THE INSTITUTE OF CHARTERED ACCOUNTANTS OF INDIA

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CASLB/G/10 February 11, 2016

Andreas Bergmann
Chairman,
International Public Sector Accounting Standards Board,
International Federation of Accountants,
277 Wellington Street West,
Toronto, Ontario M5V 3H2 CANADA

Dear Andreas,

Sub: Comment on Consultation Paper on Recognition & Measurement of Social Benefits.

We are pleased to provide comments on Consultation Paper on Recognition & Measurement of Social Benefits issued by the International Public Sector Accounting Standards Board (IPSASB) of International Federation of Accountants (IFAC). Our comments are enclosed with this letter.

Please feel free to contact us, in case any further clarification in this regard is required.

Thanking you,

Yours sincerely,

(CA. S. Santhanakrishnan)
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Comments on Consultation Paper on Recognition & Measurement of Social Benefits

Specific Matter for Comment 1 (following paragraph 2.50)

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

ICAI's view:

Yes, the scope of this CP appears to be appropriate.

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

ICAI's View:

The definition of social benefits needs to comprise not just benefits provided to mitigate the effect of social risks, but also creation of social *opportunities* for socially or economically disadvantaged individuals or households. In many cases, there may be no real social risk that a benefit mitigates, but it would certainly create social opportunities for development e.g. providing bicycles to girl children so that they attend school. Not providing a bicycle need to necessarily expose a girl child to social risk, but certainly provides enhanced social opportunities for individual development.

It may also be appropriate to include "groups of individuals" and "groups of households" alongwith "individuals and households" as the target recipients of social benefits. In certain cases, governments may provide social benefits to a group rather than an individual/household for efficiencies or better impact. E.g. Self Help Groups in the Indian context, in states such as Kerala, Andhra Pradesh etc.

A definition of who or what constitutes a household may be helpful too

Specific Matter for Comment 2 (following paragraph 3.4)

(i) Based on your review of Chapters 4 to 6, which approach or approaches do you support?
  a. The obligating event approach;
  b. The social contract approach; and
  c. 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.

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ICAI's View:

Conceptual Merits and Weaknesses

The obligating event approach is best suited across various categories of social benefits. Treating the obligation to pay social benefits in principle as any other obligation is conceptually sound. When such an obligation arises, especially in the case of social benefits, indeed is a crucial question given that the obligation to pay social benefits is unique. That however is a separate question. The obligating event approach is also simple, making it easier for users of GPFRs to understand basis of recognition of social benefits.

The social contract approach in our view is deeply problematic at several levels. Firstly, it is simplistic to argue that there is a one on one relationship between an individual or household on one hand and governments on the other, as far as the obligation to pay taxes and entitlement to receive benefits are concerned. The "social contract" in fact in many cases may not exist as individuals and households liable to taxes may not be eligible for most or many social benefits, and individuals and households eligible for social benefits may at many times not be liable to taxes. Taxation is a tool for governments to raise public finances in general and not specifically towards social benefits alone.

Secondly, the constitutional or legal validity of such a *quid pro quo* like interpretation of social benefits and taxes may not stand scrutiny in many countries. The laws governing taxation are distinct from laws or executive policies of governments governing social benefits. It would be excessive to read across legislations and match obligation of an individual arising out of one set of laws drawn up with one set of objectives, with benefits to which a citizen is eligible under a different set of laws or policies possibly drawn up with wholly different objectives.

The possible simplicity of the social contract approach alone is not in our view reason enough to override the above arguments.

The insurance approach may be appropriate for social benefits that are akin to insurance contracts, though in terms of measurement (and in understanding of such measurement by readers of financial statements) they may be complex. Further they result in differing accounting treatments for different social benefits.

Extent to which each option addresses objectives of financial reporting

GPFRs of public sector entities have a particularly diverse group of end-users comprising elected representatives, other policymakers such as bureaucrats, citizens, and intermediaries such as citizen interest groups, domain experts, economists and statisticians etc. Providing such a diverse group of end-users with information that is useful for accountability and decision-making purposes is likely to be best accomplished through an approach that is conceptually sound yet simple to understand. The obligating event approach best meets this criterion.

(ii) 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.

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ICAI's View:

The potential for a fair value approach to social benefits, especially on the assets side, needs to be researched further. All approaches in this CP recognise a social benefit as a tangible benefit that is paid out to an individual or household and measure them based on what they cost to the public sector entity/government. However many times the purpose of a social benefit is the social or economic development of individuals and households and not just aiding them to mitigate any immediate social risk. For example, giving a bicycle to a girl child may be measured at the cost of a bicycle, but the socio-economic substance of this social benefit includes better attendance at school, better health and nutrition (arising out of another social benefit, the mid-day meal scheme), better employability and therefore better economic prospects. This value of a social benefit is not covered under this CP and is crucial information for users of GPFRs of a public sector entity. A method or a set of principles to measure the net present value of the future socio-economic benefit that accrues to the individual or household from a social benefit therefore will greatly enhance the quality of GPFRs and its utility (even if only as disclosures).

Specific Matter for Comment 3 (following paragraph 3.4)

(i) 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

ICAI's View:

None, primarily because the obligating event approach is comprehensive and capable of addressing ANY social benefit.

Specific Matter for Comment 4 (following paragraph 4.69)

(i) 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 discussed in this chapter.

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.

ICAI's View:

In our view, a conceptually sound recognition principle would be c above, the eligibility criteria to receive the next benefit have been satisfied. However, we believe this description can be made simpler, more meaningful and less misleading. In our view, the core distinction between b and c is the aspect of periodic validation that is part of c but not part of b. This aspect needs to be brought out appropriately in the nomenclature for the obligating event purported to in c.

Given the diverse nature of social benefits, a higher bar as in d above should be permitted, provided there is adequate justification in a particular case on why recognition is more appropriate when a claim is approved rather than when eligibility criteria is met. E.g. in certain cases where the validated eligibility criteria under c does not provide a good basis for quantifying the liability, d may need to be invoked, with appropriate notes justifying the same. At the earliest instance where quantification under c becomes possible, a change in recognition criteria needs to be effected. This may be required in large universal schemes in jurisdictions where identification of individuals or households based on eligibility may not be reasonably accurate.

Specific Matter for Comment 5 (following paragraph 4.76)

(i) **In your view, does an obligating event occur earlier for contributory benefits than non-contributory benefits under the obligating event approach?**
Please explain the reasons for your views.

ICAI's View:

In our view, an obligating event does not occur earlier for contributory benefits than non-contributory benefits under the obligating event approach.

Firstly, whether a benefit is contributory or non-contributory is purely a matter of how a social benefit scheme is funded and does not determine the timing of the obligating event. Secondly, we agree with the IPSASB view that a non-legally binding obligation does not exist solely because an individual has a valid expectation that the entity will accept certain responsibilities and has relied on that expectation. The third criterion is a defining one, that the entity must have little or no realistic alternative to avoid an outflow of resources.

Whether a scheme is contributory or otherwise, the public sector entity or government can through legislation or executive order amend various aspects of a social benefit scheme, both nature and amount of benefit. That a scheme is contributory does not in any manner change that prerogative of the public sector entity/government.

That said, it needs to be however recognised that in most cases, contribution is likely to commence only after eligibility criteria is established.

Specific Matter for Comment 6 (following paragraph 4.80)

(i) 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.

ICAI's View:

Prima facie, there is a strong case to recommend a above. If the principal nature of a transaction is the granting or paying of a social benefit, then it ought to be accounted for as such, irrespective of whether the grant/payment happens through an exchange or non-exchange transaction. Equivalence in value (which is the distinguishing factor between exchange and non-exchange transactions) alone does not merit overlooking the "social benefit" nature of a transaction. E.g. if market labour rates are paid by government in an employment guarantee scheme which is run as a social benefit, then it would qualify as an exchange transaction but needs to be accounted as a social benefit.

Specific Matter for Comment 7 (following paragraph 4.91)

(i) 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.

ICAI's View:

We are in agreement with paragraphs 4.89 and 4.90 of the CP. In our view, scheme assets need to be included in all cases where the social benefit schemes are funded through a separate fund or through earmarked assets. This will provide useful information to end users of GPFRs.

Specific Matter for Comment 8 (following paragraph 5.38)

(i) 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.

ICAI's View:

Our view on why the social contract approach is flawed in principle is elucidated in an earlier paragraph above. Our response below needs to be read against that backdrop.

Recognition of an obligation under social contract approach needs to happen when a claim becomes enforceable. The underpinning rationale for the social contract approach is that there is a mutual obligation (as a contract) between an individual/household on one side and a public sector entity/government on the other.

The claim approval basis only considers one side of the above mutual obligation i.e. that of the individual/household being eligible to receive a social benefit, and the government being obligated to pay the same once the claim is approved. This does not factor in the other leg of the mutual obligation, that of the individual/household being obligated to pay taxes and other dues. The claim enforceability criterion considers both as a claim could be reckoned to be enforceable only when the other leg of the contract is fulfilled.

Specific Matter for Comment 9 (following paragraph 6.24)

(i) **Do you agree with the IPSASB's conclusions about the applicability of the insurance approach?**
Please explain the reasons for your views.

ICAI's View:

Yes, we are in agreement with the IPSASB's conclusions about the applicability of the insurance approach, which are elaborated in paragraphs 6.1 to 6.24 of the CP. We find the reasoning laid out in the CP to be fully consistent with the conceptual framework, specifically on the below grounds

- The Insurance approach provides useful information that enhances the verifiability and understandability (two of the "quality of information" criteria or attributes) of financial information to users of GPFRs.
- By giving information on cash flow positions and projections, it provides useful information on liquidity and solvency
- Disclosures under the insurance approach also throw light on performance of the reporting entity, especially on how well it has managed the resources it is responsible for and
- It aids users in meeting the accountability purpose (out of the "decision-making and accountability purposes")

Specific Matter for Comment 10 (following paragraph 6.35)

(i) **Under the insurance approach, do you agree that where a social security benefit is designed to be fully funded from contributions:**
   a. **Any expected surplus should be recognized over the coverage period of the benefit; and**

b. Any expected deficit should be recognized as an expense on initial recognition? Please explain the reasons for your views.

ICAI's View:

Yes, we agree with this view articulated in paragraphs 6.33 and 6.34 of this CP. Where a social security benefit is designed to be fully funded through contributions, any expected deficit should be recognised as expense on initial recognition to indicate to users the deviation from the design/the expectation. This information speaks to both the accountability and decision-making purposes of GPFRs referred to in the Conceptual Framework.

On a above, while we are in agreement with the principle, it may be useful to disclose the surplus at every reporting period as additional information in the notes.

<u>Specific Matter for Comment 11 (following paragraph 6.37)</u>

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

a. Recognize an expense on initial recognition;

b. Recognize the deficit as an expense over the coverage period of the benefit;

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?

ICAI's View:

We believe recognising the expense on initial recognition would be appropriate. However we are not clear if the reasoning provided in the CP, that all deficits would be accounted for consistently irrespective of design of the scheme, is adequate. In fact, it is the design of the scheme that provides rationale for using the insurance accounting in the first place. Wouldn't the expense be on initial recognition even under the obligating event approach?

<u>Specific Matter for Comment 12 (following paragraph 6.43)</u>

(i) 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.

ICAI's View:

The liability of the public sector entity to meet the social benefit obligation should be measured at cost of fulfilment. However risk adjustment needs to be made in respect of expected contributions from participants, based on past trends and other reasonably valid assumptions. From the CP, it is not clear why under the cost of fulfilment basis, a risk adjustment to contributions is not required. Cost of fulfilment of the public sector entity will obviously increase if participants do not contribute as expected.

Specific Matter for Comment 13 (following paragraph 6.63)

(i) **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:**
   a. **The substance of the scheme is that of a social insurance scheme; and**
   b. **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.

ICAI's View:

Agree. The CP defines social insurance as "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". The two criteria specified above both directly relate to this definition. It may be useful however to add a third criterion that benefits shall be paid to participants, again arising from the definition of social insurance.

Specific Matter for Comment 14 (following paragraph 6.72)

(i) **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.

ICAI's View:

Yes, we support this proposal. We agree with the rationale outlined in paragraphs 6.64 to 6.72.

Specific Matter for Comment 15 (following paragraph 6.76)

(i) **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

ICAI's View:

Yes, we agree with this proposal.