



**INTERNATIONAL FEDERATION
OF ACCOUNTANTS**

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DATE: SEPTEMBER 26, 2003

MEMO TO: MEMBERS OF THE PUBLIC SECTOR COMMITTEE

FROM: KEVIN SIMPKINS
CHAIR, SOCIAL POLICY OBLIGATIONS STEERING COMMITTEE

SUBJECT: DRAFT INVITATION TO COMMENT – SOCIAL POLICY
OBLIGATIONS

ACTION REQUIRED

The Committee is asked to:

- receive and review the revised Invitation to Comment (ITC); and
- approve the draft ITC for publication or identify areas for further amendment.

AGENDA MATERIAL

	Pages
8.2 Extract of minutes of PSC Meeting in July 2003	8.5-8.9
8.3 Draft ITC (clean version only)	8.10-8.128

There have been substantial changes to the ITC as a consequence of PSC decisions at the July meeting and subsequent SC review, and the mark-up version was not user friendly. Consequentially a clean copy is provided for review at this meeting.

BACKGROUND

At its July 2003 meeting, the Public Sector Committee (PSC) reviewed an updated draft of the ITC. This updated draft further elaborated and explored issues and reflected the evolving views of the SC. The PSC's views on the draft ITC are recorded in the attached extract of minutes.

Following the PSC's July 2003 meeting, I contacted the members of the Steering Committee, requested them to consider the updated draft ITC and, given the further development of views and argument, to affirm their views on accounting for old age pension benefits. This led to a change in the majority view (Option 1 is now the majority view. However a minority support Option 3 using workforce entry as the obligating event).

Staff have revised the ITC presented at the July PSC meeting to take account of the views of the Public Sector Committee and Steering Committee members. Members of the Steering Committee subsequently commented on a further draft of the ITC.

I believe we have addressed the major themes that have been raised by SC members and responded to the concerns of the PSC as identified in Vancouver. However, while we have dealt with most issues raised by SC members, there are some issues raised by individual members on this draft that we have not dealt with. In some cases, this is because they are individual views that have not been raised by other SC members (or the PSC) and we are unsure whether they would be supported by other SC members - for example, refocusing the paper so that it does not include preliminary views as such, and deleting the chapters dealing with pension accounting and collective and individual benefits. In other cases, they would require some substantial changes that I do not believe are justified at this stage - for example restructuring chapter 2, developing a comprehensive definition of social policy obligations and reintroducing text that the PSC felt should be deleted. The issues and proposals for amendment themselves all have merit and I want to think further on some of them, particularly on whether we can deal with them as specific questions at the start of the ITC. However, I believe we now should be in finalization mode and felt we should get this draft to you earlier rather than later to give you time to review it before our meeting. I also anticipate that comments from some SC members are still to come, and I shall provide members with an update on these in the second distribution of materials.

CHANGES TO ITC

Changes to the ITC since the previous draft considered by the PSC (July 2003) are outlined below by Chapter.

Chapters 1-3:

Changes to these chapters are mainly in response to specific comments by the PSC (as noted in the minutes) or comments received from members of the Steering Committee.

- Additional questions have been added and preliminary views highlighted at the commencement.
- Chapter 1 now includes a specific reference to the PSC's project on budget reporting.
- Chapter 2 has been reduced in size. As requested by the PSC, discussion of GFSM 2001 has been substantially reduced.
- Chapter 3 includes a brief discussion of the IASB's proposed changes to IAS 37.

Chapter 4:

Much of the discussion in Chapter 4 remains unaltered. Changes include:

- Reduction in length of discussion, particularly in relation to legal obligations.
- The draft has been edited to remove the implication that in order for a legal obligation to be recognized as a liability in general purpose financial reports it must be currently due and payable. As noted by a member of the Steering Committee, legal obligations may be present obligations prior to the point at which they are due and payable.
- There is now no preliminary view in relation to legal obligations. The ITC states that the existence of a legal obligation is a question of fact in a particular jurisdiction. The ITC also acknowledges that arrangements within one jurisdiction may lead to the existence of a legal obligation for benefits prior to the point at which a legal obligation would exist in other jurisdictions.
- The explanation of the three options is no longer headed as preliminary views.

Chapter 5:

- The discussion of collective and individual services has been substantially reorganized to reduce its size.
- Collective and individual services are described, current practices for both are explained, and the relevant principles are outlined.
- Chapter 5 highlights that there is no present obligation prior to the delivery of goods and services. This wording has been adopted to avoid the implication that there is a present obligation in the case of a government providing goods and services using its own resources and employees (the July 2003 draft stated that an obligation was created and simultaneously discharged).
- Chapter 5 notes that the cash provided by a government to allow individuals to purchase specific goods and services may be provided in advance of the goods and services being purchased. Such advances are similar to reimbursements as they are tied to the purchase of goods and services. They differ in nature from the cash advances discussed in Chapter 6 which are provided for use at the discretion of the recipient.
- The Chapter now includes a brief discussion of Options 2 and 3.

Chapter 6:

- There have been relatively few changes to Chapter 6.
- The Chapter now includes a brief discussion of Options 2 and 3.

Chapter 7:

- There have been substantial changes to Chapter 7. The length of the chapter has been substantially reduced by applying the principles developed in Chapters 5 and 6 to disaster relief. Previous versions, included explanation of these principles to other, similar benefits. Examples of disaster relief and legal aid have now been included in Appendix 1;

Chapter 8:

- The majority view has changed – a majority now support Option 1 for old age pensions.
- Much of the discussion on the rationale underlying Option 3 has been relocated and summarized to reduce the length and improve the flow of the Chapter.

Chapter 9:

- The ITC now highlights that the Steering Committee considers that additional disclosures are required, regardless of which option is applied.
- The Chapter does not come to any firm conclusions regarding the types of disclosures that should be required – instead it proposes that the PSC carry out further work in this area.

Appendix 1:

- Appendix 1 has not been previously distributed to the PSC.
- It contains proposed examples outlining the application of principles in the ITC.

Appendix 2

- This Appendix had been proposed during the initial stages of preparing the ITC but had never been developed. Reference to Appendix 2 has been deleted in the revised ITC.

Formatting:

- The PSC requested that the format of this ITC be aligned with the format of the ITC on Non-exchange Revenue. This has resulted in changes to the format of bulleted lists and the format of the preliminary views. A final decision on the document size – IPSAS size or Study/Occasional Paper size is yet to be made.

Chapter 7

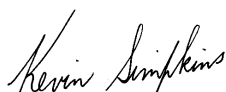
I expect that some members of the Committee may be uncomfortable with the conclusions in Chapter 7 in relation to collective services and goods and services provided to individuals. To some degree I share these concerns. However, the Steering Committee has attempted to develop an ITC that is based on consistent application of principles. We have been unable to identify the factor(s) that make disaster relief different from other benefits.

ACTION REQUIRED

The PSC is asked to address the changes made to the ITC by moving in a sequential manner from the background and discussion of principles (Chapters 1 to 3), to the application of those principles generally (Chapter 4), then to the application of principles to specific social policy obligations (Chapters 5 to 8) and finally to the discussion of possible disclosures (Chapter 9).

Members may also wish to give specific consideration to additional questions which could be raised in the ITC and raise those questions at the meeting. I would welcome suggestions for additional questions.

Kind regards

A handwritten signature in cursive script that reads "Kevin Simpkins".

Kevin Simpkins

EXTRACT OF MINUTES OF PSC MEETING – JULY 2003

DRAFT INVITATION TO COMMENT SOCIAL POLICY OBLIGATIONS

The Committee received and considered:

- a memorandum from Kevin Simpkins, the Chair of the Social Policy Obligations Steering Committee; and
- an updated draft Invitation to Comment (ITC) *Accounting for Social Policies of Governments*.

Kevin reported on the work of the Steering Committee since the PSC's last meeting in Melbourne in April. He noted that:

- the Steering Committee had not met since the April 2003 PSC meeting;
- he had met with the consultant on the project, Joanne Scott, and Paul Sutcliffe, the PSC Technical Director, and
 - reviewed all matters raised by Members at the April 2003 PSC meeting;
 - agreed a strategy for revising the draft; and
 - received advice from a legal officer on the types of government obligations that could be classified as legal obligations;
- Staff had restructured and revised the draft ITC to respond to matters identified by the PSC in April 2003; and
- the revised draft had been circulated to SC Members, with a request for comment. The UK, Australian, IMF and FEE Members had responded. All were very supportive of the changes, though the FEE Member proposed that further changes were necessary to reflect that “[View-Option 3](#)” may also apply to other benefits such as child endowment benefits and higher education.

Kevin noted that:

- the objective of the discussion of the redrafted ITC at this PSC meeting was to gain PSC approval for the SC to finalize the draft; and
- it was intended that a final draft be presented to the PSC for review and approval for issue at the PSC meeting in November 2003.

Kevin outlined the major changes to the draft, noting that all chapters had been amended to respond to PSC concerns but that the executive summary and the specific matters for comment would not be prepared until the contents had been finalized. He noted that the redrafted chapters included additional examples and sought Members' views on whether appendices dealing with recognition and measurement of certain benefits should be prepared. Members were of the view that the appendices should be prepared even if they did little more than draw out, and focus on, examples already referred to in the chapters. It was noted that the appendices need not be extensive but should highlight the difference between conclusions reached in Chapters 5 – 7 and Chapter 8.

Kevin outlined the revised ITC structure, noting that:

- the draft ITC continues to apply the definitions and recognition criteria from IPSASs;

- in determining how to group the potentially wide range of benefits for analysis purposes, the SC took its lead from IPSAS 19 and adopted a GFS type structure – accordingly the structuring of Chapters 5 to 8 reflected the GFSM2001 grouping of benefits;
- a new Chapter 4 of the ITC has been included to explain the broad principles that were adopted by the SC, and to highlight that for purposes of analysis the SC had identified three views about the circumstances which could give rise to a present obligation; and
- Chapters 5 to 8 apply the principles established in Chapter 4 to a number of different types of benefits. Kevin also noted that in some cases, the SC's conclusions about which view should prevail changed based on the facts, however the SC considers the principles are applied consistently.

Prior to considering the draft ITC in detail, the PSC discussed the structure, format and nature of the ITC in broad terms and agreed that:

- the Chairs of the Non-Exchange and SPO Steering Committees should work with Staff to align the formats and styles of their documents, and this should establish broad parameters for future studies;
- a summary of the preliminary views should be included as part of, or with, the executive summary;
- Chapter 1 should include a brief summary of the status of relevant IASB projects that were likely to impact directly on the ITC. The focus of this section should be broad and should note that the IFRS “environment” within which the SC was preparing the ITC was ever changing;
- the disclosures chapter should not attempt to identify specific detailed disclosures, but should take a higher level approach and should develop guidance on the broad characteristics of likely disclosures;
- the disclosure chapter should acknowledge the links to the budget reporting project and place disclosures in the “historic” financial reports in the context of the suite of reports, including budgets, issued by governments;
- the specific matters for comment should note that different views may be possible, and seek comment on the views proposed by the ITC and include questions on:
 - the extent and location of disclosures;
 - audit issues that might arise in respect of disclosures included in the financial statements;
 - the work of the PSC/GFS/ESA95 convergence group and in particular draw out consequences of the SC views for the alignment of IPSAS and GFSM2001 requirements; and
 - whether pension plans to provide government employees with benefits as a consequence of their employment should be included in the scope of the ITC when those pension plans were not funded and pensions were to be paid from consolidated revenue;
- the ITC was much improved and provided more comprehensive and understandable arguments to support the preliminary views;
- notwithstanding the improvement in clarity, the ITC was still an extremely long document and would benefit from reduction in its length. Kevin noted that he felt the

lengthy discussion of the GFS classification basis was not necessary and should be substantially reduced. Members agreed with this;

- where possible, Chapters 5 to 7 could also be cut down, by not fully discussing each type of benefit identified. Members noted that the conclusions were the same for all the benefits discussed in each chapter and there may be the opportunity to condense; and
- the implications of adoption of options 2 and 3 in Chapters 5, 6 and 7 should be briefly noted. Members noted this would increase the length of the document but agreed this was justified.

Members continued to express concern with the majority view on when an obligating event arose in respect of pensions. Some Members noted that option 3 may be applied to other types of long-term benefits and that the views of some SC Members appeared to be inconsistent. They expressed the view that they did not find convincing the argument that it was the magnitude of the pension, and the significant extent to which individuals relied on pensions for their post-retirement income, which was critical in creating the present obligation at the time of work force entry. Kevin noted that the SC Members were generally of the view that the principles were applied consistently, but the facts and circumstances surrounding particular benefits were such that a different conclusion was justified. Members noted that:

- this was a complex issue and the majority views of SC Members themselves had evolved and changed as the draft was developed, and the narrative exposed additional arguments and dimensions to the issue; and
- this reinforced the need to explain the implications of the views not adopted, as well as those which were adopted.

Kevin noted that the redrafting and further development of the draft may well have exposed some inconsistencies in SC Member's views and he proposed that he reconfirm the views of all SC Members on this issue as the draft is finalized. Members agreed this would be appropriate.

The PSC then undertook a detailed page by page review of the document, and in the course of that review agreed:

- to cut back on GFSM2001 commentary;
- defined terms should be bolded and a glossary of the defined terms used in the text should be included as an appendix;
- the ITC should clarify the implications for the recognition by a government of social policy obligations as liabilities of that government being able to change the legislation that imposes the obligation;
- Chapter 2 references to non-exchange transactions involving two components should be redrafted to express the notion that an arrangement to provide benefits may encompass an exchange and a non exchange arrangement;
- paragraph 3.14 should be aligned with paragraph 4.15;
- paragraph 3.18 should be amended to make clear that the commentary related to the relevance of notions of constructive obligations to social policy obligations;
- figure 3.4 should be relocated;

- Chapter 3 should include a brief explanation of the broad characteristics of an actuarial valuation;
- the second last sentence of paragraph 3.30 should be deleted.
- refinements are needed to paragraphs 4.3, 4.9, 4.22, 4.23, 4.26, 4.42, 4.52, 4.56 and Preliminary View 2;
- the final bullet point of paragraph 4.8 on page 56 should be reflected in (or about) paragraph 4.6;
- paragraph 4.16 should make it clear that there may be a legal obligation for a future payment which is not currently due and payable;
- paragraph 4.31 should be eliminated;
- preliminary view 1 should reflect that there needs to be a present obligation, and should build in the notion that a legal obligation arises when a judgment can be sought and enforced by law;
- paragraphs 4.52 – 4.55 on measurement should be moved to Chapter 8 and should note that taxation revenue may arise from pensions. Members also noted they were not convinced by the “magnitude” argument (also in paragraph 4.44);
- Chapter 4 should include a figure which summarized the preliminary views around paragraph 4.66;
- paragraph 4.62 should make it clear that whatever option is adopted, disclosure will need to be dealt with;
- it should be made clear that the ITC does not deal with the amount or timing of recognition of revenue, whether from taxation or other sources, that may be available in the future to meet benefit obligations;
- amendments and refinements should be made to paragraphs 5.9, 5.37 and 5.38;
- the use of the term “universal” benefits in paragraphs 6.3 and 6.4 and elsewhere was likely to cause confusion as the benefits may not be universally available, and a different term should be adopted;
- paragraphs 6.18 and 6.19 or at least parts thereof should be deleted, and the final sentence of paragraph 6.29 rethought;
- the title of Chapter 7 should read: Discretionary Transfers and Other Benefits;
- paragraph 7.19 should be “tested” against the principles established in 4.28;
- the inclusion in paragraph 7.24 of the implications and rationale for not recognizing costs related to the ongoing activities of the government/entity (for example, the costs of maintaining an emergency services pool of employees) should be reconsidered. If retained, it should refer to incremental expenditures rather than direct expenditures;
- paragraph 7.28 should be clarified;
- paragraphs 7.32 and 7.33 should note that the PSC had actioned a project on development assistance and should consider whether a legal obligation would ever arise in respect of development assistance that had been “promised”;
- preliminary view 19(d) should note that there is no realistic alternative but to settle;
- paragraph 8.2 first dot point should be clarified to note that the benefits are funded from general revenue, and the second dot point should make it clear that the treatment of any guarantees are not dealt with in the ITC;
- refinements are to be made to paragraph 8.8;

- amendments are to be made to paragraphs 8.11, 8.15 and 8.35 to make clear that they refer to contingent liabilities, rather than constructive obligations. The ITC should clarify the Steering Committee's views on contingent liabilities, and note that the past event applicable to the existence of a liability is not necessarily the same as the past event applicable to the existence of a possible liability. The ITC should also address the apparent inconsistency in the conclusions that a contingent liability should not be disclosed where it is not clear what the past event is, but that a liability for old age pensions should be recognized despite the fact that it may not be clear what the relevant past event is;
- references to "going concern" in paragraph 8.13 and other paragraphs are to be removed;
- the introduction to paragraph 8.27 is to be reworded;
- amendments are to be made to paragraphs 8.29, 8.30 and 8.38;
- paragraph 8.43 is to be amended to explain that GFS recognizes employer pensions but not other pensions;
- measurement options are to be dealt with in Chapter 8 rather than Chapter 4;
- Chapter 8 should acknowledge that some pension plans may be partially funded and that separate funds may be established;
- Chapter 9 should focus on the broad principles of disclosure and should:
 - note that disclosures about funding sources can provide useful information input for assessments of the sustainability of benefit programs;
 - clarify what are part of the accounts and what are supplemental disclosures;
 - note that the ITC does not mandate audit requirements; and
 - note that certain relevant information may be included in generational accounts, outline the broad characteristics of such accounts and note that the focus of such accounts is on future resource flows; and
- Chapter 1 should note that social benefits raised budgetary and policy issues which would be followed up in Chapter 9. Chapter 9 would then explain that disclosures can put in context the amounts recognized in the financial statements whether view 1, 2 or 3 is adopted and will provide input for fiscal sustainability analysis.

Members thanked Kevin and SC Members for their work in substantially improving the draft ITC, and agreed that it should be revised as indicated during the course of the meeting and presented to the November 2003 meeting of the PSC for approval to issue.

<i>Action Required:</i>	<i>Update the draft ITC for presentation at the November 2003 PSC meeting for approval to issue. Confirm or otherwise the majority views of SC Members. Arrange Steering Committee meeting, if necessary.</i>
<i>Person(s) Responsible:</i>	<i>SC Chair, PSC Staff, Consultant.</i>

IFAC

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Committee

Issued [Month Year]

Draft Invitation to Comment

Accounting for Social Policies of Governments

Issued for
comment by
the International
Federation of
Accountants

olicies of Government



The mission of the International Federation of Accountants (IFAC) is the worldwide development and enhancement of an accountancy profession with harmonized standards, able to provide services of consistently high quality in the public interest.

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The Invitation to Comment

This Invitation to Comment of the International Federation of Accountants (IFAC) was prepared by the Steering Committee on Social Policy Obligations (Steering Committee) on behalf of the Public Sector Committee (PSC). It represents the majority views of the Steering Committee and has been approved for publication as an Invitation to Comment by the PSC."

The ITC outlines the Steering Committee's views on how social policy obligations should be accounted for in general purpose financial reports of public sector entities and seeks input on these views. The views in this ITC are not necessarily those of the PSC. The Steering Committee's views and the submissions made on this ITC will provide input to the PSC's deliberations in the preparation of an Exposure Draft of an International Public Sector Accounting Standard.

Commenting on this Invitation to Comment

Comments are invited on any aspect of this Invitation to Comment (ITC). In particular, respondents are asked to provide a clear view on whether they agree or disagree with the preliminary views in this paper, and the reasons why. Comments should be submitted in writing so as to be received by [XX Month Year]. E-mail responses are preferred. Unless respondents specifically request confidentiality, their comments are a matter of public record once the Public Sector Committee has considered them. Comments should be addressed to:

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PREFACE

Preface to be prepared by Ian Mackintosh noting:

1. the Steering Committee process and the role of Steering Committees in the PSC process
2. the importance and complexity of this issue
3. the significant contribution the Steering Committee has made to debate in this area
4. the PSC's appreciation for the work of the Steering Committee and its chair.

Steering Committee

Kevin Simpkins, Deputy Controller and Auditor-General of New Zealand (Chair, member of the PSC).

Brian Donaghue, Consultant to the International Monetary Fund.

Kristina Lundqvist, Head of the Accounting Development Unit, National Financial Management Authority, Sweden.

Elizabeth Moran, Executive Manager, Finance & Business Strategy, City of Tea Tree Gully, Australia.

Thomas Müller-Marqués Berger, Senior Manager, Ernst & Young AG Wirtschaftsprüfungsgesellschaft, Germany.

Masud Muzaffar, Financial Advisor, Capital Development Authority of Pakistan, Pakistan.

Ron Salole, Director of Accounting Standards, Canadian Institute of Chartered Accountants, Canada.

Song Qichao, Deputy Division Director, Department of Social Security, Ministry of Finance, People's Republic of China.

David Watkins, Accounting Policies Manager, Her Majesty's Treasury, United Kingdom.

Members of the Steering Committee are appointed in their personal capacity rather than as representatives of their nominating body. The views expressed in this ITC are those of the members, and not those of their employers or nominating organization.

Specific Matters for Comment

The PSC welcomes comment on any matters addressed in this ITC. The PSC would particularly value comment on the issues outlined below:

- (a) whether separate Exposure Drafts and IPSASs should be prepared for:
 - (i) old age and similar pensions; and
 - (ii) other social policy obligations?
- (b) whether unfunded pension plans to provide government employees with benefits as a consequence of their employment and where pension are to be paid from the consolidated revenue of government should be included in the scope of the ITC?
- (c) the majority view of the Steering Committee regarding old age pension obligations, or whether there is evidence to support the existence of an obligating event between workforce age and retirement age?
- (d) the proposal not to require additional detailed disclosure in respect of specific social benefits?
- (e) the proposal that the PSC should explore the possibility of requiring disclosures about the overall sustainability of a government's social benefits including the assumption that higher level disclosures are more likely to meet users' needs?
- (f) audit issues that might arise if "sustainability disclosures" were included in the financial statements?
- (g) [other specific matters for comment to be inserted if required]

The PSC is a member of a convergence group which has the aim of identifying differences between IPSASs, the International Monetary Fund's (IMF) Government Finance Statistics Framework (GFSM 2001) and ESA 95 and recommending ways of reducing and eliminating these differences. The majority views of the Steering Committee expressed in this ITC are broadly consistent with the requirements of these alternative reporting systems. The PSC notes that the IMF is also reviewing its treatment of pension obligations in GFSM 2001.

INVITATION TO COMMENT
ACCOUNTING FOR SOCIAL POLICIES
OF GOVERNMENTS

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Executive Summary

The Steering Committee has prepared this Invitation to Comment (ITC) governments should account for obligations to provide social benefits. The ITC considers the circumstances in which a government's obligation to provide social benefits in future periods give rise to present obligations that should be recognized as a liability in general purpose financial statements.

The ITC considers a range of social benefits, including goods and/or services provided for collective and individual consumption, and cash transfers to individuals. It applies the definitions and principles in existing IPSASs, particularly IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*, to these social benefits.

Most jurisdictions currently recognize as liabilities those social benefits that are overdue for payment. In addition, some jurisdictions also recognize the portion of periodic cash transfers that has been accrued since the previous payment. However, there is no authoritative international guidance on accounting for long term social policy obligations and different approaches are possible. The PSC considers that it would be desirable to develop generally agreed methods of accounting for social policy obligations, supported by conceptual arguments. This ITC is the first step in filling that gap. It is intended to provide input to the development of an Exposure Draft of an International Public Sector Accounting Standard (IPSAS) on this topic.

The ITC proposes the principles to be used in determining whether social policy obligations of governments give rise to a liability that should be recognized in general purpose financial statements. The ITC tests a number of different types of social benefits against these principles and identifies the Steering Committee's views on when a liability should be recognized. For the most part, the Steering Committee is of the view that liability should be recognized for the amount accrued since the last payment. However, some Steering Committee members are of the view that a liability for age pensions arises at an earlier point.

The Steering Committee's Preliminary Views are outlined below. They identify the principles the Steering Committee adopted in analyzing a wide range of social policy obligations and the Steering Committee's view on when a liability arises.

The key contribution of this document is the development of various principles in relation to the types of social benefits considered. These principles are shown in the Summary of Preliminary Views. These are

preliminary views in relation to each type of social benefit considered. In most cases the Steering Committee has a unanimous view. In the case of old age pension benefits, there is also a minority view.

The ITC also considers whether additional disclosures about social benefits should be included in general purpose financial statements. The Steering Committee is of the view that existing disclosures are not sufficient to provide users with information necessary to form a view about the sustainability of a government's social benefits and encourages further debate and development in this area.

Summary of Preliminary Views

Constructive Obligation – Alternate views regarding the past event(s) which give rise to a present obligation.

Option 1 – Satisfy all eligibility criteria (Chapter 4)

In the absence of a legal obligation, a past event giving rise to a present obligation occurs when an individual satisfies all applicable eligibility criteria.

In the case of ongoing benefits which are subject to regular satisfaction of eligibility criteria, the maximum amount of the present obligation is the benefit that the individual is entitled to from the current point in time until the next point in time at which eligibility criteria must be satisfied.

Where validation of eligibility criteria is required only once, the present obligation is for all future benefits to be provided to that individual as a result of that validation.

Option 2 – Satisfy threshold eligibility criteria (Chapter 4)

In the absence of a legal obligation, a past event giving rise to a present obligation occurs when an individual meets the eligibility criteria for the first time (the threshold criteria). The present obligation is for all benefits to be provided to the individual in future periods regardless of whether the individual is required to satisfy eligibility criteria again in future periods.

Option 3 – Key participatory events (Chapter 4)

In the absence of a legal obligation, a past event, or series of past events, giving rise to a present obligation occurs prior to the point at which an individual meets threshold eligibility criteria (where threshold criteria are applicable).

The present obligation arises when key participatory events have occurred that lead an individual to have a reasonable expectation of eventually satisfying eligibility criteria for a benefit and, as a result, the individual has relied on that expectation over a period of time leaving the government with no realistic alternative but to settle the obligation in the future.

The present obligation is for all benefits to be provided to the individual in future periods regardless of whether the individual is required to satisfy eligibility criteria again in future periods.

**Preliminary View 1 – Collective Goods and Services
(Chapter 5)**

Where a government meets its social policy objectives by delivering services for the benefit of the community as a whole, there is no present obligation prior to the delivery of the service. Input costs associated with exchange transactions that a government enters into to deliver collective services are accounted for in accordance with generally accepted accounting practice for those costs.

**Preliminary View 2 – Individual Goods and Services
(Chapter 5)**

Where a government meets its social policy objectives by providing goods or services to individuals there is no present obligation prior to the provision of the good or service.

**Preliminary View 3 – Individual Goods and Services
(Chapter 5)**

The existence of a present obligation is not conditional on the means by which a service is provided to individuals (for example, directly by a government entity, by a third party on behalf of the government, by voucher or by cash advance or reimbursement).

Preliminary View 4 – Cash Transfers (Chapter 6)

A present obligation for the payment of future cash transfers does not arise until an individual has satisfied all eligibility criteria. The maximum amount of the obligation is the amount that the individual is entitled to from one validation point until the next.

Preliminary View 5 – Old age pension benefits (Chapter 8)

Steering Committee members do not have an unanimous view on this issue. The Preliminary Views of the Steering Committee

regarding the identification of present obligations for old age pension benefits to be provided in future periods are outlined below:

- *Option 1 (satisfy all eligibility criteria) is supported by a majority of Steering Committee members; and*
- *Option 3 (key participatory events: workforce entry) is supported by a minority of Steering Committee members.*
- *Options 2 is not supported by Steering Committee members.*

Preliminary View 6 – Disclosure (Chapter 9)

The disclosure requirements of IPSAS 1 and IPSAS 19 are applicable to liabilities and contingent liabilities arising from social policy obligations.

Preliminary View 7 – Additional Disclosures (Chapter 9)

The disclosure requirements included in general purpose financial statements will not provide users with information sufficient to make informed assessments about the future sustainability of social benefit programs. The Steering Committee is of the view that the PSC should explore the development of a framework for reporting information about the sustainability of government programs.

The PSC welcomes the views of its constituents on the issues raised in this ITC and the Preliminary Views of the Steering Committee.

Chapter 1 Introduction

Introduction

- 1.1 Governments provide a wide range of social benefits to individuals and organizations, including the provision of goods and services and the re-distribution of income via cash transfers. Governments frequently make public announcements regarding the nature or amount of social benefits that may be provided in the future and/or commit themselves to future actions.
- 1.2 Accrual based financial reporting in the public sector is still evolving and there is currently no internationally agreed method of accounting for and reporting on liabilities arising from the provision of social benefits by governments. International Public Sector Accounting Standard IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* excludes “provisions and contingent liabilities arising from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits” (paragraph 1(a)). These transactions have been excluded from the scope of IPSAS 19 to allow for further consideration of the “obligating event” and the measurement of such liabilities.
- 1.3 The publication of this ITC is intended to promote consideration and debate of this issue and to contribute to the development of an International Public Sector Accounting Standard (IPSAS). The ITC includes a number of preliminary views on financial reporting of obligations arising from the provision of social benefits by governments, and seeks comments on these preliminary views. These preliminary views are the views of the Steering Committee. They are not necessarily the views of the PSC.
- 1.4 This ITC applies the definitions and principles in International Public Sector Accounting Standards (IPSASs), particularly IPSAS 19, to a range of social benefits, IPSAS 19:
 - (a) defines provisions as liabilities of uncertain timing or amount;

- (b) identifies the circumstances in which provisions should be recognized as liabilities in an entity's general purpose financial statements;
 - (c) provides guidance on how provisions should be measured and the disclosures that should be made about them;
 - (d) defines contingent liabilities. Contingent liabilities include possible obligations whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity and present obligations that are not recognized because they do not meet the recognition criteria; and
 - (e) prohibits contingent liabilities from being recognized as liabilities in the financial statements but requires that certain information be disclosed about contingent liabilities in the notes to the financial statements.
- 1.5 IPSAS 19 focuses on provisions and contingent liabilities. This ITC also considers the recognition of short term liabilities (for example, amounts due and payable) in relation to social policy obligations.
- 1.6 The ITC also considers whether the application of the disclosure requirements in IPSAS 19 will provide relevant and sufficient information about social policy obligations, and explores the nature of any additional disclosures that might be made about a government's social policy obligations.

Current Financial Reporting Practices

- 1.7 At the present time a number of governments that have adopted accrual accounting for the preparation of general purpose financial statements apply what this ITC refers to as the "due and payable" approach to the recognition of expenses and liabilities arising from social benefits. Under this approach benefits relating to the period which were paid or due to be paid in the period are recognized as an expense and the unpaid amounts are recognized as a liability. In a number of jurisdictions the due and payable approach also encompasses the recognition of an expense and a liability accrued benefits (for that portion of ongoing benefits that has accrued since the last payment date). It may also include the recognition of an expense and a liability for benefits applied for but not yet approved.

- 1.8 Subsequent references to “amounts due and payable” or the “due and payable” approach in this ITC refer to both amounts that are due and accrued benefits.
- 1.9 Some are of the view that in order for financial statements to fully reflect a government’s liabilities, and to enable a government to discharge its obligation to be accountable for the full impact of its decisions, a liability should be recognized for obligations to provide social benefits well before such benefits become due and payable. However, even those who consider that current reporting practices have limitations find it difficult to agree on the point at which a government should recognize liabilities in relation to its obligations for social benefits and the measurement of those liabilities.

General Purpose Financial Statements

- 1.10 General purpose financial statements are those intended to meet the needs of users who are not in a position to demand financial reports tailored to meet their specific information needs. *IPSAS 1 Presentation of Financial Statements* sets out requirements for the structure and content of general purpose financial statements under the accrual basis of accounting, including general disclosure requirements.
- 1.11 In addition to the disclosures required by IPSASs in general purpose financial statements, a government may make additional disclosures in general purpose financial statements or in other reports such as statistical, economic and intergenerational reports. This ITC explores the types of additional disclosures in relation to obligations to provide social benefits in future periods that may be useful to users of general purpose financial statements.
- 1.12 This ITC does not address issues associated with budget reporting. The Public Sector Committee is undertaking a separate project which will consider issues associated with best practice in budget formulation, budget execution and budget reporting, including the disclosure of information to support proposed budgets.

Structure of the ITC

- 1.13 The ITC comprises nine Chapters. Chapters 2 to 4 provide additional background to the topic, outline the approach adopted by the Steering Committee and establish the general principles that are applied in subsequent chapters. Chapter 2 identifies the types of social benefits that fall within the scope of this ITC. Chapter 3 describes the general approach that the ITC uses in determining whether a government's intention to provide social benefits in current and future periods gives rise to liabilities or contingent liabilities in the context of general purpose financial reporting. This approach is based on the principles and definitions in IPSAS 19. Chapter 3 also discusses measurement and disclosure issues. Chapter 4 discusses the issues that arise in applying the definitions and recognition criteria in IPSAS 19 to social policy obligations and differing interpretations of the factors that are relevant in applying those definitions.
- 1.14 Chapters 5 to 8 outline the implications of the general recognition and measurement principles for the recognition of liabilities in respect of a range of social benefits. The discussion of social benefits is structured as follows:
- (a) Chapter 5 – Collective Services and Individual Services;
 - (b) Chapter 6 – Cash Transfers to Individuals;
 - (c) Chapter 7 – Disaster Relief; and
 - (d) Chapter 8 – Old Age Pension Benefits.
- 1.15 Although old age pension benefits are provided by way of cash transfer they are discussed separately from the cash transfers considered in Chapter 6. Old age pension benefits have been discussed in a separate chapter because of their significance in some jurisdictions and the reluctance of many governments to reduce such pension benefits in respect of individuals who have achieved or are nearing pensionable age.
- 1.16 Chapter 9 considers the desirability of additional disclosures about major government activities and outlines the possible form and content of such disclosures. Appendix 1 illustrates the application of the principles discussed in Chapters 5 to 8 to specific examples.

Chapter 2 Scope

Introduction

- 2.1 This ITC focuses on accounting for those social benefits specifically excluded from the scope of IPSAS 19 paragraph 1(a). That is those social benefits where the entity does not receive approximately equal value in return, including the circumstances where a charge is levied in respect of the benefit but there is no direct relationship between the charge and the benefit received. The scope of IPSAS 19 is set out in Figure 2.1 below.

Figure 2.1 IPSAS 19 Scope

- | |
|---|
| <p>1. An entity which prepares and presents financial statements under the accrual basis of accounting should apply this Standard in accounting for provisions, contingent liabilities and contingent assets, except:</p> <ul style="list-style-type: none"> (a) those provisions and contingent liabilities arising from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits; (b) those resulting from financial instruments that are carried at fair value; (c) those resulting from executory contracts, other than where the contract is onerous subject to other provisions of this paragraph; (d) those arising in insurance entities from contracts with policyholders; (e) those covered by another International Public Sector Accounting Standard; (f) those arising in relation to income taxes or income tax equivalents; and (g) those arising from employee benefits except employee termination benefits that arise as a result of a restructuring as dealt with in this Standard. <p style="text-align: right;">IPSAS 19 paragraph 1</p> |
|---|

- 2.2 The discussion and preliminary views in this ITC may also provide useful guidance on accounting for certain obligations which fall within the scope of IPSAS 19, but which are not specifically addressed in IPSAS 19. For example, as a result of

its economic rather than its social policies a government may have given assurances to private companies that it will provide certain subsidies or assistance in both current and future periods.

- 2.3 The ITC does not address obligations associated with exchange transactions such as the provision of retirement benefits to government employees as compensation for services provided during their employment, or the purchase by individuals of health or education services from a government entity.

IPSAS 19 Social Benefit Exclusion

Social Benefits

- 2.4 IPSAS 19 paragraphs 7 to 11 describe the types of social benefits that are excluded from the scope of the Standard. Paragraphs 7 and 8 of IPSAS 19 are shown in Figure 2.2.

Figure 2.2 Social Benefits

Social Benefits

7. For the purposes of this Standard “social benefits” refer to goods, services and other benefits provided in the pursuit of the social policy objectives of a government. These benefits may include:
 - (a) The delivery of health, education, housing, transport and other social services to the community. In many cases, there is no requirement for the beneficiaries of these services to pay an amount equivalent to the value of these services; and
 - (b) Payment of benefits to families, the aged, the disabled, the unemployed, veterans and others. That is, governments at all levels may provide financial assistance to individuals and groups in the community to access services to meet their particular needs, or to supplement their income.
8. In many cases, obligations to provide social benefits arise as a consequence of a government’s commitment to undertake particular activities on an on-going basis over the long term in order to provide particular goods and services to the community. The need for, and nature and supply of, goods and services to meet social policy obligations will often depend on a range of demographic and social conditions and are difficult to predict. These benefits generally fall within the “social

protection”, “education” and “health” classifications under the International Monetary Fund’s Government Finance Statistics framework and often require an actuarial assessment to determine the amount of any liability arising in respect of them.

IPSAS 19 paragraphs 7 and 8

Non-Exchange Transactions

- 2.5 The social benefits referred to in IPSAS 19 paragraph 1(a) are commonly referred to as non-exchange social benefits. However, IPSAS 19 does not define the term “non-exchange”. This ITC therefore uses the definition of non-exchange revenue proposed in *the ITC on Accounting for Non-exchange Revenue*¹ (refer Figure 2.3).

Figure 2.3 Definition of Non-exchange Transaction

A non-exchange transaction is a transaction that is not an exchange transaction. In a non-exchange transaction, a public sector entity either receives value from another party without directly giving approximately equal value in exchange or gives value to another party without directly receiving approximately equal value in exchange.

- 2.6 The characteristics of non-exchange transactions vary between jurisdictions and within jurisdictions. For example, in some jurisdictions, individuals may be required or permitted to make contributions towards their old age pensions (or other benefits) and these contributions may influence the amount of the pension (or other benefit) they eventually receive. In other jurisdictions, old age pensions (or other benefits) are provided with no contribution from constituents.

Social Benefits and GFSM 2001

- 2.7 IPSAS 19 paragraph 8 (refer Figure 2.2) notes that the social benefits excluded from the scope of IPSAS 19 generally fall within the “social protection”, “education” and “health”

¹ *Invitation to Comment – Accounting for Non Exchange Revenue*, International Federation of Accountants (2003) is available at www.ifac.org

functional classifications of the International Monetary Fund's (IMF) Government Finance Statistics Framework (GFSM 2001).

- 2.8 Social benefits are one category of economic classification of an expense within the IMF's GFSM 2001 Framework (refer to GFSM 2001, Table 6.1 for a detailed list of economic classifications). The GFS definitions of social benefits and social risk are shown in Figure 2.4. Where possible this ITC uses terminology in a manner consistent with GFS 2001 or explains the difference in use.

Figure 2.4 GFSM 2001 Definitions of Social Benefit and Social Risk

Social benefit [GFSM 2001]. A payment, in cash or in kind, to protect the entire population, or specific segments of it, against certain social risks. Examples of social benefits are the provision of medical services, unemployment compensation, and social security pensions. See social risk.

Social risk. An event or circumstance that may adversely affect the welfare of households either by imposing additional demands on their resources or by reducing their incomes.

GFSM 2001 Companion Material – Glossary

- 2.9 GFSM 2001 acknowledges the social risks in respect of which protection (social benefit) is provided will vary from government to government.²
- 2.10 Examples of social benefits under GFSM 2001 include:
- (a) unemployment benefits;
 - (b) allowances to cover education expenses;
 - (c) cash benefits to support spouses, children and invalids;
 - (d) reimbursement of expenditure by individuals on healthcare;

² Social benefits may be provided under a variety of social protection schemes. Using the GFSM 2001 classification of social protection schemes, the social protection schemes which fall within the scope of this ITC are social assistance schemes and social security schemes operated by government units where the level of contribution is low enough for it to be classified as non-exchange (refer to GFSM 2001 paragraphs 6.69 to 6.71). Employer social security schemes are outside the scope of this ITC.

- (e) the provision of educational or healthcare services in kind (where governments enter into agreements with non-government suppliers to provide such services to individuals); and
- (f) the reimbursement of expenditures by individuals on specified goods or services, such as expenditures on medicines, medical or dental treatments, hospital bills, and optometrists' bills.³

2.11 Employer social insurance schemes are social insurance schemes whereby an employer provides social insurance benefits to its employees, former employees, or their beneficiaries. Benefits provided under social insurance schemes do not fall within the category of social benefits referred to in IPSAS 19 paragraph 1(a) because the benefits are provided as part of an exchange transaction between the employer and employee. IPSAS 19 paragraph 1(g) specifically excludes employee benefits from the scope of IPSAS 19. Guidance on accounting for employee benefits is found in International Accounting Standard IAS 19, *Employee Benefits*.

Social Benefits in this ITC

- 2.12 This ITC uses a broader definition of social benefits than GFSM 2001. Under GFSM 2001 social benefits in kind are limited to the transfer of goods and services through third parties – they do not include the direct provision of goods and services to individuals by a government. By contrast this ITC includes the provision of goods and services in kind by a government, using government employees and resources, in its definition of social benefits. For example, this ITC includes the provision of education services through government owned and operated schools as a social benefit.
- 2.13 This ITC does not focus on the provision of subsidies and grants to companies, foreign governments or international organizations. Some of these grants and subsidies could be provided in relation to a government's social objectives (for example, the provision of aid to the government of another jurisdiction). The discussion of disaster relief in Chapter 7 could

³ The GFSM 2001 of a transfer transaction defines the provision of goods or services where there is *no* value given in exchange. The definition of a non-exchange transaction used in this ITC is broader than the GFSM 2001 definitions.

be useful in determining whether a government should recognize liabilities or provisions in relation to such grants and subsidies. Under GFSM 2001 subsidies and grants are a separate economic classification to social benefits.

- 2.14 Provisions and contingent liabilities arising from non-exchange transactions other than those arising from social benefits are not excluded from the scope of IPSAS 19. The discussion in this ITC may be useful in accounting for these transactions and events. For example, the discussion in Chapter 7 on foreign aid could usefully be applied to similar grants, regardless of whether such grants are made in pursuit of the government's social policy objectives, economic policy objectives or for other purposes.
- 2.15 IPSAS 19 identified Health, Education Housing, Transport, and a range of Social Protection schemes as areas of government activity in which a government could provide social benefits. IPSAS 19 makes it clear that these functional areas are indicative only. Social benefits could also be provided under other categories of government activity (for example, Defense, Public Order and Safety and Community Amenities).

Summary

- 2.16 Figure 2.5 below identifies a range of common transactions and events that may give rise to social benefits and indicates whether they are within the scope of this ITC, IPSAS 19 or another document.

Figure 2.5 Types of Transactions and Events

Transaction or Event	Location of Guidance
Provisions and contingent liabilities arising from exchange transactions apart from those specifically excluded by IPSAS 19 paragraph 1.	IPSAS 19.
Provisions relating to employee entitlements.	IAS 19 <i>Employee Benefits</i> .
Provisions and contingent liabilities arising from non-exchange transactions (other than social policy obligations).	IPSAS 19. Guidance in this ITC may also be useful in accounting for discretionary transfers to individuals or other entities where the objective of the transfer is for reasons other than social policy.

Provisions and contingent liabilities arising from non-exchange social benefits.	This ITC.
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Chapter 3 General Approach

Introduction

- 3.1 This Chapter identifies the definitions and principles in IPSASs that are relevant in considering how to account for the social benefits excluded from the scope of IPSAS 19 by paragraph 1(a) in general purpose financial statements. Hereafter these benefits are referred to simply as social benefits. This ITC applies these definitions and principles in developing its preliminary views on financial reporting of social benefits.

Definitions and Principles in Existing IPSASs

- 3.2 The two IPSASs relevant when considering how to account for these social benefits are IPSAS 1 and IPSAS 19. As noted in Chapter 1:
- (a) IPSAS 1 sets out minimum requirements for the presentation of financial statements;; and
 - (b) IPSAS 19 defines provisions, contingent liabilities and contingent assets, and sets out requirements relating to reporting them in general purpose financial statements. Key definitions⁴ and recognition criteria for provisions are shown in Figure 3.1.

Figure 3.1 IPSAS 19 (2002) Provisions – Relevant Definitions and Recognition Criteria

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.

A provision is a liability of uncertain timing or amount.

An obligating event is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to

⁴ The Glossary to this ITC contains a list of all defined terms (from IPSASs) used throughout this ITC.

⁵ IPSASs are based upon equivalent International Accounting Standards (IASs) or International Financial Reporting Standards (IFRSs) to the extent that these standards are applicable to the public sector. In turn IASs/IFRSs are built upon the IASC (now IASB) Framework for the Preparation and Presentation of Financial Statements. The IASB Framework (paragraph 91) contains the recognition criteria for liabilities.

settling that obligation.

A legal obligation is an obligation that derives from:

- (a) a contract (through its explicit or implicit terms);
- (b) legislation; or
- (c) other operation of law.

A constructive obligation 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.

IPSAS 19 paragraph 18

Recognition Criteria – Provisions

A provision is recognized when:

- (a) an entity has a present obligation (legal or constructive) as a result of a past event;
- (b) it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; and
- (c) a reliable estimate can be made of the amount of the obligation.

IPSAS 19 paragraph 22

- 3.3 IPSAS 19 is based on International Accounting Standard IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. IAS 37 was developed by the IASB for application to profit oriented entities. IAS 37 is currently under review. The proposed changes are discussed briefly at the end of this Chapter.

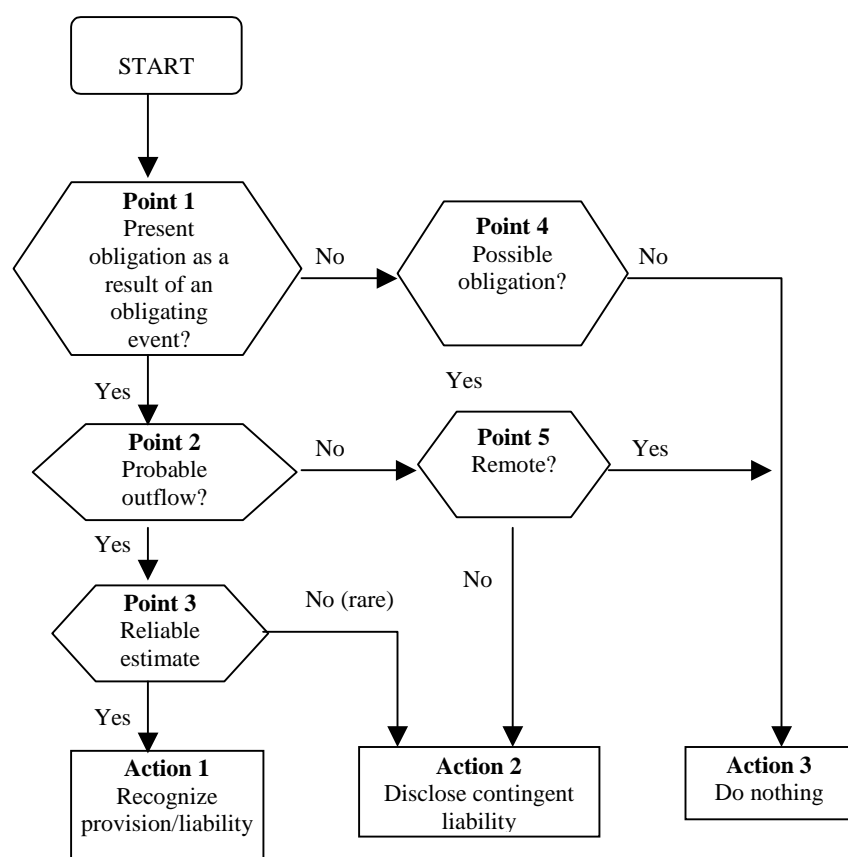
Summary of IPSAS 19 Requirements

- 3.4 Figure 3.2 summarizes the main recognition requirements of IPSAS 19. Figure 3.2 is based on the Decision Tree in Appendix B of IPSAS 19. It has been amended to highlight

⁶ The Decision Tree in IPSAS 19 does not apply to obligations arising from employee entitlements. Employee entitlements are outside the scope of IPSAS 19 and outside the scope of this ITC.

points where a decision is required and the actions required as a result of those decisions. Together with the text in the body of IPSAS 19 the Decision Tree in IPSAS 19 Appendix B provides guidance on accounting for:

- (a) liabilities that are uncertain as to timing or amount (provisions);
- (b) liabilities that are not recognized because their existence will be confirmed only by one or more uncertain future events not wholly within the control of the entity (contingent liabilities); and
- (c) liabilities that are not recognized because they do not meet the recognition criteria for liabilities (contingent liabilities).

Figure 3.2 Summary of IPSAS 19 Requirements

Present Obligation and Obligating Event – Point 1

3.5 **Point 1** in Figure 3.2 identifies the existence of a “present obligation as a result of an obligating event” as the threshold condition. For an event to be an obligating event, it is necessary that the entity has no realistic alternative but to settle the obligation created by the event. An obligating event may give

rise to a legal or constructive obligation. A liability will exist when:

- (a) a present obligation of the entity arises from a past (obligating) event; and
- (b) settlement of the obligation is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.

3.6 IPSAS 19 contains a detailed explanation of present obligations and past events (refer Figure 3.3).

Figure 3.3 IPSAS 19 Past Event

Past Event

25. A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only:
 - (a) Where the settlement of the obligation can be enforced by law; or
 - (b) In the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation.
26. Financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognized for costs that need to be incurred to continue an entity's ongoing activities in the future. The only liabilities recognized in an entity's statement of financial position are those that exist at the reporting date.
27. It is only those obligations arising from past events existing independently of an entity's future actions (that is, the future conduct of its activities) that are recognized as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage imposed by legislation on a public sector entity. Both of these obligations would lead to an outflow of resources embodying economic benefits or service potential in settlement regardless of the future actions of that public sector entity. Similarly, a public sector entity would recognize a provision for the decommissioning costs of a defense installation or a government-owned nuclear power station to the extent that the public sector entity is obliged to

rectify damage already caused (International Public Sector Accounting Standard IPSAS 17 *Property, Plant and Equipment*, deals with items, including dismantling and site restoring costs, that are included in the cost of an asset). In contrast, because of legal requirements, pressure from constituents, or a desire to demonstrate community leadership, an entity may intend or need to carry out expenditure to operate in a particular way in the future. An example would be where a public sector entity decides to fit emission controls on certain of its vehicles or a government laboratory decides to install extraction units to protect employees from the fumes of certain chemicals. Because the entities can avoid the future expenditure by their future actions - for example, by changing their method of operation, they have no present obligation for that future expenditure and no provision is recognized.

IPSAS 19 paragraphs 25 to 27

- 3.7 A government may, as a result of previous public undertakings or commitments, be seen as having an obligation to provide particular goods and services for the benefit of its constituents in both current and future periods. However, an obligation to provide goods or services (or other benefits) to constituents in the future does not of itself give rise to a liability for financial reporting purposes. Paragraph 27 of IPSAS 19 (refer Figure 3.3) makes it clear that the existence of an obligation to provide social benefits in future periods does not necessarily mean that a government has a present obligation that should be recognized as a provision. All aspects of the definitions of, and recognition criteria for, a liability must be satisfied for recognition to occur, including the requirement that the government has no realistic alternative but to settle the obligation. In addition, no provision is recognized for costs that need to be incurred to continue an entity's ongoing activities in the future.

Legal and Constructive Obligations

- 3.8 This Chapter provides a brief description of obligations that may be classified as legal or constructive obligations. Chapter 4 discusses some specific issues that need to be considered in determining the classification of obligations.
- 3.9 **Legal obligations:** Legal obligations include obligations deriving from:

- (a) contracts;⁷
 - (b) legislation; or
 - (c) other operation of law.
- 3.10 Legislation frequently imposes obligations on governments to provide social benefits. In many cases, these are obligations to provide social benefits on a collective basis to the community or sections thereof, rather than to identifiable individuals. IPSAS 19 paragraph 28 (refer Figure 3.4) clarifies that the inability to identify specific recipients of benefits does not preclude a present obligation from arising.

Figure 3.4 IPSAS 19 Paragraph 28

28. An obligation always involves another party to whom the obligation is owed. It is not necessary, however, to know the identity of the party to whom the obligation is owed — indeed the obligation may be to the public at large. Because an obligation always involves a commitment to another party, it follows that a decision by an entity's management, governing body or controlling entity does not give rise to a constructive obligation at the reporting date unless the decision has been communicated before the reporting date to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will discharge its responsibilities.

IPSAS 19 paragraph 28

- 3.11 **Constructive Obligations:** Constructive obligations may arise in respect of rights specified in legislation, but the existence of legislation is not necessary for such obligations to arise. The key issue is identifying what constitutes the obligating event.
- 3.12 It may be argued that the obligating event giving rise to a constructive obligation occurs when:
- (a) a government has publicly committed to policies which specify the provision of social benefits in future periods to constituents;

⁷ A contract is an agreement with specific terms between two or more persons or entities in which there is a promise to do something in return for valuable benefits known as consideration.

- (b) a government has advised constituents of its intention to provide social benefits to particular individuals or groups and identified the amount of those benefits and the recipients; and
- (c) as a result of these announcements and actions constituents have a valid expectation that they will receive those benefits.

3.13 However, some may argue that the events identified in the preceding paragraph would not qualify as a past event which gives rise to a present obligation. They would argue that for a present obligation to exist a government must have clearly accepted the responsibility to sacrifice resources for the provision of benefits and must have communicated its acceptance of this responsibility to relevant parties. They would argue that a government's acceptance of responsibilities needs to be supported by evidence such as:

- (a) the formal adoption of a budget incorporating the financial impact of policies or other specific decisions;
- (b) the enactment of legislation which authorizes a government to spend funds included in its budget; or
- (c) the formal establishment of a program to implement a government's policy.

3.14 In a commercial environment, judgments can be, and are made, about whether particular events and practices give rise to a constructive obligation such that the entity cannot realistically avoid the sacrifice of resources as a result. These judgments may be the subject of some debate, but nevertheless judgments are made and applied. In a commercial environment there is an ongoing and steady development of conventions, practices and guidance that can be used to assist analysis of circumstances that give rise to constructive obligations. By contrast, in the public sector, there is little precedent or practice to guide consideration of the circumstances in which constructive obligations might give rise to non-exchange transactions. In addition, it might be argued that the notion of a constructive obligation has less practical relevance to the reporting of social policy obligations in the public sector because, for example:

- (a) the nature of the relationship between a government and its constituents is not a commercial or exchange relationship. Social benefits are frequently “promised” to broad sections of the community and provided on a global or collective basis as opposed to an individual basis;
- (b) governments can amend policies on their own authority with consequential financial, and financial reporting, effects; and
- (c) of the difficulty in determining on a consistent basis within the same, and across different jurisdictions, when past actions give rise to an obligation to sacrifice resources that the government cannot realistically avoid.

3.15 Current reporting conventions support the view that there are few constructive obligations in the public sector. The Steering Committee acknowledges that the concept of constructive obligations can be difficult to apply in the public sector, but considers that this concept is necessary to guide the approach to a range of potential public sector obligations. Chapter 4 considers alternative approaches that can be adopted in determining the circumstances and events that may give rise to a constructive obligation and factors that would need to be considered in determining whether a government has no realistic alternative but to settle such an obligation.

Probable Outflow – Point 2

- 3.16 For a liability to be recognized, it is necessary to satisfy recognition criteria, including that an outflow of resources is probable. IPSAS 19 (paragraphs 31 and 32) explains that:
- (a) for a liability to qualify for recognition there must be both a present obligation and the probability of an outflow of resources embodying economic benefits or service potential to settle that obligation;
 - (b) an outflow is probable if an event is more likely than not to occur; and
 - (c) where there are a number of similar obligations it may be necessary to consider the outflow of resources required to settle a class of obligations as a whole.

- 3.17 In the context of a government providing social benefits to constituents, an outflow of resources can occur when:
- (a) a government provides cash benefits to constituents;
 - (b) a government provides goods and services to constituents by way of a contractual arrangement with another entity (sometimes referred to as a third party provider);
 - (c) a government reimburses constituents for expenditures on specified goods and services; and
 - (d) a government provides goods and services directly to constituents, using government employees and other government resources.
- 3.18 Satisfying **Point 2** on Figure 3.2 therefore requires an assessment as to whether past transactions or events have given rise to circumstances in which it is more likely than not that an outflow of resources is probable.

Reliable Estimate – Point 3

- 3.19 The second arm of the recognition criteria that needs to be satisfied before a liability is recognized is that of reliable measurement. Provisions are liabilities of uncertain nature or amount. Therefore most provisions are likely to require estimation of the size and timing of future cash flows.
- 3.20 IPSAS 19 explains that the use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. In cases where a reliable estimate of a present obligation cannot be made, IPSAS 19 requires disclosure of a contingent liability (**Action 2** in Figure 3.3).
- 3.21 The key requirements of IPSAS 19 in relation to the measurement of a provision are:
- (a) the amount recognized as a provision should be the best estimate of the expenditure required to settle the present obligation at the reporting date (paragraph 44). A range of possible outcomes may need to be used in making an estimate of the amount of a provision (paragraph 33);

- (b) risks and uncertainties surrounding the events and circumstances should be taken into account (paragraph 50);
 - (c) where the effect of the time value of money is material, the amount of a provision should be the present value of the expenditures expected to be required to settle the obligation (paragraph 53);
 - (d) the discount rate (or rates) should be a pre-tax rate (or rates) that reflects current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) should not reflect risks for which future cash flow estimates have been adjusted (paragraph 56);
 - (e) future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision when there is sufficient objective evidence that they will occur (paragraph 58); and
 - (f) gains from the expected disposal of assets should not be taken into account in measuring a provision (paragraph 61).
- 3.22 In making the best estimate of the provision it is necessary to identify future cash flows associated with cash transfers or the delivery of goods and services. Matters which will need to be considered include: the number of recipients entitled to a benefit in each period, the rate(s) of benefit to which they will be entitled in each period, the period over which the provision is being measured and changes in benefit entitlements.
- 3.23 Where the time horizon for the settlement of an obligation extends over many years, or there is a range of possible outcomes, it may be necessary to obtain actuarial valuations to form the basis of the estimate.
- 3.24 An actuarial valuation involves the valuation of uncertain future financial outcomes. It can require the use of mathematical, statistical, economic and financial analysis, together with various forms of risk assessment. In the case of assessing likely cash flows in respect of social benefits to be provided in future periods, an actuarial valuation requires an assessment of the number of recipients that would become entitled to the benefits in each period, the amount of the benefit that they would be entitled to and the period of time for which they would be entitled to the benefit. Where social benefits are contingent on

the occurrence of external events the actuarial valuation would also need to consider the likelihood of those events occurring.

- 3.25 There may be a considerable time difference between the recognition of a provision and the settlement of that provision. At each reporting date prior to settlement, the provision should be reviewed and adjusted to reflect the current best estimate. The calculation of the current best estimate should include a review of the discount rate and the assumptions underlying the variables used to calculate the estimated size and timing of cash flows. IPSAS 3 *Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies* sets out the general principles for dealing with changes in estimates.

Recognition of Provisions – Action 1

- 3.26 If the criteria for recognition of a provision are met, the amount of the provision (**Point 3** in Figure 3.3) is included in the liability amounts shown on the face of the statement of financial position. Where the amount and timing of settlement of the obligation is known with certainty, a liability, rather than a provision, will be recognized.

Disclosure of Recognized Provisions

- 3.27 Chapter 9 identifies relevant disclosure requirements in IPSASs and additional disclosures that may be made about obligations to provide social benefits.
- 3.28 However, separate disclosure of items which are not material is not required. IPSASs do not apply to items that are immaterial. IPSAS 1 (paragraphs 50 to 53) explains that information is material if its omission or misstatement could influence the decisions or assessments of users made on the basis of the financial statements.

Disclosure of Contingent Liabilities – Action 2

- 3.29 IPSAS 19 defines contingent liabilities (refer Figure 3.6) and requires them to be disclosed in the notes to the financial statements (refer **Points 4 and 5** and **Action 2** of Figure 3.3).

Figure 3.6 Contingent Liabilities – Definition

A contingent liability is:

- (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
- (b) a present obligation that arises from past events but is not recognized because:
 - (i) it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation;
 - (ii) or the amount of the obligation cannot be measured with sufficient reliability.

IPSAS 19 paragraph 18

3.30 Contingent liabilities are defined as possible obligations or present obligations. In both cases, the obligation must arise from a past event. However, in the case of possible obligations the existence of the obligating event may only be confirmed in the future.

3.31 IPSAS 19 (paragraph 100) requires that unless the possibility of any outflow in settlement is remote, an entity should disclose for each class of contingent liability at the reporting date, a brief description of the nature of the contingent liability and, where practicable:

- (a) an estimate of its financial effect;
- (b) an indication of the uncertainties relating to the amount or timing of any outflow; and
- (c) the possibility of any reimbursement.

3.32 The disclosure of uncertainties as to amount or timing of outflows could include disclosure of measurement estimates and the impact of changes in assumptions.

Proposed Changes to IAS 37 – Provisions, Contingent Liabilities and Contingent Assets

- 3.33 IPSAS 19 is based on International Accounting Standard IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. IAS 37 was developed by the International Accounting Standards Committee (now the International Accounting Standards Board (IASB)) for application by profit-oriented entities. At the time of writing (September 2003) the IASB is reviewing IAS 37 and has indicated that it intends to⁸:
- (a) amend the definitions of contingent assets and contingent liabilities to clarify that only present rights and present obligations can give rise to assets and liabilities;
 - (b) amend the recognition criteria for contingent liabilities and require the recognition of contingent liabilities if:
 - (a) it is probable that an outflow of resources will be required to settle the contingent liability; and
 - (b) a reliable estimate can be made of the amount of the obligation;
 - (c) amend the current recognition criteria for provisions and to require that a provision be recognized when the entity incurs a present obligation unless a reliable estimate cannot be made of the amount of obligation;
 - (d) require that when a contract becomes onerous as a result of the entity's own actions, the resulting provision should not be recognized until that action has occurred. This change is to give effect to a decision by the IASB that management intent does not, by itself, give rise to liabilities; and
 - (e) require that provisions be measured at the amount an entity would rationally pay to settle the obligation at the balance sheet date or to transfer it to a third party at that time.

⁸ IASB Update (May 2003). IASB Updates are available at www.iasb.org.uk

Chapter 4 Application of Principles

Introduction

- 4.1 Figure 4.1 identifies key elements of relevant definitions and recognition criteria that must be satisfied before a social policy obligation giving rise to a *legal obligation* or *constructive obligation* would be recognized as a liability (including a provision) in the statement of financial position. *Each* aspect of these definitions and recognition criteria must be met before a liability (including a provision) is recognized in the financial statements. For example, a government may have an obligation to provide certain services in future periods, but that does not necessarily mean that the obligation meets the definition of a legal or constructive obligation, or that it is a present obligation.

Figure 4.1 Criteria for Recognition

Legal Obligation	Constructive Obligation
The past (obligating) event has occurred (<i>from definitions of a liability and an obligating event</i>).	The past (obligating) event has occurred (<i>from definitions of a liability and an obligating event</i>).
A legal obligation is derived from a contract, legislation or other operation of law (<i>from definitions of an obligating event and a legal obligation</i>).	A constructive obligation arises when a government, by an established pattern of past practice, published policies or sufficiently specific current statement has indicated acceptance of responsibility and created a valid expectation that it will discharge those responsibilities (<i>from definitions of an obligating event and a constructive obligation</i>).
There is no realistic alternative to settling the obligation (<i>from definition of an obligating event</i>).	There is no realistic alternative to settling the obligation (<i>from definition of an obligating event</i>).

A present obligation must exist (<i>from definition of a liability</i>).	A present obligation must exist (<i>from definition of a liability</i>).
Settlement of the obligation is expected to result in an outflow of resources embodying economic benefits or service potential (<i>from definition of a liability</i>).	Settlement of the obligation is expected to result in an outflow of resources embodying economic benefits or service potential (<i>from definition of a liability</i>).
The expected outflow must be probable and measurable (<i>from recognition criteria</i>).	The expected outflow must be probable and measurable (<i>from recognition criteria</i>).

- 4.2 This Chapter considers social policy obligations that may be classified as legal obligations or as constructive obligations, and the factors that would need to be considered in deciding whether they meet each of the requirements for recognition in the financial statements.

Legal Obligations and Social Policy Obligations

- 4.3 Legal obligations include obligations deriving from contracts, legislation, or other operation of law. A legal obligation exists when a party has a legal right to obtain judgment through a court of competent jurisdiction to enforce payment, performance or compensation, or by way of some other binding process. This may be the result of taking legal action and obtaining an enforceable judgment via the jurisdiction's legal system. A determination of whether a particular transaction or event would give rise to a legal obligation must ultimately be made by a court. However, it is also possible to argue that a legal obligation exists when it is clear from legislation or previous examples of legal action that if the issue were taken to court the issue would be decided in the applicant's favor.
- 4.4 Legal obligations as defined in IPSAS 19 can arise from a contract, legislation or other operation of law. Each of these categories is discussed further below.

- 4.5 A **contract** is an agreement with specific terms between two or more persons or entities in which one agrees to provide goods or services or take certain actions in return for valuable consideration. Where consideration is equivalent to the value of the benefit conferred by the contract, the contract is an exchange contract and any associated liability would fall within the scope of IPSAS 19. Contracts may also arise where the consideration provided by one party is not of equivalent value to the benefits conferred by the other party. In some cases, the consideration is nominal in relation to the benefits conferred (for example, a small monetary consideration may be provided merely to give the transaction the form of a contract). If there is no consideration the transaction is a gift. Gifts are not contracts. Gifts may, but do not always, give rise to legally enforceable obligations. Deeds are sometimes used to formally record details of gifts or other settlements that do not meet the criteria for contracts.
- 4.6 In some jurisdictions, a government's delivery of social benefits to constituents may be referred to as a "social contract". Some of the social risks covered by governments are similar, if not identical, to the risks that can be covered under an insurance contract (for example, poor health or loss of income). However, a government's implicit or explicit agreement to provide social benefits in future periods does not constitute a legal contract.
- 4.7 **Legislation** and delegated legislation such as regulations can give rise to legal obligations. The existence of a legal obligation and the point at which a legal obligation leads to the creation of a present obligation for financial reporting purposes depends on the nature of the legislation, the specific arrangements covered by the legislation and the judicial or other conventions within a specific jurisdiction. In some jurisdictions, legislation on its own gives rise to a legal obligation. In other jurisdictions, it may be necessary to have legislation and budgetary authorization before it is possible to contemplate the existence of a legal obligation.
- 4.8 Depending on the circumstances, a legal obligation may exist from the time that the statute is created. For example, the creation of legislation which establishes imposes obligations on entities currently owning polluted sites to clean up those sites creates a legal obligation on such entities. In other cases legislation may set out the broad framework for certain social

policy benefits. Legal obligations would then arise under that legislation as a consequence of subsequent events. Legislation could include details of eligibility criteria for a cash transfer, requirements for ongoing validation of eligibility criteria, the length of the validation period, the time period over which the benefit is available, and whether there is any monetary limit on the value of benefits to be provided. For example, under certain health care programs, a government may have a legal obligation to provide medical assistance to eligible persons for health conditions associated with cigarette smoking, and those persons may have a legal entitlement to receive such medical assistance. However, a legal obligation would not arise until an individual who meets all the eligibility criteria has a right to take legal action against the government for payment or provision of the benefit.

- 4.9 The definition of a legal obligation also refers to legal obligations arising from “**other operation of law**”. Such obligations can arise when one party can take legal action against another party and obtain a judgment from a court in relation to matters that are not covered by a contract or legislation (for example, actions in relation to negligence, defamation, trespass, and obligations in equity). In certain jurisdictions, some of these matters are covered by what is referred to as the common law (law based on precedent rather than statutory law or legislation). Examples of social policy obligations that could fall within the “other operation of law” category include court orders in relation to deeds of settlement or assets that a government holds in trust.

Constructive Obligations and Social Policy Obligations

- 4.10 IPSAS 19 also includes the notion of constructive obligations which is much broader than the notion of legal obligations. The definition of constructive obligations in IPSAS 19 (as discussed in Chapter 3) encompasses certain obligations that a government has a “moral” duty to honor because it has led individuals or entities to believe that it will settle such obligations and has no realistic alternative but to do so. The definition of constructive obligations highlights that there must have been some action or statement by the entity that has led others to believe that the entity has accepted certain responsibilities and will discharge them.

- 4.11 In the context of an exchange transaction, the past event giving rise to a constructive obligation can often be identified by reference to the terms of the contract. For example, where an entity has a practice of rectifying problems with products sold (even in the absence of a clearly specified warranty), it can be argued that the entity has a constructive obligation for claims likely to arise from products sold. The sale of the products can be treated as the past event that has given rise to the constructive obligation.
- 4.12 IPSAS 19 is based on IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* which was developed for entities that are predominantly engaged in exchange transactions.¹ In common with IAS 37, IPSAS 19 provides only limited guidance in relation to identifying the past event that gives rise to a present obligation, particularly in circumstances where there is a range of possible past events that may combine or “build” to the point where a present obligation exists.
- 4.13 IPSAS 19 specifies that a constructive obligation may arise when the past event has occurred, the entity has indicated that it will accept certain responsibilities and as a result a valid expectation is created in potential recipients. However, IPSAS 19 does not specify the relationship between timing of the past event and the creation of a valid expectation. For example, where legislation sets out a broad framework for the payment of benefits to eligible individuals it is usually possible to identify the point at which a legal liability arises. Prior to this point it is possible that a constructive obligation may have arisen. However, it is not always clear what events would be required for a constructive obligation to be present obligation that leads to the recognition of a provision – IPSAS 19 provides little guidance on this issue.
- 4.14 As noted in Chapter 3, the Steering Committee is of the view that this concept is necessary to guide the approach to a range of potential public sector obligations.
- 4.15 Constructive obligations may be short term, long term, for a single amount or for a series of future payments. Constructive obligations are transformed into legal obligations at the point that legal rights to those benefits arise.

¹ IAS 37 is currently under review - proposed changes are discussed in Chapter 3.

Past Events Giving Rise to Present Obligations (Legal)

- 4.16 Legal obligations are recognized when a present obligation enforceable through the legal system or other binding process arises, and the obligation meets the recognition criteria in relevant IPSASs. This is often the point at which the obligation is due to be paid but it may be earlier. Where a matter is subject to court judgment or other binding process and the outcome is uncertain there may be a contingent liability rather than a liability.
- 4.17 In the context of a benefit provided by way of cash transfer and where eligibility criteria are specified in legislation a legal obligation arises at the point that an individual satisfies all eligibility criteria, including the right to receive payment.² This would often be at the point that the benefit is due and payable but for certain benefits in specific jurisdictions could occur at an earlier point.
- 4.18 Determination of the amount that is due and payable will depend on the way in which entitlement has been expressed. Arrangements can vary considerably between types of benefits and between jurisdictions. In each case, the entitlement criteria, approval processes, and details of any ongoing validation or review requirements need to be considered to establish when entitlement to a benefit commences and subsequently ceases. For example, individuals may be required to confirm eligibility for certain benefits at set intervals such as once a month or every six months. Depending on the nature of a benefit and the way in which a policy expresses entitlement, an individual may be entitled to a benefit on a day to day basis or for a set period.
- 4.19 Where eligibility criteria for entitlement to services are specified in legislation, an individual would not normally have a right to the service or be able to take action against the government to enforce performance of the service until the service was due to be provided. The existence of a legal obligation would also

² Where benefits are not specified in legislation, benefits may still be legal obligations if an individual could take legal action to enforce payment of the benefit. An individual's right to take legal action will depend on the common law which has developed within a particular jurisdiction. For financial reporting purposes the classification of an amount due and payable as a legal obligation or a constructive obligation is not significant. Both would normally meet the criteria for recognition in the financial statements.

depend on the likelihood of the individual receiving a favorable and enforceable judgment.

Past Events Giving Rise to Present Obligations (Constructive)

- 4.20 The existence of individuals or entities entitled to benefits that are due and payable clearly demonstrates that a past event giving rise to a present obligation has occurred. However, it could also be argued that a constructive obligation arises before amounts are due and payable or goods or services are due to be delivered.
- 4.21 Although the creation of legislation establishes broad parameters within which benefits may be paid, few would argue that the creation of legislation, on its own, constitutes a past event which would give rise to a present obligation which the government has no realistic alternative but to settle. Some other event such as the existence of an individual meeting the criteria specified in the legislation is usually required.
- 4.22 The range of possible past events that could give rise to a constructive obligation will depend on the type of benefit. Possible past events for a range of benefits available to individuals are:
- (a) time of birth;
 - (b) the point at which an individual reaches economic independence – that is the point at which the individual makes economic decisions based on government policies;
 - (c) the point at which it becomes likely that an individual will satisfy the criteria required to receive a benefit in the future;
 - (d) the point at which an individual satisfies all the threshold (initial) criteria required to qualify for a benefit; and
 - (e) the point at which benefits are payable or services are due to be provided.
- 4.23 The identification of past events that may give rise to a present obligation for a range of benefits is illustrated in Chapters 5 to 8 and Appendix 1. There may be a number of relevant past events

that cumulatively “build” to give rise to an obligation. However, it is only:

- (a) those past events that constitute an obligating event in the context of IPSAS 19 that give rise to a present obligation; and
- (b) only those present obligations that meet relevant definitions and recognition criteria that give rise to the recognition of provisions or other liabilities in general purpose financial statements.

4.24 There can be differing views about which of these events or combinations of events (perhaps collectively) give rise to a valid expectation and a present obligation that the entity has no realistic alternative but to settle. This ITC identifies the Steering Committee’s views on the factors to be considered and circumstances in which a constructive obligation meets all aspects of the relevant definitions and recognition criteria.

4.25 In the case of legal obligations, it is reasonable to argue that a government has no realistic alternative but to settle the obligation. Although some governments may have occasionally used their sovereign powers to enact or change legislation with the specific intention of avoiding legal obligations, this does not justify the widespread non-recognition of liabilities for legal obligations. However, it is more difficult to interpret the meaning of “no realistic alternative but to settle” in the context of constructive obligations.

Present Obligations (Constructive) – Factors to Consider

4.26 In determining what would constitute a past event that gives rise to a constructive obligation, one needs to consider the influence of key factors discussed below.

Acceptance of Responsibility to Others

4.27 The definition of a constructive obligation requires that an entity indicate acceptance of certain responsibilities to others. IPSAS 19 refers to past practice, published policies and specific current statements as examples of actions that provide such an indication. In the public sector environment published policies and specific statements could refer to policies incorporated in legislation, policies included in documents such as manifestos,

policies announced at the time a draft budget is released, inclusion of funding for policies in published budgets or the approval of budgets by legislative or governing bodies.

Creation of a Valid Expectation

- 4.28 The definition of a constructive obligation requires that one entity has engaged in actions that have created a valid expectation that it will discharge those responsibilities on the part of other parties. However, a constructive obligation would not exist solely because an individual claimed to have relied on the delivery of benefits pursuant to a government pronouncement. There must also be a past event that provides the entity with no realistic alternative but to settle the obligation.
- 4.29 Some may argue that if the right to education is set out in legislation and there is a past practice of providing education, individuals have a valid expectation that they will receive free or subsidized education services prior to the point of actually satisfying all the eligibility criteria. . In the case of tertiary education some might argue that individuals have a valid expectation from the time of birth. However, others are of the view that the birth of a child is not the past event that provides a valid expectation that the government will discharge its responsibilities to, for example, provide tertiary education. They argue that only when an individual enters secondary school and appears likely to meet entrance requirements for tertiary education could a valid expectation about the delivery of tertiary education be formed.

No Realistic Alternative But to Settle

- 4.30 The definition of an obligating event states that an entity must have no realistic alternative to settling the obligation. The Steering Committee acknowledges that interpreting the meaning of this requirement in the context of constructive obligations was difficult. On the one hand it is possible to argue, as with legal obligations, that a government's ability to change legislation should not be used to justify the non-recognition of liabilities for benefits to be provided in future periods. However, the Steering Committee considered that this approach did not seem reasonable given that governments frequently change the nature and amount of benefits and rarely provide categorical assurances that current benefits will continue to be

provided in future periods. In many jurisdictions governments are frequently in power for limited periods and would be unable to give such assurances even if they wanted to. The Steering Committee has identified a range of factors that it considers should be considered in determining whether past transactions or events have given rise to an obligation that the government or other entity has no realistic alternative but to settle. There factors are:

- (a) the extent to which constituents are dependent on a benefit provided by the government. It may be argued that if constituents are heavily dependent on a benefit it is unlikely that the government could easily cancel or decrease the benefit. The size of the obligation in relation to a government's other obligations may also be relevant. Some are of the view that it is more difficult for a government to change its policies in relation to large obligations, particularly if past practice supports the expectation that those benefits will be provided;
- (b) the government's past practice in removing or reducing particular benefits, changing the method of providing benefits or changing eligibility criteria. The ability to remove or reduce benefits may differ depending on the type of benefit and the groups of beneficiaries;
- (c) the extent to which a government has used transitional provisions to soften the impact of changes in benefit entitlements or eligibility criteria – for example, by delaying the implementation of the new criteria in order to protect the rights of existing beneficiaries or those who are close to meeting eligibility criteria;
- (d) likely political consequences of changing benefits; and
- (e) if there is a budget allocation for the item, particularly in the case of multi-year appropriations – this may provide more evidence of the government's intention to make payments. The existence of a budget allocation does not of itself guarantee that there is a present obligation. However, the absence of a budget allocation for an item that is due and payable would imply that the government has options other than to settle the obligation.

- 4.31 An assessment of whether a government has no realistic alternative to settling an obligation needs to be applied to all

constructive obligations that are being considered for recognition as provisions in the financial statements. If a constructive obligation exists, but the government has a realistic alternative to settling the obligation, a liability is not recognized.

Summary of Factors to Consider

- 4.32 The factors discussed above do not operate in isolation. Some factors provide evidence in relation to more than one aspect of the definitions. They need to be considered in conjunction with each other and in the context of cultural and institutional arrangements and traditions in different jurisdictions. Ultimately judgment will be necessary in determining when a constructive obligation arises. The Steering Committee's views on the principles that should be adopted in exercising that judgment are set out below.

Options

- 4.33 The Steering Committee has set out three alternative approaches (referred to in this ITC as options) to the identification of the past event or events that give rise to a present constructive obligation for the purposes of recognizing expenses and provisions in financial statements. These options are referred to throughout the ITC in indicating the Steering Committee's preferred method of accounting for specific social benefits and to note the existence of other alternative views.
- 4.34 The preliminary view of the majority of steering committee members is that Option 1 should be applied in determining whether a provision should be recognized for social benefits. A minority of Steering Committee members favor application of Option 3 below. Chapters 5 through 8 of this ITC explain the arguments supporting both approaches in the context of a wide range of social benefits. These Chapters also outline the consequences of application of Option 2 below to a wide range of social benefits.

Option 1 (satisfy all eligibility criteria)

In the absence of a legal obligation, a past event giving rise to a present obligation occurs when an individual³ satisfies all applicable eligibility criteria.

In the case of ongoing benefits which are subject to regular satisfaction of eligibility criteria, the maximum amount of the present obligation is the benefit that the individual is entitled to from the current point in time until the next point in time at which eligibility criteria must be satisfied.

Where validation of eligibility criteria is required only once, the present obligation is for all future benefits to be provided to that individual as a result of that validation.

- 4.35 The government or other entity has no realistic alternative but to provide to eligible recipients cash transfers and goods or services they are presently entitled to as a consequence of satisfying the eligibility criteria. If recipients are required to repeatedly satisfy all eligibility criteria in future periods for the receipt of additional benefits in those future periods, a present obligation for the provision of those additional benefits does not arise until the recipients satisfies those eligibility criteria in future periods. There can therefore be a series of obligating events.
- 4.36 The recognition of liabilities under Option 1 is broader than the “due and payable” approach described in Chapter 1. In addition to the recognition of amounts under the due and payable approach (amounts that were due to be paid⁴ in the last reporting period and remain unpaid and accrued benefits) Option 1 requires a liability to be recognized in respect of benefits to which the recipient is currently entitled as a consequence of satisfaction of the eligibility criteria but that are not due to be paid until future periods. For example, a liability for such amounts would be recognized where a government would pay the future benefit to the individual or to their estate if the individual died prior to the payment date.

³ Governments may have obligations to individuals, groups of individuals or entities. For ease of writing this ITC frequently refers to individuals only.

⁴ The explanation of Option 1 refers to cash benefits as cash benefits generally have specific payment dates and are for specific amounts. Chapter 5 explores the application of Option 1 to goods and services.

- 4.37 The amount of the liability will depend on the nature of the benefit and the way in which entitlement is specified. In the case of recurring cash benefits which require that an individual meet eligibility requirements as at each payment date, the liability would be for any benefits to which the individual is currently entitled including accrued benefits relating to the end of the reporting period. In the case of benefits paid in a single amount the government will have a liability for the entire benefit to be paid to the individual. If this amount is currently due it will be recorded as an amount due and payable. Where no further validation of entitlement is required, the government has a liability for both current and future amounts to be paid to the individual.

Option 2 (satisfy threshold eligibility criteria)

In the absence of a legal obligation, a past event giving rise to a present obligation occurs when an individual meets the eligibility criteria for the first time (the threshold criteria). The present obligation is for all benefits to be provided to the individual in future periods regardless of whether the individual is required to satisfy eligibility criteria again in future periods.

- 4.38 The present obligation arises when threshold eligibility criteria are met. The likelihood of an individual continuing to meet eligibility criteria (including being alive if relevant) in future periods is a measurement issue. The obligation is measured as the best estimate (present value of future cash flows) of the amount expected to be transferred to the individual.

Option 3 (key participatory events)

In the absence of a legal obligation, a past event, or series of past events, giving rise to a present obligation occurs prior to the point at which an individual meets threshold eligibility criteria (where threshold criteria are applicable).

The present obligation arises when key participatory events have occurred that lead an individual to have a reasonable expectation of eventually satisfying eligibility criteria for a benefit and, as a result, the individual has relied on that expectation over a period of time leaving the government with no realistic alternative but to settle the obligation in the future.

The present obligation is for all benefits to be provided to the individual in future periods regardless of whether the individual is required to satisfy eligibility criteria again in future periods.

- 4.39 In certain circumstances a government communicates to its constituents or others its intention to provide certain benefits in the future and confirms its intention by providing those benefits to current eligible recipients. The provision of old age pensions is a case in point for many jurisdictions. The potential recipient of these benefits will respond to the government's communication of intent by making economic decisions such that they become dependant on the receipt of those benefits in the future. This in turn ensures that the government has no realistic alternative but to provide those benefits. Under this Option the likelihood of an individual meeting eligibility criteria (including being alive if relevant), both initially and on an ongoing basis is a measurement issue. There are a number of possible approaches to measuring such obligations. Measurement issues in relation to old age pension benefits are discussed in more detail in Chapter 8.

Analysis of Constructive Obligation Options

- 4.40 The Steering Committee acknowledges that in relation to a number of benefits it is difficult to precisely identify the point at which a past event giving rise to a present obligation has occurred. It has developed these three options as a way of grouping alternative views on this issue.
- 4.41 Each approach has limitations in that it does not necessarily provide users of general purpose financial statements with sufficient information to assess the sustainability of a government's current social policies. The Steering Committee considers that there is a role for additional disclosures regardless of which Option is supported (refer Chapter 9).
- 4.42 Option 1 generally involves little estimation and can be readily implemented. It is the option that is closest to current practice and is likely to give comparable information across jurisdictions. Liabilities identified under Option 1 are also encompassed by the obligations under Constructive Obligation Options 2 and 3. Because Option 1 focuses solely on entitlements to benefits for which the eligibility criteria have

been satisfied, there is no need to make judgments about the likelihood of individuals satisfying eligibility criteria in future periods. Although Option 1 will lead to the recognition of liabilities (for unpaid amounts, for accrued benefits as at the end of the reporting period and where eligibility criteria need be satisfied only once) it substantially reflects the cash basis of accounting and is subject to many of the limitations of the cash basis.

- 4.43 Option 2 provides additional information on the extent of the government's obligations to provide benefits in future periods, particularly in respect of those individuals that are likely to receive ongoing benefits for which they have already satisfied the threshold eligibility criteria.
- 4.44 It can be argued that because Option 2 requires the recognition of a provision for long term constructive obligations it better reflects the government's implied acceptance of its responsibility to provide future benefits.
- 4.45 Option 3 reflects a view that the existence of legislation and established past practice can lead to the creation of circumstances in which a government has no realistic alternative but to provide benefits to recipients in the future, and that this expectation can arise prior to individuals satisfying all eligibility criteria. There is some evidence that in certain cases governments do accept that individuals have a valid expectation to receive future benefits.
- 4.46 In one case a government has compensated individuals for removing their expectation to future benefits. In May 1981 Chile replaced its government-run pay-as-you-go retirement system with a system of private pension accounts. It provided workers with recognition bonds which could be used as deposits in the new private schemes. A separate government old age pension remained for those who had not worked for the requisite number of years to obtain the worker's old age pension. However, in other cases such as when "means testing" was introduced in Australia in 1983-84, a significant number of individuals were excluded from access to old age pension benefits without recompense.
- 4.47 The difficulty that would be encountered in applying Option 3 to various social benefits is that the point at which the obligating

event occurs is not as clear as under Options 1 and 2. Although it is possible to assert that individuals have relied on the expectation of receiving future benefits, and there may be evidence that such reliance has occurred, it is difficult to identify the point at which the government has no realistic alternative but to provide those benefits and therefore the point at which expectations that the government or entity will provide these benefits become valid. In some cases, there may have been a series of points at which expectations arose, leading to an increasing expectation over time.

- 4.48 If Option 3 were adopted, it could result in a number of governments recognizing previously unrecognized liabilities for future benefit payments and could raise concerns about the sustainability of a government's operations. This change in liabilities would not be accompanied by any increase in recognized assets because the future tax revenues out of which such obligations are generally financed do not currently meet the recognition criteria for assets.⁵ Principles for the recognition of tax revenue are still being developed⁶.
- 4.49 Chapters 5 to 8 apply these three approaches to broad categories of social benefits to determine when an obligating event arises in respect of those benefits. Chapter 9 considers the types of additional disclosures that may be useful under all three approaches.

Moving Forward

- 4.50 This Chapter has highlighted the different approaches that can be adopted in applying the definitions and principles in existing IPSASs to social policy obligations. Ideally the application of such decisions and principles would lead to the development of accounting approaches that are intuitively reasonable and can be readily implemented. However, there can be a tension between these two objectives. The conclusions in this document reflect the Steering Committee's attempt to strike a reasonable balance between principles and practical solutions.

⁵ Income taxes are relevant to the measurement of liabilities for future benefits if a government provides individuals with cash transfers that are subject to income tax by that government. Where the government deducts the income tax before paying the cash transfer any liability for future benefits would be measured net of taxes.

⁶ Another IFAC Steering Committee has been charged with developing an Invitation to Comment on accounting for non-exchange revenue.

- 4.51 Accounting for social policy obligations is a major unresolved issue in public sector financial reporting. Many jurisdictions have adopted a conservative approach to accounting for social policy obligations and have recognized only the portion of such obligations that is due and payable. Despite the general reluctance of most jurisdictions to recognize long term social policy obligations as liabilities, some consider that a greater portion of such obligations should be recognized as liabilities.
- 4.52 Not all will agree with the proposals in this ITC, or consider that the proposals go far enough. Nevertheless the proposals represent an important step forward as they will encourage public debate and focus that debate on the interpretation of accounting principles in the public sector environment.
- 4.53 The Steering Committee has attempted to develop a principles based approach to the identification of an obligating event. However, the Steering Committee is mindful that where application of principles does not lead to a clear identification of an obligating event, accounting standards have often developed rules for particular types of transactions to ensure consistency in the identification of an obligating event. The Steering Committee considers that if a principles based approach would not lead to consistent reporting of expenses and liabilities arising from social benefits a criteria based approach may be required.

Summary

- 4.54 For ease of reference, Figure 4.4 provides a summary of the approaches to the identification of present obligations outlined in this chapter.

Figure 4.4 Options

Option 1 (satisfy all eligibility criteria)

In the absence of a legal obligation, a past event giving rise to a present obligation occurs when an individual satisfies all applicable eligibility criteria.

In the case of ongoing benefits which are subject to regular satisfaction of eligibility criteria, the maximum amount of the present obligation is the benefit that the individual is entitled to from the current point in time until the next point in time at which eligibility criteria must be

satisfied.

Where validation of eligibility criteria is required only once, the present obligation is for all future benefits to be provided to that individual as a result of that validation.

Option 2 (satisfy threshold eligibility criteria)

In the absence of a legal obligation, a past event giving rise to a present obligation occurs when an individual meets the eligibility criteria for the first time (the threshold criteria). The present obligation is for all benefits to be provided to the individual in future periods regardless of whether the individual is required to satisfy eligibility criteria again in future periods.

Option 3 (key participating events)

In the absence of a legal obligation, a past event, or series of past events, giving rise to a present obligation occurs prior to the point at which an individual meets threshold eligibility criteria (where threshold criteria are applicable).

The present obligation arises when key participatory events have occurred that lead an individual to have a reasonable expectation of eventually satisfying eligibility criteria for a benefit and, as a result, the individual has relied on that expectation over a period of time leaving the government with no realistic alternative but to settle the obligation in the future.

The present obligation is for all benefits to be provided to the individual in future periods regardless of whether the individual is required to satisfy eligibility criteria again in future periods.

Chapter 5 Collective and Individual Goods and Services

Introduction

- 5.1 This Chapter applies principles and definitions in existing IPSASs, particularly IPSAS 19, to determine whether a government's obligations to provide goods and services either for collective or individual consumption¹ result in the creation of obligations that meet the definitions and recognition criteria for liabilities and provisions. Chapter 4 identified the criteria that must be met before a social policy obligation (either a legal or constructive obligation) would be recognized as a liability (including a provision) in the financial statements.
- 5.2 Goods and services provided for collective consumption are those goods and services provided to the community as a whole. Under GFSM 2001 goods and services provided by a government for collective consumption include:
- (a) national defense;
 - (b) international relations;
 - (c) public order and safety (including police services, fire protection services, law courts and prisons);
 - (d) the efficient operation of the social and economic system of a country; and
 - (e) certain components of services to individuals such as formulation and administration of government policy, setting and enforcement of standards, regulation and licensing of personnel and institutions and applied research and experimental development.
- 5.3 Governments provide a range of goods and services to individuals. This Chapter focuses on goods and services provided in respect of education and health. Governments provide free or subsidized health and education goods and services to individuals in a number of ways including:

¹For a complete list of Classification of Functions of Government (COFOG) and the designation of functions as being for collective or individual consumption in terms of the IMF's GFSM framework readers are referred to the Annex to Chapter 6 in GFSM 2001.

- (a) the direct provision of free or subsidized goods and services. Governments may pay for all or part of the cost of consultations with a general medical practitioner, or for the cost of certain medicinal drugs and patent medicines. The government's contribution or subsidy is generally restricted to service providers or products that are approved by a government agency. Governments also provide health and education services through government owned and operated hospitals and schools;
 - (b) paying another organization to deliver goods and services to individuals. For example, a government may pay a private hospital a set fee per service, such as for performing an operation on an individual meeting government specified criteria. Governments may also pay private education providers a subsidy for each student. Frequently upper limits are set on the amount that the government will pay under such arrangements;
 - (c) the reimbursement of households and individuals for certain types of expenditure. Rather than providing a subsidy at point of purchase or consumption, a government may require individuals to apply for reimbursement. For example, a government may reimburse individuals who require regular treatment at a hospital for the cost of transport to the hospital or may reimburse individuals with disabilities for the cost of certain home services; and
 - (d) providing individuals with vouchers that can be redeemed for goods and services. For example, some jurisdictions provide individuals with vouchers that entitle them to free education at one of a selected number of schools.
- 5.4 All of the methods of service delivery listed above ultimately result in a transfer of resources from a government to an individual. Under each of these methods individual recipients benefit from the goods or services received, but they do not have any control over the resources used to provide the goods or services, nor do they have any option to receive alternative goods or services. This is a key difference between the provision of social benefits by way of goods and services and the provision of social benefits by way of discretionary cash transfers.

- 5.5 This ITC deals with the use of discretionary cash transfers to deliver social benefits in Chapter 6. In the case of discretionary cash transfers individuals are entitled to spend the cash transfer as they wish. They are not required to purchase specified goods and services. Some scholarships, loans, grants and allowances are discretionary cash transfers.
- 5.6 There are two main differences between goods and services provided for collective consumption as opposed to those provided for individual consumption:
- (a) goods and services provided for individual consumption are intended to benefit individuals rather than the community as a whole; and
 - (b) some, but not all, goods and services provided for individual consumption are subject to eligibility criteria. Primary, secondary and tertiary education are all individual services because they benefit the individual. However, within a jurisdiction the eligibility criteria for the various levels of education frequently differ. For example, primary and secondary education services are often provided free of charge – children are not generally required to meet any eligibility criteria apart from being residents or citizens of the jurisdiction. By contrast eligibility for ongoing access to tertiary education may include continuing to satisfy any income related criteria and meeting course attendance and course work requirements including achieving minimum grades. Such validation requirements may need to be satisfied on a regular basis.

Current Practice – Collective Goods and Services

- 5.7 Governments adopting the accrual basis of accounting generally recognize expenses associated with goods and services provided for collective consumption as they engage in the exchange transactions to provide the collective services. Salaries of government employees and other employee benefits are recognized as employees earn them. Goods and services received from suppliers are recognized as expenses when they are received – generally this is when an invoice is received, but an expense is also recognized for goods and services received but not invoiced as at the end of the reporting period. If the

government owns the buildings and other assets used to deliver these services it will account for any maintenance, depreciation or impairment of the assets as these expenses are incurred. For example, in the case of a government owned and operated prison, the relevant costs of operating the prison (salaries of staff, food, maintenance of building, depreciation of building, lighting, heating, and medical fees) would be recognized as expenses in accordance with generally accepted accounting practice for those types of costs. Recognition of these expenses would also lead to recognition of amounts due and payable and some short term accruals.

- 5.8 In order to ensure that it can continue to meet the forecast need for prison services, a government may also enter into agreements which relate to future periods such as supply contracts for future periods and capital commitments for the construction of new prison facilities. Contracts for the supply of goods and services in future periods are executory exchange contracts. The contracts are equally unperformed by both parties (the supplier will supply in future periods and the government will pay for goods supplied in accordance with the contract). Therefore, the government does not recognize a liability for future goods and services. Agreements relating to the construction of buildings are exchange transactions and are accounted for in accordance with existing IPSASs or other authoritative accounting standards.

Current Accounting Treatment – Individual Goods and Services

- 5.9 Governments adopting the accrual basis of accounting generally account for the delivery of goods and services to individuals in the same way that they account for the costs associated with collective services. That is, they account for the individual exchange transactions associated with the delivery of the service according to generally accepted accounting practice. In the case of vouchers and reimbursements, they recognize a liability for any amounts owed to external suppliers for goods and services pending to beneficiaries and amounts claimed by beneficiaries for goods and services that beneficiaries have purchased.

Application of IPSAS 19

- 5.10 Under current practice, governments do not generally recognize a liability for a government's obligations to deliver goods and

services for collective or individual consumption as a liability prior to the delivery of the service. The following paragraphs consider whether the application of IPSAS 19 would lead one to a different conclusion.

Collective Goods and Services

- 5.11 Past events that might be considered to give rise to a present obligation for collective services include government legislation or pronouncements regarding the nature and/or levels of such services to be provided in future periods, the birth of individuals who will be entitled to receive/benefit in the future and the approval of current and future (multi-year) budgets which confirm a government's intention to incur costs and commit resources in providing such services in the future. However, the Steering Committee does not consider that these, or other past events, give rise to a present obligation for the provision of goods and services in future periods for the following reasons:
- (a) collective services can be regarded as an ongoing activity of government. No provision is recognized for costs that need to be incurred to continue an entity's ongoing activities in the future (IPSAS 19, paragraph 26);
 - (b) a government pronouncement regarding the level or quality of future collective services it intends to provide may result in a community expectation that the government will provide such services in future periods. In addition, there may be strong public opposition if the government subsequently decided not to provide such services. Although such pronouncements may give rise to an obligation to provide services in the future, they do not give rise to a present obligation which the government has no realistic alternative but to settle – governments can and do change the level of services. Even where a jurisdiction professes to provide free medical care to all residents it may adopt various methods of limiting or capping the cost of providing such services. For example it could limit the availability of selected health services to subsets of the population or set limits on the total amount to be spent or the total level of services to be provided. These types of restrictions may mean that individuals who are theoretically entitled to free or subsidized services in current periods may not receive those services for a period of time, possibly a number of years, or they may lose

entitlement while waiting to receive the service. Because they are not present obligations they will not satisfy the definition of a liability;

- (c) there is unlikely to be a legal obligation to provide such services in the future. A legal obligation will arise where a government has entered into a legally binding contract with a private supplier in relation to the provision of such services in the future and is required to honor the contract (or pay compensation). Whether or not such contracts give rise to a present obligation at reporting date will depend on the terms of the contract and the extent to which performance under the terms of the contract has occurred. Such contracts are likely to be exchange contracts and accounted for accordingly;
- (d) the definition of an obligating event requires that a government has no realistic alternative to settling the obligation. Governments have a number of realistic alternatives to providing goods and services in future periods. They can reduce the level of such services, cease to provide them or introduce other programs that alter the level of demand for such services. A government can therefore avoid the future expenditure;
- (e) the birth of individuals who will receive future collective services helps a government forecast the level of demand for future collective services – it does not create a present obligation; and
- (f) the inclusion of amounts in budgets for future periods is a useful indicator of a government's intentions but it is not sufficient evidence to support the recognition of a liability.

- 5.12 The Steering Committee is of the view that a government does not have a present obligation to provide goods and services for collective consumption until the service is provided. Prior to this there may be an expectation of service, but there is no a present obligation that results in the government having no realistic alternative but to settle. Consequently, the definition of a liability is not satisfied and a government will not recognize a liability for the provision of goods and services for collective consumption, other than those liabilities that arise as a consequence of exchange transactions as discussed above.

Preliminary View 1 – Collective Goods and Services

Where a government meets its social policy objectives by delivering services for the benefit of the community as a whole, there is no present obligation prior to the delivery of the service. Input costs associated with exchange transactions that a government enters into to deliver collective services are accounted for in accordance with generally accepted accounting practice for those costs.

- 5.13 A government accounting for collective services consistent with this preliminary view would:
- (g) not recognize a liability for collective services to be provided for future periods;
 - (h) recognize expenses and liabilities for goods and services received from suppliers and employees in accordance with generally accepted practice for such exchange transactions; and
 - (i) disclose any capital commitments or contingent liabilities associated with agreements with suppliers in the notes to the financial statements.
- 5.14 If a service is provided directly by government entities using the governments own resources and employees, present obligations arise as a result of exchange contracts with employees and suppliers.

Individual Goods and Services

- 5.15 Possible past events that might be considered to give rise to individual consumption largely mirror those identified for collective services above. For example they would include legislation or pronouncements regarding the nature and/or levels of services to be provided in future periods (including any eligibility criteria to be satisfied), the birth of individuals who will be entitled to benefit from such services in the future and the approval of current and future (multi-year) budgets which confirm a governments intention to incur costs and commit resources in providing such services in the future. The Steering Committee does not consider that these past events give rise to a present obligation for the provision of goods and services at

some time in the future for the same reasons as outlined the previous section on collective goods and services.

- 5.16 Given that eligibility criteria often need to be satisfied for individuals to access certain types of benefits, there may be an argument that a present obligation for individual benefits arises in the following circumstances:
- (a) there is a change in the age or status of individuals that makes it likely that they will satisfy all eligibility criteria for free or subsidized services in future periods; and
 - (b) individuals meet all eligibility criteria (initially and subsequently on an ongoing basis).
- 5.17 As for collective goods and services, the Steering Committee is of the view that a government does not have a present obligation to provide goods and services for individual consumption until the good or service is provided. Prior to this there may be an obligation and an expectation, but it is not a present obligation that results in the government having no realistic alternative but to settle.

Preliminary View 2 – Individual Goods and Services

Where a government meets its social policy objectives by providing goods or services to individuals there is no present obligation prior to the provision of the good or service.

- 5.18 The consequences of this view are similar to those for collective goods and services:
- (a) a liability will not be recognized for individual goods and services to be provided for future periods;
 - (b) liabilities for goods and services provided by suppliers and employees will be recognized in accordance with generally accepted practice for exchange transactions; and
 - (c) capital commitments or contingent liabilities associated with agreements with suppliers will be disclosed in the notes to the financial statements.
- 5.19 A government may establish various arrangements for the delivery of goods and services for individual consumption. The implications of different arrangements are considered below.

- 5.20 If a good or service is funded by a government but provided via non-government entities or other government entities outside the reporting entity, the government's obligation to those other entities arises as an individual satisfying eligibility criteria receives the goods or services. For example, the present obligation would arise when an individual visits a general practitioner, receives outpatient services, is admitted to hospital or receives an approved pharmaceutical product. The present obligation would be for the government's portion of the cost of the consultation, hospital admission or product (whether provided to the service provider or to the individual by way of reimbursement). This obligation is discharged when the government pays those other entities for goods or services provided. At the end of a reporting period a government would therefore have a present obligation in respect of goods or services delivered to individuals by other entities but not yet paid for by the government.
- 5.21 Sometimes governments provide funding for health or education to other levels of government. Such transfers may ultimately result in the provision of education or health goods and services but the announcement of an intention to make such intergovernmental transfers does not itself represent a present obligation for education or health goods and services.
- 5.22 Where a government provides goods or services to individuals, either by reimbursement for expenditure on specific items, or by a cash advance which is to be spent on specific items, a present obligation arises when goods or services are provided to individuals meeting eligibility criteria. At the end of a reporting period the government will have a present obligation for:
- (a) amounts claimed and approved but not yet paid; and
 - (b) transactions meeting the criteria for reimbursement which have been claimed but not yet approved; and
 - (c) transactions which have taken place and meet criteria for reimbursement but for which no claim has yet been made.
- 5.23 Where a service is provided by way of vouchers the government's present obligation would arise as the individual receives services pursuant to those vouchers. The government's agreement with the entities that provide the services is in the nature of an exchange contract for services and would be

accounted for as such.. These entities would advise the government of amounts due for services provided in relation to the vouchers. Where a government made payments to entities providing services in advance of services being delivered, the government would need to decide whether the amount advanced met the definition of, and recognition criteria for, an asset.

- 5.24 The identification of the obligating event for services provided to individuals is consistent with current practice.

Preliminary View 3 – Individual Goods and Services

The existence of a present obligation is not conditional on the means by which a service is provided to individuals (for example, directly by a government entity, by a third party on behalf of the government, by voucher or by cash advance or reimbursement).

Other Possible Views

- 5.25 This Chapter has set out the Steering Committee's views. The Steering Committee's views are generally consistent with Option 1 as described in Chapter 4². Others may consider that a present obligation for goods or services arises prior to the point at which the services are provided.
- 5.26 Those that would seek to apply Option 2 (satisfy threshold eligibility criteria) would need to identify the point at which threshold eligibility criteria are satisfied. In the case of collective goods and services there are no eligibility criteria – Option 2 is therefore not relevant. Eligibility criteria often need to be satisfied for individual goods and services to be made available. Application of Option 2 would, for example, require recognition of a provision in respect of:
- (a) all education services to be provided in future periods for all individuals who have satisfied the initial eligibility criteria for free tertiary education; and

² One difference that could occur is that in rare circumstances an individual may have met eligibility criteria to receive a good in a future period and may not be subject to any further validation requirements. Under Option 1 the government would recognize a liability to provide that good from the time that the individual satisfied the eligibility criteria. Under the preliminary views expressed in this Chapter the government would not recognize a liability prior to the point that the good was provided.

- (b) in the case of medical benefits, all future medical services in respect of the injury sustained by an individual who satisfies eligibility criteria for medical benefits. The Steering Committee notes that this situation differs from the situation where a government has established health or accident insurance schemes which have characteristics of exchange transactions.
- 5.27 Those that would seek to seek to apply Option 3 (key participatory events) would need to identify the point at which an individual began making economic decisions based on government policy (or some proxy for this point) and as a consequence, the government had no realistic alternative but to provide those services in the future . For example, it would be necessary to identify the point at which an individual decided to purchase private security services rather than relying on the government to provide a secure environment. Application of Option 3 would then require recognition of a provision in respect of all future security services to be provided by the government.
- 5.28 The Steering Committee does not support these views.

Chapter 6 Cash Transfers to Individuals

Introduction

- 6.1 This Chapter considers whether a government's obligations to provide cash transfers¹ to individuals in future periods should be recognized as provisions. Cash transfers commonly provided in relation to the following are used as illustrative examples:
- (a) child benefits;
 - (b) invalid and sickness benefits;
 - (c) unemployment benefits; and
 - (d) housing benefits.
- 6.2 This Chapter does not deal with obligations for old age pension benefits. These are dealt with in Chapter 8. Old age pension benefits have been discussed in a separate chapter because of their significance in some jurisdictions and the reluctance of many governments to reduce such pension benefits in respect of individuals who have achieved or are nearing pensionable age.

Child Benefits

- 6.3 Arrangements for child benefits vary widely between jurisdictions. Some jurisdictions pay child benefits to all children of a certain age regardless of the income or wealth of their family. They may be paid at a flat or variable amount for each child and are typically paid at regular intervals from the time of birth until the child reaches a set age (for example, 16 years of age or 18 years if the child is studying at an approved education institute). There may be a requirement that the child lives with a parent and that the parent is a resident or pays income tax within the jurisdiction. The fewer eligibility criteria, the more likely it is that a child will satisfy the

¹ Accounting for the provision of various goods and services in kind (education and health) is discussed in Chapter 5. Chapter 5 also deals with cash transfers which must be spent on specific goods and services and reimbursements for purchases of specified goods and services.

eligibility criteria for the entire period that the child benefit is available.

- 6.4 In other jurisdictions, child benefits may be targeted at lower income families. Such benefits are often referred to as “income-tested” or “asset-tested” benefits. Income or asset tested child benefits are provided only to those children whose families meet certain criteria. The amount of the child benefit typically varies depending upon the number and age of the children and the joint parental income. Entitlement to the benefit is generally assessed on a regular basis. Payment of the benefit ceases if the family ceases to meet all eligibility criteria.
- 6.5 Income tested child benefits may also be provided from birth until a child reaches a set age. The age of entitlement is typically the time of birth or the point at which family income satisfies the income eligibility criterion.
- 6.6 A government’s policy on child benefits is usually incorporated in legislation. Such legislation records the details of eligibility criteria and the amount of benefit to be paid in various circumstances.

Invalid and Sickness Benefits

- 6.7 Invalid or disability benefits provide assistance to individuals whose ability to work is impaired on a long-term basis due to non-occupational injury or disease. The benefit may be provided on a permanent basis or eligibility may be subject to regular review. There may be supplements for dependents, daily assistance, and rehabilitation or training. Some jurisdictions also provide sickness benefits for short-term illnesses (these are frequently set at the same level as unemployment benefits).
- 6.8 The basic benefit may be a set amount or it may be income related – often it is calculated as a percentage of an individual’s previous earnings or a percentage of an old age pension benefit. The amount of the benefit may be adjusted annually for changes in a consumer price index or other index. Entitlement may be subject to asset or income tests and the amount of the benefit may be adjusted to reflect asset and income levels of the beneficiary.

- 6.9 Invalid or sickness benefits are provided from the time that an individual satisfies all eligibility criteria until the time that eligibility ceases. Possible causes of disability that lead to an individual being unable to work full time include:
- (a) short term illnesses;
 - (b) medical conditions arising at the time of birth – these conditions may be known at this time or may only become apparent at a later date;
 - (c) medical conditions arising at some point after birth but not of such severity or nature to qualify for disability benefits (for example a progressive medical condition); or
 - (d) medical conditions or accidents that occur at a given point in time.
- 6.10 Eligibility criteria may specify that an individual is entitled to a benefit from the point that the disability becomes known or occurs, or some time (for example, one year) after the occurrence of the disability. There may also be a minimum age from which a disability benefit is payable (for example, 18 years of age).
- 6.11 Depending upon the eligibility criteria, entitlement to invalid or sickness benefits generally ceases when an individual:
- (a) recovers from a short term illness;
 - (b) becomes employed;
 - (c) earns more than a set amount or accumulates assets worth more than a set amount and thereby fails to satisfy income or asset tests;
 - (d) is rehabilitated or trained and is assessed to be capable of full time employment; or
 - (e) dies (whether the obligation ceases at this point depends on whether there is a survivor's benefit).

Unemployment Benefits

- 6.12 Unemployment benefits are available in some jurisdictions for individuals of working age who are unable to find employment. The benefits generally commence once the individual has been unemployed for a specified period of time. Benefits may only be available for individuals who are actively seeking work and

attend job interviews arranged by government agencies. The benefits may be asset or income tested. In some jurisdictions, the amount of the benefit reduces if the individual earns income from part time employment. The amount of the benefit is frequently linked to the amount of old age pensions. Eligibility generally ceases when an individual obtains employment.

Housing Benefits

- 6.13 Entitlement to, and the amount of, housing benefits may be influenced by a number of factors including:
- (a) the income of the family or the proportion of family income spent on rent;
 - (b) the amount of rent of the specific property or of rents in the geographical area;
 - (c) the size of the family and the age of family members; and
 - (d) the size or age of the dwelling.

Past Event Giving Rise to a Present Obligation

- 6.14 Where eligibility criteria and the amount of benefits are clearly specified in legislation, individuals (and families) satisfying eligibility criteria at each payment date will have a legal right to the benefits that they are entitled to as at that date. The amount due and payable together with any amount accrued in respect of legal obligations would meet the criteria for recognition as liabilities in the financial statements. Such liabilities would generally be certain as to amount and timing – they would not generally be provisions. If there was a dispute (as to entitlement or the amount of the entitlement) which needed to be settled via the legal system then a government could have a contingent liability in respect of its legal obligations for cash transfers.
- 6.15 Although individuals (and families) satisfying eligibility criteria for benefits specified in legislation may have a legal right to enforce payment for the amounts they are entitled to as at a given date, they will not generally have a legal right to enforce payment of:
- (a) benefits not specified in legislation; or
 - (b) amounts that they will be entitled to if they satisfy eligibility criteria in future periods.

- 6.16 The nature of obligations may differ between jurisdictions because of differences in eligibility criteria, validation requirements, interpretation of legislation and different application of common law principles. In most jurisdictions, there would be no legal entitlement to future child benefits until the child (and family if appropriate) satisfied all eligibility criteria in those future periods. In jurisdictions where validation is required only once (that is, once an individual satisfies eligibility criteria they are entitled to receive cash transfers until they reach a certain age or a certain event occurs), a government could have a present legal obligation for those future benefits.
- 6.17 If a government has a legal obligation for benefit payments in future periods, the obligation would be measured in accordance with IPSAS 19 by discounting the expected future cash flows to present values. Expected future cash flows would be determined by estimating the number of individuals expected to receive the benefit in future periods and the amounts that they would be entitled to. The impact of unknown future events on the amount and duration of those benefits becomes a measurement issue.
- 6.18 IPSAS 19 (paragraph 58) requires that future events that may affect the amount required to settle the obligation be reflected in the amount of the provision only where there is sufficient objective evidence that those future events will occur. The effective functioning of the economy and the machinery of government in most, if not all jurisdictions, is predicated on the expectation that the government will honor its legal obligations and protect property and social rights. However, governments may enact legislation which has retrospective effect on an individual's entitlement to benefits. In accordance with IPSAS 19, the amount of the provision recognized in respect of those benefits will be adjusted where there is sufficient objective evidence of a government's intention to enact legislative changes with such retrospective effects. It is anticipated that this will rarely occur.
- 6.19 In some cases, benefits may be provided from the date of application rather than the date of approval. For example, unemployment benefits or income supplements for economic hardship may be provided on application, with verification of unemployment or hardship being made over future periods. In these cases, some estimation may be required of the number of applications received but not yet processed. If benefits are

provided from the date of entitlement (for example, date of birth, date of becoming ill or unemployed), some estimation may be required of the number of individuals who are entitled to benefits but have not yet applied for them.

- 6.20 In the case of ongoing benefits, unless the arrangements for the cash transfer specifically state otherwise, the entitlement is usually considered to accrue evenly over the period between payment dates.

Preliminary View 4 – Cash Transfers²

A present obligation for the payment of future cash transfers does not arise until an individual has satisfied all eligibility criteria. The maximum amount of the obligation is the amount that the individual is entitled to from one validation point until the next.

- 6.21 The Steering Committee is of the view that a present obligation arises at the point that an individual satisfies all eligibility criteria and that the present obligation is limited to the amount payable between validation periods because a government would have no realistic alternative but to settle its obligations for amounts due and payable. In theory, a government could refuse to make cash transfers that were not specified in legislation or subject to a court order, but in practice a government would suspend such payments only in extreme circumstances. Governments can change eligibility criteria and the types of cash transfers available to constituents at short notice but not at the stage that a cash transfer is due and payable.
- 6.22 In addition, an obligating event occurs, and a present obligation arises, only when the entity, in this case the government, has no realistic alternative to settling the obligation. However, governments could make, and in many cases have made, changes to the amount of child and other benefits to individuals or amend the eligibility criteria. For example, governments frequently alter the level of support provided to constituents through cash transfers by altering the mix of cash transfers and free or subsidized goods and services. This means that there is no certainty that:

² Those Steering Committee members who support Option 3 in relation to old age pension benefits (as discussed in Chapter 8) support this preliminary view in respect of cash transfers other than old age pension benefits.

- (a) individuals who currently satisfy eligibility criteria will continue to do so in the future, or
 - (b) individuals who anticipate satisfying eligibility criteria in future periods, will in fact do so.
- 6.23 In the case of unemployment and similar benefits, such benefits are only available for the period during which the eligibility criteria are satisfied. Individuals cannot have a valid expectation that they will receive an unemployment benefit in future periods as they may move in and out of employment. A government has realistic alternatives to settling obligations to make future cash transfers for the types of benefits discussed in this Chapter.
- 6.24 The ability of a government to reduce or remove a particular cash benefit (and therefore one's assessment of whether or not the government has a realistic alternative to settling the obligation) may influenced by the relative level of dependence individuals have on the cash transfer and the anticipated reaction of the community to government initiatives that remove or vary the level of benefits. These assessments will vary between jurisdictions and over time within a jurisdiction.
- 6.25 Governments may have an obligation of some form to provide future cash transfers – in some cases the obligations may even meet the definition of a constructive obligation – but such obligations are not present obligations.

Disclosure

- 6.26 The amount of cash transfers due and payable (including amounts for benefits accrued as at the end of the reporting period) or any contingent liability should be disclosed in accordance with the requirements of the relevant IPSAS (for example, IPSAS 1 and IPSAS 19).
- 6.27 The types of additional information that could usefully be disclosed in respect of cash transfers to be provided in future periods (regardless of whether such future transfers are recognized as liabilities) is discussed in Chapter 9.

Other Possible Views

- 6.28 The Steering Committee's views are consistent with Option 1 as described in Chapter 4. Others may consider that a present

obligation for discretionary cash transfers arises prior to the point at which the eligibility criteria relating to the current entitlement are satisfied.

- 6.29 Those that would seek to apply Option 2 (satisfy threshold eligibility criteria) would require recognition of a provision in respect of all future benefits to be provided in respect of, for example:
- (a) child benefits – the present value of all amounts to be provided to children that satisfy the threshold eligibility criteria (usually birth) until the child reaches the age (or other circumstance) at which such benefits are no longer available;
 - (b) unemployment benefits – the present value of all amounts that are expected to be paid to current unemployed during the full period of their unemployment. Expectations about the period of unemployment would be built into the measurement of the liability; and
 - (c) medical benefits – on initial satisfaction of the eligibility criteria, the present value of all amounts expected to be provided during the full period of expected disability – expectations about the period of disability would again be built into the measurement.
- 6.30 Those that would seek to seek to apply Option 3 (key participatory events) would need to identify the point at which an individual began making economic decisions based on government policy (or some proxy for this point) and as a consequence, the government had no realistic alternative but to provide those benefits in the future. The amount of the provision recognized would then be the estimated present value of all future payments to be made in respect of each benefit.
- 6.31 Possible past events giving rise to a constructive obligation under Option 3 are as follows:
- (a) for child benefits – time of birth; and
 - (b) for disability benefits – the time that the disability or illness is first known (the obligation would need to be adjusted to take account of the number of individuals that would potentially qualify for the benefit but do not claim the full benefit). Alternatively the past event could be when each benefit payment is due and payable.

- 6.32 For unemployment benefits it is likely that the recognition point would approximate Option 2. This is because it is unlikely that most individuals currently in employment would anticipate long term unemployment in the future and commence to make decisions on the expectation that unemployment would occur and the benefit would be paid. Alternatively the past event could be when each benefit payment is due and payable.
- 6.33 The Steering Committee does not support these views.

Chapter 7 Specific Events – Application of Principles to Disaster Relief

Introduction

- 7.1 Chapters 5 and 6 developed general principles identifying the point at which present obligations arise in respect of collective and individual goods and services, and discretionary cash transfers to individuals. This Chapter considers the application of the principles developed in Chapters 5 and 6 to circumstances in which specific events give rise to obligations which a government satisfies in one or more future periods. Disaster relief is a good example of such circumstances and has been selected to test these principles.
- 7.2 The distinguishing characteristic of this category of benefits is that when the event or circumstances arise, an individual is usually required to satisfy eligibility criteria only once – there is not an ongoing or recurring confirmation or validation of eligibility as occurs with many other benefits. Foreign aid and legal aid also have similar characteristics to disaster relief. The application of the principles developed in this Chapter to legal aid is illustrated in Appendix 1.
- 7.3 The sequence of events that leads to the payment of cash transfers or delivery of goods and services will be influenced by the arrangements in place in any jurisdiction, including:
- (a) whether the government has a policy in place setting out details of the type and amount of disaster relief it will provide, any eligibility criteria, and the process to apply for assistance; and
 - (b) funding available under an existing budgetary authority;
- 7.4 In these cases, individuals potentially entitled to benefits could submit claims immediately following the occurrence of a disaster and the government could approve such claims without seeking any further authority.
- 7.5 However, in the absence of a policy on disaster relief and approved funding, a government would need to assess damage, develop a policy, advise constituents of the policy and seek the

appropriate form of budget authorization to disburse or commit funds.

- 7.6 Individuals seeking assistance from the government are normally required to apply for disaster relief. Approval of claims for assistance is normally delayed until the government has obtained or is confident of obtaining appropriate budget authorization. In some jurisdictions, existing legislation authorizes a government to spend specified amounts on disaster relief without obtaining prior approval through the normal authorization process.

Collective and Individual Services

- 7.7 Disaster relief can take the form of collective and individual services. For example, a government may provide clean water and food or repair privately owned dwellings. The Steering Committee considers that principles developed in Chapter 5 should be applied to these benefits.
- 7.8 Applying those principles, a government would not have a present obligation for such goods or services prior to the point at which the goods or services are provided. Subsequent to this point a government may have a present obligation to third parties supplying goods and services in exchange transactions or to individuals for goods and services they have purchased and which are to be reimbursed by the government.

Cash Transfers

- 7.9 The principles developed in Chapter 6 apply where the benefit is in the form of a cash payment to eligible individuals, can be spent at the recipient's discretion, and are not a reimbursement for services provided (or a prepayment for the acquisition of

¹ Restructuring includes termination or disposal of an activity or service, the closure of a branch office or termination of activities of a government agency in a specific location or region or the relocation of activities from one region to another; changes in management structure and fundamental reorganizations that have a material effect on the nature and focus of an entity's operations.

² At time of writing (August 2003) the IASB is reviewing the application guidance on restructuring provisions in IAS 37. It is considering amending the guidance so that when a contract becomes onerous as a result of the entity's own actions, such as a decision to restructure, the resulting provision is not recognized until that action has occurred.

such services). Cash transfers that must be spent on specific goods and services are classified as services to individuals.

- 7.10 Consistent with the principles in Chapter 6 a government would have a present obligation only when the eligibility criteria are satisfied and the amount is due and payable. Once an individual has satisfied eligibility criteria the amount of the obligation depends on whether there are ongoing validation requirements. Where there are ongoing validation requirements, the present obligation is for the cash transfers that the individual is entitled to from that point in time until the next point in at which eligibility criteria must be satisfied. Disaster relief provided by way of cash transfers does not usually have ongoing validation requirements.
- 7.11 Once individuals have met the initial eligibility criteria the cash transfer may be paid as a single sum or as a series of payments.
- 7.12 In many jurisdictions, particularly where a detailed government policy is not in place or the disaster is not of a recurring nature, there may be uncertainty regarding the circumstances in which disaster relief will be paid, the criteria for entitlement to any such relief and the timing of payment. The guidance in Figure 7.1 below may also be useful in determining when a present obligation exists for cash transfers.

Alternative Views

- 7.13 The Steering Committee's views reflect Option 1 as outlined in Chapter 3. Those who would seek to apply Option 2 to disaster relief provided to individuals would identify the initial satisfaction of the eligibility criteria as the point at which a present obligation initially arose and would recognise a liability for the present value of the benefit to be transferred in future periods, when the recognition criteria are satisfied.
- 7.14 Given that disasters would be avoided, or at least their effects on individuals mitigated if they could be predicted with any certainty, the consequences of application of Option 3 are unlikely to be substantially different from Option 2. The guidance in IPSAS 19 paragraph 83 reproduced in Figure 7.1, would be useful to those who support Options 2 and 3 in determining when a constructive obligation for disaster relief to be provided in future periods arises.

Figure 7.1 Restructuring Provisions

A constructive obligation to restructure ³ arises only when an entity:	
(a)	has a detailed formal plan for the restructuring identifying at least:
	(i) the activity/operating unit or part of an activity/operating unit concerned;
	(ii) the principal locations affected;
	(iii) the location, function, and approximate number of employees who will be compensated for terminating their services;
	(iv) the expenditures that will be undertaken; and
	(v) when the plan will be implemented; and
(b)	has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.
IPSAS 19 paragraph 83	

7.15 Paragraph 83 of IPSAS 19 sets out the general recognition criteria or conditions under which a restructuring provision meets the definition of a constructive obligation.⁴ These additional criteria focus on the need for evidence that the entity with the obligation is likely to act on its intention to provide resources to another entity such that a valid expectation is created and the entity cannot avoid settlement. The criteria are intended to provide more detailed guidance and thereby improve the consistency and comparability of reported information. However, the recognition of such constructive obligations is still governed by the definition of an obligating event which requires that an entity have no realistic alternative to settling the obligation.

7.16 Any provision recognized for disaster relief would include only the direct expenditures associated with that disaster relief, which are those that are both:

³ Restructuring includes termination or disposal of an activity or service, the closure of a branch office or termination of activities of a government agency in a specific location or region or the relocation of activities from one region to another; changes in management structure and fundamental reorganizations that have a material effect on the nature and focus of an entity's operations.

⁴ At time of writing (August 2003) the IASB is reviewing the application guidance on restructuring provisions in IAS 37. It is considering amending the guidance so that when a contract becomes onerous as a result of the entity's own actions, such as a decision to restructure, the resulting provision is not recognized until that action has occurred.

- (a) necessarily entailed in order to make payments or provide goods and services associated with disaster relief; and
 - (b) not associated with the ongoing activities of the government.
- 7.17 The limitation on the amount which should be recognized in a provision is based on the guidance in IPSAS 19 paragraph 93. Disaster relief that is provided as part of the ongoing activities of entities forming part of the governmental reporting entity (for example, ongoing activities of the army or fire service forming part of the consolidated reporting entity) would not be included in the provision.
- 7.18 The recognition of any provision under Options 2 and 3 would also be subject to the ability to reliably measure the obligation.

Disclosure

- 7.19 A government should disclose a contingent liability for disaster relief:
- (a) if a present obligation for disaster relief exists, but the amount of the obligation cannot be reliably measured; or
 - (b) if the existence of the past event or present obligation is uncertain (for example, there is a dispute as to whether a claim for disaster relief in the form of a cash meets the criteria in the disaster relief policy).
- 7.20 A government recognizing a provision for disaster relief should comply with the requirements of IPSAS 19 paragraphs 97 and 98 if the disclosures are material. Disclosure issues are discussed more fully in Chapter 9.

Chapter 8 Old Age Pension Benefits

Introduction

- 8.1 This Chapter addresses the recognition of liabilities arising from old age pension benefits (also referred to as social security pensions) provided by governments to citizens when they reach pensionable age. It provides preliminary views on the recognition of these pension obligations as liabilities, and the measurement, presentation and disclosure¹ of such liabilities.
- 8.2 This Chapter does not address the recognition of liabilities arising from:
- (a) pension benefits provided to government employees in exchange for their services as employees. These pension benefits are outside the scope of this ITC because they are exchange transactions. This is the case even when the pension scheme is unfunded and pension benefits are paid from consolidated government revenue; or
 - (b) guarantees provided by governments in respect of pension rights of government employees or members of private pension schemes (both voluntary and mandatory). In some jurisdictions, government guarantees may cover the insolvency of the schemes, ensure minimum benefits or provide for indexation of benefits to price or wage movements. Although these guarantees may give rise to provisions or contingent liabilities, they are not pensions and are not addressed in this ITC.
- 8.3 The old age pension benefits considered in this Chapter:
- (a) are those principally funded by general tax revenue or earmarked taxes and which are not provided in relation to an individual's services as an employee. They are not

¹ Chapter 9 contains a discussion of the disclosure of projected cash flows associated with current government policies, including disclosures which may assist readers in making assessments of the sustainability of current government policies.

directly linked to the amount of tax paid by the ultimate beneficiaries or to contributions made by individuals;

- (b) may be provided to all citizens who reach pensionable age or only to those citizens who have participated in the work force or paid taxes for a specified period;
 - (c) generally take the form of a cash payment to be paid regularly until death;
 - (d) may be subject to means tests (assets or income); and
 - (e) may be subject to other eligibility criteria such as being made available to only those persons who are citizens and who have contributed taxes for a specified number of years.
- 8.4 These schemes are sometimes referred to as “social insurance” schemes. Such schemes are currently the dominant form of public pension².
- 8.5 The nature and amounts of benefits provided under pension schemes, and any eligibility or other conditions that must be complied with to access the benefits, are generally set out in legislation (sometimes referred to as social security law).
- 8.6 Chapter 6 included a discussion of social benefits provided by way of cash transfers to individuals. Old age pensions are a form of cash transfer. They are considered in more detail in this Chapter because of the significance of unfunded pension obligations in some jurisdictions, and because different conclusions may be reached about when a present obligation arises in respect of them.

Present Obligation – Alternate Approaches

- 8.7 This Chapter outlines the circumstances under which a legal obligation for old age pension benefits would arise and considers the implications of the three options identified in

² Countries such as France, Germany and Italy offer comprehensive public pension programs designed to provide retired citizens with a retirement income based on the income they earned during their working life. These pensions fall within the scope of this Chapter. Countries such as Australia, Canada, the United Kingdom and the United States rely more heavily on private pensions but also have some state pensions that would fall within the scope of this Chapter.

Chapter 4 to the existence of a constructive obligation in respect of old age pensions.

- 8.8 Current practice in accounting for liabilities associated with old age pension benefits is to recognize amounts due to be paid and any accrual of pension benefits since the last payment date. This method has widespread acceptance and in many jurisdictions, will reflect the legal obligation to make pension payments (the issue of whether accrued pension benefits are a legal obligation is a question of fact that can be determined in each jurisdiction). Current practice is similar to Option 1 as outlined in Chapter 4. Depending on the nature of eligibility criteria and arrangements for payment, Option 1 may also result in the recognition of a present obligation (constructive) prior to the existence of any legal obligation. Some argue that neither current practice nor Option 1 reflect the full extent of a government's present obligation to provide old age pension benefits. Under Options 2 and 3 a constructive obligation to provide pension benefits arises prior to the existence of a legal obligation to provide those benefits.

Legal obligation

- 8.9 Where the rights of individuals to benefits, and the related eligibility criteria, are specified in legislation, the government would have a legal obligation to individuals meeting the eligibility criteria. The exact nature of the legal obligation would depend on the wording of the relevant legislation in a jurisdiction. In some circumstances, there could be a legal obligation for both current and future pension benefits. However, the present obligation (legal) would arise when individuals satisfying the eligibility criteria were due to receive pension benefits and would be for the amount that the individual was entitled to receive. Where an individual is required to satisfy eligibility criteria on an ongoing basis there would be no legal obligation for old age pension benefits that are subject to the satisfaction of eligibility criteria in the future. In the rare circumstances that eligibility needs to be satisfied only once, a legal obligation for future payments could exist.
- 8.10 Some estimation of such liabilities and/or provisions may be required where, for example:

- (a) benefits are paid from date of receipt of application, some estimation may be required of the number of applications received but not yet processed; and
 - (b) benefits are paid from the date of age of entitlement, some estimation will be required of the number of individuals who have reached age of entitlement and who intend to claim their pension benefit but have not yet done so.
- 8.11 Disclosures in accordance with IPSAS 19 (and IPSAS 1 where amount and timing are certain) should be made about liabilities recognized in respect of legal obligations to make pension payments.

Constructive Obligations – Option 1

- 8.12 Application of Option 1 (as outlined in Figure 4.4) to old age pension benefits would lead to the conclusion that there is a present obligation for old age pension benefits when individuals satisfy all eligibility criteria.
- 8.13 Under Option 1 the present obligation is limited to the pension benefits receivable from the point that eligibility criteria are satisfied until the next payment date (or date at which eligibility must be satisfied again, if this point is different). Individuals can cease to meet eligibility criteria at any point in time (due to death or failing to meet income or asset tests) so there is no constructive obligation for future pension benefits beyond the current entitlement. The liabilities recognized under Option 1 will frequently be legal obligations (although accrued benefits may or may not be legal obligations depending upon the wording of legislation in a specific jurisdiction) and reflect current practice in a number of jurisdictions. However, Option 1 could also lead to the recognition of liabilities where old age pension benefits are not specified in legislation. Where a jurisdiction requires infrequent validation of eligibility Option 1 could also result in the recognition of liabilities for pension benefits to be paid from the current point in time until the next validation period. This may well go beyond current practice in many jurisdictions. *Contingent Liability*
- 8.14 Some argue that satisfaction of initial/threshold eligibility criteria for old age pension benefits can give rise to a contingent liability for all future old age pension benefits likely to be paid

to those individuals and that this contingent liability should be disclosed. Others argue that this obligation to make future payments does not satisfy the definition of contingent liability because there has been no obligating event.

Constructive Obligations – Option 2

- 8.15 Option 2 (as outlined in Figure 4.4) reflects the view that the obligating event for the constructive obligation occurs when individuals meet initial or threshold eligibility criteria. The constructive obligation in relation to future old age pension benefits under Option 2 arises prior to any legal obligation or constructive obligation under Option 1.
- 8.16 Those that hold this view note that, in the absence of advice to the contrary, persons who satisfy the eligibility criteria have a valid expectation that the pension benefits they are entitled to at this point will continue during the period of their retirement. They will have arranged personal, family and business affairs on that basis. They argue that in these circumstances, and given an individuals' dependence on the receipt of old age pensions to fund their retirement, a government has no realistic alternative but to provide, and continue to provide, pension benefits to all who satisfy the initial/threshold criteria. Those that hold this view also argue that, if a government is to prepare financial statements that are transparent and reflect the full amount of the present obligation to provide old age pension benefits to eligible individuals under current policy, this liability should be recognized in the general purpose financial statements.
- 8.17 Under Option 2 the uncertainties about whether an individual will continue to meet eligibility criteria for old age pension benefits in future periods is reflected in the measurement of the amount of the present obligation that arises when the initial or threshold eligibility criteria are satisfied. The amount includes the present value of all expected cash flows to be provided to such individuals from the time of initial entitlement until they die or fail to meet ongoing asset or income requirements.
- 8.18 Present obligations arising under Option 2 would be recognized as provisions because:

- (a) it is probable that an outflow of resources will be necessary to settle the present obligation (constructive) for future old age pension benefits; and
 - (b) the amount of the outflow is able to be reliably measured.
- 8.19 Amounts due and payable including accrued pension benefits may be disclosed separately as liabilities.
- 8.20 If there is uncertainty as to whether an individual is entitled to old age pension benefits (for example, because of a dispute as to residency or income) there may be a contingent liability for future old age pension benefits.
- 8.21 The amount of the present obligation to provide old age pension benefits in future periods would be measured as the present value of the best estimate of future cash flows. The estimated cash flows are based on current eligibility criteria and benefit amounts, with future cash flows being adjusted for any changes that have already been approved. For example, estimates of future cash flows would take account of any known changes to age of entitlement in specific future years.
- 8.22 Actuarial valuations are likely to be necessary to deal with uncertainties about the length of time that individuals are expected to continue receiving benefits (for example, based on mortality rates and the probability of an individual satisfying residency or asset tests) and their expected entitlement over that period. There may also need to be estimation of the liability to individuals who have reached the age of entitlement but have not yet claimed pension benefits.
- 8.23 In theory, the best estimate of future cash flows would be made by identifying all possible outcomes for each assumption that affects cash flows and multiplying each outcome by its probability. In practice, actuaries may derive the best estimate of cash flows based on a single set of assumptions. Estimates of future old age pension benefit obligations are possible and are already prepared by some jurisdictions – however, such estimates may be highly sensitive to changes in underlying variables.

Contingent Liability

- 8.24 The liability recognized under some approaches in Option 3 (see below) may be identified as a contingent liability under Option 2.

Constructive Obligations – Option 3

- 8.25 Option 3 (as outlined in Figure 4.4) reflects the view that the present obligation arises when key past events have occurred. The past events that in aggregate give rise to a present obligation are not specified under Option 3. Their identification will require judgment in the context of the particular benefits to be provided and any jurisdictional specific norms or precedents. Under Option 3 governments may have a constructive obligation in relation to future old age pension benefits prior to the point that a legal obligation arises and earlier than is contemplated by Options 1 and 2 above.
- 8.26 Those that hold this view consider that the past event(s) that gives rise to the present obligation to provide pension benefits (that the government cannot realistically avoid settling), occurs before the threshold eligibility criteria are satisfied. They argue that:
- (a) in the absence of advice to the contrary, individuals will make spending and investing decisions based on current policies and past practices of governments and will rely on the expectation of satisfying eligibility criteria and receiving old age pension benefits in the future;
 - (b) individuals are likely to have arranged personal, family and business affairs on the expectation that such benefits will be available and they are likely to have made these arrangements well in advance of reaching the age of entitlement; and
 - (c) the cumulative effect of these arrangements and the dependence of individuals on those benefits is such that, in effect, a government has no realistic alternative but to provide pension benefits to all who approach retirement age.
- 8.27 Under Option 3 the likelihood of an individual or group meeting the threshold eligibility criteria for old age pension benefits in the future and subsequently continuing to meet those criteria

during the period of retirement is reflected in the measurement of the amount of the present obligation at each reporting date.

8.28 The rationale underpinning Option 3 is as follows:

- (a) individuals can validly rely on the expectation of receiving future old age pension benefits prior to the point at which they meet initial eligibility criteria. Because eligibility criteria tend to be stable, particularly for those nearing retirement age, a government has a constructive obligation to individuals who have not yet qualified for old age pension benefits but who have a reasonable expectation of meeting eligibility criteria. Governments have implicitly and explicitly acknowledged individuals' reliance on the expectation of receiving old age pension benefits and the consequences of not honoring these constructive obligations will have a serious impact on the credibility and support of the government. As such there is no realistic alternative but to honor them;
- (b) a present obligation for future pension benefits exists prior to the age of entitlement, despite the fact that it is not known with certainty which individuals will eventually satisfy both the initial/threshold eligibility criteria and ongoing eligibility criteria. The likelihood of an individual meeting eligibility criteria in future periods is a measurement issue;
- (c) it is probable that an outflow of resources will be necessary to settle the present obligation (constructive) for old age pension benefits to be provided in the future. The amount of the outflow is able to be reliably measured and would be recognized as a provision; and
- (d) present obligations (legal) or present obligation (constructive) for amounts due and payable and arrears would be recognized as liabilities;
- (e) the recognition of provisions on this basis is consistent with transparent financial reporting and is necessary if a government is to be accountable for the financial consequences of its undertaking, and consequential obligation, to provide old age pension benefits in future periods.

- 8.29 Supporters of Option 3 argue that if a government decided to withdraw old age pension benefits under an unfunded public scheme in order to create a new funded scheme it would have to compensate those who voluntarily switched to the new scheme. This occurred in Chile in May 1981

Figure 8.1 Pension Reform in Chile

In May 1981 Chile replaced its government-run pay-as-you-go retirement system with a system of private pension accounts. Workers who were already in the labor force before January 1983 had the option of staying in the old, government-run system or moving to the new system. Workers who moved to the new scheme received recognition bonds from the government that acknowledged the contributions they had already made, via taxes, to the old system. The provision of recognition bonds showed that the government accepted that it had an obligation to citizens for accrued pension benefits. This obligation existed prior to those citizens reaching retirement age.

The value of the recognition bonds was computed by multiplying a percentage of the worker's average salary (indexed for inflation) in the 12 months before mid-1979 by the number of years the worker had contributed to the system (up to a maximum of 35 years) and multiplying that result by an annuity factor. Different annuity factors were used for men and women.³

- 8.30 However, others would disagree that the experience in Chile reflects what would happen or has happened in other jurisdictions. In certain other jurisdictions, individuals approaching retirement age have had their access to old age pension benefits restricted without compensation (for example, by the introduction of a means test when pension benefits were previously available regardless of an individual's income or assets).
- 8.31 Although this example supports the existence of an obligating event prior to age of entitlement, it does not assist in determining when the obligating event occurred. Participation in the workforce, the payment of contributions and the payment of taxes are all possible obligating events leading to the creation of this constructive obligation.

³ Rodríguez, L. Jacobo, July 30 1999, Social Security Privatization No. 17, *Chile's Private Pension System at 18: Its Current State and Future Challenges*

- 8.32 Those that support Option 3 note that it is difficult to determine exactly when the obligating event or events occur. The Steering Committee considered that the past (obligating) event under Option 3 could be generally expressed as the point at which an individual begins to make economic decisions based on the expectation of receiving future old age pensions. Possible proxies for this include at one extreme, entering the workforce and becoming economically independent or, beginning to pay taxes or paying taxes for a number of years. At the other extreme, a proxy could be approaching or reaching pensionable age. Measurement of provisions for old age pension benefits under both workforce entry and pensionable age are discussed in this Chapter.
- 8.33 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. This argument supports payment of taxes as the obligating event giving rise to the constructive obligation. This expectation is reinforced in some jurisdictions by the requirement that to be eligible for an old age pension an individual must have been in the workforce for a certain period of time. In many jurisdictions old age pension benefits represent a significant part of an individual’s post retirement income. Individuals’ decisions on consumption and saving during their working life are influenced by their reliance on future expected pension benefits and that reliance becomes greater as they get closer to age of entitlement.
- 8.34 In theory governments have the ability to change the amount of pension benefits or the eligibility criteria for pensions. However, in practice governments find it extremely difficult to reduce or remove old age pension benefits. A government’s ability to remove or reduce pension benefits (and therefore avoid an obligation) may vary between age groups. For example, a government may be able to reduce future old age pension benefits for people currently aged between 20 and 40 years of age but it may have considerable difficulty reducing future old age pension benefits for people aged over 40 years. This argument could be used to support the time that individuals have economic independence and make economic decisions, such as how much to save for retirement, as the obligating event.

- 8.35 Governments generally choose not to change benefit entitlements for those who have already reached retirement age and gradually phase in changes for other citizens. The circumstances in which citizens will accept pension reform that reduces benefits are limited. For example, citizens may accept pension reform when it is imperative that government spending be reduced and the alternative would be to reduce essential government services. In some countries industrial action by citizens has delayed or prevented the introduction of pension reform. In others, the courts have intervened to restrict pension changes.
- 8.36 There is no general agreement on when obligating event(s) occur from those that support this option. In seeking to identify points at which an individual could validly rely on the expectation of future old age pension benefits, the Steering Committee elected to use events at either end of the possible range (workforce entry and reaching pensionable age) to illustrate how the obligation would be measured.

Workforce entry

- 8.37 If workforce entry (to be determined in each jurisdiction, for example, age 20) is selected as the appropriate point of recognition of the obligation under Option 3 (that is the point from which such obligations would begin to accrue), the obligation is measured as the best estimate of all future pension benefit payments (from pensionable age onwards), which will eventually occur as a result of events up to the present date, discounted back to the reporting date. There are two approaches that may be adopted to the measurement of this amount. They are explained below. Under both approaches, the likelihood of an individual meeting and continuing to satisfy eligibility criteria (including being alive where relevant) in future periods is treated as a measurement issue. Under both measurement approaches estimations of the following would be required:
- (a) the number of individuals who are expected to live until pensionable age;
 - (b) the number of years that individuals are expected to receive the old age pension benefit; and

- (c) the proportion of individuals that are expected to satisfy any relevant eligibility criteria such as income tests.
- 8.38 The reliability of measurement of such provisions depends on the reliability of the assumptions and the sensitivity of the result to changes in assumptions.
- 8.39 **Measurement A:** Under the first measurement approach, the obligation is measured as the present value of estimated future cash flows associated with the accrued benefit rights. Benefit rights are considered to accrue over a period of time (in the same way that an individual's rights to employment related pensions accrue over time). They would build from an initial value of zero at time of workforce entry to the total present value of all expected future pension benefits as an individual reaches pensionable age. The present obligation would be at its largest value at the point that an individual satisfied the threshold eligibility criteria for pension benefits. The obligation would then gradually decline as the government makes pension payments to an individual over the remainder of their life or until eligibility criteria are no longer satisfied.
- 8.40 **Measurement B:** The second measurement approach is quite different from Measurement A described above. Under this approach the obligation is measured as the present value of total estimated future cash flows to individuals who are currently at, or older than, workforce entry age. This pension obligation is considerably greater than that calculated under Measurement A. The pension obligation recognized in respect of an individual at workforce entry age would measure the pension obligation as if the individual were entitled to all their expected future pension benefits. The pension benefit for an individual would increase gradually each year due to the unwinding of the discount rate. Changes in underlying assumptions could also lead to increases or decreases in the pension obligation. At the point that an individual reached pensionable age the amount of the pension obligation under Measurement A and Measurement B would be the same.
- 8.41 An alternative way of explaining the obligation measured under Measurement B is that the pension obligation for an individual at a given point in time could be derived by identifying the amount that an individual would be required to invest each reporting period in order to achieve a lump sum at retirement

age (equal to the present value of post retirement cash flows) and to calculate the present value of these cash flows.

Pensionable age

- 8.42 As noted earlier it is difficult to specify the exact point at which a past event giving rise to a present obligation for future pension benefits occurs. Those that support this view do not consider that reaching pensionable age is the specific event that gives rise to a present obligation under Option 3. Rather, they consider that the present obligation has occurred prior to that point but that it is not possible to identify exactly when this occurs. However, they consider that by the time an individual reaches pensionable age there is sufficient evidence that a past event has occurred. They note that the consequences for a government of failing to honor obligations to those who are of pensionable age or are one day, month or year short of that age are likely to be similar. They also acknowledge arguments that the present obligation could arise much earlier. However, they believe that identification of reaching pensionable age and satisfying threshold age eligibility criteria as the obligating event will provide reliable and comparable information across jurisdictions. They do not consider that workforce entry or other alternative obligating events will necessarily provide reliable and comparable information across a range of jurisdictions.
- 8.43 If pensionable age is selected as the appropriate point for recognition of the constructive obligation, measurement is as per Option 2.

Contingent Liability – Option 3

- 8.44 It may be argued that if a provision for future old age pension benefits is not recognized until an individual reaches pensionable age a contingent liability exists and should be disclosed prior to this point. However, the definition of a contingent liability requires the identification of “a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence of one or more uncertain future events not wholly within the control of the entity”. In the case of old age pension benefits the existence of the obligation

is not dependent on uncertain future events – it is rather that the timing of the past event is unknown.

Comparison of Options with GFS

- 8.45 No liability is recognized in GFSM 2001 for future retirement pensions and other benefits to be provided under social security schemes, regardless of the level of assets in a social security fund or other segregated accounts. All payments of benefits are treated as transfers (expense). Under GFSM 2001 the present value of social security benefits that have been earned (according to the existing laws and regulations) but are payable in the future are calculated in a manner similar to the liabilities of an employer retirement scheme and are shown as a memorandum item (these items are presented as supplementary information – they are not recognized as liabilities). Liabilities for the payment of benefits that were due to be paid but have not yet been paid are classified as other accounts payable (GFSM 2001, paragraphs 7.126 and 7.145)⁴.
- 8.46 The recognition of pension liabilities under GFS is therefore similar to Option 1.

Obligating Event

- 8.47 The Steering Committee does not have a unanimous view on the circumstances in which a present obligation for aged pension benefits arises and therefore the amount that should be recognized as a liability in the financial statements.

Preliminary Views 5 – Old age pension benefits

The Preliminary Views of the Steering Committee regarding the identification of present obligations for old age pension benefits to be provided in future periods are outlined below:

- ***Option 1 (satisfy all eligibility criteria) is supported by a majority of Steering Committee members; and***

⁴ At the time of writing (March 2003) the GFS treatment of government pensions is under review.

- *Option 3 (key participatory events: workforce entry) is supported by a minority of Steering Committee members.*
- *Options 2 is not supported by Steering Committee members.*

- 8.48 Steering Committee members supporting Option 3 note that their views on the circumstances which give rise to a present obligation that should be recognized in the financial statements for aged pensions differ from their views on other cash transfers and services to individuals.
- 8.49 Factors that have influenced them in concluding that there is an obligation for future old age pensions at this earlier point are:
- (a) the observed use of transitional provisions to delay the implementation of old age pension benefit changes so that individuals nearing or over pensionable age are protected from the changes. Governments may, but do not generally use transitional provisions when introducing changes to other benefits; and
 - (b) the fact that individuals' reliance on the pension benefits is generally greater than their reliance on other benefits.

Contributions by Beneficiaries

- 8.50 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. However, in some cases contributions may be separately identified and linked to particular benefits. This ITC deals only with the non-exchange aspect of such transactions.

Disclosure

- 8.51 The relevant disclosure requirements in IPSASs are discussed in Chapter 9.
- 8.52 Where assets have been specifically set aside to fund future old age pension benefits or where a government maintains separate funding for such benefits (at least in part) disclosure of such assets or funds would be appropriate.

Chapter 9 Disclosure

Introduction

- 9.1 This Chapter outlines the application of the disclosure requirements in existing IPSASs to social policy obligations and considers the extent to which the information presented in general purpose financial statements meets the needs of users. It identifies a gap in the information that should be provided to users, explores possible ways of bridging that information gap and encourages further debate on this issue.

IPSAS 1 and IPSAS 19

- 9.2 IPSAS 1 contains broad requirements concerning the classification and disclosure of liabilities in the financial statements. For example, application of the disclosure requirements in IPSAS 1 to pension obligations would lead to the following disclosures:

- (a) the accounting policy used to determine the amount of the expense and the associated liability including a description of accrued rights and the point at which these accrued rights are first recognized;
- (b) transfers payable as a line item on the statement of financial position, with additional line items, headings and sub-totals on the face of the statement of financial position when such presentation is necessary to present fairly the entity's financial position;
- (c) the amount of any provision either as a line item on the statement of financial position or in the notes to the financial statements; and
- (d) the expense associated with social benefits for the period, either as a line item on the face of the statement of financial performance or in the notes to the financial statements.

- 9.3 IPSAS 1 also:

- (a) encourages entities to disclose additional information which will assist users in assessing the performance of the

entity, and its stewardship of assets, as well as making and evaluating decisions about the allocation of resources (IPSAS 1 paragraph 23);

- (b) encourages entities to disclose information about compliance with legislative, regulatory or other externally-imposed regulations (IPSAS 1 paragraph 24); and
- (c) requires that the notes to the financial statements of an entity should provide additional information which is not presented on the face of the financial statements but that is necessary for a fair presentation (IPSAS 1 paragraph 122c).

9.4 The disclosures about provisions required by IPSAS 19 paragraphs 97 and 99 are shown in Figure 9.1.

Figure 9.1 IPSAS 19 paragraphs 97 and 98

97.	<p>For each class of provision, an entity should disclose:</p> <ul style="list-style-type: none"> (a) the carrying amount at the beginning and end of the period; (b) additional provisions made in the period, including increases to existing provisions; (c) amounts used (that is, incurred and charged against the provision) during the period; (d) unused amounts reversed during the period; and (e) the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate. <p>Comparative information is not required.</p>
98.	<p>An entity should disclose the following for each class of provision:</p> <ul style="list-style-type: none"> (a) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits or service potential; (b) an indication of the uncertainties about the

	amount or timing of those outflows. Where necessary to provide adequate information, an entity should disclose the major assumptions made concerning future events, as addressed in paragraph 58; and
(c)	the amount of any expected reimbursement, stating the amount of any asset that has been recognized for that expected reimbursement.
IPSAS 19 paragraphs 97 and 98	

- 9.5 IPSAS 19 also requires certain disclosures in relation to contingent liabilities (refer Figure 9.2).

Figure 9.2 IPSAS 19 Paragraph 100

100.	Unless the possibility of any outflow in settlement is remote, an entity should disclose for each class of contingent liability at the reporting date a brief description of the nature of the contingent liability and, where practicable:
(a)	an estimate of its financial effect, measured under paragraphs 44 to 62;
(b)	an indication of the uncertainties relating to the amount or timing of any outflow;
(c)	the possibility of any reimbursement.
IPSAS 19 paragraph 100	

- 9.6 Notes to the financial statements may include additional information useful as input to assessments about financial position and performance. For example notes may include a sensitivity analysis to identify the impact of changes in major assumptions on recognized provisions, and identify the future events that would need to occur to for a contingent liability to qualify for recognition.

Preliminary View 6 – Disclosure

The disclosure requirements of IPSAS 1 and IPSAS 19 are applicable to liabilities and contingent liabilities arising from social policy obligations.

Additional Information that should be provided to Users

- 9.7 The Steering Committee considers that the disclosures required by IPSAS 1 and IPSAS 19 are useful, but not necessarily sufficient to meet the legitimate needs of users of general purpose financial statements, and that additional disclosures may be required.
- 9.8 The Steering Committee considers that users of a government's general purpose financial statements and other financial reports could reasonably expect that such statements and reports together will provide information useful as input to assessments of the extent to which current social policies are sustainable, including the projected impact of those policies on taxation, debt and the government's overall financial condition. Disclosure of projected future cash flows and the assumptions on which such cash flows are based is a critical aspect of such disclosures.
- 9.9 The Steering Committee considers that information on the sustainability of a government's social policies needs to encompass:
- (a) all social benefits collectively. Focusing on individual social benefits is not likely to provide information relevant to assessments of the sustainability of a government's policies unless the future obligations associated with those particular social benefits are much greater than those associated with all other social benefits. In addition, it could lead to the disclosure of a large volume of information which would undermine the accessibility and usefulness of the financial statements, place unreasonable burdens on preparers and lead to the unnecessary duplication of information already presented in a government's annual budget documents (or other documents containing forecast cash flows or forecast financial statements); and

- (b) information about projected revenues under current fiscal settings as well as information about liabilities and projected.
- 9.10 The Steering Committee is of the view that the disclosure of additional information about social benefits at a whole of government level is likely to be more useful than requiring additional disclosures on specific social benefits by individual reporting entities. This is because governments make significant decisions on the nature and amount of future social benefits and allocate resources to competing areas at a whole of government basis.
- 9.11 The Steering Committee also noted that:
- (a) some governments have tried to address the information needs of financial statement users by publishing generational accounts (see below) or separate reports and papers on projected revenues, expenses and cash flows under existing policies;
 - (b) a number of governments publish medium and long term fiscal projections as part of the budget process; and
 - (c) there has been increasing interest by economists and policy agencies on longer-term fiscal issues. Much of this interest focuses on a government's long-term intertemporal budget constraint which looks at the consequences of long-term imbalances between taxes and spending.
- 9.12 The Steering Committee supports these initiatives and believes this is an area for further co-operation and co-ordination of the interests of accountants and economists.

Generational Accounting

- 9.13 Generational accounting is one approach to long-term fiscal planning and analysis that leads to the disclosure of information useful in assessing the financial sustainability of a government's current policies. Generational accounts can help in identifying any alternative policies needed to achieve generational balance and the effect of those alternative policies on the current generation. Sustainable policy occurs when a government is able to meet its commitments in a planned and timely manner.

- 9.14 Generational accounts can be used to:
- (a) disclose information which illustrates the sustainability of fiscal policies without significant increases in the tax burden on current and future generations and without cutbacks in government expenditure;
 - (b) quantify the increase in taxation revenue necessary for government policy sustainability; and
 - (c) show the size of the projected fiscal burden on future generations based on continuing current policies. For each generation, the generational account is computed as the present value of net taxes to be paid over their remaining lifetimes.
- 9.15 Generational accounts do not necessarily focus on solvency, but may include information which is relevant to assessments of ongoing solvency.
- 9.16 Generational accounts are constructed using:
- (a) projections of the population by age;
 - (b) projections of the average net payments (taxes less transfers) to government for each generation for each year in which at least one member of the generation is still alive;
 - (c) a discount rate (interest rate);
 - (d) a productivity growth rate;
 - (e) the value of government debt and financial assets; and
 - (f) projections of future government expenditure on goods and services.
- 9.17 Generational accounts are usually published separately from financial statements because they have a different purpose to financial statements. They may be published in conjunction with ex-ante budget reports or ex-post financial statements. Some of the proposed supplemental disclosures discussed in this Chapter are likely to be included in generational accounts. The preparation of generational accounts in some jurisdictions demonstrates the belief of those jurisdictions that, despite difficulties in obtaining reliable measures of some items, the

information in the accounts is sufficiently reliable to be useful to readers.

Additional Disclosures – Key Issues

- 9.18 The Steering Committee is of the view that additional disclosures about sustainability should be made in general purpose financial statements or supporting or related financial reports. If such additional disclosures were mandated in an accounting standard the PSC would need to consider a range of issues including the following:
- (a) the types of disclosures that should be made. Some jurisdictions such as Canada have developed a series of fiscal indicators designed to provide information on the degree to which a government can maintain existing programs and meet existing creditor requirements without increasing the debt burden on the economy. The long term trends in two indicators (Deficit to Gross Domestic product (GDP) and Debt to GDP) can be used to assess sustainability. Other jurisdictions such as the United States require projections of cash flows associated with major social programs;
 - (b) whether the selected fiscal indicators should be permitted to be disclosed individually or whether they should always be presented together. The risk of permitting indicators to be published in isolation is that users may see only part of the whole picture or that a government may wish to present only those indicators that give the most favourable impression of its future outlook;
 - (c) where the disclosures would be made. They could be presented in a range of documents including the suite of budget documents, in the notes to general purpose financial statements, in an annual report but separate from the financial statements or in more than one of these documents. Some support the inclusion of forecast cash flow information in general purpose financial statements or accompanying reports on the grounds that it is artificial to draw a distinction between ex-post and ex-ante reporting in the public sector. Others argue that it is not appropriate to disclose forecast cash flow information in general purpose financial statements because a

government has some discretion to change or avoid these future cash flows. They support the presentation of such information in budget documents (alongside a government's descriptions of its future intentions across a broad range of policy areas) or in separate reports such as generational accounts;

- (d) whether the disclosures should be subject to audit. The location of supplemental disclosures in certain documents would have implications for whether or not those disclosures are required to be audited. IPSASs do not establish audit requirements. Each jurisdiction establishes its audit requirements and these differ between jurisdictions. In some jurisdictions, all financial and non-financial information in annual reports is audited;
- (e) whether such disclosures are sufficiently reliable to be published and used in making assessments of the sustainability of current policies. Although such disclosures are unlikely to have the same degree of precision as obligations recognized as liabilities in the financial statements, there are a number of factors that suggest that this is not an overriding issue. For example, assumptions made can be explicitly stated and sensitivity analysis can demonstrate the sensitivity of the information to changes in assumptions. The usefulness of this information (and the fact that a number of governments prepare such information demonstrates that it is useful) indicates that it is also considered to be sufficiently reliable to have value.

Specific Additional Disclosures

- 9.19 Although the Steering Committee decided that it was not appropriate to recommend additional disclosures for specific social benefits, the Committee noted some areas where such disclosures could be helpful for readers. For example, the Steering Committee considers that the extent to which changes to provisions for benefits to individuals or entities are due to changes in the numbers of eligible individuals or entities, as opposed to changes in actuarial assumptions, would assist readers in forming a judgment on the sustainability of such benefits in future periods.

- 9.20 The Steering Committee also noted that some jurisdictions (for example, the United States in the FASAB Statement of Federal Financial Accounting Standards Number 5) require government entities to provide additional information on matters such as:
- (a) forecast long range cash inflows and outflows (real or nominal) for major classes of social benefits for each year for a specified number of years (together with a description of major assumptions used in preparing forecasts);
 - (b) the present value of future benefits to be provided to those currently meeting eligibility criteria (from the present time until they are expected to cease receiving the benefits or for a specified time period);
 - (c) the present value of future benefits to be provided to those not currently meeting eligibility criteria but expected to meet eligibility criteria at some future point (using cash flows over a specified period of time); and
 - (d) the effect of changes in significant assumptions (for example, birth and death rates) on forecast cashflows or present values.
- 9.21 The Steering Committee has not recommended detailed disclosures regarding individual social benefits. However, it is of the view that governments or individual public sector entities should be encouraged to provide such disclosures. Such disclosures may assist users in forming an opinion on the reliability of any present value information presented in the financial statements or, where such present values are not presented, in assessing the present value of certain obligations.
- 9.22 Where an entity makes disclosures of future obligations associated with specific social benefits it would also be useful to disclose any amounts or assets set aside to fund those benefits.

Preliminary View 7 – Additional Disclosures

The disclosure requirements included in general purpose financial statements will not provide users with information sufficient to make informed assessments about the future sustainability of social benefit programs. The PSC should

explore the development of a framework for reporting information about the sustainability of government programs.

Cash Basis

- 9.23 The Cash Basis IPSAS encourages entities to provide additional disclosures of items not recognized in the financial statements. Part 2 of the Cash Basis IPSAS is not mandatory. It identifies additional accounting policies and disclosures that an entity is encouraged to adopt to enhance its financial accountability and the transparency of its financial statements. It includes explanations of alternative methods of presenting certain information. The PSC envisages proposing additions to the Cash Basis IPSAS over time as additional accrual based IPSASs are approved.
- 9.24 Depending upon the reliability of forecast information prepared by an entity, entities preparing a financial statement under the cash basis could provide supplemental disclosures on projected cash flows associated with individual benefits or forecast cash receipts and expenses for the government as a whole. Entities preparing such disclosures as supplemental information to the cash basis would need to consider the cost of producing such information in relation to the benefits to users. Given the relative significance of old age pension obligations for most jurisdictions and the those obligations on a government's projected financial condition, forecast pension obligations may be one item for which supplemental disclosures would be appropriate.

Appendix 1

Examples: Recognition and Measurement

This appendix illustrates the application of the preliminary views expressed in the Invitation to Comment (ITC).

All the entities in the examples have a reporting date of 31 December. In all cases, it is assumed that a reliable estimate can be made of any outflows expected. In some examples the circumstances described may result in impairment of the reporting entity's assets — this aspect is not dealt with in the examples.

References to “best estimate” are to the present value amount, where the effect of the time value of money is material.

Example 1: Defense

A government operates an army and an airforce. The government has publicly stated its intention to maintain current levels of capability.

ANALYSIS

Present obligation as a result of a past obligating event — There is no present obligation to provide defense services in future periods.

Example 2: Free Education to Primary School Children

Under legislation, a government is required to provide free primary education to all eligible children in the jurisdiction. The government provides education through government owned and operated schools.

ANALYSIS

Present obligation as a result of a past obligating event — There is no present obligation to provide education services in future periods. The government would account for any exchange contracts entered into in order to provide these services in accordance with generally accepted accounting practice. Exchange contracts could include the employment of teachers, purchases from suppliers of school equipment and agreements with construction firms for the construction of new buildings.

Example 3: Free Education to Children from Low Income Families

A government provides free education to children from low income families. The government provides the education services through a school owned and operated by a private company. The school has been instructed to assess eligibility and provide services to children meeting eligibility criteria (there is a limit on the number of children to whom it may provide free education). A government review of the school's assessment of eligibility is conducted periodically. The government pays 500 currency units at the beginning of each month in advance to the school. The school invoices the government for services provided at the end of each month (less the 500 currency units already received) and receives payment of the balance four weeks later. The transactions with the private company are exchange transactions.

During the last month of the reporting period the school provided services worth 900 million currency units.

ANALYSIS

Present obligation as a result of a past obligating event — The present obligation arises as the schools deliver the education services.

An outflow of resources embodying economic benefits or service potential in settlement — Probable.

Recognition and Measurement — The government recognizes an expense for the total amount of services provided during the month (900 currency units) and a liability (an accrued expense) for the amount unpaid at month end (400 currency units).

Example 4A: Child Benefits

Government A has legislation that specifies the eligibility criteria for child benefits. Each eligible child receives 100 currency units each month from the government. The eligibility criteria are:

- the child is a citizen of the country;
- the child's parents have a combined income less than a specified level;
- the child is aged 16 years or under.

Entitlement commences when an application has been received and approved and details of a bank account have been provided. No payments for periods prior to this occur. Payments are made on the 20th of each month. Entitlement ceases at the end of the month that the child ceases to satisfy eligibility criteria (for example, the child reaches 16 years of age or the parents' income exceeds the specified amount). Families are expected to notify the government immediately that eligibility ceases. Parents are required to sign a declaration at the end of year stating that the child is still eligible to receive the child benefit. Any payments received in respect of periods that the child does not satisfy eligibility criteria are required to be repaid to the government.

At year end, 4,000 eligible babies have been born but applications for child benefits for only 3850 babies have been received and approved. It is assumed that all babies will eventually be registered to receive child benefits. 2% of children currently registered are expected to cease qualifying for child benefits during the following period.

At year end 10,000 children in total (including the 3850 babies registered this year) are registered to receive child benefits.

ANALYSIS

Present Obligation as a result of a past obligating event — A present obligation would exist only when children meet all eligibility criteria required to qualify for a benefit.

An outflow of resources embodying economic benefits or service potential in settlement — Probable.

Recognition — The 100 currency units would be expensed each month as the government credits the recipients' bank accounts. At year end the government would recognize a liability for the accrued benefit expense at the end of the month for approximately a third of the monthly benefit (for example, if the reporting period ended on 31 December the accrued expense would be $11/31 \times 100$ currency units per child).

Measurement — The liability for child benefits due and payable (354,839 currency units) would be recognized in the financial statements.

Example 4B: Child Benefits

Government A has legislation that specifies the eligibility criteria for child benefits. Each eligible child receives 100 currency units each month from the government. The eligibility criteria are:

- the child is a citizen of the country; and
- the child is aged 17 years or under.

Entitlement commences at time of birth. Payment commences when an application has been received and approved and details of a bank account have been provided. No further validation of entitlement is required. The first payment includes any amount owing from time of birth until the time of the first payment. Payments are made on the 20th of each month. Entitlement ceases when the child reaches 17 years of age, emigrates or dies.

At year end, 4,000 eligible babies have been born but applications for child benefits for only 3850 babies have been received and approved. It is assumed that all babies will eventually be registered to receive child benefits. 2% of children currently registered are expected to cease qualifying for child benefits due to death or migration.

An estimate of the amount due to all unregistered babies from time of birth until the end of the reporting period is 15,000 currency units.

At year end 10,000 children in total (including the 3850 babies registered this year) are registered to receive child benefits. The number of eligible children is evenly distributed between 0-16 years.

ANALYSIS

Present Obligation as a result of a past obligating event — A present obligation would exist only when children meet all eligibility criteria required to qualify for a benefit. Because there is no further validation of entitlement, the present obligation is for child benefits to be paid in all future periods.

An outflow of resources embodying economic benefits or service potential in settlement — Probable.

Recognition — The government would recognize a provision for each eligible baby for the best estimate of that baby's entitlement to child benefit from time of birth until 16 years of age. Each month as the government credited the recipients' bank accounts the government would recognize an expense of 100 currency units per child and the provision for child benefits would decline by that amount. A provision for future child benefits for each child would be made at the end of the reporting period in which the child's application was approved.

Measurement — At the time of birth the best estimate of future child benefits for each child would be the present value of 100 currency units a month for 16 years, adjusted for the 2% of children that are likely to cease receiving child benefit before the age of 16.

Using an annual discount rate of 6%, the present value of the provision for each child would be 12,077 currency units (based on monthly payments).

DR Child Benefit Expense	12,077	
CR Provision for Child Benefit		12,077
(At the time each child is born)		

DR Provision for Child Benefit	1,000,000	
CR Bank		1,000,000
(Each month 100 currency units per child – currently 10,000 children)		

DR Provision for Child Benefit	354,839	
CR Accrued Child Benefit Expense		354,839
(At year end – the purpose of this journal is to reclassify part of the provision as an accrual)		

Example 5: Housing Benefits

Government Agency C provides subsidies in the form of cash transfers to low income households to assist with rent payments. As at reporting date, 200 households were eligible to receive the benefits, but only 150 had claimed the benefit. Entitlement for the benefit is from the date at which applicants first meet eligibility criteria, not the date of application. Based on historical records, it is likely that all the remaining 50 eligible households will claim this year's housing subsidy within the next year. The benefit is paid once a year at the end of the year. The amount of the benefit varies depending on the combined income of, and number of children in, a family.

ANALYSIS

Present obligation as a result of a past obligating event — A present obligation exists when households meet, and continue to meet, all eligibility criteria. The obligating event is when households become entitled to the housing benefit.

An outflow of resources embodying economic benefits or service potential in settlement — Probable.

Recognition — A provision is recognized for the best estimate of the number of households expected to claim the housing benefit for that period and the expected amount of the benefit to be paid to those households.

Measurement — The best estimate of the number of households expected to claim the housing benefit is 200 households. The amount payable to the 150 households that have claimed the benefit is 15,000 currency units. The best estimate of the amount expected to be paid to the 50 households that have not yet claimed the benefit is 90 currency units per household. The government would therefore recognize an amount due and payable of 15,000 currency units and a provision of 4,500 currency units.

Example 6: Unemployment Benefits

Government D provides support through unemployment benefits to people who are unable to find paid employment. To receive an unemployment benefit, a claimant has to demonstrate that he or she meets the entitlement criteria when making a claim.

Unemployment benefit will be paid if the claimant is:

- aged over 18, but under retirement age;
- capable of working;
- available for work; and
- actively seeking work — as demonstrated by attending job interviews arranged by the government employment agency.

Unemployment benefit is paid to eligible claimants at a fortnightly interval. The eligibility of individuals for the unemployment benefit is checked by a government agency each month. Entitlement ceases immediately if the criteria are breached.

The benefit is 200 currency units per fortnight. The final payment occurs on the reporting date. The benefit is payable from date of approval of an application. As at reporting date there are 100 individuals whose applications have been approved but whose payments have been delayed because they were not entered into the payment system in time for the 31 December payment. These individuals are owed, on average, one week's benefit.

ANALYSIS

Present obligation as a result of a past obligating event — A present obligation would exist only when an individual meets all eligibility criteria required to qualify for an unemployment benefit. The individual must continue to meet eligibility criteria on an ongoing basis.

An outflow of resources embodying economic benefits or service potential in settlement — Probable.

Recognition — 200 currency units would be expensed every two weeks as the government credits the recipients' bank accounts. The government records a liability for any amounts due and payable at year end to individuals currently qualifying for the unemployment benefit.

Measurement – At year end the government would recognize a liability of 10,000 currency units (100 individuals x 100 currency units).

Example 7A: Disaster Relief – Services Provided

On 12 December 200X, a massive earthquake struck Country A. On 13 December 200X the national government pledged to provide immediate emergency assistance in the form of water, food and shelter and to help repair sanitation and water treatment facilities owned by local governments. It also pledged to pay for teams of private individuals to assess whether buildings were safe for occupation.

Present Obligation as a result of a past obligating event — There is no present obligation prior to the services being delivered. There will be no present obligation in respect of the services provided directly by the national government. A present obligation for services provided by the building assessors will arise as the services are provided.

Example 7B: Disaster Relief – Cash Transfers

On 12 December 200X, a massive earthquake struck Country A. On 13 December 200X the government pledged its support for victims but did not provide a detailed plan or state the total amount pledged. The government does not have an established policy regarding the provision of disaster relief. By 31 December 200X the government had received a number of applications for assistance and had approved cash transfers of 2 million currency units to be paid as lump sums in two months' time. Further applications for assistance (best estimate 3 million currency units) are expected next year.

ANALYSIS

Present obligation as a result of a past obligating event — The present obligation arises when individuals meet all eligibility criteria. In the absence of a clear policy setting out eligibility criteria the present obligation arises when applications are approved for payment.

An outflow of resources embodying economic benefits or service potential in settlement — Probable.

Recognition — The government would recognize amounts approved for payment as amounts due and payable as at reporting date.

Measurement — 2 million currency units is recognized at 31 December 200X.

Example 7C: Disaster Relief

On 12 December 200X, a massive earthquake struck Country A. On 13 December 200X the government pledged its support for victims. The government announced a detailed plan setting out the eligibility criteria for victims to qualify for disaster relief from the government and stated that cash transfers of up to 5 million currency units would be provided to victims meeting eligibility criteria. The government also announced that a further 2.5 million currency units would be available in one year's time for those meeting certain eligibility criteria at that time. By 31 December 200X the government has received and approved applications for assistance of 2 million currency units. The government is aware of the existence of individuals meeting the eligibility criteria for the remaining 3 million currency units. It is also likely that there will be individuals who meet the eligibility criteria for the additional 2.5 million currency units in the following year. None of the disaster relief announced relates to the ongoing activities of the government.

ANALYSIS

Present obligation as a result of a past obligating event — The present obligation arises as individuals satisfy the eligibility criteria. There is not yet a present obligation for the disaster relief to be provided next year because the eligibility criteria must be satisfied at that time.

An outflow of resources embodying economic benefits or service potential in settlement — Probable.

Recognition — The government would recognize applications approved (2 million) as amounts payable. It would recognize a provision for the remainder of the 5 million currency units (3 million) allocated for immediate relief.

Measurement — An amount payable of 2 million currency units is recognized. A provision for 3 million currency units is recognized at 31 December 200X. This is based on reliable information that individuals meeting eligibility criteria for the remaining 3 million currency units exist.

Example 8A: Legal Aid

A government provides legal aid to low income individuals. The government's legal aid policy is well documented (but is not set out in legislation). Legal aid has been consistently provided for a period of years. All individuals charged with a criminal offence are advised of their right to request legal aid. Based on decisions in relation to various cases over time it is possible to predict with a high degree of accuracy whether an application for legal aid will be approved.

Legal aid is administered by and provided by a government department which employs its own lawyers.

ANALYSIS

Present obligation as a result of a past obligating event — There is no present obligation. The legal aid is provided as an ongoing activity of government.

Example 8B: Legal Aid

A government provides legal aid to low income individuals. The government's legal aid policy is well documented (but is not set out in legislation). Legal aid has been consistently provided for a period of years. All individuals charged with a criminal offence are advised of their right to request legal aid. Based on decisions in relation to various cases over time it is possible to predict with a high degree of accuracy whether an application for legal aid will be approved.

Legal aid is provided entirely by lawyers in private practice and is paid on presentation of an invoice by the lawyers. The lawyers generally

invoice the government at the end of each month for legal aid services provided that month. The government administers the legal aid system through the Justice Department. The average cost of assessing an application for legal aid is 1000 currency units. The average cost of approving each legal aid invoice for payment is 5 currency units.

ANALYSIS

Present obligation as a result of a past obligating event — The present obligation arises as lawyers in private practice deliver the services to clients. The government does not have an obligation for services yet to be delivered. There is no present obligation in relation to the administration activities provided by the government department.

An outflow of resources embodying economic benefits or service potential in settlement — Probable.

Recognition — The government would recognize all amounts that have been invoiced and an estimate of services delivered but not yet invoiced.

Measurement – Amounts invoiced would be as per actual invoices. Amounts not yet invoiced would be the best estimate of services delivered as at reporting date.

Example 9: Old Age Pensions

Country A has legislation, which entitles citizens, aged 65 years and over to an old age pension of 100 currency units per week (5,200 currency units per year). In order to be eligible for the pension individuals must not be receiving unemployment benefits, disability benefits or any other form of income support benefit from the government. Claimants are required to verify eligibility on an annual basis.

Eligibility ceases immediately if an individual receiving the benefit dies or receives other income support from the government. When eligibility ceases the individual is entitled to a final payment for the pension entitlement from the previous payment date until the day on which eligibility ceases (in Country A entitlement to the final payment is legally enforceable). No individuals ceased to be eligible during the final two weeks of the reporting period.

There are currently 10,000 individuals aged over 65 receiving the pension benefit. Of these 10,000 individuals, 2,000 are aged 65 years, 6,000 are aged 70 years and 2,000 are aged 75 years. In addition there

are 2,000 individuals aged 50 years, 2,000 individuals aged 40 years, 2,000 individuals aged 30 years and 2,000 individuals aged 20 years.

The pension is paid directly into the claimants' bank accounts every four weeks on a Wednesday (400 currency units). The last payment in this financial year occurs exactly two weeks prior to year end. Due to an error, 100 individuals did not receive their pension on the final Wednesday of the reporting period (40,000 currency units).

Because the Steering Committee has expressed a majority view and a minority views in relation to old age pension benefits (Chapter 8), both the majority and minority views are illustrated. Pensionable age is also illustrated to allow readers to compare the difference in using workforce age and pensionable age as the trigger for the past event.

ANALYSIS

Option 1: Present Obligation as a result of a past obligating event —

A present obligation would exist when claimants meet all eligibility criteria and continue to meet those criteria on an ongoing basis. There is a present obligation (legal) for both amounts due to be paid and amounts accrued since the last payment date.

Option 1: An outflow of resources embodying economic benefits or service potential in settlement — Probable.

Option 1: Recognition — 400 currency units per individual (4 million currency units in total) would be expensed every four weeks as the government pays the pensions into the recipients' bank accounts. The government would record a liability for any amounts that should have been paid to recipients, but, for some reason was not paid (in this case 400 currency units for 100 individuals). The government would also recognize a liability for the two weeks' pension benefit (200 currency units per individual) relating to the final two weeks of the reporting period.

Option 1: Measurement – At year end the government would recognize an amount due and payable of 2,040,000 currency units (400 x 100 plus an accrued pension expense of 200 x 10,000). These two amounts frequently presented as a single amount in the financial statements but may be presented separately if desired.

Option 3 Workforce entry

Workforce entry of age 20 is used as a proxy for when an individual begins to make economic decisions based on the expectation of receiving old age pension benefits in the future.

Option 3 Workforce entry: Present Obligation as a result of a past obligating event — A present obligation for a portion of future pension benefits would exist when an individual reaches 20 years of the age. The probability of an individual receiving a benefit and the expected length of time that an individual will receive a pension benefit is a measurement issue. The present obligation is a mix of legal obligations (for amounts that would be recognized under Option 1 in respect of individuals that have already satisfied eligibility criteria) and constructive obligations (for future payments to both those that have already satisfied threshold eligibility criteria and those that are yet to do so).

Option 3 Workforce entry: An outflow of resources embodying economic benefits or service potential in settlement — Probable.

Option 3 Workforce entry: Recognition — A present obligation for the best estimate of expected future pension benefits in respect of an individuals aged 20 and over is recognized at the end of each reporting period.

Option 3 Workforce entry: Measurement — The best estimate of the amount that should be accrued at age 20 is 2,925 currency units per individual (at age 21 years it is 3,101 currency units). This is based on the following calculations and assumptions:

- 20% of individuals who live to age 20 will die before they reach age 65;
- on average, individuals are assumed to live until age 80;
- there is a 2% chance that an individual who has qualified for a pension benefit at age 65 will subsequently fail to meet eligibility; and
- the discount rate is 6% per annum.

The best estimate of the *total* future pension benefits that an individual would receive at age 65 is 50,332 currency units. The present value of these *total* future pension benefits for individuals aged under 65 years is 68.7 million currency units. The best estimate of total future pension benefits for individuals aged 65 years and over is 379.7 million currency units.

Assuming that Country A recognizes a liability for total *future* pension benefits, the government would recognize liabilities as follows:

- an amount due and payable of 40,000 currency units (400 x 100);
- an accrued pension expense of 2 million currency units; and
- a provision for 448.5 million currency units.

If entitlement to pension benefits is measured as accruing over time and increases each year as the individual gets closer to pensionable age, the pension provision could be measured as increasing proportionately each year. For example:

- one 45th of the present value of estimated *total* future pension benefits at age 20 is 65.01 currency units; and
- two 45ths of the present value of estimated *total* future pension benefits at age 21 is 137.81 currency units (an increase of 72.81 currency units over the first year).

This would lead to a much smaller provision being recognized.

Option 3 Pensionable age

Pensionable age is used as a proxy for when an individual begins to make economic decisions based on the expectation of receiving old age pension benefits in the future.

Option 3 Pensionable age: Present Obligation as a result of a past obligating event — A present obligation for a portion of future pension benefits would exist when an individual reaches pensionable age (65 years). The expected length of time that an eligible individual will receive a pension benefit is a measurement issue. The present obligation is a mix of legal obligations (for amounts that would be recognized under Option 1 in respect of individuals that have already satisfied eligibility criteria) and constructive obligations (for future payments to those individuals currently aged 65 years and older).

Option 3 Pensionable age: An outflow of resources embodying economic benefits or service potential in settlement — Probable.

Option 3 Pensionable age: Recognition — A present obligation for the best estimate of expected future pension benefits in respect of individuals aged 65 years and older is recognized at the end of each reporting period.

Option 3 Pensionable age: Measurement — The best estimate of the amount that should be recognized as a provision for those aged 65 years and older is 379.7 million currency units. This is based on the following calculations and assumptions:

- on average, individuals are assumed to live until age 80;
- there is a 2% chance that an individual who has qualified for a pension benefit at age 65 will subsequently fail to meet eligibility; and
- the discount rate is 6% per annum.

Assuming that Country A recognizes a liability for total *future* pension benefits, the government would recognize liabilities as follows:

- an amount due and payable of 40,000 currency units (400 x 100);
- an accrued pension expense of 2 million currency units; and
- a provision for 379.7 million currency units.