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29 January 2016

F.A.O. Mr. John Stanford
The International Public Sector Accounting
Standards Board
529 Fifth Avenue, 6th Floor
New York NY 10017, USA

by electronic submission through the IPSASB website

Dear John,

Re.: Consultation Paper: Recognition and Measurement of Social Benefits

The IDW would like to thank you for the opportunity to provide the International Public Sector Accounting Standards Board (IPSASB) with our comments on the Consultation Paper "Recognition and Measurement of Social Benefits" (hereinafter referred to as "the CP").

This letter includes general comments and then explains our views concerning each of the three preliminary views of the IPSASB. We respond to the 15 Specific Matters for Comment (SMCs) in the appendix.

General comments

We support the IPSASB issuing a Consultation Paper on accounting for social benefits following the recent completion of the Conceptual Framework (CF). Accounting for the provision of social benefits in general is an extremely complex, and highly political topic that is of key significance for the public sector in most jurisdictions. Because there is relatively little scope for comparing the provision of social benefits with the predominantly exchange transactions common to the private sector, there remains an urgent need for the IPSASB to develop public sector-specific accounting solutions in this area. We agree that it is important that the IPSASB focus on the objectives of financial reporting identified in the CF (summarized here as accountability and informing decision-making), rather than follow constituents' political preferences that may diverge therefrom.

We also agree with the IPSASB that the information portrayed in a report on the long-term sustainability of an entity's finances in accordance with Recommended Practice Guidance (RPG) 1 "Reporting on the Long-Term Sustainability of an Entity's Finances" serves one part of users' information needs that an entity's financial statements are unable to satisfy. However, such voluntary reporting fulfils a different purpose to that of a set of financial statements prepared in accordance with the IPSASs; being merely supplementary thereto. It remains important that an entity's financial statements include the necessary information so as to faithfully represent the financial position of the entity at the balance sheet date and its operations and cash flows for the period then ended, including an appropriate reflection of the entity's social benefits schemes.

Whilst the design of individual social benefit schemes may vary widely within a jurisdiction as well as between jurisdictions, in many countries the provision of social benefits to individuals and households accounts for a highly significant proportion of total government expenditure and is thus of particular interest to financial statement users. Financial statement users also need to be informed as to the nature of different social benefit schemes as well as their potentially varying impacts on the entity's financial position. This may particularly be the case where, due to shifting demographics, users have a specific interest with respect to social benefit schemes funded by the contributions of future generations; schemes which may often result in a deficit in ownership interests.

In this context, whilst not applicable to all social benefit schemes, in regard to many schemes potential beneficiaries may – as at the end of an entity's financial reporting period – have certain rights, or valid expectations, to receive a specific benefit in the future. As we discuss in our responses to SMC 2 and SMC 4, some of these rights and expectations potentially give rise to (constructive) liabilities. In addition to information about the recognition and measurement of any such liabilities, users also need information about the funding of individual social benefit schemes. For example, when a scheme is funded by past contributions that have been earmarked for the purpose, does that scheme, or part thereof, constitute in substance a fully self-funded insurance scheme, or will the scheme instead have to be funded from future increased contributions or from transfers from other income sources, such as general taxation? In many cases, the entity may – analogous to recognition of future taxation income in IPSAS 23, "Revenue from Non-Exchange

Transactions (Taxes and Transfers)" – at the period end not have a right to such income, because, in the absence of an enforceable contract, individuals' ongoing abilities to make contributions are dependent on various external factors, e.g., continuing employment etc.; furthermore, an entity's gross income from contributions may be sensitive to demographical changes in the population.

There currently seems to be a growing acceptance in some federal states in Germany of the role accruals accounting can play in budgeting for public sector expenditure (i.e., the ability of accruals accounting and accruals budgeting to inform decision making by revealing the entire magnitude of a proposed measure, rather than just the impact on the forthcoming budget).

However, we are informed that this is tempered by some discomfort particularly in regard to entities more familiar with the cash accounting basis. The initial recognition of liabilities in regard to certain schemes for which expenditure may be anticipated to reduce over time due to demographic developments (e.g., child support schemes when birthrates are in decline) could be higher on initial recognition than in subsequent periods. If a cash-based budgeting mindset is transferred to accruals accounting in such cases, this phenomenon may create a perception that an ongoing decline in (initially) high liabilities "frees up" an entity's capacity to increase borrowings from other sources. In addition, first time adoption may be an issue when public focus has historically been placed upon management's annual achievement of a balanced budget. Certainly in Germany, many social benefit schemes in the public sector are designed to operate on a so-called "pay as you go" basis, such that the current contributors fund the current beneficiaries rather than contributing funds earmarked and invested specifically for their individual future benefits (see CF 2.1 3). Since this type of design generally becomes an issue in terms of public perception in the light of anticipated demographic changes, such as those seen currently in countries in the developed world, portraying information to give a faithful representation in such circumstances becomes even more important. Presenting less useful information e.g., in order to make an entity's financial position look more palatable, would be a disservice to decision makers as well as to other financial statement users.

Whilst this has not been specifically addressed in the SMCs, we believe that the objectives of a future IPSAS on social benefits quoted in the CP ought to be expanded to include cash flows in subsection (b).

Preliminary View 1

Social Benefits *are benefits provided to individuals and households, in cash or in kind, to mitigate the effect of social risks.*

The other key definitions are as follows:

(a) ***Social risks*** *are events or circumstances that may adversely affect the welfare of individuals and households either by imposing additional demands on their resources or by reducing their income.*

Social benefits are provided to mitigate social risks in the following circumstances:

- *Households could receive benefits when they meet certain eligibility criteria that originate from a social risk without making any contributions;*
- *Households could make contributions and receive benefits in the event of the occurrence of the specified social risks; and*
- *Households could make contributions to a scheme to accumulate future entitlements to benefits, with the benefits being provided following the occurrence of the specified social risk."*

(b) ***Social Benefits in Cash*** *are social benefits paid in cash, by or on behalf of a public sector entity, that allow individuals and households to use this cash indistinguishably from income from other sources. Social benefits in cash do not include reimbursements.*

(c) ***Social Benefits in Kind*** *are goods and services provided as social benefits to individuals and households by or on behalf of a public sector entity, and all reimbursements for the costs incurred by individuals and households in obtaining such goods and services.*

(d) ***Reimbursements*** *are cash payments made as a social benefit by or on behalf of a public sector entity to compensate a service provider or an individual or household for all or part of the expense incurred or to be incurred by that individual or household in accessing specific services.*

(e) ***Social Insurance*** *is the provision of social benefits where the benefits received are conditional on participation in a scheme, evidenced by way of actual or imputed contributions made by or on behalf of the recipient. Social insurance may form part of an employer-employee relationship (employment-related social insurance) or may arise outside an employer-employee relationship (social security).*

(f) ***Social Security*** *is social insurance that arises outside of an employer-employee relationship, and provides benefits to the community as a whole,* *or large sections of the community. Social security is imposed and controlled by a government entity.*

(g) ***Social Assistance** is the provision of social benefits to all persons who are in need without any formal requirement to participate as evidenced by the payment of contributions.*

We generally agree with the IPSASB's preliminary view as to the descriptions cited above. However, in responding to SMC1, we provide comments on the definition of social insurance, since we believe that the insurance approach, whereby expected future liabilities are offset by expected future contributions, should be applied for schemes that are fully self-funding such that the level of benefits can be aligned to future contributions to which the entity will be entitled. We suggest that further clarification is needed to prevent (mis)application of the insurance approach to social benefit schemes that are, in substance, subsidized from other sources. Furthermore, for a particular scheme, there may be a component that is fully funded by an insurance mechanism (expected contributions will cover expected expenditures) but another part is expected to be covered by transfers from other sources of income, such as general taxation (the social assistance component). In terms of financial statement presentation, it is important that in these cases the insurance component and social benefit component be clearly distinguished from one another (much like certain financial instruments that have both a debt and equity component that need to be disclosed separately in the financial statements).

We would also like to emphasize that pension obligations on the part of a public sector entity for that entity's own current and former employees should not fall within this project (see para. 2.18 and 2.34 of the CP). Consequently, the differentiation between social security (covered in this project) and social insurance arising from an employer-employee relationship (e.g., civil servant pensions covered in IPSAS 25, Employee Benefits) needs to be very clear, to prevent misunderstandings.

Preliminary View 2

The IPSASB considers that a combination of option 1 (obligating event approach) and (for some or all contributory schemes) option 3 (insurance approach) may be required to reflect the different economic circumstances arising in respect of social benefits. The IPSASB does not consider that option 2 (social contract approach) is consistent with the Conceptual Framework. For this reason, the IPSASB has taken the preliminary view that the social contract approach is unlikely to meet the objectives of financial reporting.

We share the IPSASB's view that the social contract approach is unlikely to meet the objectives of financial reporting, and refer to our response to SMC 8.

Preliminary View 3

Under the obligating event approach, liabilities in respect of social benefits should be measured using the cost of fulfillment. The cost of fulfillment should reflect the estimated value of the required benefits

We share the IPSASB's view that under the obligating event approach liabilities in respect of social benefits should be measured using the cost of fulfillment.

We hope that our comments will be useful in taking this project forward, and would be happy to discuss any aspects of this letter.

Yours truly,

Klaus-Peter Feld Executive Director	Gillian G. Waldbauer Head of International Affairs

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APPENDIX 1:

Specific Matters for Comment

<u>*Specific Matter for Comment 1*</u>

In your view:

(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) Do the definitions in Preliminary View 1 provide an appropriate basis for an IPSAS on social benefits?

Please explain the reasons for your views.

(a) Scope of the CP

We note that the IPSASB intends to address the issue of accounting for expenditure on items termed collective goods and services (e.g., national security) in a separate project on non-exchange expenditure, and support the proposed exclusion from this narrow-scope project at this time.

We further note that IPSASB intends to address other (related) issues including presentation and disclosure matters after the IPSASB has reviewed responses to this consultation, and look forward to contributing to further discussions in due course.

On this basis, whilst we agree that the scope of this CP is generally appropriate, we believe that it should not exclude social benefit contributions or benefits in kind (para. 6.12), where these are merely an alternative to cash transfers but otherwise equivalent.

We appreciate the fact that as this Consultation Paper purposely has a narrow scope, it is important to have the particular issues addressed before advancing the project further.

(b) Definitions

With one exception, we accept that there is likely to be merit in a future IPSAS using the definitions already established in Government Finance Statistics (GFS), due to the fact that these should be familiar to many constituents. We agree that it would not be appropriate for the IPSASB to create different terminology or to devise different definitions without good reason.

In our opinion it needs to be clear that for a social benefit scheme (or component of a scheme) to meet the definition of social insurance the scheme must: a) be designed as self-financing; b) actually prove to be self-funding over time, i.e. it is not, in substance, subsidized through transfers from other sources of revenue; and c) cover a specific risk or a similar set of risks. The IPSASB should be careful not to create a form of quasi-insurance; rather individual schemes need to be analyzed and, where applicable, insurance components separated from components that are subsidized by funding external to the scheme, such that the latter can be accounted for accordingly as social assistance.

The IDW is not sufficiently familiar with the differences between IPSASs and GFS, but believes the Board will need to consider the different objectives of IPSAS and GFS (CF introduction, paragraphs 23-24) in exploring any need for further amendment to the GFS definitions.

Specific Matter for Comment 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;*
  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.

(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.*

(a) Support for Specific Approaches

In our view, the range of different social benefits scheme constructs will generally mean that no single approach will be appropriate for the recognition and measurement of all social benefits scheme liabilities. Consequently, the characteristics of a particular social benefit scheme need to be considered in determining which approach best fulfils the objectives of GPFS (general purpose financial statements) and potentially GPFR (general purpose financial reports) for that particular scheme or, in some cases, component of the scheme, since many social benefit schemes exhibit different component characteristics and by their design may constitute a mix of social insurance and social assistance.

In our view, the recognition and measurement of liabilities for social benefits that constitute social assistance would generally lend themselves to an obligating event approach. Indeed, under the obligating event approach some cases may be clear cut – e.g., a legal obligation exists at the balance sheet date. In other cases the determination of when the entity has little or no realistic alternative to avoid an outflow of resources will be less clear, and so the characteristics of a particular benefit scheme should guide the determination as to the existence of a realistic alternative to avoid an outflow of resources. We discuss this below in more detail in our consideration below of each of the alternatives put forth in the CP and in responding to SMC 4.

In contrast, only those social benefit schemes (or components thereof) that effectively operate in a way akin to commercial insurance contracts (social insurance) would lend themselves to an approach similar to the insurance approach under IASB ED/2013/7 “Insurance Contracts”. Such “true” social insurance schemes are self-funding exchange transactions, as any short-term deficits represent borrowing by the scheme, repaid once the scheme comes into surplus. Careful distinction will be needed to differentiate between such social insurance schemes and similar schemes that, in contrast, consistently run at a deficit to be covered by general government income or borrowing (social assistance). The latter represents, in substance, a subsidy as opposed to a tide-over loan as would be the case for a “true” social insurance scheme. We suspect that some schemes may exhibit both an insurance component and a subsidized component, which would need to be identified for accounting purposes.

We comment on three approaches discussed in the CP as follows:

(i) The obligating event approach

We agree that this approach is in line with the IPSASB’s CF. We also believe that this approach is able to deliver faithful representation for non-contributory schemes as well as contributory schemes that do not constitute insurance schemes because they are – in substance – subsidized in full or in part. For schemes designed to be funded on an intergenerational basis this approach can provide important information as to the extent of commitments at the period end, including the magnitude of the liability passed to future generations.

(ii) The social contract approach

We appreciate the fact that the CP discusses the social contract approach in detail. As noted in our covering letter, we agree with the IPSASB that it would not provide useful information to users, particularly where there is an inter-generational financing intent inherent in a social benefit scheme. We therefore do not support this approach to accounting for social benefit schemes.

(iii) The insurance approach

We agree that the insurance approach may be appropriate when a scheme is, to all extent and purpose, an insurance scheme. In determining whether this is the case in respect of an individual scheme, substance over form should prevail, and, as discussed in our response to SMC 1, the scheme would need to fulfil specific criteria in order to differentiate between insurance schemes (or insurance components) and subsidized schemes (or social assistance components).

Since, in comparison to the obligating event approach, the insurance approach ultimately results in less liability being presented in the statement of financial position than might be the case under the obligating event approach, we are concerned as to the potential for misapplication of the insurance approach, particularly when – in substance – such schemes are (wholly or in part) subsidized.

Whilst we appreciate that there may be social benefit schemes that share some characteristics of the insurance found in the private sector, we are not convinced as to the applicability of this in all but "clear cut" insurance arrangements for the following reasons:

- Schemes which only allow benefits to be drawn by contributors may exhibit some characteristics of commercial insurance, but are not generally one to one with the private sector insurance in terms of individualization of the underlying calculations, there may be a hidden social assistance component (i.e., there may be a propensity for less well-off individuals and households to receive more than they would contribute etc.)
- Where in substance shortfalls and excesses are covered by e.g., general taxation rather than their representing short-term borrowings, the scheme will not yield profits that can be released over a coverage period

or losses that would be recognized immediately. Shortfalls or excesses may constitute short-term borrowing on the part of the scheme or subsidization. Differentiation between the two may be complex.

- Whereas private sector insurers have a contractual right to receive contributions, the government will generally not have a similar basis for offsetting future contributions
- Since many contributory schemes are designed to be financed on an inter-generational basis, adopting an insurance approach to account for such schemes would likely not lead to appropriate information
- Calculations are extremely complex and, necessarily, often based on assumptions; both of which lead to high costs for the preparer and reduced reliability that in turn impacts their informative value to the users of financial statements.

(b) Additional Approaches

We are not aware of additional approaches that the IPSASB ought to consider.

Specific Matter for Comment 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.

The IDW is not aware of further social benefit transactions requiring different solutions.

Specific Matter for Comment 4

In your view, 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) The eligibility criteria to receive the next benefit have been satisfied;
(d) A claim has been approved;
(e) A claim is enforceable; or

(f) At some other point.

In coming to this conclusion, please explain what you consider to be the relative strengths and weaknesses of each view.

If, in your view, a future IPSAS should consider that an obligating event can arise at different points depending on the nature of the social benefit or the legal framework under which the benefit arises, please provide details.

Please explain the reasons for your views.

In our view, the time line for determining an obligating event will need careful assessment on a case by case basis, as it would ultimately need to be based on factors including an evaluation of the terms governing the specific social benefit scheme. Given the public sector mandate for expenditure, legal aspects should generally be key factors in determining when an obligating event arises. However, such determination may also need to be made under the premise of substance over form, particularly where a consideration of legal form alone might give rise to misleading information.

We therefore believe that a future IPSAS should consider that an obligating event can arise at different points depending on the nature of the social benefit or the legal framework under which the benefit arises. We discuss a few illustrative examples as follows:

Obligating Event

Some social benefit schemes, especially participatory schemes, will have terms that denote the point in time at which recipients have specific legal or quasi-legal rights to benefits – in our opinion, the establishment of these rights will constitute an obligating event. E.g. for a state pension scheme, making a first contribution on joining the workforce may entitle the individual to a (initially very small) pension on reaching retirement age – in order to be faithfully representative in such cases, the recognition and measurement of any liability at period end can only reflect the specific policy in place at that explicit point in time (see first three sentences of para. 4.20 of the CP); for a child support scheme, the birth of a child may obligate the state to pay support throughout a minimum specific period etc. an argument that the state might abolish such a scheme should not impact the accounting at period end, as it does not change the policy that existed at that date.

Under the insurance approach, social benefit schemes with insurance components inherently place an obligation on the entity to compensate contributory participants in the event that pre-specified circumstances arise. In such cases, the establishment of the scheme would be the obligating event, not the occurrence of each individual event giving rise to a compensation settlement.

When benefits mitigate an unanticipated event that has affected members of the general population, e.g., a major earthquake or flood, an obligating event may first occur when claims become enforceable, although it may be appropriate to consider additional factors such as valid expectations stemming from the entity's track record in determining whether – in substance – an entity has little or no realistic alternative to avoid settling the obligation at an earlier point in time, as discussed below.

Potential Revision of Social Benefits Policy

Entire social benefit schemes can change over time. However, an assumption that a government can change a past policy to avoid or change obligation will generally not affect the policy in place during a past period or at a particular point in time. On this basis, we do not believe that anticipation of possible policy revisions impacts whether at period end the entity has a liability. Indeed, a change in policy would be reflected as a non-adjusting post balance sheet event reflected in the financial statements for the period in which change occurred. Overall, only policy changes that have been approved by the appropriate body (in some cases, a legislative body) that are not subject to undue legal risks (e.g. serious constitutional challenges) and implemented on a permanent basis such that they are not likely to be reversed should be given recognition in the financial statements.

Taking Germany as an example:

- We suggest that it would be extremely unrealistic to anticipate that any German government in power in the near future would be able to obtain the necessary voting majority for an outright abolishment of the state-paid pension scheme; whereas it has recently proven somewhat easier (even if not without difficulty) to change the eligibility criteria (raising retirement age) and the amounts payable (decreasing or increasing entitlements relative to inflation).
- In other cases entire social benefit schemes have been phased out relatively recently (state paid disability pension) and new benefits phased in (elderly care insurance, childcare premium for new parents).
- There are real constitutional limits on the ability of governments to reduce certain kinds of benefits that are enforced by constitutional courts, and obtaining the political majorities to change constitutions has proven to be largely illusory.

Valid Expectations

Various cultural or jurisdictional aspects may also influence public expectations in regard to individual social benefit schemes to different degrees. The issue is whether expectations existing at period end constitute valid expectations or not.

For example, the occurrence of a major disaster prior to the period end (past event), may give rise to valid public expectations (obligating event) because the entity has established a track record in similar situations in the past and there has been no indication that the entity will not provide assistance, thus the entity has little or no realistic alternative to avoid the outflow of resources.

Where an entity has no such track record, it might be appropriate to consider whether the Board could draw on the IASB term “substantially enacted” (IAS 37.50) as the obligating event, where the stage reached in the approval process for the expenditure is virtually certain to gain a legal backing. However, in some cases, political situations have proven to be fluid, and matters enacted at one stage are reversed again after elections of new governments or through successful constitutional challenges, so some degree of caution should be exercised in assessing whether there is objective evidence in such situations.

A further factor in many such cases will be whether a lack of available information precludes measurement in line with the QCs identified in the IPSASB’s CF. To some extent this issue mirrors considerations in the private sector as to the expected vs. incurred loss model. The relative importance attached to individual QCs has to be weighed up (faithful representation, verifiability). It is possible that the incurred loss model would be viewed as more appropriate in the public sector, especially as other GPFRs can deliver supplementary information e.g., on the long-term sustainability of a public sector entity’s finances.

<u>*Specific Matter for Comment 5*</u>

In your view, does an obligating event occur earlier for contributory schemes than non-contributory schemes under the obligating event approach?

Please explain the reasons for your views.

From the viewpoint of the reporting entity the legislation at the reporting date (i.e., specific characteristics of the social benefit scheme) and not a scheme’s status as contributory vs non-contributory would ordinarily govern the obligating event.

We do not believe that whether a social benefit scheme is a contributory scheme or not can, when viewed in isolation, be considered a suitable criterion for determining the point in time at which an obligating event occurs. We refer to our response to SMC 1 where we explain in further detail what we believe to be relevant criteria.

In our view, the level of funding of a social benefit scheme from so called earmarked contributions likely increases the public's expectations as to the government's obligation to provide benefits. However, this is not clear cut, since expectations regarding a non-contributory social benefit scheme may be similar based on the past performance of the government or possibly an overall perception of its track record as a welfare state.

Specific Matter for Comment 6

In your view, 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 any examples you may have of social benefits arising from exchange transactions. Please explain the reasons for your views.

In our view, where a social benefit scheme not already covered elsewhere in the suite of IPSASs has earmarked assets or is otherwise designed and operating as a fully-funded discrete scheme such exchange transaction could be addressed in a future IPSAS on social benefits.

As noted in our covering letter, we suggest IPSASB clarify that pension schemes for civil servants who are government employees already fall under IPSAS 25, “Employee Benefits”, as we are aware that there is some confusion on this issue.

Specific Matter for Comment 7

In your view, under the obligating event approach, when should scheme assets be included in the presentation of a social benefit scheme:

(a) In all cases;
(b) For contributory schemes;
(c) Never; or

(d) Another approach (please specify)?

Please explain the reasons for your views.

We refer to our covering letter in which we discuss the need to meet financial statement users' needs for information in regard to social benefit schemes. In particular we suggest that specific disclosure is needed where the ability of the government to ensure contributions to specific schemes may not be enforceable such that, analogous to IPSAS 25, an asset is not recognized. For example, contributions as deductions of a percentage of remuneration from employment will not be enforced if an individual ceases employment altogether.

As explained in our covering letter, we believe that the features of individual social benefit schemes need to be disclosed to provide sufficient transparency in meeting financial statement users' needs. We support the insurance approach in the case of social security insurance schemes. Where there are scheme assets or contributions earmarked for a specific scheme in the absence of an insurance component these need to be presented separately rather than offset against liabilities. However, in some cases specific assets may not be earmarked for individual schemes as such, as benefits will be fulfilled from general funding. In other cases contributions may be earmarked, although these may not be aligned to the exact amount of benefit potentially available to a particular individual.

<u>Specific Matter for Comment 8</u>

In your view, under the social contract approach, should a public sector entity:

(a) Recognize an obligation in respect of social benefits at the point at which:
   i. A claim becomes enforceable; or
   ii. A claim is approved?

(b) Measure this liability at the cost of fulfillment?

Please explain the reasons for your views.

Given its inability to provide information about the intergenerational impact of social benefit schemes, we do not believe that the social contract approach is appropriate in regard to the types of social benefits falling within the narrow scope of this project. We therefore do not support the social contract approach, as its application will not result in information that can fulfil the accountability and decision-usefulness objectives of GPFS and GPFRs.

We therefore do not believe IPSASB should pursue this approach further within this narrow-scope project.

Specific Matter for Comment 9

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

Please explain the reasons for your views.

We agree that the insurance approach under IASB ED/2013/7 Insurance Contracts, discussed in the CP, may be appropriate in accounting for certain social benefit schemes or components thereof that are in substance insurance schemes (but not subsidized insurance schemes). However, as noted in our responses to SMCs1, 2 and 4, we believe that careful consideration is needed in determining whether a specific scheme or component of a scheme represents insurance as opposed to a partly subsidized contributory scheme i.e., social assistance. For example, it may be difficult to distinguish between imputed contributions made on behalf of a recipient and general subsidization of a particular scheme. We urge the IPSASB to tighten the definition of social insurance if this approach is to be considered further, as there is considerable potential for misapplication.

We see merit in applying an insurance approach provided a scheme is both designed to be – and in practice proves to be – self-funding such that a liability to provide benefits is essentially expected to be dealt with within the scheme, rather than from other sources of funding, such as transfers.

Specific Matter for Comment 10

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

(a) Any expected surplus should be recognized over the coverage period of the scheme; and
(b) Any expected deficit should be recognized as an expense on initial recognition?

Please explain the reasons for your views.

Subject to our comments on the need to distinguish social security schemes or components thereof that are fully funded from contributions from subsidized or partly subsidized-insurance schemes, we agree that any expected surplus should be recognized over the coverage period of the scheme; and any expected deficit recognized as an expense on initial recognition.

<u>Specific Matter for Comment 11</u>

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

- *(a) Recognize the deficit as an expense on initial recognition;*
- *(b) Recognize the deficit as an expense over the coverage period of the scheme;*
- *(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 taxation; or*
- *(e) Another approach?*

Please explain the reasons for your views.

As explained above, we believe the insurance approach is not generally appropriate for social security schemes that are not designed to be fully funded from contributions. There is considerable potential for misapplication of the insurance approach, since in comparison with the obligating event approach it is likely that a reporting entity would present less liability in the statement of financial position.

In our opinion, individual schemes that are not fully self-funded will need to be analyzed in order to identify whether they comprise a subsidized social assistance component (based on an assessment of substance over form) in addition to a social insurance component.

<u>Specific Matter for Comment 12</u>

In your view, under the insurance approach, should an entity use the cost of fulfillment measurement basis or the assumption price measurement basis for measuring liabilities? Please explain the reasons for your views.

In our view, the assumption price measurement basis would be impracticable in the public sector, as it will generally not be as feasible for public sector entities to transfer social benefit schemes at a cost representing the "value" of that individual scheme as might be the case in the private sector. The cost of fulfillment measurement basis is also likely to be more straightforward in terms of calculation. For both these reasons we believe that, the cost of fulfillment measurement basis would be preferable in terms of providing faithfully representative information.

<u>Specific Matter for Comment 13</u>

Do you agree that, in those cases 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 scheme is that of a social insurance scheme; and*
- *There is a clear link between the benefits paid by a social security scheme and the revenue that finances the scheme.*

If you disagree, please specify the criteria that you consider should be used. Please explain the reasons for your views.

We fully agree, and refer to our comments elsewhere in this letter in respect of the need for the IPSASB to provide a robust definition of social insurance. Since the insurance approach may ultimately result in less liability being presented in the statement of financial position than might be the case under the obligating event approach, we are concerned as to the potential for misapplication of the insurance approach, particularly where schemes may be (wholly or in part) subsidized so that they represent social assistance in substance. In assessing whether a scheme is in substance subsidized or not, it will be important for both the design of the scheme and actual operation of the scheme to be assessed.

<u>Specific Matter for Comment 14</u>

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? Please explain the reasons for your views.

We see no reason to suggest that the same approach as that used in IPSAS 25, "Employee Benefits" would not be appropriate.

<u>*Specific Matter for Comment 15*</u>

Under the insurance approach, do you support the proposals for subsequent measurement set out in paragraphs 6.73–6.76? Please explain the reasons for your views.

The proposals in IASB ED/2013/7 “Insurance Contracts” remain subject to finalization. In general, other than considerations as to the split between profit and loss and other comprehensive income which is an issue in the ongoing discussion of accounting for insurance in the private sector, the IDW is not aware of any specific reasons why the solution determined for the private sector might not generally be appropriate in this project.