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International Public Sector Accounting Standards Board Exposure Draft: *Social Benefits*

This letter provides the U.S. Government Accountability Office's (GAO) comments on the International Public Sector Accounting Standards Board's (IPSASB) Exposure Draft (Exposure Draft or ED) entitled *Social Benefits*. We welcome the opportunity to comment on the Exposure Draft and support the board's efforts to establish principles for the recognition, measurement, presentation and disclosure of social benefits.

Overall, we strongly support the ED's proposed recognition of a liability for social benefits in the financial statements under the obligating event approach when all eligibility requirements to receive the next benefit have been satisfied. In addition, we generally agree with the proposed insurance approach as an optional approach and with the proposed social benefit disclosures. We also believe that the Board should undertake further work on reporting on fiscal sustainability reporting.

This ED represents important progress on significant issues related to social benefits. We appreciate the opportunity to provide comments, which are included in the enclosure.

Please contact Robert Dacey, Chief Accountant at (202) 512-7439 or daceyr@gao.gov if you have questions on GAO's perspectives.

Sincerely,

J. Lawrence Malenich

J. Lawrence Malenich
Financial Management and Assurance
Enclosure

Enclosure: GAO Comments on the International Public Sector Accounting Standards Board Exposure Draft, *Social Benefits*

Specific Matter for Comment 1:
Do you agree with the scope of this Exposure Draft and specifically the exclusion of universally accessible services for the reasons given in paragraph BC21(c)?
If not, what changes to the scope would you make?

Response:
In our view, social benefits and universally accessible services are conceptually similar non-exchange transactions and it is critical that the accounting for recognition and measurement of social benefits is consistent with the accounting for universally accessible services. Social benefits and universally accessible services are similar in many ways, such as (1) services are delivered on a nonexchange basis to beneficiaries, generally based on meeting all eligibility criteria; (2) the same types of services may be provided (e.g., health care); and (3) benefits ultimately may be provided for many years or a lifetime. Assuming the Board proceeds with the proposed accounting treatment in this ED, we would favor retaining universally accessible services in the non-exchange expenses project, while agreeing that their recognition and measurement would need to be consistent with social benefits. This approach would allow the standard on social benefits to be issued as scheduled without re-exposure, while allowing consistent treatment for all non-exchange expenses, including social benefits. If the Board determines that the ED should be re-exposed for any reason, we believe that universally accessible services should be incorporated into the re-exposed social benefits exposure draft so that the consistency of treatment can be considered in one standard. In either case, in our view, it is essential that the two types of benefits should be consistently treated to avoid differences in the recognition and measurement of conceptually similar transactions and programs and the user confusion that would likely result.

The Board's Consultation Paper *Accounting for Revenue and Non-Exchange Expenses* (Consultation Paper) presented the Board's Preliminary View that resources provided for universally accessible services and collective services should be expensed as services are delivered. This Preliminary View, which was overwhelmingly supported by respondents, is conceptually consistent with this Exposure Draft. For example, if there are two entities, one which provides universally accessible health care under the Consultation Paper and one which provides health care benefits under this Exposure Draft, the accounting treatment would generally be consistent. Consistent with the Preliminary View in the Consultation Paper, the entity with universally accessible health care would recognize an expense when services are provided to beneficiaries meeting all of the eligibility criteria. For the entity that provides health care benefits under this Exposure Draft, a liability and an expense would be recognized when the beneficiary meets all of the eligibility criteria for the next benefit, which generally occurs when the service is provided—such as when an eligible doctor provides an eligible health care service to an eligible beneficiary.

Specific Matter for Comment 2:
Do you agree with the definitions of social benefits, social risks and universally accessible services that are included in this Exposure Draft?
If not, what changes to the definitions would you make?

Response:
We generally agree with the definitions of social benefits, social risks and universally accessible services. However, the distinction between universally accessible services and social benefits may be extremely difficult to apply in practice.

Specific Matter for Comment 3:
Do you agree that, with respect to the insurance approach:

a) It should be optional;
b) The criteria for determining whether the insurance approach may be applied are appropriate;
c) Directing preparers to follow the relevant international or national accounting standard dealing with insurance contracts (IFRS 17, *Insurance Contracts* and national standards that have adopted substantially the same principles as IFRS 17) is appropriate; and
d) The additional disclosures required by paragraph 12 of this Exposure Draft are appropriate?

If not, how do you think the insurance approach should be applied?

Response:
If the Board determines that the insurance approach is appropriate, we strongly support that its application should be optional, especially given the subjectivity involved in applying the criteria and our view that the insurance approach may not apply to very many social benefit programs. Further, we generally agree that (1) the criteria for determining whether the insurance approach may be applied are appropriate; (2) preparers should be directed to follow the relevant international or national accounting standard dealing with insurance contracts (IFRS 17, *Insurance Contracts* and national standards that have adopted substantially the same principles as IFRS 17); and (3) the additional disclosures required by paragraph 12 of the Exposure Draft are appropriate.

We continue to have concerns with respect to the use of the insurance approach and the resulting inconsistent recognition and measurement across all social benefit schemes and other non-exchange expenses. However, if the criteria are met, we believe it will generally result in assets, liabilities and expenses similar to other social benefits.

Specific Matter for Comment 4:
Do you agree that, under the obligating event approach, the past event that gives rise to a liability for a social benefit scheme is the satisfaction by the beneficiary of all eligibility criteria for the next benefit, which includes being alive (whether this is explicitly stated or implicit in the scheme provisions)?
If not, what past event should give rise to a liability for a social benefit?
This Exposure Draft includes an Alternative View where some IPSASB Members propose a different approach to recognition and measurement.

Response:
We strongly agree that, under the obligating event approach, the past event that gives rise to a liability for a social benefit scheme is the satisfaction by the beneficiary of all of the eligibility criteria for the next benefit, which includes being alive (whether this is explicitly stated or implicit in the scheme's provisions). We believe that this approach, supported by appropriate disclosures in the financial statements and/or the general purpose financial reports (GPFR), best achieves the objectives of financial reporting and provides information about the public sector entity that is most useful to users of financial statements and GPFRs for accountability and decision-making purposes. Further, recognizing a present obligation or liability for social benefits when all of the eligibility criteria to receive the next benefit have been satisfied provides (1) an appropriate basis across the wide range of different types of social benefit schemes, and (2) information that is most consistent with the objectives of financial reporting and qualitative characteristics. This approach is straightforward, is easy to understand, is simple to calculate, can result in information being reported in a timely manner, and can be verified. It is our view that when all eligibility criteria to receive the next benefit have been satisfied, an entity has an obligation to provide non-exchange benefits, for both noncontributory and contributory social

benefit schemes. If the beneficiary fails to meet any of the eligibility criteria, the beneficiary would not be entitled to receive a benefit. In our view, most social benefits have an explicit criteria that the beneficiary is alive as part of the eligibility criteria; in others, it may be implicit. In the United States, for example, one of the explicit eligibility criteria for receiving monthly Social Security payments is that the beneficiary is alive.

Also, non-exchange social benefits and other non-exchange transactions are unique to public sector entities and are fundamentally different from exchange transactions. Although beneficiaries may anticipate that benefits will continue to be provided in the future, it is our view that a valid expectation does not occur until a beneficiary has met all eligibility criteria to receive the next benefit. Although past practice may indicate that the government has accepted a responsibility to provide social benefits, a public sector entity has a realistic alternative to avoid an outflow of resources, for example, by modifying legislation, until all eligibility criteria to receive the next benefit have been satisfied. Beneficiaries should be on notice of social benefit eligibility criteria and the public sector entity's ability to change eligibility criteria and benefits.

In addition, non-exchange social benefits differ from employer-provided benefit plans, which are considered exchange transactions. In an exchange transaction, the employee exchanges employment for current wages as well as deferred compensation, such as through an employee pension plan. The entity has a liability for the deferred compensation related to work that has already been performed. Conversely, under a typical non-exchange social benefit program, the individual does not exchange his or her taxes and/or contributions for a benefit from the public sector entity. Rather, collectively the citizenry pays taxes, whether dedicated or general taxation, to fund social benefits for those that meet eligibility criteria. Accordingly, the compulsory payment of taxes by an individual and the subsequent receipt of social benefits by that same individual in a typical social benefits scheme constitute separate non-exchange transactions. For example, in the United States, the compulsory payment of Social Security taxes does not entitle an individual to a benefit in a legal, contractual sense, and benefits paid to an individual are not directly based on taxes paid by that individual. Therefore, in those programs, the U.S. government has an obligation for the benefits only when all eligibility criteria to receive the next benefit have been satisfied.

It is important to use a consistent accounting approach for recognizing non-exchange expenses across the broad range of social benefit schemes to avoid inconsistent recognition treatment among similar programs. Public sector entities have significant flexibility in determining how they will fund social benefits and other non-exchange transactions. For example, a public sector entity determines whether social benefits and other programs will be funded solely through dedicated taxes, fees, and/or contributions; solely through general tax revenues; or, some other combination. Also, the public sector entity can decide whether to raise tax revenues, reduce benefits, or borrow to finance its programs, including social insurance benefits. This is true whether the social benefit scheme is designed to be fully funded from contributions or not. Further, social benefit schemes may communicate that benefits depend on the availability of funding or other caveats that may limit the payment of benefits. We do not believe that the contributory nature of a social benefit scheme affects a beneficiary's expectation of receiving benefits. Consequently, we do not believe that funding from contributions affects when a present obligation occurs for social benefits.

It is our view that "future benefits", those for which all eligibility criteria for the next benefit have not yet been met, do not represent present obligations. Further, the recognition of future benefits does not reflect the true nature of social benefit programs, the extent of the government's responsibilities for these and other programs, or the government's ability to revise these responsibilities. Just as future government spending on programs, such as universally accessible services or defense that are relatively certain to continue, is not a present obligation of the government, future social benefits spending is also not a present obligation.

We have significant concerns that recognizing social benefit obligations based on key participatory events or threshold eligibility would result in misleading information and a lack of comparability between and within reporting entities. A public sector entity typically has significant discretion in determining whether to continue or to modify social benefits. Therefore, recognizing liabilities for social benefits based on key participatory events or threshold eligibility might not represent a likely or even reasonable policy option for policymakers or users to consider. Further, recognizing a liability for future social benefits does not faithfully represent an entity's financial position or performance and presents a misleading view of the entity's financial position. For example, two entities with comparable liabilities based on key participatory events or threshold eligibility may not be in comparable financial position, based on funding considerations. For these reasons, we do not believe that it is appropriate to recognize, in the financial statements, future social benefits that have yet to be delivered and consequently do not support recognition of a liability based on key participatory events or threshold eligibility.

Recognition of future social benefits without recognition of the future tax revenues related to the public sector entity's power to tax would not provide relevant information, would diminish significantly the relative size and importance of other liabilities and expenses shown on the financial statements, and would include long-term estimates that may be highly uncertain. Also, such estimated liabilities may be subject to significant volatility based on changes in underlying assumptions and would not provide information that is useful for accountability purposes. In addition, to the extent that a social benefit scheme is not sustainable based on dedicated tax revenues or other contributions, the amounts of social benefits that would be provided are also highly uncertain and may not be reliably estimable. Further, the time horizon for recognizing a liability for social benefits may be difficult to determine.

For example, social benefit programs, as currently structured, may be clearly unsustainable (as are Social Security and Medicare (Part A) in the United States), and reforms in these programs are a near certainty. For example, under current law in the United States, the trust funds for Social Security and Medicare Part A are projected to be exhausted in the future, after which only a portion of current benefits could be paid. However, it is not possible to predict what specific actions the entity will undertake to modify or change future benefits or taxes. Consequently, the inherent uncertainty surrounding agreement and settlement for amounts of future social benefits does not lend itself to recognizing a liability and expense for future benefits.

In addition, it is our view that the recognition of future social benefits would result in an inconsistency between the costs of services recognized during the year and the services provided during the year. The statements of financial position and of financial performance provide information for assessing the costs of providing goods and services during the period. Generally, a public sector entity has little exchange revenue and no profit motive, but instead has the goal of providing services collectively chosen to improve the well-being of its citizens. Accordingly, the accounting treatment for recognizing costs should be consistent with the delivery of related services year by year. Thus, costs can be associated with program delivery and analyzed in relation to outputs, outcomes, and relevant performance measures. These measures could assist in improving (1) resource allocation and program management, (2) the effectiveness and efficiency of service delivery, (3) the accountability to citizens for service delivery during the year, and (4) the adequacy of revenues to cover services provided during the year.

We respectfully disagree with the Alternative View's position that liability recognition would vary based on judgments about the level of expectations of the beneficiaries and that the extent of the liability for each program would be based on an assessment of the beneficiaries' expectations for each program. We do not believe that this would result in improved reporting. In our view, recognition of a liability on this basis would be highly subjective; result in entity-specific determinations and a lack of consistency and comparability; and misleadingly communicate that benefits for one program were more likely to be paid than another. Also, we question whether preparers could reasonably determine and differentiate the expectations of the beneficiaries between each social benefit program. In our view, there is generally a high expectation that social benefit and other non-exchange programs will continue to provide benefits unless the enacting law specifically limits the length or spending of the benefit program. For example, we believe that citizens expect that universally accessible services, such as health care or education, as well as collective goods and services, such as the military and police and fire, will continue in the future.

While we agree that users should be provided information to assist them in assessing the likelihood that the entity will be able to continue social benefit programs under current law, we believe that this goal cannot be achieved by recording a liability based on key participatory events or threshold eligibility, as such information would be incomplete to make this assessment. Rather, due to the complex nature of a public sector entity's finances, broader reporting on fiscal sustainability is necessary to fully reflect the complex interaction of future revenues and expenses and provide this information. Information only about long-term future benefits payments without a consideration of dedicated revenues and without considering other resources and other commitments would be incomplete and likely be misleading. Further, information on the long-term effects of current changes in policy should take into consideration much broader issues beyond simply future program benefits. Although the magnitude of future benefits may be similar in two public sector entities, many other factors should be considered to evaluate the overall financial condition of the entities and their ability to continue program benefits over time.

In conclusion, governments establish eligibility criteria for determining whether and when an individual is entitled to receive a benefit and publicly communicates such criteria. Accordingly, a liability should not be established and recognized until the beneficiary meets all of the eligibility criteria to receive the next benefit. We do not consider estimates for future social benefits to be present obligations for the reasons discussed above.

Specific Matter for Comment 5:
Regarding the disclosure requirements for the obligating event approach, do you agree that:

a) The disclosures about the characteristics of an entity's social benefit schemes (paragraph 31) are appropriate;
b) The disclosures of the amounts in the financial statements (paragraphs 32–33) are appropriate; and
c) For the future cash flows related to from an entity's social benefit schemes (see paragraph 34):
    (i) It is appropriate to disclose the projected future cash flows; and
    (ii) Five years is the appropriate period over which to disclose those future cash flows.

If not, what disclosure requirements should be included?

Response:
(a) We support disclosures about the characteristics of an entity's social benefit schemes, but caution that it should be presented at an appropriately aggregated level. Because a reporting entity may have a significant number of social benefit programs, detailed information on each program may be lengthy and not meaningful.

(b) We agree that entities should disclose information about the amounts in the financial statements, including significant assumptions used to discount the liability for social benefits and a reconciliation of the opening and closing balances of the liability for social benefits, considering the appropriate level of aggregation in situations where the reporting entity has a significant number of social benefit schemes.

(c) We agree that it is appropriate to disclose the projected future cash flows.

(d) Given the applicability of the standard to both national and sub-national entities, we support the use of a five year period for the disclosure of projected future cash flows, perhaps with an acknowledgement that an entity may present additional years.

In addition, we believe it would be appropriate to disclose significant known factors and trends that could result in significant or material changes to future social benefit cash flows (both benefits and any dedicated revenues) in relation to the economy or other appropriate measure. Such information would provide relevant information that could inform user judgments about future costs of the programs beyond the proposed five year projected cash flow period.

Specific Matter for Comment 6:
The IPSASB has previously acknowledged in its *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*, that the financial statements cannot satisfy all users' information needs on social benefits, and that further information about the long-term fiscal sustainability of these schemes is required. RPG 1, *Reporting on the Long Term Sustainability of an Entity's Finances*, was developed to provide guidance on presenting this additional information.

In finalizing ED 63, the IPSASB discussed the merits of developing mandatory requirements for reporting on the long-term financial sustainability of an entity's finances, which includes social benefits. The IPSASB identified the following advantages and disadvantages of developing such requirements at present:

Advantages	**Disadvantages**
Long-term financial sustainability reports provide additional useful information for users for both accountability and decision making, and that governments should therefore be providing.	The extent and nature of an entity's long-term financial reports are likely to vary significantly depending on its activities and sources of funding. It would therefore be difficult to develop a mandatory standard.
This especially applies to information about the sustainability of the funding of social benefits given the limited predictive value of the amounts recognized in the financial statements.	
Social benefits are only one source of future outflows. Supplementary disclosures (as proposed in the ED) on social benefits flows in isolation are therefore of limited use in assessing an entity's long-term sustainability, as they do not include the complete information on all of an entity's future inflows and outflows that long-term financial sustainability reports provide.	The nature of the information required for reporting on the long-term sustainability of an entity's finances, in particular, its forward-looking perspective, could preclude its inclusion in General Purpose Financial Statements. Given the scope and challenges involved in its preparation and audit considerations, some question whether it would be appropriate to make information in a General Purpose Financial Report mandatory.
Long-term financial sustainability reports will improve accountability and will help support Integrated Reporting (IR) in the public sector. They will also provide useful information for users, in particular for evaluations of intergenerational equity.	RPG 1 was only issued in 2013, so it may be too soon to assess whether requirements developed from those in RPG 1 should be mandatory.

Do you think the IPSASB should undertake further work on reporting on long-term fiscal sustainability, and if so, how? If you think the IPSASB should undertake further work on reporting on long-term fiscal sustainability, what additional new developments or perspectives, if any, have emerged in your environment which you believe would be relevant to the IPSASB's assessment of what work is required?

Response:
We strongly support reporting on long-term fiscal sustainability and believe that the Board should undertake further work to revisit RPG 1 to consider requiring fiscal sustainability reporting. We agree that current financial statements cannot satisfy all users' needs on social benefits. General purpose financial reports prepared in accordance with RPG 1 would provide information about expected obligations to be incurred and settled in the future. Such obligations do not meet the definition of a present obligation, and so are not recognized in the financial statements. In accordance with RPG 1, reporting would also include information about expected resources to be realized in the future that will be used to finance social benefits, or the right to tax. Because the entity does not currently control these resources, they are not recognized in the financial statements.

Therefore, in addition to disclosures discussed in our response to Specific Matter for Comment 5, a report or statement of fiscal sustainability with estimates of future costs, including social benefits, and future revenues, including dedicated revenues, would help provide a comprehensive perspective of the government's financial condition and its ability to continue to provide and finance social benefits and other goods and services. It will also provide useful information for users, in particular for evaluations of intergenerational equity.

In the United States, a statement of fiscal sustainability has been presented annually as an audited basic financial statement for the last three fiscal years and as unaudited information for five fiscal years prior to its presentation as an audited basic statement. In addition to providing an analysis of discounted, projected cash flows, such reporting provides information on "fiscal gap," the magnitude of noninterest spending reductions and/or receipts increases needed to maintain the current debt-to-GDP ratio over the valuation period. The American Institute of Certified Public Accountants (AICPA) has issued guidance for auditing and reporting on sustainability information. In our experience, fiscal sustainability reporting is used as a foundation for assessing the likelihood that the government will continue to provide public services, such as social benefits, to constituent groups and to assess whether financial burdens without related benefits are passed on by current-year taxpayers to future-year taxpayers. For example, fiscal sustainability reporting is used as a framework for analyzing the effect of proposed or implemented policy changes on fiscal sustainability, and was recently highlighted on the front page of a major national newspaper.

In summary, it is our view that "financial condition" is a forward-looking indicator that should provide predictive information about a government's long-term capacity to sustain and finance its current programs, including social benefits—information such as the right to tax that is not conveyed in the financial statements. Consideration of future taxes and other receipts are critical to assessing financial condition. In addition, the financial statements do not provide sufficient information for users to assess the extent that financial burdens have or will be passed on by current year taxpayers to future taxpayers without related benefits. Many countries face long-term challenges, including demographic and socioeconomic change with rapid increases in the old-age dependency ratio that will affect future fiscal health, level of spending for goods and services, and level of future receipts. Consequently, it is critical that the future impact of these challenges be considered in the framework of a comprehensive assessment of a government's financial condition.