



**INTERNATIONAL FEDERATION
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DATE: 19 FEBRUARY 2005
MEMO TO: MEMBERS OF IPSASB
FROM: PAUL SUTCLIFFE
SUBJECT: CONSIDERATION OF THE SCOPE OF THE PROJECT ON
ACCOUNTING FOR SOCIAL POLICIES OF GOVERNMENT

ACTION REQUIRED

The Board is asked to:

- **Consider** the paper on scope of the project on “Accounting for the Social Policies of Government”; and
- **Provide** directions on the further development of the project.

AGENDA MATERIAL

	Pages
9.2 Issues paper – Scope of IPSASB pension project	9.8 – 9.19

BACKGROUND

The ITC “Accounting for the Social Policies of Government” (the ITC) was issued in January 2004. Comments were due by 30 June 2004. Forty-nine (49) submissions were received on the ITC.

At the November 2004 meeting, members reviewed all submissions made on the ITC, and considered an analysis of comments on each of the issues raised in the ITC and other major themes identified in the submissions.

The mandate provided to the Steering Committee was to deal with social benefits excluded from IPSAS 19 “Provisions, Contingent Liabilities and Contingent Assets”. Therefore, the ITC was to deal with social benefits, including pensions, that are provided other than as a result of an exchange transaction. (The relevant extract from the scope paragraph of IPSAS 19 is included as Attachment 1 to this memorandum. An extract from the ITC which explains the nature of pension plans included within the ITC’s scope is included at Attachment 2.)

Pension benefits provided to employees as compensation for their services, and which therefore arise from an exchange relationship, were outside the scope of the ITC. These pensions relate to the government’s role as an employee and are not social benefits. There was an expectation that such employee pensions:

- Were dealt with by the IASB in IAS 19 “Employee Benefits”; and
- Would be considered when the IPSASB reviewed IAS 19 to determine whether or not it was applicable to the public sector, as part of its IASs/IFRSs convergence program.

At the last IPSASB/PSC meeting, members raised concerns that all pension arrangements did not neatly fall within social benefits as defined in the ITC, and employee benefits as dealt with in IAS 19. This was particularly so for a number of European countries which had pension benefit arrangements such as those in place in France and Belgium. (Relevant extracts from IAS 19 which outline its scope, are included as Attachment 3.)

Members also noted that irrespective of the specification of the scope of the project provided to the SC, there was a growing expectation that the IPSASB would deal with the full range of social benefit type pensions. Accordingly, it was appropriate to respond to that expectation and revisit the scope of the exposure drafts and IPSASs that were to be developed from this project.

Agenda materials for the last meeting included a paper by Francois Lequillier “Lessons from the OECD Workshop on Accounting for Implicit Pension Liabilities” (June 4, 2004). That paper noted that there appeared to be two polar positions in respect of pensions. At one extreme are jurisdictions where pension arrangements are primarily employer schemes with an additional safety net provided by social benefits. Australia, USA, Canada, and the Netherlands were identified in this group. At the other extreme are countries like Belgium and France where all/most private employees are part of the social security system, and the pension arrangements are primarily based on a global/collective scheme(s) which encompasses private sector employees and others that might receive a pension benefit from the state. The global scheme encompasses arrangements that give rise to a government’s obligations to provide, or otherwise support the provision of, pension benefits to wide sections of the community.

The IPSASB directed staff to prepare a paper which outlined key features of the French/Belgium type pension arrangements to facilitate the scope of the project. That paper is attached as Agenda item 9.2. It has been reviewed by Francois Lequillier. To attempt to flesh out the range of pension arrangements, input was also sought from the North American and European IPSASB members. I also received input from Steering Committee member Kristina Lundquist on the Swedish pension arrangements. Given the limited time to put this paper together and process all comments, I have not yet sought input from all IPSASB members. Such input of course is most welcome. In particular, members are requested to forward to me any amendments necessary to correct errors of fact or additional arrangements not captured in the attached paper. I can then advise and table any amendments at the Oslo meeting. In addition, if there are major omissions that might influence our discussion of the scope, please let me know or raise them at the meeting.

The attached paper provides an overview of certain pension arrangements as directed and staff views on two issues:

- How the project should be structured for its ongoing development;
- How pension plans could usefully be grouped for development of the IPSASB project(s) going forward.

In short, the staff view is that given observations made at the last meeting about constituent expectations regarding the development of guidance on accounting for a broad range of pension arrangements in the public sector that might captured under the umbrella of social policies of government, there is merit in splitting the project into two components at this stage:

- One component to deal with social benefits as explained in IPSAS 19, except for pensions. This is likely to involve the development of a broad definition/explanation of social benefits, which will need to be supplemented by a comprehensive explanation and commentary.
- One component to deal with pensions arising from the social policies of government. This component may be further broken down into the following two elements to reflect that the transaction and events which are likely to give rise to a present obligation under each arrangement differs:
 - a minimum/“safety net” social benefit pension for which no consideration is provided – this is a component of arrangements in most/many jurisdictions. (In some jurisdictions, these benefits may be a component of a global arrangement);
 - general government social security/protection type schemes which provide benefits as a consequence of contributions made by, or on behalf of, members (or so deemed to be made) to major sections of the community. These schemes exclude pensions provided to employees as consideration for their employment (the IAS 19 type arrangements specifically excluded from the ITC) – this is a major component of pension arrangements in some/many European countries. It is also a material component of pension arrangements in many other countries that depend more heavily on private schemes for the provision of employee pension benefits or to supplement government provided retirement (and similar) income.

Staff are of the view that this approach provides the opportunity for progress to be made on a range of social benefits in the short term, while the pension issue is further developed.

Pensions provided to public sector employees as consideration for their employment (the IAS 19 type arrangements) are encompassed under the IPSASB’s second and third priority grouping of projects: the IPSAS and IAS/IFRS convergence program and the IPSASB’s program to support convergence of IPSAS and statistical basis of reporting where appropriate. As previously agreed, additional projects under these priorities will be pursued when resources allow.

Attachment 1 –**Extracts from IPSAS 19 re: Social Benefits excluded from the scope of IPSAS 19**

The PSC directed the Steering Committee to deal with those social benefits excluded from the scope of IPSAS 19, “Provisions, Contingent Liabilities and Contingent Assets” – that is social benefits provided other than in an exchange transaction. Paragraph 1 of IPSAS 19 specifies.

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:

- (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) ...”*

IPSAS 19 further elaborates these types of social benefits as follows:

- “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.
- 9. For a provision or contingency arising from a social benefit to be excluded from the scope of this Standard, the public sector entity providing the benefit will not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of the benefit. This exclusion would encompass those circumstances where a charge is levied in respect of the benefit but there is no direct relationship between the charge and the benefit received.
.....”

Attachment 2 –
Extracts from the ITC “Accounting for Social Policies of Governments” - Pension
Benefits included in the scope of the ITC

Chapter 8 of the ITC deals with pensions. It explains these pensions within its scope as follows:

- “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 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 asset tests or income tests; 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 pension.

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. (footnote 1, page 68).”

Attachment 3 – Extracts from IAS 19 “Employee Benefits”

IAS 19 “Employee Benefits” deals with accounting by an employer for all employee benefits except those to which IFRS 2 “Share-based Payments” applies. It encompasses defined benefit and defined contribution plans¹ and multi-employer plans. Relevant extracts of IAS 19 are identified below. The definition of multi-employer plans excludes state plans. However, IAS 19.36 requires state plans to be dealt with in the same way as for multi-employer plans.

- “1. This Standard shall be applied by an employer in accounting for all employee benefits, except those to which IFRS 2 Share-based Payment applies.”***
3. The employee benefits to which this Standard applies include those provided:
- (a) under formal plans or other formal agreements between an entity and individual employees, groups of employees or their representatives;
 - (b) under legislative requirements, or through industry arrangements, whereby entities are required to contribute to national, state, industry or other multi-employer plans; and
 - (c) by those informal practices that give rise to a constructive obligation. Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the entity’s informal practices would cause unacceptable damage to its relationship with employees.
7. ***Multi-employer plans are defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that:***
- (a) ***pool the assets contributed by various entities that are not under common control; and***
 - (b) ***use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees concerned.***
29. ***An entity shall classify a multi-employer plan as a defined contribution plan or a defined benefit plan under the terms of the plan (including any constructive obligation that goes beyond the formal terms). Where a multi-employer plan is a defined benefit plan, an entity shall:***
- (a) ***account for its proportionate share of the defined benefit obligation, plan assets and cost associated with the plan in the same way as for any other defined benefit plan; and***
 - (b) ***disclose the information required by paragraph 120.***
30. ***When sufficient information is not available to use defined benefit accounting for a multi-employer plan that is a defined benefit plan, an entity shall:***
- (a) ***account for the plan under paragraphs 44-46 as if it were a defined contribution plan;***
 - (b) ***disclose:***
 - (i) ***the fact that the plan is a defined benefit plan;***
 - (ii) ***the reason why sufficient information is not available to enable the entity to account for the plan as a defined benefit plan; and***
 - (c) ***to the extent that a surplus or deficit in the plan may affect the amount of future contributions, disclose in addition:***
 - (i) ***any available information about that surplus or deficit;***
 - (ii) ***the basis used to determine that surplus or deficit; and***

¹ Defined contribution plans are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

Defined benefit plans are post-employment benefit plans other than defined contribution plans. (IAS 19.7)

(iii) *the implications, if any, for the entity.*

36. *An entity shall account for a state plan in the same way as for a multi-employer plan (see paragraphs 29 and 30).*
37. State plans are established by legislation to cover all entities (or all entities in a particular category, for example, a specific industry) and are operated by national or local government or by another body (for example, an autonomous agency created specifically for this purpose) which is not subject to control or influence by the reporting entity. Some plans established by an entity provide both compulsory benefits which substitute for benefits that would otherwise be covered under a state plan and additional voluntary benefits. Such plans are not state plans.
38. State plans are characterized as defined benefit or defined contribution in nature based on the entity's obligation under the plan. Many state plans are funded on a pay-as-you-go basis: contributions are set at a level that is expected to be sufficient to pay the required benefits falling due in the same period; future benefits earned during the current period will be paid out of future contributions. Nevertheless, in most state plans, the entity has no legal or constructive obligation to pay those future benefits: its only obligation is to pay the contributions as they fall due and if the entity ceases to employ members of the state plan, it will have no obligation to pay the benefits earned by its own employees in previous years. For this reason, state plans are normally defined contribution plans. However, in the rare cases when a state plan is a defined benefit plan, an entity applies the treatment prescribed in paragraphs 29 and 30."

ISSUES PAPER - SCOPE of IPSASB PENSION PROJECT

Introduction

The following brief overview of pension arrangements in some IPSASB member countries has been prepared following the discussion of IPSASB members at the November 2004 meeting. It attempts to draw out the nature of the past transaction or event which may give rise to a present obligation of the government to provide a pension benefit in the future. It is intended that this will assist members in identifying pension plans with similar characteristics which could usefully be grouped together for purposes of developing proposed requirements for inclusion in an exposure draft. The paper also provides staff views on:

- How the project should be structured for its ongoing development;
- How pension plans could usefully be grouped for development of the IPSASB project(s) going forward.

It is not intended that the discussion at this meeting will attempt to resolve how different arrangements should be accounted for. However, staff will seek member's initial views on the transactions and events that may give rise to a present obligation in respect of those pensions agreed to be included within the scope of the project. This will facilitate the preparation of a first draft exposure draft(s) for consideration at the next IPSASB meeting. To that end, Figure 1 below identifies the key elements of the relevant definitions and recognition criteria that must be satisfied if a legal or constructive obligation is to be recognized as a liability. It is drawn from Chapter 4 of the ITC "Accounting for the Social Policies of Government" (the ITC).

FIGURE 1 – FROM ITC CHAPTER 4

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>).

Legal Obligation	Constructive Obligation
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>).

Features of pension arrangements in some jurisdictions

The following summary of the French scheme is based on an explanation in Chapter 4 of “Pension Systems and Retirement Incomes across OECD Countries” edited by Richard Disney & Paul Johnson (2001). Chapter 4 was written by Nadine Legendre and Louis-Paul Pele. Francois Lequiller of the OECD kindly reviewed a draft of this summary and provided additional comments and updates which I have attempted to accurately reflect. References to the Canadian, and UK arrangements come from input from IPSASB members/TAs. References to particular aspects of the Swedish system come from a Steering Committee member, and again from Francois Lequiller. I will provide a verbal update on any additional feedback on the description of these arrangements at the forthcoming meeting.

The French System

In the French Social Security System, the governmental general social security scheme (the general scheme) is the basic scheme which covers most workers in the private sector. It is a pay-as-you-go scheme. There are also “special schemes” for public sector employees and for the self employed. In addition, separate “complementary” schemes provide additional benefits for those in the general scheme.

In the general scheme, contributions are compulsory and are made from the time an individual enters the work force. The pension is available at year 65, though it may be available earlier (but not before 60) for those who make contributions.

It is in the nature of a defined benefit plan. The pension is a percentage of the average wage up to the social security ceiling (which is close to the average wage for full time employment). While the calculation of the amount of the pension is complex, it is related to the years of contribution and the age of participants - the maximum pension for the general scheme is 50% of the average wage over employees 10 best years of earnings. Pension entitlement increases in proportion to the number of years of contribution or deemed contributions.

The effective maximum period of contributions in the general fund is around 37.5 – 40 years (with contributions being deemed to be made in other circumstances such as during “validated” unemployment periods and in respect of women who may leave the workforce to have children – a “credit” is provided per child). Spouses of deceased pensioners receive survivor benefits at designated/retirement age.

Contribution rules for the general scheme are based on the relationship of the wage earned by the employee below the “social security ceiling”. Contributions are paid to the government scheme both by employers and employees up to the social security ceiling. This means that some consideration is provided by, or on behalf of, members.

The scheme also encompasses the provision of a minimum old-age benefit “minimum vieillesse” provided as a safety to the elderly who qualify. This benefit is not conditional on contributions having been made in the past. It is a pure, non contributory, social benefit ensuring a minimal revenue.

The general scheme has characteristics of a multi-employer contribution based pension scheme, under the supervision of government. However, employers themselves have no pension liability. They are relieved from this liability when they pay their contribution to the collective system and the government honors payment of pension benefits.

Complementary schemes

Membership of a complementary scheme is compulsory for all private sector wage earners.

The pension formulae in complementary schemes is also based on contributions during the individual’s working lifetime which are converted into entitlements (points). Contributions to these schemes are paid both by employees and employers. The complementary schemes represent something like 25% of pension benefits. Complementary schemes allow for greater benefits than the general scheme (e.g. three times the social security ceiling for manual workers). A retiree may receive pensions from a number of schemes.

The complementary schemes are administered by unions and management and not by the government/public sector. They are private legal arrangements. The government does not control the complementary schemes and does not direct their operating or financial policies. In addition, their budgets are separate from the state budget. However, deficits in the social security and private schemes are met by government and are included as part of the governments deficit in the national accounts and they are included within government under the EU stability pact. “...although social security and complementary schemes are not financed out of the general state budget and are not state-run, their pensions are considered as public pensions”.

Public Sector Employees and Self Employed

Public sector employees and the self employed are covered by “other defined benefit schemes” outside the general scheme. Most of these schemes also receive subsidies from the state.

Public sector employees are covered by schemes in which contributions are made based on the employees wage and the pension is determined by reference to the last wage, the number of years of contribution and an annuity factor. The number of years of contribution for full entitlement is around 40-42 years. These schemes are closer to the employee pension arrangements covered by IAS 19 “Employee Benefits”. Reforms being implemented in 2006 will draw the public sector employee in 2006 closer to the general scheme.

The United Kingdom System

The UK's pension arrangements involve both private and public schemes, with probably greater dependence on private schemes than in France and many other Western European countries.

The low level of benefits paid under the basic public scheme in the UK means that for many individuals, pensions provision is often supplemented by a variety of further means-tested benefits such as incapacity benefit and income support. Some of these additional benefits are also contributory.

The basic state pension provides flat rate benefits. Contributions known as National Insurance Contributions are payable by both individuals and employers on the basis of a formula dependent upon weekly earnings. Whilst the pension payable is not related to the level of contributions paid over a working life, there is a linkage between the period over which National Insurance Contributions have been made and pension entitlement. Therefore, in principle, receipt of the full state pension is dependent upon building up a sufficient record of contributions across a working lifetime. There is a decrease from the standard level of pension entitlement if an insufficient period of contributions has been recorded, although credits are available where time out of work is attributable to illness, disability or unemployment.

Historically, the retirement age for women has been 60 years and for men 65 years. This is gradually being equalized, however, so that by 2020 both men and women will have the same retirement age. There have also been suggestions that the retirement age should be raised to 70 years.

The UK introduced a full state administered and backed earnings-related pension scheme in 1975 - this is the State Earnings Related Pension Scheme, (SERPS). SERPS is a defined benefit type scheme. Initially, SERPS promised 25 percent of earnings over the best 20 years of an individual's working life. This was later reduced to 20 percent of earnings over a working life. Entitlements under SERPS were based on contribution and earnings. SERPS has recently been replaced by private sector provided "Stakeholder" schemes, where the state gives tax and other incentives for lower paid individuals to enter into a private-sector pension plan - the plan is provided and administered by a private sector pension fund and the risk remains with the individual plans rather than the state. From 2002, no further pension rights have been accrued under SERPs.

The Canadian System

In Canada the public pensions comprise two components – the Old Age Security (OAS) and the Canadian Pension Plan (CPP).

The OAS is a universal benefit scheme that is available to all Canadian citizens who meet certain residence requirements. It provides a basic cover being a modest monthly pension to those who are 65 and over. These benefits are paid from general tax revenues. Additional benefits in the form of income supplements may also be provided to those low-income citizens receiving OAS (Guaranteed Income Supplement). Also, there is an allowance available to low

income citizens between the ages of 60 and 64.) The OAS benefit is taxable. Net income over a threshold (\$59,790 adjusted for inflation on an annual basis) is repaid at 15% of the difference.

The amount of OAS received depends on the number of years lived in Canada after the age of 18. Generally, a person receives the full amount if they lived in Canada for at least 40 years after 18 years. There is also a minimum residence criteria for current Canadian residents of 65 years old and a resident of Canada for at least 10 years after their 18th birthday. To receive the basic OAS benefit outside Canada, one must have lived in Canada for at least 20 years after their 18th birthday.

The CPP is the second level of the system. It provides a monthly retirement pension as early as 60 for those who have worked and contributed to the scheme. It also provides disability benefits and survivor benefits.

Contributions are based on earnings between \$3,500 and \$40,500 – this is adjusted each January. CPP contributions are tax-deductible. The CPP also offers disability, survivor and death benefits. The Canada Revenue Agency collects contributions on behalf of the CPP. CPP funds are kept separate from general tax revenues. They are used only to pay benefits, cover administrative costs and make investments. Generally, all workers in Canada over the age of 18 pay into the CPP and qualify for benefits.

The CPP is in the nature of a defined benefit scheme designed to replace about 25 percent of the earnings on which contributions are paid into the CPP. The amount of the pension depends on the amount of contributions (and the period of contributions). For example, early payment of benefits will be permanently reduced by 0.5 percent for each month under 65. Later payments are increased by 0.5 percent for each month that over 65, up to the age of 70. CPP payments are adjusted for inflation. CPP benefits are taxable.

These public pensions are not intended to meet all financial needs in retirement. Rather, they provide a modest base to build upon additional, private savings. Therefore, the third level of the retirement income system consists of private pensions and savings. There are private employer pension plans and Registered Retirement Savings Plans (RRSPs). The Government of Canada provides tax assistance on savings in Registered Pension Plans (RPPs) and RRSPs.

The Swedish System

(This summary is drawn from a paper by Francois Lequiller issued in December 2004).

The Swedish system provides “distress” benefits to citizens in need. The pension scheme was reformed in the 90’s. As a result two new compulsory public defined contributions schemes were created out of the old public defined benefits pension scheme:

- (1) a new *funded* system, called “Premium Pension” financed through a contribution of 2.5% of earnings; and
- (2) a new *unfunded* system called “Inkomstpension”, financed by a contribution of 16% of earnings.

Entitlements under the “Premium Pension” scheme accrue with membership and contribution: contributions made by, or on behalf of, members are directly related to the pension benefits to be received in the future. This scheme is funded and pensions are based on earnings of the scheme.

The Inkomstpension is a “notional” defined contribution scheme - individual benefits are calculated based on the cumulated individual contributions, plus earnings thereon. While a defined contribution scheme, it is a substantially unfunded “pay-as-you-go” system (there is a reserve, equal to 10% of the pension liabilities). Participation in the Inkomstpension is compulsory for all economically active residents in Sweden.

Each year, the individual contributors are provided with a statement that identifies their entitlement and the increments thereto over the year. The increments comprise the contributions paid during the year (16% of income/salary – the flat contribution rate), plus an inheritance gain (share of account balances of persons in the same age group who have died during the year), plus an “indexation” to reflect the return on capital in a savings scheme, less the charge for administration costs.

A balance sheet is prepared for the Inkomstpension each year. The pension liability is determined as the sum of the closing individual balances. The balance sheet also includes an asset - the “contribution asset” - which is equal to the liability. Calculation of this contribution asset is complex but reflects a value for future contributions – it is a notional asset.¹ Each year, a “balance ratio” (Assets/Liabilities) is calculated. If this ratio is less than 1 (i.e. assets are less than liabilities), there is an automatic adjustment of the indexation part of the pension entitlement in order to lower the change in liabilities. This ensures that the contribution asset matches the value which finances the liability. Promised benefits decrease if economic trends show that the system could not sustain them.

¹ Its value is calculated by multiplying current contributions by the average duration of the contributions of the insured (based on demographics, and weighted by pension credits of each cohort).

Staff Views

Based on input to date, staff are of the view that government pension arrangements across a number of jurisdictions can usefully be grouped under three broad categories to reflect differences in the transactions and events that might be identified as giving rise to a present obligation:

1. Pensions that are provided for little or no consideration in return. These are the social assistance/safety net type arrangements that are present to some degree in many jurisdictions. They provide a minimum social benefit subject to satisfaction of certain eligibility criteria, such as minimum residency or minimum membership periods. While some contributions may be made, the relationship between contributions made and benefits received is not strong. These pension arrangements fall within the broad scope of social benefits as explained in IAS 19. In some jurisdictions, they may be a component of a global arrangement.
2. Pensions provided as a consequence of membership of, and contributions made to, a global pension scheme managed, controlled or administered by the government, which provides pensions to the community as a whole or large sections of the community, other than a specific scheme which provides benefits to public sector employees as consideration for services provided as an employee. These arrangements may encompass the provision of a “distress” pension. There is some relationship between contributions paid over the period of benefit and the ultimate pension entitlement. These pension arrangements may also arise as a consequence of the social policies of government and provide social benefits – though in some respects they may have the character of an exchange transaction.
3. Specific employee plans established for government employees in which the entitlement to benefits are provided in consideration of the employee services provided and/or contribution made. These may be defined benefit or defined contribution plans. Under these arrangements, consistent with the terms of the pension arrangement, the employer (a government or government agency) has a present obligation to make agreed contributions to the plan and/or to provide the agreed benefits to plan members whether current or former employees. It is arguable whether these would be encompassed under social benefits as described by IPSAS 19 “Provisions, Contingent Liabilities and Contingent Assets”. Rather these types of arrangements are reflective of private sector arrangements in place in some/many jurisdictions for provision of pension benefits to employees of private sector entities. They have the characteristics of employee plans that are dealt with in IAS 19 and are also excluded from IPSAS 19.

The second category of arrangements encompass the global type pension plans that were the primary focus of discussion at the November 2004 meeting. They appear in different forms and with differing degrees of importance in the pension mix in different jurisdictions. Membership of such schemes may be compulsory or voluntary, but all require a contribution to be paid. In all jurisdictions, there is a relationship between the ultimate pension benefit entitlement and the contributions paid or deemed to be paid. In some jurisdictions, the relationship between

contributions made over the period of membership and the ultimate pension entitlement has features of an exchange relationship. In other jurisdictions, the relationship between contributions and benefits is not as strong/clear.

In some jurisdictions they provide benefits to employees in the private sector, and receive contributions from employers in the private sector. As such, they possess some features similar to multi-employer plans as encompassed in IAS 19. However, there do appear to be some significant differences to be considered if this project develops for example:

- The government is not, or need not be, the employer.
- The government, rather than the private sector employer, has the obligation to provide the pension benefits to the employees of private sector entities who are members of the scheme. The employers do not have an obligation in respect of pension benefits, once those contributions have been paid.
- The pension scheme or plan may encompass pension benefits to be provided in respect of contributions paid and benefits provided as a safety net when “distress” criteria are met.
- Notwithstanding that contributions are made with expectations of a final benefit, those benefits may change as a consequence of changes in government legislation.

In addition to the three categories identified above, governments may also accept the obligation (or provide a guarantee) to make good any short falls in the pension benefits of the members of particular arrangements. These arrangements reflect government policy decisions to support the provision of pension benefits to the community or section therefore.

Moving Forward

Staff are of the view that there is merit in splitting the project into two components at this stage:

- One component to deal with social benefits as explained in IPSAS 19, except for pensions.
- One component to deal with pensions that arise as a consequence of the social policies of government. That is category 1 and 2 pension arrangements above. The nature of this project will be further developed consequent on discussion at this meeting

In respect of dealing with the pension and other components in separate exposure drafts, members will recall that the majority of respondents to the ITC (31) supported the development of a single exposure draft (ED) to encompass old age pensions and other social policy obligations, noting it was important to apply the same principles to the recognition and measurements of all social policy obligations. There was also, a significant minority (9) who supported the development of separate IPSASs for old age pensions and for other social benefits. Some did so on pragmatic grounds because the issues involved in dealing with old age pensions were more complex and the amounts were of far greater significance in some jurisdictions than others. In other cases, respondents expressed the view that the issues to be considered in respect of pensions were different from other social policies. A number of respondents who advocated that separate EDs be prepared, also noted that the same principles should be reflected in each ED.

The majority of respondents (35) also supported the exclusion of employee pension plans from the scope of the project primarily on the grounds that that such benefits/plans relate to the government's role as an employer.

At the November 2004 meetin, it was noted that constituent expectations were that the IPSASB project would encompass the development of guidance on accounting for a broad range of social benefit pension arrangements in the public sector, and consequently the project may be broadened beyond those pensions encompassed by the ITC. In that context, staff are of the view that splitting the project into two components at this stage can be justified, notwithstanding the responses received on the ITC. This approach provides the opportunity for progress to be made on a range of social benefits in the short term, while the pension issue is further developed.

In moving forward to deal with social benefit pensions identified in categories 1 and 2 above, staff are of the view that the views of the Steering Committee (SC) in the ITC in respect of the recognition of any liabilities arising from category I type pensions above, and the adequacy of current disclosure requirements in IPSASs to deal with social benefits remain relevant. Similarly, the SC views on approaches to the measurement of any pension liabilities that might accrue over time are also relevant to category 2 type pensions above. Those views are attached as Figure 2.

ATTACHMENT – EXTRACTS FROM ITC “ACCOUNTING FOR SOCIAL POLICIES OF GOVERNMENT”

Chapter 8: Old Age Pensions

Legal Obligation

- 8.9 Where the rights of individuals to benefits, and the related eligibility criteria, are specified in legislation, the government has a legal obligation to individuals meeting the eligibility criteria. The exact nature of the legal obligation would depend on the terms of the relevant legislation....

Constructive Obligations – Option 1

Steering Committee View 5 – Old Age Pension Benefits

Steering Committee members do not have a unanimous view on this issue. The 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.

Option 3 (key participatory events: workforce entry) is supported by a minority of Steering Committee members.

Constructive Obligations – Option 1

- 8.12 Application of Option 1 to old age pension benefits would lead one 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, application of Option 1 may also lead to:
- (a) the recognition of liabilities where old age pension benefits are not specified in legislation; and
 - (b) where a jurisdiction requires infrequent validation of eligibility, to the recognition of an amount of pension benefits in excess of amounts due and payable – that is, benefits to be paid from the current point in time until the next validation period.

Constructive Obligations – Option 3

- 8.25 Option 3 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.
- 8.32 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, beginning to pay taxes or paying taxes for a specified number of years. At the other extreme, a proxy could be approaching or reaching pensionable age. Measurement of provisions for old age pension benefits using both workforce entry and pensionable age as proxies for the obligating event is discussed later in this Chapter.

Measurement Approaches for Accruing Pensions under Option 3

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 Approach A:** Under this 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 Approach B:** 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 at 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.

Chapter 9: Disclosures

Steering Committee 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.