS 25 approach)?

Option 2: Social Contract Approach

Accounting for Social Contract Approach

Recognition

Recognition

- Executory contract approach
  - contracts under which neither party has performed any of its obligations, or
  - both parties have partially performed their obligations to an equal extent
- Identifying counterparties
  - entity and individual; or
  - entity and society as a whole?
- Identifying obligations for each party
  - what obligations are to be performed by each party?

Identifying parties

- One party is entity, other party difficult to identify as no contract entered into
- Individual?
  - recipient may not contribute taxes
  - recipient may live outside jurisdiction of public sector entity
- Society as a whole?
  - individuals and households both net recipients and net contributors at different stages in life
  - i.e. children & retirement age are net recipients, working age are net contributors

Identifying obligations

- Obligation of other party (society as a whole) to pay taxes and other sources of finance
  - cannot be linked to carrying out of activities that enable an entity to achieve its objectives
  - payment of tax independent of entity providing social benefits
- Obligation of entity to provide benefits
  - enforceable/(approved) claim exists

Recognition

- Entity provides benefits to society as a whole & society as a whole pays taxes
- Executory contract approach
  - measures net asset and net liability at zero, unless contract onerous
- Entity recognises liability
  - enforceable/(approved) claim exists
  - acceptance of enforceable/(approved) claim forms part of entity’s performance of its obligation

Measurement

Measurement

- Cost of fulfilment
- Guidance provided in IPSAS 25 and IPSAS 19

SMC 8

Under the social contract approach, should a public sector entity:

(a) Recognise an obligation in respect of social benefits at the point in time at which:

  (i) A claim becomes enforceable; or

  (ii) A claim is approved?

(b) Measure the liability at the cost of fulfilment?

Option 3: Insurance Approach

Scope

Insurance accounting

- Currently no IPSASs on insurance accounting
- IFRS 4 *Insurance Contracts*
  - interim standard
  - does not provide appropriate basis for accounting for social benefits
  - developing replacement, Exposure Draft ED/2013/7

Insurance accounting

Key principles in ED/2013/7

- Recognition, earlier of:
  - beginning of coverage period (i.e. period entity provides coverage for insured events), or
  - date on which the first payment due from policyholder

Insurance accounting

Key principles in ED/2013/7

- Measurement
  - current estimate of future c/f (includes expected contract profit)
  - c/f includes premiums receivable & claims/benefits payable
  - liability discounted (timing, uncertainty risk)
  - unwinding of discounting in later periods
    - recognition of interest revenue and/or expense
  - expected profit recognised as revenue over contract period or another systematic basis

Insurance accounting

- Insurance approach
  - highlights whether contributions are sufficient to finance liabilities
- Contributions
  - unfunded social programmes outside scope
- Different forms of contributions
  a) Contributions in kind;
  b) Imputed contributions; and
  c) Contributions treated as general tax

Insurance accounting

- Contributions in kind
  - participant provides services on behalf of govt in exchange to receive similar services in future
  - IPSASB view to exclude from insurance accounting as approach cannot be based on net cash flows

Insurance accounting

- Imputed contributions
  - e.g. individual unemployed and receives benefits, but not making any contributions
  - if all contributions imputed, there would be no contributions received
  - insurance approach useful only if significant cash contributions are in addition to imputed contributions

Insurance accounting

- Contributions treated as general tax
  - only applicable if tax can be appropriately allocated to specific program
  - otherwise, useful information not provided
  - unable to assess if contributions sufficient to cover liabilities

Subsidised programmes

- Will insurance approach fairly present info for subsidised programmes?
- Deficit (net liability) will be met through future tax
- Offsetting asset be recognised?
  - right to future tax will finance liability

Conclusion on scope

- Insurance approach not useful for programmes
  - involving contributions in kind
  - high level of imputed contributions not involving cash transfers
  - contributions cannot reliably be allocated to individual programmes

Conclusion on scope

- Insurance approach may be useful for programmes
  - imputed contributions involve a cash transfer
  - low level of imputed contributions not involving a cash transfer
  - where contributions treated as general tax can be reliably allocated to individual programmes

Accounting for Insurance Approach

Recognition

General requirements

- Recognition at earlier of
  - the beginning of coverage period, or
  - date when first contribution due
- Individual level or aggregated level

Unsubsidised programmes

- Expected surplus or deficit from programme in Statement of Financial Position
- Surplus
  - recognised in surplus or deficit over coverage of programme
- Deficit
  - recognised as expense on initial recognition

SMC 9

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

SMC 10

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

(a) Any expected surplus should be recognised over the coverage period of the programme; and

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

Subsidised programmes

Accounting for deficit

a) recognise immediately (similar to unsubsidised), or
b) recognise over coverage period, or
c) adjust obligation for planned subsidy
    i. planned subsidy to be received from another public sector entity (indirect contribution), or
    ii. irrespective whether planned subsidy to be received from another entity or from future tax
        – future tax revenues recognised as asset
        – departure from current practice
        – not consistent with Conceptual Framework

SMC 11

Under the insurance approach, what is the appropriate accounting treatment under the insurance approach for the expected deficit of a social security programme that is not designed to be fully funded from contributions:

a) Recognise an expense on initial recognition;

b) Recognise the deficit as an expense over the coverage period of the programme;

SMC 11

c) Offset the planned subsidy and the liability only where this is to be received as a transfer from another public sector entity;

d) Offset the planned subsidy and the liability irrespective of whether this is to be received as a transfer from another public sector entity or as an earmarked portion of general tax; or

e) Another approach?

Measurement

Risk adjustment

- IASB approach requires risk adjustment in estimating future c/f
- If risk adj applied, use assumption price
  - amount entity willing to accept in exchange for assuming an existing liability
  - caters for significant risks associated with estimated c/f
- If risk adj not applied, use cost of fulfilment
  - cost to fulfil obligations in least costly manner (best estimate of cost expected to be incurred)

SMC 12

Under the insurance approach, should an entity use the cost of fulfilment measurement basis or the assumption price measurement basis for measuring liabilities?

Coverage period

- IASB requires future c/f to be estimated over coverage period
- Coverage period ends at point
  - entity can assess the risks associated with policy holder, and
  - can set a price that reflects those risks
- Policy holder has ability to seek alternative insurer at this point
- Coverage period ends at this point
  - coverage beyond this point is a new agreement

Coverage period

- End of coverage period difficult to identify if contributions do not represent individual risks
  - influenced by other factors, e.g. govt policy
- Social security programme providing retirement benefits
  - long coverage period (e.g. 50 yrs contribution, 20 yrs benefit payments)

Coverage period

- Social security programme providing unemployment benefits
  - contributions mandatory during employment, benefits paid during unemployment
  - in some cases, period over which benefits paid, and amount of benefits, dependent on amount of contributions during a qualifying period
    - e.g. benefits payable depending on amount of contributions in previous 52 weeks

Nature of contribution

- What if contributions payable are not directly linked benefits receivable for
  - Social insurance programme; and
  - Social security programmes?

Nature of contribution

Social insurance programme examples

- Contributions paid through a levy rather than by or on behalf of identifiable individuals
  - e.g. accident insurance benefit through a levy on future fuel sales
- Contributions paid by those creating the risk and not by individuals
  - e.g. accident insurance scheme where benefits paid to employees/public but contributions paid by employers

Nature of contribution

Social security programme example

- Contributions paid by participants but benefits also provided to non-participants
  - e.g. accident insurance scheme financed by mandatory contributions, also provides coverage to tourists
- Insurance approach only relevant & faithfully representative if clear link between
  - benefit paid & revenue financing programme (contributions)

Nature of contribution

Contributions paid through/(by)

- fuel levy – linked if levy related to accident insurance only
- employers – linked by risk covered by programme rather than individuals
- participants providing benefits to non-participants - linked if substance of programme is social insurance programme
  - as proportion of benefits paid to non-participants increases, less likely substance is social insurance programme

SMC 13

Do you agree that, in those cases that where the link between contributions and benefits is not straightforward, the criteria for determining whether the insurance approach is appropriate are:

- The substance of the programme is that of a social insurance programme; and
- There is a clear link between the benefits paid by a social security programme and the revenue that finances the programme.

If you disagree, please specify the criteria that you consider should be used.

Discount rate

- IASB rate considers timing, risk, currency and liquidity
- IPSAS 25 rate considers timing, not risk
  - actuarial, investment and entity specific risk
- IPSASB prefer rate used in IPSAS 25
  - statistical reporting - same rates to account for employee benefits & social benefits
  - IPSAS 25 - guidance in estimating rate
    - when no market in govt bonds or corporate bonds with long maturity to match estimated maturity of benefit payments exists
    - where market yields at reporting date on govt bonds does not reflect time value of money

SMC 14

Do you support the proposal that, under the insurance approach, the discount rate, used to reflect the time value of money should be determined in the same way as for IPSAS 25?

Subsequent measurement

- Based on IASB's proposals adjusted for decisions on initial recognition
  a) at reporting date, CA reflects future c/f, measured at that date, and remaining expected surplus (or deficit)
  b) remaining expected surplus (or deficit) adjusted for changes to future c/f arising from future coverage
  c) expected surplus (or deficit) would be recognised as revenue (or expenses) in I/S using a systematic basis that reflects transfer of benefits under the programme
  d) benefits payable during period recognised as expense

Subsequent measurement

- If terms of programme modified for all-participants, a modification that
  e) provides additional benefits, accounted for as new programme (surplus or deficit of new programme assessed by reference to any increase in contributions imposed)
  f) reduces benefits accounted for by derecognising that part of programme related to reduction of benefits
  g) does not change in benefits accounted for as a change in estimated c/f

SMC 15

Under the insurance approach, do you support the proposals for subsequent measurement set out in (a) to (g)?

SMC 2

a) Based on your review of Chapters 4 to 6, which approach or approaches do you support?

i. The obligating event approach;

ii. The social contract approach; and

iii. The insurance approach.

Please provide reasons for your views, including the conceptual merits and weaknesses of each option; the extent to which each option addresses the objectives of financial reporting; and how the different options might provide useful information about the different types of social benefit.

SMC 2

b) Are you aware of any additional approaches to accounting for social benefits that the IPSASB should consider in developing an IPSAS?

If yes, please describe such approach (es) and explain the strengths and weaknesses of each.

SMC 3

Having reviewed the three options in Chapters 4 to 6, are you aware of any social benefits transactions that have not been discussed in the CP, and which could not be addressed by one or more of the options set out in the CP?

If so, please provide details of the social benefit transactions you have identified and explain why the options set out in the CP do not adequately cover these transactions.

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