Comments and suggestions on the IPSASB Exposure Draft
“Retirement Benefit Plans” (ED 82)

Task force IRSPM PSAAG, CIGAR Network, EGPA PSG XII

July 15th, 2022

The IPSASB has requested comments and answers to specific questions regarding its Exposure Draft ED 82 on Retirement Benefit Plans. The following document comprises a general comment which accompanies our responses to the Specific Matters open for Comment (SMC). This document was prepared by the Task Force IRSPM A&A SIG, CIGAR Network and EGPA PSG XII.

The IRSPM A&A SIG, CIGAR Network and EGPA PSG XII are three research networks that focus on Public Sector Accounting. The Task Force is made up of 17 researchers from these networks. The views expressed in this document represent those of the members of the Task Force and not of the whole research community represented by the networks, and neither of the Institutions/Universities with which they are affiliated.

Core assumptions

We are of the opinion that Public Financial Management (PFM), in its broadest sense, is the system by which public financial resources are planned, managed and controlled. Furthermore, the PFM system is the foundation on which the accountability, both external and internal, of public sector entities is built upon, to enable and control for efficient and effective delivery of public service outcomes, and to discharge accountability towards citizens and their representatives. In our view, PFM is paramount for accountability, which should be prioritized over stewardship and decision-usefulness functions.

We are of the opinion that, in general, public sector entities require public sector specific principles and standards in order to properly address and accommodate public sector specificities. As such, when public sector transactions resemble those taking place in the private sector, principles and standards may be kept as aligned as possible between the two sectors. However, for public-sector-specific transactions, we are in favour of standards which are not artificially adapted from private sector accounting. Consequently, we argue for seeking accounting treatments that best fit the public sector specificities. This core understanding underpins our proposals and recommendations herein.

We recognise the pivotal role of the IPSASB in developing high quality international public sector accounting standards to frame and shape financial reporting by public sector entities in order to enhance citizens’ trust. We welcome, therefore, the opportunity to comment on ED 82.

General Comment on the Exposure Draft No. 82 'Retirement Benefit Plans'

The ED [Standard] 82 (ED82 thereafter) on 'Retirement Benefit Plans' aims to establish the accounting, presentation, and disclosure requirements (shortened also as 'accounting for' and 'accounting requirements for') for the financial statements of a public sector retirement benefit plan.

Although based upon the private sector standard IAS 26, it differs substantially from the latter. In particular:

- ✓ While the IAS 26 allows presentation – including for defined benefit plans - either in the financial statements, the notes or an external document, the ED82 requires presentation on the face of the financial statements. In particular, it requires presentation only on the statement of financial position (balance sheet);
- ✓ While the IAS 26 does not require plan assets to be measured at fair value, the ED82 does;
- ✓ While the IAS 26 allows using either projected or current salaries to estimate the present value of promised retirement benefit, the ED82 retains only projected salaries.

The ED82 scope includes all sorts of public sector retirement benefit plans, either: formal or informal (AG10); incorporated or not (AG11); single-employer, multi-employer or state plans (AG7 and AG8). However, neither does it apply to old-age pensions provided through welfare or social security programs, nor to social security schemes that provide pensions to all citizens (AG2).

Facing this variety and diversity of public sector retirement plans, the ED82 takes the bold stance to develop and propose a 'one size fits all' approach based upon a balance-sheet recognition of plan assets (including plan investments) and plan liabilities (including provision for the promised retirement benefits), at their current values. All retirement plans – being either benefit, contribution or other plans - are submitted to this single balance sheet approach at current values.

The overarching assumption is that every retirement plan does work - or is supposed to work – "*as if*" it were a closed financial investment fund which seeks current and prospective investments and investment earnings thereon, in order to be able to pay for current and prospective benefits owed to participants. Consequently, the plan investments are (supposed to be) funded up-front by past contributions by participants and sponsors, as well as by retained accrued earnings from the plan investments.

The proposed definition of a 'defined contribution plan' corroborates this understanding (ED82, 9):

> 'Defined contribution plans are, for the purposes of this [draft] Standard, retirement benefit plans under which amounts to be paid as retirement benefits are determined by contributions to a fund together with investment earnings thereon.'

Accordingly, the proposed standard ED82 states that 'the objective of reporting by a defined contribution plan is periodically to provide information about the plan and the performance of its investments' (AG4; see also AG14). Moreover, it is assumed that '[under a defined contribution plan,] an employer's obligation is usually discharged by contributions to the fund. Therefore, any investment risk typically falls on the participant' (AG15).

However, the ED82 itself must acknowledge that "many public pension systems operate on a pay-as-you-go basis. This means that pensions paid to current pensioners are typically financed from general

taxation and from contributions paid by current employees" (ED82, AG3 (f), p. 12). Moreover, 'many public sector retirement benefit plans are unfunded, operating on a pay-as-you-go basis whereby benefits are payable from general taxation' (AG11).

According to this acknowledgment of fact, the ED82 appears to be less aiming to harmonise public sector accounting for retirement benefit plans, than provoking their hazardous transformation through inconsistent accounting requirements. Many public pension systems do not work as closed investment funds and they do not have either intention or management capabilities to work "as if" they were. The standard would therefore impose a drastic departure from incumbent business models and economic organisation.[1]

Whether an employer has current legal or constructive obligation to pay for future pension benefits to its employees – triggering recognition of a current liability in its balance sheet - is a matter covered by IPSAS 39, Employee Benefits, approved in June 2016 and repealing IPSAS 25. The ED [Standard] 82 deals with accounting for reporting entities which manage retirement benefit schemes on behalf of sponsoring employer(s) and benefiting employees. These entities are treated separately from sponsoring entities and labelled 'retirement benefit plans'.

Countless types (also business models thereafter) of retirement benefit plans exist across jurisdictions. Some operate as closed financial investment funds which provide future benefits based upon the financial performance of invested up-front contributions. Consequently, the amount of future pension benefits is uncertain and its payment risk rests upon the beneficiaries. This type would be consistent with the 'defined contribution plan' as defined by the ED 82. Other plans promise some future defined benefits under management schemes which are more collective. Accordingly, the risk is somehow shared between sponsors and beneficiaries, but the amount of future pension benefits is generally submitted to open renegotiation clauses by contract or the law. This is the case for 'defined benefit plans', but also for 'pay-as-you-go' schemes which are typical of public sector retirement benefit plans.

Therefore, we propose an alternative view which is consistent with the existing variety of public sector retirement benefit plans. In order to harmonise public sector accounting, the IPSASB may seek to disentangle either (i) the set of common ground dimensions which virtually all retirement plans have in common, or (ii) the set of distinctive business models which subsumes the variety of existing systems.

In the first case (alternative single approach), a flow basis of accounting may be the most appropriate solution, in line with accrual-based multi-period cash flow reporting. What most retirement plans have in common is a working search for a long-term sustainable financial balance between contributions by participants and sponsors, and benefit payments owed to beneficiaries. An accrual-basis of accounting on these current and prospective flows may complete public sector budgets by informing both participants and managers about the current and prospective balance according to an undiscounted historical cost basis of accounting. Current values will not be appropriate since many public sector retirement plans do not hold and do not pursue financial investments to pay for benefits owed to beneficiaries.

[1] For a review and analysis focused on European practice, see Biondi, Yuri and Marion Boisseau-Sierra, "Pension Obligations in the European Union: A Case Study for Accounting Policy", Accounting, Economics, and Law: A Convivium, vol. 7, no. 3, 2017. DOI: https://doi.org/10.1515/ael-2017-0027

This alternative single approach may be developed by building upon the cash flow statement which the ED82 itself proposes to introduce.[2]

In the second case (harmonisation), the IPSASB may distinguish between the accounting needs of those retirement benefit plans which treat future pension payments as present obligations, and those which do not. Consequently, it shall recognise the specific needs of 'pay-as-you-go' retirement plans and let them provide information according to their specific business model and economic organisation. Generally speaking:

- ✓ This kind of retirement plans seeks to balance current and prospective contributions by participants and sponsors (including from general taxation), with current and prospective benefits owed to participating beneficiaries;
- ✓ This plan management strategy does not require plan assets in the form of investments, and it does not seek for investment earnings thereon, in order to fulfil the retirement plan promises over time;
- ✓ Its retirement benefit promises do not generally constitute 'vested interests' until the benefit payments become due.

Our alternative view concerning public sector retirement plans, including those managed on a 'pay-as-you-go' basis, acknowledges that they somehow include a solidarity dimension, which complements the contractual commitment as an employer to provide employee benefits along with employee salaries. To be sure, not all public sector entities in all juridictions offer retirement benefits to their employees. Consequently, our alternative view is quite in line with our response to the ED63 on social benefits. Concerning accounting for social benefits, we recommended treating these benefits as non-exchange transactions (similar to social service provision), which enact economic solidarity among present and future stakeholders of public sector entities. Public sector retirement plans may enact this solidarity across present and future participating parties including employees, other beneficiaries and taxpayers. Transactions with these parties may then include a solidarity dimension and represent a mix of exchange and non-exchange transactions, the latter being similar to social service provision to specific categories who meet eligibility criteria.

Moreover, for public sector retirement plans which operate as closed financial investment funds, the IPSASB may consider referring to accounting regulations for private sector pension funds and life insurance providers.

Furthermore, due to the variety of existing types (business models), the IPSASB should remain in line with IAS 26, allowing a variety of reporting options, through general purpose financial statements, the notes or a separate document. Generally speaking, for both alternative approaches, we recommend:

- ✓ Recognition of benefits and contributions in the income statement when they become due, respectively as expense and revenue of the period;
- ✓ Concerning retirement benefit plans which treat future pension payments as present obligations, recognition or disclosure of current liabilities concerning pension provision. They may apply either current value accounting, or historical cost accounting approaches;

[2] See Biondi, Yuri and Marion Boisseau-Sierra, "Pension management between financialization and intergenerational solidarity: a socio-economic analysis and a comprehensive model", Socio-Economic Review, Volume 16, Issue 4, October 2018, Pages 791–822. DOI: https://doi.org/10.1093/ser/mwx015

- ✓ Concerning retirement benefit plans which do not hold present obligations, disclosure of future liabilities (that is, promised retirement benefits) as non-debt non-cash future obligations under an undiscounted cost approach, through the notes or a separate document;
- ✓ Disclosure of plan investments only for those retirement plans which actively seek for investments in view to pay for benefits owed to participants, according to their business model and management practice. This requirement is expected to be very limited in scope concerning public sector retirement plans.

Contrary to the ED82 proposal (AG2), our alternative view may be extended to accounting for old-age pensions provided through welfare or social security programs, as well as to social security schemes that provide pensions to all citizens. This extension will enhance uniformity and comparability of public sector financial statements.

Further information on reinsurance and other joint guarantees on pension benefits may be disclosed in the notes or by referring to a separate document.

Specific issues may arise when retirement benefit plans have to be consolidated with other public sector entities, including the sponsoring entities which belong to the retirement benefit scheme. In some circumstances, the controlling party for the public sector entity as an employer may be the same as for the public sector entity as a retirement benefit plan. The ED [Standard] 82 should address these consolidation issues, including avoiding double counting and resolving measurement mismatches.

The following specific comments draw upon this alternative view to the ED82 proposed approach.

Specific Matter for Comment 1 – Paragraph 9 (see paragraphs BC10 – BC 13)

This ED proposes amending the IAS 26 definition of 'defined benefit plans' to include all retirement benefit plans that are not defined contribution plans. The definition proposed for a defined benefit plan is consistent with IPSAS 39, Employee Benefits as follows:

'Defined benefit plans are retirement benefit plans other than defined contribution plans'

Do you agree with this proposal? If not, why not?

No. This dualistic definition does not acknowledge the variety of business models which exist among public sector retirement plans.

Moreover, such definition constitutes a step toward considering both defined contribution plans and defined benefit plans 'as if' they were closed financial investment funds which can and should be accounted for under a 'one size fits all' approach (see our general comment above).

Furthermore, this definition is inconsistent with the IAS 26, which provides a self-standing definition of a 'defined benefit plan' (BC12), then implicitly enabling a residual category of 'other' plans beyond either 'defined contribution' or 'defined benefit' plans. For instance, unfunded retirement benefit plans managed under a 'pay-as-you-go' basis do not fit either of the two former categories.

Specific Matter for Comment 2 – Paragraph 9 (see paragraph BC14)

This ED proposes to retain the IAS 26 definition for 'actuarial present value of promised retirement benefits' as it addresses the plan perspective rather than to use the IPSAS 39 definition for 'present value of a defined benefit obligation'.

Do you agree with this proposal? If not, why not?

No. This definition requires current value measurements which are inconsistent with a large majority of existing business models for public sector retirement benefit plans.

Moreover, it would introduce an asymmetry between measurement of plan investments at fair value, and plan liabilities at actuarial present value. This mismatch may be exploited to obtain specific accounting results, undermining transparency and accountability.

Furthermore, it would introduce inconsistency across IPSAS standards since it differs from the IPSAS 39 (Employee Benefits) definition for an equivalent obligation. This inconsistency would be especially problematic for plans which are informal and/or not incorporated separately from the sponsor/employer. Consolidation issues may arise.

Specific Matter for Comment 3 – Paragraph 10 (see paragraph BC15)

This ED proposes that for defined benefit plans the actuarial present value of promised retirement benefits be recognised and presented on the face of the statement of financial position as a provision for that obligation. This removes two options in IAS 26 which permit the actuarial present value of promised retirement benefits to be only disclosed in the notes to the financial statements or in a separate actuarial report.

Do you agree with this proposal? If not, why not?

No. The IAS 26 remained open to the variety of business models which exist in the private sector, allowing a variety of accounting treatments for recognition, presentation and disclosure. Similarly, the public sector standard should be as much open and consistent with existing practice in the public sector.

In particular, current value recognition and presentation is consistent with retirement benefit plans in which future pension payments are actually not present obligations. However, they are inconsistent with one of the most widespread business models for the public sector, which implies a 'pay-as-you-go' basis of management in which 'promised retirement benefits' are not 'vested interests' before they become due. Therefore, those promises are not yet obligations which require a provision to be accounted for in the balance sheet.

Retirement benefits may be accounted for as an expense when they become due. Disclosure of future promised benefits may be provided through the notes or a separate document.

Specific Matter for Comment 4 – Paragraph 11 (see paragraph BC16)

IAS 26 does not specify whether or where the retirement benefit obligations for defined contribution plans should be recognised and presented. To achieve the objective of increased transparency and accountability, this ED proposes that defined contribution obligations should be recognised and presented on the face of the statement of financial position.

Do you agree with this proposal? If not, why not?

No. The IAS 26 remained open to the variety of business models which exist in the private sector. The far more stringent and uniform single approach proposed by the ED82 will not increase transparency and accountability by imposing a balance sheet recognition and presentation of future retirement benefits promised to participants. These future benefits are labelled 'defined contribution obligations' for defined contribution plans, and 'promised retirement benefits' for defined benefit plans.

In case of defined contribution plans, the proposed ED82 approach may result in weakening protection of individual vested interests, since the plan management (or policy) may be unwilling to recognise and present these interests as anything else than the accrued net surplus generated by past net individual contributions to the plan, avoiding any constructive or voluntary commitment concerning future performance of the plan. This future commitment dismissal constitutes a widespread disclaimer for most financial investment funds.

In case of defined benefit plans (all the other plans, according to the ED82 proposed definition), the ED82 proposed approach may result in expanding materially the liability side of many public sector entities which do not hold plan investments to match for that liability. This would result in disclosing pro-forma deficits which do not correspond to management reality and practice. Moreover, changes in those pro-forma deficits, including those due to changes in accounting policies and mark-to-model assumptions, will blur the information provided by other changes in deficit: One reason is that the former are often bigger than the latter changes by magnitude orders.[3]

Furthermore, for many public sector retirement plans, which are unfunded and managed under a 'pay-as-you-go' basis, benefit obligations do not become vested interests before they become due. For instance, those obligations are promises which may be changed by law and by governmental decision in the future.

[3] For an illustrative example, see Y. Biondi (2016) The HM 'Treasure's Island': The Application of Accruals-based Accounting Standards in the UK Government, Accounting in Europe, 13:1, 81-102, DOI: 10.1080/17449480.2016.1142096

Specific Matter for Comment 5 – Paragraph 12 (see paragraph BC19)

IAS 26 allows plan assets to be valued at amounts other than fair value. This ED proposes that plan investment should be measured at fair value.

Do you agree with this proposal? If not, why not?

No. For many public sector retirement plans, which are unfunded and managed under a 'pay-as-you-go' basis, no such thing as plan investments exists or is needed. This accounting requirement would then blur transparency and accountability for those plans by reporting an actuarial net worth which does not provide a fair and true representation consistent with their business models.

Fair value requirements on plan investments would further blur transparency and accountability for all the plans which seek for investment earnings to pay for their benefit obligations owed to participants, since fair value accounting is not necessarily consistent with all the long-term investment strategies behind the various types of investments. For instance, fair value accounting is not informative for bonds held to maturity when the debtor is likely to fulfil its prospective obligations.

By requiring fair value accounting for all plan investments, the IPSASB is not even aligned with private sector accounting (IAS 26), which allows for different accounting treatments according to the variety of both investments and investment strategies.

For matters of internal consistency, this requirement would introduce an asymmetry between measurement of plan investments at fair value, and plan liabilities at actuarial present value. This mismatch may be exploited to obtain specific accounting results, undermining transparency and accountability (see our response to Comment 2).

Furthermore, this requirement would further undermine consistency across IPSAS standards since it differs from accounting treatments allowed for assets under other standards. The same asset would then be treated differently only because it is included in a retirement plan.

Specific Matter for Comment 6 – Paragraph 13 (see paragraph BC17)

IAS 26 allows the actuarial present value of promised retirement benefits to be calculated using either current or projected salaries. This ED proposes that only projected salaries should be used.

Do you agree with this proposal? If not, why not?

No. Projected salaries introduce a further actuarial modelling need and then a further layer of complexity and subjective assumptions. The problems with mark-to-model accounting are well-known. This requirement will lower the reliability of accounting measurements, paving the way to arbitrariness and structuring opportunities that would undermine both transparency and accountability. Therefore, projected salaries may be include as an option but not imposed as the only measurement method.

Moreover, for many public sector retirement benefit plans, which are unfunded and managed under a 'pay-as-you-go' basis, promised retirement benefits are not yet vested interests. Indeed they do not constitute a present liability for the reporting entity, whether the latter is the employer or the separate plan acting on behalf of this employer. In this context, recognition and presentation of the actuarial present value of promised retirement benefits would be inconsistent with their business model, thus undermining both transparency and accountability.

Specific Matter for Comment 7 – Paragraphs 15(c) and 16 (see paragraph BC23)

This ED proposes that a retirement benefit plan be required to prepare a cash flow statement, whereas IAS 26 is silent on this. This ED also proposes the cash flow statement be prepared using the direct method.

Do you agree with this proposal? If not, why not?

Yes. We agree that cash flow statements are important to enhance transparency and accountability of public sector retirement benefit plans.

In fact, an alternative view on accounting for these plans may be developed. This approach may be based upon current and prospective cash flows attached to benefits and contributions, according to a flow basis of accounting (see our general comment above).

For a retirement benefit plan, the ED 82 prescribes (par 15) a specific set of financial statements, but it does not clarify its relationship with the main annual accounts of the sponsoring governmental entity. Consolidation issues may arise.

Specific Matter for Comment 8 – Paragraph 27 (see paragraph BC24)

This ED proposes prospective application of the requirements of the Standard, which would require an opening and closing statement of financial position in accordance with the Standard but no comparative figures in other financial statements.

Do you agree with this proposal? If not, why not?

No. This accounting requirement retains only the recognition and presentation on the balance sheet. This treatment might be perhaps appropriate if virtually all public sector retirement plans were closed financial investment funds which seek for investments and earnings thereon in order to pay for benefits owed to participants (see our general comment above).

In fact, even some private sector defined contribution plans do not fit with this understanding of their business model and management practice. And many public sector retirement benefit plans are unfunded and managed under a 'pay-as-you-go' basis. In this context, investment earnings generated by past invested funds are just minor sources of revenues, if they exist at all.

Therefore, recognition, presentation and disclosure of public sector retirement benefit plans should build upon a flow basis of accounting, which points to current and prospective inflows from participants and sponsors, as well as current and prospective outflows to beneficiaries.

Specific Matter for Comment 9 – Paragraphs BC20-BC21 and Implementation Guidance

> Public sector retirement benefit plans are structured and/or regulated in many different ways and jurisdiction-specific requirements on how to account for contributions and benefits may vary. As a result, this ED proposes not to require contributions or benefits to be accounted for as any specific element in the financial statements, which is aligned with the approach taken in IAS 26. Instead, Implementation Guidance and Illustrative Examples are provided to demonstrate different accounting presentations depending on how the contributions and benefits are viewed.
>
> Do you agree with this proposal? If not, why not?

No. Our previous response to Comment No. 8 shall be repeated here:

> This accounting requirement retains only the recognition and presentation on the balance sheet. This treatment might be perhaps appropriate if virtually all public sector retirement plans were closed financial investment funds which seek for investments and earnings thereon in order to pay for benefits owed to participants (see our general comment above).
>
> In fact, even some private sector defined contribution plans do not fit with this understanding of their business model and management practice. And many public sector retirement benefit plans are unfunded and managed under a 'pay-as-you-go' basis. In this context, investment earnings generated by past invested funds are just minor sources of revenues, if they exist at all.
>
> Therefore, recognition, presentation and disclosure of public sector retirement benefit plans should build upon a flow basis of accounting, which points to current and prospective inflows from participants and sponsors, as well as current and prospective outflows to beneficiaries.

Moreover, the fact that 'public sector retirement benefit plans are structured and/or regulated in many different ways and jurisdiction-specific requirements on how to account for contributions and benefits may vary' may justify some need for harmonisation, but it does certainly not justify ignoring this variety for the sake of writing an accounting standard.

Generally speaking, disclosures on retirement plans should include the past and current contributions made by employees and employers, as well as current and foreseeable amounts required to meet current and future pension payments.

The IAS 26 did not account for contribution and benefit flows because that private sector standard decided to not define a single approach to accounting for private sector retirement plans, allowing several treatments for recognition, presentation and disclosure of those plans. Its example may be followed by the public sector standard under development ED82 only if the IPSASB decides to retain such an open and permissive approach to accounting for public sector retirement plans.

Date: July 15th, 2022 Signed on behalf of the persons listed below:

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