International Federation of Accountants (IFAC)
Public Sector Committee (PSC)

Background on PSC Standards Program
and
Note on Pension Accounting Developments

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The views expressed in this paper are those of the authors and not necessarily those of IFAC or the PSC. Readers should refer to the relevant standards for a full understanding of the requirements of IPSASs, IASs and IFRSs referred to in this paper.

1- Government accounting and statistical standards

1.1 Background: worldwide accounting standard

1.1.1 IFAC

The International Federation of Accountants (IFAC) is the global organization for the accountancy profession (at www.ifac.org). It represents 155 member organizations in 113 countries. IFAC members represent 2.4 million accountants employed in public practice, industry and commerce, government, and academe.

The objective of IFAC is to serve the public interest and contribute to the strengthening of the international economy by:

- developing the global accountancy profession;
- establishing high quality standards in the areas of auditing, education, ethics, and public sector financial reporting, and advocating transparency and convergence in financial reporting;
- providing best practice guidance for professional accountants employed in business; and
- implementing a membership compliance program.

The structure and governance of IFAC provide for the representation of its diverse constituencies and interaction with external groups that rely on or influence the work of accountants.

All IFAC online guidance is available free of charge through the IFAC bookstore.

1.1.2 International Public Sector Accounting Standards (IPSAS)

The Public Sector Committee (PSC) is a standing committee of IFAC. It was established in late 1986 to address, on a coordinated worldwide basis, the needs of those involved in public sector financial management, reporting, accounting and auditing. The PSC comprises 13 members drawn from IFAC member bodies. PSC members are appointed on the basis of their knowledge of, and experience in, public sector financial reporting, financial management or audit. PSC members are supported by technical advisors drawn from the accounting profession in their own country. Members of the multilateral lending agencies and certain other regional and international organizations are observers on the PSC with full rights of the floor.

The PSC membership for 2003 is currently as follows:

Australia (Chair), Argentina, Canada, France, Germany, Hong Kong, Mexico, The Netherlands, New Zealand, Norway, South Africa, UK and USA.

The PSC also includes the following observers with full rights of the floor: the Asian Development Bank (ADB), European Commission (EC), International Accounting Standards Board (IASB), International Monetary Fund (IMF), International Organisation of Supreme Audit Institutions (INTOSAI), Organisation for Economic Co-operation and Development (OECD), United Nations (UN), United Nations Development Program (UNDP) and the World Bank.

The PSC's current activities are focussed on the development of International Public Sector Accounting Standards (IPSASs) for financial reporting by governments and other public sector entities. The PSC actioned its Standards Program in late 1996. The Program has been funded by IFAC, the World Bank, the ADB, the UNDP and the IMF.

The current status of the PSC's Standards Program is as follows:

- Twenty accrual basis IPSASs have been published. These IPSASs are based, to the extent appropriate, on International Accounting Standards (IASs) and

International Financial Reporting Standards issued by the International Accounting Standards Board (IASB). In many respects, the requirements of these IPSASs reflect the requirements of GFSM2001. However, there are differences. The PSC has initiated a Convergence Working Group, which includes representation from the PSC and IMF to explore opportunities for further convergence of the requirements of IPSASs and the IMF's Government Finance Statistics Manual 2001 (GFSM2001). (For a report on the first meeting of this Group refer to the PSC page of the IFAC website - Background Papers, July 2003 meeting at: http://www.ifac.org/PublicSector/Meeting-BGPapers.php?MID=0010&ViewCat=0055); and

- a single comprehensive Cash Basis IPSAS Financial Reporting Under The Cash Basis of Accounting was issued in January 2003. The IPSAS is divided into a mandatory and an encouragement section.

These standards set out the requirements for financial reporting by governments and other public sector entities.

The PSC has also issued Study 14 *Transition to the Accrual Basis of Accounting* to provide guidance to assist a government or other public sector entity in transitioning from the basis of accounting the entity currently adopts (whether cash, modified cash or modified accrual) to the accrual basis. This Study was published in April 2002. It identifies key components that must be addressed in the transition to the accrual basis and notes that the transitional path adopted may differ from jurisdiction to jurisdiction.

Steering Committees which include non-PSC members to assist in the development stage of the following key public sector issues have also been formed:

- Accounting for Non-Exchange Revenue; and
- Accounting for Social Policy Obligations.

The Steering Committees provide a mechanism for the PSC to broaden its experience and expertise and involve key constituents at an earlier stage of the IPSAS development process. The Steering Committees include members of the accounting profession and others with relevant experience and expertise.

The PSC has also commenced work on projects dealing with:

- Budget Reporting. The first stage of that project is to prepare a research paper which identifies best practice in budget formulation, presentation and reporting; and considers the extent to which budget reporting fits within the PSC's standards setting mandate. The PSC is forming a Steering Committee to provide input on the research paper and make recommendations to the PSC on any matters that might be dealt with by an IPSAS on budget reporting;
- Accounting for Development Assistance;
- Impairment of Assets; and
- Convergence of IPSASs with GFSM2001 and ESA 95 statistical bases.

Due Process

The PSC adopts a formal due process, which provides all interested parties with the opportunity to contribute to the development process, and to influence the final IPSAS. This process may include the issuance of an Invitation to Comment (ITC) for comment as the first stage of the IPSAS development process and, after considering comments received, the development of an Exposure Draft and a final IPSAS. ITCs and Exposure Drafts of each proposed IPSAS are published and widely distributed free of charge. The exposure period of each proposed IPSAS is usually at least four months, during which time the comments from interested parties are welcomed. Exposure Drafts can be downloaded from the IFAC website at www.ifac.org. The final IPSASs are also distributed free of charge and can be downloaded from the IFAC website.

The PSC holds its meetings in public and key PSC agenda papers can be viewed on the PSC page of the IFAC web (www.ifac.org). While interested members of the public are able to observe PSC meetings, they will not be allowed to participate in the discussion. Steering Committee meetings are not held in public.

1.1.3 International Accounting Standards Board (IASB)

The IASB is an independent, privately-funded accounting standard-setter based in London, UK (see: www.iasb.org.uk). It is responsible for the development of

International Financial Reporting Standards (IFRSs) for application to the general purpose financial statements of profit-oriented entities.

The IASB's objective is to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements and other financial reporting to help participants in the various capital markets of the world and other users of the information to make economic decisions. In pursuit of this objective, the IASB cooperates with national accounting standard-setters to achieve convergence in accounting standards around the world.

The IASB comprises 14 members appointed by the Trustees of the IASC Foundation. The IASC Foundation is funded from the major accounting firms, private financial institutions and industrial companies throughout the world, central and development banks, and other international and professional organisations. Board Members come from nine countries and have a variety of functional backgrounds.

The IASB was preceded by International Accounting Standards Committee which issued International Accounting Standards (IASs). IASs continue to be applicable unless and until they are amended or withdrawn by the IASB.

Information on the use of IASs/IFRSs around the world is available on the IASB website[1].

2 - Pension Accounting in Accounting Standards

2.1 Pensions provided as consideration for employee services provided

2.1.1 IASB Standards

International Accounting Standard IAS 19 *Employee Benefits* deals with a number of benefits provided to employees as a consequence of their employment including employee pensions. For a summary of the requirements of IAS 19, refer to the paper by Ahmad Hamidi-Ravari on the Electronic Discussion Group (EDG) at http://www.imf.org/forum/Message2.asp?forumid=10&messageid=354&threadid=340.

[1] http://www.iasb.org.uk/cmt/0001.asp?n=56&s=9213391&sc={0018F11A-6A0E-4FB7-B8CF-93ADBEF51C5E}&sd=160723710

2.1.2 International Public Sector Accounting Standards (IPSASs)

The core set of 20 IPSASs for application in the preparation of accrual based financial statements are, where appropriate, based on IASs promulgated by the IASC as at 31 August 1997 or their subsequently revised versions. (31 August 1997 is the date at which the PSC's Standards Program became active.) At that date, 22 IASs had been issued including International Accounting Standards IAS 19 *Employee Benefits* which deals with employee pensions. In 2002, the PSC considered actioning a project on the development of an IPSAS based on IAS 19. However, IAS 19 was, and is currently, under review by the IASB and may be subject to significant change. Consequently, the PSC has deferred development of a public sector accounting standard based on IAS 19 until the IASB review is complete and all implications of the review are known. (For a summary of the project see IASB's convergence project summary by Anne McGeachin at http://www.imf.org/forum/Message2.asp?forumid=10&messageid=340&threadid=340.)

Therefore, the suite of IPSASs does not currently include a standard which prescribes requirements for financial reporting of pensions provided to government employees as consideration for the services they provide as employees. However, IPSASs do specify a hierarchy of guidance that preparers may refer to in developing their own accounting policies on financial reporting issues for which a specific IPSAS has not been issued. IPSAS 1 *Presentations of Financial Statements* commentary paragraph 42 notes that:

"In the absence of a specific International Public Sector Accounting Standard, management uses its judgment in developing an accounting policy that provides the most useful information to users of the entity's financial statements. In making this judgment, management considers:

(a) the requirements and guidance in International Public Sector Accounting Standards dealing with similar and related issues;

(b) *the definitions, recognition and measurement criteria for assets, liabilities, revenue and expenses described in other publications of the International Federation of Accountants Public Sector Committee; and*

(c) *pronouncements of other standard setting bodies and accepted public or private sector practices to the extent, but only to the extent, that those are consistent with (a) of this paragraph. For example, pronouncements of the International Accounting*

Standards Committee (IASC), including the Framework for the Preparation and Presentation of Financial Statements, International Accounting Standards and interpretations issued by the IASC's Standing Interpretations Committee."

Accordingly, in the absence of an IPSAS, preparers of financial statements of public sector entities will consider the requirements of IAS 19 in developing their own accounting policies for financial reporting of employee benefits including employee pensions.

2.2 Pensions Provided by Governments by way of Social Benefits

2.2.1 Current Status

The PSC has issued IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets* which provides guidance on the recognition, measurement and disclosure of a wide range of provisions, and the disclosure of contingent liabilities. Readers should note that for financial reporting purposes provisions are defined as liabilities of uncertain timing or amount in accounting standards.

IPSAS 19 is based on International Accounting Standard IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.* IAS 37 was developed in an exchange transaction environment and does not deal with obligations arising from non-exchange transactions and events, such as those that may arise in the public non-trading sector. Like IAS 37, IPSAS 19 specifically excludes from its scope provisions relating to a number of transactions and events including provisions relating to employee benefits. As noted above, financial reporting requirements for pensions provided to employees as consideration for the services they provide will be dealt with when the PSC considers the revised IAS 19. (For a full list of exclusions from IPSAS 19, refer to paragraph 1 of the Standard.).

IPSAS 19 also excludes from its scope social policy obligations of governments that arise from non-exchange transactions. As such, it does not deal with whether, for example, a government's commitment to provide social benefits such as health, education and welfare to its constituents at no cost, or subsidised cost, will give rise to a liability, when that liability should be recognized, and for how much.

This exclusion means that IPSASs do not currently provide guidance on aged and other pensions encompassed within GFSM2001 classifications of social assistance schemes and non-exchange social insurance schemes – that is, social insurance schemes that are not funded directly by the beneficiaries.

IPSAS 19 paragraph 9 explains that "the exclusion of these provisions and contingent liabilities from the scope of this Standard reflects the Committee's view that both the determination of what constitutes the "obligating event" and the measurement of the liability require further consideration before proposed Standards are exposed. For example, the Committee is aware that there are differing views about whether the obligating event occurs when the individual meets the eligibility criteria for the benefit or at some earlier stage. Similarly, there are differing views about whether the amount of any obligation reflects an estimate of the current period's entitlement or the present value of all expected future benefits determined on an actuarial basis."

2.2.2 Current Developments – PSC Steering Committee on Social Policy Obligations

While the IPSASs do not currently include guidance on accounting for aged and other pensions, developmental work is occurring. The PSC has established a Steering Committee on Social Policy Obligations (SPO) to provide input to the development of an IPSAS on the broad issue of accounting for social policy obligations. The work of this Steering Committee will encompass accounting for aged and similar pensions that would fall within social assistance and non-exchange social insurance schemes.

The Steering Committee is chaired by the PSC member representing New Zealand and has members from Australia, Canada, Pakistan, the People's Republic of China, Sweden, the United Kingdom, the Fédération des Experts Comptable Européen (FEE) and the International Monetary Fund (IMF). (See Appendix 2 for a complete list of Steering Committee members.)

The Steering Committee is developing an Invitation to Comment for issue in late 2003 or early 2004. The ITC identifies the key issues to be addressed and the views of the Steering Committee on how those issues should be resolved. The ITC will be published by the PSC and comments are sought from interested parties – while final decisions have not been made, a comment period of four to six months is likely to be provided. The PSC will then consider the views of the Steering Committee and comments thereon as it develops an Exposure Draft of proposed requirements.

The Draft Invitation to Comment

The draft ITC on Social Policy Obligations prepared by the Steering Committee was considered by the PSC at its July 2003 meeting. This draft can be viewed on the PSC page of the IFAC website (Background Papers, July 2003 meeting). ***Note this is only a working draft - it has not yet been approved by the PSC for issue and further amendments are to be made to it.***

The ITC deals with accounting for a wide range of social benefits, including age and similar pensions, individual or household transfers and individual and collective consumption, under the accrual basis of accounting. Consistent with the terms of reference of the SC, the ITC will not deal with pensions provided as employee benefits (which are dealt with by IAS 19 *Employee Benefits*) or other pensions, which arise from an exchange transaction.

The approach adopted by the Steering Committee is to apply definitions, recognition criteria and any relevant guidance on measurement and disclosure in the existing IPSASs to each category of benefit. This means that for a social policy obligation to be recognized in general purpose financial statements as a liability it must meet the definition of a liability and the recognition criteria for liabilities. For financial reporting purposes, liabilities may arise from legal or constructive obligations and, as noted above, encompass "provisions", which are defined in IPSASs as liabilities which are uncertain as to timing or amount. Contingent liabilities are not recognized but disclosed in the notes to the financial statements.

Key definitions and recognition criteria in IPSAS 19 are identified below.

Key Definitions and Recognition Criteria from IPSAS 19

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

A provision is a liability of uncertain timing or amount.

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

A legal obligation is an obligation that derives from:

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

A constructive obligation is an obligation that derives from an entity's actions where:

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

IPSAS 19 paragraph 18

Recognition Criteria – Provisions
A provision is recognized when:

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

IPSAS 19 paragraph 22

The ITC explains that consistent with this approach, a government policy or undertaking to provide social benefits in future periods does not of itself mean that a liability should be recognized. All aspects of the definitions of a liability and an obligating event must be satisfied, including that:

- there must be a present obligation for the provision of the benefit. That is, a past event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation must have occurred;

- the government has no realistic alternative but to settle the obligation because the obligation can be enforced by operation of law (legal obligation) or because other parties have a valid expectation that the government will discharge the obligation (constructive obligation); and

- an outflow of resources is expected in settlement of that present obligation.

In addition, a reliable estimate of the amount of the present obligation must be able to be made.

The draft ITC explores a wide range of circumstances, events and factors, or combination of factors, that might be considered as providing evidence of the existence of a present obligation that should be recognized as a liability. It explains that while there is a potentially wide range of views about the circumstances/factors that would need to be present for a liability in respect of social benefits including aged pensions to arise, for purposes of analysis the Steering Committee had focussed on the following three different recognition points:

- when a legal obligation arises – that is, when an individual can seek a judgment in relation to nonpayment or non-performance which is enforced by law.
- in the absence of, or in addition to, a legal obligation - when all eligibility criteria for benefits are satisfied and cash transfers are due and payable or goods or services are due to be delivered. In this case the liability arises because the entity has a constructive obligation to provide benefits. The amount of the liability will be limited to an individual's current entitlement.
- in the absence of, or in addition to, a legal obligation - when key participatory events have occurred that lead an individual to have a reasonable expectation of satisfying eligibility criteria and the government has no realistic alternative but to settle the obligation. This may be prior to the point at which individuals satisfy all eligibility criteria and therefore be prior to the point at which cash transfers are due and payable or goods or services are due to be delivered. This is another circumstance in which a liability may be considered to arise because the entity has a constructive obligation to provide benefits. The amount of the liability will be for:
    - any current entitlements to individuals that have already met the eligibility criteria (cash transfers are due and payable or goods and services are due to be delivered); and

- in the case of ongoing benefits which are subject to regular satisfaction of eligibility criteria, estimated future entitlements, assuming that individuals meet all eligibility criteria in future periods.

As reported at PSC meetings in April and July 2003, (see PSC Updates 8 and 9 on the PSC page of the IFAC website), there is a high level of agreement amongst Steering Committee members that a liability would only be recognized for legal obligations and other amounts “due and payable” (the first and second dot points above) in respect of the provision of individual and collective benefits in the form of services and direct transfers. However, the Steering Committee members hold differing views of when a liability should be recognized for aged pension obligations, with a number of Steering Committee members being of the view that a liability would arise at a point prior to a legal obligation arising and prior to amounts being due and payable, and should be recognised on an accruing basis.

At the July 2003 PSC meeting, a number of PSC members noted that while they supported many of conclusions reached by the Steering Committee, they continued to have reservations about the recognition of pension liabilities and similar benefits on an accruing, rather than on a “due and payable”, basis and the ITC should make it clear that the views of the Steering Committee were not necessarily those of the PSC. The draft ITC will be updated and presented to the PSC at its next meeting for approval to issue.

The Project is ongoing and the ITC is to be further developed.

Annex 1

IPSASs ISSUED AS AT JUNE 2003

Financial Reporting on the Accrual Basis

- IPSAS 1 *Presentation of Financial Statements*
- IPSAS 2 *Cash Flow Statements*
- IPSAS 3 *Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies*
- IPSAS 4 *The Effects of Changes in Foreign Exchange Rates*
- IPSAS 5 *Borrowing Costs*
- IPSAS 6 *Consolidated Financial Statements and Accounting for Controlled Entities*
- IPSAS 7 *Accounting for Investments in Associates*
- IPSAS 8 *Financial Reporting of Interests in Joint Ventures*
- IPSAS 9 *Revenue from Exchange Transactions*
- IPSAS 10 *Financial Reporting in Hyperinflationary Economies*
- IPSAS 11 *Construction Contracts*
- IPSAS 12 *Inventories*
- IPSAS 13 *Leases*
- IPSAS 14 *Events After the Reporting Date*
- IPSAS 15 *Financial Instruments: Disclosure and Presentation*
- IPSAS 16 *Investment Property*
- IPSAS 17 *Property, Plant and Equipment*
- IPSAS 18 *Segment Reporting*
- IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*
- IPSAS 20 *Related Party Disclosures*
- Glossary: *Glossary of Defined Terms IPSAS 1 – IPSAS 18*

Financial Reporting on the Cash Basis

Cash Basis IPSAS *Financial Reporting Under the Cash Basis*

Annex 2

PSC Steering Committee - Social Policy Obligations Arising From Non-Exchange Transactions

Country	Name	Post
Chairman:		
New Zealand	Kevin Simpkins	*Deputy Controller and Auditor-General of New Zealand*
Committee Members:		
Australia	Elizabeth Moran	*South Australian Department of Treasury and Finance* Director Risk Management and Performance Review
Canada	Ron Salole	*Canadian Institute of Chartered Accountants* Director of Accounting Standards
China	Song Qichao	*Ministry of Finance* Deputy Division Director of the Department of Social Security
FEE	Thomas Müller-Marqués Berger	*Ernst & Young AG Wirtschaftsprüfungsgesellschaft* Senior Manager
IMF	Brian Donaghue	*IMF* Consultant
Pakistan	Masud Muzaffar	*Capital Development Authority of Pakistan* Financial Advisor / Member
Sweden	Kristina Lundqvist	*Swedish National Financial Management Authority* Head of Accounting Development Unit
United Kingdom	David Watkins	*HM Treasury* Member of Whole of Government Accounts Team
PSC Staff:		
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