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Draft EPSAS Screening Report
IPSAS 42 - Social benefits

Paper by PwC in cooperation with Eurostat
- written consultation -

This document was commissioned by Eurostat. It analyses the consistency of the named IPSAS standard with the draft EPSAS framework, with a view to informing future EPSAS standard setting. This version was prepared taking into account comments received from the participants of the Cell on Principles related to EPSAS Standards.

In advance of the autumn 2020 Working Group meeting, participants are invited to provide written comments on the analysis provided and on the conclusions reached.

Pilot EPSAS screening report

IPSAS 42 - Social benefits

March 2020

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Background

Objectives

We refer to the general introduction to the pilot EPSAS screening reports that covers the following elements:

- Key objectives of EPSAS.
- Standard setting process in the public sector.
- Purpose and scope of the screening reports.
- Approach of the screening reports.
- European public good.
- Common elements considered when preparing the reports.

General introduction to IPSAS 42

Social benefits and expenses from other non-exchange transactions represent significant flows of transactions for governments.

IPSAS 42 “Social Benefits”, provides guidance on accounting for social benefits expenditure. It defines social benefits as “cash transfers paid to **specific individuals and/or households** to mitigate the effect of social risk”.

Specific examples include state retirement benefits, disability benefits, income support and unemployment benefits. The new standard requires an entity to recognise an expense and a liability for the next social benefit payment.

IPSAS 42 seeks to improve the relevance, faithful representativeness and comparability of the information that a reporting entity provides in its financial statements about social benefits.

To accomplish this, IPSAS 42 establishes principles and requirements for:

- Recognising expenses and liabilities for social benefits;
- Measuring expenses and liabilities for social benefits;
- Presenting information about social benefits in the financial statements; and
- Determining what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the social benefits provided by the reporting entity.

The key accounting issue is when a present obligation arises for social benefits within the scope of IPSAS 42. The standard explores the concept of a “present obligation” (IPSAS 19) in the context of social benefits expenditure.

The IPSASB initiated a project on social benefits in 2002, however at that time the IPSASB did not reach a consensus on when a present obligation arises for social benefits within the scope of the project, and decided to defer further work on this topic until the completion of the IPSAS CF (which was issued in 2014). The project was re-launched and completion was achieved with the publication of IPSAS 42 ‘Social benefits’ in January 2019.

In reviewing the responses during the project, the IPSASB noted that there was no consensus as to the range of different points at which an obligating event could arise. The project therefore focused on analysing the various obligating events by reference to the IPSAS CF, noting respondents’ comments where these provided evidence about a particular obligating event or raised other matters that required consideration.

Determining the relevant past event for a particular social benefit obligation and the existence of a present obligation that meets the definition of a liability and recognition criteria in the CF is difficult and involves significant judgement. This is evidenced by the IPSASB’s discussions over many years and the fact that the basis of conclusions of the standard, in addition to the “general approach”, includes and explains the rational for an “alternative view” to the approach finally retained in IPSAS 42.

Scope of the report

The International Public Sector Accounting Standards Board (IPSASB®) issued IPSAS 42’ Social benefits’ in January 2019. The effective date of IPSAS 42 is 1 January 2022, with earlier adoption encouraged.

Governments also provide other types of services, for example healthcare and defence. Such services are outside the scope of social benefits and are not discussed in this report. The accounting for these services is covered in the broader non-exchange expenses project of the IPSASB.

Reference to EFRAG assessment

There is no IFRS equivalent of IPSAS 42, and therefore no EFRAG endorsement report is available.

The IASB published the Insurance contracts standard (IFRS 17) on 18 May 2017. Based on the results of the case studies and the user outreach, EFRAG issued a letter to the IASB on 3 September 2018 listing 6 topics that merit further consideration. On 26 June 2019 the IASB issued ED/2019/4 ‘Amendments to IFRS 17’, with targeted amendments to IFRS 17 to respond to concerns and challenges raised by stakeholders. EFRAG has issued its draft comment letter on 15 July 2019. The endorsement process is not finalised at the time of this report.

Reference to EPSAS issue papers[1]

The PwC study of 2014[2] analysed the suitability of the IPSAS standards as a basis for developing EPSAS.

[1] EPSAS Issues papers are available on https://ec.europa.eu/eurostat/web/epsas/key-documents/technical-developments

[2] Collection of information related to the potential impact, including costs, of implementing accrual accounting in the public sector and technical analysis of the suitability of individual IPSAS standards (Ref. 2013/S 107-182395)

At that time, issuance of an IPSAS standard on ‘Social benefits’ was expected and the broader topic of expenses from non-exchange transactions was proposed as one of the potential IPSASB projects. Social benefits project was classified under the category “Topics for which no standard exists yet but for which a standard or implementation guidance is needed”.

During the course of developing the technical proposal on EPSAS, Eurostat commissioned a series of twenty technical issues papers (IPs), which analyse in particular key public sector specific accounting issues. The papers were discussed at the EPSAS Working Group meetings during 2016-2018. The papers are all publicly available on Eurostat’s website.

EPSAS issue paper on Social benefits was discussed by the EPSAS WG on 22-23 November 2016.

Eurostat tentatively concluded the following in respect of the above paper:

- EPSAS should be informed by wide-ranging stocktaking of practices in the Member States, further discussions with the Member States of the ways forward and their likely impacts, as well as by the IPSASB’s own analyses, consultations and conclusions.
- There is a need to take into account the impact on the reporting under ESA, given the fact that the scope of social benefits proposals developed by IPSASB differs from the scope of social benefits in ESA.

Screening of IPSAS 42 ‘Social benefits’ against criteria set in the draft EPSAS framework

Introduction

The EPSAS criteria listed in the draft EPSAS framework have been used to perform an assessment of IPSAS 42 ‘Social benefits’, published in January 2019 by the IPSASB.

In order to develop recommendations, one should first consider whether IPSAS 42 would meet the qualitative characteristics of the draft EPSAS CF, i.e. whether it would provide relevant, reliable, complete, prudent, neutral, verifiable, economically substantive, understandable, timely and comparable information and would not be contrary to the true and fair view principle.

This report considers recognition, classification and measurement as well as presentation and disclosure requirements applicable to social benefits for each of the qualitative characteristics of the draft EPSAS CF.

Further, this paper includes a high-level comparison between the requirements of IPSAS 42 and other international accounting and financial reporting frameworks applied by the public sector entities in various jurisdictions, such as IFRS, ESA 2010 and EU Accounting Rules, bearing in mind the objective of alignment, reduction of cost of implementation and compliance cost.

Finally, this paper assesses whether IPSAS 42 would be conducive to the European public good.

The findings are presented below and the conclusion is included in the next section of this report.

Conformity with Qualitative Characteristics

Relevance

General

The delivery of social benefits to the public is a primary objective of most governments, and accounts for a large proportion of their expenditure.

Prior to IPSAS 42 'Social benefits', IPSAS did not provide guidance on accounting for social benefits; IPSAS 19 'Provisions, contingent liabilities and contingent assets', excluded social benefit provisions in non-exchange transactions from its scope. The absence of such guidance was seen as one of the major gaps in IPSASB's literature.

The objective of IPSAS 42 is to address the need for relevant information for a significant proportion of government expenditure in the public sector.

The experience of applying IPSAS 42 may provide further evidence of the extent to which the recognition and measurement of social benefits under IPSAS 42 meets users' needs.

Collective services (e.g. defence) and universally accessible individual services (e.g. universal education and healthcare) are not in the scope of the standard. The delivery of individual services such as health care services is considered an ongoing activity of the public sector entity that provides the services. No provision is recognised for the intention to deliver individual services prior to individuals and/or households accessing the services. Accounting requirements for individual services are included in IPSAS 19 (not in IPSAS 42).

Respondents to ED 63 'Social benefits' agreed that collective services and universally accessible services be excluded from the scope of social benefits but considered it important that the boundary between social benefits and individual services be clearly defined. The IPSASB agreed to clarify the boundary by defining social benefits as cash transfers in IPSAS 42.

Under the IPSAS 42 approach, obligations to pay social benefits are seen as no different (in principle) than other obligations. The key issue is when a present obligation arises and whether satisfaction of eligibility criteria for each social benefit payment is a separate obligating event.

The general approach in IPSAS 42 includes a single recognition point for all social benefits. Under the general approach, a liability for a social benefit is recognised when the eligibility criteria to receive the **next social benefit** have been satisfied.

Under the general approach, the past event that gives rise to a liability is the **satisfaction by the beneficiary of all eligibility criteria for the provision of the next social benefit**. The satisfaction of eligibility criteria for each social benefit payment is seen as a separate past event. For example, being alive at the point at which the eligibility criteria are required to be satisfied may be an eligibility criterion, whether explicitly stated or implicit. The eligibility criteria depend on the characteristics of each individual social benefit scheme.

The recognition principles in the standard are developed around the definition of a liability in the draft EPSAS CF. The question is whether satisfaction of eligibility criteria for each social benefit payment should always be seen as a separate past event (for example if the assessment of “eligibility criteria” is not performed before each individual payment is transferred).

As a reminder, a liability is a **present obligation** of the entity for an **outflow of resources** that results from **past events or transactions**. A present obligation is a legally binding obligation (legal obligation) or non-legally binding obligation, which an entity has little or no realistic alternative to avoid.

- A legal obligation is enforceable in law.
- Non-legally binding obligations differ from legal obligations in that the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement.

Because the satisfaction of eligibility criteria for each social benefit payment is a separate past event, the liability is for the next payment only. Consequently, liabilities in respect of social benefits will usually be short-term liabilities.

The application of the standard would most often lead to a small amount of liability being recognised in the balance sheet. When payments of benefits are scheduled every month, including being alive as one of the eligibility criteria to receive the next benefit will lead to only a one-month social benefit liability being recognised in the balance sheet. This would have very little predictive value. Most importantly, the accounting treatment might be seen as conflicting with the accountability and decision-making objectives of financial statements as it would not reflect the long-term impact of political decisions in financial statements. Being alive when the next benefit and series of benefits will be paid should rather be considered in the measurement of the liability (considering a mortality factor, etc.).[3]

The presentation of liabilities for social benefits as short-term liabilities could even be misleading if no further information about the nature of the benefits and the future projected cash flows is provided in the financial statements.

In coming to the conclusion that only the ‘eligibility criteria for the next social benefit have been met’ recognition point should be included in the standard, the IPSASB did not reach consensus, with some members holding the view that other recognition points should also be included. This view is further elaborated under the QC ‘Completeness’.

During the consultation process, some expressed concerns about whether recognising a large liability for social benefits without also recognising an asset for

[3] The accounting treatment finally retained in IPSAS 42 has been debated widely and divergent views existed between stakeholders. Some IPSASB members stated alternative views on the grounds explained in this screening paper.

the future taxation or contribution revenue that would fund the settlement of that liability would provide useful information. There were different views as to whether the recognition or non-recognition of this liability would best satisfy the qualitative characteristics of relevance, faithful representation, understandability and comparability.

Following the consultation process, the IPSASB members agreed that the ‘eligibility criteria for the next social benefit have been met’ recognition point would be appropriate for at least some social benefits. In addition, further information about the long-term fiscal sustainability of those social benefit schemes is needed and should be provided in the GPFRs.

The IPSASB and its stakeholders acknowledge that determining the point at which a liability arises for a social benefit is complex, and the consequences of different recognition points could be substantially different. Although conceptual basis for the IPSASB’s purposed recognition point (including being alive) can be challenged, and the alternative views expressed by some of the IPSASB members have merits, the IPSASB noted that it is important that a standard in this important area is finalised. The accounting under IPSAS 42 is relatively straightforward to implement and from a pragmatic perspective, the proposed recognition approach can be supported as an acceptable outcome.

IPSAS 42 foresees a general approach applicable to all social benefits and an optional insurance approach applicable to certain social benefits in specific circumstances.

<u>The general approach</u>

The general approach requires entities to disclose (mainly qualitative) information that: (a) explains the characteristics of its social benefit schemes; and (b) explains the demographic, economic and other external factors that may affect its social benefit schemes.

The initial exposure draft ED 63 “Social benefits” required entities to provide a reconciliation of the social benefit liability and the best estimate of the undiscounted projected cash outflows. Such information could be relevant in assessing the timing and amount of the future cash outflows of the social benefits schemes. No information about undiscounted projected future cash flows is required under the provisions of the final standard.

In order to provide relevant information to the users of the GPFSs under EPSAS, further disclosures could be required, in addition to the amounts recognised in the statement of financial position. For example, information about the present value of future expected cash flows or the long-term impact of changes in relevant assumptions (e.g. demographic, economic, or others).

With the QC of reliability and faithful representation in mind, one might argue that the requirements of the standard might not meet users’ needs for information about the long-term financial sustainability of an entity, including the long-term commitments under the social benefit schemes the entity provides.

In the context of social benefits, general purpose financial reports prepared in accordance with Recommended Practice Guideline 1 "Reporting on the long-term sustainability of an entity's finances" issued by the IPSASB in 2013 will provide information about expected obligations to be settled in the future, including obligations to individuals who have not met the eligibility criteria for a scheme, or who are not currently contributing to a scheme that would entitle them to future social benefits. This pronouncement does not address the question of whether such obligations meet the definition of a present obligation, and so should be either recognised or disclosed in the financial statements.

Under IPSAS 42, the liability for a social benefit scheme is measured as the best estimate of the costs that the entity will incur in fulfilling the present obligations represented by the liability. In this context, "costs" means the social benefit payments to be made (i.e., the cash transfers). The costs do not include other elements such as administrative costs and bank charges.

IPSAS 1 'Presentation of financial statements', provide guidance on materiality and aggregation. Entities may wish to consider these paragraphs when preparing their disclosures.

Due to the fact that, in the majority of cases, only next payment meets recognition criteria for it to be recognised as a liability, the effect of social benefits schemes approved in the reporting period, but for which beneficiaries will only meet eligibility conditions in the next reporting period, will not be recognised or disclosed in the current period

<u>The insurance approach</u>

If the social benefit scheme is fully funded from contributions and there is evidence that it is managed in the same way as private insurers manage their insurance contracts, it has the characteristics of an insurance contract. In such circumstances, permitting the use of the alternative insurance approach enables to meet the 'relevance' QC of the information presented in financial statements.

Faithful representation / Reliability

The notion of faithful representation and reliability in the draft EPSAS CF is linked to the qualitative characteristics of completeness, prudence, neutrality, verifiability and substance over form. These are separately discussed below.

As stated above, under QC 'relevance', the robustness of the assumptions used in the measurement of provisions could affect the reliability of the information. As stated above under the QC of relevance, because the satisfaction of eligibility criteria for each social benefit payment is a separate past event, the liability is recognised only for the next payment. Consequently, liabilities in respect of social benefits will usually be short-term liabilities and the measurement of these liabilities does not require the use of complex valuation techniques in order to determine the best estimate of the projected future cash outflows.

The insurance approach is applied in the limited circumstances: where the social benefit scheme is operated in a similar manner to an insurance contract and funded from dedicated sources of revenue, not general taxation. The IPSASB concluded (with the support from its stakeholders) that applying the insurance approach to other social benefit schemes would not faithfully represent the economic substance of those schemes.

The insurance approach is, however, expected to be more costly and complex to implement than the general approach. Besides, actuarial estimates may be required under the insurance approach. The insurance approach requires estimates of cash inflows and cash outflows over the duration of the scheme, affecting the reliability of the information provided to the users of GPFSs. In addition, since IFRS 17 introduces significantly different requirements from many existing national standards dealing with insurance, it may take some time for any practical issues to be fully identified and addressed. Applying the requirements of IFRS 17 to social benefits would introduce a significant level of complexity compared to the general approach. While the optional insurance approach best reflects the economics of certain social benefit schemes, governments may have cost/benefit reasons for not using it. Application of the insurance approach would also lead to two different models being applied to social benefit schemes.

A reliable assessment of the amounts to be recognised will be possible under the requirements of the standard. However, faithful representation might be somewhat questioned for the reasons explained under the ‘Relevance’ QC.

Completeness

The common understanding of the term “Social benefits” includes goods, services and other benefits provided by a government in the pursuit of its social policy objectives and for which it does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits. Social benefits represent one of the most significant financial flows of a government.

Examples of social benefits include health, education, housing, transport and other social services delivered to the community, with often no requirement for the beneficiaries of the services to pay an amount equivalent to the value of these services. Benefits paid to families, aged, disabled or unemployed persons, veterans and other (groups of) individuals to access services to meet their particular needs, or to supplement their income, may also be considered as social benefits.

The scope of IPSAS 42 does not cover the wide range of “social benefits” described above. Although the scope of IPSAS 42 is defined in para 5 of the standard, the use of the term “Social benefits” may be confusing and even misleading for the users of general-purpose financial statements. Indeed, the standard does not apply to collective and universal services that represent a significant portion of government expenditure. The definition of “social benefits” in IPSAS 42 only includes cash transfers, not the provision of services. Further, the standard does not apply to cash transfers to individuals and households that do not address social risks, for example emergency relief.

Some of the respondents to the proposals summarised in the Exposure Draft 63 “Social Benefits” supported an alternative view on the recognition point for all social benefits. They put forward the following arguments in favour of the alternative view:

- the economic substance of social benefit schemes is different and may require different recognition points;
- the proposed treatment (in IPSAS 42) is not in accordance with the QCs of relevance and completeness in the IPSAS CF;
- according to the recognition criteria in the IPSAS CF (translated into more specific recognition principles for provisions in IPSAS 19 and IPSAS 39), ‘being alive’ should be treated as a measurement criterion rather than a recognition criterion.

The IPSAS 42 approach requires all eligibility criteria for the next benefit, including being alive, to be met in order to recognise a social benefit liability. Following the alternative approach, only considering one single recognition point will not reflect the substance of the various schemes that may exist and therefore may in various situations conflict with the definition of a liability in the Conceptual framework.

The IPSAS CF 5 para 20, states: “(…) Where it is determined that an obligation is enforceable in law there can be no doubt that an entity has no realistic alternative to avoid the obligation and that a liability exists”.

The draft EPSAS CF requires that “financial statements shall be prepared on a going concern basis unless there is an intention to liquidate the entity or to cease operating, or if there is no realistic alternative but to do so. The rights and obligations specific to public action entrusted in public entities may only cease to exist, in full or in part, by law or decision of the government, even where public sector entities are merged, split or dissolved.

As a matter of fact, the government cannot take an “alternative course of action” in order to avoid its obligation arising from the condition that the beneficiary has to be alive to receive the benefit. Therefore, under the going concern AP, the fact that the beneficiary may no longer live at the following reporting date should not be considered for recognition of an existing present obligation (due to the fact that the entity cannot control whether the being alive eligibility criterion will be met at the following assessment date) .

The variety of the types of social benefits and the specific circumstances of the legal environments and jurisdictions in which they are granted should lead to different conclusions as to the most appropriate timing for recognition. In particular, there may be situations linked to certain types of social benefits in specific jurisdictions where the obligation is created over time and which should trigger recognition of the social benefit liability and of the related expense over time as well.

For example, certain schemes that are currently in place may be funded by future beneficiaries and create valid expectations towards them that they will receive the benefits later. For such schemes the requirements of the standard may not satisfy the QC of completeness.

In other circumstances (other types of benefits and/or other jurisdictions), the obligating event may be the occurrence of one specific event which then should lead to the recognition of the social benefit liability and the related expense at one point in time.

The standard requires no further disclosures for possible obligations to provide social benefits in the future. Instead, it makes a reference to the voluntary Recommended Practice Guideline (RPG) 1, “Reporting on the Long-Term Sustainability of an Entity’s Finances”. Further comments relating to disclosures are provided under the QC of Relevance.

Prudence

The inclusion of “being alive” as a recognition criterion, resulting in a present obligation for only the next due benefit for all social benefits would result in recognition of a liability for only the provision of the next social benefit. For certain schemes, such an approach might be seen as failing to recognise the valid expectation of longevity in a given recipient population and would not provide realistic and prudent estimate of the obligations under the given social benefit schemes.

Neutrality

Information is neutral if it is free from bias. GPFSs are not neutral if the information they contain has been selected or presented in a manner designed to influence the making of a decision or judgment in order to achieve a predetermined result or outcome.

IPSAS 42 may place more focus of the users of the financial statements on the short-term financial position and performance (i.e. information and disclosure related to the next payment), instead of the long-term effectiveness of the decisions made by governments. Since long-term sustainability of public finance is important for investors in bonds and other users of GPFSs, the requirements of IPSAS 42 may be subject to the same criticism as IAS 17 “Leases” (replaced by IFRS 16 as from 2019). Users may end up adjusting liabilities presented under IPSAS 42, in order to have a view on the long-term effect of social benefit schemes.

Verifiability

Under the general approach, the standard will in most cases lead to the recognition of short-term liabilities whose amounts can be easily verified.

Substance over form

Because of the special characteristics of the public sector, governments’ function is the redistribution of part of the taxes received in the form of social benefits. Thus, users agreeing with the general approach believe that only showing liabilities, but not recognising at the same time future cash flows from tax revenues would not represent the substance of the non-exchange transactions.

The proponents of the alternative approach in the ED 63 indicated that treating all social benefits in the same manner, regardless of different economic substance, would not provide users with the information they needed to assess social benefits.

The financial statement users need relevant, faithfully representative information as to the economic substance of social benefits for different decision-making purposes, including, where relevant, assessing the intergenerational impacts of social benefits. For example, in respect of a state pension scheme designed to be funded on an inter-generational basis, the amount of the entity's present obligation, to the extent an obligation exists, at the reporting date (excluding being alive as an entitlement criterion) to both current beneficiaries and participants, provides useful information as to the magnitude as at the reporting date of pension payments that will need to be funded by future contributions from current and future participants.

Not recognising a liability at the reporting date beyond the next payment would not facilitate, for example, the reflection of changes in policy for state pensions (for example, raising retirement age) in the amount of the liability at a subsequent reporting date. It may be misleading to current and future beneficiaries and participants as to the entity's acknowledgement of their respective entitlements.

Furthermore, not recognising an obligation at the reporting date beyond the next payment does not reflect the economic substance of contributory schemes. Contributions will be shown as revenue when paid by the participant, whereas the part of the benefit that is earned with this payment will not be shown at this point in time as an obligation, but only (probably years later) when the payment is due to the then beneficiary, respectively the former participant.

Finally, the fact that liability is recognised only when all eligibility criteria for the next payment are satisfied may lead to different liabilities being recognised just because of the different payment periodicity of social benefits.

If the social benefit scheme is fully funded from contributions and there is evidence that it is managed in the same way as private insurers manage their insurance contracts, it has the characteristics of an insurance contract. Therefore, accounting for those schemes using the insurance approach, which is a possibility under IPSAS 42, seems appropriate.

Understandability

The definitions of social benefits, social risks and universally accessible services are conceptually sound. For example, the universally accessible services are left out of the scope of the standard on social benefits since they are accessible without any eligibility criteria to be met in relation to social risk.

The rules under the general approach are easy to understand and therefore fully meet the understandability QC. As a consequence, the liability presented in the general approach is not subject to complex estimations (and high volatility), based on (a) actuarial assumptions and (b) expectations about future changes of policies or regulations.

The rules under the optional alternative insurance approach are more complex. They are however in line with IFRS rules for similar types of arrangements (IFRS 17). The level of understandability of IFRS 17 will be tested when the standard becomes effective in 2022. Comprehensive disclosures as required by IFRS 17 will assist users in their understanding of the numbers reported in the financial statements.

Comparability

A key objective of EPSAS is to achieve the necessary level of financial transparency and comparability of financial reporting, between and within EU Member States.

IPSAS 42 defines social benefits and includes requirements for the recognition and measurement of social benefit schemes. IPSAS 42 also includes disclosure requirements that will provide additional information that users may need to evaluate the effect that social benefits have on a government's finances. IPSAS 42 promotes consistency and comparability in how social benefit schemes are reported by public sector entities. However, the users of the financial statements may argue that one single recognition point will not reflect the substance of the various schemes that may exist in the EU member states and therefore may in various situations conflict with the definition of a liability in the draft EPSAS CF.

It should also be noted that, the definition of social risks may be subject to interpretation, given the variery of different social benefit schemes in the EU.

The "one fits all" approach in the context of complex and wide-spread social benefit systems in the EU member states would also not be consistent with the concepts underlying the accounting for employee benefits under IPSAS 39 (e.g. pension or other post-employment benefit obligations).

In acknowledging that there had been significant support for the alternative view, the IPSASB considered whether it would be appropriate to accommodate both accounting treatments in IPSAS 42. This would permit preparers to use the alternative view for social benefit schemes where they determine that a different past event to that proposed in ED 63 is appropriate. However, the IPSASB concluded that this would not satisfy the qualitative characteristic of consistency and comparability, and decided not to incorporate the accounting treatment set out in the alternative view in the final standard.

IPSAS 42 includes the insurance approach as a possible alternative approach. Entities are permitted, but not required, to use this approach where a social benefit scheme meets certain criteria defined in the standard.

IPSAS 42 does not include requirements for the insurance approach but directs entities to apply relevant international or national accounting standards by analogy.

Reference to IFRS 17 is appropriate as it represents best international practices in terms of insurance accounting in the private sector. However, referring to national standards that are substantially the same as IFRS 17 may create divergence in practice depending on how preparers interpret “substantially the same”.

The optionality of the insurance approach is justified by the fact that the insurance accounting under IFRS 17 “Insurance contracts” is a challenge for private sector entities issuing insurance contracts, not only in terms of accounting complexity, but also in terms of the processes, actuarial models and systems that need to be implemented to produce the data and information needed for IFRS 17 reporting purposes. Mandating it under IPSAS may involve undue costs or efforts for public sector entities.

In addition, it should be noted that application of the insurance approach and the obligating event approach will produce very different pattern of revenue recognition. Public sector entities may prefer applying the obligating event approach for all their social benefits for consistency reasons. Applying the simple and straightforward recognition approach by all reporting entities would bring high level of comparability. On the other hand, it also has to be noted that comparability is not enhanced by making unlike things look alike by providing only a single approach for many different social benefits. Moreover, since there is a lack of long-term information, the usefulness of this comparable information may be limited.

Except for this accounting policy choice, application of the requirements of IPSAS 42 is likely to result in comparable application of the standard across the EU.

Alignment with other frameworks

ESA 2010

Under ESA 2010, social benefits become payable when certain events occur, or certain conditions exist that may adversely affect the welfare of the households concerned either by imposing additional demands on their resources or reducing their incomes. Social benefits are provided in cash or in kind.

The time of recording of social benefits under ESA 2010 depends on whether the benefits are provided in cash or in kind (ESA 2010 para 4.106):

a) Social benefits in cash are recorded when the claims on the benefits are established;
b) Social benefits in kind are recorded at the time the services are provided, or at the time the changes of ownership of goods provided directly to households by non-market producers take place.

The scope of IPSAS 42 is limited to those social benefits that are provided to protect the entire population, or a particular segment of the population, against social risks. The universal provision of services (social transfers in kind) such as education and health are not considered as social benefits in the scope of IPSAS 42.

In practice social benefits are recorded in cash or near-cash terms in national accounts, so that the IPSAS and national accounts practices are closely aligned (only short timing differences across accounting periods for benefits payments show up on balance sheets).

IFRS[4]

Governments and other public sector entities are characterised by incurring liabilities related to their service delivery objectives. Many liabilities arise from non-exchange transactions and include those related to social benefits. The accounting for social benefits is unique for the public sector as private sector entities do not provide social benefits in non-exchange transactions.

In the insurance approach section of the standard, the term “the relevant international or national accounting standard dealing with insurance contracts” refers to IFRS 17, Insurance Contracts, and national standards that have adopted substantially the same principles as IFRS 17.

IFRS 17 has adopted principles for accounting for insurance contracts that, when applied by analogy to social benefit schemes that satisfy the criteria to use the insurance approach, will provide information that meets users’ needs and satisfies the qualitative characteristics.

EU accounting rules

EAR 10 excludes provisions or contingencies arising from social benefits granted by the European Union for which no direct charge is levied in return from the recipients of the benefit (i.e. social policy obligations).

EAR 10 specifies that where the European Union elects to recognise in its financial statements provisions for social benefits for which it does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits, it should make certain disclosures as required in para-graphs 6.1 and 6.2 of EAR 10.

[4] Refer to the IPSAS-IFRS Alignment Dashboard regularly updated by the IPSASB available on https://www.ifac.org/system/files/uploads/IPSASB/Agenda%20Item%201.5%20IPSAS%20IFRS%20Alignment%20Dashboard_June%202019.pdf

European Public Good

Assessing whether IPSAS 42 is conducive to the European public good

The assessment of whether IPSAS 42 would be conducive to the European public good addresses the following items:

a) Whether the standard will improve financial reporting;
b) The costs and benefits associated with the standard; and
c) Whether the standard could have an adverse effect to the European economy, including financial stability and economic growth.

These assessments will allow the EU authorities to draw a conclusion as to whether the standard is likely to be conducive to the European public good.

The analysis revealed a few potential conceptual issues with the proposed accounting for social benefits under IPSAS 42.

- In coming to the conclusion that only the ‘eligibility criteria for the next social benefit have been met’ recognition point should be included in the standard, the IPSASB did not reach consensus. Some members were of the opinion that prescribing a single recognition point applicable to all social benefits is inappropriate and the alternative view should be allowed. Under this view, the requirements of IPSAS 42 would not meet in full all of the QC of the draft EPSAS CF, in particular QC of relevance, completeness and substance over form. As a consequence of IPSAS 42 recognition model, financial statements will not or only partly provide information about an entity’s future cash outflows relating to its social benefit obligations.

- It should further be discussed and assessed whether the potential benefits of the “minimal” solution proposed by the IPSASB in IPSAS 42 outweighs the compromise made with respect to issuing high-quality, conceptually sound standard for the public sector portraying the economic substance of social benefit schemes.

- Because of the requirement to recognise a liability only for the next social benefit payment, the implementation of the current standard will result in the low one-off cost and should be cost-neutral on an ongoing basis for preparers. Application of the alternative insurance approach for certain types of schemes would be more costly, but this would remain an option that Member States may decide not to follow.

- The analysis has not identified any adverse effect of the standard to the European economy, including financial stability and economic growth, or any other factors that would mean the standard is not conducive to the European public good. Based on the previous research, the standard will not bring a significant change to the existing accounting practices of the EU members. The EU standard-setter may consider whether the current standard could be acceptable as a temporary solution under the condition that the alternative view could be developed as part of a longer term project addressing again the issue of recognition of social benefits in order to better portray the economic substance of social benefit schemes.

Conclusion

Assessing IPSAS 42 against the criteria formulated in the draft EPSAS framework

The analysis revealed some conceptual issues with IPSAS 42 ‘Social benefits’ and identified some potential inconsistencies between IPSAS 42 and the draft EPSAS CF.

Following the screening analysis summarised in the present report, the future standard setter could consider the following conclusions. The information resulting from the application of IPSAS 42:

- would provide relevant, reliable, complete, prudent, neutral, verifiable, economically substantive, understandable, timely and comparable information, for some of the social benefit schemes. For other benefits, concerns can be raised about whether the requirements of IPSAS 42 would meet in full all of the QC of the draft EPSAS CF, in particular QC of relevance, completeness and substance over form. In particular, this is true for those social benefit schemes designed to transfer wealth between generations. Under these schemes, the future beneficiaries would have a reasonable expectation (or even a legal right) to receive benefit subsequent to the end of the reporting period and thus under the draft EPSAS CF, the reporting entity would recognise a liability.

  Depending on the view taken, the information needed for making economic decisions and achieving the necessary level of financial transparency and comparability of financial reporting in the European Union would or would not be provided for all social benefit schemes in the scope of IPSAS 42.

- would not be contrary to the true and fair view principle (however subject to limitations described in the report); and

- would be conducive to European public good. Overall, IPSAS 42 represent a step forward in terms of getting information about social benefit programs recognised and disclosed in public sector financial statements.

However, in order to achieve consistent application of the new standard within the EU context and therefore better address the comparability objective of EPSAS financial statements, additional guidance and improvements in certain areas might be desirable.

- *Alternative insurance approach.* The use of the alternative insurance approach is conceptually justified for those schemes that have the characteristics of an insurance scheme. However, permitting the use of this approach could lead to different accounting treatments between entities applying the general approach and those applying the insurance approach. In particular the two approaches would produce a very different pattern of revenue recognition.

- *Judgment and comparability.* The use of judgment and estimates is inherent in the preparation of financial statements and may to some extent affect the comparability of financial statements. This would be particularly true in relation to the application of the optional alternative insurance approach.

The analysis has not identified any adverse effect of the standard to the European economy, including financial stability and economic growth, or any other factors that would mean the standard is not conducive to the European public good.

The EU standard-setter should consider whether the current standard is acceptable as such, or acceptable only as an interim minimal solution under the condition that the alternative view could be developed as part of a longer term project addressing again the issue of recognition of social benefits in order to better portray the economic substance of social benefit schemes, or not acceptable (therefore implying that the alternative view should be adopted upfront).