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DATE: 13 JUNE 2006
MEMO TO: MEMBERS OF THE IPSASB
FROM: JOHN STANFORD
SUBJECT: SOCIAL SECURITY PENSIONS

ACTION REQUIRED

Members are asked to:

- **Consider** the issues raised by Staff in the Key Issues Paper at Agenda Item 9.2;
- **Review** the extracts from a draft ED on Social Security Pensions at Agenda Item 9.3 and provide further directions for development of a full draft ED; and
- **Note** the latest developments for modifications to the SNA for pensions and employee pensions at Agenda Item 9.4.

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AGENDA MATERIAL

		Pages
9.2	Key Issues Paper on Present Obligations and Social Security Systems	9.4-9.16
9.3	Extracts of Draft ED on State Retirement Pensions	9.17-9.29
9.4	Extract from Short Report on Meeting of Advisory Expert Group, January and February 2006	9.30-9.32

KEY ISSUES PAPER ON TIMING OF PRESENT OBLIGATIONS IN RELATION TO NATURE OF SOCIAL SECURITY SYSTEMS

Agenda Item 9.2 is a Key Issues Paper that considers whether present obligations for social security pensions might arise at different points dependent upon the nature of the social security system. In particular, the Paper considers whether the contributory or non-contributory nature of a scheme and the type of contributory scheme has an impact on when a present obligation might arise. The main objectives are to:

- Ascertain whether, in the future development of this project, it is appropriate to depart from the principles governing the proposed ED on general social policy obligations at Agenda Item 8.2; and
- Provide input to consideration of the basis on which disclosures of potential liabilities under (what are now termed) state retirement pensions might be made.

DRAFT ED ON STATE RETIREMENT PENSIONS

At the Tokyo meeting Members agreed that Staff should modify the scope of the ED so that it includes state pensions (basic/welfare and general/contributory), but not age-related cash transfers and age-related goods and services. Staff has considered this direction and, in order to implement it, have modified the scope and certain definitions in order to implement the directions of members.

The scope includes what are now defined as state retirement pensions. The term “state retirement pensions” supercedes the term “social security pensions”.previously used in the ED extracts. It also includes what were previously termed “age-related cash transfers” (see below. In the view of Staff, the term “social security pensions” only applies to programs which involve direct contributions from either future beneficiaries or other third parties on behalf of those future beneficiaries. In this context the System of National Accounts 1993 and Government Finance Statistics Manual 2001 distinguish social security schemes and social assistance schemes. Social security schemes are government controlled and financed contributory social insurance schemes. Social assistance schemes are non-contributory schemes.

As now defined state retirement pensions include the “basic/welfare pension” and the “general/contributory pension”. These are both terms which have been used previously in the ED extracts. A key characteristic of both the “basic/welfare pension” and the “general/contributory pension” is that attainment of “retirement age” is an eligibility criterion. The definitions have, however, been modified. The basic/welfare pension is now defined at paragraph 9 as “a cash transfer payable only to individuals who have reached retirement age, where entitlements to transfers of economic benefits are not dependant on contributions made by or on behalf of the beneficiary.” The “general/contributory pension” is defined as “a cash transfer payable only to individuals who have reached retirement age where the amount of the transfer is dependant on contributions made by or on behalf of the beneficiary but the benefits provided are not approximately equal to the contributions.” In the view of Staff these modifications make the distinction between the basic/welfare and general/contributory pensions clearer and facilitate the analysis of when present obligations arise and liabilities might be recognized as at Agenda Item 9.2.

The defined term “retirement age” has been adopted to address the concerns expressed by some members that the term previously used, “pensionable age”, leads to ambiguity as to whether the ED extracts apply to a range of cash transfers where age is an eligibility criterion e.g. child benefit. “Retirement Age” is defined as “an age specified in legislation at which an individual becomes eligible for retirement pensions.” Commentary notes that retirement age is the age at which an individual is no longer expected to be active in the full-time work-force and that this age may also be the age at which an individual becomes ineligible for other social benefits such as unemployment benefit.

Staff has also considered the term “age-related cash transfer”, which has been used in previous drafts. The term is very broad. Staff has concluded that what have previously been referred to as “age-related cash transfers” and that where an eligibility criterion is attainment of retirement age such transfers are, in substance, state retirement pensions, and should be dealt with in the documents addressing the state pension. As indicated at Item 8.2 it would be both conceptually illogical and operationally difficult to distinguish pensions and other cash transfer programs which share identical or very similar eligibility criteria simply because a program or activity is or is not referred to by the term “pension”. Therefore the definitions of the basic/welfare pension and general/contributory pension include cash transfers which have as an eligibility criterion the attainment of retirement age, although governing legislation and regulations may not use the term “pension”. Individual goods and services where retirement age is an eligibility criterion are outside the scope of this Standard and in the scope of the ED at Agenda Item 8.2.

Members also agreed that for this meeting the extracts of the ED on social security pensions should be redrafted to reflect the approach agreed for the identification and recognition of present obligations and liabilities in relation to cash transfers. At paragraph 27 there is alternative commentary on measurement that mirrors the approach in the general social policy obligations ED at Agenda Item 8.2 (see section (d) of Memo at Agenda Item 8.1 for a more detailed discussion of this issue).

The ED extracts at Item 9.3 reflect these directions. Only a clean copy is included. A marked-up copy showing changes from the version on the agenda papers for Tokyo is available from Staff on request. The draft extracts considered at the Tokyo meeting included proposed disclosures of future cash transfers. These disclosures have been deleted and the current ED extracts do not include disclosure requirements. Disclosure requirements may be developed following decisions on the key issues paper at Agenda Item 9.2.

PROPOSALS FOR CHANGES IN THE SNA

At the Tokyo meeting Staff noted that the Advisory Expert Group (AEG) had met in late January/early February 2006 and considered the proposals of the Task Force on Employer's Retirement Schemes. Because a formal report of the proceedings of the AEG had not been issued by the time of the Tokyo meeting, Staff updated members on likely outcomes from that AEG meeting based on informal soundings and a session at the OECD Public Sector Accruals Symposium in February 2006.

Item 9.4 includes relevant extracts from the Short Report of the Meeting of the AEG. The outcomes noted in that short report are consistent with those highlighted for the Tokyo meeting. From the perspective of accrual reporting, Staff notes that:

- There is strong support for recognition of the liabilities in all employer retirement schemes regardless of whether they are funded;
- There is still uncertainty over the actuarial basis on which liabilities will be determined and, in particular, whether this basis will include estimated salary increases, as in the projected unit credit method required by IAS 19 and incorporated in the ED at Agenda Item 10.2;
- It is acknowledged that it is difficult in many countries to distinguish pension schemes for government employees and social security schemes and criteria need to be developed to distinguish different types of scheme; and
- There is no intention to include liabilities for social security schemes in core SNA but a possibility of including supplementary accounts for social security schemes.

If Staff becomes aware of any further developments before the Paris meeting these will be notified to Members at that meeting.

KEY ISSUES PAPER: PRESENT OBLIGATIONS IN RELATION TO SOCIAL SECURITY SYSTEMS

Introduction

In accordance with directions provided to Staff at the Tokyo meeting this Paper considers whether present obligations for social security pensions might arise at different points dependent upon the nature of the social security system. In particular the Paper considers whether the contributory or non-contributory nature of a scheme and the type of contributory scheme has an impact on when a present obligation might arise.

A contributory scheme is one where governing legislation or regulation requires contributions or earmarked taxes to be made to a program or activity and eligibility for benefits is dependent upon the record of contributions and earmarked taxes made on or behalf of a beneficiary. In some jurisdictions such contributions or earmarked taxes are paid into separate funds which are segregated from the general revenues of government. The analysis in this Paper does not distinguish programs and activities for which separate funds are established from those where no such separate funds are established. This is because staff is of the view that the existence of separate funds has no influence on when a present obligation arises.

This Paper does not consider the detail of particular social security retirement schemes and programs. It does deal with contributory programs and activities where:

- contributions are made only by individuals;
- contributions are made by both individuals and employers (or other third parties); and
- contributions are made only by employers (or other third parties)

In the context of this Paper general personal or corporate tax payments are not considered as “contributions”. However, the Paper acknowledges that programs may exist where, although there are no contributions, benefits may be dependent on a record as a taxpayer. The Paper also addresses the argument that a record as a general taxpayer may create an expectation that state retirement benefits will be paid.

Throughout the development of the project on pensions members have directed that the ED extracts should be based on the same principles as for general social policy obligations. This paper therefore:

- considers whether departure from those principles is justified; and
- explores approaches to potential disclosures in relation to state retirement pensions in the ED extracts at Agenda Item 9.3.

In order to explore the points at which a constructive obligation might arise the paper considers the options explored by the Steering Committee on Social Policy Obligations and also considers stewardship information on the sustainability of certain social security programs in the Financial Report of the United States Government (US Federal Consolidated Statements).

The paper has the following sections:

- Background and Current Position
- Steering Committee on Social Policy Obligations
- Stewardship Information in US Federal Consolidated Statements
- Contributions from and on behalf of individuals
- Conclusion

Throughout this paper certain key terms are used. These terms and their definitions are highlighted in Exhibit One below

Exhibit One: Key Terms

A <u>constructive obligation</u> is an obligation that derives from an entity's actions where:

(a) By an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
(b) As a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

A <u>legal obligation</u> is an obligation that derives from:

(c) A contract (through its explicit or implicit terms)
(d) Legislation: or
(e) Other operation of law.

<u>Liabilities</u> are present obligations arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.

An <u>obligating event</u> is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.

Background and Current Position

The draft ED presented to the Tokyo meeting of the IPSASB included disclosure requirements for the basic/welfare pension, the general/contributory pension and what were then termed "age-related cash transfers". These disclosures were based on the same methodology regardless of whether the programs under which benefits are made were contributory or financed completely or partially by earmarked taxes. The disclosures included cash flow projections of costs on a present value basis for all current participants. Current participants were defined as those who had satisfied eligibility criteria at the reporting date. These projections incorporated assumptions about the length of time that participants would remain eligible for state retirement pensions-in many instances participants would remain eligible until death. The disclosures did not include projections of future revenues from contributions, earmarked taxes or interest. These proposed requirements are highlighted in Exhibit Two below. Following directions from members these disclosure requirements were deleted from the revised ED extracts at Agenda Item 9.3 for this meeting.

Exhibit Two: Proposed Disclosure Requirements Presented in ED Extracts at Tokyo Meeting

Disclosure of Information on Present Value of Basic/Welfare pension, General/Contributory Pension and Major Age-related Cash Transfer Programs and Arrangements

35. An entity shall disclose in a separate statement the present value of future cash transfers for the basic/welfare pension, the general/contributory pension and all major age-related cash transfer programs and arrangements for all participants at the reporting date.

36. The disclosure required by this Standard is for the present value of cash transfers for current participants at the reporting date. In accordance with the definition at paragraph 8 a participant is an individual who has satisfied all eligibility criteria at the reporting date. The disclosure does not include individuals, who are making contributions or for whom contributions are being made by third parties, if those individuals have not satisfied all eligibility criteria. For example if a general/contributory pension has a pensionable age of 62 years the disclosure would not include an estimate of the present value of future cash transfers for any individual who has not reached the age of 62 years. In making the disclosure an entity needs to be aware of amounts that are payable to the estate of a deceased participant, for example where the terms of a pension or major age-related cash transfer program provide for a lump sum to be paid to a participant's estate in the event of the participant's death

37. The disclosure is made in the context of the current legislative framework for pensions and other major age-related cash transfer programs. In accordance with paragraph 22 the disclosure does not take account of possible changes to the legislative framework, for example a broadening or narrowing of eligibility criteria, unless such change has been enacted or is virtually certain to be enacted.

38. In making an assessment of the present value of future cash transfers the entity shall discount the projected amount of those future cash transfers. The discount rate used will reflect the estimated timing of benefit payments and will be related to the yield on government bonds at the reporting date.

39. This Standard requires entities to use a discount rate which reflects the time value of money. This is the yield on government bonds. The discount rate should reflect market yields at the reporting date on government bonds with an expected term consistent with the expected term of the cash transfers. .In rare cases there may be cash transfers which are payable beyond the final maturity of available government bonds. In such cases, an entity uses current market rates of the appropriate term to discount shorter term payments, and estimates the discount rate for longer maturities by extrapolating current market rates along the yield curve. The total present value of cash transfers under a pension program or age-related cash transfer program or arrangement is unlikely to be particularly sensitive to the discount rate applied to cash transfers that are payable beyond the final maturity of the available corporate or government bonds

40. An entity shall disclose the following information for the basic/welfare pension, the general/contributory pension and each major age-related cash transfer program:

(a) A general description of the basic/welfare pension, the general/contributory pension and each major age-related cash transfer program, including the principal legislation and regulations governing the program or arrangement and the number of participants at the reporting date.

(b)The rate used to discount future cash transfers to their present value.

(c)Estimated future increases of benefits under each pension and other major program.

(d)The principal actuarial assumptions, if any, used at the reporting date.

(e)Changes to the principal actuarial assumptions since the last reporting date.

(f)Comparative figures for the 4 years immediately preceding the reporting period.

41. The projections needed in order to make the disclosures are likely to require actuarial assumptions. The principal actuarial assumption for pensions and other age-related cash transfer programs is life expectancy. However, other demographic factors such as emigration and the extent to which existing participants will cease to satisfy other eligibility criteria and financial factors including future benefit increases may require actuarially based assessments.

42. Where actuarial assumptions are used this Standard requires the disclosure of the principal assumptions used to provide the projections of future cash transfers and any changes to those assumptions since projections disclosed at the previous reporting date. This information is useful in facilitating the assessment of the viability of the projections. The Standard also requires comparative information, which provides an indication of the rate at which the projected financial impact of a particular cash transfer program or arrangement is decreasing.

43. Professional judgment is applied in determining which age-related cash transfer programs are major programs by reference to the qualitative characteristics of financial reporting in IPSAS 1. Such a judgment is based primarily on the current annual expenditure of a program.

44. The disclosures required by this Standard may be a useful input to assessments of the sustainability of key pension programs and major age-related cash transfer programs However, such assessments need to take into account a wide range of factors not addressed in this Standard

The ED extracts at Item 9.3 reflect a number of further revisions from the extracts reviewed at the Tokyo meeting. These are highlighted in the memorandum at Item 9.1.

Steering Committee on Social Policy Obligations

The Steering Committee on Social Policy Obligations considered the point at which a legal obligation arises and when constructive obligations might arise for what were termed old age pension benefits in the Invitation to Comment (ITC), “Accounting for Social Policies of Government” (and are referred to as state retirement pensions in this paper and in the ED extracts). The Steering Committee explored three options for when present obligations as a result of constructive obligations might arise. These options are summarized in the next section of this Paper. They can be reviewed in more detail in Chapter 8 of the ITC. Copies of the ITC can be obtained on request from Staff or downloaded from the IPSASB section of the IFAC website.

Legal Obligations

The Steering Committee concluded that a government has a legal obligation for benefits to individuals meeting eligibility criteria for state retirement pensions where these criteria are specified in legislation. The amount of the resultant liability would be the amount that the individual was entitled to receive as a result of satisfaction of those eligibility criteria. There is no legal obligation for benefits which are subject to the satisfaction of eligibility criteria in the future. In the rare circumstances where eligibility needs to be satisfied only once a legal obligation could exist for future payments, if there is no realistic alternative but to make those future payments. In forming this conclusion the Steering Committee did not consider that the contributory or non-contributory nature of a scheme had any impact on when a legal obligation might arise.

Constructive Obligations

Option 1

Under Option 1 the present obligation arises when all the eligibility criteria are satisfied and is until the next payment date or point at which eligibility criteria have to be satisfied again, if this point is different to, and earlier tan, the payment date.. Because individuals can cease to meet eligibility criteria at any point in time due to death or failure to meet other eligibility criteria there is no obligation for future pension benefits. The analysis under Option 1 leads to a position where the recognition of liabilities is likely to be very similar to that when a legal obligation arises. However, the ITC pointed out that such a constructive obligation might lead to the recognition of liabilities in the unlikely event that requirements governing state retirement pensions are not laid down in legislation and regulations. Also, in programs with infrequent validation of eligibility, it was suggested that the amount of the liability recognized as a consequence of the satisfaction of eligibility criteria might be greater than under recognition of a liability from a legal obligation.

Option 1 was the majority view of the Steering Committee and received majority support at consultation. The analysis of when a present obligation arises is the same as in the current ED Extracts at Agenda Item 9.3, although as the memo at Agenda Item 9.1 points out, there is some ambiguity whether, at the reporting date, the liability is for the whole of the next installment following the satisfaction of eligibility criteria or only for the portion of that next installment which relates to the period up until the reporting date.

Option 2

Option 2, which received no direct support within the Steering Committee (but see discussion at Option 3) and little support at consultation, put forward the view that the obligating event for the constructive obligation is when individuals meet initial or threshold eligibility criteria-in this case the attainment of retirement age. The amount of the liability is the present value of the best estimate of future cash flows following satisfaction of those eligibility criteria. Under this option the extent to which those currently eligible continue to meet other eligibility criteria, such as income and asset tests or residency criteria, are measurement attributes, which will probably require actuarial assessments, along with estimates of mortality rates and other key variables, rather than recognition attributes. The approach in Option 2 was that which informed the proposed disclosure requirements that were included in the version of the ED considered at the March Tokyo meeting.

Because, under Option 2, no obligating event has triggered a legal or constructive obligation the liability does not include individuals who have not reached retirement age regardless of whether a retirement pension program is contributory or non-contributory. In the view of some, liabilities recognized under this option may be misleading, because they do not include obligations in respect of:

- those who are nearing retirement age and may have a valid expectation of receiving a pension benefit which the government has no realistic alternative but to settle; and

- where a scheme is contributory, those who may be a number of years from retirement age, but have been making contributions (or for whom contributions have been made by third parties for a considerable period. Such individuals also have a valid expectation of receiving cash transfers under the program and it is unrealistic to suggest that the government can avoid a transfer of resources. The fact that contributions have been made by or on behalf of individuals may reinforce the expectations of future beneficiaries.

The approach in Option 2 implicitly adopts the view that government is able to repeal or drastically amend the legislation governing state retirement pensions at any point after the reporting date and therefore can realistically avoid a sacrifice of resources to all except those who have satisfied eligibility criteria at the reporting date.

Option 3

Option 3 reflected the view that the obligating event for benefits under the state retirement pension occurs prior to the point at which threshold eligibility criteria have to be satisfied (i.e. retirement age). There was, however, no consensus amongst the advocates of Option 3 in the ITC as to when that obligating event occurs and a very wide spectrum of points was suggested.

Some argued that workforce entry is the appropriate point at which a constructive obligation arises and therefore when a liability begins to accrue. An alternative view was that the obligating event occurs close to retirement age and that, whilst the analysis of the obligating event differs from that at Option 2, retirement age is a pragmatic proxy for this point. A further view was that the obligating event occurs at an intermediate point when individuals take stock of personal and family financial affairs and plan on the expectation that post-retirement income will include inflows from the state retirement pension. This intermediate point arises at some juncture between workforce entry and retirement age. It has informally been suggested that 40 years might be a workable proxy, although the arbitrary nature of this point makes it difficult to implement an approach based on an intermediate obligating event. A more radical interpretation of option 3, not put forward by the Steering Committee, is that birth is the obligating event.

Stewardship Information in US Federal Consolidated Statements

In its consolidated financial statements the US federal government includes extensive stewardship information on the Social Security System and Medicare and two more minor contributory programs- Railroad Retirement and Black Lung. This information, which is unaudited, is actuarially based on a present value basis and provides a 75 year projection of cash flows. The information includes projections of contributions, earmarked taxes, Medicare premiums and internal interest from non-marketable, intra-governmental debt obligations, as well as projections of costs. There is also narrative discussion of the operation of the various programs and commentary on the financial impact of the sensitivity of key variables. The information presented on the face of the main statement, which is shown at Appendix One, is split into three age cohorts:

- Participants who have attained eligibility (62 years in case of the core social security program);

- Participants who have not attained eligibility (15-61 years in case of the core social security program);and

- Future participants (under 15 years and births in the period).

Staff has no details on the rationale behind the selection of these generational cohorts. However, the cohorts exemplify three feasible points for analyzing future cash flows related to programs that are partially financed from contributions, earmarked taxes and other specific inflows- attainment of retirement age or satisfaction of all eligibility criteria, entry into the workforce and future participation based on birth. There will be a presentation by the INTOSAI observer on the US stewardship information at this meeting

In the view of Staff the disclosures in the US financial statements provide highly useful information about the sustainability of major cash transfer programs, which are partially dependent upon sources of finance other than general tax revenues for their future viability. However, Staff has some reservations whether, in advance of initiation of a detailed project on sustainability reporting and consideration of the relationship of sustainability reporting to the general purpose financial statements, such disclosures are necessarily appropriate at this stage of development of the ED on State Retirement Pensions. Staff also questions whether it would be appropriate to mandate such disclosures for jurisdictions which may be on the point of migrating to the accrual basis of financial reporting and would undoubtedly find it difficult to provide long-run cost information of the sophistication of that in the US consolidated financial statements.

Contributions from and on behalf of individuals

This section of the paper examines whether the contributory nature of a State Retirement Pension program has an impact on the analysis of when a present obligation arises.

This section addresses;

- Non-contributory state retirement pensions defined in the ED extracts as the basic/welfare pension
- Contributory social security schemes including those where:
  - Contributions are made by both the individual beneficiary and employers or other third parties;
  - Contributions are made by only the individual beneficiary; and
  - Contributions are made by only an employer or third party on behalf of the beneficiary

In jurisdictions that have composite social security schemes this analysis does not deal with the component of the composite social security scheme that operates as a post-employment benefit plan.

In Agenda Item 9.3 the general/contributory pension is defined as "a cash transfer payable only to individuals who have reached retirement age where the amount of the transfer is dependant on contributions made on or behalf of the beneficiary but the benefits provided are not approximately equal to the contributions." Arrangements for general/contributory pensions vary globally, but frequently contributions are required when an individual enters the workforce. Such contributions may be made by either, or both, the individual and their employers or other third parties on behalf of the individual. In some jurisdictions benefits under the general/contributory pension do not vest until an individual has established a minimum contribution record; individuals who do not meet this minimum contribution record will not be entitled to benefits under the general/contributory scheme. In such cases they may, on reaching retirement age, be eligible for the basic/welfare pension, which, under the revised definition in the ED extracts at Item 9.3, does not involve contributions. They may also be entitled to a repayment or partial repayment of contributions.

None of the options put forward by the Steering Committee explicitly considered the extent to which earmarked contributions or earmarked taxes might have an influence on the point at which a present obligation arises. In this context the ITC did not generally distinguish pension contributions from general taxation receipts, noting that "in some cases, individuals contribute directly to the financing of their social security pensions, albeit that they are not exchange transactions. In most cases, these contributions by beneficiaries are treated as general revenues of the government concerned".

Whilst there was a recognition that, in some cases, contributions may be separately identified and linked to particular benefits the ITC did not suggest that this factor had any influence on when a present obligation arises in respect of state retirement pensions. The ITC noted that "some who support Option 3 note that many individuals consider that, because they have paid taxes for a period of years, the government "owes" them a pension"- in more formal accounting terms the payment of taxes gives rise to present obligations. However, this view had little support within the Steering Committee.

The ITC put forward two measurement approaches if liabilities were to be recognized under Option 3. Under both of these approaches workforce entry was taken to be the obligating event giving rise to a present obligation. The approaches are relevant to the measurement of liabilities which might arise under contributory programs.

- Under Approach A benefit rights would accrue over the period of an individual's working life with the liability reaching its maximum at the point that an individual reached retirement age and then declining as benefits were paid over the individual's remaining life or until eligibility criteria were no longer satisfied.

- Approach B measured the liability as the total estimated cash flows to all individuals who had reached or were older than workforce age. This is likely to result in a significantly higher liability than the approach at A

It is arguable that the contributory nature of a state retirement pension program may have an impact on when a present obligation arises. In this view the making of contributions by or on behalf of an individual or the payment of earmarked taxes might give rise to a present obligation at an earlier point than for social benefits which are non-contributory. This is because the payment of contributions or earmarked taxes are obligating events that create a valid expectation or reinforce existing expectations that an individual may receive benefits and the government may have little alternative but to settle. If it is accepted that the contributory nature of a scheme does have an impact on when present obligations arise, Staff considers that there are 2 potential points at which a present obligation might arise:

- Date when contributions are first paid into a program (normally workforce entry). This is because the payment of contributions is the obligating event that creates a constructive obligation, even though a legal entitlement only is only confirmed when an individual reaches retirement age; and

- Vesting Date (date at which the contribution record of an individual makes that individual potentially eligible for benefits under the program without making further contributions), because prior to vesting date there is no valid expectation that entitlements will ensue.

Staff does not think that the particular type of contributory system has an impact on identification of an obligating event. i.e. it is whether contributions are made by or behalf of an individual and the timing of those contributions rather than the identity of the contributor that are the key factors in analyzing when a present obligation arises.

Staff also considers that a conclusion that contributions give rise to a present obligation for state retirement pensions may have implications for other social insurance type programs and activities currently within the scope of the general social policy obligations ED at agenda Item 8.2,. In a number of programs, although the attainment of retirement age is not an eligibility criterion, the access of benefits is dependant upon a beneficiary's contribution record other than general taxation payments. In some jurisdictions unemployment benefit and certain sickness benefits are contributory schemes and benefits are only payable to individuals who have a minimum contribution record.

The argument that the contributory nature of a program affects the timing of a present obligation for the state retirement pension scheme but the contributory nature of social programs, where attainment of retirement age is not an eligibility criterion, does not is based on the assumption that the state retirement pension scheme has key distinguishing characteristics Although they did not address this issue from the perspective of the contributory/non-contributory nature of a program, the supporters of Option 3 in the Steering Committee sought to provide a rationale that the state retirement pension differs from other social benefits by arguing that:

- Transitional provisions have been used to protect individuals nearing retirement age from changes to retirement benefits, but that such transitional provisions are not used for other cash transfer programs; and that

- Individuals rely more heavily on state retirement benefits than on other social benefits.

The explicit thrust of this argument was therefore that, because state retirement benefits are generally a more significant component of the personal income of beneficiaries than other social benefits, it is more difficult for the government to avoid a sacrifice of resources in settlement of the obligation for state retirement benefits than for other social benefits. Whilst the ITC adduced a small amount of empirical evidence in support of this contention, it is, by its nature, difficult to prove or disprove as examples of jurisdictions where the state retirement pension has been drastically modified are relatively rare. It is not clear to staff that it is any easier for governments to significantly modify programs for unemployment benefits and certain other key social programs than it is for state retirement programs.

Conclusion

Staff acknowledges the view that whether a state retirement program is contributory may have an impact on when an obligating event giving rise to a constructive obligation occurs. Whilst there are a number of points at which such an obligating event might arise staff considers that, if such an argument is accepted, in some jurisdictions the most likely point is when contributions are first made on or behalf of an individual. This may be when an individual first enters the workforce. Staff considers that “vesting” is more likely to be a measurement issue rather than a recognition criterion. Staff does not think that the particular type of contributory system has an impact on identification of an obligating event.

However, staff has reservations whether such a principle is universally applicable. Staff e does not think that the payment of contributions by or on behalf of participants will always be an obligating event giving rise to a constructive obligation that leaves the government with no realistic alternative but to settle that obligation. Staff considers it quite likely that, particularly where outflows will not be made for a number of years, changed fiscal circumstances may make it quite likely that governments will drastically modify potential obligations.

Staff is also not convinced that the contributory nature of a scheme is necessarily relevant to the determination of when a present obligation arises. It can be argued that, even where a scheme is non-contributory, individuals “contribute” indirectly through general taxation and the expectation that pension benefits will be payable on attainment of retirement age strengthens as the number of years that individuals have been taxpayers increases. In the view of staff it is unproven that it is any easier for governments to avoid a sacrifice of resources for the basic/welfare pension, where, under the revised definition in Agenda Item 9.3, there are no contributions by or on behalf of future beneficiaries than for general/contributory programs.

Staff is also of the view that contributory state retirement pensions cannot be considered in isolation from other social benefits. Staff is not convinced that it is more difficult for governments to avoid an outflow of resources for state retirement pensions than for many other social benefits. It is not obvious to staff why, if present obligations for contributory state retirement pensions arise prior to the satisfaction of all eligibility criteria, the timing of a present obligation for other contributory social benefit programs should be different simply because attainment of retirement age is not an eligibility criterion. Thus, a general acceptance that the contributory nature of a program influences the timing of a present obligation could lead to recognition of significant liabilities across a range of contributory social programs.

Staff is comfortable that an ED can assert that present obligations for state retirement pensions arise when all eligibility criteria, have been satisfied, regardless of whether the program is contributory, and even though this may be prior to the creation of a legal obligation. Staff does not feel confident that a universally applicable ED can be drafted based on an assertion that a present obligation arises before all eligibility criteria have been satisfied. Staff therefore takes the view that the ED extracts at Item 9.3 should be progressed on the basis that present obligations arise when all eligibility criteria have been satisfied, but that further disclosures should be developed giving users of the financial statements information on potential outflows at points prior to the satisfaction of all eligibility criteria.

APPENDIX ONE

EXTRACTS FROM UNITED STATES GOVERNMENT STEWARDSHIP INFORMATION

United States Government
Statements of Social Insurance
Present Value of Long-Range (75-Years, except Black Lung) Actuarial Projections

(In billions of dollars)	2004	2003	2002	2001	2000
Federal Old-Age, Survivors and Disability Insurance (Social Security):					
Contributions and Earmarked Taxes from:					
Participants who have attained age 62	411	359	348	309	266
Participants ages 15-61	14,388	13,576	13,048	12,349	11,335
Future participants (under age 15 and births during period)	12,900	12,213	11,893	11,035	10,088
All current and future participants	27,699	26,147	25,289	23,693	21,689
Expenditures for Scheduled Future Benefits for:					
Participants who have attained age 62	4,933	4,662	4,401	4,256	4,020
Participants ages 15-61	22,418	21,015	20,210	18,944	17,217
Future participants (under age 15 and births during period)	5,578	5,398	5,240	4,700	4,297
All current and future participants	32,928	31,075	29,851	27,900	25,534
Present value of future expenditures less future revenue	5,229[1]	4,927[2]	4,562[3]	4,207[4]	3,845[5]
Federal Hospital Insurance (Medicare Part A):					
Contributions and Earmarked Taxes from:					
Participants who have attained eligibility age	148	128	125	113	97
Participants who have not attained eligibility age	4,820	4,510	4,408	4,136	3,757
Future participants	4,009	3,773	3,753	3,507	3,179
All current and future participants	8,976	8,411	8,286	7,756	7,033
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age	2,168	1,897	1,747	1,693	1,681
Participants who have not attained eligibility age	12,054	10,028	9,195	8,568	6,702
Future participants	3,246	2,653	2,470	2,225	1,349
All current and future participants	17,468	14,577	13,412	12,487	9,732
Present value of future expenditures less future revenue	8,492[1]	6,166[2]	5,126[3]	4,730[4]	2,699[5]
Federal Supplementary Medical Insurance (Medicare Part B):					
Premiums:					
Participants who have attained eligibility age	332	284	252	258	234
Participants who have not attained eligibility age	2,665	2,148	1,856	1,845	1,527
Future participants	891	688	600	593	404
All current and future participants	3,889	3,120	2,708	2,696	2,165
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age	1,475	1,306	1,132	1,159	1,051
Participants who have not attained eligibility age	10,577	8,845	7,463	7,415	6,094
Future participants	3,277	2,622	2,238	2,206	1,514
All current and future participants	15,329	12,773	10,833	10,780	8,659
Present value of future expenditures less future revenue[6]	11,440[1]	9,653[2]	8,125[3]	8,084[4]	6,494[5]
Federal Supplementary Medical Insurance (Medicare Part D):					
Premiums:					
Participants who have attained eligibility age	176				
Participants who have not attained eligibility age	1,857				
Future participants	618				
All current and future participants	2,651				
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility age	773				
Participants who have not attained eligibility age	7,566				
Future participants	2,431				
All current and future participants	10,770				
Present value of future expenditures less future revenue[6]	8,119[1]				

	2004	2003	2002	2001	2000
Railroad Retirement:					
Contributions and Earmarked Taxes from:					
Participants who have attained eligibility	4	4	3	3	N/A
Participants who have not attained eligibility	37	40	40	41	N/A
Future participants	39	41	41	41	N/A
All current and future participants	80	85	83	84	N/A
Expenditures for Scheduled Future Benefits for:					
Participants who have attained eligibility	81	80	74	73	N/A
Participants who have not attained eligibility	72	73	76	74	N/A
Future participants	14	14	13	13	N/A
All current and future participants	167	167	162	161	N/A
Present value of future expenditures less future revenues[7]	87[1]	83[2]	79[3]	77[4]	N/A
Black Lung (Part C) *present value of future expenditures less future revenue*	(4)[8]	(4)[9]	(5)[10]	(4)[11]	(4)[12]

[1] The projection period is 1/1/2004 - 12/31/2078 and the valuation date is 1/1/2004.
[2] The projection period is 1/1/2003 - 12/31/2077 and the valuation date is 1/1/2003.
[3] The projection period is 1/1/2002 - 12/31/2076 and the valuation date is 1/1/2002.
[4] The projection period is 1/1/2001 - 12/31/2075 and the valuation date is 1/1/2001.
[5] The projection period is 1/1/2000 - 12/31/2074 and the valuation date is 1/1/2000.
[6] These amounts represent the present value of the transfers from the general fund of the Treasury to the Supplementary Medical Insurance Trust Fund. These intragovernmental transfers are included as income in the CMS Financial Report but are not income from the Governmentwide perspective of this report.
[7] These amounts approximate the present value of the financial interchange and transfers from the general fund of the Treasury to the SSEB Account (see later discussion of Railroad Retirement program). They are included as income in the Railroad Retirement Financial Report but are not income from the Governmentwide perspective of this report.
[8] The projection period is 9/30/2004 - 9/30/2040 and the valuation date is 6/30/2004.
[9] The projection period is 9/30/2003 - 9/30/2040 and the valuation date is 6/30/2003.
[10] The projection period is 9/30/2002 - 9/30/2040 and the valuation date is 6/30/2002.
[11] The projection period is 9/30/2001 - 9/30/2040 and the valuation date is 6/30/2001.
[12] The projection period is 9/30/2000 - 9/30/2040 and the valuation date is 6/30/2000.
The "N/A" (not available) entries have not been calculated by the Railroad Retirement Board.

Note: Details may not add to totals due to rounding.

The following notes are an integral part of this statement.

Notes to the Statements of Social Insurance

Actuarial present values of the projections are computed based on the economic and demographic assumptions believed most likely to occur (the intermediate assumptions) as set forth in the relevant Trustees' reports and in the relevant agency performance and accountability reports for Railroad Retirement and Black Lung. The projections are based on the continuation of program provisions contained in current Social Security law.

Contributions and earmarked taxes consist of payroll taxes from employers, employees, and self-employed persons; revenue from Federal income taxation of OASDI and railroad retirement benefits; excise tax on coal (Black Lung); and premiums from participants in Medicare. Income for all programs is presented from a consolidated perspective. Interest payments and other intragovernmental transfers have been eliminated. For example, the Centers for Medicare & Medicaid Services' (CMS) 2004 Financial Report presents income from the trust fund's perspective, not a Governmentwide perspective. Therefore, CMS' Financial Report includes $11,440 billion for the present value of future transfers from the general fund of the Treasury to the Medicare Part B Account and $8,119 billion for the Medicare Part D Account that have been eliminated in this *Financial Report*. Expenditures include scheduled benefit payments and administrative expenses. The term "scheduled" is used to signify that projected benefits are based on the benefit formulas under current law. However, current Social Security and Medicare law does not provide for full benefit payments after the trust funds are exhausted.

Future participants include births during the projection period and individuals below age 15 as of January 1 of the valuation year.

The present values of future expenditures less future revenues is the current amount of funds needed to cover projected shortfalls, excluding the starting trust fund balances, over the projection period. They are calculated by

Accounting for State Retirement Pensions

Extracts for consideration for inclusion in Proposed International Public Sector Accounting Standard

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD IPSAS XX

Accounting for State Retirement Pensions

Objective

1. The objective of this (extract of) Standard is to establish requirements for accounting for state retirement pension arrangements in non-exchange transactions. It includes basic/welfare pensions and general/contributory pensions where attainment of retirement age is an eligibility criterion and where no contribution is made or where some contribution is required to access benefits, but the amount of the contribution is not approximately equal to the benefits provided. It excludes pensions provided as consideration in an exchange transaction, including the provision of post-employment benefits to the employees of public sector entities. It also excludes cash transfer programs, which may be termed "pensions" in governing legislation or regulations, but do not include the attainment of retirement age as an eligibility criterion.

Scope

2. An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for state retirement pensions. State retirement pensions include:

(a) Basic/welfare pensions; and

(b) General/contributory pensions.

(*Staff Note 1: The above paragraph is only needed if this is a stand alone ED.*).

3. Many jurisdictions have programs or arrangements to provide social benefits for individuals who have reached retirement age. Such benefits are often cash transfers which enable an individual to supplement their own resources or resources from post-employment benefits provided as consideration for services rendered as employees. Such cash transfers are commonly known as state retirement pensions. Benefits under state retirement pensions may be dependent upon the amount of direct and earmarked contributions paid over a recipient's working life by either the individual or a third party such as an employer on behalf of the individual. Benefits, which are dependent on the amount of contributions, are within the scope of this Standard unless the benefits provided are approximately equal to the contributions made. Where programs or activities are dependent upon contributions, such contributions may be paid to a separate fund or entity or may simply be paid into general revenue with a record of contributions maintained for the purposes of determining notional membership periods and benefit entitlements. In this context an individual's unearmarked tax expenses are not contributions.

4. The scope of this Standard includes all cash transfers, eligibility for which is restricted to individuals that have reached retirement age, if the value of the resources transferred is not approximately equal to the value of any contributions made by or on behalf of recipients. Such cash transfers may not be formally termed "pensions". In some jurisdictions there may be cash transfer programs that are only available to those who have reached retirement age –, for example, housing benefit or additional income support. These programs may be in place, because the eligibility criteria for what are formally termed pension programs are rigorous. It is therefore considered necessary to operate further ancillary cash transfer programs in order to supplement the economic benefits to which many individuals are entitled from programs which are formally termed "pensions". This Standard takes the view that all cash transfers, which have attainment of retirement age as an eligibility criterion are, in substance, state retirement pensions.

5. In some cases certain cash transfers may be referred to as pensions although entitlement does not depend on reaching retirement age laid down in legislation, for example disability pensions payable to individuals who are considered no longer capable of working due to injury or certain medical conditions. This Standard does not apply to such cash transfers.

6. Age related social benefits also include individual goods and services, such as health care. These are outside the scope of this Standard

and within the scope of the separate Standard dealing with general social policy obligations.

7. This Standard does not apply to employee benefits, including post-employment benefits provided to government employees or non-government employees in exchange for their services as employees. Such benefits are exchange transactions. Requirements in respect of employment benefits should be accounted for in accordance with the separate Standard dealing with employee benefits.

8. In some jurisdictions the government or other public sector entity acts as the guarantor of last resort for all or part of the benefits payable where a private sector retirement benefit plan is unable to meet obligations. In order to meet such guarantees government may operate a fund financed by contributions levied on some or all defined benefit plans operating in a jurisdiction and may have powers to impose further conditions on defined benefit plans. Alternatively, such guarantees, where called upon, may be financed from general taxation. Such guarantees may give rise to provisions or contingent liabilities. However, they are not state retirement pensions and are not within the scope of this Standard.

Government Business Enterprises

(*Staff Note 2: Usual exclusion will be included if this is a stand alone ED)*

Definitions

9. The following terms are used in this Standard with the meanings specified: ***(Staff Note 3: Additional definitions will be added as needed if this becomes a stand alone ED)***

> **A <u>basic/welfare aged pension</u> is a cash transfer payable only to individuals who have reached retirement age, where entitlements to transfers of economic benefits are not dependent on contributions made by or on behalf of the beneficiary.**
>
> **A <u>cash transfer</u> is a non-exchange transaction in cash, or an expense paid through the tax system, to protect individuals against certain social risks where use of the cash payment is at the discretion of the individual.**

Composite social security schemes are programs established by legislation that:

a) **Operate as multi-employer plans to provide post-employment benefits; as well as to**

b) **Provide benefits that are not consideration in exchange for service rendered by employees.**

An eligibility criterion is a requirement that an applicant must meet for entitlement to the state retirement pension.

A general/contributory aged pension is a cash transfer payable only to individuals who have reached retirement age where the amount of the transfer is dependent on contributions made by or on behalf of the beneficiary but the benefits provided are not approximately equal to the contributions.

Liabilities are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.

Multi-employer plans are defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that:

(a) **Pool the assets contributed by various entities that are not under common control; and**

(b) **Use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees concerned.**

Post-employment benefits are employee benefits (other than termination benefits) which are payable after the completion of employment.

Retirement age is an age specified in legislation at which an individual becomes eligible for state retirement pensions.

A <u>social risk</u> is an event or circumstance that may adversely affect the welfare of individuals or households either by imposing additional demands on their resources or by reducing their incomes.

A <u>state retirement pension</u> is a cash transfer payable only to individuals that have reached retirement age.

Terms defined in other International Public Sector Accounting Standards are used in this Standard with the same meaning as in those other Standards and are reproduced in the Glossary of Defined Terms published separately.

State Retirement Pensions

10. Many jurisdictions provide cash transfers known as pensions to those who have reached a specified age laid down in legislation -defined in this Standard as the retirement age. There are two principal types of state retirement pension:

- the basic/welfare pension; and
- the general/contributory pension

Basic/Welfare Pensions

11. Arrangements for the basic/welfare pension vary significantly in different jurisdictions. In some jurisdictions they may be known as social assistance programs and contrasted with social security schemes, for which entitlement is dependent upon contributions made by or on behalf of current or future beneficiaries. Basic/welfare pension programs operate as "safety nets" for individuals, who have not met the eligibility criteria for the general/contributory pension or whose contribution record is insufficient to provide more than a low level of benefits under the general/contributory pension. The key characteristics of the basic/welfare pension as defined in this Standard are that the cash transfers payable:

- are only available to those who have reached retirement age; and
- do not require that any contributions have been made by or on behalf of an individual.

12. In some jurisdictions eligibility criteria may need to be satisfied for the basic/welfare aged pension in addition to the criterion that individuals have reached retirement age. Worldwide there is very significant variation in both the eligibility criteria and the way these criteria operate. For example, criteria may include the period for which an individual has been a taxpayer or residency requirements; where an individual has only recently established residency in a jurisdiction or where a continuous period of residency was interrupted, there may be reductions in entitlement levels.

13. In some jurisdictions, the basic/welfare pension is means-tested. For example, individuals whose annual income and/or assets are above specified thresholds may forfeit eligibility completely or may be subject to a reduction from the full entitlement.

14. In some jurisdictions the basic/welfare aged pension may be provided as part of a composite social security scheme that includes the general/contributory scheme and a post-employment plan. In other jurisdictions, the basic/welfare aged pension is administered separately from any general/contributory scheme and post-employment plan.

15. The definition of the basic/welfare pension in this Standard includes all cash transfers which require an individual to have attained retirement age and do not require that contributions have been made by or on behalf of individuals. This is regardless of whether the legislation or regulations governing a program formally term that cash transfer program part of the state retirement pension.

General/Contributory Pensions

16 The main characteristic of general/contributory pension schemes is that they require contributions by or on behalf of an individual during their working lives or other periods specified in governing legislation or regulations. Benefits may be:

- related to the amount of those contributions but not approximately equal to the value of those contributions; and/or

- there may be a minimum period over which contributions must be made in order for an individual to be eligible for benefits .

17. As for the basic/welfare pension there may be other eligibility criteria involving factors such as residency. General/contributory

programs may be administered on a stand-alone basis or together with the basic/welfare scheme in a composite social security scheme. If the composite social security scheme is used to administer both benefits provided as consideration for employment services rendered and benefits which are not consideration for employment services rendered it will be necessary to distinguish the two components. Only the latter will be within the scope of this Standard.

18. The definition of the general/contributory pension in this Standard includes all cash transfers which require an individual to have attained retirement age and require that contributions have been made by or on behalf of individuals., This is regardless of whether the legislation or regulations governing a program formally term that cash transfer program part of the state retirement pension.

Reimbursements.

19. A distinguishing characteristic shared by basic/welfare and general/contributory pensions is that the purposes for which the cash transfers may be used are at the discretion of the recipient. If a recipient has to validate that the cash has been used for a specified purpose the transaction is a reimbursement rather than a cash transfer and is to be treated as an individual good or service. Such a transaction is therefore outside the scope of this Standard.

(*Staff Note 3: If a decision is taken by members to proceed with a separate ED the following terms will be defined and included in paragraph 9 and commentary will be inserted on the definitions. These definitions will be the same as those in paragraph 10 of Item 8.2 and the commentary will be the same as paragraphs 24-32 of Agenda Item 8.2.*

- **Obligating Events and Present Obligations**
- **Legal Obligations and Constructive Obligations,**
- **Contingent Liabilities**

Present Obligation: State Retirement Pension

20. **A present obligation for the state retirement pension arises when all eligibility criteria have been satisfied.**

21. Under the requirements of this Standard a present obligation for the state retirement pension arises when all eligibility criteria have been satisfied, even though the date at which the payment must be legally made may be after the satisfaction of those eligibility criteria. As noted in paragraph 12 some basic/welfare pension programs may have a number of eligibility criteria in addition to retirement age.

22. This Standard reflects the view that an entity has no realistic alternative but to settle its obligations arising from the satisfaction of eligibility criteria. Whilst governments and other public sector entities can modify eligibility criteria it is unlikely that such changes will be retrospective.

Initial Recognition

23. Where a present obligation has arisen a liability in respect of the state retirement pension shall be recognized when:

> **(a) It is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; and**
>
> **(b) A reliable estimate can be made of the amount of the obligation**

Probable Outflow of Resources Embodying Economic Benefits or Service Potential

24 For a liability arising from a present obligation to be recognized an outflow of resources embodying economic benefits or service potential must be probable. There may be rare instances where a present obligation arises from a legal obligation, but it is deemed that an outflow of economic benefits and service potential is not probable. In such cases an entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote.

Reliable Estimates

25. There may be cases where, although a liability exists, no reliable estimate can be made of the amount. In the context of the requirements of this Standard in relation to social benefits such instances

are likely to be extremely rare. Where no reliable estimate can be made a liability exists that cannot be recognized. That liability is disclosed as a contingent liability (see paragraph 29)

Contingent Liabilities

(Staff Note 4: Requirements relating to Contingent Liabilities will mirror those in SPO ED at paragraphs 42-43 of ED at Item 8.2)

Measurement: State Retirement Pensions

26. **The amount recognized as a liability in respect of state retirement pensions shall be the amount that the entity has no realistic alternative but to settle as a result of satisfaction of the eligibility criteria.**

27. Under the requirements of this Standard liabilities arise for state retirement pensions when all eligibility criteria have been satisfied by beneficiaries. The amount that the entity has no realistic alternative but to settle depends upon the legislation and regulations governing the program. In most cases this is the amount of the next payment following satisfaction of the eligibility criteria. However, there may be circumstances where governing legislation or regulations specify otherwise. In these cases, dependent upon the specification in governing legislation or regulations, the amount of the liability may be the accrued amount of the next payment following satisfaction of the eligibility criteria relating to the reporting period; or the entity may have no realistic alternative but to settle a series of payments covering one or more reporting periods. When a liability is recognized an expense is recognized for the amount of that liability. The liability is extinguished when the cash transfer is made. If the liability has not been extinguished at the reporting date it is reflected as a liability in the statement of financial position.

Alternative paragraph 27. See Memorandum At Agenda Item 9.1.

27. Under the requirements of this Standard liabilities arise for state retirement pensions when all eligibility criteria have been satisfied by beneficiaries. The amount that the entity has no realistic alternative but to settle depends upon the legislation and regulations governing the program. In most cases this is the accrued amount of the next payment following satisfaction of the eligibility criteria which relates to the reporting period. However, there may be circumstances where governing

legislation or regulations specify otherwise. In these cases, dependent upon the specification in governing legislation or regulations, the amount of the liability may be the full amount of the next payment following satisfaction of the eligibility criteria relating to the reporting period; or the entity may have no realistic alternative but to settle a series of payments covering one or more reporting periods. When a liability is recognized an expense is recognized for the amount of that liability. The liability is extinguished when the cash transfer is made. If the liability has not been extinguished at the reporting date it is reflected as a liability in the statement of financial position.

Presentation and Disclosures

Line Items

28. This Standard does not require a separate line item for liabilities for state retirement pensions in the statement of financial position and for expenses related to state retirement pensions in the statement of financial performance. However, IPSAS 1, "Presentation of Financial Statements" requires additional line items to be presented on the face of the statement of financial position and the statement of financial performance or in notes to the financial statements when such presentation is necessary to present fairly the entity's financial position and financial performance.

Contingent Liabilities

29. **Unless the possibility of any outflow in settlement is remote, an entity should disclose for the state retirement pension as one class at the reporting date a brief description of the nature of the contingent liability and, where practicable:**

(a) An estimate of the aggregate financial effect, measured under paragraphs 26-27;

(b) An indication of the uncertainties relating to the amount or timing of any outflow; and

(c) The possibility of any reimbursement.

30. In accordance with (Staff Note 4) an entity does not recognize a contingent liability. For the basic/welfare pension and general/contributory pension a contingent liability will be disclosed where a large number of individuals have applied for a pension, but, due to ambiguity over interpretation of the rules governing the program, there is uncertainty over whether one or more of the eligibility criteria have been met. If the eligibility criterion/criteria in question had been met the individuals would have been entitled to receive a payment.

31 This may have led to a legal action by applicants that should result in a clarification of the nature and extent of any liability. If the results of this legal action will not be known until after the reporting date then a contingent liability will be disclosed unless the possibility of a judgment inimical to the government is remote. Such a disclosure includes, where feasible, an estimate of the financial implications in the event of the court deciding that the eligibility criterion/criteria in question has been satisfied. The financial effect of the contingency will normally be the amount of the next payment, although the amount depends upon the legislation and regulations governing the program.

Effective Date

(Staff Note 5: To be considered when approach determined)

The treatment of employer pension schemes and other defined benefit pension schemes

Issue 2; Papers SNA/M1.06/03.1; SNA/M1.06/03.2: for decision

Description of the issue

In the 1993 SNA, promises to pay future pension benefits are not recognized as liabilities of social security schemes and unfunded employer schemes. The review will investigate the analytical relevance of recording these liabilities in the national accounts and, if appropriate, formulate recommendations regarding their valuation and measurement. The review will also formulate proposals to reconcile the recommendations of the 1993 SNA and the IMF Government Finance Manual regarding the treatment of unfunded employer pension schemes.

Summary conclusion

Recommendations/questions: Paper SNA/M1.06/03.1;

39. Does the AEG agree that:

(a) Liabilities/assets and associated economic flows of all pension schemes should be recognized in the core accounts of 1993 SNA?
(b) Accumulated benefits and related economic flows for all defined benefit schemes should be calculated using actuarial methods?
(c) Output should be calculated for non-autonomous schemes on a cost basis, and cost attributed to the beneficiaries (i.e. household sector)?
(d) Expected holding gains and losses can be used in order to explain the service charge imposed by autonomous pension schemes?

Outcomes

(a) There was strong support within the AEG for the recommendation by the Task Force on Employers' Retirement Schemes to recognise the liabilities involved with all employer pension schemes, including unfunded ones, and any associated assets and transactions.

The AEG saw that there are problems for several countries in drawing a distinction between pension schemes for government employees and social security schemes.

The AEG felt it necessary to develop criteria that would distinguish between the several types of schemes. Possible criteria, among others, could be the employer/employee relationship or the nature of the liability (e.g. whether it is a contingent or an actual liability).

The ISWGNA will explore alternatives for developing criteria.

> The AEG noted the possibility, until such criteria are developed, of countries not including the liabilities for pensions of government employees in the core accounts but of including them together with the liabilities for social security schemes in supplementary accounts.
>
> The AEG also supported the possibility of including supplementary accounts for social security schemes.

(b) The AEG agreed with this recommendation, but with the understanding that, in some circumstances, related economic flows need not be calculated on an actuarial basis.
(c) The AEG agreed that this statement should be modified by adding the words "In principle" at the start.
(d) The consensus within the AEG was to accept this recommendation but acknowledging that it may have to be revisited following discussions on other aspects of the System associated with holding gains and losses.

Questions: SNA/M1.06/03.2

40. Does the AEG:

(a) agree to add a specific recommendation in the SNA recognizing as pension liabilities those pension obligations that are exchanged in an explicit transaction between two units, even if the SNA does not record specifically pension liabilities for one or several of these units?
(b) support that the definition of social security pension schemes mentions the existence of "collective multi-employer schemes" and of "funded social security schemes"?
(c) confirm that all unfunded collective multi-employer schemes are to be treated as current transfer schemes?
(d) support to treat as saving schemes all funded schemes, even if organised as a part of social security?
(e) support that government pension schemes for its own employees should always be shown as an employer scheme (saving scheme) even if the scheme is labelled or organised under a more general social security scheme?

Outcomes

(a) The AEG agreed that, when the obligation to pay pensions passes from one unit to another, this should be recorded as a transaction in pension liabilities even if neither unit has previously recorded them.
(b) The AEG did not support this proposal. The consensus was that it is necessary to look at the economic substance behind schemes rather than the way they are labelled. There was general concern about using criteria based on distinguishing the status of schemes depending on whether they are funded or unfunded.

(c) The AEG did not support this proposal for the same reasons as for question (b).

(d) The AEG did not support using only "funded" as a suitable criterion in this context.
A liability should be recorded for schemes where the benefits are related to the contributions even though the schemes may be described as social security schemes.

(e) The AEG recommended the ISWGNA should investigate the criteria for identifying such schemes and report back to the AEG with a proposal outlining the
most appropriate approach (see the first question of paper 06/09.1).