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 Benefits

Version 2

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1. INTRODUCTION

1.1 SOCIAL 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. They 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 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 benefit schemes. The information provided should help users of the financial statements assess the nature of social benefit schemes provided by a public sector entity, the key features of the operation of those social benefit schemes and the impact of social 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 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 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, or reimbursements and vouchers. 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.

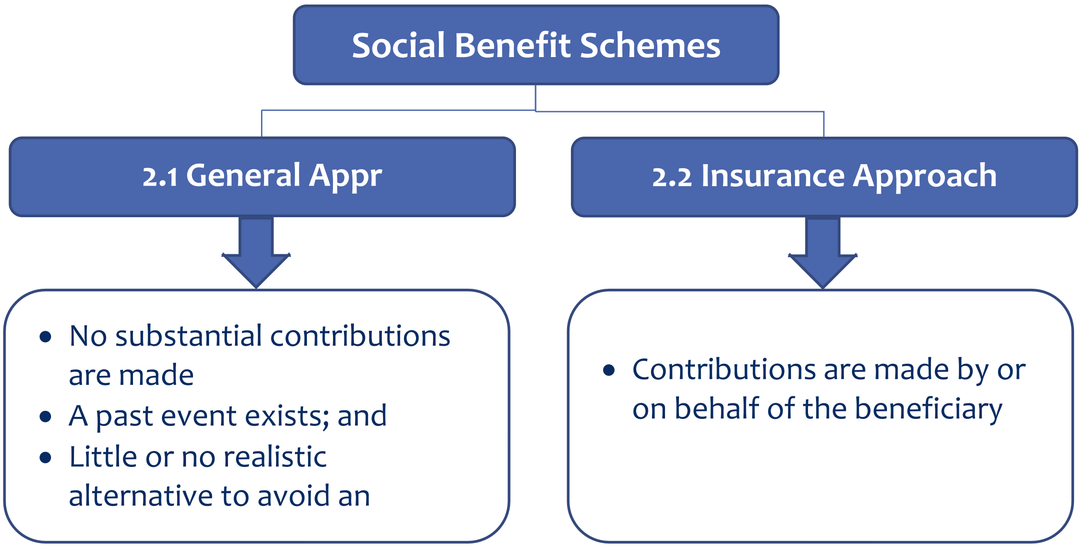
Social Benefit acquisition cash flows are those cash flows arising from the costs of starting a social benefit scheme that are directly attributable to the scheme. Such cash flows include cash flows that are not directly attributable to beneficiaries or groups of beneficiaries within the social benefit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

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 BENEFITS

There are two broad approaches for recognition of social 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 BENEFIT SCHEME

A social 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.

Past Event:

- The past event that gives rise to a liability for a social benefit scheme is the satisfaction by each beneficiary of all eligibility criteria to receive a social benefit payment at, or prior to, the reporting date, even if formal validation of the eligibility criteria occurs less frequently. The satisfaction of eligibility criteria for each social benefit payment is a separate past event.
- Where a beneficiary has not previously satisfied the eligibility criteria for the next payment, 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 payment 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 benefit payment prior to the point at which the next social benefit payment will be made, 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 benefits is recognised each time the criteria are satisfied.
- Being alive could be a separate eligibility criterion but this depends on the characteristics of each individual social 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 benefit scheme, taking all relevant factors into consideration.

2.1.1.2 RECOGNITION OF AN EXPENSE FOR A SOCIAL BENEFIT SCHEME

A social 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 benefit scheme where a social benefit payment is made prior to all eligibility criteria for the next payment being satisfied. Instead, the public sector entity shall recognise a payment in advance as an asset in the statement of financial position, unless the amount becomes irrecoverable, in which case it shall recognise 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 benefit scheme at the best estimate of the costs (i.e., the social benefit payments) that the entity will incur in fulfilling the present obligations represented by the liability. Satisfaction of the eligibility criteria for each social benefit payment is a separate past event, and the liability for each payment is measured separately. The maximum amount to be recognized as a liability is the costs the entity expects to incur in making the next social benefit payment. This is because social benefit payments 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 benefit payments) that the entity will make takes into account the possible effect of subsequent events of those social benefit payments.
3. In measuring the liability, the public sector entity takes into account the possibility that beneficiaries may cease to be eligible for the social benefit prior to the next point at which eligibility criteria for the next payment are required (implicit or explicit) to be satisfied. Examples where the beneficiary ceases to be eligible for the social 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 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 payment will be next satisfied, liabilities in respect of social 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 benefit. The Accounting Policy on Events After the Reporting Date, provides guidance on using this information.
5. Because a liability of a social 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 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 benefit scheme shall be reduced as social benefit payments are made. Any difference between the cost of making the social benefit payments and the carrying amount of the liability in respect of the social 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 benefit payments) 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 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 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 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 makes a social benefit payment prior to all eligibility criteria for the next payment being satisfied, it shall measure the payment in advance or an expense is recognized, in accordance with paragraph 2.1.1.2, at the amount of the cash transferred.

2.2 INSURANCE APPROACH

1. The insurance approach covers a social benefit scheme where:
   (a) The social benefit scheme is intended to be fully funded from contributions, by or on behalf of the beneficiary, in accordance with paragraphs 2 and 3 of this section; and
   (b) There is evidence that the public sector entity manages the scheme in the same way as an issuer of insurance contracts, in accordance with paragraphs 4 and 5 of this section, including assessing the financial performance and financial position of the scheme on a regular basis.

2. A social benefit scheme is intended to be fully funded from contributions when:
   (a) The legislation or other arrangement governing the social benefit scheme provides for the scheme to be funded by contributions or levies paid by or on behalf of either the potential beneficiaries or those whose activities create or exacerbate the social risks which are mitigated by the social benefit scheme, together with investment returns arising from the contributions or levies; and
   (b) One or more of the following indicators (individually or in combination) is satisfied:
      (i) Contribution rates or levy rates are reviewed (and, where appropriate, adjusted in line with the scheme's funding policy), either on a regular basis or when specified criteria are met, with the aim of ensuring that the revenue from contributions or levies will be sufficient to fully fund the social benefit scheme; and/or
      (ii) Social benefit levels are reviewed (and, where appropriate, adjusted in line with the scheme's funding policy), either on a regular basis or when specified criteria are met, with the aim of ensuring that the levels of social benefits provided will not exceed the level of funding available from contributions or levies.

   In subparagraphs (i) and (ii) above, reviews are undertaken on a regular basis when they are performed at a frequency appropriate for the specific scheme. While annual reviews are common, less frequent – or more frequent – reviews will be appropriate for some schemes.

3. In some circumstances, a public sector entity may be required to make contributions to a social benefit scheme on behalf of those individuals and/or households who could not afford to do so. Such contributions may be made by the public sector entity administering the scheme or some other entity. For example, a public sector entity may be required to make contributions to a retirement pension scheme for those individuals who are unemployed. Where the contributions relate to specified individuals and/or households (which in some cases will require the contributions to be credited against the individuals' contribution accounts), the contributions made by the public sector entity are to be considered as contributions for the purposes of determining whether a social benefit scheme is intended to be fully funded from contributions in accordance

with paragraph 1 (a) of this section. Where a public sector entity makes contributions to fund the deficit on a social benefit scheme, the contributions are not related to specified individuals and/or households, and are not considered as contributions for the purposes of determining whether a social benefit scheme is intended to be fully funded from contributions in accordance with paragraph 1 (a) of this section.

4. In assessing whether a social benefit scheme is intended to be fully funded from contributions, a public sector entity considers substance over form. For example, where a social benefit scheme is in deficit for a period but the scheme has an ability to adjust the future contribution rates and/or benefits payable such that the deficit is addressed, the scheme may still satisfy the criteria to be accounted for under the insurance approach.

5. The reference in paragraph 2 (a) of this section to "those whose activities create or exacerbate the social risks which are mitigated by the social benefit scheme" is intended to cover those social benefit schemes such as an accident insurance schemes that:
   (a) Are funded by levies on, for example, motorists or employers in particular industries; and
   (b) Provide coverage against social risks to the wider population.

6. A public sector entity is managing a scheme in the same way as an insurer would manage an insurance portfolio when the social benefit scheme has, with the exception of its legislative rather than contractual origins, the characteristics of an insurance contract as explained in paragraph 1.3. The social benefit scheme should confer the rights and obligations on parties similar to that of an insurance contract.
7. In determining whether it is managing a social benefit scheme in the same way as an insurer would manage an insurance portfolio, an entity considers the following indicators:
   (a) Does the entity consider itself bound by the scheme in a similar manner to an insurer being bound by an insurance contract? For example, there may be evidence that the entity considers that it can amend the terms of the scheme for existing participants in a manner that an insurer could not (such as where the entity can make retrospective changes to the scheme). In such cases, the entity will not be bound in a similar manner to an insurer, and the social benefit scheme will not have the characteristics of an insurance contract. A public sector entity will be bound by the scheme in a similar manner to an insurer where its ability to amend the scheme for existing participants is limited to:
      (i) Circumstances prescribed by the legislation that establishes the scheme (equivalent to a contractual term permitting changes in specific circumstances); or

(ii) When a government is setting new contribution or levy rates (where a trade-off between the contributions and prospective benefits is part of the process of determining an appropriate rate).

(b) Are assets relating to the social benefit scheme held in a separate fund, or otherwise earmarked, and restricted to being used to provide social benefits to participants? If a public sector entity does not separately identify amounts relating to social benefits, this will provide evidence that the entity considers the contributions as a form of taxation. The social benefit scheme will not have the characteristics of an insurance contract. There will also be practical difficulties with applying the measurement requirements of the relevant international or national accounting standard dealing with insurance contracts if the assets associated with a social benefit scheme are not separately identified.

(c) Does the legislation that establishes the social benefit give enforceable rights to participants in the event that the social risk occurs? Insurance contracts give such rights to policyholders. If the social benefit scheme does not also include such rights, then any social benefits provided by the entity will have a discretionary nature, meaning that the social benefit scheme will not have the characteristics of an insurance contract. For rights to be enforceable, a participant would need to have the right to challenge–in a court of law, via an arbitration or dispute resolution process or similar mechanism–decisions by the entity. The decisions that may be challenged include, but are not limited to, those regarding whether an event is covered by a scheme, the level of social benefits payable by a scheme, and the duration of any social benefits payable by a scheme.

(d) Apublic sector entity assesses the financial performance and financial position of a social benefit scheme on a regular basis where it is required to report internally on the financial performance of the scheme, and, where necessary, to take action to address any under-performance by the scheme. The assessment is expected to involve the use of actuarial reviews, mathematical modelling, or similar techniques to provide information for internal decision-making on the different possible outcomes that might occur.

(e) Is there a separate entity established by the government, which is expected to act like an insurer in relation to a social benefit scheme? The existence of such an entity provides evidence that the entity is managing a scheme in the same way as an insurer would manage an insurance portfolio. However, it is not a requirement for applying the insurance approach that a separate entity has been established. Relevant international and national accounting standards dealing with insurance contracts apply to insurance contracts, not just to insurance companies.

2.2.1 *AGGREGATION*

1. A public sector entity shall identify group of social benefit schemes. A group comprises social benefit schemes subject to similar risks and managed together. Social benefit schemes providing similar services or providing services to the same group of beneficiaries would be expected to have similar risks and hence would be expected to be in the same group if they are managed together. Social benefit schemes such as for example old age pension compared with sickness allowance, would not be expected to have similar risks and hence would be expected to be in different group.
2. A public sector entity shall divide the entire social benefit scheme issued as either:
   (a) onerous at initial recognition, or
   (b) not onerous at initial recognition having no significant possibility of becoming onerous subsequently,
   (c) the remaining social benefit scheme.
3. For social benefit schemes to which the public sector entity applies the General Model in accordance with paragraph 2.2.3.1, the entity shall assess whether schemes that are not onerous at initial recognition, have no significant possibility of becoming onerous subsequently:
   (a) based on the likelihood of changes in assumptions which, if they occurred, would result in the schemes becoming onerous.
   (b) using information about estimates provided by the entity's internal reporting. Hence, in assessing whether schemes that are not onerous at initial recognition have no significant possibility of becoming onerous:
      i. the public sector entity shall not disregard information provided by its internal reporting about the effect of changes in assumptions on different schemes on the possibility of their becoming onerous; but
      ii. the public sector entity is not required to gather additional information beyond that provided by the entity's internal reporting about the effect of changes in assumptions on different schemes.
4. For social benefit schemes to which the public sector entity applies the premium allocation approach, the entity shall assume none of them is onerous at initial recognition, unless facts and circumstances indicate otherwise. The public sector entity shall assess whether schemes that are not onerous at initial recognition, have no significant possibility of becoming onerous subsequently, by assessing the likelihood of changes in applicable facts and circumstances.

5. An entity shall not include beneficiaries entered more than one year apart, in the same group of social benefit schemes. To achieve this, the entity shall, if necessary, further divide the groups described in paragraphs 2 – 4 of this section.

2.2.2 *RECOGNITION*

The public sector entity shall recognise a social security scheme and/or group of social benefit schemes at the earliest of:

(a) the beginning of the coverage period of the scheme;

(b) the date when the first direct cash contribution from or on behalf of the beneficiary becomes due; or

(c) the date it becomes onerous (for a scheme that is onerous at initial recognition).

Contributions include:

- direct contributions;
- imputed contributions; and
- contributions treated as general taxation.

Direct contributions:

In most cases, contributions in the form of cash transfer are paid by the beneficiary to the social benefit scheme.

Imputed contributions:

In some cases, contributions may be imputed, for example when an individual is unemployed or when a parent stays at home to care for the children. In those cases imputed contributions involve a cash transfer from a public sector entity to the social benefit scheme. From the perspective of the scheme, there is no difference between contributions received directly from beneficiaries and those received from a public sector entity in the form of imputed contributions.

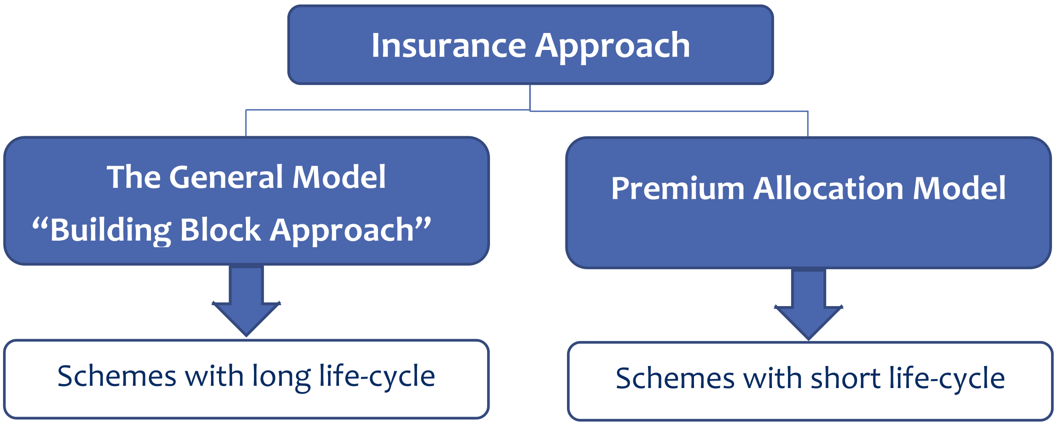
Contributions treated as general taxation:

In some cases, contributions received are treated by the Government as general taxation. Under the Insurance Approach the public sector entity shall consider only those schemes under which there is a reliable basis for allocating the general taxation contributions to individual schemes. In such cases, the financial statements should indicate:

- whether the scheme is subsidized by general taxation;
- whether the scheme is fully funded by the contributions; or
- whether the scheme is generating a surplus that is being used to finance other government expenditure.

2.2.3 MEASUREMENT

The amount recognized as an expense and a liability in respect of a social benefit scheme and/or group of social benefit schemes under the insurance approach, shall be measured using one of the two models:



Each social benefit scheme falling into the insurance approach, will be assessed individually whether it falls under the General Model or Premium Allocation Model, based on the lifespan described in the figure above.

2.2.3.1 THE GENERAL MODEL

2.2.3.1.1 MEASUREMENT ON INITIAL RECOGNITION

On initial recognition, the public sector entity shall measure a social benefit scheme and/or group of social benefit schemes at the total of:

(a) the fulfilment cash flows, which comprise:

i. estimates of future cash flows (paragraph 2.2.3.1.1.1);

ii. an adjustment to reflect the time value of money and the financial risks related to the future cash flows, to the extent that the financial risks are not included in the estimates of the future cash flows (paragraph 2.2.3.1.1.2); and

iii. a risk adjustment for non-financial risk (paragraph 2.2.3.1.1.3); and

(b) the contractual service margin (paragraph 2.2.3.1.1.4).

2.2.3.1.1.1 ESTIMATES OF FUTURE CASH FLOWS

1. The public sector entity shall include in the measurement of a social benefit scheme and/or group of social benefit schemes all future cash flows associated with the scheme. These cash flows include contributions received and benefits payable by the entity. The estimates of future cash flows shall:

(a) incorporate, in an unbiased way, all reasonable and supportable information available without undue cost or effort about the amount, timing and uncertainty of those future cash flows. To do this, the public sector entity shall estimate the expected value (i.e. the probability-weighted mean) of the full range of possible outcomes;

(b) reflect the perspective of the public sector entity, provided that the estimates of any relevant market variables are consistent with observable market prices for those variables;

(c) be current – the estimates shall reflect conditions existing at the measurement date, including assumptions at that date about the future; and

(d) be explicit – the public sector entity shall estimate the adjustment for non-financial risk separately from the other estimates. The public sector entity shall also estimate the cash flows separately from the adjustment for the time value of money and financial risk, unless the most appropriate measurement technique combines these estimates.

2. Cash flows are within the boundary of a social benefit scheme and/or group of social benefit schemes if they arise from substantive rights and obligations that exist during the reporting period in which the public sector entity can compel the beneficiary to pay the contributions or in which the entity has a substantive obligation to provide the beneficiary with coverage against social risk, including all the subsequent compensation. A substantive obligation to provide services ends when:

(a) the public sector entity has the practical ability to reassess the risks of the beneficiaries and, as a result, can set a compensation rate or benefits payable that fully reflects those risks associated with the scheme; and

(b) the pricing of the compensation for coverage up to the date when the risks are reassessed does not take into account the risks that relate to periods after the reassessment date.

Actuarial assumptions, applying Appendix 6.1, are required in determining the coverage period and boundary.

The coverage period and boundary for a social benefit scheme for example, may relate to a specific period of time. This could be the case for a retirement pension scheme, where the public sector entity's right to contributions may commence when the individual enters the workplace. The public sector entity's obligation to pay retirement benefits would end with the death of the individual. These events define the scheme boundary. However, if the public sector entity is able to amend the contribution rate or the benefits payable to reflect the risks associated with the scheme, the point at which the public sector entity can reassess the risks, would determine the scheme boundary.

2.2.3.1.1.2 DISCOUNT RATES

A public sector entity shall adjust the estimates of future cash flows to reflect the time value of money and the financial risks related to those cash flows, to the extent that the financial risks are not included in the estimates of cash flows. The discount rates applied to the estimates of the future cash flows described in paragraph 2.2.3.1.1.1(1) shall:

(a) reflect the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts;

(b) be consistent with observable current market prices (if any) for financial instruments with cash flows whose characteristics are consistent with those of the insurance contracts, in terms of, for example, timing, currency and liquidity; and

(c) exclude the effect of factors that influence such observable market prices but do not affect the future cash flows of the insurance contracts

2.2.3.1.1.3 RISK ADJUSTMENT FOR NON-FINANCIAL RISK

The public sector entity shall adjust the estimate of the present value of the future cash flows to reflect the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.

2.2.3.1.1.4 CONTRACTUAL SERVICE MARGIN

The contractual service margin is a component of the asset or liability for the social benefit scheme that represents the unearned surplus the public sector entity will recognise as it provides services in the future. The public sector entity shall measure the contractual service margin on initial recognition of the social benefit scheme at an amount that, unless paragraph 2.2.3.1.3 (on onerous schemes) applies, results in no revenues or expenses arising from:

(a) the initial recognition of an amount for the fulfilment cash flows; and

(b) any cash flows arising from the beneficiaries in the scheme at that date.

2.2.3.1.2 SUBSEQUENT MEASUREMENT

1. The carrying amount of a social benefit scheme and/or group of social benefit schemes at the end of each reporting period shall be the sum of:
   (a) the liability for remaining coverage comprising:
      i. the fulfilment cash flows related to future service allocated to the scheme at that date, measured applying paragraphs 2.2.3.1.1.1 – 2.2.3.1.1.3;
      ii. the contractual service margin of the scheme at that date measured applying paragraph 2.2.3.1.2.1; and
   (b) the liability for incurred claims, comprising the fulfilment cash flows related to past service allocated to the scheme at that date, measured applying paragraphs 2.2.3.1.1.1 – 2.2.3.1.1.3.
2. The public sector entity shall recognise revenues and expenses for the following changes in the carrying amount of the liability for remaining coverage:
   (a) Revenue – for the reduction in the liability for remaining coverage because of services provided in the period;
   (b) Expenses – for losses on onerous social benefit schemes and reversals of such losses; and
   (c) Finance revenues or expenses – for the effect of the time value of money and the effect of financial risk.

3. The public sector entity shall recognise revenues and expenses for the following changes in the carrying amount of the liability for incurred claims:
   (a) Expenses – for the increase in the liability because of claims and expenses incurred in the period;
   (b) Subsequent Expenses – for any subsequent changes in fulfilment cash flows relating to incurred claims and expenses; and
   (c) Finance revenues or expenses – for the effect of the time value of money and the effect of financial risk.

2.2.3.1.2.1 CONTRACTUAL SERVICE MARGIN

1. The contractual service margin at the end of the reporting period represents the profit in the scheme that has not yet been recognised in the statement of financial performance because it relates to the future services to be provided.

2. The carrying amount of the contractual service margin of a social benefit scheme at the end of the reporting period equals the carrying amount at the start of the reporting period adjusted for:

(a) the effect of any new beneficiaries added to the scheme;

(b) interest accreted on the carrying amount of the contractual service margin during the reporting period, measured at the discount rates specified in paragraph 2.2.3.1.1.2;

(c) the changes in fulfilment cash flows relating to future service, except to the extent that:

   i. such increases in the fulfilment cash flows exceed the carrying amount of the contractual service margin, giving rise to a loss (see paragraph 2.2.3.1.3 (2)); or

   ii. such decreases in the fulfilment cash flows are allocated to the loss component of the liability for remaining coverage applying paragraph 2.2.3.1.3 (4)(b).

(d) the effect of any currency exchange differences on the contractual service margin; and

(e) the amount recognised as revenue because of the transfer of services in the period, determined by the allocation of the contractual service margin remaining at the end of the reporting period (before any allocation) over the current and remaining coverage period.

3. Some changes in the contractual service margin offset changes in the fulfilment cash flows for the liability for remaining coverage, resulting in no change in the total carrying amount of the liability for remaining coverage. To the extent that changes in the contractual service margin do not offset changes in the fulfilment cash flows for the liability for remaining coverage, the public sector entity shall recognise revenues and expenses for the changes, applying paragraph 2.2.3.1.2 (2).

***2.2.3.1.3* ONEROUS SOCIAL BENEFIT SCHEME**

1. A social benefit scheme is onerous at the date of initial recognition if the fulfilment cash flows allocated to the scheme, any previously recognised acquisition cash flows and any cash flows arising from the scheme at the date of initial recognition in total, are a net outflow. Applying paragraph 2.2.1 (2)(a), the public sector entity shall group entire social benefit schemes separately from schemes that are not onerous. The public sector entity shall recognise a loss in the statement of financial performance for the net outflow for the scheme, resulting in the carrying amount of the liability for the scheme being equal to the

fulfilment cash flows and the contractual service margin of the scheme being zero.

2. A social benefit scheme becomes onerous on subsequent measurement if, the unfavourable changes in the fulfilment cash flows allocated to the scheme arising from changes in estimates of future cash flows relating to future service, exceed the carrying amount of the contractual service margin:

   Applying paragraph 2.2.3.1.2.1 (2)(c)(i), the public sector entity shall recognise a loss in the statement of financial performance to the extent of that excess.

3. The public sector entity shall establish (or increase) a loss component of the liability for remaining coverage for an onerous group depicting the losses recognised applying the above two paragraphs. The loss component determines the amounts that are presented in the statement of financial performance as reversals of losses on onerous scheme and are consequently excluded from the determination of revenue.

4. After the public sector entity has recognised a loss on an onerous social benefit scheme, it shall allocate:
   (a) the subsequent changes in fulfilment cash flows of the liability for remaining coverage specified in paragraph (5) of this section, on a systematic basis between:
      i. the loss component of the liability for remaining coverage; and
      ii. the liability for remaining coverage, excluding the loss component.
   (b) any subsequent decrease in fulfilment cash flows allocated to the group arising from changes in estimates of future cash flows relating to future service. Applying paragraph 2.2.3.1.2.1 (2)(c)(ii), an entity shall adjust the contractual service margin only for the excess of the decrease over the amount allocated to the loss component.

5. The subsequent changes in the fulfilment cash flows of the liability for remaining coverage to be allocated applying paragraph (4)(a) of this section are:
   (a) estimates of the present value of future cash flows for claims and expenses released from the liability for remaining coverage because of incurred insurance service expenses;

(b) changes in the risk adjustment for non-financial risk recognised in profit or loss because of the release from risk; and
(c) finance revenues or expenses.

2.2.3.2 *PREMIUM ALLOCATION APPROACH*

1. A public sector entity may simplify the measurement of a social benefit scheme using the premium allocation approach if, and only if, at the inception of the scheme:
   (a) the public sector entity reasonably expects that such simplification would produce a measurement of the liability for remaining coverage for the scheme that would not differ materially from the one that would be produced applying the requirements of the General Model; or
   (b) the coverage period of the social benefit scheme (including coverage arising from all premiums within the contract boundary determined at that date applying paragraph 2.2.3.1.1.1 (2)) is one year or less.

2. The criterion in paragraph (1)(b) of this section is not met if, at the inception of the scheme, the public sector entity expects significant variability in the fulfilment cash flows that would affect the measurement of the liability for remaining coverage during the period before compensation is incurred. Variability in the fulfilment cash flows increases with, for example:
   (a) the extent of future cash flows relating to any derivatives embedded in the social benefit scheme; and
   (b) the length of the coverage period of the social benefit scheme.

3. Using the premium allocation approach, a public sector entity shall measure the liability for remaining coverage as follows:
   (a) on initial recognition, the carrying amount of the liability is:
      i. the contributions, if any, received at initial recognition;
      ii. minus any social benefit acquisition cash flows at that date, unless the entity chooses to recognise the payments as an expense applying paragraph (7)(a) of this section; and
   (b) at the end of each subsequent reporting period, the carrying amount of the liability is:
      i. the carrying amount at the start of the reporting period;
      ii. plus the contributions received in the period;
      iii. minus social benefit acquisition cash flows, unless the entity chooses to recognise the payments as an expense applying paragraph (7)(a) of this section;
      iv. plus any amounts relating to the amortisation of social benefit acquisition cash flows recognised as an expense in the reporting

period, unless the entity chooses to recognise those cash flows as an expense applying paragraph (7.a) of this section;

v. plus any adjustment to a financing component, applying paragraph (4) of this section; and

vi. minus the amount recognised as revenue for coverage provided in that period.

4. If a social benefit scheme has a significant financing component, a public sector entity shall adjust the carrying amount of the liability for remaining coverage to reflect the time value of money and the effect of financial risk, using the discount rates specified in paragraph 2.2.3.1.1.2, as determined on initial recognition. The entity is not required to adjust the carrying amount of the liability for remaining coverage to reflect the time value of money and the effect of financial risk if, at initial recognition, the entity expects that the time between providing each part of the coverage and the related contribution due date is no more than a year.

5. If at any time during the coverage period, facts and circumstances indicate that a social benefit scheme is onerous, a public sector entity shall calculate the difference between:
   (a) the carrying amount of the liability for remaining coverage determined applying paragraph (3) of this section; and
   (b) the fulfilment cash flows that relate to remaining coverage of the scheme, applying paragraphs 2.2.3.1.1.1 – 2.2.3.1.1.3. However, if, in applying paragraph (7)(b) of this section, the entity does not adjust the liability for incurred compensations for the time value of money and the effect of financial risk, it shall not include in the fulfilment cash flows any such adjustment.

6. To the extent that the fulfilment cash flows described in paragraph (5)(b) of this section exceed the carrying amount described in paragraph (5)(a) of this section, the public sector entity shall recognise a loss in the statement of financial performance and increase the liability for remaining coverage.

7. In applying the premium allocation approach, a public sector entity:
   (a) may choose to recognise any social benefit acquisition cash flows as expenses when it incurs those costs, provided that the coverage period of the scheme at initial recognition is no more than one year,
   (b) shall measure the liability for incurred claims for the scheme at the fulfilment cash flows relating to incurred compensations, applying paragraphs 2.2.3.1.1.1 – 2.2.3.1.1.3. However, the entity is not required to adjust future

cash flows for the time value of money and the effect of financial risk, if those cash flows are expected to be paid or received in one year or less from the date the claims are incurred.

2.2.3.3 MODIFICATION OF A SOCIAL BENEFIT SCHEME

1. If the terms of a social benefit scheme are modified, for example by a change in regulation, a public sector entity shall derecognise the original contract and recognise the modified contract as a new contract and shall apply this policy if, and only if, any of the conditions in (a) – (b) are satisfied. The conditions are that:
   (a) if the modified terms had been included at scheme inception:
      i. the modified scheme would have been excluded from the scope of social benefit scheme;
      ii. the modified scheme would have had a substantially different contract boundary applying paragraph 2.2.3.1.1.1 (2); or
      iii. the modified scheme would have been included in a different group of schemes applying paragraph 2.2.1; or
   (b) the entity applied the premium allocation approach on initial recognition of the scheme, but the modifications mean that the scheme no longer meets the eligibility criteria for that approach as set in paragraph 2.2.3.2 (1).

2. If a scheme modification meets none of the conditions in paragraph (1) of this section, the public sector entity shall treat changes in cash flows caused by the modification, as changes in estimates of fulfilment cash flows by applying paragraphs 2.2.3.1.2 and 2.2.3.1.3.

2.2.3.4 DERECOGNITION OF A SOCIAL BENEFIT SCHEME

1. A public sector entity shall derecognise a social benefit scheme when, and only when:
   (a) it is extinguished, i.e. when the obligation specified in the scheme expires or is discharged or cancelled; or
   (b) any of the conditions in paragraph 2.2.3.3 (1) are met.

2. When a social benefit scheme is extinguished, the entity is no longer at risk and is therefore no longer required to transfer any economic resources to satisfy the scheme.
3. An entity derecognises a social benefit scheme by applying the following requirements:
   (a) the fulfilment cash flows allocated to the scheme are adjusted to eliminate the present value of the future cash flows and risk adjustment for non-

financial risk relating to the rights and obligations that have been derecognised from the group, applying paragraphs 2.2.3.1.2 (1)(a)(i) and (b);

(b) the contractual service margin of the group is adjusted for the change in fulfilment cash flows described in (a) above, to the extent required by paragraph 2.2.3.1.2.1 (1)(c); and

(c) the number of coverage units for expected remaining coverage is adjusted to reflect the coverage units derecognised from the scheme, and the amount of the contractual service margin recognised in the statement of financial performance in the period is based on that adjusted number.

2.2.4 *USE OF THE PROVISIONS OF THE INSURANCE APPROACH IN THE FINANCIAL STATEMENTS*

The provisions of the "Insurance Approach" model are illustrated in the Notes to the Financial Statements for information purposes only.

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 benefit schemes; and

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

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

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

i. The nature of the social benefits provided by the scheme (for example, retirement benefits, unemployment benefits, child benefits).

ii. Key features of the social 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 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 benefits recognised in the statement of financial performance, analysed by social benefit scheme.

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

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

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

3.2 INSURANCE APPROACH

1. A public sector entity shall disclose:

(a) The basis for determining that the insurance approach is appropriate. This requirement is not applicable as per the provisions of paragraph 2.3.4.

(b) The information required by the relevant international or national accounting standard dealing with insurance contracts. This requirement is not applicable as per the provisions of paragraph 2.3.4; and

(c) Any additional information required by paragraph (3) of this section.

2. Explain under which Model (General Model or Premium Allocation Approach) each social benefit scheme is treated. This requirement is not applicable as per the provisions of paragraph 2.3.4.

3. To meet the requirements of paragraph (1)(c) of this section, an entity shall disclose:

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

i. The nature of the social benefits provided by the scheme (for example, retirement benefits, unemployment benefits, child benefits); and

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

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

i. Changes to the level of social benefits provided; and
ii. Changes to the eligibility criteria, including the individuals and/or households covered by the social 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.

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”

IFRS 17 “Insurance Contracts”

6. VERSION CONTROL

Version	Date of Approval	Changes
Version 1.0	15 July 2019	-
Version 2.0	07 June 2021	• Section 2.2.4: Addition • Section 3.2 paragraph 1(a)-(b): Amendment • Section 3.2 paragraph 2: Amendment

7. APPENDICES

7.1 ACTUARIAL ASSUMPTIONS

1. Actuarial assumptions are the public sector entity's best estimates of the variables that will determine the ultimate cost of providing compensations and benefits. Actuarial assumptions shall be unbiased and mutually compatible. Actuarial assumptions comprise:
   (a) Demographic assumptions about the future characteristics of current and former eligible beneficiaries (and their dependents). Demographic assumptions deal with matters such as: (i) age, ethnic minorities, gender, educational background, marital status, individual/family revenues, economic activity status, occupation; (ii) mortality; (iii) rates of beneficiary turnover, disability, and early retirement; and (iv) claim rates under medical plans.
   (b) Financial assumptions, dealing with items such as: (i) the discount rate; (ii) beneficiary's salary and benefit levels; (iii) in the case of medical benefits, future medical costs, including, where material, the cost of administering claims and benefit payments; and (iv) taxes payable by the plan on contributions relating to service before the end of the reporting periods or on benefits resulting from that service.
   Financial assumptions shall be based on market expectations, at the reporting date, for the period over which the obligations are to be settled.
2. Mortality assumptions are determined by reference to its best estimate of the mortality of scheme's beneficiaries both during and after employment.
3. The rate used to discount compensations and benefits obligations (both for subsidized and unsubsidized schemes) 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 benefit obligation.
4. Cash flows of the social security scheme shall be measured on a basis that reflects:
   (a) the benefits set out in the terms of the scheme (or resulting from any constructive obligation that goes beyond those terms) during the coverage period; and
   (b) contributions from the public sector entity or third parties that reduce the ultimate cost to the entity of those benefits; and
   (c) subsidies from general taxation.
5. Medical costs assumptions shall take account of estimated future changes in the cost of medical services, resulting from both inflation and specific changes in medical costs.