HM Treasury

Financial Reporting Advisory Board

Review of IPSAS 42 Social Benefits

Issue:	Consideration of the new IPSASB standard IPSAS 42, Social Benefits in the context of UK public sector reporting.
Impact on guidance:	No impact proposed.
IAS/IFRS adaptation?	No adaptations or interpretations proposed.
Impact on WGA?	None.
IPSAS compliant?	The current accounting treatment for social benefits in the UK public sector is considered to be substantially compliant with IPSAS 42.
Interpretation for the public-sector context?	No adaptations or interpretations proposed.
Impact on budgetary regime and Estimates?	None.
Alignment with National Accounts	No impact on the National Accounts. Current treatment aligns.
Recommendation:	For the Board to note, HM Treasury proposes to make no adaptations or interpretations to the existing framework as a result of IPSAS 42.
Timing:	Ongoing.

DETAIL

Background

1. This paper provides the Board with a summary of the International Public Sector Accounting Standards Board (IPSASB) standard, IPSAS 42, Social Benefits issued in January 2019. The paper covers the background to the Standard and compares it to the existing accounting treatment for social benefits in the UK public sector. The paper is provided for the Board's information and comment.

2. The International Public Sector Accounting Standards (IPSAS) are a set of accounting standards issued by IPSASB for use by public sector entities in the preparation of financial statements. These standards are not applied in the UK but rather used as a reference point in considering potential adaptations and interpretations of International Financial Reporting Standards (IFRS) as applied in the public sector context.

3. IPSAS 42 was introduced in the context of the IPSASB's broader non-exchange expenses project. The purpose of which is to develop new or amended standards that provide recognition and measurement requirements applicable to providers of non-exchange transactions. It follows Exposure Draft 63 Social Benefits (ED 63) (October 2017), which addressed accounting for the delivery of social benefits, such as retirement, unemployment, and disability, aiming to improve consistency, transparency, and reporting by public sector entities of social benefit schemes. To clarify the boundary between social benefits and government-provided services, IPSASB defined social benefits as cash transfers as set out in IPSAS 42.

4. Non-exchange services are discussed separately in Exposure Draft 67, Collective and Individual Services and Emergency Relief, as an amendment to IPSAS 19, Provisions, Contingent Liabilities and Contingent Assets.

5. This paper is being presented to the Board to consider the potential implications of IPSAS 42 to public sector reporting in the UK, in the context of IFRS 17 implementation and as a result of a review of accounting for pensions during the audit of the Ministry of Defence.

UK Public Sector standard setting

6. The UK public sector applies UK-adopted IFRS, adapted and interpreted for the public sector context.

7. The Government Resources and Accounts Act 2000 (GRAA 2000) was introduced to underpin the transition to Resource Accounting and Budgeting. It is the legislation that requires the production of departmental accounts and Whole of Government Accounts and requires for them to be produced in accordance with directions from the Treasury.

8. The GRAA 2000 sets out the requirement that resource accounts should present a true and fair view and conform to generally accepted accounting practice (GAAP), amended as necessary in the context of departmental accounts.

9. The Memorandum of Understanding between the relevant authorities on developing financial reporting standards for the public sector (reviewed by the Board in 2019) is clear in the hierarchy of standard setting that the manuals and Codes shall be prepared using IFRS but where appropriate **may** refer to International Public Sector Accounting Standards.

Review of IPSAS 42

10. IPSAS 42, Social Benefits covers cash transfers paid to individuals and/or households in respect of benefits such as state pensions, unemployment benefits disability benefits, and income support. Social benefit cash transfers are those considered to be provided to mitigate the effect of social risks and address the needs of society.

11. The Standard specifically applies to cash transfers after concerns were raised in response to ED 63 that the boundary between social benefits and individual services needed to be clearly defined. However, this approach treats all cash-based social benefits as of the same economic substance, which may not be the case in practice, and does not distinguish between the types of social benefits in its treatment, except for where the alternative insurance approach is appropriate as discussed below.

12. Under the General Approach presented in IPSAS 42, a liability is recognised at the year end on the basis that, *the entity has a present obligation for an outflow of resources that results from a past event*. The past event is deemed to be *the satisfaction by the beneficiary of all eligibility criteria for the next benefit payment before or at the year end*. Each time an individual or household qualifies for a social benefit payment, this is considered as a separate past event.

13. This would result in the recognition of, usually, a short-term liability equal to the amount of the next expected benefit payment made after the year end, pro-rated if eligibility changes within the period before the next payment.

14. The alternative Insurance Approach is permitted to be used where the social benefit scheme is fully funded from dedicated contributions and there is evidence that the scheme is managed in the same way as an insurance contract.

15. Respondents to ED 63 questioned whether this two-option approach would compromise comparability between public sector entities, as well as comparability between two social benefit schemes of a single public sector entity in their responses to ED 63 but this approach was upheld for IPSAS 42.

16. According to IPSAS 42, being alive at the point at which the eligibility criteria are required to be satisfied may be an eligibility criterion. However, certain IPSASB members disagreed with this on the basis that per IPSAS 39 *Employee Benefits*, death probability is considered as part of the measurement criteria.

17. IPSAS 39 Employee Benefits and IPSAS 42 present a conceptually different treatment of the liabilities. While for social benefits a very short period is set for a liability, for Employee Benefits it typically is a period of 15 to 20 years. Accordingly, the balance sheet amounts for liabilities under IPSAS 39 and IPSAS 42 are not comparable with one another.

18. To address this concern, IPSAS 42 allows for a level of interpretation regarding whether being alive is a separate eligibility criterion or not, depending on the characteristics of each individual social benefit scheme.

19. Additionally, IPSAS 42 only addresses the outflows with respect to social benefits, and not the inflows. For social benefit schemes with contributory payments by members, these inflows represent a significant part of the financing of the scheme. As such, certain member states are currently deferring the introduction of IPSAS 42 until the project on Transfer Expenses has been completed so that both can be considered together. This project is currently in the Exposure Draft feedback review stage.

Accounting for social benefits in the UK public sector

20. In agreement with IPSAS, social benefits in the UK are also considered non-exchange transactions. However, less aligned to IPSAS 42, the full amount of the next benefit payment for which a recipient would be eligible is not accounted for as a liability on balance sheet. The current treatment for recognising a liability in relation to social benefits is to recognise an accrual for benefit payments due relating to the period before the year end.

21. Considering the state pension, for example, per the Whole of Government accounts, the government "does not include a liability for future state pension payments. This is because the payments are only recognised when they fall due, which is on an ongoing basis. Similarly, future payments for public services are also not recognised unless contractually committed." In practice, this means that only the expenditure for the period of entitlement that falls within the accounting year is recognised.

22. This treatment is mirrored in the National Accounts as social benefit expenditure is recognised in the period in which the benefit falls due.

23. FRAB discussed the accounting treatment of social benefits over a number of years, agreeing to the continuation of the current treatment until the IPSASB standard was available to review.

24. In 2001-02, FRAB accepted the view that benefits should be accounted for in the year in which amounts to be paid fall due following proper approval of a claim. It was agreed that it would be inappropriate to recognise any longer-term liability for such expenditure because they were analogous to executory contracts in FRS 12: Provisions, Contingent Liabilities and Contingent Assets. See Annex A for a timeline of FRAB discussion regarding accounting for social benefits.

25. Under UK-adopted IFRS, social benefits are recognised in the year in which the recipient is eligible for the benefit, with an accrual raised for any amounts not yet paid at the year end. This is on the basis that fulfilling the eligibility criteria is a past event that creates a present obligation to individuals and/or households. Conceptually, this is the same basis for recognition as IPSAS 42.

26. However, in practice there may be a difference in the amount that would be recognised. Under IPSAS 42 the obligating event is when an individual or a household meets the eligibility criteria for the provision of the next social benefit payment. As such, the next social benefit payment would be recognised in full, unless eligibility changes before the payment is made.

Issues raised by IPSAS 42 for UK public-sector accounting.

27. IPSAS 42 raises the argument that at the year end, a government has a present obligation to pay the next social benefit payments to the recipients that are eligible for the period between payments, even if this spans the year end. The current treatment in the UK public sector considers that eligibility can change and therefore at the year end, it is not known whether there is a present obligation to pay social benefits to recipients relating to the period following the year end and up to the next benefit payment.

28. Taking the UK State Pension as an illustrative example, social security benefits are payable if the claimant meets the entitlement conditions. Section 2(1) of the Pensions Act 2014 sets out the entitlement conditions for new State Pension, namely that if the claimant has reached State Pension age and has made 35 years of National Insurance Contributions, they will receive the full rate of new State Pension.

29. Furthermore, Section 1(2) of the Social Security Administration Act 1992 states that no-one is entitled to any benefit unless they make a claim for it. Therefore, in order to receive the full rate of new state pension, a claim must be made by the individual in addition to meeting the entitlement conditions above.

30. The eligibility criteria for Universal Credit (UC) is set in both primary and secondary legislation. For example, one of the conditions of entitlement to UC is that a person is not in education and the requirements of this are set out in secondary legislation. This definition in secondary legislation can be changed by further secondary legislation.

31. As a result of the current legislation, such as that pertaining to State Pension, the government may be 'obliged' to make payments in the future, but it may also be the case that government can avoid making the payments and fulfilling the obligation, if eligibility were to change due to a change in circumstance of the recipient or due to a change in the eligibility criteria.

32. 'Being alive', for example, can be considered an eligibility criterion under IPSAS 42, which provides the following examples pertaining to the consideration of 'being alive' as a criterion:

a) *An unemployment benefit may only be payable to those who have become unemployed and are available for work (which implicitly includes being alive).*

b) *Being alive may not be an eligibility criterion for the recipient of the social benefit. A child benefit may be paid to the parents or guardian of the child; the payment of the benefit may be dependent on the child being alive, and not on the status of the parent or guardian.*

c) *Benefits may be transferred to a survivor following the death of the beneficiary.*

33. Under the current accounting policy for UK social benefits, when assessing the recognition of a social benefit liability it cannot be certain that a specific individual who meets the eligibility criteria at the reporting date will be alive and, by implication, eligible for the entire period between benefit payments and therefore a 'present' obligation can only be considered up to the year end.

34. Additionally, considering point c) above, the transfer of benefits to a survivor following the death of the beneficiary is subject to another claim by recipients, which cannot be pre-empted. In respect of the example in point (b), being alive remains a criterion, it just so happens not to be a criterion in respect of the recipient.

35. The application of the General Approach under IPSAS 42 would most often lead to a small proportion of future outflows being recognised in the balance sheet. When payments of benefits are scheduled every month, including 'being alive' as one of the eligibility criteria to receive the next benefit will lead to only a one-month social benefit liability being recognised in the balance sheet. This would have very little predictive value.

36. The current accounting treatment in the UK for social benefits is conceptually the same as IPSAS 42, with the main potential divergence being a small timing difference in recognition. This represents the difference between recognising the full amount of the next benefit payment payable after the year end, and the amount of entitlement for the period up to year end that has not yet been paid (but not beyond).

37. The recognition of this additional provision amount would not offer added benefit for the users of UK government accounts. The current treatment is also aligned to the National Accounts and so this change would result in less relevant and aligned data.

38. Furthermore, there would be an additional cost involved in calculating the new accrual on the basis presented in IPSAS 42, with little, if any, additional benefit for the user of the accounts.

39. The Insurance Approach presented in IPSAS 42 does not appear to be relevant to accounting for social benefits in the UK. UK social benefits are not fully funded from a dedicated revenue stream as National Insurance contributions are classified as a tax and only indirectly linked to the provision of social benefits. Furthermore, benefit amounts are determined by Parliament and are not decided on a 'commercial' basis. This view was endorsed by the Association of Accounting Technicians in response to ED 63.

Question: Does FRAB agree that the issuance of IPSAS 42 does not merit any change to the accounting treatment of social benefits in the UK public sector?

Annex A

Timeline of FRAB discussion of social benefits

Taken from the FRAB Annual Reports

The Fifth Report 2001-2

- Decision to account for non-pension and pension benefits in the year in which they fall due:

  Board has agreed that ***non-pension benefits should be accounted for in the year that they fall due with no provision for future expenditure****, and that pending the development of an International Public Sector Accounting Standard on social policy obligations by the International Federation of Accountants, the working assumption should be that* ***future state pension expenditure should not be provided for either.***

- On non-pension benefits:

  The Board accepted the Treasury view that non-pension benefits should be accounted for in the year in which amounts fall due to be paid following proper approval of a claim. It agreed that it would be inappropriate to recognise any longer-term liability for such expenditure because they were analogous to executory contracts in FRS 12: Provisions, Contingent Liabilities and Contingent Assets.

- On pension benefits:

  Determining the correct accounting treatment for the basic state pension is more complex, and the Board concluded that there appears to be no clear-cut case under UK GAAP for making a provision. Other countries have found similar difficulties and the International Federation of Accountants' Public Sector Committee has set up a Steering Committee to develop an International Public Sector Accounting Standard on 'social policy obligations'. The Treasury is represented on that Committee and will invite the Board to comment on the Committee's proposals as they develop. The Board agreed that a decision on the accounting treatment of the basic state pension should be reached in time for the first set of published central government accounts. In the interim, the Board agreed that the working assumption should be that expenditure on the basic state pension should be recognised in the year in which the amounts fall due.

The Sixth Report 2002-3

- Initial findings of the International Federation of Accounts (IFAC) Steering Committee:

  The initial findings of the Steering Committee set up by the International Federation of Accountants' Public Sector Committee to develop an International Public Sector Accounting Standard on Accounting for Social Policies of Government coincided with those of the Board … i.e. that in general social security expenditure (excluding the state old age pension) does not give rise to a liability, but the treatment of the state old age pension would require further consideration. The International Federation of Accountants' Public Sector Committee will consider the draft invitation to comment in April and it is hoped that it will be issued shortly thereafter. As previously agreed, the accounting for the UK's state pension will be reconsidered by the Board in the light of the comments made on the invitation to comment and the eventual exposure draft, which is likely to emerge during the *second half of 2004. The Board looks forward to being informed of the progress of this project.*

The Seventh Report 2003-4

- On accounting for the social policies of governments:

  In its sixth report, the Board noted that the IFAC PSC Steering Committee's initial findings coincided with those of the Board in that, in general, social security expenditure (excluding the state old age pension) does not give rise to a liability, but the treatment of the old age pension would require further consideration. The Steering Committee's views as expressed in the Invitation to Comment are unanimous on the accounting treatment of collective and individual goods and services: no liability arises prior to the provision of the goods or services. The Steering Committee was also unanimous in its view that no liability exists in respect of social security benefits (other than the old age pension) until such time as the recipient has demonstrated complete satisfaction of all eligibility criteria.

  The Steering Committee was not unanimous in its views on the accounting treatment of the old age pension. The majority view expressed in the Invitation to Comment is that the old age pension is no different from other social security benefits and that no liability arises until such time as the beneficiary has demonstrated complete satisfaction of all eligibility criteria –including remaining alive. The minority view is that, as soon as people enter the workforce, they start making economic decisions based on the expectation that they will receive an old age pension in the future and that the liability builds up over the working life of the potential beneficiary.

The Eighth Report 2004-5

- IPSASB Invitation to Comment 2004:

  On accounting for the social policies of government, the Board noted that the conclusions in the IPSASB's Invitation to Comment broadly mirrored the Board's own discussions and conclusions on accounting for social security benefits, including the state old age pension (as set out in the Board's sixth report). The Board supported the view set out in the Invitation to Comment that cash transfers to individuals should be accounted for as and when those individuals have satisfied all the eligibility criteria.

The Ninth Report 2005-6

- The Deputy Chair of IPSASB attended FRAB:

  The difficulties in obtaining a consensus of views about accounting for pensions has led IPSASB to conclude that the next stage in the project is to work on three Exposure Drafts: one on accounting for employee benefits (based on IAS19 Employee benefits); a second on non-age related benefits; and the third on old age pensions.

  The Board looks forward to considering the Exposure Drafts on these topics in due course and to discussing with the Treasury the possible implications for accounting by the central government sector.

The Tenth Report 2006-7

- Awaiting guidance on social benefits from IPSASB:

In October 2006, IPSASB published an Exposure Draft on accounting for Employee Benefits. It is expected that the proposed standard, when finalised, will become effective five years after issuance, although earlier adoption is likely to be encouraged.

In further stages to its project work on pensions, IPSASB is expected to issue Exposure Drafts on non-age related benefits, and on old age pensions. The Board looks forward to considering the Exposure Drafts in due course and to discussing with the Treasury the possible implications for accounting by the central government sector.

The Twelfth Report 2008-9

- Response to Exposure Draft 34 Social Benefits: Disclosure of Cash Transfers to Individuals or Households published by IPSASB:

  Q: *Do you think that a present obligation to individuals or households in respect of cash transfers arises when all eligibility criteria have been satisfied for:*

  a) Non-contributory programs; and/or b) Contributory programs?

  A: *The Board views that an obligating event does not occur for non-contributory or contributory programs before the relevant threshold eligibility criteria are met, e.g. there is no obligating event for the payment of an old age pension until all eligibility criteria have been met, including the survival of the beneficiary to the required age for the pension to be paid.*

  Q: *Where a cash transfer program requires individuals or households to revalidate their entitlement to benefits, do you think that* ***revalidation is an attribute that should be taken into account in the measurement of the liability or a recognition criterion****? Please state your reasons.*

  A: *The Board considers that the revalidation of entitlement to benefits to be a recognition criterion, as a* ***present obligation cannot exceed the maximum amount that an individual is entitled to receive from one revalidation point to another****. The revalidation is further viewed as an implicit eligibility criterion in that the continued survival of a beneficiary is necessary for the continued entitlement of cash transfers, e.g. the continuation of a pension may be subject to the satisfactory completion of a life certificate to ensure cash transfers continue until the next revalidation point*