# The conceptual underpinnings of recent advances in international public sector accounting standards: Developing a standard for social benefits

## Abstract

We investigate the conceptual underpinnings of the developing social benefits standard from the consultation paper in 2015 to the exposure draft ED63 in 2017. The purpose of the paper is to assess the conceptual foundations in the IPSASB framework and the links with other financial reporting regimes (International Financial Reporting Standards (IFRS) and National Accounts or Government Financial Statistics (GFS) on the development of international public sector accounting standards (IPSAS). We use documentary analysis of IPSASB papers together with a content study of comment letters on the Consultation Paper. Latent content analysis is deepened by detailed exposition of accounting issues using extracts from the IPSASB documents and comment letters. The 2015 Consultation Paper put forward propositions in apparent accordance with the IPSASB framework and GFS, but respondents to the consultation paper were unconvinced of some arguments of adherence to the framework and were unsure how social benefits could be classified on the basis of obligations and largely felt an insurance approach was inappropriate. The alignment with GFS also proved unsatisfactory and is reduced in ED63. This study raises concerns regarding the coherence of the IPSASB framework as a conceptual underpinning for public sector accounting standards and questions the alignment of public sector accounting to other regimes with different users and objectives.

**Keywords:** IPSAS, conceptual framework, social benefits, government obligations.

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## 1. Introduction

This paper examines the development of a new standard since the publication of the International Public Sector Accounting Standards Board (IPSASB) Conceptual Framework in 2014, the standard on accounting for social benefits. The provision of social benefits often forms a major objective of governments and expenditure on social benefits is usually a substantial and growing part of public spending. We investigate public sector specific issues in the IPSASB framework and the links with other financial reporting regimes (International Financial Reporting Standards (IFRS) and National Accounts or Government Financial Statistics (GFS) on the development of the social benefits standard from the consultation paper in 2015 to the exposure draft ED63 in 2017. Using a latent content analysis of the comment letters, we analyse the issues raised to assess whether the developing standard for social benefits is supported by appropriate conceptual underpinnings.

Several studies have investigated standard setting for the business sector and its conceptual underpinnings (Dopuch and Sunder 1980; Gaa 1988; Page and Spira 1999; Whittington 2008; Brouwer et al. 2015; Pegler 2016), but there has been little investigation of public sector standard setting (Himick et al., 2016; Himick and Brivot, 2018). Most studies have concentrated on the adoption of accrual accounting and accounting standards (e.g., Guthrie, 1998; Ellwood 2008).

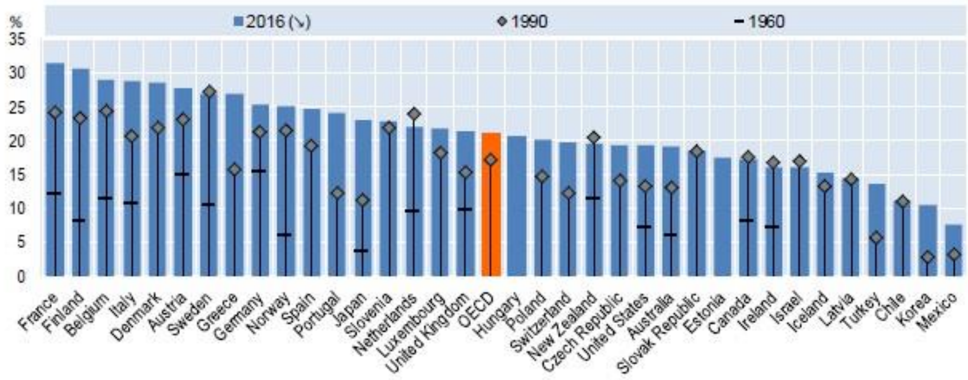
While there seems to be general agreement that governments should adopt accrual accounting supported by appropriate accounting standards (Ernst & Young 2012), there has been a long-running debate over whether one set of standards (the IASB's) should be applied to businesses and governments alike, or whether separate standards should be promulgated for each sector (Ellwood and Newbury 2006). This has resulted in mixed practices and an unclear role for standard bodies. Currently, there is debate as to whether the European Union should develop and apply European Public Sector Accounting Standards (Calmel 2014, Mussari 2014, Heald and Hodges 2015).

Social benefits are an important area of public spending. In recent years, public social spending in OECD countries has averaged around 21% of GDP (see Figure 1); the UK spends slightly above this average; pensions and health are the main spending areas (OECD, 2016). Public social spending-to-GDP ratios are highest at just over 30% in France and Finland, but eight other EU countries (Austria, Belgium, Denmark, Germany, Greece, Italy, Norway and Sweden) also spend over 25% of their economic resources on public social expenditure (OECD, 2016). Both the IFRS and the IPSAS contain currently no standards on accounting for social benefits. The omission of social benefits from current IPSAS 'was viewed as a major drawback as most of public expenses concern social benefits' (Ernst & Young, 2012, p. 156).

The fact that the first attempt to draft a standard to account for social benefits was "put on hold after 6 years pending completion of [the] conceptual framework" (IPSASB, 2017b) shows the importance of social benefits accounting to the coherence of the IPSASB conceptual framework. Social benefits are a fundamental area of government spending and have specific characteristics not found in commercial accounting.

**Figure 1. Public social spending is worth 21% of GDP on average across the OECD**

Public social expenditure as a percent of GDP, 1960, 1990 and 2016




*Source: OECD Social Expenditure Update 2016*

The purpose of the paper is thus to gain an understanding of the conceptual underpinning of IPSAS through the development of the accounting standard for social benefits. In particular, we examine legitimacy and consistency issues that arise in relation to the conceptual underpinnings of developing an accounting standard for social benefits.

The legitimacy of standard setters such as the IASB and the IPSASB has long been questioned and there is currently much debate about whether European governments can cede public sector accounting to an independent body. Literature has argued that the development of conceptual frameworks is one way to gain political legitimacy (e.g., Hines, 1989; Zhang and Andrew, 2014). Following the publication of the IPSASB conceptual framework, Ellwood and Newberry (2016, p. 233) argued that 'how the conceptual framework affects standards in the future will indicate whether the framework is functioning as a conceptual underpinning or is more cosmetic.' While conceptual frameworks may give political legitimacy, literature has also suggested that constituents may use conceptual frameworks, and the objectives identified therein, to foster their own interests by building their positions around the concepts of the framework (Botzem 2012). It is in this context that we examine the theoretical underpinnings provided by the IPSASB framework for the development of an accounting standard for social benefits and the use of conceptual arguments by constituents. How IPSASB formulates standards; how it meets its users' needs and the adherence to the conceptual framework is therefore important to inform the debate.

The paper is structured as follows: in section two we consider the development of public sector accounting: in particular the IPSASB conceptual framework and the alignment to other reporting regimes IFRS and GFS; this is followed by a section on our research methodology. Section four summarises the consultation paper on social benefits, presents our analysis of the comment letters and the proposed standard, ED63. The final section discusses the main findings, identifies further research and draws conclusions.

## 2. Development of public sector accounting and the IPSASB conceptual framework

### 2.1 Purpose of conceptual frameworks

Conceptual frameworks are designed to provide the conceptual underpinning of accounting. For instance, the Financial Accounting Standards Board (FASB, 1978, p. 2) defines a conceptual framework for accounting as:

> 'A constitution, a coherent system of interrelated objectives and fundamentals that can lead to consistent standards and that prescribes the nature, function and limits of financial accounting and financial statements.'

The Governmental Accounting Standard Board (GASB, 2007, p. i) has a similar definition that sees the framework as providing 'the GASB with the basic conceptual foundation for considering the merits of alternative approaches'. Such theoretical frameworks are not derived through scientific understanding but seek to impose a logic to financial reporting (Dean and Clarke, 2003). The IPSASB sees its conceptual framework as establishing 'the concepts that underpin financial reporting by public sector entities that adopt the accrual basis of accounting' (IPSASB, 2014, p. 9). In a similar vein to other standard setters, the IPSASB see their conceptual framework as providing a common frame of reference for developing new standards and for preparers and others in dealing with financial reporting issues (IPSASB, 2014, p.11).

### 2.2 Cash and Accruals Accounting

The private sector and parts of the public sector have long accepted the need for accruals information for economic decision-making. Accruals based information is seen as an The IASB sees accruals information as an imperative assumption for periodic profit reporting, its conceptual framework (2018) explains that in a commercial context it provides - 'a better basis for assessing the entity's past and future performance than information solely about cash receipts and payments during that period.' (para 1.17).

In contrast to organisations rooted in the private sector, sovereign governments have a tradition of cash accounting. As Eulner and Waldbauer (2018, p. 3) put it, this is 'undoubtedly a useful tool for keeping track of, and reporting on, how well a public sector entity is able to match its expenditure with incoming cash over a given period.' Cash accounting is simple, easy to operate, objective and provides useful information for monitoring fiscal factors and borrowing requirements. Nevertheless, it has fundamental deficiencies: cash accounting provides no measure of the "true" cost of operating for the period and no measure of the worth of an organisation. The general benefits of recognising capital assets and applying the accruals basis were well summarised by Evans (1995): better measurement of costs and revenues including comparisons between years; greater focus on outputs rather than inputs; more efficient and effective use of resources e.g. through charges for fixed assets; enabling the full cost of providing a service to be compared with outside suppliers; a better indication of the sustainability of Government policy; improved accountability; better financial management; and greater comparability of management performance results.

While many of the benefits of accrual based information depend on the form of accruals accounting adopted, accrual accounting can be considered to provide a more comprehensive overview of governments' situations (Eulner and Waldbauer, 2018). The more comprehensive picture of social benefits that results from accruals accounting could be particularly needed at times such as the present where aging populations lead to growing social obligations that have to be financed in the future through taxing a shrinking number of citizens . Over recent decades, New Public Management (NPM) reforms increased the use of accruals based accounting and moved public sector accounting closer to business accounting, but there is still a lack of consensus about the appropriate form of accrual accounting for the public sector.

2.3 Differences between sectors

Some writers have identified the differences between the private and public sectors and argued that these differences require a distinct approach to accounting (Barton 1999 and 2011; Newberry 2001; Ellwood and Newberry, 2006; Biondi, 2012). Christaens and Rommel (2008) make a strong case for only using accruals-based commercial accounting for government business entities.

Writers promoting the introduction of accruals-based information using private sector frameworks (McGregor, 1999; Likierman, 1998) argued that both sectors have similar transactions such as paying staff and buying goods and services and can avoid 'reinventing the wheel' by using established General Accepted Accounting Practice (GAAP). There is also a fervent belief in the strength of the private sector approach and lobbying by accounting firms for its adoption. Christensen (2005, p. 447) argued that, in an Australian context, accounting consultants had 'a zealous belief that bringing public sector accounting into line with private sector accounting was an inherently righteous objective.' Heald (2003) regarded the introduction of standards from the "independent" IASB as limiting previous abuses and manipulations such as accounting for the Private Finance Initiative (PFI), where huge liabilities were previously kept off UK public sector balance sheets.

By contrast, the GASB White Papers 2006 and 2013 identified the main environmental differences between accounting for organisations in the private sector and public sector entities as: organisational purposes (citizen well-being rather than return on investment); sources of revenue (taxation rather than voluntary exchange transactions); and the potential for longevity and intergenerational effects. The GASB also identified a differing relationship with stakeholders and highlighted the important role of the budget in the public sector. The GASB document went on to explain how these differences relate to standards, such as the impairment of capital assets related to service potential, and pensions based on actuarial value rather than fair value.

In a similar vein, the preface to the IPSASB conceptual framework (IPSASB, 2014) sets out unique characteristics of importance in public sector reporting including: the volume and importance of non-exchange transactions; the importance of the approved budget; the nature of public sector programs and the longevity of the public sector; the nature and purposes of assets and liabilities in the public sector; the regulatory role of public sector entities; and the relationship to statistical reporting. Nevertheless, the IPSASB has produced IPSASs with minimal change from IFRS and has issued many IPSASs before publishing its conceptual framework.

## 2.4 The IPSASB Conceptual Framework

*Objectives and users*

The IASB conceptual framework has since 2010 identified the single objective of financial reporting as serving the business financier in capital markets (IASB, 2010). The decision to drop stewardship as an explicit objective, which was especially pushed by members of the FASB, followed the standard-setters' view that it could be subsumed within the concept of decision-usefulness (Pelger, 2016). Following an exposure draft in 2015 (IASB, 2015), the IASB's most recent conceptual framework (IASB, 2018) aligns stewardship with the main objective, but its focus on providing decision-useful information for investors and the capital market remains:

> 'The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity. Those decisions involve decisions about:
> (a) Buying, selling or holding equity and debt instruments;
> (b) Providing or settling loans and other forms of credit; or
> (c) Exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.' (para. 1.2).
>
> 'The decisions…depend on…assessment of management's stewardship of the entity's economic resources.' (para. 1.3).

Authors have criticised the focus of commercial accounting standards on decision-usefulness at the expense of stewardship (Williams and Ravenscroft, 2015). The IPSASB distanced itself from the IASB's conceptual framework, by identifying both accountability and decision-usefulness as objectives of public sector financial reporting in its conceptual framework (IPSASB 2014: para 2.1). As such, the IPSASB conceptual framework acknowledges the differences between sectors and recognises markedly different objectives in its conceptual framework.

The primary users are identified as '*service users and their representatives and resources providers and their representatives'* (para. 2.4 to 2.6). The IPSASB further explains that the legislature (or similar body) and members of parliament (or a similar representative body) are also considered to be primary users of general purpose financial reports (GPFRs), since they make extensive and ongoing use of GPFRs. Thus the IPSASB framework acknowledges the traditional democratic accountability role (Drebin et al. 1981, Ellwood and Newberry 2006) of public sector accounting.

Although some scholars believe that there is no conflict between decision-usefulness and stewardship as parallel objectives (Lennard, 2007), other authors doubt whether objectives of both accountability and decision usefulness can be achieved simultaneously and point out the unclear relationship between both objectives (e.g., Rosenfield, 1974; Ijiri, 1975; Laughlin, 2012; Whittington, 2008). Williams (1987, p. 170) distinguished between the means-end notion of accountability and the ends-focused notion of decision-usefulness, noting that the 'perspective of arguing accounting will not necessarily lead to the same understanding of accounting phenomena'.

While the qualitative characteristics of useful information are nominally the same for the IPSASB and the IASB conceptual frameworks (relevance; faithful representation; understandability; timeliness; comparability; and verifiability) there are different information needs to serve the different objectives. Information for accountability (and stewardship) differs from that needed for decision making. For example, Whittington (2008) argues that valuing assets at (replacement) cost is more appropriate for stewardship, while fair value serves decision relevance. This argument is illustrated further by Cascino *et al.* (2016, p. 57):

> 'The research clearly documents that the information objective of financial statement users matters for the design of financial accounting standards…standard setters should make an explicit statement about potentially conflicting information objectives. One size does not therefore fit all and differing objectives require strategies for compromises… or otherwise a clear prioritization of objectives by the standard setter.'

A general purpose financial reporting model predicated on "decision-usefulness" is essentially a market-based model that assumes that users make rational decisions, facilitated by the availability of appropriate information, which results in the efficient allocation of resources (Mack and Ryan, 2006). If the IPSASB continues to converge its standards with the standards produced under the IASB conceptual framework, which are predominantly based on decision usefulness rather than accountability and serve different primary users, a mismatch between IPSAS standards and the IPSASB conceptual framework may arise.

*The balance sheet approach and definition of elements*

In common with both the IASB and FASB conceptual frameworks, the starting point for the IPSASB conceptual framework is the definition of the balance sheet elements of assets and liabilities, with the definitions of the remaining elements following accordingly. These definitions are a crucial part of the conceptual underpinning of financial reporting as any item included in financial statements should meet the definition of an element.

Arguably, governments are more concerned with the income or operating statement than the balance sheet, this often being one of the reasons why some governments prefer cash-based over accruals-based accounting systems. For instance, governments focus firstly on providing services and balancing the operating statement (i.e., removing the deficit before addressing public sector net debt). An earlier consultation paper on the IPSASB conceptual framework (IPSASB, 2012a) discussed both a balance sheet approach to defining elements and an approach based on revenue inflows and expense outflows. The revenue-expense approach is strongly linked to the idea of inter-period equity or inter-generational equity and provides a basis for assessing performance on these grounds. Inter-period equity refers to the extent to which the cost of programs and providing services in the reporting period is borne by current tax payers and current resource providers. The responses to the consultation paper on the conceptual framework were 'inconclusive' on a preference for the asset-liability (balance sheet) approach, but the definitions have nevertheless followed a balance sheet approach.

## 2.5 Government Finance Statistics (GFS)

Government's general purpose financial reports according to the IPSASB framework are proclaimed to serve accountability and decision-usefulness, but as well as GPFRs based on accounting standards, governments use Government Finance Statistics (GFS). GFS are ex-post financial information on the general government sector (GGS) for the purpose of macroeconomic analysis. The preface of the IPSASB conceptual framework (IPSASB, 2014) acknowledges this:

> 'GFS reports are used to a) analyse fiscal policy options, make policy and evaluate the impact of fiscal policies. (b) determine the impact on the economy, and (c) compare fiscal outcomes nationally and internationally. The focus is on evaluating the impact of GGS and broader public sector on the economy within the complete macroeconomic statistics framework.' (para. 23).

The standards for macro-economic statistics are set out in the System of National Accounts (SNA). In the European Union, the standards are implemented through the European System of Accounts (ESA). The European GFS are produced in accordance with the European System of Accounts 2010 (ESA 2010), which is the European version of the national accounts (2008 SNA), supplemented by further interpretation and guidance documentation from Eurostat. The GFS form the basis for fiscal monitoring in Europe, together with the statistics related to the excessive deficit procedure (EDP). In 2005 a research report systematically documented similarities and differences between the IPSAS and GFS reporting frameworks (IPSASB 2005). A 2012 report (IPSASB 2012b) considered that significant benefits could be gained by using a single integrated financial information system to generate both IPSAS financial statements and GFS reports (Dasi et al. 2016). Although IPSAS financial statements and GFS reports have commonality, in that both use accrual based financial information, both show government assets, liabilities, revenue and expenses and information on cash flows, they serve different purposes, which may have distinct implications for the definition of useful information (see Dasi *et al.*, 2016). It is important, therefore, that in the future development of IPSAS, the IPSAB considers how IPSAS relate to GFS / the SNA.

The development of IPSAS has followed IFRS with minimal deviation and has also sought alignment with GFS. However, although the acceptance of accruals based information is largely accepted as valid for the public sector there is controversy as to whether IFRS provides an appropriate reference point. The IPSASB framework identifies different objectives and users from those in IFRS, but uses a similar balance sheet focus relevant for investors or shareholders. IPSAS issued before 2014 did not consider areas unique to the public sector such as non-exchange transactions and social benefits. IPSASB has also pursued a policy of alignment with GFS which again has a different purpose and has developed separately. No accounting balance sheet or GFS includes a liability or future tax revenue for state pensions or other social spending (Irwin 2016). Therefore how the IPSASB develops the standard on social benefits in accordance with its conceptual framework will be complex and illuminating.

## 3. Research methodology

The conceptual underpinnings of the IPSAS are potentially very important for the future of public sector accounting internationally. Our overarching research question is:

*Are recent developments in international public sector accounting standards underpinned by the conceptual framework?*

### 3.1 IPSASB conceptual underpinnings –areas for investigation

Drawn from the literature, there are several conceptual aspects within the IPSASB conceptual framework that may be problematic when developing future standards that are specific to governments and public sector bodies. These areas for investigation include:

-how the dual purpose of information (accountability and decision-making) is reflected in standards

-does the balance sheet focus (i.e. starting from the definitions of assets and liabilities) provide coherence and address inter-generational equity/ sustainability?

-do the new standards reflect the cash and budget information needed for the public sector context?

Alongside these areas, the study will investigate the effects of the further constraints imposed by the IPSASB. Firstly, alignment with the IFRSs, which have a different decision usefulness objective reflecting capital market valuation and focus on the needs of distinct primary users, including potential and current investors and financiers, rather than on democratic accountability. Although the same qualitative characteristics of useful information are applied, nominally, in both conceptual frameworks, the information is used for different purposes and research has indicated, that purpose matters. Secondly, alignment with GFS which serves a completely different purpose – management of the economy – and the information required for this purpose may affect the scope of the standards and recognition criteria.

### 3.2 Data and research approach

This qualitative empirical study is based on multiple sources. Firstly, documentary material that was officially published by the IPSASB on the subject of accounting for social benefits was taken into account. Besides the IPSASB conceptual framework, this included the Consultation Paper (CP) (IPSASB, 2015) and the related exposure draft (ED) (IPSASB, 2017a) and the guidance of the IPSASB on both. Secondly, we analysed the 36 comment letters submitted in response to the CP.[1] Rather than a narrow count of words and terms, the intention of our

[1] At the time this paper was submitted, the responses to the ED were only recently available on the IPSASB website. Our intention is to extend our analysis for these responses and subsequent developments leading to the new standard.

analysis was to uncover the meaning of the conceptual rhetoric used by constituents to make or underline an argument. Following Alon and Dwyer (2016, p. 6), we chose to rely on comment letters 'as a reasonable but imperfect proxy for the actors' positions' in relation to the debate.

The comment letters were analysed using latent content analysis. Three coders read the comment letters to identify categories established on the basis of the IPSASB conceptual framework. Subsequently, the responses and their content were analysed based on the use of conceptual arguments including those consistent with the framework and the rhetoric used. We did so in order to be able to later ascertain whether respondents using terms from the conceptual framework were more influential on the IPSASB in the drafting of the subsequent ED. The categories included, but were not limited to:

C1: Use of the objectives as presented in the conceptual framework to defend/counter a choice offered in the CP.
C2: Use of the definition of a liability as offered in the conceptual framework to defend/counter a choice offered in the CP.
C3: Use of "internal" consistency arguments (i.e., consistency with other IPSASs) to defend a choice offered in the CP.

Throughout the analysis of the comment letters and their coding, the authors met several times to discuss and resolve any preliminary differences. The process of preliminary analysis was motivated, by the IPSASB requesting respondents to base the reasons for their views on 'the conceptual merits and weaknesses of each option', on 'the extent to which each option addresses the objectives of financial reporting', and 'how the different options might provide useful information about the different types of social benefits' (IPSASB, 2015, p. 7). The study was also motivated by the IPSASB's own use of rhetoric from the conceptual framework. After the preliminary analysis, we delve further into the problems raised in the comment letters to get a deeper understanding of the conceptual problems. This also enabled us to make a judgement about whether different correspondents interpreted the terms from the conceptual framework in different ways. The issues drawn from the literature and the contextual constraints that complicate the concepts in the IPSASB conceptual framework, namely consistency with (or minimum deviation from) IFRS and alignment with GFS are studied through comments made by respondents before setting out the IPSASB's response in ED63.

## 4. Analysis of the developing standard for Social Benefits

We focus our empirical analysis on the accounting for social benefits from the 2015 consultation paper to ED 63._Prior to the 2015 Consultation Paper the IPSAB had issued an earlier consultation paper in 2008 and in 2013, produced RPG1, *Reporting on Long term Sustainability of an Entity's Finances* which referred to social benefits. It should be noted however, these were before publication of the 2014 IPSASB *Conceptual Framework for Financial Reporting.* Firstly, we explain the main points in the consultation paper, we then undertake an analysis of the comment letters before summarising the new exposure draft ED63.

## 4.1 The Consultation Paper

In the 2015 Consultation Paper (CP), the definition and classification of social benefits follows GFS; and the IPSASB introduce a new approach based on insurance accounting for some social benefits. The consultation paper classifies different types of social benefit as social security and social assistance, both of which can be in cash and in kind. It defines 'social benefits' by reference to 'social risk'.

Social benefits are defined as 'benefits payable to individuals and households, in cash or in kind, to mitigate the effect of social risks'. The CP adopts a definition based on GFS (para. 1.38), this excludes collective goods and services such as defence and public order. Social risks are 'events or circumstances that may adversely affect the welfare of individuals and households either by imposing additional demands on their resources or by reducing their income'.

The objective of a future standard on accounting for social benefits is:

> To help users of financial statements and general purpose financial reports assess:
>
> > '(a) The nature of social benefits provided by the entity, and the key features of the operation of the scheme; and
> >
> > '(b) The impact of social benefits provided on the entity's financial performance and financial position.'

*Option 1: The obligating event approach*

This approach is developed in the light of the definition of a liability in the IPSASB Conceptual Framework, which is '[a] present obligation of the entity for an outflow of resources that results from a past event.' (para. 5.14). The obligation may arise in the public sector at a number of points. This is explained (para. 5.24) by the example of implementing a program or service. The early stages of implementation such as making a political promise (e.g. an electoral pledge) or announcement of policy 'are unlikely to give rise to present obligations that meet the definition of a liability. Later stages such as claimants meeting the eligibility criteria for the service to be provided, may give rise to obligations that meet the definition of a liability.' (IPSASB 2014, para 5.24). .The CP further states that '[u]nder this approach, obligations to pay social benefits are seen as no different (in principle, than other obligations). Under this approach, the key issue is when a present obligation arises.' (p3). The CP identifies five distinct points at which an obligation could be deemed to arise:

- Key participatory events occur
- Threshold eligibility criteria
- Eligibility met to receive benefits
- Approved claim
- Enforceable claim

*Option 2: Social contract approach* (previously termed 'executory contract model[2]')

This approach considers that there is a social contract between the state and the citizens, under which citizens agree to pay taxes to enable the state to pay social benefits. Consequently, both

[2] There is some debate in the comment letters whether what IPSASB describe is identical to an executory contract.

public sector obligations to provide goods, services and cash transfers to individuals or households and the rights of individuals or households to receive those benefits are regarded as commitments. Thus, the approach acknowledges that there is an on-going duty of individuals or households to contribute taxes and other sources of finance to effectively offset such obligations: 'Under this approach, present obligations only arise once claims for social benefits become enforceable (or under an alternative approach, claims for social benefits are approved).'(para 5.37)

*Option 3: the insurance approach*
Under this option some social benefits are considered akin to insurance contracts. This option is only suitable for contributory schemes, where future contributions are matched to future payments to recipients. As with insurance accounting in the private sector the net present value of the scheme would be shown in the organisation's statement of financial position. This approach recognises a present obligation to pay benefits at the point that insurance coverage begins and a right to future receipts resulting from the provision of that coverage. This approach is complicated by issues such as partially subsidised schemes and significant changes to the terms of the scheme.

The IPSASB suggests a combination of approaches may be required. The Consultation Paper was issued for comment in July 2015.

## 4.2 Analysis of the comment letters

*The IPSASB suggested influence of the framework and perceived response*

In the Specific Matters for Comment (SMCs) in the CP, the IPSASB made several references to the Conceptual Framework. For example,

> 'The CP considers the three approaches in detail, and assesses them against the objectives of financial reporting and the qualitative characteristics that are set out in the Conceptual Framework.' (IPSASB, 2015, p. 4).

In addition, direct reference is made to the following items from the CF:

- The definition of a liability (do social benefit obligations meet the definition and if so when should they be recognised?)
- The measurement bases for liabilities
- The objectives of financial reporting, qualitative characteristics and pervasive constraints, which used to frame the assessment of the different suggested approaches.

The IPSASB also used conceptual framework rhetoric to explain why, in their opinion, the social contract accounting option would not be suitable for introduction:

> 'The IPSASB does not consider that option 2 (social contract approach) is consistent with the Conceptual Framework. For this reason, the IPSASB has taken the preliminary view that the social contract approach is unlikely to meet the objectives of financial reporting.' (IPSASB, 2015, p. 7).

Based on Botzem (2012), we expected that a majority of respondents, given this guidance and IPSASB's examples, would use the conceptual framework rhetoric in their responses, especially in cases in which respondents disagreed with one of the choices provided. By contrast, we expected general arguments of consistency in cases in which the IPSASB itself guided respondents while still asking for reasons supporting their view, as in the example of the discount rate used under the insurance approach. We also expected reference to conceptual framework characteristics of useful information such as 'faithful representation.

*Respondents' compliance with the conceptual framework objectives*

The IPSASB received 36 comment letters from a diverse range of constituents (Table 1).

| **Type of Respondent** | **Number** |
|---|---|
| Preparer | 9 |
| National Standard Setter | 5 |
| International Organisation | 4 |
| Professional Association | 11 |
| Audit Firm | 3 |
| Public Audit Office | 3 |
| Individual | 1 |
| **Total** | **36** |

**Table 1:** Respondents to the Social Benefits Consultation Paper 2015

Almost a third from professional associations (accountants and actuaries) and a quarter from preparers but none from elected representatives or "users".

The SMCs prompted references to the conceptual framework and unsurprisingly, the qualitative characteristics of useful information and the objectives of public sector financial reporting were frequently referenced in the responses (Table 2). Although there are no "user" respondents reference is frequently made to users in the comment letters. Respondents reiterated the dual objective given in the conceptual framework and referred to qualitative characteristics, neither single objective predominated in terminology:

> 'Our goal as standards setters is to provide decision-useful information and hold governments accountable' (CL10).

Most respondents referred to the framework's primary users: citizens and their elected representatives, e.g. parliamentarians holding the executive government to account (Table 2).

| | |
|---|---|
| Accountability/ Stewardship/ Faithful Representation/ Reliability | 20 |
| Decision Usefulness/ Relevance | 22 |
| Intergenerational equity | 13 |
| Citizens | 22 |
| Parliament/ government | 20 |
| Investment/ financiers | 4 |

**Table 2:** References to objectives/ qualitative characteristics and users

*The balance sheet focus: using the definition of a liability*

The CP considers in detail the definition of a liability. The IPSASB conceptual framework definition (as in IFRS) is

> 'a present obligation of the entity for an outflow of resources that results from a past event.' (para. 5.14).

A present obligation is explained further for the public sector:

> 'A present obligation is a legally binding obligation (legal obligation) or non-legally binding obligation, which an entity has little or no realistic alternative to avoid' (para 5.15).

The CP therefore explains two key factors to be considered in determining when a liability arises for a social benefit: what is the past event and when does an entity have little or no realistic alternative to avoid an outflow of resources and most respondents refer to this, but there was little agreement as to the preferred approach Table 3.

Many respondents pointed out the unique position of governments when determining obligations. Indeed, the following respondents argued along the lines that the uniqueness of governmental power means governments are not obligated:

> 'As a consequence of the very power of government, it is not possible for a current government to bind a future government. In most situations therefore the government has leeway to avoid at least part of the obligation.' *(CL26).*

> 'Governments have full discretionary power over changes to their social benefit programs, particularly if there will be insufficient future revenues to fund them.' (*CL*4).

> 'Benefits under [schemes financed by government out of general revenue] can usually be significantly amended by governments passing legislation (for example, to raise the

> eligibility age or tighten other criteria for eligibility for benefits). Thus, it may be misleading to recognise future benefits from these programs as liabilities in public sector accounts when they may not turn out to be obligations at all.' (*CL8).*
>
> '[T]he government has the ability to avoid paying the benefits by modifying the relevant legislation' (*CL*25).

| | |
|---|---|
| Liability definition in the conceptual framework | 19 |
| *Preferred approach:* | |
| Obligating event | 12 |
| Social contract | 1 |
| Insurance | - |
| Combination of obligating event and insurance | 18 |
| **All** | **2** |

**Table 3**: Discussion of a liability and the preferred approach

However, CL6 accepts the above arguments but uses the reasoning in the CP to consider the point when the obligation is recognised.

> 'As a general principle of constitutional law no government can bind its successor. Hence any social benefit obligation can be changed at the whim of the government in power. Thus it is possible to argue that there should be no recognition of social benefits as a liability since there is only a political obligation to provide the benefit. On the other hand, it may be argued that in reality no government is ever likely to complete renege on an obligation by a previous government to provide social benefits. At most such obligations may be amended or reduced, but never eliminated. Therefore, the argument of substance over form is that there should be some recognition of the liability in advance of actual payment. The question posed by the Consultation Paper is how this point is identified and how the liability should be measured' (*CL6).*

Similarly, CL29 accepts this "inability to avoid" argument (as given in the CP):

> 'the government's power to amend or repeal legislation before or after the individual becomes entitled to receive {the social benefit] is not a relevant factor… even if it is not accepted that the existence of current legislation creates a legally binding obligation… individuals have a valid expectation of receiving [the social benefit], giving the government little or no realistic alternative to avoid an outflow of resources' *(CL* 29).

Half of respondents preferred a combination of the obligating event approach and the insurance approach, which was the proposed combined approach in the consultation paper. There was only one comment letter of strong support for the social contract approach that the IPSASB had earlier discarded.

When referring to the point of recognition there was very little agreement among respondents (Table 4).

| **Obligating event** *approach* | | **Social contract** *approach* |
|---|---|---|
| 1 Key participatory event | 2 | |
| 2 Threshold eligibility criteria met | 5 | |
| 3 Eligibility criteria to receive next benefit met | 8 | |
| 4 Claim approval | 1 | 6 |
| 5 Claim becomes enforceable | | 3 |
| 1, 2 and 3 | 2 | |
| 1, 2, 3 and 4 | 1 | |
| 1, 2 and 5 | 1 | |
| 2 and 3 | 5 | |
| 2, 3 and 4 | 1 | |
| 3 and 4 | 1 | |
| 3, 4 and 5 | 2 | |

**Table 4: Point of recognition**

Most respondents considered the obligating event to be either that the threshold eligibility criteria are met or that the eligibility to receive the next benefit is met. Under a social contract approach, respondents regarded claim approval to be the earliest point of recognition, with three respondents requiring enforceable claims.

The variety of different social benefit schemes was apparent in the comment letters with some seeing flexibility and the exercise of professional judgement as essential (CL20). Illustrative comments are given below (also *CL4, CL22, CL27, CL35*):

> 'We do not believe that it is possible to define a rule that would be appropriate for the recognition of a social benefit liability for all types of social benefits at the same point in time. Instead we believe that the variety of the types of social benefits and the specific circumstances of the legal environments and jurisdictions in which they are granted should inevitably lead to different conclusions as to the most appropriate timing for recognition.' (*CL*11).

> 'The Treasury is doubtful that it will be possible to get to a generally accepted international position on such a recognition point' *(CL*26).

For the measurement of social benefits, the cost of fulfilment received the support of 21 out of 22 respondents. The vast majority of respondents who responded on the discount rate (note many did not consider the insurance option, see below) supported the IPSAS 25 approach.

*Intergenerational equity/ sustainability*

The obligating event approach relates to the definition of a liability, but intergenerational equity is an increasingly important issue in public policy for social benefits. Several respondents saw this issue as outside the general purpose financial statements. For example,

> 'With respect to old age benefits, the policymaker is solely accountable for sustaining the intergenerational solidarity principle, which is insufficient in itself to generate a liability or a contingent liability for future benefits beyond the reporting period. In our opinion, sustaining the intergenerational solidarity principle does not meet the definition of a liability of the reporting entities that provide the social benefits.' (*CL3*).

> 'As noted in [the CP], long-term sustainability reporting is not considered an objective of financial statements. Recognizing future obligations as liabilities does not provide relevant or meaningful information to the user of financial statements, and does not fairly present the financial position of the entity when the future revenues that the government expects to receive to fund the social benefits are not recognized in financial statements.' (*CL4).*

Reference was made to using supplementary statements because of the 'uncertainties of such inter-generational liabilities' (CL6) and others noted the voluntary reporting in the RPG fulfilling a different purpose to a set of financial statements prepared under IPSAS (CL14) which should "faithfully represent" the financial position, operations and cash flows 'including an appropriate reflection of the entity's social benefit schemes'.

*Consistency with IFRS (minimum deviation)*

Social benefits do not exist in the context of profit making bodies and are therefore absent in IFRS. There is 'relatively little scope for comparing the provision of social benefits with the predominantly exchange transactions common to the private sector' *(CL14).* The political nature of social benefits sets them apart from commercial transactions:

> '[I]t should be considered that contrary to the situation in private insurance, social insurances are not oriented toward the maximization of profitability and primarily economically motivated decisions, but focus on the sustainable financing of benefits under the rubric of the solidarity principle in society and, in the long run, are dependent on political decisions.' (*CL2).*

> 'This is a political choice reflecting the social and economic objectives of a country. For example, full funding objectives are considered economically undesirable by some countries and affecting domestic consumption while it is not for others. It is therefore inappropriate to measure liabilities of social insurance schemes on a termination basis (closed-group)' (*CL*24).

Nevertheless, many respondents expressed agreement with an accruals approach and with IPSAS 25 (where the government is an employer). However, the insurance approach was not generally considered appropriate in a government context.

> '[I]nsurance contracts are designed to ensure that there is a direct correlation between the risks assumed (i.e. benefits to be paid) and the fees charged. In many instances, there is simply no correlation between the revenue and expense streams. Any revenue received is often based on a tax on a specific activity, or a general allocation of revenue to subsidise the scheme. This is different to the basic economic substance of an insurance contract.' *(CL*9).
>
> '[T]here is no direct link at the level of each beneficiary between the level of contributions paid and the level of benefits received. Indeed, the level of contributions does not depend on the level of risks to cover for each beneficiary unlike insurance schemes…a cause and effect relationship is not established between the contribution level of each contributor and its level of risk' *(CL1).*
>
> 'The funding mechanism for contributory social benefit schemes is a form of taxation, albeit for a specific purpose, and does not result in an enforceable right to an individual participant to the assets of the scheme in the future.' *(CL*4).

Some respondents argued against the validity of the insurance approach from the "asset" side:

> 'While there is merit in applying the liability aspects of the insurance approach, we believe that the revenue aspect of the approach, and in particular the combination of the revenue and expense streams into a single model, is inappropriate in the public sector.' *(CL*9).
>
> 'In our view, the overall effect of recognizing the future deficit without the recognition of the future tax revenues, might contradict the objectives of financial reporting by public sector entities and might result in a misleading presentation.' *(CL*25).

The appearance of an insurance style fund could be illusory:

> '[S]tate pensions in the UK appear to be hypothecated, but in reality are not underpinned by a fund. National insurance contributions which fund the state pension are paid into the same pool alongside other taxation such as income tax. As such, some benefits may appear to be funded or supported by assets when in fact they are not.' (*CL*33).

Indeed, some countries (*CL2 Swiss, CL12 Japan, CL14 Germany)* regarded "pay-as-you-go" - one-to-one matching of contributions and benefits paid as the most appropriate approach for social benefit schemes such as state pensions. Thus liabilities are not needed.

Some respondents expressed wider concerns that governments have objectives quite different from the commercial sector, accounting statements are used differently and this requires different information:

‘Generally, a public sector entity has little exchange revenue and no profit motive, but instead has the goal of providing services collectively chosen to improve the well-being of its citizens. Accordingly, the accounting treatment for recognizing costs should be consistent with the delivery of related services year by year. Thus, costs can be associated with program delivery and analyzed in relation to outputs, outcomes, and relevant performance measures.’ *(CL*31).

‘Private contracts are not settled based on a government’s GAAP-based financial results. This is not how general purpose financial statements are used.’ *(CL*10).

Thus some respondents were arguing against alignment with commercial accounting regimes such as IFRS *per se*.

*Alignment with GFS and definitional problems*

The IPSASB proposed alignment with GFS definitions in the CP but although seven [3] respondents expressed support for GFS definitions others argued eloquently against:

‘Although we understand that using the Government Finance Statistics definition of a social benefit has made it easier for the IPSASB to identify a specific group of benefits for consideration in this project, we do not think that this should be used to justify different recognition and measurement requirements for transfers in kind which may be very similar in nature.’ *(CL29).*

‘While some of the definitions may be useful in classifying information for statistical purposes in GFS, they do not assist in distinguishing or classifying transactions for accounting purposes.’ (*CL9).*

Several further problems relating to definitions and the scope of a future standard were outlined by respondents. For example, the linking with ‘social risk’ was considered inappropriate in a European context:

‘In Europe social benefits would be regarded as citizen entitlements rather than acts of charity. Persons become entitled to social benefits when they meet certain conditions in many cases without regard to their personal circumstances, e.g. disability and related social benefits are paid irrespective of an individual's income or financial status, e.g. in the UK even the richest are entitled to a state pension. Therefore, the definitions should refer to **entitlement** rather than need.’ (*CL*6).

Another problem of definition was the ‘struggle to identify differences between social benefits as defined in the project and collective goods and services’ (CL3), in particular, there was confusion over how health programmes were treated (e.g. CL8).

The IPSASB had introduced discussion on its proposed new standard on social benefits in terms of its conceptual framework (with much commonality with IFRS) and aligned its definition of social benefits with GFS. The questions for comment were couched using the conceptual

[3] *CL*11, *CL*12, *CL*14, *CL*17, *CL*26, *CL*27, *CL*36

framework as support, but the comment letters probed those conceptual underpinnings and the alignment with other reporting regimes.

4.3 ED63 Social Benefits

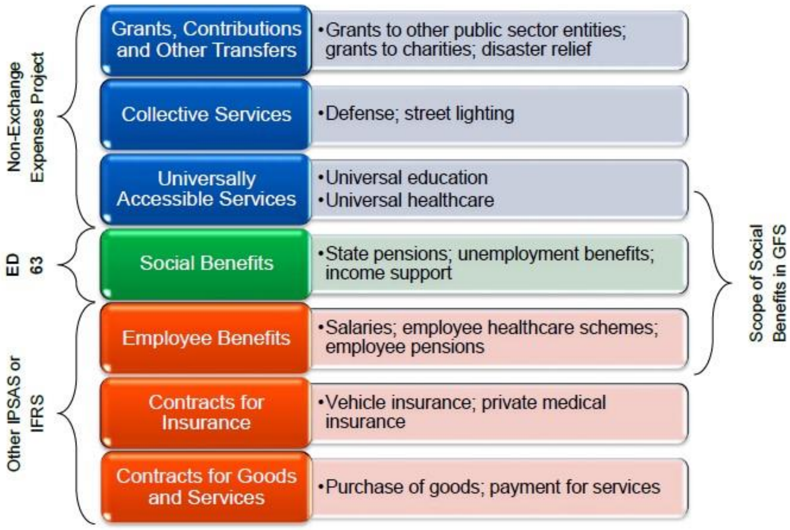
A draft standard was issued for comment in October 2017 with a response deadline of 31st March 2018.

The objective remains unchanged from the consultation paper. However, social benefits are now defined as those provided to

(a) Specific individuals and/or households who meet eligibility criteria
(b) Mitigate the effect of social risks; and
(c) Address the needs of society as a whole; but
(d) Are not universally accessible services[4]

Other items are clearly excluded from social benefits as Figure 2 illustrates:

**Figure 2: Scope of ED63**




*Source: ED 63 At a Glance*

The ED requires use of the obligating event approach for accounting for social benefits. However, it allows the use of the insurance approach (but does not require it) for recognising and measuring social benefits where the social benefit scheme is intended to be fully funded from contributions and there is evidence that the reporting entity manages the scheme in the same way as an issuer of insurance contracts.

The obligating event approach recognises a liability for a social benefit scheme when:

[4] For example UK state pensions are not means tested, but are not "universal" because of the age criteria.

‘(a) The entity has a present obligation for an outflow of resources that results from a past event; and

‘(b) The present obligation can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in general purpose financial reports.’

The ED states that the ‘past event that gives rise to a liability for a social benefit scheme is the satisfaction by the beneficiary of all the eligibility criteria for the next benefit, which includes being alive.’

## 5. Main findings and discussion of the evolving conceptual underpinnings

The IPSASB commenced its standard setting programme on the premise of minimum deviation from IFRS and did not issue its own conceptual framework, with objectives that differ from those of the IASB, until 2014. A majority of IPSASs are based on IFRS, which are designed for profit-making entities. There are inconsistencies between standards and the IFRS framework (Brouwer *et al*., 2015) and therefore inevitably similar for the IPSASB framework. However, the objectives of the IPSASB conceptual framework reflect the traditional objectives of (democratic) accountability and decision-usefulness, thus the IPSASB recognizes different purposes and users of general purpose financial reports from those of the IASB, consequently, adherence to the IPSASB framework is more complex. It is not clear how these differences translate into different standards. We examined the developing standard for social benefits that has no counterpart in profit-making entities in order to assess the impact of the 2014 IPSASB framework on the process of standards development. This is issue is important because if there is no common understanding of the relationship between the IPSAS framework and subsequent standards, the consequences could harm the transparency and accountability of public sector financial statements.

As the IPSASB aims to develop standards of a high quality that are to be applied by public sector entities worldwide (IPSASB, 2017b), issues such as consistency among standards (internal consistency) and between standards and the conceptual framework (external consistency) along with legitimacy issues of the standard setting process are heightened. The IPSASB currently strives to maintain convergence with the IFRS (IPSASB, 2017b). The IPSASB itself recently acknowledged that its future challenges include striking a relative balance between addressing public sector-specific issues and maintaining IFRS convergence (IPSASB, 2017b). At the same time, the Board is also considering the possibilities of increasing convergence with IFRS even further and/or increasing the usage of IPSAS-based information for Government Finance Statistics. At the same time, they are also considering how to improve the communication of financial information to the users of financial reports (IPSASB, 2017b). We examined these issues in relation to the developing social benefits standard.

We found that the IPSASB put forward a reasoned argument, in line with the IPSASB conceptual framework for the accounting for social benefits set out in the 2015 CP, this included alignment and development of the definition of a liability, thus the Board sought external consistency with the framework. The proposals also sought internal consistency between standards, with IPSAS 25 and the developing standard for revenue and non-exchange expenses.

The respondents who considered the application of the insurance approach to social benefits largely supported adherence to IPSAS 25 in relation to the discount rate, but there was little support for an insurance approach as used in the private sector per se. There were many comments about the definitions and scope of the CP, including clarification about the treatment ofnon-exchange transactions. These comments were reflected in ED63, where the changes in definitions and scope are consistent with the comment letters regarding (a) – meeting eligibility criteria and (d) – the exclusion of universally accessible services**.** However, this has led to a misalignment with GFS, which IPSASB wanted to avoid. Universally accessible services, such as a universal healthcare system, are considered to be social benefits under GFS but are outside the scope of the draft IPSAS, ED63. In response to 'a significant minority' of respondents 'the definition of social risks was reframed to fit an accounting framework as opposed to an economic/ statistical framework…the definition of social benefits has also been amended to improve the clarity of the definition.' (IPSASB 2017, BC21, p. 30).

Since respondents largely felt that the insurance approach was inappropriate for social benefits, the IPSASB has put forward in ED63 that it should only be applied in limited circumstances i.e. that the social benefit operated in a similar manner to an insurance contract and that the scheme was funded from a dedicated source of revenue, not general taxation. Even so, this test may not be completely effective since, as noted in CL 33 (earlier), the source of the revenue becomes irrelevant unless the fund is fully hypothecated[5].

In the CP, the IPSAB identified five distinct points at which a case could be made for recognising an obligation in the financial statements. The IPSASB noted that respondents believed that an obligating event could arise at different points, depending on the nature of the social benefit or the legal framework under which the social benefit arose. There was no consensus but most respondents favoured the point where the threshold eligibility criteria had been met and/ or the criteria for the receipt of the next benefit. This creates another misalignment with GFS as under GFS, an expense is recorded only when the payment of the social benefit is due (i.e. in line with the claim is enforceable – fifth point only). The IPSASB 'concluded that the recognition and measurement of social benefits should be consistent with the Conceptual Framework, and that this should take priority over alignment with GFS treatment. Any alignment with GFS that emerged from the IPSASB's deliberations would therefore be coincidental' (BC65, p. 37).

The IPSASB, in its conceptual framework is careful to explain the nature of the government obligation in relation to social benefits, emphasising that an obligation does not exist for 'political promises'. Many respondents point out the unique situation of governments which are not 'obligated' to provide social benefits and are not bound by predecessor governments: social benefit schemes are not operated along commercial lines and the insurance approach was

[5] In the UK, a dedicated source is later pooled with other sources of revenue.

largely regarded as irrelevant. In contrast to this, other respondents spoke about the moral obligation of governments to fulfil such promises and whether citizens had a reasonable expectation of receiving benefits. The social benefits IPSAS has implications for the balance sheet approach and issues of intergenerational equity; in particular, the consideration of when a liability arises. These issues are closely related to considerations of the political and public accountability of governments and thus to the objectives of financial reporting contained in the conceptual framework.

*Further research*

The current research indicates a mis-alignment with GFS, further work is necessary to consider whether this will affect the future use of IPSAS based statements and the repercussions for the value of GFS in the macro management of the economy; inevitably reconciliations with government debt and PBSR will be more complex and may have implications for short-term/long-term policies.

A more comprehensive examination of the conceptual underpinnings of future IPSAS provided by the IPSASB 2014 Conceptual Framework requires investigation of several IPSAS as they develop. The accounting for social benefits standard is progressing and further work is necessary to establish the conceptual underpinnings of the future standard. The development of a standard on heritage assets will be similarly exacting in relation to conceptual underpinnings but, in this case, more relevant to the concepts relating to asset recognition and measurement.

*Conclusion*

The IPSASB Conceptual Framework is based on the IFRS Framework but it has wider objectives including both (democratic) accountability and decision-making, it follows the balance sheet approach in IFRS, with modest changes to IFRS definitions. The development of the accounting standard for social benefits provides an area for rigorous testing of the conceptual underpinning in the IPSASB framework 2014. Social benefits are a major area of public spending and have distinct features in relation to spending arrangements and government obligations. The constraints requiring alignment with both IFRS and Government Financial Statistics (GFS) hinder the development of public sector accounting in line with the espoused objectives of the IPSASB framework. The 2015 Consultation Paper on social benefits put forward definitions and propositions in apparent accordance with the IPSASB framework. But in consultation, respondents raise objections to the exclusions in the definition of social benefits and debate the logic behind them. The consultation largely hinged around accounting for government obligations rather than current expenditure on social benefits. Respondents were unconvinced of some arguments of adherence to the framework and whether social benefits could be classified on the basis of obligations. The alignment with GFS proved unsatisfactory and is reduced in ED63.

Recent developments in international public sector standards, as shown by progress on accounting for social benefits indicate an attempted underpinning by use of conceptual framework definitions (i.e. obligations) and use of conceptual framework rhetoric. But respondents questioned the application of the approach and there was little agreement about the appropriate point of recognition. Respondents gave little support for a more commercial (IFRS) approach although respondents often sought internal consistency with other IPSAS. This preliminary study therefore raises concerns regarding the coherence of the IPSASB framework and the alignment of public sector accounting to other regimes with different users and objectives.

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