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Mr. Jerry Gutu  
The Technical Director  
Public Sector Committee  
International Federal of Accountants  
545 Fifth Avenue, 14<sup>th</sup> Floor  
New York, New York  
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**RE: Invitation to Comment, “Accounting for Social Policies of Governments”**

Dear Mr. Gutu:

Thank you for this Invitation to Comment (ITC) and to participate in what will undoubtedly be interesting deliberations on a number of critical issues as the Committee moves forward with exposure drafts related to accounting for social policies. The subject matter is complex and controversial and the Steering Committee is to be complimented for its thoughtful work. This work will further promote informed discussion regarding the financial reporting for the social policies and programs of government.

We believe that the approaches and options outlined in this ITC have the potential to shift some of the focus and public debate from current results and issues (financial and otherwise) to the long-term sustainability of the existing structure of state services. The question is how to ensure that financial statements present a fair assessment of government’s financial position and that a particular approach will not bias debate.

Canada, in many ways, has defined itself in terms of its social policies. The sustainability of that policy framework, particularly pensions and health care programs in light of aging populations, is the most formidable issue Canadian governments will have to face in the next decade. From CGA-Canada’s perspective, the concepts and issues raised in this ITC are extremely important and we look forward to participating in further developments.

**General observations**

**Legislation and Policy**

While governments can amend policies [paragraph 3.14 (b)], it is only the legislature that can amend laws. Therefore, when addressing obligations, care must be taken to distinguish between policy and law. A law requiring environmental remediation (hence, recognition of a liability) is no more binding than a law stipulating the payment of a pension or provision of health care services (obligation to provide). To the extent that recognizing the liability associated with one obligation is valid, it is equally valid in the others.

Additionally, there can be constitutional provisions which may transcend the authorities of individual legislatures (laws) and establish obligations. For example, in Canada the Constitution obligates the federal government to provide equalization payments to fiscally weaker provinces to enable them to provide reasonably comparable

services at reasonably comparable levels of taxation; the precise formulas governing the amounts are embodied in legislation and regulation. While there is some limited scope for amending the formula within the context of principle, the reality is that the current formula could be viewed as generating a base case payment. The obligation exists.

### Recognizing Obligations

We have some difficulty with the approaches taken to recognizing an obligation in Chapters 4 and 5. An obligation is not a function of whether a payment to an individual is involved or whether collective and individual services are involved:

*Chapter 4: satisfies eligibility criteria, threshold eligibility criteria or key participatory event.*  
*Chapter 5: no present obligation prior to delivery/provision of the service*

We would argue that whether an obligation exists for a given benefit or service that the government has no realistic option but to settle, should be determined based on consideration of the factors set out in Chapter 4. With respect to collective and individual services, the issues are most likely to pertain to whether a constructive obligation exists, and that will involve careful consideration in the context of application of the factors set out in paragraph 4.24 to 4.31 (applied on a case by case basis). The following examples, set in the Canadian context, elaborate our position.

Applying the criteria and considerations, it is reasonable to assume that an obligation would exist for Canadian Old Age Security pensions:

- Citizens are dependent on the payments and continue to factor the benefit into their planning (explicitly or implicitly).
- Past practices in removing or reducing the benefits have proven difficult and governments have, for example, backed off on de-indexing (the tendency is to capture the benefits paid through the tax system, then claw-back based on taxable income).
- The payment authority and eligibility criteria are factored into the legislation and are shown in Government Estimates for information only (statutory payments).

In a similar vein, governments in Canada have an obligation for the provision of public health care services and that obligation is not conditional on the provision of the service. Rather the obligation is to provide services:

- There are laws that prevent citizens from paying for private services or buying private health insurance for services provided through the public system — citizens are completely dependent
- Efficiency, effectiveness, and funding for the public health care system is the centrepiece of most election campaigns
- The most substantive program spending item in provincial budgets, Estimates, and federal funding is in the form statutory payments to provinces (which require no further authority either by government or by the legislature).
- The Canada Health Act is prescriptive in regards to portability across provinces, etc.
- The provision of public health care services is an integral part of Canadians' financial management, planning, and lifestyle.
- There is a series of ongoing cases before the Supreme Court that are attempting to better define the obligations of government in this regard. In particular, there is one case that is attempting to assess the constitutionality of banning of the private health care alternative.

It is acknowledged that governments have little room to modify the list of eligible services; the focus of change is with respect to cost avoidance - not reduction.

We are of the view that similar arguments can be made for education, where governments both legislate attendance at school and provide public education institutions. With the legislation requiring attendance, there is an obligation to provide the service (present obligation does not arise with the provision of the service).

### Essence of government

The essence of government is the obligations and commitments to its citizens and the resultant accountability.

Over time, governments introduce programs that become ingrained in the national fabric—in Canada’s case the public health care system is arguably one of the nations’ defining characteristics. When introduced, the decision makers could not have foreseen the potential ramifications in terms of evolution of health care, its potential to overwhelm budgets and the degree of dependence of Canadians on the health care system. However, health care is only one aspect (albeit a key one) in complex and interrelating suite of Canadian social programs.

There will be concerns, especially in G8 countries, that an obligations approach that requires the recognition of social policy costs on eligibility or key participatory event could unduly bias policy debates and/or result in an “unacceptable” financial position being reported. In this regard, it could be argued that:

- to the extent that an obligation is triggered by a decision of government and/or action of legislature, the approach fosters transparency and places the accountability for financial implications with the decision makers (in other words, promotes generational accountability);
- should an obligations approach to the recognition of social policy costs indicate that the suite of policies is not sustainable; citizens will have a context for recourse to government for policy initiatives or lack thereof to address the issue (a matter of transparency).

Notwithstanding these comments, bias is also a valid concern. Recognizing the obligations for social programs could significantly skew the perception of financial viability. When assessing financial viability of governments, informed users (such as the markets) take into account not only taxation levels, debt and debt servicing costs, program costs, and economic outlooks, but also the capacity to increase tax revenues. Here one moves from the realm of the accountant to that of the economist.

Chapter 9 references the use of generational accounting or additional disclosures such as the deficit and debt to GDP ratios currently reported by the Department of Finance, and notes the need for further co-operation between accountants and economists in additional reporting and addressing long term financial sustainability.

Notwithstanding companion reporting, the focus in discussions flowing from this ITC (which may lead to the issuing of IPSAS) has to be on the impact of reporting changes and whether financial results would present a fair assessment of government’s financial position.

### Development of an exposure draft

CGA–Canada is looking forward to continued participation in the process. CGA–Canada acknowledges the complexity of the task and recognizes that it is highly unlikely that a comprehensive framework governing accounting for social policies of government can be developed for incorporation into a draft in a timely manner. Should the Public Sector Committee decide to address accounting for social programs on an incremental basis (for example, initially addressing pensions), CGA–Canada would support the following:

- promulgation of a work plan with the draft that would set out the Committee’s strategy for addressing social programs more broadly, including specific milestones; and
- a requirement that any IPSAS emanating from the process require disclosure in financial statements of the limitations in relation to reporting on the entities’ overall social policies and programs (that is, notwithstanding compliance with the IPSAS, what is covered, and what is excluded).

## **Specific Matters for Comment**

- (a) *Do you consider that separate Exposure Drafts of IPSASs should be prepared for*
- (i) *old age security and similar pensions; and*
  - (ii) *other social policy obligations?*

While the principles and many underlying issues are common to both, pensions are sufficiently material in terms of their financial and the public policy implications that separate IPSASs are warranted. Moreover, it would provide States with an opportunity to address the matters separately rather than independently, as the pension issue may draw an undue amount of attention potentially affecting other social policy obligations. Similar comments could be made about Health Care.

If a separate IPSAS are to be prepared and not issued concurrently, there should be a requirement within a given IPSAS for reporting entities to clearly set out within their statements the scope and limitations on reporting in relation to their overall suite of social policies and programs.

- (b) *Do you consider that unfunded pension plans to provide government employees with benefits as a consequence of their employment, where the pensions are to be paid from government revenue, should be included or excluded from any IPSAS on social policy issues?*

Such unfunded plans should be excluded because the plans are a de facto part of the remuneration/benefits accruing to those employees by virtue of their employment, as opposed to social benefits.

- (c) *Do you agree that notions of social benefits are well understood and need not be defined in an IPSAS (if not state reasons and provide an appropriate definition)?*

While notions of social benefits are generally appreciated, all too often what constitutes a social benefit and a corresponding obligation of government in that regard is a matter of debate. Notwithstanding, this approach may be sufficient where there is a long-standing history of government provision of social programs (comprehensive, mature and stable program infrastructure). However, in less developed states, they are not necessarily so well understood and may be evolving.

We would note that the above question, whether to include or exclude unfunded employee pension plans from the scope of any IPSAS on social policy issues, would seem to argue for the inclusion of a definition.

Therefore, it would not be inappropriate to build on the definition in the Government Finance and Statistics Manual to include direct provision by government (as was done in the ITC), supplemented with generic descriptions of social programs by category (for example, simply extract and perhaps elaborate on the exclusion description from IPSAS 19).

This is all related to the fact that the accounting treatment should not be a factor in the policy decision as to the provision of such benefits; governments are generally predisposed to adopt the most favourable interpretations. Therefore, to the extent possible, an IPSAS should minimize scope for debate and differing interpretations. From a public policy perspective, the objectives should be to ensure that decision makers have the financial information necessary to enable them to take informed decisions and that other users have the information necessary to hold the decision makers to account.

(d) *Do you agree that the definition of a liability and the related concepts of a legal and constructive obligation on IPSAS 19 should be applied to non-exchange transactions in the public sector (if not, provide outline of your alternative)?*

Yes.

(e) *Do you agree with the Steering Committee's conclusions about the alternate approaches to determine when a constructive obligation arises in Chapter 4? Are you of the view that there are other circumstances in which a constructive obligation may arise and, if so, please describe.*

Yes, we are in agreement with the Steering Committee's conclusions about the alternate approaches to determine when a constructive obligation.

You may wish to consider the following additional circumstances:

1. Where governments have legislated particular courses for action for its populous which in turn are dependent on actions of government, for example:
  - the requirement that children between the ages of 6 and 16 attend school (in the context of public school systems).
  - the banning of for-profit hospitals and certain other health institutions/services, in the context of legislation governing the provision of health services by government.

The government in these circumstances would seem to have no alternative but to provide a basic suite of services. At issue will be levels of service — there are matters currently before the Canadian Supreme Court regarding levels of service (specifically, the rights to service versus the constitutionality of banning the provision of competing health care services by the private sector).

2. Certain regulatory programs where governments have obligations to enforce types of behaviour to defined standards, such as food inspection, medical device inspections, environmental inspections (in the case of the latter, governments have been found at fault for not having met what inquiries, courts, and others have deemed to be their obligations).

(f) *Do you agree with the Steering Committee View in Chapter 5 that a present obligation for the provision of goods or services to constituents does not arise prior to the provision of those goods and services? Do you agree that any costs incurred in acquiring goods or services for delivery in future should be recognized in accordance IPSAS (or GAAP in absence of such)?*

In general, we disagree that “a present obligation ... does not arise prior to the provision of those goods or services,” noting the obligation to provide certain goods and services may in fact be stronger than obligations for benefits (such as pensions) grounded not only in specific legislation but, also in constitutional frameworks or in long standing aboriginal treaty rights (supported by case law).

Additionally, there are situations where governments have legislated that citizens conduct themselves in certain ways, which obligates the government to provide services:

- education (as noted above), where the government by law requires attendance for children in elementary and secondary schools. The government is obligated to ensure that the capacity exists and will be there for the foreseeable future.
- where the government legislates publicly provided health care to the exclusion of alternatives. Citizens will have structured their life and economic framework around a government-funded health

care system, which for many may be far more important than pensions, leaving the government no realistic alternative but to provide the service.

To the extent that obligations in the context of non-exchange transactions with the citizen apply (for example, pensions), the same concept or logic model should apply with respect to the obligations regarding the provision of goods and services.

(g) *Do you agree that the financial reporting consequences of cash advances provided by a government to allow individuals to purchase specific goods and services, as discussed in Chapter 5 differ from cash advances discussed in Chapter 6, which are provided for use at the discretion of the recipient? If you disagree, please outline your views on how an entity should account for cash advances in Chapters 5 and 6.*

Yes, we agree they differ, subject to the recommendation of the Steering Committee being adopted in respect of the point at which the obligations occur, that is, prior to the delivery of the service (Chapter 5) or in the case of satisfying eligibility criteria (Chapter 6).

(h) *Do you agree with the Steering Committee View in Chapter 7 that the principles developed in Chapters 5 and 6 also apply to specific events, such as disaster relief, which give rise to obligations which government will satisfy in the future? (If you disagree, please identify the factor(s) that make them different).*

Agree, subject to our comments with respect to matters raised in those chapters.

(i) *Do you agree with the majority view of the Steering Committee regarding old age pension obligations, the minority view or do you have another view?*  
(i) *If you agree with majority, are you of the view that additional disclosures should be provided.*  
(ii) *If you agree with the minority, please confirm or outline conditions present to support an obligating event.*  
(iii) *If a different view, please outline that view.*

In general CGA-Canada supports the minority view.

The conditions for the obligating event would likely be a function of the individual state criteria for eligibility, for example, the Canadian Old Age pension is a function of residence with a minimum of 10 years and the benefit determined as 1/40 of the full pension for each year of residence after the age of 18. The criteria are relatively well set and an actuarial liability could be determined on the basis of demographic data available in the national statistical database.

The Committee may have not taken into account the advent of international reciprocal agreements in this area. In a typical reciprocal agreement, one country recognizes the eligibility requirements as being met in another country, and take on the accompanying liabilities. For example, typical provisions might be “consider periods of residence in the other country as periods of residence” for eligibility in Canada’s plan, or “consider periods of contribution to the other country’s plans as periods of residence for contribution to the Canada’s plan.” It should be noted that when proposals for entering into such arrangements are made, costs are identified and presented as a consideration, that is, the government takes into account the fact that it is accepting the related liability. Currently Canada has approximately 50 such arrangements with other nation states.

There are situations where governments have established pension plans that are funded by payroll taxes and taxes on earnings, but are segregated from general revenues. In the case of the Canada Pension Plan, the plan is a defined benefit plan structured on a pay-as-you-go basis. However, from time to time, participants receive Statements of Contributions which set out the retirement pension, disability benefit, and survivor benefit that one “could receive.” It is quite clear that a liability exists and can be estimated.

(j) *Do you agree with the Steering Committee View in Chapter 9 that the disclosure requirements of IPSAS 1 Presentation of Financial Statements and IPSAS 19 Provisions Contingent Liabilities and Contingent Assets should apply in respect of social benefits and the additional detailed disclosures of individual social benefits should not generally be required?*

We agree but note that materiality considerations may require disclosure at the level of the individual social benefit. For example, a social benefit may constitute the largest category of expenditure for a government, as is the case of pensions or health care. In Canada, health care can involve upwards of 40% of provincial spending. Health care may also merit a separate IPSAS as it is extremely complex and the degree of state involvement varies significantly from jurisdiction to jurisdiction, possibly giving rise to a need for discussion, consultation, and specific guidance on treatment.

(k) *Do you agree with the Steering Committee View in Chapter 9 that the PSC should explore the possibility of requiring disclosures about the overall affordability of a government's social benefits, including the assumption that higher level disclosures are most likely to meet users needs.*

The possibility should be explored and the particular approach will depend on the approach to the reporting requirements for statement presentation.

Aggregate reporting is unlikely to be helpful — certain programs such as public health, pensions (both driven by aging populations), and education should likely merit separate disclosure. It is a question of materiality and the approach proposed may not be as helpful in this regard.

(l) *Do you foresee any audit issues that might arise if “sustainability disclosures” were included in the financial statements; if so please describe?*

There are a number of issues that may arise:

- the context is likely to be politically sensitive
- the assumptions used in costing social benefits and projections, particularly where governments are taking decisions to change benefits, will be matters of issue and governments may not wish to have these assumptions publicly known
- the revenue side of the equation (assumptions and projections) will have to be addressed and will be equally complex
- it may prejudice policy deliberations which may be easily biased by minor changes in assumptions
- selection of state auditors may be further subject to political overtones

We hope that you find our input useful in your deliberations.

Regards,

[Original signed by Anthony Ariganello.]

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