This accounting policy paper is based on IPSAS 42 on Social Benefits and other relevant IPSASs as adopted by the Treasury of the Republic of Cyprus.

# Social Welfare Benefits

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Date: 15 July 2019

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# 1. INTRODUCTION

## 1.1 SOCIAL WELFARE BENEFITS

The delivery of social benefit schemes, such as unemployment benefit or disability benefit to the public, is one of the primary objectives of many Governments and often accounts for a sizeable proportion of their expenditure. These benefits however, are cash transfers provided to individuals and/or households and are dealt within the accounting policy on Social Benefits. Social welfare benefits on the other hand, include all benefits which are provided **in kind** to individuals and/or households, such as provision of educational equipment for students with special needs or provision of breakfast for free to students based on financial criteria. Similar to the accounting policy on social benefits, social welfare benefits may be recognized and accounted using two main approaches: General Approach and Insurance Approach.

## 1.2 OBJECTIVE

The objective of this accounting policy is to propose the accounting treatment and disclosure for social welfare benefit schemes so as to improve the relevance, faithful representation and comparability of the information that the public sector entity provides in its financial statements about social welfare benefit schemes. The information provided should help users of the financial statements assess the nature of social welfare benefit schemes provided by a public sector entity, the key features of the operation of those social welfare benefit schemes and the impact of social welfare benefit schemes provided, on the public sector entity's financial statements. The aim of this policy is to provide technical accounting guidance for the preparation of financial statements, so as to enable the financial statements to give a true and fair view of the financial performance and financial position of the Government.

## 1.3 SCOPE

This accounting policy applies to accounting for all social welfare benefit schemes in the financial statements of the Republic of Cyprus and its consolidated entities, as these are defined in the relevant accounting policy, except:

- private arrangements (e.g. concessionary student loans) which are financial instruments, guarantees issued to other entities, such as guarantees on social security funds and any other kind of financial instruments accounted for in accordance with the relevant accounting policy (see Accounting Policy on Financial Instruments);
- employment-related social insurance schemes, such as employment related pensions and health benefits, which are provided by the public sector entities (as an employer) and operate within the employer-employee relationship and are dealt within the relevant accounting policy (see Accounting Policy on Employee Benefits); and
- insurance contracts that are within the scope of the relevant international or national accounting standard dealing with insurance contracts.

Particular attention should be paid to the following additional exceptions:

- any benefit provided to individuals and/or households, in the form of cash transfers (including transfers in the form of cash equivalents, for example pre-paid debit cards that can be used to purchase any item except alcohol and tobacco products);
- any benefit provided to address any other type of social risk, for example domestic violence, other than those benefits given to mitigate the adverse effect of the individual's / household's welfare;
- collective services, such as defence and public order. Collective services have the following characteristics:
  - they are delivered simultaneously to all members of the community;
  - their use is passive as the explicit agreement of the beneficiaries is not required; and
  - the provision of a collective service to one individual does not reduce the amount available to other individuals;
- individual services, such as health and education services. Individual services have the following characteristics:
  - they are delivered to individuals or households to each member of the society as a whole;
  - their use is active as the explicit agreement of the beneficiaries is required; and
  - the provision of an individual service to one individual may reduce the amount available to other individuals or may delay the receipt of those services by some

individuals; and

- goods and services delivered through emergency relief. Emergency relief may be provided in response to specific emergencies, such as natural disasters (i.e. flooding, earthquakes), or the displacement of individuals / households as a result of war, civil commotion or economic failure. Goods and services delivered through emergency relief do not address the needs of the society as a whole.

## 1.4 DEFINITIONS

**Beneficiary** is a party (individual and/or household) that has a right to compensation under a social benefit scheme if a social risk occurs.

**Contractual service margin** – A component of the carrying amount of the asset or liability for a social benefit scheme representing the unearned profit the entity will recognise as it provides services under the social benefit scheme.

**Coverage period** is the period during which the entity provides coverage against social risk. This period includes the coverage that relates to all contributions within the boundary of the social benefit scheme.

**Financial risk** – The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, currency exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.

**Fulfilment cash flows** is the outcome of the explicit, unbiased and probability-weighted estimate (i.e. expected value) of the present value of the future cash outflows minus the present value of the future cash inflows that will arise as the entity fulfils the social benefit scheme, including a risk adjustment for non-financial risk.

**Insurance contracts** are those contracts under which the entity accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

**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.

**Liability** is a present obligation of the entity for an outflow of resources that results from a past event.

**Liability for incurred claims** – An entity's obligation to investigate and pay valid claims for social risks that have already occurred, including social risks that have occurred but for which claims have not been reported, and other incurred expenses related to the provision of the social benefit.

**Liability for remaining coverage** – An entity's obligation to investigate and pay valid claims under an existing social benefit scheme and/or group of social benefit schemes for those social risks that have not yet occurred (i.e. the obligation that relates to the unexpired portion of the coverage period).

**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.

**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. Obligations are not present obligations unless they are binding and there is little or no realistic alternative to avoid an outflow of resources.

**Risk adjustment for non-financial risk** – The compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk as the entity fulfils the services required by the social benefit scheme and/or group of social benefit schemes.

**Social benefits** are cash transfers 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.

**Social Benefit acquisition cash flows** are those cash flows arising from the costs of starting a social benefit scheme that are directly attributable to the scheme. Such cash flows include cash flows that are not directly attributable to beneficiaries or groups of beneficiaries within the social benefit scheme.

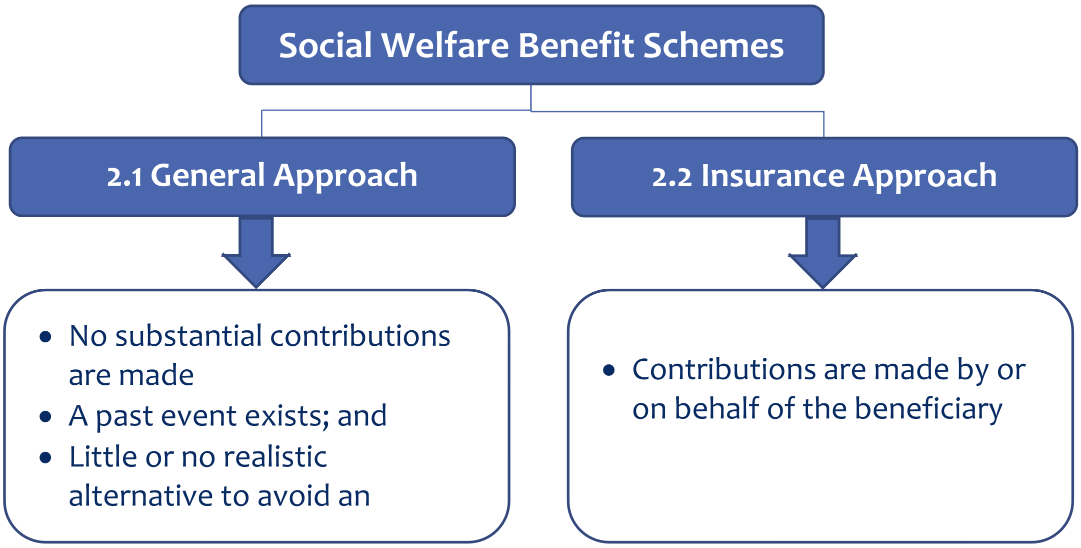
**Social risks** are events or circumstances that:
(a) Relate to the characteristics of individuals and/or households – for example, age, health, poverty and employment status; and
(b) May adversely affect the welfare of individuals and/or households, either by imposing additional demands on their resources or by reducing their income.

**Social welfare benefits** are benefits in kind which may be provided in the form of:
(a) goods and/or services,
(b) vouchers that allow individuals and/or households to access goods and/or services,
(c) reimbursements to individuals and/or households for costs incurred to access goods and/or services,
(d) subsidisation of an organisation whose purpose is the provision of benefits to individuals and/or households in need.

Any other terms defined in other accounting policies that have been adopted by the government of the Republic of Cyprus, have the meaning presented in these accounting policies.

# 2. ACCOUNTING FOR SOCIAL WELFARE BENEFITS

There are two broad approaches for recognition of social welfare benefit schemes:




## 2.1 GENERAL APPROACH

The obligating event approach covers all social benefit schemes for which no substantial contributions are made by the beneficiary.

### 2.1.1 RECOGNITION

#### 2.1.1.1 RECOGNITION OF A LIABILITY FOR A SOCIAL WELFARE BENEFIT SCHEME

A social welfare benefit scheme is recognized as a liability if the following criteria are met:

(a) a present obligation for an outflow of recourses that results from a past event exists; 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.

*An outflow of resources exists when:*

- A liability involves an outflow of resources from the public sector entity for it to be settled.
- There may be uncertainty associated with the measurement of the liability, in such case, the use of estimates can be used. Uncertainty regarding the outflow of resources does not prevent the recognition of a liability, unless the level of uncertainty is so significant that the qualitative characteristics of relevance and faithful representation cannot be met. Where the level of uncertainty does not

prevent the recognition of a liability, it is taken into account when measuring the liability.

<u>*Past Event:*</u>

- The past event that gives rise to a liability for a social welfare benefit scheme is the satisfaction by each beneficiary of all eligibility criteria to receive a social welfare benefit good or service or reimbursement or subsidisation at, or prior to, the reporting date, even if formal validation of the eligibility criteria occurs less frequently. The satisfaction of eligibility criteria to be provided for each social welfare benefit, is a separate past event.
- Where a beneficiary has not previously satisfied the eligibility criteria for the next benefit to be provided, or there has been a break in satisfying the eligibility criteria, a liability is recognised at the point that the eligibility criteria for the next benefit to be provided are first satisfied or when all the eligibility criteria are satisfied again. A public sector entity will recognize a liability where beneficiaries satisfy the eligibility criteria at, or prior to, the reporting date. Where a beneficiary satisfies the eligibility criteria for a social welfare benefit to be provided prior to the point at which the next social welfare benefit will be provided, but after the reporting date, no liability is recognised, as there is no present obligation as at the reporting date.
- Where a beneficiary has previously satisfied the eligibility criteria and there has been no break in satisfying those criteria, a liability for social welfare benefits is recognised each time the criteria are satisfied.
- Being alive could be a separate eligibility criterion but this depends of the characteristics of each individual social welfare benefit scheme. For some schemes, separate consideration of being alive is not required as it is indirectly addressed by another eligibility criterion. An entity needs to consider how being alive affects the recognition of each particular social welfare benefit scheme, taking all relevant factors into consideration.

#### *2.1.1.2 RECOGNITION OF AN EXPENSE FOR A SOCIAL BENEFIT SCHEME*

A social welfare benefit scheme is recognised as an expense at the same point that a liability is recognised. A public sector entity shall not recognise an expense for a social welfare benefit scheme where a social welfare benefit is provided prior to all eligibility criteria for the next benefit to be provided are satisfied. Instead, the public sector entity shall recognise a a benefit that is provided in advance, as an asset in the statement of financial position, unless the amount becomes irrecoverable, in which case it shall be recognised as an expense.

## 2.1.2 MEASUREMENT

### 2.1.2.1 MEASUREMENT OF A LIABILITY FOR A SOCIAL BENEFIT SCHEME

#### 2.1.2.1.1 INITIAL MEASUREMENT OF THE LIABILITY

1. A public sector entity shall measure the liability for a social welfare benefit scheme at the best estimate of the costs (i.e., the social welfare benefit to be provided) that the entity will incur in fulfilling the present obligations represented by the liability. Satisfaction of the eligibility criteria for the provision of each social welfare benefit is a separate past event, and the liability for each benefit to be provided is measured separately. The maximum amount to be recognized as a liability is the costs the entity expects to incur in providing for the next social welfare benefit. This is because social welfare benefits that are provided for beyond this point, are future events for which there is no present obligation.
2. The public sector entity's best estimate of the costs (i.e., the social welfare benefit to be provided) that the entity will make takes into account the possible effect of subsequent events of those social welfare benefit to be provided.
3. In measuring the liability, the public sector entity takes into account the possibility that beneficiaries may cease to be eligible for the social welfare benefit prior to the next point at which eligibility criteria for the next benefit to be provided are required (implicit or explicit) to be satisfied. Examples where the beneficiary ceases to be eligible for the social welfare benefit include:

   (a) The death of the beneficiary (where no survivor benefits are payable);
   (b) Commencing employment (in the case of an unemployment benefit); and
   (c) Exceeding the maximum period for which a social welfare benefit is provided (where an unemployment benefit is provided for a limited period).

   The extent to which such events affect the measurement of the liability will depend on the terms of the scheme.

4. Because a liability cannot extend beyond the point at which eligibility criteria for the next benefit to be provided will be next satisfied, liabilities in respect of social welfare benefits will usually be short-term liabilities. Consequently, prior to the financial statements being authorized for issue, an entity may receive information regarding the eligibility of beneficiaries to receive the social welfare benefit. The Accounting Policy on Events After the Reporting Date, provides guidance on using this information.

5. Because a liability of a social welfare benefit scheme will usually be a short-term liability, the time value of money may not be material. When however, the liability in respect of a social welfare benefit scheme is not expected to be settled before twelve months after the end of the reporting period in which the liability is recognized, the liability shall be discounted using the discount rate specified in paragraph 2.1.2.1.3.

#### *2.1.2.1.2 Subsequent Measurement*

The liability for a social welfare benefit scheme shall be reduced as social welfare benefit are provided. Any difference between the cost for providing the social welfare benefit and the carrying amount of the liability in respect of the social welfare benefit scheme is recognized in surplus or deficit in the period in which the liability is settled.

Where a liability is discounted in accordance with paragraph 2.1.2.1.1 (4), the liability is increased and interest expense recognized in each reporting period until the liability is settled, to reflect the unwinding of the discount.

Where a liability has yet to be settled, the liability shall be reviewed at each reporting date, and adjusted to reflect the current best estimate of the costs (i.e., the social welfare benefit to be provided) that the public sector entity will incur in fulfilling the present obligations represented by the liability.

#### *2.1.2.1.3 Discount Rate*

The rate used to discount the liability in respect of a social welfare benefit scheme shall reflect the time value of money. The currency and term of the financial instrument selected to reflect the time value of money shall be consistent with the currency and estimated term of the social welfare benefit liability. The Government will be using the discount rate that reflects the time value of money as this is explained in paragraph 3.2.2.3 (3) of the Accounting Policy on Employee Benefits.

### *2.1.2.2 Measurement of an Expense for a Social Benefit Scheme*

A public sector entity shall initially measure the expense for a social welfare benefit scheme at an amount equivalent to the amount of the liability measured in accordance with paragraph 2.1.2.1.1 (1). Where the public sector entity provides a social welfare benefit prior to all eligibility criteria for the next benefit to be provided are satisfied, it shall measure the provision of the benefit in advance or an expense is recognized, in accordance with paragraph 2.1.1.2, at the amount at which the goods and/or services are provided.

# 3. DISCLOSURES

Disclosures will differ based on each of the approach adopted:

## 3.1 OBLIGATING EVENT APPROACH

A public sector entity shall disclose information that:

(a) Explains the characteristics of its social welfare benefit schemes; and

(b) Explains the demographic, economic and other external factors that may affect its social welfare benefit schemes.

To meet the above requirements, a public sector entity shall disclose:

(a) Information about the characteristics of its social welfare benefit schemes, including:

  i. The nature of the social welfare benefits provided by the scheme (for example, the provision of educational equipment for students with special needs or provision of breakfast for free to students based on financial criteria ).

  ii. Key features of the social welfare benefit scheme, such as a description of the legislative framework governing the scheme, a summary of the main eligibility criteria that must be satisfied to receive the social welfare benefits, and a statement about how additional information about the scheme can be obtained.

  iii. A description of how the schemes are funded, including whether the funding for the schemes is provided by means of a budget appropriation, a transfer from another public sector entity, or by other means. If a scheme is funded (whether in full or in part) by social contributions, the entity shall provide:

    a. A cross reference to the location of information on those social contributions and any dedicated assets (where this information is included in the public sector entity's financial statements); or

    b. A statement regarding the availability of information on those social contributions and any dedicated assets in another public sector entity's financial statements and how that information can be obtained.

(b) The total expenditure on social welfare benefits recognised in the statement of financial performance, analysed by social benefit scheme.

(c) A description of any significant amendments to the social welfare benefit schemes made during the reporting period, along with a description of the expected effect of the amendments. Amendments to a social welfare benefit scheme include, but are not limited to:

  i. Changes to the level of social welfare benefits provided; and

  ii. Changes to the eligibility criteria, including the individuals and/or households covered by the social welfare benefit scheme.

In making the disclosures required by this paragraph, a public sector entity should take into consideration the requirements of paragraph 2.4 of the Accounting Policy on Presentation of Financial Statements, which provide guidance on materiality and aggregation.

(d) If a social welfare benefit scheme satisfies the criteria in paragraph 2.2 (1) to permit the use of the insurance approach, a statement should be made to that effect.

# 4. EFFECTIVE DATE

The rules mentioned above shall be effective for annual financial statements covering periods beginning on or after 1 January 2023.

# 5. REFERENCES

This accounting policy is based on the following papers:

IPSAS 42 "Social Benefits"